

CONTROL IN FACT:  
IGNORING THE SHAREHOLDERS' AGREEMENT

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The recent Federal Court of Appeal decision in *Plomberie J. C. Langlois Inc. v. The Queen*, 2006 DTC 6508 is an interesting reminder of the importance of adhering to the provisions of a shareholders' agreement when working to ensure that two corporations are not associated with each other for purposes of claiming the small business deduction. In this particular case, the corporate taxpayer had two individual shareholders, René and Richard, each of whom owned directly or indirectly 50% of the shares in the capital stock of the taxpayer. As a result, neither had *de jure* control. René also held all of the issued shares of various other corporate entities which he controlled directly. The Minister assessed the taxpayer, denying the small business deduction, on the basis that René had *de facto* control of the taxpayer pursuant to subsection 256(5.1) of the Act, and thus that the taxpayer was associated with the other corporations controlled by René.

Subsection 256(5.1) provides that where a person may exercise any direct or indirect influence over a corporation that, if exercised, would result in control in fact over the particular corporation, that person shall be considered to control the particular corporation. In this case, Richard was responsible for all plumbing-related business. He made bids, provided estimates, hired staff and looked after the purchase and maintenance of equipment and tools. René was responsible for office management, advertising, wages and invoices, cheque signing, banking and credit. A shareholders' agreement did exist between Richard and René which provided that any decision had to be approved unanimously by the two shareholders. Despite the shareholders' agreement, Judge Louise Lamarre Proulx of the Tax Court of Canada found that René had a degree of influence over the taxpayer which resulted in his control of the taxpayer.

The taxpayer appealed to the Federal Court of Appeal on the basis that the Court should not have ignored the shareholders' agreement and should have recognized that it effectively neutralized René's ability to dominate the taxpayer. The Federal Court of Appeal dismissed the taxpayer's appeal and held that René did, in fact, control the taxpayer. The following facts were relied upon:

1. all business cards included the names of four companies, including the taxpayer, all of which were in René's group of companies;

2. documents from the corporate website and various speeches and articles all portrayed the taxpayer as an “affiliate” in the corporate group;
3. the taxpayer’s offices were located in the same place as one of the corporations in René’s group;
4. some of the employees within René’s corporate group worked for the taxpayer at times;
5. according to the financial statements, various transactions occurred between the taxpayer and other companies in René’s group;
6. financing for the taxpayer was, on more than one occasion, guaranteed by other corporations in René’s group;
7. Richard never signed guarantees or dealt with financial matters;
8. René decided on the allocation of common expenses for the various corporations he managed, including the taxpayer; and
9. there were no resolutions evidencing unanimous shareholder approval on any issue.

The Federal Court of Appeal held that René had *de facto* control of the taxpayer. The Court described Richard’s role as an operational one, not a decision-making role. Rather, the decision-making role belonged to the sole director, being René, whose powers were vast. The Court felt that the role of director is the role that is associated with the notion of control in fact.

The case is a reminder of the importance of managing the actual activities of corporations in a group in order to manage the question of control. A unanimous shareholders’ agreement should, in theory, work to alleviate concerns about factual control. However, the facts are the facts, and nothing in a shareholders’ agreement can alleviate the reality that taxpayers create.