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BY ANDRÉANNE MILLETTE & RAPHAEL BARCHICHAT

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AFTER DE FACTO DIRECTORS, WE NOW HAVE DE FACTO SHAREHOLDERS

Under section 160 of the ITA, a transferee of property may be assessed for the tax liability of the transferor to the extent that the FMV of the transferred property exceeds the FMV of the consideration given for the property. Salary payments are generally not subject to section 160, because the recipient has given consideration for the payment by performing services. In deciding to apply section 14.4 of the Tax Administration Act (TAA) (Quebec's version of section 160), the Court of Appeal of Quebec considered a purported salary payment to be a dividend, which is deemed to be a transfer of property without consideration. This approach gave the transferee the novel status of "de facto shareholder" of the corporation (Normand c. Agence du revenu du Québec, 2020 QCCA 450; aff'g 2019 QCCQ 7533). But it is not clear that this deemed shareholder status was required in order to apply section 14.4: would the mere existence of a transfer of property in excess of consideration have been sufficient?

The case concerned the actions of Adams Holding Inc. ("the corporation"), whose sole director was Mr. Adams, a business partner of Mr. Normand. Mr. Adams was required to compensate Mr. Normand to settle a dispute between the partners in respect of a business project they carried out together. Subsequently, the corporation issued cheques to Mr. Normand at a time when a related corporation had an unpaid tax liability. Revenu Québec assessed Mr. Normand under section 14.4, applying the principles established in Ouellet c. Agence du revenu du Québec (2015 QCCQ 12916).

One prerequisite for this section to apply was that Mr. Normand and the corporation could not be dealing at arm's length. This is a question of fact, given that Mr. Normand and the corporation were not related persons: Mr. Adams was the corporation's sole director. The court concluded that Mr. Normand's claim that the sums that he received from the corporation constituted a salary, and that he was merely an employee, was implausible. Instead, the court held that Mr. Normand was a de facto shareholder of the corporation, and he controlled the business project with Mr. Adams. The court also concluded that the steps taken by Mr. Normand to have a debt owed to him recognized, as well as the resulting concessions, were evidence of a balance of power between the partners in which neither had greater control than the other (Fournier v. MNR, 91 DTC 743 (TCC)). Thus, the court established that Mr. Normand and the corporation were not dealing at arm's length.

Regarding the issue of consideration, Mr. Normand contended that the sums that he received from the corporation were for his work on the business project. The court instead established that the sums received represented dividends paid to Mr. Normand as a de facto shareholder and director of the corporation. The jurisprudence is clear: the receipt of a dividend is linked to a person's status as a shareholder. A dividend is a return on capital invested, and is in no way dependent on a shareholder's conduct (Larouche v. The Queen, 2008 TCC 448). The court concluded that the sums received had to be treated as dividends, even if Mr. Normand was not legally registered as a shareholder. In this case, the payment of dividends represented a transfer of property. The transfer is deemed to have been made without consideration (within the meaning of the TAA) where the transferor is a tax debtor (Bruneau v. The Queen, 2010 TCC 145).

With this win for Revenu Québec, we believe that the concept of "de facto shareholder" will not only be discussed at length in the near future, but will be increasingly relied on by the tax authorities.

Andréanne Millette and Raphael Barchichat
amillette@psbboisjoli.ca
rbarchichat@psbboisjoli.ca

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