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Bulletin

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GOLF –
You gotta hate it!

by ROBERT RAICH
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One of the challenges of being a tax attorney is the amount of reading we must do; whether on new legislation, case commentaries or new jurisprudence. However, once in a while, through all of this drudgery, something amusing or anomalous surfaces and in such instances, this tedious process is almost worthwhile.

Recently, while reviewing my regular reading material, I came across an interesting case which golfers should find both relevant and entertaining. The case is *Rachfalowski v. The Queen* and was heard in front of one of the best Tax Court of Canada judges, Donald Bowman (now retired).

In this case, the taxpayer was employed as a senior executive for an insurance company. In 2002, his employer paid the yearly membership dues to a golf course in Barrie, Ontario. This golf club provided year round dining privileges and was considered to be reasonably upscale for the area.

The interesting part of the story is that the taxpayer claimed, as a statement of fact, that he "hated" golf. In fact, he had asked his employer if could receive the cash equivalent of the membership fees (he could not). He then asked the employer if he could have a membership in a curling club instead of the golf course but this too was refused. The taxpayer admitted that he used the golf club occasionally to entertain clients and, on a few occasions, he played golf with clients but he gave up golf because he was such a poor golfer. When he took his wife to the golf club to socialize, he paid for the meals himself.

The question before the Court was whether the taxpayer enjoyed a "benefit" as a result of the payment of the yearly dues by his employer. The Canada Revenue Agency (the "CRA") argued that since the membership was "available" to the taxpayer, he enjoyed a benefit whether or not he actually took advantage of the membership. The taxpayer, on the other hand, stated in his notice of appeal that he "hated golf, could not golf and did not golf" and that he only accepted the membership as a result of the pressure from his employer to develop business contacts, mainly through the dining facilities.

In a rather lengthy judgment, Mr. Justice Bowman notes that the benefits section in the *Income Tax Act* uses the word "enjoyed". He then poses the question as to whether or not the taxpayer in this instance "enjoyed" his membership.

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GOLF – You gotta hate it!

by ROBERT RAICH
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"...the question that should be asked is whether an employee's membership in a golf club "is principally for the employer's benefit or the employee's"

Mr. Justice Bowman then reviews a number of contradictory cases on the question of taxable benefits and concludes that the proper question to ask should be "just what did the employee get out of the alleged benefit that ought to have increased his or her income?" Mr. Justice Bowman then analyses the hypothetical cases of three employees of the insurance company, all of whom are offered and have accepted memberships at a golf club. The first employee is an enthusiastic golfer who spends as much time as possible on the golf course; the second employee is an indifferent player who uses the golf club two or three times per year and the third employee does not play any golf and does not use the golf club at all. Mr. Justice Bowman then concludes that notwithstanding the CRA's position that all three employees should be taxed in the same manner (because the same membership is available to all three employees), this is an unreasonable result.

In holding for the taxpayer, Mr. Justice Bowman concludes that a "benefit" should not be included in a taxpayer's income if it is primarily for the need or convenience of the employer. He then goes on to discuss certain typical employee perks and comes to some rather interesting conclusions. First, he observes that if parking is provided to an employee, he has "serious doubts" whether there is ever a taxable benefit. He adds that this should also be the case even if the employee receives a particular parking space as opposed to a general admission to a garage (the CRA makes a distinction between the two situations). He also observes that for business trips, if the business use overrides the personal use, there should be no taxable benefit. Using this logic for golf club memberships, the question that should be asked is whether an employee's membership in a golf club "is principally for the employer's benefit or the employee's". He then notes that the answer to this question can be either objective or subjective but concludes that "by and large, it requires an objective determination".

In the case at hand, Mr. Justice Bowman concludes that for Mr. Rachfalowski, the membership was clearly not an advantage to him. This then leads to an inference that his employer wanted its senior personnel to have memberships at golf clubs as this would enhance the company's image and prestige and provides a place for its executives to entertain clients of the company. Accordingly, the golf club membership in this case was primarily for the benefit of the employer.

My conclusion after reading this case - the more you hate golf, the better your chances at avoiding a taxable benefit if your employer pays your golf club membership dues!

The Significance
of Signing

by MATTHEW BILMES
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We all recognize that care should be taken to avoid beneficiaries of a will having their inheritance challenged based on the validity of the will's form or the clarity of its provisions. Therefore, it is notable that a recent case decided by the Quebec Court of Appeal demonstrates the importance of taking just as much care in modifying your will as you did in first drafting it.

In *Estate of Kaouk v. Kaouk*, the Court was charged with deciding whether a series of three amendments to a testator's will met the required formalities under the *Civil Code of Quebec* ("CCQ"). The amendments were all governed by the two formalities dealing with holograph wills (the type of will or amendment thereto that, firstly, is written entirely in the hand of the testator and secondly, should be signed by the testator). The first two amendments to the will in question were handwritten directions made on stickers that were stuck to the relevant sections of the testator's will, and the third amendment was a direction handwritten in the margin of the will. The first two amendments were held by the Court to meet the two formalities required under the CCQ, namely that they were completely handwritten and signed by the testator. The writing in the margin, however, was not signed.

Regarding this third amendment, the Court reviewed a relieving provision (in force since 1994) relating to the above two formalities, namely article 714 of the CCQ which states in part that "a holograph will…that does not meet all the requirements of that form is valid nevertheless if it meets the essential requirements thereof and if it unquestionably and unequivocally contains the last wishes of the deceased." Two out of the three judges hearing the case decided that the missing signature was enough to deem the third amendment invalid, as the existence of a signature was found to be an "essential requirement". The dissenting judge's contrary view was that given the facts of the case (the testator's true intention was clear, based on the evidence presented to the Court), the signature was not necessary. This 2-1 decision of the Court of Appeal appears to highlight the significance of a testator actually signing (or perhaps at least initialing) a holograph document.

The decision is also significant because it highlights that, apparently, not all judges place the same importance on form and intention. Some judges, when interpreting the validity of a challenged will, seem to prefer the certainty of requiring strict adherence to form requirements, while others seem to give more weight to evidence surrounding the testator's true intention. It is important that whenever someone is considering making a new will or a modification to their existing will, they seek our advice. If instead, a "homemade" document is used, they may be faced with the situation where the Court will have to weigh evidence to decide whether the document was in fact their last wish, or, like in the case of *Kaouk*, the Court will overlook intention and rule strictly based on a missing requirement of form.

What's new

Alexandre Dufresne is a finalist in this year's "Rising Stars-Leading Lawyers Under 40" competition organized by the Lexpert Magazine.

L. Michael Blumenstein has been elected to the board of the Segal Center for the Performing Arts and to the executive of the foundation for the Y.M.-Y.W.H.A.

Restrictive Covenants
in Employment Contracts: New directions?

by BARRY LANDY
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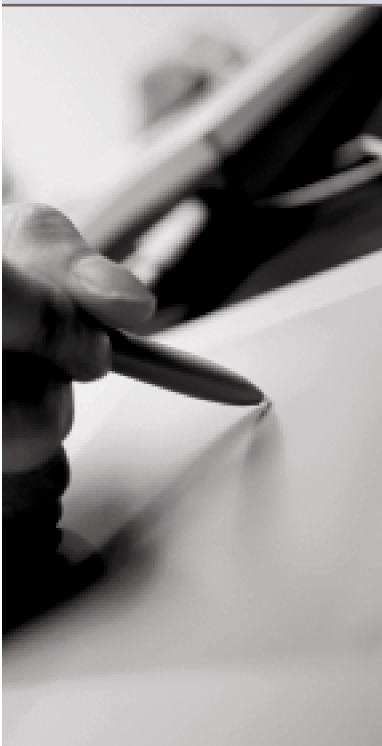
"...it is getting harder and harder to enforce restrictive covenants in employment contracts, unless they are very well drafted, and even then, an employer still has the burden to establish that the restrictions are reasonable in all of the circumstances."



Many employers rely upon restrictive covenants to protect their businesses from perceived threats from ex-employees who are privy to confidential information of all kinds during the term of their employment.

A typical restriction may provide that an employee agrees, during the term of his or her employment and for two years thereafter, not to work in a defined territory for the employer's clients. Consider the case of a chemist working for a chemical company that provides services to the pharmaceutical industry. The pharmaceutical client of the chemical company may very well be able to dispense with the chemical company's services if it could hire the chemist directly.

In fact, this is what happened in the recent case of *Menif* v. *Laboratoires Kabs Inc*. The plaintiff had left his employment with Kabs and then found work as a chemist with one of Kab's clients, namely Dimethaid.

When Kabs learned that its client had hired Menif, it sent a demand letter to the client, Dimethaid. Not wishing to harm its relationship with Kabs, Dimethaid withdrew its offer to employ Menif. Menif then sued Kabs, alleging that the restrictive covenant was illegal and abusive and caused Dimethaid to withdraw an offer of employment.

Seized with these facts, Justice Chantal Masse of the Superior Court of Quebec decided that this particular restrictive covenant that prohibited an employee from working for the clients of the employer after termination of employment was illegal. The employer was unable to justify such a restriction because while the clause in question was limited in time and geographical scope, it was not limited regarding the activities that were covered. In other words, if Menif wanted to go work for Dimethaid as a sales executive, and not as a chemist, he was prohibited from doing so because of how the restrictive covenant was drafted. The Court went on to add that it could not "read-down" the clause to make it legal. Interestingly enough, even though the Court found the clause was illegal, it went on to decide that Kabs was not at fault by trying to enforce the clause because it had not acted in an abusive way and dismissed Menif's claim for damages. The court held that when Kabs sent the demand letter to Dimethaid, it believed the clause was valid, so it was not abusive for Kabs to try to rely upon the terms of the clause. One might well ask if the result would have been the same where the clause was blatantly illegal (for example a restrictive covenant that would apply to an employee for a five year term after the employment ends).

The moral of the story is that it is getting harder and harder to enforce restrictive covenants in employment contracts, unless they are very well drafted, and even then, an employer still has the burden to establish that the restrictions are reasonable in all of the circumstances.

In conclusion, where restrictive covenants are concerned, employers are well advised to limit their restrictions to what a court will ultimately find enforceable, whereas paradoxically, employees might actually want to sign restrictive covenants that are overly-broad because they will not be enforceable. All parties should tread lightly through this difficult minefield and sophisticated legal assistance in drafting and interpreting these clauses is strongly advised.

New changes
to the compliance certificate governed by section 116 of the *Income Tax Act*

by JEAN-SÉBASTIEN LASCARY
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New changes announced by the 2008 federal Budget with respect to the compliance certificate governed by section 116 of the *Income Tax Act* have been enacted and will apply to transactions occurring after 2008.

In a nutshell, section 116 provides for a system whereby non-residents of Canada must obtain a clearance certificate with respect to the disposition of a certain type of property (Taxable Canadian Property[1]). An amount as account of taxes must usually be paid to the Minister with an application for a clearance certificate. Where the non-resident does not obtain a clearance certificate, the purchaser of the property is liable for, and is entitled to withhold, an amount of 25% of the proceeds of sale of the property as tax on behalf of the non-resident.

Starting in 2009, will be excluded from the application of section 116 the disposition of treaty-protected property[2] where the purchaser and the non-resident person are related. Moreover, purchasers will not be required to withhold 25% of the purchase price if:

(i) after reasonable inquiry, the purchaser concludes that the non-resident of Canada is resident of a country with which Canada has a tax treaty

(ii) the property sold is treaty-protected property under the tax treaty referred above; and

(iii) the purchaser provides, within 30 days of the sale, the Minister with a notice including general information about the sale.

These changes offer very limited relief in the application of the unfriendly-to-foreign-investments section 116. Effectively, changes announced by the 2008 federal budget will only have an effect on transactions between related parties.

So far, the best relief granted to foreign investors in respect of the application of section 116 may still be in the form of the new definition of "designated stock exchange". Effective December 14th, 2007, the definition of prescribed stock exchange (now designated stock exchange) was enlarged to include various new stock exchanges[3]. Shares listed on a designated stock exchange are not Taxable Canadian Property, thus are not subject to the application of section 116. Moreover, a new category of stock exchanges, "Recognized stock exchanges" was added to the *Income Tax Act*. Shares listed on a recognized stock exchange are excluded from the application of section 116.

In conclusion, section 116 still has a large scope. The extent of its application should always be properly examined in the context of transactions with a non-resident.

1 Examples of Taxable Canadian Property include real estate located in Canada and shares of Canadian corporations.
2 Treaty protected property is property the income or gain from the disposition of which would be exempt from tax in Canada as a result of a the application of tax treaty between Canada and another country.
3 A list of all designated stock exchange can be found here [http://www.fin.gc.ca/news08/data/08-049_1e.html#Annex]

What's new

"David H. Sohmer, Frank Zylberberg and Joshua C. Borenstein are listed in the Canadian Lexpert's 2008 Directory as repeatedly recommended attorneys and have all been selected to be included in the 2009 edition of The Best Lawyers in Canada"

When can we claim
extrajudicial fees?

by VÉRONIQUE BELLEY
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"...regardless of whether there was an abuse of a right on the main issues of the case or not, a party that abuses its right to take legal action causes harm to the opposing party who, in order to defend the case, *unnecessarily* pays extrajudicial fees to its attorney."

Going to court is a costly matter. A very costly one. Besides questions of recourses or grounds of defence, those concerning fees inevitably come up during initial consultations. Unfortunately, determining the cost of litigation is at best an inexact science and often a perilous exercise.

One thing we do know, fees are divided into two categories: judicial fees (commonly known as costs) and extrajudicial fees (which include attorney's fees). Costs are established in accordance with the *Tariff of judicial fees of advocates* (the "Tariff"). They compensate the victorious party for certain expenses incurred, but in general, only represent a small portion of the total costs of litigation. Unless the Court orders otherwise, the losing party assumes all expenses incurred by both parties. However be careful! Costs do not include extrajudicial fees which each party, victorious or not, shall assume. Given the ever increasing difference between costs and extrajudicial fees, victorious parties are requesting more and more that they be reimbursed. How and in which circumstances can we claim extrajudicial fees?

In order to justify the granting of damages, the requesting party must "prove actual abuse of process, for example defending a non-existing right, instituting a multiplicity of dilatory or frivolous proceedings or a proliferation of actions intended at having the opponent incur unnecessary fees" (translation) (*Ievers v. Sigma Construction Inc.*).

In the case of *Viel v. Les entreprises immobilières du terroir Ltée*, the Quebec Court of Appeal considered the question of whether an opposing party may claim as damages the extrajudicial fees of its attorney based on the reprehensible, abusive and bad faith conduct of a party concerning the main issues of the case. We must begin by differentiating between the misuse of a right on the main issues of a case and the misuse of a right to take legal action. An abuse of a right on the main issues of a case occurs at the time the fault is committed, before any procedures are instituted to penalize the abuse. An abuse of right to take legal action occurs at the time the action is instituted.

Given that a causal link is *sine qua non* to the success of a civil liability suit, the Court of Appeal determined in *Viel* that a party that institutes legal proceedings to penalize an abuse of a right on the main issues of the case shall not be entitled to the reimbursement of its extrajudicial fees. However, the Court stressed that regardless of whether there was an abuse of a right on the main issues of the case or not, a party that abuses its right to take legal action causes harm to the opposing party who, in order to defend the case, *unnecessarily* pays extrajudicial fees to its attorney. In such case, there is a causal link between the fault (abuse of process) and the harm (the fees incurred to defend it). Finally it should be noted that an abuse of process does not only occur at the time the proceedings are instituted; it may also occur during them. A party that realizes its error, but unnecessarily continues the proceedings, could be responsible for the payment of the extrajudicial fees of the opposing party who requests them.

Update: Changes Regarding
Hypothecs and RRSPs

by DANIEL FRAJMAN
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Important recent legislative changes concerning hypothecs (particularly over estates, and over brokerage accounts), and concerning RRSP unseizability, are referred to below.

As regards hypothecs, the changes (in the *Civil Code of Québec* and in a new *Securities Transfer Act*) are in force as of January 1, 2009, and include the following:

- An individual wanting to pledge vested or unvested rights in an estate appears to now have to do it by way of a "security trust" rather than a hypothec. The trust must be registered, and the secured creditor would be the beneficiary. The testator must have passed away prior to the trust being formed.
- A hypothec over a brokerage account is set up as before (usually with a signed and registered hypothec). However, the secured creditor must now obtain from the broker a "control agreement" allowing the secured creditor to take over the account on demand. The first secured creditor to obtain a control agreement gets first rank over the account. This new rule is apparently *retroactive* so, for example, a holding company with a pre-existing hypothec over a subsidiary operating company ("Opco") owning significant marketable securities, will want to obtain a control agreement from Opco's securities broker as soon as possible.
- Regarding private company shares, they can still be pledged as before (by delivering the share certificate), but the certificate must now be endorsed by the pledgor. (This was current practice anyway).

Many of the changes referred to above mirror changes made over the last few years in some of the other provinces, including Ontario, Alberta and British Columbia, and the Quebec legislation indicates that the above-mentioned current changes are "part of an effort by the Canadian provinces and territories to harmonize their laws on the matter". Perhaps this is a harbinger of further cooperation among the provinces regarding the formation of a national securities regulator, but that remains to be seen.

* * *

We had previously referred to pending federal legislation (in the *Bankruptcy and Insolvency Act*) concerning creditor-proofing of private retirement plans. That legislation finally came into force in July 2008, and states that RRSPs and RRIFs (including self-directed plans), and deferred profit-sharing plans, are unseizable on bankruptcy, except as to contributions made in the twelve months preceding the insolvency proceedings. It is also hoped that the federal government will amend the *Income Tax Act* to clarify that self-directed RRSPs and RRIFs set up in Quebec are not adversely affected even if account opening forms for some of those plans do not meet all of the requirements of Quebec trust law.

Please do not hesitate to contact us if you need additional information on these matters.

What's new

Me André Valiquette, pioneer of the mining division of securities law, has recently joined the firm as counsel.

Me Valiquette's significant experience is a perfect addition to the drive and motivation of our firm.

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Please contact Martin Piedalue at mpiedalue@spiegelsohmer.com if you would like to receive your Newsletter by email.

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