

Dockets: 2020-2382(IT)G
2020-2386(CPP)

BETWEEN:

MALAMUTE CONTRACTING INC.,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

Appeals heard on November 18 and 19, 2024 at Edmonton, Alberta

Before: The Honourable Justice Edward (Ted) Cook

Appearances:

Counsel for the Appellant: Neil Mather

Counsel for the Respondent: Allison Murray Banerjee

JUDGMENT

In accordance with the attached reasons for judgment;

The appeals of the reassessments made under the *Income Tax Act* of the Appellant's taxation years ended October 31, 2018 and October 31, 2019 are allowed;

The appeal of the decision of the Minister of National Revenue in respect of the assessments dated October 16, 2019 under the *Canada Pension Plan* is allowed;

The reassessments and assessments are returned to the Minister of National Revenue for reconsideration and reassessment on the basis that

- Mr. David Lynch and Mrs. Danielle Lynch did not receive salary from employment for income-tax and Canada-Pension-Plan withholding and remittance purposes, and
- the related penalties are to be vacated; and

The Appellant is awarded costs.

Signed at Ottawa, Ontario, this 24th day of March 2025.

“Ted Cook”

Cook J.

Citation: 2025 TCC 47
Date: 20250324
Dockets: 2020-2382(IT)G
2020-2386(CPP)

2025 TCC 47 (CanLII)

BETWEEN:

MALAMUTE CONTRACTING INC.,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

REASONS FOR JUDGMENT

Cook J.

I. Introduction

[1] These are appeals by Malamute Contracting Inc. (“Malamute”) from reassessments made under the *Income Tax Act* (the “Act”) of its taxation years ending October 31, 2018 and October 31, 2019. Malamute also appeals the decision of the Minister of National Revenue (“Minister”) in respect of the assessments dated October 16, 2019 under the *Canada Pension Plan*.

[2] Malamute is a small contracting company engaged primarily in kitchen and bathroom renovations. Mr. David Lynch is the principal shareholder of Malamute. He performs most of the work and is helped by two trades employees. His wife, Mrs. Danielle Lynch, is the other shareholder of Malamute. She is a commercial insurance broker by profession.

[3] During the relevant period, Mrs. Lynch did the bookkeeping for Malamute and it made 3 types of payments to Mr. and Mrs. Lynch: the so-called “uneven-amount” payments (the “Cheques”), which were cheques issued between

January 2018 and February 2019; other payments by cheque; and interac transfers. It is the tax treatment of the Cheques that is at issue.

[4] The Cheques had the notation “payroll” on the re: line and were in what was referred to at trial as “uneven amounts” (e.g., \$1,889.12). That is, they appeared to be in the amounts that one would get after deducting income-tax and Canada-Pension-Plan (“CPP”) withholdings from an even gross salary number. As well, the Cheques were paid in generally consistent amounts on a biweekly basis. The other payments by cheque did not have any notation on the re: line and were in even amounts (e.g., \$6,000). The interac transfers were not referred to in any detail at trial.

[5] The Minister assessed Malamute for failure to withhold and remit income-tax and CPP deductions on the basis that the Cheques were salary from employment for Mr. and Mrs. Lynch. The Minister also imposed related penalties under subsections 162(7), 227(8) and 227(9) of the Act.

[6] Malamute appeals, arguing that the Cheques were not payments of salary. Instead, the Cheques were issued to the Lynches in their capacity as shareholders of Malamute. If this is the case, Malamute had no obligation to withhold and remit.

II. Analysis

[7] The applicable law is not in dispute. The tax treatment of a payment is governed by its character at the time the payment is made. In *Adam v MNR*, [1985] 2 C.T.C. 2383, 85 D.T.C. 667 (T.C.C.) at para 13 Chief Justice Rip stated that “salary, once received, cannot for tax purposes become anything else.” It is not permissible to go back and recharacterize a payment after the fact. Past events cannot be ignored. In *Adam*, the taxpayer admittedly received salary but later tried to change the character of the payments by way of a reversal of book entries.

[8] Chief Justice Rip also recognized, however, that a taxpayer may make entries in its books of account to reflect adjustments to its accounts as and when they take place. For example, a shareholder-employee might draw money as loans from a corporation throughout the year. Then at the end of the year, the shareholder-employee’s mix of dividends and salary for the year is decided. The loan account is adjusted accordingly.

[9] In *Irmen v The Queen*, 2006 TCC 475, the taxpayer was a shareholder-employee of a company. Payments were made throughout the year to the taxpayer, and income-tax and CPP deductions were withheld and remitted on the payments.

The taxpayer later argued that the payments were not salary, but this Court found that it was intended at the time the payments were made that they be salary so that income-tax and CPP source deductions could be taken throughout the year. There was no mistake in making the deductions and remitting them.

[10] In *Park Avenue Furniture (MFG.) Corporation v MNR*, 2019 TCC 94 [*Park Avenue Furniture*] at para 20, Justice Russell, relying on *Adam and Irmen*, stated:

The law on this matter of payment characterization makes clear that it is the intention of the parties (payer and payee) at the time of the payment that characterizes the nature of the payment, and that the nature of the payment as intended at that time cannot thereafter be re-characterized.

He goes on to state at para 21 that “[i]t follows from this that a correction can subsequently be made, but only in accordance with what was the shared intent of the payor and payee at time of payment.”

[11] The Respondent’s position is that Malamute paid Mr. and Mrs. Lynch salary from employment and then engaged in after-the-fact recharacterization of the Cheques. Payroll remittances were made to the Canada Revenue Agency (“CRA”) in respect of the January and February 2018 Cheques. Subsequent Cheques were paid biweekly and in similar amounts, but remittances were not made to the CRA. There was some variation in the amounts of the Cheques consistent with the phase-in and phase-out of CPP contributions.

[12] The Respondent argues that the January and February 2018 Cheques were salary on which remittances were made. Ms. Slingerland, a CRA appeals officer, testified for the Respondent and she said that Malamute’s accountant, Mr. Pallard, admitted to her that the January and February 2018 Cheques were salary. The Respondent submits that there is nothing to distinguish the January and February 2018 Cheques from the subsequent Cheques (i.e., the Cheques issued between March 2018 and February 2019). Therefore, the subsequent Cheques also had to be payments of salary. The notation on the Cheques, the method of determination of the amounts, and number and frequency of payments, all point to the payment of salary for which withholdings were not remitted.

[13] Malamute argues that the intention of the payor, Malamute, and the payees, Mr. and Mrs. Lynch, at the time each Cheque was issued was that it be a payment to the Lynches in their capacity as shareholders and that none of the Cheques were

issued as payments of salary. I prefer Malamute's view and find that the Cheques were not payments of salary by Malamute to Mr. and Mrs. Lynch.

[14] Mr. Lynch, Mrs. Lynch and Mr. Pallard testified for Malamute. I found both Mrs. Lynch and Mr. Pallard to be generally credible and reliable. I found Mr. Lynch's testimony to be less reliable than that of the other two witnesses because his recollection was less certain. Unsurprisingly, given their educational and business backgrounds, neither Mr. nor Mrs. Lynch is sophisticated when it comes to income-tax matters. But their testimony was consistent that Malamute was a separate business for Mr. Lynch and that they were to be paid as owners of the business rather than as employees. Mr. Pallard testified that the plan all along was to pay the Lynches by way of dividends and not salary. Paying salary could create massive cash flow problems for a small business like Malamute if cash was not available for remittances.

[15] Mrs. Lynch did not have experience, nor training, as a bookkeeper. She testified that the reason she put the notation "payroll" on the re: line was to distinguish the Cheques from the other payments by cheque from Malamute to the Lynches. The Cheques were intended to be what she called "owner's pay" while the other payments by cheque were intended to be loans from Malamute to Mr. and Mrs. Lynch that would have to be repaid.

[16] Mrs. Lynch testified that she knew she and Mr. Lynch would be taxed on what they received from Malamute. She was worried about the big tax bill at the end of the year so she used a government-website calculator, almost certainly the CRA's, to try to figure out how much tax there would be in respect of each Cheque. This also resulted in remittances being made to the CRA for January and February 2018. Mrs. Lynch said she had made mistakes in making the remittances and the associated entries into the accounts of Malamute, and that she no longer does the payroll for Malamute.

[17] Mr. Pallard similarly testified that Mrs. Lynch had made mistakes and that it was her enthusiasm to comply with tax obligations that created Malamute's problems. His understanding was that all draws were to be on the shareholder loan account and that no amounts were to be paid to Mr. and Mrs. Lynch by way of salary.

[18] The financial statements for Malamute for the financial years ending October 31, 2018 and October 31, 2019 were consistent with Mr. and Mrs. Lynch not having received employment remuneration. The Cheques were generally accounted for as draws against the shareholder loan account (there were a couple

Cheques not accounted for, which I ascribe to errors in bookkeeping). A \$50,000 dividend was declared to Mr. Lynch as of January 2, 2018 and a \$65,000 dividend was declared to Mr. Lynch as of January 2, 2019. The evidence does not indicate when the dividend declarations were actually made.

[19] Ms. Slingerland testified that she had concerns as to whether Malamute had the solvency to declare the dividends. This influenced her view that the Cheques should be viewed as salary. But even if Malamute had solvency issues, I do not see how that could turn the Cheques into salary if they were not otherwise so characterized. As a result, I attach no importance to whatever solvency issues Malamute might have had.

[20] The income tax returns for Malamute, and for Mr. and Mrs. Lynch, are all consistent with Mr. and Mrs. Lynch not having received employment remuneration during Malamute's taxation years ending October 31, 2018 and October 31, 2019. The 2018 income-tax returns of Malamute, and Mr. and Mrs. Lynch, were all filed before the CRA's Trust Account Examination of Malamute started.

[21] Mrs. Lynch stopped receiving Cheques once she got a job as an insurance broker in later 2018 and she did not receive any dividend income from Malamute in either 2018 or 2019. While this is indicative of tax planning by the Lynches, it does not necessarily imply that Mrs. Lynch received salary from employment.

[22] Ms. Slingerland had a discussion in January 2020 with Mr. Pallard. She testified that Mr. Pallard admitted in the discussion that the January and February 2018 Cheques were, in fact, payroll. In her view, once those Cheques were admitted to be payroll, there was nothing to distinguish the subsequent Cheques in terms of their characterization. Her T2020 file notes, however, state that Mr. Pallard told her: **“ok fine, maybe the ones in January can be called payroll, but not the whole year”** [emphasis in original]. This does not strike me as an admission by Mr. Pallard so much as a concession by him to try to settle the file with the CRA.

[23] Ms. Slingerland also testified that she had no discussions with either Mr. or Mrs. Lynch regarding the intention of the payor and payee in issuing the Cheques.

[24] The period at issue is 14 months. The CRA relied on Malamute's remittances for the first two months and then discounted Malamute's treatment for the next 12 months, its financial statements and income tax returns, and the income tax returns of Mr. and Mrs. Lynch. This strikes me as an unwarranted extrapolation by the CRA that did not adequately consider the factual context.

[25] On the totality of the evidence, I find that the Cheques were not salary from employment for Mr. and Mrs. Lynch. Instead, the Cheques were issued to Mr. and Mrs. Lynch in their capacity as shareholders of Malamute. This was the shared intention of Malamute as payor, and Mr. and Mrs. Lynch as payees, at the time each payment was made.

[26] The controlling minds of Malamute, Mr. and Mrs. Lynch, were not sophisticated in tax matters and it resulted in the unfortunate notation on the Cheques, misguided use of the website calculator and mistaken remittances for January and February 2018. But the evidence of Mr. Lynch, Mrs. Lynch and Mr. Pallard was consistent with respect to the basic intention for all of the Cheques. It is also in line with the financial statements of Malamute and the income-tax returns of Malamute, and Mr. and Mrs. Lynch.

[27] The facts at hand can be distinguished from those in *Adam* and *Irmen*. Here I find that that the remittances made in respect of the January and February 2018 Cheques were a mistake and that the subsequent correction was made in accordance with the shared intent of Malamute and the Lynches, as contemplated by Justice Russell in *Park Avenue Furniture*. This is the type of situation referred to by Chief Justice Rip in *Adam* wherein a shareholder receives draws on the shareholder loan account throughout the year and then a dividend determination is made at some point for the year.

[28] Having found that the Cheques were not salary from employment, the relevant amounts were not subject to withholding and remittance for income-tax and CPP purposes. Consequently, the Minister was not justified in imposing the related penalties.

III. **Disposition**

[29] Malamute's appeals are allowed. The income-tax reassessments and the CPP assessments are returned to the Minister for reconsideration and reassessment on the basis that Mr. Lynch and Mrs. Lynch did not receive salary from employment for income-tax and CPP withholding and remittance purposes. The related penalties are to be vacated.

[30] Malamute is awarded costs.

Signed at Ottawa, Ontario, this 24th day of March 2025.

“Ted Cook”

Cook J.

CITATION: 2025 TCC 47
COURT FILE NOS.: 2020-2382(IT)G
2020-2386(CPP)
STYLE OF CAUSE: MALAMUTE CONTRACTING INC.
AND HIS MAJESTY THE KING

PLACE OF HEARING: Edmonton, Alberta

DATE OF HEARING: November 18 and 19, 2024

REASONS FOR JUDGMENT BY: The Honourable Justice Edward (Ted)
Cook

DATE OF JUDGMENT: March 24, 2025

APPEARANCES:

Counsel for the Appellant: Neil Mather

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