Criterion Capital Corporation v. The Queen

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Docket: 1999-4603-IT-G

BETWEEN:

CRITERION CAPITAL CORPORATION,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Reasonsfor Judgment

O'Connor, J.T.C.C.

[1] These appeals were heard at Vancouver, British Columbia on September 24 and 25, 2001.

Issue

[2] The issue is whether the Appellant ("Criterion") in 1992, 1993 and 1994 was a personal service business with the result that because of subsection 125(7) of the *Income Tax Act* (*"Act"*) it would not be entitled to the small business deduction provided for in subsection 125(1) of the *Act* and further, with respect to the 1994 year only, Criterion's deductible expenses would be limited by paragraph 18(1)(*p*) of the *Act*. It is common ground that Douglas Mason ("Mason") was a specified employee of Criterion, the Appellant did not employ more than five persons and the Appellant is not associated with Clearly Canadian Beverage Corporation ("CCBC" or "Clearly Canadian") the corporation that is involved in this matter. Thus, the only issue is whether Mason could reasonably be regarded as an employee or officer of CCBC but for the existence of Criterion.

[3] The relevant provisions of the *Act,* so far as material, read:

18(1)(*p*) an outlay or expense to the extent that it was made or incurred by a corporation in a taxation year for the purpose of gaining or producing income from a personal services business, other than

(i) the salary, wages or other remuneration paid in the year to an incorporated employee of the corporation,

(ii) the cost to the corporation of any benefit or allowance provided to an incorporated employee in the year,

(iii) any amount expended by the corporation in connection with the selling of property or the negotiating of contracts by the corporation if the amount would have been deductible in computing the income of an incorporated employee for a taxation year from an office or employment if the amount had been expended by the incorporated employee under a contract of employment that required the employee to pay the amount, and

(iv) any amount paid by the corporation in the year as or on account of legal expenses incurred by it in collecting amounts owing to it on account of services rendered

that would, if the income of the corporation were from a business other than a personal services business, be deductible in computing its income;

...

125. (7) In this section,

"active business carried on by a corporation" means any business carried on by the corporation other than a specified investment business or a personal services business and includes an adventure or concern in the nature of trade;

...

"personal services business" carried on by a corporation in a taxation year means a business of providing services where

(*a*) an individual who performs services on behalf of the corporation (in this definition and paragraph 18(1)(*p*) referred to as an "incorporated employee"), or

(*b*) any person related to the incorporated employee

is a specified shareholder of the corporation and the incorporated employee would reasonably be regarded as an officer or employee of the person or partnership to whom or to which the services were provided but for the existence of the corporation, unless

(*c*) the corporation employs in the business throughout the year more than five full-time employees, or

(*d*) the amount paid or payable to the corporation in the year for the services is received or receivable by it from a corporation with which it was associated in the year;

...

Facts

[4] Mason was the sole shareholder and sole Director and an employee of Criterion in the years in question. He was the only witness called. Although the auditor of Canada Customs and Revenue Agency was present, he was not called.

[5] Although Mason had only a high school education, over the years he had gained considerable and valuable business experience and expertise and had made many contacts in the business-world, mainly in Canada and the United States.

[6] Prior to and during the years in question, Mason was engaged in numerous businesses. In or about 1987, Mason became interested in the concept of a Canadian bottled water business. This led to the incorporation of CCBC. During the years in question Mason was a shareholder, a Director and held the position of President and C.E.O.

[7] Criterion was incorporated in 1988. Its sole shareholder, Director and one of its employees was Mason.

[8] During the years in question, Mason as President and Director, received considerable employment income by way of salaries, stock options and CCBC contributions to a retirement plan. Mason paid considerable income tax on this income.

[9] During the years in question, Criterion had one other employee namely, Lyn Dombroski and also maintained the services of Market Works Inc. which was run by Katherine Williams. She was instrumental in various areas including in particular, doing what was necessary to have CCBC registered on the Vancouver, NASDAQ and Toronto Stock Exchanges.

[10] Criterion had an office in the home of Mason, another office at Waterfront Capital Corporation, one of Criterion's clients and an office in the premises of CCBC for which Criterion paid a monthly rental to CCBC. All of the furniture and furnishings with the exception of the rug in the CCBC office were owned by Criterion.

[11] Besides CCBC, Criterion had several other clients to whom it rendered services during the years in question. See the Schedule attached at Tab 24 of the Book of Documents. During the years in question, Mason spent time on CCBC activities and Criterion activities.

[12] Mason's duties as President and Director of CCBC were essentially to look after the day-to-day running of CCBC including marketing CCBC products, dealing with suppliers, distribution, marketing, supervising staff including the executive staff, preparing agendas for Directors' meetings and attending same. Mason's duties as an employee of Criterion consisted principally in seeking out and locating financing opportunities and new business opportunities using his network of contacts he had made prior to joining CCBC.

[13] Criterion had considerable assets and liabilities and operating expenses as is evident from Tabs 1, 2 and 3 being the financial statements of Criterion for the years in question.

[14] Besides the activities mentioned above, Criterion was involved in the business of collecting and selling coins.

[15] Although the fees charged to CCBC by Criterion were paid on an equal monthly basis, the actual amount of the retainer was fixed by Mason on the basis of an annual retainer with the amounts being paid in equal monthly instalments. This was consistent with fees charged to other clients of Criterion.

[16] Criterion's services to CCBC were pursuant to Management Agreements -Tabs 5, 6, 7 and 8. Mason's services to CCBC where pursuant to Tab 4.

Submissions of Counsel for the Appellant

[17] Counsel for the Appellant submits that the services provided by Criterion to CCBC did not constitute a personal services business. Counsel submits further that even if the services did constitute a personal services business, the amount of $197,900 disallowed for the 1994 year should firstly be reduced by certain amounts which were agreed to by Counsel for the Respondent to a figure of $189,858 and that this amount should be

further reduced by salaries paid by Criterion and by those expenses that were incurred by Criterion for the purposes of producing income from clients of Criterion other than CCBC.

[18] I quote the following extracts from Criterion's Counsel's written submission:

B. ISSUE - CAN A PERSON SUPPLY SERVICES AS AN EMPLOYEE AND AS AN INDEPENDENT CONTRACTOR FOR THE SAME COMPANY?

1. Mr. Mason provides services to Clearly Canadian that would constitute the services of an employee. They are provided directly by Mr. Mason in his capacity as President/CEO and as director. These are the services which must necessarily be performed as a director and the services which must necessarily be performed by the President/CEO (i.e. overall administration of the day to day business of Clearly Canadian - the manufacture, marketing, distribution and sale of Clearly Canadian beverage products). Mr. Mason is paid directly for these services. Criterion provides services outside the day to day operations of Clearly Canadian. During the years under appeal these principally involved locating, investigating and negotiating new business and finance opportunities. Criterion says these are services of an independent contractor.

2. A person can provide some services directly as an employee and other services indirectly through a corporation. *William Scott v. Queen* 94 DTC 6193 (F.C.A.) (Tab 1).

3. There is no prohibition under the *Income Tax Act* or under employment law that prevents an employee from having other contractual arrangements with his/her employer either directly or through a company. ...

4. The Minister has not in fact alleged that the services provided under the Management Agreement are a sham or that an employee is not permitted to provide other services through a company.

...

C. ISSUE - WHAT SERVICES ARE PROVIDED BY DOUGLAS MASON AS A DIRECTOR/OFFICER AND WHAT SERVICES ARE PROVIDED BY CRITERION UNDER THE MANAGEMENT AGREEMENT

1. The services provided by Criterion during the 1992 to 1994 taxation years involve all services other than those required to be performed by a director (i.e. directors meetings, director committee meetings) and those required to be performed by a president/CEO (supervision of the day to day operations of Clearly Canadian - the manufacturing, marketing, distribution and sale of Clearly Canadian beverage products).

2. The wording of each of the Management Agreements with respect to the services that Criterion can provide is very wide ranging. This was intended to provide flexibility. As Mr. Mason's evidence indicates, the actual services are more specific.

3. Mr. Mason's evidence that Criterion does not perform day to day matters is confirmed by the following:

(a) He is the President/CEO and he is paid directly for those services. He receives a T4.

(b) The Director/Officer Agreement dated January 1, 1992 confirms that the services as President/CEO are to be provided directly by Mr. Mason - not by Criterion.

(c) Criterion provides the same services to other companies as an independent contractor.

4. The formal Director/Officer Agreement did not come into effect until January 1, 1992 - Criterion's 1992 taxation year started five months earlier (August 1, 1991). However, Mr. Mason's evidence as confirmed by T4s issued to him personally by Clearly Canadian confirms it was documenting a long standing arrangement.

5. The auditor has not in fact disputed Criterion's representation as to what services are provided directly by Mr. Mason as president/CEO and what services are provided by Criterion. It's position as set out in Mr. Ford's letters has been that the various activities which Criterion and Clearly Canadian represent as performed by Criterion are in fact duties that would normally be performed by the President/CEO.

D. LAW - PERSONAL SERVICES BUSINESS

1. The primary issue is whether the business of Criterion in providing services to Clearly Canadian constitutes a personal services business as defined in section 125(7). If it does, then Criterion is not entitled to a small business deduction in respect to that income and certain expenses incurred by Criterion to earn that income are disallowed under section 18(l)(p).

...

3. The issue in this case will be whether or not, based on the services which Mr. Mason provides to Clearly Canadian through Criterion, he "could reasonably be regarded as an officer or employee" of Clearly Canadian.

4. The test that is used is the test established by the Federal Court of Appeal in *Wiebe Door Services Inc. v. MNR* 87 DTC 5025 ...

5. The *Wiebe Door* case really involves two tests, both of which are to be considered.

(a) The standard entrepreneur "4 in 1" test detailed by Lord Wright in *Montreal Locomotive Works* (1947 Privy Council) - control, ownership of tools, risk of loss, chance of profit ...

(b) The integration or organization test of Lord Denning in *Stevenson Jordon and Harris* in (1952 - CA). However, the Federal Court of Appeal in *Wiebe Door* found the test is not whether the person supplying the service is an integral part of the employer business or only accessory to it. Instead, it is to be viewed from the"employee perspective". Is the employee/independent contractor running his own business in which case he is an independent contractor or is he just part of the business operated by the third party in which case he is an employee. Mr. Justice MacGuigan said that this test is determined by asking the question "whose business is it".

E. ISSUE - ARE THE SERVICES WHICH MR. MASON PROVIDES THROUGH CRITERION THE SERVICES OF AN EMPLOYEE OR AN INDEPENDENT CONTRACTOR?

1. In deciding whether the services of Criterion could reasonably be regarded as services of an officer or employee, the services that are provided by Douglas Mason, as President and a director, cannot be considered. These are not services provided by Criterion. As indicated in the definition of "personal services business" in Section 125(7) of the *Income Tax Act* the test directs itself to the services that would be those of an officer or employee "... but for the existence of the corporation". The Court can only look at the services of investigating and negotiating business and finance opportunities that Criterion provides.

A. Entrepreneur Tests

(a) Control Test

2. An employer is entitled to give orders and instructions to an employee regarding the manner in which an employee is to carry out his work. A principal can direct an independent contractor as to what he is to do but not the [manner] in which it is to be done.

3. In the case at hand, Douglas Mason as a representative of Criterion receives instructions from the board of directors or acts on his own initiative to consider various new business and finance opportunities. Mr. Mason does not receive any day to day direction on how he should proceed. He is left to handle the opportunities in the manner that he considers most appropriate.

4. Clearly Canadian also has no right to control Criterion's right to provide similar services with other clients or to inquire about the services Criterion provides to other persons.

5. The CCRA in fact acknowledges that the control issue would favour Criterion. ...

6. It is difficult to exert a high level of control on a person performing specialized services. However, Mr. Mason's evidence is that the directors carry out a more detailed review of the day to day operations which he deals with as president than they do of the services provided by Criterion. The reason is that day to day operations involve Clearly Canadian's business. The investigation of finance and business opportunities is Criterion's business.

(b) Ownership of Tools

(i) Business Tools

7. The main assets of such an organization involved in finding business and finance opportunities is its business connections and its expertise to evaluate a business opportunity that is being considered.

8. The maintenance of a business network will involve regular and continued time and expense, but it creates a valuable business asset - goodwill. It is however an asset of Mr. Mason used in the operation of Criterion's business. It is not an asset of Clearly Canadian. The operating expenses of Criterion in the years under review make it very clear that this is a very expensive capital asset.

9. The Tax Court in *David T. McDonald Company Limited* 92 DTC 1917 (Tab 3) confirmed at page 1922 that the experience, knowledge and goodwill are a business tool of the incorporated employee and that it qualifies as the ownership of business tools for the *Wiebe Door* test. Judge Mogan considered it a relevant criteria in deciding that the services provided by Mr. McDonald through his company were not the services of an employee.

10. The auditor ... suggests the ownership of a business network was the reason Mr. Mason was hired as a director/CEO. This is not correct. Mr. Mason was hired in 1987 as President/CEO because he could run the day-to-day business of Clearly Canadian which is the manufacturing, marketing and distributing of beverages. Criterion was hired later (1989) because of Clearly Canadian's need for its business network. It paid a separate and additional amount for Criterion's services.

11. Mr. Mason was elected as a director because shareholders presumably have confidence in his judgment when making major business decisions on behalf of Clearly Canadian. Directors are elected by the shareholders. Most shareholders will have absolutely no knowledge of Mr. Mason's business network. This type of information will not be disclosed in proxy solicitations.

12. Criterion has significant operating costs that are not reimbursed by Clearly Canadian or its other clients.

...

(ii) Business Equipment

14. A second type of "tool" that an independent contractor such as Mr. Mason requires will be office equipment which would permit him to deliver his services. Criterion maintains an office at Douglas Mason's residence at 3912 Marine Drive, West Vancouver. The equipment at that office is owned by Criterion. He also had an office at Waterfront Capital Corporation in Vancouver during the taxation years under review. Mr. Mason also owns all of the equipment located at the office which Criterion uses at Clearly Canadian' s premises.

15. Criterion contracts to use office facilities at Clearly Canadian's offices. It uses these offices (and its other offices) to provide services to Clearly Canadian and to Criterion's other clients. The payment for the use of

Clearly Canadian facilities was $450.00 per month (increased to $1,850.00 in the last months of 1994). This amount is intended to reflect Criterion's share of the actual costs.

16. The fact that Criterion owns all of the tools located at the Clearly Canadian office and it pays for their use of office facilities is inconsistent with an employee relationship. An employee would not be expected to pay for the use of space which he or she occupies at his or her employer's premises.

Société de Projets ETPA v MNR 93 DTC 5156

(c) Risk of Loss

17. Operating Costs. The risk of loss is a real issue for Criterion. In order to be in a position to provide services to Clearly Canadian and to its other clients Criterion hires its own employees and it incurs significant operating costs as confirmed by the financial statements. The total expenses of Criterion excluding Douglas Mason's salary in the years under appeal are as follows:

	Total Net Expenses	Salary	Operating Costs
1992	$154,281	$40,000	$114,281
1993	$252,688	$80,000	$172,688
1994	$197,900	$60,000	$137,900

These are expenses that are not incurred by a person in an employer-employee relationship. These expenses create a risk of loss.

18. Negligence Claims. Criterion may make an error in analysing a new business opportunity. If Clearly Canadian or another client relies on the recommendation and suffers a loss, Criterion as an independent contractor may be liable for professional negligence. The loss could be very significant as the transactions involve millions of dollars. This is a risk not typically faced by an employee. The indemnity and insurance provisions in the Management Agreement (which start in June 1994) relate to claims by third parties there is no limitation on claims by that Criterion was entitled to make. Criterion also faces the risks of claims from its other clients.

19. Effect of Retainer. Risk of loss isn't avoided because a person is paid on a retainer basis. There are provisions in the Management Agreement which would allow it to terminate. These will not terminate Criterion's expenses nor its business risks. In any event, a person who has been operating a successful business for an extended period of time should be in a position where revenues will exceed expenses and a loss is only likely to occur as a result of negligence on a major transaction or an unexpected event (eg., heart attack).

20. CCRA Position. In its letter of August 5, 1997 CCRA concludes the risk of loss does not exist.

(a) Mr. Ford represents there is no revenue risk because Criterion will be reimbursed for all of its expenses if it wishes because Mr. Mason as CEO and director could cause Clearly Canadian to pay any costs that he requests. Mr. Ford is wrong. There is no factual basis for that allegation. First, Criterion is not reimbursed except for expenses related to specific Clearly Canadian project. Second, Mr. Mason does not control the Board. This is not a private company in which he and his family own all the shares - it is a public company with independent directors who have a legal obligation to act in the best interests of Clearly Canadian.

(b) Mr. Ford indicates that paragraphs 8 and 9 of the 1994 Management Agreement eliminate the risk of a lawsuit for negligence as claimed by Criterion. This is not correct. Paragraphs 8 (which provides for indemnification) and 9 (which provides for including Criterion in Clearly Canadian's insurance) only relate to lawsuits and other claims **by third parties.** It does not protect Criterion from a negligence claim by Clearly Canadian.

(d) Chance of Profit

21. Criterion is free to offer its services to clients other than Clearly Canadian and does in fact do so. The revenue from the other clients is significant. It also receives information on business opportunities which it may (but is not required) to offer to Clearly Canadian. If Clearly Canadian doesn't use them, then Criterion can offer them to others. It is not, in fact, required to present specific opportunities to Clearly Canadian and can offer them to others instead. This creates a significant chance of profit not available to an employee. ...

B. Integration Test - the Second *Weibe Door* Test

1. Employer perspective

22. Even if the integration test was viewed from the "employer" perspective the services of Criterion ... are not part of day to day business and are not essential to the business of Clearly Canadian. A company does not require new business or finance opportunities to operate.

23. In his letter of August 5, 1997, Mr. Ford claims investigating new business opportunities is part of the day to day business of a public company like Clearly Canadian ...

24. With respect Mr. Ford is in error. We agree that in a constantly changing world any business must constantly be prepared to change. A well run company (public or private) should prepare for change rather than react to it. However, Clearly Canadian is not in the business of buying and selling businesses or in the business of raising funds - it is in the business of manufacturing, marketing, selling and distributing Clearly Canadian beverage products. All of its employees' activities are directed towards this activity. Its revenue does not arise from new financing or business acquisitions. Its revenue arises from the sale of its products. It does not make money from investigating the purchase of business but from operating the businesses successfully after acquisition.

...

2. Employee/independent contractor perspective - "Whose business is it" - Test

26. It is submitted that the business of locating business and finance opportunities is a business of Criterion and not Clearly Canadian.

(a) Performance of Criterion Services by other Persons

27. While Criterion does not have more than 5 full time employees which is required to automatically eliminate the application of the personal services business rules, the fact that persons other than Douglas Mason are providing the services contracted by Criterion is indicative that it is an independent contractor operating its own business rather than an artificial structure performing employment services for Clearly Canadian.

28. During each of the years under review Criterion has retained the services of Market Works Inc. a company operated by Katherine Williams to perform many of the services required of an administrative nature that Criterion is required to provide to its clients. This includes drafting and revising of agreements that Criterion is negotiating, preparation of submissions to regulatory authorities, preparing minutes etc., meetings etc. Payments in the 3 years under review by Criterion to Market Works Inc. total $56,450. In addition, Criterion has employed LynDombroski to handle matters that Criterion must provide to its clients but which do not require the direct involvement of Douglas Mason. This will involve the scheduling and preparing for meetings, arranging

receptions and other activities that Criterion provides to promote its clients or maintain its network. These are Criterion's employees operating Criterion's business. Neither Clearly Canadian nor Criterion's clients reimburse Criterion for these costs.

...

(b) Other Clients

30. This is the most important argument. Criterion provides the same services during the years under review to five other clients: Commonwealth Gold Corporation; ESC Envirotech; Venturex Resources; Waterfront Capital Corporation; and Columbia Yukon Exploration Inc.,Uni-Watt, Aber Resources, Criterion and its predecessors, Microton and Continental Consulting, had previously provided services to others as well (Freflex Canada, BDC Enterprises), and Criterion continues to provide the same services to an even wider group of clients today (now includes Beachfront Enterprises, Buffalo Head Resources and also included Lasik Vision). Mr. Mason's evidence is that Clearly Canadian is now about 50% of its total consulting revenues, indicating that the consulting services is a long-term business.

31. During the period 1992 to 1994 the following Criterion revenue was from Clearly Canadian:

Year	**Total Revenues**	Clearly Canadian **Source Revenues**	Revenue **Other Sources**	**Percentage**
1992	$304,901	$246,401	$64,901	80.8
1993	436,960	339,960	97,000	77.8
1994	659,093	505,092	154,001	76.4

The providing of same type of services to others using its own personnel and office tools is clear evidence that Criterion is operating its own business.

...

33. In *Healy Financial Corporation* 94 DTC 1705 an individual had been an officer and director, had agreed to provide full-time employment services, but who provided only limited day-to-day services. His corporation received $6,000 a month for his services. His corporation also carried out other business activities. The court held that the fact that the individual carried out several other ventures through the company in the years in question was relevant in finding an independent contractor relationship.

(c) Source of Experience

34. Mr. Mason did not develop his network or consulting expertise at Clearly Canadian. He acquired it before he founded Clearly Canadian. Clearly Canadian never paid for him to acquire his network. The network wasn't developed by Clearly Canadian as part of its business.

...

[19] Counsel made further submissions with respect to reducing the disallowed expenses in 1994 of $197,900.

Submissions of Counsel for the Respondent

[20] The following is a summary of the Respondent's Written Submissions.

[21] The issue is whether Mason, as the incorporated employee of the Appellant "would reasonably be regarded as an officer or employee of the person to whom services were provided but for the existence of the corporation" it being common ground that Mason is a specified shareholder of the Appellant, the Appellant does not employ more than five employees and is not associated with CCBC.

[22] The purpose of subsection 125(7) is as set out in J. Mogan's decision of *David T. MacDonaldCompany Limited v. The Minister of National Revenue, 92 DTC 1917:*

"Paragraphs (*a*) and (*d*) of subsection 125(7) were added to the Act to remove the income tax advantages which had been available to the "incorporated employee" like the conversion of salary income into corporate business income taxed at a low rate, the deferral of tax at personal rates on that income, and the possibility of splitting that income among members of a family. The purpose of the legislation was spelled out by the federal Department of Finance in Budget Supplementary Information and submitted in argument by counsel for the Respondent. The relevant note states:

Executives and highly-paid employees of business firms can gain valuable tax advantages by incorporating themselves and continuing to provide services to their former employer through a personal corporation. A federal corporate tax rate of 23 1/3 per cent, rather than personal income tax rates, now applies to the corporation's earnings in such cases. There are other tax advantages in personal incorporations, including the possibility of income splitting among family members. This type of incorporation permits the conversion of employment income into business income of the personal corporation. The budget proposes to increase the federal corporate tax rate on such incorporated executives and employees to the general corporate tax rate of 36 per cent. As a result, the combined federal and provincial corporate tax rate on such personal service corporations will be approximately 50 per cent, equivalent to the maximum marginal tax rate that the budget proposes be applied to individuals.

[23] The test typically used to analyze the nature of an employment or independent contractor relationship is that set out in *Wiebe Door Services Ltd. v. The Minister of National Revenue*, [1986] 3 F.C. 553 and referred to as the four in one entrepreneur test. The four in one test is: control, ownership of tools, chance of profit and risk of loss.

[24] However, *Wiebe Door*does not stand for the proposition that the four in one test be slavishly applied. In fact, adopting Lord Wright's comments in *Montreal v. Montreal Locomotive Works Ltd. et al* [1947] 1 DLR 161, 169-70, J. MacGuiganspeaking for the FCAdescribes the test as an integrated one and "what must always remain of the essence is the search for the total relationship of the parties".

[25] The jurisprudence has for some time recognized the failings of the control test which has been found to have 'broken down completely in relation to highly skilled and professional workers, who possess skills far beyond the ability of their employers to direct." This is one such instance.

[26] While CCBC was at all material time a public company it is clear from the evidence that Mason was the originator of CCBC, bringing to it the idea for the Clearly Canadian beverage product that was to be the cause of the company's success. There can be little doubt on the evidence that for the years under appeal, Mason was at the helm of CCBC.

[27] The inability of the control test to deal with highly sophisticated persons is highly evident here where Mason was essentially the founder of CCBC, and at all material times the CEO and president.

[28] As president and CEO of CCBC, and as director, Mason is the titular and actual head of the CCBC management team and the control test, is therefore, of little assistance.

[29] As to the ownership of tools in the Respondent's view this test is not decisive.

[30] This is not a situation dealing with a carpenter or mechanic who utilizes specialized tools and equipment to perform his duties.

[31] Mason testified that much of his work for CCBC is performed on the road and not in an office at all.

[32] To the extent that it can be argued that Mason's ownership of his desk and office accoutrements at CCBC's offices are the tools at issue, the Respondent says their ownership is not decisive in this case.

[33] Prior to moving to CCBC's previous place of business, and prior to the implementation of any management agreement between the Appellant and CCBC Mason was strictly an employee of CCBC and in that capacity was provided with an office at CCBC's expense. It was only after the first agreement in 1989 that the new "rental" agreement was effected.

[34] It is the Respondent's submission that the "rental" portion of the management agreements was simply window dressing on the part of the Appellant and CCBC.

[35] If the "tools" test is to be applied to Mason himself, the Respondent submits that the tools he employs as president, CEO and director of CCBC are indistinguishable from those he employs in his capacity of incorporated employee.

[36] Therefore, the Respondent submits that the "tools" test is not definitive in this case and certainly does not tip the scales over to independent contractor.

[37] Each of the management agreements contain provisions that Criterion shall be reimbursed by CCBC for all travelling and other expenses actually and properly incurred in connection with Criterion's duties under the agreements. As all expenses are to be reimbursed, there is not chance of loss.

[38] Mason also testified that management contracts were in place with all the other entitles listed at Tab 24 of which he was a director and officer and that those contracts were similar to those in place as between CCBC and the Appellant. It appears, therefore, that all of the Appellant's expenses were eligible to be reimbursed by one or another of those entitles and hence the risk of loss to the Appellant is further minimized.

[39] With respect to the Appellant's argument that the indemnification and insurance clauses in the management agreements do not cover the gross negligence of Mason vis a vis CCBC, one can only say that that it would be an unusual agreement indeed that would provide for coverage of one's own employee's gross negligence against the employer. The 1992 Director/Office Agreement at Tab 4 provides that CCBC will insure Mason in respect of his liability as a director and officer as well as in respect of "any claims arising out of the services he has provided in good faith on behalf of CCBC either as an officer or director" (clauses 4.1 and 4.2). Clause 4.3 even provides that the insurance coverage survives Mason's termination or resignation as an officer and director "and will be applicable to any claim whenever it arises". Between the management agreements and the Director/Officer Agreement Mason and Criterion benefit from significant insurance and indemnification protection.

[40] If it could be said that the Appellant faced any loss of opportunity as a result of its operations, then he has a risk of loss of profit but not a risk of loss.

[41] The type of remuneration to Criterion by CCBC is more consistent with a salary than it is with a contract for service.

[42] The Respondent submits that there is no revenue risk to Criterion, no amounts are at risk, and the fee structure based on an annual retainer to be paid monthly with the possibility of bonuses in 1994 and 1995 are far more indicative of an employee/employer relationship.

[43] Similarly, there is no clear chance of profit to Criterion in its dealings with CCBC given the set retainer and possible bonus model chosen by the parties.

[44] On balance, the Respondent submits that an objective analysis of the evidence on the chance of profit/risk of loss analysis, tips the scale on the side or contract of service, rather than independent contractor.

[45] As to integration, the Respondent submits that the distinction between Mason's duties as CEO and president of CCBC are indistinguishable from the so called "special projects" the Appellant relies on in support of its entitlement to the small business deduction.

[46] It cannot be said that Mason's work allegedly performed through the Appellant, was only an accessory to CCBC's business, he was an integral part of its business. The business of locating business and finance opportunities. In the words of the Appellant (at par. 26 of the Appellant's Written Argument) is an integral part of CCBC's business. Without the opportunity for development and growth through the acquisition of new product lines, diversification and financing the business of CCBC would either lose ground or stagnate completely.

[47] As CCBC was the source of approximately 80% of the Appellant's income for the period under appeal, it is clear that there is a high degree of integration even from the "employee" perspective.

[48] The Respondent submits further that before the first management contract between the Appellant and CCBC was executed in 1989 Mason as an employee performed substantially the same services as Criterion later performed. In fact, according to Mason's evidence, the duties of Criterion as set out in both the 1991 and 1993 management agreements were actually duties Mason admitted fell to him as president and CEO of CCBC. This fact, together with the fact that at the times under appeal Mason was an employee of CCBC, should be considered on its own account as being determinative of the outcome of these appeals.

[49] Mason's evidence was to the effect that as president, CEO and director of CCBC he was responsible for the day-to-day business of CCBC and that Criterion was responsible for "special projects" outside of that sphere. Although Mason testified that the inaccuracies of the 1991 and 1993 management agreements were meant to be rectified by the 1994 agreement as it sets out the services provided by the Appellant to CCBC, a review of the relevant clause 3.1 of the 1994 management agreement (Tab 7) does not support the tenuous distinction attempted to be drawn by the Appellant. Nowhere in clause 3.1 is there a reference to "special projects", either directly or indirectly. The Respondent says it is the duty of a president, CEO and director to:

- advise the employer on its business activities and organizational policies
- direct the employer's financial, organization, promotion and operational planning activities
- approve budgetary and operations objectives, monitor performance relative to established objectives of the employer
- promote positive employer relations with all external groups
- develop, recommend and implement through subordinates approved annual and long term employer policies and goals
- report and consult with the employer's Board of Directors.

Clause 3.1, 1994 and 1995 Management

Agreement, Tab 7, Tab 8

[50] To the extent that the "Schedule of Major Business Projects" at Tab 12 of the Joint Book of Documents, deals with the time period under appeal, the Respondent says this document represents an *ex post facto* attempt to justify the position taken by the Appellant, prepared by counsel for the Appellant in the course of the audit and should be given little, if any, weight. In any event, the Respondent says that all the items in that

list pertain to CCBC and are functions that a president and CEO of such an entity would normally fulfill in the course of his employment.

[51] The alleged distinctions between the day to day affairs of CCBC and the special projects that Mason says is the domain of the Appellant, is artificial. Mason is the key to the operations of CCBC as an officer, director, CEO and president. The attempted severance of "consulting" functions from that relationship does not reflect the reality or the substance of the true relationship. The distinction between day to day and special projects is contrived, artificial and does not have anything to recommend other than in a purely tax motivated context.

[52] The fact that the amounts paid by the Appellant to its part time employee Lyn Dombroski and amounts paid to Market Works Inc. are relatively minor supports a finding that the work performed by those persons was for routine and mundane matters below Mason's expertise.

[53] The retainer paid by CCBC to Criterion calculated annually but paid monthly resembles the current "salary" component one would normally expect to be accorded to the president and CEO. Again, the Respondent submits this is a very telling factor in the determination that but for the Appellant Mason would reasonably be seen as providing his services to CCBC as its president, CEO and director.

[54] On the basis of Mason's director/officer relationship with CCBC instead of a salary he was remunerated by way of CCBC's contributions on his behalf by way of an insurance policy and a retirement allowance. The flat retainer, reimbursement for expenses, indemnification and insurance provisions in each of the management agreements plus the bonus clause in the 1994 agreement between the Appellant and CCBC all approximate salary paid to an employee rather than a fee to an independent contractor.

[55] In conclusion the Respondent submits that based on all the circumstances, the entirety of the evidence and by examining the whole of the various elements constituting the relationship between the parties as required by *Wiebe Door*, but for the existence of Criterion Mason would have reasonably been perceived as providing services to CCBC as an employee and not as an independent contactor.

[56] Mason is an employee of CCBC in his capacity as president, CEO and director, subparagraph 125(7)(*d*) does not even require that he be reasonably regarded as an officer or employee with respect to the services being provided to CCBC. It only requires that he be an employee of CCBC. Since Mason is an employee of CCBC and performs services for CCBC of an employment nature the appeals for the Appellants 1992, 1993 and 1994 taxation years must be dismissed.

[57] As a "personal services business" the Appellant is restricted to those deductions set out at paragraph 18(1)(*p).*

Analysis and Decision

[58] I accept the credibility of Mason and. in my opinion, based on the documentation submitted and the verbal testimony of Mason, the principal submissions of Counsel for Criterion were correct. My main reasons are:

1. Criterion in the years in issue had several other clients.

2. Criterion retained in addition to Mason, two other employees, one through a corporation.

3. Mason's work through Criterion, was more than the work expected of a president and director.

4. The application of the *Wiebe Door* tests point more to an independent contractor. Certainly the "control" and "tools" tests, including the network of contacts and goodwill, lead to this conclusion.

5. Criterion had substantial assets and operating expenses and not all operating expenses were reimbursed, only those related to specific assignments.

6. There was no sham.

7. The existence of three offices, the ownership of the furniture and other items in the CCBC office and the payment of rent for that office are not indicative of an employee relationship.

8. The Management Agreements all refer to Criterion as an independent contractor.

Therefore, in my opinion, Criterion was not, in the years in question, a personal services business and the appeals are allowed, with costs.

[59] The above conclusion renders it unnecessary to address the submission of Criterion's Counsel as to the amount of the disallowed expenses in 1994, but if I were to, I would hold that those submissions detailed at paragraph 17 above were correct and applicable.

Signed at Ottawa, Canada this 12th day of October, 2001.

"T. O'Connor"

J.T.C.C.

COURT FILE NO.: 1999-4603(IT)G

STYLE OF CAUSE: Criterion Capital Corporation v. The Queen

PLACE OF HEARING: Vancouver, British Columbia

DATE OF HEARING: September 24, 2001

REASONS FOR JUDGMENT BY: The Honourable Judge Terrence O'Connor

DATE OF REASONS: October 12, 2001

APPEARANCES:

Counsel for the Appellant: Sadie Wetzel and Douglas Morley

Counsel for the Respondent: Lynn Burch

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1999-4603(IT)G

BETWEEN:

CRITERION CAPITAL CORPORATION,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on September 24 and 25, 2001 at Vancouver, British Columbia,

by the Honourable Judge Terrence O'Connor

Appearances

Counsel for the Appellant: Sadie Wetzel

Douglas Morley

Counsel for the Respondent: Lynn Burch

JUDGMENT

The appeals from the reassessments made under the *Income Tax Act* for the 1992, 1993 and 1994 taxation years are allowed, with costs, and the reassessments are referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the terms of the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 12th day of October, 2001.

"T. O'Connor"

J.T.C.C.