Docket: 2007-2678(IT)G

BETWEEN:

1143132 ONTARIO LIMITED,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on May 15, 2008, at Toronto, Ontario.

Before: The Honourable Justice Gaston Jorré

Appearances:

Counsel for the Appellant: Paul L. Schnier

Counsel for the Respondent: Donald G. Gibson

JUDGMENT

The appeal from the reassessments made under the *Income Tax Act* for the 1999, 2000, 2001, 2002, 2003 and 2004 taxation years is dismissed, with costs to the Respondent, in accordance with the attached reasons for judgment.

Signed at Ottawa, Canada, this 25th day of September 2009.

"Gaston Jorré"

Jorré J.

Citation: 2009 TCC 477
Date: 20090925
Docket: 2007-2678(IT)G

BETWEEN:

1143132 ONTARIO LIMITED,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Jorré J.

INTRODUCTION

[1] The Appellant manufactured equipment and distributed related advertising materials. Its sales were to customers in Canada and the United States.

[2] Sales to the U.S. were channeled through a company incorporated in Barbados referred to in this judgment as "Barco". The Appellant sold its products to Barco. Barco then sold the products to the U.S. customers.

[3] The Minister of National Revenue (the "Minister") reassessed the Appellant's 1999 to 2004 taxation years on the basis that the transfer price between the Appellant and Barco should be adjusted. The reassessments for the 1999 to 2002 years were made more than three years but less than six years after the initial assessment. In assessing the Minister relied on subparagraph 152(4)(*b*)(iii) and subsection 247(2) of the *Income Tax Act* (the "*ITA*").

FACTS

[4] At trial, no witnesses were called.

[5] The Respondent served a request to admit on the Appellant. The Appellant did not reply and, pursuant to subsection 131(2) of the *Tax Court of Canada Rules (General Procedure)* (the "*Rules*"), the Appellant is deemed to admit the facts.

[6] The facts in the request to admit are the same as the assumptions pleaded in the Minister's reply.

[7] Consequently, the facts in this appeal are:

a) The Appellant was incorporated in Ontario on 20 September 1995, and carried on business under the name Pro-Tect Plastic.

b) 2007336 Ontario Inc. ("Holdco") was incorporated in Ontario on 3 December 2001 and, at all material times, its shares were owned 50 percent by Jim Swales ("Swales") and 50 percent by his spouse Nancy Hunter ("Hunter").

c) At all material times, the shares of the Appellant were owned 50 percent by Swales and 50 percent by his business associate Tom Medland ("Medland"), then 50 percent by Holdco and 50 percent by a corporation owned by Medland, and finally 100 percent by Holdco.

d) At all material times, the Appellant, Holdco, Swales, Hunter, Medland and the corporation owned by Medland were residents of Canada.

e) Pro-Tect Plastic Fabricators International Corp. ("Barco") was incorporated in Barbados as an international business corporation ("IBC") on 14 March 1996, and was a non-resident of Canada.

f) At all material times, the shares of Barco were owned 100 percent by the Appellant. It follows that Barco and the Appellant did not deal at arm's length.

g) The Appellant was a manufacturer of point of sale display units and distributor of related advertising materials, which it sold to third party customers in Canada and (channeled through Barco as an intermediary) the United States.

h) On behalf of the Appellant, Swales initiated in Canada all sales to the customers in the United States.

i) The Appellant manufactured its products in Canada, and drop shipped them directly from Canada to the customers in the United States.

j) The Appellant "sold" its products at profit to Barco, and Barco then "sold" them at profit to the customers in the United States, with the result that approximately 60 percent of the overall profit from these "sales" was earned by the Appellant, and 40 percent by Barco.

k) The Appellant performed the following business functions: general management (including corporate strategy, treasury, legal, regulatory, and personnel), manufacturing (including product design, purchasing, and quality control) and marketing (including strategy, pricing and invoicing).

l) Except for re-typing the invoices for the customers in the United States and banking the receipts, Barco did not perform any business functions, whatsoever, and did not add any value to the Appellant's operations.

m) Barco claimed minimal operating and overhead expenses, and did not compensate either the Appellant or Swales for any services that they performed.

n) The Appellant assumed the following business risks: product, credit, foreign exchange, inventory and market.

o) Barco did not assume any business risks whatsoever.

p) Barco had no employees. It had two Barbadian directors who were inactive in the business and were paid $1,500 per year. It used agents to perform the invoicing and banking functions.

q) The sole purpose for incorporating Barco and channeling the Appellant's sales to the customers in the United States through Barco as an intermediary was to obtain a tax benefit.

r) The tax benefit referred to in the previous paragraph was that Barco would earn profits in Barbados which, because it was an IBC, would be taxed at the rate of 2.5 percent, and which would then be paid to the Appellant as tax-free dividends.

s) For the 1999, 2000, 2001, 2002 and 2003 taxation years, Barco reported net income in Barbados in the following amounts: US$ 117,077, US$ 93,683, US$ 149,731, US$ 157,777 and US$ 51,204, respectively.

t) During the 1999, 2000, 2001, 2002 and 2003 taxation years, Barco paid dividends to the Appellant in the following amounts: $170,000, $150,000, $230,000, $230,000 and $105,360, respectively.

u) The terms of the transactions between the Appellant and Barco differed from those that would have been made between persons dealing at arm's length.

v) Had the Appellant and Barco been dealing at arm's length, either none of the Appellant's sales to the customers in the United States would have been channeled through Barco as an intermediary, or the transfer price between the Appellant and Barco would have been substantially higher.

w) The transfer price for the "sales" from the Appellant to Barco was understated, and the "profit" earned by Barco from the "sales" to the customers in the United States was overstated.

x) The Appellant did not prepare a transfer pricing study.

y) The best indication of the appropriate transfer price for any particular "sale" from the Appellant to Barco is the price for that particular sale that was negotiated at arm's length between the Appellant and the customer in the United States.

z) The transfer pricing adjustment results in the quantum of profit for the Appellant that would have been determined if the Appellant and Barco had been dealing at arm's length.

[8] It is not in dispute that the reassessments of the 1999 to 2002 taxation years were made after the normal reassessment period, but within the additional reassessment period provided for under subparagraph 152(4)(*b*)(iii).

[9] It is also relevant to note that in its notice of appeal the Appellant gave the following reasons for its appeal:

> **C. Reasons For Appeal and Relief Sought**
>
> 1. The Appellant maintains that in all cases its sales, including its sales to Pro-Tect Plastics International Corp. were made on the basis of arms-length pricing in similar circumstances. Accordingly, the transfer pricing adjustment made by the Minister of National Revenue is not appropriate for the circumstances.
> 2. The Appellant further submits that the reassessments of it with respect to the 1999 to 2002 taxation years inclusive were issued beyond the three year time limit prescribed for reassessments under the Act.
> 3. The Appellant accordingly submits that its appeal ought to be allowed and the reassessments vacated.
>
> . . .[1]

ANALYSIS

Statutory provisions

[10] Subsection 152(4) of the *ITA* reads in part:

> 152(4) The Minister may at any time make an assessment, reassessment or additional assessment of tax for a taxation 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,

[1] There were two other parts to the notice of appeal. Part A (Statement of Relevant Facts) made no factual allegations about Barco at all or any reference to any dealings with Barco. It stated, among other statements, that the reassessment resulted from a transfer pricing adjustment. Part B (Statutory Provisions Relied On) made reference to subsections 247(2) and 152(4) of the *ITA*. There was no section specifying the issues, as required by section 48 of the *Rules* and Form 21(1)(*a*).

. . .

[11] Subsection 247(2) says:

> 247(2) Where a taxpayer . . . and a non-resident person with whom the taxpayer . . . does not deal at arm's length . . . are participants in a transaction or a series of transactions and
>
> (*a*) the terms or conditions made or imposed, in respect of the transaction or series, between any of the participants in the transaction or series differ from those that would have been made between persons dealing at arm's length, or
>
> (*b*) the transaction or series
>
> (i) would not have been entered into between persons dealing at arm's length, and
>
> (ii) can reasonably be considered not to have been entered into primarily for bona fide purposes other than to obtain a tax benefit,
>
> any amounts that, but for this section and section 245, would be determined for the purposes of this Act in respect of the taxpayer . . . for a taxation year or fiscal period shall be adjusted (in this section referred to as an "adjustment") to the quantum or nature of the amounts that would have been determined if,
>
> (*c*) where only paragraph 247(2)(*a*) applies, the terms and conditions made or imposed, in respect of the transaction or series, between the participants in the transaction or series had been those that would have been made between persons dealing at arm's length, or
>
> (*d*) where paragraph 247(2)(*b*) applies, the transaction or series entered into between the participants had been the transaction or series that would have been entered into between persons dealing at arm's length, under terms and conditions that would have been made between persons dealing at arm's length.

Arguments, issues[2]

[12] The Appellant says that one of the essential elements of both of the above provisions is that there must be a transaction between the Appellant and a *non-resident* person with whom the Appellant does not deal at arm's length. The Appellant's focus was on the *non-resident* character of the other party.[3]

[13] The Appellant argued that the central management and control of Barco was in Canada. Relying on the admitted facts, the Appellant argued:

> . . . The appellant manufactured the product (inaudible) in Canada to the U.S. The appellant sold the products. The appellant performed the following business functions: management, corporate strategy, treasur[y], legal, regulatory, personnel, manufacturing, marketing. Dealt with all the business risks. [Barco] assumed no business risks. [Barco] had no employees and the two Barbadian directors who were inactive and it used agents. The sole purpose of [Barco] was to channel funds.
>
> Applying the law that we have just been through to those facts, your honour, I believe the inescapable conclusion is central management and control was exercised by the appellant, a Canadian resident, and when I say the appellant is a Canadian resident, that is quite a (inaudible) yes, but we will see in the effect of the facts that it was incorporated -- the appellant was incorporated in Ontario on September 20th, 1995, and by virtue of the Income Tax Act it is deemed to be a resident of Canada. I don't think there is any dispute about that.

---

[2] The authorities cited were: Hogg, Magee and Li, *Principles of Canadian Income Tax Law*, section 3.4, taxnetpro.com; *De Beers Consolidated Mines, Limited v. Howe (Surveyor of Taxes)*, [1906] A.C. 455 (UKHL); *British Columbia Electric Railway v. R.*, 1946 CarswellNat 19 (PC), [1946] A.C. 527; *Unit Construction Co. Ltd. v. Bullock (Inspector of Taxes)*, [1960] A.C. 351 (UKHL), [1959] 3 W.L.R. 1022; *Yamaska Steamship Co. Ltd. v. Minister of National Revenue*, 1961 CarswellNat 271 (TAB), 28 Tax A.B.C. 187; *Bedford Overseas Freighters Ltd. v. Minister of National Revenue*, 1970 CarswellNat 236 (Ex.C.C.), 70 DTC 6072; *Minister of National Revenue v. Tara Exploration and Development Co.*, 1970 CarswellNat 282 (Ex.C.C.), 70 DTC 6370; *Minister of National Revenue v. Tara Exploration and Development Co.*, 1972 CarswellNat 137 (SCC), [1974] S.C.R. 1057; *Capitol Life Insurance Co. v. R.*, 1984 CarswellNat 202 (FCTD), 84 DTC 6087; *Wood and another v. Holden (Inspector of Taxes)*, [2006] 1 W.L.R. 1393, [2006] EWCA Civ. 26.

[3] It was not entirely clear if the Appellant was arguing that there was no transaction.

At page 10, lines 2 to 18 of the transcript, counsel seems to raise the argument and dismiss it:

> Whether or not there was a transaction, your honour, I submit there is some ambiguity. What the Minister says, there really were no transactions, [Barco] existed; it had nominal -- it had no employees. It had directors in name only. All the appellant basically did was dummy up invoices. It sent invoices to Barbados, Barbados retyped the invoices and sent them out. Query whether that constitutes a transaction. I don't know whether that does.

Later at page 24, lines 13 to 19, the argument appears to be raised again ever so briefly. (See also the passage of the argument quoted in paragraph 13 of these reasons.)

Taking the submissions as a whole I do not think such an argument was being made.

However, assuming it was being made, as best I can understand the argument, it appears to amount to this. The whole relation between the Appellant and Barco amounted to a fiction; Barco did not really do anything.

I do not agree with such an argument. On the facts as I have to take them, one cannot conclude that Barco did nothing. Barco's function was a very modest one indeed, invoicing customers and receiving payment, but it nonetheless had a function.

There is no question that there was a transaction or series of transactions between the Appellant and Barco.

> The appellant, a Canadian resident, exercised central management and control over [Barco]. [Barco] is therefore a resident of Canada, and therefore not a non-resident . . . .[4]

Consequently, the Appellant argued that Barco was a resident and that subsection 247(2) could have no application. For the same reason the Appellant took the position that subparagraph 152(4)(*b*)(iii) is inapplicable to the 1999 to 2002 taxation years.

[14] The Respondent's position was that on the admitted facts Barco was a non-resident, that the Appellant's argument took the Respondent by surprise and that it was too late to be raising something which should have been pleaded earlier.[5]

[15] The issues to be determined are:

(a) whether the issue of Barco being a resident of Canada was properly raised by the Appellant and the Appellant should be precluded from making the argument; and
(b) whether Barco was a resident of Canada.

Was the issue of Barco's residence properly raised?

[16] The purpose of pleadings and pretrial procedures is to clarify and narrow the issues.[6] Among other objectives it seeks to promote more efficient proceedings by eliminating surprise.

[17] The Appellant has certainly not conformed with that objective here. There is absolutely nothing in the notice of appeal to suggest that the residence of Barco is in issue.

---

[4] Transcript, pages 23 and 24.
[5] Transcript, pages 29, 37 and 38.
[6] This is reflected in the *Rules*. Section 48 of the *Rules* stipulates that a general procedure income tax appeal shall be in Form 21(1)(*a*) which provides, in part, that the Appellant shall:

> . . .
> (*b*) Identify the assessment(s) under appeal . . .,
> (*c*) Relate the material facts relied on,
> (*d*) ***Specify the issues to be decided,***
> (*e*) Refer to the statutory provisions relied on,
> (*f*) ***Set forth the reasons the appellant intends to rely on***,
> *(g)* Indicate the relief sought, and
> . . . [Emphasis added.]

[18] The failure to raise the issue in the notice of appeal is compounded by the Appellant having accepted the notice to admit thereby reinforcing the impression that there was no dispute that "Pro-Tect Plastic Fabricators International Corp. ("Barco") was incorporated in Barbados . . . and was a non-resident of Canada."[7]

[19] In the circumstances it is not surprising that the Respondent did not foresee the issue of Barco's residence.

[20] The Appellant could have sought leave to amend its pleadings, but did not do so.[8, 9]

[21] The issue of Barco's residence was not properly raised. This would be reason enough to dismiss the appeal given that the Respondent might have conducted its case quite differently had it known that Barco's residence was in issue.

[22] If this were the only reason for dismissing the appeal I would have to consider whether or not the Appellant ought to have the opportunity to amend its notice of appeal. Given that this is not my only reason for dismissing the appeal, it is unnecessary for me to decide this.[10]

Is Barco resident in Canada?

[23] The Appellant first argues that whether or not Barco is resident is a question of law which cannot be admitted and argues that as a result there is no admission that Barco is a non-resident.

---

[7] Whether or not it is possible to admit residence does not change the fact that not challenging the notice to admit on this point would lead one to assume that the residence of Barco was not an issue.

[8] The Appellant, if I understood correctly, seemed to argue that it could not raise this issue earlier because (i) it first saw the Minister's position on Barco being non-resident in the pleadings and, as well, (ii) it first saw the allegations about how little Barco did in the pleadings. (See pages 43 to 45 of the transcript.)

I simply fail to see how either would have precluded the Appellant from amending or seeking leave to amend its notice of appeal at some time before trial.

The Appellant also, if I understood correctly, seemed to argue that the Respondent did not lose any opportunity to discover since all the factual allegations were those of the Minister. (See pages 43 to 45 of the transcript.)

I am unable to understand such an argument given that virtually all the facts relevant to the appeal relate to the actions of the Appellant and Barco, a company 100% owned by the Appellant. In addition, there may be other ways in which the Respondent might have chosen to conduct its case differently had it been aware of the argument the Appellant planned to make.

[9] I also note that there was no effort pursuant to section 132 of the *Rules* to withdraw the admission that Barco was a non-resident.

[10] However, I would note that if I had to decide the question and if I were to allow an amendment, such an order would have provided for appropriate terms as to costs to the Respondent in respect of lost costs and appropriate terms as to the discovery of the Appellant and the reopening of evidence.

[24] While I agree that the Appellant cannot admit a question of law, the question of residence is a mixed question of fact and law. The question arises: what exactly is the effect of an admission of something that is a mixed question of fact and law? For the purposes of this proceeding it is not necessary to decide that question and I will proceed, without deciding the question, on the basis that there was no admission that Barco was a non-resident.[11]

[25] The Appellant then argues that the common law test as to whether a company is resident in Canada is the central management and control test. I agree.

[26] The Appellant argues that Barco is a resident of Canada based on the admitted facts, notably:[12]

(a) The Appellant did all the manufacturing of products in Canada and drop shipped them directly to U.S. customers.
(b) The Appellant sold the products.
(c) The Appellant performed the following business functions: management, corporate strategy, treasury, legal, regulatory, personnel, manufacturing and marketing.
(d) The Appellant took all the business risks.
(e) Barco assumed no business risks.
(f) Barco had no employees.
(g) Barco had two Barbadian directors who were inactive and it used agents.
(h) The sole purpose of Barco was to channel funds.
(i) Barco did not really do much of anything.

[27] I disagree. The Appellant's argument fails to distinguish between the division of roles between the companies and who has central management and control of Barco.

[28] Barco's role was very limited indeed. On the evidence admitted it did little more than send bills and collect payments. That is its function. It had no employees and used agents to carry out these functions.

---

[11] The question of what exactly is the consequence of a formal admission in the course of litigation of a mixed question of fact and law was not substantively argued. While logically one could not make such an admission as to its legal component and one could make the admission as to its factual component, it is not at all clear what that means in practice. Would it mean that there was an admission that there are underlying, unexpressed facts that support the conclusion of law? That question is better left for another case. What is clear is that, at the least as a matter of practice and procedure, if a party has made such an admission (or apparent admission) then the other party should be able to rely on it unless the party making it has either formally withdrawn the admission or at least made it clear that the particular conclusion of law is in dispute; this should be done early enough to prevent prejudice to the other party.

[12] See paragraph 13 above.

[29] The question is "where is the central management and control of Barco?" not whether, or not, as between Barco and its parent, the Appellant, Barco does most of the functions done by the two companies.

[30] The following facts are relevant to the issue of management and control:

(a) Barco was incorporated in Barbados as an international business corporation ("IBC") on March 14, 1996.
(b) It had two Barbadian directors who were inactive in the business and were paid $1,500 per year. It used agents to perform the invoicing and banking functions.
(c) At all material times, the shares of Barco were owned 100% by the Appellant.
(d) The Appellant sold its products at profit to Barco, and Barco then sold them at profit to the customers in the U.S., with the result that approximately 60% of the overall profit from these sales was earned by the Appellant, and 40% by Barco.
(e) The sole purpose for incorporating Barco and channeling the Appellant's sales to the customers in the U.S. through Barco as an intermediary was to obtain a tax benefit.
(f) The tax benefit referred to in the previous paragraph was that Barco would earn profits in Barbados which, because it was an IBC, would be taxed at the rate of 2.5%, and which would then be paid to the Appellant as tax-free dividends.

[31] Thus there is no reason to give weight to the ownership of Barco as pointing to management being in Canada. It is well accepted that it is the role of directors to manage a corporation[13] and, in the absence of any evidence to the contrary, I must proceed on the basis that it was the directors who managed the company.

[32] We know that the directors were Barbadian and that the company was incorporated in Barbados. They are factors pointing towards management and control outside of Canada.

[33] Given the very limited functions of Barco, functions which would run almost automatically once set up, one would not expect the directors to have to do much more than the bare minimum. Accordingly, I do not ascribe much significance to the

[13] See, for example, section 102 of the *Canada Business Corporations Act*. Company law being law of general application there is a presumption that the law of Barbados is the same as our law. See, for example, *Backman v. Canada*, [2000] 1 F.C. 555 (FCA).

directors being inactive. A $1,500 annual payment is consistent with the directors playing a role even if that role does not take much time.

[34] In addition facts (d), (e) and (f) set out in paragraph 30 above show that the sole purpose of Barco was to make sales through Barco and obtain a significant tax benefit. Such a benefit would evaporate if Barco were a resident of Canada. Barco had major incentives to make sure that its central management and control was not in Canada.

[35] There are no indications of management and control being exercised in Canada.

[36] While one might like to have more facts, on the facts before me I can only infer that the central management and control of Barco was outside of Canada and that, as a result, Barco was a non-resident.

[37] If there were evidence to show that the central management and control was in Canada, the Appellant, who was the sole owner of Barco, was well placed to bring forward any such evidence. It chose not to do so.

CONCLUSION[14]

[38] Having concluded that Barco was a non-resident, it follows that the appeal will be dismissed with costs to the Respondent.

Signed at Ottawa, Canada, this 25th day of September 2009.

"Gaston Jorré"

Jorré J.

[14] I do not find it necessary to deal with certain arguments relating to the Canada-Barbados Tax Treaty. I simply note article XXX, paragraph 3, thereof. I also do not find it necessary to deal with additional arguments the Respondent sought to raise after the hearing or with the Appellant's response thereto.

CITATION:	2009 TCC 477
COURT FILE NO.:	2007-2678(IT)G
STYLE OF CAUSE:	1143132 ONTARIO LIMITED v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	May 15, 2008
REASONS FOR JUDGMENT BY:	The Honourable Justice Gaston Jorré
DATE OF JUDGMENT:	September 25, 2009

APPEARANCES:

Counsel for the Appellant:	Paul L. Schnier
Counsel for the Respondent:	Donald G. Gibson

COUNSEL OF RECORD:

For the Appellant:

Name:	Paul L. Schnier
Firm:	Blaney McMurtry LLP Toronto, Ontario

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