

## INCOME TAX

### REASSESSMENT

Appeal from Tax Court of Canada (T.C.C.) decision confirming validity of reassessment issued by Minister of National Revenue (Minister) with respect to appellant's 2005 taxation year — Reassessment issued pursuant to general anti-avoidance rule (GAAR) provided for in *Income Tax Act*, R.S.C., 1985 (5th Supp.), c. 1, s. 245 — Appellant president of construction company Hervé Pomerleau Inc. — Wanting to build chalet from company funds — Tax plan put in place to minimize impact of any resulting tax liability — Central element of plan preservation of adjusted cost base (ACB) of certain shares of Groupe Pomerleau Inc. (Groupe Pomerleau), sole shareholder of Hervé Pomerleau Inc. — Groupe Pomerleau's share capital held by members of Pomerleau family as Class F shares — In order to implement tax plan, family members transferring shares into holding company, P Pom Inc. (P Pom), then to appellant — P Pom redeeming its shares at price equal to their fair market value — Act, s. 84(3) becoming operational with result that appellant deemed to have received dividend in amount of \$994,628, to have incurred capital loss in same amount — This loss in turn deemed nil by operation of Act, s. 40(3.6)(a), added to ACB of shares held by appellant in capital stock of P Pom — Accordingly, ACB of these shares increasing to \$1,993,812 — Appellant then transferring Class A shares to other holding company, Gestion Pierre Pomerleau Inc. (Gestion), receiving Class A and C shares of Gestion in exchange — Transfer made by way of rollover pursuant to Act, s. 85(1) — Shares of Gestion redeemed for amount equal to their paid-up capital, putting \$1,993,812 in hands of appellant as return of capital — Appellant avoiding application of Act, s. 84.1 — S. 84.1 providing, *inter alia*, that where taxpayer transfers shares of one corporation to another corporation (subject shares) with which it does not deal at arm's length and receives shares as consideration (new shares), paid-up capital of new shares equal to greater of paid-up capital of subject shares or their ACB — For purposes of this calculation, ACB of subject shares must be reduced when comprising amounts in respect of which taxpayer or person related to taxpayer previously claimed capital gains deduction — Reduction herein having no effect by reason of combined application of Act, ss. 40(3.6)(a),(b), 53(1)(f.2) triggered by appellant's tax plan — Minister arguing result defeating underlying rationale of s. 84.1(2)(a.1) because out of the \$1,993,812 received by appellant upon redemption of shares of Gestion, \$994,628 traced to amounts in respect of which capital gains deduction claimed, on which no tax paid — Minister's reassessment rendering appellant liable for tax on deemed dividend of \$994,628 as result of combined effect of s. 84.1(1)(a), s. 84(3) — T.C.C. concluding that object, spirit, purpose of s. 84.1 frustrated by result achieved herein — Whether T.C.C. correct — T.C.C. correctly holding that withdrawal of \$994,628 from surpluses of Gestion without tax being paid frustrating object, spirit, purpose of s. 84.1, more specifically s. 84.1(2)(a.1)(ii) — Paid-up capital of share, shareholder's ACB fundamental concepts underlying s. 84.1 — Purpose of s. 84.1 to prevent amounts which have not been subject to tax from being used in order to allow shareholders to withdraw corporate surpluses on tax-free basis — Amounts which may be extracted without tax limited to paid-up capital — Specific aim of s. 84.1 to prevent paid-up capital from being increased by non-taxed amounts generated through non-arm's length transactions — S. 84.1(2)(a.1) altering computation of ACB of subject share to prevent accrued gains, exempt amounts from increasing paid-up capital of new share — Calculation set out in subparagraph 84.1(2)(a.1)(ii) successfully avoided herein thereby giving rise to tax benefit — As result of series of transactions by appellant, family members "amount" referred to in s. 84.1(2)(a.1)(ii) no longer one "in respect of which a deduction under section 110.6 was claimed", but one reflecting deemed capital loss triggered by appellant — Follows that s. 84.1(2)(a.1)(ii) could not reduce ACB of subject shares, consequently s. 84.1(1)(a) not reducing paid-up capital of new shares — This allowing appellant to remove \$994,628 on tax-free basis following redemption of shares of Gestion — S. 84.1 having scope extending beyond its words — S. 84.1(2)(a.1)(ii) requiring to look beyond ACB of subject shares, asking whether it is made up of amounts on which tax not paid — When

regard is had to object, spirit, purpose of s. 84.1(2)(a.1)(ii), what matters is connection between amounts not subjected to tax, use that is made of those amounts in order to achieve tax-free distribution — Planned interposition of deemed dividend provided for in s. 84(3), resulting deemed loss under s. 40(3.6)(a) not altering fact that amount of \$994,628 continuing to represent funds on which no tax paid — S. 84.1 preventing persons not dealing at arm's length from taking advantage of their close relationship in order to remove corporate surplus on tax-free basis — Nothing in language or object, spirit, purpose of provision pointing to intent to exclude from its scope such extractions when carried out by family members, no matter context — Appeal dismissed.

POMERLEAU V. CANADA (A-456-16, 2018 FCA 129, Noël C.J., judgment dated June 29, 2018, 42 pp.)