

Federal Court
of Appeal



CANADA

Cour d'appel
fédérale

Date: 20090924

Docket: A-546-08

Citation: 2009 FCA 274

**CORAM: NOËL J.A.
NADON J.A.
PELLETIER J.A.**

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

PROPEP INC.

Respondent

Hearing held at Montréal, Quebec, on September 23, 2009.

Judgment delivered at Montréal, Quebec, on September 24, 2009.

REASONS FOR JUDGMENT BY:

NOËL J.A.

CONCURRED IN BY:

**NADON J.A.
PELLETIER J.A.**

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REASONS FOR JUDGMENT

NOËL J.A.

[1] This is an appeal from a decision by Justice Lucie Lamarre of the Tax Court of Canada (the TCC judge) setting aside the assessments issued against the respondent for the 1999 to 2003 taxation years, inclusive, which decreased or disallowed the deductions claimed under subsection 125(1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act).

[2] The Minister of National Revenue (the Minister) disallowed the deduction (commonly referred to as the “small business deduction”) on the ground that the respondent was associated with two other corporations, thereby sharing with these two corporations the amount of limit (referred to as the “business limit”) up to which this deduction may be claimed.

[3] The TCC judge found that the respondent was not associated with the two other corporations and therefore did not have to share this limit. According to the appellant, the opposite conclusion was warranted.

[4] The facts underlying the issue are described in a partial agreement as to the facts, which is set out in full below in the TCC judge’s reasons. It is sufficient for our purposes to note that, throughout the period in issue, all of the voting shares in the respondent’s capital stock were owned by 9059-3179 Québec inc. (9059), which in turn was owned by Fiducie Propep (the trust).

[5] This trust was incorporated in 1998 by Serge M. Racine, and its trustees were Pierre Paquette and Pierre Choquette, two persons dealing with each other at arm’s length. The two beneficiaries designated were 9059, the first-ranking beneficiary, and Pierre-Marc Paquette, born July 1, 1986, and the son of Pierre Paquette, the second-ranking beneficiary.

[6] Throughout the period in issue, PÉPinière Abbotsford inc., the first of the two other corporations considered to be “associated” for the purposes of the Act, was controlled directly or indirectly by Pierre Paquette and his father, Jean-Claude Paquette. Throughout the same period, the

other so-called “associated” corporation, Jardinage Abbotsford inc., was controlled by P epini ere Abbotsford inc.

[7] Given the share ownership in the corporations at issue and the resulting direct or indirect control, the parties agree that, if Pierre-Marc Paquette was a beneficiary of the trust, then the respondent was associated with the two other corporations, the corporations were therefore associated and the appeal should be allowed. Otherwise, the opposite conclusion is warranted.

[8] The TCC judge based her analysis on two paragraphs in the trust deed:

[TRANSLATION]

2.1.1 For capital and revenue: **First-ranking beneficiary:** 9059-3179 Qu ebec Inc., until it is wound up; **Second-ranking beneficiary:** Pierre-Marc Paquette, born 01-07-1986.

4.1 The Trustees shall hold the trust capital until such time as it is wound up. It may at any time pay to the Beneficiaries, or to one of them, all or part of the net annual income of the trust, in such proportions as it may in its absolute discretion establish. The Trustees shall also have the power, in their absolute discretion and at all times, to distribute all or part of the trust capital to the Beneficiaries. The Trustees shall accumulate and add to the trust capital all net income from the trust capital that has not been distributed in the year or within three months after the end of the trust’s year.

[9] According to the TCC judge, Pierre-Marc Paquette’s right was conditional on 9059’s being wound up. Until this condition was realized, only 9059 could have access to the trust’s income or capital, under the applicable civil law. Since 9059 still existed during the period in issue, Pierre-Marc Paquette’s right had not arisen, and Pierre-Marc Paquette was not a beneficiary.

[10] The Appellant maintains that, in saying this, the TCC judge misinterpreted the relevant provisions of the Act and the trust deed, and made various errors of law.

[11] The respondent submits that the TCC judge rightly concluded that it was not an associated corporation. Counsel for the respondent essentially relies on the TCC judge's reasoning.

STATUTORY PROVISIONS

[12] In her reasons, the TCC judge cited the following provisions:

256. (1) Associated corporations – For the purposes of this Act, one corporation is associated with another in a taxation year if, at any time in the year,

...

(c) each of the corporations was controlled, directly or indirectly in any manner whatever, by a person and the person who so controlled one of the corporations was related to the person who so controlled the other, and either of those persons owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof;

256.(1.2) Control, etc. – For the purposes of this subsection and subsections 256(1), 256(1.1) and 256(1.3) to 256(5),

256.(1) Sociétés associées – Pour l'application de la présente loi, deux sociétés sont associées l'une à l'autre au cours d'une année d'imposition si, à un moment donné de l'année:

[...]

c) la personne qui contrôle l'une des deux sociétés, directement ou indirectement de quelque manière que ce soit, est liée à la personne qui contrôle l'autre société, directement ou indirectement, de quelque manière que ce soit, et cette personne est propriétaire d'au moins 25% des actions émises d'une catégorie, non exclue, du capital-actions de chaque société;

256.(1.2) Précisions sur les notions de contrôle et de propriété des actions – Pour l'application du présent paragraphe et des paragraphes

(1), (1.1) et (1.3) à (5):

...

[...]

(f) where shares of the capital stock of a corporation are owned, or deemed by this subsection to be owned, at any time by a trust,

f) les actions du capital-actions d'une société dont une fiducie est à un moment donné propriétaire ou réputée propriétaire en application du présent paragraphe:

...

[...]

(ii) where a beneficiary's share of the accumulating income or capital therefrom depends on the exercise by any person of, or the failure by any person to exercise, any discretionary power, ... shall be deemed to be owned at that time by the beneficiary, except where subparagraph 256(1.2)(f)(i) applies and that time is before the distribution date,

(ii) sont réputées, [...], être la propriété à ce moment de chaque bénéficiaire dont la part sur le revenu ou le capital accumulés de la fiducie est conditionnelle au fait qu'une personne exerce ou n'exerce pas un pouvoir discrétionnaire,

[...]

...

256.(1.3) Parent deemed to own shares – Where at any time shares of the capital stock of a corporation are owned by a child who is under 18 years of age, for the purpose of determining whether the corporation is associated at that time with any other corporation that is controlled, directly or indirectly in any manner whatever, by a parent of the child or by a group of persons of which the parent is a member, the shares shall be deemed to be owned at that time by the parent unless, having regard to all the circumstances, it can reasonably

256.(1.3) Parents présumés propriétaires des actions des enfants – Les actions du capital-actions d'une société dont un enfant de moins de 18 ans est propriétaire à un moment donné sont réputées être la propriété à ce moment du père ou de la mère de l'enfant pour ce qui est de déterminer si la société est associée à ce moment à une autre société dont le père ou la mère ou un groupe de personnes dont le père ou la mère est membre a le contrôle, directement ou indirectement, de quelque manière que ce soit, sauf si, compte tenu des

be considered that the child manages the business and affairs of the corporation and does so without a significant degree of influence by the parent.

circonstances, il est raisonnable de considérer que l'enfant gère les affaires de la société sans subir, dans une large mesure, l'influence de son père ou de sa mère.

...

[...]

[Emphasis added.]

[13] It is also helpful to reproduce the definition of the expression “income interest” as defined at subsections 108(1) and 248(1) of the Act, as well as the definition of the expression “beneficially interested” at subsection 248(25):

108. (1) In this subdivision,

108.(1) Les définitions qui suivent s'appliquent à la présente sous-section.

...

[...]

“income interest”

« participation au revenu »

“income interest” of a taxpayer in a trust means a right (whether immediate or future and whether absolute or contingent) of the taxpayer as a beneficiary under a personal trust to, or to receive, all or any part of the income of the trust and, after 1999, includes a right (other than a right acquired before 2000 and disposed of before March 2000) to enforce payment of an amount by the trust that arises as a consequence of any such right;

« participation au revenu »

“income interest”

« participation au revenu » S'agissant de la participation d'un contribuable au revenu d'une fiducie, le droit, immédiat ou futur, conditionnel ou non, du contribuable à titre de bénéficiaire d'une fiducie personnelle à tout ou partie du revenu de la fiducie, ou de recevoir tout ou partie de ce revenu, y compris, après 1999, le droit (sauf celui acquis avant 2000 et dont il est disposé avant mars 2000), découlant d'un tel droit, d'exiger de la fiducie le versement d'une somme.

248. (1) In this Act,

...

“income interest”

« participation au revenu »

“income interest” of a taxpayer in a trust has the meaning assigned by subsection 108(1);

248.(25) **Beneficially interested** – For the purposes of this Act,

(a) a person or partnership beneficially interested in a particular trust includes any person or partnership that has any right (whether immediate or future, whether absolute or contingent or whether conditional on or subject to the exercise of any discretion by any person or partnership) as a beneficiary under a trust to receive any of the income or capital of the particular trust either directly from the particular trust or indirectly through one or more trusts or partnerships;

...

248.(1) Les définitions qui suivent s’appliquent à la présente loi.

[...]

« participation au revenu »

“income interest”

« participation au revenu » S’agissant de la participation au revenu d’une fiducie, détenue par un contribuable, s’entend au sens du paragraphe 108(1).

248.(25) **Droit de bénéficiaire** – Les règles suivantes s’appliquent dans le cadre de la présente loi:

a) comptent parmi les personnes ou sociétés de personnes ayant un droit de bénéficiaire dans une fiducie donnée celles qui ont le droit — immédiat ou futur, conditionnel ou non, ou soumis ou non à l’exercice d’un pouvoir discrétionnaire par une personne ou une société de personnes — à titre de bénéficiaire d’une fiducie de recevoir tout ou partie du revenu ou du capital de la fiducie donnée, soit directement de celle-ci, soit indirectement par l’entremise d’une ou de plusieurs fiducies ou sociétés de personnes;

[...]

[Emphasis added.]

ANALYSIS AND DECISION

[14] The TCC judge was required to interpret various provisions of the Act intended to prevent associated corporations from misusing the small business deduction. Her interpretation of these provisions had to be correct in law (*Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235). She also had to identify the legal effects of the trust deed according to its wording and the circumstances surrounding its execution. This aspect of the decision yields a question of mixed law and fact, regarding which this Court cannot intervene in the absence of a “palpable and overriding error” (*ibidem*).

[15] Under subparagraph 256(1.2)(f)(ii) of the Act, Pierre-Marc Paquette was deemed to be the owner of trust property to the extent that his share of the accumulating income or capital from the trust depended on the exercise by the trustees of any discretionary power. The TCC judge ruled that this provision did not apply because the trustees did not have the discretion to benefit Pierre-Marc Paquette during the period in issue, since his right was subject to a suspensive condition that had not yet been realized.

[16] According to the TCC judge, the discretion conferred on the trustees under the trust deed in favour of Pierre-Marc Paquette could not have been exercised before the realization of the first of the following two events: the winding-up of 9059, the first-ranking beneficiary, or the expiry of the period of one hundred years set out in article 1272 of the C.C.Q. (reasons, para. 40):

Pierre-Marc Paquette’s right to be a beneficiary of the trust, which is conditional on the winding-up of 9059, does not depend on a certain event, because no one could have predicted, at the point when the trust was created, whether it would materialize. The only certain thing is that 9059 will no longer be able to be a beneficiary in 100 years, but it is

entirely uncertain that 9059 will be wound up in Pierre-Marc Paquette's lifetime. Accordingly, I agree with counsel for the Appellant that we are dealing with a conditional obligation and not an obligation with a term, and Pierre-Marc's right will open only when 9059 is wound up, and not before.

[17] The TCC judge therefore concluded that, during the period in issue, the discretion given to trustees to distribute trust income or capital under clause 4.1 of the trust deed could be exercised only for the benefit of 9059. Thus, subparagraph 256(1.2)(f)(ii) did not apply to Pierre-Marc Paquette (reasons, paras. 43 and 44).

[18] Even assuming that Pierre-Marc Paquette's right was subject to a suspensive condition that had not yet been realized and that, according to the applicable civil law, Pierre-Marc Paquette was not a beneficiary of the trust—issues that this Court need not address and on which it expresses no opinion—the TCC judge seems to have lost sight of the fact that the trustees could, in exercising their discretion and at the time of their choosing, wind up 9059, thereby giving rise to Pierre-Marc Paquette's right as the sole beneficiary. I note that all of the capital stock of 9059 was part of the trust patrimony.

[19] It follows that, during the relevant period, the trustees could benefit Pierre-Marc Paquette in exercising their discretion. As a result, the shares of 9059 were deemed to be owned by Pierre-Marc Paquette, under subparagraph 256(1.2)(f)(ii), and therefore deemed to be owned by his father, under subsection 256(1.3).

[20] In any event, the TCC judge could not conclude that Pierre-Marc Paquette was not a beneficiary of the trust simply because his right was conditional on the winding-up of 9059. In so finding, the TCC judge failed to consider that, for the purposes of the Act, income interest in a trust, even when subject to a condition, is a right that is regarded as absolute. This follows from the definition of “income interest” at subsection 108(1) of the Act. It goes without saying that a person who has income interest in a trust is a beneficiary of that trust.

[21] By ignoring subsection 108(1), the TCC judge seems to have accepted the respondent’s argument that this provision only applies for the purposes of Subdivision k (respondent’s memorandum, para. 40). That is indeed the wording of subsection 108(1) (“In this subdivision” in the English version and “Les définitions qui suivent s’appliquent à la présente sous-section” in the French version). However, subsection 248(1), which defines this same expression for the purposes of the whole Act, (“In this Act” in the English version and “Les définitions qui suivent s’appliquent à la présente Loi” in the French version), adopts the definition given at subsection 108(1). Pierre-Marc Paquette therefore had “income interest” in the trust for the purposes of the Act, even though his right was contingent.

[22] The TCC judge also failed to consider the expression “beneficially interested” (“droit de bénéficiaire” in the French version) as defined at subsection 248(25). A taxpayer is deemed to be “beneficially interested” when that taxpayer has a right, “whether absolute or contingent”, to receive income or capital of a trust.

[23] The TCC judge seems to be of the opinion that this definition does not apply here because the expression “beneficially interested” is not used in either of the provisions dealing with associated corporations (256(1)(c), 256(1.2) and 256(1.3)) (reasons, para. 42).

[24] With respect, the expression “beneficially interested” does not have to be reproduced in each provision where it is likely to be applied. This concept applies each time the question arises whether a person is “beneficially interested” in a particular trust. A person who has a contingent right to the capital or income of a trust is “beneficially interested” for the purposes of the Act.

[25] For these reasons, I would allow the appeal with costs, set aside the TCC judge’s decision and, rendering the judgment that the TCC judge should have given, dismiss the appeal before the Tax Court of Canada with costs.

“Marc Noël”

J.A.

“I agree.

M. Nadon J.A.”

“I agree.

J.D. Denis Pelletier J.A.”

FEDERAL COURT OF APPEAL

SOLICITORS OF RECORD

DOCKET: A-546-08

(APPEAL FROM A JUDGMENT OF THE HONOURABLE JUSTICE LUCIE LAMARRE OF THE TAX COURT OF CANADA DATED OCTOBER 1, 2008, DOCKET NO. 2007-1882(IT)G)

STYLE OF CAUSE: Her Majesty the Queen and Propep Inc.

PLACE OF HEARING: Montréal, Quebec

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CONCURRED IN BY: Nadon J.A.
Pelletier J.A.

DATED: September 24, 2009

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