Docket: 2000-482(GST)G

BETWEEN:

9004-5733 QUÉBEC INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on April 24, 2003, at Montréal, Quebec

Before: The Honourable Justice Louise Lamarre Proulx

Appearances:

Counsel for the Appellant: Josée Cavalancia

Counsel for the Respondent: Louis Cliché

JUDGMENT

The appeal from the goods and services tax assessment made under the *Excise Tax Act*, notice of which is dated March 23, 1999, and bears number 02304444, is dismissed with costs to the Respondent, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 9th day of May 2003.

"Louise Lamarre Proulx"

J.T.C.C.

Citation: 2003TCC327
Date: 20030509
Docket: 2000-482(GST)G

BETWEEN:

9004-5733 QUÉBEC INC.,

Appellant

and

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[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

Lamarre Proulx, J.T.C.C.

[1] This is an appeal of two assessments made under the *Excise Tax Act* (the "*Act*") covering two periods, namely from June 16, 1995, to September 30, 1998, for an amount of $2,592.80 and the other from April 1, 1998, to June 30, 1998, for an amount of $2,086.38. Penalties and interest are not included for either time period.

[2] There are two issues in this case. The first involves consideration for rental building management services given by the Appellant to its sole shareholder/owner of those rental buildings. The second issue is to determine whether the Appellant is entitled to an input tax credit for two motor vehicles.

[3] It was admitted that the Appellant was incorporated on April 18, 1994, that all shares belong to Mr. Alain Déziel and that, accordingly, the Appellant and the latter are related persons within the meaning of the *Act*. It was also admitted that the

Appellant's activities involve the management of rental buildings belonging to Mr. Déziel.

[4] Counsel for the Appellant first asked auditor Ms. Louise Langlois to explain the reasons for those assessments.

[5] The auditor reported that she tried to reach Mr. Déziel via telephone on October 20, 1998. Towards the end of the day, she received a call to the effect that Ms. Marie-France Beaudoin would answer her questions regarding the Appellant. Among other things, Ms. Beaudoin reported that Mr. Déziel had requested her services that same day.

[6] At the time of the audit, Ms. Langlois found that the Appellant's invoices for management services rendered to Mr. Déziel indicated an amount only and no description of services rendered. She asked for details regarding the basis for these invoices. Ms. Beaudoin answered that the invoices were based on Mr. Déziel's liquid assets.

[7] The auditor computed the expenditures incurred by the Appellant. She did not add any profit margin. On that basis, she established the consideration for management services, which is higher than what had been paid; the additional tax owing on these amounts was $1,794.39.

[8] According to Exhibit I-3, the "Submission of Objection" in a letter dated April 19, 1999, written by Mr. Déziel to the auditor, he states that capital expenditures such as the purchase of computer equipment and office furniture should not be accounted for when computing management costs. He did not reiterate this point during his testimony at the hearing. He suggested that the invoice amounts had been based on the time spent working for the Appellant.

[9] Mr. Déziel also explained that an accountant had advised him to use the corporate form for management services.

[10] The auditor said that she met Mr. Déziel for the first time on November 12, 1998. Mr. Déziel was accompanied by Ms. Beaudoin and Mr. Raynald Gagnon, the Appellant's external accountant. The auditor argues that there was never any question that the invoices were based on the hours Mr. Déziel spent working for the Appellant.

[11] With regard to the vehicles required by the Appellant, the auditor asked to see the log books for the vehicles. Ms. Beaudoin told him that there were none. The auditor found invoices related to vehicles from garages located in Florida, New York and North Carolina.

[12] According to Exhibit I-1, a 1991 Chevrolet S-10 was purchased on September 30, 1995, a 1994 Pontiac Grand Am was leased on July 17, 1995, and a 1998 Jeep Cherokee was purchased on June 18, 1998. The Appellant owned the vehicles. According to information from the Société de l'assurance automobile du Québec provided by the auditor, Mr. Déziel has owned a Corvette since July 4, 1996.

[13] The auditor explained that the rental buildings are located very close to the Applicant's head office and in one of the rental buildings, there is a concierge who takes care of renting and the collection of cheques. She explained that she received no documentary evidence that would substantiate commercial use greater than 50% for the vehicles in question.

[14] During his testimony, Mr. Déziel affirmed that the Appellant used these vehicles for management services and that he himself made minimal use of them for personal reasons. He provided no record accounting for mileage and destinations.

Submissions, analysis and conclusion

[15] Counsel for the Appellant argued that the Respondent did not have an expert determine the fair market value of those services and that the Appellant's determination was the same as that of the Respondent. With regard to the vehicles, she referred to Mr. Déziel's testimony. In terms of penalties, she argues that the Appellant exercised due diligence because its primary shareholder, Mr. Déziel, had followed an accountant's advice.

[16] Counsel for the Respondent argued that the Appellant had changed versions several times regarding the basis of invoicing and that it was up to the Appellant to provide evidence of the fair market value for services rendered. With regard to mileage, the Appellant did not keep any records. There was no element of due diligence in the evidence.

[17] Subsection 155(1) of the *Act* reads as follows:

Non-arm's length supplies

155.(1) For the purposes of this Part, where a supply of property or a service is made between persons not dealing with each other at arm's length for no consideration or for consideration less than the fair market value of the property or service at the time the supply is made, and the recipient of the supply is not a registrant who is acquiring the property or service for consumption, use or supply exclusively in the course of commercial activities of the recipient,

(*a*) if no consideration is paid for the supply, the supply shall be deemed to be made for consideration, paid at that time, of a value equal to the fair market value of the property or service at that time; and

(*b*) if consideration is paid for the supply, the value of the consideration shall be deemed to be equal to the fair market value of the property or service at that time.

[18] This subsection stipulates that a supply of a service that is made for consideration less than the fair market value shall be deemed equal to the fair market value where the supplier and recipient of the service are not dealing with each other at arm's length or where the recipient of the supply is not a registrant acquiring the property or service for consumption, use or supply in the course of the recipient's commercial activities.

[19] Both parties admit the existence of the two circumstances mentioned. The non-arm's length relationship is not in question and Mr. Déziel's leasing activities are exempt. These are, therefore, not commercial activities.

[20] Therefore, one must determine the fair market value of the management services rendered to Mr. Déziel. The definition of fair market value in subsection 123(1) of the *Act* reads as follows:

"**fair market value**" of property or a service supplied to a person means the fair market value of the property or service without reference to any tax excluded by section 154 from the consideration for the supply; . . .

[21] Reading this definition is of no help in understanding this legal concept. Therefore, the usual legal meaning must be given to this expression. In the *Dictionnaire de droit québécois et canadien*, Hubert Reid, (1994) W&L, "fair market value" is defined as follows:

> [TRANSLATION]
> The highest possible price obtainable on the free market, where parties to a transaction are well-informed, prudent and independent of one another and are not forced to conclude the transaction.

[22] These words are the same as those used by Cattanach, J. in *Henderson Estate and Bank of New York v. M.N.R.*, 73 DTC 5471, at page 5476.

[23] Policy Statement P-165 explains that there are three procedures or approaches that are generally used to assess this value: the cost approach, the direct comparison approach and the income approach. It is true that the policy statement involves buildings. There may be different approaches for assessing the fair market value of services. Therefore, it is interesting to read Information Circular 87-2R entitled *International Transfer Pricing* and Interpretation Bulletin IT 468R entitled: *Management or Administration Fees Paid to Non-Residents*.

[24] However, I do not wish to elaborate further on methods for assessing the fair market value of services as I have had no specific evidence from either side on the matter.

[25] Neither the Respondent nor the Appellant provided expert evidence; and in fact, the burden of proof fell on the Appellant. Of the two proposals, I must therefore choose that which appears to be, reasonably, more representative of the fair market value of services.

[26] The auditor chose the cost approach. I am of the opinion that this approach is appropriate and reasonable. She did not even account for a usual margin of profit. The cost method is appropriate and reasonable so long as the only purpose of a business is to render building management services and that those buildings all belong to a single shareholder. The proposed computing of fair market value by Mr. Déziel based on hours that he worked for the Appellant, in my mind, only accounts for part of the Appellant's costs. One would have to explain how this could reasonably determine the fair market value of the management services rendered. With respect, I do not understand the logic of the proposal.

[27] With regard to the input tax credit ("ITC") for vehicles, subsection 199(2) of the *Act* stipulates that a registrant may claim an ITC relative to the tax payable by the registrant in respect of the acquisition of tangible personal property to be used as an

asset if the property is acquired for use primarily in the registrant's commercial activities. The Minister of National Revenue interprets "primarily" as more than 50%.

[28] Subsection 199(2) of the *Act* reads as follows:

> (2) **Acquisition of capital personal property** — Where a registrant acquires or imports personal property or brings it into a participating province for use as capital property,
>
> (*a*) the tax payable by the registrant in respect of the acquisition, importation or bringing in of the property shall not be included in determining an input tax credit of the registrant for any reporting period unless the property was acquired, imported or brought in; and
>
> (*b*) where the registrant acquires, imports or brings in the property for use primarily in commercial activities of the registrant, the registrant is deemed, for the purposes of this Part, to have acquired, imported or brought in the property, as the case may be, for use exclusively in commercial activities of the registrant.

[29] Section 286 of the *Act* also requires the keeping of records:

> 286(1) **Keeping books and records** — Every person who carries on a business or is engaged in a commercial activity in Canada, every person who is required under this Part to file a return and every person who makes an application for a rebate or refund shall keep records in English or in French in Canada, or at such other place and containing such information as the Minister may specify in writing, in such form and containing such information as will enable the determination of the person's liabilities and obligations under this Part or the amount of any rebate or refund to which the person is entitled.

[30] I have no evidence of the ratio of mileage for business purposes to the total mileage, which would allow me to conclude that the vehicles were used primarily for the Appellant's business. A simple affirmation of minimal use for purposes other than business cannot suffice.

[31] With regard to the due diligence defence, I do not find any elements of that diligence in this case. The Appellant was incorporated on an accountant's

recommendation. This does not pose a problem. However, was the invoicing method discussed with the accountant? There is no evidence in this respect: whether this was done or what the accountant said. Those statements would also have to be proven. With regard to the Appellant's vehicles for which it claimed input tax credits, there is no proof either of due diligence. No appropriate records or valid documentation were kept, which would have been used to prove the primary use of those vehicles by the Appellant.

[32] Consequently, the appeal is dismissed with costs to the Respondent.

Signed at Ottawa, Canada, this 9th day of May 2003.

"Louise Lamarre Proulx"

J.T.C.C.