Tax Court of Canada | Cour canadienne de l'impôt

Docket: 2003-2956(IT)G

BETWEEN:

AVOTUS CORPORATION,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on October 17 and 18, 2005, at Toronto, Ontario.

Before: The Honourable Justice B. Paris

Appearances:

Counsel for the Appellant:	Roger Taylor
	Al-Nawaz Nanji
Counsel for the Respondent:	Richard Gobeil
	April Tate

JUDGMENT

The appeal from the reassessments made under the *Income Tax Act* for the 1995, 1997, 1998 and 1999 taxation years is allowed, with costs, on the basis that the Appellant was entitled to take into account the losses and income of MDR of the Americas, Inc. in the calculation of its income for the years under appeal.

Signed at Ottawa, Canada, this 21st day of November, 2006.

"B. Paris"

Paris J.

Citation: 2006TCC505

Date: 20061121

Docket: 2003-2956(IT)G

BETWEEN:

AVOTUS CORPORATION,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

ParisJ.

[1] The Appellant, Avotus Corporation, is appealing from reassessments of its predecessor corporation, MDR Technologies Inc. ("MDR"), for its taxation years ended April 30, 1995, 1997, 1998 and 1999.

[2] There are two principal issues in this appeal. The first is whether, during the years in issue, the Appellant's Puerto Rican subsidiary, MDR of the Americas, Inc. ("Americas"), was carrying on business as the Appellant's agent or on its own behalf.

[3] The Appellant reported its income on the basis that Americaswas its agent throughout the years in issue. It therefore included the following losses and income of Americasin calculating its own income for Canadian tax purposes:

1995	($ 291,562)
1997	($1,428,073)
1998	($ 842,002)

1999 ($ 571,621)

[4] The Minister of National Revenue (the "Minister") reassessed on the basis that Americas carried on business on its own behalf, and accordingly deleted Americas' income and losses from the calculation of the Appellant's income.

[5] Counsel for the parties agreed that, should it be held that Americaswas not carrying on business in Puerto Rico as an agent of the Appellant, the Appellant's income for 1999 should be reduced by $571,621, which is the amount the Appellant included in its income from the Puerto Rican operations.

[6] The second issue in this case is whether the Appellant was controlled by a non-resident of Canadaduring the years under appeal. If so, the Appellant would not qualify as a "Canadian-controlled private corporation" ("CCPC") as defined in subsection 125(7) of the *Income Tax Act* (the *"Act"*)[1] and would not be entitled to the following amounts claimed in respect of the small business deduction and certain investment tax credits:

Small business deduction: 1995 - $29,244

1997 - $31,631

1998 - $26,602

Investment tax credits: 1995 - $60,691

1998 - $125,561

Carl Santoni, Steve Massel and Peter Kaju were called as witnesses at the hearing. Mr. Santoni was a director and shareholder of the Appellant until 2002. Mr. Massel has been the chief financial officer of the Appellant since June 2004 and Mr. Kaju is the current director of finance. Portions of the examination for discovery of Stan Tyo, president of the Appellant from 1991 to 1999 and from 2000 until 2002, were also read in as evidence.

Facts

[7] As indicated earlier in these reasons, the Appellant is the successor corporation of MDR Technologies Inc., which was formerly called MDR Telemanagement Ltd. The latter company was created on May 1, 1994 by the amalgamation of MDR Telemanagement Ltd., T.C. Networking Ltd. and Intelligent Computing Devices Ltd.

[8] The Appellant was in the business of engineering, manufacturing, distributing and servicing a line of software and hardware products used by organizations to allocate and cost their voice and data communications services. Its head office and principal place of business was in Oakville, Ontario. It also had offices in Calgary and Montreal.

[9] During the years in issue, 50% of the shares of the Appellant were held by Richard Malone and 25% each were held by Carl and Agnes Santoni. The directors of the Appellant were Richard Malone and Carl Santoni. Richard Malone was the chairman of the board. Up to September 15, 1994, all of the shareholders and directors of the Appellant were residents of Canada. On that date Malone left for Puerto Rico and ceased to be a resident of Canada.

Agency issue

Incorporation of Americas

[10] In or around 1994 the Appellant decided to establish business operations in Puerto Rico to sell its products in Puerto Rico and in the Caribbean. It incorporated Americason July 20, 1994 as its wholly owned subsidiary and appointed Richard Malone to run the company. Richard Malone and Carl Santoni became the directors of the new corporation. According to its certificate of incorporation, Americas' business was "to be carried on for pecuniary profit".

[11] The Appellant had several reasons for incorporating Americas. One was a desire to create a local corporation with which Puerto Rican customers and businesses could deal. Another reason was to enable Malone to obtain a visa to work in Puerto Rico. That visa could only be obtained if he was working for a corporation resident there. It was also necessary to set up the Puerto Rican corporation in order to obtain a Puerto Rican business bank account.

[12] After its incorporation, Americas proceeded to lease office and warehouse space, to hire employees, to set up a bank account, to obtain necessary licences, permits and approvals, to purchase equipment, and generally to carry on business selling the Appellant's products.

[13]According to a written agreement "made as of the 20th day of July, 1994", the Appellant and Americasagreed that Americas would act as the Appellant's agent for the purpose of establishing the Appellant's business in Puerto Rico and the Carribbean. The agreement was signed by Carl Santoni on behalf of the Appellant and by Richard Malone for Americas. The agreement was not dated but I accept that it was executed in early 1996.[2] The relevant portions of the agreement read as follows:

WHEREAS MDR desires to establish business operations (the "Business") in the Commonwealth of Puerto Rico (the "Territory"), such business to be carried on directly by MDR and not through a subsidiary of MDR;

AND WHEREAS MDR desires to appoint the Agent as its agent to facilitate the establishment and organization of the Business and to act as its agent in connection with all matters in furtherance thereof;

. . .

1. APPOINTMENT

MDR hereby appoints the Agent as its non-exclusive agent in connection with the establishment by MDR of the Business in the Territory and the Agent hereby accepts such appointment.

2. SERVICES TO BE PERFORMED BY THE AGENT

The parties hereto agree that the Agent shall act on behalf of MDR in the opening of all bank accounts, the lease or purchase of all office, warehouse or other space, the hiring of all employees, the obtaining of all required licences, permits and approvals from all applicable government or regulatory authorities, the purchase of all applicable equipment, supplies and goods for resale and the entering into of all deeds, contracts, instruments and agreements with third parties in connection with the establishment and initial organization of the Business. The parties hereto acknowledge and agree that all rights and obligations under any contracts, instruments or agreements which may become vested in the Agent shall be rights and obligations of MDR and the Agent agrees, at the request of MDR, to take all such action as is necessary and execute all such deeds, documents, assignments or agreements as may be required to effect the prompt assignment of such rights to MDR. In the event that the rights and obligations . . . which may become vested in the Agent under any contract, instrument or agreement are non-assignable by reason of operation of law or by reason of the terms of such contract, instrument or assignment prohibiting such assignment or requiring the consent of the other party or parties thereto in order to effect such assignment and where such consent is not forthcoming, the parties hereto agree that all rights under such contract, instrument or agreement shall be held in trust by the Agent for the exclusive benefit of MDR.

3. COVENANTS OF THE AGENT

The Agent covenants and agrees with MDR that it will obey MDR's orders and instructions in relation to the Business, will conduct the establishment and initial organization of the Business in an orderly and businesslike manner and will comply with all applicable laws, rules, regulation [*sic*] and requirements applicable to the Business. . . .

...

5. TERM

This Agreement shall have an initial term of twelve (12) months from the date hereof and shall be renewed automatically for additional terms of twelve (12) consecutive months commencing on the first and each subsequent anniversary date of this Agreement until such time as the Business has been fully established and organized in the Territory, at which time MDR shall give notice to the Agent of the termination of this Agreement. Notwithstanding the foregoing, either party hereto may terminate this Agreement upon providing the other party with written notice to that effect.

[14] The stated consideration for the agreement was one dollar payable by the Appellant to Americas. No other amounts, commissions or fees were payable.

[15] No notice of termination of the agreement was ever given by either party. According to Stan Tyo, the initial organization of the business would probably have been finished at some point in 1994. However, he did not agree that the business would have been fully established at the time the agreement was signed in 1996. According to Mr. Massel, the business was still not fully established in Puerto Rico at the time of the hearing of the appeal, because Americasstill required working capital and financial assistance from the Appellant to support the business. He said that up to the end of September 2005 the cumulative deficit from Americas' operations was $227,000.

[16] Carl Santoni testified that it was the Appellant's intention to run the Puerto Rico office as a branch office of the Appellant similar to its offices in Calgary and Montreal and, in his view, the agency agreement documented this business relationship.

[17] Despite the agency agreement, Americas' financial statements were prepared on the basis that it was carrying on business on its own account, and it filed tax returns in Puerto Rico in its own name on the same basis. The financial statements showed revenue and expenses related to the sale of the Appellant's products, significant outstanding shareholder debt owed by Americas to the Appellant, and assets owned by Americas.

[18] The net income or loss shown on Americas' financial statements was reported each year in its Puerto Rican tax returns. Americasclaimed losses for Puerto Rican tax purposes in 1995, 1996, 1997 and 1998 and showed income in 1999, 2000, 2001, 2002 and 2003.

[19] There were no representations in either the financial statements or tax returns that Americaswas acting as agent for the Appellant.

[20] The Puerto Rican financial statements and tax returns were prepared by professional accountants working for Americas. In cross-examination, Carl Santoni stated that the management of both the Appellant and Americaswould have provided the necessary information for the preparation of the financial statements and tax returns to the accountants for Americas. The tax returns were signed by Richard Malone.

[21] The Appellant, on the other hand, consistently treated the expenses and revenues of Americas as its own in its financial statements and in its Canadian tax returns from the time that Americaswas incorporated. No amounts were shown on the Appellant's financial statements as amounts owing by Americas, and amounts recorded by Americas in respect of assets, liabilities, revenues and expenses were accounted for on the basis that the Puerto Rico operations were a branch of the Appellant and not on the basis that the business was carried on by a subsidiary on its own account.

[22] In order to fund operations in Puerto Rico, the Appellant transferred money from Canadato Americas' Puerto Rican bank account. Apparently money would be transferred as required. Carl Santoni referred to these as "transfers" of funds, while Mr. Tyo said, in his examination for discovery, that the Appellant loaned money to Americas. Mr. Tyo also said that these loans were repaid as Americasbegan to make a profit. No loan documentation was ever prepared in respect of the transfers, and nothing in the Appellant's accounts identified the transfers as loans.

[23] The lease agreements entered into by Americaswere in its own name and not in the name of the Appellant. Similarly Americasopened a bank account in its own name.

[24] A sampling of invoices sent out by Americasto customers was produced at the hearing. Most of those invoices identified Americas as a "division" of the Appellant and one referred simply to "MDR" and showed three business addresses-one for the Oakville head office, one for the Montreal office and the address of Americas in San Juan, Puerto Rico.

[25] Another set of invoices dated between 1994 and 1997 shows that the Appellant invoiced

customers in Puerto Rico and the Carribbean for extended warranties and maintenance agreements on products that were sold by Americas. The extended warranties and service were provided directly by the Appellant. However, three distribution agreements that Americas entered into in 1998, 1999 and 2000 with local telephone companies in the Caribbean show that Americaswas to provide maintenance and technical support for the products that were sold to the telephone companies.

CCPC Issue

[26]The bylaws of MDR that were adopted when the Appellant was formed by amalgamation in May 1994 contained provisions giving the chairman of the board a deciding or "casting" vote in the event of a tie in any vote held at a meeting of the directors or shareholders. Those provisions read as follows:

14. Voting. Questions arising at any meeting of the board of directors shall be decided by a majority of votes. In case of an equality of votes the chairman of the meeting in addition to his original vote shall have a second or casting vote.

25. Chairman of the Board. The Chairman of the Board, if any, shall, when present, preside as chairman at all meetings of the directors, the committee of directors, if any, and the shareholders.

40. Votes. Every question submitted to any meeting of shareholders shall be decided in the first instance by a show of hands unless a person entitled to vote at the meeting has demanded a ballot and in the case of an equality of votes the chairman of the meeting shall both on a show of hands and on a ballot have a second or casting vote in addition to the vote or votes to which he may be otherwise entitled.

[27] The bylaws were prepared by the Appellant's lawyers, and were signed by Carl Santoni and Stan Tyo as secretary and president respectively of the Appellant. The bylaws were confirmed by a directors' resolution signed by Richard Malone and Carl Santoni and by a shareholders' resolution signed by Richard Malone, Carl Santoni and Agnes Santoni.

[28] Carl Santoni testified that he did not review the bylaws before signing them. He said that the provision giving the chairman a casting vote was a clerical error and he was not aware of the provision nor did he intend the chairman to have a casting vote when he signed the bylaws and the resolutions relating thereto. Carl Santoni said it was only in the spring of 1999, when he was reviewing corporate documents related to a proposed name change, that he discovered that the chairman had a casting vote. At that point, he immediately contacted Malone, who told him to have the provision deleted. Given Richard Malone's reaction to the news, Carl Santoni was of the opinion that Richard Malone was also unaware of the provision. He said that the casting vote provision had never been discussed by them before that time.

[29] In Carl Santoni's view, this provision in the bylaws was likely carried forward from the bylaws of the Appellant's predecessor corporations without any thought being given to the matter.

[30] Carl Santoni said that he gave instructions to change the bylaws of the Appellant by eliminating the casting vote of the chairman of the board, and that the change was put into effect by special resolution on June 24, 1999. He said that the change was not in any way linked to the audit of the

Appellant by the CRA which was then underway. He also said that he was unaware that there could be a tax issue in relation to the casting vote provision.

[31] Richard Malone was not called to testify.

Position of the parties

Appellant's submissions

[32] Counsel for the Appellant referred to the statement of the Supreme Court of Canada in *Shell Canada Ltd. v. Canada*[3] that, "absent a specific provision of the Act to the contrary or a finding that they are a sham, the taxpayer's legal relationships must be respected in tax cases", and said "that the written agreement that the Appellant entered into with Americas was effective to make Americas the Appellant's agent". According to the agreement, Americaswas to act on behalf of the Appellant in the performance of the following duties: opening bank accounts, leasing office space, hiring employees, obtaining government permits, purchasing equipment and entering into contracts with third parties. The agreement also provided that all contracts of Americaswere contracts of the Appellant and that Americaswould, as applicable, assign the rights in those contracts to the Appellant.

[33] The relationship that was created between the Appellant and Americaswas consistent with that described by G. H. L. Fridman in *The Law of Agency*:

Agency is the relationship that exists between two persons when one, called the agent, is considered in law to represent the other, called the principal, in such a way as to be able to affect the principal's legal position in respect of strangers to the relationship by the making of contracts or the disposition of property.[4]

[34] Counsel for the Appellant submitted that losses of a subsidiary are deductible by the parent in cases where the subsidiary is acting as the parent's agent.[5]

[35] Appellant's counsel cited the preamble of the agency agreement as evidence that the Appellant and Americas intended Americasto carry on the Appellant's business in Puerto Rico as an agent rather than as a subsidiary. Corroboration of this intention is found in the Appellant's consistent reporting of the revenue and expenses of Americasas its own from the time that Americaswas incorporated.

[36] Counsel argued that the agency relationship was not terminated at any point during the years in issue since none of the conditions for termination contained in the agreement were ever met. The agreement was to run for an initial 12-month term and be automatically renewed for 12-month terms until such time as the business was fully established and organized in Puerto Rico. At that point the Appellant was required to give Americasnotice of the termination of the agreement. The agreement also provided that either party could terminate it on written notice.

[37] Although the agreement did not set out a basis for determining when the business would be considered to be fully established and organized, counsel stated that given that Americas generated losses up to 1998, and still required working capital from the Appellant at the present time, it could not be said that the business in Puerto Rico was fully established and organized at any time prior to 2000.

Furthermore, according to Carl Santoni and Steve Massel, no notice of termination was ever given by either party.

[38] Also, since the agency agreement was actually executed sometime in 1996, it would not make sense to find that the phrase "fully established and organized" only contemplated the initial steps of renting premises and hiring employees, since those steps had already been accomplished before 1996. It would have rendered the agreement meaningless at the time it was entered into if the words "fully established and organized" had been construed narrowly.

[39] The Appellant's counsel argued in the alternative that if the agency agreement is found to have been terminated prior to 1999, an implied agency relationship existed between the Appellant and Americas after that date according to the indicia set out by the Federal Court, Trial Division in *Denison Mines Limited v. M.N.R.*[6]

[40] Counsel also made representations regarding how the Appellant would have been taxed in the U. S.had it filed tax returns there in respect of the business carried on in Puerto Rico. I do not intend to deal with those submissions given that, as pointed out by counsel for the Respondent, there has been no expert evidence produced to prove the U.S.tax law relied on by the Appellant.

[41] On the second issue, the Appellant's counsel submitted that the Appellant was not controlled by a non-resident of Canada- Richard Malone - during the years under appeal, and therefore it qualified as a CPPC and was entitled to the small business deduction and ITCs as claimed. Counsel stated that Richard Malone did not have *de jure* control of the Appellant because he did not own more than 50% of the shares in the Appellant and that Malone did not have control in fact of the Appellant because he did not have any direct or indirect influence that would have resulted in control in fact of the Appellant as required by subsection 256(5.1) of the *Act*. The casting vote provisions in the Appellant's bylaws did not give Richard Malone any influence because neither he nor Carl Santoni were aware that the provisions existed. Counsel said:

In order for Richard Malone to have influence (directly or indirectly) he had to have been aware of the existence of the chairman's casting vote and Carl Santoni had to be aware that Richard Malone was aware of the Chairman's casting vote. Without mutual knowledge of the casting vote, Richard Malone could not have had such influence, which if exercised would result in control in fact of the Corporation within the meaning of subsection 256(5.1) of the Act.

Respondent's submissions

[42] The Respondent takes the position that there was never a valid agreement between the Appellant and Americasmaking Americas the Appellant's agent for the purpose of carrying on business in Puerto Rico. Counsel argued that the conduct of the Appellant and Americasdoes not support the conclusion that the parties intended to have an agency relationship during the relevant period.

[43] Counsel for the Respondent relied on the decision of the Federal Court, Trial Division in *Denison Mines* (*supra*), in which the taxpayer was unsuccessful in its attempt to deduct its subsidiary's losses in calculating its own income on the basis that its subsidiary was its agent. Counsel referred to the following comments of Cattanach J. at page 5389:

. . . it is important to bear in mind that limited companies that carry on businesses are separate taxable persons and the profits of their respective businesses are separate taxable profits whether or not one be the subsidiary of the other. Any attempt to erode this principle must be based upon clear and unequivocable facts leading to the irrebutable [*sic*] conclusion that one legal entity is acting as the agent of another and that legal entity is really doing the business of the other and not its own at all.

[44] Counsel submitted that the facts in this case are far from clear and unequivocal and do not lead to a conclusion that an agency agreement existed between the Appellant and Americas.

[45] The Respondent's counsel said that the conduct of the parties was inconsistent with an intention that Americasact as the Appellant's agent. Americas' financial statements and tax returns did not disclose that it was acting as the Appellant's agent, and they were prepared on the basis that Americasoperated the business on its own behalf. In counsel's view the treatment of advances and revenue was also inconsistent with an agency arrangement. Americasrecorded advances as loans on its financial statements and used revenue from the business to pay its own expenses. Furthermore, Americasdid not disclose that it was acting as the Appellant's agent on Richard Malone's visa application and in its articles of incorporation or to any third parties. Finally, it did not receive any compensation from the Appellant for acting as its agent.

[46] Counsel for the Respondent submitted that if it is found that the written agreement created a valid agency relationship between the Appellant and Americas, the agency relationship existed only for the limited purpose of having Americasfacilitate the establishment and initial organization of the business and not for the purpose of running the business. He said that the agency agreement was intended to terminate once the business in Puerto Rico was established and organized and did, in fact, terminate at the end of 1994 because the business of the Appellant in Puerto Rico was fully established and organized at that point.

[47] The Respondent's counsel also argued that the appointment of Americasas the Appellant's agent was invalid because "an agent cannot accomplish on behalf of a principal that which the principal could not legally accomplish" (see *DenisonMines* (*supra*) and *Alberta Gas Ethylene Co. v. The Queen*[7]). Counsel submitted that one of the purposes for which Americas was set up was to enable Richard Malone to obtain a work visa, which the Appellant would not have been able to obtain for Richard Malone itself nor would the Appellant have been able to obtain a business bank account in Puerto Rico or deal with Puerto Rican utilities directly, as was done by Americas. Counsel submitted that, since Americas accomplished things that the Appellant could not accomplish, Americascould not have been the agent of the Appellant vis-à-vis the Puerto Rican banks and Puerto Rican utilities.

Analysis

[48] It is established in the case law that there is no bar to a corporation acting as agent for its shareholder. In *Denison Mines* (*supra*) Cattanach J. noted at page 5388:

. . . it is conceivable that there may be an arrangement between the shareholder and the company which will constitute the company, the shareholder's agent, for the purpose of carrying on the business and so make the business that of the shareholder. It is immaterial that the shareholder is itself a limited company.

Cattanach J. went on to say:

. . . The basis of agency is a contractual relationship either express or implied.

[49] In *Denison Mines* (*supra*) there was no express contract of agency between the taxpayer and its subsidiary corporation, and the court declined to find that there was an implied contract of agency between them. By contrast, in this case the Appellant and Americas entered into a written agency agreement.

[50] The Respondent's position is, in effect, that the written agreement was invalid because Americas' conduct was inconsistent with the terms of the agreement.

[51] However, where a written agency agreement exists and it is not alleged that the agreement is a sham, one does not need to examine the conduct of the parties in order to confirm the existence of their agreement. It is only in the absence of a written agreement that the conduct of the parties must be examined for the purpose of determining whether an agency agreement may be implied.

[52] The Respondent neither pleaded nor argued sham in this case, and, in fact, pleaded in the Reply to the Notice of Appeal that in reassessing the Appellant the Minister assumed that:

[Americas and the Appellant] entered into an Agency Agreement effective as of July 20, 1994, authorizing MDR of the Americas to establish the MDR Telemanagement's business operations in Puerto Rico.[8]

[53] This indicates that the Minister accepted that the written agreement between the Appellant and Americas was bona fide and that they intended to create an agency relationship. This legal relationship must be respected for tax purposes.

[54] According to the Reply to the Notice of Appeal, the Minister also assumed that:

The Agency Agreement authorizes . . . Americas to set up business in Puerto Ricoon behalf of [the Appellant];

The Agency Agreement does not authorize . . . Americas to operate a business on behalf of [the Appellant].

[55] In my view, therefore, what is in issue in these proceedings is the effect of the written agreement between Americas and the Appellant. The question to be answered is whether, in entering into the written agreement, the parties intended Americas to act as the Appellant's agent only for the purpose of setting up the business in Puerto Rico or for the purpose of setting up *and* carrying on the business during a start-up period.

[56] This is a matter of the proper interpretation of the written agreement, which is governed by the intention of the parties at the time they entered into the agreement. The Supreme Court of Canada held in *Eli Lilly & Co. v. Novopharm Ltd*. [9], that the contractual intent of the parties is to be determined by

reference to the words they used in drafting the document, possibly read in light of the surrounding circumstances which were prevalent at the time. It is unnecessary to consider any extrinsic evidence at all when the document is clear and unambiguous on its face.

[57] After considering the entire agency agreement, I am of the view that no ambiguity arises from the use by the parties of the terms "establish", "fully established and organized" and "establishment" in relation to the business operations of the Appellant and the role to be played by Americas in these operations. While it is true that these terms are not defined in the agreement, the ordinary meaning of "establish" includes "set up on permanent basis; settle; secure permanent acceptance for"[10] and "to found, institute, build, or bring into being on a firm or permanent basis.[11]

[58] There is a notion of permanence conveyed by the use of the word "establish" that, when applied to the business to be conducted in Puerto Rico, would extend beyond simply making arrangements for the commencement of business operations, as suggested by the Respondent's counsel. It seems apparent to me that for a business to become established, it must be carried on for a period of time to gain acceptance in the marketplace or even make a profit.

[59] Moreover, the parties also use the phrase "establishment and initial organization of the Business" in the agreement, which shows an intention to distinguish between the organization and the establishment phases of the business. When used together with the word "establishment", in speaking of a business, "initial organization" would correspond more closely to the steps to be taken prior to the commencement of business operations, while establishment would connote the period between the commencement of business operations and the point at which the business becomes self-sustaining or begins to generate a volume of sales sufficient to enable it to turn a profit.

[60] The provision that the term of the agreement be renewed automatically every 12 months until the business was "fully established and organized" tends to demonstrate that the parties contemplated that the role played by Americas in the Appellant's business in Puerto Rico would last for a number of years. This is not consistent with the view that Americas was only intended to be responsible for making arrangements to allow the Appellant to begin selling its products in Puerto Rico and the Caribbean.

[61] Therefore, I find that the agency agreement was intended to make Americas the Appellant's agent for the purpose of carrying on, as well as organizing, the Appellant's business in Puerto Rico.

[62] Since I have found that there is no ambiguity in the agency agreement, it is not necessary to consider any extrinsic evidence of the parties' intention. Had this been necessary, however, the fact that the agreement was drafted and executed approximately 18 months after the incorporation of Americas would also support the Appellant's position. According to the evidence, by the end of 1994 the initial organization of the business was completed and Americashad already started carrying on business. If the parties had intended that the agreement only cover what had been done by Americas to the end of 1994, it is reasonable to expect that this would have been reflected in the agreement. It also reasonable to expect that the Appellant would have given notice to Americas to terminate the agreement if it believed that the business had been fully established and organized in Puerto Rico. Once again, the evidence showed that neither party gave notice of termination at any point.

[63] It is of course of concern that Americas' financial statements and Puerto Rican tax returns were prepared on the basis that Americas was carrying on business on its own account. I have no doubt that

had Americas not prepared its financial statements and filed its tax returns in this manner this issue would not now be before the Court. However, there is no evidence to suggest that Americas gained any advantage by making these representations in its financial statements or in its tax returns, and since no one involved with the preparation of the financial statements or tax returns was called as a witness, it is difficult to come to any conclusion as to why they were done in this fashion.

[64] In any event, the legal effect of the contract entered into between the Appellant and Americas was to make Americas the Appellant's agent for the purpose of carrying on business in Puerto Rico, and any representations to the contrary made by Americas to third parties, such as the Puerto Rican tax authorities, would not void the agreement.

[65] The Respondent's alternative argument, namely, that Americas could not have been the Appellant's agent because the Appellant could not have done itself certain things which were done by Americas, cannot succeed either.

[66] Both the *Denison Mines* and *Alberta Gas* cases are distinguishable on their facts from the case before me. In both *Denison Mines* and *Alberta Gas* the principal activity of the alleged agent was one that the taxpayers were prohibited from carrying on themselves.[12] The courts found that the subsidiaries could not be acting as agents because the taxpayers could not authorize an agent to do what they did not have the power to do themselves. In this case, however, there is no evidence to show that the Appellant was ever prohibited from carrying on business selling its products in Puerto Rico and the Caribbean. Therefore, there would have been no restriction or impediment to it hiring an agent to carry on the business on its behalf.

[67] The second issue to be resolved is whether the Appellant was a CPPC during the year in question. According to subsection 125(7) of the *Act*, a corporation that is controlled, directly or indirectly in any manner whatever, by one or more non-resident persons does not qualify as CCPC. Subsection 256(5.1) of the *Act* provides in part that:

256(5.1) For the purposes of this Act, where the expression "controlled, directly or indirectly in any manner whatever," is used, a corporation shall be considered to be so controlled by another corporation, person or group of persons (in this subsection referred to as the "controller") at any time where, at that time, the controller has any direct or indirect influence that, if exercised, would result in control in fact of the corporation . . .

Therefore, it must be determined whether or not Richard Malone, by virtue of the Appellant's bylaws giving him a casting vote at meetings of the shareholders and directors, had any influence that if exercised would have resulted in control of the Appellant.

[68] The Appellant admits that if Malone and Santoni had been aware of the casting vote provision in the bylaws, Malone would have had control in fact over the corporation. However, the Appellant argues that Malone could not have had any "influence" within the meaning of subsection 256(5.1) by virtue of the casting vote provision of the bylaws since he was unaware of its existence. The Appellant contends that awareness of the fact which gives one influence is a necessary precondition of having that influence. In the absence of that awareness, the alleged controller will never be in a position to influence the affairs of the corporation.

[69] Whether such influence exists would be a determination of fact, and the factors to be considered in assessing whether influence exists may vary from case to case. Judge Bowman (as he then was) in *Société Foncière d'Investissement Inc. v. Canada,*[13]expressed the opinion that the addition of the words "directly or indirectly in any manner whatever" to the *Act* was intended to broaden the concept of control, and that the notion of controlling influence includes economic, contractual or moral control over a corporation's affairs. He went on to state: "It is hard to imagine words with a broader meaning".

[70] It is clear that there may be both objective and subjective elements that underlie the existence of controlling influence over a corporation. In the case of contractual control, the source of the control would be objective, while moral control would likely be based largely on subjective factors. In this case, the existence of Richard Malone's influence has been objectively established by means of the production of the corporate bylaws. The legal effect of the casting vote provision in the bylaws would not be negated by Malone's alleged ignorance of the provision. Whether he was aware of it or not, Malone had a power to control the Appellant. This is consistent as well with the fact that subsection 256 (5.1) focuses on the potential to exercise influence and not upon the actual exercise of the power. In my view, therefore, the power to cast the deciding vote is a power which, "if exercised", would result in control in fact of the corporation as contemplated in subsection 256(5.1).

[71] Although it is not necessary for me to decide the point, it also appears to me that Richard Malone had *de jure* control of the Appellant during the year under appeal.

[72]The test for *de jure* control of a corporation was set out by the Supreme Court of Canada in *Duha Printers (Western) Ltd. v. Canada*:

. . . the general test for *de jure* control remains majority voting control over the corporation, as manifested by the ability to elect the directors of the corporation. While this Court has occasionally been willing to examine factors other than the share register of the company, its assessment has been restricted only to the constating documents, not external agreements.[14]

The Court also stated that:

. . . In general terms, *de jure* refers to those legal sources that determine control: namely, the corporation's governing statute and its constitutional documents, including the articles of incorporation and by-laws. [15]

[73] In this case, Richard Malone was given the power to elect the majority of the directors by virtue of provisions contained in the Appellant's amalgamation agreement and bylaws, both of which are constating documents.[16] Under the former, Malone was appointed chairman of the board of directors, and under the latter the chairman was given the casting vote at meetings of the shareholders and directors. The casting vote provisions, along with Malone's 50% shareholding in the Appellant resulted in his having the power to control the election of the directors.

Conclusion

[74] For all of these reasons the appeal is allowed, with costs, on the basis that the Appellant was entitled to take into account the losses and income of Americasin the calculation of its income for the

years under appeal. The Appellant was not, however, a CCPC during those years.

Signed at Ottawa, Canada, this 21st day of November, 2006.

"B. Paris"

Paris J.

CITATION:	2006TCC505
COURT FILE NO.:	2003-2956(IT)G
STYLE OF CAUSE:	AVOTUS CORPORATION AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	October 17 and 18, 2005
REASONS FOR JUDGMENT BY:	The Honourable Justice B. Paris
DATE OF JUDGMENT:	November 21, 2006

APPEARANCES:

Counsel for the Appellant:	Roger Taylor
Counsel for the Respondent:	Al-Nawaz Nanji Richard Gobeil April Tate

COUNSEL OF RECORD:

For the Appellant:

Name:	Roger Taylor
	Al-Nawaz Nanji
Firm:	Couzin Taylor
	Toronto, Ontario

For the Respondent: John H. Sims, Q.C.

Deputy Attorney General of Canada

Ottawa, Canada

---

[1] R.S.C. 1985, c.1 (5th Supp.).

[2] Although counsel for the Respondent argued that there was no evidence as to when the agreement was executed, the Appellant pleaded at paragraph 9 of the Notice of Appeal that it was executed in early 1996. In the Reply to Notice of Appeal the Respondent did not deny this fact nor did it state the Respondent had no knowledge of the fact, and therefore, by virtue of subsection 49(2) of the *Tax Court of Canada Rules (General Procedure)*, the fact is deemed to be admitted. That provision reads:

49(2) All allegations of fact contained in a notice of appeal that are not denied in the reply shall be deemed to be admitted unless it is pleaded that the respondent has no knowledge of the fact.

[3] [1999] S.C.J. No. 30 (QL), at par. 39.

[4] 7th ed. *(Toronto: Butterworths,* 1996) at page 11. (As quoted by Judge Rip (as he then was) in *General Motors Acceptance Corporation of Canada Ltd. v. The Queen,* [2000] T.C.J. No. 59 (Q.L.), at paragraph 63.)

[5] *Livingston Wood Manufacturing Ltd. v. M.N.R.*, 63 DTC 535; *L. Berman & Co. Ltd. v. M.N.R.*, 61 DTC 1150 (Ex. C. Can.)

[6] 71 DTC 5375.

[7] 90 DTC 6419

[8] Subparagraph 19u) of the Reply to the Notice of Appeal.

[9] [1998] 2 S.C.R. 129 at page 166.

[10] *The OxfordIllustrated Dictionary*, 1975.

[11] *The Random House Dictionary of the English Language*, The Unabridged Edition.

[12] In *Denison Mines*, the alleged agent was incorporated to provide housing for workers at Denison's

Mine, something which Denison's articles of incorporation prohibited Denison itself from doing. In *Alberta Gas*, the alleged agent was incorporated to borrow money in the U.S., something that the parent company was prohibited from doing.

[13] [1995] T.C.J. No. 1568 (QL), at paragraph 8.

[14] [1998] S.C.J. No. 41 (Q.L.), at paragraph 50

[15] *supra*, at paragraph 58

[16] The amalgamation agreement (Exhibit A-1 tab 27, pp. 11-20) is schedule B to the Appellant's Article of amalgamation filed pursuant to subsection 178(1) of the *Ontario Business Corporations Act* R. S.O 1990 c. B-16 as amended.
