Docket: 2019-4444(IT)G

BETWEEN:

RONALD KARY BLACK,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

Appeals heard on common evidence with the appeals of *Murphy Pettypiece* (2019-4445(IT)G), *Rebecca Ford* (2019-4446(IT)G) and *Jason Murphy* (2019-4447(IT)G) on September 18, 19, and 20, 2023 and February 8 and 9, 2024 at Toronto, Ontario

Before: The Honourable Justice David E. Spiro

Appearances:

Counsel for the Appellant:	Daniel Sandler and Selena Ing
Counsel for the Respondent:	Arnold H. Bornstein and Tigra Bailey

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JUDGMENT

The appeals of reassessments under the *Income Tax Act* dated February 28, 2019 for the Appellant's 2015, 2016, and 2017 taxation years are dismissed, with costs.

The parties shall have 30 days from the date of Judgment to reach an agreement on costs, failing which the Respondent shall then have 30 days to serve and file written submissions on costs of 15 pages or less. The Appellant in this appeal and the Appellants in the three related appeals shall then have 30 days to serve and file written submissions of 15 pages or less. The Respondent may serve and file a response of 10 pages or less within 15 days of service of those submissions.

If the parties do not advise the Court that they have reached an agreement and no submissions are received within the foregoing time limits, the Respondent is entitled to four sets of costs for all four appeals as set out in the Tariff.

Signed at Toronto, Ontario, this 11th day of July 2024.

"David E. Spiro"

Spiro J.

Docket: 2019-4445(IT)G

BETWEEN:

MURPHY PETTYPIECE,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

Appeals heard on common evidence with the appeals of *Ronald Kary Black* (2019-4444(IT)G), *Rebecca Ford* (2019-4446(IT)G) and *Jason Murphy* (2019-4447(IT)G) on September 18, 19, and 20, 2023 and February 8 and 9, 2024 at Toronto, Ontario

Before: The Honourable Justice David E. Spiro

Appearances:

Counsel for the Appellant: Daniel Sandler and Selena Ing
Counsel for the Respondent: Arnold H. Bornstein and Tigra Bailey

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JUDGMENT

The appeals of reassessments under the *Income Tax Act* dated March 14, 2019 for the Appellant's 2015, 2016, and 2017 taxation years are dismissed, with costs.

The parties shall have 30 days from the date of Judgment to reach an agreement on costs, failing which the Respondent shall then have 30 days to serve and file written submissions on costs of 15 pages or less. The Appellant in this appeal and the Appellants in the three related appeals shall then have 30 days to serve and file written submissions of 15 pages or less. The Respondent may serve and file a response of 10 pages or less within 15 days of service of those submissions.

If the parties do not advise the Court that they have reached an agreement and no submissions are received within the foregoing time limits, the Respondent is entitled to four sets of costs for all four appeals as set out in the Tariff.

Signed at Toronto, Ontario, this 11th day of July 2024.

"David E. Spiro"

Spiro J.

Docket: 2019-4446(IT)G

BETWEEN:

REBECCA FORD,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

Appeals heard on common evidence with the appeals of *Ronald Kary Black* (2019-4444(IT)G), *Murphy Pettypiece* (2019-4445(IT)G) and *Jason Murphy* (2019-4447(IT)G) on September 18, 19, and 20, 2023 and February 8 and 9, 2024 at Toronto, Ontario

Before: The Honourable Justice David E. Spiro

Appearances:

Counsel for the Appellant:	Daniel Sandler and Selena Ing
Counsel for the Respondent:	Arnold H. Bornstein and Tigra Bailey

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JUDGMENT

The appeals of reassessments under the *Income Tax Act* dated March 25, 2019 for the Appellant's 2015, 2016, and 2017 taxation years are dismissed, with costs.

The parties shall have 30 days from the date of Judgment to reach an agreement on costs, failing which the Respondent shall then have 30 days to serve and file written submissions on costs of 15 pages or less. The Appellant in this appeal and the Appellants in the three related appeals shall then have 30 days to serve and file written submissions of 15 pages or less. The Respondent may serve

and file a response of 10 pages or less within 15 days of service of those submissions.

If the parties do not advise the Court that they have reached an agreement and no submissions are received within the foregoing time limits, the Respondent is entitled to four sets of costs for all four appeals as set out in the Tariff.

Signed at Toronto, Ontario, this 11th day of July 2024.

"David E. Spiro"

Spiro J.

Docket: 2019-4447(IT)G

BETWEEN:

JASON MURPHY,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

Appeals heard on common evidence with the appeals of *Ronald Kary Black* (2019-4444(IT)G), *Murphy Pettypiece* (2019-4445(IT)G) and *Rebecca Ford* (2019-4446(IT)G) on September 18, 19, and 20, 2023 and February 8 and 9, 2024 at Toronto, Ontario

Before: The Honourable Justice David E. Spiro

Appearances:

Counsel for the Appellant:	Daniel Sandler and Selena Ing
Counsel for the Respondent:	Arnold H. Bornstein and Tigra Bailey

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JUDGMENT

The appeals of reassessments under the *Income Tax Act* dated March 25, 2019 for the Appellant's 2015, 2016, and 2017 taxation years are dismissed, with costs.

The parties shall have 30 days from the date of Judgment to reach an agreement on costs, failing which the Respondent shall then have 30 days to serve and file written submissions on costs of 15 pages or less. The Appellant in this appeal and the Appellants in the three related appeals shall then have 30 days to serve and file written submissions of 15 pages or less. The Respondent may serve

and file a response of 10 pages or less within 15 days of service of those submissions.

If the parties do not advise the Court that they have reached an agreement and no submissions are received within the foregoing time limits, the Respondent is entitled to four sets of costs for all four appeals as set out in the Tariff.

Signed at Toronto, Ontario, this 11th day of July 2024.

"David E. Spiro"

Spiro J.

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Citation: 2024 TCC 96
Date: 20240711
Docket: 2019-4444(IT)G

BETWEEN:

RONALD KARY BLACK,

Appellant,

and

HIS MAJESTY THE KING,

Respondent,

Docket: 2019-4445(IT)G

AND BETWEEN:

MURPHY PETTYPIECE,

Appellant,

and

HIS MAJESTY THE KING,

Respondent,

Docket: 2019-4446(IT)G

AND BETWEEN:

REBECCA FORD,

Appellant,

and

HIS MAJESTY THE KING,

Respondent,

Docket: 2019-4447(IT)G

AND BETWEEN:

JASON MURPHY,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

REASONS FOR JUDGMENT

Spiro J.

[1] In 1993, James Schmalz ("James") established a video game business in London, Ontario that was later incorporated as Digital Extremes Limited (the "Company").[1] The Company developed, published, and sold a popular video game called *Warframe*.

I. **Issue to be Decided**

[2] The key issue to be decided in these appeals is whether distributions made in 2015, 2016, and 2017 to each of the Appellants from a trust established by the Company are taxable:

(a) under paragraph 6(1)(g) of the *Income Tax Act* (the "Act") as distributions from an "employee benefit plan" within the meaning of subsection 248(1) of the Act as reassessed by the Minister of National Revenue (the "Minister"); or

(b) under subsection 7(2) allowing the trust to make the designations necessary to characterize the distributions to the Appellants under subsection 104(19) as dividends eligible for the dividend tax credit, subsection 104(21) as taxable capital gains, and subsection 104(21.2) as taxable capital gains eligible for the lifetime capital gains exemption, as the Appellants contend.

[3] The parties agree that the distributions made to the Appellants from the trust in 2015, 2016, and 2017 were distributions from an "employee benefit plan" within the meaning of subsection 248(1) of the Act. They part company on whether those distributions are taxable under paragraph 6(1)(g) as the Respondent contends or under subsection 7(2) of the Act as the Appellants contend.

[4] For the reasons set out below, the trust is not one described in subsection 7(2) of the Act. In short, there was never any allocation of a particular number of shares to a particular employee to be held on their behalf by the trust. It is for that reason that subsections 104(19), 104(21), and 104(21.2) do not apply to characterize the distributions from the trust as dividends and taxable capital gains.

[5] I have, therefore, concluded that the Minister reassessed the Appellants correctly on the distributions from the trust in 2015, 2016, and 2017 under paragraph 6(1)(g) of the Act as distributions from an "employee benefit plan" within the meaning of subsection 248(1) of the Act.

II. **Representative Appellants**

[6] Although the four appeals are not "lead cases" under section 146.1 of the *Tax Court of Canada Rules (General Procedure)*, they do reflect a set of facts shared by three groups of employees of the Company who received grants of trust units followed by distributions from the trust in 2015, 2016, and 2017. Those groups are:

(a) holders of trust units who formerly held stock options including Mr. Ronald Kary Black and Mr. Jason Murphy;

(b) members of that group who received additional trust units including Mr. Black; and

(c) holders of trust units who did not formerly hold stock options including Mr. Murphy Pettypiece and Ms. Rebecca Ford.

[7] The parties agreed on most of the relevant facts. They filed a Partial Agreed Statement of Facts that applies across all four appeals (attached as Schedule "A") and a Partial Agreed Statement of Facts that addressed the particular facts of each Appellant (attached as Schedule "B", "C", "D" and "E"). Other facts adduced at the hearing came into evidence by way of witness testimony and documents

tendered as exhibits. Each of the four Appellants testified as did James and his brother Michael Schmalz ("Michael").

III. **Overview (Law)**

A. Paragraph 6(1)(g) of the Act

[8] Paragraph 6(1)(g) of the Act provides:

> **Amounts to be included as income from office or employment**
>
> 6(1) There shall be included in computing the income of a taxpayer for a taxation year as income from an office or employment such of the following amounts as are applicable
>
> > …
> >
> > **Employee benefit plan benefits**
> >
> > (g) the total of all amounts each of which is an amount received by the taxpayer in the year out of or under an employee benefit plan …

[9] Subsection 248(1) of the Act defines an "employee benefit plan" as:

> … an arrangement under which contributions are made by an employer … to another person … and under which one or more payments are to be made to or for the benefit of employees … of the employer …

B. Subsections 7(1) and 7(2) of the Act

[10] Subsection 7(1) of the Act provides:

> **Agreement to issue securities to employees**
>
> 7(1) … where a particular qualifying person has agreed to sell or issue securities … to an employee of the particular qualifying person …,
>
> > (a) if the employee has acquired securities under the agreement, a benefit equal to the amount, if any, by which
> >
> > > (i) the value of the securities at the time the employee acquired them
> >
> > exceeds the total of

(ii) the amount paid or to be paid to the particular qualifying person by the employee for the securities, and

(iii) the amount, if any, paid by the employee to acquire the right to acquire the securities

is deemed to have been received, in the taxation year in which the employee acquired the securities, by the employee because of the employee's employment;

[11] Subsection 7(7) of the Act defines a "qualifying person" to mean a corporation or a mutual fund trust and defines "security" of a qualifying person to mean:

(a) if the person is a corporation, a share of the capital stock of the corporation; and

(b) if the person is a mutual fund trust, a unit of the trust.

[12] Subsection 7(2) of the Act provides that:

Securities held by trustee

7(2) If a security is held by a trustee in trust or otherwise, whether absolutely, conditionally or contingently, for an employee, the employee is deemed, for the purposes of this section and paragraphs 110(1)(d) to (d.1),

(a) to have acquired the security at the time the trust began to so hold it; and

(b) to have exchanged or disposed of the security at the time the trust exchanged it or disposed of it to any person other than the employee.

C. Statutory Appendix

[13] A Statutory Appendix reproducing other relevant provisions of the Act including paragraph 104(13)(a), subsections 104(19), 104(21) and 104(21.2) and the definition of a "trust" in subsection 108(1) is attached to these Reasons.

[14] The key interpretive question is how to make sense of subsection 7(1) in light of subsection 7(2) and subsection 7(2) in light of subsection 7(1). Are they two ships passing in the night or do they work harmoniously in the trust context? That is the interpretive question to be resolved. Before doing so, however, the facts must be reviewed.

IV. **Overview (Facts)**

[15] From the founding of the business in 1993 until deciding to implement an estate freeze and corporate reorganization in 2013, James was the Company's sole shareholder and director. After the 2013 estate freeze and corporate reorganization, he remained firmly in control of the Company with two-thirds of the votes.

[16] Early on, James set up a stock option plan to reward the employees whom he valued most highly. James designed the stock option plan to allow those employees to share in the proceeds of any sale of the Company.

[17] As part of the 2013 estate freeze and corporate reorganization, the Company terminated its stock option plan and cancelled all outstanding stock options. The Company decided to provide payment to each former stock option holder of ten cents for each of their cancelled stock options.

[18] At the same time, James spoke with the Company's senior employees who held stock options and assured them that, notwithstanding the termination of the stock option plan and the cancellation of their stock options, they would continue to share in the proceeds of sale of the Company to the same extent as before – but this time, the arrangement would be more tax-effective. Michael conveyed the same message to the Company's junior employees who held stock options.

[19] The new arrangement used a trust to hold 15% of the shares of the Company for all eligible employees as a group. James, along with his brother Michael and a third shareholder, decided who would receive units in the trust and how many units they would receive. This process applied to all former stock option holders except for Michael and one other senior employee, each of whom received shares of the Company rather than trust units. The same process applied to employees who joined the Company after the termination of the stock option plan.

[20] In 2014, James agreed to sell the Company to a third party. The sale occurred in two stages. The first stage, in which 61% of the shares were sold, closed in 2015. That stake was sold for $73.2 million CDN.

[21] The second stage, in which the remaining 39% of the shares were sold, closed in 2016. That stake was sold for $63 million USD.

[22] In anticipation of each of the two stages of the sale, the Company declared pre-sale dividends on the shares held by the trust. The trust designated each of

those distributions as dividends eligible for the dividend tax credit and distributed those amounts to the Appellants. The Appellants reported those amounts as dividends on their returns of income for those taxation years.

[23] Immediately following the closing of each of the two stages of the sale, the Company paid to the trust the proceeds of disposition attributable to the shares sold by the trust to the third party. The trust designated each of those distributions as taxable capital gains. The Appellants reported those amounts on their returns of income as taxable capital gains for those taxation years.

[24] In addition, because the shares held by the trust were shares of a Canadian-controlled private corporation immediately before the first stage of the sale, the Appellants claimed the lifetime capital gains exemption in respect of the taxable capital gains designated by the trust in respect of the proceeds from the first stage of the sale.

[25] Finally, the trust distributed a small amount to each of the Appellants in 2017. The Company called that distribution the "N-Space Dividend". The Appellants claimed a dividend tax credit on their 2017 tax returns in respect of that distribution as well.[2]

V. **Findings of Fact**

A. The Old Stock Option Plan

[26] In 2007, the Company established a stock option plan for its most valued employees.[3] By 2013, James had granted stock options to 43 of the Company's employees. James granted stock options only to those employees whom he considered key to the Company's growth and development.

[27] This objective is consistent with paragraph 1.1 of the document under which the plan was established and in which James was referred to as the "Majority Shareholder":

> The purpose of the Plan is to secure for the Corporation and its shareholders the benefits of the incentive inherent in share ownership by Eligible Persons who, in the judgment of the Majority Shareholder, could have a significant impact on the future growth and success of the Corporation. It is generally recognized that share option plans aid in retaining and encouraging directors, officers and employees of exceptionable [*sic*] ability because of the opportunity offered to them to acquire a proprietary interest in the Corporation.

[28] James, as sole shareholder, made all the decisions regarding the stock option plan. This is reflected in several provisions of the plan document, including Article 3.2:

> **Powers**: In administering the Plan, the Majority Shareholder shall have the power, where consistent with the general purpose and intent of the Plan and subject to the specific provisions of the Plan:
>
> (a) to establish policies and to adopt rules and regulations for carrying out the purposes, provisions and administration of the Plan;
>
> (b) to interpret and construe the Plan and to determine all questions arising out of the Plan and any Option granted pursuant to the Plan, and any such interpretation, construction or termination so made shall be final, binding and conclusive for all purposes;
>
> (c) to determine which Eligible Persons are to receive Options, and to grant Options;
>
> (d) to determine the number of Shares covered by each Option;
>
> (e) to determine the Exercise Price;
>
> (f) to determine the time or times when Options will be granted and exercisable;
>
> (g) to determine, at any time, if the Shares that are subject to an Option will be subject to any restrictions upon the exercise of such Option; and
>
> (h) to prescribe the form of the instruments relating to the grant, exercise and other terms of Options.

[29] The only aspect of the stock option plan that was not within James' discretion was the expiration date of the options. The options were exercisable no later than seven years from the date of the grant of the option.[4] Option holders could exercise their options within seven years only if any person, or combination of persons, acquired more than 50% of the voting securities of the Company.[5] Article 11.1 provided that option holders had no rights as shareholders until they exercised their options.

[30] James was asked how he decided which employees would receive stock options. He testified that he made those decisions:

> … entirely from my perceived view of their future value to the company to achieve that ultimate goal of selling the company, just people who were -- that I knew that were going to be incredibly productive over the coming years and create great video games for us.[6]

[31] After James granted stock options to a particular employee, that employee would sign a share option agreement. The agreement set out the employee's rights and obligations under the stock option plan and incorporated the terms of the stock option plan by reference.

[32] The share option agreement began by acknowledging that James had awarded stock options to the particular employee.[7] By way of example, James testified about awarding stock options to Mr. Murphy, one of the Appellants. James decided to award Mr. Murphy 5,000 stock options under a share option agreement dated as of April 13, 2007.[8] Later on, James decided to award Mr. Murphy 10,000 additional stock options under a subsequent share option agreement.[9] On any sale of the Company, Mr. Murphy would have been entitled to exercise his options to acquire 15,000 shares at an aggregate exercise price of $2.00 ($1.00 for the first 5,000 shares and $1.00 for the next 10,000 shares).

[33] Later on, James decided to award Mr. Black another 5,000 share options under a new share option agreement dated as of November 22, 2010.[10] Under that agreement, Mr. Black was entitled to exercise his additional 5,000 options at an aggregate exercise price of $1.00. As at November 22, 2010, Mr. Black held 20,000 stock options that he could have exercised on a sale of the Company at an aggregate exercise price of $3.00, all governed by the terms of the three share option agreements he had signed.

B. The Proposed Estate Freeze and Corporate Reorganization

[34] By 2013, the Company engaged a mergers and acquisitions consultant to explore the possibility of a sale.[11]

[35] While preparing to sell the Company, James and Michael came to believe that the Company's stock option plan was not as tax-efficient as it could have been. A 17-page letter from Ernst & Young LLP ("E&Y") dated March 8, 2013 (the "E&Y Letter") formed the basis for their belief.[12]

[36] Most of the E&Y Letter is devoted to the tax planning needs of James and his family and Michael and his family, including setting up a trust for each of their

families[13] and incorporating a holding company for each of James and Michael.[14] This personal tax planning exercise was the focus of the 17-page E&Y Letter which ultimately proposed a plan of reorganization to accomplish the following objectives:

- Freeze James' current interest in the Company
- Convert the existing after-tax retained earnings into debt owing to James
- Provide an opportunity to income split with family members to the extent possible (James and Mike)
- Plan to convert future after-tax retained earnings into debt owing to principal shareholders (James and Mike)
- Access CGE (James and Mike)[15]

[37] Three of the fourteen steps set out at the end of the E&Y Letter are devoted to the trust arrangement at issue in these appeals.[16]

[38] The E&Y Letter does not include a meaningful analysis of section 7 of the Act but does include the following statement (emphasis added):

- *Securities held by a trustee are deemed, pursuant to subsection 7(2) of the Act, to be held by the employee for purposes of Section 7*; further research is required to determine if this is similarly applicable for Regulation 6205[17]

[39] The E&Y Letter refers to subsection 7(2) immediately following a statement that the revised arrangements would include the use of a plan under which units of a trust are awarded to select employees. E&Y's discussion of subsection 7(2) of the Act proceeds on the assumption that the trust was "constructed to be compliant with subsection 7(2) of the Act":

> 4. … Provided the Trust is constructed to be compliant with subsection 7(2) of the Act the units are treated, for tax purposes, as shares acquired pursuant to a stock option agreement [RID 9724915 is footnoted], Furthermore subsection 7(2) deems the employee to have acquired the shares for purposes of the stock option rules at the time that the Trust begins to hold them. The use of a trustee to hold the employee option shares will not impede the employees' access to either the CGE or the reduction of the employment benefit [Subsection 7(2) is footnoted].[18]

[40] With respect to the shares to be issued to the trust, E&Y notes that:

> … [t]he Trust will own a separate class of common shares of DE which remain under the control of a trustee(s). The Trust would ensure that the employees do not have access to the financial information or voting rights.[19]

[41] E&Y's criticized the Company's stock option plan on the following basis:

> Since the current options are only exercisable at the time of a change of control, the current stock option plan does not allow employees to access either the CGE or the 50% reduced employment benefit.[20]

[42] In order to deal with those issues (which are not explained in any further detail), E&Y suggested that the Company set up a plan and a trust along the following lines:

> It is possible to modify the [current stock option] arrangement such that the employee will still receive stock option treatment, capital gain exemption eligibility and forfeit the right to the share on departure for zero proceeds. To accommodate this arrangement an Employee Stock Rights Plan ("the Plan") is required by which units of an Employee Stock Rights Plan Trust ("the Trust") are awarded to selected employees. The Trust will own a separate class of common shares of DE which remain under the control of a trustee(s). The Trust would ensure that the employees do not have access to the financial information or voting rights. The trustees are appointed by the corporation. One feature must be included to provide the employees with stock option treatment and that is that the shares held by the Trust must be acquired at FMV, no bargain purchase option is permitted. In the current proposed arrangements this feature is easily accommodated as James' existing common share interest is to be frozen to permit Mike and Steve [Sinclair] a direct ownership interest. As a consequence of the freeze the value of the employee shares at the date of subscription by the Trust will be nominal and so acquired at FMV. Certain features of the Plan and Trust are described in #4 below. We believe that it is not possible to amend the existing arrangements to include these features and the existing Plan would have to be canceled.[21]

[43] E&Y went on to describe, in considerable detail, the proposed plan and trust (footnotes omitted):

> 4. As noted above the revised arrangements would include the use of a Plan whereby units of a Trust are awarded to select employees. Provided the Trust is constructed to be compliant with subsection 7(2) of the Act the units are treated, for tax purposes, as shares acquired pursuant to a stock option agreement. Furthermore subsection 7(2) deems the employee to have acquired the shares for purposes of the stock option rules at the time that the Trust begins to hold them. The use of a trustee to hold the employee option shares will not impede the employees' access to either the CGE or the reduction of the employment benefit.

In order for the employee to benefit from the CGE the Trust must own the shares for the full 24 month holding period. At the date of sale of DE the trustee will be permitted to distribute the shares to the beneficiaries for sale, or sell the shares and allocate the capital gains to beneficiaries so that the employee may claim the CGE. The basic features of the Trust are as follows:

> a. The Trust would be settled by DE, by a contribution of cash sufficient to subscribe for the specific percentage of shares to be set aside for the employees as determined by the shareholders
>
> b. The Trust agreement will specifically refer to subsection 7(2) of the Act
>
> c. The Trust would manage the property settled upon the Trust including shares and all income from the property and property substituted thereof [*sic*] in accordance with the provisions of the Trust and the Plan
>
> d. The trustee will make payments of cash or property out of the Trust in accordance with directions received from the Committee; the Committee administers the Plan
>
> e. The beneficiaries of the Trust will be certain employees of DE as determined by the Committee (the Committee operates the Plan). The trustees will be empowered to, in accordance with the Trust indenture, take directions from the Committee to:
>
>> i. Grant Rights to participants, who are employees
>>
>> ii. Do all things as directed by the Committee in connection with the granting, vesting or termination of Rights in accordance with the Plan
>>
>> iii. Make distributions of Trust assets to the beneficiaries in cash or in kind
>>
>> iv. Make all elections and designations pursuant to the Act in respect of granting, vesting or termination of the Rights or distributions from the Trust (including the allocation of income or deemed income)[22]

[44] E&Y described the provisions of the proposed plan:

> 5. The provisions of the Plan would include the following:
>
>> a. The Plan awards Rights to acquire units in the Trust

b. The Plan is administered by a Committee appointed by the Board of Directors

c. The Rights cannot be transferred or assigned

d. The Plan defines various events including termination for cause, retirement and other events

e. Eligibility to participate in the Plan is at the sole discretion of the Committee

f. The terms under which the Committee may grant Rights to acquire a number of units and the conditions which are required to be satisfied in [order] to permit the Rights to vest are all determined by the Committee, including the following

> i. Individuals to participate
>
> ii. Number of units granted
>
> iii. Time or times at which Rights may be granted
>
> iv. Price to be paid as consideration for the grant
>
> v. Vesting provisions
>
> vi. Restrictions on the units
>
> vii. Acceleration of vesting, waiver of forfeiture
>
> viii. Terms and conditions necessary to comply with the terms and conditions of any employment contract
>
> ix. Purchase price of the Rights

g. The Committee is also empowered to interpret the provisions of the Plan and prescribe and rescind regulations in respect of the Plan

h. The units are subject to forfeiture even if vested, if the employee resigns or is terminated for cause

i. The participant does not have any right as a shareholder with respect to the units until the trustees distribute the Plan shares to the participant[23]

[45] The E&Y Letter did not mention that a particular number of shares would have to be allocated to a particular employee in order to comply with subsection 7(2) of the Act. More on that later.

[46] In his evidence, Michael described the 2013 estate freeze and corporate reorganization proposed by E&Y as including:

> … the setup of an employee trust to administer the benefits to the employees in a different way than what we had conceived for the stock options.[24]
>
> ***
>
> [E&Y] indicated that there were some tax opportunities that were not being taken advantage of under the old option plan, and that this plan would be a more advantageous plan for our employees, should we sell the company. And that was the basis for … their recommendation to move forward with the new plan.[25]

[47] At the time of the 2013 estate freeze and corporate reorganization, James understood his shares to have been worth $12,000,000.[26] By the time the 2013 estate freeze and reorganization were complete, James had reduced his equity interest in the Company from 100% to 67%. The other 33% of the Company would then belong to his brother Michael (7%), Steve Sinclair (10.1%), and the soon to be established trust (15.9%).[27]

C. <u>The Three Individual Shareholders</u>

[48] As part of the 2013 estate freeze and corporate reorganization, Michael subscribed for shares representing 7% of the equity in the Company. Along with the Company's creative director, Steve Sinclair, Michael was one of two former option holders to receive shares rather than units in the trust.

[49] Following the 2013 estate freeze and corporate reorganization, the only individual shareholders were James, Michael, and Steve Sinclair.[28]

D. <u>Termination of the Old Stock Option Plan</u>

[50] On June 24, 2013, James, as sole director of the Company, resolved to terminate the stock option plan and cancel all outstanding options.[29] The resolution provides:

> WHEREAS it has been determined that it is the best interests of Digital Extremes Ltd. (the "Corporation") to terminate the Corporation's 207 [*sic*] Stock Option Plan and the [*sic*] cancel all outstanding option agreements and options outstanding thereunder, effective as of the date hereof;
>
> AND WHEREAS it has also been determined that, as a settlement for such cancellation and in consideration of the delivery of a full and final release in respect thereof in favour of the Corporation, all option holders shall be offered the sum of $0.10 per outstanding option;
>
> THEREFORE BE IT SOLVED THAT:
>
> 1. The Corporation's 2007 Stock Option Plan and all options outstanding thereunder are hereby cancelled and terminated and shall be of no further force or effect as of and from the date hereof.
>
> 2. As a settlement for such cancellation and in consideration of the delivery of a full and final release in respect thereof in favour of the Corporation, all option holders shall be offered the sum of $0.10 per outstanding option.[30]
>
> …

[51] In his evidence, James described that resolution as:

> … the cancellation of the 2007 Stock Option Plan completely terminating it and giving the employees compensation for that termination.[31]

[52] The Company asked each stock option holder to sign a letter and declaration (the "Declaration") and a settlement and release agreement (the "Settlement and Release Agreement"). Read together, those documents describe what the employees agreed to give up and what the Company agreed to provide in return.

[53] The language of the Declarations and the Settlement and Release Agreements is consistent with the language of the resolution, namely, that the compensation the Company resolved to provide to each former stock option holder was "the sum of $0.10 per outstanding option".

[54] The resolution attached templates for a letter agreement and a settlement and release agreement substantially similar to the Declarations and the Settlement and Release Agreements that were later signed by the former stock option holders. James described the letters as "outlining the cancellation of their options and what they would be paid for that."[32]

[55] An example is the Declaration and Settlement and Release Agreement entered into by Mr. Black.[33] The Declaration signed by Mr. Black immediately follows a letter written on the Company's stationery dated July 29, 2013. The letter is reproduced at Schedule "F" and the Settlement and Release Agreement is reproduced at Schedule "G".

[56] The letter broadly reflects the advice received by James and Michael from E&Y. In it, the reader is cautioned that on a sale of the business the holders of stock options would receive proceeds that would:

> … not qualify for an individual's lifetime capital gains exemption and may not qualify for the 50% reduction in employment income for tax purposes.[34]

[57] In light of that, and because options would begin to expire the following year, the letter served notice to each option holder that the Company had decided to terminate the stock option plan and to cancel all outstanding stock options effective immediately. The Company notified the stock option holders that they were, effective immediately, former stock option holders.

[58] The letter went on to inform each former option holder that the Company was prepared to make a one-time payment to them of $0.10 per cancelled option in consideration of the cancellation of each option and in settlement of any claim that the former option holder may have against the Company as a result of the cancellation. They would receive that payment if they signed and returned the Declaration and Settlement and Release Agreement. In the Settlement and Release Agreement, each former option holder agreed to accept the settlement amount (a one-time payment of $0.10 per cancelled option) as:

> … full and final settlement of any and all claims or demands that I now have, ever had, or can, or may have against the Company … resulting or arising from the Company's termination of its 2007 Stock Option Plan (the "**Plan**") and the cancellation of the [insert number of] options to purchase shares in the capital of the Company that were previously granted to me under the Plan.

[59] The Settlement and Release Agreement went on to provide that upon payment of the settlement amount, the former option holder would:

> … irrevocably release and forever discharge the [Company] and forever compromise any and all claims and demands whatsoever by me, which I now have, ever had, or can, or may have against the [Company] with respect of the administration or termination of the Plan; the granting of the Options … under the Plan or the cancellation of the Options … or any cause, matter or thing arising out of or connected therewith.

[60] The Settlement and Release Agreement concluded with this declaration by each former option holder:

> AND IT IS HEREBY DECLARED that the terms of this Settlement and Release Agreement are fully understood; that the amount stated herein is the sole consideration of this Settlement and Release and that the said consideration is accepted voluntarily with the benefit of having been afforded the opportunity of obtaining independent legal advice for the purpose of making a full and final settlement and release of all claims.

[61] Before the senior employees signed the Declaration and Settlement and Release Agreement, they met with James. Before the junior employees signed the Declaration and Settlement and Release Agreement, they met with Michael. The Company recommended that each former option holder review the Declaration and Settlement and Release Agreement with a lawyer before signing. None of them did.

(1) Mr. James Schmalz's Conversations with Senior Employees

[62] James testified that he spoke to each of the senior employees to tell them about the cancellation of their stock options. James assured them that the proceeds of any sale of the Company would be shared with them:

> MR. SANDLER: Okay. And maybe you can just describe again what you would have discussed with these individuals.
>
> MR. J. SCHMALZ: Yeah, I think it's important to note, like, as I was saying, since they were long-term employees and people I'd talk to regularly, they -- and since they were senior, they'd be very interested -- they were very interested in the outcome of what these options or trust units could do for them, ultimately, because they're very aware that often companies are sold, and so I would have ongoing discussions just throughout the years about this whole process.

> And then as it began over this one specifically in 2013, and especially the cancellation of the options, obviously, if they were not aware of what was replacing that, they would be very concerned -- very, very concerned that we were taking these away from them for no reason so the discussion would have been kind of walking them through exactly what was happening to reassure them that they're not being -- that we're doing something more beneficial for them and not taking away anything from them that had been -- that they had received previously.
>
> So I would have described the termination of the options and what that meant, and then the issuance of the trust units and the benefit that that -- the key thing would be the benefit that that would have for them in terms of the tax effectiveness of those new units and just reassure them everything, you know, is for their betterment in terms of the tax effectiveness and that we're not taking away anything.[35]

[63] James told the senior employees that the stock option plan would be replaced by something more tax-effective on the basis of:

> … a proposal made by Ernst & Young. My understanding as a CEO in reading that and talking to them, that -- and as was communicated to the employees -- is that we're going to change the stock option plan to something more tax effective …[36]

(2) Mr. Michael Schmalz's Conversations with Junior Employees

[64] Michael spoke to junior employees before they signed their Declaration and Settlement and Release Agreement. He told them that the Company had engaged a mergers and acquisitions consultant to explore the possibility of a sale of the Company and, for that reason, it was important for the Company to ensure that its plan was up to date. He told them that because its plan was not up to date, the Company needed to fix it. By meeting with them personally, Michael wanted the junior employees to understand:

> … that they weren't losing anything and they could equate what they were getting with what we were being forced to take back from them.[37]

[65] One of the junior employees with whom Michael spoke was Mr. Murphy. During his examination-in-chief, Mr. Murphy testified that Michael assured him that there would be a new arrangement:

> MR. SANDLER: Okay. So when were you advised that you had received an interest in this trust that you referred to?
>
> MR. MURPHY: Pretty much, like, upon signing the termination of the old one, because before I signed, I was adamant, I said, "Are you sure that there's going to

> be a new plan?" because I didn't want to lose out on any benefit if the Corporation was sold. And so they assured me, like, "Yes, yes. It's going to be -- it's going -- there's going to be a new plan," and explained the plan to me personally. That's when I was made aware of it.[38]

[66] In cross-examination, Mr. Murphy described the extent to which he placed his trust in James and Michael:

> MS. BAILEY: And at the time this old option plan was being cancelled, you said you were aware of a new plan with a trust?
>
> MR. MURPHY: Yes.
>
> MS. BAILEY: Did you ask whoever you spoke to for a copy of the trust document?
>
> MR. MURPHY: I didn't.
>
> MS. BAILEY: Did you ask them for any documentation at all?
>
> MR. MURPHY: I didn't.
>
> MS. BAILEY: So your understanding of what would happen is based on this letter alone?
>
> MR. MURPHY: And personal conversations. I talked to Mike about the new plan as well, because I was adamant that I was not going to sign the termination of the options unless they -- that there was going to be a new share plan. But I trusted them at the time and just from the -- this letter talking about the tax reduction and how -- my conversations with them about why they were doing it, at the time, for me, that was enough of an understanding.
>
> MS. BAILEY: So it was very important to you that a new plan be put in place, but you didn't ask for any additional information ---
>
> MR. MURPHY: I mean ---
>
> MS. BAILEY: --- in writing?
>
> MR. MURPHY: Yeah. It's 10 years ago. I wasn't as mature back then. So I personally trusted them.[39]

(3) Mr. Black's Conversation with the Human Resources Department

[67] Mr. Black held stock options under the stock option plan. He received a letter dated July 29, 2013 entitled "RE: Termination of 2007 Stock Option Plan

and Cancellation of Your Outstanding Options" along with a document entitled "Settlement and Release Agreement".[40]

[68] During his examination-in-chief, Mr. Black was asked whether he discussed the letter with anyone. He replied:

> MR. BLACK: Yeah, I did. I don't remember them entirely clearly. I know I had a conversation with the Human Resources Department about it, amongst some other things because, you know, I was curious what might happen after the company was sold as well, and things like that. But they, you know, kind of, as it implies here, you know, the existing plan was going to happen irregardless for tax purposes and that we would kind of all be needing to sign something like this to kind of move everything forward.
>
> MR. SANDLER: Okay. Maybe can you elaborate on that?
>
> MR. BLACK: I suppose so. I'm not sure which way though, sorry.
>
> MR. SANDLER: So you said it needed to be changed in order to move forward?
>
> MR. BLACK: Oh, yes. That, you know, the existing plan wasn't set up well for tax purposes, basically. And that the new one would be aimed at sorting that out.
>
> MR. SANDLER: And then was this new plan discussed with you at the same time then?
>
> MR. BLACK: Just to kind of reassure me that, you know, there was going to be one and that it would essentially have -- function the same way as the old one had.[41]

[69] Following his conversations with the Human Resources Department, Mr. Black understood that if the shares of the Company were sold, he would enjoy "a small part share of the sale."[42] Why did Mr. Black not ask the Human Resources Department for documentation of the new arrangement? Once again, it all came down to trust:

> … DE's [been] really good to me and other employees over the years. Like, when people were sick and stuff like that, they've been great. So I was going on, you know, good faith that they were going to be following through.[43]

(4) Summary of Conversations

[70] In the context of an anticipated sale of the Company, the purpose of all these conversations was to assure the former stock option holders that, as long as they continued with the Company:

(a) the proceeds realized from the sale of the Company would be shared with them;

(b) their share of the proceeds would not be less than the share of the proceeds they would have received under the old stock option plan; and

(c) the old stock option plan would be replaced by a more tax-efficient arrangement.

E. Constating Documents for the New Trust Arrangement

(1) The Trust Deed

[71] On July 12, 2013, the Company settled a trust and recorded its terms in its Deed of Trust (the "Trust Deed").[44] In the recitals, the Company, as settlor, stated that it intended to establish a trust in accordance with and for the purposes of subsection 7(2) of the Act for the benefit of its employees and for the benefit of James, regardless of whether he was an employee.

[72] The Company, as settlor, then stated its desire that the trustees subscribe for 3,180,000 Class D Common Shares in the Company for an aggregate purchase price of $31.80. The Company, as settlor, then noted that it had adopted the Employee Rights Plan (the "Plan") and established a Committee under the Plan to direct the trustees in respect of their rights and obligations under the Trust.

[73] The parties then stated that they agreed on the provisions of the Trust Deed "in accordance with and for the purposes of Section 7(2) of the *Income Tax Act*". In paragraph 2.2 of the Trust Deed the parties stated:

> 2.2 For greater certainty, it is hereby confirmed that this Trust shall for all purposes be deemed to be a trust for the purposes of section 7(2) of the *Income Tax Act*.

[74] What was the stated primary purpose of the Trust?

> 2.5 The primary purpose of the Trust is to hold the Class D Common Shares for the benefit of the Beneficiaries and in furtherance of that purpose, to distribute such income and capital to one or more of the Eligible Beneficiaries as the Committee may authorize and direct from time to time in accordance with this Deed and the Plan.

[75] The Trust Deed defines a "Beneficiary" as "any present and future employee" of the Company. "Eligible Beneficiary" is defined as a Beneficiary who has been granted Trust Units in accordance with the Plan.

[76] Article 2.5 of the Trust Deed provides that only the Committee "may authorize and direct from time to time in accordance with this Deed and the Plan" the distribution of income and capital to one or more Eligible Beneficiaries. Article 2.6 of the Trust Deed provides that it is "in the sole and unfettered discretion of the Committee" when to distribute or allocate income to Eligible Beneficiaries. If the Committee decides to distribute or allocate income to an Eligible Beneficiary (i.e., an employee who has already been granted Trust Units), the amount allocated to that Eligible Beneficiary is "at his or her Pro Rata Share" or "to his or her Pro Rata Share".[45]

[77] What is a "Pro Rata Share"? Assuming that James is alive when the Committee, in its sole and unfettered discretion, decides to distribute or allocate income to Eligible Beneficiaries, "Pro Rata Share" means the number of Trust Units held by the Eligible Beneficiary divided by 3,180,000.

[78] When would Eligible Beneficiaries become entitled to their "Pro Rata Share" of the Trust Fund? According to paragraph 2.7 of the Trust Deed, it is on the "Division Date" which is the first to occur of:

(i) the date, as determined in the sole and unfettered discretion of the Committee, on which the Trust Fund has been entirely distributed to Eligible Beneficiaries; or

(ii) one day before the 21st anniversary of the death of the last surviving Beneficiary who was alive on July 12, 2013.

[79] Eligible Beneficiaries had no right to receive any distribution from the Trust until one day before the 21st anniversary of the death of the last surviving employee who was alive on July 12, 2013. When might that occur? Assume that the youngest employee of the Company was 20 years old in 2013 and that life expectancy was 77 years for a Canadian born in 1993. An Eligible Beneficiary would be entitled to

receive a distribution from the Trust in 2091 – assuming, of course, that they were alive and employed by the Company at that time.[46]

[80] Articles 3.1 and 3.2 of the Trust Deed make it clear that the powers of the Trustees are "subject to the authorization and direction from the Committee required to authorize the distribution or allocation of any income or capital from the Trust Fund as contemplated in Section 2.6 and 2.7" of the Trust Deed. Article 4.14 of the Trust Deed precludes the Trustees from making any distributions from the Trust without the authorization and direction of the Committee (bold in original):

> 4.14 **Provided that, the Trustees shall only be entitled to do any of the following with the authorization and direction of the Committee:**
>
> > (a) make any payments, provisions, or distributions which may be required under the terms hereof in whole or in part in monies, securities or other property and on every division or distribution.
> >
> > (b) make any division of the Trust Fund or set aside or pay any interest or share therein, either wholly or in part in the assets forming the Trust Fund or any part thereof
>
> The Committee's authorization and direction on such matters shall be final and binding upon all interested persons, including the Trustees and the Beneficiaries.

(2) The Employee Rights Plan

[81] One of the recitals to the Plan states that the Company:

> … through the Committee, wishes to grant certain Beneficiaries certain rights in and to any distribution of income or capital of the Trust Fund of the Trust that may be authorized and directed by the Committee from time to time …

[82] After reciting that the Committee wished to "grant certain Beneficiaries certain rights" the Committee proceeded to grant no rights to any Beneficiary. Article 2.1 describes the purpose of the Plan:

> 2.1 The purpose of the Plan is to advance the interests of the Corporation by (i) providing Eligible Beneficiaries with additional incentive to develop and promote the growth and success of the Corporation; (ii) encouraging Eligible Beneficiaries to remain with the Corporation or its Affiliates; and (iii) attracting and retaining persons of outstanding competence whose efforts will dictate, to a large extent, the future growth and success of the Corporation and its Affiliates.

[83] Consistent with the terms of the Trust Deed, Articles 3.2 and 3.3 of the Plan confirm that all decisions would be made by the Committee:

> 3.2 The Plan shall be administered by a Committee of three individuals appointed from time to time by the Board (the "Committee") who shall be responsible for the administration of the Plan.
>
> 3.3 The Committee shall have the power, where consistent with the general purpose and intent of this Plan, and subject to the specific provisions hereof:
>
> (a) to establish policies and to adopt rules and regulations for carrying out the purposes, provisions and administration of the Plan;
>
> (b) to interpret and construe the Plan and to determine all questions arising out of the Plan and any Trust Unit granted pursuant to the Plan, and any such interpretation, construction or termination made by the Committee shall be final, binding and conclusive for all purposes;
>
> (c) to determine which Beneficiaries are to receive Trust Units and how many Trust Units such person shall receive;
>
> (d) to determine any vesting provisions applicable to the grant of any Trust Units;
>
> (e) to determine if the Trust Units that are the subject of any grant will be subject to any restrictions;
>
> (f) to prescribe the form of the instruments relating to the grant and other terms of any Trust Units; and
>
> (g) to authorize and direct the Trustees to make any distribution of income or capital from the Trust Fund to Eligible Beneficiaries.

[84] Article 5.1 states that the Committee may resolve to grant Trust Units to one or more Eligible Beneficiaries. Article 5.2 further provides that the Committee would determine:

(a) the number of Trust Units subject to each grant;

(b) the expiration and termination date of each Trust Unit;

(c) the extent to which any such Trust Units vest; and

(d) any other terms and conditions relating to each such grant.

[85] Would the Beneficiaries or Eligible Beneficiaries have any right to receive a grant of Trust Units? Section 5.5 explicitly provides that "the Committee shall have no obligation to grant any Trust Units". Even after having been granted Trust Units, Article 8.1 of the Plan provides that Eligible Beneficiaries have no rights as shareholders or otherwise:

> 8.1 Nothing in the Plan or any Rights Agreement, or the fact that an Eligible Beneficiary holds any Trust Units at any time, shall confer upon any Eligible Beneficiary any rights as a shareholder of the Corporation, nor shall he or she have any right to the distribution of any income or capital of or from the Trust unless and until such distribution of or from the Trust Fund has been authorized and directed by the Committee.

F. The Committee Granted Trust Units on a Discretionary Basis

[86] The documents under which the trust arrangement was established were the Plan[47] and the Trust Deed,[48] both dated July 12, 2013. James was the settlor and James, Michael, and Steve Sinclair were the Trustees. The members of the Committee created by the Plan were James, Michael, and Steve Sinclair.[49]

[87] The combined effect of the Plan and the Trust Deed was to create a discretionary arrangement run by the Committee to provide financial benefits on a discretionary basis to the holders of Trust Units. In his evidence, Michael testified that the Committee had the power to make all decisions regarding distributions from the Trust in order "to give us additional degrees of control."[50] This important admission confirms, in Michael's own words, the discretionary nature of the arrangement.

[88] The Committee decided from time to time whether Trust Units would be granted to a particular employee and, if so, how many would be granted to that employee. The Committee was authorized to grant any number of Trust Units to employees until all 3,180,000 Trust Units had been granted.[51]

[89] James was quite candid about the nature of the discretion he exercised in deciding whether to grant Trust Units to any particular employee and how many of them to grant. He was asked about the resolution of the Committee (Exhibit A-1) listing the number of Trust Units awarded to 41 employees who formerly held stock options:

> Yeah, I mean I think it shows kind of what I was saying, that the people that we valued -- or I valued very highly are the ones that were given higher percentages of

> trust units. Yeah, Sheldon Carter -- you can see the ones I've mentioned were -- like Glen Miner who got almost 500,000 [Trust Units]; Scott McGregor, 260,000 [Trust Units]; Michael Brennan, who was our art director; Sheldon Carter, who was our head of production; and Geoff Crookes, who was our lead animator.
>
> They were kind of people from the different disciplines within the company that were essentially -- I was -- I felt these were people we cannot afford to lose; they were given the highest percentages.[52]

[90] James testified that he wanted to give to the former option holders a percentage ownership equal to that reflected by their former stock options:

> So the idea, for me, was to give the equivalent amount in terms of percentage of the company. And so I can't recall the amount offhand but that was the essence of what was to be done, is give an equivalent percentage ownership of the company. So it would be equivalent on a percentage-of-the-company basis.[53]

[91] Michael testified to the same effect:

> MR. SANDLER: And how was it determined how many trust units each of these individuals received?
>
> MR. M. SCHMALZ: They were roughly the same. The initial set of options, as I recall, our discussions in the committee was that they would receive … units equal to their options that they were formerly held so that it was roughly, a fair trade then, or an equal trade, I guess, would be a better ---[54]

[92] Both James and Michael testified that they wanted to ensure this type of equivalence. But how exactly they planned to achieve it remains a mystery. More importantly, it is impossible to ascertain, on the evidence, to what extent that goal had been achieved. In argument, the Appellants asserted, as a matter of fact, that the former holders of stock options:

> … received an equivalent number of trust units as part of the consideration they received on the cancellation of their stock options. And when I say an equivalent number of trust units, [I mean] trust units that represented an equivalent percentage of common shares.[55]

[93] There are no facts on the record to support such an assertion.

[94] In fact, neither the Trust Deed nor the Plan promised to provide that kind of equivalence to former stock option holders. Both documents are silent on the point. Indeed, no document in evidence listed:

(a) the ownership interest of a particular employee in the Company under the former stock option plan; or

(b) the ownership interest of that employee in the Company as reflected by the number of Trust Units granted to him or her.

[95] In the absence of any such documentary evidence, how would James and Michael have known if or when they achieved their goal? That question remains unanswered.

[96] In any event, the subjective desire of James and Michael to provide such equivalence did not flow from any legal obligation on James, Michael, or the Company. Employees were simply told, most often verbally, of the number of Trust Units the Committee – in its discretion – decided to grant them. There is no evidence that they were ever informed of the percentage of the Company that their Trust Units represented.

[97] Following the conversation informing the employee of the grant of Trust Units, a letter would be sent to the employee confirming the grant. James testified that in so doing, the Committee was:

> … following the procedures that the lawyers suggested to us in terms of the administration of … granting trust units to the employees. We would dole out -- as we've seen many times -- the documents and make them aware of what units they were getting, mostly often verbally.[56]

[98] During his examination-in-chief, Michael was asked how it was determined how many Trust Units each of the 41 employees received:

> MR. SANDLER: And how was it determined how many trust units each of these individuals received?
>
> MR. M. SCHMALZ: They were roughly the same. The initial set of options, as I recall, our discussions in the Committee was that they would receive options equal to their -- sorry, that they would receive units equal to their options that they were formerly held so that it was roughly, a fair trade then, or an equal trade, I guess, would be a better ---[57]

[99] How Michael – or anyone else – would have known that the number of Trust Units granted to a particular employee represented “roughly the same” percentage ownership as their former stock options remains a mystery.

(1) The Grant of Trust Units to Mr. Black

[100] On December 1, 2015, the Committee exercised its discretion to grant Mr. Black 10,038 Trust Units[58] in addition to the 6,667 Trust Units that the Committee had granted to him in August 2013.[59] Because the evidence was less than entirely clear as to why the Committee decided to grant Mr. Black an additional 10,038 Trust Units, I asked James about it:

> MR. J. SCHMALZ: I think again it's where Mr. Black has been really proving himself to be, you know, an exceptionally valuable employee at Digital Extremes -- and as he is still today all this time later -- we just wanted to award -- we still have -- I don't -- I wouldn't say "significant". We still had units left in the trust to allocate and he was one that we discussed that we wanted to allocate those units to.
>
> JUSTICE SPIRO: Do you know how the committee [arrived] at the number of 10,038?
>
> MR. J. SCHMALZ: Oh, it would have been with other units -- there would have been several other people getting units at the same time. I can't recall offhand. I can't say for certain but my guess would be that we have so many units left, I probably would have made the call to say, "Let's take this block of X number of units."
>
> And then I would discuss with various managers and various senior people how we should allocate those so that the people most deserving of those trust units -- and we have some back and forth as to how those would be divided up. So it is a particularly strange specific number of units but I can't say why.[60]
>
> ***
>
> MR. J. SCHMALZ: I can actually answer it more specifically now seeing this [paragraph 24 of the PASF]. So December 1st, it looks like we decided to allocate all the remaining units of the trust and so we would have had a discussion that we want to do that and then come up with a list of people that we wanted to award those to and award them accordingly through some back and forth conversations with managers and senior people.[61]

(2) The Grant of Trust Units to Mr. Pettypiece

[101] Mr. Pettypiece testified that in January, 2014, he met with Michael who told him that he had been granted 25,000 Trust Units[62] because James and Michael wanted to recognize the work he had done and wanted him to stay with the Company:

> MR. SANDLER: And how were you made aware that you were awarded units in the Digital Extremes trust?
>
> MR. PETTYPIECE: So this would have been a conversation with Michael Schmalz.
>
> MR. SANDLER: And to the best of your recollection -- and I appreciate this is almost 10 years ago now -- but what would that conversation have entailed?
>
> MR. PETTYPIECE: I believe it entailed, you know, him basically recognizing the great work I had done so far and letting me that, you know, James felt the same way, and you know, this was in recognition of that, and it was his desire and James' desire that I stay with the company long term.[63]

[102] On January 22, 2014, Mr. Pettypiece was granted 25,000 Trust Units.[64] That was his original grant of Trust Units. He was not a former stock option holder. Michael explained why the Committee decided on January 22, 2014 to grant another employee - Mr. McGregor – an additional 225,000 Trust Units and, at the same time, grant Mr. Pettypiece his initial 25,000 Trust Units:

> Scott McGregor was a big one because the committee felt that he deserved a lot more than he did in the [stock option] plan, based on his contributions in the company, and Murphy [Pettypiece] was also considered to be an increasingly important person in the organization, justifying his allocation of additional trust units.[65]

[103] On September 3, 2014, the Committee decided to grant Mr. Pettypiece 26,000 additional Trust Units.[66] This was his first additional grant of Trust Units. Originally, the plan was to grant him more than 26,000 additional Trust Units, but he advocated on behalf of an employee who reported to him:

> MR. SANDLER: And were you involved in discussions with any employees who were issued trust units after August 14th, 2013?
>
> MR. PETTYPIECE: Only one which was an employee who reported in to me. His name was Gavin Acton and I had advocated for him and actually gave up a few of my own units so that he could participate in the trusts as well. So I spoke to him but he is the only one that I would have met with that received units.
>
> MR. SANDLER: Sorry, what do you mean by “gave up” some of your own units?
>
> MR. PETTYPIECE: Not that I -- so when James notified me that I was receiving the 26,000 units on the previous resolution, he initially was suggesting to give me more and I asked that we instead carve out a little bit for Gavin and recognize him.

So prior to there being any finalizing of the allocation, he and I guess the rest of the committee decided that they would allocate to Gavin a little as well.[67]

[104] James was asked why the Committee decided to grant 26,000 additional Trust Units to Mr. Pettypiece on September 3, 2014:

At this point, Murphy [Pettypiece] -- and again, I can't recall if we made him CFO quite yet at that point but he was becoming one of those people that was incredibly valuable to the company and has since -- has become, for me, over the 10 years since then, incredibly valued -- valuable to Digital Extremes. So we had a number of trust units that were still allocatable and he was one of the top people that we wished to award those to.[68]

[105] On May 9, 2016, the Committee decided to grant Mr. Pettypiece 6,287 additional Trust Units.[69] This was his second additional grant of Trust Units.

(3) The Grant of Trust Units to Ms. Ford

[106] On September 3, 2014, the Committee decided to grant 17,335 Trust Units to Ms. Ford.[70] Ms. Ford was not a former stock option holder. This is how Ms. Ford learned that she had been granted the Trust Units:

MS. FORD: My boss at the time had called me into the office to let me know that she wanted to talk to me about something exciting. And at this point, I had been with the company for just over three years. We had had a pretty successful launch of the game *Warframe* that I was working on. I started the publishing department with my boss and she presented me this letter and told me that she was really proud of the work that I put into the game, *Warframe*, and how she felt that I had so much potential to grow and continue to grow as a game developer within the company and she wanted me to be able, you know, to participate and be part of, you know, something big, a bigger thing, with the success of the company.

So this was -- my understanding when we were talking about this, and when she gave it to me, you know, emotions and excitement aside is that, you know, I'm just getting shares in Digital Extremes, which is how that situation happened in her office.[71]

[107] Ms. Ford's supervisor was James' spouse at the time.[72] Her name was Meredith. In cross-examination, Ms. Ford offered additional details of that meeting:

At the meeting with Meredith, I didn't ask for documents for sure. It was more of a: "Holy smokes. This is so exciting. Very appreciative. Thank you." I had a couple

> "What does this mean" questions that she was forthcoming with, you know, with the nature of the games industry is acquisitions do happen and that in the event that, you know, we continue to grow and we continue to launch *Wargame* [*sic*] the way it was going, which was up, that I would participate in the long-term financial benefits, essentially. I mean, not to be crass, but at the time, I kind of asked, like, "Oh, are these shares in the company, are they going to be worth money?" And she was conversationally like, "Well, if we ever sell, yes."[73]

(4) The Grant of Trust Units to Mr. McGregor

[108] On August 14, 2013, the Committee decided to grant Mr. Scott McGregor 266,667 Trust Units.[74] On January 22, 2014, the Committee decided to grant Mr. McGregor an additional 225,000 Trust Units.[75] Why did the Committee decide to make the additional grant? James explained how effectively Mr. McGregor advocated for additional Trust Units:

> Scott McGregor is one of the senior people. He's currently our chief creative officer -- sorry, no chief creative -- our chief creative person at Digital Extremes. At this time, he was our lead level designer so a very -- one of these very important people. And the issuance of these units came about through these continued discussions that I mentioned previously with the senior people.
>
> Scott was one the few that really petitioned that he was worth even more to the company. In going into the future, he requested a substantial increase in his trust units from what he got from -- in conversion from the options. And so he is an incredibly valuable person to the company so I was more than happy to agree to that with him.[76]

G. No Shares Were Allocated to Each of the Former Stock Option Holders

[109] By resolution dated as of August 14, 2013, the Committee resolved to make an initial grant of 2,946,665 Trust Units to 41 employees (or "Eligible Beneficiaries" in the language of the Trust Deed and the Plan).[77] All 41 initial grantees of Trust Units were former stock option holders. The only former holders of stock options who received shares of the Company rather than Trust Units were Michael and Steve Sinclair.

[110] I find as a fact that no one at that time, or at any other time, allocated any particular number of shares of the Company to any particular employee among the 41 employees who formerly held stock options.

H. No Shares Were Allocated to Each of the New Employees

[111] With respect to employees who were not former stock option holders, I find as a fact that no one at any time allocated any particular number of shares of the Company to any particular employee among those new employees.

I. Email Message on Agreement to Sell 61% of the Company

[112] On October 14, 2014, James sent an email message to all holders of Trust Units announcing the signing of an agreement to sell 61% of the Company for $73,200,000.[78] A copy of that email message is attached as Schedule "H".

[113] In that email message, James provided what he called a "rough ballpark # just so you know":

> I'm sure you have some obvious questions as to what $ amounts are involved and when it will happen. Below will give you a rough estimate of the amount. We will announce in follow-up emails in the coming month to address timing and more details on the actual transaction.
>
> ***
>
> $9,000,000 * X/3,180,000 = your payment

[114] The $9 million referred to was that portion of the $73.2 million purchase price the Company attributed to the shares held by the Trust. The part of the email message describing "your payment" was the focus of the message. James told the Trust Unit holders what was going to happen with the Trust Units and, most importantly, "how much they'll get paid."[79]

[115] Several references to "shares" appear in James' email message including the heading "DE Share Trust Holders" and the first line stating that the email was intended for the group of individuals that own DE 'Share Units in Trust'. James also informed the holders of Trust Units that "61% of your Shares in Trust will be purchased."

[116] It is clear from the context that the word "shares" in James' email message does not refer to the shares of the Company held by the Trust. It refers to Trust Units that James himself refers to as "Shares in Trust" meaning the recipient's "share" of the proceeds of sale. This is clear from the formula that James provided in the email message:

> X = The number of shares in trust you have. If you don't have your number feel free to email me to ask. I have the list right in front of me.
>
> $9,000,000 * X/3,180,000 = your payment

[117] One could speculate that the "X" must have represented the number of Trust Units held by the particular employee rather than any number of shares of the Company. But rather than leaving the matter to speculation, I asked James:

> JUSTICE SPIRO: … So in the final, the A-2 Exhibit, the one you did send out to everybody, you say in the fifth paragraph, the one that starts with the letter "x".
>
> MR. J. SCHMALZ: M'hm.
>
> JUSTICE SPIRO: It says:
>
> > "If you don't have your number, feel free to email me to ask. I have the list right in front of me." (As read)
>
> Do you have the list that you had in front of you that day in front of you now or accessible to you now?
>
> MR. J. SCHMALZ: That's a good question. I think ---
>
> MR. SANDLER: It's not in the documents, Your Honour.
>
> MR. J. SCHMALZ: No.
>
> JUSTICE SPIRO: Okay.
>
> MR. J. SCHMALZ: Yeah, I only have the one that was initially -- yeah, I do not.
>
> JUSTICE SPIRO: What would it have listed?
>
> MR. J. SCHMALZ: Just the exact -- it would be similar to -- I can't remember what exhibit this is.
>
> JUSTICE SPIRO: A-1?
>
> MR. J. SCHMALZ: A-1 where it listed all the trust unit holders except for it would be up to date with the latest issuances. This is the initial issuances of the trust units and it would be a list that Murphy [Pettypiece] would have supplied me with. And at that time, I guess, it would have been the 3,180,000 trust units allocated to however many people it was to go to.[80]

[118] Just as the Committee's resolution dated as of August 14, 2013 did not reflect the allocation of any particular number of shares of the Company to any particular employee, so too the list that James had before him when he sent his email message of October 14, 2014 did not reflect the allocation of any particular number of shares of the Company to any particular employee.

[119] After announcing the sale of 61% of the Company on October 14, 2014, James and Michael met with the holders of Trust Units. Michael testified that those meetings dealt with the amount of money that the holders of the Trust Units would receive on the sale:

> So we had separate meetings then with the unit holders and then in the time between the purchase agreement and the final closing, which was quite a while -- it was, you know, seven or eight months -- we had discussions with them in terms of what that meant, because it's not 100 percent clear what the final price was going to be in the purchase agreement or how much money that they were going to get because of issues around dividends and the calculations of the stock price.
>
> So there was a lot of discussions with people who really wanted to know what was going on and what they were going to get.[81]

VI. **Submissions of the Parties**

A. Submissions of the Appellants

[120] Counsel for the Appellants, Mr. Sandler, concedes that the trust arrangement constituted an "employee benefit plan" within the meaning of subsection 248(1) of the Act. However, counsel submits that subsection 7(2) of the Act also applies and, in light of the maxim *generalia specialibus non derogant*, the more specific provisions of subsection 7(2) prevail over the more general provisions of paragraph 6(1)(g) of the Act.

[121] The Appellants argue that an agreement to issue shares to an employee that is required by subsection 7(1) is not required for subsection 7(2) to apply because subsection 7(2) includes no requirement for any such agreement.

[122] The Appellants contend that as long as a subsection 7(2) trust holds shares for employees, it matters not on what terms the trust holds them – whether or not pursuant to an agreement – in light of the words of subsection 7(2) that a trust may hold the shares "absolutely, conditionally or contingently". The presence of those

words confirms that no agreement is necessary in order for a subsection 7(2) trust to be recognized.

[123] In addition, the words of subsection 7(2) allowing the trust to hold shares “absolutely, conditionally or contingently” are satisfied here because the Trust Units granted to employees represent a “contingent interest” of the employees in the trust property and, by logical extension, a “contingent interest” in the shares of the Company held by the Trust.[82]

[124] That a standalone subsection 7(2) trust can exist, independent of subsection 7(1) and its requirement for an agreement, is confirmed by several provisions of the Act referring specifically to a subsection 7(2) trust including subsection 104(21.2), paragraph (a.1) of the definition of “trust” in section 108, and subsection 110.6(16) of the Act.

[125] In the alternative, if the requirement for an agreement in subsection 7(1) applies for purposes of subsection 7(2) as well, that requirement is satisfied because there was an agreement to issue shares to each of the Appellants. The Appellants ask me to recognize any or all of the following in satisfaction of the requirement for an agreement:

(a) An agreement between the former stock option holders and the Company to surrender their stock options in consideration for ten cents per option and whatever number of Trust Units would reflect the percentage ownership of the Company they formerly held through their stock options (applies to Mr. Murphy and Mr. Black);

(b) An agreement between the Trustees and the Company for the Company to issue shares to the Trustees on behalf of the beneficiaries of the Trust (applies to all Appellants); and

(c) An agreement between all Trust Unit holders and the Company for the Appellants to provide future employment services in consideration for a beneficial interest in the shares held by the Trust (applies to all Appellants).

[126] The Appellants say that, in light of the maxim *generalia specialibus non derogant*, the more specific provisions of subsections 7(1) and 7(2) prevail over the more general provisions of paragraph 6(1)(g).

[127] Finally, the Appellants concede that unless the Court finds that subsection 7(2) applies to the Trust, subsections 104(19), 104(21) and 104(21.2) do not take precedence over paragraph 6(1)(g) under the maxim *generalia specialibus non derogant* because the definition of "trust" in subsection 108(1) of the Act specifically excludes an "employee benefit plan" from the scope of paragraph 104(13)(a) and, in the context of these appeals, the application of that provision is a necessary precondition to the application of:

(a) subsection 104(19) (designation of trust distributions as dividends);

(b) subsection 104(21) (designation of trust distributions as taxable capital gains); and

(c) subsection 104(21.2) (designation of trust distributions as taxable capital gains eligible for the lifetime capital gains exemption on the sale of 61% of the Company).

B. Submissions of the Respondent

[128] Counsel for the Respondent, Mr. Bornstein, argues that the Minister properly reassessed the distributions from the Trust to the Appellants in 2015, 2016, and 2017 as employment benefits under paragraph 6(1)(g) of the Act because the discretionary arrangement in which they participated constituted an "employee benefit plan" within the meaning of subsection 248(1).

[129] Subsection 7(2) of the Act does not apply to this discretionary arrangement because the Company did not agree to issue shares to any of the Appellants within the meaning of subsection 7(1) of the Act. A subsection 7(2) trust cannot exist in the absence of an agreement to issue shares to an employee under subsection 7(1). There is no such thing as a standalone subsection 7(2) trust because subsection 7(2) is a relieving provision that uses a deeming rule to determine timing. Subsection 7(2) does not refer to an agreement because subsection 7(1) already refers to it. Subsection 7(2) simply describes the way that subsection 7(1) applies when a trust holds shares for employees.

[130] The words of subsection 7(2) stating that the trust may hold the shares "absolutely, conditionally or contingently" do not contemplate a discretionary arrangement such as this one. Where Parliament wishes to include a discretionary arrangement, it says so specifically (see, for example, subsection 248(25) of the Act).

[131] Because subsection 7(2) does not apply to the Trust, subsections 104(19), 104(21) and 104(21.2) do not take precedence over paragraph 6(1)(g) under the maxim *generalia specialibus non derogant* because the definition of "trust" in subsection 108(1) of the Act specifically excludes an "employee benefit plan" from the scope of paragraph 104(13)(a) and, in the context of these appeals, the application of that provision is a necessary precondition to the application of:

(a) subsection 104(19) (designation of trust distributions as dividends);

(b) subsection 104(21) (designation of trust distributions as taxable capital gains); and

(c) subsection 104(21.2) (designation of trust distributions as taxable capital gains eligible for the lifetime capital gains exemption on the sale of 61% of the Company).

[132] As the Trust was an "employee benefit plan" and was not a subsection 7(2) trust, the Court should dismiss the appeals.

VII. **The Jurisprudence**

[133] The two most important provisions in these appeals, subsections 7(1) and 7(2) of the Act, provide:

> **Agreement to issue securities to employees**
>
> 7(1) … where a particular qualifying person has agreed to sell or issue securities … to an employee of the particular qualifying person …,
>
> (a) if the employee has acquired securities under the agreement, a benefit equal to the amount, if any, by which
>
> (i) the value of the securities at the time the employee acquired them
>
> exceeds the total of
>
> (ii) the amount paid or to be paid to the particular qualifying person by the employee for the securities, and
>
> (iii) the amount, if any, paid by the employee to acquire the right to acquire the securities

> is deemed to have been received, in the taxation year in which the employee acquired the securities, by the employee because of the employee's employment;

Securities held by trustee

7(2) If a security is held by a trustee in trust or otherwise, whether absolutely, conditionally or contingently, for an employee, the employee is deemed, for the purposes of this section and paragraphs 110(1)(d) to (d.1),

> (a) to have acquired the security at the time the trust began to so hold it; and
>
> (b) to have exchanged or disposed of the security at the time the trust exchanged it or disposed of it to any person other than the employee.

[134] The most important words are those at the beginning of subsection 7(1): "where a particular qualifying person *has agreed to … issue securities to an employee* of the particular qualifying person".

[135] The question is this: to what extent, in the context of a trust holding shares for employees, does that requirements in subsection 7(1) apply? Fortunately, a decision of the Federal Court (then the Federal Court – Trial Division) helps us answer that question. That decision is *Chrysler Canada Ltd. v Canada*, [1991] 2 CTC 156; 91 DTC 5526 [*Chrysler No. 1*].[83] In applying the law to the facts, I have relied heavily on Justice Strayer's reasons for judgment in *Chrysler No. 1*. Before reviewing those reasons in detail, a brief summary of its central teaching is in order.

[136] *Chrysler No. 1* teaches that the requirement in subsection 7(1) that a corporation agree to "issue" shares to an employee is satisfied in the trust context where the corporation has agreed to "allocate" a particular number of shares to a particular employee to be held by a trust.

A. *Chrysler No. 1*

[137] In *Chrysler No. 1*, Justice Strayer was asked to determine the following question under subsection 174(1) of the Act:

Whether the Chrysler Employee Stock Ownership Plan was

(a) an "employee benefit plan" as defined in subsection 248(1) of the Act, and referred to in paragraph 6(1)(g), or

(b) an agreement to sell or issue shares to employees within the meaning of section 7.

[138] Justice Strayer found that the Chrysler Employee Stock Ownership Plan (“ESOP”) was both an “employee benefit plan” and an agreement to issue shares to employees within the meaning of section 7.

[139] By way of background, Chrysler faced the prospect of bankruptcy in 1979. The United States government came to its rescue. At the same time, Chrysler’s workforce made significant wage concessions. In recognition of the sacrifices made by its employees during that difficult time, Chrysler set up the ESOP and issued common shares that it contributed to a trust. Chrysler contributed some shares for the benefit of Chrysler employees in the United States and contributed other shares for the benefit of Chrysler Canada employees.

[140] By 1984, Chrysler’s financial situation improved and the fair market value of its shares had increased significantly. Two years later, Chrysler terminated the ESOP. The trustee distributed the shares to the employees. Some employees chose to keep the shares while others chose to receive the value of the shares in cash.

[141] The facts appear in Justice Strayer’s reasons for judgment. I have italicized certain of them for emphasis:

> The application states that it is the Minister’s understanding that the employees believe certain other relevant facts to be:
>
> (a) Under ESOP, Chrysler issued new common shares which it contributed to the Trust, and *the Trustee allocated those shares to the accounts of eligible individual employees*. The basic features of ESOP are described in a Chrysler document dated January 5, 1980. ….
>
> (b) The effective date for implementation of ESOP was July 1, 1980.
>
> (c) ESOP had a proposed term of four years. Each plan year began on July 1st and ended on June 30th.
>
> (d) The terms of ESOP required Chrysler to contribute to the Trust, before June 30th of each plan year, shares having a market value of not less than $40,625,000.00.
>
> (e) Over the four year term of ESOP, Chrysler was required to contribute shares having a total value of not less than $162,500,000.00.

(f) As soon as practicable after the end of the plan year, *the Trustee divided the shares equally among all eligible employees by crediting those shares to accounts in the name of individual employees*.

(g) As soon as practicable after the end of the plan year, *employees received a statement of account showing the number of shares allocated to their account for that plan year and the market value of those shares*.

(h) Employees were entitled to direct the Trustee on how to vote the shares held in their accounts at any Chrysler shareholders' meeting.

(i) Some employees did, in fact, exercise their right to vote their shares at Chrysler shareholders' meetings.

(j) Any dividends earned on shares held in an employee's account were invested by the Trustee in additional shares of Chrysler. *Those shares were also allocated to the particular employee's account*.

(k) When ESOP became effective on July 1, 1980 only employees of Chrysler were eligible to participate. This appears from a letter dated March 31, 1980 from Chrysler to the United Auto Workers,…..Employees of Chrysler Canada initially chose not to participate.

(l) However, by letter dated January 14, 1981 from Chrysler to the United Auto Workers,… employees of Chrysler Canada became eligible to participate in ESOP retro-active to the plan year commencing July 1, 1980.

(m) A new plan was not implemented for employees of Chrysler Canada. Rather, those employees simply became eligible to participate in the existing ESOP established pursuant to the Loan Act. Chrysler Canada reimbursed Chrysler for those Chrysler shares allocated to the accounts of Chrysler Canada employees.

(n) Accordingly, *shares contributed to ESOP by Chrysler for the plan years 1980 and 1981 were allocated to the accounts of Chrysler Canada employees. Those employees received statements of account shortly after the end of the plan year verifying the number and value of their shares*.

[142] Four critical facts played a leading role in Justice Strayer's reasons:

- Chrysler issued new common shares which it contributed to the trust, and the trustee allocated those shares to the accounts of eligible individual employees.[84]

- As soon as practicable after the end of the plan year, the trustee divided the shares equally among all eligible employees by crediting those shares to accounts in the name of individual employees.[85]

- As soon as practicable after the end of the plan year, employees received a statement of account showing the number of shares allocated to their account for that plan year and the market value of those shares.[86]

- Dividends earned on shares held in an employee's account were invested by the trustee in additional shares of Chrysler. Those shares were also allocated to the particular employee's account.[87]

[143] Under the ESOP, the trustee would allocate a particular number of shares to a particular employee and would regularly inform the employee of the number of shares allocated to him or her and their market value.

[144] Justice Strayer noted that subsection 7(1) requires that a corporation issue shares to "an employee" and that the Chrysler arrangement – because of the existence of the trust – did not involve the issuance of shares to any particular employee. In light of the nature of a trust, where the trustee holds the shares for the particular employee, Chrysler was not required to enter any shares in its shareholder register in the name of any employee. It was sufficient that

> … the trustee held the shares as owner and it "allocated" a certain number of shares to the account of each employee.[88]

[145] After reviewing the facts, Justice Strayer concluded that subsection 7(2) applied in light of the limited role of the trustee in the Chrysler plan.[89] He found that the role of the trustee was limited to:

- allocating the shares notionally to the employees during the duration of the employee's participation in the plan;

- reinvesting dividends in further shares which would be similarly allocated and held; and

- distributing the shares at the conclusion of the plan to each employee in the numbers allocated to such employee (or selling the shares and giving the employee the cash value at that time).[90]

[146] Justice Strayer also found that each employee would ultimately receive shares of Chrysler or, at the employee's election, the cash equivalent.[91] Even where an employee elected to receive the cash equivalent, the employee was legally entitled to receive the shares on the date of distribution.[92] Justice Strayer interpreted subsection 7(1) in light of subsection 7(2) of the Act and concluded that an agreement to allocate a particular number of shares to a particular employee would satisfy the requirements of subsection 7(1) in the context of a trust holding the shares for the employee.

[147] Because of the importance of this decision to the disposition of these appeals, I have reproduced Justice Strayer's reasoning in its entirety (emphasis added):

> Although in my view an agreement existed within the meaning of subsection 7(1), if that subsection stood alone there could be serious doubt as to its application to the ESOP in question here. *Subsection 7(1) requires, for present purposes, that a corporation issue shares "to an employee"* and paragraph 7(1)(a), which determines the year of taxability, refers to the time at which the employee has "acquired" the shares. The arrangement in question here did not involve the direct issue of shares by Chrysler Corporation to the employees of Chrysler Canada and upon the initial issue of the shares by Chrysler Corporation to the trustee the employees did not "acquire" the shares in the normal sense of that word. There is no evidence that at that stage the shares were ever entered in the names of the employees in the share registry of Chrysler Corporation. Instead, the trustee held the shares as owner and it "allocated" a certain number of shares to the account of each employee. As dividends were received those dividends were converted into shares and credited on a proportional basis to the accounts of the respective employees. The only right which the employees could exercise in respect of the shares was to give instructions, if they wished, as to how the shares should be voted at shareholders' meetings. The employees could not assign, or use as security, the number of shares allocated to them during the years when ESOP existed and they were participants in it.
>
> It appears to me, however, that *paragraph 7(2)(a) requires a broader interpretation of such words as "issue ... to an employee ..." and "acquired" as found in subsection 7(1)*. For convenience I will quote again the provisions of paragraph 7(2)(a).
>
>> 7.(2) *Shares held by trustee*.—Where a share is held by a trustee in trust or otherwise, either absolutely, conditionally or contingently, for an employee, the employee shall be deemed, for the purposes of this section and paragraphs 110(1)(d) and (d.1),
>>
>>> (a) to have acquired the share at the time the trust commenced so to hold it;

. . .

> Although counsel for the Minister and Chrysler Corporation took the position that subsection 7(2) could have no bearing on the matter unless it was first found that subsection 7(1) applied, I do not think the matter is that simple.It appears to me that *subsection 7(2) provides a special broad interpretation of the words of subsection 7(1), and its effect is to recognize that there can be an "issue" of shares to an employee through a trust* and that such shares are deemed to have been "acquired" by the employee when they are acquired by the trust. Further, I believe that the present arrangement falls within the words of subsection 7(2), that is that the shares here were held by a trustee "absolutely, conditionally or contingently, for an employee ..." It is clear from the description of the plan prepared by Chrysler and the trust agreement, in respect of which documents both union and non-union employees contracted in agreeing to accept rollbacks and continue employment, that the trustee had only a limited role in holding the shares. This role was: to allocate the shares notionally to the employees during the duration of the employee's participation in the plan; to reinvest dividends in further shares which would be similarly allocated and held; and at the end of the plan (or in the case of death or termination of employment of an employee), to distribute the shares themselves to each employee in the numbers allocated to such employee or to sell the shares and give the employee the cash value at that time. It was understood that the duration of the plan would be limited and it was inevitable, if the plan and the trust agreement were implemented by their terms, that each employee would ultimately receive shares of Chrysler Corporation or, at his election, the cash equivalent being the market value of the shares at that time. It does not alter the situation that some of the employees in question here took the cash instead of the shares: they were entitled to the shares on the date of distribution. It therefore appears to me that the trust scheme here provided for shares being held by the trustee "absolutely, conditionally or contingently ..." for the employees, and I need not determine which of those adverbs is appropriate to describe the arrangement.[93]

[148] Justice Strayer used a textual, contextual, and purposive interpretation of subsections 7(1) and 7(2) to conclude that the subsection 7(1) requirement for an agreement to “issue” a particular number of shares to a particular employee included an agreement to “allocate” a particular number of shares to a particular employee where a trust held the shares for the employee. He was able to make sense of subsection 7(2) in light of subsection 7(1) because, in his words, subsection 7(2) provides a “special broad interpretation of the words of subsection 7(1)” in the context of a trust.

[149] The Appellants misunderstand the central teaching of *Chrysler No. 1*. That misunderstanding led them to take the position that employees of Chrysler had only a “notional interest” in the shares held for them[94] and that Chrysler merely maintained a “notional account” for each employee.[95] That misunderstanding also

led them to misinterpret the specific number of shares allocated to each employee by Chrysler as a “notional number of shares”.[96]

[150] A careful reading of Justice Strayer’s reasons for judgment discloses that he used the word “notionally” only once in the course of his reasons. He used it when describing the limited role the trustee played in holding Chrysler shares for each employee. He noted that part of the trustee’s role was:

> … to allocate the shares notionally to the employees during the duration of the employee’s participation in the plan.[97]

[151] The Appellants misinterpret the phrase “allocate the shares notionally” to suggest that Justice Strayer was referring to a “notional interest”, a “notional account” and a “notional number of shares” none of which appear anywhere in his reasons. Justice Strayer used the word “allocated” in two other places in his reasons. On neither of those occasions is the word “notional” associated with it.[98]

[152] Because he had also referred to the corporate share register, Justice Strayer used the concept of a “notional” allocation to distinguish it from an “actual” allocation of shares to an employee. An “actual” allocation would clearly be impossible in the trust context because the trustee would be the registered owner of the shares.

B. <u>*McAnulty v The Queen*</u>

[153] In addition to the reasons for judgment of Justice Strayer in *Chrysler No. 1*, I have relied on the reasons for judgment of Associate Chief Justice Bowman in *McAnulty v The Queen*, [2002] 1 CTC 2035; 55 DTC 942 [*McAnulty*].

[154] In *McAnulty*, Judge Bowman had to decide on what date an agreement had been reached to issue a particular number of shares by way of stock options to a particular employee. Although neither subsection 7(1) nor 7(2) was involved, Judge Bowman was dealing with a similarly worded provision (subparagraph 110(1)(d)(i) of the Act) involving an agreement to issue shares to the employee.

[155] The question before Judge Bowman was whether the agreement to issue shares to the employee was made when:

(a) the corporation committed to issue a particular number of option shares to the employee in April 1994; or

(b) when the corporation and the employee signed a written agreement and the corporation passed a resolution authorizing the issuance of those option shares to that employee in May 1994.

[156] The date on which the agreement was made was critical because the amount of the benefit would be the difference between the fair market value of the shares when the agreement was made and the amount paid by the employee (clauses 110(1)(d)(i)(A) and (B) of the Act). The fair market value of the underlying shares had increased significantly between April and May 1994.

[157] In April 1994, the president of the corporation told the employee that the corporation would issue 45,000 option shares to her at $1.50. This was confirmed by an immediate phone call to the exchange on which the shares would be listed, a meeting the following Monday, and a letter on Wednesday confirming the meeting.[99]

[158] In May 1994, the board of directors resolved to grant that employee an option to purchase 45,000 common shares at a price of $1.50 per share.[100] On that date, both parties signed a share option agreement.[101]

[159] The issue was whether the agreement to issue 45,000 option shares to the employee was made in April when the president of the corporation verbally committed to issue 45,000 option shares to that employee or in May when the parties signed a written agreement and the corporation resolved to issue the 45,000 option shares to her.

[160] Judge Bowman concluded, for the purposes of subparagraph 110(1)(d)(i) of the Act, that an agreement to issue 45,000 option shares to the employee had been made in April 1994. That agreement to issue 45,000 option shares to that employee was confirmed and implemented in May 1994 by way of written agreement and corporate resolution.[102] Judge Bowman based that conclusion on his finding of fact that the corporation had agreed by way of oral commitment in April 1994 to issue 45,000 option shares to that employee.[103] The Appellants agree that in *McAnulty* "you had an oral agreement to give an employee a certain number of shares."[104]

[161] That is the key to these appeals as well – was there an oral or written commitment to allocate a particular number of shares of the Company to a particular employee? Here, neither James nor Michael – nor anyone else on behalf of the Company – made any oral or written commitment to allocate a particular number of shares of the Company to a particular employee.

VIII. **Analysis and Conclusion**

[162] Once the number of shares issued or allocated – or to be issued or allocated – to the particular employee has been determined, an agreement to issue shares to an employee arises as contemplated by subsection 7(1) of the Act. That is the central teaching of *Chrysler No. 1*.

[163] Such an agreement will arise regardless of whether the corporation has committed itself to (a) issuing a particular number of shares directly to the particular employee or (b) allocating a particular number of shares to that employee by way of a trust as contemplated by subsection 7(2) of the Act.

[164] Conversely, an agreement to issue shares within the meaning of subsection 7(1) does not arise when the corporation commits itself to allocating a certain number of shares in the aggregate to *all* eligible employees by way of a trust. That is exactly what happened here. By committing itself to issuing 1,380,000 shares to a trust for the benefit of *all* eligible employees, the Company failed to meet the requirements of subsections 7(1) and 7(2) as interpreted by Justice Strayer in *Chrysler No. 1*.

[165] Michael himself understood the distinction between Trust Units and shares. He testified that while 41 of the former stock option holders received Trust Units, two of the former option holders – himself and Steve Sinclair – received shares of the Company instead.[105] When the Company wanted to issue a particular number of shares to a particular employee, it knew how to do so.

[166] Unfortunately, the treatment of subsection 7(2) of the Act in the E&Y Letter assumed away the central point. E&Y simply stated, as an assumed fact, that the trust would be "constructed to be compliant with subsection 7(2) of the Act".[106] The E&Y Letter did not explain what exactly that meant nor did it refer to the need to allocate a particular number of shares to a particular employee.

[167] But what about the recitals to the Trust Deed where the Company, as settlor, stated that it intended to establish a trust in accordance with and for the purposes of section 7(2) of the Act? In paragraph 2.2 of the Trust Deed the parties stated:

> 2.2 For greater certainty, it is hereby confirmed that this Trust shall for all purposes be deemed to be a trust for the purposes of section 7(2) of the *Income Tax Act*.

[168] In the absence of the allocation of a particular number of shares to a particular employee, self-serving statements and recitals are ineffective.

[169] Had the statutory definition of “security” in subsection 7(7) included ordinary trust units, the analysis might have been different. Parliament decided that a trust unit should qualify as a “security” only if it is a unit of a mutual fund trust. Had Parliament intended to include other types of trust units in the definition of “security” it would have done so. If that had been the case, the allocation of a particular number of trust units to a particular employee might have satisfied the requirements of subsections 7(1) and 7(2).

[170] In none of the three potential agreements urged upon me by the Appellants (paragraph 125 above) was there any allocation of a particular number of shares to a particular employee. For that reason, none of the potential agreements suggested by the Appellants meets the requirements of subsections 7(1) and 7(2). An agreement to issue 1,380,000 shares to a trust for the benefit of *all employees* who are eligible does not meet the requirement to allocate a particular number of shares to *each employee* participating in the trust arrangement.

[171] Notwithstanding Mr. Sandler’s able argument, as subsection 7(2) does not apply to the Trust, subsections 104(19), 104(21) and 104(21.2) do not take precedence over paragraph 6(1)(g) under the maxim *generalia specialibus non derogant* because the definition of “trust” in subsection 108(1) of the Act specifically excludes an “employee benefit plan” from the scope of paragraph 104(13)(a) and, in the context of these appeals, the application of that provision is a necessary precondition to the application of:

(a) subsection 104(19) (designation of trust distributions as dividends);

(b) subsection 104(21) (designation of trust distributions as taxable capital gains); and

(c) subsection 104(21.2) (designation of trust distributions as taxable capital gains eligible for the lifetime capital gains exemption on the sale of 61% of the Company).

[172] The Minister correctly reassessed tax to the Appellants on the distributions from the Trust in 2015, 2016, and 2017 under paragraph 6(1)(g) of the Act as distributions from an “employee benefit plan” within the meaning of subsection 248(1) of the Act.

[173] The appeals will, therefore, be dismissed with costs.

Signed at Toronto, Ontario, this 11th day of July 2024.

“David E. Spiro”

Spiro J.

Statutory Appendix

Income of beneficiary

104(13) There shall be included in computing the income for a particular taxation year of a beneficiary under a trust such of the following amounts as are applicable:

> (a) in the case of a trust (other than a trust referred to in paragraph (a) of the definition *trust* in subsection 108(1)), …

Designation in respect of taxable dividends

104(19) A portion of a taxable dividend received by a trust, in a particular taxation year of the trust, on a share of the capital stock of a taxable Canadian corporation is, for the purposes of this Act other than Part XIII, deemed to be a taxable dividend on the share received by a taxpayer, in the taxpayer's taxation year in which the particular taxation year ends, and is, for the purposes of paragraphs 82(1)(b) and 107(1)(c) and (d) and section 112, deemed not to have been received by the trust, if

> (a) an amount equal to that portion
>
> > (i) is designated by the trust, in respect of the taxpayer, in the trust's return of income under this Part for the particular taxation year, and
> >
> > (ii) may reasonably be considered (having regard to all the circumstances including the terms and conditions of the trust) to be part of the amount that, because of paragraph (13)(a), subsection (14) or section 105, was included in computing the income for that taxation year of the taxpayer;

Designation in respect of taxable capital gains

104(21) For the purposes of sections 3 and 111, except as they apply for the purposes of section 110.6, and subject to paragraph 132(5.1)(b), an amount in respect of a trust's net taxable capital gains for a particular taxation year of the trust is deemed to be a taxable capital gain, for the taxation year of a taxpayer in which the particular taxation year ends, from the disposition by the taxpayer of capital property if

> (a) the amount
>
> > (i) is designated by the trust, in respect of the taxpayer, in the trust's return of income under this Part for the particular taxation year, and
> >
> > (ii) may reasonably be considered (having regard to all the circumstances including the terms and conditions of the trust) to be part of the amount that, because of paragraph (13)(a), subsection (14) or section 105, was included in computing the income for that taxation year of the taxpayer;

Beneficiaries' taxable capital gain

104(21.2) Where … a trust referred to in subsection 7(2) designates an amount in respect of a beneficiary in respect of its net taxable capital gains for a taxation year (in this subsection referred to as the "designation year"),

> (a) the trust shall in its return of income under this Part for the designation year designate an amount in respect of its eligible taxable capital gains, if any, for the designation year in respect of the beneficiary equal to the amount determined in respect of the beneficiary under each of subparagraphs 104(21.2)(b)(i) and 104(21.2)(b)(ii); and
>
> (b) the beneficiary is, for the purposes of sections 3, 74.3 and 111 as they apply for the purposes of section 110.6,
>
>> (i) deemed to have disposed of the capital property referred to in clause (ii)(A), (B) or (C) if a taxable capital gain is determined in respect of the beneficiary for the beneficiary's taxation year in which the designation year ends under those clauses, and
>>
>> (ii) deemed to have a taxable capital gain for the beneficiary's taxation year in which the designation year ends
>>
>> …
>
> and
>
>> (B) from a disposition of a capital property that is a qualified small business corporation share (as defined for the purpose of section 110.6) of the beneficiary equal to the amount determined by the formula
>>
>> $$(\mathbf{A} \times \mathbf{B} \times \mathbf{F})/(\mathbf{D} \times \mathbf{E})$$
>>
>> where
>>
>> **A** is the lesser of
>>
>>> (I) the amount determined by the formula
>>>
>>> $$\mathbf{G - H}$$
>>>
>>> where
>>>
>>> **G** is the total of amounts designated under subsection (21) for the designation year by the trust, and

H is the total of amounts designated under subsection (13.2) for the designation year by the trust, and

(II) the trust's eligible taxable capital gains for the designation year,

B is the amount, if any, by which the amount designated under subsection (21) for the designation year by the trust in respect of the beneficiary exceeds the amount designated under subsection (13.2) for the year by the trust in respect of the beneficiary for the taxation year,

C is the amount, if any, that would be determined under paragraph 3(b) for the designation year in respect of the trust's capital gains and capital losses if the only properties referred to in that paragraph were properties that, at the time they were disposed of, were qualified farm properties, qualified fishing properties or qualified farm or fishing properties of the trust,

D is the total of all amounts each of which is the amount determined for B for the designation year in respect of a beneficiary under the trust,

E is the total of the amounts determined for C and F for the designation year in respect of the beneficiary, and

F is the amount, if any, that would be determined under paragraph 3(b) for the designation year in respect of the trust's capital gains and capital losses if the only properties referred to in that paragraph were properties that, at the time they were disposed of, were qualified small business corporation shares of the trust, other than qualified farm property, qualified fishing property or qualified farm or fishing property,

and for the purposes of section 110.6, those capital properties shall be deemed to have been disposed of by the beneficiary in that taxation year of the beneficiary.

Definitions

108(1) In this Subdivision,

trust includes an *inter vivos* trust and a testamentary trust but […] does not include

(a) … an employee benefit plan …

Schedule "A"

2019-4444(IT)G, 2019-4445(IT)G
2019-4446(IT)G, 2019-4447(IT)G,

TAX COURT OF CANADA

BETWEEN:

RONALD KARY BLACK

and

MURPHY PETTYPIECE

and

REBECCA FORD

and

JASON MURPHY

Appellants

and

HIS MAJESTY THE KING

Respondent

PARTIAL AGREED STATEMENT OF FACTS (GLOBAL)

For the purposes of these appeals, the parties admit the truth of the facts set out in this Partial Agreed Statement of Facts and agree that they are not precluded at trial, if there is a trial, from calling evidence to supplement these facts as long as this evidence does not contradict these facts.

For the purposes of these appeals, except as noted, the parties also agree that the documents referred to in this Partial Agreed Statement of Facts may be accepted for their truth and

that the copies of the documents appended in tabs to this Partial Agreed Statement of Facts are authentic within the meaning of rule 129 of the *Tax Court of Canada Rules (General Procedure)*.[1] To the extent that a document is said to be made "as of" a particular date, the respondent does not agree that the document was actually executed on that date.

A. Digital Extremes Limited

1. Digital Extremes Limited (**Digital**) is a Canadian corporation. It was founded in 1993 by James Schmalz (**James**).

2. As described below in Part E, Digital amalgamated with two shareholders, 2375250 Ontario Ltd. and 2377289 Ontario Ltd. on July 21, 2015. The amalgamated corporation retained the same name (**Amalgamated Digital**).

3. At all material times, Digital and Amalgamated Digital were in the business of developing video games.

4. At all relevant times up to the sale of shares of Amalgamated Digital to arm's-length third parties on July 21, 2015, as described below in Part E, Digital and Amalgamated Digital were Canadian-controlled private corporations (**CCPC**) as that term is defined in s. 125(7) of the *Income Tax Act*, RSC 1985, c. 1 (5th supp), as amended (**ITA**), and the shares of Digital and Amalgamated Digital were qualified small business corporation shares, as that term is defined in s. 110.6(1) of the ITA. After that sale, Amalgamated Digital was no longer a CCPC.

---

[1] Apart from hand-written marks and notes and "Protected B" headers found on some copies of the documents.

5. From December 23, 1993 to July 21, 2015, the sole director of Digital was James. From February 1, 2009, James was the CEO of Digital and then Amalgamated Digital. He was also secretary of Amalgamated Digital.

B. The Old Stock Option Plan

6. In or around 2007, Digital established an employee stock option plan (the **Old Stock Option Plan**). A copy of the Old Stock Option Plan is attached as **Tab 1**.

7. Under the Old Stock Option Plan, employees of Digital could be granted options.

8. The appellants, Ronald Kary Black (**Black**) and Jason Murphy (**Murphy**), participated in the Old Stock Option Plan.

C. The New Employee Incentive Plan and the Trust

9. In 2013, Digital replaced the Old Stock Option Plan with a new employee incentive plan.

10. Under the new plan, eligible employees received units in a trust, rather than options to acquire shares of Digital.

11. The new plan and the trust were originally described in a memorandum prepared by Ernst & Young LLP (**E & Y**) dated March 8, 2013. Changes were made to this description in the months that followed. A copy of this memorandum is attached as **Tab 2**.

12. By Resolution of the Sole Director of Digital, dated June 24, 2013, Digital cancelled the options of employees who held options under the Old Stock Option Plan. Pursuant to this resolution, Digital also required that each employee who held options to

sign a Settlement and Release Agreement. The resolution, with the attached form of Settlement and Release Agreement and cover letter for that agreement, is attached as **Tab 3**. The final version of the cover letter was dated July 29, 2013 and imposed a deadline of August 9, 2013 to accept the settlement offer contained in the cover letter.

13. Each employee who held stock options under the Old Stock Option Plan and who signed a Settlement and Release Agreement in the form attached to the Resolutions dated June 24, 2013 received a payment of 10¢ per option, as required by that agreement.

14. By Resolution of the Sole Director of Digital, dated July 12, 2013, Digital was authorized to settle an *inter vivos* trust for the benefit of its current and future employees. A copy of this Resolution is attached as **Tab 4**.

15. The Digital Extremes Ltd. Employee Share Trust (**Trust**) and the Digital Extremes Ltd. Employee Rights Plan (**Plan**) were established together (collectively, the **New Employee Incentive Plan**), each to operate in conjunction with the other, on July 12, 2013, as follows:

a) Pursuant to a Deed of Trust dated July 12, 2013, the Trust was settled by Digital with a $10 bill and the sum of $31.80 in cash. The Trust was administered by three trustees (the **Trustees**). The Trustees consisted of three senior employees of Digital: James, Michael Schmalz (**Michael**) who was at the time President of Digital (and later of Amalgamated Digital) and Steven Sinclair (**Sinclair**) who was at the time Creative Director of Digital (and later of Amalgamated Digital). A copy of the Deed of Trust is attached as **Tab 5**.

b) The Plan was established by the board of directors of Digital, and was to be administered by a committee of three people who were appointed by the board of directors of Digital (the **Committee**). The Committee consisted of the same three senior employees of Digital who were the Trustees. A copy of the Plan is attached as **Tab 6**.

16. On or about July 12, 2013, in accordance with the Plan and the Deed of Trust, the Trust subscribed for 3,180,000 Class D Common Shares of Digital (the **Shares**), for a total subscription price of $31.80 (the **Subscription**). Copies of the Trustees' Resolutions authorizing the Subscription and the Subscription, both dated July 12, 2013, are attached as **Tab** 7. Copies of the Resolution of the Sole Director of Digital accepting the Subscription, and Digital's receipt of the $31.80, both dated July 12, 2013, are attached as **Tab 8**.

17. The terms of the Class D Common Shares are set out in Special Resolutions of the Sole Shareholder of Digital dated July 12, 2013. A copy of these Special Resolutions is attached as **Tab 9**.

18. The respondent does not accept assertions in any document, including the memorandum from E & Y, the Plan and the Deed of Trust, that the Trust was established in accordance with or for the purposes of, or is deemed to be a trust for the purposes of, s. 7(2) of the ITA.

D. Grants and cancellations of Trust Units

19. Pursuant to art. 4.1 of the Plan, the Trust could grant no more than 3,180,000 trust units (**Trust Units**).

20. The number of Trust Units corresponded to the number of Class D Common Shares of Digital subscribed for by the Trust on or about July 12, 2013.

21. On or about August 14, 2013, 41 employees of Digital were granted 2,946,665 Trust Units in the aggregate.

22. Not all employees of Digital received Trust Units on that date.

23. The only employees who received Trust Units on or about August 14, 2013 were former option holders under the Old Stock Option Plan, and each former option holder received that number of Trust Units equal to the number of former options held multiplied by 4/3 (rounded to the nearest whole number).

24. On the following dates, the Committee granted additional Trust Units or cancelled Trust Units:

Date	Action	Number of Trust Units
September 24, 2013	Cancellation	33,333
October 2, 2013	Cancellation	33,333
November 29, 2013	Cancellation	166,667
January 22, 2014	Grant	250,000
May 14, 2014	Grant	27,000
July 17, 2014	Grant	33,333
August 26, 2014	Grant	20,000
September 3, 2014	Grant	136,335
November 18, 2015	Cancellation	100,380
December 1, 2015	Grant	100,380
December 17, 2015	Cancellation	6,287
May 9, 2016	Grant	6,287
June 13, 2016	Cancellation	13,333
December 1, 2016	Cancellation	213,333
August 11, 2017	Cancellation	6,667

25. The granting of Trust Units to Black and Murphy in August 2013 and afterward to Black, Murphy Pettypiece (**Pettypiece**) and Rebecca Ford (**Ford**) is described in a separate Partial Agreed Statement of Facts for each appellant, all of which are to be read in conjunction with this Partial Agreed Statement of Facts.

26. As of December 5, 2015, the number of Trust Units held by an individual employee of Digital ranged from 6,000 to 493,333.

27. The following table sets out the number of Trust Units that were outstanding on particular dates:

Date	Number of outstanding Trust Units
August 14, 2013	2,946,665
October 2, 2013	2,879,999
November 29, 2013	2,713,332
December 31, 2013	2,713,332
January 22, 2014	2,963,332
May 14, 2014	2,990,332
July 17, 2014	3,023,665
August 26, 2014	3,043,665
September 3, 2014	3,180,000
December 31, 2014	3,180,000
November 18, 2015	3,079,620
December 1, 2015	3,180.000
December 17, 2015	3,173,713
December 31, 2015	3,173,713
May 9, 2016	3,180,000
May 20, 2016	3,180,000
June 13, 2016	3,166,667
December 1, 2016	2,953,334

Date	Number of outstanding Trust Units
August 11, 2017	2,946,667

28. No written acknowledgements or written agreements were signed by the employees of Digital, including the appellants, when they were granted Trust Units. For further clarity, it is each appellant's position that neither a written acknowledgement nor written agreement was required to be signed when each appellant was granted Trust Units in order for there to be an agreement for the purposes of s. 7 of the ITA.

E. The sales of Amalgamated Digital shares

29. On October 14, 2014, Digital and all of its shareholders including the Trust (the **Vendors**), executed a Sale and Purchase Agreement with arm's-length third parties, Multi Dynamic Games Group Inc. (**Sumpo**) and Perfect Online Holding Limited (collectively the **Purchasers**), in which the Vendors agreed to sell 61% of the issued shares of Digital to the Purchasers. A copy of the Sale and Purchase Agreement is attached as **Tab 10**.

30. Digital and two of its shareholders entered into an Amalgamation Agreement made as of July 20, 2015. A copy of the Amalgamation Agreement is attached as **Tab 11**.

31. Pursuant to s. 2 of the Amalgamation Agreement, Digital amalgamated under the laws of Ontario to form Amalgamated Digital effective on July 21, 2015. A copy of the Articles of Amalgamation, dated July 21, 2015, is attached as **Tab 12**.

32. Pursuant to s. 7(d) of the Amalgamation Agreement, all of the issued and outstanding Class D Common Shares held by the Trust were converted into an equal

number of ordinary Common Shares of Amalgamated Digital (the **New Shares**). As a result, the Trust held 15.9% of the Common Shares of Amalgamated Digital.

33. Pursuant to s. 6 of a Supplemental Agreement to the Sale and Purchase Agreement, dated as of July 21, 2015, among other things, the Purchasers consented to the reorganization of Digital. A copy of this agreement is attached as **Tab 13**.

34. On July 21, 2015, the Trust sold 61% of its 3,180,000 New Shares, that is, 1,939,800 New Shares, to the Purchasers for gross proceeds of $13,691,193.33 (the **First Closing**).

35. Also on the same day, Amalgamated Digital and its shareholders (including the Purchasers) entered into a Unanimous Shareholders' Agreement by which Sumpo was given the option to purchase the remaining 39% of the issued shares of Amalgamated Digital still owned by the original shareholders (**Call Option**). A copy of the Unanimous Shareholders' Agreement is attached as **Tab 14**.

36. At this time, the Trust held 6.20% of the Common Shares of Amalgamated Digital.

37. By notice dated December 30, 2015, Sumpo exercised the Call Option by which it would acquire the remaining 39% of the shares of Amalgamated Digital.

38. On or about May 20, 2016, as a result of the exercise of the Call Option, the Vendors sold their remaining 39% of the issued shares of Amalgamated Digital to Sumpo (the **Second Closing**) for US $63 million.

39. In particular, the Trust sold the remaining 1,240,200 New Shares to Sumpo. It received US $9,216,797.97 for the sale, which it exchanged for $12,111,794.21.

40. Under the terms of the Sale and Purchase Agreement, the Vendors received proceeds of sale in respect of the sale of the New Shares, on or around the following dates:

a) the First Closing; and

b) the Second Closing.

F. Dividend declarations by Digital and Amalgamated Digital

41. Section 4.1 of the Sale and Purchase Agreement permitted Digital to pay certain dividends to the Vendors prior to the Closing (as defined by s. 3.1 of that Agreement).

42. In this Partial Agreed Statement of Facts:

a) "eligible dividend" has the meaning given to this term in s. 89(1) of the ITA.

b) "ineligible dividend" refers to a dividend that is not an eligible dividend within the meaning of s. 89(1) of the ITA.

43. On May 20, 2015, Digital declared aggregate dividends of $2,703,000 on its Class D Common Shares, comprising a dividend (i.e., an ineligible dividend) in the amount of $1,252,922.70 and an eligible dividend in the amount of $1,450,077.30. The Resolutions of the Directors of Digital to this effect, dated the same day, along with its accompanying Certificate With Respect to Subsection 38(3) of the *Business Corporations Act* (Ontario), are attached as **Tab 15**. On July 20, 2015, Digital retroactively amended its declaration of dividends from May 20, 2015 to alter the amount of eligible and ineligible dividends on its

Class D Common Shares totaling $2,703,000 to be $1,431,015.10 and $1,271,984.90, respectively. The Resolution to this effect, along with its accompanying Certificate With Respect to Subsection 38(3) of the *Business Corporations Act* (Ontario), is attached as **Tab 16**.

44. On July 15, 2015, by three separate resolutions, Digital declared dividends on the Class D Common Shares as follows:

a) in the amount of $2,067,000;

b) for 15.9% of Excess Receivables, as that term is defined in the Sale and Purchase Agreement; and

c) for 15.9% of the "N-Space Loan", as that term is defined in the Sale and Purchase Agreement.

A copy of each of these Resolutions, along with their Certificates With Respect to Subsection 38(3) of the *Business Corporations Act* (Ontario), is attached as **Tabs 17, 18** and **19**, respectively.

45. On May 20, 2016, Amalgamated Digital declared dividends on all its outstanding Common Shares as follows:

a) in the amount of $19,222,929;

b) in an amount to be determined by a formula, based in part on "2016 Adjusted Net Profit". By two Resolutions dated June 15, 2016, this amount is defined as $9,296,712.31; and

c) in the amount of $17,476,292.

A copy of each of these Resolutions, along with any accompanying Certificate With Respect to Subsection 38(3) of the *Business Corporations Act* (Ontario), is attached as **Tabs 20, 21, and 22**, respectively.

46. The Trust reported that it had received dividends from Digital or Amalgamated Digital as follows:

Year	Actual amount of eligible dividends ($)[2]	Actual amount of ineligible dividends ($)[3]	Total ($)
2015	6,539,977.46	1,271,984.90	7,811,962.36
2016	2,852,207.80	0	2,852,207.80
2017	454,027.68	0	454,027.68

47. The respondent accepts that the dividends that the Trust reported having received in 2015 and 2016 related to the Shares or the New Shares, as the case may be.

48. In respect of the dividends received by the Trust in 2017:

a) The Trust had carrying charges that reduced the amount received as dividends that was distributed to the Eligible Beneficiaries holding Trust Units;

b) As the Trust no longer held the Shares or the New Shares, the respondent disputes that these dividends relate to shares of Digital or Amalgamated Digital.

[2] This is the amount of dividends received before applying the dividend gross-up.

[3] This is the amount of dividends received before applying the dividend gross-up.

G. Distributions by the Trust

49. In 2015 and 2016, Eligible Beneficiaries received several distributions from the Trust, further to the payment of dividends on the Shares and New Shares held by the Trust, and from the proceeds of sale of the New Shares.

50. Under the terms of the Plan, the Trust allocated and paid these proceeds of sale and dividends, net of expenses incurred by the Trust, to each of the Eligible Beneficiaries holding Trust Units, *pro rata*, based on the number of Trust Units held by each Eligible Beneficiary.

51. In 2015 and 2016, the Trust made the *pro rata* allocation based on the number of Trust Units held by each Eligible Beneficiary divided by 3,180,000, regardless of how many Trust Units had been granted at the time.

52. In 2015 and 2016, there were 3,180,000 Trust Units issued at the time of each distribution except one, dated December 14, 2016, at which time there were 2,953,334 Trust Units issued. The other distribution dates in 2015 and 2016 were: May 28, 2015; July 22, 2015; October 21, 2015; December 17, 2015; and May 24, 2016.

53. In 2017, the Trust made the *pro rata* allocation based on the number of Trust Units held by each Eligible Beneficiary divided by 2,953,334. On October 19, 2017, the date of the distribution made in 2017, there were 2,946,667 Trust Units issued.

54. The T3 Trust Income and Tax Information Return for the Trust for each of the 2015, 2016 and 2017 taxation years included a Schedule 9 (Income Allocations and Designations

to Beneficiaries). In these Schedules 9, the Trust reported the following income allocations and designations to the Eligible Beneficiaries, including the appellants:

Item	2015 ($)	2016 ($)	2017 ($)
Taxable capital gains	6,220,089.98	6,024,431.47	0
Taxable capital gains eligible for deduction on qualified small business corporation shares	12,020,758.33	0	0
Actual amount of ineligible dividends	1,271,984.90	0	0
Taxable amount of ineligible dividends	1,450,595.99	0	0
Actual amount of eligible dividends	6,539,977.46	2,811,116.46	434,882.62
Taxable amount of eligible dividends	8,888,330.74	3,879,340.70	600,138.01
Dividend tax credit for ineligible dividends	159,810.72	0	0
Dividend tax credit for eligible dividends	1,335,009.51	582,669.22	90,139.53

55. The T3 Trust Income Tax and Information Return for the Trust for each of the 2015, 2016 and 2017 taxation years is attached as **Tabs 23, 24 and 25**, respectively. These returns have been redacted in accordance with Practice Note No. 16.

56. In 2015 and 2016, 49 Eligible Beneficiaries received distributions. In 2017, 45 Eligible Beneficiaries received distributions.

57. The Trust's characterization of the amounts allocated, distributed or paid to, or designated for, the Eligible Beneficiaries, including the appellants, is in dispute. Whether the amounts distributed to the Eligible Beneficiaries, including the appellants, in 2017 relate to shares of Digital or Amalgamated Digital is also in dispute.

H. Audited consolidated financial statements of Digital and Amalgamated Digital

58. The audited consolidated financial statements for Digital for the year ended December 31, 2014 contain note 23, which describes the Trust (referred to therein as the Employee Trust). This note reads as follows:

> Share-based payment and employee trust
>
> (a) Employee trust
>
> Digital Extremes Share Ownership Trust (the "Employee Trust") was set up in 12 July 2013 to hold the class D Common Shares for the benefit of the beneficiaries and to distribute such income and capital to the beneficiaries in accordance with the Employee Trust Deed and the pro rata share of Trust Units held by the beneficiaries.
>
> Under the Employee Trust, the beneficiaries are only entitled to the distribution of income in the trust but not the shares held by the Trust. Any Trust Units granted to a beneficiary under the employee trust shall expire and terminate immediately upon such beneficiary ceasing to be an employee of the Company...

59. The audited consolidated financial statements for Amalgamated Digital for the year ended December 31, 2015 contain note 19, which describes the Trust (referred to therein as the Employee Trust). The note reads in part as follows:

> Share-based payment and employee trust
>
> (a) Employee trust

> Digital Extremes Share Ownership Trust (the "Employee Trust") was set up in 12 July 2013 to hold the Common Shares (2014 – Class D common shares) for the benefit of the beneficiaries and to distribute such income and capital to the beneficiaries in accordance with the Employee Trust Deed and the pro rata share of Trust Units held by the beneficiaries.
>
> Under the Employee Trust, the beneficiaries are only entitled to the distribution of income in the trust but not the shares held by the Trust. Any Trust Units granted to a beneficiary under the employee trust shall expire and terminate immediately upon such beneficiary ceasing to be an employee of the Company …

60. The audited consolidated financial statements for Amalgamated Digital for the year ended December 31, 2016 contain note 18, which describes the Trust (referred to therein as the Employee Trust). The note reads in part as follows:

> Share-based payment and employee trust
>
> (a) Employee trust
>
> Digital Extremes Share Ownership Trust (the "Employee Trust") was set up in July 2013 to hold the class D common shares for the benefit of the beneficiaries and to distribute such income and capital to the beneficiaries in accordance with the Employee Trust Deed and the pro rata share of Trust Units held by the beneficiaries. On 21 July, 2015, the Company cancelled the class D common shares and issued a proportionate number of ordinary common shares to the Employee Trust.
>
> Under the Employee Trust, the beneficiaries are only entitled to the distribution of income in the trust but not the shares held by the Trust. Any Trust Units granted to a beneficiary under the employee trust shall expire and terminate immediately upon such beneficiary ceasing to be an employee of the Company …

61. The audited consolidated financial statements for Amalgamated Digital for the year ended December 31, 2017 make no reference to the Trust.

62. Copies of the 2014, 2015, 2016 and 2017 audited consolidated financial statements are attached as **Tabs 26, 27, 28** and **29**, respectively.

63. The respondent agrees only on the authenticity of the attached consolidated financial statements.

I. The appellants

64. In the taxation years under appeal and at the time they received their Trust Units, each of the appellants was:

a) an individual resident in Canada for the purposes of the ITA;

b) a Beneficiary, as that term is defined in the Deed of Trust, art. 1.1(b); and

c) an Eligible Beneficiary, as that term is defined in the Deed of Trust, art. 1.1(f).

65. For each of the 2015, 2016 and 2017 taxation years, each of the appellants received a T3 Statement of Trust Income Allocations and Designations, setting out the amount of the eligible and ineligible dividends and capital gains of the Trust allocated and paid to them and so designated by the Trust, as well available dividend tax credits and capital gains eligible for deduction. The capital gains represented the net proceeds of sale of the New Shares.

66. In each of these T3 Statements of Trust Income Allocations and Designations, the Trust characterized the amounts allocated as eligible or ineligible dividends or as capital gains and the Trust made the designations as such. The respondent does not agree with these characterizations and designations or any statement by the Trust about available dividend tax credits or capital gains eligible for deduction.

67. In each of the 2015, 2016 and 2017 taxation years, the Trust distributed to the appellants by cheque the amounts of the eligible and ineligible dividends and capital gains allocated to them for that year.

68. Except as noted in a separate Partial Agreed Statement of Facts for an appellant, each appellant filed their T1 Income Tax and Benefit Returns in respect of the 2015, 2016, and 2017 taxation years,

a) reporting taxable dividends and taxable capital gains in respect of amounts that had been allocated and paid to them by the Trust in respect of their Trust Units;

b) claiming dividend tax credits under s. 121 of the ITA in respect of some or all of the dividends; and

c) claiming a deduction under s. 110.6 of the ITA in respect of some or all of the capital gains.

69. A separate Partial Agreed Statement of Facts for each appellant is to be read in conjunction herewith. Among other things, the details of each T3 Statement of Trust Income Allocations and Designations and of the filing positions for each of the appellants are set out in these Partial Agreed Statements of Facts.

J. Reassessments of other Eligible Beneficiaries

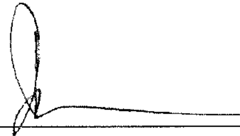
70. In addition to the appellants, the Minister reassessed the other Eligible Beneficiaries of the Trust, within the meaning of art. 1(1)(f) of the Deed of Trust, for the 2015, 2016 and 2017 taxation years.

71. Notices of Objection have been served by other Eligible Beneficiaries for the 2015, 2016, and 2017 taxation years.

72. The appeals filed by the appellants are cases that raise identical or substantially similar issues to those issues raised by the other Eligible Beneficiaries in their Notices of Objection.

73. The Notices of Objection of the other Eligible Beneficiaries are being held in abeyance pending the final outcome of the appeals of the appellants.

Dated at the city of Toronto, Ontario, this 11th day of September, 2023.



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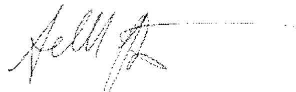
Counsel for the Appellants

Dated at the city of Toronto, Ontario, this 11th day of September, 2023.



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Counsel for the Respondent

Schedule "B"

2019-4444(IT)G

TAX COURT OF CANADA

BETWEEN:

RONALD KARY BLACK

Appellant

and

HIS MAJESTY THE KING

Respondent

PARTIAL AGREED STATEMENT OF FACTS (BLACK)

For the purposes of this appeal, the parties admit the truth of the facts set out in this Partial Agreed Statement of Facts and agree that they are not precluded at trial, if there is a trial, from calling evidence to supplement these facts as long as this evidence does not contradict these facts.

For the purposes of this appeal, except as noted, the parties also agree that the documents referred to in this Partial Agreed Statement of Facts may be accepted for their truth and that the copies of the documents appended in tabs to this Partial Agreed Statement of Facts are authentic within the meaning of rule 129 of the *Tax Court of Canada Rules (General Procedure)*.[1] To the extent that a document is said to be made "as of" a particular date, the respondent does not agree that the document was actually executed on that date.

[1] Apart from hand-written marks and notes found on some copies of the documents.

This Partial Agreed Statement of Facts (Black) is to be read in conjunction with the Partial Agreed Statement of Facts (Global) under the following appeals:

1. Ronald Kary Black v. His Majesty the King – 2019-4444(IT)G
2. Murphy Pettypiece v. His Majesty the King – 2019-4445(IT)G
3. Rebecca Ford v. His Majesty the King – 2019-4446(IT)G
4. Jason Murphy v. His Majesty the King – 2019-4447(IT)G

All of the defined terms contained herein are defined as in the Partial Agreed Statement of Facts (Global).

The Appellant – Ronald Kary Black (Black)

a) Black's employment

1. Black was hired by Digital on October 14, 2008 as an Environment Artist. He was promoted on more than one occasion, most recently to the role of Art Director, and continues to be employed in that capacity.

b) Black's participation in Old Stock Option Plan

2. On or about November 22, 2010, Black was granted 5,000 options under the Old Stock Option Plan. A copy of the Share Option Agreement in respect of the 5,000 options is attached as **Tab 1**.

3. On or about July 29, 2013, Digital advised Black that the Old Stock Option Plan was being terminated and his options were being cancelled. Attached to the letter was a

Settlement and Release Agreement in the form described at paragraph 12 of the Partial Agreed Statement of Facts (Global).

4. On or about August 7, 2013, Black executed a Settlement and Release Agreement. Pursuant to that agreement, Digital paid Black $500.00 by cheque.

5. A copy of the July 29, 2013 letter and the executed Settlement and Release Agreement are attached as **Tab 2**.

c) Trust Units granted to Black

6. On or about August 14, 2013, Black was granted 6,667 Trust Units. A copy of the Resolutions of the Committee, dated August 14, 2013, which contains a resolution to this effect, is attached as **Tab 3**. The parties have redacted the names of grantees of Trust Units who are not Black.

7. On or about December 1, 2015, Black was granted 10,038 additional Trust Units. A copy of the Resolutions of the Committee, dated December 1, 2015, which contains a resolution to this effect, is attached as **Tab 4**.

8. In total, by these grants, Black received 16,705 Trust Units.

9. Black's Trust Units have never been cancelled.

10. Other than the distributions made to Black in 2015, 2016 and 2017, he has not reported any other distributions from the Trust.

d) Trust Distributions to and designations for Black

11. A copy of the T3 Statement of Trust Income Allocations and Designations received by Black for each of the 2015, 2016 and 2017 taxation years is attached as **Tab 5**. These copies have been redacted in accordance with Practice Note no. 16.

12. The Trust also sent Black cover letters dated May 28, 2015, July 23, 2015, October 21, 2015, December 17, 2015, May 24, 2016, and December 14, 2016, setting out Black's share of dividends received by the Trust and/or the proceeds of the sale of the New Shares, as the case may be. Copies of these letters are attached as **Tabs 6, 7, 8, 9, 10 and 11**.

13. Based on the T3 Statements of Trust Income Allocations and Designations, the amounts allocated or designated by the Trust in respect of Black's Trust Units were as follows:

	Taxation year		
	2015 ($)	**2016 ($)**	**2017 ($)**
Capital gain	25,857.80	63,303.66	0
Capital gain eligible for deduction	25,857.80	0	0
Actual amount of eligible dividends	25,732.61	14,983.06	2,465.40
Taxable amount of eligible dividends	35,511.00	20,676.62	3,402.25
Dividend tax credit for eligible dividends	5,333.68	3,105.59	511.01
Actual amount of ineligible dividends	2,666.77	0	0
Taxable amount of ineligible dividends	3,146.79	0	0

	Taxation year		
	2015 ($)	**2016 ($)**	**2017 ($)**
Dividend tax credit for ineligible dividends	346.68	0	0

e) Tax reporting by Black and reassessments by the Minister

14. Black prepared and filed T1 Income Tax and Benefit Returns in respect of the 2015, 2016, and 2017 taxation years, and in doing so:

a) inadvertently included in his income the full amount of the capital gains in respect of amounts that had been allocated and paid to him by the Trust in respect of his Trust Units; and

b) claimed the deduction available under s. 110.6 of the ITA in respect of the full capital gain allocated to him by the Trust.

15. If Black's appeal is allowed, only the taxable capital gains allocated to him by the Trust will be included in his income and he will be entitled to claim the capital gains exemption in respect of only 50% of the capital gains allocated to him by the Trust.

16. On February 28, 2019, the Minister issued Notices of Reassessment to Black for his 2015, 2016 and 2017 taxation years.

17. The following table sets out Black's filing position and the Minister's adjustments for the 2015 taxation year:

2015			
	Filing ($)	**Adjustment ($)**	**Reassessed amount ($)**
Employment income	114,524	54,257	168,781
Gain from disposition of qualified small business corporation shares	51,716	(51,716)	0
Taxable amount of eligible and ineligible Dividends	38,658	(38,658)	0
Taxable amount of dividends other than eligible dividends	3,147	(3,147)	0
Capital gains deduction	25,858	(25,858)	0
Federal dividend tax credit	5,680	(5,680)	0

18. The following table sets out Black's filing position and the Minister's adjustments for the 2016 taxation year:

2016			
	Filing ($)	**Adjustment ($)**	**Reassessed amount ($)**
Employment income	129,712	78,287	207,999
Capital gain	63,304	(63,304)	0
Taxable amount of dividends	20,677	(20,677)	0

2016			
	Filing ($)	**Adjustment ($)**	**Reassessed amount ($)**
Federal dividend tax credit	3,106	(3,106)	2

19. The following table sets out Black's filing position and the Minister's adjustments for the 2017 taxation year:

2017			
	Filing ($)	**Adjustment ($)**	**Reassessed amount ($)**
Employment income	147,205	2,465	149,670
Taxable amount of dividends	3,402	(3,402)	0
Federal dividend tax credit	511	(511)	0

20. On April 15, 2019, Black served Notices of Objection to these reassessments pursuant to s. 165 of the ITA.

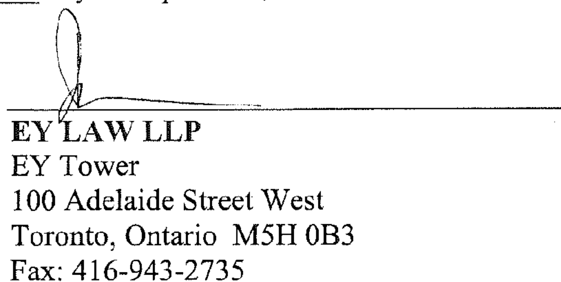
21. In respect of the truth of the attached documents, the respondent:

a) does not accept assertions in any document that the Trust was established in accordance with or for the purposes of, or is deemed to be a trust for the purposes of, s. 7(2) of the ITA;

b) does not agree with the characterizations and designations made by the Trust in respect of the monies it allocated or distributed to Eligible Beneficiaries; and

c) disputes that dividends allocated or distributed to Eligible Beneficiaries in 2017 related to shares of Digital or Amalgamated Digital.

Dated at the city of Toronto, Ontario, this 11th day of September, 2023.



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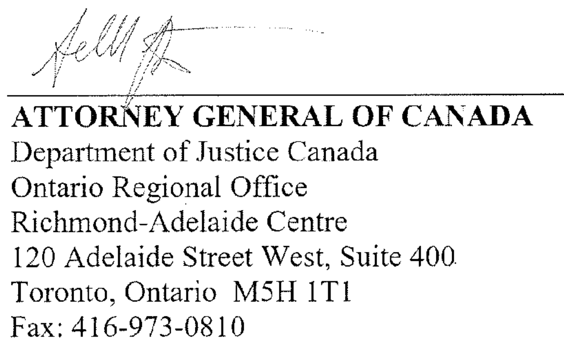
Counsel for the Appellant

Dated at the city of Toronto, Ontario, this 11th day of September, 2023.



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Counsel for the Respondent

Schedule "C"

2019-4445(IT)G

TAX COURT OF CANADA

BETWEEN:

MURPHY PETTYPIECE

Appellant

and

HIS MAJESTY THE KING

Respondent

PARTIAL AGREED STATEMENT OF FACTS (PETTYPIECE)

For the purposes of this appeal, the parties admit the truth of the facts set out in this Partial Agreed Statement of Facts and agree that they are not precluded at trial, if there is a trial, from calling evidence to supplement these facts as long as this evidence does not contradict these facts.

For the purposes of this appeal, except as noted, the parties also agree that the documents referred to in this Partial Agreed Statement of Facts may be accepted for their truth and that the copies of the documents appended in tabs to this Partial Agreed Statement of Facts are authentic within the meaning of rule 129 of the *Tax Court of Canada Rules (General Procedure)*.[1] To the extent that a document is said to be made "as of" a particular date, the respondent does not agree that the document was actually executed on that date.

[1] Apart from hand-written marks and notes found on some copies of the documents.

This Partial Agreed Statement of Facts (Pettypiece) is to be read in conjunction with the Partial Agreed Statement of Facts (Global) under the following appeals:

1. Ronald Kary Black v. His Majesty the King – 2019-4444(IT)G
2. Murphy Pettypiece v. His Majesty the King – 2019-4445(IT)G
3. Rebecca Ford v. His Majesty the King – 2019-4446(IT)G
4. Jason Murphy v. His Majesty the King – 2019-4447(IT)G

All of the defined terms contained herein are defined as in the Partial Agreed Statement of Facts (Global).

The Appellant – Murphy Pettypiece (Pettypiece)

a) Pettypiece's employment

1. Pettypiece was hired as the Controller of Digital on June 28, 2011. He was promoted to Chief Financial Officer in or around July 2014, and continues to be employed in that capacity.

2. Pettypiece did not hold any options under the Old Stock Option Plan.

b) Trust Units granted to Pettypiece

3. By resolution dated January 22, 2014, the Committee granted Pettypiece 25,000 Trust Units. A copy of the Resolutions of the Committee, dated January 22, 2014, which contains a resolution to this effect, is attached as **Tab 1**. The name of a grantee of Trust Units who is not an appellant is redacted in the copy of the Resolutions.

4. By resolution dated September 3, 2014, the Committee granted Pettypiece an additional 26,000 Trust Units. A copy of the Resolutions of the Committee, dated September 3, 2014, which contains a resolution to this effect, is attached as **Tab 2**. A copy of the letter from Digital confirming this grant and dated September 3, 2014 is attached as **Tab 3**.

5. By resolution dated May 9, 2016, the Committee granted Pettypiece an additional 6,287 Trust Units. A copy of the Resolutions of the Committee, dated May 9, 2016, which contains a resolution to this effect, is attached as **Tab 4**.

6. In total, the Committee granted Pettypiece 57,287 Trust Units.

7. Pettypiece's Trust Units have never been cancelled.

8. Other than the distributions made to Pettypiece in 2015, 2016 and 2017, he has not reported any other distributions from the Trust.

c) Trust Distributions to and designations for Pettypiece

9. A copy of the T3 Statement of Trust Income Allocations and Designations received by Pettypiece for each of the 2015, 2016 and 2017 taxation years is attached in **Tab 5**. These copies have been redacted in accordance with Practice Note no. 16.

10. The Trust also sent Pettypiece cover letters dated May 28, 2015, July 23, 2015, October 21, 2015, December 17, 2015, May 24, 2016, and December 14, 2016, setting out Pettypiece's share of the dividends received by the Trust and/or proceeds of the sale of the New Shares as the case may be. Copies of these letters are attached as **Tabs 6, 7, 8, 9, 10, and 11**.

11. Based on the T3 Statements of Trust Income Allocations and Designations, the amounts allocated or designated by the Trust in respect of Pettypiece's Trust Units were as follows:

	Taxation year		
	2015 ($)	**2016 ($)**	**2017 ($)**
Capital gain	199,484.10	217,089.30	0
Capital gain eligible for deduction	199,484.10	0	0
Actual amount of eligible dividends	104,886.44	51,381.90	8,454.68
Taxable amount of eligible dividends	144,743.29	70,097.02	11,667.46
Dividend tax credit for eligible dividends	21,740.15	10,650.09	1,752.43
Actual amount of ineligible dividends	20,399.76	0	0
Taxable amount of ineligible dividends	24,071.72	0	0
Dividend tax credit for ineligible dividends	2,651.96	0	0

d) Tax reporting by Pettypiece and reassessments by the Minister

12. On March 14, 2019, the Minister of National Revenue (**Minister**) issued Notices of Reassessment to Pettypiece for his 2015, 2016 and 2017 taxation years.

13. The following table sets out Pettypiece's filing position and the Minister's adjustments for the 2015 taxation year:

2015			
	Filing ($)	**Adjustment ($)**	**Reassessed amount ($)**
Employment income	322,753	324,770	647,523
Gain from disposition of qualified small business corporation shares	199,484	(199,484)	0
Taxable amount of eligible and other than eligible dividends	169,367	(168,615)	752
Taxable amount of dividends other than eligible dividends	24,072	(24,072)	0
Capital gains deduction	99,317	(99,317)	0
Federal dividend tax credit	24,475	(24,362)	113

14. The following table sets out Pettypiece's filing position and the Minister's adjustments for the 2016 taxation year:

2016			
	Filing ($)	**Adjustment ($)**	**Reassessed amount ($)**
Employment income	215,394	268,471	483,865
Capital gain	217,089	(217,089)	0
Taxable amount of dividends	78,156	(70,907)	7,249

2016			
	Filing ($)	**Adjustment ($)**	**Reassessed amount ($)**
Federal dividend tax credit	11,738.79	(10,650)	1,089

15. The following table sets out Pettypiece's filing position and the Minister's adjustments for the 2017 taxation year:

2017			
	Filing ($)	**Adjustment ($)**	**Reassessed amount ($)**
Employment income	318,113	8,455	326,568
Taxable amount of dividends	24,546	(11,667)	12,879
Federal dividend tax credit	3,687	(1,753)	1,934

16. On April 11, 2019, Pettypiece served Notices of Objection to these reassessments pursuant to s. 165 of the ITA.

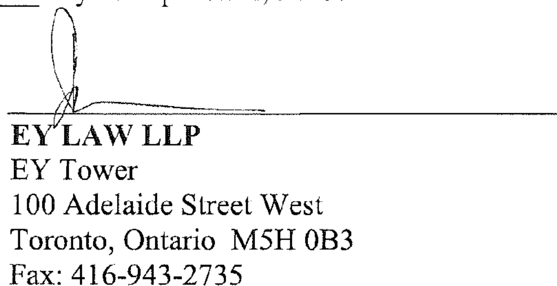
17. In respect of the truth of the attached documents, the respondent:

a) does not accept assertions in any document that the Trust was established in accordance with or for the purposes of, or is deemed to be a trust for the purposes of, s. 7(2) of the ITA;

b) does not agree with the characterizations and designations made by the Trust in respect of the monies it allocated or distributed to Eligible Beneficiaries; and

c) disputes that dividends allocated or distributed to Eligible Beneficiaries in 2017 related to shares of Digital or Amalgamated Digital.

Dated at the city of Toronto, Ontario, this 11th day of September, 2023.



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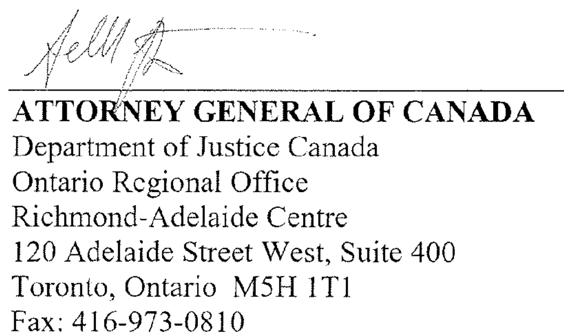
Dated at the city of Toronto, Ontario, this 11th day of September, 2023.



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Counsel for the Respondent

Schedule "D"

2019-4446(IT)G

TAX COURT OF CANADA

BETWEEN:

REBECCA FORD

Appellant

and

HIS MAJESTY THE KING

Respondent

PARTIAL AGREED STATEMENT OF FACTS (FORD)

For the purposes of this appeal, the parties admit the truth of the facts set out in this Partial Agreed Statement of Facts and agree that they are not precluded at trial, if there is a trial, from calling evidence to supplement these facts as long as this evidence does not contradict these facts.

For the purposes of this appeal, except as noted, the parties also agree that the documents referred to in this Partial Agreed Statement of Facts may be accepted for their truth and that the copies of the documents appended in tabs to this Partial Agreed Statement of Facts are authentic within the meaning of rule 129 of the *Tax Court of Canada Rules (General Procedure)*.[1] To the extent that a document is said to be made "as of" a particular date, the respondent does not agree that the document was actually executed on that date.

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[1] Apart from hand-written marks and notes found on some copies of the documents.

This Partial Agreed Statement of Facts (Ford) is to be read in conjunction with the Partial Agreed Statement of Facts (Global) under the following appeals:

1. Ronald Kary Black v. His Majesty the King – 2019-4444(IT)G
2. Murphy Pettypiece v. His Majesty the King – 2019-4445(IT)G
3. Rebecca Ford v. His Majesty the King – 2019-4446(IT)G
4. Jason Murphy v. His Majesty the King – 2019-4447(IT)G

All of the defined terms contained herein are defined as in the Partial Agreed Statement of Facts (Global).

The Appellant – Rebecca Ford (Ford)

a) Ford's employment

1. Ford was first hired by Digital on April 18, 2011 as an intern. She was promoted on more than one occasion, most recently to the role of Creative Director, and continues to be employed in that capacity.

2. Ford did not hold any options under the Old Stock Option Plan.

b) Trust Units granted to Ford

3. At the time the Plan was created, Ford did not hold, nor was she issued, any Trust Units.

4. On or about September 3, 2014, Ford was granted 17,355 Trust Units. A copy of the Resolutions of the Committee, dated September 3, 2014, which contains a resolution

to this effect, is attached as **Tab 1**. A copy of the letter from Digital confirming this grant, dated September 3, 2014, is attached as **Tab 2**.

5. These were the only Trust Units Ford was granted.

6. Ford's Trust Units have never been cancelled.

7. Other than the distributions made to Ford in 2015, 2016 and 2017, she has not reported any other distributions from the Trust.

c) Trust Distributions to and designations for Ford

8. A copy of the T3 Statement of Trust Income Allocations and Designations received by Ford for each of the 2015, 2016 and 2017 taxation years is attached in **Tab 3**. These copies have been redacted in accordance with Practice Note no. 16.

9. The Trust also sent Ford cover letters dated May 28, 2015, July 23, 2015, October 21, 2015, December 17, 2015, May 24, 2016, and December 14, 2016, setting out Ford's share of the dividends received by the Trust and/or proceeds of the sale of the New Shares as the case may be. Copies of these letters are attached as **Tabs 4, 5, 6, 7, 8, and 9**.

10. Based on the T3 Statements of Trust Income Allocations and Designations, the amounts allocated or designated by the Trust in respect of Ford's Trust Units were as follows:

	Taxation year		
	2015 ($)	**2016 ($)**	**2017 ($)**
Capital gain	67,805.03	65,691.05	0

	Taxation year		
	2015 ($)	**2016 ($)**	**2017 ($)**
Capital gain eligible for deduction	67,805.03	0	0
Actual amount of eligible dividends	35,651.10	15,548.11	2,558.38
Taxable amount of eligible dividends	49,198.52	21,456.39	3,530.56
Dividend tax credit for eligible dividends	7,389.52	3,222.71	530.28
Actual amount of ineligible dividends	6,933.92	0	0
Taxable amount of ineligible dividends	8,182.03	0	0
Dividend tax credit for ineligible dividends	901.41	0	0

d) Tax reporting by Ford and reassessments by the Minister

11. Ford filed T1 Income Tax and Benefit Returns under the ITA in respect of the 2015, 2016, and 2017 taxation years.

12. In her return of income for the 2015 taxation year, Ford erroneously reported a gain from the disposition of a qualified farm or fishing property with respect to the capital gain allocated to her by the Trust.

13. On March 25, 2019, the Minister issued Notices of Reassessment to Ford for her 2015, 2016 and 2017 taxation years.

14. The following table sets out Ford's filing position and the Minister's adjustments for the 2015 taxation year.

2015			
	Filing ($)	**Adjustment ($)**	**Reassessed amount ($)**
Employment income	60,198	110,390	170,588
Gain from disposition of qualified farm or fishing property	67,805	(67,805)	0
Capital gains deduction	33,902	(33,902)	0
Taxable amount of eligible and ineligible dividends	57,380	(57,380)	0
Taxable amount of dividends other than eligible dividends	8,182	(8,182)	0
Federal dividend tax credit	8,291	(8,291)	0

15. If Ford's appeal is allowed in respect of her 2015 taxation year, the $67,805 reported as a gain from the disposition of qualified farm or fishing property will be treated as a capital gain from qualified small business corporation shares, and Ford will be entitled to claim as a capital gains deduction one-half of this amount, or $33,902.

16. The following table sets out Ford's filing position and the Minister's adjustments for the 2016 taxation year:

2016			
	Filing ($)	**Adjustment ($)**	**Reassessed amount ($)**
Employment income	107,461	81,239	188,700
Capital gain	65,691	(65,691)	0

2016			
	Filing ($)	**Adjustment ($)**	**Reassessed amount ($)**
Taxable amount of dividends	21,456	(21,456)	0
Federal dividend tax credit	3,223	(3,223)	0

17. The following table sets out Ford's filing position and the Minister's adjustments for the 2017 taxation year:

2017			
	Filing ($)	**Adjustment ($)**	**Reassessed amount ($)**
Employment income	122,616	2,558	125,174
Taxable amount of dividends	3,530	(3,530)	0
Federal dividend tax credit	530	(530)	0

18. On April 15, 2019, Ford served Notices of Objection to these reassessments pursuant to s. 165 of the ITA.

19. In respect of the truth of the attached documents, the respondent:

a) does not accept assertions in any document that the Trust was established in accordance with or for the purposes of, or is deemed to be a trust for the purposes of, s. 7(2) of the ITA;

b) does not agree with the characterizations and designations made by the Trust in respect of the monies it allocated or distributed to Eligible Beneficiaries; and

c) disputes that dividends allocated or distributed to Eligible Beneficiaries in 2017 related to shares of Digital or Amalgamated Digital.

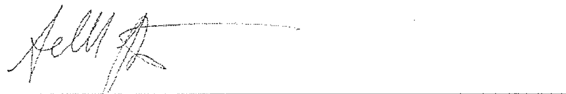
Dated at the city of Toronto, Ontario, this 11th day of September, 2023.

EY LAW LLP
EY Tower
100 Adelaide Street West
Toronto, Ontario M5H 0B3
Fax: 416-943-2735

Per: Daniel Sandler
Selena Ing
Tel: 416-943-4434
416-934-4567
E-mail: daniel.sandler@ca.ey.com
selena.ing@ca.ey.com

Counsel for the Appellants

Dated at the city of Toronto, Ontario, this 11th day of September, 2023.



ATTORNEY GENERAL OF CANADA
Department of Justice Canada
Ontario Regional Office
Richmond-Adelaide Centre
120 Adelaide Street West, Suite 400
Toronto, Ontario M5H 1T1
Fax: 416-973-0810

Per: Arnold H. Bornstein
Tigra Bailey
Tel: 647-256-7337

647-614-0987
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tigra.bailey@justice.gc.ca

Counsel for the Respondent

Schedule "E"

2019-4447(IT)G

TAX COURT OF CANADA

BETWEEN:

JASON MURPHY

Appellant

and

HIS MAJESTY THE KING

Respondent

PARTIAL AGREED STATEMENT OF FACTS (MURPHY)

For the purposes of this appeal, the parties admit the truth of the facts set out in this Partial Agreed Statement of Facts and agree that they are not precluded at trial, if there is a trial, from calling evidence to supplement these facts as long as this evidence does not contradict these facts.

For the purposes of this appeal, except as noted, the parties also agree that the documents referred to in this Partial Agreed Statement of Facts may be accepted for their truth and that the copies of the documents appended in tabs to this Partial Agreed Statement of Facts are authentic within the meaning of rule 129 of the *Tax Court of Canada Rules (General Procedure)*.[1] To the extent that a document is said to be made "as of" a particular date, the respondent does not agree that the document was actually executed on that date.

---

[1] Apart from hand-written marks and notes found on some copies of the documents.

This Partial Agreed Statement of Facts (Murphy) is to be read in conjunction with the Partial Agreed Statement of Facts (Global) under the following appeals:

1. Ronald Kary Black v. His Majesty the King – 2019-4444(IT)G
2. Murphy Pettypiece v. His Majesty the King – 2019-4445(IT)G
3. Rebecca Ford v. His Majesty the King – 2019-4446(IT)G
4. Jason Murphy v. His Majesty the King – 2019-4447(IT)G

All of the defined terms contained herein are defined as in the Partial Agreed Statement of Facts (Global).

The Appellant – Jason Murphy (Murphy)

a) Murphy's employment

1. Murphy was first hired by Digital on April 2006 as an IT technician. He was promoted on more than one occasion, most recently to the role of senior systems administrator, and continues to be employed in that capacity.

b) Murphy's participation in the Old Stock Option Plan

2. On or about April 13, 2007, Murphy was granted 15,000 options under the Old Stock Option Plan. Copies of the Share Options Agreement in respect of the 15,000 options are attached as **Tabs 1** and **2**.

3. By letter dated July 29, 2013, Digital advised Murphy that the Old Stock Option Plan was being terminated and his options were being cancelled. Attached to the letter was

a Settlement and Release Agreement in the form described at paragraph 12 of the Partial Agreed Statement of Facts (Global).

4. On or about August 6, 2013, Murphy executed the Settlement and Release Agreement. Pursuant to that agreement, Digital paid Murphy $1,500.00 by cheque from Digital.

5. A copy of the July 29, 2013 letter and the executed Settlement and Release Agreement are attached as **Tab 3**.

c) Trust Units granted to Murphy

6. On or about August 14, 2013, by resolution, the Committee granted Murphy 20,000 Trust Units. A copy of the Resolutions of the Committee, dated August 14, 2013, which contains a resolution to this effect, is attached as **Tab 4**. The parties have redacted the names of grantees of Trust Units who are not Murphy.

7. These were the only Trust Units Murphy was granted.

8. Murphy's Trust Units have never been cancelled.

9. Other than the distributions made to Murphy in 2015, 2016 and 2017, he has not reported any other distributions from the Trust.

d) Trust Distributions to and designations for Murphy

10. A copy of the T3 Statement of Trust Income Allocations and Designations received by Murphy for each of the 2015, 2016 and 2017 taxation years is attached as **Tab 5**. These copies have been redacted in accordance with Practice Note no. 16.

11. The Trust also sent Murphy cover letters dated May 28, 2015, July 23, 2015, October 21, 2015, December 17, 2015, May 24, 2016, and December 14, 2016, setting out Murphy's share of the dividends received by the Trust and/or proceeds of the sale of the New Shares as the case may be. Copies of these letters are attached as **Tabs 6, 7, 8, 9, 10 and 11**.

12. Based on the T3 Statements of Trust Income Allocations and Designations, the amounts allocated or designated by the Trust in respect of Murphy's Trust Units were as follows:

	Taxation year		
	2015 ($)	**2016 ($)**	**2017 ($)**
Capital gain	78,229.06	75,790.08	0
Capital gain eligible for deduction	78,229.06	0	0
Actual amount of eligible dividends	41,131.93	17,938.41	2,951.69
Taxable amount of eligible dividends	56,762.06	24,775.01	4,073.33
Dividend tax credit for eligible dividends	8,525.55	3,718.15	611.81
Actual amount of ineligible dividends	7,999.91	0	0
Taxable amount of ineligible dividends	9,439.89	0	0
Dividend tax credit for ineligible dividends	1,039.98	0	0

e) Tax reporting by Murphy and reassessments by the Minister

13. On March 25, 2019, the Minister issued Notices of Reassessment to Murphy for his 2015, 2016 and 2017 taxation years.

14. The following table sets out Murphy's filing position and the Minister's adjustments for the 2015 taxation year:

2015			
	Filing ($)	**Adjustment ($)**	**Reassessed amount ($)**
Employment income	83,969	127,361	211,330
Gain from disposition of qualified small business corporation shares	78,229	(78,229)	0
Capital gains deduction	39,067	(39,067)	0
Taxable amount of eligible and ineligible dividends	66,201	(66,201)	0
Taxable amount of dividends other than eligible dividends	9,439	(9,439)	0
Federal dividend tax credit	9,566	(9,566)	0

15. The following table sets out Murphy's filing position and the Minister's adjustments for the 2016 taxation year:

2016			
	Filing ($)	**Adjustment ($)**	**Reassessed amount ($)**
Employment income	85,690	93,728	179,418
Capital gain	76,057	(75,790)	267
Taxable amount of dividends	25,645	(24,755)	890
Federal dividend tax credit	3,852	(3,719)	133

16. The following table sets out Murphy's filing position and the Minister's adjustments for the 2017 taxation year:

2017			
	Filing ($)	**Adjustment ($)**	**Reassessed amount ($)**
Employment income	82,069	2,952	85,021
Taxable amount of dividends	4,170	(4,073)	97
Federal dividend tax credit	626	(611)	15

17. On May 6, 2019, Murphy served Notices of Objection to these reassessments pursuant to s. 165 of the ITA.

18. In respect of the truth of the attached documents, the respondent:

a) does not accept assertions in any document that the Trust was established in accordance with or for the purposes of, or is deemed to be a trust for the purposes of, s. 7(2) of the ITA;

b) does not agree with the characterizations and designations made by the Trust in respect of the monies it allocated or distributed to Eligible Beneficiaries; and

c) disputes that dividends allocated or distributed to Eligible Beneficiaries in 2017 related to shares of Digital or Amalgamated Digital.

Dated at the city of Toronto, Ontario, this 11th day of September, 2023.

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EY Tower
100 Adelaide Street West
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Fax: 416-943-2735

Per: Daniel Sandler
Selena Ing
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416-934-4567
E-mail: daniel.sandler@ca.ey.com
selena.ing@ca.ey.com

Counsel for the Appellant

Dated at the city of Toronto, Ontario, this 11th day of September, 2023.

ATTORNEY GENERAL OF CANADA
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Ontario Regional Office
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Toronto, Ontario M5H 1T1
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Per: Arnold H. Bornstein
Tigra Bailey
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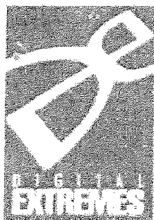
Counsel for the Respondent

Schedule "F"



250 York Street, Ste 100
London, ON Canada N6A 6K2
Phone 519.657.4260 • Fax 519.471.9972

WITHOUT PREJUDICE

July 29, 2013

Kary Black
464 Moore St.
London, ON
N6C 3C2

Dear Kary:

RE: Termination of 2007 Stock Option Plan and Cancellation of Your Outstanding Options

Over the past several months, we have been working with Digital Extremes accountants, Ernst & Young LLP ("**E&Y**"), to review certain aspects of our business, including the Company's employee stock option plan that was established in 2007 (the "**Existing Plan**").

The Existing Plan was established to enable eligible employees to benefit in the Company's growth and success in the event of the Company's sale to a third party. However, during our review with E&Y, we learned that, due to the fact the option holders are not able to exercise their options unless and until the sale of the business is about to occur, the proceeds that option holders would receive on such sale would be not qualify for an individual's lifetime capital gains exemption and may not qualify for the 50% reduction in employment income for tax purposes. Given that many of the options will begin to expire next year, **the Company has decided to terminate the Plan and cancel all outstanding options to purchase shares of the Company, including the 5,000 options held by you, effective immediately.**

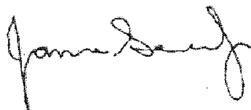
In consideration of the cancellation of your options, and in settlement of any claim that you have or may have against the Company as a result of such cancellation, the Company is prepared to make a one-time payment to you of $500.00, representing the payment of $0.10 per cancelled option. This payment will constitute employment income to you, and will be subject to the standard statutory deductions. The settlement offer contained in this letter is open for your acceptance on or before August 9, 2013.

In order to receive this payment, you are required to sign and return the Declaration below and the attached Settlement and Release Agreement. <u>As with all legal agreements, we recommend that you review the Declaration and the Settlement and Release Agreement with a lawyer before you sign and turn this agreement to us.</u>

If you or your lawyer have any questions regarding the termination of the plan and cancellation of your options or the terms of the settlement and release agreement, please speak to Michael Schmalz directly.

Yours Truly,

DIGITAL EXTREMES LTD.

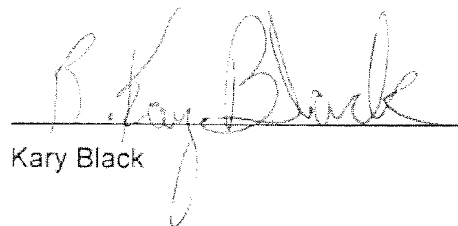


James Schmalz, President

DECLARATION

I have read and understood the provisions of this letter and have sought such professional advice regarding the contents hereof as I have determined to be appropriate. I hereby advise Digital Extremes Ltd. and its directors and officers, that I accept the terms set forth in this letter and agree to act in accordance therewith.

Dated August 7, 2013.



Kary Black

Schedule "G"

SETTLEMENT AND RELEASE AGREEMENT

TO: DIGITAL EXTREMES LTD. (the "Company")

AND TO: THE OFFICERS AND DIRECTORS THEREOF

IN CONSIDERATION of the terms as set out in attached correspondence from James Schmalz as the President of the Company dated July 29, 2013, I, Kary Black, (the "**Releasor**", which term includes my heirs, executors, administrators, successors and assigns), hereby accept the amount of $500.00 (the "**Settlement Amount**") as full and final settlement of any and all claims or demands that I now have, ever had, or can, or may have against the Company and its successors and assigns and all of their respective officers, directors, employees, servants and agents, (collectively, the "**Releasees**") resulting or arising from the Company's termination of its 2007 Stock Option Plan (the "**Plan**") and the cancellation of the 5,000 options (the "**Options**") to purchase shares in the capital of the Company that were previously granted to me under the Plan. Upon the payment of the Settlement Amount to me by the Corporation, net of applicable statutory deductions, I irrevocably release and forever discharge the Releases and forever compromise any and all claims and demands whatsoever by me, which I now have, ever had, or can, or may have against the Releasees with respect of the administration or termination of the Plan; the granting of the Options or any other options under the Plan or the cancelation of the Options or any other options, or any cause, matter or thing arising out of or connected therewith.

AND FOR THE SAID CONSIDERATION it is further agreed that I will not make any claim or take proceedings against any other person or corporation who might claim contribution and indemnity from the Releasees pursuant to the provisions of any statute or otherwise.

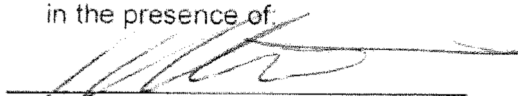
AND IT IS UNDERSTOOD AND AGREED that the Releasees do not by payment and performance as aforesaid or otherwise admit that I have any valid claim against them nor do they admit any liability to me and such liability is denied by them.

IT IS FURTHER AGREED that in consideration of the aforesaid payment and settlement, the terms of this Release are confidential between me and the Releasees and I agree that I will be strictly liable for any damages which may be incurred by the Releasees by my breach of that confidence.

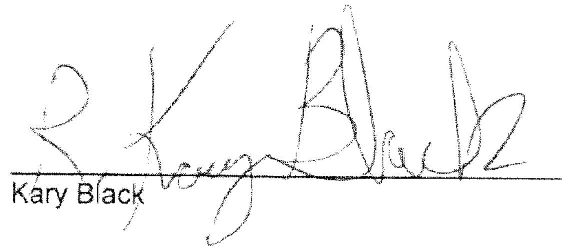
AND IT IS HEREBY DECLARED that the terms of this Settlement and Release Agreement are fully understood; that the amount stated herein is the sole consideration of this Settlement and Release and that the said consideration is accepted voluntarily with the benefit of having been afforded the opportunity of obtaining independent legal advice for the purpose of making a full and final settlement and release of all claims.

DATED AUGUST 7, 2013.

SIGNED, SEALED AND DELIVERED in the presence of:



WITNESS



Kary Black

Schedule "H"

DE Share Trust Holders

James Schmalz
Sent: October-14-14 5:32 PM
To: James Schmalz

Hello all,

This email is going to the group of individuals that own DE 'Share Units in Trust'.

First of all, congratulations. I'm so happy that those options we handed out starting so many years ago appear to have ended up turning into something meaningful for you.

I'm sure you have some obvious questions as to what $ amounts are involved and when it will happen. Below will give you a rough estimate of the amount. We will announce in follow-up emails in the coming month to address timing and more details on the actual transaction.

So, 61% of DE for $73.2M. So, 61% of your Shares in Trust will be purchased. Leaving you with 39% of what you had.

X = The number of shares in trust you have. If you don't have your number feel free to email me to ask. I have the list right in front of me.

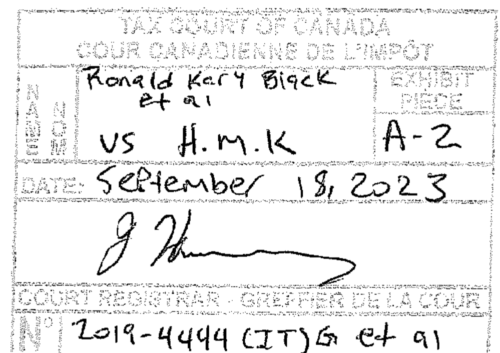
$9,000,000 * X/3,180,000 = your payment

Please note this is a rough and hopefully conservative estimate as there are possible dividends to be included and there are exchange rate benefits from US to Canadian dollars and a few other factors that need to be taken into consideration to come up with exact results. And of course capital gains tax will apply. The full payment also depends somewhat on Warframe performance in the next few months, so we still need it to kick ass on all platforms.

But this will give you a rough ballpark # just so you know. Remember that you will still have 39% of your share units in trust left over even after this transaction completes.

Also, remember, this is a deal in progress and there are agreements that still require negotiations, so there is no 100% guarantee the deal will happen.

James



CITATION:	2024 TCC 96
COURT FILE NO.:	2019-4444(IT)G, 2019-4445(IT)G, 2019-4446(IT)G and 2019-4447(IT)G
STYLE OF CAUSE:	RONALD KARY BLACK AND HIS MAJESTY THE KING MURPHY PETTYPIECE AND HIS MAJESTY THE KING REBECCA FORD AND HIS MAJESTY THE KING JASON MURPHY AND HIS MAJESTY THE KING
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	September 18, 19 and 20, 2023 and February 8 and 9, 2024
REASONS FOR JUDGMENT BY:	The Honourable Justice David E. Spiro
DATE OF JUDGMENT:	July 11, 2024

APPEARANCES:

Counsel for the Appellants:	Daniel Sandler and Selena Ing
Counsel for the Respondent:	Arnold H. Bornstein and Tigra Bailey

COUNSEL OF RECORD:

For the Appellants:

Name:	Daniel Sandler and Selena Ing
Firm:	EY Law LLP Toronto, Ontario

For the Respondent: Shalene Curtis-Micallef
Deputy Attorney General of Canada
Ottawa, Canada

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[1] Transcript of September 18, 2023, page 56, lines 11-16, page 58, lines 3-5.
[2] Whether the "N-Space Dividend" was a dividend was the subject of some debate at trial. As I have dismissed the appeals partly on the basis that subsection 104(19) does not apply, there is no need to deal with it.
[3] Exhibit J-1-1.
[4] Exhibit J-1-1, paragraph 5.3.
[5] Exhibit J-1-1, paragraph 8.1.
[6] Transcript of September 18, 2023, page 61, lines 17-24.
[7] Exhibits J-2-1, J-5-1, and J-5-2.
[8] Exhibit J-5-1.
[9] Exhibit J-5-2. It later became clear that the date on this document was incorrect.
[10] Exhibit J-2-1.
[11] Transcript of September 19, 2023, page 63, lines 1-3.
[12] Exhibit J-1-2. It was not clear from the evidence what stimulated the production of the E&Y Letter.
[13] Exhibit J-1-2, page 10, point 3.
[14] Exhibit J-1-2, page 10, point 4.
[15] Exhibit J-1-2, page 9.
[16] Exhibit J-1-2, pages 9-12. Only steps 12, 13, and 14 at page 12 of the E&Y Letter are devoted exclusively to the Plan or the Trust.
[17] Exhibit J-1-2, page 15, Appendix I. The potential application of section 6205 of the *Income Tax Regulations* was not at issue in these appeals.
[18] Exhibit J-1-2, page 6, item 4. The meaning of "RID 9724915" remains unexplained.
[19] Exhibit J-1-2, page 4.
[20] Exhibit J-1-2, page 3.
[21] Exhibit J-1-2, page 4.
[22] Exhibit J-1-2, pages 6-7.
[23] Exhibit J-1-2, pages 7-8.
[24] Transcript of September 19, 2023, page 55, lines 2-8.
[25] Transcript of September 19, 2023, page 55, lines 12-19.
[26] Transcript of September 18, 2023, page 80, lines 11-16.
[27] Transcript of September 18, 2023, page 140, lines 12-24, page 194, lines 22-28.
[28] I consider them to have been individual shareholders notwithstanding that the shares were held by their personal holding companies.
[29] Exhibit J-1-3.
[30] Exhibit J-1-3.
[31] Transcript of September 18, 2023, page 97, lines 13-18.
[32] Transcript of September 18, 2023, page 110, lines 20-23.
[33] Exhibits J-2-2A and J-2-2B. Mr. Murphy signed a Declaration and Settlement and Release Agreement identical to those signed by Mr. Black. They were marked as Exhibits J-5-3A and J-5-3B.
[34] Exhibit J-2-2A.

[35] Transcript of September 18, 2023, page 105, line 6 to page 106, line 10.
[36] Transcript of September 19, 2023, page 8, line 24 to page 9, line 1.
[37] Transcript of September 19, 2023, page 63, lines 21-24.
[38] Transcript of September 20, 2023, page 94, lines 12 to 23.
[39] Transcript of September 20, 2023, page 106, line 7 to page 107, line 7.
[40] Exhibit J-2-2A and J-2-2B.
[41] Transcript of September 20, 2023, page 52, line 21 to page 53, line 21.
[42] Transcript of September 20, 2023, page 57, lines 1-5.
[43] Transcript of September 20, 2023, page 74, line 24 to page 75, line 3.
[44] Exhibit J-1-5.
[45] Article 2.6 includes both the "at" and the "to" formulation. This was likely a typographical error, but there was no evidence on the point. Ultimately, nothing turns on it.
[46] An individual who was 20 years of age in 2013 would have been born in 1993. At the end of their life expectancy, the year would be 2070. Twenty-one years from then would be 2091.
[47] Exhibit J-1-6.
[48] Exhibit J-1-5.
[49] Exhibit J-1-4 at para 3.
[50] Transcript of September 19, 2023, page 152, lines 15-16.
[51] Transcript of September 18, 2023, page 89, lines 5-11.
[52] Transcript of September 18, 2023, page 102, lines 2-18.
[53] Transcript of September 18, 2023, page 124, lines 20-26.
[54] Transcript of September 19, 2023, page 66, lines 14-24.
[55] Transcript of February 8, 2024, page 69, lines 1-6.
[56] Transcript of September 19, 2023, page 23, lines 19-25.
[57] Transcript of September 19, 2023, page 66, lines 14-24.
[58] Exhibit J-2-4.
[59] Exhibit A-1.
[60] Transcript of September 18, 2023, page 149, line 10 to page 150, line 8.
[61] Transcript of September 18, 2023, page 151, lines 18-25. Paragraph 24 of the PASF states:

> 24. On the following dates, the Committee granted additional Trust Units or cancelled Trust Units:

Date	Action	Number of Trust Units
September 24, 2013	Cancellation	33,333
October 2, 2013	Cancellation	33,333
November 29, 2013	Cancellation	166,667
January 22, 2014	Grant	250,000
May 14, 2014	Grant	27,000
July 17, 2014	Grant	33,333
August 26, 2014	Grant	20,000
September 3, 2014	Grant	136,335
November 18, 2015	Cancellation	100,380
December 1, 2015	Grant	100,380
December 17, 2015	Cancellation	6,287
May 9, 2016	Grant	6,287

June 13, 2016	Cancellation	13,333
December 1, 2016	Cancellation	213,333
August 11, 2017	Cancellation	6,667

[62] Exhibit J-3-1.
[63] Transcript of September 19, 2023, page 168, lines 4-18.
[64] Exhibit J-3-1.
[65] Transcript of September 19, 2023, page 73, lines 14-19.
[66] Exhibit J-3-2.
[67] Transcript of September 19, 2023, page 172, lines 1-21.
[68] Transcript of September 18, 2023, page 143, line 26 to page 144, line 9.
[69] Exhibit J-3-4.
[70] Exhibit J-4-1.
[71] Transcript of September 20, 2023, page 14, line 23 to page 15, line 14. Ms. Ford is obviously using the word "share" in the colloquial sense rather than the legal sense.
[72] Transcript of September 20, 2023, page 32, lines 2-16.
[73] Transcript of September 20, 2023, page 37, lines 1-15. Same comment as endnote 71 above regarding her use of the word "shares in the company".
[74] Exhibit A-1.
[75] Exhibit J-3-1.
[76] Transcript of September 18, 2023, page 137, lines 2-17.
[77] Exhibit A-1.
[78] Exhibit A-2. The sale price for the other 39% of the Company was $63,000,000 USD.
[79] Transcript of September 18, 2023, page 166, lines 15-19.
[80] Transcript of September 18, 2023, page 170, line 6 to page 171, line 12.
[81] Transcript of September 19, 2023, page 87, lines 13-25.
[82] Transcript of February 9, 2024, page 54, lines 11-19.
[83] *Chrysler No. 1* was the first decision in a trilogy. It was followed by *Chrysler Canada Ltd. (No. 2) v Canada*, [1992] 1 CTC 61; 92 DTC 6061 and *Chrysler Canada Ltd. (No. 3) v Canada*, [1992] 2 CTC 95; 92 DTC 6346. Because Justice Strayer found in *Chrysler No. 1* that the distributions fell within both paragraph 6(1)(g) and section 7, the follow-up question was which provision applied. The form of the follow-up question was settled in *Chrysler No. 2* and the follow-up question itself was answered in *Chrysler No. 3*.
[84] Paragraph (a) near the bottom of page 158 at [1991] 2 CTC 156.
[85] Paragraph (f) near the top of page 159 at [1991] 2 CTC 156.
[86] Paragraph (g) near the top of page 159 at [1991] 2 CTC 156.
[87] Paragraph (j) near the top of page 159 at [1991] 2 CTC 156.
[88] Last paragraph of page 163 at [1991] 2 CTC 156.
[89] Large paragraph in the middle of page 164 at [1991] 2 CTC 156.
[90] The limited role of the trustee in the Chrysler plan is in contrast to the unlimited discretion available to the Committee with respect to the granting of Trust Units.
[91] Large paragraph in the middle at page 164 at [1991] 2 CTC 156.
[92] Large paragraph in the middle at page 164 at [1991] 2 CTC 156.
[93] Pages 163-164 at [1991] 2 CTC 156.
[94] Transcript of February 8, 2024, page 72, line 7, page 151, lines 9-10, page 164, lines 11-12

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[95] Transcript of February 8, 2024, page 119, line 4, page 120, lines 10 and 12, page 154, lines 26-27, page 158, line 25.
[96] Transcript of February 8, 2024, page 120, lines 10-11.
[97] Page 164 at [1991] 2 CTC 156.
[98] Last paragraph of page 163 at [1991] 2 CTC 156.
[99] Paragraphs 12 and 27 at [2002] 1 CTC 2035.
[100] Paragraph 16 at [2002] 1 CTC 2035.
[101] Paragraph 17 at [2002] 1 CTC 2035.
[102] Paragraph 33 at [2002] 1 CTC 2035.
[103] Paragraph 36 at [2002] 1 CTC 2035.
[104] Transcript of February 8, 2024, page 131, lines 24-25.
[105] Transcript of September 19, 2023, page 66, lines 4-7. Michael was also careful to distinguish between Trust Units and shares of the Company earlier in his evidence when he noted that he and Steve Sinclair "instead of being a part of the employee trust … became owners of the corporation and exchanged our options for shares in the corporation." (Transcript of September 19, 2023, page 61, lines 18-21).
[106] Exhibit J-1-2, page 6, item 4. The meaning of "RID 9724915" remains unexplained.