Tax Notes

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TRUSTS AND SECTION 160 — THE *YU V. THE QUEEN* DECISION

— *Jacob Yau, Associate, Dentons Canada LLP, Toronto*

The appellant was assessed under section 160 in respect of $119,500 transferred to him from his sister-in-law. Section 160 is a collection provision that allows the CRA to assess a person receiving property for the tax liability of the transferor to the extent that the fair market value of the transferred property exceeds the fair market value of the consideration given in exchange.

The appellant's mother-in-law had sold her house and was left with $200,000 after purchasing a smaller home. She gave approximately $200,000 to her oldest daughter ("the transferor") with instructions to give "about $100,000" to her second daughter (the appellant's wife) for the medical expenses of the second daughter's son. The mother-in-law testified that it was customary for her to leave the oldest child in charge of the money and that nothing was put in writing. The transferor transferred the sum of $119,500 to the appellant. At the time of the transfer, the transferor owed money to the CRA.

The appellant did not dispute that he had received the $119,500 for no consideration, nor did he dispute that he was related to the transferor. He only disputed whether the transferor had had any beneficial interest in the money, as it was his position that the money was placed by his mother-in-law in trust with the transferor for the benefit of his wife and their son. On this basis, he argued that when the transferor transferred the $119,500 to him she transferred only her legal interest in the property, which had no value, given that the beneficial interest in the money at all times remained with his wife. He argued that since the money was in trust it was not part of the transferor's property and section 160 was therefore inapplicable to the subsequent transfer by the transferor to him.

The Court noted that in order for section 160 to apply, the following conditions must be met:

(1) The transferor must be liable to pay tax under the *Income Tax Act* (Canada) at the time of transfer;

(2) There must be a transfer of property, either directly or indirectly, by means of a trust or by any other means whatever;

(3) The transferee must either be:

(i) The transferor's spouse or common-law partner at the time of transfer or a person who has since become the person's spouse or common-law partner;

(ii) A person who was under 18 years of age at the time of transfer; or

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(iii) A person with whom the transferor was not dealing at arm's length.

(4) The fair market value of the property transferred must exceed the fair market value of the consideration given by the transferee.

Boyle J. cited the decision in *Canada v. Livingston* (2008 DTC 6233 (FCA)), which, in turn, cited the decision in *Medland v. Canada* (98 DTC 6358 (FCA)) which stated that "the object and spirit of section 160 is to prevent a taxpayer from transferring his property to his spouse, or to a minor or non-arm's length individual, in order to thwart the Minister's efforts to collect the money which is owed to him." Moreover, the Federal Court of Appeal in *Livingston* stated that section 160 will apply even when beneficial ownership has not been transferred: "subsection 160(1) applies to any transfer of property — 'by means of a trust or by any other means whatever'". Thus, transfers to a trust are considered a transfer of property under subsection 160(1), which is "designed, *inter alia*, to prevent the transferor from hiding his or her assets, including behind the veil of a trust, in order to prevent the CRA from attaching the asset."

The Court noted that to be considered a valid trust, a trust must meet three certainties:

(1) certainty of intention to create a trust,

(2) certainty of the subject matter of the trust, and

(3) certainty of the beneficiaries.

In reviewing the facts, however, the Court found several problems with the appellant's evidence which weighed against a finding that a valid trust had been created. Firstly, the terms of the trust were unclear and nothing was put in writing. Secondly, the subject matter of the trust was uncertain because the amount given by the mother-in-law to the transferor was not the same as the amount that was transferred to the appellant.

Moreover, the transferor's handling of her mother's money was found to be inconsistent with the existence of a trust. She would transfer money when she had the ability, not when the appellant's wife (the alleged beneficiary) requested it, or when it was needed for her son's medical expenses. The Court also found that the testimony regarding the use of funds by the appellant and his wife was inconsistent.

Finally, the Court found that the transferor did not behave like a trustee. She was not certain of the amount in trust and did not keep the amounts purported to be in trust separate from her own assets and available for distribution to the beneficiary. She also made no attempt to ensure the money was used for its stated purpose, and it is unclear that it in fact was. Accordingly, the Court found that a valid trust was not created and dismissed the appeal.

Although the evidence in *Yu* was clearly insufficient to support the appellant's position that a valid trust had been established, the decision suggests that the Court has not foreclosed the possibility that, in different circumstances, a transfer of property to a *bona fide* trustee tax debtor who then on-transfers the property to a beneficiary would escape the reach of section 160. In a valid and *bona fide* trust arrangement, this approach would seem sensible, since property held by a trustee in his or her capacity as trustee is separate and distinct from that individual's personal property and a beneficiary should not be expected to bear the tax liabilities of a trustee who is merely discharging his or her responsibilities under a trust.

Yu v. The Queen, 2017 DTC 1012

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.

CURRENT ITEMS OF INTEREST

2017 Federal Budget

Federal Minister of Finance Bill Morneau tabled the 2017-2018 Budget on March 22, 2017. Subscribers to the *Canadian Tax Reporter* and *Canada Income Tax Guide* (print, DVD, and online) will have received Wolters Kluwer's *Budget Special Report* No. 098H, which contains the Budget Plan, the Notice of Ways and Means Motion, and practical commentary by Dentons Canada LLP, Joe Frankovic, and the rest of the Wolters Kluwer team. Additional copies of the special report can be ordered at: http://www.cch.ca/product.aspx?WebID=5035.

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.

Budget 2017 proposes 74 resolutions to amend the *Income Tax Act*. The most notable tax measures are briefly summarized below.

Personal Tax Measures

- The eligibility rules for the disability tax credit are expanded so that a nurse practitioner can certify that a taxpayer qualifies for the credit;
- Fertility treatment costs are eligible for the medical expense tax credit regardless of whether the patient is medically infertile;
- The infirm dependant, caregiver, and family caregiver tax credits are all consolidated into the new Canada caregiver credit;
- The mineral exploration tax credit is extended to flow-through share agreements entered into on or before March 31, 2018;
- The registered plan advantage rules, prohibited investment rules, and qualified investment rules are expanded so they apply to registered education savings plans and registered disability savings plans;
- The tuition tax credit is expanded to include tuition paid to a post-secondary institution for occupational skills courses that are not at a post-secondary level;
- The public transit tax credit is repealed as of July 1, 2017; and
- The home relocation loan deduction is repealed after 2017.

Business Tax Measures

- A new mark-to-market election and an anti-avoidance rule for straddle transactions are introduced with respect to derivatives;
- The concept of *de facto* control is amended in order to override the decision in *McGillivray Restaurant Ltd. v. The Queen* (2016 DTC 5048) and allow the consideration of all relevant factors;
- The investment tax credit with respect to child care spaces is repealed as of Budget Day;
- The election to exclude work in progress from the income of designated professionals such as accountants, dentists, lawyers, doctors, veterinarians, and chiropractors (subsection 10(14)) is repealed, subject to a phase-out transition;

- CCA Classes 43.1 and 43.2 are expanded to include more categories of geothermal equipment;
- Expenses with respect to oil and gas discovery wells are treated as Canadian development expenses going forward (currently treated as Canadian exploration expenses), except in limited circumstances;
- The ability for small oil and gas corporations to reclassify up to $1 million of Canadian development expenses as Canadian exploration expenses when renounced to shareholders under a flow-through share agreement was eliminated; and
- The Part II surtax on tobacco manufacturers was eliminated and the excise duty rates were increased.

Other Measures

- The EI premium rate for 2018 will increase to $1.68 per $100 of insurable earnings (up from $1.63 in 2017);
- The government has been conducting further reviews of planning strategies relating to the use of private corporations to reduce personal income taxes of high income earners. A paper will be released in the next few months which will contain proposed policy responses to various tax planning strategies involving private corporations — no specifics were provided with respect to which kinds of strategies will be targeted;
- The government confirmed that it will move forward with outstanding draft legislative proposals announced on September 16, 2016 (technical amendments) and October 3, 2016 (changes to the principal residence exemption).

Filing for Taxpayers Affected by Phoenix Payroll Issues

According to recent news coverage by the CBC, approximately 50,000 T4 slips were reissued due to continuing problems with the Phoenix Pay System. Public servants were urged not to print their slips until February 28, 2016. Any overpayments reported before December 31, 2016, should be properly accounted for on the T4. However, if overpayments are included on a T4, taxpayers have been instructed to file using that information — the CRA will adjust tax returns automatically when the amended T4s are filed.

The CRA has published an extensive Q&A page regarding filing issues relating to taxpayers affected by the Phoenix Pay System. Emergency salary advances and priority payments received in 2016 will be included on the T4 slip. There are various implications in the case of receiving overpayments depending on the timing of the repayment. Where a taxpayer is not paid an amount receivable in respect of 2016 until 2017, the amount received is taxable in 2017. If as a result of this there is an increase in taxes or decrease in benefits, taxpayers may submit a claim. Taxpayers affected by the payroll system are still required to file their personal income tax returns by April 30, 2017. See *Questions and Answers — Tax Implications of Phoenix payroll issues* on the CRA website for further guidance.

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.

Court Imprisons Man who Counselled Tax Evasion

***The Queen v. Lawson*, 2017 DTC 5006 (British Columbia Supreme Court)**

In *Lawson*, the British Columbia Supreme Court imposed a sentence of 18 months of incarceration and a fine of over $30,000 on a man who was found guilty of tax evasion and counselling others to defraud the Canadian tax authorities by teaching "Paradigm theories" designed to deprive the government of tax revenue. In her oral reasons, Watchuk J. emphasized the fact that the scheme took aim at the relationship of trust between government and taxpayers.

The accused, Keith David Lawson, was found guilty by a jury of:

(i) counselling fraud, pursuant to paragraph 464(*a*) and section 380 of the *Criminal Code* (the "Code");

(ii) income tax evasion, pursuant to paragraph 239(1)(*a*) of the *Income Tax Act* (Canada) (the "Act"); and

(iii) goods and services tax ("GST") evasion, pursuant to paragraph 327(1)(*c*) of the *Excise Tax Act*.

It fell to Watchuk J. to determine a fit and appropriate sentence for Mr. Lawson in light of these convictions.

The offences related to Mr. Lawson's activities as an instructor for the Paradigm Education Group ("Paradigm"), which was in the business of teaching its students how to evade the payment of Canadian taxes. Through presentations and the sale of written and videotaped materials, the founder of Paradigm, Russell Porisky, instructed teachers such as Mr. Lawson to educate students about the scheme, which was based upon bizarre and unfounded theories about how individuals can structure their affairs so as to avoid being subject to tax.

The evidence indicated that Mr. Lawson was involved with Paradigm from 2001 to 2010 and taught the Paradigm theories to approximately 33 students, all of whom paid a percentage of their income in consideration for instruction and materials. In addition, Mr. Lawson used the Paradigm theories to evade payment of his own taxes.

At his sentencing hearing, Mr. Lawson argued for a conditional sentence of two years less one day in respect of his conviction for counselling fraud and the minimum fines that may be imposed in respect of his convictions for income tax and GST evasion (i.e., 100% of the total tax evaded). The Crown argued for a total of two years of imprisonment, comprising (i) a six-month jail sentence for each of the tax evasion offences, to be served concurrently, and (ii) an 18-month jail sentence in respect of counselling fraud, to be served consecutive to the jail time imposed in respect of tax evasion. In light of Mr. Lawson's financial difficulties, the Crown agreed that the Court should impose the minimum fines in respect of the income tax and GST evaded.

Watchuk J. noted that, in order to be fit, a sentence must be proportionate to both the gravity of the offence and the degree of responsibility of the offender. There was no dispute that the fit sentence for counselling fraud was jail time of up to two years; the issues were the length of the sentence and whether the sentence should be served in the community or an institution. With respect to Mr. Lawson's convictions for income tax and GST evasion, the issue was whether to impose a jail sentence in addition to the minimum fines noted above.

Watchuk J. stated that a conditional sentence was available for the offence of counselling fraud, so long as it would not endanger the community and was consistent with the fundamental purposes and principles of sentencing set out in the Code.

Watchuk J. was satisfied that sentencing Mr. Lawson to serve time in the community would not endanger the community. She then turned to whether a conditional sentence would be consistent with the sentencing objectives of denunciation and deterrence.

Mr. Lawson argued for a conditional sentence on the basis of his remorse, lack of prior criminal record, good reputation in the community, and personal circumstances such as significant health problems and the hardship incarceration would impose upon his family. He noted that conditional sentences had been imposed in other tax cases, and cited jurisprudence to support his position that a conditional sentence can provide sufficient deterrence and denunciation "even in serious cases of tax evasion where deceitful intent is present." Mr. Lawson also argued that he ceased involvement with Paradigm once it became clear the theories being taught were illegal. In addition, Mr. Lawson argued for leniency on the basis that his promotion of the Paradigm theories was not hidden from the public.

The Crown argued that a conditional sentence would not satisfy the objectives of denunciation and deterrence in Mr. Lawson's specific case, and furthermore, that the sentences of other Paradigm educators had been made conditional only where those educators had pleaded guilty and joint submissions were made. The Crown also submitted that the Paradigm theories were "blatant in their falsehood and subversion of the law" and constituted "organized pseudo-legal commercial arguments".

Watchuk J. disagreed with Mr. Lawson's assertion that he had shown sincere remorse. Watchuk J. also noted the jury's finding that Mr. Lawson had actual knowledge that the Paradigm scheme was illegal but that he continued both teaching and using it in respect of his own tax returns. Watchuk J. held that a lack of concealment of his teachings did not render Mr. Lawson less responsible and that Mr. Lawson had employed deceit in teaching the theories to his

students. In addition, Watchuk J. noted that the Paradigm scheme did not simply encourage tax evasion, but sought to undermine the relationship of trust between the government and taxpayers that underpins the entire tax system. In effect, the Paradigm theories taught by Mr. Lawson "promoted disorder or revolt against the established rules and laws of Canada." Watchuk J. concluded that Mr. Lawson's actions throughout the proceedings indicated a "continued mindset of mistrust and defiance of authority, the CRA and the courts, and require[d] a sentence that addresses specific deterrence."

Watchuk J. held that the sentencing principles of deterrence and denunciation required that Mr. Lawson be incarcerated. As Watchuk J. stated, "[n]ot only was tax revenue lost from Mr. Lawson's repeated tax evasion, but the fabric of Canadian society was undermined by the actions of Mr. Lawson as he taught the Paradigm theories and participated with Mr. Porisky over eight years." In addition, the fact that the offences were "planned and deliberate profit-motivated crimes" militated in favour of incarcerating Mr. Lawson.

Watchuk J. sentenced Mr. Lawson to a total of 18 months of imprisonment in an institution, comprising: (i) six months for each of the offences of income tax evasion and GST evasion, to be served concurrently, and (ii) 12 months for the offence of counselling fraud, to be served consecutive to his incarceration for tax evasion. Watchuk J. also imposed the minimum fine of 100% of the income tax and GST Mr. Lawson evaded in respect of his own returns ($30,717.60), and ordered that a DNA sample be taken from him pursuant to the Code.

It is worth noting that this is not the harshest sentence that has been recently imposed in respect of similar offences. In *R. v. Blerot* (2014 DTC 5029 (SKQB)), for example, a Paradigm educator was sentenced to three years and seven months of jail time in addition to a fine. Nonetheless, the reasons of Watchuk J. demonstrate the seriousness with which the courts take these crimes. In sentencing Mr. Lawson to 18 months of incarceration (including 12 months for counselling fraud), Watchuk J. focused on the sentencing principles of deterrence and denunciation. She noted prominently both the deceit employed by Mr. Lawson in teaching students the Paradigm theories and the nature of the teachings themselves, describing them as promoting disorder or revolt against the established rules and laws of Canada. This is consistent with the Supreme Court of Canada's statement in *Knox Contracting Ltd. v. The Queen* (90 DTC 6447) — quoted by Watchuk J. in this decision — that the Act poses a "fundamentally important public duty". The sentence imposed on Mr. Lawson should be taken under advisement by anyone who may consider engaging in similar activities to defraud Canadian tax authorities.

Mr. Lawson has filed an appeal in respect of this matter.

— *Ryan Walker*

Attempt To Modify Stock Option Plan To Allow Participants To Exercise Options Prior to a Sale of Business Runs Afoul of Prescribed Share Requirement in Paragraph 110(1)(*d*)

***Montminy v. The Queen*, 2017 DTC 1005 (Tax Court of Canada)**

In this decision, the Tax Court considered whether certain shares issued pursuant to an employee stock option program qualified as "prescribed shares" for the purposes of section 6204 of the *Income Tax Regulations* (the "Regulations"). Paragraph 110(1)(*d*) of the *Income Tax Act* (the "Act") allows an employee to deduct 50% of the employment benefit that arises when the employee exercises his or her options. The deduction is, however, subject to certain requirements, including that the shares issued pursuant to the option program qualify as "prescribed shares".

In this case, the option holders were management employees of an industrial IT consulting, design, and development business, Cybectec Inc. ("Cybectec"). On May 1, 2001, Cybectec established an employee stock option program pursuant to which, on December 17, 2001, it issued to its officers and managers options with an exercise price of $0.20 per share.

The terms of the option agreement provided, in effect, that the options could not be exercised until the earliest of:

- an initial public offering;
- a sale of all of the issued and outstanding shares of Cybectec; and
- the tenth anniversary of the date on which the options were granted.

In 2007, Cybectec received an unsolicited offer from Cooper Industrial Electrical Inc. to buy substantially all of Cybectec's assets. As the form of the deal (asset sale rather than share sale) would exclude the option holders from being able to exercise their rights under the plan, Cybectec's board of directors passed a written resolution authorizing employees with options under the stock option plan to exercise their options.

Cybectec sent a letter to each of the option holders advising them of the resolution, but in the body of the letter advised that, upon exercise of the options, each option holder would be obligated to sell the shares received to 9135-8184 Québec Inc., the parent company to Cybectec. Nine employees, including the appellants, endorsed the letter agreement, and, on January 28, 2007, Cybectec issued shares from its treasury to the employees at $0.20 per share. On the same day, these shares were sold to 9135-8184 Québec Inc. at $1.2583 per share.

In accordance with the provisions of paragraph 110(1)(*d*) of the Act, seven of the employees attempted to claim deductions in their 2007 tax returns corresponding to 50% of the taxable benefit arising on the exercise of their options. On reassessment, the Minister of National Revenue denied their deductions on two grounds: first, the Minister argued that the optioned shares were not prescribed shares within the meaning of section 6204 of the Regulations; and second, the Minister alleged that the exercise price of $0.20 was less than the fair market value of the shares at the time the options were granted, which the Minister alleged was $0.3246, putting the options "in the money" and offside under the provisions of paragraph 110(1)(*d*). The option holders appealed the reassessment, giving rise to the present proceeding.

Subsection 6204(1) of the Regulations describes the conditions a share must meet in order to qualify as a prescribed share. Subparagraphs 6204(1)(*a*)(i) through (vi) list certain terms and conditions that must be met by both a share and any agreement in respect of the share and its issuance to ensure the share is a so-called "plain vanilla" common share. Paragraph 6204(1)(*b*) further requires that, at the time the share was issued, neither the issuing corporation nor a specified person in relation to the corporation can reasonably be expected to redeem, acquire, or cancel the share within the following two years. Subsection 6204(3) defines a specified person for purposes of subsection 6204(1) to be any person with whom the corporation does not deal at arm's length (although with certain carve-outs for persons who might otherwise be deemed offside solely by virtue of paragraph 251(5)(*b*) of the Act). Paragraph 6204(1)(*c*) prevents an issuer from circumventing paragraph 6204(1)(*a*) by way of an amendment to the terms and conditions of the share subsequent to its sale or issue.

The appellant option holders conceded that there was an expectation that 9135-8184 Québec Inc., which was a corporation that did not deal at arm's length with Cybectec, would immediately purchase the shares received by the appellants pursuant to the option program. However, the appellants nonetheless argued that the shares were prescribed shares under subsection 6204(1) of the Regulations.

The appellants based their argument on a reading of paragraph 6204(2)(*c*) of the Regulations which they argued should allow them to disregard the normal requirement in paragraph 6204(1)(*b*) that at the time of issue there be no reasonable expectation that the issuing corporation or a specified person would acquire the shares within the two year holding period.

Paragraph 6204(2)(*c*) provides for a carve-out when applying the rules in subsection 6204(1), allowing for a right or obligation to exist which enables the issuer to redeem, acquire, or cancel a share in certain circumstances. This provision does not expressly deal with the "reasonable expectation" provisions of paragraph 6204(1)(*b*).

According to the appellants, if Parliament had intended for the carve-out to apply only to the restriction on the share terms in paragraph (1)(*a*) and not the "reasonable expectation" in paragraph (1)(*b*), it would have so specified rather than stating that paragraph 6204(2)(*c*) applies for the purposes of all of subsection (1).

The appellants further argued section 6204 of the Regulations was meant to prohibit the mischief of compensation being disguised as stock options, and that their share program had been implemented to retain key employees rather than take advantage of the employee stock option deduction in paragraph 110(1)(*d*) of the Act to shelter guaranteed compensation.

The Tax Court rejected the appellants' arguments, finding instead that the paragraph 6204(2)(*c*) carve-out could not be applied to paragraph 6204(1)(*b*) to relieve the appellants of having to satisfy the requirement that, upon issuance of the shares, there be no reasonable expectation that the shares will be acquired in the following two years by the issuer or a specified person.

According to the Tax Court, the time for determining if a share is a prescribed share for purposes of paragraph 110(1)(*d*) is at the time of a share's issue. In the view of the Tax Court, paragraph 6204(1)(*b*) concerns *expectations* about potential redemptions, acquisitions, and cancellations, whereas paragraphs 6204(1)(*a*) and 6204(2)(*c*) concern *rights and obligations* then in existence.

In order to reach the conclusion that paragraph 6204(2)(*c*) was limited to the provisions of paragraph 6204(1)(*a*), the Tax Court undertook an analysis of paragraphs 6204(2)(*a*) and (*b*) to demonstrate that each such paragraph had a logical connection with particular subparagraphs of paragraph 6204(1)(*a*). This logical connection test led the Tax Court to its conclusion that, structurally, the provisions of subsection 6204(2) were meant to modify particular components of paragraph 6204(1)(*a*) and not paragraph 6204(1)(*b*).

Purposively, the Tax Court found that if paragraph 6204(2)(*c*) could be used to override the restriction in paragraph 6204(1)(*b*), it would frustrate Parliament's goal of ensuring that employees are exposed to some level of risk (implicitly two years' worth) by participating in a stock option plan instead of simply receiving a benefit in the form of additional remuneration.

Despite having concluded that the appellants could not use the paragraph 110(1)(*d*) deduction because the shares they received were not prescribed shares, the Tax Court went on to consider whether or not the stock options had been granted at a strike price less than the fair market value of Cybectec's shares in violation of the requirements of paragraph 110(1)(*d*).

After assessing the positions of both the appellants and the Minister on various forecasting and discounting mechanics, the Tax Court accepted that the appellants' valuation of the shares was superior and the options had not been issued "in the money" in violation of the requirements of paragraph 110(1)(*d*). Of note in its reasons for judgment is the Tax Court's criticism of a report prepared by an expert for the Minister which contained analysis conducted by a third party the expert had not verified and could not justify.

This decision is noteworthy because it represents the first time the Tax Court has considered the interaction of the various provisions of section 6204 of the Regulations. The Tax Court itself acknowledged that these provisions are complex, and seemed to lament that an apparently innocuous attempt to modify an otherwise plain vanilla stock option program had fallen afoul of the regime. In an unusual bit of *obiter dictum*, the Tax Court went so far as to agree with the appellants that if Cybectec had employed a different strategy to allow its employees to participate in the acquisition, the shares could have qualified as prescribed shares. In concluding its analysis of the section 6204 issue, the Tax Court called upon Parliament to reform the regime, which it felt to be overly complicated given the popularity of stock option plans as a means of retaining key employees.

While presumably not argued before the Tax Court, there was a possible interpretation of the provisions that could have given effect to the introductory text in subsection 6204(2), which plainly states that the provision applies to all of subsection 6204(1): while it is true that paragraph 6204(2)(*c*) concerns rights and obligations, and although paragraph 6204(1)(*b*) concerns expectations, in this interpretation paragraph 6204(2)(*c*) could still apply to the latter provision so that the reasonableness of the expectation that the issuing corporation would acquire the shares during the two years following their issuance would have to be based on more than the mere existence of a right or obligation for the issuer to acquire those shares. Admittedly, this reading of the provision might not have been of much assistance to the appellants since there was a clear expectation apart and aside from the rights and obligations conferred in the letter agreement that 9135-8184 Québec Inc. would purchase the shares issued under the program.

The Tax Court's decision has been appealed by the taxpayer to the Federal Court of Appeal.

— *Justin Shoemaker*

Recent Tax Court Guidance on Valuing Private Corporation Shares

***Ozerdinc Family Trust No. 2 et al v. The Queen*, 2016 DTC 1210 (Tax Court of Canada)**

Fair market value is easier to calculate (not surprisingly) where there is a market. Difficulty arises when one tries to value shares of a private corporation for which there may be no ready market. In *Ozerdinc*, the Tax Court provides guidance on how fair market value of private corporation shares should be assessed.

The dispute in this case arose in the context of the 21-year deemed disposition rule for trusts in subsection 104(4) of the *Income Tax Act* (the "Act"). Generally speaking, this rule forces trusts to recognize accrued gains on certain properties held by the trust by deeming the trust to have disposed of and to have reacquired such properties at their fair market values every 21 years.

The sole issue on appeal was the fair market value of the taxpayer trust's interest in "Holdco", a private corporation of which the trust held common and preferred shares. Holdco's main asset was 100% of the shares of the corporation "SPL". The trustees of the taxpayer trust were two individuals — a husband and wife, Mr. Ozerdinc and Ms. Grimes — who were also the directors of SPL. The trust had a minority interest in Holdco, which was controlled by Ms. Grimes by way of ownership of 69% of the voting rights in Holdco.

"Fair market value" is not defined for purposes of the Act, so its definition is left to case law. The jurisprudence generally looks to the highest price that would be paid for the asset in the market. Where no market exists, the exercise is to estimate this price based on the factors which would influence value in a hypothetical market.

The focus of the Tax Court decision was on whether the three factors set out in the following comments should influence the fair market value calculation.

First, the Tax Court considered whether advances made by SPL to its directors (Mr. Ozerdinc and Ms. Grimes) and by Holdco to the trust as its shareholder should reduce the value of the SPL and Holdco shares, respectively.

SPL's practice was to pay advances to its directors throughout the year, which were set off at the end of the year by declaration of a bonus to the directors. The directors did not receive regular salary from SPL; instead, they received only this annual bonus as compensation for their work.

The Holdco advance was made to Ms. Grimes in her capacity as trustee of the trust in order to purchase property on behalf of a beneficiary of the trust. Following the end of the year, Holdco paid a dividend to the trust by way of set off against such advance.

Since the bonuses and the dividend were not declared until year-end (or later), and the relevant valuation date was during the year, the Tax Court considered whether the advances should be viewed as ordinary receivables of SPL and Holdco (as they technically were at the valuation date, which was during the year and before the bonuses and dividend, respectively, were determined), or reduced or ignored given the subsequent payment of offsetting bonuses or dividends.

The Tax Court held that the advances to the directors should be viewed as a liability of SPL at the valuation date and should reduce the fair market value of SPL on that basis. It was SPL's practice to pay bonuses to the directors in this manner, and a hypothetical buyer and seller would take these annual bonuses into account in determining the price of the SPL shares. While hindsight should not, as a general rule, be used to determine fair market value, it is acceptable to use hindsight to test the reasonableness of assumptions made by the valuators — in this case, the assumption that bonuses would be so declared at the end of the relevant taxation year.

In contrast, the Tax Court held that Holdco's advances to the trust should be viewed as an ordinary receivable of Holdco. Unlike the bonuses, it was not Holdco's practice to make such advances to the trust set off against a dividend, and so the same argument for the application of hindsight could not be made.

Second, the Tax Court considered the effect on value of embedded income taxes that Holdco's shareholders would have to pay on redemption of Holdco's shares. While a prudent purchaser would consider potential taxes where the corporation was near liquidation, in the case of a corporation which operated as a going concern (as Holdco did), tax on distribution could be deferred. As such, the Tax Court held that such embedded taxes should not reduce Holdco's fair market value.

Third, the Tax Court considered whether a minority or marketability discount should be applied. A minority discount is typically applied in valuing private corporation shares to account for lack of control, and a marketability discount is typically applied where there is a lack of marketability for the shares.

The Crown's position was that neither discount should be applied here on the basis that the trust was not in a true minority position because one of its trustees (Ms. Grimes) controlled Holdco, and Holdco and SPL's assets were marketable (mostly current assets and marketable securities).

The Tax Court rejected the Crown's submissions and applied both a minority and a marketability discount. The minority discount was relevant because it was not correct to assume that the shares of Holdco would necessarily be sold in their entirety, even though the corporation was family-controlled. Further, the relevant consideration for marketability is the marketability of the Holdco shares, and not the marketability of Holdco as a whole (which was what the Crown had considered in evaluating the marketability of Holdco and SPL's assets). The Tax Court held that Holdco's shares were not marketable (there were no put arrangements, there was a limited market for the shares, there were no redemption policies, and there had historically been limited distributions on the shares and limited assurance as to future distributions). Since the marketability determination is influenced by the lack of control, the Tax Court adjusted the marketability discount so as not to double-count for the trust's minority interest in Holdco.

Although valuation cases are fact-specific, the Tax Court provides some useful guidance here into the nature of the approach and the sorts of factors which are relevant in determining the fair market value of private corporation shares.

— *Amanda Laren*

Taxpayer's Complacency Renders Invalid Claims of Estoppel by Representation

***Vallelunga v. The Queen*, 2016 DTC 5132 (Federal Court of Canada)**

The Vallelunga case is an interesting decision that considers the applicability of the doctrine of estoppel in the tax law context.

In *Vallelunga*, the taxpayer's father transferred real estate to the taxpayer for less than fair market value. On the basis of this non-arm's length transfer, the taxpayer was assessed by the Minister for approximately $69,000 pursuant to section 160 of the *Income Tax Act* (the "Act"). The Minister secured the debt by causing a memorial to be issued by the Federal Court pursuant to section 223 of the Act. The memorial was registered against the title of the real estate in November 2007. In 2012, the taxpayer decided to sell the real property in question, and obtained both a Client Summary from the Minister (which stated that his account balance was zero) and a copy of the lien from the Land Registry Office (which stated that the outstanding debt was approximately $69,000, plus interest). In order to complete the sale of the property, a holdback in the amount of $150,000 was set aside until the apparent discrepancy between the lien and the Client Summary was resolved. The taxpayer did not contact the Minister to seek resolution or clarification with respect to the discrepancy.

In an application by the taxpayer to the Federal Court to cancel the memorial and all associated interest and penalties (the total amount being approximately $160,000), the taxpayer argued that the Minister's representations (made in the context of the Client Summary) resulted in the doctrine of estoppel by representation applying.

In the course of determining whether the doctrine of estoppel by representation applied, Boswell J. noted that the three essential factors giving rise to an estoppel by representation were set out in *Canadian Superior Oil Ltd. v. Paddon-Hughes Development Co.* (1970 SCR 932) as follows:

> (1) A representation or conduct amounting to a representation intended to induce a course of conduct on the part of the person to whom the representation is made.
>
> (2) An act or omission resulting from the representation, whether actual or by conduct, by the person to whom the representation is made.
>
> (3) Detriment to such person as a consequence of the act or omission.

Additional requirements as set out in *Canada (Attorney General) v. Jencan Ltd.* ([1997] FCJ No. 876) and *Livingstone v. Jannetta Livingstone* (1932 SCR 175) are that the representation needs to be unambiguous and unequivocal, and not known to the party relying on the representation. In addition, the Court cited authority to suggest that estoppel will not bind the Minister in instances in which to do so would result in "a contrary result to that set out in a statute [. . .]". In the tax context, the Court noted that the Crown may be bound by estoppel "where a statute allows a government official some discretion."

In light of the case law, Boswell J. held that the doctrine of estoppel by representation did not apply to erase the taxpayer's outstanding income tax debt. Furthermore, Boswell J. noted that, pursuant to *Maritime Electric Co. v. General Dairies Ltd.* ([1937]1 DLR 609), estoppel cannot be used to remove an obligation to obey a statute or, as in this case, to pay a valid and binding tax assessment.

The Court held that the Minister did not represent to the taxpayer that the tax debt was forgiven and, therefore, held that the taxpayer had failed, in a fundamental sense, to establish an estoppel by representation. With respect to the taxpayer's failure to establish the first prong of the test, or the requisite intention, the Court held that:

> [T]he Client Summary was not a clear and unequivocal representation intended to induce the Applicant to sell his property in the belief that the lien against the property would be or had been removed. [. . .] Nothing in the Client Summary warrants that there are no other assessments against a taxpayer who relies upon it. Indeed, the words used in the Client Summary, e.g., "status of return", "instalments" and "payments made on filing", are suggestive of assessments made with respect to annual income tax returns.

Furthermore, the taxpayer could not satisfy the second prong of the test, as there was no act or omission resulting from the representation made in the Client Summary. Despite the fact that the taxpayer was notified on numerous occasions prior to the sale of the property about the assessment, the debt, and the collection of debt, the taxpayer never contacted the Minister to inquire further about the debt or the Minister's intention to register a lien. Consequently, the taxpayer had failed to establish he was unaware that the alleged representation in the Client Summary was false.

Lastly, the Court held that the taxpayer had not suffered any detriment by "allegedly" acting on the representation in the Client Summary. From a practical perspective, "[e]ven if the Applicant had never received the Client Summary, he still would have likely been compelled to agree to the holdback to effect sale of the property, unless he contacted the CRA and had the lien discharged." Moreover, the Court held that the fact that the taxpayer failed to contact the Minister and have the lien discharged prior to the sale of the property underscored the "lack of detriment" suffered by the taxpayer as a result of the representation made in the Client Summary. As a result, the taxpayer's application under subsection 223(7) of the Act was dismissed, with costs awarded to the Minister.

Although the decision has been appealed to the Federal Court of Appeal, this judgment sends a clear message that taxpayers whose conduct suggests complacency with respect to resolving and clarifying alleged representations will not be permitted, at least in the tax context, to rely on such representations for the purposes of evoking the doctrine of estoppel by representation to avoid liability for amounts outstanding under the Act.

— *Krupa Kotecha, Articling Student*

RECENT CASES

Rectification remedy refused in absence of prior written document incorrectly recording intent of parties

The taxpayer was a personal trust in which the trustees were empowered to sign a trust minute to make amounts payable to its sole beneficiary. The trustees had executed such a trust minute each year from 2002 to 2011, allocating all of its income to the beneficiary. In 2011, the Canada Revenue Agency initiated a review of the trust's 2008 through 2010 tax returns and that review led to the issuance of reassessments for those years. The trustees filed Notices of Objection to the reassessments. They also determined that, in light of certain designations made by the CRA in the reassessments, making an allocation of income for 2012 might be contrary to the *Income Tax Act* and consequently a breach of their fiduciary duties. They therefore exercised their discretion not to execute a trust minute for 2012. The dispute raised by the Notices of Objection was eventually settled and the designations made by the CRA were reversed. The trustees then applied to the Federal Court for an order permitting them to sign a trust minute making an income allocation to the trust beneficiary for the 2012 tax year and allowing it to amend its tax return for 2012 to reflect that change.

The application was dismissed. The Court held that the issue for determination was whether the trustees' decision not to allocate income to the beneficiary in 2012 was a mistake that ought to be remedied either by application of the doctrine of rectification or by the inherent jurisdiction of the Court. It noted that recent Supreme Court of Canada jurisprudence held that a common continuing intention of tax efficiency is insufficient to establish an entitlement to rectification. Rectification is limited to cases where a written instrument has incorrectly recorded the parties' antecedent agreement. It is not available where the basis for seeking it is a party's wish to amend, not the instrument that records the agreement, but the agreement itself. The Court held that, on the evidence, there was no written agreement or other document which incorrectly recorded the petitioner's intentions at the time that the document was prepared. The doctrine of rectification was therefore not available to the petitioner. The Court then considered whether relief should be provided based on the inherent jurisdiction of the Court, and concluded that it should not. In the Court's view, the decision made by the trustees to refrain from making an allocation of income for the 2012 tax year was a decision made by sophisticated individuals, based on professional advice, and was the result of the exercise of the trustee's judgment. The trustees were now, in effect, seeking the assistance of the Court to take a different course of action than they took in 2012 as a result of hindsight. In the Court's view, the fact that the dispute with the CRA was settled was not an admission that the CRA was in error and, in addition, there was nothing improper about the CRA settling a taxpayer dispute when the facts and/or the law are unclear. The Court concluded that a court order was not necessary in order for the trustees to execute a trust minute providing for an income allocation for the 2012 tax year and for the CRA to decide whether to give that allocation retroactive effect. Similarly, the trustees were free to file an amended trust tax return for 2012, under the provisions of the *Income Tax Act* dealing with the reporting, filing, and assessing of income tax. The Court held that the Tax Court of Canada possessed exclusive original jurisdiction to determine appeals from tax assessments, while the Federal Court exercised supervisory powers over the CRA in respect of its application of the *Income Tax Act*. In the Court's view, an order from the Federal Court that the petitioner be permitted to amend its 2012 return would amount to the Court exceeding its jurisdiction.

BC Trust v. AG of Canada

2017 DTC 5017

CRA's Requirement to Pay having priority with respect to funds paid into Court

The Canada Revenue Agency had issued a Requirement to Pay in respect of a company known as Falcon Creek Industries Inc. resulting from unremitted payroll source deductions. That company had entered into a contract with the Manitoba Housing and Renewal Corporation ("MHRC") to act as the general contractor for a construction project on a residential housing complex. There were funds which had been held back in relation to that project, and a dispute arose over the holdback funds and who was entitled to them. MHRC brought an interpleader application seeking to pay the funds into Court and obtain an order that, once such payment was made, any liability it had in relation to those funds was extinguished. The application was opposed by a bonding company and an unpaid subcontractor, which argued that MHRC did have an interest in the funds and a legal obligation to pay the funds to them.

The application was allowed. The Court held it was common ground that, if the funds in question were payable to Falcon Creek as the general contractor, then MHRC would be required to pay those funds to the CRA pursuant to the Requirement to Pay, as subsection 224(1.2) of the *Income Tax Act* would give priority to that Requirement to Pay over the interests of the subcontractors. The respondent subcontractors and the bonding company took the position that, as the funds were payable to them and not Falcon Creek, subsection 224(1.2) did not come into operation. The Court rejected that argument, holding that the private arrangements between MHRC, Falcon Creek, and the bonding company could not affect the rights of the Crown under subsection 224(1.2). In the Court's view, the Crown acquired its rights by operation of law and the issuance of the Requirement to Pay and those rights could not be displaced by private arrangements. In addition, in the Court's view, there were important policy considerations involved in the collection of withholding tax or source deductions, as they were integral to collection procedures for Canadian personal income tax. The Court also rejected the argument put forward by the respondents that the bonding company was subrogated to the position of MHRC and an argument based on the third party beneficiary exception to the general rule respecting privity of contracts. It concluded that MHRC had no obligation, in the circumstances, to pay the disputed funds to the bonding company or to the unpaid subcontractors. Consequently, MHRC had no interest in the funds, was entitled to interplead them, and was granted the extinguishment order sought. It followed that the funds were payable to the

general contractor, Falcon Creek, and that, while such funds were subject to lien and trust claims in favour of the unpaid subcontractors, the CRA's Requirement to Pay took priority over those claims. The CRA was therefore entitled to the funds that were to be paid into Court.

Manitoba Housing Renewal Corp. v. Able Eavestroughing Ltd. et al.

2017 MBQB 27

The liquidator of the estate could elect for a tax-free rollover in respect of a rental property even if the surviving spouse beneficiary disagreed

Following A's death in 2012, her spouse B inherited the family residence and a rental property, and seven relatives (including C, liquidator of the estate) inherited the remainder of the estate. B and C could not agree on the disposition price of the rental property because C wanted to elect for a low price (i.e., adjusted cost base of property) to reduce the immediate tax implications for the estate and B wanted to elect for a high price (i.e., fair market value of property) to reduce his future capital gain when he would sell the property. Because of his disagreement with C, B only took possession of the rental property in 2015 and has not yet taken possession of the family residence. The Court had to decide what the sales proceeds of the rental property would be, and dispose of: (1) Claims by B against the estate: $391,352 re mismanagement of the rental property; $10,000 re moral damages; and $6,000 re punitive damages; and (2) Claims by the estate against B: $57,239 re family residence expenses; $5,903 re deposit with the lawyer; $15,000 re legal fees; and $5,000 re punitive damages. The Court had to determine the validity of each of those claims.

The appeal was dismissed in the main. Regarding the tax-free rollover of the rental property, the Court held that the terms of the will were clear and allowed C, not B, to determine the tax treatment of the rental property for the benefit of the estate. The property was deemed to be transferred to B at a price of $385,679 (i.e., its adjusted cost base, not its fair market value). This was the case even if B assumed that the estate would bear the tax impact of the property transfer when he accepted the bequeath. The liquidator was justified to elect for a tax-free transfer of the rental property to the surviving spouse for the benefit of the estate and other beneficiaries. The claims made by B against C were reduced to $13,804 (i.e., $10,804 re property mismanagement and $3,000 re moral damages). Those made by C against B were reduced to $56,708 re family residence expenses and $5,903 re deposit with the lawyer. All other claims were dismissed by the Court. Since the appeal was dismissed in the main, all legal costs of both parties had to be paid by the appellant.

Picard v. Succession de Lagotte

2017 DTC 5023

Minister's jeopardy collection order vacated

Mr. Khunkhun was the sole director and shareholder of the respondent corporation (the "Respondent"), which was in the process of dissolution. Mr. Khunkhun also owned and controlled a corporation known as RA Homes, to which the Respondent had lent funds. RA Homes used those funds to purchase certain real estate holdings, which it transferred away. Alleging that the Respondent owed in excess of $929,000 in tax as a result of a disallowed charitable donation claim, the Minister obtained an *ex parte* jeopardy collection order. The Minister's concerns, in part, were that: (a) the Respondent had engaged in unorthodox financial behaviour; (b) it was possible that money was being spirited away by the Respondent and Mr. Khunkhun to avoid tax collection efforts; and (c) there had been possible securities fraud on the part of a third party attempting artificially to raise the price of certain corporate shares with respect to which the Respondent had held a purchase option, although no such security fraud claims were ever made directly against either the Respondent or Mr. Khunkhun. The Respondent filed a motion with the Federal Court for an order setting aside the jeopardy collection order.

The Respondent's motion was granted. In setting aside a jeopardy collection order the issue to be determined is not only whether the taxpayer has the assets to pay the tax debt in issue, but whether the collection itself is at risk from the delay in effecting that connection (see *Danielson v. Canada (Deputy Attorney General)*, [1987] 1 FC 335). In the present proceedings Mr. and Mrs. Khunkhun had in excess of $2.8 million in equity in their family home alone, and there was no evidence that Mr. Khunkhun was attempting to evade the payment of tax or to move assets outside of

the jurisdiction. The Minister's position was based on suspicion, and on his view (which was untenable) that it is unorthodox for companies to be structured in such a way as to legally minimize their liabilities. In this case, moreover, which was unlike those in which jeopardy collection orders had been affirmed, there was no evidence of criminality or questionable and nefarious behaviour on the Respondent's part. The Respondent also provided evidence to show that it was able to pay the tax debt outstanding, and the Minister chose not to cross-examine that evidence, so it was taken to be true. From the foregoing findings, the conclusion was that the Minister failed to justify the continued need for the jeopardy collection order that had been issued in this case, inasmuch as his emphasis on the Respondent's alleged unorthodox behaviour as a cornerstone of his case was simply unsupported. The order was therefore vacated.

MNR v. 684761 B.C. Ltd.

2017 DTC 5010

Minister bound by terms of agreement not to reassess as long as taxpayer upholds its undertakings

The taxpayer brought an application for judicial review, challenging a demand letter sent to him in January 2013 by the Minister seeking information regarding his tax returns for 2006 and 2007. The taxpayer was the sole common shareholder of two corporations, one of which acted as a nominee for the taxpayer and family members in conducting straddling transactions in 2006 and 2007. Business losses were claimed in December 2006 and capital gains were reported in January 2007. After an extensive audit of his 2006 and 2007 taxation years, focusing on partnership losses sustained in 2006 and capital gains reported in 2007, the taxpayer and the Minister entered into an agreement in February 2010. Under the terms of the agreement, the Minister stated it was satisfied with the reporting positions taken by the taxpayer for 2006 and 2007. The Minister agreed not to proceed with any reassessment for 2006 and 2007 provided that the taxpayer refrained from entering into any further straddling transactions. If there was a change in the fact pattern upon which the conclusions were reached, the Minister would be able to review its position. The taxpayer did not engage in any further straddling transactions and there was no change of fact pattern. The Minister argued that the agreement did not prevent it from further auditing the taxpayer. The demand letter sent in January 2013 demanded information for 2006 and 2007, specifically with respect to the straddling transactions. The taxpayer argued that the agreement was binding and prevented the Minister from re-auditing and reassessing the 2006 and 2007 taxation years. The Minister argued that the agreement did not bar it from another audit and the agreement was only valid for the time at which it was signed. It argued that preventing it from re-auditing would fetter its administrative responsibilities and legislative powers to conduct audits.

The application for judicial review was granted. The 2010 agreement made it clear that there was to be no process leading to a reassessment whilst the taxpayer upheld his terms of the agreement. The 2013 demand for information was for the ultimate purpose of reassessment. The Minister's argument that the agreement only bound it at the time it was signed would mean it would not be obligated in the future. That interpretation is not rational. Entering into an agreement with a taxpayer does not fetter the Minister's duty to administer the *Income Tax Act*. The discretion to enter into agreements helps fulfil the administration and enforcement of the *Income Tax Act* and in no way disables the Minister's responsibilities. An agreement leads to certainty which is very important for the efficient administration of tax legislation. The Minister has no obligation to enter into agreements with taxpayers, but once an agreement is signed, it is valid and binding. The demand letter of January 2013 violated the terms of the 2010 agreement and the taxpayer did not need to respond to the demand for further information.

Rosenberg v. MNR

2017 DTC 5011

Lack of testing was fatal to claim for scientific research and experimental development expenses

The taxpayer was appealing a reassessment that denied its claim for scientific research and experimental development ("SR&ED") expenses. The taxpayer was a natural health product company, with ninety-two products on the market which focused on chronic care for patients dealing with late-stage cancer, multiple sclerosis, and AIDS. The expenses claimed related to the formulation of three new natural health products aimed at treating cancer, reversing neurological degradation, and removing arterial plaque. The taxpayer argued its activities constituted applied research and qualified for SR&ED claims.

The appeal was dismissed. To qualify for the SR&ED claim, there must be a systematic investigation carried out in the field of science by means of experiment or analysis with the objective of advancing scientific knowledge. There must be a technical risk or uncertainty and hypotheses must be formulated aimed at reducing or eliminating the uncertainty. The incentives are meant to encourage scientific research and should be given a fair and liberal interpretation to meet that goal. The taxpayer consulted with experts and reviewed clinical studies, and tested his formulations from pre-existing evidence of others and his own knowledge and clinical observations. While there was scientific uncertainty as to whether the natural health products could be effective, the lack of testing was fatal to the claim for the SR&ED expenses. No detailed records of the hypotheses were kept and no testing was done to gauge, verify, or assess the effectiveness of the products formulated by hypotheses alone. The taxpayer hypothesized formulations aimed at being effective in their abilities to mimic existing pharmaceutical products and minimize any possible adverse effects, but no detailed records were kept. The absence of testing means it is unknown whether the formulations represented any type of advancement of scientific knowledge. Literature review and consultation with experts are legitimate SR&ED activities, but they are not enough. In order for there to be a systematic investigation by means of experiment or analysis, testing is essential.

Life Choice Ltd. v. The Queen

2017 DTC 1011

Application for judicial review of denial of taxpayer relief application allowed

The taxpayer's father had, without the taxpayer's knowledge or consent, filed tax returns in the taxpayer's name and subsequently made representations to the Canada Revenue Agency concerning those returns for the 2004, 2005, and 2006 taxation years. In 2009, the taxpayer received reassessments for those taxation years, indicating that a substantial amount of taxes were owed and imposing interest and penalty charges, including gross negligence penalties. The taxpayer filed Notices of Objection to those reassessments, and a settlement was reached with the Canada Revenue Agency. A second reassessment was issued in 2014 in accordance with the terms of the settlement agreement and consent judgment, which fully reversed the first reassessments in respect of 2004 and 2005, and partially reversed the reassessment for 2006. The taxpayer paid the interest and penalty charges owed under the reassessment and then applied, under the Taxpayer Relief Program, for relief in respect of the interest and penalties levied for 2006. The first-level decision in response to that application provided relief in respect of arrears interest charged from the date of the first reassessment in 2009 to the date of the final reassessment in 2014. Relief with respect to such charges imposed in 2007 and 2008 was refused. The taxpayer sought a second-level review of that decision, which determined that no further relief was warranted. The taxpayer applied for judicial review of that second-level review decision.

The application was allowed. The Court held that the issues for determination were whether the decision made by the Minister was unreasonable and whether the Minister had fettered her discretion in the circumstances of the case. The applicant submitted, and the Court agreed, that the Minister's delegate had inconsistently applied the facts as they related to the extraordinary circumstances beyond the applicant's control. The Court noted that the CRA had agreed that the fraudulent conduct of the applicant's father was a circumstance beyond his control and held that such fraud pertained to the filing as a whole. The Minister's delegate had determined that such circumstance warranted relief from penalties and interest imposed only for the period from 2009 to 2014. The Court held that the standard of reasonableness required it to determine whether the decision made fell within a range of possible acceptable outcomes which were defensible in respect of the facts and the law. In the Court's view, with respect to the 2007 and 2008

taxation years, the decision made was unreasonable because of the apparent failure to apply the same factual finding in a consistent manner, leading to an arbitrary decision. The Court then considered whether the Minister had fettered her discretion in the circumstances of the case, and held that she had not. However, the application was granted on the basis that the second-level decision made under the Taxpayer Relief Program was unreasonable.

Pylatuik v. Canada (AG)

2017 DTC 5013

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