Docket: 2015-4583(IT)G

BETWEEN:

EYEBALL NETWORKS INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on January 16, 2019 at Vancouver, British Columbia

Before: The Honourable Mr. Justice Randall S. Bocock

Appearances:

Counsel for the Appellant:	Paul A. Hildebrand
Counsel for the Respondent:	Whitney Dunn

JUDGMENT

The appeal of the notice of reassessment issued under section 160 of the *Income Tax Act* as Assessment No. 2587838 dated March 19, 2014 is hereby dismissed.

Costs are awarded provisionally to the Respondent subject to the right of either party to make written submissions thereon within 30 days of the date of the judgment, whereupon the Court may consider such submissions and vary its provisional cost award, failing which this provisional cost award shall become final.

Signed at Hamilton, Ontario, this 18th day of July, 2019.

"R.S. Bocock"

Bocock J.

Citation: 2019TCC150
Date: 20190718
Docket: 2015-4583(IT)G

BETWEEN:

EYEBALL NETWORKS INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Bocock J.

I. INTRODUCTION AND TRANSFER OF ASSETS

[1] On March 19, 2002 the Appellant ("Newco") purchased certain assets from a non-arm's length affiliate ("Oldco"). Those assets comprised certain information technology assets and patents (the "transferred property"). The transferred property related to software developed by Oldco concerning bi-directional, internet-based, video-conferencing technology (the "new business"). As part of the transfer, certain liabilities owed to Oldco's trade creditors were assumed by Newco (the "assumed liabilities"). Assets retained by Oldco were uni-directional video software programs and related licenses, mostly expired, concerning the gaming industry (the "old business").

[2] The sole director, shareholder and officer of both Oldco and Newco, Mr. Piche, determined that the creation of Newco and the conveyence of the transferred property were necessary to continue the development and exploitation of the new bi-directional, video-conferencing technology. Oldco was associated with the online gaming industry; such a company might have an unsavoury pedigree which prospective customers might find unnerving and off-putting. Hence, a separate company, free of that concern, would be preferable. Therefore, the transferred property was to be conveyed to, and the assumed liabilities satisfied by, Newco. What remained to be determine was how best to do this.

[3] Mr. Piche retained a noted tax law firm to structure the transfer. For these primary business reasons, a tax-free rollover of the new business was utilized at the outset. Aside from the business purpose, Mr. Piche declared that tax structured transfer overall was to establish a present distinct value for the new business' video-conferencing software and avoid a subsequent dispute of value arising from a later-in-time transfer. As such, a fairly common rollover transaction was undertaken in pursuance of section 85 of the *Income Tax Act*, R.S.C. 1985, c.1 (the "Act"). Its particulars are described in the steps below.

A. Oldco Reorganization Agreement

[4] At the outset, Mr. Piche owned 11,000,000 class A shares in Oldco. Under the initial Oldco Reorganization Agreement, Mr. Piche sold those shares back to Oldco in consideration of Oldco issuing 11,000,000 new class A shares and 11,000,000 new class C shares. The Piche-Oldco Agreement included the following provisions:

> 1. Effective March 19, 2002, the Vendor [Mr. Piche] sells and the Purchaser [Oldco] purchases the Property [11,000,000 class A shares of Oldco] for and at a price equal to the fair market value of the property at the date of this Agreement, which the Vendor and Purchaser agreed to be $30,000,000 (the "Estimated Value"). The Vendor and Purchaser further agree that their best estimate of the fair market value of the Subject Assets less the amount of the Subject Liabilities (the "Net Asset Value") is $30,000,000.
>
> 2. In consideration of the transfer of the Property to it by the Vendor, the Purchaser will issue to the Vendor 11,000,000 class A shares without par value and 11,000,000 class C shares without par value in the capital of the Purchaser, having the special rights and restrictions set forth in Schedule "C" to this Agreement. The 11,000,000 class C shares without par value will have an aggregate redemption value equal to $30,000,000, subject to adjustment in accordance with section 5, below.
>
> 4. The Vendor and the Purchaser covenant and agree that:
>
> (a) the purchase price of the Property will be the fair market value of the Property at the date of this Agreement;
>
> (b) the Estimated Value is the parties' best estimate of the fair market value of the Property presently available;
>
> (c) the aggregate redemption value of the class C shares without par value to be issued to the Vendor pursuant to section 2 will be the Net Asset Value; and

(d) the parties' best estimate of the Net Asset Value is $30,000.000

B. Newco Reorganization Agreement

[5] Under the Newco Reorganization Agreement, Mr. Piche sold his 11,000,000 class C shares in Oldco to Newco in consideration of 11,000,000 class A shares of Newco and 11,000,000 class B shares of Newco. The Newco Reorganization Agreement included the following provisions:

> 1. Effective March 19, 2002, the Vendor [Mr. Piche] sells and the Purchaser [Newco] purchases the Property [11,000,000 class A Shares of Oldco] for and at a price equal to the fair market value of the Property at the date of this Agreement, which the Vendor and Purchase agree to be $30,000,000 (the "Estimated Value").
>
> 2. In consideration of the transfer of the Property to it by the Vendor, the Purchaser will issue to the Vendor 11,000,000 class A shares without par value and 11,000,000 class B shares without par value in the capital of the Purchaser, having the special rights and restrictions set forth in Schedule "B" to this Agreement.
>
> 4. The Vendor and the Purchaser covenant and agree that:
>
> (a) the purchase price of the Property will be the fair market value of the Property at the date of this Agreement; and
>
> (b) the Estimated Value is the parties' best estimate of the fair market value of the Property presently available.

[6] In clause 5, the parties also agreed to file a subsection 85(1) election under the Act.

[7] All the above agreements were dated simultaneously. To maintain a logical sequence of events, the Oldco Reorganization Agreement had to precede the Newco Reorganization Agreement, but the Newco Reorganization Agreement did not have to fit into any particular sequence.

C. The Asset Transfer Agreement ("ATA")

[8] Oldco sold the assets critical to the new business to Newco in exchange for (a) Newco satisfying the assumed liabilities equal to $175,000.00, and (b) the 11,000,000 class C shares of Newco. The ATA included the following provisions:

> 1. Effective March 19, 2002, Oldco sells and Newco purchases the Property [computer software, equipment, goodwill, etc.] for and at a price equal to the fair market value of the Property at the date of this Agreement, which the Vendor and Purchaser agreed to be $30,175,000 (the "Estimated Value"), as more particularly set forth in Schedule "B".
>
> 2. In consideration of the transfer of the Property to it by Vendor, the Purchaser will:
>
> (a) assume the Subject Liabilities shown in Schedule "A", which will not exceed the Aggregate Agreed Amount as that time is defined in section 9; and
>
> (b) issue to the Vendor 11,000,000 class C shares in the capital of the Purchaser with an aggregate redemption value equal to the amount by which the fair market value of the Property exceeds the amount of the Subject Liabilities (the "Net Asset Value"). The class C shares to be issued to the Vendor shall have the special rights and restrictions set forth in Schedule "C" to this Agreement. The Vendor and Purchaser agree that their best estimate of the Net Asset Value is $30,000,000, which will be the aggregate redemption value of the class C shares to be issued to the Vendor, subject to adjustment in accordance with section 5."
>
> 4. The Vendor and the Purchaser covenant and agree that:
>
> (a) the purchase price of the Property will be the fair market value of the Property at the date of this Agreement;
>
> (b) the Estimated Value is the best estimate of the fair market value of the Property presently available;
>
> (c) the aggregate redemption value of the class C shares without par value to be issued to the Vendor pursuant to the section 2 will be the Net Asset value; and
>
> (d) the parties' best estimate of the Net Asset Value is $30,000,000.

[9] Clause 5 was a price adjustment clause which would be triggered if a tax authority disputed either the fair market value of the transferred property or other values. It also provided for adjustment of the redemption amount of the class C shares. Again, the parties also agreed to file a subsection 85(1) election.

D. Articles of Newco

[10] The rights and restrictions attaching to the class C shares of Newco provided that such shares were both redeemable and retractable, and also included the following:

> 7. The class C shares have the following additional special rights and restrictions:
>
> (a) the class C shares will only be issued as consideration of the acquisition of property by the Corporation in circumstances where the transferor of such property and the Corporation have agreed to effect the transfer of such property pursuant to the provisions of section 51, 85, or 86 of the *Income Tax Act*;
>
> (b) the aggregate redemption amount of the class C shares issued in connection with a purchase and sale transaction to which section 51, 85, or 86 applies will be the sum of:
>
> i) The amount by which:
>
> (A) the aggregate fair market value of all the property acquired by the Corporation in the transaction wo which section 51, 85, or 86 applies and in respect of which the class C shares were issued,
>
> exceeds
>
> (B) the aggregate fair market value of all the consideration (other than any class C shares in the Corporation or a right to receive any such shares) received from the Corporation by the transferor of such property,
>
> as determined by the directors of the Corporation at the time of the issuance of the class C shares, provided that the directors may, in accordance with the terms of any agreement between the Corporation and the holders of the class C shares, amend from time-to-time their determination of the aggregate redemption amount of the class C shares after the time of issuance of such shares…

E. Other corporate actions and the Mutual Debt Cancellation Agreement

[11] To convey the transferred assets from Oldco to Newco, the parties executed a General Conveyance and an Assignment is respect of certain patent applications.

[12] Effective March 19, 2002:

(a) Oldco redeemed the 11,000,000 class C Oldco shares owned by Newco, issuing a demand promissory note to Newco in the amount of $30,000,000;

(b) Newco redeemed the 11,000,000 class B Newco shares owned by Oldco, issuing a demand promissory note to Oldco in the amount of $30,000,000; and

(c) Oldco and Newco entered into a Mutual Debt Cancellation Agreement pursuant to which the liabilities created by the two promissory notes referred to above were set off against each other.

[13] The items of the Mutual Debt Cancellation Agreement (the "Cancellation Agreement") are as follows:

> WHEREAS:
>
> A. Eyeball has issued a demand promissory note in the amount of $30,000,000 to 398 (the "Eyeball Note").
>
> B. 398 has issued a demand promissory note in the amount of $30,000,000 to Eyeball (the "398 Note").
>
> C. The parties wish to set off the Eyeball Note against the 398 Note and the 398 Note against the Eyeball Note, and thereby cancel both the Eyeball Note and the 398 Note.
>
> NOW THEREFORE withnesseth that in consideration of the mutual covenants and promises contained herein, the parties agree as follows:
>
> 1. Eyeball sets off the 398 Note against, and in payment of, the Eyeball Note payable by Eyeball, and the 398 Note is canceled and 398 is released from all liability thereunder.
>
> 2. 398 sets off the Eyeball Note against, and in payment of, the 398 Note payable by 398, and the Eyeball Note is canceled and Eyeball is released from all liability thereunder.

[14] For illustrative purposes, the before and after corporate landscape in chart form may be contrasted as follows:

Figure 1 – Before share for property exchange;

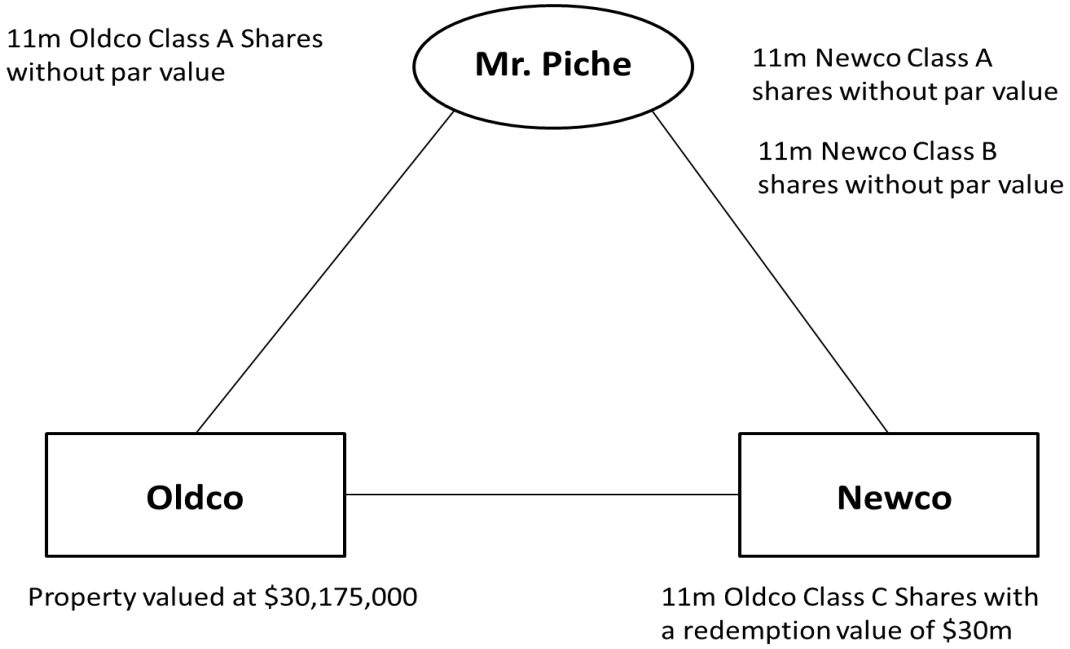


Figure 2 – Upon execution of the ATA;

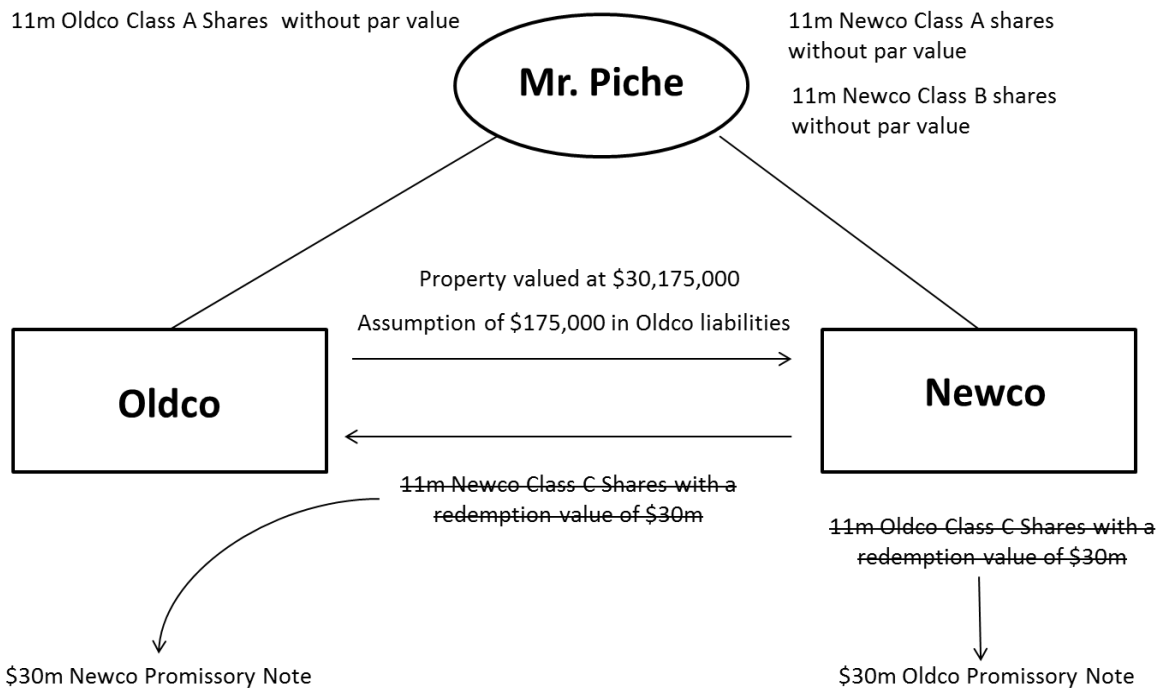


Figure 3 – After set-off/Mutual Debt Cancellation Agreement;

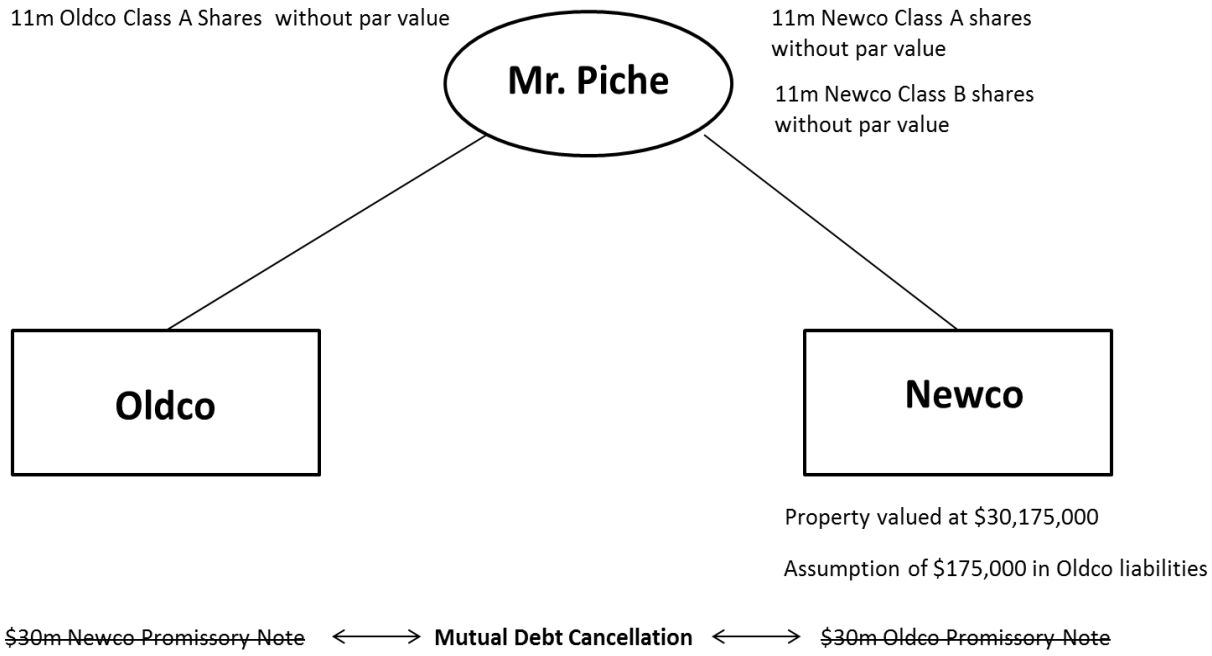
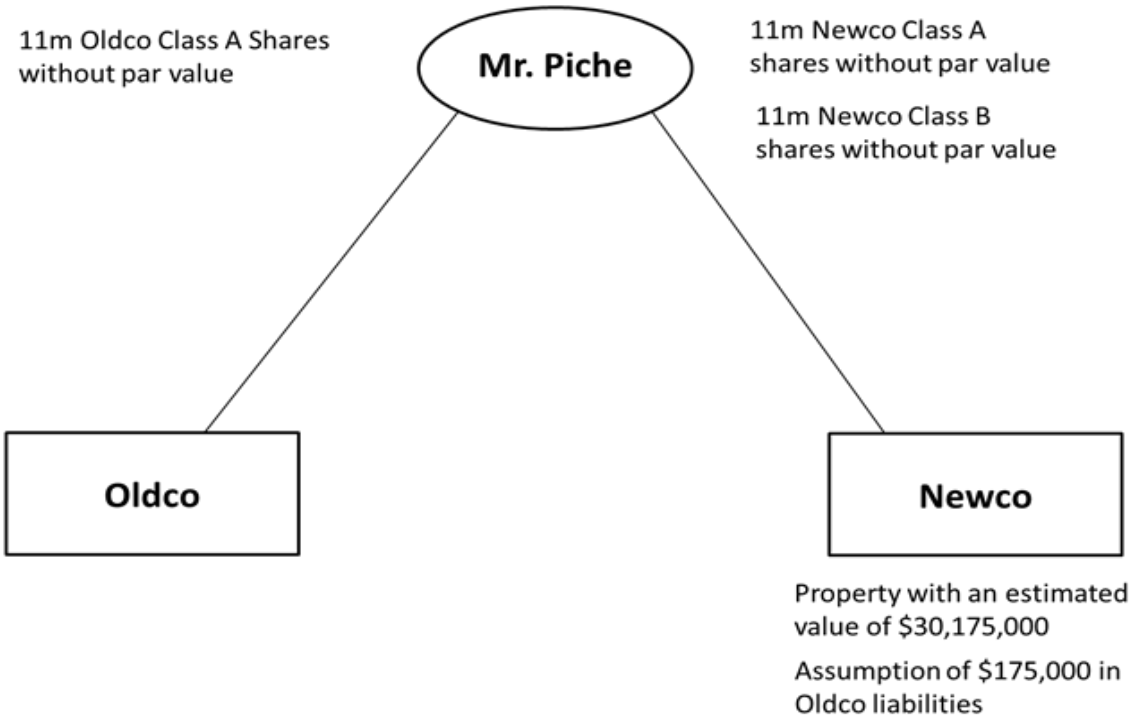


Figure 4 – Upon Escrow Release;



[15] Lastly the parties entered into an escrow agreement ("Escrow Agreement") under which various documents were placed into escrow for a short number of days. This resolved an administrative filing glitch which had arisen in the change of the corporate name of Newco. The relevant effective provisions of that agreement provided:

> [….]
>
> 1. The parties agree that the Agreements and all closing and other documents delivered in connection therewith are delivered in escrow until the change of name of [Newco] to Eyeball Networks Inc. is complete.
>
> 2. The documents may be held in escrow by any person agreed by the parties hereto and will be released from escrow forthwith upon the change of name of [Newco] to Eyeball Networks Inc. being completed.
>
> [….]

[16] The documents were released from escrow pursuant to a release from Escrow Agreement dated March 22, 2002 (the "Escrow Release"). The relevant provision is as follows:

> 1. The parties agree that all documents put into escrow pursuant to the Escrow Agreement are released from escrow.

[17] In the absence of the Escrow Agreement, all agreements would otherwise have been delivered and released on a single transaction date: March 19, 2002 (the "transaction date"). Ostensibly, such documents were held in escrow for 3 days or so and then released with legal effect pursuant to a single discharge from escrow under the Escrow Release.

F. The fates of the new business and the old business

[18] The new business had some initial success, but never fulfilled Mr. Piche's expectations. In the business year ending February 28, 2003, Newco had an operating loss of $487,665 and an operating profit in 2004 of $200,604. Its gross revenue for those two years and the next was approximately $7,000,000. The operating loss or profit for Newco's third year of operation was not adduced into evidence.

[19] The old business was not operating for all intents and purposes beyond the transaction date. Although Mr. Piche took exception to the Minister's assumption that Oldco and its old business were obsolete at the transaction date, there was no evidence to suggest otherwise. Revenue streams under its old business licenses were in default. During discoveries, Mr. Piche suggested anecdotally that Oldco had value. No financial statements were produced demonstrating this. Moreover, after cessation of payment of the license fees, Mr. Piche also admitted on discoveries that Oldco had no paying customers or revenue from the old business activities as at the transaction date.

G. Reassessments

[20] On September 16, 2003, the Minister reassessed Oldco for its taxation years ending July 31, 2000 and July 31, 2001. The total amount of the reassessments was $13,368.48, including $972.48 in interest.

[21] On August 9, 2004, the Minister reassessed Oldco for its taxation year ended July 31, 2002. The total amount of that reassessment was $113,366.10, including $13,491.39 in interest and a late filing penalty of $14,511.71.

[22] There is no dispute that both underlying reassessments were issued long after the transfer date. As well, it was not disputed that Mr. Piche was unaware of

any outstanding tax liability at the transaction date after the primary tax debtor failed to satisfy the debt, Newco was assessed on March 19, 2014.

II. THE LAW

[23] The relevant provision of the Act applicable to the liability of the Appellant in this appeal is the well litigated section 160. An excerpt of the relevant provisions to this appeal are as follows:

> Subsection 160(1) of the Act
>
> **Tax liability re property transferred not at arm's length**
>
> **160 (1)** Where a person has …. transferred property, either directly or indirectly, …. or by any other means whatever, to
>
> **[….]**
>
> **(c)** a person with whom the person was not dealing at arm's length,
>
> the following rules apply:
>
> **(d)** the transferee and transferor are jointly and severally, or solidarily, liable to pay a part of the transferor's tax under this Part for each taxation year, and
>
> **(e)** the transferee and transferor are jointly and severally, or solidarily, liable to pay under this Act an amount equal to the lesser of
>
> > **(i)** the amount, if any, by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property, and
> >
> > **(ii)** the total of all amounts each of which is an amount that the transferor is liable to pay under this Act,….
>
> [….].

[24] The Federal Court of Appeal in *Livingston v. R*[1] established the four requirements which must be present to engage section 160:

> 1) The transferor must be liable to pay tax under the Act at the time of transfer;

[1] Livingston v R, 2008 FCA 89 at paragraph 17.

2) There must be a transfer of property, either directly or indirectly, by means of a trust or by any other means whatever;

3) The transferee must either be:

i. The transferor's spouse or common-law partner at the time of transfer or a person who has since become the person's spouse or common-law partner;

ii. A person who was under 18 years of age at the time of transfer; or,

iii. A person with whom the transferor was not dealing at arm's length.

4) The fair market value of the property transferred must be equal to or exceed the fair market value of the consideration given by the transferee.

III. PARTIES' POSITIONS IN SUMMARY AND ISSUES

[25] There are essentially no facts in dispute. The crux of the dispute before the Court is whether section 160 is engaged in this type of subsection 85(1) tax neutral rollover transaction. In this appeal, the sole issue is the presence and/or value of consideration for the transferred property. The Appellant concedes there was a transfer of property; the conveyance of the assets concerning the new business to Newco was the very essence and object of the transaction. The transferor and the transferee were non-arm's length parties by virtue of their identical sole shareholder, Mr. Piche. As well, although the tax liability of Oldco was quantified well after the transaction, legally it subsisted for the purposes of section 160 because the liability for tax was, at the time of the transaction, exigible under the Act[2]. Further, the underlying assessment was not challenged by the Appellant at the hearing. Therefore, the sole outstanding issue remains the existence and value of consideration tendered for the transferred property.

A. The Appellant's Position

[26] Mr. Piche's counsel acknowledges that an unsatisfied tax liability existed and that a transfer of property occurred between Oldco and Newco. However, such a transfer of property, which related to the new business, was in consideration of the Newco issuance of shares to Oldco. Those shares had a value precisely equal to the value of the estimated value of the transferred property. As a result of the price

[2] R v Simard-Beaudry Inc, 71 DTC 5511 at paragraph 20.

adjustment, should that fair market value ("FMV") be wrongly estimated, the value of the shares issued in consideration would be adjusted accordingly. Moreover, the CRA's value would be adopted, no questions asked. No disparity in the difference between the FMV of the consideration tendered and the transferred property could occur. The shares of Newco issued as consideration for the assets concerning the new business (i.e. the transferred property) would be of equivalent value at the date of transfer, and if not, subsequently adjusted so that any disparity would be made good. As such, no deficiency between the value of the transferred property and the consideration could ever occur. On this basis, definitionally, section 160 would not be engaged.

B. The Respondent's Position

[27] The Respondent accepts that at the first step of the transaction, namely, the issuance of the tendered shares to Oldco, sufficient consideration existed. However, the redemption of shares and cross-cancellation of the debt as the final step(s) on the transaction date nullified the consideration. In short, before the day was done, Oldco, as transferor had no subsisting valuable consideration in hand for its transferred assets conveyed to Newco. Taken as a whole, all steps, when accounted for, resulted in conveyance of this transferred property for no value during a period when Oldco, as transferor, had a currently subsisting tax debt at law. Such a results-based economic reality engages the very purpose of section 160, namely a collection tool designed to prevent the dissipation of a tax debtor's property where, upon transfer to a non-arm's length transferee, no or insufficient consideration is meaningfully tendered and retained by the transferor/tax debtor in respect of the transferred property.

C. Issues before the Court

(i) Was there "consideration given" by Newco for the transferred assets?

[28] Given the contrary positions, the appearance of consideration within the closing documents has elicited two contrary views. Quite apart from the FMV of the alleged tendered consideration when compared to the transferred assets, if the shares and promissory note ("tendered property") do not constitute consideration given ("tendered consideration") in exchange for the transferred property, then no analysis of the comparative FMV need be undertaken. While it may seem obvious that such tendered property had *prima facie* value when it was tendered, the Respondent seems to have implicitly argued otherwise, at least by end of business on the effective closing date.

(ii) Ascertaining the FMV of the tendered property at the "time the property was transferred".

[29] Assuming there was property tendered in exchange for the transferred assets, the Court, within the meaning of section 160, must ask itself certain additional questions:

(a) What period is measured within "at the time [the property] was transferred and "at that time of consideration" (conjunctively the "time of transfer")"; when do such concepts begin and when do they end under section 160?

(b) If the tendered property was tendered consideration, what amount may be ascribed to its FMV at any or various time(s)?

(c) Did the FMV of the transferred assets exceed, and by how much, that of the tendered consideration at the "time of transfer"?

IV. ANALYSIS OF ISSUES

(i) Was "consideration given" by Newco for the new business assets?

[30] There is a difference between the ostensible and implicit positions of the Respondent which goes to the heart of one concept: the time of transfer. The Respondent plainly states consideration was initially tendered by virtue of the class C shares and promissory note offered to Oldco by Newco. However, consequently and subsequently, the set-off/cancellation of the promissory note rendered that tendered consideration valueless. Logically and implicitly, the Respondent's position is that, consequentially, at the "time of transfer", no aggregate consideration was actually tendered for the transferred property. The tendered consideration evaporated before the lights went out. The Court rejects this initial, implicit argument. The documents, given the context in which they were envisaged, crafted and deployed, cannot support this first line argument. The purpose of the entire specific transaction is properly and substantively reflected by the documents in each step.

[31] No-one more than the Minister's revenue agents, themselves, have relied upon the documents. There has been no specific reassessment which challenges the precise goal of the section 85 rollover. As well, there has been no GAAR

assessment to suggest that section 85 has been deployed in an abusive manner in order to thwart the Minister's collection of tax. The Court observes that there has certainly been a tax benefit under section 85 and a primary purpose of its use was to gain that benefit. This Court's role, in saying so, is not to second guess the Minister for not pursuing a GAAR assessment. It merely states this fact to establish that, initially at least, no serious question can exist that the tendered property at the inception of transfer had valuable consideration; by the very terms of the agreement such consideration was symmetrical with the value of the transferred property. The question remains, did that inceptive value change, if so, when and, if when, was that at a moment occurring within the "time of transfer" and thereby engaging section 160.

(ii) Ascertaining the FMV of the tendered property during the "time of transfer".

[32] The tendered consideration, both the shares and promissory note, at the inceptive moment of the time of transfer had a FMV deemed to be equal to $30,000,000. If that FMV changed, as submitted by the Minister, what became of its value and when? If the FMV of the tendered consideration changed to a value less than the FMV of the transferred property outside the definitional scope of the time of transfer, then such an event will fail to engage section 160. This requires a determination of when the "time of transfer" begins and ends.

(a) What is "the time of transfer"; when does it begin and end under section 160?

[33] The phrase "time of transfer" is used because its semblance appears twice in the same subsection: "at the time [the transferred property] was transferred exceeds the FMV at that time of the [tendered] consideration given for the property[3]. In turn, the phrases "at the time' and "at that time" are neither defined within the Act nor necessarily unequivocally clear from the chosen text. Even relatively unambiguous text does not preclude the application of the mandated test to discharge the Court's duty to further analyse all of the combined meaning of the text, context and purpose of the language as a whole in a non-GAAR analysis of a provision of the Act[4].

[3] Subparagraph 160(l)(e)(i) of the Act.

[4] Canada Trustco Mortgage Co v Canada, 2005 SCC 54 at paragraph 43.

TEXTUAL ANALYSIS

[34] No submissions explored these provisions subsequent to the preamble or charging provision in section 160. Subparagraph 160(1)(e)(i) describes when section 160 applies. It states that "the amount, if any, by which the FMV of the property **at the time** it was transferred exceeds the FMV **at that time** of the consideration given for the property and," (emphasis added). The phrase "at that time" suggests a point in time analysis; subparagraph 160(1)(e)(i) takes a "value" snapshot of the transfer of property when it occurs.

[35] In the *Kiperchuk* decision, Associate Chief Justice Lamarre found that:

> 29. There is nothing in the wording of that subsection that relates the relationship between the transferor and the transferee to any moment other than that of the transfer of the property…The subsection refers throughout to the act of transferring and the time of the transfer, without specifying that other moments in time, previous to the transfer, could be contemplated for the purpose of its application to the transferee[5].

[36] In the *Kvas* decision, this Court agreed with Associate Chief Justice Lamarre's findings in *Kiperchuk* and found that the time of transfer is critical to a section 160 assessment[6]. Therefore, it can be said that subparagraph 160(1)(e)(i) assesses liability at the moment of transfer.

CONTEXTUAL ANALYSIS

[37] There should be consistency throughout a section. The fact that subparagraph 160(1)(e)(i) assesses liability based on a transfer at one point in time suggests that the charging provision and specifically "by any other means whatever" should be applied in the same manner. That is particularly true when examining the existence of a transfer in the case of *Kiperchuk* and *Kvas* and in the assessment of the valuation of the consideration rather than the methodology of transfer, the latter of which is unequivocally subject to the modifier "by a trust or by any other means whatever".

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[5] 2013 TCC 60 at paragraph 29.

[6] 2016 TCC 199 at paragraph 41.

[38] Respondent's counsel examined the economic reality of the net result of the March 19, 2002 transactions. It is accepted that Oldco lost substantially all its value at some point subsequent to the asset transfer to the Newco. Furthermore, by the end of the March 19, 2002 transactions, the Appellant obtained most of Oldco's valuable assets; Oldco lost the ability to repay its promissory note and ultimately its latent tax debts. If the net result of the March 19, 2002 series of transactions may be examined, then the evidence provided by the Respondent supports that there was insufficient consideration provided for the transferred assets.

[39] The Respondent argues that a plain reading of "by any other means whatever" allows for the examination of the net result from the March 19, 2002 series of transactions. However, the authorities cited do not support this interpretation. In *Livingston*, the Federal Court of Appeal found that it is the "property at the time of transfer which is the relevant time for the purpose of subsection 160(1)"[7]. In that leading authority, the Court did not look at the net result of the series of transactions as it found that the ultimate return of the transferred funds to the transferor is irrelevant to the application of section 160.

[40] In *MacDonald*, the Federal Court of Appeal Court found, in applying subsection 84(2), that the Tax Court should not have focused exclusively on the legal character of transactions in the series[8]; however, there is a difference between the wording of subsections 160(1) and 84(2). Specifically, subsection 84(2) refers to the "funds or property…distributed or otherwise appropriated in any manner whatever to or **for the benefit** of the shareholders …" (emphasis added)[9]. "For the benefit" suggests looking into the purpose of a transaction. Unlike section 160, this allows for an examination into the role of that transaction in a series of transaction. In *594710 British Columbia Ltd v. HMQ*[10], the Federal Court of Appeal also examined "by any other means whatever" through a GAAR analysis on whether there was a tax benefit. The wording of section 245 (relating to GAAR) specifically provides for an analysis of a series of transaction, which is not the case for section 160.

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[7] Supra note 1 at paragraph 24.

[8] 2013 FCA 110 at paragraph 28.

[9] Supra note 3.

[10] 2018 FCA 166 at paragraph 112.

[41] On the other hand, an effective comparison between section 160 and paragraph 20(1)(c) may be made. Similar to paragraph 20(1)(c), the text of section 160 lacks any reference to a series of transaction or to the purpose of the transfer. The line of cases for interest deductibility referenced and upheld in TDL Group Co all found that the Minister is limited to assessing paragraph 20(1)(c) at the time when the money is used[11].

[42] In the *Louie* decision[12], Associate Chief Justice Lamarre discussed the application of "by any other means whatever" to paragraphs 94(1)(b) and 207.01(1)(b) of the Act. Specifically, the Court recognized the differing approaches taken by the Tax Court and the Federal Court of Appeal in the *Garron Family Trust* decisions in applying paragraph 94(1)(b)[13]. Justice Woods, then of this Court, found for a restrictive application that respected the separate nature of an identifiable transfer. On the other hand, Justice Sharlow of the Federal Court of Appeal found that the phrase "in any manner whatever" was chosen by Parliament to permit a broad examination of all relevant transactions. Ultimately, Associate Chief Justice Lamarre found that the lack of "in any manner whatever" in paragraph 207.01(1)(b) permitted her to apply Justice Woods' restrictive analysis when she said:

> 81 […] A transfer of property has a defined end point, although a circuitous route may be taken to get there. Here, there is no easily defined or delineated end point for the purpose of the analysis regarding the length of time during which an increase may still be attributed to an impugned transaction.
>
> 82 A more restrictive interpretation of paragraph (b) of the definition [of paragraph 207.01(1)(b)] avoids these difficulties while still fulfilling the anti-avoidance purpose of the provision.

PURPOSIVE ANALYSIS

[43] As a whole, and by way of background, the purpose of section 160 is again clearly described in *Medland*[14].

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[11] 2016 FCA 67 at paragraph 26.

[12] 2018 TCC 225.

[13] 2009 TCC 450 and 2010 FCA 309.

[14] 1998 CarswellNat 3892 (Fed CA), 98 DTC 6358 at paragraph 14.

> It is not disputed that the tax policy embodied in, or the object and spirit of subsection 160(1), is to prevent a taxpayer from transferring his property to his spouse in order to thwart the Minister's efforts to collect the money which is owned to him.

[44] Similarly, *9101-2310 Quebec Inc* and *Heavyside*[15] pinpoint that both value of the transferred property and tax debtor liability must be established at the "moment" of transfer.

[45] The Minister cannot ignore the separate nature of the Oldco-Newco Agreement by applying the phrase "by any other means whatever" from section 160. The phrase "by any other means whatever" does not allow the Minister to ignore the separate nature of each and any event that created an identifiable transfer. Specifically, the *McClarty Family Trust*[16] decision and the facts before this Court arising from the March 19, 2002 transactions are substantially similar.

[46] Section 160's purpose does not conflict with the view that the application of section 160 precludes the examination of the net result from a series of transactions. Reliance upon the final result of Oldco's stranded tax debts to justify analyzing the entire March 19, 2002 series of transactions approaches motivational reasoning. While it may make for compelling rationale for legislative amendment, it does not allow the Minister to use the net result of a series of transactions to justify examining that very series of transactions. As Justice Dawson of the Federal Court of Appeal said in *TDL Group Co*:

> 22. In Shell Canada Ltd. v. R., [1999] 3 S.C.R. 622 (S.C.C.), the Supreme Court concluded, at paragraph 47, that this Court's "overriding concern with tax avoidance not only coloured its general approach to the case, but may also have led it to misread the clear and unambiguous terms of s. 20(1)(c)(i) itself". In my view, the same error led the Tax Court to its conclusion with respect to the purpose for which the borrowed monies were used[17].

[47] As such, the view that the Minister is similarly limited and cannot assess the net result of a series of transaction in applying section 160 is more supportable than the contrary on the basis of the authorities.

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[15] 9101-2310 Quebec Inc v Canada, 2013 FCA 241 at paragraphs 60-61 and Heavyside v Canada, [1996] FCJ No 1608 at paragraph 9.

[16] McClarty Family Trust v R, 2012 TCC 80.

[17] Supra note 11 at paragraph 22.

(b) What was the FMV of the tendered consideration for the transferred property at various stages of the transaction(s)?

[48] At the outset, the FMV of the tendered consideration was definitionally symmetrical with that of the transferred assets. The use of the term "symmetrical" is advisedly used rather than simply equal. Equality suggests a static state at a point. The inclusion of a price adjustment clause went further. That clause introduced a dynamic. Not only would the transferred assets equal the FMV of the tendered consideration at the outset, it would do so dynamically should the chosen valuation of those assets be challenged hence, presumably by the Minister's agents.

[49] So, when did that value change? According to the reply, the Minister logically asserts it occurred with the invocation and effect of the Cancellation Agreement. This was not meaningfully challenged in evidence or argument by the Appellant, at least to the extent of that document's impact on the recoverability and enforceability of the debt represented and evidenced by the outstanding and subsisting Oldco promissory note. That is to say, the tendered consideration for the transferred assets disappeared at the point the Cancellation Agreement takes effect. According to the documents, which were not challenged, that point occurred with effect on a single day, May 19, 2002, but delivery was delayed until the 22nd of May under the Escrow Release. While the effect of the Escrow Agreement and the Escrow Release did not alter the sequence within the day, it certainly compressed the duration of the effective transactions into a much shorter time.

[50] Above, the Court has determined that the Minister cannot look at the totality of the result of the series of transactions and apply section 160 *en bloc*. Newco pleaded just that. On this point the Appellant shall succeed.

[51] However, no such restriction definitionally applies to a single, distinct, stand-alone transaction, provided it otherwise meets the definitional elements of a transfer. A distinct transaction occurred as the final act: the Cancellation Agreement. The separate nature of this transaction is distinctly documented; the Minister and the Appellant alike must live by its terms. Within it, Oldco forgives, releases and cancels the $30 million promissory note held by it and made by Newco ("Newco Note") in exchange for the forgiveness, release and cancellation of its obligation to pay Newco under its $30 million promissory note ("Oldco Note"). In effect, this transaction deploys contractual set-off as an abbreviation for a longer form sequence of duplicative presentment and transfer of payment under each promissory note. Both obligations are debts and both are mutual "cross-

obligations"[18]. There is no dispute that each owed the other a sum certain under the promissory note[19].

[52] Logically and empirically, contractual set-off is a legal notion or device which obviates otherwise necessary steps between mutual creditors and debtors[20]. Certain transfers are avoided: firstly, the transfer or conveyance by the first debtor of an amount of money, money's worth or property to satisfy its creditor and, secondly, the re-transfer or re-conveyance by the second debtor (the creditor in the first instance) of a like or differing amount of money, money's worth or property to its creditor (the debtor in the first instance). The avoidance of these steps occurs solely because each is both a creditor and debtor of the other. Through contractual set-off the mutual debtors/creditors accept identical or differing values in full satisfaction of their co-existing debts[21].

[53] There is also no question that Oldco and Newco, *inter se*, fully determined contractually that the amount owed and the FMV of the Newco Note and Oldco Note were equal in value. The Cancellation Agreement said so. Afterwards, the parties treated both obligations and rights as fully or partially accorded and satisfied, a critical requirement of set-off[22]. The parties used the term "set-off" expressly; they expected the mutual debts and entitlements to be expunged without further payment, carry-forward or difference in value. Between the two parties such an agreement to make the debts co-terminus is binding[23].

[54] However, is the Minister so bound? The expunged property comprising the Newco Note held and owned by Oldco is property. At law, as a negotiable instrument it is valuable; that value paid by a willing arm's length purchaser, should Oldco attempt to sell (negotiate) it to someone other than a related party, would undoubtedly be its FMV. The same would be true of the Oldco Note should Newco have attempted to sell or negotiate it; its FMV would be what an arm's

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[18] Telford v Holt, [1987] 2 SCR 193 at paragraph 24.

[19] Wolf v Minister of National Revenue, 1992 CarswellNat 376, 92 DTC 1858 at paragraph 16.

[20] Black's Law Dictionary, 10th ed., page 1581; "set-off": 2. … "a debtor's right to reduce the count of a debt by any sum the creditor owes the debtor, the counterbalancing sum owed by the debtor".

[21] Ministre du Revenu national c. Caisse Populaire du bon Conseil, 2009 SCC 29 at paragraph 26.

[22] Fisher v R, 2000 CarswellNat 1002, 2000 DTC 3612 at paragraph 9.

[23] *Bank of Montreal v. Tudhope*, 1911 CarswellMan 40, aff'd by Man. CA in 1911 CarswellMan 127.

length purchaser would pay for the Oldco Note at the time of its transfer, that is to say its negotiation. The measure of the consideration occurs precisely at the time of the step outlined in Figure 3 above. This transaction, in the form of contractual set-off, is a "transfer"…"indirectly"… "by any other means whatsoever". What precedes or follows is independent. The debt forgiveness by cancellation or set-off is distinct. This salient question remains: is the relative FMV between the mutually forgiven Newco Note and the Oldco Note unequal?

> (c) Did the FMV of the exchanged or transferred property exceed, and by how much, that of the tendered consideration "at the time of transfer"?

[55] The tendered consideration should be viewed "at the moment" of transfer or transfers. Within the ATA, Oldco and Newco estimated the value of the transferred assets based on audit reports, detailed their mutual legal obligations in a contract, and included a price adjustment clause to ensure FMV was received as consideration. There is completeness to this first transfer.

[56] The timing of the set-off and debt cancellation, which occurred under the Cancellation Agreement, immediately following the tender and receipt of FMV consideration, was a distinct transaction and transfer of property. It need not have occurred at the time of the ATA. Such a set-off could have occurred years later, but whenever it happened, the actual longer form exchange or transfer between Oldco and Newco of the property in the form of the promissory notes would have been avoided and short-circuited by means of set-off. At any point in the future, Newco and Oldco would have faced the same challenge: the disparity between the face value of the promissory notes and their respective FMV. That snap-shot of value is to be taken at the time of transfer, not before or after. This focus applies equally to the Minister and the taxpayer alike.

[57] The FMV of the Oldco Note held and owned by Newco was nominal in any fair market for such negotiable bills. The FMV of the Newco Note held and owned by Oldco had considerable value as a negotiable bill; its worth was backed by the $30 million (or some value) of assets now owed by Newco. This cannot be said of the Oldco Note tendered as commensurate consideration for cancellation. The consideration for the surrender or forgiveness of the valuable Newco Note was the surrender or forgiveness of the Oldco Note with nominal value. Oldco transferred valuable property (the Newco Note) for little value (forgiveness of the valueless Oldco Note). It is precisely "at the time" of transfer that the consideration proffered "at such time" was deficient, perhaps well hidden, but insufficient, just the same.

V. SUMMARY AND COSTS

[58] This application of section 160 is not unfair; the result is balanced. Just as Newco indemnified Oldco and/or assumed the liabilities of trade creditors of Oldco, it could have assumed Oldco's contingent liabilities for tax to the Minister, no longer capable of being satisfied because of the uncompensated transfer of Oldco's assets, all of which Newco received. The collection efforts of the Minister have not been thwarted through the mutual, tit-for-tat cancellation of promissory notes between non-arm's length parties where one promissory note had considerable value and the other little or none. Through this disparity, the consideration paid or exchanged under Cancellation Agreement, which obviated the need for presentment and transfer through payment, was vastly different for each party and failed to measure up. This gap created the deficiency under the FMV comparison mandated by subparagraph 160(1)(e)(i) of the Act.

[59] For these reasons the appeal is dismissed. Costs are awarded provisionally to the Respondent subject to the right of either party to make written submissions thereon within 30 days of the date of the judgment, whereupon the Court may consider such submissions and vary its provisional cost award, failing which this provisional cost award shall become final.

Signed at Hamilton, Ontario, this 18th day of July, 2019.

"R.S. Bocock"

Bocock J.

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