Tax Notes

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1245989 ALBERTA LTD.: TAX COURT APPLIES GAAR TO PUC AVERAGING TRANSACTION[1]

— Jeremy Ho, Associate, Dentons Canada LLP;
Margaret MacDonald, Associate, Dentons Canada LLP

In *1245989 Alberta Ltd. v. The Queen*[2] the Court considered whether the GAAR applied to a reorganization (the "Reorg") undertaken to spin out corporate business assets to two holding corporations. In the course of the Reorg the appellants increased the paid-up capital ("PUC") of certain preferred shares by relying on the PUC averaging rule in subsection 89(1) of the *Income Tax Act* (Canada)[3] (the "Act"). They did this to avoid section 84.1, which otherwise would have deemed the PUC to be reduced. As a result of the Reorg the individual owner-manager of the business could extract corporate surplus tax free. The Court upheld the Minister's application of the GAAR to deny the PUC increase.

Mr. Wild owned all the outstanding shares of P.W. Rentals Ltd. ("Opco"), an Alberta oilfield rental company. Mr. Wild's Opco shares had nominal adjusted cost base ("ACB") and PUC and an accrued gain. The Reorg occurred as follows:[4]

> (1) Mr. Wild sold some of his Opco shares to a newly incorporated corporation ("Holdco") for redeemable preferred shares of Holdco with a redemption amount equal to the fair market value of those Opco shares (the "Share Transfer"). Mr. Wild and Opco elected jointly under subsection 85(1) at an amount that resulted in Mr. Wild realizing a capital gain that he sheltered with his lifetime capital gains exemption. By virtue of paragraph 84.1(1)(*a*), the PUC of the Holdco preferred shares was reduced to the PUC of the transferred Opco shares.
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> (2) Opco then sold certain depreciable property (the "Property") to Holdco (the "Property Transfer") for preferred shares of the same class issued to Mr. Wild on the Share Transfer.[5] The shares issued to Opco had a redemption amount equal to the fair market value of the Property. The undepreciated capital cost ("UCC") of the Property was equal to the fair market value of the Opco shares. Opco and Holdco elected jointly under subsection 85(1) at an amount equal to the Property's UCC.

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[1] Sincere thanks go to Joel Nitikman for providing feedback and edits to an earlier version of this paper, although the authors take sole responsibility for any errors contained herein.

[2] 2017 DTC 1026 (TCC).

[3] RSC 1985, c 1 (5th Supp), as amended. All statutory references are to the Act.

[4] Additional transactions occurred as part of the Reorg, including a second set of similar transactions, whereby Mr. Wild transferred some of his Opco shares to another holding corporation ("Holdco 2") owned by his spouse. This was followed by a transfer of land and depreciable property from Opco to Holdco 2 and cross-redemption as described in steps 2 and 3. The Court's decision did not turn on the fact that these additional transactions had occurred.

[5] Under the *Business Corporations Act* (Alberta), a subsidiary is permitted to hold shares in its parent corporation for a maximum of 30 days. The shares issued to Holdco by Opco were subsequently redeemed within this permitted time period.

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(3) Holdco then redeemed the preferred shares issued to Opco in exchange for a promissory note with a principal amount equal to those shares' aggregate redemption amount. Opco then repurchased the Opco shares owned by Holdco and issued a promissory note in the same amount. The two corporations set off the notes against each other. Holdco then leased the Property to Opco for use in its business.

As Holdco issued shares of the same class as consideration for both the Share Transfer and the Property Transfer, the PUC averaging rule in subsection 89(1) caused an increase in the PUC of the shares Holdco issued to Mr. Wild that had been reduced by paragraph 84.1(1)(*a*). The averaging rule also reduced the PUC that would otherwise have been attributable to the shares that Holdco issued to Opco. The cross-redemption resulted in deemed dividends arising under subsection 84(3), but each corporation deducted the dividends under subsection 112(1).

The Minister sought to deny Mr. Wild's PUC increase by applying the GAAR.

In a statement of agreed facts, Mr. Wild and the Crown agreed that the Reorg was carried out for creditor-proofing reasons.

The Court began its analysis by reiterating the three-step GAAR test outlined by the Supreme Court of Canada in *Canada Trustco Mortgage Co. v. Canada*:[6]

(1) Was there a "tax benefit" arising from a "transaction" under subsections 245(1) and (2)?

(2) Was the transaction an avoidance transaction under subsection 245(3)? and

(3) Was the avoidance transaction abusive under subsection 245(4)?

Mr. Wild conceded that the first two steps of the GAAR analysis were met: there was a tax benefit and there were avoidance transactions.[7] However, the parties disagreed on the source of the tax benefit. Mr. Wild argued that the subsection 112(1) deduction was the source of the tax benefit because it offset gains and was the reason why the PUC shift worked. The Crown argued that subsection 89(1) was the source of the tax benefit because Mr. Wild directed and obtained the PUC increase through the issuance of shares of the same class on the Share Transfer and the Property Transfer. The Court sided with the Crown because if the same class of preferred shares had not been issued to Opco on the Property Transfer as had been issued to Mr. Wild on the Share Transfer, there would have been no PUC averaging and no tax benefit.

In determining whether the avoidance transactions were abusive, the Court, again referring to *Canada Trustco*, identified three types of abusive tax avoidance: (i) where a taxpayer relies on provisions to achieve an outcome the provisions are intended to prevent; (ii) where a transaction defeats the underlying rationale of the provisions relied on; and (iii) where a transaction circumvents the application of certain rules in a manner that defeats the object, spirit, or purpose of the provisions. The Court noted that one or more of the three types of abuse could occur in a given case. Furthermore, in determining whether abuse was present, the transactions had to be viewed in the context of the series of which they were a part and the overall result achieved.

The Court then considered subsection 89(1) and section 84.1 to determine their objects, spirits, and purposes.

The Court noted that the text of the PUC definition in subsection 89(1) says that PUC is calculated initially by reference to the capital stock (i.e., stated capital) of a corporation in respect of a class of shares and is then adjusted by the provisions listed in subparagraph 89(1)(*b*)(iii). As the PUC of shares of a particular class is determined by dividing the PUC of the class by the number of issued and outstanding shares, all shares of the class have the same PUC regardless of the capital contribution made by a particular shareholder. Contextually, the Court noted that there were anti-avoidance provisions in the Act, such as sections 84.1 and 212.1 and subsection 85(2.1), all of which reduce PUC. The Court concluded that the purpose of the definition of PUC in subsection 89(1) is to mirror the corporate law concept of stated capital, subject to adjustments under the Act, to ensure that the PUC, calculated and averaged

[6] 2005 DTC 5523 (SCC), [2005] 2 SCR 601.

[7] Although the parties agreed that the Reorg was carried out for creditor-proofing reasons, the appellants conceded that the Share Transfer and Property Transfer steps were avoidance transactions that resulted in a tax benefit.

within the class, represents accurately and is restricted to the total capital contributed by shareholders.

With respect to section 84.1, the Court noted that it applies to non-arm's length transfers of shares of a Canadian corporation by an individual resident in Canada to another such corporation where the corporations are "connected" immediately after the disposition of the shares. When section 84.1 applies, the PUC of the acquired corporation's shares is subject to a "PUC grind", whereby the increase in PUC of the acquired corporation's shares as a result of the transfer is limited to the PUC of the transferred shares. Contextually, the Court found that the Act's "PUC grind" provisions, including section 84.1, are intended to apply where the result of relying on corporate stated capital to determine the PUC would be inconsistent with the goal of allowing only tax-paid capital invested to be repaid to a shareholder as a tax-free return of capital.[8] The Court found that section 84.1 was analogous to sections 84 and 212.1 and subsection 85(2.1): each is designed to tax shareholders on distributions of corporate surplus in excess of capital invested.

In regard to the purpose of section 84.1, the Court referred to *Descarries v. Canada*[9] and found that the object, spirit, or purpose of section 84.1 is to prevent the removal of taxable corporate surplus as a tax-free return of capital through the use of the capital gains exemption (or tax-exempt margin), where there is a non-arm's length transfer of shares by an individual resident in Canada from one corporation to another.

Mr. Wild argued that subsection 89(1) was a formulaic mechanism dealing with the computation of PUC and was not susceptible to abuse, and that the PUC averaging had occurred as the section contemplated. Further, section 84.1 had applied as intended: a PUC grind had occurred when Mr. Wild transferred his Opco shares to Holdco. He further argued that *Descarries* was not applicable because: (i) the transactions in that case were carried out purely in a surplus stripping context whereas Mr. Wild's agreed intent was creditor proofing; and (ii) the taxpayers in *Descarries* had used their V-day values to offset a transitory capital gain generated solely for the purpose of allowing Descarries to receive a tax-free return of capital, whereas here there was no link between Mr. Wild's use of the capital gains exemption and the subsequent increase in the PUC of his Holdco shares.

The Crown argued that the transactions were carried out with the same purpose as in the *Descarries* case: to allow Mr. Wild to use his capital gains exemption in a manner that allowed him to receive tax-free corporate distributions in excess of his capital contributions. The manner in which this was done frustrated the underlying rationale or circumvented the application of section 84.1 as a specific anti-avoidance provision by misusing the PUC definition in subsection 89(1) which triggered the PUC averaging.

In determining that the transactions were abusive, the Court looked at the overall result of the transactions, which was that Mr. Wild could receive a portion of Opco's earnings tax-free as a return of capital by using his capital gains exemption to offset a capital gain created by the non-arm's length Share Transfer.

The Court found that despite the agreement regarding the taxpayer's purpose in carrying out the Reorg (creditor-proofing), certain key transactions in the course of the Reorg were carried out solely for the purpose of surplus stripping, and the evidence indicated that the Reorg had been implemented primarily to convey a tax benefit to Mr. Wild.

The avoidance transactions achieved the exact result, extraction of corporate surplus in conjunction with the use of the capital gains exemption, that section 84.1 was intended to prevent; it also defeated its underlying rationale (and the rationale of the PUC definition in subsection 89(1)) by misusing the PUC averaging mechanism to increase the PUC of Mr. Wild's shares without further capital contribution. They were, therefore, abusive tax avoidance transactions.

In coming to its conclusion regarding the abusive nature of the transactions, the Court noted that, typically, each shareholder or associated group of shareholders demand a class of shares that is different than the class issued to unrelated shareholders, to avoid the PUC of their shares being averaged down. Here, the Reorg included that same class of shares being issued specifically to create a PUC averaging.

[8] See *Copthorne Holdings Ltd. v. Canada*, 2012 DTC 5007 (SCC) at paragraphs 95-96.

[9] 2014 DTC 1143 (TCC).

Respectfully, the Court's decision in this case, although it seems correct in terms of the result, does not give much guidance regarding the legislative intent of the component of the PUC definition in subsection 89(1). Given that there was a clear legislative choice to calculate PUC on a class-by-class basis and that the decision hinged on a finding that the PUC averaging mechanism had been misused, further guidance would have been helpful to guide taxpayers' considerations when issuing the same class of shares to multiple shareholders. Absent such guidance, there may be uncertainty as to when PUC averaging may offend the GAAR.

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

Recent CRA Publications

The CRA released a new income tax folio: S1-F4-C1, *Basic Personal and Dependant Tax Credits*. The folio discusses the rules relating to the basic personal, spousal, and dependant tax credits, and will later be updated to reflect the Canada Caregiver Credit proposed by Budget 2017. Comments about the structure or content of the folio will be accepted until July 29, 2017.

A new 2017 TD1 form (and TD1 worksheet) was also released. The TD1 has been revised to reflect the proposed Canada Caregiver Credit.

The CRA has also published a Q&A page on the proposed GST/HST amendments to make supplies of naloxone (and its salts) zero-rated. The page discusses as of which date supplies of naloxone are zero-rated, what to do where GST/HST was incorrectly charged, and whether the amendment applies to imported naloxone, and confirms that provincial PST rules are unaffected by this amendment.

Canadian Businesses Withdrawing from Tax Havens

According to the Toronto Star, Canadians pulled a modest $11.4 billion out of tax havens in 2016. Since Canadian businesses have been moving billions of dollars into tax havens over the years, it remains to be seen whether this is a short-term deviation from the trend or the beginning of a permanent change. Notably, from 2011 to 2015, more than $120 billion of Canadian investment flowed into tax havens, so the sudden halt of net positive flows into tax havens in 2016 at least represents a pause in that trend. Allan Lanthier, the former chair of the Canadian Tax Foundation, stated that "there's been no substantive Canadian legislative change to address corporate tax base erosion that would account for a change in the behaviour of Canadian multinationals." Moreover, it is possible that recent negative public perception of tax haven use may be forcing businesses to rethink the tax risk associated with such planning strategies.

Small Business Deduction Rules Amended for Farmers and Fishers

On May 5, 2017, the Department of Finance announced draft amendments to the *Income Tax Act* to ensure that qualifying farmers and fishers selling to agricultural and fisheries cooperatives are eligible for the small business deduction in respect of income from those sales. Specifically, the amendments are proposed to clarify that the previously enacted rules that were intended to prevent the multiplication of the small business deduction do not inappropriately deny access to the small business deduction for a farmer's or fisher's corporation selling farming products or fishing catches to an arm's length agricultural or fisheries cooperative. These amendments would apply to taxation years that begin on or after March 21, 2016.

Changes to Voluntary Disclosure Program Coming Soon

According to the Canadian Press, the government is expected to release proposed restrictions to the Voluntary Disclosure Program ("VDP"). Although the proposed changes have yet to be confirmed, the offshore compliance advisory committee suggested that taxpayers who sought out and implemented aggressive offshore tax planning structures should benefit less (if at all) from the program. The committee also recommended that the VDP require taxpayers to disclose the identity of any tax professionals who advised them to be non-compliant.

FOCUS ON CURRENT CASES

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

Tax Court Finds Subsection 55(2) Applies to a Deemed Dividend Even Where Amount at Issue Is Taxed as a Capital Gain in the Hands of Another Taxpayer

***101139810 Saskatchewan Ltd. v. The Queen*, 2017 DTC 1008 (Tax Court of Canada)**

This Tax Court decision considers the application of the anti-surplus stripping rule in subsection 55(2) to a pre-sale divisive reorganization that allowed the vendor to access the section 110.6 capital gains deduction.

CSM was an audio and electronic equipment business. In 2008, CSM was owned indirectly by three individuals, Mr. Case, Mr. Melby, and Mr. Rae. Each of the three men owned, through their respective holding companies, a one-third interest in the issued share capital of CSM.

Due to a disagreement as to the direction of the business, Mr. Case decided to sell all of his 34 shares of CSM to Mr. Melby and Mr. Rae. As a result of valuations carried out of CSM, the three of them agreed that the value of Mr. Case's CSM shares was $2,600,000.

In order to carry out the share sale on a tax-effective basis, Mr. Case carried out a divisive reorganization of his shareholdings in CSM. Prior to the reorganization, Mr. Case's 34 shares in CSM were owned through his holding company, 8231. On March 6, 2009, Mr. Case incorporated two additional holding companies, 9810 and 9807. Mr. Case transferred, on a rollover basis, 34 shares of his existing holding company to each of 9810 and 9807 on the basis that, given other assets owned by the holding company, 34 shares of the holding company had a value of $1,300,000.

8231 then transferred, on a rollover basis under subsection 85(1), 17 of its 34 CSM shares to each of 9810 and 9807. In exchange for the CSM shares, 8231 took back 17 redeemable shares from each of 9810 and 9807. The aggregate redemption value of the redeemable shares received from 9810 and 9807, respectively, was $1,300,000 each. On each of the transactions, the parties elected in an agreed amount equal to the adjusted cost base of the 17 CSM shares to 8231, or $280,500.

Between March 8 and 9, 2009, 8231 entered into transactions with each of 9810 and 9807 to cross-redeem the shares each held in the other in exchange for offsetting promissory notes. More particularly, on March 8, 2009, 9810 and 9807 each redeemed the 17 redeemable shares they had issued to 8231 for their redemption amount of $1,300,000. In satisfaction of the redemption amounts, 8231 was issued promissory notes in the amount of $1,300,000 each, one from 9810 and one from 9807. For tax purposes, 8231 reported a deemed dividend of $1,019,500 on each redemption, which income inclusion was fully offset by the dividend deduction in subsection 112(1). On March 9, 2009, 8231 redeemed each tranche of 34 shares held, respectively, by 9810 and 9807. In satisfaction of the share redemptions, 8231 issued promissory notes in the amount of $1,300,000 to each of 9810 and 9807. These promissory notes were offset against the amount of the promissory notes issued on March 8. On the second set of share redemptions, both 9810 and 9807 reported taxable dividends of $1,300,000 under subsection 84(3), which income they offset by claiming deductions pursuant to subsection 112(1).

At the end of the reorganization, 9810 and 9807 each held 17 shares in the capital of CSM. Mr. Case then sold the shares of 9810 and 9807 to Mr. Melby and Mr. Rae, respectively, realizing an aggregate capital gain of $2,599,998. Mr. Case claimed a section 110.6 capital gains deduction of $238,529, representing Mr. Case's remaining lifetime capital gains deduction.

The CRA reassessed each of 9810 and 9807 on the basis of subsection 55(2), re-characterizing as capital gains the deemed dividends on the cross-redemptions. The CRA also reassessed 8213, but later vacated that reassessment.

Both 9810 and 9807 appealed their reassessments giving rise to the present proceeding.

The anti-surplus rule in subsection 55(2) applies to re-characterize a deemed dividend arising pursuant to subsection 84(3) as proceeds of disposition giving rise to a potential capital gain where:

- a taxpayer is a corporation resident in Canada;
- a taxpayer received a taxable dividend in respect of which it is entitled to a deduction under subsections 112(1) or (2);
- the dividend is received as part of a transaction or event or a series of transactions or events;
- one of the results of the transactions was to effect a significant reduction in the portion of the capital gain that, but for the dividend, would have been realized on a disposition at fair market value of any shares of the capital stock immediately before the dividend; and
- the capital gain that would have been realized on a disposition immediately before the dividend could reasonably be considered to be attributable to anything other than income earned or realized by any corporation after 1971 and before the safe-income determination time.

On appeal, the taxpayers raised several arguments as to why subsection 55(2) should not apply in the circumstances.

The taxpayers argued that the transactions in the reorganization and sale should be considered in their entirety and not in isolation, and that if such a view were taken there was no significant reduction in the capital gain since Mr. Case had personally reported $2,599,998 in capital gains arising on the sale of the shares of 9810 and 9807 to Mr. Melby and Mr. Rae.

The Tax Court considered the meaning of the phrase (relevant in respect of deemed dividends under subsection 84(3)) "one of the results of which is to effect a significant reduction in the portion of the capital gain" in subsection 55(2). After applying both a purposive and textual analysis of the phrase, the Court determined that the phrase would not prevent subsection 55(2) from applying to the deemed dividends received by 9810 and 9807.

The Tax Court found that, under a plain and ordinary reading of subsection 55(2), the provision contemplates a notional sale of shares when it measures whether there has been a significant reduction in the portion of the capital gain that would have been realized on a disposition. The Tax Court also concluded that the corporation that receives the deemed dividend must be the same entity against which the notional capital gain is to be measured. In addition, the Tax Court observed that, throughout the provision, the language describing the notional capital gain refers to a Canadian resident corporation and not an individual, like Mr. Case. The Tax Court noted that subsection 55(2) sets the timing of this notional disposition to a point immediately before the deemed dividend; thus, the Court found no support for the view that Mr. Case's capital gain, which occurred after the deemed dividend, could "stand in" for the notional capital gain that would have been incurred by the taxpayers if they had disposed of the shares immediately before the deemed dividend. Under this reading of subsection 55(2), the taxpayers had effected a significant reduction of their notional capital gain, from $1,299,999 to zero, by realizing deemed dividends.

Under a purposive reading of subsection 55(2), the Tax Court discussed the mischief that subsection 55(2) was intended to prevent, namely, the use of deductible intercorporate dividends to reduce the capital gain that would be realized on the disposition of a corporation's shares attributable to the unrealized appreciation, since 1971, of the fair market value of the underlying assets of the corporation. The taxpayers took the position that they had not offended the purpose of subsection 55(2) since the unrealized and untaxed appreciation of the shares was recognized when Mr. Case reported a capital gain. However, the Tax Court was unconvinced. Looking to the scheme of section 55, the Tax Court observed that Parliament had provided three general exceptions to subsection 55(2): (i) amounts representing safe income earned after 1971; (ii) dividends allowed under paragraph 55(3)(*a*); and (iii) dividends received in certain butterfly reorganizations in paragraph 55(3)(*b*). In the Tax Court's view, the taxpayers had carried out the very type of transaction that Parliament had intended to restrict by failing to order their affairs to ensure that the dividends deemed to be paid by 8231 were not caught by subsection 55(2).

The taxpayers also argued that subsection 55(2) could not be applied against them because it would offend the policy goal under the Act of avoiding double taxation.

The Tax Court considered several cases on the subject of double taxation, including *Prosperous Investments Ltd*. (92 DTC 1163) and *Scott Jones and Ascot Enterprises* (96 DTC 6015), and determined that the policy of preventing double taxation is a policy that aims to avoid an amount being taxed twice in the hands of a single taxpayer. These cases provided no recourse in circumstances in which the same amount was being taxed in the hands of *separate* taxpayers.

The Tax Court found that Mr. Case and the taxpayers each had separate legal personality and, therefore, the line of case law on double taxation was inapplicable since no single person was double taxed. In the Tax Court's view, the case law on double taxation could not prevent the CRA from re-characterizing the deemed dividends under subsection 55(2).

On its face, the outcome in this case seems harsh given that, as the taxpayers argued, the amount at issue was taxed twice, and, had the CRA not vacated its assessment against 8231, could have been taxed a third time. The outcome, however, may be reflective of the construction of subsection 55(2), which clearly considers objective results rather than purpose when applied to deemed dividends under subsection 84(3).

— *Justin Shoemaker*

"Gross Resource Profits" Include Gains From Closing Out Forward Contracts

***Barrick Gold Corporation v. The Queen*, 2017 DTC 1010 (Tax Court of Canada)**

The taxpayer in this case was a gold producer and the issue was whether the taxpayer's profits from closing out forward contracts for the sale of gold were "gross resource profits" for the purposes of the resource allowance regime in the Act. As discussed below, the Tax Court held that the profits from closing out the forward contracts were to be considered part of the taxpayer's gross resource profits. As the resource allowance regime in the Act was phased out in 2007, the Tax Court's decision on the substantive issue in this case is only of historical significance. However, it is nonetheless interesting to see how the Court made the link between the taxpayer's conventional resource profits and what were essentially profits from dealing in derivative contracts.

As mentioned above, the taxpayer in the case was in the business of producing and processing gold. In 1998, the taxpayer had a 100% ownership stake in two gold mines and a 50% ownership of a third gold mine. In order to hedge the economic risk associated with future fluctuations in the price of gold on the revenues that it would ultimately derive from the sale of gold produced from its gold mines, the taxpayer routinely entered into forward contracts for the sale of gold in quantities corresponding to the anticipated production for each mine.

Early in 1998, the taxpayer began taking steps to sell its 50% interest of the gold mine it did not wholly own to the other joint venturer. The sale was completed on January 27, 1998, and the purchase agreement contemplated that the transfer of the taxpayer's interest was deemed to have occurred on January 1, 1998; in other words, the taxpayer was accountable to the purchaser for any gold production from the taxpayer's 50% interest in the mine after January 1, 1998. During January 1998, the taxpayer closed out three forward contracts that it had previously entered into as a hedge for the proceeds from its anticipated share of production of the joint venture mine. It did so by purchasing gold at the current spot price and using the purchased gold to satisfy its obligations under the three forward sale contracts. The taxpayer realized an economic gain of approximately $56.7 million between the cost to purchase the gold at the spot price and the total sale price under the three forward contracts.

Prior to its repeal, paragraph 20(1)(*v*.1) of the Act allowed mineral producers to deduct a resource allowance as allowed by regulation; the resource allowance was intended as a means for compensating the taxpayers for the fact that, when the resource allowance regime was in place, any Crown royalties paid by mineral producers were outlays that were expressly non-deductible under the Act. Subsection 1210(1) of the *Income Tax Regulations* provided for a resource allowance of 25% of the taxpayer's "adjusted resource profits". The term "adjusted resource profits" depended on "resource profits", which, in turn, depended on "gross resource profits". In the context of this case, the relevant aspect of the meaning of "gross resource profits" was "the aggregate of [the taxpayer's] incomes for the year from [. . .] the production and processing in Canada of [. . .] ore, other than iron ore or tar sands ore, from mineral resources in Canada operated by him to any stage that is not beyond the prime metal stage or its equivalent [. . .]." Accordingly, the relevant question for the Court was whether the $56.7 million profit from the close-out of the forward contracts to sell gold was part of the taxpayer's income from the production and processing in Canada of gold in the 1998 taxation year, particularly in light of the fact that the taxpayer ceased to have an economic interest in the gold production that was being hedged after January 1, 1998.

The Minister's position was that income from production and processing, as defined under the *Income Tax Regulations,* is a narrow concept restricted to income that can be traced to activities that directly relate to extraction of ore from the ground. The test for inclusion of such profit, the Minister argued, was set out in *3850625 Canada Inc*. (2011 DTC 5062) and requires that there be a sufficient connection between the income and the taxpayer's production and processing activities.

The Court (*per* Paris J.) acknowledged that the test to be applied was the one set out in *3850625 Canada Inc*., where the Federal Court of Appeal held that refund interest earned on the taxpayer company's tax overpayments was properly included in calculating its resource profits for the purposes of computing its resource allowance. But, the Court noted that the Minister's contention that income from production and processing was "a narrow concept restricted to extraction from the ground," was specifically rejected by the Federal Court of Appeal in that case. The Court held that the relevant nexus for determining gross resource profits is between the taxpayer's business of production, as opposed to the more narrow nexus between the income and the physical act of extracting resources.

On the basis of the relevant nexus, the Court also decided that the Minister's position that the income in question be specifically referable to production and processing activities carried out by the taxpayer in the particular tax year — in this case, 1998 — was overly restrictive. In this regard, the Court noted that, in *3850625 Canada Inc*., "[d]espite the fact that the tax refund was received several years after the resource activities were completed in the 1985 to 1990 taxation years, Woods J. found that the refund interest was properly included in the computation of the taxpayer's resource allowance."

Given that the forward contracts at issue were entered into and closed out in the course of the taxpayer's business of production and processing and with the sole purpose of hedging the risk of price fluctuations in the gold that it expected to produce, the Court held that the forward contracts were an integral part of the taxpayer's business of producing and processing gold ore. Therefore, the profit that arose from closing out the contracts was sufficiently connected to those activities to constitute income from that source. The profit was thus deemed to be properly part of the taxpayer's gross resource profits in 1998. The Tax Court also noted that the legal test for determining whether income earned by a taxpayer falls within the definition of gross resource profits was decided in *3850625 Canada Inc*.

and, consequently, there was no need to resort to accounting principles to assist in the required determination, contrary to the arguments raised by the Minister.

The conclusion that the profit realized by the taxpayer in this case was properly included in the taxpayer's gross resource profits is consistent with the fact that the taxpayer would not have entered into the forward contracts, had it not been a gold producer. Moreover, the profit realized was only as a result of an extraordinary situation where it had to close out the contracts without using its own gold production. The decision also aligns with the underlying reason for which the hedges were made by the taxpayer, being to crystalize the taxpayer's revenues for selling the gold (which ultimately benefitted the taxpayer in the face of the dropping prices of gold).

— *Krupa Kotecha, Articling Student*

Rectification Claim Denied on the Basis of Precedent Set in *Fairmont Hotels*

***BC Trust v. AG of Canada*, 2017 DTC 5017 (British Columbia Supreme Court)**

The taxpayer in the *BC Trust* case was a personal trust, the sole beneficiary of which was another trust, Alta Trust. The trusts were intended to create a tax efficient structure for the ownership and distribution of assets and wealth, and to utilize subsection 104(6) of the Act to allow the taxpayer trust to deduct income made payable to Alta Trust from the net income of the taxpayer.

Accordingly, from 2002 to 2011, the taxpayer made all of its net income payable to Alta Trust, and claimed a deduction each year pursuant to subsection 104(6). In April 2012, in the course of reviewing the taxpayer's 2008, 2009, and 2010 taxation years, the Minister advised the taxpayer that the Minister had made a designation under subsection 104(2), such that the property and the income of the Alta Trust were combined with the property and income of the taxpayer. As a result, the Minister issued Notices of Reassessment of the taxpayer's 2008, 2009, and 2010 taxation years. In response, in August 2012 the taxpayer filed Notices of Objection objecting to the reassessments.

As a result of the designation made pursuant to subsection 104(2) and given the Minister's lack of response to the taxpayer's Notices of Objection, the trustees of the taxpayer concluded in respect of the taxpayer's 2012 taxation year that making income payable to Alta Trust and claiming a deduction pursuant to subsection 104(6) might be contrary to the provisions of the Act, and thus a breach of their fiduciary duties. This decision was at least partially informed by professional and legal accounting advice that the trustees had received. However, by December 2013, the trustees had become confident that allocating income to the Alta Trust would not breach their fiduciary duties; the trustees therefore made such allocations in 2013 and 2014.

In 2015, the dispute raised by the Notices of Objection was settled, and, in essence, the Minister agreed that, from and after 2015, income earned by the petitioner would be taxed in the taxpayer's or Alta Trust's hands as a British Columbia resident, and that the subsection 104(2) designation would be revoked.

As there had not been an allocation of income from the taxpayer to Alta Trust in 2012, the taxpayer sought a determination that it could retroactively allocate its income for 2012 to Alta Trust. The taxpayer asserted that the decision of the trustees in December 2012 not to allocate the taxpayer's 2012 income to Alta Trust was based on the mistaken belief that doing so might be contrary to the provisions of the Act. The taxpayer further asserted that the trustees' mistaken belief was the direct result of the Minister's subsection 104(2) designation, which was later revoked, and that the Minister should not be permitted to take advantage of a mistake resulting from the Minister's own wrongful conduct.

In considering whether the trustees' decision not to allocate income to Alta Trust in 2012 was a mistake that ought to be remedied by application of the doctrine of rectification, the Court drew on the recent decision in *Fairmont Hotels Inc*. (2016 DTC 5135). Weatherill J. noted that, on the basis of the Supreme Court of Canada's decision in *Fairmont Hotels*, "a common continuing intention of tax efficiency is insufficient to establish an entitlement to rectification", given that the Supreme Court "made clear that rectification is limited to cases where a written instrument has incorrectly recorded the parties' antecedent agreement." Thus, on the basis that there was no written agreement or other document (including the taxpayer's 2012 T3 tax return) that incorrectly recorded the taxpayer's intentions at the time the document was created, the doctrine of rectification was not available to the taxpayer.

The Court then considered whether the trustees' decision not to allocate income to Alta Trust in 2012 was a mistake that ought to be remedied by the inherent jurisdiction of the Court. The Court noted that the decision not to allocate the taxpayer's income to Alta Trust in 2012 was a decision in the trustees' absolute discretion, made based upon professional advice and after the trustees had weighed the risks and benefits of making or not making the allocation. The Court rejected the taxpayer's argument that the Minister's decision to retroactively revoke the subsection 104(2) designation amounted to an admission that the designation was erroneous on the facts or the law:

> There is no evidence as to what motivated the CRA to settle the dispute or as to its rationale in agreeing to revoke the Designation. The mere fact of a settlement does not mean that the petitioner's position was correct all along and that the CRA's position was incorrect all along.

Weatherill J. also stated that the trustees could execute a trust minute in respect of the taxpayer's 2012 income allocation, and that the Minister could, if such a minute were executed, decide to give such an allocation retroactive effect.

The Court noted as follows as to the distribution of powers pertaining to tax assessments:

> Parliament has set out in the ITA a detailed and comprehensive scheme for reporting, filing and assessing income tax. The Federal Court exercises supervisory powers over the CRA in respect of its application of the ITA. The Tax Court of Canada has exclusive original jurisdiction to determine appeals from tax assessments: s. 12 of the *Tax Court of Canada Act* [. . .]

As a result, the Court concluded that the issuance of an order that the taxpayer "be permitted to amend its 2012 T3 tax return" would amount to the Court exceeding its jurisdiction. Consequently, the taxpayer's application was dismissed.

The *BC Trust* case provides useful guidance on the issue of rectification in the tax context and illustrates the application of the rectification test set out in the *Fairmont Hotels* decision. The decision also underscores that successful rectification claims must be in respect of a written instrument that incorrectly sets out the parties' agreement.

— *Krupa Kotecha, Articling Student*

Taxpayer Successfully Challenges a Demand for Information

***Rosenberg v. MNR*, 2017 DTC 5011 (Federal Court)**

This case was a judicial review application brought by the taxpayer to review an auditor's exercise of power with respect to issuing a demand letter under section 231.1 of the Act. The demand letter at issue was seeking information pertaining to taxation years that had already been reviewed by the CRA, and in respect of which the taxpayer and Minister had already reached an agreement. This case provides insight into the standard of review applicable to the exercise of power under section 231.1, and demonstrates the court's willingness to uphold agreements between taxpayers and the Minister.

In February 2010, the taxpayer and an auditor signed a letter regarding certain straddle transactions in the taxpayer's 2006 and 2007 taxation years. This letter was the "agreement" at issue in this case, specifically its scope and validity. The letter stated that, after review of the relevant transactions and applicable law, the CRA was satisfied with the taxpayer's reporting position. However, the CRA added that its position may change if (1) the taxpayer, the taxpayer's spouse, and/or future executors engaged in similar "straddling transactions" in the future, or (2) if the fact pattern on which the auditor based its conclusions changed.

In January 2013, an auditor who was not a party to the 2010 letter sent a demand letter requesting further information on the 2006 and 2007 returns of the taxpayer. The demand letter specifically stated that the review was in relation to the "straddle loss" in those years. It was not disputed that this "straddle loss" was the same transaction reviewed in 2010.

The taxpayer took the position that the 2010 letter was a binding agreement, which barred the Minister from re-auditing or reassessing the taxpayer's 2006 and 2007 taxation years unless the taxpayer breached the 2010 "agreement". The taxpayer argued that the 2010 letter must be binding in order to bring certainty to arrangements between taxpayers and the CRA. On the other side, the Minister made two key arguments. First, the 2010 letter did not bar an audit, it barred an assessment, and audits and assessments are two different things. Secondly, the Minister argued that if there were an agreement, it would be void as such an agreement would be illegal and contrary to the Act and public order.

The court began its analysis by raising the issue of the standard of review that should apply to this case, an issue that the parties had not raised. The matter under judicial review was the exercise of power by the Minister under section 231.1 of the Act when it issued the demand letter in 2013 despite the "agreement" in 2010. The court stated the default standard of review of a decision by the Minister was reasonableness; however, the court noted that there was a "cogent argument for why reasonableness should not be used". Ultimately, the court decided not to reach a conclusion on the standard of review applicable because, even if the Minister were given a generous standard of review, the Minister's interpretation did not fall "within the range of acceptable and rational solutions".

The court then proceeded to review the subject matter of the dispute, and stated that there were two issues to be determined:

- As a matter of contractual interpretation, what was the scope of the 2010 letter?
- Was the 2010 letter a binding agreement?

On the first issue, the Minister claimed that the interpretation of the "agreement" should be narrow, arguing that it stood only for declining to reassess the 2006 and 2007 taxation years at the point in time of the letter. The court found that this interpretation was unreasonable as the agreement would be valid only on the day it was made, and then invalid the next day. The Minister also tried to argue that in order to determine if the taxpayer had breached the conditions of the "agreement", for example, due to a change in the fact pattern, the Minister should not be precluded from a new review under section 231.1 of the Act.

To determine the scope of the "agreement", the court interpreted the contract using the applicable law, which was the *Quebec Civil Code*. The court found that there was an agreement between the parties whereby the taxpayer benefited from not being reassessed for the 2006 and 2007 tax years if he refrained from conducting business in a way that would create straddling transactions — there was a *quid pro quo*. The court found the agreement to be neither ambiguous nor vague. Further, there was no allegation that the taxpayer's fact pattern had changed or that the taxpayer had engaged in any further straddling transactions.

Lastly, the court determined that the letter clearly stated that the CRA would not proceed with any reassessments of the 2006 and 2007 taxation years regarding the straddling transactions. The court held that based on the following factors the 2013 demand letter was part of the process of proceeding with a reassessment: the 2013 auditor was a member of the Specialty Audit Section of the International and Ottawa Tax Services Office; the 2013 letter stated it was a compliance audit; and the new audit from Ottawa, and not Montreal, had the aim of reassessing the taxpayer.

To address the second issue, whether there was a valid and binding agreement, the court first considered an argument made by the Minister that such an agreement is not valid because an agreement cannot waive the Minister's obligation to enforce the Act. The Minister relied on section 220 of the Act, which states that "[t]he Minister shall administer and enforce this Act". The court interpreted section 220 and the use of the word "shall", and held that in the context of this provision, the word "shall" was simply Parliament vesting the executive branch with certain powers and jurisdiction. The court added that section 220 requires the Minister to administer and enforce the Act, but does not mandate how this is to be done. The Minister did not waive its duty by entering into the 2010 "agreement", but rather chose to enter into the agreement as a means of administering and enforcing the Act.

The court then considered whether the agreement was valid. The Minister argued that, based on the *Galway* (74 DTC 6247) line of cases, it cannot be bound by an agreement where, if the facts are known and the law is understood, the agreement is to assess an amount that is less than the amount that the Act provides. The court held that this proposition from the *Galway* line of cases was correct but was limited in scope and only stands for the position that once the facts are determined, the law is applied and there is one result, an agreement cannot depart from that. The court went on to add that, from a policy standpoint, tax disputes are settled every day and settlement should be encouraged. An agreement that does not encroach on the *Galway* line of cases will be enforceable. In this case, the assessment of the taxpayer's liability had already taken place in 2010 and no evidence was provided to suggest that it was not justifiable on the facts and law. In fact, the agreement stipulated that if the facts changed, the Minister could proceed with a reassessment.

Lastly, in considering the second issue of the validity of the contract, the court considered whether or not it would be contrary to public order to find an agreement that limited the Minister's powers to be valid. The Minister put forward a bold proposition that the "law is clear, no agreement between the Minister and taxpayers can interfere with the Minister's powers to conduct audits". The court held that legislative power cannot be fettered, but there was no such fettering in this case. The real question is whether or not a contract is compatible with the objectives of the legislation. In conclusion, the court held that the Minister was not fettering its discretion, and that the agreement was in furtherance of the legislative goals as it allowed the matter to be settled.

— Andrea Schneider, Articling Student

Minister Unable To Discharge Onus To Allow Reassessment Beyond Normal Reassessment Period

***Kotilainen v. R.*, 2017 DTC 1006 (Tax Court of Canada)**

This case is an interesting example of a situation where the Minister was unable to discharge the onus of proving that the taxpayer made a misrepresentation in circumstances that would allow the Minister to reassess the taxpayer beyond the normal reassessment period. More particularly, the Minister was unable to show that the amounts alleged to be shareholder benefits were not repayments of shareholder advances, as asserted by the taxpayer.

In the 1980s, the taxpayer invested in a rundown and unprofitable motel with some co-investors. The venture was not successful and, at some point, the taxpayer formed a corporation and became its sole shareholder to buy out the interests of the co-owners and have the corporation own and operate the motel. From 1991 to 2002 the corporation declared $425,000 in tax losses, and the taxpayer had to fund these losses using his personal funds. In 2002, the taxpayer refinanced the mortgage of his personal residence and used more than 50% of the loan proceeds to fund the corporation's operations.

In 2003, the corporation received proceeds of $235,000 from mortgaging the motel property and the taxpayer received $96,451 and $70,701 of those funds in 2003 and 2004, respectively. Since no amounts were recorded in the relevant company balance sheets as loans from the shareholder, the Minister reassessed the taxpayer to include the amounts in income as shareholder benefits. The Minister also imposed gross negligence penalties. By the time the matter reached the Tax Court, the Minister had agreed to withdraw the gross negligence penalties and reduce the alleged shareholder benefit by more than half.

The CRA's audit of the taxpayer began in November 2008 and was not completed until April 2011. Since the normal three-year limitation period for 2003 and 2004 had expired before 2011 without a waiver being requested by the CRA, the Minister was only entitled to reassess if the taxpayer had made a misrepresentation attributable to neglect, carelessness, or wilful default in connection with the reassessed amounts.

When the Minister seeks to rely on subparagraph 152(4)(*a*)(i) to reassess a taxpayer beyond the normal reassessment period, the jurisprudence establishes that the Minister has the onus of proving that the taxpayer made a misrepresentation and that the misrepresentation was attributable to neglect, carelessness, or wilful default. In this case, there was an issue as to whether the taxpayer had made a misrepresentation at all in his 2003 and 2004 tax returns since the taxpayer's explanation for those amounts was that they were repayments of unrecorded shareholder advances to the corporation.

From an evidentiary standpoint, it seems that the Minister was relying on the fact that the corporation's balance sheets for the relevant years did not show any recorded liabilities to shareholders, together with a "deposit" analysis showing that the assessed amounts flowed from the corporation to the taxpayer.

However, in light of the evidentiary burden placed on the Minister in the circumstances, the Tax Court (*per* Hogan J.) decided that the use of the deposit method was an inadequate method in the circumstance for trying to show that the amounts could not be explained away as repayments of shareholder loans, as argued by the taxpayer. The Court indicated that a combined net worth analysis — accounting for the economic inflows and outflows for both the taxpayer and corporation — over a period of years would have likely been required for the Minister to discharge the onus of proof in this type of case. Had the Minister done so, the Court suggested that the outcome of the case may have been different. In the meantime, the Court considered it plausible that the financial statements (prepared by the taxpayer's stepson, who was not a professional) would not accurately reflect the corporation's outstanding liabilities to its sole shareholder, and that the taxpayer's conduct during subsequent years was consistent with a practice of him advancing money to the corporation to fund its operations.

Interestingly, the Appellant was self-represented and was under the mistaken belief that his documentary evidence would be entered into the Court's record by the Minister. The Court commended the Minister's counsel for his assistance in ensuring that the taxpayer's documentary evidence and his case in general were properly presented to the Court. Thus, despite the fact the Minister lost this appeal and that costs normally follow the cause, the Court found that the taxpayer greatly benefited from the assistance provided to him by the Minister in presenting his case and the Court ruled that it is only fair that each party bear its own costs (although the taxpayer's out-of-pocket costs in this case would likely have been nominal, if the taxpayer did not engage legal counsel to assist him with any stage of the Tax Court proceedings).

— Dean Xiao, Articling Student

RECENT CASES

Lump sum payment received by taxpayer from frozen pension account held by his employer after taxpayer's retirement not "pension income" for GIS calculation purposes

From 2009 to 2011 the taxpayer was routinely receiving his monthly guaranteed income supplement ("GIS") without any problem. On September 30, 2011, however, the taxpayer retired, which resulted in a diminution of his income for 2011. In addition, on June 14, 2012, the taxpayer transferred $19,941 into an RRSP. This amount had come from a lump sum of $21,314 (the "Lump Sum") which the taxpayer had withdrawn from a frozen pension account ("compte de retraite immobilise") which he was holding in relation to his former employment. As a result, the minister re-calculated the taxpayer's income for purposes of determining the monthly GIS amount to which he was entitled for the period from July 2012 to December 2012 (the "Period"). In that re-calculation the minister included in his estimate of the taxpayer's pension income for 2012 the Lump Sum, on the assumption that it constituted "pension income" as defined in section 14 of the *Old Age Security Regulations* (the "Regulations"). The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was allowed. The two issues in this case were: (a) whether the minister complied with the provisions of the *Old Age Security Act* (the "OAS") in estimating, for GIS purposes, the taxpayer's "actual income" ("revenu réel") for the Period, as defined in section 18 of the OAS; and (b) whether the Lump Sum was "pension income" as defined in section 14 of the Regulations. In calculating the taxpayer's "actual income" for the Period for GIS purposes, the minister's methodology, in effect, involved adding together his Pension income for 2012, his income from all remunerated activity for 2012, and his income from all other sources for 2011 (excluding income from remunerated activity and pensions for 2011). Using this methodology, the minister initially calculated the taxpayer's "actual income" for the Period to be $5,583.96, which consisted entirely of his wife's pension income of $5,583.96 for 2011. After receiving the taxpayer's return for 2012, however, the minister recalculated the taxpayer's "actual income" for the Period to be his pension income for 2012 of $8,192, plus the Lump Sum of $21,314, less an RRSP deduction of $9,000 for 2011, plus his wife's pension income for 2011 of $5,583.96. This resulted in a combined "actual income" figure for the Period of $26,089.96, which, when compared with the taxpayer's reported income of $5,831.96 for 2012, led to an assessment requiring the taxpayer to remit a GIS overpayment. Although this methodology had been used by the minister for some time, and was one that led to a more favourable result for the taxpayer, it did not comply with the definition of "actual income" in section 18 of the OAS. That section defines "actual income" as the taxpayer's income for the "base calendar year" (which in this case was 2011 as opposed to 2012). Despite the methodology used by the minister, therefore, the taxpayer's "actual income" for the Period was not his true income for 2012 as calculated by the minister under section 14 of the OAS following the filing of the taxpayer's return for 2012. As a result, the minister ought to have calculated the GIS overpayment by comparing the $5,583.96 against an amount of $29,390.96 as opposed to the $26,089.96 that he actually used. ($29,390.96 was the number resulting from using the taxpayer's "actual income" for the 2011 "base calendar year" instead of for the Period). All of this having been said, however, the minister's interpretation of section 18 should be left undisturbed. Turning to the second issue in this case, the words "annuity payments" and "superannuation or pension payments" appearing in the definition of "pension income" in section 14 of the OAS Regulations connote a periodicity in the payments involved. The Lump Sum, therefore, did not meet that periodicity requirement, and hence could not be considered as "pension income", despite the minister's allegation to the contrary. The minister was ordered to reassess accordingly.

Lévesque v. MESD

2017 DTC 1024

Taxpayers not entitled to Capital Gains Deduction on their disposition of corporate shares, since corporation not a CCPC

Gestion Lagarde held all of the shares of Dale Parizeau, which operated an insurance brokerage business. RJCG owned all of the common shares of Gestion Lagarde, and Aviva, an Ontario corporation, owned all of the preferred shares of Gestion Lagarde. Aviva International, a non-resident corporation, was the parent of Aviva. RJCG, Aviva, Gestion Lagarde, and Dale Parizeau were parties to a unanimous shareholders' agreement (the "USA"). Article 6 of the USA recognized that Aviva had been given an option to acquire up to 66.305% of the Class A common shares of Gestion Lagarde. Article 7.3 of the USA granted Aviva the right to purchase from RJCG its Class A shares of Gestion Lagarde. Article 7.3 had undergone several modifications which gave rise to a number of questions, including the effects of a certain letter of December 20, 2005. Relying on paragraph 251(5)(*b*) of the *Income Tax Act* (the "Act"), the minister refused the taxpayers the capital gains deduction claimed by them with respect to their sale of their shares of RJCG, on the ground that RJCG was not a CCPC. (Paragraph 251(5)(*b*) provides that, for certain purposes, the holders of options to purchase shares are to be treated as the owners of those shares.) In the minister's view, it could be assumed that the effect of the previously mentioned letter of December 20, 2005, was to accord to Aviva the right to acquire the controlling shares of RJCG, thus conferring on Aviva the control of RJCG, while Aviva itself was controlled by the non-resident corporation Aviva International. On appeal to the Tax Court of Canada, the taxpayers argued that: (a) the options conferred on Aviva under Articles 6 and 7.3 of the USA (the "Options") infringed section 148 of the *Act Respecting the Distribution of Financial Products and Services* (the "DFPSA"), since they conferred on Aviva more than 20% of the shares of Dale Parizeau; (b) under paragraph 251(5)(*b*) Aviva was deemed to have exercised the Options, so that it was the owner of the shares covered by the Options for purposes of section 148; and the Options were therefore void. The Tax Court refused to accept the arguments that the Options were void, and upheld the minister's position accordingly. On the taxpayers' appeal to the Federal Court of Appeal, they chose to limit their presentation to the question of whether the Options were void, admitting that if their arguments on this point failed, their appeals would be dismissed. While supporting the Tax Court judge's findings, the Crown questioned the Tax Court's jurisdiction to determine the issue of whether the Options were void, arguing that this question fell within the exclusive jurisdiction of the Quebec Superior Court.

The taxpayers' appeals were dismissed. As the Tax Court judge correctly pointed out, he had jurisdiction to determine whether the Options were void, and was required to make this determination solely for the purposes of ascertaining the validity of the minister's assessments. The fact remained, however, that Aviva had not exercised the Options. And although the taxpayers' counsel recognized that there was no provision in the DFPSA which was equivalent to paragraph 251(5)(*b*) of the Act, he sought to argue that the words "held directly or indirectly" in section 148 of the DFPSA were intended to encompass not only the holding of shares but the holding of options to acquire those shares as well. The Tax Court judge rejected this argument on the ground that there simply was no provision in the DFPSA which was equivalent to paragraph 251(5)(*b*) of the Act. The Tax Court was correct, since the reality is that a future right to acquire shares is not the same as the actual holding of those shares. As a result of the foregoing analysis, the taxpayers' argument that the Options were void was untenable. The minister's position was affirmed accordingly.

Durocher v. The Queen

2017 DTC 5050

Taxpayer's gains from securities transactions properly assessed as being on income account

The taxpayer was the co-head of institutional trading for a Canadian brokerage firm, and he maintained personal investment accounts with that firm. He realized gains on the purchase and sale of securities during the 2009 taxation year, and reported such gains as capital gains. However, the minister assessed such gains as being on income account, and the taxpayer appealed from that assessment.

The appeal was dismissed. The Tax Court of Canada held that the legal test to be applied was whether or not the securities giving rise to a loss or gain were sustained or realized from a business or an adventure in the nature of trade. The critical factor in making that determination is the intention of the taxpayer at the time the property in question is acquired, and such intention is to be ascertained from the taxpayer's whole course of conduct. The evidence to be considered in determining intention includes the frequency of the transactions, the duration of the holdings, the nature and quantity of the securities held, the time spent on the activity, financing, and particular knowledge possessed by the taxpayer. The Court reviewed the appellant's testimony and did not accept his argument that he was buying and selling on capital and not income account. Specifically, the Court concluded that the appellant's primary intention when purchasing the securities was to sell them at a profit as soon as a reasonable return could be realized. As well, the Court found that the appellant spent considerable time each day monitoring the markets, beyond what he indicated was required for his employment. That employment also provided him with well beyond average access to market information and he availed himself of that access and information. Finally, the appellant was buying and selling regularly throughout the year and the holding periods for his securities were clearly short and often "very very short". The Court concluded, based on those findings, that the appellant was trading in the securities as a business activity, or at least was buying and selling the securities as part of an adventure in the nature of trade. The gains realized were properly assessed as being on income account.

Foote v. The Queen

2017 DTC 1032

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For Wolters Kluwer Canada Limited

Tara Isard, Senior Manager, Content
Tax & Accounting Canada
(416) 224-2224 ext. 6408
email: Tara.Isard@wolterskluwer.com

Natasha Menon, Senior Research Product Manager
Tax & Accounting Canada
(416) 224-2224 ext. 6360
email: Natasha.Menon@wolterskluwer.com

Wolters Kluwer Canada Limited
300-90 Sheppard Avenue East
Toronto ON M2N 6X1
1 800 268 4522 tel
1 800 461 4131 fax
www.wolterskluwer.ca

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