Federal Court of Appeal | Cour d'appel fédérale

Date: 20100512

Docket: A-61-09
A-62-09
A-64-09
A-65-09

Citation: 2010 FCA 119

CORAM: **BLAIS C.J.**
NADON J.A.
TRUDEL J.A.

BETWEEN:

Docket A-61-09

HER MAJESTY THE QUEEN

Appellant

and

DANIELLE VAILLANCOURT-TREMBLAY

Respondent

BETWEEN:

Docket A-62-09

HER MAJESTY THE QUEEN

Appellant

and

GÉRARD TREMBLAY

Respondent

BETWEEN :

Docket A-64-09

HER MAJESTY THE QUEEN

Appellant

and

MARTIN TREMBLAY

Respondent

BETWEEN :

Docket A-65-09

HER MAJESTY THE QUEEN

Appellant

and

THE ESTATE OF HÉLÈNE TREMBLAY

Respondent

Heard at Montréal, Quebec, on March 23, 2010.

Judgment delivered at Ottawa, Ontario, on May 12, 2010.

REASONS FOR JUDGMENT BY:	TRUDEL J.A.
CONCURRED IN BY:	NADON J.A.
DISSENTING REASONS BY:	BLAIS C.J.

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REASONS FOR JUDGMENT

TRUDEL J.A.

Introduction

[1] This decision addresses four appeals of a decision of Justice Favreau of the Tax Court of Canada (2009TCC6, [2009] 4 C.T.C. 2127). The appeals were consolidated by order of Justice Décary of April 22, 2009 pursuant to the *Federal Courts Rules*, SOR/98-106, r. 342.

[2] The respondents are members of the Tremblay family who held shares in 9000-8855 Québec Inc. (8855). In contemplation of their emigration from Canada, the respondents engaged in a series of transactions ultimately leading to the exchange of their 8855 shares for subordinate common shares in Le Groupe Vidéotron Ltée (Vidéotron). The Minister of National Revenue (the appellant) reassessed the respondents, ruling that the disposition of their 8855 shares gave rise to a deemed dividend under subsection 84(2) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act). On appeal to the Tax Court, Justice Favreau (the Tax Court Judge) ruled that subsection 84(2) did not apply. For the reasons that follow, I agree with the Tax Court Judge and would dismiss the appeal.

Background

Statutory provisions

[3] This appeal relates primarily to the interpretation of subsection 84(2) and, to a lesser extent, section 85.1 of the Act. Both provisions are found in Subdivision h of Division B of Part I of the Act, which provides rules for the computation of income of Canadian resident corporations.

[4] Section 84 deems a taxable dividend in the case of certain distributions by Canadian resident corporations. Subsection 84(2) operates to prevent corporations, upon the winding up, discontinuance, or reorganization of their business, from issuing to shareholders what should be taxable earnings in the form of an ostensibly tax-free return of paid-up capital, by deeming amounts distributed in excess of paid up capital (PUC) to be taxable dividends. It states as follows:

Distribution on winding-up, etc.

(2) Where funds or property of a corporation resident in Canada have at any time after March 31, 1977 been distributed or otherwise appropriated in any manner whatever to or for the benefit of the shareholders of any class of shares in its capital stock, on the winding-up, discontinuance or reorganization of its business, the corporation shall be deemed to have paid at that time a dividend on the shares of that class equal to the amount, if any, by which

(*a*) the amount or value of the funds or property distributed or appropriated, as the case may be,

exceeds

(*b*) the amount, if any, by which the paid-up capital in respect of the shares of that class is reduced on the distribution or appropriation, as the case may be,

and a dividend shall be deemed to have been received at that time by each person who held any of the issued shares at that time equal to that proportion of the amount of the excess that the number of the shares of that class held by the person immediately before that time is of the number of the issued shares of that class outstanding immediately before that time.

Distribution lors de liquidation, etc.

(2) Lorsque des fonds ou des biens d'une société résidant au Canada ont, à un moment donné après le 31 mars 1977, été distribués ou autrement attribués, de quelque façon que ce soit, aux actionnaires ou au profit des actionnaires de tout catégorie d'actions de son capital-actions, lors de la liquidation, de la cessation de l'exploitation ou de la réorganisation de son entreprise, la société est réputée avoir versé au moment donné un dividende sur les actions de cette catégorie, égal à l'excédent éventuel du montant ou de la valeur visés à l'alinéa *a*) sur le montant visé à l'alinéa *b*):

a) le montant ou la valeur des fonds ou des biens distribués ou attribués, selon le cas;

b) le montant éventuel de la réduction, lors de la distribution ou de l'attribution, selon le cas, du capital versé relatif aux actions de cette catégorie;

chacune des personnes qui détenaient au moment donné une ou plusieurs des actions émises est réputée avoir reçu à ce moment un dividende égal à la fraction de l'excédent représentée par le rapport existant entre le nombre d'actions de cette catégorie qu'elle détenait immédiatement avant ce moment et le nombre d'actions émises de cette catégorie qui étaient en circulation immédiatement avant ce moment.

[5] Section 85.1 creates a “rollover”. When a taxpayer receives proceeds of disposition of an asset in excess of the tax cost of the asset (the adjusted cost base), he or she generally realizes a taxable capital gain. In certain situations, a taxpayer is permitted to defer the recognition of a capital gain on the disposition of an asset until the asset is disposed of again, further down the line. In these situations, the tax characteristics of the asset are said to be “rolled over” until the ultimate taxable disposition. Section 85.1 provides a rollover where shares of a Canadian resident corporation are issued to a taxpayer in exchange for shares in another Canadian resident corporation (a “share-for-share exchange”):

Share for share exchange	Échange d’actions
85.1 (1) Where shares of any particular class of the capital stock of a Canadian corporation (in this section referred to as the “purchaser”) are issued to a taxpayer (in this section referred to as the “vendor”) by the purchaser in exchange for a capital property of the vendor that is shares of any particular class of the capital stock (in this section referred to as the “exchanged shares”) of another corporation that is a taxable Canadian corporation (in this section referred to as the “acquired corporation”), subject to subsection 85.1(2),	85.1 (1) Les règles suivantes s’appliquent, sous réserve du paragraphe (2), dans le cas où une société canadienne (appelée « acheteur » au présent article) émet des actions d’une catégorie de son capital-actions en faveur d’un contribuable (appelé « vendeur » au présent article), en échange d’immobilisations du vendeur qui sont des actions d’une catégorie du capital-actions (appelées « actions échangées » au présent article) d’une autre société qui est une société canadienne imposable (appelée « société acquise » au présent article):
(*a*) except where the vendor has, in the vendor’s return of income for the taxation year in which the exchange occurred, included in computing the vendor’s income for that year any portion of the gain or loss, otherwise determined, from the disposition of the exchanged shares, the vendor shall be deemed	*a*) sauf lorsque le vendeur a, dans sa déclaration d’impôt pour l’année d’imposition au cours de laquelle a eu lieu l’échange, inclus dans le calcul de son revenu pour cette année, toute partie du gain ou de la perte, par ailleurs déterminée, provenant de la disposition des actions échangées, le vendeur est réputé :
(i) to have disposed of the exchanged	(i) avoir tiré un produit de disposition des

shares for proceeds of disposition equal to the adjusted cost base to the vendor of those shares immediately before the exchange, and

actions échangées égal au prix de base rajusté de celles-ci, pour lui, immédiatement avant l'échange,

(ii) to have acquired the shares of the purchaser at a cost to the vendor equal to the adjusted cost base to the vendor of the exchanged shares immediately before the exchange,

(ii) avoir acquis les actions de l'acheteur à un coût, pour lui, égal au prix de base rajusté des actions échangées, pour lui, immédiatement avant l'échange;

and where the exchanged shares were taxable Canadian property of the vendor, the shares of the purchaser so acquired by the vendor shall be deemed to be taxable Canadian property of the vendor; and

en outre, lorsque les actions échangées étaient un bien canadien imposable du vendeur, les actions de l'acheteur qu'il a ainsi acquises sont réputées être un bien canadien imposable du vendeur;

(*b*) the cost to the purchaser of each exchanged share, at any time up to and including the time the purchaser disposed of the share, shall be deemed to be the lesser of

b) le coût pour l'acheteur de chaque action échangée à un moment donné qui n'est pas postérieur au moment où il a disposé de l'action est réputé être le moins élevé des montants suivants :

(i) its fair market value immediately before the exchange, and

(i) la juste valeur marchande de l'action immédiatement avant l'échange,

(ii) its paid-up capital immediately before the exchange.

(ii) le capital versé au titre de l'action immédiatement avant l'échange.

Where s. (1) does not apply

(2) Subsection 85.1(1) does not apply where

Non-application du par. (1)

(2) Le paragraphe (1) ne s'applique pas dans l'un ou l'autre des cas suivants :

(*a*) the vendor and purchaser were, immediately before the exchange, not dealing with each other at arm's length (otherwise than because of a right referred to in paragraph 251(5)(*b*) that is a right of the purchaser to acquire the exchanged shares);

a) le vendeur et l'acheteur avaient un lien de dépendance immédiatement avant l'échange (autrement qu'à cause d'un droit visé à l'alinéa 251(5)*b*) qui permet à l'acheteur d'acquérir les actions échangées);

(*b*) the vendor or persons with whom the vendor did not deal at arm's length, or the vendor together with persons

b) le vendeur, les personnes avec qui il a un lien de dépendance ou le vendeur et les personnes avec qui il a un lien de

with whom the vendor did not deal at arm's length,

(i) controlled the purchaser, or

(ii) beneficially owned shares of the capital stock of the purchaser having a fair market value of more than 50% of the fair market value of all of the outstanding shares of the capital stock of the purchaser,

immediately after the exchange;

(*c*) the vendor and the purchaser have filed an election under subsection 85(1) or 85(2) with respect to the exchanged shares;

(*d*) consideration other than shares of the particular class of the capital stock of the purchaser was received by the vendor for the exchanged shares, notwithstanding that the vendor may have disposed of shares of the capital stock of the acquired corporation (other than the exchanged shares) to the purchaser for consideration other than shares of one class of the capital stock of the purchaser; or

(*e*) the vendor

(i) is a foreign affiliate of a taxpayer resident in Canada at the end of the taxation year of the vendor in which the exchange occurred, and

(ii) has included any portion of the gain or loss, otherwise determined, from the disposition of the exchanged shares in computing its foreign accrual property income for the taxation year of the vendor in which the exchange occurred.

dépendance :

(i) soit contrôlaient l'acheteur,

(ii) soit avaient la propriété effective d'actions du capital-actions de l'acheteur dont la juste valeur marchande est égale à plus de 50 % de la juste valeur marchande de toutes les actions en circulation du capital-actions de l'acheteur,

immédiatement après l'échange;

c) le vendeur et l'acheteur ont présenté un choix en vertu du paragraphe 85(1) ou (2) à l'égard des actions échangées;

d) la contrepartie, à l'exception d'actions de la catégorie donnée du capital-actions de l'acheteur, a été reçue par le vendeur en compensation des actions échangées, malgré le fait que le vendeur ait pu disposer d'actions du capital-actions de la société acquise (à l'exception des actions échangées) en faveur de l'acheteur moyennant une contrepartie autre que des actions d'une catégorie du capital-actions de l'acheteur;

e) le vendeur, à la fois :

(i) est la société étrangère affiliée d'un contribuable résidant au Canada à la fin de l'année d'imposition du vendeur au cours de laquelle l'échange a été effectué,

(ii) a inclus, dans le calcul de son revenu étranger accumulé, tiré de biens pour son année d'imposition au cours de laquelle l'échange a été effectué, une partie du gain ou de la perte, déterminé par ailleurs, provenant de la disposition des actions échangées.

The transaction on appeal

[6] As I indicated earlier, the respondents are members of the Tremblay family. Until 1989, the Tremblay family, through its company “Les Placements M.H.T. Inc.” (MHT), owned Télésag Inc., a cable television distribution company. In February 1989, MHT sold its shares in Télésag to Vidéotron in exchange for Vidéotron preferred shares.

[7] In 1994, the respondents decided to emigrate from Canada and sought to reorganize their business affairs to facilitate their departure. Accordingly, they incorporated 8855 on February 2, 1994. On February 15, 1994, the respondents sold their shares in MHT to 8855 in exchange for Class A shares of 8855. The respondents deferred the recognition of any capital gain on this transaction through the use of a rollover provision in subsection 85(1) of the Act.

[8] The next day, February 16, 1994, MHT used the rollover provision in subsection 85(1) of the Act to transfer the following Vidéotron securities to 8855 (the convertible securities):

a. 425,174 Series B 8% cumulative first preferred shares, convertible into subordinate voting shares at a rate of three subordinate shares for each Series B preferred share (the preferred shares);
b. 92 unsecured subordinate debentures bearing interest at the rate of 11 3/4% with a face value of $5,175,000 overall ($56,250 per debenture), convertible at

> Vidéotron's call into subordinate voting shares at a rate of 3,000 subordinate shares per debenture (the debentures).

[9] On February 25, 1994, Vidéotron and the respondents entered into an agreement whereby Vidéotron agreed to "lend its assistance indirectly and subsidiarily during the final stage of the corporate reorganization". The Agreement stated that Vidéotron would participate provided the following conditions were met:

a. The respondents would waive $335,071.48 in dividends on the preferred shares and $200,928.52 in interest on the debentures;
b. The Vidéotron Board of Directors would approve the issue of subordinate shares of Vidéotron capital stock in consideration of the purchase of shares of a corporation controlled by the respondents;
c. The respondents would undertake to compensate Vidéotron for any claims arising out of the transaction and would provide an irrevocable bank letter of credit for at least $1,000,000, valid for at least five years from the date of issue;
d. Vidéotron would obtain exemptions from required stock exchanges and securities regulators, and the respondents would provide undertakings necessary to do so;
e. The respondents would pay all expenses incurred by Vidéotron in connection with the reorganization;
f. The reorganization would be completed by April 8, 1994.

[10] The Agreement also stated that Vidéotron would redeem the convertible securities on April 26, 1994 unless they had been converted by that date.

[11] On March 7, 1994, Vidéotron split its subordinate shares on a two-for-one basis; 8855 did the same for its Class A shares. On March 31, 1994 the Commission des valeurs mobilières du Québec granted the proposed transaction an exemption from prospectus and registration requirements.

[12] On April 6, 1994, Vidéotron and the respondents engaged in the share-for-share exchange contemplated by the Agreement, pursuant to the rollover provision in subsection 85.1(1) of the Act. The respondents transferred to Vidéotron all outstanding capital stock in 8855. Vidéotron then issued 3,103,044 new subordinate common shares to the respondents (the Vidéotron common shares). Immediately after the exchange, Vidéotron, now the owner of 8855, cancelled all 8855 debt owing to Vidéotron under the former subsection 80(3) of the Act. Vidéotron then wound up and dissolved 8855, cancelling the convertible securities for no consideration. Accordingly, the requirement that Vidéotron redeem the convertible securities on April 26, 1994 ceased to have any effect. The respondents then obtained the required letter of credit from the National Bank of Canada.

[13] The respondents left Canada on April 7, 1994.

[14] On December 30, 2004, the appellant reassessed the respondents for the 1994 tax year. The reassessments included in the respondents' income grossed-up taxable dividends deemed under subsection 84(2) in connection with the transaction.

The Tax Court Decision

[15] On appeal to the Tax Court, the parties made arguments similar to those presented before the Court. The respondents argued primarily that subsection 84(2) does not apply to the transaction, and that the transaction qualified for a rollover as a share-for-share exchange under section 85.1. The appellant conceded that the transaction qualified for a rollover under section 85.1, but argued that subsection 84(2) applied concurrently.

[16] The Tax Court Judge allowed the appeal and ruled that subsection 84(2) did not apply. First, he found that subsection 84(2) and section 85.1 can be applied concurrently. Second, the Tax Court Judge noted that the appellant did not argue that the transaction was a sham or that the general anti-avoidance rule in section 245 should apply. Accordingly, the Tax Court Judge based his decision only on whether subsection 84(2) applied. He noted that in *RMM Canadian Enterprises Inc.* v. *Canada* [1998] 1 C.T.C. 2300 at paragraph 22 [*RMM*], Chief Justice Bowman held that subsection 84(2) contains "words of the widest import [that] cover a large variety of ways in which corporate funds can end up in a shareholder's hands" (decision at paragraph 18).

[17] Third, the Tax Court Judge surveyed existing jurisprudence on the matter, including *RMM*, *Geransky* v. *Canada*, [2001] 2 C.T.C. 2147 [*Geransky*] and *Merritt* v. *Canada (Minister of National Revenue – M.N.R.*) [1941] Ex.C.R. 175. He considered *RMM* in particular depth. *RMM* concerned Equilease Corporation, an American parent corporation that sought to wind up its Canadian subsidiary, Equilease Limited, without incurring a non-resident withholding tax liability. To accomplish this, *RMM* secured a loan against the assets of Equilease Limited for the value of the assets of Equilease Limited. *RMM* used the loan to purchase Equilease Limited from Equilease Corporation and used the assets of Equilease Limited to pay back the loan. *RMM* also received $140,000 in outstanding leases owing to Equilease Limited. Chief Justice Bowman ruled that subsection 84(2) created a deemed dividend as *RMM* was "interested only in earning what was in essence a fee for acting as a facilitator or accommodator in the transaction" (*RMM* at paragraph 17, cited in decision at paragraph 32).

[18] Having surveyed the facts and relevant jurisprudence, the Tax Court Judge then ruled that the transaction in the case at bar was not caught by subsection 84(2), and accordingly allowed the appeal. He noted that Vidéotron was not an "accommodation company" as contemplated by *RMM* (decision at paragraph 46). He also stressed that the legal nature of the Vidéotron common shares received by the respondents was different from that of the preferred shares and debentures held by 8855. Indeed, the subordinated shares issued to the respondents were newly issued shares and therefore could never have been 8855 property (decision at paragraph 48).

Issues on appeal

[19] The appellant asserts that the convertible securities were distributed to the respondents and that the Tax Court Judge erred in requiring that the respondents have received identical property («biens identiques») in return for the 8855 shares.

Appellant's submissions

[20] The appellant argues that the overarching goal of the transaction was to permit the respondents to retain the Vidéotron common shares without incurring departure tax under section 128.1. Section 128.1 in essence deems a disposition of property at fair market value upon a taxpayer's emigration from Canada, but exempts taxable Canadian property. With this in mind, the appellant makes four arguments.

[21] First, the appellant argues that Vidéotron acted as a "facilitator." This in turn benefited Vidéotron, as the respondents waived dividends and interest payments on the convertible securities.

[22] Second, the appellant submits that the transaction had the effect of transforming the 8855 convertible securities into the Vidéotron common shares and then transferring those to the respondents. The appellant notes that the value of the convertible securities and the Vidéotron common shares was the same, and that the Commission des valeurs mobilières du Québec considered the two types of securities to have the same effect. Accordingly, even though the legal

nature of the securities received by the respondents was not identical to that of the convertible securities, the property was substantially the same.

[23] Third, the appellant submits that nothing in subsection 84(2) required the active participation of 8855.

[24] Fourth, the appellant claims that the Tax Court Judge erroneously added an extra condition to subsection 84(2) by requiring that the property transferred and received be identical.

Respondents' submissions

[25] The respondents broadly make seven points in their submissions. First, they argue that the *ratio* of the Tax Court Judge's decision was not that the property transferred and received must be identical. Rather, the *ratio* of the decision was that since the shares received by the respondents were newly created, there could not have been any appropriation of 8855 property.

[26] Second, the respondents dispute the appellant's suggestion that the goal of the transaction was to avoid a deemed dividend under section 128.1. They note that the 8855 shares were considered taxable Canadian property before the transaction and therefore would not have been subject to the deemed disposition in section 128.1. Rather, the respondents claim that the only benefit they sought to achieve was increased liquidity resulting from their ability to sell Vidéotron shares without the need to obtain a clearance certificate or withhold part of the purchase price.

[27] Third, the respondents argue that the 8855 assets were not attributed to them in the form of Vidéotron common shares. They provide four arguments in support. First, 8855 retained all of its assets until it was wound up by Vidéotron. Second, the Vidéotron common shares were newly issued and could not have previously been the property of 8855. Third, the legal nature of the Vidéotron common shares was different from that of the convertible assets, as different rights attach to different classes of securities. Finally, a taxpayer's legal relationships must be respected absent a sham (see *Shell Canada Ltd.* v. *Canada*, [1999] 3 S.C.R. 622 [*Shell Canada*]). Since the appellant does not allege a sham, the legal effect of the transaction is paramount.

[28] Fourth, the respondents argue that *RMM* can be distinguished on five different counts. First, in *RMM* the property remitted to the shareholder was legally identical to the assets of the corporation. Second, in *RMM* the assets of Canadian subsidiary were pledged as collateral to pay the bank loan used to purchase it. Third, *RMM* was created as "a mere instrumentality" to facilitate the transaction; Vidéotron, on the other hand, is a well established corporation, and the Tax Court Judge explicitly found that it was not a mere facilitator. Finally, in *RMM* the Tax Court found that the transaction was a "surplus strip" of the Equilease Canada assets. In this case, the respondents submit that the purpose of the transaction was to increase the liquidity of their Vidéotron holdings.

[29] The respondents submit that the case at bar is closer to *Geransky*. In *Geransky*, the appellant and his brother owned all of the shares in Geransky Brothers Construction Ltd. (GBC), a concrete construction and manufacturing business. For business reasons, GBC decided to sell off the manufacturing part of the business to Lafarge Canada Inc. To effect the sale, the brothers transferred

shares in their holding company, Geransky Brothers Holding Ltd. (GH), to a numbered company (NumCo) in exchange for NumCo shares. GBC then transferred the target assets to GH as a $1 million dividend-in-kind. GH in turn bought back its stock from NumCo in exchange for the assets, thereby giving NumCo the target assets. The brothers then sold their NumCo shares to Lafarge for $1 million, giving Lafarge control of the assets. The Minister of National Revenue assessed a deemed dividend under subsection 84(2). Acting Chief Justice Bowman (as he then was) ruled that subsection 84(2) did not apply, basing his decision in part on an interpretation that Lafarge was not the type of accommodation company contemplated by *RMM* (*Geransky* at paragraph 21(c)).

[30] Fifth, the respondents argue that the Tax Court Judge did not add an extra condition to subsection 84(2). When the Tax Court Judge used the word “identical” he only used it as a qualifier to make clear that 8855 property was not distributed to the respondents.

[31] Sixth, the respondents argue in the alternative that if there was a distribution or appropriation of corporate property to the shareholders, the distribution or appropriation was not made on the winding up of 8855, as 8855 continued to hold the convertible securities until it was wound up by Vidéotron after the exchange.

[32] Finally, in the further alternative, the respondents submit that even if 8855 property was distributed or appropriated on its winding up, section 85.1 and subsection 84(2) cannot apply concurrently. They argue that concurrent application would render it impossible to determine the proceeds of disposition of the shares of 8855 or the cost base of the Vidéotron common shares,

would result in double taxation, would run contrary to the maxims of statutory interpretation, and would defeat tax policy goals.

Analysis

[33] The appellant claims that the Tax Court Judge erred in requiring the exchange of identical property. This is a question of law and is therefore reviewable on a standard of correctness (*Housen* v. *Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 at paragraph 8).

[34] I agree with the Tax Court Judge that subsection 84(2) cannot apply because the property received by the respondents was never the property of 8855. As such, the property of 8855 was never "distributed or otherwise appropriated in any manner whatever" to the respondents and the appeal must fail. I rely on two sources to justify this interpretation. First, I believe that the plain and ordinary meaning of subsection 84(2) is clear. Second, I believe existing jurisprudence confirms this interpretation.

Plain and ordinary meaning

[35] In *Canada Trustco Mortgage Co.* v. *Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601 [*Canada Trustco*] at paragraph 10, the Supreme Court held that "When the words of a provision are precise and unequivocal, the ordinary meaning of the words play a dominant role in the interpretive process." The appellant argues that the phrase "distributed or otherwise appropriated in any manner whatever" must be given a broad meaning. That may well be the case, but the part of subsection

84(2) most relevant to this case is actually the opening phrase “Where funds or property of a corporation resident in Canada ….” The only tenable understanding of this phrase is that the property distributed to or appropriated by the recipient must be property of the Canadian resident corporation in question. In this case, the Vidéotron common shares were newly issued securities and had never been the property of 8855. As the respondents point out, 8855 retained its assets until it was eventually wound up into Vidéotron.

[36] The appellant argues that even though the legal nature of the property received by the respondents was different from the 8855 shares, the transaction substantively involved the same property throughout, subject to a transformation from the convertible securities to the Vidéotron common shares. This argument does not hold. In income tax law, the legal nature of the transaction is paramount. In *Canada Trustco*, the Supreme Court stated at paragraph 11 that “Where Parliament has specified precisely what conditions must be satisfied to achieve a particular result, it is reasonable to assume that Parliament intended that taxpayers would rely on such provisions to achieve the result they prescribe.” In *Shell Canada*, the Supreme Court stated as follows:

> 39 This Court has repeatedly held that courts must be sensitive to the economic realities of a particular transaction, rather than being bound to what first appears to be its legal form: *Bronfman Trust*, *supra*, at pp. 52-53, *per* Dickson C.J.; *Tennant*, *supra*, at para. 26, *per* Iacobucci J. But there are at least two *caveats* to this rule. First, this Court has never held that the economic realities of a situation can be used to recharacterize a taxpayer’s *bona fide* legal relationships. To the contrary, we have held that, absent a specific provision of the Act to the contrary or a finding that they are a sham, the taxpayer’s legal relationships must be respected in tax cases. Recharacterization is only permissible if the label attached by the taxpayer to the particular transaction does not properly reflect its actual legal effect: *Continental Bank Leasing Corp. v. Canada*, [1998] 2 S.C.R. 298, at para. 21, *per* Bastarache J.

> 40 Second, it is well established in this Court's tax jurisprudence that a searching inquiry for either the "economic realities" of a particular transaction or the general object and spirit of the provision at issue can never supplant a court's duty to apply an unambiguous provision of the Act to a taxpayer's transaction. Where the provision at issue is clear and unambiguous, its terms must simply be applied: *Continental Bank*, *supra*, at para. 51, *per* Bastarache J.; *Tennant*, *supra*, at para. 16, *per* Iacobucci J.; *Canada v. Antosko*, [1994] 2 S.C.R. 312, at pp. 326-27 and 330, *per* Iacobucci J.; *Friesen v. Canada*, [1995] 3 S.C.R. 103, at para. 11, *per* Major J.; *Alberta (Treasury Branches) v. M.N.R.*, [1996] 1 S.C.R. 963, at para. 15, *per* Cory J.
>
> (Emphasis added).

[37] In this case, the appellant does not allege a sham and has not proceeded under the section 245 general anti-avoidance rule. The legal transaction and the provision in question are clear. Accordingly, the narrow and unambiguous legal effect of this reorganization must be respected and subsection 84(2) cannot apply.

Jurisprudence

[38] The appellant relies heavily on *RMM*. However, I do not believe *RMM* is on all fours with the case at bar. In *RMM*, there was no "transformation" of the property in question. *RMM* paid cash to Equilease Limited for Equilease Limited shares. *RMM* then liquidated Equilease Limited and repaid Equilease Corporation (the American parent corporation of Equilease Limited) the exact amount it used to purchase the shares in the first place. Nowhere did the nature of the property transform.

[39] Indeed, Chief Justice Bowman clearly turned his mind to the legal substance of the transaction:

> 18 What of the fact that there was a sale of shares? Of course there was a sale. It was not a sham. "Sale of shares" is a precise description of the legal relationship. Nor do I suggest that the doctrine of "substance over form" should dictate that I ignore the sale in favour of some other legal relationship. That is not what the doctrine is all about . Rather it is that the essential nature of a transaction cannot be altered for income tax purposes by calling it by a different name. It is the true legal relationship, not the nomenclature that governs. The Minister, conversely, may not say to the taxpayer "You used one legal structure but you achieved the same economic result as that which you would have had if you used a different one. Therefore I shall ignore the structure you used and treat you as if you had used the other one".
>
> 19 One cannot deny or ignore the sale. Rather, one must put it in its proper perspective in the transaction as a whole. The sale of [Equilease Limited's] shares and the winding-up or discontinuance of its business are not mutually exclusive. Rather they complement one another. The sale was merely an aspect of the transaction described in subsection 84(2) that gives rise to the deemed dividend. . . . I do not think that the brief detour of the funds through RMM stamps them with a different character from that which they had as funds of [Equilease Limited] distributed or appropriated to or for the benefit of [Equilease Corporation]. Nor do I think that the fact that the funds that were paid to [Equilease Corporation] by RMM were borrowed from the bank and then immediately repaid out of [Equilease Limited's] money is a sufficient basis for ignoring the words "in any manner whatever".
>
> (Emphasis added)

[40] Chief Justice Bowman therefore clearly stated that in *RMM* the funds received were the same property as that which had been distributed. For the foregoing reasons, however, in the case at bar the property received by the respondents simply never existed in the hands of 8855. Deeming the Vidéotron common shares received by the respondents to have been the corporate property of 8855 would be tantamount to saying "I shall ignore the structure you used and treat you as if you had used the other one." Such an interpretation would contradict *RMM*, *Shell Canada*, and *Canada Trustco*.

[41] While the respondents urge the Court to find support in *Geransky*, there is no need to either rely on or distinguish it. In the case at bar, the plain and ordinary meaning of subsection 84(2) is dispositive: since the Vidéotron common shares received by the respondents were never the property of 8855, it simply cannot be the case that subsection 84(2) is engaged. Subsection 84(2) requires the appropriation or distribution of corporate assets, but 8855 retained the entirety of its assets until it was wound up by Vidéotron. Accordingly, I find that there was no distribution or appropriation of 8855 property and the transaction therefore does not give rise to a deemed dividend.

Other issues

[42] In light of my finding that there was no distribution or appropriation within the meaning of subsection 84(2) and the appellant's concession that section 85.1 applies, there is no need to address whether the transaction occurred upon wind up or whether subsection 84(2) and section 85.1 can apply concurrently. On the facts of this case, subsection 84(2) does not apply and section 85.1 does.

[43] The parties have also made submissions with respect to the respondents' motivation to pursue the transaction under review. Once again, the appellant argues that the goal of the transaction was to avoid a deemed disposition under section 128.1 The respondents argue that section 128.1 would have applied regardless of the transaction as 8855 assets were taxable Canadian property, and that the goal was to increase liquidity by avoiding the need to obtain a clearance certificate prior to disposition. However, the appellant does not argue the transaction was in any way a sham. Accordingly, the respondents' motivation does not matter. The appellant assessed the respondent

under subsection 84(2) and the subsection makes no reference to the motives of the parties; therefore, the reason for which the respondents entered into the transaction is entirely irrelevant to the disposition of the case.

Conclusion

[44] At its root, this case is about whether there was a distribution of 8855 property to the respondents. As stated above, the respondents never received 8855 property. Accordingly, section 84(2) is not triggered. I would dismiss the appeal and award one set of costs to the respondents in this Court and the Court below. These reasons will be placed in file A-61-09 with a copy in each of files A-62-09, A-64-09, and A-65-09.

"Johanne Trudel"
J.A.

“I agree
M. Nadon J.A.”

CHIEF JUSTICE BLAIS (Dissenting Reasons)

[45] I have had the benefit of reading the reasons of my colleague Trudel J.A. While the factual background is not in dispute, with all due respect, I am unable to agree with her conclusion.

[46] It cannot be disputed that, as the result of a pre-arranged series of transactions culminating in the winding-up of 8855, the respondents became the direct owners of an investment in Vidéotron in place of what had been an indirect investment in Vidéotron which they held through their ownership of 8855. *Prima facie*, that is a sufficient factual foundation for the application of subsection 84(2). The question is whether the application of subsection 84(2) is avoided simply because the respondents' direct investment in Vidéotron takes the form of newly issued shares of Vidéotron, rather than the shares and convertible debentures of Vidéotron previously owned by the respondents indirectly through 8855. In my opinion, the answer must be no.

[47] In my view, the result of this case is governed by *Smythe v. Canada (Minister of National Revenue – M.N.R.)*, [1970] S.C.R. 64 [Smythe], in which the Court concluded that subsection 81(1) of the *Income Tax Act*, R.S.C. 1952, c. 148, applied to a series of transactions that in material respects is similar to the series of transactions in this case.

[48] The wording of subsection 81(1) as it read at the time is as follows :

> 81. (1) Where funds or property of a corporation have, at a time when the corporation had undistributed income on hand, been distributed or otherwise appropriated in any manner whatsoever to or for the benefit of one or more of its shareholders on the winding-up,

> discontinuance or re-organization of its business, a dividend shall be deemed to have been received at that time by each shareholder equal to the lesser of
>
> *a*) the amount or value of the funds or property so distributed or appropriated to him, or
>
> *b*) his portion of the undistributed income then on hand.

[49] The following is a summary of the facts in *Smythe* as provided in the decision :

> In 1961, the appellants owned almost all the shares of an active company having substantial assets and an undistributed income of $728,652 on hand. A new company was incorporated in Ontario in which the appellants held shares in the same proportion as their respective holdings in the old company. All the assets of the old company were sold to the new company in exchange for a promissory note for $2,611,769. The new company obtained a bank loan to pay the old company which used the cash thus received to purchase preferred shares in two Vancouver based companies. The appellants sold their shares in the old company to the two Vancouver companies for cash at dollar for dollar on capital and 95 per cent on undistributed income. The appellants then reinvested part of that cash in debentures of the new company. When all the transactions had been completed, the undistributed income of the old company was in the hands of the appellants partly in cash and partly in debentures of the new company, without any income tax having been paid on such distribution. The Minister reassessed the appellants under s. 81(1) of the *Income Tax Act*, R.S.C. 1952, c. 148.

[50] Although *Smythe* involved the appropriation of undistributed income on hand to shareholders, the assets were transformed through various transactions which involved the incorporation of a new company and unrelated companies as well as bank loans until the assets in the desired form were back into the appellants' hands.

[51] At page 68, Justice Judson expressed the following :

> There is only one possible conclusion from an examination of these artificial transactions and that must be that their purpose was to distribute or appropriate to the shareholders the "undistributed income on hand" of the old company. No oral or other documentary evidence is needed to supplement this examination. There was, however, an abundance of other evidence. This was a well-considered scheme adopted on the advice of professional advisers after other means of extraction of the undistributed income (…)

[52] On this basis, I would allow the appeal.

"Pierre Blais"

C.J.

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

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