

Letter of the Law



Home Inspector Liable for House Defects

A British Columbia Supreme Court judgment has recently found a home inspector liable for almost \$200,000 in damages for an inadequate pre-purchase inspection of a residential property. The facts behind the case, *Salgado v. Toth*, are both straightforward and cautionary. The plaintiffs, Manuel Salgado and Nora Calcaneo, were considering the purchase of a North Vancouver property valued at approximately \$1,200,000.

They made an offer subject to obtaining a satisfactory pre-purchase home inspection for which they retained the services of Imre Toth, a member of the Canadian Association of Home and Property Inspectors. The inspector attended at the house and discussed his findings on site with the plaintiffs and gave them a handwritten report. They paid him a fee of \$450 for his services.

The inspector examined some, but not all, of the structural beams supporting the house. He identified two beams that he felt were rotten and in need of repair. He advised the purchasers that he estimated the cost of repairing those two beams to be about \$4,000. After purchasing the house, the plaintiffs discovered that nearly all the structural beams in the

home were rotten and that the cost of undertaking those structural repairs was \$90,000.

However, that was not the end of the purchasers' problems. The home was constructed on a hillside and much of the foundation was supported on fill. The inspector had noted some "moderate" settlement of the structure in his report. He suggested that repairs to address the settlement of the home could be completed for approximately \$15,000. After buying the home, further inspection determined that the settlement of the house was a more significant problem and would cost \$126,000 to repair.

The purchasers sued the inspector for breach of contract and negligence. Following a trial, the Court found the inspector negligent due to his decision to inspect only some of the structural beams of the home—especially in circumstances where the beams he had checked had revealed evidence of decay and rot. Relying on

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ILLUSTRATION: John Bellisle, Signals Design



... the circumstances under which the contract was presented for signature were such that the inspector could not rely on the limitation of liability clauses.

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expert evidence, the Court held that the indication there were two rotten beams triggered the need to inspect the remaining beams. The Court also found that the inspector ought to have recommended the involvement of a structural engineer to assess the structural integrity of the beams once it became clear that at least some of them were decaying.

The Court also found fault with the estimate provided for the beam repair since it was, in the words of the Judge, Mr. Justice Grant Burnyeat, "woefully inadequate" and lulled the purchasers into believing the issue with the structural beams was not a major concern.

The Judge made similar comments about the inspector's description of the stability of the house foundations. The inspector's report described the foundation settlement as "moderate" and in a condition between "average and below average." In the Court's view, this characterization did not convey to the purchasers the significance of the foundation problems. In addition, the estimate for addressing this problem was so far off the mark that it failed to reveal both the seriousness and the scope of the problem. Like the structural beams, the Court found that the inspector's observations of the foundation

settlement should have triggered a recommendation to the purchasers to obtain the advice of a geotechnical engineer.

In his judgment, Mr. Justice Burnyeat found that the inspector was liable for the cost of carrying out the necessary repairs to the structure and foundation, less the value that the inspector had assigned to those items in his report.

Like many home inspection contracts, the contract used by Mr. Toth in this instance contained a clause that purported to limit the liability of the inspector for errors to no more than the value of the inspection fee charged. However, the Court declined to give effect to this provision because the circumstances under which the contract was presented for signature were such that the inspector could not rely on the limitation of liability clauses.

The Court noted that the purchasers were not given an opportunity to fully review the contract before signing it. The inspector had conveyed his verbal advice while on site at the conclusion of his inspection, while at the same time filling out the written report and then handing it to the plaintiffs for their signature. The Court also noted that the purchasers' attention had not been drawn to those

specific provisions in the contract that the inspector now sought to rely on in limiting his liability for errors. In the absence of those steps being taken, the Court was not convinced that the purchasers had agreed to limit the inspector's liability for errors.

This decision will interest those practising in the home inspection field. Identifying the presence of some defects likely triggers an obligation to undertake a more extensive inspection. Alternatively, the nature of the defects may require the inspector to recommend the services of a specialized consultant to provide additional advice. Reliance on exclusionary clauses in contracts will not be enforced unless those clauses are specifically brought to the attention of the purchaser. The purchaser must be given the opportunity to fully review and consider the contract terms before signing it. **SU**

For information on this decision and other matters involving defective construction, please contact



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EDITOR'S NOTE

After six months of planning and development, the third generation of Singleton Urquhart's website has finally launched. The new website boasts all the usual bells and whistles including a full text publication search. Stay tuned for continuing advancements and the latest articles in the "Our Knowledge" section.



Look for this icon on the opposite page and in future editions of *Letter of the Law*. It indicates that there are expanded articles or references to previous articles available on our website.

Kudos to our manager of business development Catherine Tsang for managing the project. And special thanks to E-Cubed Media Synthesis for programming and integration as well as Signals Design Group for creative direction.

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You can teach an old lawyer new rules?

On July 1, 2010, while the rest of Canada celebrates 143 years of Confederation, judges, lawyers and litigants in British Columbia will be bracing for the launch of the new *Rules of Court*. The new Rules, which govern the conduct of civil litigation, are designed to promote better access to the courts by reducing the complexity and increasingly high costs of litigation.

The impetus for change came from a working group of the B.C. Justice Review Task Force. After years of research and consultation, the Task Force concluded that the high

- **Active Case Planning** The courts will become more involved in helping to manage litigation at case planning conferences; judges will apply proportionality to establish timeframes and limits on the exchange of documents, examinations for discovery, expert reports and other pre-trial procedures.

- **Limits on Document Discovery** Currently, litigants are required to produce all documents in their control “relating to every matter in question in the action.”

Too often this resulted in litigants spending countless hours collecting, describing and disclosing a huge volume of paper, at great expense, even though most of the information was of little or no import-

many cases, the Task Force found, experts take on the role of an advocate and trials are reduced to a “battle of experts.” The new Rules will require an expert to certify that he or she is aware of the duty to be objective and to assist the court. A judge can also require “competing” experts to confer at the case planning conference.

Only time will tell if the new Rules will achieve their ambitious objective. But it is certain that the new Rules represent a radical change in how litigation will proceed in British Columbia.

To make the most effective use of the new Rules, it will be important not only to know what has changed but to understand how to use the changes to achieve successful and cost-effective results. At Singleton Urquhart, we have established a committee to study the new Rules, update internal resources, and develop a new set of practice guidelines. Starting in January, the committee will begin presenting a series of in-house training sessions to ensure that we “hit the ground running” on July 1. **SU**

For more information on the new Rules and civil procedure in general, please contact



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Daniel Barber, articulated student, assisted with the research and writing of this article.

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cost of litigation was discouraging and, in some cases, preventing people from accessing the judicial process to resolve disputes. To address this concern, it recommended a complete overhaul of the existing Rules. At root, the new Rules introduce the concept of proportionality—balancing the cost of the litigation with the value of the dispute is the underlying rationale for most of the changes.

Proportionality is the overarching feature of all the new Rules. The current Rules state that their purpose is to promote a “just, speedy and inexpensive determination of a proceeding”; to achieve this end, the new Rules direct that courts bear in mind the amount involved, the importance of the issues, and the complexity of the litigation.

Some of the more significant features of the new Rules that will undoubtedly impact future litigation are:

ance to the “real” issues in the case. The prevalence of electronic documents, such as e-mails, added to this burden. The new Rules significantly reduce the scope of document production by requiring parties to now produce only those documents which “could be used at trial to prove or disprove a material fact.”

- **Limits on Oral Discovery** Under the current Rules, there is no limit on the time which may be spent conducting oral discovery. It is not uncommon for days or even weeks of lengthy and expensive examinations for discovery which, while thorough, are not necessarily focussed on the critical issues. Under the new Rules, an examination for discovery will be limited to seven hours, subject to the parties’ consent or a court order.

- **Changing Role for Experts** In theory, experts provide an independent opinion on technical matters to assist a court. In



ON OUR WEBSITE

Singleton Urquhart’s lawyers have been informing our clients about the new *Rules of Court* for several years. For more in-depth coverage of this important development, please go to our website to view or download “Proposed New Rules for Civil Procedure” by Paul McDonnell and Wei Kiat Sun and “Experts and Law Reform Recommendations” by Robert Hodgins and Wei Kiat Sun. Go to www.singleton.com/Our_Knowledge.aspx and search for one of the authors’ names or article titles to find the reports.

The Real Estate Development Marketing Act and Shifting Realities

The boom and subsequent decline of British Columbia's real estate markets over the last few years — combined with the banks' insistence on pre-sales of new strata units as a precondition for construction financing — has led to a plethora of issues and questions for developers and purchasers alike.

Due to the inherent uncertainty involved in pre-sales, the B.C. Legislature enacted the *Real Estate Development Marketing Act* (REDMA) to govern pre-sale contracts. These are agreements for the purchase of a new unit and typically entered into before construction starts and subdivision is completed. They are contingent, therefore, on several factors, including successful registration of the subdivision plan and raising of title.

Depending on market conditions, what happens after a pre-sale can be problematic for both developers and purchasers. Pre-selling strata units as a requirement for receiving construction financing forces developers to sell at existing prices — in a rising market, these may well not fully anticipate price escalation. In fact, in the years before 2008, pre-sale prices completely failed to predict the unprecedented rise in construction and labour costs. Developers faced a triple pain: purchasers pocketed large market gains made at the developers' risk; profit margins eroded as construction costs went up; and refinancing was made almost impossible because the banks' inexorable demand for pre-sales effectively capped a project's returns.

Consequently, developers faced two equally unpalatable options: sell a unit under the pre-sale contract at reduced (often zero) return or refuse to complete the sale (and risk a purchaser's likely lawsuit). Some developers, however, were able to renegotiate prices with cooperative purchasers who were concerned about a developer's ability and desire to complete a project.

More recently, the situation reversed as markets tumbled. Purchasers looked for excuses to walk away from pre-sale contracts as values declined and comparable properties became available for significantly reduced prices. An additional complication has been lenders' reticence to provide the expected takeout mortgage financing; units are now often appraised

below pre-sale prices, forcing purchasers to inject additional personal equity.

Wrongfully refusing to complete a transaction is not a comfortable option. Purchasers who do so expose themselves to potential liability to the developer for the difference between the contract price and the price (presumably lower) at which the developer can resell the unit. Additionally, in many cases (depending on the wording of the purchase agreement) they may lose their deposits.

Not surprisingly, current condominium market conditions are encouraging some purchasers to look for legitimate ways to escape from pre-sale contracts. By scrutinizing projects in search of unmet statutory obligations — and discrepancies between a developer's mandatory pre-sale disclosure and the finished product — purchasers hope to find wording that will support a refusal to complete the transaction.

One of the most important sources for unwilling purchasers is REDMA, which came into force on January 1, 2005 and establishes developers' disclosure obligations. REDMA's underlying purpose is to protect consumers, as stated by the B.C. Supreme Court in a 2009 case, *Dwane v. Bastion Coast Homes Ltd.*:

It is common ground that the *REDMA Act* is a piece of consumer protection legislation and that one of its central objectives is to ensure that material facts are provided to Purchasers when developments are being marketed to them.

REDMA imposes consistent standards of disclosure to ensure that purchasers of unbuilt property know what they are buying and are kept abreast of the inevitable changes that occur between the initial design and the finished building. Additionally, purchasers can change their minds within seven days of the later of the date they sign the purchase contract or the date they receive the disclosure statement from the developer.

Broadly, if a developer fails to properly and continuously disclose pertinent information about a project or otherwise fails to comply with the Act, Section 23 of REDMA allows purchasers to 'walk away' from the purchase agreement without penalty. Furthermore, once the initial disclosure is complete, changes to a unit or project which, although properly disclosed, are substantial or material may warrant an action for damages and trigger either a statutory or common law right of rescission for the purchaser.

More specifically, REDMA's requirements for developers of residential developments include the following:

- A developer cannot market a development unit unless it has filed a disclosure statement with the Superintendent of Real Estate (Superintendent) nor enter a pre-sale contract without providing a copy of the disclosure statement to the purchaser.
- A disclosure statement must be in the prescribed form and set out all material facts (see below) as established in REDMA as well as a purchaser's rescission rights.
- Developers have a duty to plainly disclose all changes to material facts as a project evolves and file new or amended disclosure statements.

A material fact in this context, as defined in REDMA, is:

- (a) a fact, or a proposal to do something, that affects, or could reasonably be expected to affect, the value, price, or use of the development unit or development property;
- (b) the identity of the Developer;
- (c) the appointment, in respect of the Developer, of a receiver, liquidator or trustee in bankruptcy, or other similar person acting under the authority of a court;
- (d) any other prescribed matter; . . .

A developer must disclose a change to a material fact falling under subsections (b), (c) and (d) in a *new* disclosure statement. But, curiously, a change to a material fact falling in subsection (a) usually only requires an amended disclosure statement; nonetheless, if the change is substantial, the Superintendent can require the developer to file a new one.

The distinction between a new and amended disclosure statement is key as it dictates the statutory rights of the parties to a pre-sale contract when a developer's circumstances change. REDMA provides purchasers with a statutory seven-day rescission period following the filing and delivery of a *new* disclosure statement; this allows them to cancel the pre-sale contract without penalty. But REDMA does not attach an express statutory right of rescission to an *amended* disclosure statement (otherwise, presumably, developers would be disinclined to update material facts by way of amendment).

However, the wording of the statute is circular: the definition of "disclosure statement" in REDMA includes the words "any amendment," leaving open

Changes to items classified in subsection (a) of REDMA's material fact definition (see above) probably qualify as misrepresentations substantial enough to trigger a purchaser's rescission rights.

REDMA deems all purchasers to have relied on misrepresentations contained in a disclosure statement regardless of the type of material fact involved. Therefore, if a developer files a disclosure statement containing a misrepresentation, the purchaser has a right of action for damages against various entities including the developer, its corporate directors, and any signatory to the disclosure statement. Even if a developer corrects a misrepresentation that existed when a purchaser originally signed a contract, REDMA allows the purchaser to

should obtain legal advice upon receipt of any new or amended disclosure statement in such a circumstance.

When a development is in financial trouble, developers, as well as their financiers and other creditors, are well advised to seek legal advice *before* a receiver is appointed. They should *assess* the risk of triggering a potentially devastating turn of events that might allow purchasers to withdraw from their pre-sales contracts. The appointment of a receiver is usually intended to preserve the assets and business of a developer but, given the nature of REDMA's rescission rights, the intervention of a receiver can have exactly the opposite effect—pre-sales will evaporate, destroying a project's value and financiers' ability to recover their loans from the developer.

The past year marks the first time the real estate market has slumped since REDMA's enactment so it is difficult to predict how the legislation will affect other interest holders. Developers' financiers are the most likely group to be impacted. To take one possible scenario: a financier of a pre-sold development may find itself unable to appoint a receiver without facing an argument from guarantors of the developer's loan that the appointment was imprudent and prejudicial to the guarantors, thus releasing them from their guarantees.

REDMA is designed to govern developers and purchasers throughout the pre-sale and construction period with an overall intention of protecting purchasers. The courts have not yet had much occasion to consider REDMA so it is unknown how they will balance the above interests while interpreting the legislation. In the interim, approaching the pre-sale process with a broad view and understanding of how REDMA may affect the various involved parties is wise. **SU**

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the possibility that an amendment may trigger the statutory rescission rights. The Superintendent's position is that the purchaser's recourse when a disclosure statement is amended is either a statutory claim for damages under Section 22 for misrepresentation or common law contract remedies (which may include rescission). Given REDMA's overriding purpose of consumer protection, the lack of statutory rescission for changes to some types of material facts appears inconsistent.

At common law, a party to a contract can only rescind the agreement if there has been a material misrepresentation by the other party before the completion of the performance of the contract.

seek damages for the misrepresentation by treating the statement as if it was never corrected. While the protection afforded by this part of REDMA doesn't provide an opportunity to rescind the contract, it does allow purchasers to sue for monetary compensation and, effectively, to receive the value of what they initially negotiated.

Of particular note in the present economic downturn are parts (b) and (c) of the "material fact" definition (see above). The appointment of a receiver would be a decisive step allowing purchasers to rescind a pre-sale contract without incurring the risks described above. However, the window of opportunity is narrow and purchasers



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Alter Ego and Joint Partner Trusts

In the last issue of *Letter of the Law*, we discussed how the provisions of your will could be subject to variation under dependent relief legislation, if, in the opinion of the court, you fail to make “adequate, just, and equitable” provision for your spouse and children. One way of preventing the courts from interfering with your estate plan is to transfer your assets to a trust during your lifetime (known as an inter vivos transfer) through the creation of either an alter ego trust or a joint partner trust. Placing your assets in a trust may also have additional benefits such as reducing probate fees, protecting against creditor claims, and deferring or saving taxes.

Under an alter ego trust, the settlor transfers his or her property to a trust which provides that the settlor alone is entitled to receive all of the income of the trust and no-one else can receive any of the income or the capital of the trust before the settlor’s death. To qualify for an alter ego trust the settlor must be over 65 and a resident of Canada. When the settlor dies the assets are distributed pursuant to the terms of the trust rather than a will.

A joint partner trust is much like an alter ego trust but is particularly useful for spouses. The main difference from an alter ego trust is that the assets are disposed of upon the death of the surviving spouse. With a joint partner trust the settlor must again be over 65 and both the settlor and his or her spouse must be Canadian residents. And the terms of the trust must again provide that only the settlor and his or her spouse receive the trust’s income or the capital of the trust.

By using a joint partner trust, the settlor can ensure that his or her spouse continues to receive the benefit of the assets during their lifetimes. The assets only devolve on the deaths of the settlor and his or her spouse.

There are considerable advantages that lead estate planners to favour an alter ego trust over a will. The assets in such a trust do not form part of the estate. *The Wills Variation Act* only applies to a person’s estate so a settlor’s spouse and children cannot apply to a court for variation of the trust.

Other advantages of an alter ego or joint partner trust include the following:

- No probate is necessary for the assets to be passed under the trust, creating fewer administrative complications and lower probate fees payable on the settlor’s death.
- The trust can include provisions for the management of assets if the settlor becomes incapacitated.
- To be probated, a will must be filed in the B.C. Supreme Court—it becomes a public document. This subjects the devolution of assets in the will to public scrutiny. But an alter ego or joint partner trust is a private document and information regarding assets and beneficiaries of that document remains private.
- An alter ego or joint partner trust may offer some level of creditor protection.
- There may be tax benefits, due to the possibility that the disposition of assets can be made on a tax-deferred basis.
- Transfers of property to these trusts do not constitute dispositions of property for the purposes of the *Income Tax Act*.
- A joint partner trust is particularly useful in a blended family scenario where a deceased wishes to ensure that a surviving spouse from a second marriage receives the benefit of the assets but, on the latter’s death, the assets pass to the children of a first marriage.

These types of trusts are not necessarily advantageous; some drawbacks include:

- A loss of control of property, since a settlor must transfer the legal and beneficial ownership of the property to the trustee.
- If the settlor is also acting as the trustee (for the purpose of controlling the assets of the trust), capital gains earned and accumulated by the trust



will be attributable to the settlor during his or her lifetime.

- The cost of administering a trust is higher than simply preparing a will because the latter doesn’t take effect until the testator’s death.
- Changing the method of asset distribution can also be potentially difficult because the settlor has disposed of the property upon the making of the trust. It is not as straightforward as writing a new will or a codicil.

The establishment of an inter vivos trust is more complex than the creation of a will and usually requires that the settlor also obtain tax advice. However, in many circumstances, the creation of an alter ego trust or a joint partner trust can prevent costly disputes and save estate fees and taxes over the long run. **SU**

If you have any questions about alter ego or joint partner trusts, or any other matter involving wills and estates, please contact



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JOHN SINGLETON, Q.C. spoke at ENCON Group's Loss Control Seminar in Victoria on November 25 and in Vancouver on November 26. This year ENCON celebrates its fortieth year of Loss Control Seminars.

JEFFREY HAND has been appointed to the Property Assessment Appeal Board of British Columbia.

DEREK BRINDLE, Q.C. is the co-editor of, and a contributing author to, the revised *B.C. Builders Lien Practice Manual* (3rd ed.) published in December 2009.

On October 16, **ROBERT HODGINS** spoke at the Better Business Bureau on issues relating to builders' liens.

ELIZABETH (BETSY) SEGAL has been elected to the University of British Columbia Vancouver Senate to serve as Convocation Senator.

As a former winner of the Robert H. Guile, Q.C. Memorial Debate, **MITCH DERMER** was invited to judge tryouts for this year's debate on "Resolved that 'tis more than reason that goes to persuasion" on November 20.



SU partners and associates took to the Elaho River's rapids on an exciting team-building retreat this fall.

SU thanks all our friends and donors who helped raise a record-breaking \$29,640 at the Fifth Annual Singleton Urquhart Charity Auction in support of the BC Childhood Cancer Parents' Association, held on November 6. The heart-warming event featured live and silent auctions, a

raffle with a grand prize of two round-trip airfares to any North American Air Canada destination, and a stunning performance by Flamenco Rosario. For more information on this and future charity events, please visit the Our Events section of our website at www.singleton.com.

Lauren Woolstencroft, Champion Paralympic Skier

With less than 90 days until the Vancouver 2010 Paralympic Games, SU is eagerly looking forward to cheering on their sponsored athlete Lauren Woolstencroft.

Known as Canada's Golden Girl for the Paralympic Winter Games, Lauren is an incredible athlete. She has been a skier since the age of four when she started in Whitefish, Montana on family ski holidays. Watching her ski, few can tell that she was born without legs below the knee and her left arm below the elbow.

Born in Calgary, she started ski racing at the age of 14 when a friend convinced her to join the Alberta Disabled Ski Team. She has four World Championship titles under her belt and has won five Paralympics medals, including three gold.

Vancouver 2010 will be Lauren's third Paralympic Games. Her extraordinary success is testimony to her dedication to sport and determination to overcome any obstacle. When Lauren is not racing, she works as an engineer-in-training at BC Hydro. **SU**



Deductibility of Management Fees Paid to Related Corporations

BUSINESS LAW | *Les Entreprises Réjean Goyette Inc. v. Her Majesty the Queen*

We have previously written about using holding corporations in conjunction with operating corporations to achieve a higher level of limited liability protection. (See *Letter of the Law*, Summer 2005.) With this structure, one company is incorporated to operate the main business or profession of the company (Opco) and the other company (Holdco) is incorporated to own the former's shares; in other words, Opco becomes a wholly-owned subsidiary of Holdco. In this structure, liability and risk are ordinarily in the hands of the Opco while the assets are

other related company. While the receiving company declares the management fee as income, the paying Opco is able to deduct the management fee expended.

However, a recent decision of the Tax Court of Canada in *Les Entreprises Réjean Goyette Inc. v. Her Majesty the Queen* questioned this deductibility of intercorporate management fees. In this case, a taxpaying subsidiary, Les Entreprises Réjean Goyette Inc., was appealing a decision by the Canada Revenue Agency to disallow the deduction

of management fees paid to its related company, 2744-2870 Québec Inc. The two companies were subsidiaries of the same holding corporation.

Les Entreprises Réjean Goyette Inc. lost in court so the management fees paid to 2744-2870 Québec Inc. were held to be not deductible.

The Court determined that the lack of a formal written management agreement between the two related companies raised

the question of whether Les Entreprises Réjean Goyette Inc. was legally obligated to pay the management fees. The Court held further that Les Entreprises Réjean Goyette Inc. had not received valuable consideration for the management fees and the true purpose of the management fees was to shift income to the related company in order to offset non-capital losses.

The result of this decision is that the taxpayer was doubly taxed: 2744-2870 Québec Inc. paid tax on the management fees it received as income but Les Entreprises Réjean Goyette Inc. could not deduct them as an expense.

Despite this decision, the Opco/Holdco structure—and the payment of management fees—continues to be an advantageous method of structuring a business and protecting both assets and income. However, to preserve the deductibility of the management fees paid by an Opco to a Holdco or an otherwise related company, all such arrangements should have a valid management and/or services agreement in place to substantiate the management fee. The services which are supplied to the Opco should be clearly stipulated in the agreement and the management fee should be in line with the value of the services provided by the Holdco or related company.

The Court held... the true purpose of the management fees was to shift income to the related company in order to offset non-capital losses.

usually held in the hands of the Holdco. In more complicated structures, a Holdco may have more than one Opco subsidiary.

Traditionally, one method of moving income from Opco to Holdco or between two related Opcos has been for one Opco to pay a management fee to its parent company or

The decision in *Les Entreprises Réjean Goyette Inc.* concerned deductions claimed in 2002 and 2003. Accordingly, any businesses which have claimed deductions for management fees paid to a related company in recent years, or intend to claim such deductions at any time in the future, should consider entering into a management and/or services agreement. **SU**

For more information about management and services agreements or the structure of your business, please contact



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