Date: 20061208

Docket: A-34-06

Citation: 2006 FCA 403

CORAM: **NADON J.A.**
PELLETIER J.A.
MALONE J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

DON NUNN

Respondent

Heard at Ottawa, Ontario, on November 15, 2006.

Judgment delivered at Ottawa, Ontario, on December 8, 2006.

REASONS FOR JUDGMENT BY: MALONE J.A.

CONCURRED IN BY: . NADON J.A.
PELLETIER J.A.

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REASONS FOR JUDGMENT

MALONE J.A.

I. Introduction

[1] This is an appeal from a judgment of the Tax Court of Canada dated December 21, 2005 (reported at 2005 TCC 806). In her written reasons, the Tax Court Judge (the Judge) determined that the Minister of National Revenue (Minister) improperly included $29,000.00 in the respondent's income for the taxation year 1999. While the shares in Jovalguy Inc. were not a qualified investment under subsection 146(1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp) (the *Act*) (and certain regulations thereunder), the Judge in this case concluded that the taxpayer did not acquire a non-qualified investment because he was the victim of an unlawful scam.

[2] There are two grounds of appeal: whether the Judge erred by confusing the concepts of fraud and misrepresentation with the doctrine of sham and whether she violated a principle of natural justice by allowing the appeal on a ground not raised by either party. In my analysis, the appeal should be allowed on both grounds for the reasons which follow.

II. Factual Background

[3] In 1999, Don Nunn answered a newspaper advertisement which offered the possibility of tax free withdrawals from 'locked-in' registered retirement savings plans (RRSP). At that time, Mr. Nunn was ill and in debt. He had $29,000.00 invested in an RRSP with Maritime Life Assurance Company (Maritime Life).

[4] Mr. Nunn met with a representative of Planification Plus who explained how he could obtain money by transferring his RRSP from Maritime Life to Planification Plus as a new trustee. The RRSP would be used as collateral for a loan from Planification Plus and once repaid, the funds would be returned to his RRSP.

[5] During the course of this meeting, Mr. Nunn signed a set of blank documents that directed Maritime Life to transfer all of the funds held in his RRSP to Planification Plus. He also signed an undated authorization directing Planification Plus to purchase shares in an unspecified company. Subsequently, Planification Plus purchased on behalf of the respondent 1,160 shares in a company called Jovalguy Inc. (Jovalguy) on June 16, 1999. Jovalguy then used the funds to purchase shares in a second company called La Financière Telco Inc. (Telco).

[6] Subsequent to this meeting, Mr. Nunn contacted Maritime Life concerning the proposed scheme and told them not to transfer his RRSP if there was any suspicion respecting its legality. Maritime Life informed him that they would make inquiries on his behalf. Several months later, he received a statement from Planification Plus stating that the RRSP had been transferred from Maritime Life.

[7] A comfort letter dated June 16, 1999, addressed to Planification Plus and signed by Rene Beauregard, a chartered accountant, certified that the purchase of the shares in Jovalguy constituted a qualified RRSP investment under the Act. The evidence revealed that this letter was part of the scheme used to entice potential investors.

[8] An investigation by the Tax Avoidance Section of the Canada Revenue Agency (CRA) determined that Jean Tremblay was the promoter and mastermind behind Planification Plus and that he also controlled both Jovalguy and Telco. CRA investigators also determined that there was no real business activity disclosed in the financial statements of Jovalguy but rather, it was simply used as a vehicle to purchase shares in Telco.

[9] The investigation also determined that a related company, Les Immeubles Tremesco Inc. (Immeubles) owned and operated a retirement home in Rigaud, Quebec that was also controlled by Mr. Tremblay. Essentially, Telco funnelled funds, which came from unsuspecting investors, to Immeubles, which in turn used the money to renovate its building. In essence, Telco's funds were

used to finance the renovation expenses and Mr. Beauregard manipulated its balance sheet entries so as to create the impression that these amounts were revenues, instead of receivables.

[10] Most investors actually did receive funds from Planification Plus, which were discounted by thirty-five percent as provided in their loan agreements. However, Mr. Nunn did not receive any funds because the Quebec Securities Commission conducted a raid of Planification Plus in August 2000. As a result, individuals such as the respondent whose documents were then being processed never received any money.

[11] The Minister reassessed Mr. Nunn on the basis that these RRSP funds were not invested in a qualified investment pursuant to subsection 146(1) of the Act.

[12] In the Minister's Notice of Reply, among his assumptions was the following statement:

> m) the fair market value ("FMV") of the Appellant's RRSP was $29,000.00 at the time of the acquisition of the shares in Jovalguy;

III. Relevant Provisions

[13] The provisions relevant to this appeal are as follows:

146(1) "non-qualified investment", in relation to a trust governed by a registered retirement savings plan, means property acquired by the trust after 1971 that is not a qualified investment for the trust.	**146(1)** « placement non admissible » Dans le cas d'une fiducie régie par un régime enregistré d'épargne-retraite, s'entend des biens acquis par la fiducie après 1971 et qui ne constituent pas un placement admissible pour cette fiducie.
146(8) There shall be included in computing a taxpayer's income for a taxation year the total of all amounts received by the taxpayer in the year	**146(8)** Est inclus dans le calcul du revenu d'un contribuable pour une année d'imposition le total des montants qu'il a reçus au cours de

as benefits out of or under registered retirement savings plans, other than excluded withdrawals (as defined in subsection 146.01(1) or 146.02(1)) of the taxpayer and amounts that are included under paragraph (12)(b) in computing the taxpayer's income.	l'année à titre de prestations dans le cadre de régimes enregistrés d'épargne-retraite, à l'exception des retraits exclus au sens des paragraphes 146.01(1) ou 146.02(1), et des montants qui sont inclus, en application de l'alinéa (12)b), dans le calcul de son revenu.
146(10) Where at any time in a taxation year a trust governed by a registered retirement savings plan (a) acquires a non-qualified investment, …	**146(10)** Lorsque, à un moment donné d'une année d'imposition, une fiducie régie par un régime enregistré d'épargne-retraite: *a*) acquiert un placement non admissible; …
the fair market value of (*c*) the non-qualified investment at the time it was acquired by the trust, or (*d*) the property used as security at the time it commenced to be so used,	la juste valeur marchande: *c*) du placement non admissible au moment de son acquisition par la fiducie; *d*) du bien utilisé à titre de garantie, au moment où il a commencé à être ainsi utilisé,
as the case may be, shall be included in computing the income for the year of the taxpayer who is the annuitant under the plan at that time.	selon le cas, doit être incluse dans le calcul du revenu, pour l'année, du contribuable qui est le rentier en vertu du régime à ce moment.

IV. The Decision Below

[14] The issue before the Judge was whether the amount of $29,000.00 had been properly included in the computation of Mr. Nunn's income for the 1999 taxation year. The Judge concluded that the acquisition of shares in Jovalguy was not a qualified investment within the meaning of subsection 146(1) because Jovalguy was not a small business corporation, nor an eligible corporation within the meaning of Regulations 4900(12) and 5100(1); regulations made pursuant to the *Act* (the Regulations). At paragraph 17 of her reasons, she wrote:

> The evidence, both oral and documentary, is clear that Jovalguy is simply a shell company, without any form of business activity, except to facilitate the purchase of shares in Telco using the RRSP funds of investors. Based on the evidence, Telco had no active business activity either.

[15] The Judge went on to conclude that because this scheme was a scam, and as no money was received, Mr. Nunn never actually acquired a non-qualified investment in Jovalguy within the meaning of subsection 146(1). She arrived at this conclusion on her own account as neither party raised this issue in their pleadings or in argument.

[16] The Judge made no determination as to the fair market value of this non-qualified investment at the time it was acquired by the trust.

V. STANDARD OF REVIEW

[17] In appellate review, the nature of the questions at issue determines the applicable standards of review. Questions of law are reviewable on a standard of correctness, while findings of fact or of mixed law and fact will be set aside only if it is determined that the trial judge has committed a palpable and overriding error: *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235.

VI. Analysis

[18] The Judge was correct to initially conclude that the purchase of Jovalguy shares did not constitute a qualified investment within the meaning of subsection 146(1) because Jovalguy was neither a small business corporation nor an eligible corporation within the Regulations. The Regulations essentially provide additional scope to the definition of "qualified investment" in subsection 146(1) and define "qualifying active business" to mean any business carried on primarily in Canada by a corporation, subject to certain restrictions.

Doctrine of Sham

[19] However, in my analysis, the Judge erred in grounding her ultimate decision on the doctrine of sham. The Supreme Court of Canada in *Stubart Investments Ltd. v. The Queen* [1984] 1 S.C.R. 536 adopted Lord Diplock's statement in *Snook v. London & West Riding Investments Ltd.*, [1967] All E.R. 518 (C.A.) as to what constitutes sham:

> … it means acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create [Emphasis added].

In other words, the elements of a sham require that the parties to a transaction together have deliberately set out to misrepresent the actual state of affairs to a third party (i.e. the Minister): Vern Krishna, *The Fundamentals of Canadian Income Tax*, 8th ed. (Scarborough: Carswell, 2004 at 998).

[20] That is not the case here. Under the present scheme, Mr. Nunn agreed to transfer his RRSP to Planification Plus with the intent of reinvesting it. This indeed occurred. Under his authorization, Maritime Life transferred his RRSP to Planification Plus, the new trustee, which then purchased shares in Jovalguy and issued a share certificate.

[21] While the Judge found that Mr. Nunn took reasonable steps to ascertain that the investment was legitimate, the fact that the shares were worthless does not in and of itself constitute a sham. But for the Quebec Securities Commission raid, Mr. Nunn would have received the loan that he negotiated. Had the Judge applied the proper definition of sham to the facts before her, she would have had to conclude that there was no sham, and accordingly, the Judge erred in law by concluding

that a sham existed. At best, the respondent could have argued that he was defrauded but that too is of no assistance.

[22] By purchasing the shares in a non-qualified investment, subsection 146(1) was automatically triggered. Undoubtedly, this result is harsh but it would be unfair to exempt a taxpayer from his or her tax obligation on the basis of mistake or fraud: *Vankerk v. Canada*, 2006 FCA No. 371 at paragraph 3. Put simply, other Canadian taxpayers should not have to bear the financial burden which arises from unfortunate circumstances such as those that exist here.

Breach of Natural Justice

[23] The Minister also argues that the Judge, on her own initiative, and without inviting counsel to make submissions, erroneously applied the doctrine of sham in support of the taxpayer's position. Issues pertaining to breach of natural justice are questions of law and are to be decided on a standard of correctness: *Ellis-Don Ltd. v. Ontario (Labour Relations Board)*, [2001] 1 S.C.R. 221 at paragraph 65.

[24] The Minister relies on a decision of Rothstein J.A. (as he then was) in *Pedwell v. Canada*, [2000] 4 F.C. 616 (C.A.). In that case, the Tax Court Judge made his determination on the basis of an assessment not at issue during the court proceedings. The taxpayer appealed on the basis that liability could not be imposed on a ground not contained in the Minister's reassessment.

[25] Rothstein J.A. found that the Tax Court Judge erred in finding the taxpayer liable on a basis different from that in the Minister's notice of reassessment. Since the Tax Court Judge's finding was made on an issue not raised at the hearing, he found that the taxpayer was deprived of his opportunity to address the issue. At paragraph 18, he reasoned:

> Here, on his own motion, the Tax Court Judge, in his decision and after the completion of the evidence and argument directed to the Minister's basis of assessment, changed the basis of that assessment without the appellant having the opportunity to address the change.

[26] In this case, having concluded that the acquisition of the shares constituted a non-qualified investment, it was not open to the Judge to go the extra step to conclude that a sham existed. The doctrine of sham was not raised in the Notice of Objection or Notice of Appeal nor was it argued by the parties. Accordingly, in my analysis, the fact that the Judge made a finding outside the scope of the 'pleadings' that was not argued by the parties amounts to a violation of a principle of natural justice which includes the right to be heard: *Rodaro v. Royal Bank of Canada* (2002), 59 O.R. (3d) 74 (C.A.).

Collateral Issue

[27] One further issue requires resolution. During the course of oral argument, it was pointed out that the Judge failed to factually determine the fair market value of Mr. Nunn's investment. In the case of *Nash v. Canada*, 2005 FCA 386, noting that 'fair market value' was not defined in the *Act*, Rothstein J.A. adopted the following definition taken from Cattanach J. in *Henderson Estate and Bank of New York v. M.N.R.* 73 D.T.C. 5471 at 5476:

> The statute does not define the expression "fair market value", … 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.

[28] This definition, therefore, compelled the Judge to make a factual finding on the issue of fair market value in accordance with subsection 146(10), which she failed to do. The question therefore, is what value, if any, does this non-qualified investment have if the investor was seized with all relevant information on June 16, 1999 when the Jovalguy shares were purchased? Obviously, in the present case, this would include all of the background information not initially known by Mr. Nunn.

VII. CONCLUSION

[29] The appeal should be allowed without costs on the issues of sham and natural justice, the judgment of the Tax Court of Canada dated December 21, 2005 should be set aside in part, and the issue of fair market value should be remitted to the Judge for determination in accordance with the existing record and these reasons.

"B. Malone"

J.A.

"I agree
M. Nadon J.A."
"I agree
J.D. Denis Pelletier"

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-34-06
Appeal from an Order of the Tax Court of Canada dated December 21, 2005	
STYLE OF CAUSE:	HER MAJESTY THE QUEEN v. DON NUNN
PLACE OF HEARING:	OTTAWA
DATE OF HEARING:	NOVEMBER 15, 2006
REASONS FOR JUDGMENT:	MALONE J.A.
CONCURRED IN BY:	NADON AND PELLETIER JJ.A.
DATED:	DECEMBER 8, 2006

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