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

[TRANSLATION]

Citation: *Canada Employment Insurance Commission v. R. T.*, 2017 SSTADEI 155

Tribunal File Number: AD-16-1222

BETWEEN:

Canada Employment Insurance Commission

Appellant

and

R. T.

Respondent

SOCIAL SECURITY TRIBUNAL DECISION
Appeal Division

DECISION BY: Pierre Lafontaine

DATE OF HEARING: April 4, 2017

DATE OF DECISION: April 13, 2017

Canada

REASONS AND DECISION

DECISION

[1] The appeal is allowed, the General Division decision concerning the allocation of earnings on September 26, 2016, is rescinded and the Respondent's appeal before the General Division concerning the allocation of earnings is dismissed.

INTRODUCTION

[2] On September 26, 2016, the General Division of the Social Security Tribunal of Canada (Tribunal) 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* (Act) and cannot be allocated in accordance with section 36 of the *Employment Insurance Regulations* (Regulations).

[3] On October 20, 2016, the Appellant submitted an application for leave to appeal to the Appeal Division. The Appeal Division granted leave to appeal on October 28, 2016.

FORM OF HEARING

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

- The complexity of the issue or issues;
- The parties' credibility was not a prevailing issue;
- The cost-effectiveness and expediency of the hearing choice; and
- The requirement to proceed as informally and as quickly as possible, while observing the rules of natural justice.

[5] At the hearing, the Appellant was represented by Jean-François Cham (intern), and the Respondent was represented by Mr. Pierre Hébert.

THE LAW

[6] Subsection 58(1) of the *Department of Employment and Social Development Act* (DESD Act) sets out the grounds of appeal as being limited to the following:

> a) the General Division failed to observe a principle of natural justice or otherwise acted beyond or refused to exercise its jurisdiction;
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> b) the General Division erred in law in making its decision, whether or not the error appears on the face of the record; or
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> c) the General Division based its decision 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.

SUBMISSIONS

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

- An individual who operates a business is self-employed, whether on their own account or through a partnership or co-adventure.
- The General Division acknowledged that the Respondent was self-employed;
- The rules of interpretation of the sections of the Act and Regulations concerning the allocation of income from self-employment were clarified in 1997 in *Bernier*;

- In *Bernier*, Judge Marceau specified the following: “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, actually receiving income from the operation or business while unemployed is unnecessary, as the mere right to receive such income is sufficient.”

- 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 established and followed in *Drouin*, *Bernier* and *Viel*;

- In 2013, Judge Noël wrote in *Canada (Attorney General) v. Talbot*, 2013 FCA 53, that the Regulations equate the business he undertakes with a job and, in the case of an incorporated business, the benefits that this company generates, to earnings.

- In 2016, the Appeal Division overturned the General Division’s decision that had determined that unallocated dividends from an incorporated business could be subject to an allocation under section 36 of the Regulations. This decision was not subject to a judicial review before the Federal Court of Appeal.

- The General Division reached a decision that runs counter to current case law when it made the legal status of a company a critical factor in determining whether the net profits of the Respondent’s incorporated business 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 judgments. 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 argues 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.

- 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 the nature of the business, in accordance with the Regulations and current jurisprudence.

- 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 by the Federal Court of Appeal in *Caron-Bernier*, 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.

- 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 argues herein that there were no exceptional circumstances that would challenge the observations of Judge Marceau in *Bernier*. By deviating from the trend in existing case law, the General Division committed an error in law that permits the intervention of the General Division.

- 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 argues that the General Division did not need to use the principle of complementarity to define income in relation to 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.

- The General Division erred in finding that there were no benefits to allocate, given that the company was showing an accumulated deficit for the fiscal year ending on August 31, 2014. In arriving at this conclusion, the General Division relied on the balance sheet results, which are calculated by subtracting the company's liabilities from its assets.

- The General Division erred because it did not apply the test provided in paragraph 35(10)(*c*) of the Regulations. Following this paragraph, the earnings to allocate are the gross income from self-employment work after the deduction of all operating expenses (capital expenditures) incurred. This amount can be found on page 1 of the Respondent's financial statements.

- From the financial statements, it appears that for the fiscal year ending on August 31, 2014, the revenues exceed the operating costs by $18,427.

- 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 submitted the following reasons against the Appellant's appeal:

- The General Division did not err, because a non-existent profit cannot be shared.

- Furthermore, in a company, profit sharing is done through granting dividends, which is not the case here.

- It would be unwarranted to lift the corporate veil, because he does not hide behind a company, he works there only as a paid employee.

- Net profits do not constitute earnings within the meaning of the Act since these returns did not actually exist, having been allocated to the business's deficit.

STANDARDS OF REVIEW

[10] The Appellant's counsel argues that the Appeal Division should show deference with respect to the General Division's errors on the determination of facts. The Appeal Division can only intervene if these errors were made in a perverse or capricious manner or without regard for the material before General Division. The Appeal Division does not have to show deference towards General Division decisions with respect to errors of law, jurisdiction, or non-compliance with the principles of natural justice—*Pathmanathan v. Office of the Umpire*, 2015 FCA 50.

[11] The Respondent did not make any submissions regarding the applicable standard of review.

[12] The Tribunal notes that the Federal Court of Appeal in the case of *Canada (Attorney General) v. Jean*, 2015 FCA 242, indicates in 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 further indicated 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, in the case of "federal boards", for the Federal Court and the Federal Court of Appeal […]

[14] The Court concluded that "[w]he[n] it 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 sections 55 to 69 of that Act."

[15] The mandate of the Tribunal's Appeal Division as described in *Jean* was later confirmed by the Federal Court of Appeal in *Maunder v. Canada (Attorney General)*, 2015 FCA 274.

[16] Therefore, unless the General Division failed to observe a principle of natural justice, erred in law, based its decision on an erroneous finding of fact that it made in a perverse or capricious manner or without regard for the material before it, the Tribunal must dismiss the appeal.

ANALYSIS

[17] On September 26, 2016, the General Division determined that the Respondent's company's income could not be subject to an allocation under section 36 of the Regulations because no dividend had been paid out to the shareholders and the financial statements were showing an accumulated deficit.

[18] The Respondent is an employee, owner and shareholder of 50% of the company "Déneigement J.P.R. Inc." The company has existed since 2003 and provides snow-removal services in X.

[19] The Respondent filed a claim for Employment Insurance benefits beginning on September 15, 2013. After a reconsideration of the Respondent's benefit periods, the Appellant determined that the Respondent had failed 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 benefits, and informed him accordingly on December 21, 2015. This allocation created an overpayment. 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.

[20] The General Division allowed the Respondent's appeal and found that:

> [Translation]
>
> [38] In this case, I notice that the calculation method used by the Commission for the Appellant's files does not account for the company's accumulated deficit.
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> [39] I have often noted, and several of my colleagues at the Social Security Tribunal have also emphasized, that the Employment Insurance Regulations remain indefinite on the types of businesses in subsection 30(1) and paragraph 35(1)(*b*).
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> [40] Furthermore, paragraph 35(10)(*c*) does not specify that a self-employed person's income drawn from his or her company includes net profits of an incorporated business—particularly if they are unallocated profits.
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> [41] Let us recall that, in Québec, since we are talking here about a company incorporated in Quebec, the law makes a precise distinction between having a company and having shareholders. An incorporated business has a separate legal personality.
>
> [42] In order for the net profits to become the property of the shareholders, they must be paid out as dividends. These dividends, if they are collected and paid, will have to be considered as income to be allocated under the Employment Insurance Act.
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> [43] However, in the present matter, the situation is entirely different. It has to do with unallocated sums that were not subject to dividend payments. From the financial statements (pages GD3-31 to 40), it clearly appears that the company is showing an accumulated deficit that ensures that the balance at the end of the fiscal year for the periods at issue is negative.
>
> [44] It is helpful to recall that a deficit is constituted from exceeding passives on shares of the organization. The accumulated deficit corresponds to the sum of the net results of each prior fiscal year. If the result is a loss, it wholly affects the following year. There can be no allocation to dividends and reserves as long as this negative balance brought forward has not been filled by prior profits.
>
> [45] The Appellant's representative argued that the calculations carried out by the Commission do not account for the company's actual accounting, namely of the accumulated deficit. It argued that to share a profit again, there must be one, which is not the case.
>
> [46] I accept this argument and determine the calculation done by the Commission to allocate the net profits weekly is automatically flawed.

> [47] The Tribunal determines that net returns do not constitute earnings within the meaning of the Act given that these returns did not actually exist since they were allocated to offset the business's deficit, as required by generally accepted accounting principles (GAAP). Therefore, they cannot be allocated in accordance with section 36 of the Regulations.

[21] With respect, the General Division's decision cannot stand since it conflicts with the Appeal Division's decisions, the Federal Court of Appeal case law 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 the Respondent's self-designation as self-employed under subsection 30(1) and paragraph 35(1)(*b*) of the Regulations.

[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 benefits, 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:

> 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 (Attorney General) v. Bernier*, A-136-96, decision rendered on February 27, 1997, the claimant filed a claim for benefits 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, Judge Marceau stated the following:

> Over time, as the result of certain "constants" in the case law 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. 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 (Attorney General) v. Drouin*, A-348-96, also rendered on February 27, 1997, Judge Marceau 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 that were entitled to the company's dividends, 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 (Attorney General)*, 2003 FCA 66, Judge Desjardins 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 Federal Court of Appeal was not convinced that it should disregard the principles set out in *Drouin*, *Bernier* and *Viel*, for which leave to appeal to the Supreme Court of Canada was refused on October 4, 2001, after the codification of June 2001.

[33] And in 2013, in *Canada (Attorney General) 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 paragraph 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 the decisions made by "Déneigement J.P.R. Inc." shareholders with respect to whether to distribute profits or whether net profit affected the company's prior deficit.

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

[39] The Court also pointed out that the requirements 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 justified, it will make the decision that should have been made herein.

[42] Based on the evidence before the General Division, especially the company's financial statements that show a net profit of $18,427 for the year ending on August 31, 2014, the Tribunal concludes that the net profits of "Déneigement J.P.R. 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, set out in the instructions received by the Federal Court of Appeal in *Talbot*, *supra*.

CONCLUSION

[43] The appeal is allowed, the General Division decision concerning the allocation of earnings on September 26, 2016, is rescinded and the Respondent's appeal before the General Division concerning the allocation of earnings is dismissed.

Pierre Lafontaine
Member, Appeal Division