Docket: 2010-1972(IT)G

BETWEEN:

MICHEL MATHIEU,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on May 13, 2013, at Montréal, Quebec.

Before: The Honourable Justice B. Paris

Appearances:

Counsel for the appellant:	Emmanuelle Campeau Paul Ryan
Counsel for the respondent:	Marie-Aimée Cantin

JUDGMENT

The appeals from reassessments made under the *Income Tax Act* for the 2004, 2005, 2006, 2007 and 2008 taxation years are allowed, with costs to the appellant, in accordance with the attached Reasons for Judgment and Partial Consent to Judgment.

Signed at Ottawa, Canada, this 27th day of June 2014.

"B. Paris"

Paris J.

Translation certified true
on this 4th day of February 2015

François Brunet, Revisor

Citation: 2014 TCC 207
Date: 20140627
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MICHEL MATHIEU,

Appellant,

and

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Respondent.

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REASONS FOR JUDGMENT

Paris J.

[1] These are appeals from reassessments made by the Minister of National Revenue (the Minister) for the 2004 to 2008 taxation years.

[2] Some issues for the 2004 to 2008 taxation years were settled by the parties before the start of the hearing in writing in a Partial Consent to Judgment filed by the parties (Appendix A). The terms of consent will be included in the judgment in this case.

[3] The remaining issues concern the 2004, 2005 and 2006 taxation years in which the appellant's deductions under paragraph 110(1)(*d*) of the *Income Tax Act* (the ITA) were disallowed. That provision allows a deduction of 50% of an employment benefit that is included in the taxpayer's income under section 7 of the ITA, which provides for the taxation of stock options granted by an employer to an employee.

[4] A deduction under paragraph 110(1)(*d*) is only possible if the employer and employee are dealing with each other at arm's length. In this case, the Minister found that the appellant and his employer Forages Garant & Frères inc. (Forages Garant)

were not dealing with each other at arm's length and disallowed the appellant's deductions under paragraph 110(1)(*d*).

Issues

[5] The first issue is whether the appellant and Forages Garant were not dealing with each other at arm's length, justifying the Minister's disallowance of the deductions.

[6] If the Court decides that the appellant and Forages Garant were not dealing at arm's length, the respondent and appellant agree that the benefits received by the appellant and resulting from the stock options are not taxable under section 7 of the ITA. Therefore, a second issue arises: should the value of the benefit received by the appellant each year be added to his income under paragraph 6(1)(*a*) of the ITA?

Facts

[7] The following facts are taken from the Partial Agreement on the Facts filed at the hearing.

[8] During the years at issue, the appellant was employed by Forages Garant. As an employee, he was eligible for Forages Garant's stock option plan.

[9] In 2004, 2005 and 2006, Forages Garant issued notices to exercise stock options, and each year the appellant chose to have Forages Garant redeem his options.

[10] Forages Garant paid the following amounts to the appellant for buying his options:

2004	$1,117,594
2005	$2,037,379
2006	$1,401,630

[11] The appellant indirectly held 37.5% of Forages Garant's shares.

[12] Doris Landry, who married the appellant on August 19, 1972, indirectly held 6.25% of the shares of Forages Garant.

[13] Ken Mathieu, the adult son of the appellant and Doris Landry, indirectly held 12.5% of the shares in Forages Garant.

[14] The interests of the appellant, Doris Landry and Ken Mathieu in Forages Garant derive from the following facts:

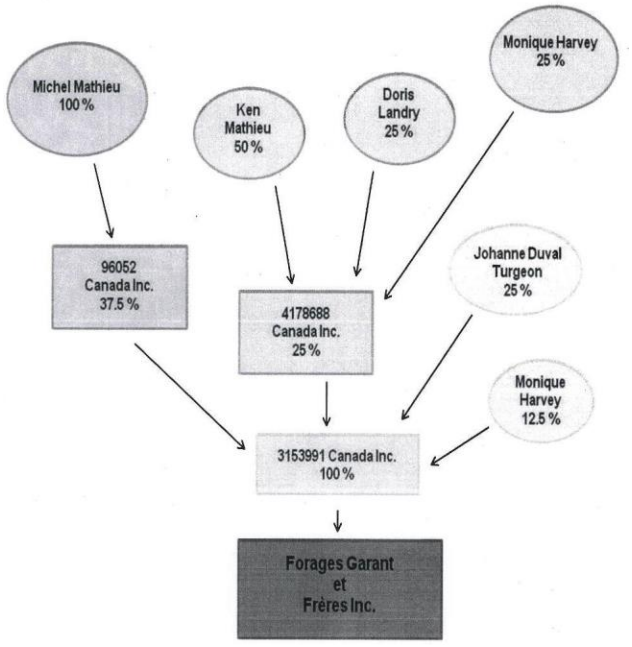
- 3153991 Canada Inc. (315) held the entire share capital of Forages Garant.

- The shares of 315 were held as follows: 37.5% by 96052 Canada Inc. (960), 25% by 4178688 Canada Inc. (417) and 37.5% by others.

- The appellant held 100% of the shares of 960.

- Doris Landry held 25% of the shares of 417, and Ken Mathieu held 50% of the shares of 417.

- This situation is illustrated as follows:



[15] The appellant and Doris Landry stopped living together on October 1, 1990, and obtained a judgment of separation as to bed and board on September 29, 1993. The judgment ratified a [TRANSLATION] "draft agreement and agreement on corollary relief" between the appellant and Doris Landry dated May 17, 1993.

[16] The appellant and Doris Landry signed an agreement on corollary relief (the agreement) on January 10, 2008, whereby they stipulated that they had never gone back to living together and that wanted to make the [TRANSLATION] "effects of the dissolution of the matrimonial regime retroactive to the date when they ceased living together, namely, October 1, 1990". The Superior Court of Québec ratified the agreement in the judgment of divorce dated March 27, 2008. The divorce took effect on April 27, 2008, and the certificate of divorce of the appellant and Doris Landry was issued on May 15, 2008.

[17] At all relevant times, the appellant had a common-law partner.

Relevant legislation

[18] Generally, when an employer (a "qualifying person") agrees to sell or to issue securities of the corporation to one of its employees, subsection 7(1) of the ITA (which will be discussed in more detail further in these reasons) provides that the employee is deemed to have received a benefit either in the year when he exercised the option and acquired the securities or in the year when he disposed of the rights provided by the option. In each case, the employee is deemed to have received a benefit from employment.

[19] An employee who is deemed by section 7 to have received a benefit and who is dealing with the employer at arm's length will be entitled (if certain conditions are met) to a deduction under paragraph 110(1)(*d*). For the years at issue here in, that provision provided the deduction of 50% of the amount of the benefit deemed to have been received by the employee. The goal of this provision is to tax the benefit at the same rate as capital gains.

[20] For 2004, 2005 and 2006, the relevant portion of paragraph 110(1)(*d*) reads as follows:

> **(*d*) Employee options** – an amount equal to 1/2 of the amount of the benefit deemed by subsection 7(1) to have been received by the taxpayer in the year in respect of a security that a particular qualifying person has agreed after February 15, 1984 to sell or issue under an agreement, or in respect of the transfer or other disposition of rights under the agreement, if
>
> (i) the security
>
> . . .

(B) would have been a prescribed share if it were issued or sold to the taxpayer at the time the taxpayer disposed of rights under the agreement,

. . .

(ii) where rights under the agreement were not acquired by the taxpayer as a result of a disposition of rights to which subsection 7(1.4) applied,

. . .

(B) at the time immediately after the agreement was made, the taxpayer was dealing at arm's length with

(I) the particular qualifying person,

. . .

[21] The provisions with respect to determining the existence of an arm's length relationship for the purposes of the ITA are found in section 251. Subsection 251(1) provides that "related persons shall be deemed not to deal with each other at arm's length", and subsection 251(2) includes in the definition of "related persons" "individuals connected by . . . marriage".

[22] In accordance with subsection 251(2), the definition of "related persons" also includes a corporation and a person who is a member of a related group that controls the corporation.

[23] Subsection 251(4) provides that a "related group" is a "group of persons each member of which is related to every other member of the group".

[24] Finally, 251(6)(*b*) provides that, for the purposes of the ITA, "persons are connected by marriage if one is married to the other or to a person who is so connected by blood relationship to the other".

[25] The relevant parts of section 251 read as follows during the relevant years:

251. (1) Arm's length. For the purposes of this Act,

(*a*) related persons shall be deemed not to deal with each other at arm's length;

. . .

(2) Definition of "related persons". For the purpose of this Act, "related persons", or persons related to each other, are

(*a*) individuals connected by blood relationship, marriage or common-law partnership or adoption;

(*b*) a corporation and

(i) a person who controls the corporation, if it is controlled by one person,

(ii) a person who is a member of a related group that controls the corporation, or

(iii) any person related to a person described in subparagraph 251(2)(*b*)(i) or 251(2)(*b*)(ii); and

(*c*) any two corporations

(i) if they are controlled by the same person or group of persons,

(ii) if each of the corporations is controlled by one person and the person who controls one of the corporations is related to the person who controls the other corporation,

(iii) if one of the corporations is controlled by one person and that person is related to any member of a related group that controls the other corporation,

(iv) if one of the corporations is controlled by one person and that person is related to each member of an unrelated group that controls the other corporation,

(v) if any member of a related group that controls one of the corporations is related to each member of an unrelated group that controls the other corporation, or

(vi) if each member of an unrelated group that controls one of the corporations is related to at least one member of an unrelated group that controls the other corporation.

. . .

(4) Definitions concerning groups. In this Act,

"related group" "related group" means a group of persons each member of which is related to every other member of the group;.

. . .

(5) Control by related groups, options, etc. For the purposes of subsection 251(2) and the definition "Canadian-controlled private corporation" in subsection 125(7),

(*a*) where a related group is in a position to control a corporation, it shall be deemed to be a related group that controls the corporation whether or not it is part of a larger group by which the corporation is in fact controlled;

. . .

(6) Blood relationship, etc. For the purposes of this Act, persons are connected by

. . .

(*b*) marriage if one is married to the other or to a person who is so connected by blood relationship to the other;

. . .

First issue: arm's length dealing

[26] The issue in this case is whether the appellant and Doris Landry were connected by marriage during the relevant period. If so, they would be deemed to have formed, together with Ken Mathieu, a related group under subsection 251(4) of the ITA because each of them would be deemed to be related to every other member of the group. Given that this related group would be deemed to be controlling Forages Garant, every member of this group would be deemed to be related to Forages Garant, and therefore the appellant and Forages Garant would be deemed to not be dealing at arm's length.

The appellant's position

[27] Counsel for the appellant stated that a contextual and purposive analysis of the term "connected by marriage" shows that Parliament did not intend to include situations when a separation from bed and board has been obtained. According to him, it is clear that the appellant and Doris Landry had not been "connected" by marriage since 1990, when they stopped living together, or, at the very least, since 1993, when they obtained a judgment of separation as to bed and board and provided for all of the civic and family consequences of the breakdown of their marriage.

[28] The appellant argues that the Court must accept an interpretation of the phrase "connected by marriage" in section 251 of the ITA that is, according to him, more consistent with the scheme of the ITA and with Parliament's objective. Indeed, he suggests that the Court take into account the substance, and not the form of the relationship between the appellant and Doris Landry during the relevant period.

[29] He notes that, in Quebec, it is recognized that spouses may completely sever their marital relationship without obtaining a formal divorce, in choosing to become separated from bed and board. In support of that proposition, he cites *Droit de la famille – 2285*[1] at page 12:

> [TRANSLATION]
> In fact, as I noted earlier, the Code sets off the process of accumulating family patrimony on the date of marriage and continues it without disruption until its official breakdown. Nothing between these two times disrupts or suspends it. However, there are times when spouses decide to sever their marital relationship generally, completely and irrevocably although without having this new status formally recognized by a court decision. It is conceivable that, in such a case, it may become inequitable that the family patrimony accumulated by one of the two spouses after such a severance may continue to grow for the benefit of his or her former spouse only because no judgment has sanctioned such a status change, which the two parties wanted to become permanent. . . . Such a disruption of married life must be irrevocable and, most importantly, complete, such that the spouses consider themselves to be and are, from then on, in all aspects of their lives, completely independent, as they would be if the breakdown of their marriage was sanctioned by a judgment. Fairness, which must prevail in these matters, demands it.

[30] Counsel for the appellant cites a case decided by the Supreme Court of Canada, *Éric v. Lola*,[2] for the proposition that, in Quebec, the breakdown of a marriage may take the form of a separation from bed and board. At paragraph 82 of that judgment the Supreme Court stated the following:

> 82 As a result of the reforms outlined above, marriage is now subject to a legal framework that governs the mutual relationships of spouses. This framework is made up of a primary regime and a legal or conventional matrimonial regime the effects of which are felt both during the marriage and when it ends. However, before looking at the effects of each of these regimes during and after marriage, I note that, aside from the death of a spouse, marriage can end as a result of separation from bed and board under the *Civil Code of Québec* or divorce under the *Divorce Act* . . . .

[1] [1995] R.D.F. 619 (C.A.).
[2] *Quebec (Attorney General) v. A.*, 2013 SCC 5, [2013] 1 S.C.R. 61.

[31] Counsel for the appellant also notes that the Superior Court of Quebec ruled that the phrase [TRANSLATION] "former spouse" does not refer only to a divorced spouse.[3]

[32] He also cites on article 518 of the *Civil Code of Québec* (C.C.Q.),[4] which provides that divorce carries with it the dissolution of the matrimonial regime, but allows the court to make the effects of the dissolution of the regime, as between the spouses, retroactive to the date on which the spouses ceased to live together. He submits that, this means that separation from bed and board may be considered as a permanent breakdown of the marriage.

[33] In addition, counsel for the appellant cites various Quebec acts in which the words "spouse" and "former spouse" are defined in a way that leads one to understand that a separation from bed and board terminates the matrimonial relationship between spouses. For example, the *Act Respecting the Québec Pension Plan*[5] provides at section 102.2 that "two married persons separated from bed and board" are considered to be "former spouses". Under the *Regulation respecting the application of the Health Insurance Act*,[6] two married persons must live together to be considered "spouses". Similar provisions are found in the *Individual and Family Assistance Act*,[7] the *Labour Standards Act*,[8] and the *Supplemental Pension Plans Act*.[9]

[34] With respect to the ITA, counsel for the appellant submits that Parliament recognizes that married persons who live separate and apart as a result of the breakdown of their marriage have undergone a breakdown of their marriage without being divorced. The concept of "breakdown of marriage" appears repeatedly in the ITA in order to provide to the parties a different tax treatment from that which would be used had there not been a separation.

[35] Counsel for the appellant cites *Caron c. Québec*,[10] where the Court of Québec ruled on the application of section 14.4 of the *Tax Administration Act*,[11] which renders a person liable for the tax debt of another person when there has been a

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[3] *RL c. EB*, 2003 R.D.F. 55.
[4] R.S.Q., c. C-1991.
[5] R.S.Q., c. R-9.
[6] R.R.Q., c. A-29, r.5.
[7] R.S.Q., c. A-13.1.1.
[8] R.S.Q., c. N-1.1.
[9] R.S.Q., c. R-15.1.
[10] 2003 R.D.F.Q. 102.
[11] R.S.Q., c. A-6.002.

transfer of property. Among others, this provision applies to those who do not deal at arm's length with the transferor. In *Caron*, the appellant was separated from bed and board from her former spouse (the transferor), but they were not divorced. The Court stated that, in that case,

> [TRANSLATION]
> even if, in the absence of divorce, the marriage bond remains, this single bond is not sufficient to establish non-arm's length dealing when section 2.2.1 of the *Taxation Act*[12] makes it possible to defeat the solidarity between spouses set out in sections 14.4 and 14.5 of the *Act respecting the ministère du Revenu*. [13]

[36] In conclusion, counsel for the appellant alleges that Doris Landry and the appellant were no longer "connected" by marriage within the meaning of paragraph 251(2)(*a*) of the ITA as of 1990, or, at the very least, as of 1993, so that Forages Garant and the appellant were dealing with each other at arm's length from 2004 to 2006.

Analysis: arm's length dealing

[37] Paragraph 251(2)(*a*) of the ITA provides that persons connected by marriage are considered to be related persons, and, according to paragraph 251(1)(*a*) of the ITA, related persons are deemed to not be dealing with each other at arm's length.

[38] The issue in this case is whether two married persons stop being individuals "connected by marriage" within the meaning of paragraph 251(2)(*a*) of the ITA when they are separated from bed and board.

[39] The appellant stated that a contextual and purposive analysis of the expression "connected by marriage" shows that Parliament did not intend to include situations where a separation from bed and board has been issued.

[40] I am not satisfied that the appellant's approach is consistent with the rule applicable to the construction of fiscal legislation, as explained by the Supreme Court of Canada in *Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*.[14] The Supreme Court reiterated the importance of the textual aspect of interpreting taxation statutes. At paragraph 21 of this judgment, the Supreme Court stated the following:

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[12] Chapter I-3.
[13] R.S.O. 1990, c. M.33.
[14] [2006] 1 S.C.R. 715; 2006 SCC 20.

> . . . "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament" (p. 578): see *65302 British Columbia Ltd. v. Canada*, 1999 CanLII 639 (SCC), [1999] 3 S.C.R. 804, at para. 50. However, because of the degree of precision and detail characteristic of many tax provisions, a greater emphasis has often been placed on textual interpretation where taxation statutes are concerned: *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54 (CanLII), [2005] 2 S.C.R. 601, 2005 SCC 54, at para. 11. Taxpayers are entitled to rely on the clear meaning of taxation provisions in structuring their affairs. Where the words of a statute are precise and unequivocal, those words will play a dominant role in the interpretive process.
>
> [Emphasis added.]

[41] In my view, a textual analysis of paragraphs 251(1)(*a*), (2)(*a*) and (6)(*b*) does not reveal any ambiguity in the phrase "connected by marriage" because paragraph 251(6)(*b*) provides that persons are connected by marriage "if one is married to the other". Thus, the bonds of marriage are those that exist if the persons concerned are married and the bonds connect the married persons.

[42] In Canada, a marriage is dissolved only by divorce or the death of one of the spouses. The dissolution of marriage by divorce is provided for in section 14 of the *Divorce Act*:[15]

> **14.** On taking effect, a divorce granted under this Act dissolves the marriage of the spouses.

[43] In Quebec, article 516 of the C.C.Q. provides as follows:

> **516.** Marriage is dissolved by the death of either spouse or by divorce.

[44] Even though, in practice, a separation from bed and board reflects a permanent breakdown of the marriage, it does not, strictly speaking, break the marital bond and is not equivalent to a divorce: article 507 C.C.Q. reads as follows:

> **507.** Separation from bed and board releases the spouses from the obligation to live together; it does not break the bond of marriage.

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15 R.S.C., 1985, c. 3 (2nd Supp.).

As stated by the Supreme Court of Canada in *Éric v. Lola*,

> 87. . . . Since separation from bed and board — although it loosens the marital bond by releasing the spouses from the obligation to live together — does not terminate the marriage, it does not terminate the other effects of marriage . . . .

[45] In addition, it cannot be concluded, on the basis of the context of the ITA, that Parliament intended to exclude spouses separated from bed and board from the phrase "connected by marriage" found at paragraph 251(2)(*a*). When Parliament wanted to take into account in the ITA situations where spouses are still married but live separate and apart, it did so by using language such as "living separate and apart because of the breakdown of their marriage" in the definition of support amount in subsection 56.1(4), or "separated and living apart as a result of the breakdown of their marriage" at subsection 160(4). It also seems to me that, under subsection 251(6), due to the mere fact of being married, persons are connected by marriage.

[46] Finally, although neither the appellant nor the respondent has referred to the object of paragraph 251(1)(*b*) of the ITA, it seems to me that Parliament wanted to define certain categories of persons who, because of their relationships, are likely not to act in their best commercial interests. Parliament intended to create a rule that is simple to apply. It is not incompatible with this goal to include all married persons.

Second issue: inclusion in income

[47] Having concluded that the appellant was not dealing at arm's length with Doris Landry, and therefore, with Forages Garant, I must now decide whether the amounts received by the appellant from Forages Garant for disposing of his stock options are taxable.

[48] The starting point for analyzing the tax treatment of a benefit resulting form a stock option granted to an employee is found at section 7 of the ITA.

[49] In general, section 7 sets out that a stock option granted by an employer to its employee gives rise to an employment benefit, but that the benefit is not acknowledged at the time the option is granted. If the employee exercises the option, the benefit is deemed to have been received at the time when the employee exercises it: paragraph 7(1)(*a*) (except when the employer is an arm's length Canadian-controlled private corporation: subsection 7(1.1), which is not relevant in this case).

[50] Paragraphs 7(1)(*b*) to (*d*) apply to scenarios where the employee transfers or disposes of the rights provided by the option without acquiring shares.

[51] Paragraph 7(1)(*b*) deals with a transfer of rights by an employee to an arm's length person.

[52] Paragraph (*c*) applies when an employee transfers the stock option to a non-arm's length person who acquires shares under the option.

[53] Paragraph (*d*) provides for the case where, following one or more transactions between non-arm's length persons, the rights under the option are subsequently transferred to an arm's length person.

[54] During the relevant years, paragraphs 7(1)(*a*) to (*d*) read as follows:

> **7. (1) Agreement to issue securities to employees** — Subject to subsections (1.1) and (8), where a particular qualifying person has agreed to sell or issue securities of the particular qualifying person (or of a qualifying person with which it does not deal at arm's length) to an employee of the particular qualifying person (or of a qualifying person with which the particular qualifying person does not deal at arm's length),
>
> (*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;
>
> (*b*) if the employee has transferred or otherwise disposed of rights under the agreement in respect of some or all of the securities to a person with whom the employee was dealing at arm's length, a benefit equal to the amount, if any, by which
>
> (i) the value of the consideration for the disposition
>
> exceeds
>
> (ii) the amount, if any, paid by the employee to acquire those rights

shall be deemed to have been received, in the taxation year in which the employee made the disposition, by the employee because of the employee's employment;

(*c*) if rights of the employee under the agreement have, by one or more transactions between persons not dealing at arm's length, become vested in a person who 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 person acquired them

exceeds the total of

(ii) the amount paid or to be paid to the particular qualifying person by the person 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 person acquired the securities, by the employee because of the employee's employment, unless at the time the person acquired the securities the employee was deceased, in which case such a benefit is deemed to have been received by the person in that year as income from the duties of an employment performed by the person in that year in the country in which the employee primarily performed the duties of the employee's employment;

(*d*) if rights of the employee under the agreement have, by one or more transactions between persons not dealing at arm's length, become vested in a particular person who has transferred or otherwise disposed of rights under the agreement to another person with whom the particular person was dealing at arm's length, a benefit equal to the amount, if any, by which

(i) the value of the consideration for the disposition

exceeds

(ii) the amount, if any, paid by the employee to acquire those rights

shall be deemed to have been received, in the taxation year in which the particular person made the disposition, by the employee because of the employee's employment, unless at the time the other person acquired the rights the employee was deceased, in which case such a benefit shall be deemed to have been received by the particular person in that year as income from the duties of an employment performed by the particular person in that year in the country in which the employee primarily performed the duties of the employee's employment; and

[55] If the appellant and Forages Garant are dealing with each other at arm's length, the parties agree that the amounts received by the appellant would be taxable under paragraph 7(1)(*b*). They also agree that, if they are not dealing at arm's length, the payments received by the appellant are not taxable under section 7.

[56] However, the respondent alleges that the benefits resulting from dispositions of stock options by the appellant are nonetheless taxable under paragraph 6(1)(*a*) of the ITA as employment benefits. Paragraph 6(1)(*a*) provides for the taxation of "the value of board, lodging and other benefits of any kind whatever received or enjoyed by the taxpayer in the year in respect of, in the course of, or by virtue of an office or employment" except for certain benefits listed.

[57] The appellant submits that the application of paragraph 6(1)(*a*) is precluded by paragraph 7(3)(*a*). Paragraph 7(3)(*a*) reads as follows:

> **(3) Special provision** — If a particular qualifying person has agreed to sell or issue securities of the particular person, or of a qualifying person with which it does not deal at arm's length, to an employee of the particular person or of a qualifying person with which it does not deal at arm's length,
>
> > (*a*) except as provided by this section, the employee is deemed to have neither received nor enjoyed any benefit under or because of the agreement; and

Respondent's submissions

[58] The respondent is of the view that the general provision, that is, paragraph 6(1)(*a*) of the ITA, prevails over section 7. The respondent cites *Canada v. Chrysler*,[16] in support of the proposition that the general provision applies automatically and that the general provision ceases to apply only if the conditions of the specific provision are met.

[59] The respondent also submits that, for section 7 to apply, all of the conditions listed in it – not just those found in the opening words – must be met. To that effect, the respondent submits that, in the English version of this section (unlike in the French version), the opening words are separated from the body of the provision ***only*** by a comma and that the same sentence that starts in the opening continues through the various paragraphs. Thus, the respondent is of the view that the inclusion of the conditions in the opening is insufficient to conclude that section 7 applies: one of the conditions at paragraphs 7(1)(*a*) to (*e*) must also be met.

[16] [1992] F.C.J. No. 361.

[60] The respondent also cites *Robertson v. Canada*[17] and *Henley v. Canada*,[18] where the Federal Court of Appeal concluded that, since the conditions set out in section 7 were not met, the benefit was therefore taxable under paragraph 6(1)(*a*) of the ITA. In short, if the conditions for applying the specific provision are not met, the general provision applies.

[61] The respondent submits that, if section 7 did not exist, the employee would be allowed a taxable benefit under paragraph 6(1)(*a*) of the ITA. Thus, the respondent argues that paragraph 7(3)(*a*) aims to prevent double taxation. In other words, section 7 does not exclude the application of section 6, but excludes only the double application of both sections 6 and 7. Thus, section 7 takes precedence only as long as section 7 provides for the inclusion of the benefit.

[62] In the same vein, the respondent submits that paragraph 6(1)(*a*) must be interpreted and applied as broadly as possible under *The Queen v. Savage*.[19] The respondent also argues that, when Parliament seeks to exclude a benefit under paragraph 6(1)(*a*), it does so expressly. However, Parliament does not state anywhere that an amount paid following the redemption of stock options is not a taxable benefit.

[63] The respondent also cites section 12 of the *Interpretation Act*,[20] which reads as follows:

> 12. Every enactment is deemed remedial, and shall be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects.

[64] According to the respondent, the object of the ITA is to tax a person's income. The scheme of the ITA is that any employee who acquires any salary, wages or remuneration must include it in his income. For that reason, the non-taxation of the benefits in this case would be absurd, and such an interpretation is to be avoided.

[65] The respondent cites subsection 45(3) of the *Interpretation Act*, *supra*, and argues that paragraph 7(1)(*b.1*) clarified the ITA.

[66] The respondent submits that section 7 is an incentive measure and aims to make acquiring a corporation's securities more accessible to employees.

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[17] [1990] 2 F.C. 717.
[18] 2007 FCA 370.
[19] [1983] 2 S.C.R. 428.
[20] R.S.C., 1985, c. I-21.

Appellant's submissions

[67] The appellant submits that section 7 of the ITA is a complete code with regard to taxing benefits received under options granted by an employer to his or her employee for purchasing shares of the employer or a related person, but that section 7 does not provide for taxable benefits in the appellant's case.

[68] The appellant submits that from the moment one cites the introductory part of subsection 7(3), one cannot have recourse to other provisions of the ITA to tax the benefit received under a stock option. As a result, the benefit realized by the appellant under the stock options is not taxable.

Analysis: inclusion in income

[69] It is clear from reading section 7 that it is a code for taxing employee stock options and that, hence, this section is a special provision in the ITA relative to a particular employment benefit.

[70] Therefore, the *generalibus specialia derogant* principle would apply with the result that the special provision would override the general provision: paragraph 6(1)(*a*). As Justice Strayer stated in *Chrysler*,

> 7 . . . The common law has well established that wherever there is a particular provision and a general provision in the same statute and the latter if taken in its broadest sense would overrule the former, then the particular provision must be given effect and the general provision must be taken not to apply in these specific circumstances . . . .

[71] It is true, as the respondent submits that, if the pre-conditions for the application of a special provision are not met, the general provision may apply. Indeed, that is what happened in the two cases of the Federal Court of Appeal cited by the respondent, *Henley* and *Robertson*.

[72] In both cases, all the criteria stated in the opening of subsection 7(1) were not met, and for that reason the Minister was able to tax the benefits received by the taxpayers under paragraph 6(1)(*a*).

[73] In *Henley*, the employee received warrants for shares of a company that was not related to the employer. For section 7 to apply, the shares provided for by the stock option agreement must be the shares of the employer or a related company.

[74] In *Robertson*, the employer was an individual and therefore the phrase "qualifying person" in the opening of subsection 7(1) did not apply to him. On the basis of the definition at subsection 7(7), a "qualifying person" is a corporation or a mutual fund trust. In addition, the appellant in *Robertson* did not dispute that he had received a benefit under subsection 5(1) and paragraph 6(1)(*a*).

[75] However, there is an important distinction to be made between these cases and the circumstances in this case. In *Henley* and *Robertson*, the Federal Court of Appeal did not have to rule on the application of subsection 7(3). The conditions of application of subsection 7(1), which the taxpayers in *Henley* and *Robertson* did not meet, were in the opening part of subsection 7(1). Since the conditions specified in the opening of subsection 7(1) are the same as those found at subsection 7(3), the taxpayers clearly did not meet the conditions for the application of subsection 7(3).

[76] Contrary to the situation in *Henley* and *Robertson*, the appellant meets the conditions in the opening part of subsection 7(1), which is to say that he meets all of the application conditions set out in the opening of subsection 7(3): Forages Garant is a qualifying person (in accordance with the definition at subsection 7(7)), which has agreed to issue its securities to its employee (the appellant).

[77] I do not agree with the respondent that one of the conditions listed at paragraphs 7(1)(*a*) to (*d*) must also be met before subsection 7(3) is overridden. Subsection 7(3) does not mention any of those conditions. Thus, in the appellant's case, the *generalibus specialia derogant* principle applies, and subsection 7(3) overrides the general provision, paragraph 6(1)(*a*). In accordance with paragraph 7(3)(*a*), the appellant is deemed to not have received a benefit under the stock option agreement with Forages Garant, unless otherwise specified at section 7. The parties had already agreed that section 7 does not provide for the taxation of the benefit received by the appellant during the relevant years.

[78] It is true, as stated by the respondent, that subsection 7(3) is aimed at preventing the double taxation of benefits related to stock options granted to employees, but, at the same time, it must be acknowledged that Parliament also chose to specify at section 7 which benefits related to options would be taxed and when they would be deemed to have been realized by employees.

[79] The respondent has not shown that there was an ambiguity at paragraph 7(3)(*a*) or at subsection 7(1) with regard to the benefits that Parliament chose to tax, and, in my view, the language used in these provisions is clear and unequivocal. The fact that the benefits received by the appellant will not be taxed is due to a loophole in the legislation, but it is not the role of the Court to interpret tax

provisions in a way that protects the tax authorities. The Federal Court of Appeal recently ruled to that effect in *Canada v. Quinco Financial Inc.*[21] at paragraphs 8 and 9:

> [8] Overall, the Act consists of clear, precise rules to facilitate ease of application, consistency and predictability. This underscores the dominance of the plain meaning of the text of the Act in the process of interpreting provisions of the Act.
>
> [9] There may be cases where precisely-worded provisions or their interaction creates an advantage or a windfall for a registrant under the Act. But we do not interpret taxation provisions in a tendentious or result-oriented way to enhance the federal treasury: *Shell Canada*, *supra* at paragraphs 39 and 40. Instead, absent words allowing us to address situations of abuse or windfall, where the provisions are precisely-worded, clear and unambiguous, they must be given their plain effect.

[80] In 2010, Parliament amended the ITA to introduce the new paragraph 7(1)(*b.1*). This paragraph is a copy of paragraph (*b*), but it applies in cases where the employee and the issuing corporation are not dealing with each other at arm's length. In other words, it would apply where there is a transfer of rights provided by a stock option, where the employee transfers his or her rights to the employer (or a related person) with whom he is not dealing at arm's length. In that case, the employee would be deemed to have received a benefit because of his employment. The new paragraph 7(1)(*b.1*) reads as follows:

> (*b.1*) if the employee has transferred or otherwise disposed of rights under the agreement in respect of some or all of the securities to the particular qualifying person (or a qualifying person with which the particular qualifying person does not deal at arm's length) with whom the employee was not dealing at arm's length, a benefit equal to the amount, if any, by which
>
> (i) the value of the consideration for the disposition
>
> exceeds
>
> (ii) the amount, if any, paid by the employee to acquire those rights
>
> is deemed to have been received, in the taxation year in which the employee made the disposition, by the employee because of the employee's employment;

[81] The respondent submits that the amendment was a clarification of the ITA, as indicated in Annex 5 of the 2010 Budget:[22]

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[21] 2014 FCA 108.

[22] Department of Finance, *Annex 5: Tax Measures: Supplementary Information and Notices of Ways and Means Motions*. March 4, 2010, at p. 391.

> Budget 2010 also proposes to amend the income tax rules to clarify that the disposition of rights under a stock option agreement to a non-arm's length person results in an employment benefit at the time of disposition (including cash out). Although the Government considers that these benefits are taxable in these circumstances under existing tax rules, the Government also believes that clarification of these rules is warranted.

[82] The respondent also cites subsection 45(2) of the *Interpretation Act*, which reads as follows:

> **45.** (2) The amendment of an enactment shall not be deemed to be or to involve a declaration that the law under that enactment was or was considered by Parliament or other body or person by whom the enactment was enacted to have been different from the law as it is under the enactment as amended.

[83] Although the mere fact that the Act was amended does not give rise to a presumption of an intention to amend the Act, the Court must take into account the nature of the amendment and of the circumstances surrounding it in deciding whether the goal of the amendment was to change the Act. In *Silicon Graphics Ltd. v. The Queen*,[23] the Federal Court of Appeal ruled as follows:

> [43] However, the *Interpretation Act* does not preclude the Court from drawing an inference that amendments to legislation are intended to change the legislation where the internal and external evidence warrants such a conclusion. It has been suggested that there is a presumption that changes to the wording of legislation are purposeful and that the provisions of the *Interpretation Act* referred to above do not preclude the Court from acknowledging that, in principle at least, the foremost purpose of amendments is to bring about a substantive change in the law. See R. Sullivan, ed., *Driedger on the Construction of Statutes*, 3rd ed. (London: Butterworths, 1994), at page 451.

[84] In my view, the introduction of the new paragraph 7(1)(*b.1*) made a change to the ITA, not a mere "clarification". First, the respondent is not disputing that the benefits received by the appellant are not taxable under section 7 (the version in effect during the years at issue), but she maintains that paragraph 6(1)(*a*) applies to include the benefits in the appellant's income. However, there is an important difference between the application of paragraph 6(1)(*a*) and of the new paragraph 7(1)(*b.1*). Paragraph 6(1)(*a*) would add the benefit to the appellant's income at the time when the stock option is granted, not when the right is disposed of, as paragraph 7(1)(*b.1*) now provides. Thus, the addition of paragraph 7(1)(*b.1*), at

[23] 2002 FCA 260.

the very least, amends the time when the benefit is included in the employee's income.

[85] Even more important is the effect of subsection 7(3) of the ITA, which is that section 7 is a complete code for the taxation of benefits received under stock options granted by an employer to its employee. Since the respondent does not dispute that, for the years at issue, section 7 did not apply to the benefits received by the appellant, it is clear that the addition of paragraph 7(1)(*b.1*) results in a change in section 7, not a clarification.

[86] Finally, we must ask ourselves whether the interpretation stemming from the ordinary meaning of the words of section 7 may be disregarded due to an absurd result. The statutory interpretation principle that an interpretation that leads to an absurd result should be avoided is well established. The validity of this principle is acknowledged by the Supreme Court of Canada in *Re Rizzo & Rizzo Shoes Ltd.*,[24] among others, where the Court stated the following:

> 27. . . . It is a well established principle of statutory interpretation that the legislature does not intend to produce absurd consequences. According to *Côté, supra,* [Pierre-André Côté, *The Interpretation of Legislation in Canada*, 2nd ed. (Cowansville: Yvon Blais, 1991)], an interpretation can be considered absurd if it leads to ridiculous or frivolous consequences, if it is extremely unreasonable or inequitable, if it is illogical or incoherent, or if it is incompatible with other provisions or with the object of the legislative enactment (at pp. 378-80). Sullivan echoes these comments noting that a label of absurdity can be attached to interpretations which defeat the purpose of a statute or render some aspect of it pointless or futile (Sullivan, *Construction of Statutes*, *supra,* [Ruth Sullivan, *Driedger on the Construction of Statutes*, 3rd ed. (Toronto: Butterworths, 1994)]. at p. 88).

[87] However, the courts have no licence to interpret legislation, however harsh or absurd a result it may lead to, until it is first shown that the words in question are capable, in the context in which they are used, of having more than one meaning. Ruling for the majority of the Supreme Court of Canada in *R. v. Mclntosh*,[25] the former Chief Justice Lamer stated the following:

> **34** . . . where, by the use of clear and unequivocal language capable of only one meaning, anything is enacted by the legislature, it must be enforced however

[24] [1998] 1 S.C.R. 27.
[25] [1995] 1 S.C.R. 686; [1995] S.C.J. No. 16.

> harsh or absurd or contrary to common sense the result may be (*Maxwell on the Interpretation of Statutes*, *supra*, at p. 29). The fact that a provision gives rise to absurd results is not, in my opinion, sufficient to declare it ambiguous and then embark upon a broad-ranging interpretive analysis.
>
> . . .
>
> **36** Thus, only where a statutory provision is ambiguous, and therefore reasonably open to two interpretations, will the absurd results flowing from one of the available interpretations justify rejecting it in favour of the other. . . .
>
> [Emphasis added.]

[88] In a similar vein, Judge Bowman stated in *Datacalc Research Corp. v. Canada*:[26]

> 54 In any event, I do not think that the fact that a statutory provision can in some circumstances lead to an unjust or inconvenient or even absurd result can justify ignoring it or not applying it to a different set of circumstances. . . . To modify the plain legislative language so that it conforms to the judge's notion of what is more reasonable or more fair or less absurd would be to usurp the role of Parliament.
>
> [Emphasis added.]

[89] In this case, the wording of paragraph 7(3)(*a*) is clear, and there is no need to resort to the presumption that its interpretation is likely to lead to absurd results.

[90] Hence, I conclude that the amounts received by the appellant from Forages Garant in relation to the stock option should not be included in the appellant's income for 2004, 2005 and 2006.

[91] The appeal is allowed in accordance with these reasons and with the partial consent to judgment filed by the parties, with costs to the appellant.

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[26] [2002] T.C.J. No. 99, [2002] C.T.C. 2548.

Signed at Ottawa, Canada, this 27th day of June 2014.

"B. Paris"

Paris J.

Translation certified true
on this 4th day of February 2015

François Brunet, Revisor

Appendix A

[TRANSLATION]

2010-1972(IT)G

TAX COURT OF CANADA

BETWEEN:

MICHEL MATHIEU

Appellant,

and

HER MAJESTY THE QUEEN

Respondent.

PARTIAL CONSENT TO JUDGMENT

WHEREAS Michel Mathieu appealed to the Tax Court of Canada, appeal No. 2010-1972(IT)G, in respect of his 2004, 2005, 2006, 2007 and 2008 taxation years.

POINTS ON WHICH THE PARTIES AGREE:

2004, 2005 AND 2006 TAXATION YEARS

The parties agree that the Court render a judgment allowing the appeal in respect of the reassessments for 2004, 2005 and 2006 and referring the matter back to the Minister of National Revenue for reconsideration and reassessment to be made as follows:

1. For the 2004 taxation year only, the criteria at subparagraph 152(4)(*a*)(i) of the Act are met; accordingly, the Minister could make a reassessment for that taxation year.

2. The following amounts are deductible under subsection 110(1)(*d*) of the Act in computing the appellant's employment income:

	MATÉRIAUX 3 + 2	BRETON THIBAULT	VOLUMAT	TIMMINGS
2006	$101,097	$108,211	$137,683	$368,898

3. The following amounts are not deductible under paragraph 110(1)(*d*) of the Act in computing the appellant's employment income:

	MATÉRIAUX 3 + 2	BRETON THIBAULT	VOLUMAT
2004	$36,502	$102,544	$56,701
2005	$83,974	_	$88,030
2006	_	_	_

2007 AND 2008 TAXATION YEARS

The parties consent to the Court's rendering a judgment allowing the appeal from the reassessments for 2007 and 2008 and referring the matter back to the Minister of National Revenue for reconsideration and reassessment to be made as follows:

4. The following amounts are deductible under subsection 110(1)(*d*) of the *Income Tax Act* (the Act) in computing the appellant's employment income:

	MATÉRIAUX 3 + 2	**BRETON THIBAULT**	**VOLUMAT**	**TIMMINGS**
2007	$85,347	$287,495	$87,862	$407,742
2008	$83,817	$297,407	$87,539	

5. The following amounts are not deductible under paragraph 110(1)(*d*) of the Act in computing the appellant's employment income:

	TIMMINGS
2008	$317,657

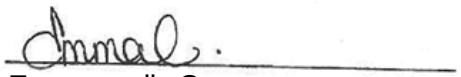
POINTS REMAINING AT ISSUE:

6. The parties agree that the subject of the appeal is only the deduction of the following amounts:

	FORAGE GARANT
2004	$558,797
2005	$1,018,688
2006	$700,817

7. The parties refer the Court to the pleadings for further clarifications on the exact content of the dispute with respect to the options of Forages Garant:

MONTRÉAL, August 10, 2011.

per: 
Emmanuelle Campeau
RAVINSKY RYAN LEMOINE
L.L.P. Barristers and Solicitors

MONTRÉAL, August 15, 2011

Myles J. Kirvan
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per: 
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Counsel

2010-1972(IT)G

TAX COURT OF CANADA

BETWEEN:

MICHEL MATHIEU

Appellant,

and

HER MAJESTY THE QUEEN

Respondent.

PARTIAL CONSENT TO JUDGMENT

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File No.: 3-238437

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COURT FILE NO.:	2010-1972(IT)G
STYLE OF CAUSE:	MICHEL MATHIEU AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Montréal, Quebec
DATE OF HEARING:	May 13, 2013
REASONS FOR JUDGMENT BY:	The Honourable Justice B. Paris
DATE OF JUDGMENT:	June 27, 2014

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