

Docket: 2014-4328(GST)I

BETWEEN:

OTTE & ASSOCIATES CONTRACTORS INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on December 8 and 9, 2015, at Regina, Saskatchewan

By: The Honourable Justice Don R. Sommerfeldt

Appearances:

Counsel for the Appellant: Jason M. Clayards

Counsel for the Respondent: John Krowina

JUDGMENT

The Appeal is allowed and the reassessments dated September 10, 2014 are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis set out in the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 24th day of June 2016.

“Don R. Sommerfeldt”

Sommerfeldt J.

Citation: 2016 TCC 162
Date: 20160624
Docket: 2014-4328(GST)I

BETWEEN:

OTTE & ASSOCIATES CONTRACTORS INC.,

Appellant,

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REASONS FOR JUDGMENT

Sommerfeldt J.

I. INTRODUCTION

[1] These Reasons pertain to an appeal by Otte & Associates Contractors Inc. (“OAC”) in respect of a series of reassessments (collectively, the “Reassessments”) which were issued under Part IX of the *Excise Tax Act* (the “ETA”)¹ on September 10, 2014, which related to twelve quarterly reporting periods, extending over a three-year period from December 1, 2009 to November 30, 2012, and which imposed goods and services tax (“GST”) in the amount of \$30,800.07, pursuant to the formula set out in paragraph 173(1)(d) of the *ETA*.

II. BACKGROUND

A. Corporation and Shareholders

[2] The Appellant, OAC, was incorporated under the laws of Saskatchewan in 2008. Patrick Otte and his wife, Jane, are shareholders (but not necessarily the only shareholders) of OAC.

¹ *Excise Tax Act*, R.S.C. 1985, c. E-15, Part IX, as enacted by S.C. 1990, c.45, and as subsequently amended.

[3] In subparagraph 18(b) of the Crown's Reply (the "Reply"), the Minister of National Revenue (the "Minister") assumed that the shareholders of OAC are Mr. and Mrs. Otte. Perhaps it is implicit in the wording of subparagraph 18(b) that Mr. and Mrs. Otte were assumed by the Minister to be the only shareholders of OAC, but this was not stated explicitly in the Reply, in the Crown's evidence or in argument.

[4] In his opening statement, counsel for OAC admitted that a number of the Minister's assumptions, as set out in paragraph 18 of the Reply, are true. However, in the context of subparagraph 18(b) of the Reply, counsel for OAC admitted only that Mr. and Mrs. Otte are two of the shareholders of OAC. He went on to say that there are two other shareholders of OAC, as well. However, the names and shareholdings of the other two shareholders of OAC were not provided to me, either in the opening statement or in evidence.

[5] The only witness called on behalf of OAC was Mr. Otte, whom I found to be credible. Mr. Otte, who is a journeyman carpenter, has worked in the construction industry for 41 years. As a sole proprietor, he began building custom homes for customers in the 1990s. For many years, he has also done home renovations and additions. In 2008 he arranged for OAC to be incorporated, after which the home-construction business has been carried on by OAC.

B. Purchase of Land

[6] In or about 2007, Mr. and Mrs. Otte decided to build a new home for themselves. To that end, they found a 4.90-acre (1.983-hectare) parcel of vacant land (the "Land"), whose parcel description is Surface Parcel No. #####, whose reference land description is Lot #, Block #, Plan No. ##### Extension #, and whose municipal address is ## XXXX Crescent,² in a relatively new development known as "Stone Pointe Estates," which is located in or near White City in the Rural Municipality of Edenwold No. 158 (the "Municipality") in Saskatchewan. Effective as of December 27, 2007, Mr. Otte and Stone Pointe Estates Ltd. ("SPE") entered into an Option to Purchase Agreement (the "Agreement," which was entered as Exhibit A-2), pursuant to which Mr. Otte obtained an option to purchase the Land from SPE for a price of \$124,900.00 plus GST in the amount of \$6,245.00, resulting in a total payment of \$131,145.00. On December 27, 2007 (according to the Agreement) or on January 8, 2008 (according to Mr. Otte's handwritten tally sheet, which was entered as Exhibit A-7), Mr. Otte

² The numbers and street name in the land description and the address have been redacted.

paid a deposit of \$16,237.00 to SPE. Mr. (and perhaps Mrs.) Otte subsequently paid the remainder of the price of the Land, in two additional payments in the amounts of \$60,000.00 and \$59,000.00 on December 1, 2008 and August 1, 2009 respectively. The total of the three payments for the Land, as set out in Mr. Otte's handwritten tally sheet, is \$135,237.00, which is slightly more than the total payment of \$131,145.00 stipulated in the Agreement. No explanation for the discrepancy was given at the hearing.

[7] On September 21, 2009 (about seven weeks after the final payment for the Land had been made), the Saskatchewan Land Titles Registry issued Title #138137867 (the "Title," which was entered as Exhibit A-1), showing that Mr. and Mrs. Otte were the registered owners, as joint tenants, of the Land. Exhibit A-1 indicates that the stated value of the Land on September 21, 2009 was \$124,900.00.

[8] During his testimony, Mr. Otte was adamant that it was he and his wife, and not OAC, who paid the price of the Land to SPE. However, OAC's financial statements for the fiscal year ended November 30, 2010 (which were entered as Exhibit R-5) raise an issue in this regard. The balance sheet dated November 30, 2010 shows that OAC had inventories with a cost of \$1,081,850.00 at the end of the 2010 fiscal year. A schedule attached to those financial statements shows that the inventories consisted of four lots in Stone Pointe Estates, one of which was the lot described above as the "Land." The schedule also shows three payments in respect of the Land, namely \$16,237.00 on January 11, 2008, \$60,000.00 on December 3, 2008 and \$59,000.00 on August 13, 2009. These three amounts correspond with the amounts set out in paragraph 6 above; however, the dates do not correspond.

[9] No explanation was provided during the hearing as to why the 2010 financial statements were prepared in the above-described manner. Exhibit A-1 (i.e., the above-mentioned Title) clearly shows that Mr. and Mrs. Otte became the registered owners of the Land on September 21, 2009 and continued to be the registered owners of the Land on December 2, 2015 (which was the date on which that particular copy of the Title was issued by the Saskatchewan Land Titles Registry). During the hearing, there was no evidence or suggestion (even during cross-examination) that Mr. and Mrs. Otte had transferred either legal title or beneficial ownership of the Land to OAC. While the Reassessments were based on the premise that OAC had sold the Land (as well as a house (the "House")) to Mr. and Mrs. Otte, the Minister, as represented by the Canada Revenue Agency (the "CRA"), did not provide any evidence or explanation as to how OAC came to be

the owner of the Land before the alleged sale of the Land by OAC to Mr. and Mrs. Otte.³ As will be discussed more fully below, I am not convinced that OAC's financial statements for the fiscal periods in question correctly reflected the transactions between OAC and Mr. and Mrs. Otte. Accordingly, I am of the view that, from September 21, 2009 to the date of the hearing, Mr. and Mrs. Otte were the registered, legal and beneficial owners of the Land (in using the term "Land," I am referring only to the surface beneath and around the House, and not to the House itself; I will use the term "Property" to refer to the Land and the House together).

C. Construction of House

[10] On June 12, 2009 the Municipality issued Building Permit and Development Permit No. 2009-28 (which was entered as Exhibit A-3) to Mr. Otte, permitting him to construct a residence on the Land. Construction began in August 2009.

[11] Mr. Otte and OAC had a unique, customized arrangement for the construction of the House, with each party providing different things. Mr. Otte explained that he, and on occasion his sons, performed (or arranged for) most of the construction work in respect of the House. In particular, Mr. Otte arranged for a friend to dig the hole for the foundation. Mr. Otte, sometimes (but not often) with the help of his sons, poured the concrete for the foundation and did other concrete work, framed the House, installed the windows and doors (including the garage doors), built the soffits and fascia, insulated the House, installed the hardwood floors, did the finishing work, installed the cabinets and painted the House. Mr. Otte arranged for a friend to install the carpets. Mr. and Mrs. Otte personally purchased and paid for the doors, some of the drywall (labor and materials), and some of the sound equipment and wiring. I will refer to the items described in this paragraph as the "Owners' Items."

[12] Mr. Otte also explained that OAC procured and supplied most of the materials for the House (other than those mentioned in the preceding paragraph) and arranged for OAC's employees or subcontractors to do the electrical work, the plumbing, the shingling, the stuccoing, the exterior stonework, and the installation of the tile and countertops. As well, OAC built the cabinets (which, as mentioned above, Mr. Otte installed). I will refer to the items provided by OAC, as described in this paragraph, as the "OAC Items."

³ It was the CRA, and not the Ottes, which made this allegation.

[13] Mr. and Mrs. Otte moved into the House on December 23, 2010, before the construction of the House had been completed. The items that had not yet been completed included the installation of the handrails on the stairs and balconies, the finishing work, the tiling, the installation of the back splashes, the cabinetry, the exterior stonework, and the construction of the front step, veranda, deck⁴ and driveway.

[14] Mr. Otte testified that the construction of the House took about a year and a half, as he spent his normal work week managing and working on projects for OAC's other customers. With the exception of the pouring of the foundation and the installation of the roof trusses, Mr. Otte confined his work on the House to his spare time in evenings and on weekends. Mr. Otte and his sons poured the foundation during a regular work day, as that was the only time that the concrete could be delivered. They installed the trusses on a regular work day because they needed to use one of OAC's cranes.

[15] From the time that construction of the House began in August 2009 until November 2009, when the House was closed in, and then from January 2010 to May 2010,⁵ Mr. Otte worked only weekends on the House. He typically worked from 9:00 a.m. to 6:00 p.m. on Saturdays and Sundays. From May 2010 to December 2010, in addition to working weekends on the House, Mr. Otte also worked three or four hours each evening on the House. Although Mr. Otte's sons helped him occasionally with the House, Mr. Otte personally did most of the work constituting the Owners' Items. Mr. Otte estimated that the aggregate value of the labor provided by him and his sons in constructing the House was approximately \$140,000. OAC did not pay Mr. Otte or his sons for any of the work that they did on the House.

D. Financing

[16] To finance the construction of the House, in October 2009 Mr. and Mrs. Otte, pursuant to a builder's loan, personally borrowed \$500,000 from HSBC Bank Canada ("HSBC"). The loan was secured by a mortgage of the Property, granted by Mr. and Mrs. Otte to HSBC on or about October 6, 2009.⁶

⁴ At the time of the trial, on December 8, 2015, the deck had still not been constructed.

⁵ Mr. Otte did not work on the House in December 2009.

⁶ The HSBC mortgage does not appear as a registered interest on the copy of the Title that was entered as Exhibit A-1. The HSBC mortgage may well have been registered against an earlier version of the Title.

The loan was to be repaid when the construction of the House was substantially completed.

[17] When the construction of the House neared substantial completion, Mr. and Mrs. Otte negotiated a loan from Manulife Bank of Canada (“Manulife”), apparently in the amount of \$1,052,000.00.⁷ However, during his testimony, Mr. Otte stated that Manulife appraised the Property at \$1,052,000.00, and that 80% of that amount was “lendable.” The proceeds of the Manulife mortgage were used, in part, to pay out the HSBC mortgage.

[18] While the evidence was not conclusive on this point, it seems that, as the OAC Items were provided by OAC in the course of the construction of the House and as HSBC made loan advances to Mr. and Mrs. Otte, they paid those advances from time to time to OAC to cover the cost of the OAC Items (i.e., the materials, subcontracting and other items described above).

E. Invoice

[19] As OAC approached its 2011 year-end, OAC’s accountant advised Mr. Otte that, on or before November 30, 2011 (i.e., the last day of OAC’s fiscal period and taxation year), she wanted to clear out the expenses incurred by OAC in respect of the House. Accordingly, effective as of November 30, 2011, OAC issued invoice no. 326242 (the “Invoice,” which was entered as Exhibit A-6) to Mr. and Mrs. Otte. The Invoice contains the following handwritten statement under the heading “Details”:⁸

For THE SALE

of ## XXXX Cres Stonepointe Estates⁹

5400 sft Home Comple*¹⁰

⁷ Paragraph 2.4.1 of the Manulife mortgage (Exhibit A-5) states that the mortgage secures an amount of up to \$1,052,000.00, and the notation of the mortgage registered against the Title (Exhibit A-1) shows the mortgage value (which is the term used in that notation) as being \$1,052,000.00.

⁸ Most of the Invoice was written by hand in a combination of large upper-case letters, small upper-case letters and lower-case letters. In reproducing the particular statement from the Invoice in these Reasons, I have substituted lower-case letters for the small upper-case letters used in the Invoice. Otherwise, I have endeavoured to reproduce the spelling, punctuation and spacing of the Invoice in these Reasons.

⁹ The number and street name in the address have been redacted.

to owner's specs

Split Level on owner Lot

Start Date Aug 2009.

Finish Date Sept 11.

For the sum of. 45,5,437 61¹¹

Interest on Builder M¹² -18,105.95

GST 21866.88

Paided [*sic*] in Full

TOTAL \$459,19.8.24¹³

It is apparent that there were several clerical errors in the monetary amounts set out in the Invoice, pertaining primarily to misplaced or omitted commas or decimal points. The hearing of this appeal was conducted on the understanding that the four monetary amounts set out in the Invoice were as follows:

For the sum of. 455,437.61

Interest on Builder M -18,105.95

GST 21,866.88

TOTAL \$459,198.24

[20] The Invoice attracted the attention of the CRA, and later became one of the focal points of the hearing.

III. ISSUES

¹⁰ The letter represented by the asterisk is not legible in the Invoice.

¹¹ This is the format in which this particular number is shown in the Invoice. It appears that the number was intended to be \$455,437.61.

¹² This is presumably a reference to the builder's mortgage, i.e., the HSBC mortgage.

¹³ This is the format in which this particular number is shown in the Invoice. It appears that the number was intended to be \$459,198.24.

[21] In reassessing OAC, the CRA took the position that it was OAC, and not Mr. and Mrs. Otte and their sons, which constructed the House. The CRA also took the position that OAC transferred the Property in its entirety (i.e., the Land and the substantially completed House, including all labor and materials) to Mr. and Mrs. Otte. Accordingly, the CRA reassessed OAC pursuant to subsection 173(1) of the *ETA*. In this regard, the CRA took the position that the fair market value of the Property as of December 20, 2011 was \$1,200,000.00, with the result that there was a benefit amount (as defined in paragraph 173(1)(a) of the *ETA*) in the amount of \$762,668.34 (i.e., \$1,200,000.00 – \$437,331.66), in respect of which OAC had an obligation to collect GST in the amount of \$38,133.42 (i.e., \$762,668.34 × 0.05).

[22] In challenging the Reassessments, OAC took the position that Mr. and Mrs. Otte personally constructed the House. OAC acknowledged that some aspects of the construction were arranged by it, but it submitted that, in so doing, it acted only as agent for Mr. and Mrs. Otte. OAC also took the position that it did not transfer or supply anything to Mr. and Mrs. Otte in circumstances that would trigger the application of section 173 of the *ETA*. Alternatively, if GST is exigible pursuant to section 173 of the *ETA*, OAC took the position that the fair market value of the Property at the relevant time was less than the value used by the CRA.

[23] This case illustrates the difficulties and challenges that may arise when there are dealings between a closely held corporation and its shareholder concerning the construction of a house for the shareholder and the respective roles of the corporation and the shareholder are not expressly delineated. Previous situations where these difficulties and challenges arose were considered in *S.E.R. Contracting Ltd. v The Queen*¹⁴ and *Best for Less Painting & Decorating Ltd. v The Queen*.¹⁵ The facts in those cases are slightly different from the facts in this Appeal. I have mentioned those cases simply for illustrative purposes, and not

¹⁴ *S.E.R. Contracting Ltd. v The Queen*, 2006 TCC 6. In written submissions that were provided to me after the hearing, counsel for the Crown included a copy of this case, and submitted that it is relevant to the issue discussed under subheading “IV.C. Input Tax Credits” below. In those same written submissions, counsel for the Crown also included submissions that pertained to the issue which he described as “Who Built the House in Question.” As I had invited written submissions only in respect of the issue pertaining to certain input tax credits (the “ITCs”), and as counsel for OAC had limited his written submissions to the ITC issue, to be fair, I have not considered the written submissions made by counsel for the Crown in respect of the issue of “Who Built the House in Question.”

¹⁵ *Best for Less Painting & Decorating Ltd. v The Queen*, 2005 TCC 239.

because those cases are determinative of the issues in this Appeal. As well, during oral argument counsel for the Crown referred me to the *Best for Less* case, although he submitted that the facts of that case were sufficiently different from those of this Appeal as to distinguish that case from this Appeal.

IV. ANALYSIS

A. Agency

[24] As indicated above, OAC took the position that, although some aspects of the construction of the House were arranged through OAC, in so doing, OAC acted only as agent for Mr. and Mrs. Otte. For its part, the Crown denied that OAC purchased construction materials as agent for Mr. and Mrs. Otte, and instead alleged that Mr. and Mrs. Otte made certain purchases for OAC as OAC's agent.

[25] There was no written agency agreement or other document to substantiate that OAC acted as the agent of Mr. and Mrs. Otte or that Mr. and Mrs. Otte acted as the agents of OAC. However, as an agency relationship may be express or implied, it is also necessary to determine whether there was an implied agency relationship between OAC on the one hand and Mr. and Mrs. Otte on the other.

(1) Legal Principles

[26] The views of the CRA in respect of implied agency are set out in a Policy Statement as follows:

Agency exists where one person (the principal) authorizes another person (the agent) to represent it and take certain actions on its behalf. The authority granted by the principal may be express or implied. In other words, an agency relationship may be created where one person explicitly consents to having another act on its behalf or behaves in such a way that consent is implied....

While two parties may agree that one party is to act as agent with respect to transactions undertaken on behalf of the other party, the absence of such an agreement is not sufficient to conclude that an agency relationship does not exist.

Although the intention of the parties is an important determinant of the nature of the relationship between the parties, case law supports the possibility that two parties may be engaged in an agency relationship without even being aware of it, provided their actions indicate that one party is acting as agent on behalf of another. In other words, agency is generally evident from the conduct of the parties.¹⁶

[27] A leading textbook, *Canadian Agency Law*, discusses the creation of an agency relationship by implied contract in these terms:

As with other contracts, the agency relationship may be impliedly created by the conduct of the parties, without anything having been expressly agreed as to terms of employment, remuneration, *etc.*.... The assent of the agent may be implied from the fact that he has acted intentionally on another's behalf. In general, however, it will be the assent of the principal which is more likely to be implied.... Such assent may be implied where the circumstances clearly indicate that the principal has given authority to another to act on his behalf. This may be so even if the principal did not know the true state of affairs. Mere silence will be insufficient. There must be some course of conduct to indicate the acceptance of the agency relationship. The effect of such an implication is to put the parties in the same

¹⁶ Canada Revenue Agency, *Agency*, GST/HST Policy Statement P-182R, p. 2 & 4. In *The Queen v Merchant Law Group*, 2010 FCA 206 at ¶15, the Federal Court of Appeal indicated that, although Policy Statement P-182R is not binding on the Court, it is “a useful tool in determining whether an agency relationship exists.”

position as if the agency had been expressly created.¹⁷ [Footnote numbers omitted.]

[28] In *Fourney et al v The Queen*,¹⁸ Hogan J quoted portions of the above statement, as set out in an earlier edition of Professor Fridman's text on agency law, and stated several principles pertaining to implied agency. Three of those principles are paraphrased as follows:

- a) In the absence of a written agency agreement, a court must closely examine the conduct of the parties to determine whether there was an implied intention to create an agency relationship.¹⁹
- b) In reviewing the conduct of the alleged principal and the alleged agent, a key consideration is to determine the level of control which the former exerted over the latter.²⁰
- c) Where it is alleged that a corporation is acting as the agent of its shareholders, a high threshold of evidence is needed.²¹

(2) Application to Facts

[29] Having examined the conduct of Mr. and Mrs. Otte and OAC, as explained in the paragraphs which follow, I have come to the conclusion that, for certain purposes, Mr. Otte acted as the agent of OAC in procuring certain materials, some of which were used in constructing the House and others of which were used in constructing buildings for other customers.

[30] For approximately ten or fifteen years before the incorporation of OAC, Mr. Otte, in his capacity as a sole proprietor, carried on a construction business. He established relationships with numerous suppliers, which provided materials to him and billed him in his own name. After OAC was incorporated in 2008, Mr. Otte, now on behalf of OAC, continued to use the same suppliers, which, in many cases, continued to issue their invoices in the name of Mr. Otte, rather than billing OAC. Understandably, this situation lead to difficulty when the CRA undertook a GST

¹⁷ G.H.L. Fridman, *Canadian Agency Law* (2d ed.) (Markham: LexisNexis Canada Inc., 2012), p. 40-41.

¹⁸ *Fourney et al v The Queen*, 2011 TCC 520.

¹⁹ *Ibid.*, ¶44.

²⁰ *Ibid.*, ¶45.

²¹ *Ibid.*, ¶47.

audit and found that OAC had claimed certain input tax credits (defined above as the “ITCs”) totalling \$37,302.87 (and relating to various materials, only some of which pertained to the House), notwithstanding that the supporting invoices had been addressed by the particular suppliers to Mr. Otte, rather than to OAC.

[31] One of the suppliers used by Mr. Otte, when he was carrying on his construction business as a sole proprietor, was Sherwood Co-operative Association Limited (the “Co-op”). As a sole proprietor, Mr. Otte had an account with the Co-op. When OAC was incorporated, OAC took over that account, but did not change the name of the account. In 2012, when the CRA was challenging OAC’s claim for the ITCs in respect of purchases made by OAC from suppliers used by Mr. Otte before OAC was incorporated, Mr. Otte arranged for Joanne Zummack, the credit manager of the Co-op, to send a letter, dated November 5, 2012, addressed “To Whom it may concern.” The substantive portion of the letter, which was entered as Exhibit A-8, reads as follows:

Otte & Associates Contractors Inc has been operating their account with the Sherwood Co-operative Assoc Limited under the name Patrick (Pat) Otte since their incorporation in 2008.

The above letter is consistent with the proposition that Mr. Otte was the agent of OAC.

[32] Although there was not any extensive evidence in respect of the disallowance of the ITCs (as that disallowance was not the subject of this Appeal), it appears that the initial reassessments, which were dated September 17, 2013 (and which predated the Reassessments that are the subject of this Appeal), disallowed the ITCs, and also imposed the GST which ultimately became the subject of this Appeal. It appears that the Notice of Objection filed by OAC with the CRA on October 25, 2013 (which was not entered into evidence) submitted that OAC should be allowed to claim the ITCs that were supported by supplier invoices issued to the agent or representative of OAC. In acceding to OAC’s submission, the CRA’s Appeals Division²² referred to subparagraph 3(c)(ii) of the *Input Tax Credit Information Regulations*, which sets out certain information that must be obtained by a registrant in order to claim an ITC, and which reads as follows:

(ii) the recipient’s name, the name under which the recipient does business or the name of the recipient’s duly authorized agent or representative....

²² See the letter dated September 5, 2014 from the Appeals Division to OAC, which was entered as Exhibit R-3.

The Appeals Division indicated that it was prepared to accept the supplier invoices issued to the shareholders of OAC for the purpose of calculating eligible ITC claims by OAC. Thus, it appears that Mr. Otte, OAC and the CRA all considered Mr. Otte to be the agent or representative of OAC for the purpose of acquiring the properties or services that gave rise to the ITCs.

[33] As OAC has taken the position that Mr. Otte was its agent or representative for the purpose of claiming the ITCs pursuant to subsection 169(1) of the *ETA*, it would appear to be inconsistent, or at least circular, for OAC to argue that it was the agent of Mr. and Mrs. Otte in constructing the House and procuring some of the materials that were used in building the House. While I acknowledge that it is possible for two parties each to be the agent of the other, such a situation is unusual, and in this case, was not supported by the evidence. Furthermore, I did not find any conduct on the part of OAC or Mr. and Mrs. Otte to substantiate the proposition that OAC acted as the agent of Mr. and Mrs. Otte in respect of the construction of the House.

[34] During cross-examination, Mr. Otte stated that various expenses pertaining to the House “were run through the company.” The CRA auditor testified that, when she met with Mr. Otte during the initial audit interview on September 25, 2012, he told her that he “built the house through the company” and that “the company built it at cost so there was no profit on it.” The precise meaning and the legal implications of those statements are unclear. In my view, those statements could, depending on one’s perspective, be construed as supporting the proposition that OAC built the House as principal or the proposition that OAC built the House as the agent of Mr. and Mrs. Otte. In any event, the statements are not sufficiently clear as to persuade me that OAC was the agent of Mr. and Mrs. Otte.

B. OAC Items

[35] As I have found that OAC was not acting as the agent of Mr. and Mrs. Otte, it follows that the goods and services that were supplied by OAC to Mr. and Mrs. Otte were supplied by OAC in its capacity as principal. In particular, I find that the OAC Items were, for the purposes of the *ETA*, supplied by OAC to Mr. and Mrs. Otte. However, this finding does not mean that OAC supplied other goods or services to Mr. and Mrs. Otte.

C. Input Tax Credits

[36] As noted above (under the subheading “IV.A. Agency”), OAC claimed ITCs in respect of certain materials that had been acquired in the name of Mr. Otte or that had been billed by the various suppliers to accounts that were in the name of Mr. Otte. Also as noted above, the CRA acknowledged that Mr. Otte was the agent or representative of OAC, with the result that the CRA allowed OAC’s claim for the ITCs.

[37] At the conclusion of the hearing, counsel for the Crown pointed out that, if I were to find that OAC, in supplying goods and services to Mr. and Mrs. Otte, had been acting as their agent, it would not be appropriate for OAC to retain the ITCs in respect of those goods and services. As I have found that OAC was not acting as the agent for Mr. and Mrs. Otte, and as I have further found that OAC, in supplying the OAC Items to Mr. and Mrs. Otte, was acting as principal, and not as agent, it is not necessary for me to consider this issue.²³

D. Financial Statements

[38] As indicated above, OAC’s financial statements for the fiscal year ended November 30, 2010 (Exhibit R-5) included the Land in OAC’s inventories and recorded three payments corresponding somewhat to the three instalments paid by Mr. Otte (and perhaps Mrs. Otte) to SPE as the purchase price for the Land. However, those entries in the financial statements do not correspond with the facts as I have found them. As noted above, SPE sold the Land to Mr. and Mrs. Otte and there is no evidence or suggestion that the Land was ever sold, transferred or otherwise conveyed to OAC. As well, Mr. Otte testified that the price of the Land was paid to SPE by Mrs. Otte and him, and not by OAC.

[39] It is well accepted that accounting documents or entries only reflect reality, and do not create it.²⁴ In this regard, the Supreme Court of Canada has stated:

²³ As indicated in footnote 14 above, at the *conclusion* of the hearing, I invited counsel to provide written submissions in respect of the above ITC issue. I gratefully appreciate the time and effort expended by counsel in preparing those submissions, particularly as I was ultimately not required to address the ITC issue, given my finding in respect of the agency issue.

²⁴ For instance, see *Sochatsky v The Queen*, 2011 TCC 41, fn 34; *Merchant v The Queen*, 2009 TCC 31, ¶11-13; *Canada Trustco Mortgage Company v The Queen*, 2004 TCC 792, ¶29; *Loyens v The Queen*, 2003 TCC 214, ¶42; *Jabs Construction Limited v The Queen*, [1999] 3 CTC 2556, 99 DTC 729, ¶33; *Palardy v The Queen*, [1997] 2 CTC 2906, 97 DTC 1043 (TCC), ¶38; *Phillips v The Queen*, [1994] 2 CTC 2416, 95 DTC 194

The law is well established that accounting documents or accounting entries serve only to reflect transactions and that it is the reality of the facts that determines the true nature and substance of transactions....²⁵

[40] Useful guidance in the context of property ownership is provided by *Finch v The Queen*,²⁶ which dealt with a situation where a house was registered in the name of an individual, but there was an allegation that the beneficial owner of the property was a corporation of which the individual's parents were the shareholders. The legal documentation showed that the property had been purchased in the name of the individual. As well, there was further documentation in respect of a mortgage given by the individual to his parents' corporation. Nevertheless, the accountants for the corporation had sent a letter of instructions to the corporation's lawyers instructing them to prepare a trust document showing that the individual held the property in trust for the corporation. However, the lawyers ignored that request and did not prepare the trust document. When the question of ownership arose in the proceeding before the Tax Court of Canada, *Bowman ACJTC* (as he then was) stated:

The legal form of the documents points to beneficial ownership in the appellant [i.e., the individual] but the accounting treatment is inconsistent with that position. The legal form prevails in my view.²⁷

[41] In my view, a similar principle applies in the present situation. The legal documentation supports, and is consistent with, the view that at all material times the Land has been continuously owned by Mr. and Mrs. Otte.²⁸ While there are entries in the financial statements which suggest that OAC, for a short period of time, may have accounted for the Land as part of its inventory, in my view the legal documents prevail.

[42] I am reinforced in this view by a comment made at the hearing by the CRA auditor who audited this matter. During the testimony of the auditor, she stated that

(TCC), ¶19; *Berube v The Queen*, [1994] 1 CTC 2655 (TCC), ¶19; *Sinclair v MNR* (sometimes referred to as *Prosperous Investments Ltd. v MNR*), [1992] 1 CTC 2218, 92 DTC 1163 (TCC), ¶45; *MNR v Wardean Drilling Ltd.*, [1969] CTC 265, 69 DTC 5194 (Ex. Ct.), ¶17; and *MNR v Société coopérative agricole de la vallée d'Yamaska*, [1957] CTC 132, 57 DTC 1078 (Ex. Ct.), ¶33-34.

²⁵ *Hickman Motors Ltd. v The Queen*, [1997] 2 SCR 336, [1998] 1 CTC 213, 97 DTC 5363 (SCC), ¶87.

²⁶ *Finch v The Queen*, 2004 TCC 353.

²⁷ *Ibid.*, ¶14.

²⁸ See paragraph 9 of these Reasons.

she reviewed the Transactions by Account Report which related to the period December 1, 2010 to November 30, 2011 and which was one of the documents on which the 2011 financial statements were based. She indicated that journal entry J785, which was dated November 30, 2011, was perplexing and did not add up. It appears that this journal entry may have had some connection to the Invoice; however, the amounts set out in the entry do not correspond with the amounts set out in the Invoice. The auditor stated that she did not know why OAC's accountant had prepared the entry the way she did. The auditor also stated that, although there were references to the Land and the House in OAC's financial statements and other accounting records, she did not see any documents to show that title to the Land was ever in the name of OAC or that the House was ever the property of OAC.

E. Invoice

[43] The Respondent took the position that the Invoice (Exhibit A-6), which was dated November 30, 2011, established that OAC sold the entire Property to Mr. and Mrs. Otte. However, an invoice is an accounting document, and not a transactional document, with the result that an invoice merely reflects transactions, and does not create them. This principle was established in *Mountwest Steel Ltd. v The Queen*,²⁹ in which the Court considered an invoice which had been issued in error, which had never been paid, and in respect of which no goods or services had ever been supplied. Nevertheless, it was argued by the appellant in that case that the invoice had created a liability, which had become a bad debt. In dealing with this argument, Kempo J stated:

For a debt to be a bad debt there must be a debt extant in the first place. The issuance of an invoice does not induce or create a debt or liability. This kind of document is merely a means of recording a liability; it is not itself evidence of the passing of goods or services or consideration which created or gave rise to the liability. Accounting documents or entries serve to merely reflect transactions, they do not create them;... Either there was a substantive debtor/creditor relationship underlying the subject invoice or there was not. Here, there was not.³⁰

[44] Accordingly, it is my view that, to determine the applicable GST treatment in this Appeal, this Court must consider the actual transactions between OAC and Mr. and Mrs. Otte, and not confine itself merely to a reading of the Invoice.

²⁹ *Mountwest Steel Ltd. v The Queen*, [1994] GSTC 71, 2 GTC 1087 (TCC).

³⁰ *Ibid.*, ¶9.

F. Land

[45] As indicated above, the evidence is clear that it was Mr. and Mrs. Otte (and not OAC) who purchased the Land from SPE. In particular, it was Mr. Otte (in his personal capacity) who signed the Agreement (Exhibit A-2), pursuant to which he obtained an option to purchase the Land from SPE.

[46] In his testimony, Mr. Otte indicated that he (or perhaps he and his wife) paid the three instalments (i.e., \$16,237.00, \$60,000.00 and \$59,000.00 respectively) in respect of the price of the Land. However, the cancelled cheques were not put in evidence; therefore, I have not been able to ascertain on which account or accounts those cheques were drawn. As noted above, OAC's financial statements for the fiscal year ended November 30, 2010 seem to suggest that the three payments may have been made by OAC, although the dates in the financial statements do not match with the dates set out in Exhibits A-2 and A-7. As I am not convinced of the reliability of the financial statements, I accept Mr. Otte's testimony, rather than the financial statements, in respect of this discrepancy.

[47] As stated above, legal title to the Land was registered in the names of Mr. and Mrs. Otte on September 21, 2009. There was no evidence and no suggestion that they transferred the Land to OAC or that OAC somehow acquired the Land and later transferred it back to them. Furthermore, as indicated above, the CRA auditor acknowledged that title to the Land was never in the name of OAC.

[48] During argument, I raised the Land-ownership issue with counsel for the Crown, who admitted that he could not explain how, if the Land was part of the property supplied by OAC to Mr. and Mrs. Otte, the Land would have been acquired by OAC prior to that supply. He acknowledged that he did not have any submissions to overcome that hurdle.

[49] Hence, I find that, at all material times (i.e., from September 21, 2009 to the date of the hearing), Mr. and Mrs. Otte were the registered, legal and beneficial owners of the Land. Accordingly, as OAC did not at any time become the registered, legal or beneficial owner of the Land, the transaction which is the subject of the Invoice (Exhibit A-6) did not include a supply of the Land by OAC to Mr. and Mrs. Otte.

G. Labor

[50] As explained above, Mr. Otte clearly delineated the labor that he provided in constructing the House from the labor that he provided to OAC in his capacity as an employee of OAC. In particular, with only two exceptions (which arose by reason of the limited availability of the cement when pouring the foundation and the limited availability of a crane when installing the roof trusses), Mr. Otte worked on the House only on evenings and weekends. During normal working hours, he worked for OAC in fulfilling OAC's obligations to its regular customers.

[51] OAC did not pay any salary, wages or other remuneration to Mr. Otte (who was the major provider of labor) or to his sons (who only worked occasionally on the House) in respect of any of the labor that they provided in constructing the House. As noted above, Mr. Otte testified that the value of the labor provided by him and his sons was \$140,000.00. I accept that amount as reasonable and accurate.

[52] During oral argument, the labor component in the House was referred to by counsel for the Crown as "sweat equity." He acknowledged that he did not have any submission that would be persuasive in showing that OAC supplied (as that word is used in the *ETA*) the sweat equity to Mr. and Mrs. Otte. He argued that it is not the CRA's job to get to the bottom of what the supply was (a position with which I disagree).³¹

[53] Counsel for the Crown also acknowledged that it would create a hardship if Mr. Otte were to be viewed as having gratuitously contributed his sweat equity to OAC in such a manner that OAC could later supply that sweat equity back to him and his wife in circumstances that would require OAC to collect GST in respect of the supply of the sweat equity.

³¹ In the Reply, the Deputy Attorney General of Canada, on behalf of the Crown, stated that the Minister assumed that OAC sold the Property to Mr. and Mrs. Otte, that Mr. and Mrs. Otte purchased the Property from OAC, and that OAC supplied the Property to Mr. and Mrs. Otte. During the hearing of this Appeal, Mr. Otte adduced credible evidence to establish that OAC did not supply the Land, the labor component (or sweat equity) in the House or the other Owners' Items to Mr. and Mrs. Otte, with the result that the onus shifted to the Crown to rebut the case made out by OAC and Mr. Otte (which, in my view, was greater than a *prima facie* case in respect of those items). See *Hickman Motors*, *supra* footnote 25, ¶91-97. Thus, in my view, to succeed in respect of the items in question, the Crown would need to adduce evidence (which it did not do) to prove that OAC supplied the Land, the labor component (or sweat equity) in the House and the other Owners' Items to Mr. and Mrs. Otte.

[54] Thus, I find that the labor component (or sweat equity) in the House that pertains to the work done by Mr. Otte and his sons was not supplied by OAC to Mr. and Mrs. Otte.³²

H. Owners' Items

[55] Consistent with my finding that OAC did not supply the labor component (or sweat equity) to Mr. and Mrs. Otte, I find that OAC did not supply the Owners' Items to Mr. and Mrs. Otte. More specifically, OAC did not supply the digging of the hole for the foundation, the pouring of the concrete for the foundation, the other concrete work, the framing of the House, the procurement of the doors, drywall materials and sound equipment and wiring, the installation of the windows and doors, the building of the soffits and fascia, the insulating of the House, the installation of the hardwood floors and carpets, the finishing work, the installation of the cabinets, the painting of the House, the installation of the drywall, and the installation of the sound equipment and wiring (see paragraph 11 above).

[56] The Owners' Items (as described in paragraphs 11 and 55 above) were a blend of labor and materials. I have discussed above the value of the labor provided by Mr. Otte and his sons. I will now consider the cost of the materials acquired by Mr. and Mrs. Otte from various suppliers and the cost of the labor provided by the drywalling contractor.

[57] I was not provided with a specific delineation of the cost of the materials (in particular, the doors, drywall materials, sound equipment and wiring) that were paid for directly by Mr. and Mrs. Otte, rather than being supplied to them by OAC. Exhibit A-10 is an invoice issued by Audio Warehouse to Mr. Otte, which appears to relate to the sound equipment and wiring that was paid for by Mr. Otte himself. However, due to the handwritten alterations made to the document, I am not able to determine the amount actually paid by Mr. Otte for the sound equipment and related materials. The difficulty in respect of the sound equipment is compounded by the fact that part of the cost was paid by Mr. Otte personally and part of the cost was paid by OAC and then reimbursed to OAC by Mr. and Mrs. Otte.

³² If this finding (i.e., that the labor component in the House was not supplied by OAC to Mr. and Mrs. Otte) were to be determined to be incorrect, or if it were to be determined that the labor component cannot be segregated from the OAC Items and treated separately for the purposes of the *ETA*, I would find that the labor provided by Mr. Otte and his sons formed part of the consideration provided by Mr. and Mrs. Otte to OAC in respect of the OAC Items.

[58] Exhibit A-13, an invoice from Premier Doors & Millworks LLC, of Thompson Falls, Montana, relates to the doors that Mr. Otte purchased personally and then installed in the House. Those doors formed part of the Owners' Items and were not supplied by OAC to Mr. and Mrs. Otte. The amount of the invoice is US\$25,591.18. I was not provided with the Canadian-currency equivalent of this amount.

[59] If the parties are unable to determine the cost of the sound equipment and wiring paid for by Mr. and Mrs. Otte and the Canadian-currency equivalent of the cost of the doors, they may refer the determination of those amounts back to me, although it may be necessary for me to obtain additional evidence and receive additional submissions before making such a determination.

[60] The drywalling materials and labor were provided by Superior Drywall Services. Exhibit A-16 is an invoice from Superior Drywall Services, in the amount of \$28,193.55 (which amount includes GST in the amount of \$1,342.55). OAC paid \$9,877.87 in respect of the drywall materials and labor (which, to the extent of that payment, form part of the OAC Items) and Mr. Otte paid \$18,315.68 in respect of the drywall materials and labor (which, to the extent of that payment, form part of the Owners' Items).

I. Valuation

[61] The Crown provided a valuation of the Property that was given by Edward Klymchuk, who is employed by the CRA as a Real Estate Appraiser. Mr. Klymchuk prepared an Appraisal Report, which was dated January 21, 2013 and which was an exhibit to an affidavit that he swore and that was filed with the Court at the time of the hearing. As well, Mr. Klymchuk testified at the hearing as an expert witness. Mr. Klymchuk opined that, as of December 20, 2011, the fair market value of the Property (i.e., the Land and the House) was \$1,200,000.00.

[62] At the hearing, I was given to understand that OAC had obtained a valuation in respect of the Property; however, no evidence of that valuation was put before me. Therefore, the only expert evidence available to me is that which was provided by Mr. Klymchuk.

[63] In performing his valuation, Mr. Klymchuk used the direct-comparison approach, because he viewed that approach as being preferable to the cost approach. Mr. Klymchuk found three comparable properties, that he labelled as “Comparable No. 1,” “Comparable No. 2,” and “Comparable No. 3.” He made various adjustments to the sales prices of those comparable properties, so as to adjust for various factors, including the time of sale, the size and value of the lot, the extent to which the basement was developed, the size of the garage, the number of fireplaces, and the status of the deck. After arriving at an adjusted value for each of the comparable properties, Mr. Klymchuk calculated the value per square foot of each comparable property and then determined the value per square foot that was midway between the highest and lowest of those values for the comparable properties. By so doing, he arrived at a value per square foot of \$340.00, which he multiplied by the livable floor area of the House (i.e., 3,512 square feet), so as to arrive at a House value of \$1,194,080.00, which he rounded to \$1,200,000.00.

[64] During Mr. Klymchuk’s testimony, I questioned the appropriateness of making upward adjustments to the values of Comparable No. 1 and Comparable No. 2 in respect of the land values,³³ as it seemed to me that this would have the tendency to skew upward the value per square foot of each of those comparable properties. I suggested to Mr. Klymchuk that it might be preferable to exclude the value of the land from the sale price of each comparable property, so as to compute the value per square foot of each house in a manner that did not include any value

³³ Mr. Klymchuk did not make any adjustment to the value of Comparable No. 3 in respect of its land value.

for the land, then to determine the value per square foot to be used in valuing the House, and then, once the value of the House had been calculated, to add the value of the Land. Mr. Klymchuk thought that my suggested approach would result in the same value as the value that he had obtained. As explained below, I disagree with that view.

[65] Mr. Klymchuk testified that, as of December 20, 2011 (which was the effective date of his valuation), the fair market value of the Land was \$170,000.00. Accordingly, I subtracted \$170,000.00 (so as to remove the land value) from the adjusted value that Mr. Klymchuk had calculated in respect of each of the three comparable properties, and then used the resultant values (which represented only the values of the respective houses, and not the values of the land) to calculate a value per square foot of each of the three comparable houses. The high and low values per square foot were \$310.00 and \$260.00, respectively. I then took the mid-point, i.e., \$285.00. When I multiplied that amount (i.e., \$285.00 per square foot) by the livable floor area of the House (i.e., 3,512 square feet), I arrived at a value of \$1,000,920.00 which I have rounded to \$1,000,000.00.

[66] If one were to add the value of the Land (i.e., \$170,000.00) to the House value that I calculated (i.e., \$1,000,000.00), the result would be \$1,170,000.00, which is \$30,000.00 less than the value determined by Mr. Klymchuk.

[67] I prefer the approach that I have taken, particularly because I have found that OAC did not supply the Land to Mr. and Mrs. Otte. Therefore, in my view, it makes sense to determine the value of the House without considering the value of the Land or the value of the land in the three comparable properties.

[68] Accordingly, I find that as of December 20, 2011, the value of the House was \$1,000,000.00.

J. Application

[69] As set out above, I have found that OAC, as principal, supplied the OAC Items to Mr. and Mrs. Otte. I have also found that OAC did not supply the Land or the Owners' Items (including the labor component or sweat equity) to Mr. and Mrs. Otte. Accordingly, it is my view that the application of subsection 173(1) of the *ETA* to this situation should be resolved by calculating the benefit amount in the manner set out below:

Fair market value of the House	\$1,000,000.00
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Less value of labor by Mr. Otte and his sons ³⁴	(140,000.00)
Less cost of sound equipment and wiring paid by Mr. & Mrs. Otte	(To be determined)
Less Canadian-currency equivalent of cost of doors (US\$25,591.18) paid by Mr. & Mrs. Otte	(To be determined)
Less cost of drywall materials and labor paid by Mr. & Mrs. Otte	(18,315.68)
Less consideration paid by Mr. & Mrs. Otte in respect of the OAC Items	<u>(437,331.66)</u>
Benefit amount for the purposes of subsection 173(1) of the <i>ETA</i>	To be determined

V. CONCLUSION

[70] For the reasons set out above, this Appeal is allowed and the Reassessments are referred back to the Minister for reconsideration and reassessment on the basis that:

- a) OAC supplied only the OAC Items to Mr. and Mrs. Otte;
- b) OAC did not supply the Land or the Owners' Items (including the labor component or sweat equity) to Mr. and Mrs. Otte;
- c) the fair market value of the House as of December 20, 2011 was \$1,000,000.00; and
- d) for the purposes of subsection 173(1) of the *ETA*, the benefit amount is to be calculated in the manner set out in the table above, after the cost of the sound equipment and wiring and the Canadian-currency equivalent of the cost of the doors have been determined.

[71] As indicated under subheading "IV.H. Owners' Items" above, it is my expectation that the Parties will be able to determine the cost of the sound

³⁴ As mentioned in footnote 32 above, if the labor component (or sweat equity) in the House cannot be segregated from the OAC Items, I would treat the value of the labor, i.e., \$140,000.00, as additional consideration paid by Mr. and Mrs. Otte to OAC in respect of the OAC Items. Hence, the benefit amount for the purposes of subsection 173(1) of the *ETA* would still be the same as that set out in the above table.

equipment and wiring and the Canadian-currency equivalent of the cost of the doors. If the Parties cannot reach a consensus in this regard, they may refer the matter back to me.

[72] As success in this Appeal has been divided, subject to any submissions that counsel may desire to make, each party is to bear its own costs.

Signed at Ottawa, Canada, this 24th day of June 2016.

“Don R. Sommerfeldt”

Sommerfeldt J.

CITATION: 2016 TCC 162

COURT FILE NO.: 2014-4328(GST)I

STYLE OF CAUSE: OTTE & ASSOCIATES CONTRACTORS
INC. AND HER MAJESTY THE QUEEN

PLACE OF HEARING: Regina, Saskatchewan

DATES OF HEARING: December 8 and 9, 2015

REASONS FOR JUDGMENT BY: The Honourable Justice Don R.
Sommerfeldt

DATE OF JUDGMENT: June 24, 2016

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