Docket: 2004-2211(IT)G

BETWEEN:

YVAN LAFONTAINE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on common evidence with the appeal of *Larry St-Pierre* (2004-2219(IT)G), June 1, 2006, at Trois-Rivières, Quebec.

Before: The Honourable Justice Alain Tardif

Appearances:

Counsel for the Appellant:	Pierre Bordeleau
Counsel for the Respondent:	Anne Poirier

JUDGMENT

The appeal from the assessment under the *Income Tax Act* for the 1998 taxation year is dismissed, with costs to the Respondent, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 28th day of February 2007.

"Alain Tardif"

Tardif J.

Translation certified true
on this 29th day of January 2009

François Brunet, Revisor

Citation: 2007TCC89
Date: 20070228
Docket: 2004-2211(IT)G

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REASONS FOR JUDGMENT

Tardif J.

[1] This is an appeal concerning the 1998 taxation year. This issue is whether the capital gain realized by the Appellant's spouse is deemed to be the Appellant's capital gain under subsection 74.2(1) of the *Income Tax Act* (the "I.T.A").

[2] Since the facts are substantially the same in 2004-2211(IT)G (*Yvan Lafontaine*) and 2004-2219(IT)G (*Larry St-Pierre*), the Appellants and the Respondent have indicated that the same evidence would be submitted for both cases, which will however receive separate judgments.

[3] Concerning the determination and confirmation of the assessments being appealed from, the Respondent made the following assumptions of fact:

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(a) The audit division proceeded with the analysis of the various share transactions by Groupe Mégatech (for a better understanding, the transactions are shown in the attached flow-chart, an integral part of this Reply), more specifically, the following companies:

- 9035-3772 Québec inc. (management company of Larry St-Pierre)
- 9035-3756 Québec inc (management company of the Appellant)

- 3101-0119 Québec inc. (Holding owning Mégatech until November 3, 1998).
- Mégatech Électro inc. (after the merger of November 3, 1998).
- Mégatech Électro inc. (before the merger of November 3, 1998).

(b) For all of the transactions and the flow-chart, the class A and AA shares are voting and participating, the others are preferred.

(c) On February 21, 1994, the Appellant and Larry St-Pierre were equal shareholders of 3101-0119 Québec inc. (the "Company");

(d) At the same date, the Appellant held 10 class B shares and 5 class A shares of the Company;

(e) The Company held 20 class A shares of Mégatech Électro inc. ("Mégatech");

(f) On March 21, 1997, the Appellant transferred, pursuant to subsection 85(1) of the *Income Tax Act* (the "Act"), his 5 class A shares and his 10 class B shares of the Company for the respective amounts of $2,800,000 and $5,600,000 payable in shares of the Company, to wit 90 class AA shares and 9,000 class BB shares;

(g) On March 21, 1997, the Appellant transferred, pursuant to subsection 85(1) of the *Income Tax Act*, for an agreed sum of $1, his 90 class AA shares to the management company 9035-3756 Québec inc. ("3756");

(h) On December 18, 1997 (9:30 a.m.), the Appellant, pursuant to subsection 85(1) of the Act, transferred 9,000 class BB shares of the Company in exchange for 5 class D shares and 6 class AA shares of the same Company; the agreed sum used by the Appellant was $300,005;

(i) On December 18 (10:00 a.m.), the Company sold to the management company 3756, 105,000 class A shares of Mégatech for the sum of $250,000 payable by note;

(j) On December 19, 1997, the Appellant transferred to the management company 3756, under subsection 85(1) of the Act, 6 class AA shares of the Company, in exchange for 50,005 class D shares and 1 class A share of 3756;

(k) On March 20, 1998, management company 3756 disposed of 3.84 class AA shares of the Company to Johanne Rufiange, spouse of the Appellant; the sale was for the amount of $510,000 payable by promissory note without interest;

(l) On August 28, 1998 (2:00 p.m.), the class AA shares held by the Appellant's spouse were exchanged for 990,000 class E shares of the Company (redemption value of $990,000);

(m) On November 3, 1998, at the time of the merger of the Company and Mégatech, the 990,000 class E shares held by the Appellant's spouse were converted into 990,000 class B shares of the new company resulting from the merger;

(n) On November 3, 1998, the 990,000 class B shares of the new company held by the Appellant's spouse went to 924593 Ontario Ltd. for $990,000;

(o) The taxable capital gain declared by the Appellant's spouse was $360,000, calculated as follows:

Proceeds of disposition	$990,000
(-) ACB	$510,000
Capital gain:	$480,000
Taxable capital gain (75%)	$360,000

(p) The Appellant's spouse claimed the capital gains exemption against this gain;

(q) The Appellant had previously used nearly all of his capital gains deduction;

THE FACTS:

[4] On March 21, 1997, the Appellant transferred, pursuant to subsection 85(1) of the I.T.A., his class AA shares in 3101-0119 Québec inc. to his management company 9035-3756 Québec inc.

[5] On March 20, 1998, the management company 9035-3756 Québec inc. disposed of 3.84 class AA shares of 3101-0119 Québec inc. to the Appellant's spouse.

[6] On August 28, 1998, the Appellant's spouse exchanged her class AA shares of 3101-0119 Québec inc. for 990,000 class E shares of the same company.

[7] On November 3, 1998, 3101-0119 Québec inc. merged with Mégatech Électro inc. Following this merger, the Appellant's spouse received

990,000 class B shares of the new company in consideration of the conversion of her class E shares of 3101-0119 Québec inc.

[8] On November 3, 1998, the Appellant's spouse disposed of her 990,000 class B shares of Mégatech Électro inc., realizing a capital gain of $480,000.

[9] The Appellant received a notice of assessment in March 2003 attributing to him the capital gain realized on November 3, 1998, by his spouse in the disposition of her class B shares of Mégatech Électro inc.

ISSUES:

The issues are the following:

(1) Can the capital gain realized by the Appellant's spouse be reassigned to the Appellant under subsection 74.2 (1) of the I.T.A.?

(2) Alternatively, is the capital gain realized by the Appellant's spouse deemed to be that of the Appellant under subsection 74.5(6) of the I.T.A.?

(3) Is the exception provided for in 74.5(1) of the I.T.A. applicable in this case?

THE APPELLANT'S SUBMISSIONS:

[10] The Appellant argued that there was no direct or indirect transfer of shares to his spouse; therefore, according to him, there is no possible application of the attribution rules of subsection 74.2 (1) of the I.T.A.

[11] First, he claimed that there was no direct transfer of his shares, since it was his management company, 9035-3756 Québec inc., that transferred the class AA shares to his spouse.

[12] Second, he specified that there was no indirect transfer of his shares either, since the management company's asset base is distinct from his, although he is the sole shareholder; he therefore concluded that he is not the owner of the Company's

property. He cited *Army and Navy Department Stores* v. *Minister of National Revenue*, 53 DTC 1185 in support of his position.

[13] Furthermore, the Appellant stated that article 317 of the *Civil Code of Québec*, that provides for the piercing of the corporate veil, is not applicable because this is not a case of transaction made in bad faith to merge the assets of the Company's shareholders.

[14] Finally, the Appellant argued that subsection 74.5(6) of the I.T.A. does not apply because the transactions that he made between 1996 and 1998 are unrelated to one another. Therefore, according to him, it is not a series of transactions aimed at transferring property.

[15] According to his interpretation, subsection 74.5(6) of the I.T.A. covers transactions that are interrelated and made through a middle man to ultimately benefit the designated person; furthermore, that provision only covers cases where the transfer is conditional upon another transfer, which, according to him is not the case here.

CLAIMS OF THE RESPONDENT'S SUBMISSIONS:

[16] The Respondent argued first of all that the class AA shares were indirectly transferred from the Appellant to his spouse, through the Appellant's management company, and attract the application of subsection 74.2(1) of the I.T.A.

[17] The class B shares constitute property substituted for property transferred by the Appellant within the meaning of subsection 248(5) of the I.T.A.

[18] Alternatively, she submitted that the class AA shares were transferred by the Appellant to a third party. This third party having thereafter transferred these same shares to a specified person, subsections 74.5(5), (6) and (8) of the I.T.A. apply.

ANALYSIS:

[19] Application of the provision of 74.2(1) of the I.T.A.

Subsection 74.2(1) of the I.T.A. reads as follows:

> **74.2.** (1) Where an individual has lent or **transferred** property (in this section referred to as "lent or transferred property"), either directly or **indirectly**, by means of a trust or **by any other means whatever**, to or for the benefit of a person (in this subsection referred to as the "recipient") who is the individual's spouse or common-law partner or who has since become the individual's spouse or common-law partner, the following rules apply for the purposes of computing the income of the individual and the recipient for a taxation year:
>
> (*a*) the amount, if any, by which
>
> (i) the total of the recipient's taxable capital gains for the year from dispositions of property (other than listed personal property) that is lent or transferred property **or property substituted therefor** occurring in the period (in this subsection referred to as the "attribution period") throughout which the individual is resident in Canada and the recipient is the individual's spouse or common-law partner
>
> exceeds
>
> (ii) the total of the recipient's allowable capital losses for the year from dispositions occurring in the attribution period of property (other than listed personal property) that is lent or transferred property or property substituted therefor
>
> shall be deemed to be a taxable capital gain of the individual for the year from the disposition of property other than listed personal property;
>
> [Emphasis added.]

[20] It must first be determined whether the transfer of shares of the management company 9035-3756 Québec inc. from the Appellant to his spouse constitutes a “[transfer] by any other means whatever” within the meaning of subsection 74.2(1) of the I.T.A.

[21] Several decisions deal with the notion of “transfer,” including *Canada* v. *Albert Kieboom*, [1992] 3 F.C. 488, in which Linden J.A. stated in paragraph 18 that the notion of transfer in subsection 74.2(1) of the I.T.A. must receive a broad

interpretation. Lush L.J., in *Gathercole* v. *Smith* (1880-1881), 17 Ch. D.1 (C.A.), stated in page 9 that the word “transferable” includes:

> every means by which the property may be passed from one person to another.

[22] In *Fasken Estate* v. *Minister of National Revenue* [1948] Ex. C.R. 580, Thorson P. stated, at paragraph, 34 that:

> The word "transfer" is not a term of art and has not a technical meaning. It is not necessary to a transfer of property from a husband to his wife that it should be made in any particular form or that it should be made directly. All that is required is that the husband should so deal with the property as to divest himself of it and vest it in his wife, that is to say, pass the property from himself to her. **The means by which he accomplishes this result**, whether direct or circuitous, **may properly be called a transfer**.
>
> [Emphasis added.]

[23] Since the Appellant had 100% control of the management company 9035-3756 Québec inc. and was, therefore, the only one to decide on its actions, I must find that he was the instigator of all of these operations.

[24] The class AA shares that the Appellant held in 3101-0119 Québec inc. were transferred to his management company, to then be transferred to his spouse, between March 21, 1997, and March 20, 1998, which constitutes a transfer “by any other means whatever” within the meaning of subsection 74.2(1) of the I.T.A.

[25] The short time between the two operations and the fact that Mr. Saint-Pierre had full control of his management company lead me to hold that the class AA shares were indirectly transferred by the Appellant to his spouse.

[26] The argument that the Appellant’s first intention was to create personal management companies and to go public rather than benefit his spouse is not pertinent since intent is not a factor for the purposes of subsection 74.2(1) of the I.T.A.

[27] The analysis must be essentially based on the result of the transactions. In other words, the analysis must be done essentially on the basis of what was done and not of what the parties intended to do.

[28] Was the property transferred from the Appellant to his spouse, by any means, and was it direct or indirect, since there is no doubt in this case as to the reality of the transfer?

[29] The Appellant argued that a transfer between two parties necessarily makes one party richer and the other party poorer. The decrease of the Appellant's assets as a result of the transfer of the class AA shares from his asset base and the corresponding increase in the assets of the Appellant's spouse resulting from the transfer to her asset base of these same shares (I will deal with the notion of substituted property further on) indeed took place, even if they were not simultaneous.

[30] Indeed, the time between the two operations is irrelevant, regardless of the shares going through the assets of the management company. The result is the same: the shares came out of the Appellant's assets and increased his spouse's assets; this is the situation provided for in subsection 74.2 (1) of the I.T.A.

[31] It seems important to determine whether the class B shares of the merged company Mégatech Électro inc., which resulted in the capital gain, constituted substituted property within the meaning of paragraph 248(5)(*a*) of the I.T.A. which reads as follows:

> (5) For the purposes of this Act, other than paragraph 98(1)(*a*),
>
> (*a*) where a person has disposed of or exchanged a particular property and acquired other property in substitution therefor and subsequently, by one or more further transactions, has effected one or more further substitutions, the property acquired by any such transaction shall be deemed to have been substituted for the particular property;

[32] To do this, it is important to take into consideration the movement of class AA shares to be able to establish whether they were substituted. At the start, the class AA shares of 3101-0119 Québec inc. belonged to the Appellant; these same shares were then transferred to the management company 9035-3756 Québec inc., which then sold them to the Appellant's spouse.

[33] After their conversion, these shares became class E shares of 3101-0119 Québec inc. Finally, after the merger of 3101-0119 Québec inc. and Mégatech Électro inc., these same shares became class B shares.

[34] These shares indeed constitute substituted property within the meaning of paragraph 248(5)(*a*) of the I.T.A. since, following the series of operations, they were only, in fact, transferred from one asset base to another.

[35] For these reasons, I hold that subsection 74.2(1) of the I.T.A. is applicable.

Application of subsection 74.5(6) of the I.T.A.

[36] Although the appeals must be dismissed on the basis of the application subsection 74.2(1) of the I.T.A., may I also make the following comments:

Subsection 74.5(6) of the I.T.A. reads as follows:

> **74.5** (6) Where an individual has lent or **transferred property**
>
> (*a*) **to another person and that property, or property substituted therefor, is lent or transferred by any person** (in this subsection referred to as a "third party") directly or indirectly to or for the benefit of a specified person with respect to the individual, or;
>
> (*b*) to another person on condition that property be lent or transferred by any person (in this subsection referred to as a "third party") directly or indirectly to or for the benefit of a specified person with respect to the individual,
>
> the following rules apply:
>
> (*c*) for the purposes of sections 74.1, 74.2, 74.3 and 74.4, the property lent or transferred by the third party shall be deemed to have been lent or transferred, as the case may be, by the individual to or for the benefit of the specified person, and
>
> (*d*) for the purposes of subsection 74.5(1), the consideration received by the third party for the transfer of the property shall be deemed to have been received by the individual.
>
> [Emphasis added.]

[37] It must first be pointed out that this section does not prevent the general application of subsection 74.2(1) of the I.T.A., based on paragraph 6 of the decision in *Lipson* v. *R.*, [2006] 3 C.T.C. 2484 (T.C.C.).

[38] The Appellant argued that the multiple transfers have to have been made within a series of interrelated transactions. On reading this section from Interpretation Bulletin IT-511R of the Canada Revenue Agency on this subject (CRA, Interpretation Bulletin IT-511R, “Interspousal and Certain Other Transfers and Loans of Property” (February 21, 1994) para. 8.), there is no basis to hold that there has to be a series of interrelated operations here. All that the provision provides is that the person must have transferred property to a third party and that this third party must have transferred it to a “designated person” within the meaning of subsection 74.5(5)of the I.T.A.:

> (5) For the purposes of this section, "designated person", in respect of an individual, means a person
>
> (*a*) who is the spouse or common-law partner of the individual, or
>
> (*b*) who is under 18 years of age and who
>
> (i) does not deal with the individual at arm's length, or
>
> (ii) is the niece or nephew of the individual.

[39] Indeed, the Appellant’s spouse is a designated person within the meaning of paragraph 74.5(5)(*a*) of the I.T.A.

[40] Moreover, the transfer must have been made by a third party, which is the case here, since the transfer was made through the Appellant’s management company. Indeed, according to article 309 of the *Civil Code of Québec*, S.Q. 1991, c. 64.:

> **309.** Legal persons are distinct from their members. Their acts bind none but themselves, except as provided by law.

[41] As all of the conditions of this provision are met, we have no choice but to hold conclude that subsection 74.5(6) of the I.T.A. is applicable in this case.

[42] Application of the exception provided for in subsection 74.5(1) of the I.T.A.

Subsection 74.5(1) of the I.T.A. reads as follows:

> **74.5.** (1) Notwithstanding any other provision of this Act, subsections 74.1(1) and (2) and section 74.2 do not apply to any income, gain or loss derived in a

particular taxation year from transferred property or from property substituted therefor **if**

(*a*) at the time of the transfer the fair market value of the transferred property did not exceed the fair market value of the property received by the transferor as consideration for the transferred property;

(*b*) **where the consideration received by the transferor included indebtedness:**

(i) **interest was charged** on the indebtedness at a rate equal to or greater than the lesser of:

(A) the prescribed rate that was in effect at the time the indebtedness was incurred, and,

(B) the rate that would, having regard to all the circumstances, have been agreed on, at the time the indebtedness was incurred, between parties dealing with each other at arm's length,

(ii) the amount of interest that was payable in respect of the particular year in respect of the indebtedness was paid not later than 30 days after the end of the particular year, and

(iii) the amount of interest that was payable in respect of each taxation year preceding the particular year in respect of the indebtedness was paid not later than 30 days after the end of each such taxation year; and

(*c*) where the property was transferred to or for the benefit of the transferor's spouse or common-law partner, the transferor elected in the transferor's return of income under this Part for the taxation year in which the property was transferred not to have the provisions of subsection 73(1) apply.

[Emphasis added.]

[43] In this case, as the Appellant’s spouse paid for the class AA shares with an interest-free note, it is impossible to hold that the exception provided for in subsection 74.5(1) of the I.T.A applies to her.

[44] For all of these reasons, the appeal is dismissed. The capital gain realized by the Appellant's spouse must be attributed to the Appellant in accordance with the provisions of subsection 74.2(1) of the I.T.A., with costs to the Respondent.

Signed at Ottawa, Canada, this 28th day of February 2007.

"Alain Tardif"

Tardif J.

Translation certified true
on this 29th day of January 2008

François Brunet, Revisor

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APPEARANCES:

Counsel for the Appellant:	Pierre Bordeleau
Counsel for the Respondent:	Anne Poirier

COUNSEL OF RECORD:

For the Appellant:

Name:	Pierre Bordeleau
Firm:	Lambert Therrien Bordeleau Soucy
City:	Shawinigan, Quebec

For the Respondent:	John H. Sims, Q.C. Deputy Attorney General of Canada Ottawa, Canada