Docket: 2011-3912(CPP)

BETWEEN:

VSEVOLOD FRENKEL,

Appellant,

and

THE MINISTER OF NATIONAL REVENUE,

Respondent.

Appeal heard on June 1, 2012, at Toronto, Ontario

By: The Honourable Justice Campbell J. Miller

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Stephen Oakey

JUDGMENT

The appeal pursuant to section 28 of the *Canada Pension Plan* is allowed and the decision of the Minister of National Revenue on the appeal made to him under section 27 of the *Canada Pension Plan* is vacated.

Signed at Ottawa, Canada, this 18th day of June 2012.

"Campbell J. Miller"

C. Miller J.

Docket: 2011-3911(CPP)

BETWEEN:

ELENA FRENKEL,

Appellant,

and

THE MINISTER OF NATIONAL REVENUE,

Respondent.

Appeal heard on June 1, 2012, at Toronto, Ontario

By: The Honourable Justice Campbell J. Miller

Appearances:

Agent for the Appellant:	Vsevolod Frenkel
Counsel for the Respondent:	Stephen Oakey

JUDGMENT

The appeal pursuant to section 28 of the *Canada Pension Plan* is allowed and the decision of the Minister of National Revenue on the appeal made to him under section 27 of the *Canada Pension Plan* is vacated.

Signed at Ottawa, Canada, this 18th day of June 2012.

"Campbell J. Miller"

C. Miller J.

Docket: 2012-1518(CPP)

BETWEEN:

EFFECTIVE TECHNOLOGIES & IDEAS INC.,

Appellant,

and

THE MINISTER OF NATIONAL REVENUE,

Respondent.

Appeal heard on June 1, 2012, at Toronto, Ontario

By: The Honourable Justice Campbell J. Miller

Appearances:

Agent for the Appellant:	Vsevolod Frenkel
Counsel for the Respondent:	Stephen Oakey

JUDGMENT

The appeal pursuant to section 28 of the *Canada Pension Plan* is allowed and the assessment of the Minister of National Revenue of November 24, 2011, confirmed by letter dated April 20, 2012, is vacated.

Signed at Ottawa, Canada, this 18th day of June 2012.

"Campbell J. Miller"

C. Miller J.

Citation: 2012 TCC 216
Date: 20120618
Docket: 2011-3912(CPP),
2011-3911(CPP) and
2012-1518(CPP)

BETWEEN:

VSEVOLOD FRENKEL, ELENA FRENKEL AND
EFFECTIVE TECHNOLOGIES & IDEAS INC.,

Appellant,

and

THE MINISTER OF NATIONAL REVENUE,

Respondent.

REASONS FOR JUDGMENT

C. Miller J.

[1] These appeals concern the employment status of Vsevolod Frenkel and Elena Frenkel with Effective Technologies & Ideas Inc. ("ETI") for the purposes of determining whether the Frenkels were in pensionable employment with ETI throughout 2010. The Minister of National Revenue (the "Minister)" notified the Frenkels by a letter dated October 24, 2011 that they were in pensionable employment and subsequently on November 24, 2011 assessed ETI for *Canada Pension Plan* ("*CPP*") contributions ($4,137.60) that ETI had failed to remit plus penalties. The Frenkels, believing themselves to be self-employed and not employees of ETI, had personally remitted *CPP* contributions in amounts very close to the $4,137.60. The Minister's position is that the wrong person has made the contributions. Mr. Frenkel's frustration was palpable that ETI might have to make the same payment again, and that he would then have to seek a refund from the Government for the contributions made personally.

Facts

[2] ETI was incorporated in November 2009. Mr. Frenkel and Ms. Frenkel were 50-50 shareholders and also directors of ETI. Unfortunately, Ms. Frenkel was not present at the trial and only Mr. Frenkel testified, but he indicated that the company was established because Ms. Frenkel had been advised she could only get contracts for her computer consulting services through a company. There was no suggestion the company was incorporated for limited liability purposes. Until the incorporation of ETI, Mr. Frenkel had been carrying on his business of market research, marketing and selling know-how in innovative products, primarily from Russia or the Ukraine, as a sole proprietor under the business name CMT NET Co. ("CMT"). With the incorporation of ETI he decided to continue the two businesses, his and his wife's, under one name. What exactly he means by that is at the bottom of this dispute.

[3] Mr. Frenkel showed me some of the products he was attempting to market in North America. It was clear that he carried on what he referred to as "my business" no differently after the incorporation than before the incorporation. He stated that in his business dealings in Russia and the Ukraine it was immaterial whether the business name was ETI or CMT, as it was the individual relationship that was key. Everyone would know that it was Mr. Frenkel they were dealing with.

[4] Ms. Frenkel's business of computer consulting appears to have been for GSI International Consulting Group ("GSI"), though the contract presented as evidence by Mr. Frenkel in support of this arrangement was dated February 2, 2011, the year after the year in issue. It is an unusual contract, excerpts of which follow:

> AGREEMENT FOR SYSTEMS & PROGRAMMING SERVICES
>
> BETWEEN: GSI International Consulting Group ("GSI GROUP")
>
> AND: Effective technologies & Ideas, Inc. (hereafter called the SUB-CONTRACTOR)
>
> It is understood that this contracts related to services to be provided by Elena Frenkel as Agent or Principal for the SUB-CONTRACTOR.
>
> …
>
> The SUB-CONTRACTOR acknowledges that they are self-employed and are not an employee of GSI Group.
>
> …

It is interesting to note that there is no indication in the agreement as to remuneration.

[5] Neither Mr. Frenkel nor Ms. Frenkel entered any written agreement between themselves and ETI. Although Mr. Frenkel indicated he appreciated ETI was a separate legal entity, he made it very clear his product market business was his business and that ETI existed only because it was required for Ms. Frenkel to get contracts. Even ETI's bank account was set up jointly between the company and the Frenkels personally. Mr. Frenkel testified that if Ms. Frenkel was paid for work it could be in her name or in the company's name. I am not convinced that Mr. Frenkel truly appreciated the significance of inserting a corporate entity into his or his wife's businesses, as when describing what would happen if the business needed to hire help, he said the worker would be paid by the company, because you need to do that to be self-employed. His answer reflects the misunderstanding of what is meant by self-employment.

[6] With respect to remuneration, Mr. Frenkel testified that the Frenkels would simply take money out as needed. According to an income statement of ETI, Mr. Frenkel took out approximately $17,000 and Ms. Frenkel took out approximately $31,000 throughout 2010 in irregular payments. The amounts, according to Mr. Frenkel, were based on the incomes their respective businesses generated. It is also of note that on the ETI income statement, the $48,000 taken out by the Frenkels falls under the category of Directors' Fees. Mr. Frenkel explained that was put there because it was the only option available in the software program he used.

[7] According to Mr. Frenkel, invoices could be issued in ETI's name or his name, depending on the wish of his clients, though again he mentioned that big companies want a corporate name on it. A copy of an ETI invoice to GSI shows:

> Business name – Effective Technologies & Ideas Inc.
>
> Contractor: Elena Frenkel

The invoice has ETI's GST registration number, as neither Mr. Frenkel nor Ms. Frenkel had GST numbers. The invoice also stipulated payment was to be made to ETI's bank account. Mr. Frenkel did acknowledge that all his business is done under the ETI name but it was clear he saw no difference between that arrangement and his former arrangement when simply using the trade name CMT.

[8] Returning to the income statement, Mr. Frenkel answered yes to Mr. Oakey's question whether the company reimbursed the Frenkels for the operating expenses, as neither Mr. Frenkel nor Ms. Frenkel personally reported any, or very little, business expenses on their tax returns. The major expense was rental ($4,821), presumably of the Frenkels' home office. However, earlier in his testimony, Mr. Frenkel had said the company covers a third of the property expenses but "doesn't pay".

[9] Mr. Frenkel was unsure who would be legally liable if there was a problem with a customer.

[10] With respect to tools, Mr. Frenkel indicated he provided the computer, car, printer and fridge (for storing some potential marketable products that required refrigeration) and that the company provided a table and chair.

Analysis

[11] Were the Frenkels self-employed in 2010, each carrying on their own business, providing services to ETI or were they ETI's employees in contracts of service? The usual analytical path taken in employee versus independent contractor cases based on *Wiebe Door Services Ltd. v. Canada*[1], *671122 Ontario Ltd. v. Sagaz Industries Canada Inc.*[2] and the plethora of subsequent jurisprudence is not readily applicable when dealing with non-arm's length owner-managers. As Deputy Judge Rowe put it in *MacMillan Properties Inc. v. Canada*[3] as follows:

> 29. … Of course, it is always a walk on the metaphysical wild side when one begins to speak of a corporation wholly owned by an individual as having a separate and distinct personality in everyday terms rather than as a matter of law. …

[12] This predicament has been faced in many similar cases. Chief Justice Rip characterized it in *Pro-Style Stucco & Plastering Ltd. v. Canada*[4] as follows:

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1 [1986] 3 F.C. 553.

2 2001 SCC 59.

3 2005 TCC 654.

4 2004 TCC 32.

> 21. In a situation where one person is the sole director and shareholder of a corporation and provides services to that corporation, the traditional tests to determine whether that person is an employee or an independent contractor are not always useful. How can one measure, for example, the level of control the employer has over the worker's activities when the person who directs the employer is the worker? It may well be, as Mr. Marocco implied, that Pro-Style was incorporated because he wanted limited liability in carrying on the business. Therefore he caused all contracts to be taken in the name of Pro-Style. Pro-Style, however, accepted all risk with respect to the quality of the work. The business carried on was Pro-Style's, not Mr. Marocco's, and his services were integral to that business.

[13] As is clear from the Supreme Court of Canada's comments in *Sagaz* the usual analytical path suggests that control is always a factor. But as Mr. Frenkel vigorously put it, as owner of ETI no one controls him, and certainly the company does not control him. He could at any time liquidate the company or simply not use it. As he emotionally asked me – how many employees can liquidate their employer. An attempt to explain the different hats the owner-manager wears did not seem to resonate with Mr. Frenkel.

[14] The Supreme Court of Canada in *Sagaz* put the penultimate question this way:

> … whether the person who has been engaged to perform the services is performing then as a person in business or on his own account.

[15] Again, however, this general test rings somewhat hollow when applied to a situation such as the Frenkels when the engagement between the payer and the worker is not in writing, and there is no verbal agreement that can be identified, as the two individuals who would make any such agreement are one and the same person. The usual indices of control and intention simply are not helpful where controller and controllee are the same. And in this particular case, when Mr. Frenkel says he and the company intended a self-employment arrangement, this is of little value as it was evident Mr. Frenkel did not fully appreciate what self-employment meant. He believed a company was necessary to show self-employment. It was difficult to grasp his concept of self-employment.

[16] To add to the difficulty of relying on the traditional four-pronged test, the type of businesses involved required little tools or equipment. Further, the chance of profit – risk of loss factor would be the same for the Frenkels and the company: if there was profit, the Frenkels took it out of the company; if there was no profit from their businesses nothing would be available to take out of ETI.

[17] This is one of those cases where judge-made legal tests only take you so far and you have to step back and ask whether the Frenkels transferred their business into ETI, such that ETI operated the business with the Frenkels as their employees or whether the Frenkels personally continued to carry on operating their respective businesses, relying on ETI as nothing more than a corporate name to attract business which it could contract out to the Frenkels and then collect payment on their behalf – in effect, acting as a form of management agency.

[18] In attempting to evaluate the factors that might suggest one relationship versus another, there is no clear direction. This is attributable, I would suggest, to the extremely vague nature of the arrangement. In any event, what are some of the opposing factors:

1. ETI's income statement showed the company paid almost all business expenses, but were they paid on behalf of the Frenkels?

2. The contract with a third party, GSI, refers to ETI as a sub-contractor but Elena Frenkel as either agent or principal: an acknowledgment ETI could be acting on Ms. Frenkel's behalf.

3. The invoice to GSI showed the "Business Name" as ETI but the contractor as Elena Frenkel.

4. While there were no invoices from the Frenkels to ETI, that might be explained by the view that ETI simply acted as agent.

5. The Frenkels were certainly free to use ETI or not; nothing obligated them to be accountable to ETI for how, where or when time was spent for ETI's benefit.

6. Effectively, for Mr. Frenkel nothing changed in how he carried on business after incorporation, other than using the name ETI instead of CMT.

[19] This all leads me to ask exactly what is the contract or the deal between the Frenkels and ETI. I suggest it is this: that the company acts as the Frenkels' agent to meet the requirements of potential customers for the Frenkels' business, to collect payment on their behalf, pay the expenses of their businesses from such income but with the ability to retain some of that income for providing these management

services. I conclude the most accurate way to describe the legal arrangement is that ETI was established as an agent to manage the Frenkels' business which they continued to operate personally. As such, ETI might indeed own some equipment, but I have been satisfied that the chance of profit and risk of loss in their respective businesses was borne by the Frenkels. All that changed for the Frenkels after incorporation was that ETI managed their businesses as an agent, but did not operate them as such. This seems to be the most commercially logical way to interpret Mr. Frenkel's testimony in what in fact was going on. Given that interpretation, I find the Frenkels were not paid as employees of ETI but were remunerated for their independent consulting and marketing services. As owners of ETI they could decide to pay no salary to individuals performing the management agency services and to retain some profit, as in 2010, for future dividend distribution perhaps. There is no doubt the Frenkels could just as readily shift their individual businesses lock, stock and barrel into ETI and draw salaries from ETI. Indeed, that may logistically be easier for them: I believe, however, that they did not intend to do that and effectively have not done that and so have left themselves in this somewhat murky arrangement. I would encourage them to seek professional accounting and legal advice to determine the most efficacious route to follow in the future.

[20] The Minister's alternative position was that the amounts paid to the Frenkels in 2010 were fees for acting as directors and therefore caught by the definition of office and officer in section 2 of the *CPP* which specifically includes a position of a corporation director. The Minister notes that ETI itself identified the payments to the Frenkels as directors' fees in the financial statements. Mr. Frenkel explained that this was the only category in the software program that he thought was available to identify this payment. I put little significance on that labelling. The evidence clearly suggested that the payments to the Frenkels were for the work they performed for customers, albeit withdrawn on an as-needed basis, and had nothing to do with their role as directors. It would not reflect the commercial reality of the arrangement to suggest that any part of this payment was in fact for directors' fees.

[21] Finally, I will briefly address Mr. Frenkel's argument that the Government did not follow the provisions of the *CPP* in that neither the Minister of Social Development, an employer or employee requested an officer to make a ruling on this issue, as required by section 26.1 of the *CPP*. Section 27.3 covers the situation as it reads:

> 27.3 Nothing in sections 26.1 to 27.2 restricts the authority of the Minister to make a decision under this Part on the Minister's own initiative or to make an assessment after the date mentioned in subsection 26.1(2).

[22] I also dealt with this same issue in *6005021 Canada Inc. v. Canada*[5] and in *Zazai Enterprises Inc. v. Canada*[6] and in the latter case said as follows:

> 17. Looking at these provisions as a whole, the Minister is unrestricted in assessing as he did in this case. To put the interpretation on subsection 26.1(4) that Mr. Sarmiento seeks, would be to completely fetter the Minister's authority; indeed, it would render section 27.3 useless (a result that could not have been intended by the legislators), as it would allow the Minister to assess but with no ability to hold that non-payment was not in accordance with the *Act*. Excuse the triple negative but the result is nothing to assess. I grant that the wording of these provisions is not a clarion of clarity, but they must be interpreted to make some sense. And the sense I make of them is that the lack of a ruling request in no way handcuffs the Minister. This interpretation is supported further by subsection 26.1(2) of the *CPP* which allows the Minister of Human Resources and Development to request a ruling at any time; all to say the Government can always overcome Mr. Sarmiento's hurdle by simply making the request. My view of this matter appears to be borne out by the Federal Court of Appeal's comments in *Care Nursing Agency Ltd.* cited earlier.

[23] As is clear from these reasons this is a somewhat inelegant solution for the Frenkels. Yet, it reflects more accurately their intentions and their business arrangement. There is confusion in the arrangement, and the Frenkels would be well-advised to get professional help to sort it out. It is clear they are not attempting to shirk any responsibility, as they personally paid the *CPP* contributions. The decision of the Minister that the Frenkels are in pensionable employment is vacated as is the reassessment of ETI on the basis that the Frenkels are not employees of ETI.

Signed at Ottawa, Canada, this 18th day of June 2012.

"Campbell J. Miller"

C. Miller J.

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5 2009 TCC 339.

6 2008 TCC 606.

CITATION:	2012 TCC 216
COURT FILE NO.:	2011-3912(CPP), 2011-3911(CPP) and 2012-1518(CPP)
STYLE OF CAUSE:	VSEVOLOD FRENKEL, ELENA FRENKEL AND EFFECTIVE TECHNOLOGIES & IDEAS INC. AND THE MINISTER OF NATIONAL REVENUE
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	June 1, 2012
REASONS FOR JUDGMENT BY:	The Honourable Justice Campbell J. Miller
DATE OF JUDGMENT:	June 18, 2012

APPEARANCES:

For the Appellant:	The Appellant himself
Agent for the Appellants:	Vsevolod Frenkel
Counsel for the Respondent:	Stephen Oakey

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