Federal Court of Appeal  Cour d'appel fédérale

Date: 20160106

Dockets: A-416-14
A-429-14

Citation: 2016 FCA 1

[ENGLISH TRANSLATION]

CORAM: **NADON J.A.**
BOIVIN J.A.
DE MONTIGNY J.A.

Docket: A-416-14

BETWEEN:

GUY GERVAIS

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Docket: A-429-14

AND BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

LYSANNE GENDRON

Respondent

Heard at Montréal, Quebec, on October 7, 2015.

Judgment delivered at Ottawa, Ontario, on January 6, 2016.

REASONS FOR JUDGMENT: BOIVIN J.A.

CONCURRED IN BY: NADON J.A.
DE MONTIGNY J.A.

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REASONS FOR JUDGMENT

BOIVIN J.A.

[1] These are two appeals from a decision of a judge of the Tax Court of Canada (the judge) rendered on September 2, 2014 (2014 TCC 119), whereby the judge first dismissed the appeal from the reassessments of Guy Gervais for taxation years 2002 and 2003 and, second, allowed the appeal of Lysanne Gendron regarding the reassessments for taxation years 2002, 2003 and 2004.

[2] Before this Court, Mr. Gervais is the appellant in docket A-416-14 and the Minister of National Revenue (the Minister) is the respondent. In docket A-429-14, the Minister is appealing from the judge's decision and Ms. Gendron, Mr. Gervais's wife, is the respondent.

[3] The two cases were heard consecutively by order of a judge of this Court dated December 4, 2014.

[4] For the reasons that follow, I would allow Mr. Gervais's appeal in docket A-416-14 and dismiss the Minister's appeal in docket A-429-14.

I. The facts

[5] The relevant facts in these two cases are not disputed. Here is a brief overview to help understand the issues in this case.

[6] Vulcain Alarme Inc. (Vulcain) is a family business, incorporated in 1968 under Part 1A of the Quebec *Companies Act* (CQLR chapter C-38). Based in Delson, Quebec, it manufactures in particular toxic gas monitors. During 2002, a company from Calgary, BW Technologies Ltd. (BW Technologies), presented a purchase offer for the purpose of acquiring Vulcain. At that time, Mr. Gervais and his brother were the only two shareholders of Vulcain. Ms. Gendron, Mr. Gervais's wife, had worked for Vulcain since 1992, but was not a shareholder when BW Technologies made its purchase offer.

[7] On June 12, 2002, BW Technologies and Vulcain entered into a confidentiality agreement. Approximately three months later, the purchase offer for the entirety of the capital stock was accepted by the shareholders, which had to be finalized on October 7, 2002. In the weeks preceding this date, Mr. Gervais and Ms. Gendron made the decision to obtain tax advice from a law firm in the light of the purchase offer in question.

[8] A series of transactions relating to the capital stock of Vulcain followed, all before the date planned for finalizing the sale to BW Technologies. For the purpose of the cases at issue, the following two transactions are relevant.

[9] The first transaction is that of September 26, 2002, whereby Mr. Gervais sold to his wife, Ms. Gendron, 1,043,889 shares for $1,043,889. With respect to this transaction, Mr. Gervais opted, in his return of income for the taxation year 2002, not to avail himself of the provisions in subsection 73(1) of the *Income Tax Act*, R.S.C. (1985), c. 1 (5th Suppl.) (the Act). In other words, there was no rollover of the tax consequences resulting from the transaction between Mr.

Gervais and his wife, Ms. Gendron. Therefore, as the adjusted cost base of the shares was $43,889, Mr. Gervais reported a gain of $1,000,000. As for the adjusted cost base of the shares purchased by Ms. Gendron, it was set at $1,043,889.

[10] The second relevant transaction occurred four days later on September 30, 2002. At the relevant time of this transaction, Mr. Gervais gave 1,043,889 of his shares gratuitously to Ms. Gendron. This time, Mr. Gervais did not choose to exempt this transaction from subsection 73(1) of the Act. Therefore, there is a rollover, such that Mr. Gervais is deemed to have disposed of the shares at the adjusted cost base, i.e. $43,889, and Ms. Gendron is deemed to have acquired them at the same price.

[11] Ms. Gendron's shares, those purchased on September 26, 2002, and those given to her on September 30, 2002, were then sold to BW Technologies on October 7, 2002.

[12] At the end of the day, in her return of income for taxation year 2002, Ms. Gendron, under the mechanism provided for in section 47 of the Act, reported a capital gain of $1,000,000 and invoked the exemption provided for at subsection 110.6(2.1) of the Act in the amount of $250,000. Mr. Gervais also claimed an exemption of $158,720 in capital gains corresponding to the maximum available amount that he could claim when he sold his shares to Ms. Gendron. As a result of the transactions of September 26 and 30, 2002, Ms. Gendron pays no tax on her disposition of the shares and half of the gain is attributed to Mr. Gervais.

[13] The Minister considered that this result it not consonant with the Act. He rejected the tax benefits resulting from the sale of the shares from Ms. Gendron to BW Technologies and reassessments were issued to that effect. Therefore, the Minister reassessed Ms. Gendron on the ground that the gain derived from the sale of her shares is an income. Simultaneously, the Minister reassessed Mr. Gervais by applying the general anti-avoidance rule (GAAR) and attributed the capital gain realized by Ms. Gendron, for which she had claimed the capital gain exemption, back to Mr. Gervais' income as capital gain.

[14] Mr. Gervais and Ms. Gendron appealed from the Minister's reassessments to the Tax Court of Canada.

II. The decision of the Tax Court of Canada

[15] First, the judge made a thorough statement of the facts and background that led to the sale and gift of shares prior to the sale of these shares to BW Technologies by Ms. Gendron.

[16] The judge then began his analysis by choosing to review Ms. Gendron's file. According to the judge, if the entire gain made by Ms. Gendron should have been attributed to Mr. Gervais, it follows logically that Mr. Gervais could not have received a tax benefit within the meaning of section 245 of the Act and, consequently, the GAAR cannot be applied.

[17] The judge continued his analysis by discussing the case law relating to the sale of shares from Mr. Gervais to Ms. Gendron and their subsequent resale to BW Technologies. The judge considered whether shares (or bonds) held on a long term basis could result in the acquisition of

a capital asset that generates a capital gain when it is sold, but he was of the view that, in the circumstances, the shares acquired and then sold by Ms. Gendron to BW Technologies were inconsistent with an investment (judge's reasons at paragraphs 91 and 92).

[18] In coming to this conclusion, the judge made a distinction between *Irrigation Industries Ltd. v. Canada (The Minister of National Revenue – M.N.R.)*, [1962] S.C.R. 346 [*Irrigation Industries*] and this case. Specifically, he explained that: (i) the shares purchased by Ms. Gendron had been issued, which was not the case in *Irrigation Industries*; and (ii) there were "clea[r]" indicia that the resale of shares had been "planned" before the purchase (judge's reasons at paragraph 121). Consequently, the judge found that he had before him an adventure in the nature of trade and the gain on the sale of the shares purchased by Ms. Gendron therefore had to be qualified as a business income and not a capital gain.

[19] Second, the judge discussed the question of the shares that Ms. Gendron received gratuitously. At the outset, he made a distinction between receiving a gift or an inheritance and purchasing a property for resale. On that basis, the judge qualified the gain derived from the sale to BW Technologies of the shares acquired gratuitously by Ms. Gendron as a capital gain and not as a business income.

[20] Given his finding that the disposition of the shares purchased resulted in income and that the disposition of the shares received as gifts resulted in a capital gain, the judge excluded the application of section 47 of the Act relating to identical property and, in accordance with section 74.2 of the Act, he attributed to Mr. Gervais the gain subsequently achieved when the

shares received as gifts by Ms. Gendron were sold to BW Technologies. By thus attributing Ms. Gendron's entire gain to Mr. Gervais, the judge concluded that it was not necessary to decide on the application on the GAAR since Mr. Gervais had not profited from a tax benefit within the meaning of the GAAR.

III. The issue

[21] At issue in this appeal is whether the judge erred by qualifying as income the gain derived from the sale of the shares purchased by Ms. Gendron and by qualifying as capital gain the gain derived from the sale of the shares received by Ms. Gendron as gifts.

[22] The standard applicable is that developed in *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.R.C. 235. The findings of fact must be reviewed on the standard of palpable and overriding error. The judge's conclusions on questions of law are reviewable on the correctness standard. Questions of fact and law are also subject to the standard of palpable and overriding error, unless an error of law is extricable, in which case the correctness standard applies.

IV. The parties' submissions

[23] In the A-416-14 case, Mr. Gervais alleged that the judge erred in deciding that the sale of the shares purchased by Ms. Gendron resulted in business income. Rather, he argued that all the shares held by Ms. Gendron were capital property. Specifically, the disposition of the shares purchased by Ms. Gendron was part of a broader context of property that also resulted in capital gain in the same way as the shares received as gifts by Ms. Gendron. According to Mr. Gervais,

section 47 of the Act applies and the reassessments issued in his case, which essentially rely on the GAAR, are without basis.

[24] Opposite to Mr. Gervais, the Minister argued in the A-429-14 case that the sale of all the shares held by Ms. Gendron was instead an adventure in the nature of trade. The Minister asked thus this Court to find that the shares acquired gratuitously as gifts were aimed at making a profit and were in the nature of trade, in the same way as the shares purchased by Ms. Gendron. In addition, the Minister argued that if this Court were to find that the entire gain resulting from the sale of Ms. Gendron's shares to BW Technologies constitutes a capital gain, the GAAR applies and the gain is that of Mr. Gervais.

V. Analysis

A. *The shares purchased by Ms. Gendron and resold to BW Technologies*

[25] In his analysis relating to the shares purchased by Ms. Gendron and resold to BW Technologies, the judge considered Ms. Gendron's intention and eventually concluded that the transaction was an adventure in the nature of trade and, thus, resulted in income.

[26] From his perspective, the judge accepted several facts: (i) prior to September 26, 2002, Ms. Gendron was not a shareholder, but she knew of the existence of the purchase offer that had been submitted by BW Technologies and its subsequent acceptance by Vulcain shareholders; (ii) Ms. Gendron also knew the negotiated sale price and the time limit set for the sale of Vulcain's shares to BW Technologies; (iii) she knew that a significant profit would be made from the sale

of Vulcain's shares to BW Technologies; and (iv) Ms. Gendron participated with Mr. Gervais in tax planning meetings that took place at a law firm.

[27] Although the judge noted in passing that "[t]raditionally, the nature of the property in question, namely, the shares, is considered to be an indicia of an investment"—which results in a capital gain—in contrast, he noted three indicia that are, in his view, inconsistent with this presumption (judge's reasons at paragraph 94):

(a) Even before Ms. Gendron had acquired her shares, she intended to resell them quickly.

(b) The shares had not produced any income while she had them.

(c) The shares had been resold less than two weeks after their acquisition.

[28] Despite these three indicia, the judge was of the view that an aspect "seems to be missing" to qualify the gain derived from the sale of the shares as income: Ms. Gendron had not made any profit by selling the purchased shares.

[29] At the end of his analysis and after weighing the indicia surrounding the transaction, the judge decided that the sale of the shares purchased by Ms. Gendron is tantamount to an adventure in the nature of trade resulting in income: "[a]lthough there was no gain or loss on the disposition of the shares purchased, the indicia point very strongly in favour of characterizing the sale as income" (judge's reasons at paragraph 101).

[30] In justifying this conclusion, the judge pointed out that although the sale of the shares purchased by Ms. Gendron did not result in any profit, this transaction has nevertheless resulted in a tax benefit over a few years as Ms. Gendron reimbursed Mr. Gervais over a period of 5

years. Thus, Ms. Gendron obtained the benefit of very advantageous net cash flow (judge's reasons at paragraphs 95-98). The judge considered that financial benefit sufficient to conclude that the transaction resulted in income, despite the absence of profit. With respect, I cannot agree with the judge's analysis on this point.

[31] First, judge's introduction of the concept of financial benefit as opposed to the well-established concept of profit is not supported by any case law to this effect. Second, the case law accepts the test of the reasonable expectation of profit to apply to a finding of adventure in the nature of trade. For example, in *Friesen v. Canada*, [1995] 3 S.C.R. 103, [1995] S.C.J. No 71 (QL) [*Friesen*], the Supreme Court of Canada, referring to an adventure in the nature of trade, noted at paragraph 16 that "[t]he taxpayer must have a legitimate intention of gaining a profit from the transaction" (see also *Canada v. Loewen*, [1994] 3 FC 83 (C.A.) (QL) at paragraphs 22-24).

[32] Moreover, in this case, not only has the sale of the shares by Ms. Gendron not resulted in any profit, she had no reasonable expectation of profit. Since she purchased Mr. Gervais's shares, the share purchase agreement provided that she could not sell her shares without Mr. Gervais's authorization. Ms. Gendron's sale of the shares she purchased was predetermined and she sold them at the same price that she had acquired them from Mr. Gervais, thereby not making any profit from the transaction. In these circumstances, although the sale of the shares was "planned before the purchase" as the judge stated, it appears at the least incongruous to attribute to Ms. Gendron a reasonable expectation of profit and to qualify this transaction as an adventure in the nature of trade.

[33] Absent a reasonable expectation of profit and in the light of *Friesen*, I conclude that the judge erred in ruling that this transaction resulted in income. With respect, the distinction that he made between *Irrigation Industries* and this case, which resulted in displacing the strong presumption that a company's sale of shares results in the acquisition of a capital asset that generates a capital gain when the shares are sold, is not apposite in this case.

[34] In my view, had it not been for the errors he made, the judge could not but rule that the shares purchased and sold by Ms. Gendron resulted in a capital gain and not income.

[35] Now I will address the second transaction that occurred on September 30, 2002, relating to Ms. Gendron's sale of the shares received as gifts.

B. *The shares received by Ms. Gendron as gifts and sold to BW Technologies*

[36] On September 30, 2002, 4 days after purchasing the shares, Ms. Gendron received gratuitously from Mr. Gervais a gift of shares within the meaning of article 1806 of the *Civil Code of Quebec*. For the purposes of this transaction, Mr. Gervais then invoked the rollover provided for at section 73 of the Act with the result that he would not make any gain contrary to the transaction of September 26, 2002. Therefore, Ms. Gendron is deemed to have acquired the shares at their adjusted cost base from Mr. Gervais. As the judge stated, this cost was small so to speak.

[37] In his reasons, the judge made a distinction between the transaction to purchase shares of September 26, 2002, and the transaction to give shares of September 30, 2002, and found that the

sale of the shares received as gifts, contrary to the sale of the shares purchased, resulted in a capital gain (judge's reasons at paragraphs 125 and 126). It is not disputed by the parties that Mr. Gervais gave part of his shares to Ms. Gendron and that was not called into question before this Court. Although I do not endorse the judge's entire reasoning in this matter, I agree with his conclusion that the gain derived from the sale of the shares received by Ms. Gendron and sold to BW Technologies must be qualified as a capital gain.

[38] Since both transactions result in a capital gain, the question that remains at this point is whether the rules for computing the cost of identical property provided for at section 47 of the Act, which, combined with the effect of the attribution rules provided at sections 73, 74.2 and 74.5 and the exemption for capital gain under subsection 110.6(2.1) result in a possible violation of the purpose and spirit of the Act.

[39] The GAAR was adopted by Parliament for the purpose of regulating the type of questions raised by the parties when no other anti-avoidance provisions apply (Vern Krishna, *The Fundamentals of Canadian Income Tax*, Toronto, Carswell, 2009 at page 806; *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601 at page 614 [*Trustco*]). The three steps involved in the application of the GAAR noted at section 245 of the Act, in my view, help resolve the problem in the context of the facts in this case and the scheme of the Act (*Trustco* at paragraphs 16 and 17). In the context of this case, the discussion of the questions raised by the parties is appropriate for review under this authority: the GAAR is an integral part of this issue and the Minister's position relies on its application. Indeed, the Minister invoked the GAAR in assessing Mr. Gervais.

[40] Specifically, the application of the GAAR will help review the transactions independently so as to consider the true legal effect resulting from each one and give effect to them (*Singleton v. Canada*, 2001 SCC 61, [2001] 2 S.C.R. 1046).

VI. Conclusion

[41] Since I hold that the gain realized as a result of the sale of the shares purchased and received as gifts by Ms. Gendron constitutes a capital gain, it follows that the judge should have reviewed the question of the application of the GAAR provided for at section 245 of the Act. I considered the possibility of conducting the analysis myself, but in the circumstances, I conclude that it is preferable to refer the matter back to the Tax Court of Canada, giving it the directive to carefully review the application of the GAAR to the facts of this case.

[42] Therefore, I propose that Mr. Gervais's appeal in the A-416-14 case be allowed with costs and that the Minister's appeal in the A-429-14 case be dismissed with costs. I would refer the two cases back to the judge or to another judge to be designated by the chief justice of the Tax Court of Canada so that the application of the GAAR can be reviewed and determined.

[43] These reasons will be filed in docket A-416-14 and a copy thereof will be filed in docket A-429-14 as reasons for judgment.

"Richard Boivin"

J.A.

"I agree
Marc Nadon J.A."

"I agree
Yves de Montigny J.A."

FEDERAL COURT OF APPEAL

SOLICITORS OF RECORD

DOCKET:	A-416-14
STYLE OF CAUSE:	GUY GERVAIS v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	MONTRÉAL, QUEBEC
DATE OF HEARING:	OCTOBER 7, 2015
REASONS FOR JUDGMENT:	BOIVIN J.A.
CONCURRED IN BY:	NADON J.A. DE MONTIGNY J.A.
DATED:	JANUARY 6, 2016

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FEDERAL COURT OF APPEAL

SOLICITORS OF RECORD

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