Docket: 2018-1212(IT)G

BETWEEN:

GENTILE HOLDINGS LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on November 28 and 29, 2019, at Vancouver, British Columbia

Before: The Honourable Justice Diane Campbell

Appearances:

Counsel for the Appellant:	George Douvelos
Counsel for the Respondent:	Shannon Fenrich

JUDGMENT

The appeal from Notice of Assessment number 3283024, dated June 30, 2015, made under section 160 of the *Income Tax Act*, is dismissed, with costs to the Respondent, in accordance with the attached Reasons for Judgment.

Signed at Vancouver, British Columbia, this 12th day of February 2020.

"Diane Campbell"

Campbell J.

Citation: 2020 TCC 29
Date: 20200212
Docket: 2018-1212(IT)G

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REASONS FOR JUDGMENT

Campbell J.

Introduction

[1] On June 30, 2015 the Minister of National Revenue (the "Minister") assessed the Appellant corporation for $116,754.22 (the "Amount") respecting a transfer of property to it by 0699406 B.C. Ltd. ("0699") pursuant to subsection 160(1) of the *Income Tax Act* (the "*Act*"). This assessment related to an underlying assessment of 0699 for the taxation year ending November 30, 2006. The transfer of property to the Appellant occurred on June 20, 2006 through the payment of dividends in the amount of $600,000 in the 2006 fiscal year. For the taxation year ending November 30, 2006, 0699 filed its income tax return on November 10, 2011, even though the filing deadline was May 30, 2007. By June 30, 2015, 0699 owed and had failed to pay the Amount respecting the taxation year ending November 30, 2006. The Appellant has been assessed in respect to this Amount.

[2] Two witnesses provided evidence, Bryce Clark, the accountant for the Appellant corporation and Cesare Gentile, the director and sole shareholder of both 0699 and the Appellant corporation. Mr. Gentile and his spouse are the shareholders of the Appellant corporation. The sole shareholder of 0699 is the Appellant corporation.

[3] The Appellant's position rests on the fact that it gave fair market value consideration for the transfer of the property from 0699 because the Appellant

executed a loan agreement in favour of 0699 in the amount of $600,000 on or about June 2006. According to the Appellant's argument, since the property transferred did not exceed the value of the consideration that was provided to 0699, the two companies were therefore dealing at arm's length. Respondent counsel submits that the only issue is with respect to whether the parties were, in fact, dealing with each other at arm's length.

[4] There was much time spent on what the actual issue was in this appeal. After the direct examination of Bryce Clark concluded, Respondent counsel requested an adjournment because she submitted that the evidence on direct examination in court was contrary to the pleadings in the Appellant's Notice of Appeal, as well as the evidence obtained on written discovery. This evidence related to whether the dividends had been paid in 2006. On discovery, it was stated that the reported dividends had been paid in 2006 while Mr. Clark's testimony raised doubt in this regard. Appellant counsel stood by the discovery responses concerning the transfer.

[5] Some of this problem arose from the different framing of the issue in the respective pleadings. The Appellant, at paragraph (d) of the Notice of Appeal, stated that the issue to be decided was "(w)hether the Appellant and 0699406 B.C. Ltd. were at all material times dealing at arm's length with each other." The Respondent, at paragraph B-13 of the Reply to the Notice of Appeal stated "(t)he issue is whether the Appellant is jointly and severally liable for the Amount respecting the transfer of the Property."

[6] Appellant counsel in its pleadings devoted several paragraphs to the alleged fact that the Appellant corporation and 0699 were not related companies and were dealing at arm's length with each other. However, the Notice of Appeal, at paragraphs (c)2, (f)11, and (f)12, references the transfer of property to the Appellant by payment of dividends in the amount of $600,000 and the subsequent loan agreement of $600,000 in favour of 0699. On the day following the adjournment request, I directed that the hearing recommence in light of the Appellant's position on the discovery answers and the issues.

Analysis

[7] "The power to tax means little without the power to collect." (Sexton J.A., *The Queen v Livingston*, 2008 FCA 89, at para. 1). This is an apt statement in respect to the purpose and intent behind subsection 160(1) of the *Act* in that it is meant to prevent taxpayers from avoiding a tax liability by transferring their property to a related person. Although the provision has been labelled "draconian," it remains an "important tax collection tool." (*Wannan v Canada*, 2003 FCA 423 at para. 3). When subsection 160(1) is successfully applied to a given set of facts, a transferee becomes jointly and severally liable for the transferor's tax liability in respect to the taxation year of that transfer or any preceding year to the extent that the fair market value of the property transferred exceeds the consideration given for the property.

[8] The Federal Court of Appeal in *Livingston*, at paragraph 17, set out the following criteria that should be applied in a consideration of subsection 160(1):

> [17] In light of the clear meaning of the words of subsection 160(1), the criteria to apply when considering subsection 160(1) are self-evident:
>
> 1) The Transferor must be liable to pay tax under the Act at the time of transfer;
>
> 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 of 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 exceed the fair market value of the consideration given by the transferee.

[9] If all of the foregoing four criteria are met, the Court will have no option but to uphold the assessment. (*Woodland v The Queen*, 2009 TCC 434, at para. 28).

[10] As a general rule, a taxpayer "bears the onus of establishing that an assessment or reassessment is incorrect." (*Monsell v The Queen*, 2019 TCC 5, at para. 22). However, where the facts concerning the underlying assessments are exclusively within the knowledge of the Minister, the onus will then be shifted to the Minister to show the correctness of the assessments. Paris J. in *Mignardi v The Queen*, 2013 TCC 67, at para. 41, summarized the general rule on onus and its exception in the following manner:

> [41] I return now to the proposition that appears to flow from the *Gestion Yvan Drouin Inc.* case that the Minister bears the onus to prove the underlying tax liability in every appeal from a derivative liability assessment under subsection 160(1) or section 227.1 of the *ITA* or sections 323 or 325 of the *ETA*. I agree with respondent's counsel that such a conclusion is inconsistent with the decisions of the Supreme Court and Federal Court or Appeal to which I have referred. It is only where the facts concerning the underlying tax debt are exclusively or peculiarly within the knowledge of the Minister that the burden will be shifted. Each case will turn on its own facts. Although there may be situations where the tax liability of the original tax debtor is something that is solely within the knowledge of the Crown, more often a taxpayer will have access to that information from the original tax debtor. It should be recalled that one of the bases on which a person is assessed under those provisions is his or her relationship with the tax debtor, either as in this case as a director of the debtor corporation or as a party not dealing at arm's length with the tax debtor. As a result of this relationship, a taxpayer may very well already have or be able to obtain the information required to verify the existence or amount of the underlying liability. [Emphasis added.]

[11] In *Yates v The Queen*, 2009 DTC 5062 (FCA), at paragraph 41, the Federal Court of Appeal made the following comment:

> [41] …subsection 160(1) does not contain any ambiguity. If there is a transfer within the purview of the provision, then the transferee must satisfy the Court that he or she provided consideration at fair market value. …

[12] In the present appeal, the burden of proof in respect to the criteria as stated in *Livingston* remains with the Appellant to demolish the Minister's assumptions of facts. The onus does not shift to the Minister because there was no dispute respecting whether the facts relating to the underlying assessment are exclusively or peculiarly within the Minister's knowledge.

[13] To determine if the Appellant will be jointly and severally liable for the tax liability of $116,754 owed by 0699, I will address each of the four criteria of *Livingston* separately:

A. Was the transferor, 0699, liable to pay tax under the *Act* at the time of the transfer?

[14] There was no dispute in the present appeal concerning the tax liability of 0699. It owed and failed to pay taxes in respect to the 2006 taxation year. Whether the Appellant had actual knowledge of this tax debt is irrelevant. (*Woodland*, para. 27).

B. Transfer of Property

[15] The parties did not dispute that the payment of the $600,000 dividend by 0699 to the Appellant is a transfer of property pursuant to subsection 160(1) of the *Act*. Although the *Act* does not provide a definition of "transfer," jurisprudence supports that it is to be given wide latitude in meaning and that it will include every means by which a property may be passed (*Biderman v The Queen*, 2000 FCJ No. 194, at para. 40). In *Algoa Trust v Canada*, [1993] 1 C.T.C. 2294, Rip J. at paragraphs 46 and 49, concluded that the payment of a dividend by a corporation in money or other property will be considered a "transfer" of property for the purposes of subsection 160(1). This accords with the clear wording of this provision as it applies to any transfer of property by "any other means whatever" as well as the wide definition given to the word "property" in subsection 248(1) of the *Act*.

C. Were the Appellant corporation and 0699 dealing at arm's length?

[16] The term "arm's length" is defined in subsection 251(1) of the *Act*. The relevant portions read as follows:

> **251(1) Arm's length**. For the purposes of this Act,
>
> (*a*) related persons shall be deemed not to deal with each other at arm's length;
>
> […]
>
> (*c*) in any other case, it is a question of fact whether persons not related to each other are, at a particular time, dealing with each other at arm's length.

[17] The term "related persons," referred to in subsection 251(1), is defined at subsection 251(2) of the *Act*. The relevant portions read as follows:

> **251(2) Definition of "related persons"**. For the purpose of the Act, "related persons" or persons related to each other, are

[…]

(*c*) any two corporations

(i) if they are controlled by the same person or group of persons,

[…].

[18] The Federal Court of Appeal in *Peter Cundill & Associates Limited v The Queen*, 91 DTC 5085, 91 DTC 5543 (FCA), identified three criteria that may be used in a determination of whether or not parties are dealing at arm's length:

a) the existence of a common mind directing the bargaining for both parties to the transaction;

b) the parties to the transaction were acting in concert without separate interests; and

c) one party to the transaction exercised *de facto* control over the other.

[19] The Supreme Court of Canada in *McLarty v The Queen*, 2008 SCC 26, at paragraph 54, affirmed these three criteria as discussed by the Federal Court of Appeal in *Peter Cundill*.

[20] According to the evidence, Cesare Gentile acted as the sole director for both the Appellant corporation and 0699. While Mr. Gentile and his spouse owned all of the Appellant's shares, the sole shareholder of 0699 was the Appellant. In addition, Mr. Gentile had sole signing authority for both companies and was their sole decision maker. Ownership and control of these corporations reside directly or indirectly with Mr. Gentile. While one factor alone may not necessarily be conclusive, when considered together, it is clear on the facts before me that Mr. Gentile is the "mind" acting for one corporation and the same "mind" directing the second corporation. As stated by Cattanach J. in *MNR v Merritt Estate*, [1969] 69 DTC 5159, at p. 5165, and as referenced by the Federal Court of Appeal in *Peter Cundill*, when this occurs they cannot really be said to be dealing at arm's length. Based on these facts, it is apparent that one individual, in this case Cesare Gentile, is dictating the terms of the bargain for both sides of this transaction. Finally, while the Court may consider whether the terms of the transaction between parties reflect the "ordinary commercial dealings", it is not a separate requirement but may be used to "reflect on the soundness" of the conclusions reached by a judge after applying the three tests enunciated in *Peter Cundill*. [Hogg, Magee & Li, *Principles of Canadian Income Tax Law*, 8d ed (Toronto: Thomson Reuters,

2013)]. In *Remai Estate v The Queen*, 2009 FCA 340, Evans J., at paragraph 34, stated:

> [34] … whether the terms of a transaction reflect "ordinary commercial dealings between parties acting in their own interests" is not a separate requirement of the legal tests for determining if a transaction is at arm's length. Rather, the phrase is a helpful definition of an arm's length transaction which it is the purpose of the components of the *Peter Cundill* analytical framework to identify. It may also enable a judge to reflect on the soundness of the conclusion to which an application of the individual *Peter Cundill* factors has led.

[21] While not binding on this Court, I note that the Canada Revenue Agency, in its discussion of the role of ordinary commercial dealings in *de facto* non-arm's length relationships, has adopted a position congruent with that of Evans, J. in *Remai Estate* (Income Tax Folio S1-F5-C1, "Related Persons and Dealing at Arm's Length", effective November 26, 2015). The facts before me do not reflect ordinary commercial dealings between parties acting in their separate interests as it is apparent no reasonably prudent arm's-length person would pay $600,000 for the opportunity to obtain a loan for the same amount.

[22] Subsection 251(1) is a deeming provision and it is not, therefore, as Respondent counsel pointed out, a rebuttable presumption. It is clear on the facts that Mr. Gentile controlled both corporations and, consequently, the Appellant and 0699 are deemed not to be dealing with each other at arm's length.

D. The Fair Market Value of the Consideration

[23] The Appellant submits that the loan agreement was the consideration for the dividend and that one offset the other for the exact amount. (Appellant's Submissions, Transcript, Volume 2, page 64). The crux of the Appellant's argument was that "(t)he documents were legally binding between the numbered company and Gentile Holdings. The loan agreements evidenced the fact they were trading at arm's length." (Appellant's Submissions, Transcript, Volume 2, page 62). This argument was alluded to in the Notice of Appeal but it was not a stated issue in the pleadings.

[24] The Respondent contended that, in light of the evidence respecting the dealings between the two corporations and the stated issue in the Notice of Appeal, it would address this criteria as an alternative argument. The Respondent maintained that the exchange of the dividend and the loan was not an exchange with consideration because firstly, "the loan was a separate transaction with its

own consideration in the form of loan repayments, as well as security" and secondly, "the loan does not have a fair market value in the same amount as the dividend…the fair market value of a loan is zero dollars." (Respondent's submissions, Transcript, Volume 2, page 70).

[25] The onus of establishing the fair market value of the consideration given in return for the property resides with the Appellant. The Appellant contends that consideration was given for the amount of the $600,000 dividend declared in favour of the Appellant because the loan agreement was executed for the same value as the dividend amount.

[26] In *Connolly v The Queen*, 2016 TCC 139, Favreau, J., at paragraphs 33 to 34, concluded that advances and loans from a transferee to a transferor can constitute consideration provided the transferor had "a legal obligation to reimburse," as opposed to a moral obligation.

[27] I have several problems with the Appellant's submissions in regard to this criteria, which directly relates to the evidence provided by the two witnesses. Although both witnesses were credible and presented their responses to questioning as best they could, neither Mr. Clark nor Mr. Gentile possessed a great deal of first-hand knowledge of the relevant documentation. Neither witness was able to testify as to the exact circumstances surrounding the drafting of these documents. The accountant had no first-hand knowledge of what really occurred in 2006. He did not draft the documents and he was not involved in the events that led to the drafting. His testimony was vague and left me with the impression that he was unaware of the true nature of these transactions. He confirmed that he completed tax returns that recorded the actual payment of this $600,000 dividend and yet he also testified that the dividend had not actually been paid:

> A. Well, we have no payment of $600,000 going from the company, from one company to the other.
>
> (Transcript, Volume 2, page 27).

On cross-examination, he eventually admitted that this dividend was a "notional" payment:

> Q. So, I guess notionally shall we say, the idea was that Gentile would loan 699 (*sic*) $600,000 in order for 699 to notionally give the dividend of $600,000?
>
> A. This was done through Thorsteinssons, but I believe you're correct.

(Transcript, Volume 2, page 32).

[28] While there was a brief reference to the Appellant's solicitor being now deceased, the law firm of Thorsteinssons had been involved in the instructions to Mr. Clark, the accountant. However, no one was called from that firm to give any better particulars on what had actually occurred in 2006.

[29] Mr. Gentile was equally unsure of the "story" behind these transactions. He had very little knowledge of what had actually occurred or why. When asked whether the purpose of the loan of $600,000 to 0699 had been to actually pay off the dividend that had been declared, he responded:

> A. Again, I'm not really going to answer yes on this question because I don't really know what that means.
>
> Q. Okay.
>
> A. So, I mean, you spoke to my accountant, he answered all the question(s) you wanted. Don't ask me this question again because I won't know what to answer.
>
> Q. Okay. So you don't really understand ---
>
> A. No, I don't. …

(Transcript, Volume 2, page 50)

> Q. So you don't really understand what the purpose of the loan agreement was, is that correct?
>
> A. Yes
>
> Q. And you don't understand what the purpose of the dividend was?
>
> A. I do a little bit but not a whole lot.

(Transcript, Volume 2, page 51)

However, he did testify that he agreed with his responses in discovery proceedings when he stated that the loan was used to pay off the dividend.

[30] Neither witness had specific knowledge or even a basic understanding of the details concerning these transactions. Mr. Gentile did not know the intent of the documents. Mr. Clark had no hand in drafting the documents, which he had

received from Thorsteinssons. What apparently occurred was that 0699 declared a dividend of $600,000 in favour of the Appellant, which it then owed to the Appellant. In order for 0699 to pay this declared dividend, the Appellant agreed to loan 0699 the amount of $600,000. Both of these transactions occurred on the same day. However, the facts do not support that such a transfer occurred. Mr. Clark testified that this transfer never took place and, in cross-examination, agreed that it was only a notional transfer. It therefore appears that no actual exchange of funds occurred on that date. There is no documentary evidence to support that it did and this was likely the case because the amounts were the same. The documentary evidence then shows various repayments of the loan in subsequent years. This was confirmed by Mr. Clark's evidence, suggesting there was separate consideration for the loan. There was no other documentation to suggest that the Appellant had any legal obligations with respect to the dividend. Since there was a debt owing by 0699 subsequent to June 20, 2006, with payments being made by 0699 to the Appellant to pay down this loan, the dividend cannot be a repayment of that loan. This loan appears to be an entirely separate transaction with its own consideration in the form of loan repayments. The evidence was to the effect that the amount owing pursuant to this loan decreased over the years after 2006 as 0699 attended to the loan repayment. This indicates that there was separate consideration for the loan other than the dividend.

[31] Finally, a review of the pertinent documents relating to these transactions discloses no connection between the dividend and the loan. These documents include the Consent Resolution of 0699 respecting the dividend paid to the Appellant (Exhibit A-1, Tab 4); the Consent Resolution of 0699 respecting the loan from the Appellant to 0699 (Exhibit A-1, Tab 5); the Demand Promissory Note for 0699 (Exhibit A-1, Tab 6); the Security Agreement between 0699 and the Appellant (Exhibit A-1, Tab 7); and the Loan Agreement between 0699 and the Appellant (Exhibit A-1, Tab 8). The Tab 4 director's resolution simply declares a dividend of $600,000 payable on June 20, 2006 in respect to the 100 issued shares. The Tab 5 corporate resolution references that the Appellant has agreed to loan 0699 the sum of $600,000 and agrees to execute a loan agreement as well as grant certain security but nowhere, throughout this resolution, nor even in the whereas clauses, is there any reference to the reason for the loan and no mention made of a dividend payment. None of the remaining documents, the promissory note, the loan agreement or the security agreement make any reference that could connect the dividend to this loan.

[32] Consequently, based on the evidence before me, I am of the view that the dividend payment must be considered as a separate transaction without

consideration in return. Even if I were to conclude that the loan was consideration, I would not conclude that the fair market value of that consideration was $600,000. It would in all likelihood be zero dollars, as Respondent counsel suggested. Following the analysis in *Livingston*, it is apparent that no prudent, arm's length person would declare and pay $600,000 for the opportunity to take on a loan of $600,000. Pursuant to subsection 160(1) of the *Act*, fair market value must exist at the date the transfer was completed.

[33] To conclude, the Appellant has not discharged the onus of establishing on a balance of probabilities that the Appellant and 0699 did, in fact, deal with each other at arm's length and, in addition, did not establish that the Appellant gave fair market value consideration in respect to the payment of the dividend. Since the Appellant was the sole shareholder of 0699 and Cesare Gentile was the directing mind of both, it is unrealistic to assume that 0699 was in a position to act exclusively on the basis of its own best interests. Since the four criteria established in *Livingston* are satisfied, I conclude that the Appellant and 0699 are jointly and severally liable under subsection 160(1) of the *Act* to pay the Amount of $116,754 as assessed by the Minister in respect to the 2006 taxation year.

[34] For these reasons, the appeal is dismissed, with costs to the Respondent.

Signed at Vancouver, British Columbia, this 12th day of February 2020.

"Diane Campbell"

Campbell J.

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DATE OF JUDGMENT:	February xx, 2020

APPEARANCES:

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