Docket: 2018-1954(IT)G

BETWEEN:

JOANNE LAURIA,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeal of *Jeremy Freedman* (2018-1955(IT)G) on September 27, 28 and 29 2021, at Toronto, Ontario

Before: The Honourable Justice F.J. Pizzitelli

Appearances:

Counsel for the Appellant:	Matthew G. Williams E. Rebecca Potter
Counsel for the Respondent:	Iris Kingston Rebecca L. Louis

JUDGMENT

The appeal of the reassessment made under the *Income Tax Act* for the 2006 taxation year is allowed, only to the extent as conceded by the Respondent at trial, and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the terms of the below Reasons for Judgment, and on the following basis:

1. The fair market value of Ms. Lauria's Common Shares in issue is $307,200.00 and the under-reported taxable capital gain was therefore $140,710.00;

2. The Respondent shall be entitled to costs in this matter. If the parties are unable to agree on the quantum of costs within 60 days of the date of this

decision, then the parties shall file costs submissions within 30 days following such 60 day period for my consideration in determining such costs.

Signed at Vancouver, British Columbia, this 13th day of October 2021.

"F.J. Pizzitelli"

Pizzitelli J.

Docket: 2018-1955(IT)G

BETWEEN:

JEREMY FREEDMAN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeal of *Joanne Lauria* (2018-1954(IT)G) on September 27, 28 and 29, 2021, at Toronto, Ontario

Before: The Honourable Justice F.J. Pizzitelli

Appearances:

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JUDGMENT

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1. The Fair market value of Mr. Freedman's Common Shares in issue is $921,000.00 and the under-reported taxable capital gain was therefore $422,130.00; and

2. The Respondent shall be entitled to costs in this matter. If the parties are unable to agree on the quantum of costs within 60 days of the date of this

decision, then the parties shall file costs submissions within 30 days following such 60 day period for my consideration in determining such costs

Signed at Vancouver, British Columbia, this 13th day of October 2021.

"F.J. Pizzitelli"

Pizzitelli J.

Citation: 2021 TCC 66
Date: 2021 10 13
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BETWEEN:

JOANNE LAURIA,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

Docket: 2018-1955(IT)G

AND BETWEEN:

JEREMY FREEDMAN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Pizzitelli J.

[1] Jeremy Freedman ("Freedman") and Joanne Lauria ("Lauria"), the Appellants, who were both officers and directors of the wealth management corporation, Gluskin Sheff+Associates Inc. ("GS+A") at all material times, appeal from reassessments of their 2006 taxation years issued on January 30, 2017 and March 30, 2017 respectively that increased reportable taxable capital gains by $587,730.00 and $195,910.00 respectively. The transactions which gave rise to the aforesaid taxable capital gains occurred on April 1, 2006 when each of the Appellants sold part of their Common Shares in GS+A to their non-arm's length family trusts shortly before GS+A was reorganized and then went public with an Initial Public Offering("IPO") effected on May 26, 2006.

[2] The Respondent conceded at the beginning of this trial that the underreported taxable capital gains of Freedman was reduced to $422,130.00 and that of Lauria to $140,710.00 in lieu of the above reassessed amounts, based on the fair market value

of the above transacted shares now assumed by the Minister. The Minister amended the Replies to the Notices of Appeal for each Appellant accordingly without objection.

[3] The Appellants appeal the Minister's right to reassess their 2006 tax returns almost 10 years beyond the normal assessment periods pursuant to subsection 152(4) of the *Income Tax Act* ("ITA") as well as the fair market value reassessment of the share transaction in issue.

[4] These matters were heard at the same time and on common evidence and the parties filed a Partial Agreed Statement of Facts at the onset of this trial.

I. Issues

[5] There are two main issues to be decided in this appeal:

1. Whether the Minister is statute barred from reassessing the Appellants under paragraph 154(2)(a); which in essence requires the Court to decide whether the Appellants made a misrepresentation in filing their 2006 tax returns attributable to neglect, carelessness or willful default; and if so,

2. Whether the fair market value ultimately reassessed and reduced by concession at trial represents the fair market value of the shares in issue at the time of the transfer of shares by the Appellants to their non-arm's length trusts on April 1, 2006.

[6] While I will address the first issue first, the determination of the second issue is relevant and crucial to the determination of the first, particularly in determining whether there has been a misrepresentation in filing the 2006 tax return, which is assumed to be the inaccurate reporting of the fair market value of the shares in issue. Accordingly, I will address the fair market value issue at the time and in the context of determining whether there has been a misrepresentation and then deal with the issue of whether same would amount to neglect, carelessness or wilful default afterwards.

II. Position of Parties

[7] The Appellants' position is that they reported the transaction in their 2006 tax return filing and set out proceeds of disposition based on a Valuation Formula (later described) utilized by GS+A for all prior transactions and which they argue represents the fair market value of the shares in issue in the circumstances and so made no misrepresentation in the filing of such returns.

[8] The Respondent takes the position that the Appellants made a misrepresentation attributable to neglect and carelessness in their 2006 tax return by substantially underreporting the fair market value of the shares disposed of by relying on the Valuation Formula which did not take into account the possibility of a liquidity event, the IPO, taking place and that the failure of the Appellants to seek independent verification of the fair market value of the shares in issue in such circumstances did not demonstrate the reasonable care expected of a wise and prudent person in the same circumstances. The Respondent concedes there was no fraud.

[9] I intend to first set out the factual context of this appeal followed by the legal context, setting out both the general applicable principles and then specific jurisprudence in the follow-up analyses undertaken.

III. Facts

[10] The following are the facts agreed upon or established by the evidence at trial that are not in dispute.

[11] GS+A was an independent wealth management firm founded in 1984 by Ira Gluskin and Gerald Scheff (collectively the "Founders") that managed investment portfolios for high net worth clients and various institutional investors.

[12] The Appellant Freedman is a well-educated man having graduated from Queen's University with a law degree in 1982 and from Harvard Business School with a Master's degree in Business Administration in 1986. Freedman then practiced law for 14 years with the well-known law firm of Davies Ward and Beck as it was then known until the end of March, 2000 as a mainly corporate and commercial litigator although he had appeared before this court on a few occasions. Freedman left his law practice to join GS+A as Vice-President of Client Services and remained with GS+A until June, 2016 as it's Executive Vice-President and Chief Operating Officer, managing the day to day operations of GS+A.

[13] The Appellant Lauria is a high school graduate who joined the work force as a secretary and eventually met Gerald Scheff while working for Cadillac Fairview and followed him, after the division they worked in was discontinued, to join GS+A at its inception in 1984. At GS+A she worked her way up, so to speak, from a secretary and office manager, performing multiple services including trades while the firm was small to eventually serving as Vice-President Client Support Services responsible for coordinating the opening of client accounts and providing ongoing information to the firm's clients. Lauria learned and grew in position from actual work experience with GS+A.

[14] Both Appellants were vice-presidents and directors of GS+A at all material times.

[15] When Freedman joined GS+A, his offer of employment dated Febraury 9, 2000 provided that GS+A would be providing him with an opportunity to become a partner of the firm effective July 1, 2000. Freedman testified he understood that to mean he would have an equity or ownership stake in GS+A, a requirement that was important to him as he had been a partner of his former law firm and wanted to participate in ownership. On April 12, 2001 Freedman signed a letter agreement with the Founders, pursuant to which he was given the right to purchase a 10% equity interest in GS+A, either from the Founders or their holding companies. He was required to purchase a minimum of 2.5% of the Common Shares (25% of the stake offered to him) effective July 1, 2001 and the balance over the next four calendar years during the month of July pursuant to an Option agreement he signed on July 1, 2001 when he purchased such initial shares.

[16] Lauria also signed an almost identical letter agreement on the same date, April 12, 2001 with the Founders and their holding companies pursuant to which she was given the right to purchase a 2.5% equity interest in GS+A and under which she was required to purchase a minimum of 25% of such 2.5% of the Common Shares effective July 1, 2001 and the balance over the next four calendar years during any July pursuant to the Option agreement she also signed on July 1, 2001. She testified she was offered an equity stake, asked for more, but accepted what was offered to her without negotiation or investigation as to the value of such stake.

[17] On July 1, 2001 Freedman entered into two identical Share Purchase Agreements, save that one was with Ira Gluskin and the other with Gerald Sheff as respective Vendors, pursuant to which he purchased a total of 25,000 Common Shares for a total purchase price of $370,000.00. Likewise, Lauria entered into like agreements under which she purchased a total of 6,250 Common Shares for a total

purchase price of $92,671.00. Under each of the applicable Share Purchase Agreements the purchase price was calculated pursuant to article 2.2 of the agreement that provided it was the amount determined by the formula set out in Paragraph A of Schedule A (the "Valuation Formula").

[18] Paragraph A of Schedule A provides that the purchase price shall be determined by multiplying:

(a) The number of Shares to be purchased and sold divided by the number of outstanding Shares as at the relevant date; by

(b) The aggregate of:

(I) 1/2 of the Formula Revenue for the immediately preceding twelve(12) month period;

(II) 1/3 of the Formula Revenue for the twelve (12) month period immediately preceding the twelve month period referred to in (i) above; and

(III) 1/6 of the Formula Revenue for the twelve (12) month period immediately preceding the twelve(12) month period referred to in (ii) above.

[19] The definition of the Formula Revenue referred to above is found in paragraph 1.1(k) of each agreement and reads as follows:

> (k)"Formula Revenue" means the aggregate of all management fees earned by GS+A from accounts managed by GS+A which, for greater certainty, shall not include any performance fees or performance related fees earned by GS+A on such accounts, multiplied by one(1.0), all as determined by the Chief Financial Officer of GS+A.

[20] Freedman described the formula for calculating the purchase price as the weighted average of the last 3 years of earned management or fixed fees earned by GS+A while ignoring the other income stream of GS+A which were performance fees that were bonused to all employees of the firm each year in the discretion of the Founders. In fact, Freedman's employment agreement, letter of offer of employment and those of Lauria all reference bonuses as part of the remuneration to be received by them.

[21] As mentioned above, each of Freedman and Lauria executed almost identical Option Agreements on July 1, 2001 pursuant to which Freedman was given an option

to purchase up to 75,000 Common Shares and Lauria was given an option to purchase up to 18,750 Common Shares, representing the balance of the shares they could have but did not purchase on July 1, 2001, at a price based on the Valuation Formula calculated on July 1, 2001 but increased by 10% year over year for the next four years. In fact, each of the Option Agreements already set out that any shares purchased in July, 2002 would be at $16.31 per share, any shares purchased in July , 2003 at $17.94, any shares purchased in July, 2004 at $19.74 and any shares purchased in July, 2005 at $21.71, thus incorporating the 10% cumulative increase mentioned.

[22] Each of Freedman and Lauria exercised their option to purchase the remainder of their shares on July 1, 2004 at $19.74 per share, or $1,480,500.00 in total for Freedman and $370,126.00 in total for Lauria, which were effected pursuant to almost identical Share Purchase Agreements as in the past, with multiple vendors, either being a Founder or their respective holding corporation.

[23] It should be noted that each share certificate issued to Freedman or Lauria pursuant to any of the above transactions had notations on the face of the certificate advising they were subject to transfer restrictions and a reference was printed on the reverse side thereof advising the shares were subject to the restrictions contained in the Share Purchase Agreements entered into by them with the Founders, their respective holding corporations and GS+A.

[24] The restrictions contained in the Share Purchase Agreements included the following:

1. Article 5.1 prohibits any Purchaser from transferring or encumbering their Common Shares without the prior consent of the Board of Directors, unless otherwise specified; such as in Article 5.3 which allows transfers by the Purchaser to a corporation, partnership or trust beneficially owned by him if advance notice is given and such entity executes an agreement satisfactory to GS+A to be bound by the Share Purchase Agreement;

2. Article 6.1 requires any existing or new spouse to sign an agreement agreeing to waive any right or entitlement to the Common Shares;

3. Article 5.6 requires any Purchaser to sell all or part of his shares to any current or prospective officers or employees if the Board of Directors determines it is desirable at the Valuation Formula price determined with adjustments to the date of closing;

4. Article 4.2 requires a purchaser whose employment is terminated with GS+A by either party or for any reason to sell all of his Common Shares beneficially owned or over which he has control, to GS+A or such directors, officers or employees of GS+A as the board of directors may designate at the Valuation Formula price.

[25] Freedman testified that these restrictions, together with fact the Founders' shares had 100 votes per share instead of 1 vote per common share, meant that there was no market for the Common Shares other than as the controlling shareholders, being the Founders, might direct; a sentiment echoed by Lauria. This is not disputed by the Respondent for the time period prior to the disclosure by the Founders to the Appellants and others that they decided to pursue going public.

[26] In February of 2006, Freedman testified that to his surprise and out of the blue the Founders decided to pursue a public offering of the shares of GS+A (the "IPO") and hired an underwriter for that purpose. Lauria also expressed like sentiment in her testimony. The underwriter was formally engaged on March 2, 2006 and Freedman testified he was charged with explaining the business and its operations to the underwriter and to assist him in putting together a preliminary prospectus, which was filed on April 18, 2006. Lauria does not appear to have had any role in assisting the underwriter in preparation for the IPO.

[27] Following the news that the Founders wished to issue an IPO, Freedman testified that he was advised by Mr. Bernstein, the then Chief Financial Officer or Bruce Leboff, a fellow executive, that all the common shareholders should do some estate planning and arranged for the same law firm representing GS+A on the IPO, Goodman's LLP, to advise all of them. Such law firm advised that a family trust be settled for the benefit of their children or spouses and that some portion of their shares be transferred to it. Freedman testified he does not remember ever meeting the estate planning lawyer from said law firm but testified the decision to go public and the price information from the underwriter got him thinking of estate planning while Lauria testified that the partners met and were advised to go the trust route which she agreed to because all the other partners she considered more expert also went along.

[28] On March 31, 2006 each of Freedman and Lauria, and it appears all the other executives with Common Shares, executed an agreement that settled a family and/or a spousal trust and on April 1, 2006, the same date, the directors of GS+A, which included Freedman and Lauria, executed a Resolution approving the transfer by the Appellants and 4 other of the said executive employees of some of their Common

Shares to their respective trust or trusts. Freedman transferred 3,000 Common Shares to the JMF Children's Trust 2006 at a price of $77,340.00 and Lauria transferred 1,000 of her Common Shares to the Lauria Family Trust at a price of $25,780.00 and each filed a T1 General Tax Return in a timely manner reporting the capital gain from such transaction that is in issue here.

[29] Each of the Agreements between Freedman and Lauria and their respective family trust, all prepared by the same law firm, contains the following provisions:

> 1.02 Purchase Price: The purchase price for the Transferred Shares shall be the fair market value as of the date hereof which has been computed to be the sum of $77,340.00.
>
> 4.01. Fair Market Value: The parties hereby acknowledge and confirm that they have reasonably and in good faith determined that the fair market value of the Transferred Shares is equal to the Purchase Price.

A price adjustment clause is included in case of reassessment after a finding by a competent tribunal if there is no agreement on the issue.

[30] It should be noted that there were no similar restrictions contained in the aforesaid Purchase and Sale Agreements with the trusts as in past Share Purchase Agreements and no evidence that the Directors of GS+A required the trusts to execute an agreement to be bound by such restrictions, although both Freedman and Lauria testified they believed the intention was that the Trusts would be bound by the restrictions.

[31] On April 18, 2006, six weeks after the above transfer of Common Shares by the executives to their trusts, the preliminary Prospectus was filed.

[32] In contemplation of the IPO, GS+A was reorganized. Articles of Amendment were filed on May 25, 2006 creating three classes of shares;

(a) Multiple Voting Shares;

(b) Subordinate Voting Shares; and

(c) Preferred Shares;

as referenced in the Prospectus.

According to the Articles of Amendment the outstanding 560,000 Founders Shares and the outstanding 440,000 Common Shares were converted into Multiple Voting Shares in the same ratio of 28.8 Multiple Voting Shares issued for each Founders Share and Common Share. The Articles contained another provision however that automatically converted any Multiple Voting Shares not held by defined Founders or Non-founders groups into Subordinate Voting Shares with the effect that all the shares held by the Trusts were converted automatically into Subordinate Voting Shares.

[33] There was also another conversion clause that allowed holders of Multiple Voting Shares to convert into Subordinate Voting Shares the result of which allowed the Founders holding companies and the Appellants and other executives to have converted between 13% and 26% of their Multiple Voting Shares into Subordinate Voting Shares as well, presumably allowing the partners of GS+A to cash out some of their equity stake in the IPO as well.

[34] The Reorganization was approved by the Board of Directors, which included the Appellants, on the same date. The result is that the 3,000 Common Shares transferred to the JMF Children's Trust were converted into 86,400 Voting Subordinate Shares and the 1,000 Common Shares transferred to the Lauria Family Trust were converted into 28,800 Voting Convertible Shares.

[35] Pursuant to the terms of the Prospectus, the Trusts were obligated to sell their Subordinate Voting Shares when the IPO occurred.

[36] The IPO was completed on May 26, 2006, a day after the reorganization described above. As a result, the JMF Children's Trust sold its 86,400 Subordinate Voting Shares for $$1,598,000.00 and the Lauria Family Trust sold its 28,800 Subordinate Voting Shares for $495,418.00 while the Appellants and the other partners of GS+A also sold the shares they had converted in Subordinate Voting Shares as well, while retaining the majority of their Multiple Voting Shares. The sale price in all cases was the issue price of $18.50 per such converted share. Working backwards and for comparison purposes, based on the 28.8 to 1 conversion ratio above referenced, each Subordinate Voting Share would have had an initial flow through value of $0.895 per share based on the Common Share sale price of $25.78 to the trusts before the IPO occurred.

[37] As mentioned, each of the Appellants filed their 2006 tax returns on time in 2007 and reported the taxable capital gain from the April 1, 2006 sale of their shares to their respective trusts based on proceeds of disposition of $77,340.00 for

Freedman's 3,000 Common Shares and $25,780.00 for Lauria's 1,000 Common Shares, being $25.78. per common share as determined by Mr. Bernstein, the Chief Financial Officer of GS+A pursuant to the Valuation Formula.

[38] The tax returns were initially assessed as filed, but about 8 years later, audits for the Appellants' 2006 taxation years were commenced within a few months of one another, resulting in the ultimate reassessments issued in 2017, beyond the normal assessment period whereby Freedman's taxable capital gain was increased by $587,730.00 and Lauria's taxable capital gain was increased by $195,910.00 as referenced at the outset.

[39] The above reassessments resulted from an internal valuation report issued by the Canada Revenue Agency ("CRA") that found the 3,000 Common Shares sold by Freedman to his trust were valued at $1,252,800.00 and the 1,000 Common Shares sold by Lauria to her trust were valued at $417,600.00; or $417.00 per Common Share. The valuator used a market approach comparing share prices for similar businesses that were public companies and applied a discount for size.

[40] At the commencement of this hearing the Respondent conceded that the fair market value of the 3,000 Common Shares sold by Freedman to his trust was $921,600.00 and that the fair market value of the 1,000 Common Shares sold by Lauria to her trust was $307,200.00, all based on a share price of $307.20, that reduced the alleged underreported taxable capital gains to $422,130.00 and $140,710.00 respectively. This concession was based on a second valuation report prepared by an expert witness, who testified at this trial, and who relied on an Income Approach to valuing the business of GS+A en bloc and applied a 40% marketability discount.

[41] The CRA reassessed the Appellants almost 10 years beyond the normal reassessment period on the basis the non-arm's length share transfers did not occur at fair market value subject to the aforesaid concession.

IV. The Law

[42] The parties agree that the transactions in issue were on a non-arm's length basis and accordingly if found the Appellants transferred their Common Shares to their respective trusts for proceeds less than fair market value, subparagraph 69(1)(b)(i) deems the taxpayer to have received proceeds equal to fair market value. There is no dispute on this issue.

[43] Subsection 152(3.1) of the ITA sets out the normal periods for reassessing. There is no dispute that the reassessments of the Appellants occurred outside such normal assessment periods so it is not necessary to delve into the detail of such provision.

[44] Subsection 152(4) contains provisions that allow the Minister to reassess a taxpayer's return outside the normal assessment period and the part relevant to theses appeals, paragraph (a) reads as follows:

> (4)Assessment and reassessment: The Minister may at any time make an assessment, reassessment or additional assessment of tax for a taxation year, interest or penalties, if any, payable under this Part by a taxpayer or notify in writing any person by whom in a return of income for a taxation year has been filed that no tax is payable for the year, except that an assessment, reassessment or additional assessment may be made after the taxpayer's normal reassessment period in respect of the year only if
>
> (a)The taxpayer or person filing the return
>
> (i) has made any misrepresentation that is attributable to neglect, carelessness or wilful default or has committed any fraud in filing the return or in supplying any information under this Act, or
>
> (ii) has filed with the Minister a waiver in prescribed form within the normal reassessment period for the taxpayer in respect of the year;

[45] The parties agree there has been no fraud committed and there was no waiver filed with the Minister.

[46] As counsel for the Appellants has argued, the purpose of a statutory limitation period is to give some certainty to the tax system as stated in *Tingley v Canada,* [1999] 1 CTC 2177(TCC) at paragraph17:

> 17. The very purpose of the limitation period is to provide a window during which the Minister may review and make such re-assessment and yet provide the taxpayer who has not made misrepresentations some certainty in their tax affairs.

[47] Clearly, the goal of certainty expressed above is dependent on the taxpayer not having made any misrepresentations. Where a misrepresentation is made, subsection 152(4) allows the Minister to reassess beyond the normal assessment period. As pointed out by counsel to the Appellants, the Minister cannot reassess a taxpayer simply because it becomes aware of it having lost an opportunity to collect

more revenue and relies on the Federal Court of Appeal's statement in *Canada v Regina Shoppers Mall Ltd.*, [1991] 1 CTC 297(FCA) at paragraph 21:

> The mere fact that a taxpayer may ultimately benefit from a failure of the taxing authority to properly reassess obviously does not constitute authority for reassessment which is not found in the legislation itself. There is no rule of equity or of common law which may somehow assist the taxing authority to obtain revenue which it has lost solely and entirely through its own negligence or failure to exercise the powers granted to it by the Act.

[48] I agree and do not believe there is any dispute that where the authority to reassess is found in the legislation, in this case under subparagraph 152(4)(a)(i) where there is a misrepresentation, the Minister has the legislative authority to pursue that lost revenue. In *Jencik v The Queen,* 2004 TCC 295, also relied upon by the Appellants, Bonner J stated this premise clearly at paragraph 5:

> The Minister's right to reassess for 1994 to 1998 [the "statute barred years"] was therefore dependent on the Appellant having made misrepresentations attributable to neglect, carelessness or wilful default or having committed fraud as set out in subparagraph 152(4)(a)(i) of the Act.

[49] There is also no dispute that the onus is on the Minister to establish that the misrepresentations were made. This is well settled law recited in Jencik above also at paragraph 5, but also recently by the Federal Court of Appeal in *Deyab v Canada,* 2020 FCA 222 at paragraph 40:

> 40 … the onus was on the Minister to establish the facts that would justify the reassessments issued for the statute barred years.

[50] In fact, in *Vine Estate v R,* 2015 FCA 125 ,Webb JA described the onus in a two step process as follows at paragraph 24:

> 24. In this case, there is no allegation of any fraud. Therefore, the onus is on the Minister to prove, on a balance of probabilities, that the taxpayer or the person filing the return:
>
> (a) has made a misrepresentation; and
>
> (b) such misrepresentation is attributable to neglect, carelessness or wilful default.

Webb JA further stated at paragraph 25:

> As in any civil case, if a person has the onus of proof for particular facts, the question for the trier of fact is whether, based on all of the evidence admitted during the hearing, that person has proven, on a balance of probabilities, that such facts exist. There is no shifting onus.

I will consider the jurisprudence on the above steps during my analysis thereof to come.

[51] Finally, with respect to this provision, it must be noted that the time for determining the misrepresentation is at the time of filing the tax return and that it remains a misrepresentation even if the Minister could have ascertained the true facts prior to the expiration of the limitation period. In *Vine supra* at paragraph 33, Webb JA confirmed and adopted the principles set out by Stayer JA in the 1996 Federal Court of Canada-Appeal division decision in *John G. Nesbitt v Her Majesty the Queen,* 96 DTC 6588 at paragraphs 8 and 9:

> 33. The principles as set out by this Court in Nesbitt are also applicable:
>
> 8. … It appears to me that one purpose of subsection 152(4) is to promote careful and accurate completion of income tax returns. Whether or not there is a misrepresentation through neglect or carelessness in the completion of a return is determinable at the time the return is filed. A misrepresentation has occurred if there is an incorrect statement on the return form, at least one that is material to the purposes of the return and to any future reassessment. It remains a misrepresentation even if the Minister could or does, by a careful analysis of the supporting material, perceive the error on the return form. It would undermine the self-reporting nature of the tax system if taxpayers could be careless in the completion of returns while providing accurate basic data in working papers, on the chance that the Minister would not find the error but, if he did within four years, the worst consequence would be a correct reassessment at that time.
>
> 9. Thus it is irrelevant that the Minister might, despite the misrepresentation on the return form, have ascertained the true facts prior to the expiry of the limitation period. The faulty return was when submitted, and remained, a misrepresentation within the meaning of subparagraph 152(4)(a)(i) of the Act.

[52] Finally, as a last general principle of law, there is no dispute that the ITA does not define Fair Market Value. However, there was also no dispute that the well accepted definition of fair market value in the jurisprudence is that set out in *Nash v. Canada,* 2005 FCA 386 at paragraph 8, citing Justice Cattanach of the Federal Court:

> 8. The well-accepted definition of fair market value is found in the decision of Cattanach J. in *Henderson Estate and Bank of New York v Minister of National Revenue (1973),73 D.T.C. 5471(Fed.T.D.)*,at 5476:
>
> The Statute does not define the expression “fair market value”, but the expression has been defined in many different ways depending generally on the subject matter which the person seeking to define it had in mind. I do not think it necessary to attempt an exact definition of the expression as used in the statute other than to say that the words must be construed in accordance with the common understanding of them. That common understanding I take to mean the highest price an asset might reasonably be expected to bring if sold by the owner in the normal method applicable to the asset in question in the ordinary course of business in a market not exposed to any undue stresses and composed of willing buyers and sellers dealing at arm’s length and under no compulsion to buy or sell. I would add that the foregoing understanding as I have expressed it in a general way that includes what I conceive to be the essential element which is an open and unrestricted market in which the price is hammered out between willing and informed buyers and sellers on the anvil of supply and demand.

[53] Since the misrepresentation alleged by the Minister were the reported values of the share proceeds of the Common Shares sold to their trusts by the Appellants, it follows that the Minister has first the onus of proving the fair market value of such shares was higher in order to engage the provisions of paragraph 69(2)(b) above and secondly that such misrepresentation was attributable to neglect, carelessness or wilful default. I will address these issues in order.

V. Analysis

1. Has there been a Misrepresentation?

[54] As stated in Vine and Nesbitt above, “a misrepresentation has occurred if there is an incorrect statement in the return form, at least one that is material to the purposes of the return and to any future reassessment.”

[55] In order to determine whether the fair market value reported in Freedman’s and Lauria’s 2006 tax return is incorrect, I must examine the evidence during trial, which essentially consisted of the oral testimony of the Appellants and the expert witness testimony of Mr. David Feher, the CRA valuator together with the documentary evidence tendered into evidence. Since the onus is on the Respondent to prove the reported proceeds was not the fair market value of the shares in issue, I will address its evidence first.

VI. Expert Witness

[56] Mr David Feher, a certified public accountant and certified business valuator, prepared an expert report dated March 26, 2021 to value the 3,000 Common Shares of Freedman and 1,000 Common Shares of Lauria transferred to their respective trusts as at April 1, 2006 (the "Valuation Date"). Mr Feher's qualifications were not questioned and his report was admitted as Exhibit R-1 at trial with the consent of the Appellants. While not necessary to delve into his impressive qualifications found in the report, it is important to note that I found his qualifications very impressive; including his 22 years experience as a valuator, his role in teaching and lecturing on business valuations at McGill University and his experience in high complexity valuations including valuing private Company minority shares.

[57] In the report summary found in paragraph 17 of the report, Mr. Feher concludes that the fair market value of each share as at the Valuation Date should be the midpoint of the range of share prices he calculated equal to $307.20 per common share. This would value Freedman's 3,000 Common Shares at $921,600.00 and Lauria's 1,000 Common Shares at $307,200.00, the amounts conceded by the Respondent at the beginning of this trial. Recall that the price per share used by the Appellants was $25.78 in the transactions in question.

[58] Mr. Feher adopted the accepted standard definition of "Fair Market Value" referenced in *Nash supra*, found in paragraph 18 of the Report:

> 18. For the purposes of this report, the term Fair Market Value is defined as the highest price available in an open and unrestricted market, between informed and prudent parties acting at arm's length and under no compulsion to transact, expressed in terms of money or money's worth.

[59] In arriving at such valuation Mr. Feher assumed certain facts that are mainly what I would term boiler plate except for the following:

> 9. There are no documents, relevant to the valuation, which have not been provided to us except as set out in this report.
>
> 10. The interim financial statements as at February 28, 2006 reasonably reflect the financial position of the Company as at that date.
>
> 15 The Shareholders had prior knowledge of the intention of the Company to proceed with an initial public offering ("IPO") and secondary offering of shares as at the Valuation Date.

16. The IPO process was already underway on the Valuation Date.

[60] With respect to assumption 9 above, there is no dispute that the expert witness reviewed essentially all the documents put into evidence pertaining to the transactions in issue. While the expert witness agreed under cross-examination that he never interviewed any of the Appellants or other officers or representatives of GS+A, I cannot find that anything could have been added based on the testimony of the Appellants that would have materially affected his assumptions or report.

[61] I see no reason to question the interim financial statements prepared by the Company nor the facts and information contained in the IPO prospectus that Freedman helped create and issued by GS+A and no specific issue has been raised with respect to same.

[62] As for the assumptions in paragraph 15 and 16 above, I have found, based on the evidence earlier cited, including the admissions of both Freedman and Lauria, that all the Shareholders were aware of the intention of the Company to proceed with an initial public offering and that the process started in February of 2006, almost two months before the Valuation Date. The underwriter had been hired under contract on March 2, 2006, almost a full month before.

[63] I also felt Mr. Feher's analysis of GS+A business operations to be more detailed than the evidence on same the Appellants gave at trial, including the fact that it had approximately $3.75 billion of assets under management and that it served high net worth individuals who accounted for 83% of its assets under management while 17% came from institutional investors, many clients of which have been long term. Mr. Feher described the firms two main sources of revenue, base fees and performance fees based on 25% of the returns generated in excess of targets reached, certainly consistent in general with the evidence of the Appellants, and analysed the firms strong investment performance and high standards of personalized services as its strengths to continue growing in a highly competitive market that is experiencing high growth due to aging populations increasing their savings and pension assets putting larger assets under management. Mr. Feher also described the strong Canadian Economy in 2006 fueled by strong demand in housing and the strong or record performance of major stock market indexes and high market indicators. The Appellants took no issue with the contextual market described by this witness.

[64] In valuing the shares, Mr Fehrer first valued the Company en bloc and then the individual minority shares.

[65] Mr. Feher described the 3 main methodologies used in valuing a business, the Asset Approach, the Income Approach and the Market Approach and determined the Income Approach was the most appropriate method. The Appellants have not disputed this so I will not delve into the relative strengths and weakness of the different approaches, save to say that based on the stated purpose of such approach, the Income Approach is clearly the best suited and was used by the underwriter in the IPO as well.

[66] In paragraph 55 of the Report, the Income Approach is described:

> The income approach values a business based on its ability to generate future cash flows and earn a reasonable return on investment after consideration of risks related thereto. Examples of the income approach included the capitalized earnings and cash flow techniques and the discounted cash flow technique.

[67] Mr. Feher selected the capitalized earnings technique as the most appropriate technique to value the business as a whole and essentially calculated Maintainable Earnings of the Company and applied a capitalization multiple.

[68] Although the details of the calculations are contained in the Report, it is important to summarize the two-step process used in arriving at the corporation's Maintainable Income which involved recognizing both income streams of the corporation; fixed base management fees and performance fees, similar to the approach taken in the IPO itself.

[69] To calculate the low end of the range of values Mr. Feher added the normalized after tax base or fixed income earnings of $11,431,000.00 for the 2006 year and added 89% of said fixed earnings to represent the firm's performance fees, based on a calculation of the firm's 21 year historical average of performance fees as a percentage of such fixed fees of 89%, being $10,173,000.00 to the year to arrive at an estimated maintainable after tax earnings of $21,604,000.00 at the low end. Mr. Feher only used 89% of such average instead of 100% of such average to account for volatility in performance fees reflected in the IPO information on which he relied. Counsel for the Appellants questioned Mr. Feher on cross-examination as to the volatility of performance fees, which over the aforesaid period have ranged from 0% to 517% as referenced in the IPO prospectus (paragraph 42) and Mr. Feher explained this was the reason a prior 21 year average was used which showed performance fees averaged 89% of those base fees. As Mr. Feher pointed out, if only the last 5 years were used, the percentage would have been 124% and substantially more if only the last 3 years were used that would have driven the price calculation

significantly higher. I find he was being very reasonable and conservative in using only the 89% average to the benefit of the Appellants, especially when one considers that the actual performance fees for the year would have been over $81,000,000.00, a substantial increase over the $10,173,00.00 used that represented 89% of the year's base income.

[70] To calculate the high end of the range of values, Mr. Feher added the same base or fixed after tax income earnings of $11,431,000.00 and the average of the last 3 years of estimated after tax performance fees of $18,364,000.00 for a total of $29,795,000.00 [see paragraph 60 of Report].

[71] To this range of Maintainable Earnings, from $21,604,000.00 to $29,800,000.00, Mr. Feher then applied a low and high range capitalization multiple, the inversion of a capitalization rate, and calculated the capitalization rate based on market and firm risks and factors as ranging from 4.55 to 5.5%, resulting in 22.3 to 18.2 capitalization multiples [see paragraph 61 of Report].

[72] Finally to value the Company en bloc, the Maintainable Earnings are multiplied by the capitalization multiples resulting in a value ranging from $481,069,000.00 to $542,805,000.00 or a midpoint of $512,000,000.00, $512.00 per share.

[73] Finally, to calculate the value of individual shares, since there were 1,000,000 shares issued as at the Valuation Date, consisting of 440,000 Common Shares and 560,000 Founders shares that share equally on distribution, the range of values is divided by 1,000,000 with the result that each share is worth between $481.00 to $543.00 before any discount is applied for minority or other reasons.

[74] Mr. Feher then turned to a suitable minority share discount, the quantum of which required consideration of Precedent Transactions, any Shareholders Agreement and the discussions pertaining to the pending IPO and secondary offering.

[75] As noted earlier, the Share Purchase Agreements contain the restrictions on the commons shares issued to the Appellants and other executives as well as the formula for determining the share price in transactions, much as would a Shareholders Agreement. Although a review of precedent transactions using such formula show amounts ranging from $14.83 in 2001 transactions to $25.78 on March 31, 2006 for the transfers to the trust, Mr. Feher used the one on the Valuation Date of $25.78. He summarizes his conclusion in paragraph 84 of the Report as follows:

> 84. The price per share as per precedent transactions is determined by the Formula in the respective shareholders agreements that include restrictions on transfer, drag along rights, voting directives, forced sale of shares to new employees. The price established by the Formula is for Common Shares that are not liquid and have no control. Lacking any foreseeable or imminent event that changes control or liquidity, such as a going public transaction, the minority discount due to lack of control and lack of marketability can be determined by comparing the pro rata value per share based on the en-bloc value and the price paid by the Formula. As of March 31, 2006, the pro rata per share based on the en-bloc value falls in the range of $481.00 to $543.00 per share. The implied minority discount based on a share price of $25.78 per share will be between 94.6% and 95.3 %.

[76] Mr. Feher testified that had the IPO not been pending, the above discount rates would have been applicable, however since, based on working backwards from May 26, 2006, being the date of the IPO and subtracting the time it normally takes to effect an IPO based on various law firm and accounting firm published guides, Mr. Feher calculated the process started at the beginning of March, 2006, well before the share transfers that took place on April 1, 2006.We in fact know from the evidence of Mr. Freedman that the underwriter was hired on March 2, 2006, within a few weeks from the time the Founders announced their decision to seek going public.

[77] Mr. Feher considered the proposed IPO as an imminent liquidity event, which he stated is one that occurs within 6 months, that pre-empted the use of the 95% minority discount above. Notwithstanding this, he still considered a discount was in order due to the risks that the IPO may not take place or the market for the shares does not materialize, or there would be a failure to agree on price, or the worsening of market conditions or a change of heart by the Founders among other reasons and, relying on a study known as the Emory Pre-IPO studies that observed 543 transactions for which a discount was calculated based on the time between the transaction and the IPO and determined for transactions that occurred in 30-60 days before the IPO that a proper discount would be 40%. In the case of hand, there were 56 days from the time of the transfer to the trusts by the Appellants and the date of the IPO.

[78] Counsel for the Appellants also questioned Mr. Feher's use of a 40% discount relying on a published study titled "Discounts for Lack of Marketability, Emory Pre-IPO Discount Studies 1980-2000 As Adjusted October 10, 2002" by John D. Emory et al Tab 10 of Exhibit R-2 by reference to comments made by Philip Saunders in an article titled "Marketability Discounts and Risk in Transactions Prior to Initial Public Offerings" Tab 9 of Exhibit R-2 at page2 which found "There is enormous dispersion of the discounts. They range in each study from highs of 80-95% to lows

generally in single digits or even negative, i.e. the pre-IPO prices were higher than the IPO prices." Counsel suggested that the discounts for the considered transaction were essentially "all over the place" and suggested the use of a mean average of 40% for transactions occurring 30-59 days before an IPO were in essence unreliable. In alternative argument however, he suggested if the Court found there to be a misrepresentation that the price be discounted by the highest of the dispersed findings of 95%. With respect to counsel for the Appellant, using a mean average appears to be the only sensible approach in the circumstances of this accepted practice, particularly as the evidence actually shows the IPO was far more certain to occur than not in my opinion. Certainly more sensible than adopting the outlier numbers, like the negative one or zero that would have resulted in a much higher fair market value to the detriment of the Appellants.

[79] As a result of the discount in anticipation of an IPO, a 40% reduction to the pro-rata value of the shares ranging from $481.00 to $543.00 would result in a range of $288.60 to $325.80 with a mid-point value of $307.20 per share. Based on this, Freedman's shares were valued at $921,600.00 and Lauria's shares at $307,200.00.

[80] The result is in my opinion already highly favourable to the Appellants. In the case at hand the IPO occurred within 85 days of the underwriter being hired, the preliminary prospectus was filed on April 18, 2006, 47 days from such time of hiring, and every indication is that all steps moved along expeditiously to effect the IPO including setting up the trusts and transferring shares to it within 6 weeks of the Founders' announcement of their intention to pursue an IPO, reorganizing GS+A before the IPO, marketing the IPO using the road show slides and documents and of course finalizing the IPO. There has been absolutely no evidence led by the Appellants to suggest in any way, shape or form that the IPO was not expected to occur or be impacted for me to weigh and it did in fact occur and the Appellants undertook their estate planning in contemplation of it. In my opinion, having regard to the above, the Respondent could easily have argued that a higher share price was justified based on the actual sale at a higher price occurring so close to the transaction date, which suggests to me the Respondent has acted reasonably in establishing fair market value.

[81] I find the Expert Witness's testimony and report to be detailed, thorough and highly convincing and credible.

[82] Before deciding the issue however, I must also have regard to the evidence of the Appellants themselves, who did not have any expert witness or report before the Court.

[83] It should be noted that while both Appellants testified they were aware of the IPO and were aware or had expectations that the IPO would increase the price for their shares as publicly offered shares over the Valuation Formula, neither Appellant sought to obtain independent legal advise nor a valuation of the fair market value of the shares being transferred to the trusts either before the transaction or before the time of filing their tax returns and neither factored in the proposed IPO in arriving at a price for the shares transferred to their respective trusts, choosing instead to rely on the Valuation Formula for the following stated reasons;

1. The Valuation Formula recognizes that there is no market for the Common Shares due to the restrictions attached to them, has been calculated on a consistent basis and was used in all the several transfer of shares from the Founders to the executive members of GS+A, or between them, since 2001 to 2005, in what they consider arm's length transactions prior to the IPO and thus is indicative of fair market value.
2. There was no certainty that the IPO would proceed due to many risks outside the Appellants control and the Common Shares could continue to be held by the trust indefinitely. The Appellants argued the following were the risks that could derail the IPO process:

   (a) The risk that a market for the shares would not materialize;

   (b) The risk that market conditions might worsen;

   (c) The risk that the condition of the Company might worsen;

   (d) The risk that a private offer would have been made to the Founders and they would have agreed to a different arrangement; and/or

   (e) The risk that the Founders might simply change their minds.
3. The completion of the IPO was not guaranteed and the Founders could have forced them to sell all their shares at any time at the Valuation Formula amount beforehand.

[84] With respect to the argument the Valuation Formula was used for arm's length transactions up to 2005, there is no evidence it was used for transactions other than those involving employees and so has not been tested in a wider market. Although counsel for the Appellants took issue with the Respondent characterizing those precedent share transactions as employment incentives or benefits, the context of their issue certainly suggests there is some basis for the Respondent's said

characterization. Moreover, as the Respondent has pointed out, all these transactions, were before the possibility of a liquidity event in the form of the IPO in question.

[85] No evidence was tendered as to why a proposed liquidity event would have no effect on the Valuation Formula for the Court to consider in weighing the Appellant's position even in light of then existing jurisprudence that has considered same. The Courts have accepted that the potential for a future IPO should be taken into account in valuing minority shares. In *McClintock v. Canada,* 2003 TCC 259, C.J. Rip accepted the CRA valuators fair market valuation of shares sold by the Appellant that were originally acquired through an employee stock option plan and sold while an IPO was being considered that occurred expeditiously and successfully and where a marketability discount of 25% was justified. The Appellant argued the lower value of $6.00 per share as set by the Board of Directors for issuance of employee stock options applicable to that year should be applied, as had occurred in past years, as the fair market value since the IPO was not certain while the Respondent argued that a discount from the prospectus price of $15.00 Canadian for lack of marketability in the interim to address risk factors of the IPO not occurring should be applied. Like the case at hand, the IPO occurred within 3 months of the first meeting with underwriters. C.J. Rip accepted the valuator's view as to value "as substantially correct" and saw no substantial error in his report.

[86] This marketability discount approach in McClintock above was also accepted in *Grimes v Canada,* 2016 TCC 280 by this Court by Lafleur J., 13 years following McClintock, who decided on an appropriate discount. It is worth noting in *Grimes supra*, that at paragraph 168 thereof the valuator considered factors in the quantification of the marketability discount that included "(iv) Management Plans for the business and (vi) Potential for capital appreciation during the holding period". These factors clearly demonstrate, as counsel for the Respondent argued, that the process involves a looking forward aspect and not just a reliance on historical data or past transactions.

[87] Moreover, as pointed out by Counsel for the Respondent, relying on *Stellarbridge Management Inc. v The Queen,* 2019 TCC 134 , at paragraph 31 that "the definition of fair market value in a tax case contemplates willing and knowledgeable buyers". In that case Lafleur J. found factors known to the Appellant, like the requirements for land fill on land being valued and the delays in servicing the lands, had to be factored in and were not considered by the Minister's expert valuator in arriving at value, thus found the Minister's expert report unreliable. In the case at hand, a knowledgeable buyer would have considered the effect of the

proposed IPO and possibly, depending on timing, the circumstances of its expeditious processing in arriving at a price point.

[88] The Appellants also gave no evidence as to the possibility of any of the risks listed in the paragraph 83(2) above actually happening. In fact, the evidence of the Appellants is that the Company was growing and performing well, also evidenced by the increase in revenues it experienced in the last two years especially. The Prospectus indicates that the Company's Performance fees as a percentage of Fixed Management fees was $179.95 in 2004 and grew to $266.35 in 2005 and that the rates of the Company's portfolio returns were almost double the S&P/TSX rates of returns in those years, while being higher than those exchange markets for the period since the firm started, [see pages 33 and 42 of Prospectus in Tab 31 of Joint Book of Documents]. In the Growth Strategy segment found on page 44 of said Prospectus the Company states: "We believe that the successful execution of the following elements of our strategy have the potential to enable us to increase our Assets Under Management." The parties agree that there turned out to be no major business or income changes between April 1, 2006 when the Appellants sold the Common Shares and May 26, 2006, the date of the IPO, and there was no fundamental change in the operations of the Company during that time. As C.J. Rip noted in McClintock at paragraph 57, referencing the expeditious manner in which the IPO proceeded to completion while there was no fundamental change in operations:

> 57. The Alias shares were definitely worth more than $6.00 each on the relevant dates. I am influenced by the fact that there was no fundamental or significant change in the operation of Alias between April 25, 1990 and July 19, 1990. If this is correct, Mr. McClintock has not explained the reason for the increase in value of the shares during the period from $6.00 to the IPO price of $15.00.

[89] The Appellant's explanation for the increase in price, that the Subordinate Voting Shares have no transfer restrictions and thus are not equivalent to the restricted Common Shares, ignores the fact that the IPO was the event that triggered the liquidity of the Common Shares which were converted to the Subordinate Voting Shares with the knowledge and participation of the Appellants. In fact I note that, although the Share Purchase Agreements, under which the Appellants initially purchased Common Shares mentioned earlier, contained the restriction that if a transfer to a trust was approved by the Board, the Board could require the transferee to enter into agreements containing the same restrictions, such new restrictive agreements were not entered into with regard to the Trust's ownership of shares, despite every other of the precedent transactions having contained such agreement. While the Appellants both testified they considered the Common Shares now held by the Trust to be subject to them, there is no actual written evidence they were. This

suggests to me that the Founders and Appellants considered the point to be moot in light of the pending IPO.

[90] In addition, the Founders or anyone having knowledge of the matters did not testify whether they were open to, received or considered any private offer for their shares or whether they had any concerns that would change their minds.

[91] As for item 3 in paragraph 83 above, no evidence was tendered to suggest the Founders had any plans to force the Appellants or other executive to sell their shares to others at the Valuation Formula. Furthermore, the Prospectus, which was originally filed only two weeks after the date the shares in issue were transferred to the trusts, highlighted the strengths of the executive team and listed the executives by name, suggesting they were considered an integral part of the team and would remain so. It seems counter-productive and highly unlikely then that the Founders would risk upsetting the executive team in these circumstances.

[92] While I appreciate there are always risks beyond the control of the parties, I do not believe the Appellants and other executives of GS+A, with obvious in depth knowledge of the Company and the markets it operated in, some of who helped create the Prospectus and its contents, could reasonably have considered any of these risks to be very likely. The fact they all undertook estate planning at the same time, with the same law firm representing the Company, leading to the transactions in issue that occurred less than one month after the underwriter was engaged and only 6 weeks before the IPO was filed, together with the fact they all obviously agreed to sell a portion of their personally held shares suggests they were all in fact relying on the successful completion of the IPO and working together to that end.

[93] Having regard to all the above evidence I am of the view the Respondent has met the onus of proving the fair market value of the Common Shares in issue is $921,600.00 for Freedman's and $307,200.00 for Lauria's. I found Mr. Feher's report took into consideration both the common share restrictions and the potential market risks that exist prior to an IPO into this valuation and applied an appropriate marketability discount and I find no fault with his approach or conclusions. The evidence of the Respondent was convincing and reliable while I could not find the Appellant's limited evidence convincing or reliable enough to challenge the only expert witnesses' conclusions.

2. Is the Misrepresentation attributable to neglect, carelessness or wilful default?

[94] As mentioned earlier there is no allegation of fraud by the Respondent in this matter.

[95] As stated in *Lewin Estate v The Queen,* 2019 TCC 21 at paragraph 36, relying on *Venne v R,* [1984] F.C.J. No. 314 (Fed T.D.) "a taxpayer has been negligent if it is shown that he has not exercised reasonable care." Reasonable Care was defined at paragraph 37 of Lewin, adopting the definition in *Robertson v. R,* 2015 TCC 256 affirmed by the Federal Court of Appeal in 2016 FCA 303 as follows:

> 37. "…reasonable care has been defined by the Courts as the care that would be expected of a wise and prudent person in the same circumstances."

[96] I agree with the Respondent that both Appellants were negligent and careless in making the misrepresentation and find there was ample evidence to support same, including the following:

1. Both the Appellants were aware of the proposed IPO before the transfer of their Common Shares to their respective trusts. Both Appellants are intelligent and knowledgeable about the wealth management business they are in, both being vice presidents and directors of GS+A at the relevant times. These people engage in a business that involves securities values on a daily basis in constructing client portfolios and trading in securities and it defies credibility in my view that they would not have believed a proposed IPO could not possibly impact the value of their equity stake in the firm.

2. Freedman was a highly educated man, having both a law and business degree and good work experience and ran the daily operations of GS+A as Executive Vice President and Chief Operating Officer. He testified he was assisting the underwriter in the preparation of the Prospectus and was aware of the values for the issue. Lauria, as mentioned earlier, had worked for the firm since 1984 with multiple duties including trading and client services and testified the partners met during the period after the announcement by the Founders. Part of her duties involved reporting to the firm's clients. The Appellants had both the intelligence and experience to recognize the impact of an IPO on the values of shares.

3. Both Appellants acted on the potential impact the IPO would have on their equity in the firm in two significant ways:

(a) Firstly, both Appellants, together in fact with all the other executives who owned Common Shares, expeditiously undertook some estate planning to establish family or children's trust and transfer part of their holdings to same. Freedman testified he turned his mind to what the shares would be worth upon the IPO in order to determine what portion of such value he would transfer to the trust for the benefit of his children. Lauria testified she met with the other "partners" and went along with their expertise as if she just went along for the ride, but in fact she acknowledged that she had expectations of an increase in value from the IPO.

(b) Secondly, according to the Prospectus as earlier mentioned, each of the Appellants together with the Founders and the remaining Common shareholders agreed to personally sell anywhere from 13%-26% of their Common Shares subsequently converted to Subordinate Voting Shares after the mentioned reorganization. The Prospectus also required the Trust to sell its Subordinate Voting Shares. It is clear to me the Appellants and those other Common shareholders had input into the content of the Prospectus at least to the extent of contributing the information as to what portion of their holding they were going to cash out, via their trusts or personally and had turned their mind to the cash out value.

It is not credible that the Appellants would consider the effect on the value of their equity state resulting from the IPO for the purposes of their estate planning or cashing out purposes but ignore it for the purposes of filing their tax returns.

4. All the transactions that used the Valuation Formula occurred before the announcement of the IPO. In fact, according to the information of past transactions contained in the Prospectus, the last such transactions occurred on July 1, 2005. It would appear to me that a reasonable person might question whether such historical approach to valuation might not be appropriate in light of the IPO liquidity event.

5. As mentioned earlier on this decision, having regard to the expeditious manner in which the IPO proceeded to completion, the strong state of the economy and stock markets and the continued strong performance of GS+A,

the Appellants had every reason to believe the IPO be successful. Both the Appellants testified that they believed in the strong prospects for the firm and were surprised when the Founders announced their intention to take GS+A public.

6. There is no evidence to support the concerns expressed by the Appellants that the Founders could have forced them to sell their shares at the formula price before the IPO. In fact, this appears highly unlikely since both the IPO and the pre-IPO marketing "road show" document emphasized the skills and continued presence of the executive team as a strength of GS+A. It would seem highly unlikely the Founders would have risked having the Appellants leave before the IPO as that would have been a fundamental change to circumstances that could have imperilled it.

7. The IPO happened on May 26, 2006, a few short months after the process began and the Appellants knew of the actual proceeds received from both the trusts' disposition of their Subordinate Voting Shares as well from their own personal disposition of a portion of their said shares, the latter which they personally reported on their tax returns at the $18.50 issue price. The JMF Children's Trust received $1,598,400.00 for the 86,400 converted Subordinate Voting Shares that represented the 3,000 Common Shares Freedman transferred to the said Trust for $77,340.00 two months before. The Lauria Family Trust received $495,418.00 for the 28,800 Subordinate Voting Shares that represent the converted 1000 Common Shares Lauria transferred to said Trust for $25,780.00 two months before. In both cases, there was an over 2,000% increase in value over two months. This remarkable difference in value alone should have raised a red flag, particularly when there was no change in the operations of the Company over that period and no other explanation has been offered to explain such increase, other than the IPO.

[97] Notwithstanding the above evidence, neither Appellant chose to seek independent confirmation of the value of such shares in issue, either before the transfer to their trusts on April 1, 2006 nor at the time of filing their 2006 tax returns which I strongly believe a wise and prudent person in their circumstances would do and thus I find the Respondent has strongly proven the Appellants were careless and negligent in making the misrepresentation of the fair market value of the shares in issue.

[98] At this time I would also like to address the position taken by the Appellants that the Appellants honestly and reasonably believed the value they determined on April 1, 2006 was the correct value of the Common Shares in the circumstances and thus they made no misrepresentation. As counsel for the Respondent pointed out, the following cases relied upon by the Appellants precede the Federal Court of Appeal decision in *Vine supra* where Webb JA set out the two step approach to analysing subparagraph 152(4)(a)(i) and that is the approach I followed. Nonetheless, although these cases address the reasonableness of the misrepresentation in the context of determining whether there has been a misrepresentation, I consider it more appropriate, following the Vine approach, to consider reasonableness in the context of the second element of whether the misrepresentation is attributable to carelessness, neglect or wilful default.

[99] The Appellants rely on the case of *Petric v The Queen,* 2006 TCC 306 which stated at paragraph 40:

> 40 … In the case at bar, I am of the view that unless it can be said that the Appellants' view of fair market value was so unreasonable that it could not have been honestly held, there was no real misstatement.;

[100] They also rely on *Regina Shoppers Mall Ltd supra* where at paragraph 7, the Federal Court of Appeal stated:

> … Where a taxpayer thoughtfully, deliberately and carefully assesses the situation and files on what he believes *bona fide* to be the proper method there can be no misrepresentation contemplated by section 152.

[101] The Appellant argues that the Appellants honestly and reasonably believed the value they determined on April 1, 2006 was the correct value in the circumstances and that they made a considered determination of value and reported the resulting transaction to the Minister, thus there is no basis upon which the Minister should be permitted to disrupt the certainty afforded by the normal reassessment period.

[102] With respect to the Appellants, I have found that it was not reasonable in my analysis above to ignore the effect of the proposed IPO for the multiple reasons therein stated. The Test of reasonableness expressed in *Robertson supra* is an objective test and thus the simple belief by a taxpayer that he properly filed his tax return is not determinative. Notwithstanding the language of the above statements, the Courts therein considered whether there was an underlying reasonable basis for such beliefs. In fact, in *Petric*, the taxpayer has obtained a valuation and relied on it

so had taken steps to address the value and thus why Lamarre J therein found the taxpayer's value was not unreasonable. In *Regina Shoppers Mall*, the dispute centered on the characterization of the income, whether a capital gain or business income. The Court found the taxpayer had reason to believe the basis for considering the item a business income, and found that the Minister relied on the fact a special reserve had been declared which the Court found not to be true, meant that the Minister's basis for alleging a misrepresentation did not exist. Having found the factual basis for the Minister's characterization of business income did not exist, it stands to reason the Appellant could not have made a misrepresentation when it correctly filed. Clearly, such finding is consistent with the new *Vine* approach, as the Minister could not have satisfied its onus to prove that fact. In the case at hand, I found there was a misrepresentation based on the evidence.

[103] In *Johnson v R,* 2012 FCA 253 the taxpayer relied on the assurances of a Trust manager that certain income receipts from options trading transactions were not taxable without taking further steps to verify such assurances. Sharlow J.A. stated at paragraph 58 that:

> 58 "… she had no factual basis for assessing the reliability of those assurances and she failed to do what any reasonable person in her position would have done, which was to seek independent advice." … "Having failed to take that obvious and simple step, she cannot claim to have considered the matter thoughtfully, deliberately and carefully as a wise and prudent person would have done."

[104] In the case at hand the Appellants did not seek an independent valuation and cannot be said to have thoughtfully, deliberately and carefully considered whether the proposed IPO would affect the share price. In fact, the Appellants just seemed to ignore it, when in my opinion, having regard to their skills in and knowledge of the securities industry from working as executives for a wealth management firm and the multiple other circumstances or red flags that went up that were earlier discussed, they were clearly aware of the impact of the IPO's value on their holdings.

[105] Finally, I would also like to comment on the Appellants' argument that the Appellants did not hide the transaction and thus did not mislead the Minister. With respect, the fact the transaction was not hidden does not mean the Minister was required to reassess within the normal limitation period. As pointed out in *Vine supra*, relying on *Nesbitt supra*, it is irrelevant whether the Minister could have reassessed during such time as a misrepresentation remains a misrepresentation that is subject to reassessment beyond the normal reassessment period if the elements of subparagraph 152(4)(a)(i) are proven by the Respondent.

VII. Conclusion

[106] The appeals are allowed, only to the extent as conceded by the Respondent at trial that the Appellants returns for the 2006 taxation years be reassessed by the Minister on the basis that:

1. The Fair market value of Mr. Freedman's Common Shares in issue is $921,000.00 and the under-reported taxable capital gain was therefore $422,130.00; and

2. The fair market value of Ms. Lauria's Common Shares in issue is $307,200.00 and the under-reported taxable capital gain was therefore $140,710.00.

3. The Respondent shall be entitled to costs in this matter. If the parties are unable to agree on the quantum of costs within 60 days of the date of this decision, then the parties shall file costs submissions within 30 days following such 60 day period for my consideration in determining such costs.

Signed at Vancouver, British Columbia, this 13th day of October 2021.

"F.J. Pizzitelli"

Pizzitelli J.

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PLACE OF HEARING:	Toronto, Ontario
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APPEARANCES:

Counsel for the Appellants:	Matthew G. Williams E. Rebecca Potter
Counsel for the Respondent:	Iris Kingston Rebecca L. Louis

COUNSEL OF RECORD:

For the Appellants:

Name:	Matthew G. Williams E. Rebecca Potter
Firm:	Thorsteinssons LLP
For the Respondent:	François Daigle Deputy Attorney General of Canada Ottawa, Canada