

*Federal Court of Appeal*



*Cour d'appel fédérale*

**Date: 20051014**

**Docket: A-561-04**

**Citation: 2005 FCA 329**

**CORAM: DESJARDINS J.A.  
NOËL J.A.  
PELLETIER J.A.**

**BETWEEN:**

**GIUSEPPE COLUBRIALE**

**Appellant**

**and**

**HER MAJESTY THE QUEEN**

**Respondent**

Heard at Montréal, Quebec, on September 13, 2005.

Judgment delivered at Ottawa, Ontario, on October 14, 2005.

**REASONS FOR JUDGMENT BY:**

**NOËL J.A.**

**CONCURRED IN BY:**

**DESJARDINS J.A.  
PELLETIER J.A.**

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**REASONS FOR JUDGMENT**

**NOËL J.A.**

[1] Mr. Colubriale is appealing a decision of the Tax Court of Canada (2004 DTC 3432; 2004 TCC 578), confirming an assessment for his 1996 taxation year on the grounds that the fair market value of the immovable property he sold to a company of which he was the majority shareholder was \$1,000,000 and that consequently the sum of \$1,500,000 received as

consideration included a taxable benefit of \$500,000 under subsection 15(1) of the *Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1 (the Act).

### **Facts**

[2] The appellant is shareholder, director and president of a paper recovery and processing business operating under the name of J.C. Fibers Inc. (J.C. Fibers). The processing takes place in a plant located at Chambly, south of Montréal. This plant occupies the rear of a building, which has been held by the appellant and his wife and leased to J.C. Fibers since 1986. The front of the building was occupied by offices.

[3] Following a fire which destroyed the building in 1989, the appellant erected a new building at the same location, at a cost of \$1,574,788. J.C. Fibers became the tenant of the property under a new 10-year lease, covering the period from November 1, 1989, to December 31, 1999.

[4] While it was a tenant, J.C. Fibers paid for various improvements to the property, including the installation of a weighing apparatus and a loading dock and the construction of a parking area. The evidence did not indicate the cost of this work or when it was done.

[5] On February 2, 1996, the appellant sold the property to J.C. Fibers for the sum of \$1,500,000. In order to reduce the taxes applicable to the transfer of title, his wife's share had been assigned to him on the same day.

[6] The consideration was set at \$1,500,000 on the basis of an appraisal made in December 1995 (Reasons, paragraph 7). This appraisal had been done in order to determine an insurable value for the building. At that time the building's replacement value was determined to be \$1,392,610.

[7] The appellant and his accountant also took into account the actual cost of reconstructing the building after the fire, which was \$1,574,788. This accounting value and the replacement value exclude the land, the cost of which was \$174,450. The transaction was carried out on the basis of this information.

[8] Having sold the property for a price which he considered lower than its cost, the appellant did not report any gain for tax purposes. In fact, since the building was depreciable property in the hands of the appellant and he had no other asset in this category, he claimed a terminal loss of \$124,619 under subsection 20(16) of the Act, on the basis that the part of the proceeds of disposition relating to the building (depreciable property) was \$1,390,000 and the part relating to the land (non-depreciable property) was \$110,000.

[9] Under an assessment issued on May 30, 2000, the Minister of National Revenue refused the loss claimed by the appellant and added to his income a benefit of some \$523,775 (which, at trial, was reduced to \$500,000) on the ground that the fair market value of the property sold to J.C. Fibers by the appellant was \$1,000,000 rather than \$1,500,000.

[10] This assessment was confirmed on January 11, 2011, which gave rise to the appeal before the Tax Court of Canada.

[11] At the hearing before the Tax Court of Canada, the appellant's expert witness, Benoît Egan, a chartered appraiser, indicated that the price paid by J.C. Fibers was fair and reasonable as J.C. Fibers was a special purchaser. His report, which was not challenged in this respect, indicated that there were few alternative sites for J.C. Fibers and that it would have cost more than the price paid to its shareholder to locate elsewhere. Mr. Egan conceded, however, that the market value of the property for a typical purchaser was \$1,000,000.

[12] The respondent's expert witness, Gaston Laberge, put the fair market value of the property at \$1,000,000, using the three recognized appraisal methods, namely: the cost method, the parity method and the income method. However, he did not try to determine whether the property might have had a higher value for J.C. Fibers in view of the particular situation in which that corporation found itself.

### **Tax Court of Canada decision**

[13] On the basis of the opinions of the two expert witnesses, the Tax Court of Canada judge was satisfied that the market value of the property on February 2, 1996, was \$1,000,000 (paragraph 14). However, he wondered whether it was possible "to add a premium to this market value to justify the fact that J.C. Fibers paid a price greater than the market value in the context of a genuine commercial transaction between non-arm's length parties" (paragraph 15).

[14] In answering this question, the judge undertook the following analysis:

[17] This Court dealt at length with the concept of market value in relation to the concept of the purchaser having a special interest, and it acknowledged that it is possible, in certain circumstances, for a purchaser to have a special interest in acquiring property for a price higher than what others would be prepared to pay. In *Morneau v. Canada*, [1998] T.C.J. No. 680 (Q.L.), Dussault J. set out a number of doctrine and case law passages dealing with this issue, in particular, the comments made by Joyal J. in *Dominion Metal & Refining Works Ltd. v. The Queen*, 86 DTC 6311 (F.C.T.D.). Moreover, in *Morneau*, Dussault J. concluded in the existence of a special purchaser and spoke of how to deal with the issue of persons not at arm's length:

43 Since in our law the concept of market value presupposes an open and unrestricted market, it is also wrong to say that the value which property would have for a potential purchaser desiring to use it for different purposes can be disregarded on the ground that he is the only one who wants to use it for those purposes, there is no competition in the market for this use and the value is thus purely subjective. To do so would be to disregard one aspect of the situation, with the result that the appraisal exercise would become highly theoretical, disconnected from the specific circumstances of the case under consideration and so very questionable.

44 Several other decisions mentioned or analysed by Joyal J. in *Dominion Metal & Refining Works Ltd.*, *supra*, establish that two relevant factors in determining the value of property are the possibility of using the property in accordance with its special features and its use contemplated by a special purchaser. Two such decisions are those of the House of Lords in *Vyricherla Narayana Gajapatiraju v. The Revenue Divisional Officer, Vizagapatam*, [1939] A.C. 302, and the Supreme Court of Canada in *Fraser v. The Queen*, [1963] S.C.R. 455. Joyal J. also mentioned *Laycock v. The Queen*, 78 D.T.C. 6349 (F.C.T.D.), and *931 Holdings Limited v. M.N.R.*, 85 D.T.C. 388 (T.C.C.), and he analysed the Tax Review Board's decision in *Lakehouse Enterprises Ltd. et al. v. M.N.R.*, 83 D.T.C.

388. The least that can be said on reviewing these decisions is that it is impossible to disregard the special interest which a potential purchaser may have in acquiring property for a value higher than what others would be prepared to pay, in view of the special circumstances in which it finds itself and the use it intends to make of the property, to the extent that such an interest can be demonstrated at a given date.

...

47 While the determination of fair market value presupposes a transaction between people who are dealing with each other at arm's length, I agree with the view that this question must be answered by looking at the particular circumstances of a given case, and not by reference to the presumption stated in s. 251(1)(a) of the Act that related persons are deemed not to deal with each other at arm's length.

[18] In *Morneau*, Dussault J. reminds us of what is required to apply subsection 15(1) of the Act. I will set out his comments on this issue, which are found in paragraphs 31 and 32 of his reasons:

31 It should be noted that under s. 15(1) the Court must first determine whether a benefit was conferred on a shareholder in that capacity. Such a finding can only be made by looking at all the particular circumstances surrounding a given transaction. If a benefit was so conferred, its value must then be determined. It is primarily at this stage that the application of certain accepted principles of appraisal becomes truly relevant. The fact that a transaction between a company and a shareholder does not at first sight appear to have been made at the fair market value does not necessarily mean that a benefit was conferred by the company on its shareholder *qua* shareholder. Having said that, I hasten to add that although a transaction such as a sale of property which at first sight appears to have been made for an amount below or above the fair market value may of course be an indication in this regard, it must still be established that in the circumstances this

transaction was not a genuine commercial transaction between the parties.

32 In the recent Federal Court of Appeal judgment in *Canada v. Fingold*, [1998] 1 F.C. 406, Strayer J.A. referred on this point to the classic comments of Cattanach J. in *Minister of National Revenue v. Pillsbury Holdings Ltd.*, [1965] 1 Ex. C.R. 676 (Ex. Ct.), at p. 684, on the real meaning to be given to the equivalent provision of the Act as applicable prior to 1972, namely s. 8(1)(c). These comments read as follows, at p. 413 of *Fingold*:

. . . in my view, there can be no conferring of a benefit or advantage within the meaning of paragraph (c) where a corporation enters into a *bona fide* transaction with a shareholder. For example, Parliament could never have intended to tax the benefit or advantage that accrues to a customer of a corporation, merely because the particular customer happens to be a shareholder of the corporation, if that benefit or advantage is the benefit or advantage accruing to the shareholder in his capacity as a customer of the corporation. It could not be intended that the Court go behind a *bona fide* business transaction between a corporation and a customer who happens to be a shareholder and try to evaluate the benefit or advantage accruing from the transaction to the customer.

On the other hand, there are transactions between closely held corporations and their shareholders that are devices or arrangements for conferring benefits or advantages on shareholders *qua* shareholders and paragraph (c) clearly applies to such transactions . . . It is a question of fact whether a transaction



that purports, on its face, to be an ordinary business transaction is such a device or arrangement.

[15] Although Judge Dussault was able to conclude from the facts and circumstances in *Morneau* that the price negotiated was entirely normal and reasonable in view of the purchaser's special needs, the Tax Court of Canada judge held that "[i]n the instant case, the evidence does not show that actual negotiations took place between the parties" (paragraph 23). The Tax Court of Canada judge went on to say:

[24] Contrary to *Morneau*, in the instant case we do not find an actual need to purchase the property at a particular time, namely February 2, 1996. The facts in this case do not reveal that there was an urgency to conclude this transaction before the end of the lease. Even though J.C. Fibers had taken into consideration all of the possibilities listed in its expert's report to justify adding a premium to the market value, it should have also taken into consideration the seller's expected vulnerability in that type of situation. That is, in fact, the very essence of the negotiations that must take place between persons at arm's length. In *Morneau*, Dussault J. summarized the determination of a fair market value as follows in paragraph 46:

When the interests of a seller can be reconciled with those of a buyer, albeit a special one, after a mutual compromise consistent with each side's bargaining power, a price which has been negotiated and finally accepted may be regarded as representing a value which could be obtained on the market.

[25] The facts in this case do not show that these types of negotiations took place; however, this does not mean that the selling price of the appellant's property would not still have surpassed the fair market value established by the respondent's expert, but only genuine negotiations could have enabled us to know this. The facts in this case lead me to the conclusion that the fair market value of the property was \$1,000,000, and there are no points here that can justify adding a premium to this value.

[16] Consequently, J.C. Fibers was not a “special purchaser”, and since the fair market value of the property was \$1,000,000, J.C. Fibers conferred a benefit of \$500,000 on the appellant on the sale of the immovable property (paragraph 29).

### **Statutory provisions**

[17] In subsection 15(1), the Act provides in the following terms for the taxation of a benefit conferred on a shareholder by a company:

#### **Benefit conferred on shareholder**

**15. (1)** Where at any time in a taxation year a benefit is conferred on a shareholder, or on a person in contemplation of the person becoming a shareholder, by a corporation otherwise than by

**(a)** the reduction of the paid-up capital, the redemption, cancellation or acquisition by the corporation of shares of its capital stock or on the winding-up, discontinuance or reorganization of its business, or otherwise by way of a transaction to which section 88 applies,

**(b)** the payment of a dividend or a stock dividend,

**(c)** conferring, on all owners of common shares of the capital stock of the corporation at that time, a right in respect of each common share, that is identical to every other right conferred at that time in respect of each other such share, to acquire additional

#### **Avantages aux actionnaires**

**15. (1)** La valeur de l'avantage qu'une société confère, à un moment donné d'une année d'imposition, à un actionnaire ou à une personne en passe de le devenir est incluse dans le calcul du revenu de l'actionnaire pour l'année — sauf dans la mesure où cette valeur est réputée par l'article 84 constituer un dividende — si cet avantage est conféré autrement que:

**a)** par la réduction du capital versé, le rachat, l'annulation ou l'acquisition, par la société, d'actions de son capital-actions ou à l'occasion de la liquidation, cessation ou réorganisation de son entreprise, ou par une opération à laquelle l'article 88 s'applique;

**b)** par le paiement d'un dividende ou d'un dividende en actions;

**c)** par l'octroi à tous les propriétaires d'actions ordinaires du capital-actions de la société à

shares of the capital stock of the corporation, and, for the purpose of this paragraph,

(i) where

(A) the voting rights attached to a particular class of common shares of the capital stock of a corporation differ from the voting rights attached to another class of common shares of the capital stock of the corporation, and

(B) there are no other differences between the terms and conditions of the classes of shares that could cause the fair market value of a share of the particular class to differ materially from the fair market value of a share of the other class,

the shares of the particular class shall be deemed to be property that is identical to the shares of the other class, and

(ii) rights are not considered identical if the cost of acquiring the rights differs, or

(d) an action described in paragraph 84(1) (c.1), (c.2) or (c.3), the amount or value thereof shall, except to the extent that it is deemed by section 84 to be a dividend, be included in computing the income of the shareholder for the year.

ce moment d'un droit, relatif à chaque action ordinaire et identique à chacun des autres droits conférés à ce moment relativement à chacune des autres semblables actions, d'acquérir d'autres actions du capital-actions de la société; pour l'application du présent alinéa:

(i) les actions ordinaires d'une catégorie donnée du capital-actions d'une société sont réputées être identiques aux actions ordinaires d'une autre catégorie du capital-actions de la société dans le cas où, à la fois: (A) les droits de vote rattachés à la catégorie donnée d'actions diffèrent de ceux rattachés l'autre catégorie d'actions,

(B) les modalités des catégories d'actions ne présentent pas d'autres différences qui pourraient donner lieu à un important écart entre la juste valeur marchande d'une action de la catégorie donnée et la juste valeur marchande d'une action de l'autre catégorie,

(ii) des droits ne sont pas considérés comme identiques si leur coût d'acquisition diffère;

(d) par une opération visée à l'alinéa 84(1) c.1), c.2) ou c.3).

[18] It is also worth reproducing section 69 whereby the consideration received or paid by related persons in certain circumstances is deemed to be equal to the fair market value of the service or property that is the subject of the transaction:

**Inadequate considerations**

**69. (1)** Except as expressly otherwise provided in this Act,

(a) where a taxpayer has acquired anything from a person with whom the taxpayer was not dealing at arm's length at an amount in excess of the fair market value thereof at the time the taxpayer so acquired it, the taxpayer shall be deemed to have acquired it at that fair market value;

(b) where a taxpayer has disposed of anything  
(i) to a person with whom the taxpayer was not dealing at arm's length for no proceeds or for proceeds less than the fair market value thereof at the time the taxpayer so disposed of it,

...

the taxpayer shall be deemed to have received proceeds of disposition therefor equal to that fair market value;

...

**Contreparties insuffisantes**

**69. (1)** Sauf disposition contraire expresse de la présente loi :

a) le contribuable qui a acquis un bien auprès d'une personne avec laquelle il avait un lien de dépendance pour une somme supérieure à la juste valeur marchande de ce bien au moment de son acquisition est réputé l'avoir acquis pour une somme égale à cette juste valeur marchande;

b) le contribuable qui a disposé d'un bien en faveur :  
(i) soit d'une personne avec laquelle il avait un lien de dépendance sans contrepartie ou moyennant une contrepartie inférieure à la juste valeur marchande de ce bien au moment de la disposition,

[...]

est réputé avoir reçu par suite de la disposition une contrepartie égale à cette juste valeur marchande;

[...]

[Emphasis added.]

**Appellant's position**

[19] The appellant submits that the Tax Court of Canada judge erred in law in adopting too narrow an interpretation of the concept of the "special purchaser". According to the appellant, in order to calculate the benefit to a shareholder, the value that is fair from the standpoint of the particular buyer must be determined. The fair market value is not in itself conclusive.

[20] The appellant recognizes that a typical purchaser would not have paid \$1,500,000 for the property. He argued, however, that the Court should look at the particular facts of the case at bar, which establish that, for J.C. Fibers, the property had an increased value that was at least equal to the price paid. That value derives from the actual cost of the property acquired by J.C. Fibers and results from the fact that in order to locate elsewhere J.C. Fibers would have had to pay a higher amount than that paid to its shareholder.

[21] Since the price paid by J.C. Fibers was fair and reasonable in light of its specific needs, it cannot be said that the company intended to confer a benefit on its shareholder. According to the appellant, on the facts of this case the Tax Court of Canada judge could not find that there was a benefit.

### **Respondent's position**

[22] According to the respondent, the Tax Court of Canada judge was entitled to hold that J.C. Fibers was not a "special purchaser" within the meaning of the case law. She further argued that the transfer of the property did not occur in a genuinely commercial context.

[23] The respondent contended that, in the case at bar, the judge was justified in stating that subsection 15(1) does not require an intention to confer a benefit. It is enough to show that, given the circumstances of the case, the shareholder knew or ought to have known that a benefit was conferred on him as a result of a transaction. (See *Chopp v. Canada*, [1995] T.C.J. No. 12 (Q.L.), [1997] F.C.J. No. 1551 (Q.L).)

[24] In the case at bar, the respondent emphasized that the Tax Court of Canada judge found that the appellant and his accountant made no effort to arrive at a price based on the fair market value of the property, as no appraiser was consulted and the price they determined corresponded rather to the replacement cost of the building for insurance purposes and the actual cost of construction paid by the appellant to rebuild.

[25] The respondent further submitted that the Tax Court of Canada judge was right in concluding that there was no justification for the decision to sell the property to J.C. Fibers at the particular time it was sold.

### **Analysis and decision**

[26] In my humble opinion, the evidence did not support a conclusion by the Tax Court of Canada judge that J.C. Fibers conferred a benefit on the appellant as a shareholder when it bought the property for the price paid, namely \$1,500,000.

[27] As pointed out by Judge Dussault in *Morneau*, above, although the fair market value may be indicative of a benefit under subsection 15(1), each case is to be analyzed on the basis of its particular circumstances (paragraph 31). (On this point see also the remarks of Judge Bowman, now Chief Justice of the Tax Court of Canada, in *Long v. Canada*, [1997] T.C.J. No. 722 (Q.L.) at paragraph 12.) To be taxable under subsection 15(1), the benefit must be real.

[28] In the absence of a real benefit, there is no legal fiction whereby a benefit is deemed to exist on the facts of this case. Indeed, contrary to what the Minister's expert witness appeared to

think, the question is not purely one of fair market value (Appeal Book, Vol. III, at p. 500). The Act (section 69) does not have the effect of deeming the consideration received by the seller to be equal to the fair market value of property sold in a transaction between related persons if this consideration is greater than the market value. This is because the tax authorities have no interest in reducing the proceeds of disposition actually received by a seller, whereas the opposite is true with regard to the price paid by a buyer. Accordingly, the evidence had to show that the appellant did in fact receive a benefit.

[29] In the case at bar, the following two pieces of evidence, which were not disputed, should be noted. The actual cost of the building as incurred by the appellant amounted to \$1,574,788. Furthermore, the appraisal done in 1995 for insurance purposes put the replacement cost of the building at \$1,392,610 (which, I point out again, ignores the cost of the land, which was \$174,450).

[30] Moreover, it is an established fact that the building was rebuilt by the appellant solely to meet the needs of J.C. Fibers. There is no indication that, as erected, the building had any purpose other than to enable J.C. Fibers to conduct its business, or that the construction was in any way superfluous or ill-conceived.

[31] The appellant decided to rebuild rather than to consider moving because the site had a number of advantages for his company. It was close to Montréal (the source of the paper for recycling), was located near major highways and had the necessary area, and although it was in an agricultural zone, it was being put to industrial use by virtue of a vested right to such use.

[32] It is apparent from this evidence that the location was ideal and that if J.C. Fibers had purchased the land and put up the building itself it would have had to spend at least the amount which it paid for the property. The cost of construction does not have to be justified since it is the actual cost. Although this cost was incurred some time before, the fact remains that the replacement value of the building determined in December 1995, which is not disputed, confirms that J.C. Fibers would have had to pay at least \$1,500,000 if it had undertaken the construction itself and borne the cost of the land.

[33] Under these circumstances, there is no basis for applying subsection 15(1). The purpose of that provision is the collection of the tax payable on any property appropriated by a shareholder by the taxation in the hands of the shareholder of a benefit equal to the value of the property appropriated. On the facts of this case, no property was appropriated and no benefit was conferred, since J.C. Fibers did not pay one cent more than it had to in order to be the owner of the site on which it operated, and the appellant did not receive one cent more than the amount spent to provide his company with that site.

[34] In view of this evidence, the trial judge could not conclude that the appellant had in fact received a benefit, nor could he attribute a theoretical benefit to the appellant by deeming the consideration received for the property to be equal to its fair market value since, as we have seen, section 69 does not have that effect on the facts of this case.

[35] I would add that the appellant did not have to justify his decision to consolidate the operations and the site of those operations in the hands of his company (Reasons, paragraph 24).



The appellant was free to carry out the transaction at any time he so chose. His only duty, having regard to subsection 15(1), was to ensure that his company was not disadvantaged and, correspondingly, that he did not receive any benefit. The evidence in this regard is compelling.

[36] Finally, the respondent also referred to the improvements carried out by J.C. Fibers before the sale in 1996, for which it was not compensated. It is true that these improvements, since they were made on the property of the appellant (and his wife), could have created a benefit by accession (see articles 955 et seq. of the *Civil Code of Québec*). However, any such benefits, if indeed they were benefits, would have been taxable in the years in which they were conferred.

[37] Accordingly, the Tax Court of Canada judge was wrong in concluding that J.C. Fibers conferred a benefit on the appellant as a shareholder by purchasing the property for the price paid during his 1996 taxation year.

[38] As for the terminal loss, the amount thereof is not in issue. However, it was up to the appellant to show that the portion of the proceeds of disposition which he allocated to the building in computing this loss was reasonable. The report filed by Mr. Egan says nothing in this regard, and the appellant did not explain the logic behind the allocation that was made.

[39] In this respect, the appellant allocated almost 8% of the proceeds of disposition to the land (\$110,000) and the balance (\$1,390,000) to the building. This allocation seems excessive when one considers that both the Minister's expert witness and the municipal appraisal entered in evidence allocated at most 4% of the estimated value of the property to the land (report of the

Minister's expert witness, Appeal Book, Vol. III, at p. 469; municipal assessment for 1996, Vol. I, at p. 180). Allocating the proceeds of disposition on the basis of this percentage, that is, \$60,000 to the land and \$1,440,000 to the building, seems reasonable.

[40] For these reasons, I would allow the appeal with costs in both the Tax Court of Canada and this Court, I would set aside the decision of the Tax Court of Canada and, issuing the appropriate order, I would refer the assessment back to the Minister for reassessment on the basis that no taxable benefit arose from the sale of the property for the amount of \$1,500,000 and that the terminal loss should be calculated on the basis that the proceeds of disposition of the building were \$1,440,000.

“Marc Noël”

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J.A.

“I concur.

Alice Desjardins J.A.”

“I agree.

J.D. Denis Pelletier, J.A.”

Certified true translation  
Erich Klein

**FEDERAL COURT OF APPEAL**

**SOLICITORS OF RECORD**

**DOCKET:** A-561-04

**STYLE OF CAUSE:** GIUSEPPE COLUBRIALE v. HER MAJESTY  
THE QUEEN

**PLACE OF HEARING:** Montréal

**DATE OF HEARING:** September 13, 2005

**REASONS FOR JUDGMENT BY:** NOËL J.A.

**CONCURRED IN BY:** DESJARDINS J.A.  
PELLETIER J.A.

**DATED:** October 14, 2005

**APPEARANCES:**

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