

Dockets: 2010-2326(IT)G,
2010-2445(IT)G,
2010-2375(IT)G,
2010-2332(IT)G

BETWEEN:

9016-9202 QUÉBEC INC.,
9016-9293 QUÉBEC INC.,
9017-6298 QUÉBEC INC.,
9046-0221 QUÉBEC INC.,

Appellants,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeals heard on June 11, 12, 13 and 14, 2013, at Montréal, Quebec.

Before: The Honourable Justice Réal Favreau

Appearances:

Counsel for the appellants:	Aaron Rodgers Bernard Larose
Counsel for the respondent:	Anne Poirier Simon Vincent

JUDGMENT

The appeals from the reassessments made by the Minister of National Revenue under the *Income Tax Act* regarding the 2007 and 2008 taxation years are allowed, without costs, and the reassessments are referred back to the Minister for reconsideration and reassessment in order to cancel the penalties, in accordance with the attached Reasons for Judgment.

The appeals from the reassessments made by the Minister of National Revenue under the *Income Tax Act* for the 2004, 2005 and 2006 taxation years are dismissed with costs, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 25th day of September 2014.

“Réal Favreau”

Favreau J.

Translation certified true
On this 19th day of February 2015

François Brunet, Revisor

Citation: 2014 TCC 281
Date: 20140925
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REASONS FOR JUDGMENT

Favreau J.

[1] The appellants are part of a group of 36 appellants for which the issue is the same; it must be determined whether, during the 2004, 2005 and 2006 taxation years, each of the appellants was a “personal services business” within the meaning of subsection 125(7) of the *Income Tax Act*, R.S.C. 1985 c. 1 (5th Supp.) as amended (the Act), and whether the Minister of National Revenue (the Minister) was justified in disallowing the small business deduction set out at subsection 125(1) of the Act.

[2] The appellants, except 9016-9293 Québec inc., were also part of a group of 32 appellants for which the issues were the same, namely,

- (a) whether each of the appellants was for the 2007 and 2008 taxation years a “personal services business” within the meaning of subsection 125(7)

of the Act, and whether the Minister was justified in disallowing the small business deduction set out at subsection 125(1) of the Act; and

- (b) In the affirmative, whether each of the appellants was entitled to limited deductions for personal services businesses within the meaning of paragraph 18(1)(p) of the Act, and whether the penalties imposed under subsection 163(2) of the Act were justified in the circumstances.

[3] The cases of the other appellants, except 2010-2369(IT)G and 2010-2396(IT)G, for which discontinuances were filed the day before the hearing, are suspended until a final decision is rendered in these four test cases. The list of appellants and groups of files is appended to this judgment.

9016-9202 Québec inc. (9016-9202)

[4] On April 16, 2007, the Minister made reassessments in respect of 9016-9202 for its taxation years ending on August 31, 2004, 2005 and 2006, disallowing the amounts deducted as small business deductions, namely, \$9,282, \$8,140 and \$7,105 respectively on the ground that 9016-9202 was a personal services business.

[5] On September 30, 2010, the Minister made reassessments in respect of 9016-9202 for its taxation years ending on August 31, 2007 and 2008, disallowing the amounts deducted as small business deductions, namely, \$10,411 and \$8,101 respectively and the amounts deducted as expenses, namely, \$47,717 and \$7,575 respectively on the ground that 9016-9202 was a personal services business and imposing penalties under subsection 163(2) of the Act, namely, \$278 and \$773 respectively.

9016-9293 Québec inc. (9016-9293)

[6] On April 24, 2007, the Minister made reassessments in respect of 9016-9293 for its taxation years ending on August 31, 2004, 2005, 2006, disallowing the amounts deducted as small business deductions, namely, \$4,069, \$733 and \$3,124, respectively on the ground that 9016-9293 was a “personal services business”.

9017-6298 Québec inc. (9017-6298)

[7] On April 18, 2007, the Minister made reassessments in respect of 9017-6298 for its taxation years ending on August 31, 2004, 2005, 2006,

disallowing the amounts deducted as small business deductions, namely, \$6,620 \$5,148 and \$6,016 respectively on the ground that 9017-6298 was a personal services business.

[8] On July 28, 2010, the Minister made reassessments in respect of 9017-6298 for its taxation years ending on August 31, 2007 and 2008, disallowing the amounts deducted as small business deductions, namely, \$7,276 and \$6,910 respectively and the amounts deducted as expenses, namely, \$122,054 and \$124,831 respectively on the ground that 9017-6298 was a personal services business and imposing penalties under subsection 163(2) of the Act, namely, \$13,449 and \$12,716 respectively.

9046-0221 Québec inc. (9046-0221)

[9] On April 16, 2007, the Minister made reassessments in respect of 9046-0221 for its taxation years ending on August 31, 2004, 2005, 2006, disallowing the amounts deducted as small business deductions, namely, \$7,608, \$9,410 and \$8,894 respectively on the ground that 9046-0221 was a personal services business.

[10] On September 20, 2010, the Minister made reassessments in respect of 9046-0221 for its taxation years ending on August 31, 2007 and 2008, disallowing the amounts deducted as small business deductions, namely, \$6,547 and \$7,584, respectively and the amounts deducted as expenses, namely, \$77,849 and \$69,167 respectively on the ground that 9046-0221 was a personal services business and imposing penalties under subsection 163(2) of the Act, namely, \$8,610 and \$7,046, respectively.

Partial agreement on the facts

[11] At the beginning of the hearing, the parties filed by consent a partial agreement on the facts. To make the content easier to understand, it should be clarified that EBI refers to the corporation EBI Environnement inc., which has since December 1, 2004, operated the business that was previously operated by Services Sanitaires RS inc. and that 9069-1122 Québec inc. and 9120-2358 Québec inc. are not part of the test cases. The partial agreement on the facts reads as follows:

[TRANSLATION]

- 4 EBI operates its business mainly in the areas of Berthierville, Joliette, Repentigny and Sorel-Tracy.
- 5 EBI bids on contracts with the cities for garbage collection and signed contracts with some municipalities or corporations.
- 6 The specifications signed by EBI and the municipalities set out the conditions and schedule of collection.
- 7 Before March 1995, EBI's employees performed the garbage collection.
- 8 Since March 1995, EBI has developed a new operating structure under which the collection is done by garbage collectors who are independent contractors.
- 9 EBI signed about forty contracts with garbage collectors for garbage collection, including the appellants.
- 10 The garbage collectors do not perform the same operations but have signed the same type of contractor agreement with EBI. Only the appendices of the contracts are different.
- 11 Operations are divided as follows among the garbage collectors hired by EBI:
 - 65% of the workers collect household waste and remove it to Groupe EBI's landfill.
 - 25% of the workers collect construction waste and remove it to the landfill.
 - 10% of the workers deal with front loading and removal to the landfill.

GARBAGE COLLECTORS

- 12 The following table specifies the incorporation date and shareholder name for each appellant:

Years at issue	Appellants	Created	Shareholders	Type of work
2004 to 2008	9016-9202 Québec inc. (Group A)	28/02/1995	2004 to 2008: Jean-Rock Bernèche	Roll-off

2004 to 2006	9016-9293 Québec inc. (Group A)	28/02/1995	2004 to 2006: Jocelyn Vincent	Roll-off
2004 to 2008	9017-6298 Québec inc. (Group B)	15/03/1995	2004-2008: Jean Houde	Garbage pick-up
2004 to 2008	9046-0221 Québec inc. (Group C)	23/01/1997	2004-2008: Richard Arnold	Front loading
2006 to 2008	9069-1122 Québec inc. (Group D)	5/10/1998	2004: Services administratifs inc. 2005: Robert Mandeville 2006-2008: Jacques Bell	Rear loading
2004 to 2008	9120-2358 Québec inc. (Group E)	28/08/2002	2004: Jacques Bell 2005: Sylvain Gravel 2006-2007: Roger Douaire 2008-2011: Services administratifs inc.	Rear loading

- 13 The appellants who do roll off pick up garbage containers. Drivers work alone. They are paid per trip at a rate established based on region.
- 14 The appellants who pick up garbage are paid based on an annual lump sum. The appellants employed a person to help with pick-up.
- 15 The appellants who do front loading are paid per load. Drivers work alone.
- 16 The appellants who do rear loading are paid per hour.
- 17 Before their companies were incorporated, Jean-Rock Bernèche, Jocelyn Vincent, Jean Houde, Richard Arnold, Jacques Bell and Roger Douaire were employees of EBI.
- 18 Appellants 9017-6298 Québec inc., 9069-1122 Québec inc. and 9120-2358 Québec inc. employed no more than five (5) full-time employees during the years at issue.
- 19 Each of the appellants signed a contract with Services Sanitaires R.S. inc. whereby it undertook to deliver pick-up and transportation services identified in the appendix to the contract.
- 20 The income of each of the appellants for the years at issue came entirely from EBI.

STRUCTURE OF THE COMPANIES

- 21 During the years at issue, EBI was the appellants' sole client.
- 22 During the years at issue, the appellants' address was 61 Montcalm Street, Berthierville, P.O. Box 120, that is, the same as EBI's address.
- 23 During the years at issue, the appellants' financial statements and tax returns were prepared by Pontbriand, Roy, Éthier, that is, the same firm that prepared them for EBI.
- 24 During the years at issue, the appellants' bookkeeping and remittances were done by Monique Grégoire, an employee of Les Services Administratifs PRE inc. (PRE).
- 25 Ms. Grégoire works in the offices of , at 61 Montcalm Street in Berthierville.
- 26 Ms. Grégoire was designated as a contact person for the purposes of tax, income tax and source deductions for each of the garbage collector's companies.
- 27 During the years at issue, the appellants paid to the corporation and claimed as operation expenses \$300 per month in professional fees for the services performed by Monique Grégoire and Pontbriand, Roy, Éthier.
- 28 EBI assumes the insurance and licensing for its trucks. Part of the insurance expenses is billed to the appellants by EBI based on the truck rental contract.
- 29 The appellants pay for the fuel and for regular maintenance of the vehicle.
- 30 The appellants have taken out a health insurance policy provided by the Comité paritaire des boueurs specifically designed for garbage collectors.
- 31 Time sheets are completed by the garbage collectors.
- 32 Jean-Rock Bernèche, Jocelyn Vincent, Jean Houde, Richard Arnold, Jacques Bell and Roger Douaire became employees of EBI when they were no longer shareholders of the appellants.

Additional facts from testimony

[12] The following people testified at the hearing for the appellants: Pierre Sylvestre, President of EBI; Arthur Pontbriand, a member of the chartered accountants' firm Pontbriand, Roy, Ethier s.e.n.c.; Jocelyn Vincent, driver of a

roll-off truck; Jean-Rock Bernèche, dispatcher at EBI since 2008; Guy Brissette, Director General of the Comité Paritaire des Boueurs de la Région du Richelieu; Alain Senneville, Operations Coordinator at EBI; Richard Arnold, driver of a front-loading truck; Jean Houde, driver of a rear-loading truck who had an employee under his supervision; Serge Brière, Director General of EBI and Monique Desrochers Grégoire, an employee of Services Administratifs PRE Inc.

[13] For the respondent, only Johanne Desmarais, delivery officer at the Canada Revenue Agency (CRA) testified at the hearing. She processed the Notices of Objection filed by the appellants.

[14] EBI is a wholly owned subsidiary of Gestion Bayonne Inc., a Canadian-controlled private corporation belonging to the four (4) Sylvestre brothers (Pierre, Michel, Bernard and René). Services Administratifs PRE Inc. is held 50% by Gestion Bayonne Inc., while the other 50% is held by 3099-012 Québec Inc., a management company belonging to Arthur Pontbriand, Denis Roy and Sylvain Ethier. Since 2008, that is, when the companies' structure was dissolved following the CRA's audit, Services Administratifs PRE Inc. has held all of the appellants' shares. During the years at issue, Services Administratifs PRE Inc. held all of the shares of 9074-2073 Québec Inc., which was in charge of personnel placement for the appellants.

[15] Pierre Sylvestre explained the proposal to become a self-employed driver was put to about forty good drivers recognized for their reliability and their quick work. For EBI, this resulted in an economic benefit of about 15% to 20%, mainly due to a reduction in payroll taxes. For the drivers, the proposed structure enabled them to benefit from a 15 to 20% pay increase and to be assured of an annual rather than seasonal contract. With regard to disadvantages, the drivers lost benefits flowing from their employee status and had to assume the costs of the operation and maintenance of the trucks put at their disposal by EBI and the administrative costs of the companies belonging to them.

Role of Les Services Administratifs PRE Inc. (PRE)

[16] PRE dealt with all of the administrative aspects of the companies belonging to the drivers.

[17] All of the appellants, with a few exceptions, were incorporated under Part 1A of the Quebec *Companies Act* by the notary Robert Williamson from

Boucherville. The authorized share capital included an unlimited number of voting, participating, no par value class A shares redeemable at the option of the company and an unlimited number of non-voting, non-participating, no par value class B shares with a non-preferential and non-cumulative dividend of 10% yearly, redeemable at the option of the company. The share capital issued and paid was at the outset generally comprised of 100 class A shares issued for a consideration of \$100. The companies' fiscal year ended on August 31 of each year. The driver to whom a company belonged was also the sole director of the company. The companies' incorporation fees were \$2,000 payable in 10 monthly instalments of \$200.

[18] With the help of Pontbriand, Roy, Ethier s.e.n.c., a chartered accountants' firm, PRE took care of bookkeeping, including records, preparing financial statements, federal and provincial tax returns for the companies and personal returns of their respective shareholders as well as preparing tax reports and T4 and T5 slips, declarations of dividends and share transfers. Pontbriand, Roy, Ethier invoiced PRE for the services it provided to it.

[19] PRE paid the accounts payable, cashed and deposited cheques payable to the companies and took care of inter-company billing.

[20] PRE also managed a pool of resource-persons to facilitate the replacement of drivers who were on vacation or sick and to replace employees who worked on rear-loading trucks when they were absent. PRE paid directly the people whose services were used and billed the companies who used the services of those people.

[21] PRE billed each company \$300 per month in management fees.

[22] PRE had only one employee, namely, Monique Grégoire, and she worked from an office located at 61 Montcalm Street in Berthierville, that is, at the same address as EBI. Ms. Grégoire was supervised by Arthur Pontbriand of the chartered accountants' firm Pontbriand, Roy, Ethier.

The standard contracts concluded by the garbage collectors' companies

[23] Each garbage collector's company signed a non-notarized contract with Services Sanitaires RS Inc., which was then assigned to EBI. All of the garbage collectors' companies signed the same contract; only the appendices were different to account for the type of truck used by the company and to determine the price of the pick-up and transportation of garbage.

[24] Under the contract, the garbage collector's company undertook to rent the truck described in Appendix A of the contract, which belonged to Services Sanitaires RS Inc., was licensed in its name, covered by appropriate insurance and used to provide services to the clients of Services Sanitaires RS Inc. The garbage collector's company was required to leave on the truck the signage that Services Sanitaires RS Inc. installed on it.

[25] The garbage collector's company was entirely responsible for ensuring that the truck was maintained and in good condition, repaired and filled up with fuel at a garage recognized and approved by Services Sanitaires RS Inc and parked in the place indicated by Services Sanitaires RS Inc. The garbage collector had to drive the truck himself at all times and could be replaced only in emergencies and with the consent of Services Sanitaires RS Inc. Services Sanitaires RS Inc. had the right to inspect the truck in order to ensure that it met its requirements and legal requirements.

[26] The garbage collector's company undertook to conduct service calls in accordance with instructions and terms and conditions that could be occasionally revised by the parties. If a garbage collector's company was for any reason whatever unable to complete the pickup and transportation of garbage, Services Sanitaires RS Inc. could take any measure it deemed appropriate to provide the service even if that measure resulted in a pecuniary loss to the garbage collector's company. None of the contract's clauses should be interpreted as a guarantee by Services Sanitaires RS Inc. of any volume of work to be given to a garbage collector's company.

[27] The garbage collector's company picked up and transported garbage as an independent contractor, and as such, it was responsible (i) for any damage or harm to third parties or to the truck when damage to the truck resulted from its negligence or that of its employees; (ii) for continuously holding an insurance policy for general and professional civil liability; and (iii) for holding all licences, certificates and authorizations required by law in order to perform the operations and services set out in the contract.

[28] The contract provided for the deposit by the garbage collector's company of \$7,000 as a security to protect Services Sanitaires RS Inc. against any loss and/or damage to the truck supplied to the garbage collector's company or to guarantee for any amount that could be owed to it by the garbage collector's company and in order for the garbage collector's company to meet its contractual obligations.

[29] The contract included a non-competition clause, a non-assignment clause, except with the written consent of the co-contractor, and termination clauses, one of which allowed the contract to be terminated by either party upon four weeks' notice.

[30] The cost of the services rendered by the garbage collector's company was payable monthly by Services Sanitaires RS Inc., that is, no later than the 15th day of each month for the services rendered the previous month.

[31] The garbage collector personally signed the contract and gave an undertaking to Services Sanitaires RS Inc., as a solidary co-debtor together with his company to meet each and every obligation that the garbage collector's company had agreed to perform and fulfill under the contract.

Modus operandi of the garbage collectors' companies

[32] Jocelyn Vincent, a driver of a roll-off truck used to transport large containers, explained that he would go to EBI's garage at about 6 a.m. to pick up the truck and check its general condition, the motor-oil level and tire pressure. He would leave the garage at about 6:15 a.m. to do the assignments assigned to him by the dispatcher the day before. He would make 4 to 6 trips per day depending on the distances to travel. He did not have a regular route, and he often received assignments from the dispatcher through the truck's onboard communication system. He would come back to EBI's garage between 5:30 and 6 p.m., where he would refuel it and fill out a mechanical sheet and activity logs, which he would give every day to the dispatcher.

[33] For his services, he would receive advances from his company every week, which were based on the number of containers transported each week. Those advances would be given to him without source deductions. At the end of the company's fiscal year, the advances would be converted into dividends, which would be included in computing his income for the year.

[34] Mr. Vincent was a shareholder of 9016-9293 from 1995 to 2006, and he explained that, before he became a shareholder of that company, he had been an employee of a business bought by EBI and that he became an employee of EBI again in 2006 after he had sold the company to PRE. As an employee of EBI, he performed the same tasks that he had performed before as a shareholder of his company. He also acknowledged that he had not incurred any advertising expenses to increase his sales and that he had always been exclusive to EBI. When he was

sick or on vacation, the truck did not go out. He could not recall if he had used the resource-persons' pool to replace himself.

[35] Mr. Vincent's testimony was corroborated very largely by that of Jean-Rock Bernèche, another roll-off truck driver, who was a shareholder of 9016-9202 from 1995 to 2008. From 1982 to 1995, he was an hourly paid employee of Services Sanitaires RS Inc., and, starting in 2008, he became a dispatcher for EBI.

[36] For fiscal years ending on August 31, 2004, 2005, 2006, 2007 and 2008, the main operation expense items of his company were as follows:

	2004	2005	2006	2007	2008
	\$	\$	\$	\$	\$
Truck rental	20,710	19,685	22,895	21,600	850
Maintenance and repair	15,089	19,866	13,684	6,419	689
Fuel	13,198	12,689	13,887	13,178	511
Insurance	1,080	1,080	1,080	1,080	45
Contributions	2,667	2,667	2,267	2,667	2,500
Fees	3,600	3,600	3,600	3,600	3,600

[37] Mr. Bernèche explained that lost work hours were not paid and gave as an example the hours of waiting at the Sorel-Berthier ferry. The cost of the ferry was reimbursed by EBI, however.

[38] Alain Senneville, a driver of a rear-loading truck requiring an employee to handle garbage cans, was an employee of Services Sanitaires RS Inc. when he became a shareholder of 9017-6413 Québec Inc. He stopped being a shareholder of that company in 2008 and transferred his shares in the company to PRE without receiving consideration after it had been stripped of its assets. He became an operations coordinator at EBI.

[39] He prepared his timesheets daily and gave them to Ms. Grégoire at the end of each workday. The timesheets were used to prepare monthly billing at EBI. His assistant's salary was billed to EBI at a pre-established rate. He recruited his assistant himself from people he knew and he was not obliged to choose an EBI employee.

[40] The contact concluded between 9017-6413 Québec Inc. and EBI was a year-long contract and the routes were specified in an appendix to it as was the

yearly billing for each route. The prices paid by municipalities could vary from one year to the next. The garbage collection days were five working days from Monday to Friday.

[41] Mr. Senneville's testimony was largely corroborated by the testimony of Jean Houde, another former employee of Services Sanitaires RS Inc., who incorporated 9017-6298 in 1995. The truck he rented was a rear-loading truck operated with an assistant. He rented additional trucks in the spring and fall to complete his routes. He took four to five weeks' vacation per year and he was replaced by other drivers, who were mainly employees of EBI. When he was absent, he had to inform Ms. Grégoire at least 24 hours in advance.

[42] The routes he was responsible for occupied him five days per week, and he was paid in dividends. The company's operations ceased in 2009, and his shares were transferred to PRE without consideration.

[43] Mr. Senneville's and Mr. Houde's companies are part of group B of companies whose cases are on appeal.

[44] Richard Arnold, a former employee of Services Sanitaires RS Inc. since 1993, also testified at the hearing. He became an independent garbage collector in 1997 following the creation of 9046-0221, a company from group C, which has 3 files on appeal.

[45] His company's activities consisted in emptying dumpsters as a sub-contractor for EBI. It was an annual contract renewable every year. The truck rented from EBI was front-loading that did not require an assistant. The truck was parked at the MPC garage in Tracy, not at EBI's garage in Berthierville. The truck was also repaired at the MPC garage and the fuel was bought at a Shell station in Sorel.

[46] The price of the services rendered by 9046-0221 was based on the loading of each dumpster.

[47] The timesheets prepared by the witness were given each day to Robert Mandeville, an EBI employee, and were used to prepare EBI's monthly billing.

[48] His company served 536 commercial clients of EBI located on the south shore of the St. Lawrence every week. The garbage collector had to cross the river

four times per day to empty the dumpsters into EBI's landfill. The cost of the ferry was assumed by EBI. EBI also paid for a cell phone given to the witness.

[49] Mr. Arnold remained a shareholder of his company until August 31, 2010, on which date he again became an employee of EBI, and was again paid an hourly wage and served the same clients with the same truck.

Contribution to the Comité Paritaire des Boueurs

[50] The Comité Paritaire manages a mandatory group insurance plan for employees in the industry whose contributions are paid by employers. The plan is optional for self-employed workers. Since 2003, the industry did business with 180 self-employed workers, only 30 of whom were using the group insurance plan. The interposition of a company did not affect the self-employed status of the workers who joined the plan. The premium payable for a worker, which was paid as a dividend, was \$25 per month. The current monthly premium for employees is \$350. A self-employed worker who was a plan member benefited from long-term wage insurance up to age 60.

[51] The Comité Paritaire established the conditions of employment including remuneration for workers who were subject to the order, namely, employees who had worked 350 consecutive hours in a quarter. The order set out a base salary of \$17 to \$18 per hour, with time and a half paid after 40 hours of work from Monday to Saturday and double time on Sundays.

End of the companies' operations

[52] All activities of the companies ceased on August 31, 2010, with the cancellation of the truck rental contracts.

[53] At the end of operations, the goal was to distribute the net value of each company's assets in the form of dividends after the accounts payable were paid to suppliers. Each company's shares were acquired by PRE for a consideration of \$1. Some companies, including that of Jean Houde, had a deficit when they closed. The deficit amounts were not claimed from the garbage collectors because they were mainly attributable to mechanical failures or compensation guarantees.

Applicable law

[54] Subsection 125(7) of the Act provides that in cases where, but for the existence of the corporation, the incorporated employee would reasonably be regarded as an officer or employee of the corporation to which the services are provided, as opposed to a self-employed worker, the corporation must be considered a “personal services business” (PSB). More specifically, subsection 125(7) of the Act defines a PSB as follows:

125(7) Definitions — In this section,

“personal services business” carried on by a corporation in a taxation year means a business of providing services where

- (a) an individual who performs services on behalf of the corporation (in this definition and paragraph 18(1)(p) referred to as an “incorporated employee”), or
- (b) any person related to the incorporated employee is a specified shareholder of the corporation and the incorporated employee would reasonably be regarded as an officer or employee of the person or partnership to whom or to which the services were provided but for the existence of the corporation, unless
- (c) the corporation employs in the business throughout the year more than five full-time employees, or
- (d) the amount paid or payable to the corporation in the year for the services is received or receivable by it from a corporation with which it was associated in the year;.

[55] Paragraph 18(1)(p) of the Act limits the expenses that PSBs can deduct in the computation of their business income. Paragraph 18(1)(p) of the Act reads as follows:

18. (1) In computing the income of a taxpayer from a business or property no deduction shall be made in respect of

...

Limitation re personal services business expenses

(p) an outlay or expense to the extent that it was made or incurred by a corporation in a taxation year for the purpose of gaining or producing income from a personal services business, other than

(i) the salary, wages or other remuneration paid in the year to an incorporated employee of the corporation,

(ii) the cost to the corporation of any benefit or allowance provided to an incorporated employee in the year,

(iii) any amount expended by the corporation in connection with the selling of property or the negotiating of contracts by the corporation if the amount would have been deductible in computing the income of an incorporated employee for a taxation year from an office or employment if the amount had been expended by the incorporated employee under a contract of employment that required the employee to pay the amount, and

(iv) any amount paid by the corporation in the year as or on account of legal expenses incurred by it in collecting amounts owing to it on account of services rendered

that would, if the income of the corporation were from a business other than a personal services business, be deductible in computing its income;

[56] For the 2007 and 2008 taxation years, the CRA imposed penalties under subsection 163(2) of the Act the conditions for the application of which are as follows:

False statements or omissions

163(2) Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form, certificate, statement or answer (in this section referred to as a “return”) filed or made in respect of a taxation year for the purposes of this Act, is liable to a penalty of the greater of \$100 and 50% of the total of

...

[57] Since the contracts concluded between the garbage collectors’ companies and EBI and/or Services Sanitaires RS Inc. are governed by the Quebec civil law and since the concepts of contract of employment and of contract for services are not defined in the Act, we must refer to the *Civil Code of Québec* (the CCQ) in accordance with what is set out in the *Federal Law—Civil Law Harmonization Act, No. 1*, S.C. 2001, c. 4, and in section 8.1 of the *Interpretation Act*, R.S.C., 1985, c. I—21.

[58] More specifically, the definitions of the contract of employment and the contract for services found in articles 2085, 2098 and 2099 of the CCQ are relevant to this dispute. These provisions read as follows:

2085

A contract of employment is a contract by which a person, the employee, undertakes for a limited period to do work for remuneration, according to the instructions and under the direction or control of another person, the employer.

...

2098

A contract of enterprise or for services is a contract by which a person, the contractor or the provider of services, as the case may be, undertakes to another person, the client, to carry out physical or intellectual work or to supply a service, for a price which the client binds himself to pay to him.

2099

The contractor or the provider of services is free to choose the means of performing the contract and, with respect to such performance, no relationship of subordination exists between the contractor or the provider of services and the client.

Analysis

[59] Under the civil law of Quebec, the existence of a relationship of subordination is essential in order to find that a contract of employment exists.

[60] Subordination exists if the payer has the power of determining the work to be done, overseeing its performance and controlling it.

[61] It is not whether control has been exercised by the employer, or not, that matters; it suffices that the employer had the power to exercise it. That principle has been reaffirmed many times by the Federal Court of Appeal, for example, in *Gallant v. M.N.R.*, (1986) F.C.J. No. 330 and *Les entreprises une affaire d'anglais inc. v. M.N.R.*, 2008 TCC 524.

[62] The contract of enterprise is characterized by the lack of control by the client with regard to the performance of work. The provider of services is free to choose the methods of performing the contract.

[63] The criteria developed by the common law, namely, ownership of tools, expectation of profit, risk of loss and integration into the business may be useful in

qualifying a contract concluded under the civil law of Quebec because they constitute indicia of supervision among many others.

[64] However, the criterion of the intention of the parties to a contract does not need to be analyzed as to determination of the existence of a PSB. The leading cases on this point are, *inter alia*, 609309 *Alberta Ltd. v. Canada*, 2010 TCC 166, 1166787 *Ontario Ltd. v. Canada*, 2008 TCC 93, *Dynamic Industries Ltd. v. Canada*, 2005 FCA 211 and 758997 *Alberta Ltd. v. Canada*, 2004 TCC 755. This is because the concept of a PSB is an anti-avoidance provision aimed at denying the reduced small business corporate tax rate and associated tax deferral to certain corporations' businesses. The reduced rate and the sought-after tax deferral could not be achieved to begin with unless the parties intended an independent contractor relationship. The wording of the definition of a personal services business in subsection 125(7) requires a court to ignore the independent contractor relationship and make a reasonable guess but for the existence of the corporations.

[65] The question that the Court must raise at this stage is as follows: but for the existence of the corporations, would it be reasonable to consider that, during the 2004, 2005, 2006, 2007 and 2008 taxation years, there was a relationship of subordination between the incorporated garbage collectors and EBI?

Context

[66] At the outset, let us remember the context in which the system was set up. Before 1995, Services Sanitaires RS Inc. used only employees to collect garbage. In March 1995, Services Sanitaires RS Inc. decided that its garbage collectors should function as independent garbage collectors (i.e. as independent sub-contractors) and be incorporated; if not, Services Sanitaires RS Inc. would not sign service contracts with them. Services Sanitaires RS Inc. thus took the initiative to set up the system and had information sessions with the most reliable and most experienced truck drivers to convince them to incorporate. Arthur Pontbriand and Serge Brière, among others, took part in the information sessions.

[67] With the help of the chartered accountants' firm of Pontbriand, Roy, Éthier, its external auditors, Services Sanitaires RS Inc. took care of all of the administrative aspects of setting up the turn-key system. The garbage collector had to only sign the service contract with appendices, the truck rental contract, documents for incorporating the company and the bank documents for opening a bank account to be in business.

[68] All of the companies belonging to the garbage collectors had the same fiscal year ending on August 31 of each year and had only one shareholder and one director. The chartered accountants' firm of Pontbriand, Roy, Éthier prepared the financial statements, the companies' tax returns and the personal tax returns for almost all of the garbage collectors. Arthur Pontbriand insured that the garbage collectors' companies were in order.

[69] The appellants all had the same capital structure; they were created with a nominal capital investment and they were operated in the same fashion. The appellants had the same mailing address as EBI, and they all incurred the same administrative and insurance expenses.

[70] Following the reassessments made by the CRA, EBI decided to terminate the system, and all of the garbage collectors transferred their respective companies' shares to PRE without consideration, and most of them returned to work for EBI. EBI even had to assume some deficits owed to suppliers that existed when the shares were transferred.

Indicia of supervision

Powers of supervision and control

[71] In view of the evidence before me, it seems clear to me that the degree of control exercised by EBI over the appellants was significant and leads me to find that, but for the existence of the corporations, the garbage collectors would have been considered to be employees of EBI. In addition, the garbage collectors had been employees of Services Sanitaires RS Inc. or EBI, as the case may be, before they incorporated, and most, if not all, of them became employees of EBI again after the appellants' shares had been sold to PRE.

[72] The service contracts concluded by the appellants were *intuitu personae* contracts because the garbage collectors had to drive the trucks belonging to EBI themselves at all times and could only be replaced in emergencies with EBI's consent. This kind of contract normally shows an employer-employee relationship rather than a contractor-client relationship where the contractor is free to choose the means of performing the contract.

[73] During the years at issue, EBI required very detailed daily activity logs, which enabled it to know for each appellant the exact time when tasks were performed as well as the time required to perform them.

[74] EBI's supervisors ensured that the tasks assigned to each appellant were performed correctly. The supervision of the appellants' activities was no less significant than that exercised over the garbage collectors when they had been employees of EBI.

[75] The evidence showed that, during the years at issue, EBI monitored very closely the ownership, use and disposal of the garbage collection trucks, which were, no doubt, the main work tool of the appellants.

[76] The trucks used by the appellants all belonged to EBI and were leased to each of them. The appellants were required to use EBI's trucks to do the work that was assigned to them. Therefore, the appellants could not use their own trucks. According to some contracts concluded by EBI with its clients, EBI had to be the owner or lessee of a minimum number of trucks. The list of trucks had to be provided to the clients in question, and only those trucks could be used for the purposes of the contract. The contracts binding the appellants specifically provided that, even in case of a breakdown, they had to use EBI's rental equipment. The appellants had to keep on the trucks the signage installed by EBI.

[77] The appellants had to park the trucks in places indicated by EBI, namely, in almost all cases, at EBI's garage. The appellants had to have their trucks repaired and refuel them at garages recognized and approved by EBI. Insurance for the trucks was mandatorily purchased by EBI, which in turn required part of the premiums to be reimbursed.

[78] It is clear from the evidence that the appellants and their shareholders were under EBI's control with regard to freely disposing of the rental truck. There is no doubt that the appellants would not have had such a rental contract if they had rented the trucks from a third party rather than EBI.

[79] The restrictions imposed on the appellants with regard to the use of the trucks tend to show that the garbage collectors were not free to choose the means of performing the contract.

[80] The control exercised by EBI over the appellants applied even to the internal operations of the companies in the relationship between the companies and their employees. As part of the written agreements between EBI and the appellants, EBI insured that the appellants deduct from their own employees' salaries the source deductions prescribed by the Act. Under the standard contract appended to the Notices of Objection, EBI had the right to make verifications regarding this and, if

the appellants had not made all of the source deductions, EBI had the right to withhold the payments owed to the appellants found at fault. I do not know any independent contractors who would accept that the payments of amounts owed to them be subject to such conditions.

Chance of profit and risk of loss

[81] The analysis of the facts shows that the chances of profit and risk of loss was rather low.

[82] The garbage collectors' investment in the appellants' share capital was of nominal value. The appellants' incorporation fees were advanced by EBI and then repaid by the appellants over a period of 10 months. EBI also advanced the funds needed for the appellants to operate in the first month of operations until they received the first monthly payment set out in the service contracts.

[83] The amounts to be collected were set in advance and the tasks to perform were determined by a year-long contract. Remuneration was paid periodically, namely, every 30 days, for a minimum of 50 hours of work per week, from Monday to Friday. The amount of the periodic payments was determined by EBI and the appellants could not, as a practical matter, negotiate the price.

[84] The appellants were bound by non-competition clauses prohibiting them from, among other things, soliciting clients in the territory served by EBI and its clients, and thus the appellants did not seek to operate their businesses for other clients in order to increase their profits. In addition, a clause of the standard contract signed by the appellants made any assignment or transfer of rights conditional on EBI's approval. The appellants could not sub-contract their contracts, which clearly shows that they were not free to choose the methods of performing the contract.

[85] The evidence has shown that the appellants' revenues did not change significantly since their incorporation and the only prospect of increasing the garbage collectors' income came from the tax benefits that such a structure permitted.

[86] With regard to risk of loss, the rental fees for the trucks, the cost of administrative services and insurance set in advance, at a fixed rate.

[87] Since the trucks did not belong to the appellants and since the cost of major repairs related to their normal use as well as part of the insurance fees for the trucks were assumed by EBI, the risk of loss was that much lower.

[88] The evidence has also shown that EBI paid for the ferry for the appellants as part of their tasks as well as for cell phones put at the garbage collectors' disposal.

[89] Sometimes, even the diesel used by the appellants' trucks was sold at a discount and was repaid by EBI. It was the same for the rental costs of trucks, which was charged back to EBI.

[90] The evidence also clearly showed that the appellants were all recovered by PRE even though several companies had significant deficits, which were never repaid by the garbage collectors. Those deficits were likely absorbed by EBI.

The appellants' integration into EBI's activities

[91] An analysis of the facts related to this case reveals a high degree of integration of the appellants into EBI's activities, which in itself shows the existence of a relationship of subordination.

[92] The most telling indication of the appellant's integration into EBI is, undoubtedly, the fact that the garbage collectors had been salaried employees of EBI before the appellants were incorporated and became employees of EBI once again after the years at issue. The appellants performed the same tasks as their respective shareholders had performed before using the same methods to perform them.

Conclusion

[93] In the light of the considerations examined as part of the indicia of supervision, it seems reasonable to me to conclude that, but for the existence of the appellants, their shareholders would have provided services to EBI as employees of EBI in 2004, 2005, 2006, 2007 and 2008, not as independent contractors operating their own businesses.

Penalties

[94] Contrary to the claims of the respondent's counsel, I do not believe that the Minister has discharged his burden of proving that the conduct of the appellants and their shareholders amounts to gross negligence based on wilful blindness.

[95] The appellants were informed that the CRA had rejected their Notices of Objection for the 2004, 2005 and 2006 taxation years only on May 5, 2010, that is, well after the appellants' tax returns for the 2007 and 2008 taxation years had been filed on the same basis as those for the previous years. In filing their tax returns for the 2007 and 2008 taxation years, the appellants and their shareholders had not been grossly negligent or willfully blind. The appellants and their shareholders had at that time been represented by competent professionals, namely, Jacques Pontbriand of the chartered accountants' firm of Pontbriand, Roy, Ethier, and Isabelle Pison of Spiegel Sohmer, and they were fully justified in trusting their advice when they filed their tax returns for the 2007 and 2008 taxation years.

[96] At no time had the appellants and their shareholders made false statements to the CRA. The sub-contractor system had lasted from 1995 to 2008, that is, for close to 13 years, for 9 of which the CRA did not dispute the structure in place. The assessments for the 2004, 2005 and 2006 taxation years did not include penalties, and the expenses claimed by the appellants were allowed by the CRA. Only in the assessments for the 2007 and 2008 taxation years were the appellants' expenses disallowed and penalties imposed. Taking these facts into account, I do not see how the Minister can claim in 2010 that the appellants and their shareholders have made false statements in filing their tax returns for the 2007 and 2008 taxation years.

[97] The only reason why the penalties were imposed seems to me to be to force the parties to put an end to their fiscal arrangements.

[98] For these reasons, the appeals from reassessments made in respect of the 2004, 2005 and 2006 taxation years are dismissed with costs. The respondent is entitled to one set of costs for all of the files on appeal and another set of costs for files 2010-2396(IT)G and 2010-2369(IT)G, for which discontinuances were filed the day before the trial. The respondent is also entitled to disbursements for all of the files, including those that had been discontinued.

[99] The appeal from the reassessments made in respect of the 2007 and 2008 taxation years are allowed without costs and the reassessments are referred back to the Minister for reconsideration and reassessments in order to cancel the penalties.

Signed at Ottawa, Canada, this 25th day of September 2014.

“Réal Favreau”

Favreau J.

Translation certified true
On this 19th day of February 2015

François Brunet, Revisor

APPENDIX

LIST OF GROUPS

GROUP A

9016-9202 Québec Inc.	2010-2326 (IT)G
9016-9228 Québec Inc.	2010-2366 (IT)G
9016-9251 Québec Inc.	2010-2381 (IT)G
9016-9277 Québec Inc.	2010-2415 (IT)G
9016-9293 Québec Inc.	2010-2445 (IT)G
9016-9319 Québec Inc.	2010-2443 (IT)G
9080-7413 Québec Inc.	2010-2335 (IT)G
9082-6694 Québec Inc.	2010-2453 (IT)G
9120-2424 Québec Inc.	2010-2361 (IT)G

GROUP B

9017-6298 Québec Inc.	2010-2375 (IT)G
9016-9954 Québec Inc.	2010-2327 (IT)G
9017-6413 Québec Inc.	2010-2420 (IT)G
9017-6421 Québec Inc.	2010-2331 (IT)G
9086-4794 Québec Inc.	2010-2351 (IT)G
9017-6249 Québec Inc.	2010-2329 (IT)G
9017-6272 Québec Inc.	2010-2377 (IT)G
9017-6314 Québec Inc.	2010-2440 (IT)G
9017-6348 Québec Inc.	2010-2416 (IT)G
9017-6363 Québec Inc.	2010-2373 (IT)G
9017-6371 Québec Inc.	2010-2398 (IT)G
9017-6389 Québec Inc.	2010-2439 (IT)G
9091-0704 Québec Inc.	2010-2456 (IT)G
9101-7616 Québec Inc.	2010-2444 (IT)G
9129-5055 Québec Inc.	2010-2367 (IT)G
9129-5063 Québec Inc.	2010-2368 (IT)G
9129-5089 Québec Inc.	2010-2414 (IT)G
9071-0039 Québec Inc.	2010-2349 (IT)G
9071-0625 Québec Inc.	2010-2402 (IT)G
9071-0633 Québec Inc.	2010-2438 (IT)G
9086-4810 Québec Inc.	2010-2455 (IT)G
9063-7828 Québec Inc.	2010-2401 (IT)G
9074-2040 Québec Inc.	2010-2403 (IT)G

GROUP C

9046-0221 Québec Inc.	2010-2332 (IT)G
9038-0486 Québec Inc.	2010-2397 (IT)G
9073-0912 Québec Inc.	2010-2408 (IT)G

GROUP D

9069-1122 Québec Inc.	2010-2396 (IT)G
9120-2465 Québec Inc.	2010-2362 (IT)G

GROUPE

9120-2358 Québec Inc.	2010-2369 (IT)G
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CITATION: 2014 TCC 281

COURT FILE NOS.: 2010-2326(IT)G, 2010-2445(IT)G
2010-2375(IT)G, 2010-2332(IT)G

STYLES OF CAUSE: 9016-9202 Québec Inc.,
9016-9293 Québec Inc.,
9017-6298 Québec Inc.,
9046-0221 Québec Inc.,
v. Her Majesty the Queen

PLACE OF HEARING: Montréal, Quebec

DATES OF HEARING: June 11, 12, 13 and 14, 2013

REASONS FOR JUDGMENT BY: The Honourable Justice Réal Favreau

DATE OF JUDGMENT: September 25, 2014

APPEARANCES:

Counsel for the appellants: Aaron Rodgers
Bernard Larose

Counsel for the respondent: Anne Poirier
Simon Vincent

COUNSEL OF RECORD:

For the appellants:

Names: Aaron Rodgers
Bernard Larose

Firm: Garfinkle Nelson-Wiseman Bilmes
Rodgers, S.E.N.C.R.L. - L.L.P.
Montréal, Quebec

For the respondent: William F. Pentney
Deputy Attorney General of Canada
Ottawa, Canada

