Docket: 2007-1971(IT)G

BETWEEN:

BLACKBURN RADIO INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on February 9-10, 2009, at Toronto, Ontario

Before: The Honourable Justice Valerie Miller

Appearances:

Counsel for the Appellant:	Daniel Sandler
Counsel for the Respondent:	André LeBlanc

AMENDED JUDGMENT

The appeal of the reassessment, dated April 13, 2004, of the Appellant's 1999 taxation year is allowed **and the reassessment is vacated** on the basis that the circumstances of this appeal did not permit the Minister of National Revenue to reassess the Appellant beyond the normal reassessment period.

This judgment is issued in substitution for the judgment dated February 27th, 2009.

Signed at Ottawa, Canada, this 17th day of March 2009.

"V.A. Miller"

V.A. Miller, J.

Citation: 2009TCC155
Date: 20090317
Docket: 2007-1971(IT)G

BETWEEN:

BLACKBURN RADIO INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

V.A. Miller, J.

[1] The issues in this appeal are (a) whether the reassessment dated April 13, 2004 was statute barred; and if not, (b) whether the Appellant is entitled to deduct from its income in the taxation year ended August 31, 1999, a Bonus in the amount of $7,621,517 which was paid by Blackburn Group Incorporated ("BGI"), a predecessor corporation of the Appellant, to one of its employees.

[2] In reassessing the Appellant, the Minister of National Revenue (the "Minister"), in error, included the amount of $7,681,517 in the Appellant's income.

[3] The Blackburn Group Inc. ("TBGI") and its successor corporation, BGI, were located in London, Ontario and carried on business as private equity investment management companies. I will hereinafter refer to TBGI and BGI as the Appellant. The Appellant is a Canadian-controlled private corporation.

The Corporate Group

[4] Between 1993 and 1999, the Appellant owned all or a majority of the shares of various operating companies in two lines of business: media and information services. The Appellant earned its revenues from management fees, dividends and gains from the sale of its investments.

[5] Although the Appellant was a family company, its Board of Directors ("the Board") consisted of non-family members who had diverse backgrounds and expertise. Mr. Bruce Pearson, a management consultant, testified that he was a member of the Board from 1982 to 2007. He held various positions with the Appellant and in 1992 he became Chairman of the Board and CEO of the company. He described the expertise of the members of the Board and the workings of the Board. He stated that the Board was very active in all of the Appellant's businesses. It kept control of all funds. It met quarterly and made all decisions with respect to the Appellant's business, including which investments should be pursued, strategic management of the investments, budgeting for the investments and divestiture of the investments.

[6] This appeal involves the companies which were in the business of information services. In particular, it involves companies called Blackburn Marketing Services (US) Inc. and Carfax. I will describe the corporate events that gave rise to the relationship between these companies.

[7] Prior to August 1993, the Appellant held 100% of the shares in two U.S. domestic corporations, Urban Decision Systems ("UDS") and Blackburn Marketing Services (U.S.) Inc. which operated under the name of National Research Bureau ("NRB"). NRB owned approximately 85% of the shares of Carfax, and VRH Inc. ("VRH") was a wholly-owned U.S. subsidiary of Carfax. On August 31, 1993, the Appellant incorporated Blackburn Marketing Services Holdings Inc. ("BMSI Holdings"), a United States (U.S.) domestic corporation. On the same day, it transferred its shares in UDS and NRB to BMSI Holdings in exchange for shares of BMSI Holdings. A diagram which shows this relationship is attached to these reasons as Appendix "A".

[8] Bruce Pearson stated that the shares were placed in BMSI Holdings so as to create a consolidated group for U.S. corporate income tax purposes. It was his evidence that some of the U.S. companies were operating at a profit but Carfax was operating at a loss. Once the shares were placed in BMSI Holdings, there was only one corporate tax return that had to be filed in the U.S.

[9] On November 2, 1993, NRB sold shares of Carfax to an arm's length party, R.L. Polk & Co. Ltd. ("Polk (US)"), so that the ratio of shares between NRB and Polk (US) was 65:35. A diagram which shows this transaction is attached to these reasons as Appendix "B".

[10] On January 7, 1997, UDS and all of the assets of NRB (except the shares of Carfax) were sold to arm's length parties. On August 31, 1997, NRB was merged/liquidated into BMSI Holdings. The legal entity thus merged retained the name Blackburn Marketing Services (US) Inc. ("BMSI (US)"). Consequently the shares of Carfax previously held by NRB became held by BMSI (US). A diagram which shows this relationship is attached as Appendix "C".

[11] BMSI (US), like its predecessor BMSI Holdings, did not have any employees and did not carry on business. It did have a board of directors but it was the evidence of all witnesses, that the board had no independent decision-making authority with respect to the companies whose shares it held. All decisions with respect to the BMSI companies were made by the Board of the Appellant.

Long-term incentive Plan

[12] William D. Goldstein was employed by the Appellant since 1989. He stated that his duties included finding investment opportunities for the Appellant, negotiating and completing the investments and providing general supervision and management of those investments. He was also responsible for finding profitable ways for the Appellant to sell the investments. His duties were assigned to him by the Board and the decision to purchase or sell an investment was made by the Board.

[13] Pearson testified that Goldstein wanted to get away from the day-to-day operations of the business. After 4 years of negotiations, the Appellant and Goldstein signed an Employment Agreement (the "Agreement") on September 1, 1993. In that Agreement, the Appellant agreed to provide Goldstein's services to the BMSI companies.

[14] In accordance with the Agreement, Goldstein received an annual salary and benefits from the Appellant. He was also entitled to incentive compensation in accordance with both a short-term incentive plan and a long-term incentive plan. The purpose of the incentive compensation plan was to "reward Goldstein based on the short-term performance of the BMSI companies, as well as the long-term appreciation in the value of the BMSI companies." The long-term incentive payments to Goldstein were described as performance units that could be redeemed

for 12% of the increase in value of the Appellant's share of all BMSI companies subsequent to August 31, 1993. The right to receive the long-term incentive payments was triggered by the occurrence of certain events including, the sale of the Appellant's interest in any of the BMSI companies.

[15] Goldstein stated that from his point of view, the long-term incentive plan was the main part of the Agreement as the Appellant did not offer an employee stock option plan and he received only an annual salary and a few short-term benefits.

[16] Pearson stated that Goldstein was given the long-term incentive plan because his duties included finding opportunities for investment, monitoring the investments and insuring that if the investment was not successful, the loss suffered by the Appellant would be minimal. It was his opinion that Goldstein "did the job brilliantly".

[17] It was the evidence of both Pearson and Goldstein that the investment and management services provided by Goldstein under the Agreement were always provided to the Appellant and not to BMSI Holdings or BMSI (US).

Management Services Agreement

[18] On November 2, 1993, the Appellant entered into a Management Services Agreement (MSA) with BMSI (US), Carfax and VRH whereby the Appellant would perform general management services, financial and accounting services, human resource and payroll services as well as certain other administrative and corporate services for Carfax and VRH. The MSA provided a method for calculating the cost that would be charged to Carfax and VRH for the provision of the services. The MSA specified that Goldstein and another executive of the Appellant, would be responsible for the general supervision and management of the operations of Carfax and VRH. As compensation for the services of senior management (which included Goldstein), the Appellant agreed to charge no more than $190,000 annually. It was Goldstein's evidence that he provided strategic management only, and not the day-to-day management of Carfax and VRH.

[19] The MSA provided for a charge that would have been used toward the short-term incentive plan of Goldstein. There was no evidence as to whether or not any amount was ever paid to the Appellant that would be used for the short-term incentive. There was no charge in the MSA that related to the long-term incentive plan that the Appellant provided to Goldstein.

[20] Pearson stated that Polk (US), who owned 35% of Carfax, was not only aware of the MSA but that he actively participated in its negotiation. It was his evidence that Polk (US) would not agree to Carfax making any contribution towards the long-term incentive plan with Goldstein. By way of a letter dated, October 7, 1993, Pearson reassured Stephen Polk, the owner of Polk (US), that the long-term incentive plan with Goldstein would "not impact on you …as it will only apply to the (Appellant's) share of the value of those assets".

[21] Pearson testified that Polk (US) and Carfax were in the same business. He said that Stephen Polk knew that when the Appellant was ready to sell its shares in Carfax, Goldstein would probably set up a competition between Polk (US) and a third party for those shares. Stephen Polk knew that there would be a conflict situation as Goldstein would always put the Appellant's interest first. As it turned out, Stephen Polk was correct.

Sale of Carfax

[22] On July 30, 1999, BMSI (US) sold its shares in Carfax to Polk (US). This sale triggered the payment of a long-term incentive bonus in the amount of $7,681,517 (the "Bonus") to Goldstein. It was the evidence of all witnesses that the sale of Carfax shares required the approval of the Board and that the board of directors for BMSI (US) had no involvement in the decision.

[23] The capital gain resulting from the sale was reported by BMSI (US) in the US. The Appellant reported the Bonus as an expense and deducted only the amount of $7,621,517 from its income. Goldstein testified that he reported the Bonus in his income and paid taxes on it. At all relevant times, Goldstein was a resident of Canada.

[24] The Minister reassessed the Appellant by notice dated April 13, 2004 for its taxation year ending August 31, 1999 by adding back the entire Bonus on the basis that it was an expense incurred on behalf of a related non-resident corporation. In the Reply to the Fresh Amended Notice of Appeal, the Respondent submitted the following:

> 19. He further submits that the Incentive Payment, calculated on the value of the increase of BMSI(US)'s investment, is directly related to capital gains realized by BMSI(US) on the sale of shares in Carfax. Accordingly, the Incentive Payment deducted by the Blackburn Group Incorporated in its 1999 taxation year did not relate to Blackburn Group Incorporated and should be allocated to and reimbursed by BMSI(US) and/or Carfax.

> 20. He further submits that from 1993 to 1999, Mr. Goldstein, as an employee of The Blackburn Group Inc. and Blackburn Group Incorporated, was in charge of managing and building businesses and investment portfolios including Blackburn Polk Marketing Services Inc. and several US companies, notably, Carfax, that were owned by BMSI(US). Whether or not separate employment contracts or management services agreements existed, by virtue of the provisions of Mr. Goldstein's services to Carfax, the value of the shares in Carfax held by BMSI(US) increased such that the capital gains were realized by BMSI(US) on the disposition of shares in Carfax. Based on this fact, he submits The Blackburn Group Inc. and Blackburn Group Incorporated transacted with BMSI(US) to provide services to, *inter alia*, Carfax. Furthermore, under the Management Services Agreement, The Blackburn Group Inc. and Blackburn Group Incorporated transacted with *inter alia*, Carfax, to provide the services of senior managers, including Mr. Goldstein's, to Carfax. Accordingly, he submits that The Blackburn Group Inc. and Blackburn Group Incorporated transacted with non-arm's length, non-resident parties, namely BMSI(US) and Carfax, in reference to the provision of Mr. Goldstein's services to Carfax, on terms or conditions made or imposed, in respect of the transactions that differ from those that would have been made between persons dealing at arm's length, for purposes of paragraph 247(2)(a) of the Act.

Issues

[25] The first issue that must be determined is whether the reassessment dated April 13, 2004 was out of time. The Appellant was initially assessed for its taxation year ended August 31, 1999 by notice dated March 24, 2000. The normal reassessment period expired on March 24, 2003. The Minister reassessed beyond the three year normal reassessment period on the basis that the extension in subparagraph 152(4)(*b*)(iii) of the *Income Tax Act* (the "Act") applied in this situation. The relevant statutory provisions are paragraph 152(3.1)(*b*) and subparagraphs 152(4)(*b*)(iii) and 152(4.01)(*b*)(iii) which read:

> **(3.1) Definition of "normal reassessment period"** -- For the purposes of subsections (4), (4.01), (4.2), (4.3), (5) and (9), the normal reassessment period for a taxpayer in respect of a taxation year is
>
> (…)
>
> (*b*) in any other case, the period that ends 3 years after the earlier of the day of mailing of a notice of an original assessment under this Part in respect of the taxpayer for the year and the day of mailing of an original notification that no tax is payable by the taxpayer for the year.
>
> (…)

> **(4) Assessment and reassessment [limitation period]** -- The Minister may at any time make an assessment, reassessment or additional assessment of tax for a taxation year, interest or penalties, if any, payable under this Part by a taxpayer or notify in writing any person by whom a return of income for a taxation year has been filed that no tax is payable for the year, except that an assessment, reassessment or additional assessment may be made after the taxpayer's normal reassessment period in respect of the year only if
>
> (…)
>
> (*b*) the assessment, reassessment or additional assessment is made before the day that is 3 years after the end of the normal reassessment period for the taxpayer in respect of the year and
>
> (…)
>
> (iii) is made as a consequence of a transaction involving the taxpayer and a non-resident person with whom the taxpayer was not dealing at arm's length,
>
> **(4.01) Assessment to which para. 152(4)(*a*) or (*b*) applies** -- Notwithstanding subsections (4) and (5), an assessment, reassessment or additional assessment to which paragraph (4)(*a*) or (*b*) applies in respect of a taxpayer for a taxation year may be made after the taxpayer's normal reassessment period in respect of the year to the extent that, but only to the extent that, it can reasonably be regarded as relating to,
>
> (…)
>
> (*b*) where paragraph (4)(*b*) applies to the assessment, reassessment or additional assessment,
>
> (…)
>
> (iii) the transaction referred to in subparagraph (4)(*b*)(iii),

[26] In *SMX Shopping Centre Ltd. v. R.*[1], Sharlow J.A. discussed section 152 of the Act and at paragraphs 18 and 24 she stated the following:

> 18 Subparagraph 152(4)(*b*)(iii) asks whether there is reason, "as a consequence of a transaction involving the taxpayer and a non-resident person with whom the taxpayer was not dealing at arm's length," to assess or reassess the taxpayer's tax for any relevant taxation year. If the answer is yes, the reassessment can be made within the extended reassessment period but, according to paragraph

> 152(4.01)(*b*)(iii), only to the extent that the reassessment may reasonably be regarded as relating to the transaction referred to in subparagraph 152(4)(*b*)(iii).
>
> (…)
>
> 24 In the context of subparagraph 152(4)(*b*)(iii) of the *Income Tax Act*, the word "transaction" must be interpreted to include a transaction that the taxpayer alleges forms the factual foundation for a deduction claimed in an income tax return. Thus, for example, if a taxpayer claims to be entitled to a deduction for a particular expense it has paid, and the payment of the expense (assuming it occurred), would have involved the taxpayer and a non-resident person with whom the taxpayer was not dealing at arm's length, the Minister has the legal authority to reassess within the extended reassessment period to disallow the deduction. That legal authority does not disappear if the taxpayer later denies that the expense was paid, or fails to prove that it was paid.

[27] It is the Respondent's position that the reassessment is as a consequence of all the transactions which gave rise to the Bonus. These transactions involved the Appellant, BMSI (US), a non-resident, and Goldstein. At paragraph 30 of his Written Representations, Counsel for the Respondent wrote:

> 30. In addition, since the directing mind is the same for both the appellant and the US Sub, the corporate decision to reward Mr. Goldstein by redeeming 12% of the increase value of the shares sold by the US Sub using the funds of the appellant constitutes a transaction or a series of transactions which for all purposes resulted in $7,681,517 of the appellant's income to be voluntarily transferred to the US Sub.

[28] At the discovery of the Respondent's representative, counsel for the Appellant asked 'what was the "transaction" between the Appellant and BMSI (US) that the reassessment is a consequence of?' The question was taken under advisement and the response was given in writing as:

> The provision of Mr. Goldstein's ongoing strategic services by Blackburn Group Incorporated to BMSI (US) to increase the value of its US holdings without receiving any compensation from BMSI (US) for the long-term incentive amount (an amount that was tied directly to the increase in value of BMSI (US)'s holdings) that Blackburn Group Incorporated paid to Mr. Goldstein.

[29] Counsel for the Respondent relied on the decision of Justice Thurlow in *Minister of National Revenue v. Granite Bay Timber Co.*[2] to state that the word "transaction" was wide enough to include an arrangement. In conclusion on this issue, counsel stated that by virtue of subsection 247(11) of the Act, the definition of the word "transaction" in section 247 applies to that word as it is used in subparagraph 152(4)(*b*)(iii).

[30] First, I disagree that the definition of the word “transaction” in section 247 applies to that word as it is used in section 152. The relevant subsections in 247 read as follows:

> **247. (1) Definitions** -- The definitions in this subsection apply in this section. **"transaction"** includes an arrangement or event.
>
> **(11) Provisions applicable to Part** -- Sections 152, 158, 159, 162 to 167 and Division J of Part I apply to this Part, with such modifications as the circumstances require.

[31] From the preamble in subsection 247(1), it is clear that the defined terms in that subsection apply only to section 247. Also subsection 247(11) ensures that the assessment, payment, penalty, refund, objection and appeal provisions in Part I of the Act apply to Part XVI.1[3]. Its reference to sections in Part I of the Act does not import all of the defined terms in section 247 into those sections in Part I of the Act.

[32] Second, it is my opinion that the word “transaction” as it is used in subparagraph 152(4)(*b*)(iii) does not include an arrangement.

[33] The word “transaction” is defined in both sections 245 and 247 to include an arrangement or event. In *Canadian Pacific v. R*[4]., Sexton J.A. said the following:

> By the definition in subsection 245(2) a transaction includes an arrangement or event. Thus the definition of transaction is extended to include circumstances that would not strictly be considered to be a transaction within the normal meaning of that term.

[34] Based on the above and using a textual, contextual and purposive approach[5] to the interpretation of the word “transaction” in subparagraph 152(4)(b)(iii), I conclude that it does not include an arrangement. It is also my opinion that the word “transaction” in subparagraph 152(4)(b)(iii) does not include a series of transactions. If the Act had intended that a series of transactions would be included, it would have specifically stated it as it did in other sections such as the Avoidance Transaction section.[6]

[35] There is no general definition of the word “transaction” in section 248 of the Act but it is defined in the Canadian Oxford Dictionary as follows:

> 1 a. a piece of esp. commercial business done; a deal (*a profitable transaction*).
> b. *N Amer*. = TRADE 4b.

> c. the management of business etc.
> 2. (in *pl*.) published reports of discussions, papers read, etc., at the meetings of learned society.

[36] The "transaction" described by the Respondent (see paragraph 28 above) did not take place. Rather, Goldstein's investment services were provided to the Appellant and his supervisory services were provided to Carfax. These were different hats that Goldstein wore. The Bonus paid to Goldstein related to the investment services that he provided to the Appellant.

[37] The question now becomes whether in the 1999 taxation year, there was a transaction or a piece of commercial business done between the Appellant and a non-resident person with whom the Appellant was not dealing at arm's length.

[38] In this appeal, there was evidence of three transactions that took place in 1999. In the first transaction, the Appellant made the decision that BMSI (US) would sell its shares in Carfax. In the second transaction, BMSI (US) sold its shares in Carfax to Polk (US). The Appellant was not a party to this transaction. As counsel for the Respondent argued, BMSI (US) was a legal entity and it was the legal owner of the shares in Carfax. In the third transaction, the Appellant paid Goldstein the Bonus.

[39] In the circumstances of this appeal, the reassessment was made as a consequence of the payment of the Bonus by the Appellant to Goldstein. However, Goldstein was an arm's length employee of the Appellant and he was a resident of Canada. It is my opinion that subparagraph 152(4)(*b*)(iii) of the Act did not permit the Minister to reassess the Appellant's 1999 taxation year within the extended reassessment period.

[40] As this decision will resolve the appeal, I will not comment on the transfer pricing issue which was also raised.

[41] The appeal is allowed with costs.

Signed at Halifax, Nova Scotia, this 17th day of March 2009.

"V.A. Miller"

V.A. Miller, J.

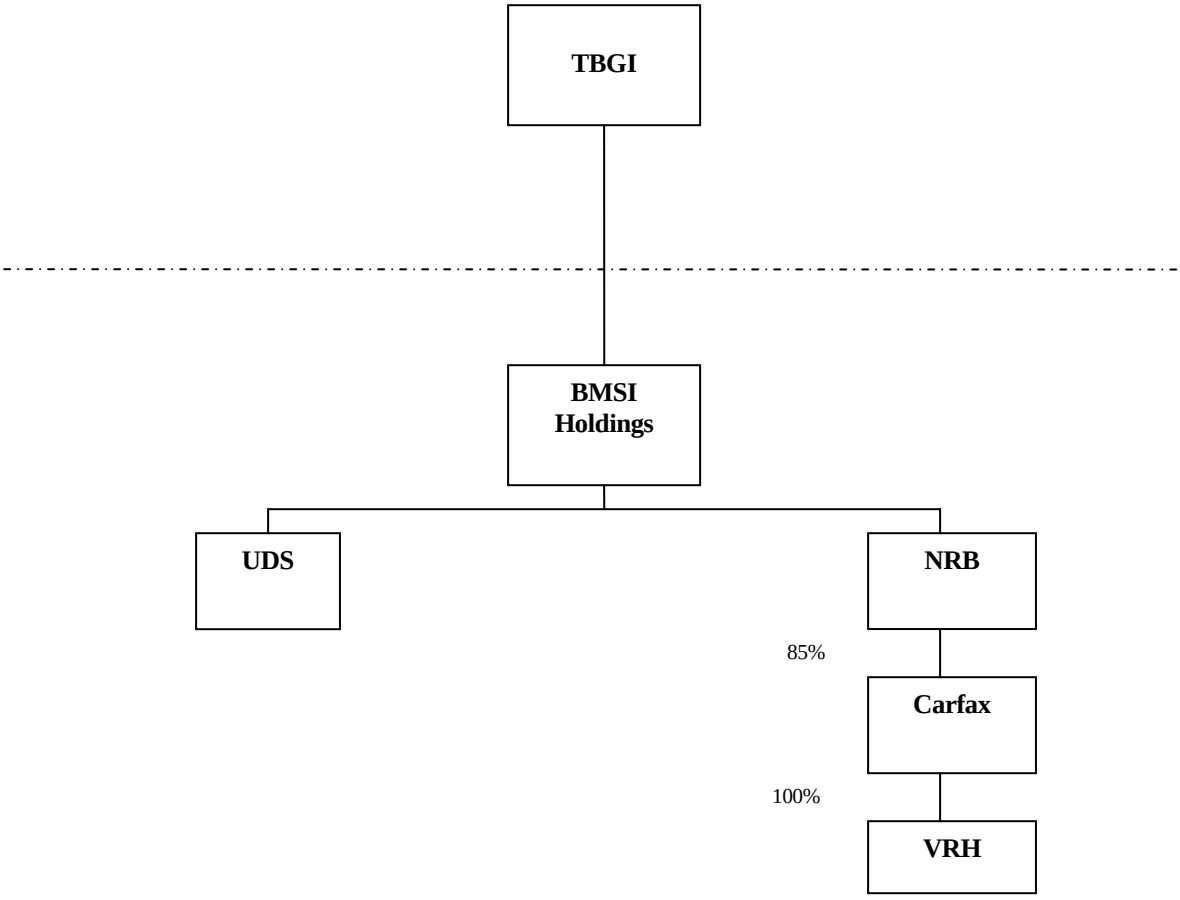
[1] 2003 FCA 479

[2] 58 D.T.C. 1066 (EX. Ct.)
[3] Canada Tax Service, 247-26
[4] 2001 FCA 398
[5]Imperial Oil Ltd. v. Canada, 2006 SCC 46
[6] See for example, sections 183.1, 188.1, 233.1, 245 and 247 of the Act.

Appendix A

August 31, 1993

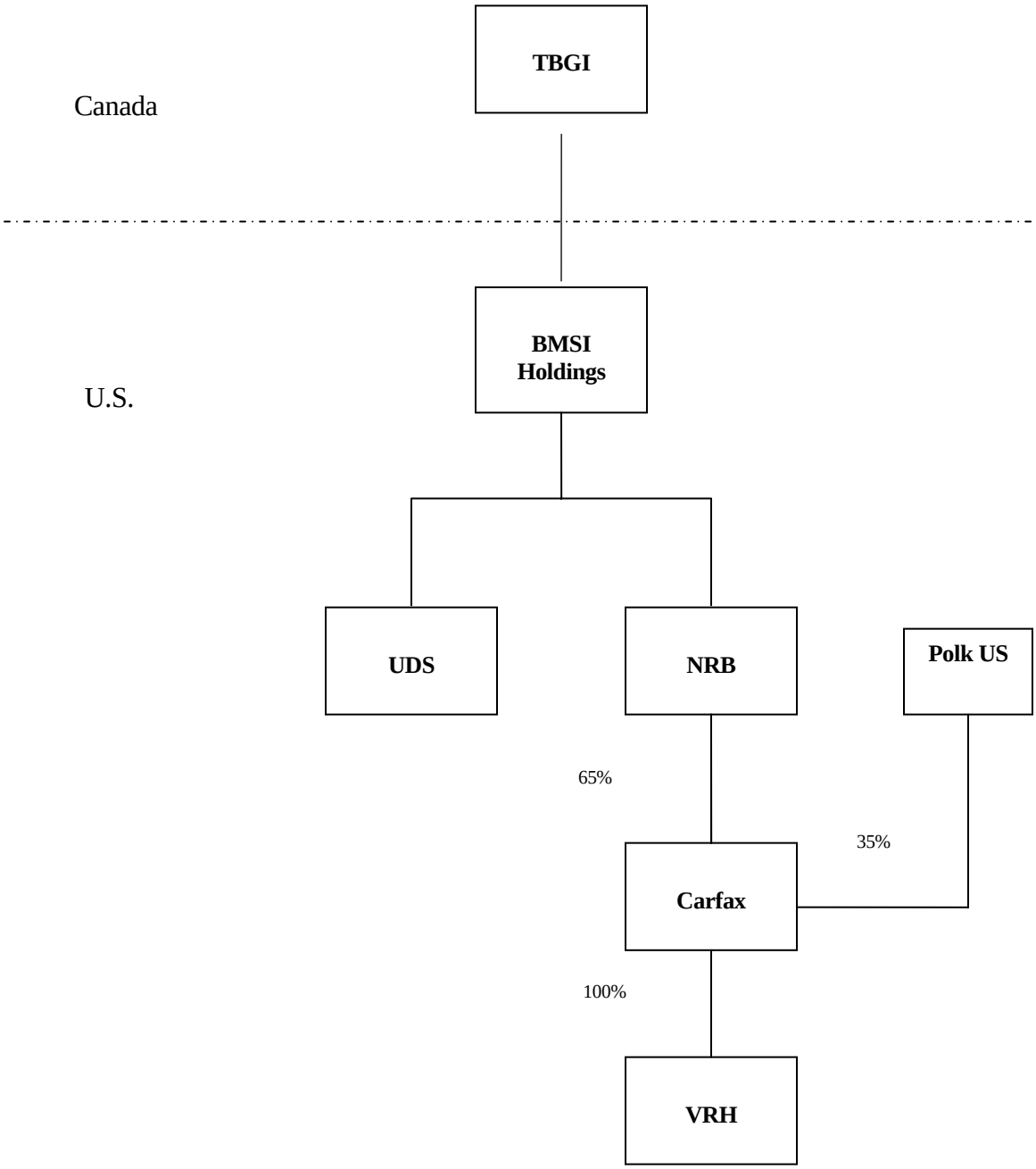
Canada



USA

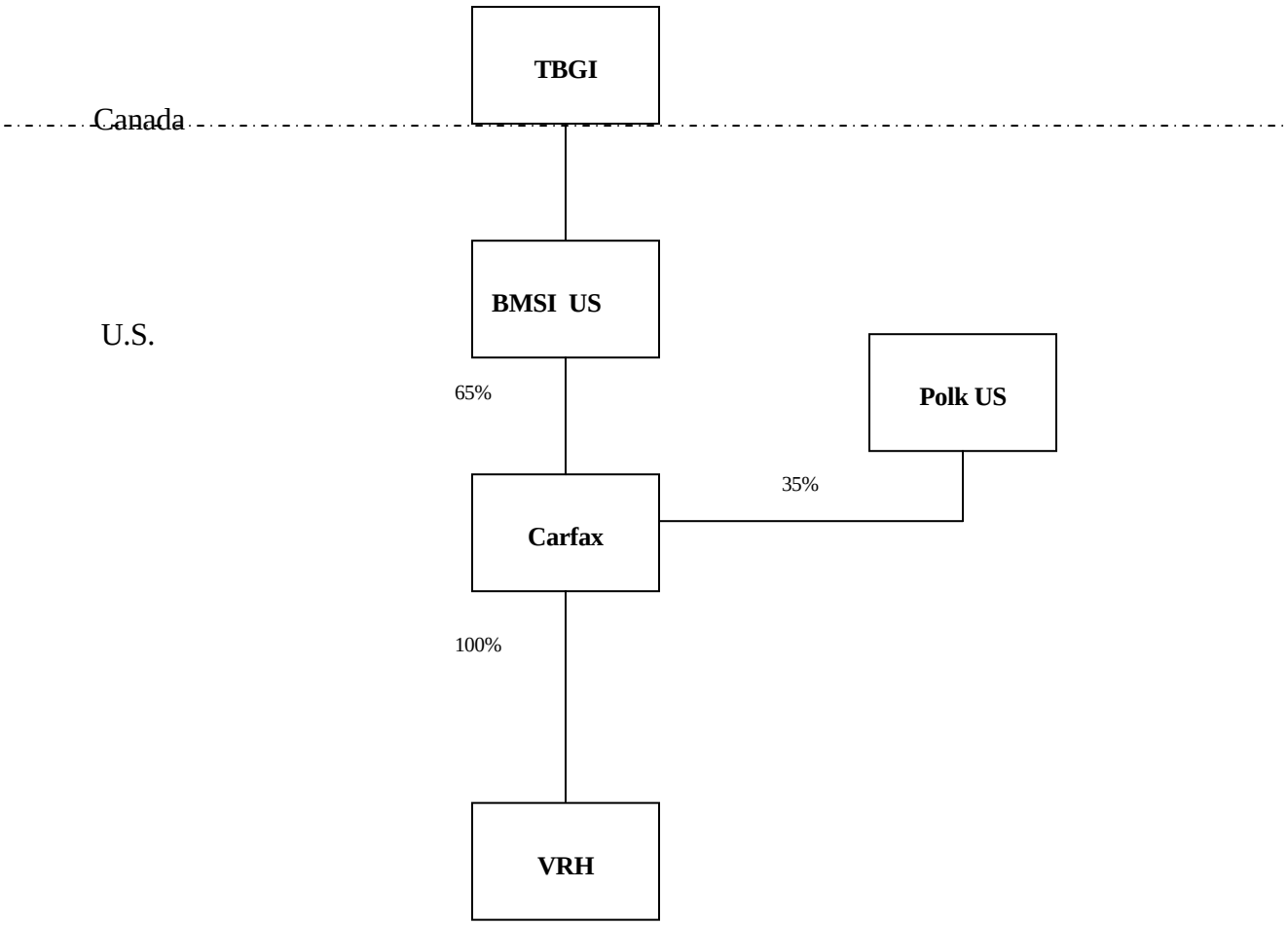
Appendix B

November 2, 1993



Appendix C

September 1, 1997



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DATE OF JUDGMENT:	February 27, 2009
DATE OF AMENDED JUDGMENT:	March 17, 2009

APPEARANCES:

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