

Docket: 2009-1863(IT)G

BETWEEN:

GEORGE SMITH,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

---

Appeals heard on November 9, 2010, at Montréal, Québec.

By: The Honourable Justice Réal Favreau

Appearances:

Counsel for the Appellant: Aaron Rodgers

Counsel for the Respondent: Alain Gareau

---

**JUDGMENT**

The appeals from the reassessments made under the *Income Tax Act* dated March 1, 2007 with respect to the 2003, 2004 and 2005 taxation years are dismissed with costs in accordance with the attached reasons for judgment.

Signed at Ottawa, Canada, this 29th day of September 2011.

« Réal Favreau »

---

Favreau J.

Citation: 2011 TCC 461  
Date: 20110929  
Docket: 2009-1863(IT)G

BETWEEN:

GEORGE SMITH,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

### **REASONS FOR JUDGMENT**

Favreau J.

[1] The appellant appeals, by way of the general procedure, the reassessments dated March 1, 2007 made by the Minister of National Revenue (the "Minister") pursuant to the *Income Tax Act*, R.S.C. 1985 c.1 (5<sup>th</sup> Supp.), as amended (the "Act") in respect of his 2003, 2004 and 2005 taxation years.

[2] The issues to be decided concern the tax treatment of (i) amounts received by the appellant pursuant to a price adjustment clause in a sale agreement of the appellant's clientele to B.F. Lorenzetti & Associates Inc. ("BFL") and (ii) the interest payments received by the appellant on the balance of the sale price.

[3] In determining the appellant's tax liability for the 2003, 2004 and 2005 taxation years, the Minister made the following assumptions of fact set out in paragraph 9 of the Reply to the Notice of Appeal:

- (a) BFL carries on an active insurance brokerage business and related insurance activity from and located in the Province of Quebec.
- (b) The Appellant has practised for a number of years as a licensed insurance broker domiciled in Quebec and is registered in the Province of Quebec.
- (c) BFL and the Appellant entered into an Agreement of Referral effective November 1, 1995 whereby BFL provided the Appellant with the use of

BFL's office facilities and services in consideration of splitting the commission/fee income earned and paid on any premiums paid by the Insurer's policyholder during the term of this Agreement of Referral.

- (d) The Agreement of Referral also provided BFL with the option to purchase the Appellant's Clientele.
- (e) BFL and the Appellant entered into a Sale Agreement effective January 1, 2002 whereby the Appellant agreed to sell his Clientele and BFL agreed to purchase the Appellant's Clientele.
- (f) On January 1, 2002, the Appellant had a Clientele in the Province of Quebec which represented current annual base commission revenue of \$156,000.
- (g) Based on annual commissions generated of \$156,000 times an acquisition factor of 2.25, BFL agreed to purchase the Appellant's Clientele for a total purchase price of \$351,000 commencing as of the date of the Sale Agreement and adjusted each year for the period based on actual commission revenue for the past year Purchase Price.
- (h) Subject to an adjustment, the Purchase Price was payable as follows:
  - (i) January 1, 2002: \$142,000 representing 40.70% of the purchase price;
  - (ii) January 1, 2003: \$69,500 representing 19.77% of the purchase price;
  - (iii) January 1, 2004: \$69,500 representing 19.77% of the purchase price; and
  - (iv) January 1, 2005: \$69,500 representing 19.76% of the purchase price.
- (i) It was understood that the Purchase Price was based on represented annual revenue of \$156,000 and that the subsequent payment due on January 1, 2003, 2004 and 2005 would be calculated by applying the percentage mentioned above (see paragraph 9(h) of this Reply) to the actual year's revenue from the Appellant's Clientele times the acquisition factor of 2.25.
- (j) The balance of payment due to be paid was subject to an interest rate calculated at prime at then prevailing interest rates.
- (k) The Appellant warranted and represented that his Clientele, as at January 1, 2002, yielded for the benefit of BFL and would continue to yield to BFL, in the future, annualized commission revenue of at least \$156,000.

- (l) If the annualized commission revenue at anniversary payment date was greater or lesser than the amount warranted and represented then the annual payments contemplated above (see paragraph 9(h) of this Reply) would be adjusted upwards or downwards accordingly.
- (m) Pursuant to the Sale Agreement, BFL made the following down payment to the Appellant:

<u>Date</u>	<u>Actual Year's Revenue</u>	<u>2.25 Factor</u>	<u>Percentage</u>	<u>Down Payment</u>
April 18, 2002	\$156,000	\$351,000	40.70%	\$142,500

- (n) Pursuant to the Sale Agreement, BFL made the following subsequent adjusted payments to the Appellant:

<u>Date</u>	<u>Previous Year's Revenue</u>	<u>2.25 Factor</u>	<u>Percentage</u>	<u>Subsequent Down Payment</u>
January 15, 2003	\$166,160	\$373,860	19.77%	\$73,912
February 26, 2004	\$208,098	\$468,221	19.77%	\$92,568
January 10, 2005	\$192,370	\$432,833	19.76%	\$85,571

- (o) Pursuant to the Sale Agreement, BFL made the following interest payments to the Appellant:

<u>Date</u>	<u>Interest Payments</u>
January 15, 2003	\$9,383
February 26, 2004	\$3,125
January 10, 2005	\$4,429

[4] The appellant included in his income for the 2002 to 2005 taxation years, the total consideration received for the sale of the clientele, including the interests, as eligible capital amounts in accordance with subsection 14(1) of the *Act*.

[5] The Canada Revenue Agency ("CRA") reassessed the appellant and included the subsequent adjusted payments received in 2003, 2004 and 2005 as income from the sale of the business in accordance with paragraph 12(1)(g) of the *Act* and the

interest payments as investment income in accordance with paragraph 12(1)(c) of the *Act*.

[6] Paragraphs 12(1)(c) and (g) of the *Act* read as follows:

(c) **Interest** – subject to subsections (3) and (4.1), any amount received or receivable by the taxpayer in the year (depending on the method regularly followed by the taxpayer in computing the taxpayer's income) as, on account of, in lieu of payment of or in satisfaction of, interest to the extent that the interest was not included in computing the taxpayer's income for a preceding taxation year;

...

(g) **Payments based on production or use** – any amount received by the taxpayer in the year that was dependent on the use of or production from property whether or not that amount was an instalment of the sale price of the property, except that an instalment of the sale price of agricultural land is not included by virtue of this paragraph;

[7] The relevant clauses of the sale agreement, bearing an effective date of January 1, 2002, are the following:

1. [...]
2. GS has a loyal and personal book of property/casualty portfolio of clients in the Province of Quebec which represents current annual base commission revenue of One Hundred and Fifty Six Thousand Dollars (\$156,000.00); the client list is appended hereto as a Schedule "A" ("Clientele").
3. GS agrees to sell his Clientele and BFL agrees to purchase the Clientele for a total purchase price of Three Hundred and Fifty One Thousand Five Hundred Dollars (\$351,000) (based on annual commissions generated of 156,000 times an acquisition factor of 2.25) commencing as of the date of this Agreement and adjusted each year for the period based on actual commission revenue for the past year Purchase Price ("Purchase Price")

Subject to Section 5 below, the Purchase Price shall be payable over three (3) years as follows:

- i. January 1<sup>st</sup>, 2002: \$142,500 representing 40.70% of the purchase price;
- ii. January 1<sup>st</sup>, 2003: \$69,500 representing 19.77% of the purchase price;
- iii. January 1<sup>st</sup>, 2004: \$69,500 representing 19.77% of the purchase price;
- iv. January 1<sup>st</sup>, 2005: \$69,500 representing 19.76% of the purchase price.

4. It is understood that the Purchase Price shall be based on represented annual revenue of One Hundred and Fifty Six Thousand Dollars (\$156,000), and that the subsequent payments due on January 1, 2003, 2004 and 2005 will be calculated by applying the percentage mentioned above to the actual year's revenue from GS's Clientele times the acquisition factor of two point two five (2.25). The balance of payment due to be paid will be subject to an interest rate calculated at prime at then prevailing interest rates.
5. GS warrants and represents that the Clientele, as at January 1<sup>st</sup>, 2002, yielded for the benefit of BFL and now yields and shall continue to yield to BFL, in the future, annualized commission revenue of at least One Hundred and Fifty Six Thousand Dollars (\$156,000). If the annualized commission revenue at any anniversary payment date are greater or lesser than the amount warranted and represented, then the annual payments contemplated in Section 3 will be adjusted upwards or downwards accordingly.

### The Appellant's Position

[8] In the Notice of Appeal, the appellant invoked the following reasons:

18. In the hands of the Appellant, the clientele was an asset with an enduring benefit. Accordingly, the sale of the Appellant's clientele in 2002 constituted a disposition of an eligible capital property.
19. Subject to the Price Adjustment Clause, the Purchase Price was established at the time of the sale at fixed amount of \$351,000 and was not dependent upon the use or production.
20. In accordance with subsection 14(1) of the *Act*, the Appellant included in his income for the taxation years 2002 to 2005 the total consideration received for the sale of the clientele as eligible capital amounts.
21. It is submitted that the formula set in the Price Adjustment Clause did not change the nature of the above-mentioned instalments received by the Appellant in the taxation years 2003, 2004 and 2005.
22. Even if the above-mentioned instalments were viewed as dependent upon the use or production, it is submitted that section 14 of the *Act* takes precedence over paragraph 12(1)(g) of the *Act*.
23. In alternative, it is submitted that paragraph 12(1)(g) of the *Act* is only applicable to the amounts received in excess of the Purchase Price.

### Analysis

[9] Income from property is included in a taxpayer's total income for the year under section 3 of the *Act*. By virtue of subsection 9(1) of the *Act*, a taxpayer's income from property for a taxation year is the taxpayer's profit from that property for the year. So, income derived from the ownership of property, in the form of rents or royalties, clearly falls into the taxpayer's income under the general provisions of sections 3 and 9 of the *Act*. Paragraph 12(1)(g) of the *Act* includes incomes that are dependent on the use of or production from that property, although expressed as instalments of the sale price of the property. Paragraph 12(1)(g) of the *Act* applies to any kind of property except agricultural land in certain circumstances. The term "property" is broadly defined in subsection 248(1) of the *Act* to mean "property of any kind whatever whether real or personal or corporeal or incorporeal and, without restricting the generality of the foregoing, includes *a*) a right of any kind whatever, a share or a chose in action; *b*) unless a contrary intention is evident, money; *c*) a timber resource property, and *d*) the work in progress of a business that is a profession."

[10] In this instance, the property sold was clearly the appellant's list of clients. Section 2 of the sale agreement specifically referred to the client list that is appended as Schedule "A" to the sale agreement and that was defined as being the "Clientele". The appellant owned proprietary rights to his client list and transferred those rights to BFL and was paid for it.

[11] In *Gifford v. R.*, [2002] 4 C.T.C. 64 (Fed. C.A.), Rothstein J.A. reviewed the jurisprudence respecting client lists and came to the following conclusion:

... the jurisprudence has consistently concluded, in a variety of situations, that payment for a client list is a capital expenditure. Frequently, the acquisition is accompanied by a non-compete clause and the vendor endorses the purchaser to his clients. ...

[12] The fact that the client list of the appellant was the subject of a "business" transaction to which section 14 of the *Act* would normally apply, can nevertheless become the subject of further review as "property" under paragraph 12(1)(g) of the *Act* (see *289018 Ontario Ltd. v. Minister of National Revenue*, 87 D.T.C. 381 (Tax Court of Canada)).

[13] In considering the application of paragraph 12(1)(g) of the *Act*, it is necessary to determine whether the amounts received were dependent upon use or production of the property. In the present case, the parties entered into the sale agreement made effective as of January 1, 2002, in which they fixed the purchase price at \$351,000

(based on annual commissions generated of 156,000 times an acquisition factor of 2.25) payable over a three-year period. They agreed to adjust the purchase price each year for the period based on actual commissions received for the previous year's purchase price (the "Purchase Price"). With such conditions, it cannot be said that the Purchase Price was fixed and determined in advance since the annual payments to the appellant were calculated each year based on commissions received for the previous year. The initial price of \$351,000 was only an estimate and the Purchase Price was not fixed and did not constitute a guaranteed minimum price. The total purchase price of \$351,000 could fluctuate depending upon the annualized commissions received on any anniversary payment date. The client list was also variable as new clients referred by the appellant could be added to the list and existing clients on the list could be removed as well.

[14] The appellant's counsel contends that the Purchase Price was not entirely dependent upon the production or use of the client list since it was also dependent upon the profitability of the insurance company which was based on the experience of claims of the portfolio of the insurance policies subscribed by the appellant's clients. I do not accept this argument. Pursuant to the sale agreement, the Purchase Price and the adjustments to the Purchase Price were all computed and determined by the annual commissions received from the appellant's client list and nothing else.

[15] The source of the commissions received was indeed the client list, all amounts received by the appellant, although expressed as instalments of the sale price of the client list, were dependent entirely on the use of or production from that property and were taxable under paragraph 12(1)(g) of the *Act*.

[16] The interest payments received by the appellant in respect of the balance of payment due to be paid pursuant to the sale agreement are taxable by virtue of paragraph 12(1)(c) of the *Act* and not by virtue of section 14 of the *Act* as submitted by the appellant. Considering that, pursuant to the sale agreement, no part of the adjusted payments received by the appellant from BFL are taxable under section 14 of the *Act*, the interest payments, which are accessories to the principal, cannot also be taxed under that section of the *Act*.

[17] Consequently, the appeals are dismissed with costs.

Signed at Ottawa, Canada, this 29th day of September 2011.



« R al Favreau »

---

Favreau J.

CITATION: 2011 TCC 461

COURT FILE NO.: 2009-1863(IT)G

STYLE OF CAUSE: George Smith v. Her Majesty the Queen

PLACE OF HEARING: Montréal, Québec

DATE OF HEARING: November 9, 2010

REASONS FOR JUDGMENT BY: The Honourable Justice Réal Favreau

DATE OF JUDGMENT: September 29, 2011

APPEARANCES:

Counsel for the Appellant: Aaron Rodgers

Counsel for the Respondent: Alain Gareau

COUNSEL OF RECORD:

For the Appellant:

Name: Aaron Rodgers

Firm: Spiegel Sohmer Inc.  
Montreal, Quebec

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