

BETWEEN:

JEAN-PIERRE DESMARAIS,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeals heard on August 22, 2013, at Montréal, Quebec

Before: The Honourable Justice Réal Favreau

Appearances:

Counsel for the appellant: Eva Derhy
Counsel for the respondent: Gabriel Girouard

JUDGMENT

The appeals from the reassessments dated June 23, 2010, made by the Minister of National Revenue under the *Income Tax Act* in respect of the appellant's 2003 and 2004 taxation years are allowed and the reassessments are vacated in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 7th day of November 2013.

“Réal Favreau”

Favreau J.

Citation: 2013 TCC 356

Date: 20131107

Docket: 2012-2689(IT)I

BETWEEN:

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and

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REASONS FOR JUDGMENT

Favreau J.

[1] These are appeals, under the informal procedure, from the reassessments dated June 23, 2010, made by the Minister of National Revenue (the Minister) under the *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.) as amended (the Act), in respect of the appellant's 2003 and 2004 taxation years.

[2] In making these two reassessments, the Minister imposed a penalty of \$2,500 for each of the 2003 and 2004 taxation years under subsection 162(7) of the Act for failure to file Form T1134-A within the period prescribed in subsection 233.4(4) of the Act.

[3] Form T1134-A is an annual Information Return Relating to Foreign Affiliates that are not Controlled Foreign Affiliates of the taxpayer. The obligation to file Form T1134-A is imposed by subsection 233.4(4) of the Act, which was introduced into the Act in 1997 but applicable commencing in the taxation years after 1995. This form must be filed with the Minister in respect of each foreign affiliate that, at any time in a taxation year or fiscal period, was not a controlled foreign affiliate of the taxpayer. The form must be filed by a taxpayer required to do so within 15 months after the end of the taxation year or fiscal period, as the case may be.

[4] In making the reassessments in issue, the Minister relied on the following assumptions of fact set out in paragraph 21 of the Amended Reply to the Notice of Appeal:

[TRANSLATION]

- (a) On May 6, 1997, OREX A.G. was incorporated in Liechtenstein.
- (b) On February 10, 2004, OREX A.G. was continued under the *Canada Business Corporations Act* as “OREX Mines d’Or Ltée” (OREX).
- (c) Prior to its continuance in Canada, OREX was a non-resident of Canada.
- (d) Some time prior to December 6, 2003, the appellant acquired 256 shares of the capital stock of OREX from Omar Fakieh.
- (e) The appellant still held those shares when OREX was continued under the *Canada Business Corporations Act*.
- (f) Prior to its continuance, the capital stock of OREX was allocated as follows:

Shareholder [<i>sic</i>]	Number of common shares
Greymount Associates Ltd.	256
Alexandre Kovalev	256
Jean-Pierre Desmarais	256
Alexei Barbariush	112
Total	880

- (g) Accordingly, and following the continuance of OREX under the *Canada Business Corporations Act*, the capital stock of OREX was converted as follows:

Shareholder [<i>sic</i>]	Number of common shares
Greymount Associates Ltd.	20,000
Alexandre Kovalev	20,000
Jean-Pierre Desmarais	20,000
Alexei Barbariush	8,775
Total	68,775

- (h) The principal asset of OREX at the time of its continuance in Canada consisted of ownership of 68,778,000 Class B shares of the capital stock of Amour International Mines d’Or Limitée (AIMO).

- (i) The fair market value of those 68,778,000 shares, at the time, was \$2,090,000.
- (j) The shares held by OREX represented, at the time, 43.33% of the voting and participating shares of AIMO's capital stock.
- (k) At the time, AIMO held 429 common shares of the capital stock of the private corporation Okhotsk Mining and Geological Company (OMGC).
- (l) The fair market value of the 429 shares was, at the time, \$8,689,000.
- (m) The shares held by AIMO represented, at the time, 20% of the common shares of OMGC's capital stock.
- (n) The other common shares (1,716 shares) of OMGC's capital stock were held by ISPA Polymetal.
- (o) During the month of February 2004, ISPA Polymetal sold 538 common shares of OMGC's capital stock to a third party for US\$5,000,000.
- (p) During the month of April 2004, OMGC issued 20,592 new shares for US\$33,420,000.
- (q) OMGC is a corporation incorporated under the corporate laws of the Russian Federation.
- (r) OMGC held mining licences for the Khanjakan and Yousken gold and silver mines located in Russia.
- (s) Under an objection to another assessment dated May 21, 2010, for the 2004 taxation year, the appellant represented to the Canada Revenue Agency that the fair market value of OREX at the time of its continuance in Canada was \$1,856,925.
- (t) The appellant had previously represented to the Canada Revenue Agency that the fair market value of OREX at the time of its continuance was \$2,375,000.
- (u) Under a settlement reached as part of that objection, the appellant and the Canada Revenue Agency agreed that the fair market value of OREX at the time of its continuance was \$1,856,925.

[5] In the Amended Reply to the Notice of Appeal, the respondent admitted the following facts:

[TRANSLATION]

- (a) the acquisition cost of the 256 shares in OREX A.G. that the appellant purchased from Omar Fakieh, on or about December 3, 2003, was US\$200,000 payable by a demand promissory note;
- (b) prior to OREX A.G.'s continuance in Canada, the balance of the shares in Amour International Mines d'Or Ltée (AIMO) held by OREX A.G. was 68,775,000 Class "NB" shares;
- (c) at the time of OREX A.G.'s continuance in Canada, the appellant held 256 shares of OREX A.G., that is, approximately 29% of the company's issued and outstanding shares;
- (d) at the time of OREX A.G.'s continuance in Canada, which took place on February 10, 2004, the remaining 880 OREX A.G. common shares were split and as of then represented 68,775 Class "A" shares. The only asset held by OREX Mines d'Or Ltée (OREX) at the time was the investment in AIMO, that is, 68,775,000 Class "NB" shares.

[6] Jean-Pierre Desmarais, senior counsel with Boscher Derhy Desmarais Godwin, testified at the hearing to explain that he was not required to file Form T1134-A for the 2003 and 2004 taxation years because, during that period, OREX A.G. was a dormant or inactive foreign affiliate as defined by the Act and Form T1134-A.

[7] During the testimony of Mr. Desmarais, the following documents were filed with the Court:

- the Minister's decision rejecting the appellant's objection (Exhibit A-1);
- the notice of reassessment issued to the appellant for the year 2003 (Exhibit A-2);
- the notice of reassessment issued to the appellant for the year 2004 (Exhibit A-3);
- the objection to the notices of reassessment for the years 2003 and 2004 (Exhibit A-4);
- the appellant's acknowledgement of debt to Omar Fakieh dated December 3, 2003 (Exhibit A-5);

- OREX A.G.'s financial statements for the fiscal year ending December 31, 2002, dated October 29, 2003 (Exhibit A-6);
- the US dollar exchange rate vis-à-vis the Canadian dollar as of December 3, 2003, and February 10, 2004 (Exhibit A-7);
- an organization chart showing the share ownership in OREX A.G. as of December 3, 2003 (Exhibit A-8), which is appended to this judgment;
- the financial statements (balance sheet and notes only) of OREX for the fiscal year ending December 31, 2004, dated March 30, 2007 (Exhibit A-9);
- AIMO's non-consolidated financial statements for the fiscal year ending December 31, 2004, dated July 11, 2005 (Exhibit A-10).

[8] The appellant is a resident of Canada who, on December 9, 1994, incorporated AIMO under Part IA of the Quebec *Companies Act*. OREX A.G. was incorporated in Liechtenstein on May 6, 1997.

[9] In December 2003, OREX A.G. held 49.33% of the shares of AIMO's capital stock, which, in turn, held a 20% ownership interest in the capital stock of the Russian company Okhotsk Mining and Geological Company (Okhotsk). The other 80% of Okhotsk's capital stock was held by another Russian company, ISPA Polymetal (ISPA).

[10] During his testimony, the appellant indicated that Okhotsk was formed in 1993 to allow the transfer of three mining licences and one mining licence for a gold mine in Russia to the company. The licence transfers were made in consideration for shares in Okhotsk, which were held by AIMO for the purpose of conducting a public offering in Canada. The investment in Okhotsk was, in 2003 and 2004, AIMO's only significant asset.

[11] During his testimony, the appellant stated that, when he acquired the OREX A.G. shares in December 2003, he was aware that the assets of the company had no value.

[12] At the time of OREX A.G.'s continuance in Canada, the appellant was the secretary and director of the company. According to the appellant, OREX A.G.'s assets on the date of continuance had no value and that this is why he did not have financial statements prepared on that date or hire a valuation firm to obtain a valuation report on the value of the OREX A.G. shares on that date. To support his position that the OREX A.G. shares had no value, in December 2003 and January 2004, the appellant filed OREX A.G.'s financial statements for the fiscal year ending

December 31, 2002, which show that the investment in AIMO was entered in the books as having a value of only one Swiss franc.

[13] The appellant also indicated that, during the month of February 2004, ISPA sold 538 common shares of AIMO to a third party for US\$5,000,000 and, during the month of April 2004, issued shares of its capital stock to increase the value of the shares and dilute its shareholdings in AIMO, which decreased from 20% to 1.9%. According to the appellant, the shares were sold and issued to related parties or to parties not dealing at arm's length with ISPA and/or its shareholders. AIMO's financial statements for the fiscal year ending December 31, 2004, indicate that (a) the company was incorporated on December 9, 1994, under Part IA of Quebec's *Companies Act*; (b) the company's accumulated deficit was \$19,370,002 as of December 31, 2004, and \$18,572,440 as of December 31, 2003; (c) the company's interest in Okhotsk consisted of 429 common shares representing 1.90% of the voting and participating shares; (d) the book value of this investment was \$3,869, that is, the same value as for the fiscal year ending December 31, 2003; and (e) the capital stock issued consisted of 158,691,061 Class "B" shares with a paid-up capital of \$6,551,816.

[14] The appellant revealed that, on June 30, 2006, AIMO sold all of its shares in Okhotsk for US\$7,500,000, paid in cash. Prior to the end of the fiscal year ending December 31, 2006, AIMO was dissolved, and it distributed \$1,800,000 to its shareholders. On June 30, 2007, OREX was also dissolved.

[15] OREX's financial statements (balance sheet and notes only) for the fiscal year ending December 31, 2004, dated March 30, 2007, show an investment of 68,775,000 Class "NB" shares in AIMO valued at \$2,375,000 (at fair market value at the time of continuance) and capital stock, issued and paid for, of 68,775 Class "A" shares with a paid-up capital of \$1,392,600.

[16] On cross-examination, the appellant confirmed that the company never paid the US\$200,000 promissory note or acknowledgement of debt to Omar Fakieh for the acquisition of the OREX A.G. shares.

[17] Ante Kumanovic, CGA, LL.M. Fisc., director and tax specialist at Rochon Legault CA, testified at the hearing and explained that OREX's balance sheet as at December 31, 2004, was prepared by the firm Rochon Legault on March 30, 2007, that is, almost three years after the Okhotsk shares were sold. He also confirmed that he prepared the memorandum to the Canada Revenue Agency dated May 9, 2008,

which summarized the tax consequences of the continuance of OREX A.G., the dissolution of AIMO and the dissolution of OREX (Exhibit I-1).

[18] Mr. Kumanovic also provided explanations regarding OREX A.G.'s financial statements as at December 31, 2002 (Pièce A-6). *Inter alia*, he indicated that the investment in AIMO was entered on the balance sheet as one Swiss franc, that the investment represented 39.43% of the issued and outstanding shares, that the shares' paid-up capital was \$6,551,816 and, finally, that the company's accumulated deficit was \$17,969,774.

[19] The witness also confirmed that he had not been consulted by the appellant with respect to filing the T1134-A forms for the 2003 and 2004 taxation years.

[20] Bic Thu Tran Thi, CBV, a valuation specialist working for the Canada Revenue Agency, testified at the hearing as a valuation expert. The appellant did not challenge her expert status, and the narrative in the expert report dated August 8, 2013, represents this witness' testimony. Her mandate was to provide an indication of the fair market value of the 68,775,000 Class "B" AIMO shares held by OREX as of February 10, 2004, the date of continuance of OREX A.G. The valuation was conducted in July 2009, several years after the years 2003 and 2004, and does not constitute a formal opinion as to the fair market value of the shares. The valuator did not contact ISPA and did not visit the operating mines. She primarily relied on the information contained in ISPA's 2004 annual report, which contained the consolidated financial statements and external auditors' report for the years ending December 31, 2003 and 2004.

[21] The valuator used the adjusted net asset method to determine the fair market value of the 68,777,500 Class "B" AIMO shares and the 880 OREX shares. According to the valuator, the fair market value of the shares of each of the two investment companies was estimated at \$2,500,000. For the Okhotsk shares, the valuator used the discounted cash flow method to determine their fair market value. According to the valuator's calculations based on a number of assumptions, the fair market value of the investment of 20% of the shares of the company was \$8,300,000 as at February 10, 2004.

[22] Based on the transaction undertaken by Okhotsk in April 2004, the value of the investment of 20% of the company's shares held by AIMO was estimated at \$8,689,000 (based on an exchange rate of US\$1.3 on the Canadian dollar). The transaction in question is the one in which Okhotsk issued 20,592 new common shares of its capital stock for a total price of US\$33,420,000. ISPA subscribed to

14,136 shares for US\$22,942,000, and the other shareholders subscribed to 6,456 shares for US\$10,478,000. AIMO did not participate in the issuance of new shares, which decreased its percentage of shares from 20% to 1.89%.

Analysis

[23] The obligation to file Form T1134-A arises from the application of subsection 233.4(4) of the Act, which reads as follows:

233.4(4) **Returns respecting foreign affiliates.** A reporting entity for a taxation year or fiscal period shall file with the Minister for the year or period a return in prescribed form in respect of each foreign affiliate of the entity in the year or period within 15 months after the end of the year or period.

[24] The term “reporting entity” for the purposes of section 233.4 of the Act is defined in subsection 233.4(1) of the Act as follows:

233.4(1) For the purpose of this section, “reporting entity” for a taxation year or fiscal period means

- (a) a taxpayer resident in Canada (other than a taxpayer all of whose taxable income for the year is exempt from tax under Part I) of which a non-resident corporation is a foreign affiliate at any time in the year;

...

[25] At the hearing, it was admitted that the appellant resided in Canada during the 2003 and 2004 taxation years and that OREX A.G. was at any time in the 2003 and 2004 taxation years a non-resident corporation that was a foreign affiliate within the meaning of subsection 95(1) of the Act, of the appellant. Consequently, the appellant was, in principle, required to file a Form T1134-A for each of the 2003 and 2004 taxation years. The deadline for filing said form was March 31, 2005, for the 2003 taxation year and March 31, 2006, for the 2004 taxation year.

[26] The appellant did not file Forms T1134-A because, according to the form’s instructions, he was not required to do so owing to the fact that OREX A.G. was a

“dormant” or “inactive” foreign affiliate for the purposes of said form, that is, a corporation

- a. that had gross receipts (including proceeds from the disposition of property) of less than \$25,000 in the year; and
- b. at no time in the year had assets with a total fair market value of more than \$1,000,000.

[27] The issue, therefore, is whether the fair market value of OREX A.G.’s assets was, at any time between December 3, 2003, and February 10, 2004, more than \$1,000,000.

[28] The reassessments that are the subject of this dispute were issued on June 23, 2010, under subsection 162(7) of the Act, which states as follows:

162(7) **Failure to comply.** Every person (other than a registered charity) or partnership who fails

(a) to file an information return as and when required by this Act or the regulations, or

(b) to comply with a duty or obligation imposed by this Act or the regulations

is liable in respect of each such failure, except where another provision of this Act (other than subsection 162(10) or 162(10.1) or 163(2.22)) sets out a penalty for the failure, to a penalty equal to the greater of \$100 and the product obtained when \$25 is multiplied by the number of days, not exceeding 100, during which the failure continues.

[29] Considering that the reassessments were issued outside the normal reassessment period, the respondent has the burden of establishing that the appellant made a misrepresentation attributable to neglect, carelessness, or wilful default by not filing Forms T1134-A.

[30] According to the appellant, the value of the OREX A.G. shares was determined at the time of AIMO’s dissolution, which occurred on June 30, 2007, well after the reporting periods for Form T1134-A for 2003 and 2004. The appellant alleged that he had acted in good faith and that there was no neglect or wilful default on his part. He took a reasoned and reasonable position during the reporting periods, even though he later admitted that the AIMO shares held by OREX were worth over \$1,000,000.

[31] According to the respondent, the relief provided in Form T1134-A is only administrative relief and the appellant had the burden of ensuring that the value of the AIMO shares was less than \$1,000,000. The appellant made no effort to try to determine the value of the shares and only relied on his general knowledge that the shares had no value even though he acquired them for US\$200,000. He did not have the financial statements of OREX A.G. and OREX for the 2003 and 2004 taxation years prepared within the prescribed time limits. He did not have OREX A.G.'s tax returns for the 2003 and 2004 taxation years prepared and did not consult his accountant about his obligation to file Forms T1134-A. The respondent alleged that the appellant did not exercise due diligence as he could have filed Forms T1134-A in 2007 under the Voluntary Disclosures Program. For the respondent, good faith is not sufficient, and concrete action was required on the appellant's part to determine the fair market value of the AIMO shares.

[32] In light of the facts adduced in evidence, it appears clear to me that the appellant had in-depth knowledge of the operations of OREX A.G. and OREX, of AIMO and the private corporation Okhotsk, which was incorporated to hold mining licences for the two gold and silver mines located in Russia. He handled OREX A.G.'s continuance in Canada. He was informed of the financing transactions (share issuance and sales) performed in 2004 by Okhotsk and its shareholders. He saw AIMO's financial statements for the year ending December 31, 2004, along with the 2003 comparative figures, which were prepared by external auditors on July 11, 2005.

[33] The appellant acquired the OREX A.G. shares under very specific circumstances. The acquisition price of the 256 OREX A.G. shares was set at US\$200,000. The shares' acquisition price was not paid at the time of acquisition but was the subject of an acknowledgement of debt in the amount of US\$200,000 that would only become payable within ten days after the appellant received the funds from the proceeds of sale of AIMO's securities held by OREX A.G. and the proceeds of sale were distributed to OREX A.G.'s shareholders, which included the appellant.

[34] The terms and conditions of the transaction described above suggest that the value of the OREX A.G. shares and its investment in AIMO was very dubious. The acquisition price of the OREX A.G. shares was payable only through the proceeds of disposition of its investment in AIMO. The shares surely had a certain value at the time of their acquisition, and it was likely that the value of the shares would increase in future years for the appellant to have seen fit to acquire them. The appellant did not assume any financial risk when he acquired the OREX A.G. shares.

[35] The transaction performed in April 2004 by which Okhotsk issued 20,592 new shares to some of its shareholders for a total consideration of US\$33,420,000 enabled it to finance future transactions. AIMO was not involved in this financing, and its investment in Okhotsk was significantly diluted. Even if the appellant had wanted at that point to have this very minor ownership in a Russian private corporation valued, it would have been a very arduous task, and the result would surely have been very unreliable.

[36] The market value of AIMO's investment in Okhotsk was only really determined at the time of the redemption, in August 2006, of the 429 shares for US\$7,500,000, and it was not until then that it became possible to establish with some degree of certainty the fair market value of OREX's investment in AIMO.

[37] In the circumstances, I am of the view that the appellant made a thoughtful, deliberate and careful assessment of the value of OREX's investment and that he did not make any misrepresentation attributable to neglect or wilful default by not filing Forms T1134-A for the 2003 and 2004 taxation years. I do not believe the appellant's interpretation of the facts can be considered unreasonable in the circumstances.

[38] For these reasons, the appeals are allowed and the reassessments are vacated.

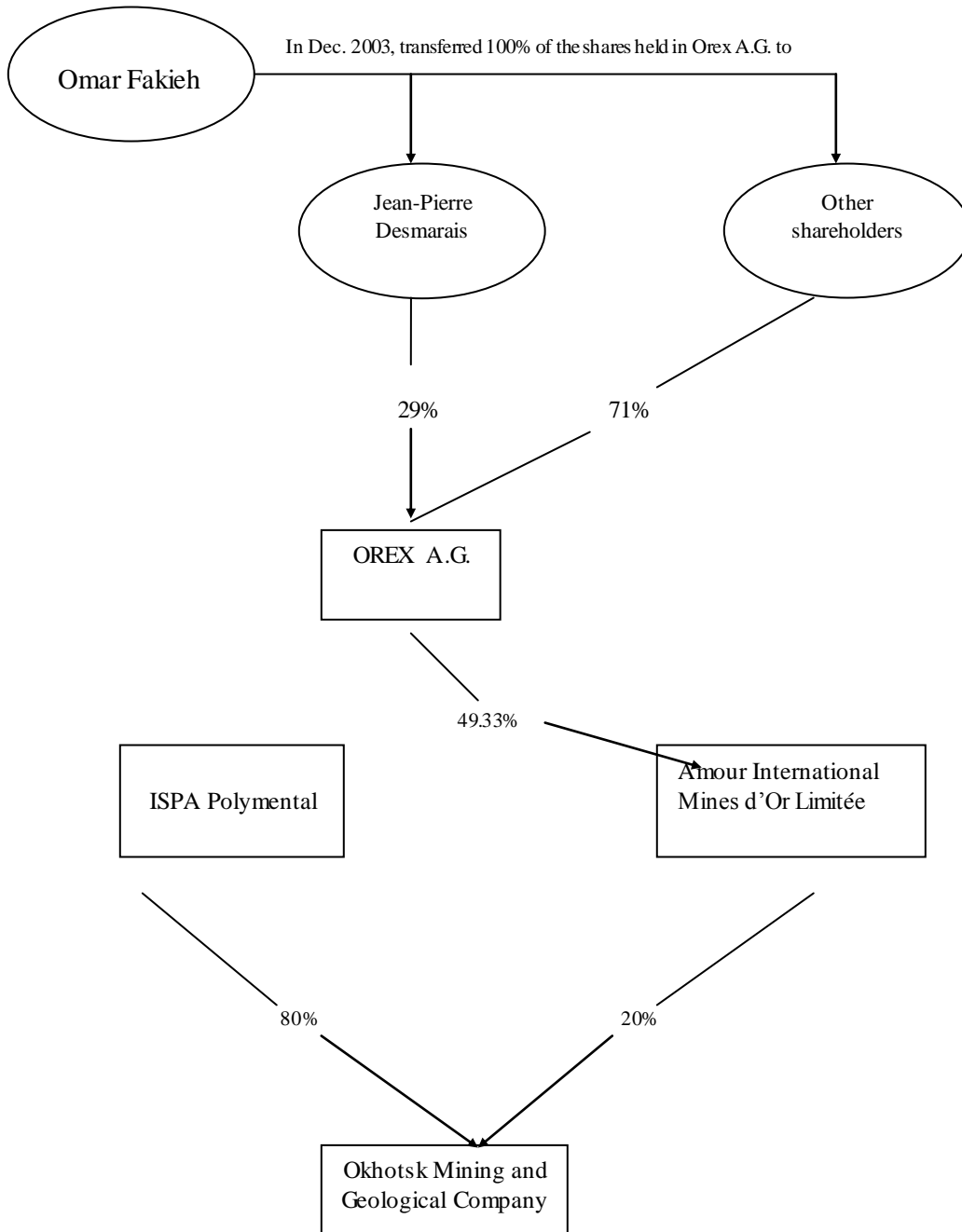
Signed at Ottawa, Canada, this 7th day of November 2013.

“Réal Favreau”

Favreau J.

Translation certified true
on this 3rd day of January 2014
Daniela Guglietta, Translator

Situation in December 2003



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APPEARANCES:

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Counsel for the respondent: Gabriel Girouard

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