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NOMINEES IN THE CONTEXT OF LITIGATION

Léa Maalouf

In commercial matters, it frequently happens that two persons agree to hide their true intent from third parties and express such intent in a secret contract (or counter letter), while publicizing another contract, known as a fictional or apparent contract. This process is called simulation.

This practice is entirely legal unless it is used to break the law or allow a party to avoid liability, for instance, by removing an item of property from his patrimony in order to avoid the execution of a judgment. Simulation is governed by articles 1451 and 1452 of the *Civil Code of Québec*. A counter letter is subject to no condition as to form: it is valid whether it is in the verbal or written form.

A nominee agreement is one of the forms under which simulation may be carried out: when a person uses a third party to enter into a contract with another person, the third party is called a nominee.

With as many players at the table, it is interesting to review the issues related to the liability of the parties and the precedence of the contracts in the event a dispute occurs.

If a dispute occurs between the parties to the nominee agreement, the law is clear: the counter letter, whether verbal or written, prevails over the apparent contract. Either party cannot refuse to give effect to the nominee agreement. It is interesting to note that proof of the existence of a counter letter may be made by any mean, including testimony. This is rather exceptional, considering that the rules of evidence do not allow the parties to a written contract to use testimony to contradict or vary its terms. The reasoning of the courts is that the nominee agreement constitutes a contract by itself, which is separate from the apparent contract. This being so, testimony is not used to contradict the apparent contract but rather to establish the existence of a new contract.

However, if a third party institutes proceedings while being in good faith – meaning that the third party is unaware of the existence of the secret instrument, the *Civil Code of Québec* provides that

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the third party may, according to his interest, avail himself of the apparent contract or the counter letter. In principle, third parties do not need to prove fraudulent intent of the parties to the counter letter to rely on the secret instrument. However, according to some judgments, third parties should at least prove that they suffered some kind of harm as a result of the simulation. Once again, proof of the simulation may be made by any mean. Conversely, parties to a counter letter may decide to publish it to end the simulation: in that case, it will be more difficult for third parties to rely on the apparent contract. However, in a recent case[1], the Superior Court found liable both the nominees and true owners of an immovable, concluding that the parties had deliberately created confusion tantamount to abuse of right and that the theory of *alter ego* had also to be applied.

In closing, although it may look surprising at the outset, a fictive instrument, such as a nominee agreement, is entirely legal unless it is used for improper purposes.

However, parties to that fictive instrument must remember that a third party in good faith may set such instrument aside and rely on the apparent contract as being the true agreement between the parties, even if this does not constitute the initial intent of the contracting parties.

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[1] *9087-7135 Québec inc.* c. *Centre de santé et de services sociaux Lucille-Teasdale*, 2013 QCCS 3856.

USE OF A NOMINEE BY LIMITED PARTNERSHIPS AND TRUSTS FOR HOLDING IMMOVABLES

Dominique Bélisle

Several legal arguments justify the practice that has developed in Quebec and in the common law provinces of registering the ownership title to immovables or real estate, acquired by a limited partnership or a real estate investment trust ("**REIT**"), in the name of a nominee.

One of these arguments is based on the fact that partnerships and trusts created under the *Civil Code of Québec* ("**Civil Code**") do not benefit from legal personality and therefore are not separate «persons» distinct from their members, partners or beneficiaries. Indeed, historically, under the civil law, the patrimony was always considered to be attached to a natural or legal person. Over time, the concept developed which attributed a distinct patrimony to the partnership from the patrimonies of the partners, and which attributed a patrimony by appropriation to the trust, autonomous and distinct from the patrimonies of the settlor, trustee or beneficiary thereof.

In the case of trusts constituted under the Civil Code, including REITs, nominees have not been consistently used in practice and are less common. Indeed, article 1278 of the Civil Code states that the titles relating to the property of the trust are drawn up in the trustees' names. On this basis, it is common to see the title to property held by a REIT registered in the land registry under the names of all the trustees acting in their capacity as trustees of the trust. Other legal advisers still register the title to the property directly in the name of the REIT, despite article 1278. For the time being, nothing indicates that this practice affects the validity of the property title.

In the above cases, however, a nominee is not used on the basis of the lack of legal personality of the trust because the Civil Code expressly recognizes that the parties involved have no real rights in the distinct patrimony. This recognition helps resolve the ambiguity caused by this lack of personality.

The advantage of a nominee for a REIT therefore lies elsewhere, such as, for example, in the flexibility offered for transfers of title between parties related to the trust, and in relation to the transfer duties that are triggered when these transfers are registered in the land register. Indeed, the exemptions provided for in section 19 of the *Act respecting duties on transfers of immovables* (Quebec) with respect to a corporate restructuring do not apply in the cases of a trust or partnership.

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Some exemptions contained in section 20 of that statute do apply to trusts, but in very specific cases.

In the case of a partnership, however, the use of a nominee is more common and warranted not only in connection with the *Act respecting duties on transfers of immovables*, but also due to the uncertainty caused in relation to the holding of title to property because of the partnership's lack of legal personality. Indeed, in contrast to the situation pertaining to trusts, the Civil Code does not directly provide for the autonomous nature of the patrimony for partnerships, or that the partners hold no real right in the partnership's property.

Furthermore, in the case of *Ville de Québec c. Compagnie d'immeubles Allard ltée* [1], the Court of Appeal stated that since the limited partnership did not have a distinct legal personality from its members, it did not hold the partnership's assets, and therefore found that the partners held an undivided real right in the property. In that case, the Court determined that the transfer by a partner of his interest in the partnership constituted a transfer of his undivided share, thereby triggering transfer duties (the parties having had the bad idea of registering the transfer…).

This decision has created some uncertainty surrounding the identity of the property owner. Is the property title really held in undivided co-ownership by each of the partners? And what about limited partnerships? The argument relied on by the Court of Appeal to justify its conclusions applies equally to limited partnerships. In practice, however, the partners in a limited partnership would certainly not intend to trigger a transfer in undivided co-ownership of the property each time a unit is transferred. This uncertainty has led to the commercial practice of registering the property title in the land register in the name of the general partner, or a nominee corporation.

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[1] [1996] RJQ 1566 (C.A.).

VOLUNTARY REGISTRATION FOR GST AND QST PURPOSES BY A NOMINEE
Diana Darilus

In an immovable property context, a person can act as a nominee for another person for the purpose of holding title to the property and handling the property management. This type of structure implies the existence of a mandatary-mandator relationship that is not disclosed to third parties.

In the context of this type of relationship, the mandator is the person considered to be carrying on commercial activities involving the property, and is therefore generally required to register for GST and QST purposes.

However, a nominee corporation holding title to immovable property on behalf of the true owner may wish to register voluntarily for several reasons, such as the following:

> use of the nominee's GST and QST registration numbers in the legal and administrative documentation, such as invoices or commercial leases, in order to preserve the confidentiality of the true owner of the property;
> joint election by the mandator and mandatary provided for in subsection 177(1.1) of the *Excise Tax Act* (**"ETA"**) and section 41.0.1 of An Act respecting the *Québec sales tax* (**"AQST"**), which allows the mandatary to remit the GST and QST collected to the tax authorities on the mandator's behalf; and
> joint venture election provided for in sections 273 ETA and 346 AQST, which enables the co-venturers to designate an "operator" responsible for remitting the GST and QST collected to the tax authorities and claiming the input tax credits and input tax refunds (ITCs/ITRs) on behalf of the co-venturers.

A nominee corporation can only register voluntarily for GST and QST purposes if it carries on a commercial activity in Quebec. The definition of "commercial activity" is very broad and includes the carrying on of a business by a corporation without a reasonable expectation of profit, except to the extent to which the business involves the making of exempt supplies. As for the definition of the term "business", this includes any undertaking of any kind whatever, whether or not engaged in for

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profit. In light of these definitions, it seems that a nominee corporation whose activities are limited to holding title to property on behalf of the true owner without receiving compensation for doing so, could be considered to be carrying on a commercial activity.

However, Revenu Québec has raised doubts in the past few years about the voluntary registration of certain nominee corporations in the form of “shell corporations” on the basis that they did not carry on any commercial activities, and retroactively canceled their registration numbers. To avoid such a dispute with the tax authorities, one should in our view be cautious when setting up a nominee corporation as part of a structure for holding immovable property in Quebec. We recommend that the following minimum measures be taken to reduce the risk of contestation by Revenu Québec:

- monthly fees (plus applicable taxes) should be paid to the nominee corporation pursuant to terms of a written nominee agreement; and
- the nominee corporation should open a bank account to receive its compensation.

We believe that if such measures are taken, it is more reasonable to consider that the nominee corporation is in fact carrying on a commercial activity, i.e., the taxable supply of services as a mandatary on behalf of a mandator or participants in a joint venture.

IMMOVABLES HELD BY A NOMINEE: ISSUES WITH RESPECT TO CONSUMPTION TAXES
Jean-Philippe Latreille

In the last few years, tax authorities have intensified their auditing efforts aimed at corporations holding immovables as nominees. In this context, the validity of some elections pertaining to joint ventures in respect of GST and QST has been questioned.

These elections allow the participants in a joint venture to designate one of them as “operator”, whose role is to remit taxes and claim input tax credits and input tax refunds in the name of the other participants. Now, in some circumstances, tax authorities adopt a position whereby a corporation which is solely used as a nominee is not a participant in the joint venture and thus, cannot validly be appointed as “operator”.

However, tax authorities recently announced that they gave instruction to their auditors not to assess when such a situation occurs. This administrative tolerance is conditional to all returns having been filed and all amounts due having been paid.

This measure is temporary since it only applies to reporting periods ending prior to January 1, 2015. Furthermore, tax authorities expect all participants in a joint venture relying on the tolerance to make valid elections in the future. Owners of immovables relying on a nominee should therefore now review their holding structure in the light of the positions published by tax authorities.

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