Docket: 2013-705(IT)G

BETWEEN:

PAUL A. GOLINI JR. REPRESENTING
PAUL C. GOLINI BY POWER OF ATTORNEY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on November 2 to 6, 23, 24 and December 10, 2015, at Toronto, Ontario

By: The Honourable Justice Campbell J. Miller

Appearances:

Counsel for the Appellant:	Nathalie Goyette, Geneviève Léveillé, Laurie Beausoleil
Counsel for the Respondent:	Jenna Clark, Christa Akey, Alisa Apostle

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JUDGMENT

The Appeal is dismissed in accordance with the Reasons for Judgment.

The Parties are to file written submissions on costs within 60 days of this Judgment.

Signed at Ottawa, Canada, this 19th day of July 2016.

"Campbell J. Miller"

C. Miller J.

Citation:2016 TCC 174
Date:20160719
Docket: 2013-705(IT)G

BETWEEN:

PAUL A. GOLINI JR. REPRESENTING
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Appellant,

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REASONS FOR JUDGMENT

C. Miller J.

[1] Tax Planning – one side calls it "structured transactions", while the other side calls it "smoke and mirrors". Certainly there is a spectrum, and it is for me to determine where the Golini transactions fall on that spectrum.

[2] Mr. Paul C. Golini established a successful development business in conjunction with the Guizzetti family in the 1990's (a business that ultimately went on to operate under the name of Empire). Mr. Paul C. Golini, his son Paul A. Golini, Mr. A. Guizzetti and his nephews Dan and Andrew Guizzetti, were all integral parts of the business. Mr. A. Guizzetti died in 2001 triggering the family's realization that estate and shareholder planning was in order, specifically in connection with Paul C. Golini's transition into retirement.

[3] In the mid-2000's Empire advisors were consulted to consider retirement plans for Paul C. Golini. Initially a Retirement Compensation Arrangement ("RCA") was established followed by an estate freeze, followed by what was known as an RCA Optimizer Plan, the steps of which are summarized as follows:

i. Paul C. Golini incorporated a new holding company, 2161845 Ontario Inc. ("Holdco").

ii. Paul C. Golini exchanged shares of another of his holding companies, 1066167 Ontario Inc. ("Ontario Inc.") for shares of Holdco; the value of the shares of Ontario Inc. was not less than $6,000,000. An election was made by Paul C. Golini and Holdco under section 85 of the *Income Tax Act* (the "*Act*").

iii. Ontario Inc. borrowed $6,000,000 from DGM Bank, an offshore financial institution (the "bridge loan").

iv. Ontario Inc. redeemed the shares Holdco acquired from the Appellant directing the bridge loan proceeds to Holdco.

v. Holdco purchased an annuity that would pay it $400,000 annually for 15 years (the "annuity") by directing the $6,000,000 to St. Joseph's Assurance Company in Nevis.

vi. Holdco purchased a life insurance policy on Paul C. Golini's life from DGM Insurance Corporation an insurance company in Barbados by directing that the annuity company pay the $400,000 annual annuity to the insurer as the premium: the policy was to pay a death benefit of $6,000,000, which increased annually (the "Life Insurance").

vii. St. Joseph's Assurance and DGM Insurance acquired reinsurance on the annuity and the life insurance by directing $6,000,000 to another Barbadian company, Stellar Insurance.

viii. Stellar Insurance invested $6,000,000 with Trafalgar Holdings, a company in St. Vincent and Grenadines.

ix. Trafalgar loaned $6,000,000 to a Canadian company, Metropac Services Inc. a Canadian company incorporated for these transactions.

x. Metropac provided a $6,000,000 limited recourse loan to Paul Sr., guaranteed by Holdco for a fee of $40,000 a year, secured by Holdco's Life Insurance.

xi. Ontario Inc. amended its share capital to include an unlimited number of Class D preferred shares with a cumulative dividend preference.

xii. Paul C. Golini acquired 6,000,000 new Class D preferred shares of Ontario Inc. with a paid up capital of $6,000,000 for which he used the $6,000,000 loan from Metropac;

xiii. Ontario Inc. repaid the $6,000,000 bridge loan to DGM Bank.

[4] This is all shown schematically in Appendix A attached to these Reasons. Two of the results of the plan were, first, the ability of Paul Sr. to deduct interest on the Metropac loan from his RCA income and second, the increase in the paid up capital of shares held by Paul C. Golini in Ontario Inc.

[5] The Minister of National Revenue (the "Minister") has challenged the tax ramifications of the plan on several fronts:

i. The $6,000,000 Metropac loan to Paul C. Golini and/or each of the related transactions in the scheme were a sham such that Paul Sr. overstated his interest expense and carrying charges in respect of the loan and:

   a. failed to report a deemed dividend in the amount of $6,000,000; or
   b. failed to report a $6,000,000 benefit;

ii. In the alternative, the Minister properly included the amount of $6,358,626 as a taxable benefit in Paul Sr.'s income pursuant to subsections 15(1) or 246(1) of the *Act*;

iii. In the alternative, the loan and/or the Class D preferred shares were a "tax shelter" as defined in subsection 237.1(1) of the *Act*;

iv. In the alternative, the carrying charges claimed in respect of the loan were unreasonable in the circumstances; and

v. In the alternative, the tax benefits resulting from the series of transaction should be denied under subsection 245(2) of the *Act*, the General Anti-Avoidance Rules ("GAAR").

[6] It is helpful to describe at the outset the cast of characters in this arrangement:

- Paul C. Golini (“Paul Sr.”): the Appellant, currently suffering from Alzheimer’s disease and unable to testify, considered one of the founders of the Empire Community Group.

- Paul A. Golini (“Paul Jr.”): Paul Sr.’s son, who held common shares in Holdco.

- A. Guizzetti: a late contemporary of Paul Sr. and also one of the founders of the Empire Community Group;

- Andrew Guizzetti (“Andrew”): an executive vice-president and thereafter chief financial officer of the Empire Community Group and considered as the trusted financial advisor of Paul Sr.

- Dan Guizzetti: also an executive with the Empire Community Group.

- 1066167 Ontario Inc. (“Ontario Inc.”): the Golini family holding corporation of the interest in the active business of Empire Community Group.

- PGE Contracting Inc.: an operating company, part of the Empire Community Group, held 100% by Ontario Inc.

- 2161845 Ontario Inc. (“Holdco”): an Ontario company incorporated to serve as a holding company of the Golini family’s interest.

- Robert Young: an insurance agent familiar with the nature of the plan and serving as the Golinis’ and Empire Community Group’s advisor with respect to the insurance aspects.

- A. Etcovitch and C. Sharobim: the tax and commercial lawyer respectively with MacMillan Binch Mendelsohn, retained by Ontario Inc. and the Golinis with respect to these transactions.

- Aida Van Wees: a lawyer and owner of New Haven International Co., a business partner and, subsequently, wife of Robert Young and instrumental in the handling of documents and overall implementation of the transactions.

- New Haven International Co. (“New Haven”): a Canadian corporation owned and operated by Ms. Van Wees.

- Relius Global Corporation: a Canadian corporation owned by Robert Young to provide consulting services.

- Chris Potter: a tax accountant with PricewaterhouseCoopers retained by the Golinis and their companies.

- Heenan Blaikie: corporate counsel to the Golinis' corporations.

- DGM Bank and Trust Inc. ("DGM Bank"): a Barbadian bank providing the bridge loan to Ontario Inc.

- St. Joseph Assurance Company Ltd. ("St. Joseph"): a Nevis corporation providing the annuity to Holdco.

- DGM Insurance Corporation ("DGM Insurance"): a Barbadian insurance company providing the Life Insurance to Holdco.

- Stellar Insurance ("Stellar"): a Barbadian insurance corporation providing the reinsurance of the annuity and Life Insurance.

- Trafalgar Holdings LCC ("Trafalgar"): a St. Vincent and Grenadines corporation in which Stellar invested $6,000,000 that Trafalgar loaned on to Metropac.

- Metropac Services Inc. ("Metropac"): a British Columbia corporation incorporated by Dawn Wattie for purposes of these transactions.

- Dawn Wattie: a lawyer practicing in British Columbia and former friend of Aida Van Wees.

- Liza Harridyal-Sodha of Sodha & Associates ("Liza Law"): a lawyer with the Barbadian law firm acting as escrow agent for the handling of documents in connection with this transaction.

- K.N. Hyde & Associates ("Hyde"): a Barbadian law firm acting as escrow agent for the funds on behalf of DGM Insurance.

- Bruce Magwood: a Canadian chartered accountant working for Stellar and also a shareholder and director of St. Joseph's Assurance.

- BSD Consulting: company owned by Steven Parker to whom Robert Young directed annual fees from this transaction.

[7] The Appellant's case was presented through three witnesses, Paul Jr., Andrew and A. Etcovitch. Their explanations were consistent that the RCA Optimizer Plan was part of retirement estate planning, primarily for the transition out of the business by Paul Sr., though given how the RCA Optimizer Plan unfolded this motivation appears to have become less significant.

FACTS

[8] The Golini-Guizzetti families worked together since the late 1980's taking a land development business into home building and community development; indeed, going from a handful of employees to well over 200 by 2008. Upon the death of A. Guizzetti in 2001, it was apparent to Andrew that, while the business was flourishing, little or no attention had been paid to shareholder or retirement planning. It was time to do so for the families and especially for Paul Sr.

[9] Paul Sr. very much relied on Andrew for financial advice. A first move by the families was to switch from a small accounting firm to a major chartered accounting firm. Andrew approached PricewaterhouseCoopers in 2004 and developed a working relationship with a tax partner Mr. C. Potter. The business' legal advisors were Heenan Blaikie.

[10] The primary focus of the planning at this stage was on making appropriate retirement arrangements for Paul Sr. In this regard, an RCA was recommended and implemented in 2005, through the auspices of a Royal Bank Insurance product. This resulted in the first payment in 2008 of approximately $350,000. No evidence other than that was adduced with respect to the RCA.

[11] A second step in the overall planning was an estate freeze in late 2006. This freeze was to shift growth in the business from Paul Sr. to Paul Jr. and utilize Paul Sr.'s $500,000 capital gain exemption. Accordingly, Ontario Inc.'s articles were amended to authorize common shares, Class B preferred shares and Class C preferred shares. Paul Sr.'s 100 common shares were exchanged for 500,098 Class B preferred shares with a fair market value of $500,098, plus 1 common share, which was changed into 1,000 Class C shares redeemable at $5,598,000 and 100 common shares. Paul Sr. then gifted the 100 common shares to Paul Jr. At this stage the paid up capital of the shares held by Paul Sr. in Ontario Inc. was nominal.

[12] In 2007, Mr. Potter introduced the Golini and Guizzetti families to Robert Young, an insurance agent, self-described as "an insurance sales guy". Robert Young and Mr. Potter discussed a triple back to back possibility,

determining it was too costly to do in Canada, and would be more efficient to go offshore. Robert Young sought a Thorsteinssons' opinion. PricewaterhouseCoopers was retained to review the opinion and structure the plan on a tax effective basis. Andrew, Dan, and perhaps Paul Jr., were at an initial meeting where Robert Young explained the structured transaction forming the basis for the RCA Optimizer Plan. Robert Young testified he would have presented the plan at a high conceptual level. Paul Jr. understood the benefit to be a new class of cumulative shares that would accommodate a steady flow of income for Paul Sr.'s retirement. He also understood it involved the purchase of insurance and an annuity and an exchange of shares. At trial he suggested that PricewaterhouseCoopers had advised that after the RCA ran out, this would provide income for Paul Sr.: this information did not come out at Paul Jr.'s examination for discovery.

[13] Robert Young was subsequently retained by Empire through the auspices of his business partner, and later wife, Ms. Van Wees' company New Haven. By a letter of June 27, 2007 from New Haven to Empire, Ms. Van Wees confirmed that New Haven was engaged to:

a) Research and evaluate insurance structures both domestically and internationally;

b) Review and identify available sources of banking, insurance and annuities both domestic and international; and

c) Implement a structure.

Ms. Van Wees testified that New Haven knew nothing of tax planning arrangements but simply looked into the different insurance, annuities and loan facilities available and facilitated introducing the parties, ultimately ensuring everyone worked together. It was Robert Young who said he understood the fundamentals of the transaction.

[14] Andrew described the plan as necessary to replace the RCA which yielded insufficient income. Andrew viewed Robert Young's proposal as the use of a leveraged insurance product to result in shares with better attributes, primarily a cumulative dividend feature, though admitted no dividends have actually been paid on these new shares to date. Andrew also described the plan as not being a burden on the business. He recalled the only representations with respect to tax ramifications at this stage was in connection with the interest deductibility on the

loan Paul Sr. was to obtain from a Canadian lender, which he understood was to shelter the RCA income.

[15] It was clear Paul Jr. was not as intimately familiar with the plan as Andrew, who was viewed as the financial advisor in the business, certainly by Paul Sr. It was Andrew who valued Ontario Inc. at $6,000,000.

[16] Robert Young indicated that he had for several years designed non-traditional insurance plans, not seen in Canada. He acknowledged he had handled several, what he called, Corporate Equity Optimizer plans. He then suggested the plans were developed from the Canadian triple back to back plans that, according to Robert Young, were common in the Canadian insurance industry at the time. He stated their goal was to reduce taxable income, though also stated "he did not do tax *per se*". It was Robert Young who obtained tax opinions from Thorsteinssons, as he suggested the professionals to whom he marketed the plans required such opinions.

[17] Andrew was referred by Robert Young and Mr. Potter to Mr. A. Etcovitch at McMillan Binch Mendelsohn LLP ("MBM") who had familiarity with these plans. MBM was retained to review and act on behalf of the Golinis and their companies as a tax consultant in advising and documenting the plan on a tax effective basis. As Mr. Etcovitch put it, MBM was to assist in documenting the plan and advising as to tax, which he would look after and the commercial elements, which Mr. Sharobim would look after. He advised that he had previously worked on similar plans with Robert Young, who he referred to as a friend, though could not remember how many plans before and how many after the Golini plan. It was clear he had worked with many of the same offshore participants including Hyde and Liza Law.

[18] Mr. Etcovitch testified there was unlikely a written retainer with MBM. He also testified he provided no written description of the plan to his clients, suggesting it was too costly. He further indicated that he had seen a copy of a 40-page opinion from the Thorsteinssons law firm which had been provided to New Haven. There was considerable testimony with several witnesses as to whether the Golinis or Guizzettis ever saw the Thorsteinssons' opinion at the time. Both Robert Young and Mr. Etcovitch suggested they had not, Mr. Etcovitch describing the opinion as an interesting read for tax geeks such as himself, but not relevant to the Golini plan. Interestingly, however, the Thorsteinssons' opinion was listed on the Golini RCA Optimizer Plan closing agenda, but then at the tab where it was to appear there was a notation "intentionally omitted". Mr. Etcovitch was

adamant it was not to be relied upon by the Golini group, but they should rely on their advisors, MBM and Heenan Blaikie, as opposed to what he called a fictitious transaction. Robert Young testified that Mr. Etcovitch provided facts to him to pass on to Thorsteinssons for purposes of the opinion. Having reviewed the Thorsteinssons' opinions, there is a striking similarity with some of the Golini plan.

[19] Mr. Etcovitch stated he did not advise Paul Sr. with respect to the paid up capital in the Class D shares in Ontario Inc. upon subscription; according to Mr. Etcovitch there was no need to focus on that as it was an obvious conclusion of law. He did confirm that he discussed the risk of the GAAR but, as stated earlier, nothing was put in writing.

[20] I will now go through the transaction in greater detail though state at the outset that my clear impression from Paul Jr.'s, Andrew's, Mr. Etcovitch's, Robert Young's and Ms. Van Wees' testimony was that the Golinis and Guizzettis were entirely guided by their professional advisors as to the structure of the plan, and also as to who the participants were, including the lender of the bridge financing, the issuer of the annuity, the issuer of the insurance policy and the Canadian lender of $6,000,000 to Paul Sr. Indeed, Andrew testified he was led to believe that Robert Young had worked with Metropac previously. It was clear many of the players in the overall transaction, DGM, St. Joseph's, Stellar, Trafalgar and Metropac were chosen by, or set up for this very purpose by Robert Young and Ms. Van Wees through their contacts.

[21] I am also satisfied the families were not aware of the machinations that moved the $6,000,000 proceeds of the bridge loan from Ontario Inc. to St. Joseph's to DGM Insurance to Stellar to Trafalgar and into (and coincidentally out of) the hands of Metropac. Mr. Etcovitch acknowledged that all he was concerned about from his client's perspective was that ultimately Metropac had the $6,000,000 to loan to Paul Sr. More on that later when going over the escrow agreement.

[22] There was an extensive record book of closing documents prepared by MBM titled Paul C. Golini RCA Optimizer Transaction. It contained all the documents in connection with the plan except the offshore reinsurance with Stellar, the investment by Stellar in Trafalgar and the loan by Trafalgar to Metropac: these exceptions were part of a separate closing agenda prepared by Ms. Van Wees, relying it appears on the MBM template for the onshore agenda.

<u>Step 1</u> Incorporation of Holdco and amendment of articles

[23] The incorporation of Holdco was handled by Heenan Blaikie. It was incorporated January 29, 2008. Paul Sr. was issued 1 common share. He was the sole director. The articles were amended on February 26, 2008 to create Class B preferred shares to accommodate the rollover by Paul Sr. of his Ontario Inc. shares into Holdco.

<u>Step 2</u> Amendment of the Ontario Inc. share structure to create Class D preferred shares effective February 26, 2008

[24] This amendment was handled by Heenan Blaikie creating a class of shares with an 8.25% cumulative dividend rate. According to Mr. Etcovitch this was the class that would ultimately provide Paul Sr. with the retirement flow of income.

<u>Step 3</u> Transfer by Paul Sr. of 401,108 Class B shares and 1000 Class C shares of Ontario Inc. to Holdco for 401,108 Class B shares and 99 common shares of Holdco effective February 26, 2008

[25] The documents implementing this transaction (resolution of the companies, rollover agreement, certificates…) were tabled at closing by Heenan Blaikie. I should note that there was no physical, everyone in the room together, closing as such. All documents were simply circulated amongst the appropriate parties with the request to execute a number of copies leaving them undated. Mr. Etcovitch testified they would be dated when proceeds were in place and everyone knew that the plan would definitely be proceeding. As Mr. Sharobim explained in an email to the St. Joseph's representative February 27, 2008 forwarding an escrow agreement, direction to pay and notice of assignment, "dates of various documents are to be completed in accordance with the flow of funds".

[26] The transfer of Ontario Inc. shares was done on a subsection 85(1) of the *Act* rollover basis. Mr. Etcovitch described this as isolating $6,000,000 worth of shares into Holdco.

<u>Step 4</u> Loan of $6,000,000 to Ontario Inc. by DGM Bank, described as the bridge loan in the closing record

[27] While Heenan Blaikie prepared the corporate authorizing documents for this loan, MBM prepared and provided the loan agreement itself dated February 28, 2008 between DGM Bank and Ontario Inc. It also provided a disbursement direction letter from Ontario Inc. to DGM Bank directing the funds into the MBM trust account. The DGM Bank carried on business in Barbados and was

represented by its president, Rob Reid, and vice-president, Keiran Young. The bridge loan of $6,000,000 had an interest rate of 8% and was repayable not later than March 11, 2008. While there was no collateral, the following provision was part of the bridge loan:

> 5.2 The LENDER hereby represents and warrants to the BORROWER that the escrow agent selected by the LENDER will respect its obligations under the Escrow Agreement ("ESCROW AGREEMENT") dated February 27, 2008 between K.N. Hyde & Associates, Attorneys-at-Law ("ESCROW AGENT"), 2161845 Ontario Inc., Paul C. Golini, St. Joseph Assurance Company Ltd., Metropac Services Inc., McMillan Binch Mendelsohn LLP and Liza Harridyal Sodha & Associates and in the event the obligations of the ESCROW AGENT under the Escrow Agreement are not fulfilled, the BORROWER shall not be obligated to repay the LOAN to the LENDER.

[28] Mr. Etcovitch confirmed that it was Robert Young who chose this lending institution. The money was deposited in MBM's trust account February 28, 2008.

[29] Andrew testified this bridge loan was never recorded in Ontario Inc.'s general ledger.

<u>Step 5</u> Redemption by Ontario Inc. of 401,108 Class B preferred shares and 1000 Class C preferred shares held by Holdco effective February 28, 2008 for $6,000,000

[30] Robert Young testified he had no idea why this element of the Plan was included, but that it came from Mr. Etcovitch.

[31] Heenan Blaikie tabled the resolutions and share certificates necessary for the redemption of the Ontario Inc. shares held by Holdco. MBM prepared an irrevocable letter of instructions from Ontario Inc. to MBM as follows:

> <u>RE: SUM OF $6,000,000 HELD IN YOUR TRUST ACCOUNT</u>
>
> You are irrevocably instructed to attribute to the account of 2161845 Ontario Inc. the sum of $6,000,000 held by you in trust for the benefit of the undersigned in payment of the redemption price of 401,108 Class B preferred shares and 1,000 Class C preferred shares of the share capital of the undersigned held by 2161845 Ontario Inc.

[32] Mr. Etcovitch suggested MBM would sign a confirmation that funds were so attributed, though no such confirmation was produced. What was part of the closing agenda, however, was an escrow agreement between Paul Sr., Holdco, St. Joseph's, Metropac, Liza Law and MBM and Hyde. While getting a bit ahead of myself it helps explain what follows and it is therefore worth reproducing parts of that escrow agreement dated February 27, 2008:

> WHEREAS:
>
> A. Holdco wishes to purchase an annuity contract from Annuity Company for a purchase price of $6,000,000 (the "Annuity");
>
> B. The sum of $6,000,000 shall be ultimately transferred to Metropac;
>
> C. Metropac shall disburse the sum of $6,000,000 to Golini under a limited recourse loan agreement to be entered into between Metropac and Golini (the "Loan"), which Loan shall be guaranteed by Holdco;
>
> D. The parties wish that the sum of $6,000,000 representing the purchase price of the Annuity be transferred by MBM on behalf of Holdco to the Escrow Agent on account of Annuity Company, be ultimately attributed by the Escrow Agent, acting in accordance with the irrevocable instructions of Liza Law on account of Metropac and be disbursed by the Escrow Agent in accordance with the irrevocable instructions of Liza Law to Golini as disbursements of the Loan;
>
> NOW THEREFORE, in consideration of the mutual benefits and obligations contained herein and in the transactions between the parties, the receipt and sufficiency of which is acknowledged by all, the parties agree as follows:
>
> 1. The Escrow Agent shall act in accordance with the instructions of the parties provided herein only and of no other party in relation to the matters set out herein.
>
> 2. The Escrow Agent shall accept from MBM (acting on behalf of Holdco) the sum of $6,000,000 (to be held on behalf of Annuity Company) as payment to Annuity Company of the purchase price of the Annuity.
>
> 3. The Escrow Agent shall accept the irrevocable instructions from Liza Law to ultimately attribute to the benefit of Metropac the sum of $6,000,000 held by the Escrow Agent.

> 4. The Escrow Agent shall accept the irrevocable instructions from Liza Law to immediately disburse said sum to Golini as disbursement of the Loan.
>
> 5. All parties agree that in no event the sum accepted hereunder by the Escrow Agent shall leave its trust account other than to be transferred to MBM, for and on behalf of Golini in accordance with Section 4 above and this sum, notwithstanding any other direction or instruction contrary to those provided herein to be given at any time to the Escrow Agent by any of the parties hereto, should, in case of any conflicting instructions, be immediately returned to MBM in trust for Holdco, in which case the matters contemplated herein shall be deemed to be null, *ab initio*, provided that this shall be without prejudice to the continued operation of Sections 1, 2, 6 and 11 for the benefit of the Escrow Agent and MBM.

[33] The $6,000,000, indeed, followed exactly the requirements set out in this escrow agreement, leaving MBM's account briefly going to the Hyde trust account and on the same day that Hyde acknowledged receipt, March 3, 2008, the funds were returned to MBM's trust account, ultimately to be returned to DGM Bank to repay the bridge loan. It is understandable in these circumstances why DGM Bank required no collateral.

<u>Step 6</u> Purchase of annuity by Holdco from St. Joseph's: policy dated February 27, 2008

[34] Andrew could not recall any application for this annuity purchased by Holdco. Holdco authorized the Barbados law firm of Liza Law to file with St. Joseph's all documents necessary to acquire the annuity for $6,000,000. No such documents were in evidence or were part of the closing agenda. Notwithstanding the policy was dated February 27, 2008, its authorizing resolutions were dated February 28, 2008. As Mr. Etcovitch explained, this sometimes happens.

[35] Hyde confirmed with St. Joseph's and Liza Law receipt of the $6,000,000 from MBM on March 3, 2008 to be held as payment for the annuity. MBM tabled the documents for closing in connection with the annuity. The annuity policy described its investment fund as follows:

> The Investment Fund is a single or group of underlying investments that are not directly purchased by the investment performance of which will be mirrored in the Unit Value for each Policy. St. Joseph Assurance Company Ltd. will select the underlying investments and will ensure that the initial Premium is guaranteed as all are Annuity Benefit payments. If the Investment Fund has performance resulting in a decrease in Unit Value the Annuity Benefit will not be affected. If

> the Investment Fund has an increase in unit value the Annuity Benefit will be affected. The Investment Fund will be stated in Schedule A, managed by the Investment Advisor.

[36] Mr. Etcovitch indicated he did not investigate the nature of the investment fund as it was important only that the annuity yielded the $400,000 annual payment, to be used to cover the annual insurance premium (to be acquired from DGM Insurance), and that there was a mechanism for excess from an investment fund. In addressing the question of the so-called investment fund, Ms. Van Wees testified she did not know how St. Joseph's did their business. I would say at this point that I found Ms. Van Wees' testimony generally evasive and at times disingenuous. This is an example of how she handled several questions. She knew St. Joseph's paid the $400,000 annuity amount to DGM Insurance for the first insurance premium and that both DGM Insurance and St. Joseph's reinsured 100% of their policies with Stellar. There was clearly nothing left for any investment fund.

[37] Mr. Magwood was more forthright. He was a Canadian chartered accountant who worked on behalf of Stellar as well as being a shareholder and director of St. Joseph's, the annuity company registered as a Nevis insurance company in December 2007. He described his role as simply a document processor though he did testify that, with respect to the annuity policy, St. Joseph's had no discretion as to the use of the $6,000,000: everything was set out in the escrow agreement. He confirmed there was in fact no investment fund. The plan was that the entire transaction would be reinsured, all of the $6,000,000 going to Stellar. As he stated, no one understood there would be any excess from an investment fund.

[38] Holdco directed Liza Law as agent to deliver instructions to St. Joseph's irrevocably directing it to pay the annual payments of $400,000 to DGM Insurance as payment of the insurance policy premiums in the exact same amount. The insurance policy is the next step.

<u>Step 7</u> Life insurance policy purchased by Holdco on life of Paul Sr. from DGM Insurance dated February 27, 2008

[39] Robert Young was clear that the annuity and insurance premium had to match. As will be seen later there was also a perfect matching with the Metropac loan. Mr. Keiran Young, a Vice-President with DGM Bank, the lender of the bridge financing, testified that DGM Bank and DGM Insurance were somehow related. He had signing authority for both. He also indicated DGM Insurance held

only about 10 policies and that DGM Insurance re-insured as DGM did not intend to assume any risk of their own accord. He could not recall the application for this policy nor the medical in connection with it: neither were produced at trial He was not sure exactly what DGM Insurance was licensed to do. Indeed he could not recall very much, and was unsure what the Golinis were trying to achieve.

[40] Holdco's resolution authorizing this insurance policy was dated February 28, 2008 notwithstanding the policy was dated February 27, 2008. The policy called for premiums of $400,000 annually for 15 years for initial coverage of $6,400,000, increasing over 15 years to coverage of over $16,000,000. After 15 years the premiums ceased but the insurance coverage escalated thereafter at not only the 8% rate, but as if $400,000 premiums were continuing to be paid.

[41] Liza Law was instructed by Holdco to file the necessary documents to acquire the policy. As mentioned, the premiums were to be covered by the annuity payments. Mr. Etcovitch testified that given the insurance policy was issued, presumably the initial payment was made.

[42] I now diverge from the MBM closing agenda of the RCA Optimizer transaction and turn to the other closing agenda for the offshore transactions that moved the $6,000,000 from St. Joseph's and DGM Insurance, as required by the escrow agreement, through Stellar and Trafalgar and ultimately to the Canadian company Metropac, to then lend to Paul Sr. I am reminded of Alice in Wonderland that "so many out of the way things had happened lately that Alice had begun to think that very few things indeed were really impossible".

Step 8: Reinsurance of annuity and life insurance policy by St. Joseph's and DGM Insurance with Stellar

[43] The offshore closing agenda includes the reinsurance treaties for both the reinsurance of the annuity contract between St. Joseph's and Stellar and the reinsurance of the life insurance policy between DGM and Stellar. Mr. Magwood testified that the forms of these contracts were developed from a template from which he developed the finished form. With respect to the annuity, Mr. Magwood described the reinsurance as a transfer of the entire portfolio to Stellar for a commission shown in the agreement to be $7,500 a year. With respect to the insurance policy the annual premium fee payable to DGM Insurance was $16,000 a year.

[44] Mr. Magwood confirmed the effect of these provisions of reinsurance with Stellar was that the $400,000 annuity payment and $400,000 policy premium (designed to match) were simply dealt with internally by Stellar. Also, he testified that the $5,600,000 and $400,000 respectively from St. Joseph's and DGM Insurance were, by the escrow arrangements, attributed to Stellar. Article 5 of the Reinsurance Agreement between DGM Insurance and Stellar reads in part as follows:

> B. In the event of a Claim under the Policy, the Reinsurer agrees that settlements shall take place at the same time as on the Policy, in order that the Reassured shall not be required to advance funds on behalf of the Reinsurer.
>
> C. The Reinsurer may, at its sole discretion, satisfy any obligation it may have under this Contract to pay an amount to the Reassured in respect of a claim made under the Policy by paying the amount directly to the person making the claim under the Policy on behalf of the Reassured. The Reinsurer shall notify the Reassured of any such payment and any such payment shall relive the Reinsurer of all liability under this Contract in respect of the subject matter thereof.

[45] There were several escrow agreements as part of the offshore closing agenda: one between St. Joseph's and Liza Law, one between DGM Insurance and Liza Law, one between Stellar and Liza Law and one between Trafalgar, Metropac and Liza Law. Mr. Magwood suggested these were likely prepared by Ms. Van Wees or Hyde. The thrust of these escrow agreements, in combination with the escrow agreement described earlier, was that Hyde would receive funds in trust from MBM and hold those funds ultimately to be returned to MBM to hold for Paul Sr., ultimately to be released to repay the bridge loan. The escrow agreements track the flow of funds from St. Joseph's and DGM Insurance to Stellar, to Trafalgar, to Metropac and to Paul Sr. via the delivery of acceptances and receipts by Liza Law in terms like the following found in the escrow agreement amongst Trafalgar, Metropac and Liza Law:

> 1. Liza Law is hereby irrevocably authorized and directed by Long Term Lender to:
>
> i) accept the sum of ________ as a deposit under the Investment Contract from Reinsurance Co. and to issue to Reinsurance Co. a receipt in the sum of ________, to be signed by Liza Law;
>
> ii) accept confirmation from MBM that MBM is holding in trust the following sums and an irrevocable direction from the Client that on the Client receiving the advance contemplated under section 2(v)

of this escrow agreement, said sums will be released forthwith as follows:

a) __________ to Liza Law, to be held in trust, on account of prepayment of interest from the Client to MetroPac pursuant to the Golini Loan Agreement and from MetroPac to Long Term Lender on account of interest pursuant to the MetroPac Loan Agreement;

b) __________ to Liza Law on account of Liza Law's fees and disbursements;

c) __________ to Hyde on account of Hyde's fees;

d) __________ to MetroPac on account of MetroPac's counsel fees and disbursements;

e) __________ to MetroPac on account of the administrative fees payable to MetroPac under the MetroPac Loan Agreement;

f) __________ to Banasha Shah Consulting Services Inc. for an actuarial opinion;

g) __________ to Hyde, in trust, on account of consulting fees payable to ___________; and

h) __________ to Hyde, in trust, on account of interest payable to DGM Bank & Trust Inc. ("DGM");

iii) deliver a direction ***(missing word) MBM to pay the sum of ___________ on account of interest pursuant to the MetroPac Loan Agreement (the "MetroPac Direction") to Liza Law, in trust and to issue to MetroPac a receipt from Long Term Lender to be signed by Liza Law;

iv) accept delivery of the following documents from MetroPac:

a) The MetroPac Loan Agreement;

b) MetroPac resolutions approving borrowing _________ from Long Term Lender;

c) Security agreement(s) required pursuant to the MetroPac Loan Agreement, including collateral assignment agreement(s), and registration thereof;

d) Certificate of incumbency of MetroPac;

e) Statutory declaration of MetroPac; and

f) The MetroPac Direction;

v) direct, by fax or electronic transmission, Hyde to advance to MetroPac under the MetroPac Loan Agreement out of the funds Hyde holds in trust for Long Term Lender, the sum of ________;

vi) distribute the sum of _________ in accordance with the instructions received.

[46] Ms. Van Wees testified that everything was handled through Liza Law as there was not a high level of trust from DGM Insurance, St. Joseph's and Trafalgar so everything had to be signed and in her hands before the transactions went ahead. This type of vague representation by Ms. Van Wees gives me concern with respect to her testimony generally.

[47] Interestingly, the offshore closing agenda indicates the escrow agreements were to be tabled by "D.W.", which I take to mean Dawn Wattie, the lawyer asked by Ms. Van Wees to set up Metropac and review documents that included Metropac. It is extremely unlikely Ms. Wattie tabled these escrow agreements. She testified that Ms. Van Wees provided all documents for the offshore closing. Wherever there is any discrepancy between the testimony of Ms. Van Wees and Ms. Wattie, I accept completely Ms. Wattie's evidence.

<u>Step 9</u> Stellar invests $6,000,000 in Trafalgar pursuant to an agreement dated February 27, 2008

[48] Trafalgar was a St. Vincent and Grenadine company. This contract was labelled a "Term Investment Agreement" for an investment of $6,000,000 at an interest rate of 8% as follows:

> 2.2 The Lender shall credit 8% interest per annum to the accumulated value of the Deposit for each full year from the effective date such Deposit is paid until this Agreement terminates. Interest at the annual rate of 8% shall also be credited

> for any partial year that the Deposit is invested. The accumulated value of the Deposit shall equal the amount of the Deposit plus previously credited interest.

[49] Mr. Magwood clarified that in fact all the interest was not capitalized but $80,000 in cash was to be received annually (as will soon be seen, this will track the $80,000 payment Paul Sr. agreed to pay as interest on the loan from Metropac). The $80,000 was used to compensate the participants in the structure (Stellar got $22,500 of which St. Joseph's got its share, DGM got $12,500 and BSD got $45,000). Mr. Magwood did not know who BSD was but presumed it was Robert Young. Indeed, as explained by Robert Young these were fees he directed to BSD. Robert Young acknowledged the $80,000 was determined based on what the fees would be: that was the starting point. He referred to the amount as the cash cost of the deal.

[50] Although Stellar is investing the $6,000,000 in Trafalgar, Trafalgar is characterized as the "Lender". There is no indication as to how Trafalgar would invest the funds, but it was clearly part of the plan the $6,000,000 was to go by way of loan from Trafalgar to Metropac. Mr. Magwood was a signing authority for Trafalgar along with Mr. Chandaria, Mr. Bonnett and Mr. Philip Young. Ms. Van Wees testified that she had commented on the investment agreement but that it was negotiated between Stellar and Trafalgar. Given Mr. Magwood represented both companies, and given his testimony suggested the participants knew exactly what constituted the transaction, I am unclear what was left to be negotiated other than the participants' share of the $80,000 annual payment that went from Paul Sr. through to Trafalgar and Stellar.

<u>Step 10</u> Trafalgar loan of $6,000,000 to Metropac effective February 26, 2008 entitled "Limited recourse Loan Agreement"

[51] First, who is Metropac? It is a Canadian company established by Dawn Wattie, a British Columbia lawyer, in 2007 in response to a request from her law school friend, Ms. Van Wees. Ms. Van Wees testified that she believed Ms. Wattie already had incorporated Metropac. She also testified this Canadian company was used as Paul Sr. wanted a Canadian company lender. There is no evidence to suggest that Paul Sr. would have had such intimate knowledge of what was going on that he would require a Canadian lender. Robert Young was clear that it was on PricewaterhouseCoopers' advice a Canadian lender was required.

[52] Once again, I find Ms. Van Wees' evidence lacking credibility. Ms. Wattie's evidence, however, was straightforward and honest, notwithstanding it was obviously difficult for her to admit signing documents as a lawyer which evidenced something far beyond what she believed her, or Metropac's, role to be.

[53] Metropac was incorporated in December 2007 after Ms. Van Wees had first approached Ms. Wattie (at Ms. Wattie's wedding earlier in 2007). Ms. Wattie had been assured there would be "zero risk" to her to be involved in the transaction. She acknowledged she did not understand the nature of the transaction and never received a detailed explanation. Ms. Wattie incorporated Metropac to provide a service for her friend, a service which she understood would later become clear. She also understood MBM and Heenan Blaikie were driving the transaction, whatever it was. It was very clear from Ms. Wattie's testimony that she was doing her friend a favour but had no background or understanding of the transaction. She felt Metropac would only be providing an administrative service, and it would at no time be receiving any funds other than a fee for such administrative services.

[54] Ms. Wattie acknowledged that Metropac entered the Limited Recourse Loan Agreement with Trafalgar, along with a Collateral Assignment Agreement, the copy in the closing book being undated.

[55] The loan stipulated an interest rate of 8% payable as follows:

> 2.2 Rate and Payment of Interest – The Borrower shall pay interest on the Borrower's Liabilities at the Loan Rate prior to and as a condition of the advance of the Loan Amount and on every anniversary of the advance of the Loan Amount thereafter, as well after as before demand, maturity, default and judgment, together with interest on overdue interest until the Borrower's Liabilities have been paid in full. Interest shall be calculated annually in advance for the entire year and on every anniversary date of the advance of the Loan Amount on the then outstanding balance of the Borrower's Liabilities and the Lender will have no obligation to refund interest upon the expiry of the Term. Save and except for the sum of Eighty Thousand Dollars ($80,000) which will be payable each year and applied to the interest owing hereunder, the remainder of all residual interest payable shall be capitalized each year.

[56] The loan was repayable upon payment of insurance proceeds under the insurance policy on Paul Sr.'s life. Trafalgar's recourse was limited to that policy. Ms. Wattie admitted the loan agreement was for a $6,000,000 loan from Trafalgar but reiterated that was not her understanding, as Metropac was never to get any monies, so Ms. Van Wees advised. Ms. Wattie presumed Ms. Van Wees prepared

the agreement. She testified she did not negotiate any terms of the contracts entered into by Metropac. She was advised she could not change the substance of the agreements as it had to be in the form presented. Even the form of authorizing resolution from Metropac was provided.

[57] In the collateral assignment agreements, Metropac assigned its rights in the annuity and in the policy (which as will be seen shortly were assigned by Holdco to Metropac as security) along the following terms (this with respect to the life insurance policy):

> …
>
> It is agreed that the rights assigned hereby include the rights assigned to the Assignor in a collateral assignment between the Assignor and 2161845 Ontario Inc., substantially in the form attached hereto, including:
>
> (1) The exclusive right to collect from the Insurer the net proceeds of the Policy when it becomes payable;
>
> (2) The exclusive right to surrender the Policy and receive any surrender value thereof at any time provided by the terms of the Policy and at such other times as the Insurer may allow; and
>
> …

[58] Ms. Wattie had been led to believe that Metropac would have to sign an agreement with DGM, not Trafalgar, which was a change just before closing. She further testified that she was not aware the funds were ever to be held in trust for Metropac. She did acknowledge though that she signed the escrow agreement with Trafalgar and Liza Law, one of the terms of which was:

> Upon receiving confirmation from Hyde that Long-Term Lender has advanced funds to Metropac under the Metropac Loan Agreement and that Hyde has ___________ in trust for Metropac…

[59] Ms. Wattie confirmed that Metropac received an administration fee of $2,500 but no interest income as her understanding was that it was never intended to receive such. She also confirmed that Metropac never reported any loan from Trafalgar in its financial statements nor any loan to Paul Sr.

[60] In cross-examination Ms. Wattie was directed to the escrow agreement, which she signed, which indicated Metropac would have $6,000,000 transferred to it and disburse the same sum to Paul Sr. She admitted the agreement speaks for itself but "what I understood is what I understood". She also acknowledged there were a lot of emails flying back and forth, as the transaction seemed consistently in flux, though there was little actual discussion. She recalled some conversation with Hyde who, according to her, shared some of her concerns.

<u>Step 11</u> Loan of $6,000,000 from Metropac to Paul Sr. dated March 3, 2008 guaranteed by Holdco

[61] The documents implementing this element of the RCA Optimizer Plan were tabled by MBM, including the Limited Recourse Loan Agreement, the collateral assignment by Holdco of the annuity policy and life insurance policy, notice from Holdco to St. Joseph's and DGM Insurance of the assignment of policies, the PPSA registration of the collateral assignments and an irrevocable direction of payment by Holdco to DGM Insurance to pay insurance proceeds on death of Paul Sr. to Metropac.

[62] The loan agreement was signed by Ms. Wattie on behalf of Metropac, though she did not negotiate any of the terms, including the 8% interest rate. Andrew testified the rate was determined through discussion between him and Robert Young. Andrew did confirm there was no loan application by Paul Sr.

[63] Like the other loans, interest was to be paid in cash of $80,000 with the balance of $400,000 (8% on the $6,000,000) being capitalized annually.

[64] Holdco guaranteed the loan: the agreement identified the collateral as the rights in the life policy and annuity contract held by Holdco, and limits Metropac's recourse to the realization of that collateral, specifically assigned to Metropac by Agreement dated March 3, 2008. The following terms of the loan agreement are noteworthy:

> 2.3 <u>Term of Loan</u> – The Borrower's Liabilities herein shall become fully due and repayable upon the payment of the insurance proceeds under the Life Policy following the death of the Insured or as envisaged under Section 7.1 (the "Term")
>
> …

2.7 Guarantee – For good and valuable consideration, the Guarantor hereby guarantees, as solidary co-debtor of the Borrower, the payment of the Borrower's Liabilities arising hereunder to the Lender, subject to the terms and conditions provided herein including the Lender's Limited Remedies provided in Article VII hereof.

…

6.2 Notice of Default – In the event that the Borrower or Guarantor shall commit an Event of Default, as noted in 6.1 above, the Lender shall send a written notice to the Borrower and Guarantor of such default and the Borrower or Guarantor shall remedy same within five (5) Business Days.

7.1 Generally – Failure by the Borrower or Guarantor to remedy an Event of Default within five (5) Business Days shall render the Borrower in breach of this Agreement, the Borrower's Liabilities shall immediately become due and payable and the Lender shall have the right, but not the obligation, to treat this Agreement as terminated and realize on its security under the Security Documents hereunder.

7.2 Limited Recourse – Notwithstanding any other provisions in the Security Documents, the parties hereto agree that the Borrower and the Guarantor shall be bound to fulfill their obligations hereunder (and under the Collateral Assignments) solely from the Collateral. Without limiting the generality of the foregoing, (i) the Lender's recourse against the Borrower and the Guarantor shall be restricted to realization of the Collateral in full satisfaction of the Borrower's Liabilities, being agreed that the realization of the Collateral shall be limited to the absolute transfer of all rights, title and interest of the Guarantor under the Annuity Contract and the Life Policy to the Lender and that the Lender shall not exercise any further rights under the Annuity Contract or the Life Policy until the death of the Insured, (ii) the Lender agrees that in any action instituted or in the exercise of any recourse provided for herein or by law to obtain the fulfillment of any obligations of the Borrower or Guarantor hereunder and any judgment obtained may be satisfied and all recourses may be exercised solely against the Borrower or Guarantor, nor any of their other assets and neither the Borrower nor the Guarantor shall be liable to pay any additional amounts to the Lender nor for any loss or damage occasioned thereby to the Lender. In the event that the Guarantor or the Lender surrenders the Annuity Contract or the Life Policy, the proceeds shall be paid to the Lender to reduce the Borrower's Liabilities and the Lender agrees that any surplus shall be paid to the Guarantor or as directed by the Guarantor.

Also, I note the following terms in the Collateral Assignment:

A. The provisions of this Agreement are meant to secure the obligations of the Owner to the Assignee under the Loan Agreement. The assignment

> contemplated herein is contingent upon the default of the Owner under the Loan Agreement and this Agreement shall not be construed as an absolute transfer of title and ownership until the occurrence of such default.
>
> It is agreed that the following rights are included in the assignment:
>
> (1) The exclusive right to collect from the Insurer the net proceeds of the Policy when it becomes payable;

[65] Mr. Etcovitch testified the terms of the loan agreement were negotiated, though clearly not with the owner and sole director of Metropac. He referred to back and forth negotiations to ensure everything matched up or, as he put it, made sense in relation to annuity, insurance and subscription by Paul Sr. for shares in Ontario Inc. This is quite clear from the chart at Appendix B attached hereto, which is an excerpt from the expert report of Mr. H. Johnson.

[66] Paul Sr. and Holdco also entered a Guarantee Fee Agreement dated March 3, 2008 in which Paul Sr. agreed to pay Holdco a guarantee fee of $40,000 a year. Andrew testified that the fee was presented as part of the overall structured transaction and was based on his industry knowledge of such matters. He stated the amount of fee was discussed with Mr. Potter and "other industry people" and it was determined that 10% of the $6,000,000 ($600,000), payable over 15 years was appropriate. Mr. Etcovitch confirmed the parties believed the fee represented an arm's length fee. Holdco also provided at Closing a Direction to Pay, signed by Paul Sr. dated March 3, 2008 directed to DGM Insurance as follows:

> WHEREAS Holdco agreed to guarantee the obligations of Paul C. Golini under a loan agreement dated as of March 3, 2008 (the "Loan Agreement") between Paul C. Golini, as borrower, and Metropac Services Inc., as lender (the "Lender").
>
> NOTICE
>
> 1. Holdco hereby directs Life Insurance Company to pay the Lender, in the event of death of the insured under the Life Insurance Policy, the proceeds of the Life Insurance Policy.
>
> 2. This direction is irrevocable by Holdco and cannot be modified or revoked except with the express written consent of the Lender.

[67] At this point, March 3, 2008, the $6,000,000 is transferred back into MBM's trust account on written direction of Paul Sr. to Hyde.

[68] On March 11, 2008, Metropac directed MBM to disburse $80,000 "of interest payable to Metropac" to Liza Law. This letter, while having Metropac's name at the top, had Ms. Van Wees' address in Windsor at the bottom of the page. I conclude Ms. Wattie signed what she was provided by Ms. Van Wees. Ms. Wattie testified that Ms. Van Wees provided to her account statements to ensure the $80,000 was paid offshore.

[69] In July 2009, Paul Sr. sent an $80,000 cheque to Metropac, which Ms. Wattie returned to him as she believed payment was not to come to Metropac.

[70] Liza Law was instructed by Stellar, DGM, BSD and Trafalgar to distribute the $80,000 to be received annually to Stellar ($22,500), DGM ($12,500) and BSD ($45,000).

<u>Step 12</u> Subscription by Paul Sr. for 6,000,000 Class D preferred shares in Ontario Inc. on March 4, 2008 for $6,000,000

[71] The documents tabled by MBM and Heenan Blaikie to effect this part of the RCA Optimizer Plan were the authorizing resolutions and share certificates, along with an irrevocable letter of instructions from Paul Sr. to MBM to attribute the $6,000,000, in trust for him, to the account of Ontario Inc. as payment for 6,000,000 Class D preferred shares with a paid up capital of $6,000,000. As Mr. Etcovitch pointed out, he did not focus on advising Paul Sr. as to the effect of the paid up capital of shares being $6,000,000. Robert Young professed no idea what this element of the transaction was about, indicating Mr. Etcovitch looked after it.

[72] The shares carried an 8.25% cumulative preferred dividend. To date dividends have accrued but not been paid in the Class D shares to the tune of $3,500,000.

<u>Step 13</u> Reimbursement of bridge loan by Ontario Inc. to DGM Bank

[73] By letter dated March 4, 2008, Holdco instructed MBM to repay DGM Bank the Bridge Loan of $6,000,000 plus interest of $7,890. DGM acknowledged receipt dated the same day.

[74] The closing book included several opinions:

i. Opinion from Hyde acting for DGM Insurance opining: - DGM was a duly incorporated exempt insurance company under the laws of Barbados – policy was duly executed and delivered and constituted a legal, valid and binding obligation.

ii. Opinion from Appleby law firm in British Virgin Islands acting for St. Joseph's opining amongst others: - the company was incorporated August 14, 2007, under the *Nevis Companies Act* and licensed under the *Insurance Act* – the policy is a valid annuity policy.

iii. Opinion from Heenan Blaikie acting for Holdco opining to St. Joseph's the annuity policy was authorized and duly executed and delivered by Holdco.

iv. Opinion from Heenan Blaikie acting for Holdco opining to DGM the life insurance policy was authorized and duly executed and delivered by Holdco.

v. Opinion from Heenan Blaikie to Metropac that the loan agreement and collateral assignment agreements were authorized and duly executed by Holdco.

vi. Opinion from Heenan Blaikie acting for Ontario Inc. opining to DGM Bank the loan agreement was authorized and duly executed and delivered by Holdco.

[75] Mr. Magwood confirmed that on Paul Sr.'s death all that would happen, given the structured transactions, is that there would be no insurance proceeds paid but simply the surrender of the insurance certificate by Trafalgar to Stellar, having made its way from Holdco to Metropac to Trafalgar. By this act I understand that all obligations pursuant to the guarantee, the Metropac loan to Paul Sr., the Trafalgar loan to Metropac, the Stellar investment in Trafalgar and under the annuity and life insurance policy are met and consequently terminated.

[76] A few further observations. Ms. Van Wees understood the RCA Optimizer to mean a restructure to pay less tax. Mr. Magwood testified the term meant nothing to him at the outset. Ms. Wattie could not comment on the transaction and struggled to understand it. Mr. Etcovitch had no interest in what took place between the acquisition of the life insurance policy and the annuity and the ultimate loan from Metropac to his client.

Experts

[77] The Respondent presented two expert witnesses, Mr. Hawkins, an actuary, to opine on the annuity and life insurance policies and their pricing, and Mr. Johnson, a valuator, to opine on the economic effects and nature of the bridge loan, the Metropac loan, the annuity, the life insurance policy and guarantee fee. I limited Mr. Johnson's evidence to two elements: first, his view of an appropriate commercial interest rate for the Metropac loan and second, the economic effect or benefit to Paul Sr. of the Metropac loan guaranteed by Holdco. The Appellant provided a Rebuttal Report by Ms. Marks, an actuary, who opined mainly with respect to Mr. Hawkins report. Mr. Hawkins provided a SouRebuttal to Ms. Marks report.

[78] Ms. Marks and Mr. Hawkins were in some agreement that the terms and conditions of the annuity and life insurance policy, on their face, were not unusual for such policies, but they diverged on pricing of the policies and ultimately whether the leveraged insurance annuity structure was typical of such structures used in the industry prior to legislative changes in 2013.

[79] I accept Mr. Hawkins' views with respect to the policies in preference to Ms. Marks who, with respect to the annuity, appeared to rely to a considerable extent on the Global Index Fund feature, which as was clear from testimony, (which Ms. Marks would not have heard to be fair) was meaningless; there was no such fund. She did ultimately agree that the pricing was unattractive. With respect, I do not need actuaries to satisfy me that paying $6,000,000 for an annuity in your late seventies yielding $400,000 a year to the earlier of death or 15 years is "unattractive".

[80] With respect to the life insurance policy, Ms. Marks also acknowledged that the pricing was aggressive, but that there may be reasons for that, such as the reinsurance, if many policies were being reinsured: there was, however, in this case only the Golini policy being reinsured. Ms. Marks was simply not fully aware of the transactions to give context to her opinion. She did acknowledge that the triple back-to-back structures that were marketed by the Sun Life for example were driven by tax benefits.

[81] Mr. Hawkins responded to Ms. Marks report by addressing her conclusion that this leveraged annuity structure was similar to leveraged annuity structures that would have typically been used prior to the legislative changes in 2013. He disagreed for a couple of reasons:

a) Typically the borrower would be the owner of the annuity and life insurance policy; Mr. Hawkins did agree there could be exceptions.

b) While reinsurance itself is not unusual, in this case it is because:

i) there is a solitary contract;

ii) there is 100% reinsurance (effectively St. Joseph's simply gets a $7,500 commission and DGM simply gets a $16,000 a year commission);

iii) Stellar, the reinsurer, can pay the insurer directly;

iv) the Reinsurance Agreement makes no mention of the Global Index Fund;

v) St. Joseph's did not invest as required by the annuity contract itself.

[82] I accept Mr. Hawkins' rebuttal that the transactions before me are not typical of products offered at the time. They are unique and are to be analyzed, I suggest, as a one-of-a-kind.

[83] Mr. Hawkins also concluded that the insurance policy was priced in a way that would result in a significant loss to DGM, but that it was saved by the 100% reinsurance which allowed it to earn the commission income.

[84] I also accept Mr. Johnson's evidence that, given the virtually risk-free nature of the Metropac loan, a comparable loan for determining interest rates would be Government Bond Yields and AAA Corporate Debt, which would yield a rate of 5.5%. This rate was not seriously challenged on cross-examination.

[85] With respect to the economic benefit to Paul Sr., Mr. Johnson calculated that the cash flow benefit to Paul Sr. arising due to the deductibility of interest and guarantee fee (if calculated at 8%) over the 15 years as approximately $3,950,000. If the rate was 5%, the value of the benefit decreases to approximately $1,200,000.

[86] Mr. Johnson also analyzed the benefit of the guarantee fee from Paul Sr.'s perspective using a simple calculation of deriving the same benefit as though he had paid $400,000 a year for the insurance policy as opposed to just paying $40,000 for the guarantee fee. The cumulative effect over 15 years would be a

$5,400,000 benefit, without taking into account the deductibility of the guarantee and $5,700,000, considering the deductibility of the guarantee fee.

[87] Paul Sr. filed his 2008 tax return claiming a deduction of $397,150.68 as interest and $33,096.04 as a guarantee fee. By Notice of Assessment dated September 7, 2012 the Minister assessed Paul Sr.'s 2008 tax liability by adding a taxable dividend in the amount of $7,500,000 and by denying an interest expense of $438,626.

Issues

[88] In determining the correctness of the reassessment, the issues are as follows:

a. Whether the transactions are shams;

b. In the alternative, did the Appellant receive taxable benefits pursuant to subsections 15(1) or 246(1) of the *Act*;

c. In the further alternative, whether the Metropac loan and the purchase of Class D shares of Ontario Inc. constitute a "tax shelter" as defined by subsection 237.1(1) of the *Act*;

d. In the further alternative, whether the carrying charges and expenses claimed in respect of the Metropac loan were unreasonable in the circumstances; and

e. In the further alternative, whether the GAAR would apply to the transactions and more specifically, whether there was a misuse or abuse of subsections 20(1) and 84(1) of the *Act*.

Analysis

[89] The Respondent made several arguments, putting considerable emphasis on its first position that the transactions are a sham. I do not decide on that basis. I find the transactions are GAARable and I will give my reasons in that regard later in this judgment, but my preference is likewise not to rely on GAAR. My approach is to analyze what really (legally) has transpired and determine the tax consequences that flow from that. I conclude the *Act* adequately covers this situation through the shareholder benefit provision. And that is where I start.

Subsection 15(1) and subsection 246(1) of the *Act*

[90] Did Paul Sr. receive a taxable benefit in 2008 pursuant to subsection 15(1) or 246(1) of the *Act*? Yes, he received a taxable benefit pursuant to subsection 15(1) of the *Act*, which for the 2008 taxation year read:

> **15. (1) Benefit conferred on shareholder** – Where at any time in a taxation year a benefit is conferred on a shareholder, or on a person in contemplation of the person becoming a shareholder, by a corporation otherwise than by
>
> (a) the reduction of the paid-up capital, the redemption, cancellation or acquisition by the corporation of shares of its capital stock or on the winding-up, discontinuance or reorganization of its business, or otherwise by way of a transaction to which section 88 applies,
>
> (b) the payment of a dividend or a stock dividend,
>
> (c) conferring, on all owners of common shares of the capital stock of the corporation at that time, a right in respect of each common share, that is identical to every other right conferred at that time in respect of each other such share, to acquire additional shares of the capital stock of the corporation, and, for the purpose of this paragraph,
>
> (i) where
>
> (A) the voting rights attached to a particular class of common shares of the capital stock of a corporation differ from the voting rights attached to another class of common shares of the capital stock of the corporation, and
>
> (B) there are no other differences between the terms and conditions of the classes of shares that could cause the fair market value of a share of the particular class to differ materially from the fair market value of a share of the other class,
>
> the shares of the particular class shall be deemed to be property that is identical to the shares of the other class, and
>
> (ii) rights are not considered identical if the cost of acquiring the rights differs, or
>
> (d) an action described in paragraph 84(1)(c.1), (c.2) or (c.3),
>
> the amount or value thereof shall, except to the extent that it is deemed by section 84 to be a dividend, be included in computing the income of the shareholder for the year.

[91] The documents clearly reflect Paul Sr.'s obligation to pay $120,000 per year ($40,000 as a guarantee fee and $80,000 in interest) to Metropac until the earlier of his death or 15 years, in return for receiving a loan for $6,000,000, with which he

obligated himself to acquire Ontario Inc. shares with a paid up capital ("PUC") of $6,000,000 and a cumulative dividend rate attached to them. Holdco obliged itself to pay Paul Sr.'s loan, including capitalized interest, through the assignment of the annuity and insurance proceeds. Paul Sr. raises a technical argument that, as there is no "absolute assignment", there can be no benefit. I will address this in detail shortly, but put in its simplest terms, immediate access to $6,000,000 tax-free, with only the obligation of a guarantee fee of $40,000 for 15 years, is a benefit, a benefit arising from Paul Sr.'s position as a shareholder, and a benefit conferred by Holdco, given the inadequacy of the guarantee fee and the foregoing by Holdco of retaining the insurance proceeds. Paul Sr. argues that there can be no benefit as the annuity and life insurance policy were only collateral security for Holdco's guarantee and do not constitute an absolute assignment. Paul Sr. referred me to the Supreme Court of Canada case of *Alberta (Treasury Branches) v MNR*; *Toronto Dominion Bank v MNR*, [1996] 1 SCR 963 in which Justice Cory stated:

> Further, all the assignments limit liability to the extent of the outstanding indebtedness. Thus, if the loan secured by the GABD was repaid the Bank or Treasury Branch would have no further interest in the assignment. The documents themselves refer to the assignment as being a continuing collateral security for the payment of the indebtedness. The clear intention of the parties is that the assignment is given as security for the payment of a debt and upon payment of the debt the GABD is to be of no force of effect. That is to say the lending institution could not, after payment of the debt, make use of the GABD to realise upon any of the book debts of the assignor. In my view since the assignment by its terms can be redeemed by payment of the debt it cannot or at least should not be construed as an absolute assignment.

[92] Further, in dissent, Justice Major stated:

> It was noted in Royal Bank of Canada v. R., at p. 202, that there may be a distinction between an absolute assignment and one that provides that, in the event of default and the non-remedy of the default, the bank may without further notice deal with the book debts. Such wording appears to be less than an absolute assignment and creates for the lending institution a charge on the book debts which does not crystallize into property in the debts until there has been an unremedied default.
>
> While it does not fall to be decided in this case, it seems likely that such an assignment does not transfer property to the lending institution and thus, at least prior to default on the part of the assignor, the lending institution would be a secured creditor under s. 224(1.3). This type of conditional wording is not present in any of the instruments at issue in these appeals, all of which are unconditional and absolute.

[93] With respect, these comments were made in an entirely different context and not with the issue of a taxable benefit in mind. Paul Sr. is effectively suggesting that, because it was open to him to repay the Metropac loan without having to fall back on the guarantee, there is no absolute assignment of the debt and, therefore, there is no benefit. Frankly that does not follow.

[94] In reviewing this sort of planning it behooves the Court to take a bird's eye view: to consider the details and intricacies of cleverly-drafted legal paperwork in context. For example, the Appellant's counsel points out certain provisions in the Metropac loan:

> 8.3(a) Each of the Borrower and Guarantor shall have the right to assign its rights and obligations under this Agreement, the Annuity Contract of the Life Policy, <u>subject to the rights remaining after the Collateral Assignment to the Lender,</u> […]
>
> 6.2 <u>In the event that the Borrower or Guarantor shall commit an Event of Default</u>, as noted in 6.1 above, the Lender shall send written notice to the Borrower and Guarantor of such default and <u>the Borrower or Guarantor shall remedy same within five (5) Business Days.</u>
>
> 7.1 Failure by the Borrower of Guarantor to remedy an Event of Default within five (5) Business Days shall render the Borrower in breach of this Agreement, the Borrower's Liabilities shall immediately become due and payable and the <u>Lender shall have the right, but not the obligation, to treat the Agreement as terminated and realize on its security under the Security Documents hereunder.</u>

[95] The Appellant takes from the wording of these provisions that the assignment of the annuity and insurance is security arising only in the event of default. The Appellant concludes the collateral assignments are not complete and perfected. The Appellant suggests that to ignore these legal realities would fly in the face of the Supreme Court of Canada's direction in *Shell Canada Ltd v The Queen*, [1999] 3 SCR 622:

> ...<u>absent a specific provision of the Act to the contrary or a finding that they are a sham, the taxpayer's legal relationships must be respected in tax cases. Recharacterization is only permissible if the label attached by the taxpayer to the particular transaction does not properly reflect its actual legal effect</u>: Continental Bank Leasing Corp. v. Canada, [1998] 2 S. C. R. 298, at para. 21, per Bastarache J.

[96] I cannot ignore the legal realities nor the context in which the agreements operate. Whether there is an absolute assignment or an assignment arising only on default, the reality, supported by the documents and the context of the overall plan, is that Paul Sr. would not have to repay the loan. I'm not going to get hung up on the distinction between an absolute or conditional assignment when determining whether this arrangement constitutes a benefit to Paul Sr. It does – and the wording of the contract in no way contradicts such a finding.

[97] The transactions were structured such that there would be no sensible reason for Paul Sr. to repay the loan. Everyone's understanding was the annuity and insurance were the only manner in which the obligation of the Metropac loan would be met: the documents do not contradict that understanding. Frankly, so what if it is not termed an "absolute assignment", the circumstances of the surrounding transactions combined with the legal obligations arising under the Metropac loan, guarantee and assignments clearly establish there is a benefit to Paul Sr.: Holdco is using its assets to pay his debt. Just because the documents would allow him to behave in an irrational way to forego that benefit is insufficient for me to find there is no benefit.

[98] I grant the documents may be interpreted as not constituting an absolute assignment, but they can as readily be interpreted to do exactly what the parties intended, and that is to relieve Paul Sr. of his burden of repayment and have Holdco repay the loan with insurance proceeds – pure and simple. So while the documents may be written to avoid the interpretation of an absolute assignment, they're equally written to ensure Paul Sr. does not have to repay the loan and therefore has an immediate benefit from the receipt of $6,000,000 used to acquire the Ontario Inc. shares.

[99] But, argues Paul Sr., I paid for the guarantee that effectively created the benefit. Frankly that goes to the value of the benefit, not the existence of the benefit itself. The payments of $40,000 a year to a maximum of 15 years do not constitute full consideration for obtaining immediate access to $6,000,000 tax-free. Basic math and common sense trump legal skirmishing on this point. This goes beyond a good commercial deal: it is a significant benefit to Paul Sr. He argues the evidence supports a finding the guarantee fee was considered appropriate compensation, based on Andrew's testimony. I place little weight on that. Andrew relied on personal experience with no concrete evidence to back it up. Unlike commercial guarantees, this was pre-ordained to come into play. In those circumstances, the fee is inadequate. Paul Sr. acknowledges if there is a benefit it

could only be the difference between a $40,000 annual fee and a commercial guarantee fee, for which we have no evidence, expert or otherwise.

[100] The Appellant's position is also that his net worth has not increased as a result of these transactions. Certainly, if I consider his obligation under the Metropac loan to not be completely offset by the guarantee and assignments, then the Appellant is correct. But the reality, legal and practical, and the intention is that Paul Sr. was relieved of that obligation. The Appellant's argument that the contracts would still allow him to pre-pay is, with respect, insufficient to find, in the face of the overall plan, that Paul Sr. ever intended to do so. The documents more heavily favour and support the position that Paul Sr.'s intent was Holdco would cover the debt with the insurance and annuity. At the risk of being redundant, because legally he could behave irrationally to forego the benefit, does not convince me he had no increased net worth. He did.

[101] The Appellant then argues that there can be no benefit if the bestower of the benefit is not disadvantaged in some way, or as Justice Bowman put it in *Del Grande v MNR*, 93 DTC 133, [1992]TCJ No 724, "a corresponding economic detriment of the corporation".

[102] The Appellant argues there has been no appropriation of Holdco's assets. I disagree. Holdco has agreed to use insurance proceeds from a policy it owns to pay off its shareholder's debt. The Appellant relies on the fact that Holdco remains a beneficiary of the insurance proceeds. I rely on the fact that Holdco has obligated itself to pay insurance proceeds to pay off the shareholder debt.

[103] So, what is the value of the benefit? The Respondent says $6,000,000. The Appellant says if there is a benefit, it is the difference between $40,000 a year and a commercial guarantee fee for this form of guarantee. The expert, Mr. Johnson, says it is $5,400,000. I could attempt to go through a convoluted actuarial process, throwing into the hopper all factors such as Paul Sr.'s age, life expectancy, the tax deductibility of the interest and guarantee fee, present valuing of insurance proceeds 15 years out, tax-free status of insurance proceeds, market value of a guarantee fee to name a few. I'm not going to do that. The only evidence presented to me quantifying a benefit was that of Mr. Johnson. I accept that evidence. It was based on a simple premise of what Paul Sr. would pay for the guarantee fee over 15 years ($40,000 per year) versus the cost of the insurance, a $360,000 annual benefit. The attractiveness of this approach lies in its simplicity and comprehensibility. While I recognize Mr. Johnson did not opine directly on a commercial guarantee fee, the effect of his view is it reflects a position that a

commercial guarantee fee would have to have been $400,000 per year. As indicated, and the Appellant's counsel acknowledged, that if there was a benefit it would indeed be the difference between a commercial guarantee fee and a $40,000 fee though provided no further expert evidence on this point.

[104] I find the circumstances and the documents themselves support a finding of a $5,400,000 benefit conferred by Holdco on Paul Sr. as a shareholder of Holdco, falling clearly within the purview of subsection 15(1) of the *Act*.

Sham

[105] If I am wrong with respect to the application of subsection 15(1) of the *Act*, and if the Appellant's counsel is correct that because there is no absolute assignment there cannot be a benefit to Paul Sr., then I would fall back on a position that some of the transactions are indeed sham transactions, presented as something that they are not. To be clear, I do not feel it is necessary to rely on the sham doctrine, if such a concept can even be elevated to such status. Taken at their face value the documents support a finding of benefit. However, if a finding of an absolute assignment is necessary to justify the benefit, then I find the documents misrepresented what was indeed an absolute assignment, and in this respect there is a sham element to the transaction. Frankly, reliance on the sham concept only gets me in the back door when the front door is open to me.

[106] The Respondent's sham argument is more far reaching than how I intend to rely upon such a concept. The Respondent's argument is that the transactions in their entirety were just "papering over", and that the funds were simply circled through various entities to achieve a $6,000,000 increase in the paid out capital for the shares held by Paul Sr., along with significant annual interest deductions: a shell game according to the Respondent. I do not go that far.

[107] The RCA optimizer plan was established to create specific deductions to offset retirement income in Paul Sr.'s hands. The planners down-played the significance of the increased PUC as though it simply happened as a matter of law, almost incidental. While I find this attitude somewhat disingenuous, I do not conclude it is deceitful. These transactions abound with smoke and mirrors, but clearing the smoke and looking through the mirrors, as difficult as the Respondent suggests that is to do, the underlying transactions, I conclude, are for the most part (though not all) legal and enforceable transactions presented in accordance with their legal reality. There are, however, a couple of areas where the presentation stretches the legal reality to its breaking point:

1. As mentioned above, the presentation of the loan, guarantee and collateral assignments as something other than an absolute assignment; and

2. Presenting the annuity as an investment vehicle.

[108] Although the parties do not appear to view the law differently with respect to the evolution of the sham concept, it is useful to conduct a very brief review. Both parties rely on the Supreme Court of Canada’s comments in *Stubart Investments Ltd v The Queen*, [1984] 1 SCR 536, that a sham transaction is a transaction “conducted with an element of deceit so as to create an illusion calculated to lead the tax collector away from the taxpayer or the true nature of the transaction; or, simple deception whereby the taxpayer creates a façade of reality quite different from the disguised reality”. They both go on to indicate how the subsequent cases of *Faraggi v The Queen*, 2008 FCA 398, 2009 DTC 5023, and *Antle v The Queen,* 2010 FCA 280, have tweaked the concept. In *Faraggi,* sham is described as “acts done or documents executed by the parties to the sham which are intended by them to give to third parties or to the Court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create”.

[109] In *Faraggi*, the Federal Court of Appeal also described sham as requiring “an element of deceit which generally manifests itself by a misrepresentation by the parties of the actual transaction taking place between them. When confronted with this situation the Courts will consider the real transaction and disregard the one that was represented as being the real one”.

[110] In *Antle*, the Federal Court of Appeal wrote:

> …The required intent or state of mind is not equivalent to *mens rea* need not go so far as to give rise to what is known at common law as the tort of deceit. It suffices that parties to a transaction present it as being different from what they know it to be….

[111] The parties argue in terms of what is real or, as the Respondent put it, what is artificial. The question of what is real or artificial when dealing with contracts is a question I would suggest of what is legal. Are the legal rights and obligations that are stipulated in the agreements the true legal rights and obligations to which the parties knowingly have bound themselves, understanding they are enforceable as such, with no element of nudging and winking. This presupposes it is Paul Sr. who must be the party to the transaction at issue. I would extend that however to

contracts which Paul Sr. signed not only on his own behalf but also on behalf of Holdco or Ontario Inc. In that regard, therefore, the contracts which I intend to scrutinize to see if they are sham transactions are the Metropac loan agreement, guarantee and collateral assignments taken together and the annuity acquired by Holdco.

[112] The Appellant makes the point that notwithstanding recent comments of Justice Pizzitelli in *Mariano v The Queen*, 2015 TCC 244, regarding the level of knowledge of a pretence in documents, the requirement is that the party knows the agreements are not what they purport to be: willful blindness is not sufficient. I need not go the willful blindness route as I conclude Paul Sr., in signing the agreements, with a basic understanding of the overall plan, knew the true import of the documents.

[113] The Respondent claims the increase in PUC is artificial and the interest deduction is artificial. Clearly, those are consequences of the agreement, consequences the Respondent finds abhorrent, yet consequences the parties expected to flow from the agreements. Consequences that flow from the transactions are not what drive the issue of the real or artificial nature of the transactions.

[114] Let’s go then through the key transactions at issue to which Paul Sr. was a party or for which he signed on behalf of Holdco or Ontario Inc.

1. <u>Bridge Loan</u>

[115] The Respondent claims this was not a loan from DGM Bank to Ontario Inc. but “an amount advanced by DGM to the MBM trust account to give the appearance that all subsequent transactions were bona fide”, the funds to be returned a week later. So, a short-term loan secured by escrow arrangements. That’s what the document said. That’s what happened. That’s what the parties intended. I find no element of sham.

2. <u>Life Insurance and Annuity</u>

[116] The Respondent’s attack on the annuity is that it referenced investment in a global index fund, an investment fund, yet the parties knew there would be no such fund given the circular movement of the money. The annuity provided for a possible upside, when indeed there was none, but no downside, a condition that was in fact met. The money was not invested in a global index fund and it was

never intended that it would be, but instead was reinsured and invested in Trafalgar. The annuity provided for annual $400,000 payments, a condition that was met. So is it a sham transaction presented as something that it wasn't, or as a contract not honoured?

[117] Without the investment of the funds, the annuity was not a particularly attractive commercial vehicle for Paul Sr. Yet a bad investment does not imply a sham transaction. The annuity was to fund the insurance, which it did. Paul Sr. and his advisors knew that was its purpose. Anyone reading the overall plan would see that was its purpose. I do reflect, however, on the Federal Court of Appeal's comments in *Antle* that it suffices, for a finding of sham, that parties present a transaction as different from what they know it to be. That is certainly a broad statement that places a very strong arrow in the CRA's avoidance quiver. While the parties did not present the annuity as anything other than an annuity, they clearly represented there would be a certain type of investment element which there was not. They agreed to a contract that stipulated funds would be invested in an investment fund knowing there would be no such investment fund.

[118] In *Antle*, the false impression was the trustee had discretion when there was none. This went to the very essence of a discretionary trust, which the Federal Court of Appeal consequently determined was a sham. Here, is the essence of the annuity in play? St. Joseph's reinsured with Stellar and Stellar invested in Trafalgar. There was no investment in a global index fund and therefore there could be no upside. It was presented as a commercial investment vehicle. Yet, anyone looking at the overall plan and the role of the annuity could easily discern the true nature of the annuity. The pretense or misrepresentation I conclude is not fundamental to the essence of the annuity. Although there has been a misrepresentation, my view is that to void the entire transaction as a sham transaction because of a misrepresentation that is not fundamental to the nature of the annuity extends the concept too broadly. This is especially so where anyone looking at the annuity in context would quickly appreciate the annuity is simply to fund the insurance. While there may be a minor pretense in how the funds were to be invested, there is no deception by Paul Sr. as to what was really going on with this contract. It was to provide $400,000 a year and it did provide $400,000 a year.

[119] I suggest the experts fell into a trap in reviewing the annuity by simply analyzing it in isolation. In doing so they both placed some value on the investment aspect of the annuity. That was not where the parties clearly and openly intended there to be any significance. In that light I am not prepared to strike the annuity down as a sham transaction.

[120] With respect to the insurance contact, the Respondent argues that the insurance contract was a sham because, first, Paul Sr. produced only the policy and not the entire contract and, second, because it was not commercially priced. I do not accept either of these reasons to conclude the insurance in its entirety was a sham.

[121] There was an insurance policy issued by an insurance company. There was some evidence of requests for medical information to support the application. The trail of escrow arrangements suggests that monies were paid for insurance. The lack of complete documentation is not sufficient for me to draw an inference that the insurance policy was not what it purported to be.

[122] Although the Respondent went over the subsequent documents in some detail in her sham argument, as Paul Sr. was not party to those contracts (the reinsurance with Stellar and Trafalgar agreement with Metropac) I will not review those transactions in this sham review. I therefore turn to the Metropac loan, guarantee and collateral assignments.

[123] I start with Ms. Wattie's role as owner of Metropac as well as legal advisor, positions I have no doubt she regrets to this day being put in. She acknowledges having signed the loan agreement and indeed providing an opinion as to Metropac's capacity and authority to enter the loan, which was duly executed. Yet, clearly from her evidence, she did not believe Metropac was a lender but was simply some form of conduit, Metropac never having been in funds to lend $6,000,000 to Paul Sr. She never expected Metropac to receive or repay interest. Metropac never recorded any receipt of interest. Ms. Wattie was duped. Yet she went along with instructions received from Ms. Van Wees. I find Ms. Wattie's unfortunate role and conflicting views is not however determinative of sham. The documents are what they are, and Ms. Wattie's view, as principal of Metropac, only brings into question whether there was a true meeting of the minds between Metropac and Paul Sr. The loan agreement, guarantee fee and collateral assignments are not out of line with Ms. Wattie's understanding that Metropac was something of a middleman to accommodate the rights and obligations of Holdco and Trafalgar, rather than a commercial loan contract between Metropac and Paul Sr. Yes, documents support $6,000,000 flowing to Paul Sr. though Metropac but repayment is from the assignment of insurance proceeds. Herein lies the pretense. The documents may evidence the assignment was not absolute, but I conclude it was. Say, for example, Paul Sr. did not make an $80,000 annual payment, Metropac's only recourse would, according to section 7.2 of the loan agreement be "the absolute transfer of all rights, title and interest of the guarantor

under the annuity contract and the life policy”. Again, putting this in context of the RCA optimizer plan, I find the guarantee was an absolute assignment. Yes, there was a loan and yes interest was paid by Paul Sr. but no, he had no obligation to repay.

[124] The result of a finding of a sham element to this aspect of the transactions must be tied to the nature of the sham. In effect, I should consider only the real transaction not the misrepresented aspect of the transaction. I find the real transaction is a commercially vague annuity, not a commercial investment but still an annuity. I find the real transaction of the Metropac loan, guarantee and collateral assignment is to relieve Paul Sr. of his obligation to repay. I conclude, therefore, there was a benefit similar to my finding there was a taxable benefit pursuant to subsection 15(1) of the *Act*; that is, ignoring the sham element, there is a clear benefit being bestowed on Paul Sr. This is not what the Respondent’s counsel seeks, as she argues the entire plan, with all its interconnected transactions, should be set aside and section 84(1) of the *Act* apply to deem a dividend and further, because there was no real loan that no interest was deductible. Although deemed dividend treatment may be preferable to Paul Sr., I find it does not accurately reflect what is really going on. I also do not accept that relying on the sham argument wipes out all Paul Sr.’s annual deductions. I would still allow the $120,000 per year Paul Sr. was paying, whether identified as guarantee fee, interest or simply fees to get the benefit.

[125] As is no doubt clear, I rely on the Respondent’s sham argument only to cement my initial view that there was a benefit. I do not rely on it to wipe out the many contractual arrangements constituting the plan. I find Paul Sr.’s plan does not have the tax consequences he was lead to believe it had as the Metropac loan, guarantee and collateral assignment were not quite what they were presented to be.

<u>Interest Deductibility</u>

[126] Relying on the shareholder benefit basis for deciding the substantive issue, I turn now to the deductibility of interest issue. Paragraph (20)(1)(*c*) of the *Act* allows for the deduction of interest on borrowed money or “used for the purpose of earning income from a business or property” or “a reasonable amount in respect thereof”.

[127] The Parties did not concentrate their argument on whether or not the money was used for the purpose of earning income from a property, as presumably, if I

found there was no sham, there remains a legitimate loan, monies from which were used to acquire dividend bearing shares.

[128] I need to take a step back. The arguments did not pursue in detail the impact of the finding of a shareholder benefit on the interest deductibility issue. I therefore sought further written arguments from the Parties.

[129] Relying on the same reasoning to conclude there was a taxable benefit arising from the one-time $6,000,000 receipt by Paul Sr., I find there was likewise a benefit equal to the amount of capitalized interest that Paul Sr. was relieved of ever having to pay, due to the very structure of the transactions. Each year Paul Sr. would have the additional benefit of Ontario Inc. relieving him of his obligation of the interest payment other than the $80,000 cash portion. What would happen on a yearly basis then is that Paul Sr. would deduct the interest payable on the Metropac loan, but coincidently would have to bring in as a taxable benefit the interest portion ultimately absorbed by Ontario Inc. So, apart from his $80,000 cash payment, the inclusion and deduction would offset one another. It is therefore immaterial whether the rate is 5.5% or 8%. I conclude Paul Sr. is entitled to his $80,000 interest deduction, prorated for the 2008 taxation year.

[130] The Respondent argues, however, that the determination of a reasonable rate is significant. She argues that the capitalized interest benefit is to be determined at the contractually agreed 8% rate, yet the amount deductible should be limited to interest at the reasonably determined rate of 5.5%. I repeat a portion of the Respondent’s written argument in this regard:

> The Respondent maintains that the deduction at an 8% interest rate is unreasonable, and if the interest is otherwise deductible under the *Act*, it should be limited to 5.5%. The difference is material: interest on the Metropac loan deducted from income in 2008 was $397,150 comprised of a capitalized portion of $317,150 and a cash portion of $80,000 applying the reasonable rate of 5.5% interest, the amount of deductible interest in 2008 is limited to $273,040 in total for the capitalized and cash amounts. Consequently, the shareholder benefit of $317,150 would exceed the interest paid or payable, such that even if the Appellant is entitled to the interest deduction, it is fully offset by the annual benefit of the capitalized interest amounts.

[131] This is an attempt to have it both ways and is, with respect, unfounded. The benefit and deduction should be calculated at the same rate, which results in an offset, leaving Paul Sr. with an annual deduction of the cash portion of $80,000. It

is consequently unnecessary to rule on the interest rate, but for the purposes of completeness, I make the following comments.

[132] The Respondent claims the 8% interest amount was unreasonable and relies on Mr. Johnson's evidence of a reasonable rate being 5.5%. The Appellant's counsel argues that because Paul Sr. and Metropac were acting at arm's length the rate is reasonable, but in any event 8% is reasonable because: 1) it is not far off the 5.5% rate suggested by Mr. Johnson, 2) it is comparable to rates for comparable products, 3) Andrew viewed it as reasonable.

[133] I would reject all of the Appellant's positions. To say that Paul Sr. and Metropac (Dawn Wattie being owner and director) came to a negotiated arm's length interest rate would be stretching the facts beyond belief. Ms. Wattie had no hand in negotiating rates, though she did ultimately sign the loan agreement on behalf of Metropac. The rate was determined by the planners, not by the two parties signing the loan document. It had to make the plan work and was determined taking into account fees payable to all the third parties involved. I simply do not see it as a third party commercially negotiated rate.

[134] With respect to the Appellant's contention that 5.5% is close enough to 8% to be considered reasonable, I just disagree. In the context of the movement of commercial interest rates by quarter percentage points, the differential of 2.5% points on a 5.5% rate is monumental.

[135] With respect to the Appellant's point that 8% is comparable to rates on leveraged insurance annuities at the time, I find that it is not comparing apples to apples. As Mr. Hawkins pointed out, unlike in LIA situations, here Paul Sr. is not the owner of the contracts, a fundamental distinction. Paul Sr.'s RCA optimizer plan was tailor-made, and it is not useful to attempt to compare it to LIA's generally or to transactions known as 10/8.

[136] With respect to Andrew's evidence, he was neither a financial expert nor had any extensive experience in these types of plans. He also obviously had some self-interest. His testimony is not persuasive on this point.

[137] Given my finding of an offset, the rate is immaterial, however, if such a determination was necessary, I determine the interest rate should be 5.5%, being the rate suggested by the expert.

<u>GAAR</u>

[138] While I need not turn to any of the remaining alternative arguments, I do wish to comment on the Respondent's argument that GAAR applies and is therefore correct in turning to subsection 84(1) of the *Act* to assess a deemed dividend to Paul Sr. I agree, but only as a fallback position. The Appellant's counsel, while agreeing there were tax benefits resulting from avoidance transactions, argues the third element to find GAAR applies is missing: that is, there was no abuse of the underlying rationale of subsection 84(1) of the *Act*. Subsection 84(1) of the *Act* reads in part as follows:

> Where a corporation resident in Canada has at any time after 1971 increased the paid-up capital in respect of the shares of any particular class of its capital stock, otherwise than by
>
> (a) payment of a stock dividend,
>
> (b) a transaction by which
>
> (i) the value of its assets less its liabilities has been increased, or
>
> (ii) its liabilities less the value of its assets have been decreased,
>
> by an amount not less than the amount of the increase in the paid-up capital in respect of the shares of the particular class,
>
> (c) a transaction by which the paid-up capital in respect of the shares of all other classes of its capital stock has been reduced by an amount not less than the amount of the increase in the paid-up capital in respect of the shares of the particular class,
>
> …
>
> the corporation shall be deemed to have paid at that time a dividend on the issued shares of the particular class equal to the amount, if any, by which the amount of the increase in the paid-up capital exceeds the total of
>
> (d) the amount, if any, of the increase referred to in subparagraph 84(1)(b)(i) or the decrease referred to in subparagraph 84(1)(b)(ii), as the case may be,
>
> (e) the amount, if any, of the reduction referred to in paragraph 84(1)(c), and
>
> …

> and a dividend shall be deemed to have been received at that time by each person who held any of the issued shares of the particular class immediately after that time equal to that proportion of the dividend so deemed to have been paid by the corporation that the number of the shares of the particular class held by the person immediately after that time is of the number of the issued shares of that class outstanding immediately after that time.

[139] The parties reviewed the evolution of GAAR jurisprudence primarily as applicable to subsections 84(1) and 89(1) of the *Act*, relying heavily on the case of *Copthorne Holdings Ltd. v The Queen*, 2011 SCC 63. There seems to be little divergence of opinion on the policy objectives or underlying rationale for subsection 84(1) of the *Act*, being a limitation on returns to shareholders on a tax-free basis to only the shareholder's tax paid investment in a corporation, where such investment creates an equivalent increase in the company's assets or decrease in its liabilities. The difference between the parties' positions is the application of the facts in determining whether there has been an abuse of this policy. The Appellant argues that because $6,000,000 was contributed by Paul Sr. to the company, which was used to repay a $6,000,000 debt, the transaction does not run afoul of GAAR. The Respondent argues that because, after repayment of the bridge loan, Ontario Inc. is in exactly the same position as it was before it took out the bridge loan, only now showing a $6,000,000 higher PUC, the transaction is offside as it allows for a tax-free return when there has been no corresponding increase in assets or decrease in liabilities of the company. This appears to be a matter of timing: at what point do you consider whether the injection of $6,000,000 results in a decrease in liabilities or increase in assets? The Respondent's position is that you consider it from the financial position of Ontario Inc. prior to the bridge loan. The Appellant's position is that you consider it from the financial position of Ontario Inc. immediately prior to the $6,000,000 injection by Paul Sr. Given all the steps in the RCA optimizer plan were designed to work in a specific order and as one overriding plan, the starting point for determining whether the $6,000,000 injection by Paul Sr. into Ontario Inc. runs afoul of the underlying rationale of section 84, I find has to be before the first step of the plan, that is before the bridge loan. Viewed thus, if I had to rely on GAAR I would find there is an abuse of the underlying policy of subsection 84(1) of the *Act* and the Minister's assessment of a deemed dividend is correct.

<u>Conclusion</u>

[140] The *Act* is comprehensive: it has grown to be a mammoth tome attempting to cover every possible situation that taxpayers and their planners can concoct to minimize taxes – and concoct they do. Fearing plans were outwitting the

legislation, the GAAR was introduced as an overriding general anti-avoidance provision. This was not to deny a taxpayer's right to arrange affairs to minimize taxes, but to ensure such was done within the spirit of the law, hopefully saving the need for several hundred more pages of legislation to cover off more and more complex plans. And the plans continued, in the Fisc's eyes skirting with legitimacy, and thus the non-legislative concept of sham got life. In these reasons I am simply attempting to make a common sense interpretation of the legislation without resort to the more nebulous concepts of sham or spirit of the law that admittedly can tie us all in knots. Subsection 15(1) of the *Act* taxes a shareholder benefit. I find Paul Sr. clearly benefitted as a shareholder both with respect to the $6,000,000 loan and the capitalized interest. But I also find he is entitled to deduct the cash portion of the interest.

[141] So, what then is the effect of finding a $5,400,000 taxable benefit and an entitlement to a deduction of $80,000 interest? The Respondent advises that my ruling will increase Paul Sr.'s tax liability beyond the amount assessed by the Minister. Even allowing Paul Sr. the ability to deduct the cash portion of the interest, it would still result in an increase in 2008 to the amount of tax assessed. I cannot do that. The Appeal is therefore dismissed.

[142] The parties are to file written submissions on costs within 60 days of this Judgment.

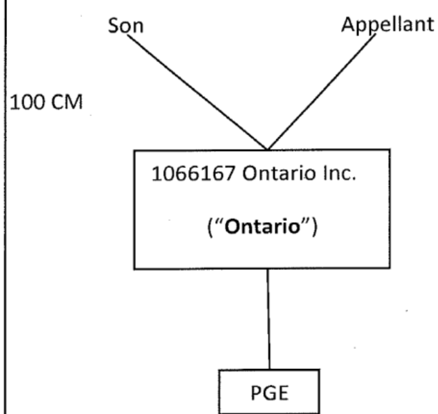
Signed at Ottawa, Canada, this 19th day of July 2016.

"Campbell J. Miller"

C. Miller J.

APPENDIX A

SITUATION PRIOR TO REOGANIZATION
(AS AT DECEMBER 22, 2006)



500,098 B Pref.	PUC: $8.20 ACB/FMV: $500,098
1,000 C Pref.	ACB/PUC: $89.90 FMV: $5,598,892
Total FMV	$6,098,990

LEGEND

Appellant: Mr. Paul C. Golini (Sr.)

Son: Mr. Paul A. Golini (Jr.)

CM: common shares

ACB: adjusted cost base (i.e. cost for tax purposes)

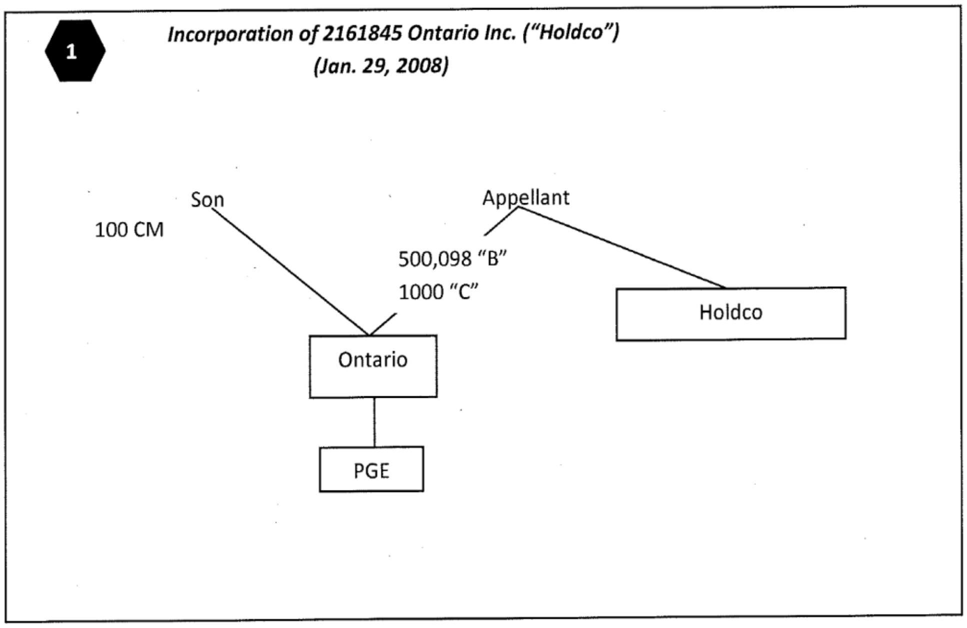
FMV: fair market value

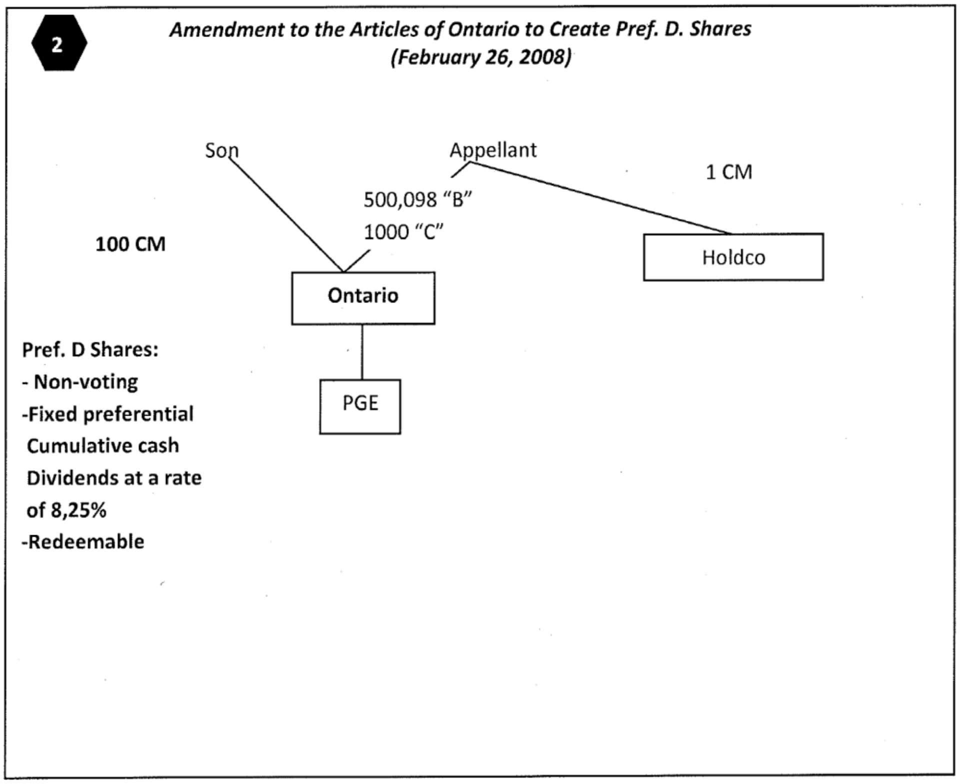
PUC: paid-up capital

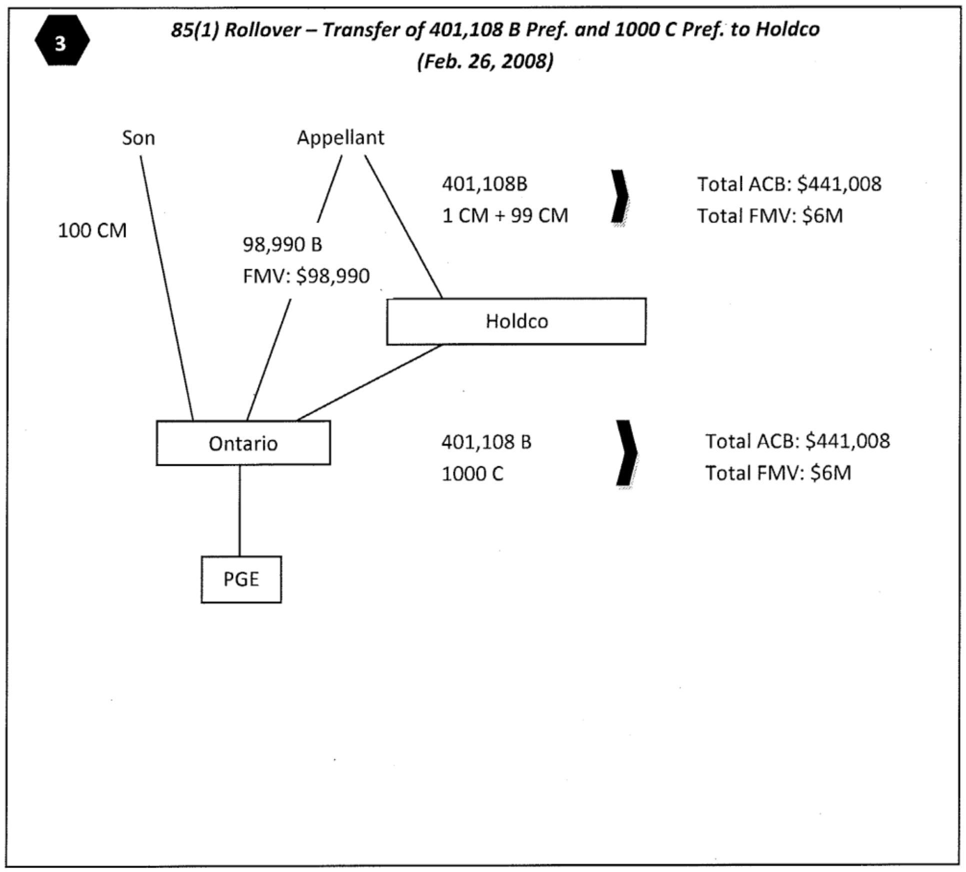
B Pref.: redeemable at $1 per share, carry right to a 7.25% dividend non-cumulative

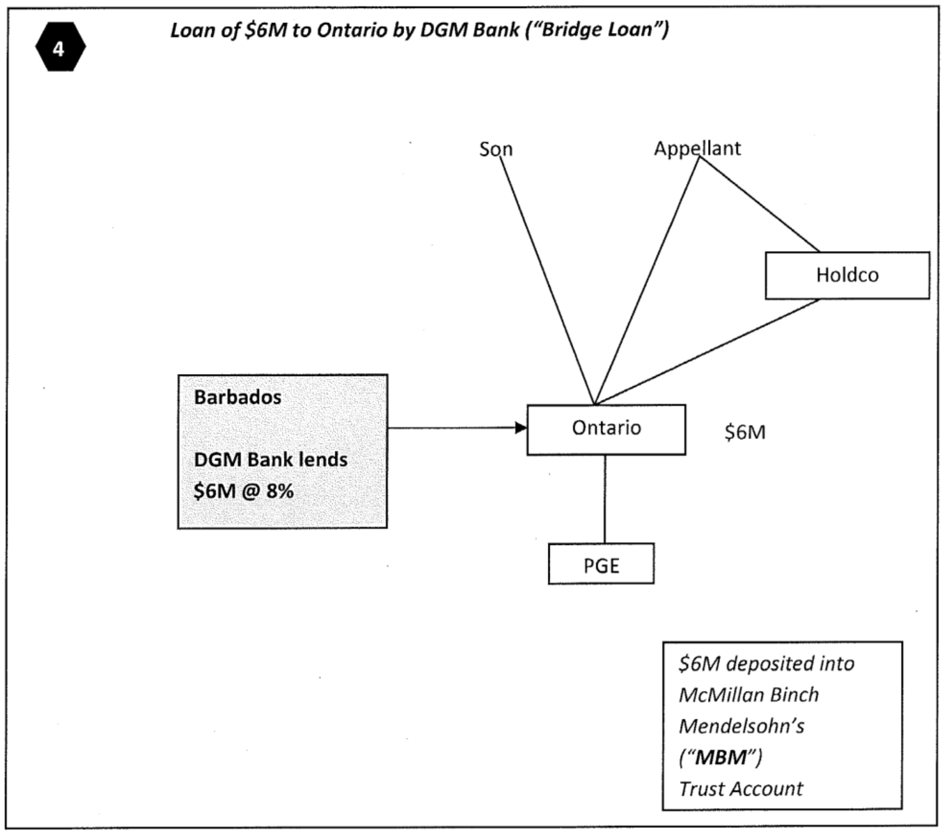
C Pref.: Directors have discretion to declare dividend up to 12% of redemption amount, non-cumulative

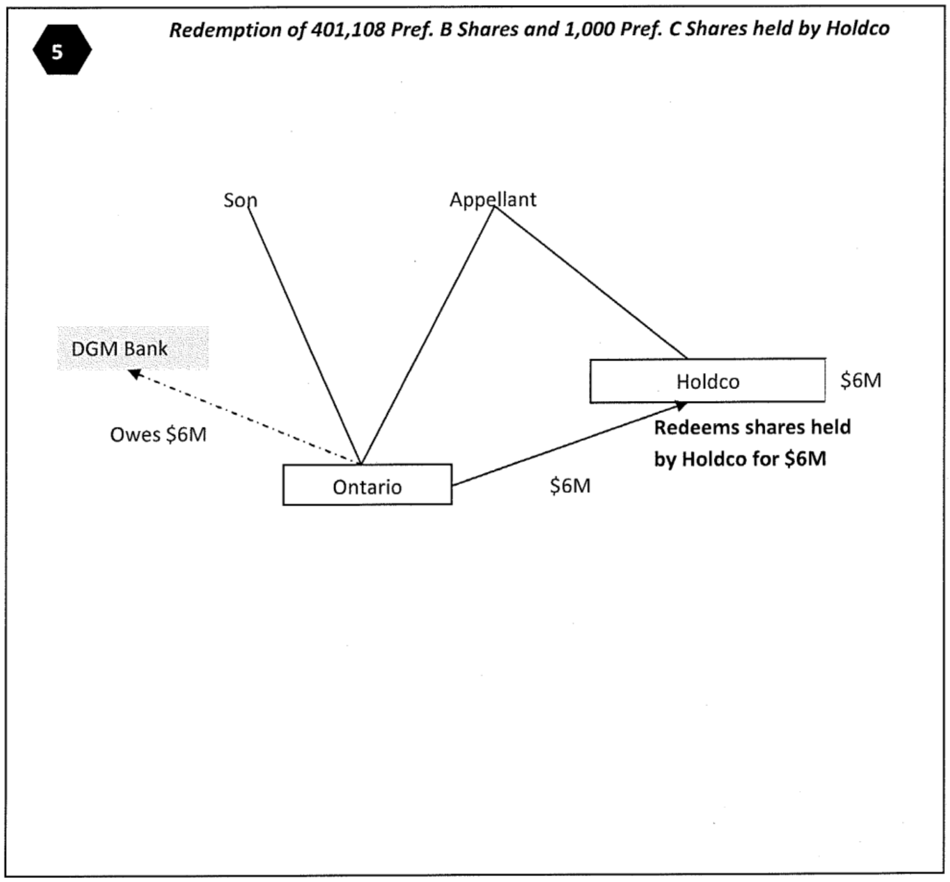
THE TRANSACTION IN ISSUE

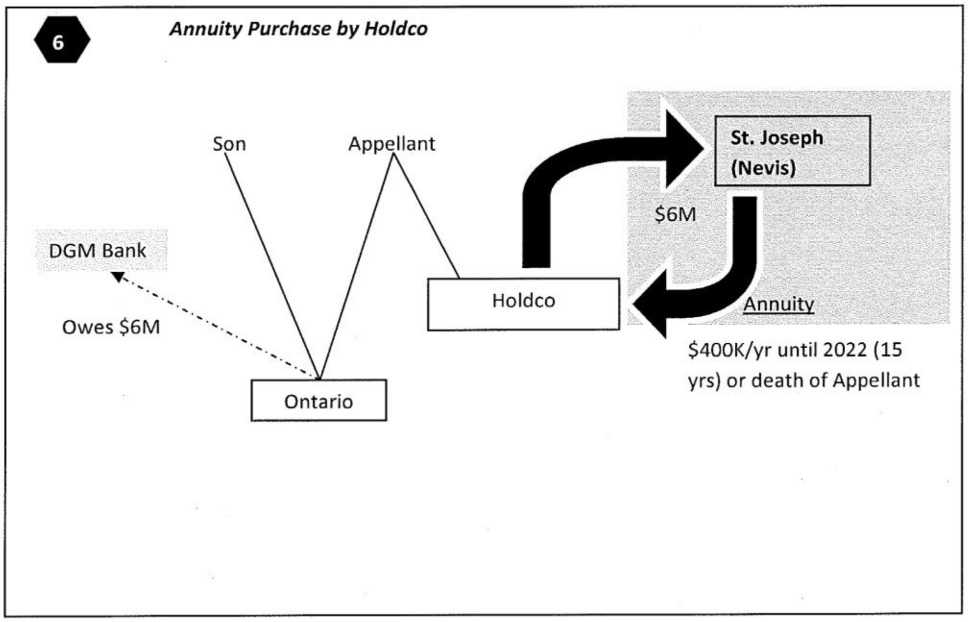


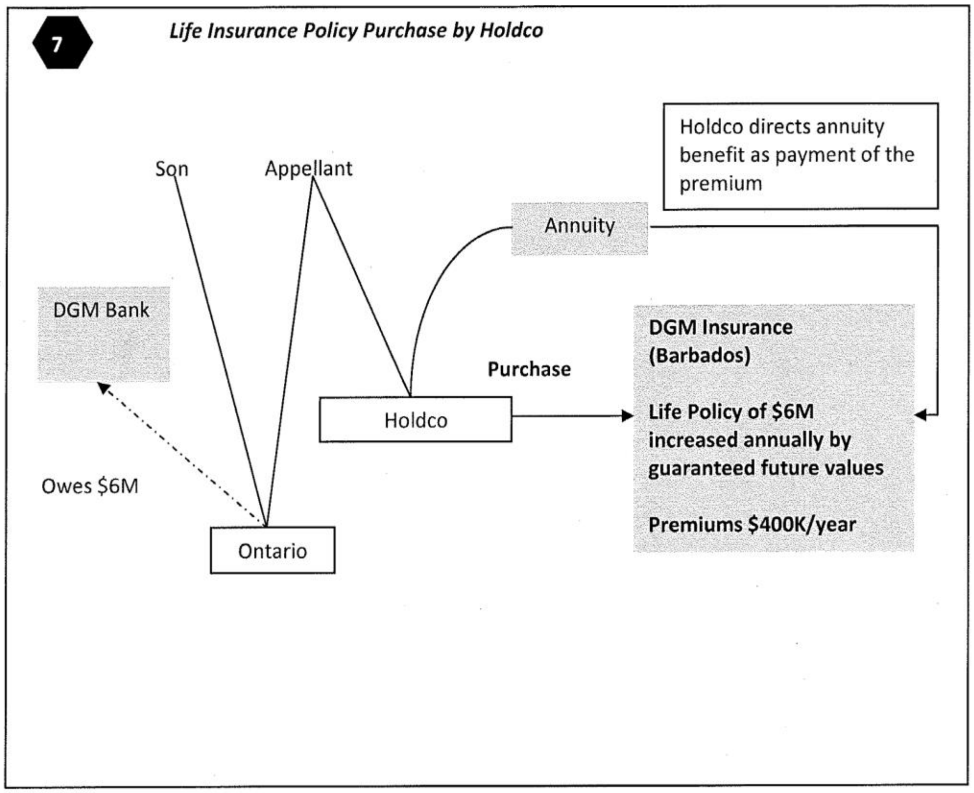

2
Amendment to the Articles of Ontario to Create Pref. D. Shares
(February 26, 2008)
Son
Appellant
1 CM
500,098 “B”
1000 “C”
100 CM
Holdco
Ontario
PGE
Pref. D Shares:
- Non-voting
-Fixed preferential
Cumulative cash
Dividends at a rate
of 8,25%
-Redeemable

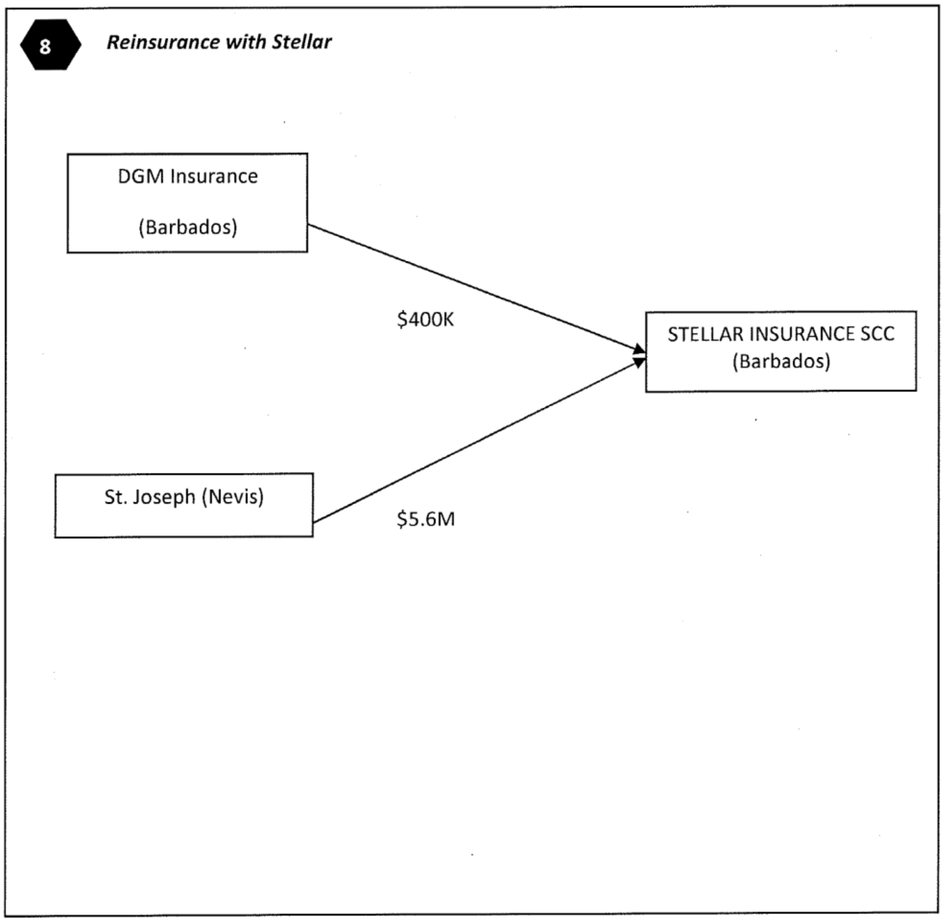

3
85(1) Rollover – Transfer of 401,108 B Pref. and 1000 C Pref. to Holdco
(Feb. 26, 2008)
Son
Appellant
100 CM
98,990 B
FMV: $98,990
401,108B
1 CM + 99 CM
Total ACB: $441,008
Total FMV: $6M
Holdco
Ontario
401,108 B
1000 C
Total ACB: $441,008
Total FMV: $6M
PGE

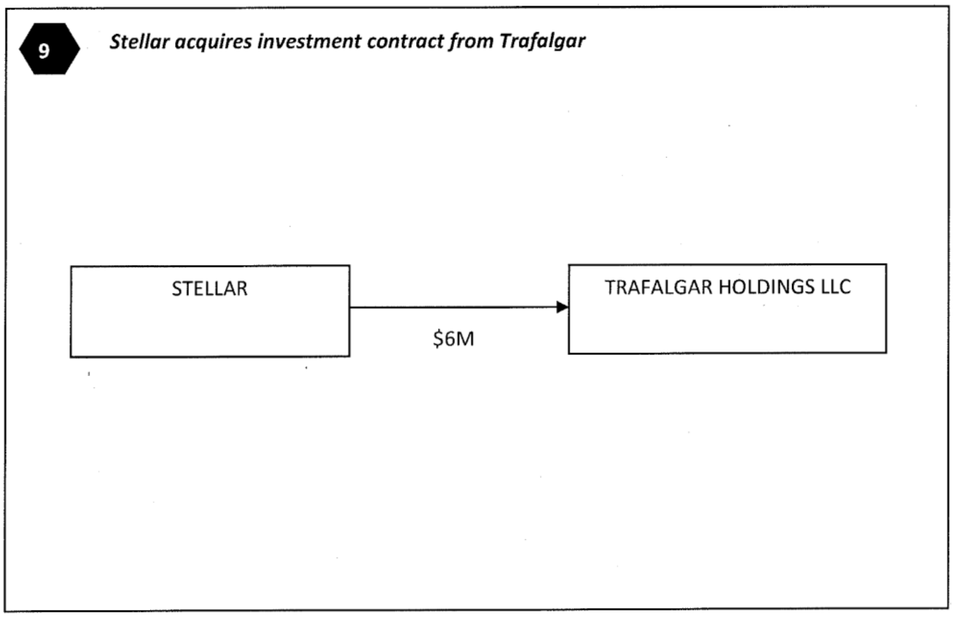

4
Loan of $6M to Ontario by DGM Bank ("Bridge Loan")
Son
Appellant
Holdco
Barbados
DGM Bank lends
$6M @ 8%
Ontario
$6M
PGE
$6M deposited into
McMillan Binch
Mendelsohn's
("MBM")
Trust Account

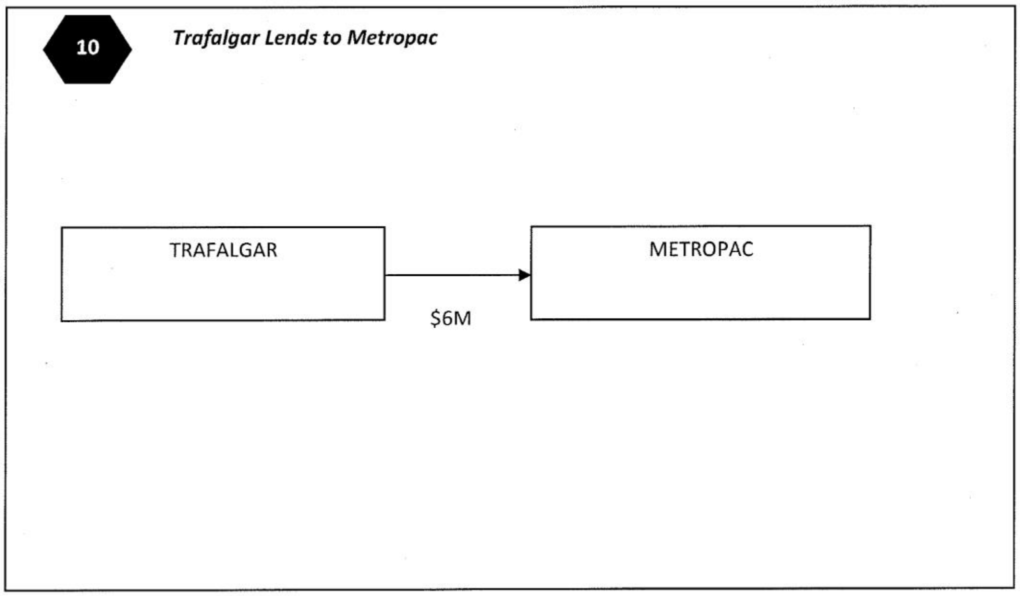

5
Redemption of 401,108 Pref. B Shares and 1,000 Pref. C Shares held by Holdco
Son
Appellant
DGM Bank
Holdco
$6M
Owes $6M
Redeems shares held
by Holdco for $6M
Ontario
$6M

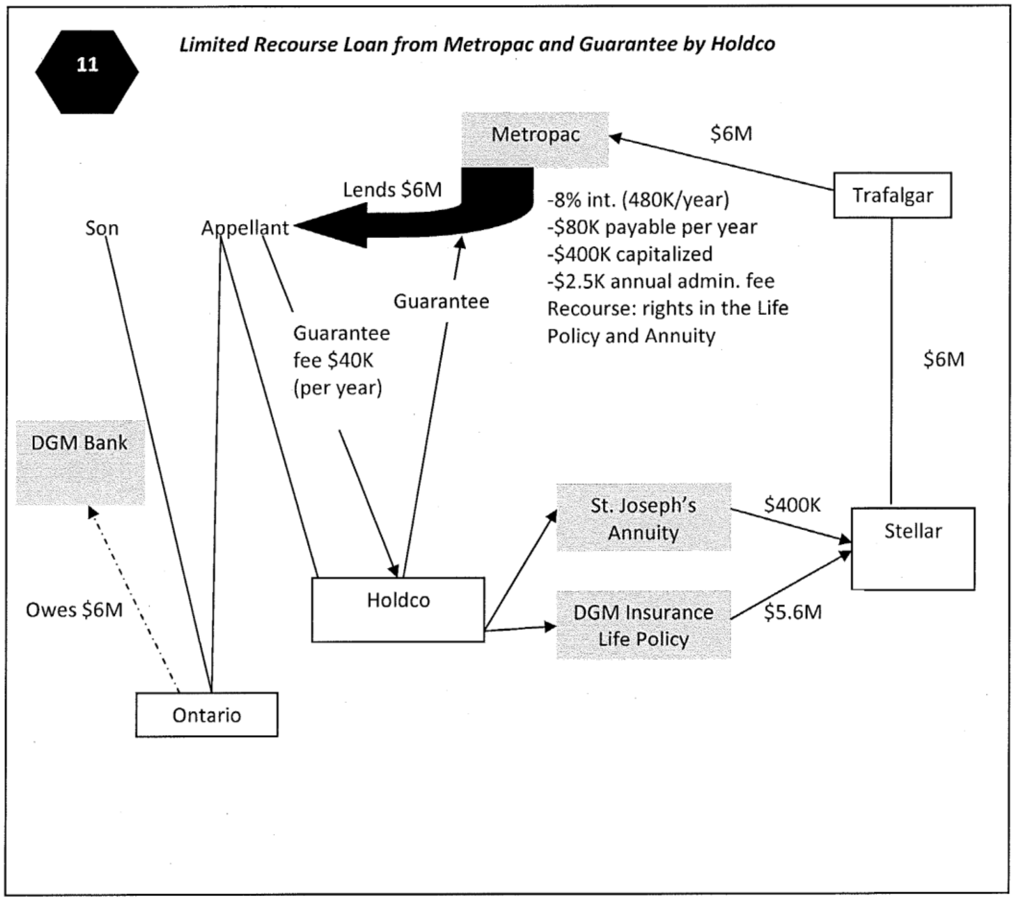

6
Annuity Purchase by Holdco
Son
Appellant
St. Joseph
(Nevis)
$6M
DGM Bank
Holdco
Annuity
Owes $6M
$400K/yr until 2022 (15
yrs) or death of Appellant
Ontario

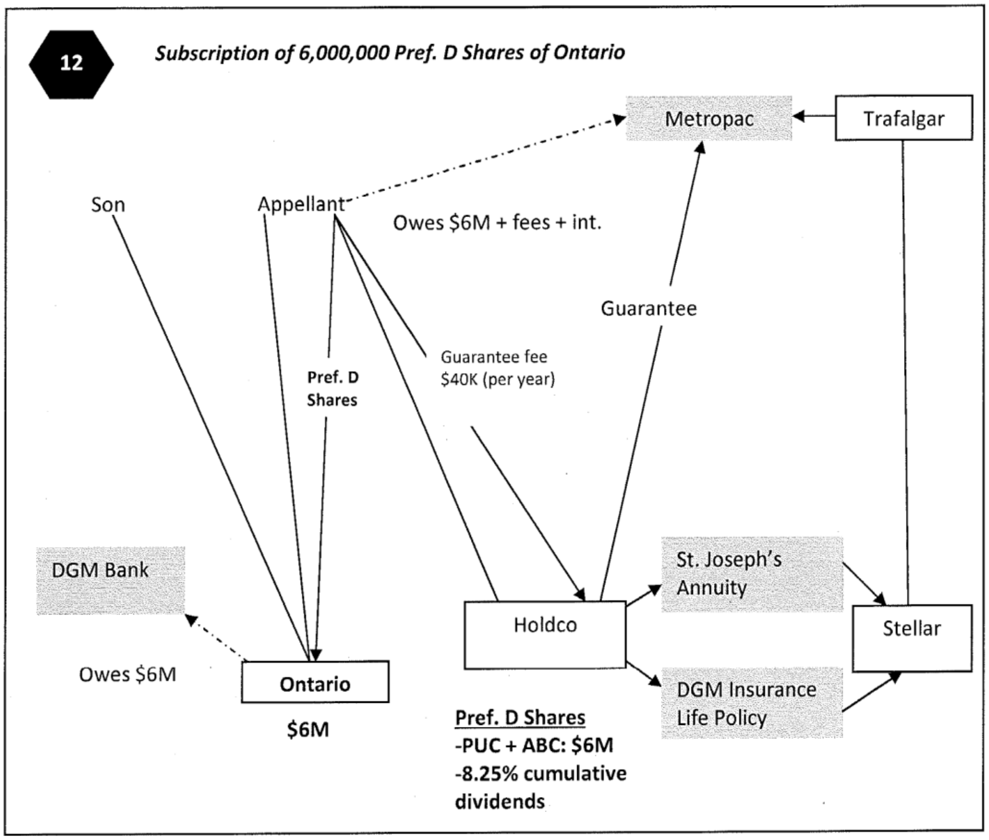

7
Life Insurance Policy Purchase by Holdco
Holdco directs annuity benefit as payment of the premium
Son
Appellant
Annuity
DGM Bank
DGM Insurance (Barbados)
Purchase
Holdco
Life Policy of $6M increased annually by guaranteed future values
Owes $6M
Premiums $400K/year
Ontario

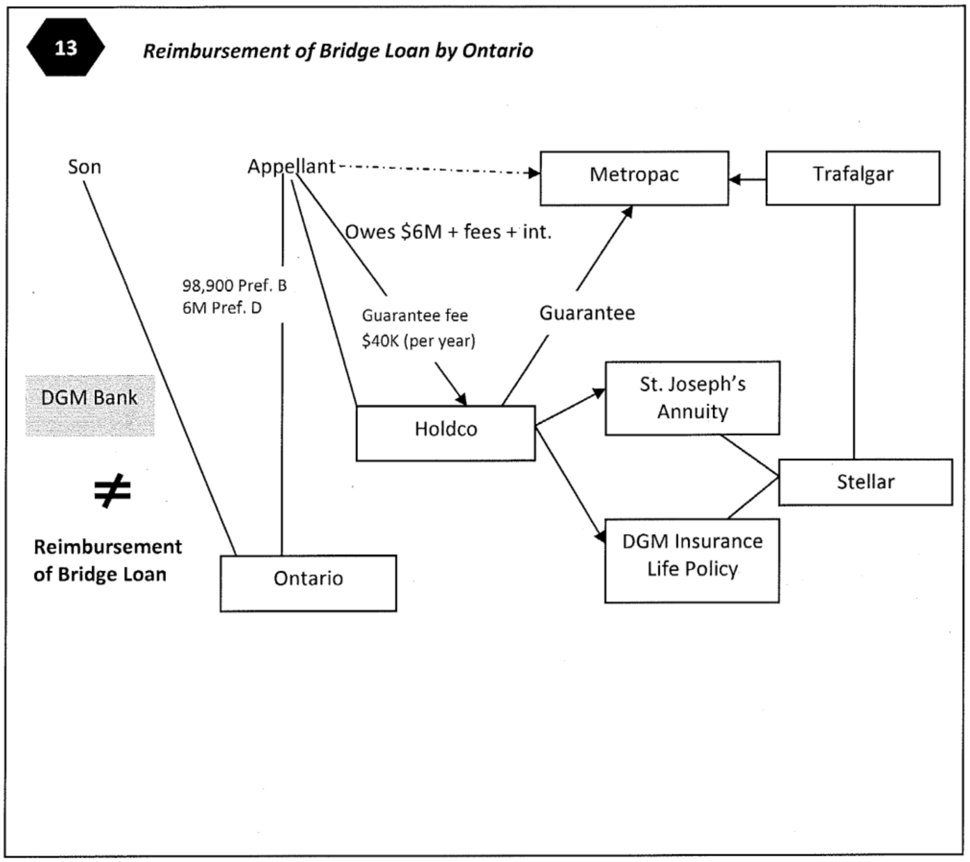

8
Reinsurance with Stellar
DGM Insurance
(Barbados)
$400K
STELLAR INSURANCE SCC
(Barbados)
St. Joseph (Nevis)
$5.6M


9
Stellar acquires investment contract from Trafalgar
STELLAR
$6M
TRAFALGAR HOLDINGS LLC


10
Trafalgar Lends to Metropac
TRAFALGAR
METROPAC
$6M


11
Limited Recourse Loan from Metropac and Guarantee by Holdco
Metropac
$6M
Trafalgar
Lends $6M
-8% int. (480K/year)
-$80K payable per year
-$400K capitalized
-$2.5K annual admin. fee
Recourse: rights in the Life
Policy and Annuity
Son
Appellant
Guarantee
Guarantee
fee $40K
(per year)
$6M
DGM Bank
St. Joseph's
Annuity
$400K
Stellar
Owes $6M
Holdco
DGM Insurance
Life Policy
$5.6M
Ontario


12
Subscription of 6,000,000 Pref. D Shares of Ontario
Metropac
Trafalgar
Son
Appellant
Owes $6M + fees + int.
Guarantee
Guarantee fee
$40K (per year)
Pref. D
Shares
DGM Bank
St. Joseph's
Annuity
Holdco
Stellar
Owes $6M
Ontario
DGM Insurance
Life Policy
$6M
Pref. D Shares
-PUC + ABC: $6M
-8.25% cumulative
dividends


13
Reimbursement of Bridge Loan by Ontario
Son
Appellant
Metropac
Trafalgar
Owes $6M + fees + int.
98,900 Pref. B
6M Pref. D
Guarantee fee
$40K (per year)
Guarantee
DGM Bank
St. Joseph's
Annuity
Holdco
Stellar
≠
Reimbursement
of Bridge Loan
Ontario
DGM Insurance
Life Policy

APPENDIX B

Metropac Loan Balance vs. Life Insurance Proceeds							
Year #	Life Insurance Proceeds[1]	Metropac Loan - Opening Balance	Metropac Loan Interest	Cash Loan Interest Paid	Capitalized Loan Interest	Metropac Loan - Ending Balance	Difference
	A	B	C = B x 8.0%	D	E = C + D	F = B + E	G = A - F
1	$ 6,400,000	$ 6,000,000	$ 480,000	$ (80,000)	$ 400,000	$ 6,400,000	$ -
2	6,832,000	6,400,000	512,000	(80,000)	432,000	6,832,000	-
3	7,298,560	6,832,000	546,560	(80,000)	466,560	7,298,560	-
4	7,802,445	7,298,560	583,885	(80,000)	503,885	7,802,445	-
5	8,346,640	7,802,445	624,196	(80,000)	544,196	8,346,640	-
6	8,934,372	8,346,640	667,731	(80,000)	587,731	8,934,372	-
7	9,569,121	8,934,372	714,750	(80,000)	634,750	9,569,121	-
8	10,254,651	9,569,121	765,530	(80,000)	685,530	10,254,651	-
9	10,995,023	10,254,651	820,372	(80,000)	740,372	10,995,023	-
10	11,794,625	10,995,023	879,602	(80,000)	799,602	11,794,625	-
11	12,658,195	11,794,625	943,570	(80,000)	863,570	12,658,195	-
12	13,590,851	12,658,195	1,012,656	(80,000)	932,656	13,590,851	-
13	14,598,119	13,590,851	1,087,268	(80,000)	1,007,268	14,598,119	-
14	15,685,968	14,598,119	1,167,849	(80,000)	1,087,849	15,685,968	-
15	16,860,846	15,685,968	1,254,877	(80,000)	1,174,877	16,860,846	-
16	18,129,713	16,860,846	1,348,868	(80,000)	1,268,868	18,129,713	-
17	19,500,090	18,129,713	1,450,377	(80,000)	1,370,377	19,500,090	-
18	20,980,097	19,500,090	1,560,007	(80,000)	1,480,007	20,980,097	-
19	22,578,505	20,980,097	1,678,408	(80,000)	1,598,408	22,578,505	-
20	24,304,786	22,578,505	1,806,280	(80,000)	1,726,280	24,304,786	-

(1) Source: Life Insurance Policy Schedule 1 Page 7.

CITATION:	2016 TCC 174
COURT FILE NO.:	2013-705(IT)G
STYLE OF CAUSE:	PAUL A. GOLINI JR. REPRESENTING PAUL C. GOLINI BY POWER OF ATTORNEY AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATES OF HEARING:	November 2, 3, 4, 5, 6, 23, 24 and December 10, 2015
REASONS FOR JUDGMENT BY:	The Honourable Justice Campbell J. Miller
DATE OF JUDGMENT:	July 19, 2016

APPEARANCES:

Counsel for the Appellant:	Nathalie Goyette, Geneviève Léveillé, Laurie Beausoleil
Counsel for the Respondent:	Jenna Clark, Christa Akey, Alisa Apostle

COUNSEL OF RECORD:

For the Appellant:

Name:	Nathalie Goyette, Geneviève Léveillé, Laurie Beausoleil
Firm:	PwC Cabinet d’avocats, s.e.n.c.r.l./s.r.l.

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