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SELL NOW! (HOW THE 2016 BUDGET WILL IMPACT BUSINESS OWNERS' EXIT STRATEGIES)

— Michael Goldberg, Tax Partner, Minden Gross LLP, MERITAS law firms worldwide and founder of "Tax Talk with Michael Goldberg", a quarterly conference call about current, relevant and real-life tax situations for professional advisors who serve high net worth clients.

The second instalment of "NRT Tax Traps and the Non-Specialist Advisor" will appear in the next issue of Tax Notes.

Back in 2014 I wrote an article reviewing the significant impact on business owners of potential changes to the taxation of eligible capital property ("ECP"), as that term is defined in section 54 of the *Income Tax Act* (Canada) (the "Act"),[1] that had been floated in the 2014 federal Budget ("2014 Budget").[2] The 2014 Budget papers were somewhat light on details and included a promise to hold consultations about the proposed changes.

Although the consultations never took place and the status quo had continued for the past two years under the former Conservative government, this has all changed as part of the new Liberal government's ambitious 2016 federal Budget ("2016 Budget"). In particular, the 2016 Budget includes in its Notice of Ways and Means Motions ("NWMM") detailed legislative proposals to eliminate the current ECP regime ("Current Regime") by causing ECP to be taxed in essentially the same manner as ordinary depreciable capital property ("New Regime") effective January 1, 2017.

Since my 2014 concerns will likely now become a reality in 2017, I thought it would be worth dusting off that old article and updating it a bit.

Assuming legislation released with the 2016 Budget to implement the New Regime is enacted substantially as proposed in the NWMM, then beginning in 2017 business owners' exit strategies will become much less tax effective. While at first glance a move from the Current Regime to co-ordinate it with the existing capital cost allowance regime applicable to other depreciable capital property seems completely logical and relatively innocuous,[3] it is the change to how ECP is taxed upon its disposition that

[1] Unless otherwise noted, all statutory references are to the Act. A good summary of the broad class of property that can comprise ECP is found in Brent Kerr, "Eligible Capital Property: Update on the Rules," 2006 British Columbia Tax Conference, (Vancouver: Canadian Tax Foundation, 2006), 17:1-29 at 13 and includes goodwill; customer lists; milk quotas, marketing quotas and farm quotas; licences of an unlimited duration; taxi and other government licenses; perpetual or indefinite franchises; certain trademarks which do not give rise to deductible expenses; other intellectual property such as from copyrights and trade secrets and property resulting from incorporation and certain other qualifying corporate reorganization expenses.

[2] See Tax Notes No. 614, March 2014, as well as in the Estate Planner No. 230, March 2014, both published by Wolters Kluwer (CCH) Limited.

[3] In some cases the impact of the changes may even be positive. For example, vendors with capital losses will now be able to offset capital gains on a sale of ECP against their capital losses, which would not have been the case under the Current Regime.

should cause owner-managers who may be considering selling their businesses to start thinking about selling a lot more seriously.

In this regard, for most owner-managers whose ECP has been internally generated and subject to few, if any, eligible capital expenditure claims, the recapture element associated with the sale of ECP is usually not a big deal. However, for many clients, ECP and, in particular, goodwill will be the single biggest asset they will have to sell, and the shift from the Current Regime of taxing such income at 50% of the active business rate to the traditional capital gains regime applicable to other depreciable property under the New Regime will result in a significant loss of tax deferral in situations where the owner-manager has no personal need for the full amount of the proceeds of sale.

For example, assume that your client Ely has been carrying on a hat business under the name Ely's Caps Limited ("Ely Cap" for short), and the goodwill of Ely Cap has recently been valued at $20 million. What would be the impact to Ely and Ely Cap under the Current Regime, and under the New Regime, assuming that it is implemented as suggested in the 2016 NWMM?

Under the Current Regime, if Ely Cap sold all of its business assets (I'll assume that the remainder of its assets, inventory, etc. would be sold at cost), the $20 million of proceeds receivable for the goodwill would give rise to a $15 million income inclusion under paragraph E of the cumulative eligible capital definition in subsection 14(5). Two thirds ($^2/_3$) of this income inclusion, an amount of $10 million, would be taxable at ordinary corporate rates pursuant to paragraph 14(1)(*b*). As a result, assuming that Ely Cap would otherwise have used up its $500,000 small business deduction in the year, in Ontario the $10 million of taxable income will be subject to corporate taxes at a rate of 26.5% for a total of $2.65 million of tax.

In addition, the sale will give rise to a $10 million addition to Ely Cap's capital dividend account (after the end of Ely Cap's current taxation year), which will allow Ely to remove $10 million of cash from Ely Cap for his personal use with no additional taxation.

If Ely wanted to remove the remaining $7.35 million of goodwill proceeds ($10 million net of the $2.65 million of corporate tax) for his personal use, Ely would likely do so by way of Ely Cap declaring eligible dividends on his shares of Ely Cap, which would result in him paying additional tax of 39.34%,[4] being another $2.89 million and change. If Ely were to do this, the total tax payable on a $20 million sale of goodwill would be approximately $5.54 million.

Under the New Regime, the full $20 million of proceeds would be subject to corporate capital gains tax rates, which in Ontario are currently about 25.08% and which would give rise to tax of slightly more than $5,015,000 in the corporation. As was the case under the Current Regime, this sale would generate a capital dividend account in Ely Cap of $10 million, which could be distributed to Ely tax free. However, due to ongoing and continuing tax rate changes that have increased the tax rate for ordinary taxable dividends to 45.89% in 2017 when the New Regime comes into force,[5] the integrated tax rate to remove the remaining goodwill proceeds of $4,985,000 ($10 million less $5,015,000 of corporate tax) from Ely Cap would increase the total tax payable on the sale of its goodwill (net of refundable taxes receivable by Ely Cap) to approximately $5,640,000.

As the Ely Cap example makes clear, there will be a cost of making a personal distribution of the corporate after-tax ECP proceeds under the New Regime of about $100,000 ($5,640,000 - $5,540,000[6]). On the other hand, by leaving the ECP proceeds in excess of capital dividend account amounts in a vendor corporation such as Ely Cap, it will be possible to enjoy some personal deferral of tax in both of these cases. In particular, under the Current Regime, this deferral would be about $2,890,000 ($5,540,000 - $2,650,000[7]), and under the New Regime it will be reduced to about $625,000 ($5,640,000 - $5,015,000[8]).

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[4] For simplicity I have assumed that Ely pays tax at the top marginal tax rates in Ontario. It should be noted that on death and possibly in other situations the use of "pipeline"- type structures could allow for a reduction in the additional taxes otherwise payable. Such structures have their own tax risks associated with them and are beyond the scope of this article.

[5] The ordinary dividend tax rate, which is 45.30% in 2016, is anticipated to increase to 46.34% in 2018 and to 46.75% in 2019.

[6] Determined by calculating the difference between the total integrated tax under the New Regime and under the Current Regime.

[7] Determined by calculating the difference between the total integrated tax under the Current Regime and the corporate tax under the Current Regime.

[8] Determined by calculating the difference between the total integrated tax under the New Regime and the corporate tax under the New Regime.

The "cost" of the loss of this deferral should not be understated since as a practical matter, most clients in Ely's situation and in situations involving far more modest sales than Ely's would likely not draw more than the CDA balance out of Ely Cap for a very long time, *if ever*. As a result, in many cases the corporate deferrals under both regimes will really amount to effective personal tax "savings" and the change from the Current Regime to the New Regime on a $20 million sale of Ely Cap's goodwill will "cost" Ely Cap nearly $2,365,000 ($5,015,000 - $2,650,000[9]) by forcing it to pay those additional corporate taxes in the year of the sale.

Assuming the New Regime becomes law, then it would certainly appear that given the massive transition of wealth that is set to occur over the next number of years this new 12% tax will likely be a significant revenue generator for the Canada Revenue Agency, though for reasons that I still can't understand, the Department of Finance still hasn't touted the change in this manner.[10]

Although the New Regime is not yet law, business owners who were already thinking about selling would be advised to carefully reconsider the timing of their exit because now may be a very good time to sell. At the very least, consideration should be given to implementing strategies[11] that may allow business owners to enjoy the benefits of the Current Regime while they still can.[12]

Special thanks to Ryan Chua of Minden Gross LLP for his comments on earlier drafts of this article. All errors and omissions are the author's.

SCOPE OF TAXPAYER AGREEMENTS NARROWED: MARINE ATLANTIC INC. V. THE QUEEN, 2016 TCC 46

— Ashvin R. Singh, Associate, Tax, Dentons Canada LLP, Edmonton.

A taxpayer agrees to be bound by the outcome of another appeal involving identical issues. The parallel appeal is eventually decided in light of admissions by the appellant that the taxpayer does not intend to make. Are the taxpayer's hands tied as a result of the agreement, or can the taxpayer seek independent determination by the court of the issues in its original appeal?

Such was the issue to be decided by the Tax Court of Canada in *Marine Atlantic Inc. v. The Queen*, 2016 TCC 46. The taxpayer, Marine Atlantic Inc. ("Marine"), operated a ferry service between Newfoundland and Nova Scotia. The ferry service was an exempt supply for the purposes of HST; the provision of ancillary services on board, such as dining and sales, was not. Marine claimed input tax credits ("ITCs") on the fuel it used during the period, claiming that fuel was a common input to its taxable and non-taxable supplies. The Minister denied those credits, contending that they were used purely in the exempt supply of the taxpayer's ferry service.

Another taxpayer represented by the same counsel, British Columbia Ferry Services Inc. ("BCF"), had also commenced an appeal in respect of the ITCs on its own fuel costs (the "BCF Appeal"). Marine entered into an agreement with the Minister whereby, in exchange for the Minister's consent to hold its appeal in abeyance, it agreed to be bound by the decision in the BCF Appeal as it related to the ITCs available on its fuel expenditures. The BCF Appeal was eventually resolved in favour of the Minister, in part because BCF admitted in the Agreed Statement of Facts that it could not prove that less than 90% of its fuel was used in the provision of the propulsion of its vessels (that function being related to an exempt supply).

[9] Determined by calculating the difference between the corporate tax under the New Regime and the corporate tax under the Current Regime.

[10] The 2016 Budget papers do show an increasing positive fiscal impact from these changes (2016-17 - $30 million and 2017-2018 - $190 million of new revenue). Query if even these numbers are too modest.

[11] A discussion of such transactions, which are sometimes referred to as goodwill (ECP) bump or "crystallization" strategies is beyond the scope of this article.

[12] Assuming the New Regime is legislated, expect a return to the old status quo of vendors having a very strong preference to sell shares (it appears that the CCA rate for new ECP acquisitions will be set to emulate the existing eligible capital expenditure rates with some slightly more favourable variations for existing ECP, so that the New Regime should be relatively tax neutral for purchasers). Due to the low tax rates applicable to ECP sales, this may not have always been the case in the more recent past, even for vendors whose shares would otherwise have qualified for capital gains exemption treatment. Though, in some situations it has been possible for both vendors and purchasers to achieve the best of both worlds from a tax perspective by employing so-called "hybrid" sale structures, whereby transactions are structured to allow vendors to sell their shares and also sell assets of the corporation. For more on hybrid sale structures, see Charles P. Marquette, "Hybrid Sale of Shares and Assets of a Business" in "Personal Tax Planning" (2014), vol. 62, no. 3 Canadian Tax Journal, 857-879.

Marine notified the Minister of its intention to pursue its appeal on the basis that the BCF Appeal did not fully resolve the ITC issue. Marine contended that because it did not intend to make the admission that more than 90% of its fuel was used in the provision of exempt supplies, the court's finding in the BCF Appeal did not resolve a common issue between the appeals. In other words, BCF's admission had narrowed the issue so that the decision in the BCF Appeal no longer addressed the common question. The Minister sought an order that Marine was bound by the initial agreement, barring Marine from raising an issue at the appeal and striking portions of the Notice of Appeal. It was argued that, in spite of BCF's admissions, the broader issue of whether fuel attributable to taxable and non-taxable activities in any proportion would give rise to ITCs had been argued in the BCF Appeal, and consequently the matter had been property considered.

Justice Lyons found that the crucial issue was the substance of the agreement between the parties. General principles of contractual interpretation applied to its construction, so the court examined not only the language of the letter agreements exchanged, but also the surrounding objective evidence, such as the pleadings, to determine what the parties intended. Finding that the parties had reached an agreement on the broad issue of whether fuel used in exempt and non-exempt activities was eligible for ITCs, the court looked to the actual conduct of the BCF Appeal. The argument and decision in the BCF Appeal showed that the broader matters had not been fully considered subsequent to BCF's admission, and therefore the issue was no longer a common issue between the appeals.

Certain procedural points were also addressed by the court, which should assist counsel in disputes surrounding similar agreements between taxpayers and the Crown. First, even if the Crown had been correct in its reading of the agreement and the facts, Justice Lyons confirmed that the Tax Court of Canada had no statutory jurisdiction to make a declaratory order or grant specific performance, as sought by the respondent. The Tax Court of Canada is a creation of statute whose powers were limited by Parliament to the ability to "dispose of an appeal from an assessment by dismissing it, allowing it, and vacating the assessment, or referring the assessment back to the Minister for reconsideration and reassessment". There was no statutory authority for the granting of equitable remedies. Further, the inherent jurisdiction of the court to control its proceedings did not extend to the enforcement of an agreement external to the court's processes. Unlike certain procedural agreements governed by tax statutes (for example, an agreement to hold an objection or appeal in abeyance under subsection 225.1(5) of the *Income Tax Act*), an agreement to be bound by another court decision fell outside the jurisdiction of the court.

Secondly, contrary to the Crown's assertions, Marine's conduct in seeking to pursue its rights did not reach the high standard to strike pleadings based on an abuse of process, which requires delay and prejudice. This finding follows from the fact that the court favoured Marine's position that the issues in the appeals were no longer common.

Third, while the court does have the authority to bar a party from raising an issue in certain situations, it did not find sufficient justification to do so in this case.

Finally, the court struck certain exhibits to an affidavit which contained documents subject to settlement privilege, indicating that such documents — however relevant — could not be relied on in showing the context of the parties' agreement.

Tax litigators should note the functional and circumstantial approach taken by the court in interpreting the agreement between Marine and the Crown. Rather than mechanically comparing the stated parameters of each appeal, the court carefully examined the intersection of the agreement with the true conduct of the parallel appeal, including the nature of evidence elicited, admissions made, and reasons given. The court's finding suggests that even where arguments were made that might be applicable to both appeals, the parallel appeal may not be fully dispositive of the common issue by virtue of its particular facts and admissions.

This interpretive approach reflects an understanding that issues to be determined in a given trial can evolve on the basis of factual admissions. The court's appreciation of that point diminishes the possibility that when entering into an agreement to be bound by another decision (for reasons of efficiency, judicial economy, or otherwise), a taxpayer will bind itself to a decision made on the basis of new issues shaped by an unknown factual context.

That being said, the success of the taxpayer in this case and the emphasis of the court on the contractual mechanics of the agreement reinforces the need for counsel to be meticulous in drafting such agreements to ensure that they are not inadvertently excessive in scope.

A number of tax lawyers from Dentons Canada LLP write commentary for Wolters Kluwer's Canadian Tax Reporter *and sit on its Editorial Board as well as on the Editorial Board for Wolters Kluwer's* Income Tax Act with Regulations, Annotated. *Dentons Canada lawyers also write the commentary for Wolters Kluwer's* Federal Tax Practice *reporter and the summaries for Wolters Kluwer'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 Wolters Kluwer:* 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 Dentons Canada LLP and a member of the Editorial Board of Wolters Kluwer's* Canadian Tax Reporter*, is the editor of the firm's regular monthly feature articles appearing in* Tax Topics.

2016 FEDERAL BUDGET

Federal Finance Minister Bill Morneau presented his first budget on March 22, 2016. Subscribers to the *Canadian Tax Reporter* (print, DVD, and online) will have received Wolters Kluwer's *Budget Special Report* No. 089H containing the Budget Plan, the Notice of Ways and Means Motion, and commentary by Dentons Canada LLP, Joe Frankovic, and Wolters Kluwer on the proposals. Additional copies of the *Special Report* may be ordered by:

- calling 416-224-2248 (toll-free 1-800-268-4522),
- faxing 416-224-2243 (toll-free 1-800-461-4131), or
- emailing cservice@wolterskluwer.com.

The commentary, table of effective dates, and tax-related portions of the government's Budget Plan are available in the *Canadian Tax Reporter* online and will soon be available on DVD under the heading Budgets/Federal Budget. The Budget documents are also posted on the Wolters Kluwer federal income tax News Tracker.

The 2016 Budget contained an Income Tax Notice of Ways and Means Motion with 76 resolutions as well as some revisions that were not part of the Notice of Ways and Means Motion. Items of special interest are:

- the introduction of the much anticipated Canada Child Benefit,
- the repeal of the Family Tax Cut Credit, and
- the proposal to repeal the rules respecting eligible capital property ("ECP") and replace them with a new regime that would treat these amounts as depreciable capital property subject to the capital cost allowance ("CCA") rules, commencing in 2017.

Some of the other key tax measures in the Notice of Ways and Means Motion are summarized below.

Personal Tax Measures

- The introduction of a refundable School Supplies Tax Credit for eligible educators in the amount of 15% of "eligible supplies expenses", to a maximum of $1,000, thus generating $150 in potential tax savings, commencing in 2016;
- The elimination of the education and textbook tax credits commencing in 2017;
- A 50% reduction to the Children's Fitness Tax Credit and the Children's Arts Tax Credit, to $500 and $250 respectively, for 2016 and the elimination of these credits effective for 2017 onwards;
- The imposition of a deemed disposition at fair market value where shares of a mutual fund are exchanged, resulting from the investor switching between funds administered by that mutual fund; and
- The exclusion from income of certain credits received from the Ontario Electricity Support Program.

Corporate Tax Measures

- An increase of 5% in the tax rate payable by certain personal services corporations, increasing their effective rate from 28% to 33% for taxation years ending after 2015;
- A freeze on the reduction of the small business deduction, freezing the tax rate applicable to qualifying income of a CCPC to 10.5% for 2016 and subsequent taxation years;
- The introduction of new measures to eliminate the use of certain structures designed to multiply the use of the small business deduction, effective for taxation years beginning after March 22, 2016;
- The tightening of complex and detailed anti-avoidance provisions relating to life insurance policies;
- New rules proposed for 2016 that apply to taxpayers that enter into a debt parking arrangement to avoid foreign exchange gains;
- A tightening of the anti-surplus-stripping rules that apply to certain cross-border transactions; and
- The extension of the back-to-back rules.

Charities

The proposal to provide enhanced tax treatment to donations of certain private corporation shares and real estate as proposed in the 2015 Budget was withdrawn.

Other

The Government announced that it conducted a review of the types of activities that would qualify for the small business tax rate and concluded that no revision was required at this time. The government proposes to make obtaining employment insurance easier and to offer better support to those seeking employment. It also proposes to launch consultations to gain insight into how best to enhance the Canada Pension Plan. The government also plans to aggressively pursue tax evaders and collect outstanding tax debts.

The government announced that it would proceed with the trust taxation changes announced on January 15, 2016, as well as several other tax initiatives previously announced. These initiatives and other important details are all in our special report.

CURRENT ITEMS OF INTEREST

Income Tax Regulations Amended for Withholding Tax on Payments from RDSPs

The Canada Gazette published amendments (SOR/2016-30) to the *Income Tax Regulations* which provide for withholding tax on payments from registered disability savings plans ("RDSPs"). The definition of "remuneration" has been amended to include the taxable portion of a payment from an RDSP. This taxable portion is subject to the withholding tax. Where multiple lifetime disability assistance payments ("LDAPs") are made in a single year, the sum of these payments is used to determine the correct withholding rate. Furthermore, the regulations are amended so the beneficiary's basic personal amount and disability tax credit are subtracted from the base payment before withholding taxes are calculated.

Provided that the payment is made to a Canadian resident, the withholding rates are as follows:

- If the payment does not exceed $5,000: 10% (5% for Quebec),
- If the payment exceeds $5,000 but does not exceed $15,000: 20% (10% for Quebec), and
- If the payment exceeds $15,000: 30% (15% for Quebec).

These withholding rates are based on the amount required by federal and provincial statutes. The amendments apply to payments made from an RDSP on or after July 1, 2015.

Comfort Letter on Limited Partnership Non-Capital Losses for AMT Purposes

A comfort letter originally issued in January 2016 was recently released. The letter addresses legislative amendments originally contained in Bill C-4 (the second Budget 2013 bill). Specifically, these amendments removed the exclusion of non-capital losses from limited partnerships when calculating alternative minimum tax (AMT). These generally favourable amendments apply to 2012 and subsequent taxation years, and also apply to 2006 to 2011 if a taxpayer makes an election in writing to the Minister of National Revenue.

However, the Department of Finance's letter addresses specific taxpayers who have losses from 2003 that do not benefit from the above amendments. As a result, the Department will recommend to the Minister that the election should apply to 2003 and subsequent taxation years so these taxpayers will also benefit from the legislative relief. If the Minister chooses to act upon the recommendation, the proposed amendments may appear in a technical bill in the future.

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.

Equitable Remedies Used To Right a Tax Wrong

***Re Morrison Estate*, 2015 DTC 5140 (Alberta Court of Queen's Bench)**

The *Morrison* case provides a cautionary tale for investment advisors and testators: designating someone other than a spouse as the beneficiary of a RRIF or RRSP without clearly specifying the reason, and without clearly setting out how taxes in respect of the RRIF or RRSP are to be accounted for, could have significant and potentially unintended tax consequences for the estate.

Background

Morrison was an application for advice and direction brought by one of the beneficiaries of the estate of John Robert Morrison. The application sought a direction that a certain registered retirement income fund ("RRIF") was an asset of the estate and not the property of the beneficiary named in it.

The facts of the case are relatively straightforward. The testator, Mr. Morrison, died in November of 2011, and was survived by his four children, Robert, Douglas, Cameron, and Heather. The bulk of Mr. Morrison's estate consisted of a RRIF. Mr. Morrison's will directed that his estate be divided equally among the children, with the exception of $11,000, which was to be divided equally among Mr. Morrison's eleven grandchildren. When Douglas and Heather began the process of calling in Mr. Morrison's estate, they learned that Douglas had been designated as the sole beneficiary of the RRIF. Given the income tax treatment of RRIFs, while the proceeds of the RRIF went to Douglas, the tax burden resulting from Mr. Morrison's death fell on his estate. The tax burden was sufficiently high that there was not enough money left in the estate to satisfy the bequests to the grandchildren.

Cameron brought the application seeking a declaration that Douglas held the RRIF proceeds in a resulting trust for the estate, arguing that (a) there was no consideration for Douglas to be designated as a beneficiary in the RRIF, and (b) there was no clear indication that Mr. Morrison intended a gift to Douglas. Cameron cited *Pecore v. Pecore* (2007 SCC 17) for the proposition that an unexplained gratuitous transfer from a parent to an adult independent child should be placed in a resulting trust for the estate if it cannot be demonstrated that the transferor intended to treat the children unequally. Cameron also suggested that Mr. Morrison's intent was expressed through his will in 2002 and through the distribution, prior to his death, of proceeds from the sale of his home equally among his children; accordingly, Cameron maintained, Mr. Morrison's RRIF should be divided equally among his children. In response, Douglas argued that simple lack of consideration does not avoid the effectiveness of the designation of a beneficiary of a RRIF and that a resulting trust should not be found to have been created.

Summarizing the problem before him, Justice Graesser noted the "manifestly unfair" circumstances that had arisen as a result of the RRIF's beneficiary designation:

> It seems manifestly unfair for this estate to be unable to pay modest bequests to the testator's grandchildren because he had given most of his estate away to one of his four children and the tax consequences of that transfer denuded the estate.

Distinguishing *Pecore*: What must be proven?

Despite his clear sympathy for the children other than Douglas, Justice Graesser distinguished the holding in *Pecore* from the case before him: *Pecore* dealt with rebuttable presumptions that applied in respect of joint bank accounts when no other evidence was available as to the deceased's intentions. By contrast, absence of evidence regarding the intention behind a beneficiary designation should not create a rebuttable presumption. Rather, "[i]n the absence of evidence to the contrary, it should be presumed that [the testator] knew what he was doing".

Moreover, beneficiary designations are unlike joint ownership of bank accounts in that beneficiary designations do not confer a present property interest. Justice Graesser considered that it would create significant uncertainty if the *Pecore* principles regarding joint bank accounts were extended to encompass beneficiary designations in RRIFs. However, rather than deciding this point, Justice Graesser determined that he was able to resolve the issue based upon the evidence, applying the balance of probabilities standard.

Justice Graesser accepted Douglas' evidence as to his father's intentions. Douglas cited his close relationship with his father at the time the beneficiary designation was made; the assistance he gave his father after Mrs. Morrison died; and the fact that the RRIF exclusively designated Douglas, even though the will, which was made at almost the same time as the RRIF designation, named both Douglas and his sister joint executors of Mr. Morrison's estate. Despite the thin and conflicting evidence that was presented, Justice Graesser found that, on a slim (what he called a "50.01%") balance of probabilities, Douglas had established that his father intended to give him the RRIF.

Who pays the tax? Applying equitable remedies

This was not the end of the matter. In light of the "manifestly unfair" situation that would otherwise result, Justice Graesser applied the principles of equity allowed under the Alberta *Judicature Act* to make Douglas liable to the estate for the taxes payable in respect of the RRIF. To establish the appropriateness of this remedy, Justice Graesser began by noting that even if Mr. Morrison did intend to name Douglas as the RRIF's beneficiary, it seemed "highly unlikely" that Mr. Morrison would have understood the tax consequences of the decision. Rather, Justice Graesser inferred on a balance of probabilities that either (a) Mr. Morrison intended that Douglas be responsible for the tax on the RRIF and expected the tax would be deducted from the RRIF when it was transferred or paid to Douglas, or (b) Mr. Morrison was mistaken about the tax treatment of his RRIF having designated Douglas as beneficiary. "In either circumstance," Justice Graesser found, "Douglas has received an unintended and unexpected benefit from the Estate".

Justice Graesser noted that two potential remedies were available to right the wrong done to the estate and the other beneficiaries by the estate having to bear the cost of the tax resulting from the RRIF: (1) rectification of the will, and (2) applying the principles of equity under the *Judicature Act*. He considered, but ultimately rejected, using rectification as a remedy. Section 39 of the Alberta *Wills and Succession Act* allows a court to add or delete "characters, words or provisions" in a will if the court is satisfied "on clear and convincing evidence" that the will does not reflect the testator's intentions. Yet in this instance Justice Graesser felt that such clear and convincing evidence — a term he interpreted as meaning more than merely a balance of probabilities — was not present.

Instead, Justice Graesser adopted an approach allowed under section 8 of the Alberta *Judicature Act,* which gives the court a generic — and extremely broad — remedial power, to remedy the unfair consequence to Mr. Morrison's estate. Justice Graesser further justified an equitable remedy, rather than a statutory one under the *Wills and Succession Act*, on the bases that (a) probate law's origins are in equity, such that equitable remedies are appropriate where the common law is inadequate to remedy a wrong, and (b) equity is not limited to injunctions, and the court's jurisdiction to provide just and equitable remedies allows for a broad range of solutions.

Here, two equitable principles justified the remedy: unjust enrichment and the doctrine of mistake. Since the tax paid by the estate enriched Douglas to the detriment of the other beneficiaries of the estate, Justice Graesser found that it would be unjust for Douglas to retain the benefit. Under the doctrine of mistake, Douglas would be obliged to reimburse the estate, since the tax paid was the result of Mr. Morrison's mistaken understanding of the consequences of the beneficiary designation. Either way, the result was a declaration of a constructive trust on the proceeds of the RRIF received by Douglas to the extent of the estate's payment to the CRA on account of the RRIF.

Justice Graesser noted that despite the apparent novelty of the remedy, the facts before him were precisely the kind that equity was intended to address:

> I recognize that the approach I have taken here may be viewed as extraordinary. But that is what s 8 is for: creating an equitable remedy where the law would otherwise leave the injured party (here, the Estate and beneficiaries other than Douglas) with no adequate remedy.

Thus, Justice Graesser allowed Douglas to keep the RRIF, but required Douglas to reimburse the estate for the tax it paid in connection with the RRIF.

Morrison is an example of the extraordinary lengths courts will go to resolve inexplicably unfair treatment of beneficiaries. Yet the need the need to draw on equitable remedies is also an indication of the unsettled nature of the common law. *Pecore* may have created clear presumptions in the case of joint ownership and rights of survivorship, but there are still no bright-line rules about what to do when some of the most common and valuable forms of estate property — RRIFs, RRSPs, and life insurance policies — designate non-spouses for unclear reasons. In the meantime, investment advisors and testators should take care to document that a gift to a non-spouse was intended and, in all cases, to document how taxes are to be accounted for. Providing such documentation can avoid litigation between designated beneficiaries and disappointed estate beneficiaries.

— *Aaron Wenner, Articling Student*

RECENT CASES

Taxpayer deprived of ABIL deduction owing to non-compliance with statutory election requirements

The taxpayer was the sole owner of a building (the "Building"). She was also the sole shareholder of a numbered corporation ("9133"), whose principal business was the operation of a restaurant until August 2003 when the restaurant closed and 9133 ceased carrying on business. From that point on the taxpayer rented the Building to another numbered corporation, 9132, which continued to operate the restaurant. On or about December 20, 2005, the taxpayer sold the Building to a corporation related to 9132 and caused 9133 to transfer all of its assets to 9132. The minister disallowed the taxpayer's claim for an ABIL of $48,813 for 2005 (i.e., ½ of $97,627) on the ground that she had not advanced $97,627 to 9133. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. The minister's contention that the taxpayer had not advanced $97,627 to Corporation 9133 was untenable, since the taxpayer continued to pay the restaurant's operating expenses while the Building was being rented by her to 9133. The taxpayer, however, did not dispose of the debt owing to her by Corporation 9133. That debt survived 9133's dissolution in 2006, and there was no evidence that she made an election under subsection 50(1) of the *Income Tax Act* (the "Act") at any time. During 2004 and 2005, moreover, 9133 was not a "small business corporation" as defined in subsection 248(1) of the Act, since it stopped carrying on business in August 2003. Nor was the advance of $97,627 made by the taxpayer to 9133 for the purpose of earning income from business or property. For the foregoing reasons, the excepting provisions of paragraph 40(2)(*g*) of the Act were inapplicable to the taxpayer.

D'Amour v. The Queen, 2016 DTC 1023

Taxpayer's failure to verify accuracy of return justifies imposition of gross negligence penalties

The taxpayer engaged a tax preparer with whom he was not familiar to prepare his tax return for the 2009 tax year. That tax preparer claimed very large fictitious business losses on that return, and also claimed loss carrybacks for the previous three taxation years. The overall result of claims made on the return was that the taxpayer would receive a refund of all taxes paid or withheld for the 2006, 2007, 2008, and 2009 taxation years. The minister disallowed the false business losses claimed and imposed penalties under section 163(2) for gross negligence. The taxpayer appealed from the imposition of those penalties.

The appeal was dismissed. In order to justify the assessment of penalties for gross negligence under section 163(2), the minister must show that a false statement was made in a return and that the false statement was made knowingly or

in circumstances amounting to gross negligence. As well, the jurisprudence provides that gross negligence can include wilful blindness, in which the taxpayer deliberately fails to make enquiries in circumstances which raise suspicion, in order to remain in ignorance. The Court held that false statements had clearly been made in the taxpayer's return, but that it was satisfied that the taxpayer was unaware of those statements since, by his own admission, he had not looked at the completed return. In the Court's view, however, there were ample warning signs which should have aroused the taxpayer's suspicions and alerted him to the need to make further enquiries, but he failed to do so. That failure was, in the Court's view, evidence of wilful blindness. As well, the jurisprudence has held that a failure to review one's return before signing and filing it may in and of itself be sufficient to amount to gross negligence. The Court concluded that the taxpayer had made no effort whatsoever to verify the accuracy and completeness of his return, and that making even the most minimal effort would have enabled him to discover the false claims made. As such, the taxpayer was properly subject to the penalties for gross negligence imposed on him.

Ramlal v. The Queen, 2016 DTC 1026

Crown entitled to file inconsistent pleadings in separate appeals by different taxpayers

The appellant corporate taxpayer was a member of a corporate group. The minister reassessed the taxpayer and a second member of that group in relation to the allocation of income and profits between them, and both companies appealed from those assessments. The pleadings filed by the Crown in relation to the appeals were irreconcilable, in that each included a different fact scenario with respect to inter-corporate transactions. The appellant brought a motion to strike the Crown's pleadings on the basis of that inconsistency. The motion was dismissed, with the Tax Court judge holding that the Crown could have a reply in relation to an appeal of one taxpayer that was inconsistent with the reply filed in relation to the appeal of another taxpayer. The appellant appealed from that determination to the Federal Court of Appeal.

The appeal was dismissed. The appellate Court held that, although the two corporations were related persons for purposes of the *Income Tax Act* (the "Act"), they were nonetheless separate persons. Under section 152 of the Act, the Minister is required to assess each taxpayer and, because each taxpayer is assessed separately, inconsistent assessments can result. The Court held that such inconsistent assessments will, where the taxpayers appeal, lead to inconsistent pleadings being filed. The Crown had acknowledged that both the assessments and the pleadings were inconsistent and that it did not seek to have both assessments upheld. In the Court's view, even though the Crown made certain admissions of fact in the pleadings filed with respect to one of the corporations, those admissions would relate only to that corporation's appeal, and not to the appeal of the related corporation. Since the appeals were to be heard on common evidence, the Court held that the way in which any admission of facts would affect the outcome of the appeals was a matter best left to the trial judge who would hear all of the evidence and make a determination as to what facts had been established.

AgraCity v. The Queen, 2016 DTC 5006

Reassessments made outside normal period cannot include transactions not included in assessments made within such period

In 2007, the taxpayer acquired a fishing vessel and licence and incorporated a company to operate the fishing business. In January 2012, based on the filing of a waiver by the taxpayer, the minister issued a reassessment in connection with those transactions. The effect of that reassessment was to include a shareholder benefit in the taxpayer's income for the 2007 tax year. The taxpayer objected to that assessment and, in August 2012, he filed a Notice of Revocation of Waiver. In May 2014, the minister issued a second reassessment, again including a shareholder benefit in the taxpayer's income for 2007, but reducing the amount of that benefit. The taxpayer objected, on the

basis that the application of section 152(5) of the *Income Tax Act* precluded the minister from issuing the 2014 reassessment.

The appeal was dismissed. Section 165(3)of the *Income Tax Act* permits the minister to issue a reassessment outside of the normal reassessment period. The taxpayer argued, and the Court agreed, that the minister's powers under section 165(3) are limited by section 152(5). Section 152(5) provides that no amount can be included in a reassessment made outside the normal reassessment period that was not included in computing the taxpayer's income for purposes of an assessment or reassessment made within that period. The Court concluded that, as a result of the section 152(5) limitation, the minister is not permitted, after the expiry of the normal reassessment period, to include amounts that arise from transactions other than those that underlie an assessment or reassessment made within the normal reassessment period, even if the dollar amount of the reassessment would be unchanged. The Court was therefore required to determine whether the transactions underlying the minister's 2014 reassessment were the same as those on which the 2012 reassessment was based, and it concluded that they were. In the Court's view, the crux of the reassessments was identical, both involving an overpayment and resulting shareholder benefit. The minister therefore had the statutory authority to issue the 2014 reassessment.

Foster v. The Queen, 2016 DTC 1010

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