Social Security Tribunal of Canada | Tribunal de la sécurité sociale du Canada

[TRANSLATION]

Citation: *Canada Employment Insurance Commission v. L. L.*, 2016 SSTADEI 185

Tribunal File Number: AD-15-123

BETWEEN:

Canada Employment Insurance Commission

Appellant

and

L. L.

Respondent

SOCIAL SECURITY TRIBUNAL DECISION

Appeal Division – Appeal Decision

DECISION BY: Pierre Lafontaine

DATE OF HEARING: February 23, 2016

DATE OF DECISION: April 7, 2016

Canada

REASONS AND DECISION

DECISION

[1] The appeal is allowed, the decision by the General Division concerning the allocation of earnings on February 11, 2015 is rescinded and the Respondent's appeal before the General Division concerning the allocation of earnings is dismissed.

I INTRODUCTION

[2] On February 11, 2015, the Tribunal's General Division found that:

> - The net profits of a business incorporated under Quebec law, if not paid out by declaring a dividend to shareholders in accordance with the applicable law, cannot be considered earnings received by a claimant within the meaning of the *Employment Insurance Act* (the "Act") and cannot be allocated in accordance with section 36 of the *Employment Insurance Regulations* ("*the Regulations*").

[3] The Appellant filed an application for leave to appeal to the Appeal Division on March 13, 2015. Leave to appeal was granted by the Appeal Division on June 10, 2015.

FORM OF HEARING

[4] The Tribunal determined that the hearing of this appeal would proceed by teleconference for the following reasons:

- the complexity of the issue or issues;
- the fact that the parties' credibility was not one of the main issues;
- the cost-effectiveness and expediency of the hearing choice;
- the need to proceed as informally and quickly as possible while complying with the rules of natural justice.

[5] The Appellant was represented at the hearing by counsel Stéphanie Yung-Hing and the Respondent was present and represented by counsel Jean-Guy Ouellet.

THE LAW

[6] Under subsection 58(1) of the *Department of Employment and Social Development Act*, the only grounds of appeal are that:

(a) the General Division failed to observe a principle of natural justice or otherwise acted beyond or refused to exercise its jurisdiction;

(b) the General Division erred in law in making its decision or order, whether or not the error appears on the face of the record; or

(c) the General Division based its decision or order on an erroneous finding of fact that it made in a perverse or capricious manner or without regard for the material before it.

ISSUE

[7] The Tribunal must decide whether the General Division erred in law or in fact and in law in finding that the net profits of a business incorporated under Quebec law, if not paid out by declaring a dividend to shareholders, could not be considered earnings under paragraph 35(10)c) of the *Regulations*.

ARGUMENT

[8] The Appellant's arguments in support of its appeal are as follows:

- An individual who operates a business is self-employed, whether on his or her own account or through a partnership or co-adventure;

- The General Division acknowledged that the Respondent was self-employed in a co-adventure;

- The rules of interpretation applicable to the sections of the *Act* and *Regulations* concerning the allocation of income from self-employment were clarified in 1997 in *Bernier*;

- First, the legal status of the operation or business in which the self-employed person works is irrelevant. Second, the relative amount of time spent on the operation or business is irrelevant. Third, current receipt of income from the operation or business while unemployed is not required; simple entitlement to such income suffices;

- Although the Federal Court of Appeal acknowledges that these statements may draw criticism, they have nevertheless long been followed and are still followed now, even after codification of the principle of complementarity between provincial private law and federal legislation, referred to by the General Division;

- In 2003, in *Peter Lafave*, the Court allocated the claimant's business income under paragraph 35(10)c) of the *Regulations* even though the Applicant, like the Respondent, was entitled to only a one-third (1/3) share in the company's net profits, and dividends had not been paid out. The Court was not convinced that it should disregard the principles laid down and followed in *Drouin*, *Bernier* and *Viel*;

- The General Division reached a decision that runs counter to current case law when it made the legal status of Les Constructions X Inc. a critical factor in determining whether the net profits of the Respondent's incorporated business, as presented in the financial statements, should be included in the Respondent's entire income;

- Within a hierarchical system of justice, the General Division was obliged to give effect to Federal Court of Appeal judgements. It could not decide to set aside current jurisprudence by placing importance on the company's legal status. It was not up to the General Division to attempt to reinterpret these provisions;

- The Appellant submits that the state of the law still holds that a company's legal status is irrelevant in the allocation of earnings, and the General Division was therefore unwarranted in failing to apply paragraph 35(10)c) of the *Regulations* and in following the principle of complementarity. In doing so, it committed an error in law that permits the intervention of the Appeal Division;

- Once considered a self-employed person under subsection 30(2) of the *Regulations*, the fact that paragraph 35(l)b) of the *Regulations* does not define the types of business is irrelevant and is not a ground for enlisting the principle of complementarity; in doing so, the General Division erred in law;

- The Appellant further submits that once a claimant is considered a self-employed person not working a full working week, subsection 30(1) of the *Regulations* no longer applies, given that its sole purpose is to determine whether a "full working week" exists in cases where disentitlement has been imposed;

- In the case herein, the Appellant determined that the Respondent was a self-employed person who was entitled to employment insurance benefits under subsection 30(2) of the *Regulations*. This decision was made without considering for the nature of the business, in accordance with the *Regulations* and current jurisprudence;

- Given that subsections 30(1) and 35(1) of the *Regulations* are irrelevant to this case, the General Division could not cite them to support application of the complementarity principle. It thus committed an error in law that permits the intervention of the Appeal Division;

- The General Division erred in law when it found that the net benefits of a business incorporated under the *Quebec Business Corporations Act* (*QBCA*), if not paid out by declaring a dividend to shareholders in accordance with the applicable law, cannot be considered earnings within the meaning of the Act;

- As mentioned in *Caron-Bernier* by the Federal Court of Appeal, it is well established in case law that the current receipt of income from the operation or business is not required; simple entitlement to such income suffices;

- In 2003, in *Peter Lafave*, and in 2013, in *Talbot*, the Federal Court of Appeal allocated income from the claimant's business under paragraph 35(10)c) of the *Regulations*, whereas the Applicants, like the Respondent, were minority shareholders and dividends had not been paid;

- The Federal Court of Appeal has never rebutted this constant in order to ensure a degree of consistency within the Court's decisions and to promote legal certainty;

- The Appellant submits herein that there were no exceptional circumstances that would challenge the observations of Marceau J. in *Bernier*. The General Division, by deviating from the trend in existing case law, committed an error in law that permits the intervention of the General Division;

- The Appellant submits that the General Division had no grounds to follow the principle of complementarity because the *Regulations* very clearly define the income to be allocated;

- Given that the *Regulations* specifically indicate what they intend to deduct as earnings in the case of a self-employed person who operates a business, the Appellant submits that the General Division did not need to use the principle of complementarity to define income in relation to the *QBCA*;

- Alternatively, if the Appeal Division considers that the General Division was correct to apply the principle of complementarity, the Appellant respectfully submits that the General Division erred in law in its interpretation of the *QBCA*;

- According to the Federal Court of Appeal, simple entitlement suffices; dividends need not have been paid out. Under the *QBCA*, the right to receive dividends

depends primarily on the type of shares held by the shareholder, not the payment of dividends;

- In the case of Les Constructions X Inc., given that there was only one type of share, the shares issued must be deemed to include the three rights listed in section 47 of the *QBCA*, which includes the right to receive dividends;

- The Appellant submits that the net profits of Les Constructions X Inc. meet the test set out in paragraph 35(10)c) of the *Regulations*. In fact, this amount was taken from the financial statements submitted by the Respondent, and represents the amount left to the company once operating costs, direct costs and taxes have been deducted from the company's gross income;

- Once the Appellant determined the amount of the earnings, it allocated the amount in accordance with subsection 36(6) of the *Regulations*.

[9] The Respondent's arguments against the Appellant's appeal are as follows:

- The approach followed by the General Division takes account of the amendment made to interpretation legislation, its scope finally given explicit recognition after a few tergiversations in *9041-6868 Québec Inc. v. Canada (Minister of National Revenue)* and *NCJ Educational Services Limited v. Minister of National Revenue*, namely, to codify the principle of complementarity between provincial private law and federal legislation;

- These decisions were made subsequent to the precedents cited in support of the Appellant's appeal;

- In the absence a definition of the types of companies listed in sections 30(1) and 35(1)b) of the *Regulations* and the serious reservations stated by Marceau J. in *Caron-Bernier*, the General Division had to apply the rule of complementarity;

- This application does not give precedence to a provincial law over a federal law, but enlists the default role assigned to provincial law under interpretation legislation;

- Accordingly, based on the evidence on file and the rules governing joint stock companies, the General Division had to find that none of the Respondents were considered entitled to such income, namely, to receive or require a share of undistributed profits during the periods at issue;

- Such an interpretation also permits an interpretation consistent with sections governing the insurability of an employment;

- The Appellant is simply repeating the submissions made in *Caron-Bernier*, although one of these statements was later contradicted in *Leeming*;

- The Appellant submits that none of the evidence in the record shows that the Respondents were not entitled to receive their dividend. The rules governing a company such as theirs minimally require a decision by a majority of directors. None of the Respondents could make such a decision individually, or demand a pay-out of the said profits;

- Such a claim asks the Tribunal to make a decision without regard for the facts of the cases or the proper exercise of its authority;

- The evidence is plain (see all of the financial statements entered, the documents of incorporation governing the company's decision-making rules, applicable legislation and doctrinal interpretation of the said rules), no decision was made to pay out dividends during any of the years at issue;

- Quite the contrary, the decisions made had the opposite effect, and these decisions as the General Division reports have nothing to do with the rules assumed by the Appellant (distribution of unallocated profits), rules that were unknown to the Respondents;

- Lastly, when the Appellant stated that the General Division had erred when it claimed that net profits constitute earnings within the meaning of s. 36 of the *Regulations*. The only passage that might support such an assertion is section 82 of the decision, and we submit that the General Division is simply restating or

summarizing previous case law to show, in the same section mentioned, that such an interpretation contradicts the principle of complementarity and challenges the integrity of *QBCA* provisions;

- Furthermore, the Appellant states that uncontroverted evidence on file shows that the Respondents are self-employed persons. We refer to the decision in *Childs* entered in support of complementary statements to the contrary.

STANDARDS OF REVIEW

[10] The Appellant submits that the standard of review applicable to a decision of a Board of Referees (now the General Division) or an Umpire (now the Appeal Division) on questions of law is correctness, and that the standard of review applicable to questions of mixed fact and law is reasonableness (AD4-15-16) - *Chaulk v. Canada (AG),* 2012 FCA 190.

[11] The Respondent submits that the alleged errors in law are not included among the accepted exceptional circumstances, and this is not an instance where an administrative tribunal and a court of law can be called upon to decide the same issue in a lower court, and the factors established in the case law together do not argue in favour of correctness. A presumption exists that the standard of review is reasonableness. Decisions concerning the alleged errors of fact or errors in applying statutory provisions to the facts herein are reviewable under the reasonableness standard - *Canada (AG) v. Jean*, 2015 FCA 242, *Thibodeau v. Canada (AG)*, 2015 FCA 167, *Atkinson v. Canada (AG), 2014 FCA 187.*

[12] The Tribunal notes that the Federal Court of Appeal in *Jean* states at paragraph 19 of its decision that when the Appeal Division acts as an administrative appeal tribunal for decisions rendered by the General Division of the Social Security Tribunal, the Appeal Division does not exercise a superintending power similar to that exercised by a higher court.

[13] The Federal Court of Appeal continues by underscoring that not only does the Appeal Division have as much expertise as the General Division of the Social Security Tribunal and thus is not required to show deference, but an administrative appeal tribunal

also cannot exercise the review and superintending powers reserved for higher provincial courts or “federal boards,” or for the Federal Court and the Federal Court of Appeal.

[14] The Federal Court of Appeal concluded by underscoring that where the Appeal Division hears appeals pursuant to subsection 58(1) of the *Department of Employment and Social Development Act*, the mandate of the Appeal Division is conferred to it by ss. 55 to 69 of the Act. In particular, it must determine whether the General Division "erred in law in making its decision, whether or not the error appears on the face of the record" (paragraph 58(1)b) of the *Department of Employment and Social Development Act*).

[15] The mandate of the Appeal Division of the Social Security Tribunal is described in *Jean* and was subsequently affirmed by the Federal Court of Appeal in *Maunder v. Canada*, 2015 FCA 274.

ANALYSIS

[16] For the purposes of this appeal, the Tribunal must decide whether the General Division erred in fact or in fact and in law when it found that the net profits of a company incorporated under the *Quebec Business Corporations Act* (“*QBCA*”), if not paid out by declaring a dividend to shareholders, cannot be considered earnings received by a claimant and therefore allocated.

[17] The Respondent is an employee, owner and shareholder of Les Constructions X Inc. The company has been in operation since approximately 1989. It specializes in construction and renovation, and operates year-round, depending on its contracts, although its activities slow in winter. The company has three shareholders, each with 33 1/3% of the shares. The shareholders are the Respondent, J. T. and M. T.

[18] The Respondent filed a claim for employment insurance benefits beginning on December 19, 2010. After a reconsideration of the Respondent’s benefit periods, the Appellant determined that the Respondent had omitted to report the net profits of his company. It therefore allocated these net profits as earnings from the Respondent’s employment to each week covered by the Respondent’s claim for benefit, and informed him accordingly on November 14, 2013.

[19] The Respondent applied for an administrative review of the Appellant's decision and the Appellant stood by its position. The Respondent then appealed the Appellant's decision to the General Division. The General Division allowed the Respondent's appeal and found that the net profits of an incorporated business could not be considered earnings received by the Respondent if they had not been paid out by declaring a dividend.

[20] The General Division, after underscoring in its decision that Federal Court of Appeal decisions set precedents (AD1-22, s. 74), found that:

> [Translation]
> [77] Herein, given that the *Employment Insurance Regulations* do not define the types of companies listed in ss. 30(1) and 35(1)b) and given that s. 35(10)c) does not specify whether the income that a self-employed person draws from his/her company includes the net profits of an incorporated company, the Tribunal must apply the rule of complementarity set down by the Federal Court of Appeal and refer to the applicable rules of Quebec civil law.
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> [78] Recall that the company operated by the Appellants is a company incorporated in Quebec, and they are its directors and shareholders, each holding 33 1/3% of its shares. During the periods at issue, the company generated net profits that were not paid out to anyone by means of any dividend. The Commission allocated these net profits as earnings received by the Appellants during their benefit periods, in proportion to the shares held by each.
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> [79] The *Quebec Business Corporations Act*, CQLR c. S-31.1, establishes a separation between the patrimony of the corporation and those of its shareholders. For the net profits of an incorporated company to become the property of its shareholders, the profits in question must be distributed through the payment of a shareholders' dividend.
>
> [80] In the absence of a unanimous shareholder agreement, s. 112 of the *Act* lists the powers of the board of directors and s. 118(6) provides that the board of directors cannot delegate its power to declare dividends. Section 104 of the same Act further states that a dividend may not be paid if there are reasonable grounds for believing that the corporation is, or would after the payment be, unable to pay its liabilities as they become due.
>
> [81] The Appellants testified that there was no unanimous shareholder agreement among Les Constructions X Inc. shareholders, and that no dividends were paid out during the periods at issue. Concerning the solvency test in section 104 of the *Quebec Business Corporations Act*, the Tribunal has no expert testimony on the matter.

> [82] The constant established in case law concerning the allocation of earnings pursuant to s. 36 of the *Employment Insurance Regulations* whereby simple entitlement to such income suffices for it to be allocated (namely, the net profits of an incorporated company) existed before the Federal Court of Appeal reached a decision concerning the principle of complementarity between the applicable legal systems. To disregard this principle would challenge the integrity of *Quebec Business Corporations Act* provisions.
>
> [83] The Tribunal must find that the net profits of a business incorporated under Quebec law, if not paid out by declaring a dividend to shareholders in accordance with the applicable law, cannot be considered earnings received by a claimant within the meaning of the *Employment Insurance Act* and cannot be allocated in accordance with section 36 of the *Employment Insurance Regulations*.

[21] With respect, the decision by the General Division cannot stand since it conflicts with the case law of the Federal Court of Appeal and the state of law.

[22] A person who operates a company, even as a co-adventurer, is a self-employed person and the income that he or she thus earns must be allocated in accordance with subsection 36(6) of the *Regulations*.

[23] Herein, the General Division recognized that the Respondent, as a shareholder of Les Constructions X Inc., was a co-adventurer and that the term “co-adventurer” was used to determine whether a claimant could be described as a self-employed person for the purposes of the *Act* (AD1-20, par. 69).

[24] In the first Federal Court of Appeal decision on a series of dispositions related to self-employed workers, *Laforest v. Commission et al*, #A-296-86, given on February 2, 1988, the claimant had started a business selling ladies’ clothing while receiving benefit, and became the sole proprietor and prime mover of a company operating under the name, "Boutique Daniel Laforest Inc." The claimant argued at the time that it was unnecessary to make corporate disclosures and that a company’s undistributed profits are not earnings.

[25] After determining that the undistributed net profits of this business could constitute earnings within the meaning of the *Regulations*, the Federal Court of Appeal dismissed the application for a judicial review of the decision by Pierre Denault J.A., who had previously found as follows:

> [Translation]
> We must therefore examine the activity in which the claimant is engaged and it matters little at this point whether the business is registered or incorporated. It is true that people usually draw income from a company either in the form of salary if they are employed by the company, or a dividend, if their interest is an investment and the company has decided to pay its shareholders. In this regard, the undistributed profits belong to the company, not to the shareholder, even a sole shareholder. However, the scope of the aforementioned s. 57(6)(c) cannot be limited by considerations related to the corporate framework."

[26] Later, in *Canada (AG) v. Bernier*, A-136-96, in a decision given on February 27, 1997, the claimant filed a claim for benefit shortly after becoming unemployed. She submitted two records of employment, one from the Commission scolaire de la Mitis and the other from La Ferme Duregard Inc., a corporation that owned a dairy operation, where she had worked as a day labourer from July 4 to October 21. The Respondent held 40% of the corporation's shares and her husband held the remainder.

[27] Writing for the Court, Marceau J. stated the following:

> Over time, as the result of certain "constants" that have emerged from the decisions of umpires, the application of these provisions has become more consistent and less uncertain. First, the legal status of the operation or business in which the self-employed person works is irrelevant. Second, the relative amount of time spent on the operation or business is irrelevant.
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> Third, actually receiving income from the operation or business while unemployed is unnecessary, as the mere right to receive such income is sufficient. These constants were of course influenced by this Court's only decision (as far as I know) on the subject, *Laforest v. C.E.I.C et al*, file no. A-296-86, rendered on February 2, 1988 (CUB 12019), I pointed out that these constants had seemed necessary in order to give effect to Parliament's intention to include all income directly or indirectly related to work, as opposed to pure investment income.

[28] In *Canada (AG) v. Drouin*, A-348-96, in a decision also rendered on February 27, 1997, Marceau J. spoke further about the constants he had established in *Bernier*, stating that although they could lend themselves to criticism, they nevertheless constituted the state of law concerning the application of provisions related to the allocation of earnings from self-employment.

[29] In *Viel v. Canada (Employment Insurance Commission)*, 2001 FCA 9, a decision rendered on February 9, 2001, the claimant owned 20% of "D" shares, which entitled him to dividends in the company, yet he had not collected the income available to him and the company had not declared or issued any dividends. The Federal Court of Appeal reiterated that no exceptional circumstance gave it cause to reconsider the decision given in *Bernier*.

[30] The Tribunal notes from the aforementioned case law that the argument of separation of patrimonies and non-sharing of profits with shareholders is nothing new. Over time, even after the principle of the complementarity between private provincial law and federal legislation was codified in June 2001, as referenced by the General Division in its decision, the Federal Court of Appeal stood by the application of these constants.

[31] In February 2003, in *Peter Lafave v. Canada (AG)*, 2003 FCA 66, Desjardins J. allocated the income of the claimant`s company even though the claimant held only one-third (1/3) of the company's shares and no dividends had been paid out.

[32] The Court was not convinced that it should disregard the principles set down in *Drouin*, *Bernier* and *Viel*, for which leave to appeal to the Supreme Court of Canada was denied on October 4, 2001, after the codification of June 2001.

[33] And in 2013, in *Canada (AG) v. Talbot*, 2013 FCA 53, a case in which the claimant and his father were equal shareholders in a company whose activity was limited to snow removal.

[34] In the Tribunal's view, the General Division erred in this case when it applied the first and third constant. In fact, it erroneously placed importance on the legal status of the Respondent's business, and erred by refusing to recognize the Respondent's right to profits.

[35] The Federal Court of Appeal has repeatedly confirmed that the scope of s. 35(10)(c) of the Regulations cannot be limited by considerations related to corporate structure.

[36] It is true that shareholders receive no dividends until net profits are available to cover their payment, and until the directors determine that they must be paid. However, based on the third constant identified by the Federal Court of Appeal, the simple entitlement to dividends suffices, and dividends need not have been paid out.

[37] Therefore, pursuant to the *Regulations* and precedents of the Federal Court of Appeal, it is appropriate to allocate the amounts owed to the Respondent, regardless of the legal status of the company or decisions by Les Constructions X Inc. shareholders concerning about whether or not to distribute profits.

[38] As underscored by the Federal Court of Appeal in *Bernier, supra*, the constants are necessary to give effect to Parliament's intention to include all income directly or indirectly related to work, as opposed to pure investment income.

[39] The Federal Court of Appeal also pointed out that the exigencies and purposes of justice would not be served if it were to challenge or even reverse the constants arising from the application of these provisions concerning self-employed persons.

[40] In reaching its conclusion, the Tribunal considers that the General Division disregarded the continuing and well-established case law of the Federal Court of Appeal concerning provisions applicable to self-employed persons. The General Division therefore erred in law in making its decision.

[41] Since the Tribunal's intervention is permitted, the Tribunal will make the decision that should have been made herein. Based on the evidence before the General Division, the Tribunal has determined that the net profits of Les Constructions X Inc. constitute earnings under paragraph 35(10)c) of the *Regulations* and that such earnings must be allocated pursuant to subsection 36(6) of the *Regulations*.

CONCLUSION

[42] The appeal is allowed, the General Division's decision concerning the allocation of earnings on February 11, 2015 is rescinded and the Respondent's appeal before the General Division concerning the allocation of earnings is dismissed.

[43] The net profits of Les Constructions X Inc. constitute earnings under paragraph 35(10)c) of the *Regulations* and such earnings must be allocated pursuant to subsection 36(6) of the *Regulations*.

Pierre Lafontaine

Member, Appeal Division