Docket: 2010-1719(IT)G

BETWEEN:

RENÉ LUPIEN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on common evidence with the appeal of *3775305 Canada inc.* (formerly Enduits LCR inc./LCR Coatings Inc.) (**2010-1720(IT)G**) on July 15 and 16, 2013, at Québec, Quebec and on December 3, 2013, at Montréal, Quebec, by the Honourable Justice Gaston Jorré and judgment delivered on January 5, 2016, by

The Honourable Associate Chief Justice Lucie Lamarre

Appearances:

Counsel for the appellant:	Jacques Demers
Counsel for the respondent:	Michel Lamarre

JUDGMENT

In accordance with the attached Reasons for Judgment, the appeal from the assessment made under section 160 of the *Income Tax Act*, notice of which is dated August 31, 2007, and bears number 47153, is dismissed with respect to its substance, but the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the assessment amount should have been $136,739.39 instead of $136,773.10. The taxation of one bill of costs is granted to the respondent in this case and in 2010-1720(IT)G.

Signed at Ottawa, Canada, this 5th day of January 2016.

"Lucie Lamarre"

Lamarre A.C.J.

Translation certified true
on this 27th day of June 2017

François Brunet, Reviser

Docket: 2010-1720(IT)G

BETWEEN:

3775305 CANADA INC.
(formerly Enduits LCR inc./LCR Coatings Inc.),

Appellant,

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Appeal heard on common evidence with the appeal of *René Lupien* (**2010-1719(IT)G**) on July 15 and 16, 2013, at Québec, Quebec, and on December 3, 2013, at Montréal, Quebec, by the Honourable Justice Gaston Jorré and judgment delivered on January 5, 2016, by

The Honourable Associate Chief Justice Lucie Lamarre

Appearances:

Counsel for the appellant:	Jacques Demers
Counsel for the respondent:	Michel Lamarre

JUDGMENT

In accordance with the attached Reasons for Judgment, the appeal from the assessment made under section 160 of the *Income Tax Act*, notice of which is dated August 30, 2007, and bears number 47152, is dismissed. The taxation of one bill of costs is granted to the respondent in this case and in 2010-1719(IT)G.

Signed at Ottawa, Canada, this 5th day of January 2016.

"Lucie Lamarre"

Lamarre A.C.J.

Translation certified true
on this 27th day of June 2017

François Brunet, Reviser

Citation: 2016 TCC 2
Date: 20160105
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REASONS FOR JUDGMENT

Lamarre A.C.J.

Introduction

[1] This is an appeal from the assessments under section 160 of the *Income Tax Act* (**Act**).

[2] The appellant 3775305 Canada inc., formerly Enduits LCR inc.\LCR Coatings Inc. (**LCR**), was the subject of an assessment for $136,739.39 on the ground that the company Revêtements Antoni Coatings inc. (**Antoni**, now M.C.D. Wood Finishings inc.), with which it had a non-arm's length relationship,

apparently transferred $185,837.14 to it, without giving consideration equivalent to that transfer.

[3] According to the Minister of National Revenue (**Minister**), Antoni paid $478,845.99 to LCR in the following manner. Antoni paid $300,000 by promissory note in addition to assuming the liabilities of LCR worth $178,845.99, while the value of the assets that it apparently acquired from LCR was only $293,008.85. However, on June 30, 2002, at the time of the transfer, Antoni had a tax debt of $136,739.39.

[4] The appellant René Lupien is the shareholder and sole director of LCR. He has a non-arm's length relationship with LCR. He was the subject of an assessment for $136,773.10 on the ground that he apparently received, in 2003 and in 2004, dividends from LCR exceeding $185,837.14. However, according to the Minister, LCR still had, at the time when the dividends were paid, a tax debt of $136,739.39, with the result that René Lupien is jointly and severally, or solidarily, liable with LCR for that unpaid tax. The difference between the amount of the assessment, that is, $136,773.10, and LCR's tax debt of $136,739.39 is unexplained. It was likely an error made in the course of the assessment and must be corrected.[1]

[5] The appellants submit that they cannot be held jointly and severally liable under paragraph 160(1)(*e*) of the Act because the Minister should have allocated a value of at least $185,837.14 to LCR's goodwill at the time of the transfer of its assets to Antoni. The Minister submits that LCR had no goodwill. The appellants do not dispute any other conditions for the application of section 160.

[6] If LCR is correct, it had no tax debt when the dividends were paid to René Lupien and the two appeals will have to be allowed. If there was goodwill, but the value of the goodwill was less than $185,837.14, the appeals will have to be allowed in part to the extent that the goodwill exceeded $49,097.75, that is, the difference between $185,837.14 and $136,739.39. If there was no goodwill, or if there was goodwill but the value of the goodwill was less than $49,097.75, the appeals will have to be dismissed.

[7] There are two issues. First, did the appellant 3775305 Canada inc., formerly LCR, have goodwill on June 30, 2002? Second, if there was goodwill, what was its value?

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[1] See the second page of René Lupien's assessment in Exhibit A-1, Tab 2, second page.

[8] The following individuals testified: Normand Guindon, the former president of Chemcraft International inc., including during the relevant period in this dispute; Claude Lupien, the owner of Antoni and the brother of René Lupien; Bernard Côté, a chartered accountant who, during the relevant period in this dispute, was given the mandate to audit Antoni and LCR; Denys Goulet, a member of the Canadian Institute of Chartered Business Valuators, a witness for the appellant; and Lucie Demers, also a member of the Canadian Institute of Chartered Business Valuators, an employee of the Canada Revenue Agency (**CRA**). Denys Goulet and Lucie Demers testified as expert witnesses. Bernard Côté testified as a fact witness.

[9] The appellant René Lupien did not testify.

[10] Many documents were filed in the record upon consent.

[11] The appeals were heard on July 15 and 16, 2013, and on December 3, 2013, by Justice Jorré. The parties accepted by letter dated July 14, 2015, that the determination of the appeals would be rendered by another judge of the Court on the basis of the transcripts and exhibits in the Court records.

The facts

[12] In 1990, Antoni was created by Claude Lupien, who indirectly holds 100% of the shares of Antoni, a company that manufactures lacquers and develops varnishes and stains.

[13] In 1993, René Lupien started working as Antoni's controller and he was also its director.

[14] Before creating Antoni, Claude Lupien was the shareholder of a company in the Chemcraft group. Chemcraft worked in the same field as Antoni.

[15] An Italian company, Milesi Spa (**Milesi**), wanted to enter the Canadian and American markets.

[16] On May 15, 2000, an exclusive distribution agreement was signed between Antoni and Milesi. Antoni would import Milesi products and distribute them in Canada and in 23 states in the United States. A copy of that agreement is at Exhibit I-1, Tab 7.

[17] The terms of the agreement are not entirely clear as to its duration (section 4 on the second page). For example, the following sentence is difficult to understand: "[t]he present agreement will be renewed previous consent of the parts".

[18] It is also clear that there was an initial period of one year, that Milesi could end the agreement by simply providing notice after one year if Antoni was not selling the minimum quantities of products set out for the first year and that either party could end the contract at the end of the first year by providing three months' notice.

[19] For the rest, even though there is some ambiguity, it is clear from the other provisions in the agreement that before the end of January every year the parties had to agree on the target quantities of the products to be sold over the upcoming year, that one essential condition of the validity of the agreement was that Antoni had to reach the targets and that, if the targets were not reached, Milesi could end the contract by providing some notice.

[20] In summary, it seems that, in essence, there was an intention to renew the agreement each year. However, if the targets were not reached, Milesi could end the agreement. If the parties could not agree on the targets, the contract would end.

[21] In June 2000, René Lupien created LCR, and was its shareholder and sole director. He remained employed by and continued to be a director of Antoni.

[22] LCR and Antoni's fiscal years ended on January 31.

[23] Antoni mandated LCR to distribute Milesi products in Canada and in the United States. Antoni continued to manufacture, sell and distribute its own products.

[24] There was no written contract between Antoni and LCR regarding the distribution of Milesi products. Claude Lupien's testimony on that issue was vague and did not clarify, assuming that there was a contract, its terms. *Inter alia*, his testimony did not clarify whether it was determinate or determinable in duration or whether Antoni could end it at any time.

[25] The Minister assumed that LCR was operating its company on Antoni's premises and that it used Antoni's facilities, staff, equipment and accounting software. However, according to the evidence, René Lupien was both an employee

of LCR (the only employee) and of Antoni. Tab 11 of Exhibit I-1 shows the salaries René Lupien received from Antoni and LCR in 2000, 2001 and 2002.

[26] Antoni ordered products from Milesi, imported them, stored them on its premises and handled them. LCR distributed the products and was also in charge of after-sales services. It was only when LCR sold products that it purchased the corresponding quantity of products from Antoni. Antoni received a certain percentage as remuneration for its services. The Milesi products were therefore still owned by Antoni until LCR bought the products, at which point LCR became responsible for insuring them.[2]

[27] At times, in his testimony, Claude Lupien seemed to suggest that LCR took over the distribution contract between Antoni and Milesi and that before the sale to Chemcraft International inc. (Chemcraft), which I will discuss later, Antoni took back the contract. Factually, it is clear from the evidence that such was not the case. Antoni had always ordered products from Milesi to sell them to LCR.

[28] Antoni and LCR had representatives and distributors. They could sell products distributed by Antoni or LCR, but the Milesi products had to be ordered from LCR and, save some exceptions, non-Milesi products had to be ordered from Antoni.[3]

[29] In 2001, Normand Guindon, the president of Chemcraft, and Claude Lupien met at a trade show in the United States. Normand Guindon told Claude Lupien that Chemcraft wanted to buy Antoni. For Chemcraft, an essential element of the proposed transaction was the distribution of Milesi products.

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2 See pages 114 and 115 of the transcript. At page 114, Claude Lupien stated the following, in particular:

> [TRANSLATION]
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> The products that were imported from Italy were the property of Antoni Coatings and were stored in Antoni Coatings warehouses. When René made the sale, he had to, at that time, transfer that account receivable to L.C.R. The products were re-sold to consumers or manufacturers, if you will. That meant that at that time, any storage costs were normally absorbed by Antoni Coatings and not transferred.

3 Transcript, pages 164 to 168.

[30] Subsequently, on November 15, 2001, Chemcraft sent a letter of intent reflecting its interest. That letter did not mention LCR because at that stage Chemcraft did not know that LCR existed. The suggested purchase price for Antoni's shares was approximately $2.2 million and the value assigned to the goodwill was $1.2 million. There were also non-competition agreements to be signed by Antoni's directors and officers. Everything was subject to an audit. Chemcraft reserved the right to purchase assets instead of shares.

[31] After a careful audit, Chemcraft found out about LCR and wanted to acquire LCR and Antoni. Chemcraft wanted to acquire everything. A factor that pushed Chemcraft to want to acquire everything was the past legal dispute between it and Claude Lupien after the latter left Chemcraft. That legal dispute was settled out of court.

[32] A memorandum of understanding between LCR, Antoni and Chemcraft was signed on April 29, 2002. It provided that Chemcraft would purchase the assets of LCR and Antoni. The price was $2.2 million. It also provided that Claude Lupien would be employed by Chemcraft for a period of one year after the acquisition of Antoni and that Claude and René Lupien would have to sign non-competition agreements.

[33] Antoni bought LCR's assets through a contract signed on June 30, 2002.[4] The purchase price for the assets was $332,632.80. The price was to be paid in the following manner: Antoni had to assume the liabilities of $21,433.36 indicated in Annex B of the contract and also had to issue a promissory note for $311,199.44 to LCR. The contract itemized the goods purchased and their value in Annex A. Annex B itemized each liability and its value.

[34] No goodwill was included in the acquired goods itemized in Annex A. However, subsection 5.2 of the contract stipulates that LCR will change its name and will not use, in its name, or in the course of its operations, the words "REVÊTEMENTS ANTONI COATINGS INC." or "ENDUITS LCR INC./LCR COATINGS INC." It also stipulated that LCR will not use similar words. The contract also contained a price adjustment clause.

[35] After the signing of the contract on June 30, 2002, it was purportedly discovered that the liability amount declared in the contact had been understated by $157,412.63.

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4 Exhibit I-1, Tab 3.

[36] Indeed, Antoni had paid the LCR a total of $478,845.99 instead of the $332,632.80 stipulated in the contract. That amount was paid in the following manner: Antoni assumed LCR's liabilities for a total value of $178,845.99 and issued LCR a promissory note for $300,000 (not for the $311,199.44 set out in the contract).

[37] No new contract amended the contract dated June 30, 2002.

[38] In his testimony, Claude Lupien did not describe negotiations or discussions with his brother regarding the contract dated June 30, 2002, and did not explain how the brothers decided on the price of $332,632.80 stipulated in the contract. He also did not describe negotiations or discussions after June 30, 2002, with his brother regarding the increase in price, which went from $332,632.80 to the payment of $478,845.99. In cross-examination, he recognized that the two brothers discussed about an approximate figure of $300,000, subject to confirmation by the financial statements.[5]

[39] However, Claude Lupien explained why he was of the view that a price of $478,845.99 was warranted. According to him, that price of $478,845.99 was warranted because it was close to a quarter of the price paid by Chemcraft, and LCR represented about 25% to 30% of the sales of Antoni and LCR combined.[6] However, it must be noted that as to gross sales, the financial statements for Antoni's 2002 fiscal year indicate sales of $3,584,650 whereas, as to gross sales, the financial statements for LCR's 2002 fiscal year indicate sales of $698,411, that is, a total of $4,283,061 for the two companies. LCR's sales represented about 16% of the total.[7]

[40] A few days before July 31, 2002, Normand Guindon went to Italy to personally meet the president of Milesi to ensure that Chemcraft would keep the exclusive right to distribute Milesi products in Canada and in the United States after purchasing Antoni. Mr. Milesi orally agreed that it would keep the

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5 Transcript, pages 136 and 142.

6 Transcript, pages 95, 132 and 133.

7 See the financial statements at pages 5-55 of Tab 5 and 9-12 of Tab 9 of Exhibit I-1. Antoni's sales of $3,584,650 do not include its sales to LCR—see Exhibit I-3. For the five months of LCR operations during the fiscal year ending in 2003, LCR had sales of about $290,000 whereas for the same five months Antoni had sales of about $1,721,000, a total of about $2,011,000 for the two companies. LCR's sales represented about 15% of that total of $2,011,000. Those amounts did not include the inventory on hand at the end of the five months. See Annexes 3.3 and 4.1 of Mr. Goulet's report, Exhibit A-5.

distribution if the sales targets were reached; Normand Guindon and Mr. Milesi shook hands.

[41] On July 31, 2002, Chemcraft bought Antoni's assets, including Antoni's product formulas, considering that Antoni had previously bought LCR's assets. The total purchase price was $2,697,248 ($2.2 million for the purchase of the assets and the rest for the assumption of liabilities) and $755,993 was attributed to goodwill.

[42] On July 31, 2002, René Lupien signed a non-competition agreement with Chemcraft. He did not receive any payment in exchange for that agreement. The agreement states that Chemcraft bought Antoni's assets and that part of the purchase price that Chemcraft paid to Antoni would allow Antoni to pay the promissory note to LCR.

Goodwill

[43] The Minister assumed, at paragraph 17(p) of the Reply to the Notice of Appeal in the two cases, that LCR received $185,837.14 more than the fair market value of the assets LCR had sold to Antoni.[8]

[44] That calls for two comments. First, on June 30, 2002, Antoni and LCR signed a contract for Antoni's purchase of LCR's goods for a price of $332,632. After the discovery that LCR had additional debts, Antoni paid a total of $478,845.99, an increase of about 44% with respect to the agreed price of $332,632, despite the fact that there was no other written contract that identified the purchase of an additional asset. Furthermore, the evidence did not show any negotiations between Claude and René Lupien on the increase in the amount paid by Antoni. That does not reflect the conduct typical of persons dealing with each other at arm's length.

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[8] This implies that the value of the assets listed in Annex A of the contract dated June 30, 2002, was $293,009 and not $332,632.80, as stated in the Annex. The difference between $293,009 and $332,632.80 comes from the fact that LCR, in filing its income tax return, declared the value of those assets at $293,009, including inventory valued at $139,077. During the presentation of evidence, everything proceeded on the basis that the only issue was whether there was goodwill valued at $185,837.14. The logical conclusion to draw from the evidence was that both parties agreed on the value of $293,009 for the assets described in Annex A of the contract dated June 30, 2002.

[45] Second, according to the appellants, the additional amount paid in excess of the agreed price ($332,632) in the contract dated June 30, 2002, was offset by the goodwill valued at between $150,000 and $200,000, according to Mr. Goulet's expert report. Given the importance now sought to be attributed to the goodwill, it is surprising to say the least that the list of assets in Annex A of the contract does not mention that goodwill.

[46] What is this goodwill? That is not clear. It could not have been René Lupien's personal goodwill, as LCR could not sell that.[9] Was it a contract? It could not be the contract with Milesi, as the evidence is clear Antoni is the one that had a contractual relationship with Milesi.

[47] Was it a contract between Antoni and LCR that stipulated that LCR would distribute Milesi products for Antoni? There is certainly a lack of evidence on this. If there was such contract, its value is impossible to determine without knowing its provisions. In particular, it would be fundamental to know the terms with respect to its duration. Was there a fixed term? Could the contract be terminated without notice, or was notice necessary? If so, what was the notice period? A company would not pay to end a contract if it could simply give the required notice under the contract.

[48] Claude Lupien's testimony and the documents do not contribute any information on any terms of such contract between Antoni and LCR for the distribution of Milesi products, assuming that such contract existed. René Lupien did not testify. The contract dated June 30, 2002, does not mention any such contract. Logically, the inference is that there was no need to mention it. Indeed, either there was no contract, or there was a contract that could be terminated without notice, or there was a contract and the necessary notice was given.

[49] According to the contract of sale dated July 31, 2002, between Chemcraft and Antoni, LCR had 18 clients or distributors. In comparing the lists of Antoni and LCR clients, it can be seen that 14 of LCR's clients were also Antoni's clients, including the two distributors Contemporary Furniture and Ferreira Pitts. Those two distributors were bound by a distribution contract with Antoni and those two contracts were part of what Antoni sold to Chemcraft. The contract of sale dated

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9 The non-transferability of personal goodwill is well settled. See paragraph 30 of *Placements A & N Robitaille Inc. v. Canada*, [1994] T.C.J. No. 612 (QL).

July 31, 2002, does not mention a distribution contract between LCR and Contemporary Furniture or between LCR and Ferreira Pitts.[10]

[50] In its first year, all of LCR's clients were also Antoni's clients.[11]

[51] Claude Lupien testified that Antoni was paid for the services provided to LCR in the form of a percentage of LCR's sales. LCR's financial statements indicate storage costs of $0, $69,095 and $14,440 paid by LCR to a non-arm's length company, Antoni, during the 2001, 2002 and 2003 fiscal years, respectively. The financial statements do not indicate any other expenses paid to Antoni. Those amounts are highly variable and are not a fixed percentage of LCR's sales.

[52] Bernard Côté is a chartered accountant and he was given the mandate to audit Antoni and LCR. He testified as a fact witness. He explained that he had assumed that the surplus of $185,837.14 paid to LCR in excess of the amount of $293,009 for the goods listed in Annex A of the contract was goodwill. At one point after July 31, 2002, after the two transactions, he did the calculation mentioned in Exhibit A-4. That calculation compares the relative profits of Antoni and LCR. Based on his calculation, he believed that an allocation to LCR of 25% in the amount of $775,993 paid by Chemcraft to Antoni for goodwill was reasonable.

[53] Mr. Côté's calculation merged the results for the 2002 fiscal year and the first five months of the following year, that is, the last five months of LCR's operations. For those 17 months combined, LCR received about 26% of LCR and Antoni's combined profits. However, looking at the 2002 fiscal year and at the first five months of the following year separately, it is apparent that during the 2002 fiscal year, LCR received about 40% of the combined profits, whereas for the first five months of the following year, LCR received only 12% of the combined profits.

Denys Goulet's expert report

[54] Mr. Goulet's mandate was as follows:

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10 See the contract dated July 31, 2002, between Chemcraft and Antoni at pages 5-91 (numbers 2 and 3), 5-106 and 5-107, Tab 5, Exhibit I-1.

11 The sales from the first year are in the financial statements (page 9-21, Tab 9, Exhibit I-1) and the list of clients is at pages 8-2 to 8-6, Tab 8, Exhibit I-1.

> [TRANSLATION]
>
> The goal of this report is to estimate the fair market value of the portion of goodwill paid by Chemcraft [$755,993], at the closing of the Transaction [between Chemcraft and Antoni], which was attributable to LCR's activities at July 31, 2002 . . . .[12]

Because some documents were missing and a lot of time had passed since the transaction, he did what is called an estimate of value report.

[55] Mr. Goulet determined that the transactions on June 30, 2002, and July 31, 2002, needed to be assessed as a whole and that the transaction on June 30, 2002, could not be assessed in isolation.

[56] Mr. Goulet is of the view, but did not consider this in his valuation, that Chemcraft was a special purchaser, that is, a purchaser that, for its own reasons, such as the possibility of achieving economies of scale, synergies or strategic advantages in the long term, would be likely to pay a premium to acquire a company. According to Mr. Goulet, he did not explicitly consider this, but it was a consideration that he had to keep in mind when it came to establishing the value,

[57] Mr. Goulet stated that, in the context of a business valuation, there must be consideration of the [TRANSLATION] "nuisance value", that is, a shareholder's ability to block a transaction, and because, according to him, René Lupien had such ability, he considered that element in his analysis.

[58] Mr. Goulet assumed, among other things, that

> [TRANSLATION]
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> 1. all of the remuneration paid to the officers of Antoni and L.C.R. and to members of their family, corresponded to that which a potential buyer of all of the outstanding shares of Antoni and L.C.R. would have had to assume globally;
>
> 2. the transactions between the non-arm's length parties, in particular the transactions between Antoni and L.C.R., were done on the same terms as those of the arm's length parties;

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12 Denys Goulet's expert report, Exhibit A-5, page 1.

3. there was an oral agreement between Antoni and L.C.R. according to which L.C.R. exclusively distributed Milesi products on behalf of Antoni; and

4. potential buyers of Antoni's shares or assets would continue to honour the Milesi product distribution agreement reached orally between Antoni and L.C.R. on the same terms as those that prevailed in the 2002 fiscal year and for a reasonable period of time.[13]

[59] There are four significant points that arise from Mr. Goulet's analysis: the fact that if Chemcraft did not acquire LCR, the transaction would fail; the fact that even if, contractually, the transaction was made through two separate documents, from a business perspective, there would only be one transaction; the fact that René Lupien did not receive any remuneration for his undertaking to not compete with Chemcraft; and the fact that the distribution of Milesi products was an activity that could very quickly be integrated into Chemcraft.

[60] Mr. Goulet opted to assess the portion of the purchase price attributable to LCR's goodwill using two market-based approaches: first, an analysis using the parameters of the transaction between Chemcraft and Antoni and, second, an analysis based on transactions of comparable public companies. He also used the performance-based approach and, more specifically, the method of capitalizing the representative net cash flow before carrying charges.

[61] The first market-based approach consisted in comparing the sales of Antoni and LCR together and the sales of Antoni alone, both for the 2001 fiscal year and for 2002. He found that profitability would have been different if LCR had not been included in Antoni and Chemcraft's transaction. Mr. Goulet therefore estimated, on that basis, that the value of LCR's goodwill was approximately between $175,000 and $245,000.

[62] The second market-based approach consisted in comparing the transaction between Antoni, LCR and Chemcraft with other similar transactions involving public companies active essentially in the same field. Mr. Goulet found that by buying both LCR and Antoni, Chemcraft paid about 34% less than if it had bought a public company directly, and he noted that that was normal because public companies are more substantial (in sales and size) than private companies. He therefore applied that reduction factor to the sales and determined that the fair

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13 Exhibit A-5, pages 7 and 8.

market value of LCR's goodwill on the valuation date was between $120,000 and $190,000.

[63] The last approach used by Mr. Goulet was to assess LCR's value on the basis of its own financial performance and he considered not only its past profits, but also its future profits. Using that valuation method, he found that the fair market value of LCR's goodwill on the valuation date was between $160,000 $ and $230,000.

[64] In the light of all of the results derived from the various methods applied, the fact that, according to him, René Lupien could have, at any time, terminated the transaction between Antoni and Chemcraft and the fact that he signed a non-competition agreement without provision for remuneration,[14] Mr. Goulet found that the fair market value of LCR's goodwill on the valuation date was in the range of $150,000 to $200,000.

Lucie Demers' expert report

[65] As to Ms. Demers, she provided another type of valuation report, a comprehensive valuation report, and determined the fair market value of LCR's goodwill as of June 30, 2002.

[66] Ms. Demers considered that there had been two transactions between the parties, an initial transaction between LCR and Antoni and a second transaction between Antoni and Chemcraft. She therefore took into account, in her valuation, only the facts pertaining to Antoni's acquisition of LCR.

[67] Ms. Demers assumed that there was no exclusive product distribution contract between Antoni and LCR and that in the event of a misunderstanding between the two brothers, the continuation of LCR's activities would be compromised. She accepted that hypothesis because, in an interview with René Lupien, he had told her that he was never told about the contract between Milesi and Antoni and that Antoni had not told him that there were product purchasing targets that had to be achieved in order for the contract to remain valid. Thus, if Antoni had given LCR the exclusive right to distribute Milesi products as claimed, Antoni would have, logically, provided LCR with the contract details.

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14 Mr. Goulet's report, Exhibit A-5, section 8.4, end of second paragraph.

[68] Ms. Demers does not believe that the transactions between Antoni and LCR took place under the same conditions as those between parties dealing with each other at arm's length. She gave the example that LCR had no line of credit because Antoni was financing it by not requesting inventory payments.

[69] Ms. Demers believes that the only reason Chemcraft wanted to acquire LCR at the same time as it acquired Antoni was that it did not want a repeat of the litigation that had occurred with Claude Lupien.

[70] Ms. Demers is not of the opinion that Chemcraft or Antoni was a special purchaser. To use that phrase, there would have needed to be, for example, another buyer that had wanted to acquire LCR and that other buyer would have had to be systematically acquiring distributors at that time. Furthermore, she stated that Chemcraft was indifferent to the structure of the sale, because it stated in the letter of intent and in the memorandum of understanding that it could buy the assets or the shares, whichever was most beneficial from a tax perspective.

[71] In her evaluation, Ms. Demers did not consider the presence of a "nuisance value" because Chemcraft did not necessarily need to acquire LCR to have the right to exclusively distribute Milesi products.

[72] Ms. Demers did not give weight to the non-competition agreement signed by René Lupien in determining the fair market value of LCR's goodwill because, in the letter of intent of November 2001, Chemcraft already stated that in exchange for the purchase price it wanted Antoni and Antoni's subsidiaries, officers and directors to sign a non-competition agreement, and René Lupien was one of Antoni's directors at the time.

[73] Ms. Demers used, for her analysis, the profit-based approach and, specifically, the capitalization of cash flow method.

[74] In examining the financial statements, she discovered that on June 30, 2002, LCR had made slightly lower sales than it had on the same date the year before. She therefore does not agree with the theory that LCR's sales were growing and that LCR's possible future profits needed to be considered in determining the value of the goodwill, particularly given that LCR was fragile as an entity because 82% of its sales came from only two clients and those clients were also clients of

Antoni,[15] or even because there was no stability in its expenditures (for example, the rental expenses in 2001 were $0 and, in 2002 they were $70,000). She also pointed out that LCR's profits were overvalued because it was not covering certain expenses that it was supposed to be covering, as Antoni was helping it. For all of these reasons, she concluded that LCR had no goodwill on June 30, 2002, and that LCR's only assets that could have been sold were cash, inventory and client accounts.

Analysis

[75] The Federal Court of Appeal discussed the nature of goodwill in *TransAlta Corporation v. Canada*.[16] At paragraphs 51 to 55, the Court stated:

> *The concept of goodwill*
>
> [51] The Tax Court judge relied on the following definition of goodwill set out by Lord Macnaghten in *Muller* at pp. 223-224:
>
> > What is goodwill? It is a thing very easy to describe, very difficult to define. It is the benefit and advantage of the good name, reputation, and connection of a business. It is the attractive force which brings in custom. It is the one thing which distinguishes an old-established business from a new business at its first start. The goodwill of a business must emanate from a particular centre or source. However widely extended or diffused its influence may be, goodwill is worth nothing unless it has power of attraction sufficient to bring customers home to the source from which it emanates. Goodwill is composed of a variety of elements. It differs in its composition in different trades and in different businesses in the same trade. One element may preponderate here and another element there. To analyze goodwill and split it up into its component parts, to pare it down as the Commissioners desire to do until nothing is left but a dry residuum ingrained in the actual place where the business is carried on while everything else is in the air, seems to me to be as useful for practical purposes as it would be to resolve the human body into the various substances of

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15 However, it must be noted that the percentage of 82% pertains to the year ending January 31, 2001 (pages 8-2 to 8-6, Tab 8, Exhibit I-1). Two distributors, Contemporary Furniture Hardware and Ferreira Pitts, made up approximately 82% of LCR's sales for LCR's first year ending January 31, 2001.

16 2012 FCA 20. See also *Manitoba Fisheries Ltd. v. The Queen*, [1979] 1 S.C.R. 101, and *Veuve Clicquot Ponsardin v. Boutiques Cliquot Ltée*, 2006 SCC 23, [2006] 1 S.C.R. 824, at paragraph 50.

> which it is said to be composed. The goodwill of a business is one whole, and in a case like this it must be dealt with as such.

[52] This definition was developed well over a century ago at a time when a client base and good reputation were understood as the principal elements of goodwill. Although this definition is still useful, important developments in the fields of business, accounting, valuation and law in the last century also need to be taken into account in order to better understand the modern concept of goodwill.

[53] As noted by Lord Macnaghten, goodwill is a concept which is difficult to define. It is composed of a variety of elements, and its composition varies according to different trades and different businesses in the same trade. Consequently, even after much study and numerous publications on the subject, a proper definition of goodwill has eluded both the legal and the accounting professions. Like the accounting profession, I conclude from this that any attempt to define goodwill is doomed to failure. Rather, various characteristics inherent to the notion of goodwill should be identified and then used to ascertain goodwill on a case-by-case basis.

[54] As noted at the outset of these reasons, three characteristics must be present in order for goodwill to be found: (a) goodwill must be an unidentified intangible as opposed to a tangible asset or an identified intangible such as a brand name, a patent or a franchise; (b) it must arise from the expectation of future earnings, returns or other benefits in excess of what would be expected in a comparable business; (c) it must be inseparable from the business to which it belongs and cannot normally be sold apart from the sale of the business as a going concern. If these three characteristics are present, it can be reasonably assumed that goodwill has been found: see John W. Durnford, "Goodwill in the Law of Income Tax" (1981), 29(6) Canadian Tax Journal 759 ("Durnford"), at pp. 763 to 775; see also *Muller* above; *Manitoba Fisheries Ltd. v. Canada*, [1979] 1 S.C.R. 101; *Dominion Dairies Limited v. Minister of National Revenue* (1965), 66 D.T.C. 5028 (Ex. Ct.); *Les Placements A & N Robitaille Inc. v. The Minister of National Revenue* (1994), 96 D.T.C. 1062 (T.C.C.); *FCT v. Murray* (1998), 155 ALR 67 (Aus. H.C.).

[55] An established reputation, customer satisfaction, a unique product or process leading to a monopolistic position, good or astute management, favourable location, manufacturing efficiency, harmonious labour relations, advertising, quality of products, and financial standing have all been found to constitute goodwill insofar as they meet the three characteristics: Durnford at pp. 772-773.

[76] It is apparent from what I just cited that goodwill is a whole that can consist of various elements. The existence of elements that would bring additional value to other acquired assets must be shown.

[77] In this case, the goodwill must be valued at at least $49,097.75 before the assessments at issue can be reduced.

[78] There is no doubt that Chemcraft wanted to acquire everything.

[79] According to the appellants, regard must be had to (i) the fact that there was, in reality, from an economic perspective, a single transaction, the transaction whereby Chemcraft bought Antoni and LCR, (ii) the leverage for Chemcraft, which resulted from combining the distribution of all of the products purchased with the distribution of its own products, (iii) the existence of an exclusive contract for the distribution of Milesi products in Canada and in the United States between LCR and Antoni, (iv) the reputation of the Milesi products, (v) LCR's "nuisance value" and (vi) the fact that goodwill is a whole, as held by the case law.

[80] While it is true that Chemcraft wanted to buy everything and that the transaction on July 31, 2002, was part of the context, Antoni and LCR were separate legal entities and the transaction on June 30, 2002, between those two companies was separate from the one on July 31, 2002, between Chemcraft and Antoni. It is necessary to examine the sale between Antoni and LCR separately.

[81] Factually, even assuming that there was a Milesi product distribution contract between Antoni and LCR, we do not have evidence on the terms of that contract. Claude Lupien could have testified on that point. He did not. René Lupien did not testify at all.

[82] The respondent asked the Court to draw a negative inference from the fact that René Lupien did not testify. In this case, regarding the terms of the contract that may have existed between Antoni and LCR, there should be a negative inference from René Lupien's absence of testimony.

[83] With respect to the possible need to prematurely terminate the distribution contract between LCR and Antoni, that would have needed to have been addressed in the contract dated June 30, 2002, and have been attached a value. The contract between Antoni and LCR did not impede the transaction with Chemcraft because it could be terminated without notice and because the notice period was very short and did not pose any problem. The consequence is that that contract also had no "nuisance value".

[84] More generally, on a practical level, LCR did not have a significant "nuisance" power for the following reason: Antoni could adversely affect LCR

more than LCR could adversely affect Antoni because LCR was almost completely dependent on Antoni. If Antoni had ended the distribution contract with LCR, LCR would have had nothing left to distribute.

[85] The reputation of the Milesi products certainly has a value, but the Milesi brand did not belong to LCR and could not create goodwill that belonged to LCR. The distribution contract was between Antoni and Milesi and not between Milesi and LCR. That contract also could not create goodwill belonging to LCR.

[86] The leverage raised by the appellants involves benefits from the common distribution of not only Milesi products, but also Antoni products, with products that Chemcraft already had. For Chemcraft, those benefits have a financial value. The logic of such argument is that the seller, being aware of the value of those benefits, may succeed in negotiating that it be paid a portion of that value. For LCR to negotiate a portion of that value, LCR would have had to have been able to block the transfer of the distribution of Milesi products to Chemcraft. For the above-mentioned reasons, LCR was not able to jeopardize the transfer. Antoni had the exclusive distribution contract with Milesi.

[87] The list of LCR clients was mentioned, but that list could not have substantial value given that the clients were almost all clients of Antoni, including the two LCR distributors, which were also distributors of Antoni.

[88] The appellants submitted that René Lupien signed the non-competition agreement without receiving direct remuneration, that that agreement alluded to the fact that René Lupien indirectly profited from Chemcraft's purchase of Antoni's assets because part of the price paid by Chemcraft allowed Antoni to pay the price to LCR for the purchase of its goods and that the memorandum of understanding dated April 29, 2002, provided for that non-competition agreement.

[89] All of that is correct, but that is no use to the appellants. Assuming that there was a substantial value to René Lupien's commitment to not compete with Chemcraft, LCR had no right that would have allowed it to sell René Lupien's personal commitment to any party.[17]

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[17] The situation here is very different from that of an individual who has an unincorporated business, who, at the same time, sells the business' assets and commits to not compete with the purchaser. Individuals can make such a commitment. In such a case, the commitment could constitute goodwill and a portion of the total price paid by the purchaser could relate to that goodwill, regardless of whether the purchaser is an

[90] I agree with the appellants that goodwill is a residual category of goods that can include several elements of a considerably varied nature. However, there must still be elements of goodwill.

[91] Factually, I am not convinced of the presence of elements of goodwill, with one exception, which I will address shortly.

[92] There is also another ground that leads to the same finding. The contract dated June 30, 2002, is very specific. Antoni bought the goods listed in Annex A. There is no mention in Annex A of goodwill or elements that can constitute goodwill.

[93] The appellants did not submit that there was a change to the contract, or a second contract, to purchase something else, and there is no evidence that there was a change to the contract or a second contract. Assuming, hypothetically, that there was substantial goodwill, LCR could not have sold Antoni that which was not set out in the contract dated June 30, 2002. It is worth bearing in mind that Antoni bought the assets, not the company LCR.

[94] As stated above, there is only one exception. Clause 5.2(c) of the contract dated June 30, 2002, states that LCR commits to changing its name and to no longer using that name. A name can constitute goodwill, but Antoni and LCR did not give it value in the contract dated June 30, 2002. They did not even mention the name in Annex A.

[95] Clause 2.1(n) of the contract dated July 31, 2002, between Chemcraft and Antoni gives, *inter alia*, Chemcraft the exclusive right to use the name LCR.

[96] What is the value of the name LCR? The factual evidence does not indicate that the name LCR could have significant value. The factual evidence is that the Milesi products were important for Chemcraft and, also, the Antoni products, including Antoni's formulas. When Chemcraft sent its letter of intent in November 2001, it did not know that LCR existed. The evidence does not support the finding that the name LCR had substantial value.

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individual or a company. In this case, not only did the contract dated June 30, 2002, not contain any non-competition agreement that Antoni could then resell to Chemcraft, but LCR had no right that would have allowed it to sell such commitment.

[97] In summary, the factual evidence does not show that there are elements of goodwill, let alone that there was at least $49,097.75 in goodwill value.

[98] Although I am of the opinion that that is unnecessary, before concluding, I will make a few comments on Mr. Goulet's expert report.

[99] Among the factors that have a significant impact on any expert report is the question put to the expert and whether the facts on which the opinion is based are accurate.

[100] Mr. Goulet's task was [TRANSLATION] "to estimate the fair market value of the portion of goodwill paid by Chemcraft Sadolin inc. on July 31, 2002, which was attributable to [LCR's] activities".[18] Although there is a connection, that was not directly the issue to be determined in this dispute. The issue here is: what is the value of the goodwill sold by LCR to Antoni?

[101] For the purposes of his analysis, Mr. Goulet assumed, in particular, that

> [TRANSLATION]
>
> 1. all of the remuneration paid to the officers of Antoni and L.C.R. and to members of their family, corresponded to that which a potential buyer of all of the outstanding shares of Antoni and L.C.R. would have had to assume globally;
>
> 2. the transactions between the non-arm's length parties, in particular the transactions between Antoni and L.C.R., were concluded on the same terms as those of the arm's length parties;
>
> 3. there was an oral agreement between Antoni and L.C.R. according to which L.C.R. exclusively distributed Milesi products on behalf of Antoni; and
>
> 4. potential buyers of Antoni's shares or assets would continue to honour the Milesi product distribution agreement reached orally between Antoni and L.C.R. on the same terms as those that prevailed in the 2002 fiscal year and for a reasonable period of time.

[102] I believe that those assumptions are not realistic in the factual circumstances of this dispute.

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[18] See the first page of Exhibit A-5. The reference to Chemcraft Sadolin inc. is erroneous because it was actually Chemcraft International inc. that bought Antoni.

[103] As for the first assumption, regarding remuneration paid in incorporated family businesses, there can be no assumption that remuneration paid to owners who are also directors or employees, including the remuneration LCR paid to René Lupien, is the same as that which the business would pay to an arm's length employee. For example, contrary to what happens when an arm's length individual is paid, sole owners who are employees can very well choose a lower salary for various reasons, such as tax planning, because they can subsequently be paid the resulting increase in profits in the form of dividends.

[104] Regarding the second assumption, Antoni and LCR were not operating under the same conditions as would be the case if they were dealing with each other at arm's length. That can be seen in the conduct after the sale on June 30, 2002, when, after discovering LCR's additional debt, Antoni simply increased the price paid.

[105] That can also be seen in the financial statements. Claude Lupien testified that Antoni was paid in the form of a percentage for the services provided to LCR. However, according to the financial statements, the fees paid by LCR to Antoni seemed to vary significantly from year to year, and it seems that the percentage varied from year to year with respect to sales. For the eight months of the 2001 fiscal year, LCR, which had sales of $165,000, paid Antoni nothing in storage fees, whereas, for the 2002 fiscal year, LCR, which had sales of $698,000, paid Antoni $69,000 in storage fees. For the five months of operations in the 2003 fiscal year, LCR, which had sales of $290,000, paid Antoni $14,400 in storage fees.[19] Between arm's length companies in the 2001 fiscal year, one company would not have rendered its services to the other company free of charge.

[106] Regarding the last two assumptions, as seen above, the contract between LCR and Antoni could not have value because it could be terminated quickly and it follows that there was no obligation to continue the contract.

[107] The financial statements do not faithfully represent LCR's profits if the transactions between Antoni and LCR and between René Lupien and LCR were not done under the same conditions as transactions between third parties, in particular regarding prices. Had it been necessary to consider the expert reports, since Mr. Goulet's estimates depended in large part on LCR's financial statements,

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19 See LCR's financial statements at Tab 9 of Exhibit I-1, especially pages 9-16 (footnote 5 regarding 2002 and 2001), 9-17 (second line regarding 2002 and 2001) and 9-8 (second line regarding 2003 and 2002).

in particular the profits stated therein, the consequence would have been that his calculations could not have been accepted as stated.[20]

Conclusion

[108] The evidence does not show goodwill elements that could have substantial value. What that value might be, it would fall very short of the threshold of $49,097.75, which is necessary before there can be a practical effect on the assessments. As a result, the appeals are dismissed with respect to their substance.

[109] However, as stated at the beginning of these reasons, René Lupien's assessment is a few dollars more than LCR's tax debt for unknown reasons. The appeal from René Lupien's assessment will be allowed only to correct this.

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[20] In her expert report, Ms. Demers made an adjustment to take into account the fact that the persons were not at arm's length. She thus adjusted René Lupien's pay. If, for example, René Lupien's pay had been adjusted by $35,000, in Mr. Goulet's calculations, its results would have been greatly impacted. In terms of principles, that is the proper procedure. However, it is unnecessary for me to rule on Ms. Demers' report.

Signed at Ottawa, Canada, this 5th day of January 2016.

"Lucie Lamarre"

Lamarre A.C.J.

Translation certified true
on this 27th day of June 2017

François Brunet, Reviser

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PLACE OF HEARING:	Québec and Montréal, Quebec)
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