Herman Dekker
3291 Atkinson Lane
Abbotsford, BC
V3G 2G5

March 27th, 2009

Dear Mr. Dekker;

RE: Your 2005 Income Tax Return

Our review of the above mentioned Tax Return is nearing completion. At this time we propose the following adjustments:

Add shareholder appropriations:	$ 1,306,960
Reverse capital gain previously reported:	$ (955,724)

The shareholder appropriations above consist of 50% of the cash received by you and your spouse ($1,563,917.89), 100% of the donation made on your behalf from trust funds and 50% of the mortgage received by you from the purchaser of the assets of Vision Poultry Ltd. **(Vision)** and/or 570129 BC Ltd. **(570129)**.

It is our position that the proceeds received by you pursuant to the sale of farm assets were in fact funds received by Vision/570129 on the sale of its assets and paid out to you at a time when you were a shareholder of Vision/570129. The amount is therefore taxable to you under subsection 15(1) of the *Income Tax Act*. Alternatively, if subsection 15(1) does not apply, section 84.1 applies to tax the funds received by you as a deemed dividend. Reasons for our position are set out below.

PARTIES INVOLVED

Theanon Charitable Foundation **(Theanon)** was incorporated under the British Columbia Society Act on September 22, 1986. It is a registered charity.

Vision was incorporated in British Columbia on January 14, 1988. Prior to February 2005, it was owned by 570129. It owned various assets including bird quota, real estate and equipment.

570129 was incorporated in British Columbia on August 13, 1998. Prior to February 2005, it was owned by Herman Dekker and Riet Vogel.

Essential Grace Foundation **(Essential)** was incorporated under the BC Society Act. It is a registered charity.

Prescient Foundation (**Prescient**) was incorporated under the BC Society Act. It is also a registered charity.

Gateway Benevolent Society (**Gateway**) was incorporated under the BC Society Act. It is also a registered charity.

(Essential, Prescient and Gateway are henceforth referred to as '**the foundations**")

Philanthropy Without Frontiers (**PWF**) was incorporated under the BC Society Act. It was also a registered charity.

Herman Dekker is the spouse of Marie Vogel. (The **Dekkers**). They are Canadian residents of British Columbia.

BC Farm and Ranch Realty (**BC Farm**) is a real estate company in BC specializing in farm property.

Legacy Advisors Law Corporation (**Legacy**) is a law firm that acted for various foundations.

Sliman Stander & Co (**Sliman**) is a law firm that acted for the Dekkers.

John Glazema (**Glazema**) is a shareholder of BC Farm and a director of Gateway.

SUMMARY OF FACTS AND ASSUMPTIONS

Nov. 15, 2004 — A listing agreement was signed between BC Farm and Vision whereby BC Farm agreed to sell property owned by Vision for a commission. The property included real estate, '30,050 BC Egg Hatching Quota' and various equipment.

Dec. 14, 2004: — A contract of Purchase and Sale was signed whereby Johnston Farms Ltd. offered to purchase property from Vision for $3,460,000. A deposit of $50,000 was to be paid once conditions were removed.

January 24, 2005: — All conditions on Dec. 14th agreement were removed. This agreement was transferred from Johnston Farms Ltd. to Steve and Krista Brandsma (the Brandsmas).

January 25, 2005: — A cheque from The Borderline Cattle Company to BC Farm in Trust, in the amount of $50,000 was written. (It is assumed that Borderline Cattle Company is the name of the Brandsma's business.)

February 8, 2005: A share purchase agreement was signed between Gateway and the Dekkers whereby Gateway agreed to purchase all the shares of Vision for $3,460,000. The deal was to close Feb 9th, 2005, although there is no evidence that it did.

February 14, 2005: Theanon purportedly gifted to PWF $1,100,000.

February 25, 2005: Theanon purportedly gifted to PWF $90,000.

PWF purportedly lent Vision $1,440,000, for the purpose of paying off amounts owing to the Bank of Montreal (BMO) A cheque was written in this amount from Legacy to Sliman, a law firm acting on behalf of the Dekkers.

Theanon purportedly made the following "Specified Gifts"

- $665,000 to Gateway
- $665,000 to Essential
- $570,000 to Prescient

These gifts were purportedly disbursed through Legacy's trust account.

A total of $3,332,000 was deposited into a trust account at Sliman. The funds were purportedly from the foundations and PWF.

February 28, 2005: A payment was made to BMO in the amount of $1,086,955.38 from the trust account of Sliman.

The foundations purportedly purchased all the outstanding shares of 570129 from the Dekkers for $3,370,000, per an Agreement for Sale (this is henceforth referred to as the AFS). The purchase price was reduced by $1,440,000 for the outstanding loan, resulting in a net purchase price of $1,930,000. (According to the foundations this transaction actually happened on February 25th, 2005).

A cheque was received by Legacy from Sliman in the amount of $350,000. The letter accompanying this cheque states that it is a charitable gift from Herman Dekker to Theanon.

March 1, 2005: 570129 and Vision amalgamated and continued as 570129.

570129 purportedly gifted all its assets to Theanon, Assets transferred purportedly included a broiler breeder birds quota, land and improvements (at 42420 Keith Wilson Road, Sardis), poultry, machinery and equipment and miscellaneous inventory in addition

to livestock. It received a donation receipt in the amount of $2,020,000.

The amount due to PWF by 570129 appears to have been assumed by Theanon in this transaction. It recorded a liability of $1,440,000.

Theanon purportedly sold the former 570129 assets to the Brandsmas for proceeds of $3,460,000. Theanon purportedly took back a mortgage in the amount of $350,000 secured by the assets.

March 2, 2005 — A document titled "Assignment Loan & Security" purportedly assigned the Brandsma mortgage to the Dekkers in exchange for $350,000. This document, however, was not signed by any of the parties involved.

Payment of $3,109,152.98 was received from the Brandsma's lawyer representing the amount owing for the assets purchased.

March 3, 2005: The following cheques were written from the Sliman trust account:

- $3,002,852.98 to Legacy (in trust for Theanon)
- $96,300.00 to BC Farm (regarding commissions plus GST)
- $1,563,917.89 to the Dekkers

May 9, 2005: A mortgage transfer was registered with Land Titles. This document purportedly records the transfer of the Brandsma mortgage from Theanon to the Dekkers. Its Terms indicate that consideration paid for the mortgage was $350,000.

Primary Position

It is our position that the following transactions were shams and secondly that they had no legal substance and were legally ineffective:

- The loan from PWF to Vision.
- The termination of the purchase agreement between Vision and the Brandsmas.
- The sale of Vision shares to the foundations.
- The donation of assets by Vision to Theanon.
- The sale of assets by Theanon to the Brandsmas.

Sham

Based on the facts of the case, the CRA is of the position that transactions involving the Vision shares and assets were shams. A sham transaction is one in which acts

committed or documents executed by the parties to the transaction are intended to give to third parties the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations which the parties actually intended to create. In *Stubart Investments Ltd. v. HMQ*, ***(84 DTC 6305)*** Estey. J. of the Supreme Court of Canada stated:

> *A sham transaction: This expression comes to us from decisions in the United Kingdom, and it has been generally taken to mean (but not without ambiguity) a transaction conducted with an element of deceit so as to create an illusion calculated to lead the tax collector away from the taxpayer or the true nature of the transaction; or, simple deception whereby the taxpayer creates a facade of reality quite different from the disguised reality. The courts will not permit the taxpayer to take advantage of deductions or exemptions which are founded on a sham transaction.*

It is our belief that documents evidencing these transactions were signed to give the appearance that you sold your shares of Vision, when in fact only the assets of Vision were sold to third parties. Evidence to support this view includes the following:

1. There was an unconditional agreement in place as of January 24th, 2005 for the sale of assets from Vision to the Brandsmas. The closing date on this deal was to be March 1, 2005. In the end, the Brandsmas ended up with these assets on March 1, 2005 but purportedly from a different vendor than Vision.

2. There is disagreement between the parties involved as to when the purported sale of 570129 shares by the Dekkers took place. According to the Dekkers the transaction took place on February 28th, 2005 and according to the foundations the transaction took place on February 25th, 2005. The share certificates show date of transfer being February 25th. Change of control was reported to the CRA on Vision's Corporate Tax Return to have occurred on February 28th. The first copy of the AFS received from the foundations was undated, as was the copy received from the Dekkers. The second copy received from the foundations, upon the request for a dated copy, was dated February 25th, 2005.

3. The Dekkers did not receive the bulk of their proceeds (net over 1.5 Million) until March 3, 2005, the day after cash was received from the Brandsmas. This would suggest that the funds were held back from the Dekkers until the asset sale took place. The AFS states that the proceeds are due upon closing.

4. There is differing evidence as to the date that the Dekkers resigned as directors of Vision and 570129. The Dekkers apparently signed resolutions resigning as directors of Vision on February 25th, 2005, but it would make no commercial sense for them to resign on that date if they had not, as they contend, yet sold the 570129 shares. The change in directors is registered at the Ministry of

Finance Companies Office for 570129 and Vision to be effective March 1, 2005. Also, a resolution of the directors of Vision dated March 1, 2005 is signed by the Dekkers as directors.

5. A 'Contract of Purchase and Sale', undated, purportedly between Theanon and the Brandsmas refers to a $50,000 deposit. This is apparently the same deposit issued regarding the agreement dated December 14th, 2004 with Vision. The deposit, however, is not included in the statement of adjustments relating to the purported sale of assets from Theanon to the Brandsmas.

6. The undated Contract of Purchase and Sale, mentioned above, states that the buyer and seller had signed a limited dual agency agreement on December 14, 2004. The only such agreement apparently was the one between Vision, BC Farm and Johnston Farms, (later assigned to the Brandsmas).

7. Although the only signed listing agreement regarding the Vision asset sale was between Vision (represented by the Dekkers) and BC Farm, the only sales commission was purportedly paid by Theanon. There are apparently no documents in Theanon's or BC Farm's possession explaining what commitment Theanon had to pay this commission. What is apparent, however, is that the price that Theanon purportedly paid for the shares of 570129 was $90,000 less that what Gateway had agreed to pay for the same shares. The commission paid by Theanon was equal to $90,000.

8. A request to the Dekkers for "any agreements entered into regarding the sale of any assets from these corporations" was responded to with a partial copy of the agreement between Vision and Johnston Farms Ltd. The part of the agreement regarding the assignment of the contract to the Brandsmas was missing. The representative for the Dekkers responded: "if this is not the agreement you are referring to, please be more specific in your request." This suggests a reluctance on the part of the representative to make complete disclosure.

9. The BC Hatching Egg Commission, which owned the quota held by Vision, did not approve of and was not made aware of its transfer between anyone other than Vision and the Brandsmas. The only application for transfer of quota was made February 7, 2005 by Vision and Borderline Farms, represented by Steve Brandsma.

10. It was not Theanon, but the Dekkers that ultimately owned the $350,000 Brandsma mortgage.

11. The abandoned deal with Gateway suggests that there was the intention on the part of principals of BC Farm to assist the Dekkers in reducing taxes by effecting a sale of shares rather than a sale of assets and at the same time earn some money in Gateway.

12. The representative of the Dekkers stated that they knew nothing about a purported loan to Vision of $1,440,000. The AFS, however, states that proceeds due the Dekkers were to be reduced by the amount of this loan. The purported loan, therefore, would have had to be in place before the sale of shares. How could it be then that the Dekkers would know nothing of it?

It is our position that if the above-mentioned 'transactions' are ignored, then any funds or assets received by you from the sale of assets of Vision or 570129 were actually appropriations from that corporation and taxable under subsection 15(1) of the *Income Tax Act*.

Legally ineffective/incomplete

We are of the position that beneficial ownership of the shares did not pass from you and your spouse to the foundation; this transaction was not accomplished in law. Also it is the CRA's opinion that there was no transfer of assets from 570129 to Theanon or from Theanon to the Brandsmas. If a transaction is ineffective or legally incomplete, it can be ignored for tax purposes.

In *Atinco Paper Products Limited, (78 DTC 6387)* the Federal Court of Appeal held that contracts were ineffective because of a failure to complete certain essential legal steps. Urie, J. commented that tax planners must ensure that tax driven transactions are fully implemented and carefully documented:

> It is the duty of the Court to carefully scrutinize everything that a taxpayer has done to ensure that everything which appears to have been done, in fact, has been done in accordance with applicable law. It is not sufficient to employ devices to achieve a desired result without ensuring that those devices are not simply cosmetically correct, that is, correct in form, but, in fact, are in all respects legally correct, real transactions. If this Court, or any other court, were to fail to carry out its elementary duty to examine with care all aspects of the transactions in issue, it would not only be derelict in carrying out its judicial duties, but in its duty to the public at large.

The evidence in this case suggests that certain 'transactions' were not legally correct. We base this finding on the following:

1. There is no compelling evidence that the shares purportedly transferred to the foundations were actually paid for in full by the foundations. As mentioned above, you and your spouse were not paid out in full until the Brandsmas had paid for the assets, although $1.5 million purportedly should have been paid to you on February 26th, 2005 (the purported closing date).

2. At the time of the foundation's purported purchase of the 570129 shares it was predetermined that the foundations transfer the assets to Theanon and that Theanon would sell the assets to the Brandsmas. Therefore, neither the foundations nor Theanon ever had unfettered ownership of the shares or the assets. The shares were not purchased unconditionally but with the proviso that the assets would be immediately donated to Theanon and then sold to the Brandsmas.

3. One of the main assets of Vision was a quota issued by the British Columbia Broiler Hatching Egg Commission. According to the Consolidated Order of the Commission, "All Placement Quota is a revocable licence to produce only and remains the exclusive property of the Commission." How, then could Vision transfer this quota, that it did not own, to Theanon without permission from the Commission? The only applications for transfer of quota prepared were those from Vision to the Brandsmas.

   One could argue that even though you, your spouse and the foundations were not allowed to transfer the quota by law, you did it anyway and we must recognize that. We would argue that you did not and could not accomplish the quota transfer – it was not yours or the foundation's to sell. Transfer of the licence to use the quota could only be done if approved by the Commission. Neither the quota nor the licence would be of any value to anyone unless it was thus endorsed by the Commission – therefore it could not be considered an asset or even a 'thing' that could be bought and sold; it would be nothing. An unauthorized transfer of quota would not meet the test established by the Federal Court of Appeal in *Atinco* of a correct, real transaction.

   In addition, the Commission would consider the transfer of shares of 570129 to be equivalent to a transfer of quota. The company would not be able to use the quota once the sale took place and therefore the quota would be of zero value to Vision once the shares of 570129 were sold.

It is our position that if the above-mentioned 'transactions' are ignored, then any funds or assets received by you from the sale of Vision's assets were actually appropriations from that corporation and taxable under subsection 15(1) of the *Income Tax Act*.

<u>Secondary Position: Section 84.1 and non-arm's length</u>

In the event that it is found that the all transactions mentioned above did, in fact, occur and were not shams, section 84.1 would then apply to deem the proceeds paid to you for the shares of 570129 to be a dividend. This section is designed to prevent surplus stripping. In order for it to apply, all the following conditions must be present:

- A disposition of shares of any class of capital stock (the 'subject shares'.)

  - In this case the shares of 570129 were transferred from you to the foundations.

- The subject shares are shares of a corporation resident in Canada.
  - 570129 was a resident in Canada

- The vendor held the 'subject shares' as capital property.
  - 570129 shares were capital property to you.

- The vendor was not a corporation.
  - You and your spouse were the vendors.

- The transfer or sale of the subject shares was made to any other corporation.
  - The sale was to the foundations which are corporations.

- The transferor /vendor and purchaser corporation are not dealing at arm's length.
  - The question of whether persons are dealing at arm's length is one of fact. IT-419 provides guidance. It states that an indicator of non-arm's length would be a situation where the parties to a transaction are acting in concert without separate interests. The courts have expanded this principle to include the concept of 'acting in concert' with respect to an element of common interest. Therefore, even when there are two distinct minds to a transaction, but these parties act in a highly interdependent manner (in respect of a transaction of mutual interest) it can be assumed that the parties are acting in concert and therefore are not dealing with each other at arm's length. Another indication of non-arm's length is transactions taking place at below fair market value. The 570129 shares were not worth what the foundations paid for them since the foundations did not have a licence to use any quota. It is our conclusion that the foundations were merely accommodating you and your spouse and that they were not dealing at arm's length with you when and/or if they acquired the shares of 570129.

- The purchaser corporation and subject corporation are connected within the meaning of subsection 186(4) immediately after the transfer of the subject shares.
  - Each of the foundations purportedly owned more than 10% of the shares of 570129 immediately after the transfer and therefore were each connected to it per paragraph 186(4)(b)(i).

As a result of the application of paragraph 84.1(1)(b), you would be assessed a deemed dividend, calculated as follows:

(A + D) – (E + F)

A = Legal capital increase by purchaser of all classes of new shares
D = FMV immediately after the transfer of the non-share consideration
E = Greater of PUC and ACB of transferred shares.
F = Total PUC reductions under 84.1 (1)(a)

In this case, since there was no share consideration received on the transfer of 570129 shares, the dividend would be calculated:

$1,306,960 - $120 = $1,306,840.

The deemed dividend is calculated to be $1,306,840.

Next Step

We will keep these adjustments in abeyance until April 24th, 2009 to allow you time to make representations. If representations are not received by the undersigned prior to this date, the adjustments will be processed as proposed. If you have any questions, please do not hesitate to contact me.

Yours truly,

Marilyn Brown
Vancouver Island Tax Services Office
Audit Division

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