Docket: 2009-1051(GST)I

BETWEEN:

STÉPHANE DESJARDINS,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on February 10, 2010, at Montréal, Quebec.

Before: The Honourable Justice Réal Favreau

Appearances:

Counsel for the appellant:	Gilles Gravel
Counsel for the respondent:	Benoît Denis

JUDGMENT

The appeal of the assessment for which the notice is dated December 17, 2007, and has no number, made pursuant to Part IX of the *Excise Tax Act* for the monthly reporting period of September 2007, is dismissed in accordance with the attached reasons for judgment.

Signed at Ottawa, Canada, this 15th day of October 2010.

"Réal Favreau"

Favreau J.

Translation certified true
on this 30th day of November 2010.

Elizabeth Tan, Translator

Citation: 2010 TCC 521
Date: 20101015
Docket: 2009-1051(GST)I

BETWEEN:

STÉPHANE DESJARDINS,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

Favreau J.

[1] This is an appeal under the informal procedure of an assessment made pursuant to Part IX of the *Excise Tax Act*, R.S.C. 1985, c. E-15, as amended (the ETA) for which the notice is dated December 17, 2007, and has no number, for the appellant's monthly reporting period of September 2007.

[2] According to the notice of assessment, the Minister of Revenue of Québec as agent for the Minister of National Revenue (collectively, the Minister) determined the appellant's net tax amount for September 2007 to be $960,864.59 as follows:

Goods and services tax ("GST") collected or collectable	=	$964,722.65
Input tax credits ("ITC") allowed (unchanged)	=	$3,858.06
Net tax		$960,864.59

and imposed interest in the amount of $11,198.89 for a total of $972,063.48.

[3] When making the assessment in question, the Minister added to the collected or collectable GST reported the GST the appellant was deemed to have paid, as a recipient, and collected, as supplier, in the amount of $962,076.84 ($964,722.65 - $2,645.81) regarding the self-supply of the property, calculated using the fair market value (FMV) of said property established by the Minister, since the appellant did not self-assess during the self-supply of the property in question.

[4] The $962,076.84 adjustment to the appellant's net tax calculation mentioned in the previous paragraph represents the GST calculated on the FMV of the property established at $16,034,613.05 before GST, the Quebec sales tax (QST) payable and all applicable GST and QST rebates for new rental housing.

[5] Within the prescribed time frame, the appellant filed his monthly net tax report in which his net tax was calculated for a negative amount of ($1212.25) as follows:

GST collected or collectable	$2,645.81
ITC claimed	$3,858.06
Net tax	($1,212.25)

[6] The appellant did not claim the GST rebate for the new rental housing for the property in question and as a result, the Minister did not allow it to the extent that he would have been eligible.

[7] The issue results from the fact that, during the month of September 2007 when the building at 25 Place Casavant in Sainte-Thérèse (hereinafter the "property") was almost completed, the appellant transferred the occupation of a residential unit by lease to an individual who was the first to occupy such a residential unit. The appellant did not pay, as recipient, and did not collect, as supplier, the GST regarding the self-supply of the property on the FMV of the property at the time. GST was not included in the net tax calculation for the period in question that was reported to the Minister, or for any other monthly period prior to or after the period in question.

[8] The only issue in question is the determination of the FMV of the appellant's property in September 2007 and, as a result, the amount of GST payable by the appellant for the period in question, for the self-supply of the property in question.

[9] The appellant claims the FMV of the property is between $14,700,000 and $14,900,000 whereas the Minister determined the FMV of the property was $16,034,614.05 according to the replacement cost method.

[10] The appellant mandated a certified appraiser to assess the FMV of the property as of September 30, 2007. An opinion letter on the FMV of the property was submitted on March 7, 2008, and an appraisal report dated November 20, 2009, was prepared for the purposes of the case.

[11] Before proceeding with the analysis of the appraisal report, clarifications are needed regarding certain characteristics of the building in question. It is a 6-storey (including ground floor), multi-residence building with a basement garage. The building is made of concrete and has 180 units, namely 12 studio or 1½-room units, 60 3½-room units, 95 4½-room units and 13 5½-room units. The building has an indoor heated pool, a whirlpool tub, a sauna, an exercise room and a common room, 243 parking spaces including 154 indoor spaces and 10 for visitors. The underground garage and main levels are connected by two elevators. Each housing unit has its own electric meter for lighting and heating; hot water is included in the rent and is provided by the gas-powered central hot air heating system, which also heats the common areas. The units are heated with electric baseboard heaters. The flooring in the common areas is ceramic tile and carpet, while in the housing units ceramic tile and laminate (floating floors) were used. According to the appraiser's observations, the quality of the structure's construction is "B class" and the interior and exterior finishing is a "low cost" type.

[12] Sylvie Lavoie, certified appraiser, testified at the hearing and she provided explanations about the appraisal method used and the factors involved in her appraisal. She noted that she considered the three methods usually used to evaluate real-estate property, namely the cost method for which the value index was $17,700,000, the income method for which the value index was $14,900,000 and the comparison method for which the value index was between $12,700,000 and $16,700,000. In her opinion, the best method to use in the circumstances was the income method since the property generated income and income was a better reflection of the property's value than the cost of construction. In her appraisal report (Exhibit A-1), she made the following observation at page 21:

> [TRANSLATION]
> A potential and well-advised recipient will focus much more on the income the property generates as well as the percentage of expenditures and the property's monetary flow than on what it cost to build.

The comparison method was not used because of the low comparability rate of sales catalogued and analyzed.

[13] The appraiser explained that the income method is based on the fact that a property's value depends on its ability to regularly generate a steady level of income on a long-term basis. To carry out the income method, the effective gross income is estimated and standardized, then the operating expenses are estimated and standardized to establish a standardized net income which is converted to the market rate investors seek.

Rental income

[14] As of the appraisal date, the rental summary according to the valid leases was:

Apartments	Number of units	Average monthly price	Actual rent potential	Vacant units	Vacancy % (# of units)	Vacancy % (income $)
1½ rooms	12	$628	$90,360	0	0.0%	0.0%
3½ rooms	60	$679	$488,880	0	0.0%	0.0%
4½ rooms	95	$859	$979,200	18	10.0%	11.2%
5½ rooms	13	$1,068	$166,680	2	1.1%	1.5%
Total	180		$1,725,120	20	11.1%	12.7%

[15] The appraiser noted in her appraisal report that the monthly rent in the building was higher than the average rent noted by the Canadian Mortgage and Housing Corporation (CMHC) in Zone 26, published in its October 2007 rental market report, but that the monthly rent was comparable to that noted for large residential complexes (100 or more units) in the Laval and Rive-Nord area. However, the appraiser applied a risk premium to the overall discount rate (ODR) because the rental rate could be hard to maintain over time due to the interior finishing of the apartments, which is inferior to what might be expected for this type of construction. In her opinion, the owner might have to offer incentives (free month of rent or parking) to maintain the current rental rate.

Vacancies and uncollected rent—apartments

[16] The building's overall vacancy rate (11.1% to 12.7%) was higher than that observed by the CMHC (0.8% to 4.4%). According to the appraiser, this gap was due to the building being in the rental process at the time of the appraisal. For the purposes of the appraisal, she standardized the vacancy rate at 4.0%, including vacancies and uncollected rent.

Income from parking, vacancies and uncollected rent

[17] The property under review has 79 indoor parking spots, 154 outdoor parking spots and 10 outdoor parking spots reserved for visitors. The rental fee is $60/month for an indoor spot and $15/month for an outdoor spot. On the date of the appraisal, the situation was as follows:

Parking	Available	Rented		Vacant	
Indoor	79	51	64.6%	28	35.4%
Outdoor	154	101	65.6%	53	34.4%
Sub-total	233	152	65.2%	81	34.8%
Visitor (outdoor)	10				
Total	243				

The appraiser noted that the number of parking spots was greater than the renters' needs and for the purposes of the review, she applied a vacancy and uncollected rent rate of 30% based on the vacancy rate used for the apartments.

Operating expenses

[18] Since the property is a new construction, no history of operating expenses was available for analysis and comparison with buildings in the same category. To estimate the usual expenses, the appraiser consulted the expected operating expenses for 2008 and conducted estimates using the monthly expenses of January 2008 and maintenance contracts for 2007-2008. In her opinion, the amounts for operating expenses seemed normal. Expenses for which she had no information were estimated using data from comparable buildings.

Management fees and structural reserve

[19] For the purposes of the appraisal, the appraiser used management fees of 4% of the effective gross income ("EGI") and a structural reserve of 2% of the EGI.

Estimated value using the income method

[20] Considering the above-noted data, the auditor estimated the effective net income of the property was $1,156,606 to which she applied an ODR of 7.75% whereas the rates noted in the market were from 6.24% to 7.60%. The ODR of 7.75% includes a risk premium of 0.50% or the equivalent of half a month's free rent or a 4% deduction in rent. Additionally, considering the low quality of the

construction material, she estimated that there was a risk over time that the maintenance and repair expenses would be higher than normal. Using the direct discounting method, she estimated the value of the property at $14,900,000, or $82,778 per housing unit (excluding applicable taxes and rebates).

[21] The Minister had the appraisal report analyzed by a certified appraiser, Jocelyn Martin. The Court acknowledged him as an expert and he testified at the hearing. In his opinion, in the context of self-supply, a simulation must be made of the price an investor would have had to pay an independent builder to acquire property including the land and the building. According to the appraiser Martin, the cost method is the one to use to determine the FMV of the property as of September 30, 2007.

[22] In his analysis of the cost method, the appraiser considered the value of the lot, the replacement cost of the building and the cost of preparing the lot were an accurate reflection of the value of each component on the appraisal date. However, he indicated that in the case of a residential building, the FMV should include the various taxes and rebates that apply on the date of the appraisal. As a result, the value of the property for appraisal purposes would be $15,533,129 (without the 36% rebate) or $16,264,795 (with the 36% rebate).

[23] In his analysis of the income method, the appraiser considered that the gross rental income, the vacancy rate, operating expenses and income accurately represented the property's rental potential. The only element in question was the ODR of 7.75% including a risk premium of 0.50%. In his opinion, the risk premium is not at all justified considering the quality of the interior finishing of the rental units in the building was the same as that found in the majority of recent constructions built for rental purposes. Moreover, he feels that the ODR should be closer to the lower limit of comparable rates calculated, which vary from 6.24% to 7.60% for an average of 6.93%, because comparable properties considered were the sales of rental properties constructed between 1961 and 1967. Significant capital expenses must be made to these buildings in order to maintain the level and quality of rental income.

[24] Appraiser Martin also felt that the comparison method could not be used because of the low comparability level of listed sales.

[25] Regarding the appraiser Lavoie's reconciliation exercise, appraiser Martin noted that the $14,900,000 excluded provincial and federal taxes, where applicable. However, since the economic value is based on the analysis of exempt property transactions, the indication obtained by this approach includes automatically the net

taxes (GST and QST minus the rebates). According to the appraiser Martin, the net effective income of $1,156,606 divided by 17,700,000 indicates an ODR or 6.53%. This rate is supported by the market (a rate lower than 7% is often used in cases of new constructions) and shows that the owner is justified to build the building.

[26] During his testimony, appraiser Martin noted that the actual cost of construction, $16,034,000 before taxes, corresponded to a cost established by appraiser Lavoie, $17,700,000 based on reference books.

Analysis

[27] The rule of self-supply of a multiple-unit residential complex is stated at subsection 191(3) of the ETA as follows:

> **(3) Self-supply of multiple unit residential complex** — For the purposes of this Part, where:
>
> (a) the construction or substantial renovation of a multiple unit residential complex is substantially completed,
>
> (b) the builder of the complex
>
> (i) gives, to a particular person who is not a purchaser under an agreement of purchase and sale of the complex, possession or use of any residential unit in the complex under a lease, licence or similar arrangement entered into for the purpose of the occupancy of the unit by an individual as a place of residence,
>
> (i.1) gives possession or use of any residential unit in the complex to a particular person under an agreement for
>
> (A) the supply by way of sale of the building or part thereof forming part of the complex, and
>
> (B) the supply by way of lease of the land forming part of the complex or the supply of such a lease by way of assignment, or
>
> (ii) where the builder is an individual, occupies any residential unit in the complex as a place of residence, and
>
> (c) the builder, the particular person, or an individual who has entered into a lease, licence or similar arrangement in respect of a residential unit in the complex with the particular person, is the first individual to occupy a residential unit in the complex as a place of residence after substantial completion of the construction or renovation,

the builder shall be deemed

> (d) to have made and received, at the later of the time the construction or substantial renovation is substantially completed and the time possession or use of the unit is so given to the particular person or the unit is so occupied by the builder, a taxable supply by way of sale of the complex, and
>
> (e) to have paid as a recipient and to have collected as a supplier, at the later of those times, tax in respect of the supply calculated on the fair market value of the complex at the later of those times.

[28] The application of the self-supply rule to the property in question is not challenged by the appellant; only the FMV of the property as of September 30, 2007, is being challenged.

[29] The term "fair market value" is defined at subsection 123(1) of the ETA as follows:

> **"fair market value"** of a 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.

[30] This Court has considered the meaning of the expression "fair market value" and the use of the cost method when applying subsection 191(3) of the ETA in many decisions (*Résidences Majeau Inc. v. R.*, [2009] G.S.T.C. 90 (TCC) affirmed by [2010] G.S.T.C. 10 (FCA), *Timber Lodge Ltd. v. R.*, [1994] G.S.T.C. 173 (TCC), *Charleswood Legion Non-Profit Housing Inc. v. R.*, [1998] G.S.T.C. 8, *Métal Santigen Inc. v. R.*, 2007 D.T.C. 1037, *Sira Enterprises Ltd. v. R.*, [2000] G.S.T.C. 102 (TCC)).

[31] At page 20 of her appraisal report, Ms. Lavoie admitted that the cost method could lead to conclusive results when the property is new or relatively new:

> [TRANSLATION]
> According to the manual, *Traité de l'évaluation foncière* [(DESJARDINS, Jean-Guy, *Traité de l'évaluation foncière*, 1992) [sic], the use of the cost method to determine the market value may represent an acceptable alternative when the income method cannot be used and when the rarity of recent sales of comparable property means the comparison method cannot be used. The cost method may still lead to conclusive results with new or relatively new buildings. This is the case when the property reflects optimal use and is situated in neighbouring units where vacant lots are sold regularly. In this context, we can calculate the value of a lot with fairly high

> accuracy and considering the building is new or relatively new, potential errors in the calculation of depreciation are lower.

[32] The appraisal did not follow the cost method because the income method could apply in this case and the property was not situated in an area with regularly sold vacant lots. It was noted that in April 2006, the appellant had purchased the lot on which the building was constructed from the City of Sainte-Thérèse for $390,906.64 before taxes. This sale was considered representative of the market price. For the purposes of the appraisal, Ms. Lavoie rounded off to $3.00 per square foot, which represents a 2% increase in value at the time.

[33] Based on the appraisal report, we note that the value obtained using the cost method is higher than the value obtained using the income method. The difference between the two values is a significant economic depreciation. Unless there are specific circumstances, I doubt that a building contractor or any business person with the expertise and knowledge required to carry out a project of such scope would agree to sell a new construction at a lower price than the actual cost in the context of a strongly rising property market.

[34] The evidence did not show that there were excesses in the cost of construction or any specific problems with soil contamination or with the connection infrastructure with municipal services, or any errors of development or construction.

[35] In the circumstances, I feel that the cost method should be considered as the best method for determining the FMV of the property, which was completely new and in the rental period on the appraisal date.

[36] The income method, as applied by appraiser Lavoie, includes three weak elements, namely the history of income and expenses, the ODR and the risk premium. Appraiser Lavoie used a single year's history or income and expenses, which is insufficient for determining a long-term trend. Appraiser Lavoie used an ODR of 7.25% based on only three comparable properties, two of which were from 2004. The sample was lacking, and the result is therefore of little probative value; a rate lower than 7% should have been used. The application of a risk benefit of 0.50% is not justified because the vast majority of rental properties are now built the same way the property was built. The material of inferior quality could easily be replaced at low cost.

[37] As a result, the appeal is dismissed.

Signed at Ottawa, Canada, this 15th day of October 2010.

"Réal Favreau"

Favreau J.

Translation certified true
on this 30th day of November 2010.

Elizabeth Tan, Translator

CITATION:	2010 TCC 521
COURT FILE NO.:	2009-1051(GST)I
STYLE OF CAUSE:	Stéphane Desjardins v. Her Majesty the Queen
PLACE OF HEARING:	Montréal, Quebec
DATE OF HEARING:	February 10, 2010
REASONS FOR JUDGMENT BY:	The Honourable Justice Réal Favreau
DATE OF JUDGMENT:	October 15, 2010

APPEARANCES:

Counsel for the appellant:	Gilles Gravel
Counsel for the respondent:	Benoît Denis

COUNSEL OF RECORD:

For the appellant:

Name:	Gilles Gravel
Firm:	Lawyer Laval, Québec

For the respondent:	Myles J. Kirvan Deputy Attorney General of Canada Ottawa, Canada