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NOTICE OF WAYS AND MEANS MOTION TABLED

On October 18, 2013, a detailed Notice of Ways and Means Motion ("NWMM") was tabled to implement remaining tax measures from the 2013 Budget and certain previously announced tax measures. Copies of the CCH *Special Report* No. 075H, which contains the NWMM and Explanatory Notes, may be ordered by calling (416) 224-2248 (toll-free 1-800-268-4522), by faxing (416) 224-2243 (toll-free 1-800-461-4131), or by emailing cservice@cch.ca.

Briefly, some of the NWMM clauses deal with measures relating to increasing and indexing the lifetime capital gains exemption (clause 46), modifying capital cost allowance treatment of mining and specified energy properties (clauses 100 and 116–119), taxing synthetic dispositions as actual dispositions (clauses 38, 48, and 56), and making changes to the treatment of character conversion/derivative forward agreement transactions (clauses 22 and 89). Some other NWMM measures involve the transfer of trust tax attributes (clauses 92 and 94), the amendment of rules applicable to non-resident trusts (clauses 8, 42, and 44), the elimination of unintended tax benefits under leveraged insurance annuities and 10/8 insurance policies (clauses 11, 34, 65, 96, and 97), and restrictions on the trading of corporate losses (clauses 39 and 93). As well, the NWMM addresses stapled securities in the context of specified investment flow-through entities and real estate investment trusts (clauses 5 and 10) and also addresses previously issued Comfort Letters from the Department of Finance (clauses 23, 40, and 74).

CAN TAXPAYERS SUCCESSFULLY SUE THE CRA FOR NEGLIGENCE?

— Shaira Nanji, Tax Associate with the Toronto office of Dentons Canada LLP

Canadian taxpayers who are mistreated by the Canada Revenue Agency ("CRA") in the course of an audit are likely troubled by the noticeable absence of mechanisms in taxing statutes by which the CRA may be held accountable for its behaviour or supervision.

Canadian case law is clear that a taxpayer may not launch a "collateral attack" on a tax assessment by bringing a civil claim against the CRA.[1] However, there is no judicial authority that has yet foreclosed the possibility that a taxpayer may bring a civil claim for damages against the CRA for negligence in the course of administering or enforcing various taxing statutes.

In fact, several recent decisions have wrestled with the question of whether a negligent act or negligent supervision by the CRA in the course of administering a taxing statute can give rise to a private law remedy. The courts have determined that the answer to that question depends on whether a duty of care should be imposed on the CRA towards a taxpayer.

In three recent cases, *Leroux v. Canada Revenue Agency* ("*Leroux*"),[2] *Gordon v. R.* ("*Gordon*"),[3] and *McCreight v. Canada (Attorney General)* ("*McCreight*"),[4] the courts have opened the door (slightly) to the possibility that such a duty of care may exist at law.

In all three cases, the courts dismissed the Crown's motions to strike certain of the taxpayers' claims — including negligence — and, in doing so, demonstrated that some civil actions against the CRA may have a reasonable chance of success at trial. Although the trial judgments are yet to be rendered, the courts explored several factors which, if factually substantiated, may be persuasive in establishing that CRA officials acted negligently.

Such negligence could exist where the CRA:

- prematurely targets taxpayers without proper investigation;
- uses deceptive tactics;
- appoints an underqualified auditor;
- unnecessarily interferes with contractual relations with clients and harms the reputation of taxpayers;
- wrongfully seizes and destroys documents;
- triggers improper collection procedures; or
- acts maliciously or intends to cause loss.

Background

The CRA has a standard response to civil lawsuits alleging negligence or other misconduct: a motion to strike the claim on the basis that it is plain and obvious the claim cannot succeed. Generally, the CRA makes the following two arguments.

Firstly, the taxpayer's negligence claim cannot be successful because no "duty of care" exists between the taxpayer and the CRA officials. Part XV of the *Income Tax Act* ("ITA")[5] outlines the administration and enforcement provisions which empower the CRA officials to review taxpayer filings and to ensure compliance in a self-assessing system. There is no provision in the ITA that creates a statutory "duty" to taxpayers.

Secondly, there is no reason to justify the creation of a novel duty of care between the CRA officials and the taxpayers under the *Anns/Cooper* test.[6] This two-step test, created in tort law to give legal recognition to a relationship not yet recognized in law, examines whether the proximity of parties is sufficient to justify the imposition of a duty of care and whether any residual policy considerations will negate or reduce the scope of this duty. Either there is insufficient proximity between the taxpayer and CRA officials or, alternatively, any duty of care found by the courts should be overruled for policy reasons.

In *Leroux*, *Gordon*, and *McCreight*, the courts did not agree with these arguments put forth by the CRA.

Leroux

Leroux has garnered significant media attention and is one of the more public cases on CRA negligence. The story has been featured in news magazines and CBC radio and even has its own Facebook account, YouTube channel, and website: lerouxed.com.[7]

In this case, the CRA conducted a prolonged income tax and GST audit on Mr. Leroux, who owned a recreational vehicle park business. In what was termed by the British Columbia Supreme Court a "series of Kafkaesque events",[8] the CRA not only seized Mr. Leroux's original documents during an initial audit without authorization and refused to return the documents when requested, but also subsequently informed Mr. Leroux that the original documents had been accidentally shredded and that it was his responsibility to provide more documents to substantiate his tax returns.

Mr. Leroux alleged that, during the audit, a Prince George auditor requested a cash bribe of $25,000 to resolve his "tax problem". When Mr. Leroux refused to pay, the auditor triggered an unjustified collection action and ignored his requests to refinance. This resulted in severe cash flow problems for Mr. Leroux's business. After 13 years of audit, assessment, reassessment, and collections activities, the taxpayer's business was financially ruined.

Mr. Leroux brought an action against the CRA for negligent behaviour during the audit, reassessment, and collection process. The British Columbia Supreme Court dismissed the CRA's motion to strike portions of the claim. The British Columbia Court of Appeal confirmed the lower court decision that it was not plain and obvious that the claims of

negligence would fail. It held that whether a duty of care was owed by the CRA to the taxpayer is an issue that should be decided by the trial court when a full matrix of facts was available.

The British Columbia courts' refusals to strike the claims of negligence indicates that wrongful seizure and destruction of documents, improper collection procedures, abusive behaviour of audit officials, and actions by the CRA done for malicious purposes with intent to cause loss or harm to the taxpayer are factors that may form the basis of a successful negligence claim against the CRA.

McCreight

In *McCreight*, the CRA audited two accountants, their accounting firm, and some of the firm's corporate clients. The CRA alleged that the accountants helped their clients apply for fraudulent research and development tax credits. During the investigation, the CRA investigators obtained warrants for and seized over 60 boxes of documents from the corporate clients and the accountants. The CRA was authorized to retain these documents until July 1999 but failed to complete its investigation on time and requested a judicial extension of the warrants. The Ontario Superior Court of Justice denied the request and ordered the return of the documents. Two weeks later, the CRA investigator charged various individuals with fraud and conspiracy under the ITA and the *Criminal Code*.[9] In subsequent court proceedings, it was determined that there was no legitimate basis for the criminal charges and the primary purpose of those charges was to retain the seized documents and circumvent the judicial order.

The plaintiffs brought an action against the CRA for, among other matters, claims of negligence, misfeasance in public office, and abuse of process. The Ontario Superior Court of Justice allowed the CRA's motion to strike portions of the claim but this was overturned in part on appeal. The Ontario Court of Appeal noted that it was not plain and obvious that CRA officials who operated under provisions in the ITA that attract criminal sanction did not owe a duty of care to the taxpayers who were the subject of investigations.[10]

The *McCreight* decision suggests that the premature targeting of taxpayers with criminal charges without proper investigation or for deceptive purposes (such as surreptitiously circumventing judicial orders) could provide a basis for a negligence claim against the CRA.

Gordon

In *Gordon*, the CRA laid fraud-related criminal charges against two accountants and their accounting firm with respect to SR&ED claims. The case continued for seven years until the charges were stayed at the request of the Crown.

The accountants and their firm brought claims against the CRA for misfeasance, abuse of authority, negligence, and engaging in a fraudulent scheme against them.[11] They sought compensation for loss of income and loss of clients, general damages, and punitive damages. The taxpayers alleged that, during the audit, the CRA threatened existing and potential customers with criminal charges and read the accountants their rights in front of clients. Consequently, the company lost significant potential earnings and business opportunities. In addition, they alleged that the CRA was negligent in assigning and failing to supervise an unqualified auditor.

The Crown brought a motion to strike substantial portions of the claims. The Prothonotary struck out a number of claims with the exception of two, namely, intentional interference with contractual relations and negligence. The Crown appealed to a judge of the Federal Court. The Crown's appeal was dismissed.

The Federal Court refused to strike the claims for intentional interference with contractual relations and negligence. Importantly, the Court held that the Prothonotary had correctly concluded that it was not plain and obvious there was no duty of care owed by the CRA to the taxpayers. The Court stated, "The case law is clearly evolving in this area, and the last word has yet to be written by an appellate court. The continuation of this claim at this stage of the proceedings is not unduly burdensome. The matter is proceeding in any event, and the relevant facts will have to be established and considered in dealing with the other claims. I decline to strike this claim at this stage of the actions".[12]

The *Gordon* decision suggests that a negligence claim may be well-founded where the CRA unnecessarily interferes with contractual relations with clients to the extent that the taxpayer's reputation is harmed or where the CRA appoints an underqualified auditor without adequate supervision.

Conclusion

The litigation in this area has not yet progressed beyond preliminary motions. The taxpayers, however, have been successful in fighting the CRA's repeated attempts to dismiss civil claims on the basis that it is plain and obvious that the claims must fail. The three decisions seem to foreshadow a new tort. A court determination that the CRA owes a duty of care to taxpayers would undoubtedly provide a helpful deterrent mechanism against potentially negligent administration and enforcement actions by the CRA.

A number of tax lawyers from Dentons Canada LLP write commentary for CCH's Canadian Tax Reporter *and sit on its Editorial Board as well as on the Editorial Board for CCH's Canadian* Income Tax Act with Regulations, Annotated. *Dentons Canada lawyers also write the commentary for CCH's* Federal Tax Practice *reporter and the summaries for CCH's* Window on Canadian Tax. *Dentons Canada lawyers wrote the commentary for* Canada–U.S. Tax Treaty: A Practical Interpretation *and have authored other books published by CCH:* Canadian Transfer Pricing *(2nd Edition, 2011);* Federal Tax Practice; Charities, Non-Profits, and Philanthropy Under the Income Tax Act; *and* Corporation Capital Tax in Canada. *Tony Schweitzer, a Tax Partner with the Toronto office of Denton's Canada LLP and a member of the Editorial Board of CCH's* Canadian Tax Reporter*, is the editor of the firm's regular monthly feature articles appearing in* Tax Topics.

For more insight from the tax practitioners at Dentons Canada LLP on the latest developments in tax litigation, visit the firm's Tax Litigation blog at http://www.canadiantaxlitigation.com/.

Notes:

[1] See *Main Rehabilitation Co. v. R.*, 2004 DTC 6762 (FCA) and *Ereiser v. Canada*, 2013 DTC 5036 (FCA).

[2] 2012 DTC 5050 (BCCA).

[3] 2013 DTC 5112 (FC).

[4] 2013 ONCA 483.

[5] R.S.C. 1985, c. 1 (5th Supp.), as amended.

[6] A cause of action in respect of negligence is to be examined using the *Anns/Cooper* test. This test originated in the House of Lords decision *Anns v. Merton London Borough Council*, [1978] AC 728 (UK HL) and was further developed by the Supreme Court of Canada in *Cooper v. Hobart*, [2001] 3 SCR 537.

[7] See, for example, the *National Post* article entitled "I want my life back: After more than a decade, B.C. man still fighting to right damages wrought by tax agency", April 26, 2013, http://news.nationalpost.com/2013/04/26/irvin-leroux-still-fighting-to-right-damages-wrought-by-canada-revenue-agency/.

[8] *Leroux v. Canada Revenue Agency*, 2010 DTC 5123 (BCSC).

[9] R.S.C., 1985, c. C-46.

[10] The Court of Appeal found that the duty owed by police officers to criminal suspects could be analogous to the CRA and certain taxpayers. See *Hill v. Hamilton-Wentworth Police Services Board*, 2007 SCC 41.

[11] The claims in *Gordon* were brought via the Federal Court, which shares concurrent jurisdiction with the provincial superior courts with respect to claims by and against the federal Crown.

[12] *Supra* note 3, paragraph 39.

BIDIRECTIONAL LINKING BETWEEN CCH ONLINE AND TAXFIND

We are pleased to announce that bidirectional linking between CCH Online and the Canadian Tax Foundation's online database, TaxFind, is now live! Subscribers to both products can now navigate seamlessly between both platforms. Link directly to CTF articles from our related matter in the *Income Tax Act* and *Canadian Tax Reporter*, and from TaxFind articles to our *Income Tax Act*.

HOME BUYERS' PLAN — MOTOR HOME

The Canada Revenue Agency ("CRA") was asked if a motor home would be a "qualifying home" for purposes of the Home Buyers' Plan ("HBP"). In order for an individual to participate in the HBP, the funds withdrawn from the individual's RRSP must be used to acquire a qualifying home that the individual has either begun or intends (within a year after acquisition) to use as the individual's principal place of residence (see definition of "regular eligible amount" in subsection 146.01(1) of the *Income Tax Act*). The term "qualifying home" is defined in subsection 146.01(1) and includes a housing unit located in Canada. The CRA referred to the list of types of housing units in paragraph 3 of Interpretation Bulletin IT-120R6, "Principal Residence" (now cancelled and replaced by Income Tax Folio S1-F3-C2, "Principal Residence") and Guide RC4135, "Home Buyers' Plan", which includes a mobile home as a housing unit. The CRA drew a distinction between a mobile home, which is permanently parked and used as a residence, and a motor home, which is powered by an engine and is used for long trips rather than as a residence. As a result, it stated that it does not consider a motor home to be a housing unit for purposes of the HBP. The CRA went on to say that it was unlikely that a motor home could be considered an individual's principal place of residence.

In CRA Document No. 2011-0423971E5, "Home Buyers' Plan — Qualifying Home" (June 27, 2012), the CRA had stated that a motor home is a type of mobile home and so would be a housing unit for purposes of the definition of "qualifying home" in subsection 146.01(1). The CRA now says that this comment was in error and apologized for any misunderstanding from this earlier interpretation. It should be noted that the question in CRA Document No. 2011-0423971E5 referred to a motor home that was used outside of Canada for six months of the year and so the CRA had said that the motor home was not a qualifying home for purposes of the HBP because it failed to meet the requirement that it be located in Canada.

— *Internal Technical Interpretation, Business and Employment Division, March 25, 2013, Document No. 2013-0482291I7*

INTEREST DEDUCTIBILITY ON RESTRUCTURED BORROWINGS

The taxpayer proposed to sell publicly traded common shares and to use the funds from the sale to pay down a mortgage on a personal residence. The taxpayer would then borrow money to repurchase identical shares in the public corporation. The Canada Revenue Agency ("CRA") was asked if the interest on the money borrowed to repurchase the common shares would be deductible. In this context, the CRA was also asked for clarification as to why the Supreme Court decided that interest was deductible in *Singleton v. The Queen* (2001 DTC 5533) and not deductible in *Lipson v. the Queen* (2009 DTC 5015).

In its response, the CRA set out the general requirements in paragraph 20(1)(*c*) of the *Income Tax Act* (the "Act") for the deduction of interest expense. These include that an amount be paid or payable in respect of the year, the amount be in respect of a legal obligation, and the amount be reasonable. As well, the current use of the funds that are borrowed must be in order to earn income and, if the funds are borrowed to acquire property, the property must be acquired for the purpose of earning income.

The CRA noted that in the *Singleton* case, the taxpayer withdrew funds from his law firm capital account and used this amount to assist in the purchase of a house. Later on the same day, he borrowed funds from a bank which he used to refinance his capital account. Interest on the loan was deductible because the transactions were viewed independently and the proceeds from the loan were used to earn income. In *Lipson*, the taxpayer's wife obtained a bank loan to purchase from him shares of a family corporation. The taxpayer used the proceeds to buy a new house. He and his wife then took out a mortgage on the house and used it to pay off the bank loan. The mortgage interest was deducted from her dividend income and the resulting loss was attributed to him under subsection 74.1(1). The Court held that this was not an abuse of paragraph 20(1)(*c*) or subsection 20(3), yet it was, however, an abuse of the attribution rules in subsection 74.1(1) and so the general anti-avoidance rule applied to disallow deduction of the mortgage interest. The CRA noted that the *Lipson* decision still made it clear that, provided the rules of the Act are followed, a taxpayer can arrange his or her affairs to be entitled to deduct interest on borrowed funds.

— *External Technical Interpretation, Corporate Financing Section, February 27, 2013, Document No. 2013-0477601E5*

AMENDMENT TO PRIOR YEARS' CCA

The Canada Revenue Agency ("CRA") was asked if it would allow a corporate taxpayer to reduce capital cost allowance ("CCA") claims of a predecessor corporation that were allowed in prior years. The response was negative. The taxpayer wanted to deduct non-capital losses that had expired in prior years. It proposed to replace the losses that expired with increased undepreciated capital cost balances which would then be ground down and converted to non-capital losses in accordance with subsection 111(5.1). The non-capital losses would then be deducted in the earliest year open for reassessment.

The Rulings Directorate agreed with the Audit Division that this request should be denied. The CRA distinguished the taxpayer's situation from the decision made by the Federal Court of Appeal in *Clibetre Exploration Ltd v. The Queen*, 2003 DTC 5073. In that case, the Court had held that the corporate taxpayer could recharacterize, as Canadian exploration expenses ("CEEs"), expenses that had given rise to non-capital losses in previous years. The expenses qualified as CEEs, but were misclassified as general expenses. The recharacterization of the expenses allowed the taxpayer to carry forward the CEEs and reduce income in years beyond that permitted with the non-capital losses. In the current situation, the taxpayer chose how much CCA to deduct in prior years and there was no error that needed to be corrected. The CRA noted that to allow the request to amend prior years' CCA claims would make the

restrictions in section 111 regarding the application of losses ineffective. It considered amending the prior years' CCA claims in order to reinstate expired losses to be retroactive tax planning.

See also CRA Document No. 2010-0387011I7, "Capital Cost Allowance Claimed in a Statute-Barred Year " (January 7, 2011) and CRA Document No. 2010-0352901I7, "Re-characterising Expenses of Statute-Barred Years" (July 7, 2010).

— *Internal Technical Interpretation, March 25, 2013, Document No. 2013-0474111I7*

CAPITAL LOSS FOR WORTHLESS SHARES ON TAX RETURN FOR YEAR OF DEATH

At the 2012 STEP Conference, the Canada Revenue Agency ("CRA") was asked about the timing for claiming a capital loss where worthless securities are found after the death of an individual. It was asked if the loss on the worthless securities could be claimed on the tax return for the year of death or if a statute-barred year in which the loss arose could be reopened.

The CRA responded that where the securities are worthless at the time of a taxpayer's death, as with other capital properties, they are deemed to be disposed of for the fair market value at that time. The capital loss on the securities would be reported on the tax return for the year of death. If the securities were disposed of prior to the year of death (the example cited was shares of a dissolved corporation), the capital loss would arise in that earlier year of disposition. The CRA noted that the definition of "net capital loss" in subsection 111(8) is, in general, the excess of allowable capital losses in a taxation year over taxable capital gains for that year. The CRA also noted that a net capital loss exists whether or not it is reported on the tax return for the year in which it is incurred and any unused loss from that year can be carried forward to a year that is not statute-barred. Citing subsection 152(4.2), the CRA stated that the deceased taxpayer's representative can request that the year in which the loss was incurred be reassessed to apply the allowable capital loss to any taxable capital gains for that year as long as the request is made within 10 years of that taxation year. If the time limitation prevents the CRA from reassessing that year, the allowable capital loss that can be carried forward would be reduced by any taxable capital gains for that statute-barred year, which would ultimately mean that part of the loss could not be claimed.

— *STEP 2012 CRA Roundtable, Question 7, June 11, 2012, Document No. 2012-0442961C6*

UPDATE: INCOME TAX FOLIO S1-F1-C2, DISABILITY TAX CREDIT

On October 2, 2013, the Canada Revenue Agency announced updates to Income Tax Folio S1-F1-C2, Disability Tax Credit. Paragraphs ¶2.37, ¶2.38, and ¶2.48 were revised to reflect changes to sections 118.3 and 118.7 of the *Income Tax Act* made by S.C. 2013, c. 34 (formerly Bill C-48).

PRESCRIBED INTEREST RATES — FOURTH QUARTER OF 2013

The prescribed interest rates for the fourth quarter of 2013 were released by the Canada Revenue Agency on September 23, 2013. Except for corporate taxpayers' rates pertaining to interest on loans and indebtedness (which will be 5.02%), the rates have all increased 1% from the third quarter of 2013 and are noted below.

- 2% to calculate a deemed interest taxable benefit on subsidized employee and shareholder loans;
- 2% on refunds of income tax overpayments paid to corporate taxpayers;
- 4% on refunds of income tax overpayments paid to non-corporate taxpayers; and
- 6% on payments of overdue income taxes, insufficient income tax instalments, unremitted employee source deductions, CPP contributions or EI premiums, and unpaid penalties.

These rates will be in effect from October 1, 2013 to December 31, 2013.

FOCUS ON CURRENT CASES

This is a regular feature examining recent cases of special interest, coordinated by *John C. Yuan* and *Christopher L.T. Falk* of McCarthy Tétrault LLP. The contributors to this feature are from McCarthy Tétrault LLP, Montreal, Toronto, Calgary, and Vancouver.

Tax Court Dismisses Appeal of Taxpayer Who Claimed Canadian Residency for Child Care Benefits

***Goldstein v. The Queen*, 2013 DTC 1137 (Tax Court of Canada — Informal Procedure)**

In *Goldstein*, the Tax Court dismissed an appeal by the taxpayer, Gita Goldstein, who lived in New Jersey but took the position that she was a resident of Canada for purposes of eligibility for child care benefits and credits under the *Universal Child Care Benefit Act* and the *Income Tax Act* (the "ITA").

The taxpayer was born in Canada. In the late 1990s, she met her future spouse, Shmuel Goldstein ("Shmuel"), in the United States. Shmuel was also born in Canada. They married in early 2000, and a marriage certificate was issued by the state of New Jersey. Since the marriage, the Goldsteins have lived in Lakewood, New Jersey, where Shmuel is pursuing full-time studies. They have seven children. The taxpayer operates a daycare business from the Goldsteins' Lakewood home.

In 2008, the taxpayer filed Canadian tax returns to make retroactive applications for:

(1) child care benefits under the *Universal Child Care Benefit Act*; and

(2) child tax benefits and goods and services tax credits under sections 122.5 and 122.6 to 122.63 of the ITA.

The ITA requires Canadian residency in order to be eligible for these benefits. The Minister concluded that the taxpayer was a non-resident of Canada from 2000 to 2009 and consequently denied her the benefits.

The taxpayer appealed to the Tax Court. The taxpayer did not attend the hearing and was represented by Shmuel.

At the outset, Justice Woods quashed the appeal under the *Universal Child Care Benefit Act* on the basis that the Tax Court does not have jurisdiction to decide appeals under that legislation.

On the question of benefits under the ITA, Shmuel argued that the Goldsteins were indeed Canadian residents throughout the relevant period because:

(1) The Goldsteins have close family and religious ties to Canada.

(2) The Goldsteins have come to Canada for every school break (four annually) since 2000, for an average stay of two weeks.

(3) When in Canada, the Goldsteins stay in the Toronto home of Shmuel's parents, where they have been renting two rooms for $100 each for the family's use and storage of personal possessions.

(4) The taxpayer operated a monogramming and matchmaking business in Canada and maintained a phone and fax number at Shmuel's parents' house.

(5) The taxpayer holds securities at a Canadian financial institution, and Shmuel has active Canadian bank accounts and a Canadian credit card.

(6) The Goldsteins and their children are Canadian citizens, and the taxpayer and Shmuel are registered to vote in Canada and are active members of the Conservative Party.

(7) Shmuel has a tentative job offer in Toronto, which he intends to accept upon the completion of his studies.

(8) Shmuel has retained an Ontario driver's licence and health card.

(9) The Goldsteins do not own many possessions in the United States.

As a whole, Woods J did not find Shmuel's testimony entirely reliable. In this regard, she found that he could not establish whether the connections that he cited had actually been in place for the entire period in issue (2000 to 2009). This, in turn, supported the Minister's argument that most of the Goldsteins' "ties" to Canada were recently obtained in order to bolster the taxpayer's entitlement to child care benefits.

Furthermore, Woods J did not find that any of the connections enumerated by Shmuel either individually or collectively established Canadian residency. In particular, she found that the Goldsteins' visits to Canada were in the nature of holidays and had the quality of intermittent stays rather than a settled routine. She found the "rent" paid by the Goldsteins for rooms at Shmuel's parents' home to be nominal, and in any event found that there was insufficient evidence to conclude that rent had been paid throughout the period in issue. She also found that Shmuel provided insufficient evidence relating to the taxpayer's purported monogramming and matchmaking business in Canada, including the periods in which the business operated and whether family members in Canada were involved with the operation of the business. Finally, she gave little weight to the other factors raised by Shmuel and concluded that none of them were determinative of Canadian residency.

In light of the evidence, Woods J concluded that the taxpayer sufficiently severed residential ties to Canada by the time of her marriage in early 2000, and, since then, the settled routine of her life has been in New Jersey. Accordingly, she dismissed the taxpayer's appeal relating to claims for child care credits under the ITA.

This decision highlights the often tricky question of determining an individual taxpayer's residency for tax purposes. Usually, such cases involve a taxpayer arguing that he or she has severed all ties to Canada and therefore is not resident in Canada for income tax purposes. *Goldstein* involved the less common scenario of a taxpayer arguing the reverse: that she had not severed all ties to Canada and therefore remained a Canadian resident.

Accordingly, in *Goldstein*, the Tax Court was faced with the key question of whether the taxpayer severed all significant residential ties in Canada such that she could be said to no longer be "ordinarily resident" in Canada for the tax years in issue pursuant to subsection 250(3) of the ITA (a provision that was not cited in Woods J's reasons but that certainly underpinned them). The Court in this case found that she severed those ties by the time of her marriage to Shmuel in 2000, despite the fact that the taxpayer could point to a number of "secondary residential ties" (a term used by the Canada Revenue Agency but not used in the decision), including familial, social, economic, and religious ties, as well as Canadian citizenship and, in the case of Shmuel, a driver's licence and provincial health insurance. She could also point to a stated intention to one day return to Canada, although in previous decisions this intention by itself has usually been of only limited persuasive value.

While the Court did not expressly find that the Goldsteins deliberately took steps before trial to bolster their claim of Canadian residency (although the Minister argued that they did), the Court did find that the taxpayer's evidence was insufficient to show that the connections cited by the taxpayer persisted throughout the tax years in issue. While Woods J found that none of the connections cited was determinative of Canadian residency, partly due to Shmuel's unreliable testimony, her reasons leave it open as to whether a different decision would have been reached if the taxpayer could have shown that each of those connections continued uninterrupted from the time the taxpayer emigrated from Canada.

The decision therefore serves as a caution that, on questions of whether a taxpayer is ordinarily resident in Canada following relocation to another country, a court will not defer to a "tick box" approach, especially for connections that appear to have been artificially created or severed with the question of residency in mind and will instead consider the overall substance of where a taxpayer's settled routine of life actually takes place.

— *Mark Firman*

RECENT CASES

Spousal and child support payments predicated on taxpayer's receipt of bonuses from employer not deductible

The taxpayer and his former wife, W, entered into a separation agreement under which he was obligated to pay monthly spousal support and child support payments, and to pay to W one-half of any bonuses he received from his employer (the "Bonus Payments") as "lump sum child and spousal support". The Minister disallowed the taxpayer's deduction of $11,739 in Bonus Payments made during 2010 to W, allegedly as spousal support payments. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. There was no guarantee that the taxpayer would ever receive bonuses and therefore the $11,739 was not "periodic" for the purposes of the definition of "support amount" in subsection 56.1(4). Without the taxpayer's separation agreement having any allocation of the Bonus Payments between child and spousal

support, the entire amount of those Bonus Payments had to be treated as child support in accordance with the definition of "child support amount" in subsection 56.1(4). The Bonus Payments therefore were not solely for the support of the taxpayer's spouse. As a result of the foregoing findings, the $11,739 was not deductible under subsection 56.1(4) or paragraph 60(*b*).

— *Berty*, 2013 DTC 1171

Principal residence exemption did not apply to sale of mobile home not ordinarily inhabited by taxpayer

The taxpayer realized a taxable capital gain in the amount of $32,880 on the sale of a mobile home in 2008. He claimed that the principal residence exemption ("PRE") applied to exempt the entire amount from income tax. The Minister argued that the PRE did not apply as the taxpayer never lived in the home. During the relevant period, the taxpayer leased out the mobile home to third parties at the time of his purchase in 2006. The tenants moved out in March 2007 and the taxpayer stated that he started repairs and renovation work on the property thereafter with a completion date of May 2008. Soon after completing the renovations, the taxpayer was approached by a prospective purchaser of the mobile home. The taxpayer agreed to sell and the sale took place in June 2008. Through this period, the taxpayer resided at a rental apartment.

The taxpayer's appeal was dismissed. The principal residence exemption was properly denied as the mobile home was not "ordinarily inhabited" by the taxpayer. The mobile home was never lived in by the taxpayer and while he may have intended to reside there at some future time, that never happened.

— *Kuntz*, 2013 DTC 1173

ABIL disallowed as it related to public shares and not a CCPC

The taxpayer claimed capital losses and an allowable business investment loss ("ABIL") in his 1998 tax return, which the Minister disallowed. The taxpayer made a loss determination request that the Minister replied to in the same manner, denying his claims. The taxpayer argued that he transferred shares in a public company to a trust for a promissory note as consideration in the amount of $354,830. The trust subsequently went insolvent and the taxpayer claimed his note became a bad debt.

The taxpayer's appeal was allowed in part. The capital loss was allowed but the ABIL did not meet the requirements of the *Income Tax Act* as it related to public shares and was not a debt owing to the taxpayer by a Canadian-controlled private corporation.

— *Nicholls*, 2013 DTC 1170

Taxpayer not required under contract to pay for car expenses, which were therefore not deductible

The taxpayer was employed full-time as a teacher and part-time as a group home counsellor for seven group homes run by the Eastern Residential Support Board ("ERSB") in St. Johns, Newfoundland. He was appealing the denial of his claim for car and cellphone expenses and an employee/partner GST/HST rebate for his ERSB employment. After consultations with the Canada Revenue Agency ("CRA") in 2002 and 2003, the ERSB understood that they could issue positive T2200 forms that enabled their employees to deduct car expenses if the employees used their own cars and paid the expenses. That practice stopped when employees were audited in 2010 and were denied the car expense claims on the basis that their contracts did not require them to pay motor vehicle expenses. The ERSB offered to reimburse all those employees whose car expense claims were disallowed, but the taxpayer chose to proceed with his appeal. The taxpayer argued that it was an implicit term of his employment contract that he use his own car when taking residents shopping or to appointments or recreational activities. He was also seeking to deduct travel expenses to and from work. He argued his cellphone was necessary for work because if he were to miss calls he could lose his seniority.

The appeal was dismissed. Car expenses are only deductible if an employee is ordinarily required to carry out duties in different places, which the taxpayer was required to do, and is required by contract to pay for car expenses incurred in the performance of employment duties. The expenses incurred in commuting to and from work were not incurred as part of the taxpayer's employment duties. While it was convenient for the taxpayer to use his own car and have a cellphone, his contract did not require him explicitly or implicitly to pay for his car expenses. He could have used public transportation or taxis in taking clients to their appointments or activities. He failed to meet the statutory criteria and accordingly was also not entitled to an employee/partner GST/HST rebate.

— *Barry*, 2013 DTC 1176

TAX NOTES

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