Docket: 2003-1855(GST)G

BETWEEN:

ARTISTIC IDEAS INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeal heard on September 5, 6, 7 and 8, 2006 and
June 11, 12, 13 and 14, 2007, at Toronto, Ontario

Before: The Honourable Justice B. Paris

Appearances:

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|---|---|
| Counsel for the Appellant: | Irving Marks<br>Shawn Pulver |
| Counsel for the Respondent: | Perry Derksen<br>P. Michael Appavoo<br>(September 5, 6, 7 and 8, 2006)<br>Brianna Caryll<br>(September 5, 6, 7 and 8, 2006) |

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## JUDGMENT

The appeal from the assessment made under Part IX of the *Excise Tax Act*, notice of which bears number 05B 8247 and is dated March 4, 2002, is allowed, in part, with costs, and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 7th day of August 2008.

"B. Paris"

Paris J.

Citation: 2008TCC452
Date: 20080807
Docket: 2003-1855(GST)G

BETWEEN:

ARTISTIC IDEAS INC.,

Appellant,

and

THE MINISTER OF NATIONAL REVENUE,

Respondent.

## REASONS FOR JUDGMENT

Paris, J.

[1] Between November 4, 1998 and January 31, 2001, the Appellant, Artistic Ideas Ltd., ("Artistic") operated what it referred to as an "art donation program". For all intents and purposes the program was a tax shelter[1]. Artistic arranged for Canadian residents to purchase lithographic prints at less than their supposed fair market value from two US vendors and donate the prints to charities and receive a donation receipt for their supposed fair market value. This enabled purchasers paying income tax at the highest marginal rate to claim tax credits for charitable donations in excess of the amount they paid for the prints.

[2] Artistic earned commissions totaling $10,588,970 from it operations during the relevant period. It did not collect GST on the services for which it received the commissions.

[1] The arrangements did not technically meet the definition of "tax shelter" in subsection 237.1(1) of the *Income Tax Act* as it then read because the claims made by purchasers were for tax credits rather than for deductions or losses. The definition was amended effective February 18, 2003 to cover arrangements involving claims for tax credits.

[3] The Minister of National Revenue (the "Minister") assessed Artistic for $741,228 of GST under Part IX of the *Excise Tax Act*, (the "*Act*") on the basis that the commissions were received from the purchasers of the prints for taxable supplies made by Artistic to them in Canada. The Minister also assessed an additional $21,213.72 of GST for a re-supply of art work by Artistic, and disallowed $144,599.89 of input tax credits and imposed a penalty of $99,129.37 under subsection 280(1) of the *Act* on the unremitted GST and the over-claimed input tax credits.

Concessions

[4] The Respondent now concedes that the GST on the re-supply of artwork should be reversed, and that the Appellant is entitled to $52,118,96[2] of the disallowed input tax credits.

[5] The Respondent also concedes that the Appellant was entitled to an allowance under subsection 296(2.1) of the *Act* for GST paid in error of $1,050.00 for the period ending January 31, 2000, and $1,693.30 for the period ending January 31, 2001.

[6] Finally, the Respondent also concedes that if Artistic is found to have received the commissions as consideration for taxable supplies, it would be entitled to offset GST of $110,762.86 that it previously reported against the GST collectible on the taxable supplies in issue[3].

Issues in appeal

[7] The first issue in appeal is whether Artistic was required to collect GST in respect of the services for which it received the commissions.

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[2] The ITCs are to be allowed as follows:
For the period ending January 31, 1999-$16,016.70
For the period ending January 31, 2000-$22,917.69
For the period ending January 31, 2001-$13,184.57

[3] The GST relates to the following periods :
Period ending January 31, 1999 $23,941.32
Period ending January 31, 2000 $56,574.86
Period ending January 31, 2001 $30,246.68

[8] If it is found that Artistic was required to collect GST, the second issue is whether the Minister properly calculated the amount of GST due, and the third issue is whether Artistic is liable for the subsection 280(1) penalty on the amount due.

[9] The final issue is whether Artistic is liable for the subsection 280(1) penalty in respect of the disallowed input tax credits.

Position of the parties

Appellant

[10] The Appellant says that the commissions did not attract GST because they were paid by the US vendors to the Appellant for acting as the vendors' agent arranging for orders for the prints which the vendors supplied to the purchasers outside Canada. The Appellant says that the services to the vendors were therefore zero rated pursuant to section 5 of schedule IV of Part V of the *Act*.

[11] If it is found that any consideration was received from the purchasers, the Appellant says that the services that the Appellant supplied to the purchasers were incidental to the supply of the agent services to the US vendors and should be treated as incidental supplies having the same character as the main supply pursuant to section 138 of the *Act* and therefore would be zero rated supplies.

[12] In the alternative, if any amounts were paid to it by the purchasers, only 5% of the commissions it received would be attributable to services supplied to the purchasers. Also, the Appellant says that the GST was included in the amounts paid.

[13] The Appellant says that it exercised due diligence to ensure it collected and remitted the GST required under the *Act* and is not liable for the penalty.

Respondent

[14] The Respondent says that the commissions were paid to the Appellant by the purchasers of the prints for services supplied to them by the Appellant in Canada. The services were therefore taxable supplies on which the Appellant was required to collect and remit GST in respect of the services supplied to them pursuant to

subsection 165(1) of the *Act*. The supplies to the purchasers were separate and substantial supplies and not incidental to any supplies made to the US vendors. The

GST was not included in the consideration paid to the Appellant by the purchasers, and the penalty was properly imposed.

Witnesses

[15] Seven witnesses gave evidence on behalf of the Appellant: the two directors of the Appellant, Mark Pearlman ("Pearlman") and Allan Grossman ("Grossman"); the Appellant's tax lawyer, Graham Turner; the principal of the U.S. vendor companies; Paul Sloan, ("Sloan") the Appellant's office administrator, Susan Read; an art appraiser retained by the Appellant, Edith Yeomans; and an accountant who prepared the Appellant's financial statements and tax returns, Dan Kowalchuk.

Facts

[16] The Appellant was incorporated in the fall of 1998 by Pearlman and Grossman to operate the art donation tax shelter. The shares of the Appellant were owned beneficially by companies owned by Pearlman's and Grossman's spouses and by a company owned by an unrelated person. Pearlman and Grossman were at all times the only directors. They are both chartered accountants.

[17] Both Pearlman and Grossman gave evidence that the idea of setting up and operating an art donation tax shelter was suggested to them sometime in or around 1997 by Sloan, a resident of Los Angeles, California. Pearlman and Grossman had become acquainted with Sloan in the mid-1990s, and had worked together promoting a software tax shelter named Protosource that was marketed to Canadian taxpayers in 1995 and 1996. That tax shelter was apparently also conceived by Sloan.

[18] According to Grossman and Pearlman, Sloan was aware of certain art donation tax shelters that were being marketed in Canada and he proposed to Pearlman and Grossman that they (i.e. Pearlman and Grossman**)** set up such a tax shelter using lithographic prints that Sloan had left in inventory over from some art galleries that he used to own in the United States. Sloan supposedly had a very large volume of prints available.

[19] Pearlman explained the program in the following terms:

> "The art tax shelter was sort of based on the concept of what we thought the definition of fair market value was or our understanding of the definition of fair market value, being one that would reflect a retail price of something.

> If one could buy something at a wholesale price, if one could buy something at a wholesale price and donate that property, then if the differential between the retail price and the wholesale price was substantial enough, the tax benefit would turn a profit for the person making the purchase and donation."[4]

[20] Initially, Pearlman and Grossman declined Sloan's proposal because they were involved in other projects, and because Pearlman had concerns about the application of the personal-use property provisions of the *Income Tax Act* to art donation tax shelters. Pearlman said that some time later he discussed the technical aspects of the proposed tax shelter with Graham Turner, ("Turner") a tax lawyer with whom he was acquainted, and satisfied himself that the tax shelter was, in fact, technically workable.

[21] Pearlman and Grossman contacted Sloan and said that they were interested in working with him on the deal if he was still interested in supplying the art. Pearlman said that they discussed the need to be able to have art that they could buy for a third of its "retail value" and Sloan assured them that he could provide appraisals to support the required retail values.

[22] Sloan said that in the conversation in which Pearlman and Grossman expressed their interest in doing the tax shelter, they said they could be his agents in Canada, and he said he would give them a 50% commission. He said that the agent/principal relationship was their idea, and he accepted it because that is what they wanted.

[23] According to Pearlman's and Grossman's testimony, their decision to act as Sloan's agent was not made until a later point, after Pearlman and Grossman had consulted again with Turner. First, they said that they began working out the details of their arrangement and "crunching the numbers to see what would work**.**"

[24] Pearlman said that they told Sloan that they wanted to sell the prints in groups of ten and proposed a price to the purchaser of $3,500 which they would

share "50-50" with Sloan. Sloan would provide an appraisal for at least $1,000 per print and pay for shipping the art to Toronto, and Pearlman and Grossman would market the art and find charities to accept the donations. Sloan said that he could work with the proposed arrangement.

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[4] Transcript of proceedings, p. 11

[25] Pearlman and Grossman then met with Turner to discuss the deal and to confirm that he would provide a favorable tax opinion for it. Pearlman said that among other things they discussed he and Pearlman acting as Sloan's agent for selling the art, and also discussed whether GST would be payable on the purchases.

[26] Pearlman said and it was decided that the sale of the prints would take place in the U.S. between Sloan or his companies, and that the purchaser would donate the prints while they were still located in the U.S. This way no GST would be payable by the purchaser, and the prints could be brought into Canada by the charity on a tax-exempt basis. Donations could be made as soon as the purchaser acquired the prints, making it possible to sell the prints right up to the end of the calendar year.

[27] Grossman, Pearlman and Turner also decided that the prints should be sold in groups of eleven so that the buyer could retain one of the prints, in order to "give it more of a flavour of personal-use property."

[28] Turner recalled having met with Pearlman and Grossman about setting up the tax shelter and discussing the GST implications of the deal, and the fees to be paid by Sloan's companies. He said that everything that was done [by Pearlman and Grossman] for Sloan's companies was done in the U.S. "so it was not a GST issue as far as we were concerned."

[29] Grossman said that after discussions with Turner, they told Sloan that the best way to carry out the sales of the prints was for Grossman and Pearlman to act as his agent, that they would market the art program for him and that they would get paid a commission of 50%.

[30] Pearlman and Grossman told Sloan that they wanted him to supply eleven prints for the same price as previously agreed, and that they "still needed 50% of the selling price." They also proposed that, rather than having the buyer pay the sales taxes on the eleventh print when it was imported, Sloan should pay half and they should pay half. Pearlman also said that Sloan agreed to the procedure that he and Grossman were suggesting for the sale of the prints and that Sloan knew that he [Sloan] was selling art to the purchasers and paying a fee to Pearlman and Grossman from the purchaser price.

[31] The agreement between Sloan, Pearlman and Grossman was never put in writing. Pearlman and Grossman said they all trusted one another as a result of their earlier dealings, and did not feel the need for a written contract. Pearlman said that they often did deals on a handshake. On the other hand, Sloan said Grossman was

supposed to come up with a written agreement but never did and that after the first year of operation a comfort level had been established. Turner said that he asked Grossman and Pearlman about drafting a written agreement but they had assured him that they had a deal with Sloan that was not in writing.

[32] In the early fall of 1998 Sloan sent up some prints along with appraisals, but Pearlman and Grossman felt that the appraisals were too high and were not credible. They told Sloan that they wanted to arrange for their own appraisals and they wanted Sloan to pay for them. Once again, Sloan agreed, and Pearlman and Grossman hired Edith Yeomans, ("Yeomans") and a second appraiser, Leslie Finks, to supply the appraisals.

[33] Turner prepared the tax opinion and drafted the agreements to be signed by the purchasers of the prints. In the tax opinion Turner stated that the prints were to be acquired by the purchasers from the US vendors for $3,500 per set. Turner said that there was no provision in any of the documents he drafted for payment of any commission or fee by the purchasers to Artistic because Artistic was selling art as agent for the US vendors and was not involved in a fee-generating process vis-à-vis the purchasers. Both Pearlman and Grossman denied charging any fees or commission to the purchasers.

[34] Grossman found charities willing to accept donations of the prints and give a charitable receipt for $1,000 per print and Pearlman and Grossman incorporated the Appellant**.** They made up some marketing materials, a catalogue of prints to be offered and organized a sales force of commission sub-agents to sell the prints and an office staff to process the orders.

[35] Sloan sent samples of prints to the Appellant for Yeomans to appraise. Prints that she felt had a value of at least $1,000 CND were included in groupings of prints that were offered for sale. Yeomans said that she initially gave verbal assurances regarding the value of the prints and then provided written appraisals after the calendar year end. She said that the work of researching the prints was done prior to giving the verbal assurances of value, and that all that remained to be done was to put the appraisal in writing. Grossman was unable to say whether similar verbal assurances were given by the second appraiser prior to the sale of the prints.

[36] The Appellant began selling the prints in November 1998. Purchasers were required to sign a Purchase Agreement, an order form and an Agency Agreement as well as a Deed of Gift.

[37] The vendor of the prints under the Purchase Agreements entered into in 1998, 1999 and the first half of 2000 was Coleman Fine Arts Ltd. ("Coleman"), a company owned by Sloan. In the latter part of 2000, Silver Fine Arts Ltd. ("Silver"), another company owned by Sloan, became the vendor. No reason was given for this change.

[38] The purchase price was $3,500 per set of eleven prints. This was set out in the order form, which was incorporated by reference into the Purchase Agreement. The price was stated to include GST and PST "where applicable". Pearlman said that was for the GST and PST due on the single print that was to be retained by the purchaser.

[39] The Purchase Agreement also appointed the Appellant as escrow agent for both the vendor and purchaser. As escrow agent the Appellant was required to pay the expenses of the proposed transaction and to hold the payment for the prints until the transfer of the ownership of the prints to the purchaser was confirmed and two bona fide appraisals of the prints valuing each group of prints at not less than $10,000 had been received.

[40] The Purchase Agreement was executed by Grossman on behalf of Coleman, and for the latter half of 2000 on behalf of Silver. Grossman and Sloan both testified that Sloan had given Grossman the authority to sign the agreements on behalf of the vendor companies.

[41] Under the Agency Agreement the purchaser appointed the Appellant as its agent for the purpose of acquiring prints from one or more dealers. The purchaser acknowledged and agreed that the Appellant and all its sub-agents would seek a commission and a fee from the dealers of the prints. The Appellant also agreed "to seek one or more charities, or other institution qualified under the *Income Tax Act* to give donation receipts, and obtain agreement from such charities and or institutions to accept donations and issue charitable receipts satisfactory to the Purchaser."

[42] Under the Deed of Gift the purchaser transferred the prints to a charity chosen from a list supplied by the Appellant. Grossman had previously confirmed with those charities that they would accept gifts of prints arranged by the Appellant. The Deed of Gift also authorized the Appellant to take all steps necessary to complete the transfer.

[43] The charity was required by the terms of the donation to hold the works for at least ten years. This was done in order to circumvent the requirement that a charity disburse 80% of any donation within one year of receiving the donation. An exception to that rule allows charities to build endowment funds, so that where a gift

is directed to be held for a minimum ten year period the charity is exempted from the normal rule and is required to disburse only 4% of the gift in the following year.

[44] The Appellant sent the Deeds of Gift to the respective charities along with a letter setting out the value of the prints and requesting that the charities acknowledge the gift and forward a charitable receipt to the Appellant. The Appellant had arranged with the charities that it would hold on to the receipts until it received the written appraisals confirming the value of the prints and then send them to the purchasers.

[45] The funds received from the purchasers were generally put into a trust account set up by the Appellant, although a few cheques were deposited to other accounts in the Appellant's name. Once payment was received from a purchaser, Grossman said that the Appellant's office staff confirmed the order with Sloan by telephone to ensure he had sufficient stock of the prints that were selected.

[46] Upon confirmation of the order, the Appellant considered that the terms of the escrow clause in the Purchase Agreement had been met, that the purchase was complete and that the Appellant was free to send 50% of the proceeds to the vendor and keep the balance for itself. The Appellant kept the interest on term deposits made with money in this account.

[47] Both Grossman and Pearlman said that they felt that the escrow condition that required two bona fide appraisals was met when they had received two verbal valuations of the prints from the appraisers. They said that they expected that the verbal valuations would be confirmed in writing.

[48] The Appellant offered discounts on purchases made early in the year, and to some purchasers on large sales. Pearlman and Grossman said that in some cases they got Sloan's agreement to split the discount with him and in other cases they absorbed the entire discount out of their commission. Artistic accepted promissory notes in payment for the prints from some purchasers. Grossman said that Sloan was aware that Artistic accepted the promissory notes and shared the risk of non-payment of the notes. Sloan said that he never agreed to accept the risk on the promissory notes.

[49] After year end, the vendor shipped the prints to Artistic's office, where they were inspected, sorted, repackaged and then shipped to the charities, or in the case of the eleventh print, to the purchasers. The Appellant paid the cost of these activities.

[50] Once the written appraisals were received, the Appellant forwarded a copy to the charities. A copy was also sent to the purchasers along with their charitable receipts.

[51] Transfers of funds to Sloan's companies were made at various intervals starting November 20, 1998. After the calendar year end Grossman sent Sloan an accounting showing the number of units sold and any adjustments that reduced the amount due to the vendors. The statement that Grossman sent contained little detail other than an aggregate of sales and adjustments to be made to the vendors' share of the proceeds. The adjustments included items Sloan had agreed to pay or share with the Appellant (such as appraisals, sales discounts, sales taxes, brokerage fees and legal fees and contributions to a legal defence fund for the purchasers.)

[52] Artistic's operations were largely the same in each year. The appraisers worked on continuous stream of prints that were received throughout the year and gave verbal assurances of value, followed by written appraisals after the calendar year end. Finks was replaced by another appraiser in 1999.

[53] Grossman testified that each year Artistic added new charities that would accept donations. At some point, Artistic began paying the charities a fee that was said to be intended to help them defray storage and insurance costs brought about by the ten year holding period for the donations. The fee ranged between $1,000 and $4,000 per million dollars of donations accepted. Grossman said that he probably asked Sloan to pay but he refused. Sloan said he was unaware of payments.

[54] Artistic in certain cases arranged for purchasers to donate the eleventh print they received, thereby increasing their charitable donation tax credit. Artistic did not charge the purchasers for this extra service.

[55] Over the period that the tax shelter was operated, the Appellant earned commissions of $10,588,970. According to Sloan approximately fifty thousand prints were sold.

[56] In the Appellant's financial statements filed with its income tax returns for its taxation years ending January 31, 1999 and January 31, 2000 it originally reported its income on the basis that it was the vendor of the prints, by showing its revenue was from gross sales and deducting an amount for the cost of goods sold. After the GST audit began in 2000, and the CRA auditor showed Pearlman the returns, Pearlman told the auditor that the financial statements and returns were wrong and that the Appellant's income consisted of commissions received from Sloan's companies and

not proceeds from the sale of the prints. Amended financial statements were prepared and amended tax returns were filed even though the error did not ultimately affect taxable income. According to the pleadings of the Respondent, the Minister accepted that the Appellant was not the vendor of the prints**.**

[57] Grossman, who signed the original returns, said that he did not read the financial statements attached to the returns, and relied on the accountant who prepared them. He said that the financial statements were prepared from information given to the accountant by the Appellant's bookkeeper, who mistakenly set up the Appellant's accounting records on the basis that the Appellant was the vendor of the prints. The accountant, Dan Kowalchuk, confirmed that he prepared the financial statements and returns on the basis of the working papers provided to him by the bookkeeper. Grossman said that they had never looked at the records for the Appellant kept by the bookkeeper because he kept his own tracking sheets for the sales.

Appellant's arguments

[58] Counsel stated that all of the evidence showed that Sloan wanted to market his art in Canada under an art donation program and that Artistic agreed to act as his agent to set up the program and to sell the art. Sloan's companies were the vendors of the art, as admitted by the Respondent, and they paid a commission on the sale to Artistic. Those commissions were received for services that were zero rated supplies pursuant to section 5 of Schedule VI of Part V of the *Act*, which reads:

> **[Agent's or representative's service]** — A supply made to a non-resident person of a service of acting as an agent of the person or of arranging for, procuring or soliciting orders for supplies by or to the person, where the service is in respect of
>
> (a) a supply to the person that is included in any other section of this Part; or
> (b) a supply made outside Canada by or to the person.

[59] Counsel said that it was open to the Appellant and US vendors to structure their affairs in such a way as to minimize the amount of tax payable and that tax consequences must be based on the legal character of the relationships as structured, regardless of their economic or commercial substance and the absence of any non-tax purpose for their existence.

[60] The Appellant's counsel submitted that the commissions earned by the Appellant in this case were consideration for acting as the vendors' agent pursuant to an oral agreement between Sloan on behalf of the US vendors and Grossman and

Pearlman on behalf of the Appellant. Counsel said that there was no requirement that the Agency Agreement be put in writing and that the documentary evidence as well as the testimony of Grossman, Pearlman, Sloan and Turner proved the oral agreement was a valid, bona fide agreement and its terms were followed by the parties.

[61] The purchase price for the prints was paid by the purchaser to the Appellant as escrow agent, but belonged to the vendor once the escrow conditions were fulfilled. At that point the vendor could use the money to pay the Appellant its commission. Pursuant to the oral Agency Agreement with Sloan, the Appellant took its commission from the funds and the payment of the commissions was corroborated by year end statements provided to Sloan showing the amount of sales made and the amount of fees paid to the Appellant. Counsel said that it was irrelevant that the Appellant mistakenly filed its returns on the basis that it was the vendor of the prints, since the Minister in these proceedings had accepted that Sloan's companies were the vendors.

[62] Counsel referred to the provision in the Agency Agreement which stated that the Appellant would seek its commission or fee from the dealers from whom the prints were acquired, and said that the Respondent had not met the onus on it to show that that provision was a sham. In addition, he said that the Respondent had neither pleaded nor proved that the agreement between the purchasers and the vendors which set the purchase price of the prints at $3,500 was a sham.

[63] In the absence of any proof that the agreement to pay $3,500 for the prints to the US vendors was a sham, there is no basis for finding that any of the consideration paid by the purchaser's was paid for services provided by the Appellant. There was nothing in any of the documentation or any of the testimony of the witnesses that indicates that the purchaser paid or agreed to pay any fee or commission. On the contrary, the purchaser acknowledged that any commission that was paid would be paid by the dealer.

[64] Counsel also said that the vast majority of the work performed by the Appellant to market the art for sale was carried out prior to any purchaser being identified, such as getting verbal valuations from the appraisers and lining up the charities to accept the donations. This work was necessary to create a market for the artwork so that it could be sold in large quantities. After the sale of the prints, some services were performed by the Appellant for the benefit of the purchasers or charities, but these were minimal and no fees were charged for those services.

Furthermore, the benefit of those services to the purchasers was incidental to the main benefit accruing to the vendors, ensuring ongoing sales of prints.

[65] Counsel referred to the evidence of Grossman that, in his view, less than 5% of the services which the Appellant rendered were for the benefit of the purchasers. Overall, counsel said that any services that benefited the purchasers or charities were subservient or incidental to the services supplied by the Appellant to the US vendors for the sale of the art and paid for by the vendors and that section 138 of the *Act* would therefore apply to deem the supply of any services to the purchasers to be part of the service supplied to the US vendors. Section 138 reads:

> **Incidental supplies** —For the purposes of this Part, where
>
> (a) a particular property or service is supplied together with any other property or service for a single consideration, and
>
> (b) it may reasonably be regarded that the provision of the other property or service is incidental to the provision of the particular property or service,
>
> the other property or service shall be deemed to form part of the particular property or service so supplied.

[66] The Appellant's counsel said that if it is determined the purchasers paid commissions to the Appellant, the consideration should be allocated pursuant to subsection 153(2) of the *Act* which deals with consideration paid for multiple supplies. On the basis of Grossman's testimony, only 5% of the services provided by the Appellant were for the benefit of the purchasers and therefore only 5% of the commissions should be attributed to those services. Subsection 153(2) reads:

> **Combined consideration** -- For the purposes of this Part, where
>
> (a) consideration is paid for a supply and other consideration is paid for one or more other supplies or matters, and
>
> (b) the consideration for one of the supplies or matters exceeds the consideration that would be reasonable if the other supply were not made or the other matter were not provided,
>
> the consideration for each of the supplies and matters shall be deemed to be that part of the total of all amounts, each of which is consideration for one of those supplies or matters, that may reasonably be attributed to each of those supplies and matters.

[67] The Appellant's counsel said that if it is determined the purchasers paid commissions to the Appellant, the GST was included in the commissions that were

paid according to the Purchase Agreement. Therefore, if it is found that any portion of the fee was subject to GST because the purchaser was really paying a fee to the Appellant, that fee would have to be deemed to be inclusive of GST. The Minister's calculation failed to take this into account.

[68] Counsel said that if it is found that the Appellant failed to collect GST, the penalties should be reversed on the grounds that the Appellant acted reasonably and with due diligence to structure its affairs in accordance with legal advice.

Position of the Respondent

[69] The Respondent says that all of the commissions earned by the Appellant from its operations in the period in issue were paid to it by the purchasers for services performed for them. Those services included assisting with purchase of the prints, making the prints available in Canada, arranging for appraisals of the prints and finding charities that would accept them. The services were provided in Canada to persons resident in Canada and therefore they were taxable supplies on which the Appellant was required to collect GST under subsection 165(1) of the *Act*. That provision read at the time:

> **Imposition of goods and services tax** -- Subject to this Part, every recipient of a taxable supply made in Canada shall pay to Her Majesty in right of Canada tax in respect of the supply calculated at the rate of 7% on the value of the consideration for the supply.

[70] The Respondent said that that the provision of the Agency Agreement that provided that the Appellant would seek its commission from the vendors of the prints, and the provision of the Purchase Agreement that the purchase price of the prints was $3,500 were both shams.

[71] Counsel for the Respondent said that:

> Despite the documentation, the $3500 is paid by the donor, the purchaser, and it is split, and half of that represented Artistic's consideration from the donor for the services that it provided and the other half represented the portion that went to Sloan for the artwork.
>
> What was really going on was that A was taking its consideration from the funds paid by the donors, because the donors were paying $3500 for art plus services, and that what they were really buying, is a tax receipt through an art donation program.[5]

[5] Transcript of proceedings, p. 920

[72] In essence**,** the Appellant earned 50% of amount paid by the purchasers which "represented its fee that it received from the donors for operation an art donation program."

[73] Counsel said that the Appellant did not follow the agreements in a number of respects: for example, he said that the Appellant treated the purchase price as its own rather than as funds held in trust. It released funds to the vendors and took money for itself from the purchase funds before two written appraisals were provided for the prints.

[74] Counsel submitted that the evidence showed that Artistic set up the tax shelter infrastructure to serve the purchasers of the prints, and that Artistic did a substantial amount of work for the purchasers to facilitate the acquisition and donation of the prints. It received, inspected, repackaged and shipped the prints, and obtained acknowledgment of donations and receipts from charities and forwarded the receipts to the purchasers. In some cases it arranged the donation of the eleventh print. It was not credible, he said, that Artistic provided these services to the purchasers for free.

[75] Nor was it credible that most of the work in arranging for the donations was done before the purchasers bought the prints or that this work was done for the vendors. He referred to the evidence that showed that Grossman continued to sign up new charities to accept donations throughout the years the shelter operated, and pointed out that Artistic was obligated to do this work for the purchasers pursuant to the Agency Agreement. Despite what Grossman said in cross-examination, this work was not done for Sloan. Counsel said that:

> This was Artistic's art donation program and the only role that Coleman and Silver played was to source the artwork, that the whole purpose of this was to create charitable tax receipt, which is what Artistic was facilitating. There is no reason to for Sloan to be paying a commission when Artistic needed Sloan's artwork for the art donation program Artistic was operating and that it had created.[6]

[76] Counsel for the Respondent also submitted that the Appellant did not act as Coleman's and Silver's agent and there was no agreement by which Coleman and Silver agreed to do so or to pay a commission to Artistic. Counsel said that the Court should reject Sloan's, Grossman's and Pearlman's evidence that an oral Agency Agreement existed between the parties, because they were not credible. Counsel pointed out a number of inconsistencies in their evidence and, in the case of

[6] Transcript of Proceedings, p. 995

Pearlman, inconsistencies between his evidence given at his examination for discovery and at the hearing.

[77] Counsel says that the Appellant has failed to show a bona fide legal relationship of agency existed between Coleman and Silver and Artistic. Even if the Court accepts that there was an agreement between Artistic and Coleman and Silver, the Court should find that it did not create an agent-principal relationship between them because their conduct was not consistent with such a relationship. The labels that the parties use to describe their relationship are not determinative.

[78] Counsel said that the essential ingredients of an agency relationship are:

(i) the consent of both the principal and the agent,
(ii) authority given to the agent by the principal, allowing the former to affect the latter's legal position, and
(iii) the principal's control of the agent's actions.[7]

[79] According to counsel, significant factors in determining whether an agency relationship exists are the risk assumed by the parties and whether there was any obligation on the alleged agent to account for moneys received. He pointed out that in this case that Artistic assumed risk for a part of the purchase price of the prints that was paid by promissory notes by some of the purchasers. He said that if Artistic was acting on behalf of Sloan's companies, one would expect the principal to carry the risk.

[80] Counsel also said that it did not appear that Sloan or his companies exercised control over Artistic in a manner that would indicate that the latter was acting as agent. Counsel said that there was minimal financial accounting made to Sloan, that Sloan was not familiar with the purchase agreement documents that were supposedly signed on his companies' behalf and he said that he did not receive copies of Purchase Agreements. Sloan was also unaware that Artistic was making payments to charities to help defray the cost of storage and insurance. Counsel said that one would expect Sloan to be more rigorous about what his supposed agents were doing on his behalf and about the accounting for profits.

[81] Counsel asked the Court to find that Sloan never intended to create any legal relationship with the Appellant other than to supply prints for the latter's art tax

[7] (*Royal Securities Corp. v. Montreal Trust Co*. (1966), 59 D.L.R. (2nd) 666 (Ont. H.C.) at p. 684).

shelter. He said that Sloan and his companies functioned as an accommodator for the Appellant, and let the Appellant determine all aspects of the relationship, including the price of the prints.

[82] With respect to the calculation of the amount of GST due, counsel said that the reference to GST being included in the sale price would not be determinative, because the payment by the purchasers to the Appellant was a commission and not part of the sale price of the prints.

[83] Counsel for the Respondent submitted that if the Appellant was found to have received consideration from the purchasers for supplies and services made to them, though supplies could not be considered incidental supplies for the purpose of the rule in section 138 of the *Act*. Counsel said that the incidental supply rule only applies to two separate supplies made by the same party, and not to separate supplies made by different parties. In support of this proposition counsel referred to the decision of Lamarre Proulx, J. in *Association Recreative Les Jardins du Château Inc.*,[1994] G.S.T.C. 32.

[84] Even if it were possible to apply the rule to supplies made by two different parties, counsel said that the services Artistic was providing were not simply incidental to the supply of the prints as contended by the Appellant. He said that the whole reason for the donation programs existence was the tax receipt and that the services arranging to obtain a tax receipt were not secondary to the purchase of the art.

[85] With respect to any apportionment of the consideration, counsel said that the evidence showed that the services provided to the purchasers far exceeded 5% of the overall services provided by Artistic.

[86] Finally counsel for the Respondent said that if the written agreements between the purchasers and Artistic are found to be shams, and if Artistic is found not to be the agent for Sloan's companies, the subsection 280(1) penalties should be maintained since the Appellant did not show that it took all reasonable steps to ensure that it complied with the *Act*.

Analysis

[87] Subsection 165(1) of the Act, as it read at the time, requires that GST be charged on the provision of a taxable supply at a rate of 7% of the value of the consideration given for the supply. That provision read:

> **Imposition of goods and services tax** -- Subject to this Part, every recipient of a taxable supply made in Canada shall pay to Her Majesty in right of Canada tax in respect of the supply calculated at the rate of 7% on the value of the consideration for the supply.

[88] The Respondent in this case maintains that the Appellant received commissions or fees of $10,588,970 from the purchasers of the prints as consideration for services the Appellant supplied to the purchasers in Canada.

[89] The Appellant maintains that it did not charge any commissions to the purchasers, that it received its commissions from the US vendors and that any services performed for the purchasers were done for no charge.

[90] It is clear from the evidence that the Appellant did provide services to the purchasers, including locating and arranging for the purchase of the prints, identifying charities to accept donation of the prints, and inspecting and delivering the prints to the charities and to the purchasers.

[91] These were services that the Appellant had agreed to provide to the purchasers under the Agency Agreement and, in my view, the fact that some or most of the arrangements required of the Appellant had already been put in place prior to the signing of the Agency Agreement does not mean that the services were not provided to the purchasers. The services were performed in anticipation of the signing of the Agency Agreement and the purchasers received the benefit of those services.

[92] However, it is also clear from the evidence that the purchasers did not agree to pay anything to the Appellant for those services. The Agency Agreement expressly required the Appellant to look to the dealers from which the prints were acquired for any commission. There is no ambiguity in the wording of the Agency Agreement in this respect.

[93] The Respondent contends that this provision in the Agency Agreement is a sham. This position was advanced for the first time in the Reply to Notice of Appeal, as an additional fact the Respondent was relying on in the appeal. Therefore, the Respondent has the onus of proving sham here.

[94] In order to constitute a sham, there must be a common intention that the rights and obligations created by the documentary evidence are different from the actual rights and obligations contemplated by the parties to the transaction. As Lord

Diplock said in *Snook v. London & West Riding Investments Ltd.*, [1967] 1 All E.R. 518 at 528.

> I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. One thing I think, however, is clear in legal principle, morality and the authorities…that for acts or documents to be a "sham", with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating. No unexpressed intentions of a "shammer" affect the rights of a party whom he deceived.

[95] In this case, there is no evidence of a common intention that the rights and obligations in the Agency Agreement were different than those contemplated by the parties. None of the purchasers were called as witnesses and Grossman and Pearlman both said that the Appellant did not charge the purchasers any fee or commission.

[96] Rather, the Respondent asks the Court to infer that the purchasers must have agreed to pay a fee or commission to the Appellant because of the extent of the services that the Appellant provided to them. The Respondent says that it is not credible that those services were provided for free.

[97] The Respondent also says that the evidence shows that the Appellant did not treat the funds it received from the purchasers as funds held in trust for the vendors and took the commissions from the purchasers funds before the escrow conditions relating to the appraisals were met, and that this is a further indication that the Appellant did not intend to be bound by the agreements.

[98] I do not believe it is necessary to determine whether the Appellant breached any escrow terms of the Agency Agreement because there was no evidence which led to show that the purchasers were ever aware of the alleged breaches or that they consented to the Appellant's conduct. More importantly to the Respondent's sham argument, the evidence did not show that the purchasers did not intend to bind the Appellant to the escrow conditions when they entered into the agreements. At most, the evidence shows that the Appellant did not carry out certain of its escrow obligations in accordance with the agreement, but that this did not affect its overall performance under that agreement and the Purchase Agreement, and no purchaser took issue with the performance in itself. The fact that the purchasers did not take issue with the allege failure of the Appellant regarding the escrow condition cannot be construed as an indication of a sham.

[99] With respect to the Respondent's point that the Appellant provided extensive services to the purchasers, I am not aware of any requirement that the Appellant charge for those services. Furthermore the services were provided in the context of the overall tax shelter operations in order to ensure the ongoing sale of prints from which the Appellant benefited. It was apparent that these arrangements were extremely lucrative for the Appellant, and that it could well absorb the relatively minor cost of the services provided to the purchasers.

[100] In order to show that the purchasers paid fees on commission to the Appellant, the Respondent would have also been required to prove that the purchase price set out in the Purchase Agreement and order forms signed by the purchasers was also a sham. Under that agreement the purchasers agreed to pay $3,500 per set of prints to the US vendors. As I noted above, none of the purchasers were called to testify, and I cannot infer from the remaining evidence that they did not intend to be bound by that agreement, or that the deal to purchase the prints was other than what was contained in the agreement. No provision in those agreements was made for the payment of a commission to Artistic by the purchasers. I conclude that it was not the intention of the purchasers to pay any commission to the Appellant for its services.

[101] For all of these reasons, I find that the Respondent has not succeeded in showing that the agreements entered into by the purchasers or any part of them were shams. Therefore there is no basis on which to find that the commissions received by the Appellant were paid by the purchasers. The transactions entered into by the purchasers with the US vendors and with the Appellant must be accepted as they are found in the Purchase and Agency Agreements. As stated by the Supreme Court of Canada in *Shell Canada Ltd. v. The Queen*[8]:

> . . . absent a specific provision of the Act to the contrary or a finding that they are a sham, the taxpayer's legal relationships must be respected in tax cases. Recharacterization is only permissible if the label attached by the taxpayer to the particular transaction does not properly reflect its actual legal effect.

[102] I also accept the evidence of Pearlman, Grossman and Sloan that the US vendors agreed to pay a commission to the Appellant for acting as their agent in the sale of the prints. This evidence was corroborated by the testimony of Turner, a disinterested witness, whose testimony was not challenged in cross-examination. Turner provided advice on the structuring of the relationship between Artistic and the

[8] [1999] 3 S.C.R. 622 at paragraph 39.

US vendors to minimize tax, and that advice appears to have been acted on by the parties.

[103] I disagree with the Respondent that the Appellant's conduct was inconsistent with an agency relationship between it and the vendors of the prints. There was evidence of consent by the vendors to the Appellant acting as its agent and evidence that the vendors granted the necessary authority to the Appellant to bind it under the Purchase Agreements. The risk under those agreements was on the vendors rather
[104] than on the Appellant which is also consistent with an agency relationship. Only in a few cases did the Appellant take on some risk regarding payment, but this was insignificant in the context of the overall number of prints sold. The Appellant did account to the vendors for the proceeds from the sales and for the vendors' portion of certain shared expenses. It is true that the accounting was rather rudimentary, but it met the requirements of the parties in the circumstances. Sloan said that he was aware of roughly how much was due to the vendors at any point because he kept close track of the number of prints shipped, and had regular discussions with Grossman about the expenses incurred. Overall, the relationship between the Appellant and the US vendors meets the generally accepted definition of "agency" set out by Fridman in *The Law of Agency* ( 7th ed.) at page 11 :

> Agency is the relationship that exists between two persons when one, called the *agent*, is considered in law to represent the other, called the *principal*, in such a way as to be able to affect the principal's legal position in respect of strangers to the relationship by the making of contracts or the disposition of property.

[105] In light of my conclusions above, the only issue that remains to be addressed is the Appellant's liability for the subsection 280(1) penalty in respect of the disallowed input tax credits. After the concession made by the Respondent noted at the beginning of these reasons, there remains the disallowed input tax credits of $92,480.93 for the periods in issue. Although Artistic stated that it was challenging the penalty on the remaining amount, no evidence was led to show that it exercised due diligence in reporting its input tax credits and no argument on the point was presented. Therefore I find that there is no basis for deleting the penalty in this case.

[106] For all of these reasons the appeal is allowed in part, with costs and the assessment is referred back to the Minister for reconsideration and reassessment on

the basis that the Appellant was not required to collect GST on the commissions it received during the period under appeal and on the basis of the concessions set out in paragraphs 4 and 5 of these reasons.

Signed at Vancouver, British Columbia, this 7th day of August 2008.

"B. Paris"

Paris J.

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| REASONS FOR JUDGMENT BY: | The Honourable Justice B. Paris |
| DATE OF JUDGMENT: | August 7, 2008 |

APPEARANCES:

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|---|---|
| Counsel for the Appellant: | Irving Marks<br>Shawn Pulver |
| Counsel for the Respondent: | Perry Derksen<br>P. Michael Appavoo<br>(September 5, 6, 7 & 8 2006)<br>Brianna Caryll<br>(September 5, 6, 7 & 8 2006) |

COUNSEL OF RECORD:

For the Appellant:

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|---|---|
| Name: | Irving Marks and Shawn Pulver |
| Firm: | Robins, Appleby & Taub<br>Toronto, Ontario |

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