Docket: 2006-2838(EI)

BETWEEN:

GROUPE J.L. LECLERC INC.,

Appellant,

and

THE MINISTER OF NATIONAL REVENUE,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on common evidence with the appeal by
J.L. Leclerc et fils inc. (2006-2840(EI))
on May 30, 2007, at Québec, Quebec.

Before: The Honourable Justice Gaston Jorré

Appearances:

Counsel for the Appellant:	Jérôme Carrier
Counsel for the Respondent:	Christina Ham

JUDGMENT

The appeal under subsection 103(1) of the *Employment Insurance Act* is dismissed and the decision rendered by the Minister is confirmed, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 25th day of March 2008.

"Gaston Jorré"

Jorré J.

Translation certified true
on this 8th day of May 2008.

Elizabeth Tan, Translator

Docket: 2006-2840(EI)

BETWEEN:

J.L. LECLERC ET FILS INC.,

Appellant,

and

THE MINISTER OF NATIONAL REVENUE,

Respondent.

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"Gaston Jorré"

Jorré J.

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on this 9th day of May 2008.

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2006-2840(EI)

BETWEEN:

GROUPE J.L. LECLERC INC.,
J.L. LECLERC ET FILS INC.,

Appellants,

and

THE MINISTER OF NATIONAL REVENUE,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

Jorré J.

Issues

[1] The two cases were heard on common evidence.

[2] The issue is whether the work of Gilles, Michel and Jean Leclerc (the "three brothers") was excluded from insurable employment because of the non-arm's length relationship between the Appellants (the "business").[1]

[3] The Appellants claim that the Minister did not correctly exercise his discretionary power under paragraph 5(3)(*b*) of the *Employment Insurance Act*, in that it was not reasonable to find that the workers and the business would have entered into a similar contract of employment, had they been dealing at arm's length. The periods in question are: from January 1 to August 28, 2004, in the case of J.L. Leclerc et fils inc. and from August 29, 2004, to August 30, 2005, in the case of Groupe J.L. Leclerc inc.

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[1] The respective role of the two Appellant companies, and a numbered company that owns the shares in the Appellants has no impact on the issue in question.

[4] The existence of a non-arm's length relationship is not being challenged.

[5] The Appellants submitted an alternative argument that it was not a contract of employment between the three brothers and the Appellants, but rather a contract for services.

The facts

[6] This is a family business that holds certain buildings, and develops and makes products for markets in the energy and transportation sectors. It had between 100 and 115 employees and sales of close to $12 million for the year ending August 31, 2004, and close to $16 million for the year ending August 31, 2005.

[7] Each of the three brothers received compensation of $950 per week from January 1 to August 31, 2004. From September 1 to December 31, 2004, each brother received a set compensation of $950 per week plus a bonus payment of $43,550. This bonus was for the year ending August 31, 2004. From January 1 to August 30, 2005, each brother received compensation of $1,925 per week, but there was no bonus.

[8] The three brothers were shareholders in the company starting in 1988.[2] The board of directors, during the period in question, was made up of the three brothers and an external administrator, Serge Olivier.

[9] The three brothers worked for the business full time.

[10] During the period in question, Michel Leclerc was the director general; he managed the human resources and was responsible for the business's administration and finances. Gilles Leclerc was the director of operations; he managed operations and inventory, and supervised the foremen and team leaders. Jean Leclerc was the sales director; he worked mainly on the road maintaining good relations with clients and seeking out new clients.

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[2] Michel Leclerc controls 40% of the shares in the numbered company. Gilles and Jean Leclerc each control 30% of the shares in the numbered company. Each brother is a shareholder and controls a family trust that is also a shareholder. The numbered company holds 100% of the business's shares.

[11] There was a council of governors made up of the three brothers, prior to September 2004. In September 2004, they added four members to the council of governors. They were Julie Leclerc (Michel Leclerc's daughter), Pierre Laroche, François Matte, and Jérôme Leclerc (Michel Leclerc's son) (the "four others").

[12] Jérôme Leclerc earned $720 per week in 2004 and was 24 years old; he was the director of finances and marketing. Julie Leclerc earned $675 per week in 2004 and was 27 years old; she was director of continuous improvement. Pierre Laroche joined the company in 1997 as director of production, industrial products division; prior to this, he worked at AMT Marine and Bombardier. François Matte earned $1,035 per week as director of research and development. He was an engineer with 10 years' experience with the research service at the "Jet Boat" division of Bombardier.

[13] The three brothers had more than 25 years' experience leading the business.

[14] Michel Leclerc testified that the seven members of the council of governors were somewhat interchangeable and that, hypothetically, one of the members could have replaced another for a fixed period of time.

[15] Michel Leclerc also said that the position of one of the brothers could have been filled by someone else[3] after a period of adjustment.

[16] The three brothers worked 50 to 60 hours a week, whereas the four other members of the council of governors worked 40 hours a week.

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[3] His testimony was that someone else would have been able to replace one of the three brothers and not that just any member of the council of governors could have done it:

> [TRANSLATION]
> Q. So at that time, I am to understand that the position of director, held by one of the Appellants, could have been filled by someone else?
> A. Absolutely.
> Q. Yes?
> A. Yes.
> Q. Without any problems, or...
> A. Well, there would certainly be a period of adjustment, but...
> Q. Yes.
> A. It could have been done.

[17] Michel Leclerc testified that if the three brothers had only worked 40 hours a week, they may have been required to add one or two members to the council of governors.

[18] The council of governors held meetings once a month.

[19] The Respondent filed an organizational chart of the business as it was before September 1, 2005 (Exhibit I-2, tab M, page 1). On the organizational chart, the three brothers are above the four others, which usually implies that their positions are higher within the business. However, in his testimony, Michel Leclerc explained that it was not a "conventional" organizational chart.[4]

[20] Michel Leclerc also testified that he was a "coach" to Jérôme Leclerc, whose duties were under his responsibility. Similarly, Gilles Leclerc was responsible for Pierre Laroche and François Matte; he was also responsible for continuing improvement (Julie Leclerc).[5]

[21] Gilles Leclerc testified that aside from the three brothers, only Jérôme Leclerc had access to the business's offices outside business hours.

[22] The Appellants presented certain advantages the three brothers had that the four others did not, in particular:

(a) The three brothers were paid better than the other members of the council of governors (see below).
(b) The three brothers had a pension plan, which the four others did not. This plan was set up in 2004, when the business paid between $60,000 and $65,000 for the "buyback of past service" of each of the brothers.
(c) The three brothers had dental insurance, which the four others and other employees did not.
(d) The three brothers had $300,000 life insurance whereas the four others and the other employees only had the amount of their salary in life insurance.
(e) The business provided a car to the three brothers, but not to the other employees.
(f) The three brothers had more vacation time than all the other employees.

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4 Transcript, pages 101 to 105.
5 Transcript, pages 103 to 105.

[23] Michel Leclerc also testified on the compensation of executive managers.[6]

[24] Gilles Leclerc testified that the three brothers had "partnership" life insurance of $2 million paid by the business. The four others did not have this insurance.

[25] Gilles Leclerc's testimony did not explain the nature of this "partnership" life insurance. He did not testify as to who would be the beneficiary.

[26] There is a shareholder agreement (Exhibit I-2, tab I) dated July 21, 2004, that provides for certain obligations between shareholders in case of death (clause 7(b) of the agreement). The agreement also provides for the obligations to take out and maintain life insurance on the other shareholders in order to finance the obligations set out at clause 7(b) (clauses 9 to 11 of the agreement).

[27] Gilles Leclerc's testimony does not clarify whether the "partnership" insurance he spoke of is the same insurance set out in the shareholder agreement. On this, I find that the Appellants did now show that the three brothers were the beneficiaries of $2 million in life insurance *as employees*.

Analysis

[28] The Appellants claim that the employment conditions of the three brothers were very different from those that would have existed if there had been an arm's length relationship between the three workers and the business.

[29] To support this, the Appellants compared the employment conditions of the three brothers (much higher salary and benefits) with those of the four other members of the council of governors.

[30] I agree that the three brothers' employment conditions were very different from those of the four others. However, to decide whether the employment conditions of the four others are a valid basis of comparison, the following question must be examined: were the positions and duties of the three brothers comparable to those of the four others?

[31] The Appellants' position was that if one of the three brothers left for a period of six months to a year, any of the four others on the council of governors would have been able to take his place for a temporary period only.

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[6] Michel Leclerc's testimony, pages 39 to 41.

[32] The evidence does not support this claim. It is possible for one of the other members of the council of governors to replace one of the three brothers for a short period—for example, during a vacation. However, the different degrees of experience, differences in fields of expertise and different training among the seven members are such that it would not be easy to replace any of the three brothers by any of the other members of the council of governors.

[33] Even if this claim had been proved, the fact that a person is able to take over the position does not mean the person's old position is comparable to the new position. For example, a vice president's promotion to president does not show that the position of vice president is comparable in terms of duties and responsibilities.

[34] Therefore the duties and responsibilities of the three brothers and the four others must be compared.

[35] Although the three brothers and the four others are all members of the council of governors and they all have the title of director, an overall review of the evidence leads me to find that the positions are not comparable and the three brothers have positions of a different nature. This is clear, in particular, by the fact that the three brothers work longer hours, that it would be necessary to hire one or two additional people if they only worked 40 hours a week, that they are the only ones—aside from Jérôme Leclerc—with access to the offices outside business hours, and they are—aside from Jean Leclerc—responsible for some of the other members of the council of governors.

[36] Not only are the positions not comparable, but they are also positions with more responsibility and that require more work than those of the four others. It is therefore completely normal for them to be paid better.

[37] The Appellants seem to raise a second comparison,[7] according to which the three brothers could easily have earned more money had they worked for another business.

[38] The way to make such a comparison is described by Archambault J. in *Lacroix v. M.N.R.*, 2007 TCC 81, at paragraphs 40 to 43:

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[7] Transcript, page 111, second paragraph.

40 Does the decision rendered by the Minister via the appeals officer still seem reasonable after hearing the Workers' evidence? Before answering this question, it is important to again analyze the wording of paragraph 5(3)(b) of the Act. What the Minister had to determine was: could it appear reasonable to him that the Workers would have entered into a substantially similar agreement with the Payor if they had been dealing with the Payor at arm's length? It is not a matter of determining whether the work conditions necessarily reflect normal market conditions, although that can generally be a relevant circumstance to be taken into account.

41 I emphasize this nuance because we are dealing with three workers who, at the same time, through their respective holding companies, each own one third of the Payor. They are in a way the indirect owners of the Payor and its business. When paragraph 5(3)(b) of the Act requires that it must be determined whether the contract of employment would have been substantially similar in an arm's length relationship, I believe it must be taken into account that these are three workers who are at the same time the indirect owners of the Payor. Individually, none of the three control the Payor and, therefore, had they not been related, none of the Workers would have been a person related to the Payor within the meaning of the Tax Act and they would then be at arm's length. Indeed, paragraph 5(3)(b) of the Act does not indicate that the financial interests that the workers hold in the company must be ignored. Therefore, it is possible to imagine three workers with no family relation between them, each holding one third of the capital stock of the Payor and remaining at arm's length with the Payor.8 The issue to be determined by the Minister could therefore be expressed as follows: if each of the Workers had held one third of the Payor's shares while remaining at arm's length with the Payor, would they have entered into a substantially similar agreement?

42 It is known in law that workers who are both employees and owners (as shareholders) of the employer behave differently from those who are just employees. Indeed, the remuneration of an employee-shareholder may take into

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[8] It is important to stress the fact that because a person is a shareholder of his or her employer does not necessarily mean that they are not dealing with each other at arm's length. An employer's shares could be held by five or ten employees of that employer. Assuming the shares are distributed equally, none of the shareholders would be able to dictate the Payor's course of action and therefore none of them would be able to control it. In this case, unless there are special circumstances, it could not be concluded either that there is a factual non-arm's length relationship. For a discussion of the existence of a factual non-arm's length relationship between shareholders at arm's length with the company, see Gestion Yvan Drouin Inc. v. The Queen, 2001 DTC 72; [2001] 2 C.T.C. 2315, at paras. 73 et seq. and in particular paras. 80 et seq. In this case, I do not believe that there are any indicators that could demonstrate the existence of a factual non-arm's length relationship between the Workers and the Payor.

> consideration the fact that unpaid wages will become non-distributed profits that may, for example, be declared as dividends at a later date. Moreover, employees often prefer to receive dividends rather than a salary when they are shareholders of their employer because that is often more advantageous for taxation purposes. However, to be entitled to contribute to a registered retirement savings plan, it is necessary (in general) that these employee-shareholders receive a salary. That is the context in which employees work who are also shareholders of their business and the context which the Court must take into account. In this case, it is not surprising to note that the income that the Workers receive from a job may vary from one year to the next. As shareholders, the Workers may consider the financial needs of their company, in particular whether it must face a difficult economic situation.
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> 43 Does the Minister's decision still seem reasonable? Was it reasonable for the Minister to conclude that the worker-shareholders would have entered into a substantially similar contract of employment had they been at arm's length with the Payor? In my opinion, the Workers did not succeed in demonstrating that the Minister's decision seems unreasonable, given the circumstances of this matter. This is not a case where the Court should intervene to substitute its opinion for that or the Minister. If the three Workers had been hired as mere labourers without holding any interests in the Payor, whether as granite workers or machinery maintenance workers, whose work is normally paid by the hour, they would not have accepted, I admit, to work overtime without being paid. However, these are people in positions where the work is not paid by the hour, but rather yearly or at least weekly. It is perfectly normal for workers in such positions to be paid as the Workers were in this case and for them to have a great deal of independence in deciding when to perform their duties. Moreover, due to their involvement as executives of the Payor and as its indirect shareholders, they worked during normal vacation periods. This is perfectly normal behaviour for executives, even when dealing at arm's length with the Payor. However, if one of the Workers had only worked three hours per week throughout the year while receiving the same salary as the others who were working 65, the situation could have been very different. Remuneration determined based on the needs of the employees (supposing this was indeed the case) is also not unusual for workers who are also owners of the Payor. Furthermore, it is perfectly common for an executive to use a credit card (even without a credit limit) for the benefit of his or her employer.

[39] At paragraph 41 Archambault J. phrases the issue to be determined by the Minister as follows: "if each of the Workers had held one third of the Payor's shares while remaining at arm's length with the Payor, would they have entered into a substantially similar agreement?"

[40] In the present case, the facts are slightly different, but the principle is the same; a comparison must be made between the contract of each worker (each brother) who

is a shareholder[9] and who is related to the payor and the contract of employment that would have been entered into in a similar situation, including being a shareholder, by a worker who is not related to the payor.

[41] On this issue, the evidence that was presented is very general and does not lead to the conclusion that persons with an arm's length relationship to the payor would have entered into a similar contract.[10]

[42] As a result, the Appellants have not shown that the Minister's decision is unreasonable.

Alternative argument

[43] The Appellants presented an alternative argument that it was not a contract of employment and, as a result, the three brothers were not insurable.[11]

[44] Although the nature of the three brothers' duties means they undoubtedly have great independence, all their work is dedicated to the business, they are fully integrated into the business, hold high positions and work at the business's offices (except for Jean Leclerc, who is sales director).[12] The three brothers are part of a pension plan set up by the company. There is a contract of employment within the meaning of the *Civil Code of Québec* between the company and each of the brothers.

Conclusion

[45] For all these reasons, the appeal is dismissed.

Signed at Ottawa, Canada, this 25th day of March 2008.

"Gaston Jorré"

Jorré J.

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9 And who controls a family trust that also holds shares in the payor.

10 Michel Leclerc's testimony, transcript: pages 39 to 41.

11 The Notice of Appeal does not raise an alternative argument. There is no objection by the Respondent. I did not decide (i) whether it was relevant to consider the argument or (ii) whether it was necessary to impose conditions should there be a decision to consider the argument.

12 It is totally normal for a sales director to leave frequently. Jean Leclerc travels in a car provided by the employer.

Translation certified true
on this 8th day of May 2008.

Elizabeth Tan, Translator

CITATION:	2008TCC157
COURT FILE Nos.:	2006-2838(EI), 2006-2840(EI)
STYLES OF CAUSE:	GROUPE J.L. LECLERC INC. v. M.N.R., J.L. LECLERC ET FILS INC. v. M.N.R.
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APPEARANCES:

Counsel for the Appellants:	Jérôme Carrier
Counsel for the Respondent:	Christina Ham

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