Tax Notes

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AMENDMENTS TO THE TAXATION OF DERIVATIVES

— *Joseph Frankovic, Toronto*

Background

In the decision of *Kruger v. The Queen* (2015 DTC 1127), the Tax Court of Canada held that certain foreign currency exchange options held by the taxpayer constituted inventory for income tax purposes, even though it seemed apparent that the taxpayer was not in the business of buying and selling the options. In response to that decision, in its 2016 Federal Budget the Department of Finance introduced new subsection 10(15) of the *Income Tax Act* (the "Act"), which provides that swap agreements, forward purchase or sale agreements, forward rate agreements, futures agreements, option agreements, or any similar agreements are deemed not to be inventory.

Subsequently, upon appeal of the Tax Court decision in *Kruger* (2016 DTC 5079), the Federal Court of Appeal reversed that aspect of the decision and held that the taxpayer's options were not inventory.[1] However, the Federal Court held that the taxpayer was entitled to use a mark-to-market method in computing its profit from the options for income tax purposes. Under this method, the taxpayer reported accrued but unrealized losses on the option contracts, valued as of the end of the relevant taxation year. The Crown unsuccessfully argued that the losses could only be recognized when they were realized, namely when the options were closed out or settled. In response to *Kruger*, in its 2017 Federal Budget the Department of Finance proposed amendments to the Act to "clarify" certain aspects of the income tax treatment accorded to derivatives. These amendments and related amendments are discussed below.

Elective Mark-To-Market Method

Proposed section 10.1 will allow a taxpayer to make an election to use a mark-to-market method of income recognition for all of the taxpayer's "eligible derivatives" held at the end of a taxation year. Once the election is made in respect of a taxation year, it will remain effective for all subsequent taxation years unless it is revoked with the consent of the Canada Revenue Agency ("CRA").

Under the mark-to-market method, a taxpayer other than a financial institution is deemed to have disposed of each eligible derivative immediately before the end of a taxation year and to have received proceeds or paid an amount, as the case may be, equal to the fair market value ("FMV") of the derivative at that time.[2] As a result of the deemed disposition, the otherwise unrealized profit or loss in respect of the derivative will be recognized in the taxation year. If the taxpayer is a financial institution, each eligible derivative will be deemed to be a mark-to-market property for the purposes of

[1] The Kruger decision is discussed in the lead article in *Tax Topics* no. 2321, September 1, 2016.

[2] Proposed subsection 10.1(5).

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the existing mark-to-market rules in section 142.5, which essentially provide the same result.

The elective method and related provisions are applicable to taxation years that begin after March 21, 2017.

For taxpayers other than financial institutions, if the election is not made, a mark-to-market method of computing profit is expressly not allowed such that the realization method is the presumed "default" position.[3] In other words, the *Kruger* decision is effectively overturned.

An "eligible derivative" is defined as a swap agreement, a forward purchase or sale agreement, a forward rate agreement, a futures agreement, an option agreement, or a similar agreement if:

(a) the agreement is not capital property, a Canadian resource property, a foreign resource property, or an obligation on account of capital of the taxpayer;

(b) either the taxpayer has produced audited financial statements prepared in accordance with generally accepted accounting principles for the taxation year, or the agreement has a readily ascertainable FMV; and

(c) where the agreement is held by a financial institution, the agreement is not a tracking property, other than an excluded property, of the financial institution.[4] (An agreement that is a tracking property other than an excluded property is normally subject to the existing mark-to-market rules in section 142.5.)

A transitional rule applies if a taxpayer holds an eligible derivative at the beginning of the year in respect of which the election is made ("election year"), where the taxpayer did not use a mark-to-market method in the immediately preceding year in respect of the derivative (such as the method allowed under *Kruger*). Under the transitional rule, the taxpayer is deemed to have disposed of the derivative immediately before the beginning of the election year and to have received proceeds or paid an amount, as the case may be, equal to the FMV of the derivative at that time. The taxpayer is deemed to have reacquired, reissued, or renewed the derivative at the beginning of the election year at an amount equal to that same FMV. The resulting profit or loss is not recognized in the immediately preceding year. Rather, it is deferred and recognized in the taxation year in which the taxpayer actually disposes of the derivative. Otherwise, the derivative is subject to the mark-to-market method beginning in the election year.

Straddle Transactions

In conjunction with the proposal of the mark-to-market method, the Department introduced a new stop-loss rule that is intended to combat the selective recognition of losses in straddle transactions. Under existing income tax rules, under a typical straddle a taxpayer could settle or otherwise realize a loss position in respect of a derivative (or other agreement or property or obligation) in one taxation year while deferring the recognition of an offsetting gain position to a later taxation year. Even if the pre-tax profit involving the positions taken together was *nil* or a nominal amount, an after-tax profit could be generated because of the timing differences. The after-tax profit could be increased if the gain position was deferred further through a subsequent position. The foregoing type of transaction, where the net economic gain arises solely or largely because of the income tax treatment, is sometimes referred to as a form of "tax arbitrage".

The Department indicated that straddles were being challenged under judicial principles and existing provisions of the Act. However, since these challenges can be costly and time-consuming, the Department felt that it was appropriate to introduce a specific stop-loss rule.

In its most basic form, the stop-loss rule applies to reduce the loss on a disposition by a person or partnership ("taxpayer") of a particular position in a taxation year by the total of the "unrecognized profit" in respect of each "offsetting position" in respect of the particular position at the end of the year.[5] The unrecognized profit means the profit that would be realized if the position were disposed of immediately before the end of the taxation year for proceeds equal to its fair market value.[6] The amount of the denied loss of the initial position is regenerated in the next taxation year,[7] where it may be recognized if there is no unrecognized profit in respect of any offsetting positions at the end of that year, or may be reduced again to the extent of any unrecognized profit in respect of offsetting positions at the end of that year.

A "position" of a taxpayer is defined broadly and includes the following types of derivatives: a swap agreement, forward

[3] Proposed subsection 10.1(7), subtitled "Default realization method".

[4] Financial institution, tracking property, and excluded property all have the definitions found in existing subsection 142.2(1).

[5] For these purposes, the unrecognized profit of the offsetting position is the net of unrecognized losses of offsetting positions at the end of the year, if any. See amounts D and E in the formula in proposed subsection 18(19).

[6] "Unrecognized profit", proposed subsection 18(17).

[7] Amount B in the formula in proposed subsection 18(19).

purchase or sale agreement, forward rate agreement, futures agreement, option agreement, and any similar agreement. A position also includes a property, obligation, or liability of the taxpayer that is a share in the capital stock of a corporation, an interest in a partnership, an interest in a trust, a commodity, foreign currency, and certain types of debt (among other items).[8] A position of a taxpayer can include two or more such derivatives, properties, obligations, or liabilities if it is reasonable to conclude that each of them is held in connection with each other.

An "offsetting position" in respect of a particular position of a taxpayer means one or more positions that are held by the taxpayer that have the effect of eliminating all or substantially all of the holder's risk of loss and opportunity for gain or profit in respect of the particular position. An offsetting position in respect of the particular position can also include a position held by a person or partnership that does not deal at arm's length with, or is affiliated with, the taxpayer ("connected person"), that has the same effect or would have the same effect if the position were held by the taxpayer. If held by a connected person, the position will normally be an offsetting position in respect of the particular position only if it can reasonably be considered to have been held with the purpose of obtaining that effect.[9] However, a position held by the taxpayer or connected person is specifically deemed to be an offsetting position in respect of the particular position if there is a high degree of negative correlation between changes in value of the position and the particular position, and it can reasonably be considered that the principal purpose of the series of transactions or events, or any of the transactions in the series, of which the holding of both the position and the particular position are part, is to avoid, reduce, or defer tax.[10]

The stop-loss rule can also take into account a "successor position" in respect of the position ("initial position") whose disposition gives rise to a loss in a taxation year. A successor position is a position that is itself an offsetting position in respect of the position that is the offsetting position in respect of the initial position, if the successor position was entered into in the period that begins 30 days before the disposition and ends 30 days after the disposition. As with unrecognized profit in respect of an offsetting position, the unrecognized profit in respect of the successor position at the end of the taxation year can reduce the amount of the loss on the disposition of the initial position in the year. Furthermore, if there is a further offsetting position in respect of the successor position, any unrecognized profit in respect of that position at the end of the year can also serve to reduce the loss of the initial position.[11]

There are various exceptions where the stop-loss rule does not apply. For example, it does not apply to:[12]

- Certain deemed dispositions, such as those that occur upon death or emigration;
- Positions that are on capital account;
- Financial institutions as defined in subsection 142.2(1), mutual fund trusts, and mutual fund corporations;
- A position where either the position or the offsetting position consists of commodities that the taxpayer manufactures, produces, grows, extracts, or processes, or debt incurred in the ordinary course of business, where one of the positions serves as a hedge of the other;[13]
- A particular position where the offsetting position is held throughout a 30-day period after the disposition of the particular position and the risk or opportunity with respect to the offsetting position is not changed materially during that period by another position; and
- A position where it can reasonably be considered that none of the main purposes of the series of transactions or events that include the holding of both the position and offsetting position is to avoid, reduce, or defer tax.

The stop-loss rule applies to a position if the position or an offsetting position is acquired, entered into, renewed or extended, or becomes owing by the person or partnership after March 21, 2017.

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[8] "Position", proposed subsection 18(17).

[9] "Offsetting position", proposed subsection 18(17).

[10] Proposed paragraph 18(21)(*c*).

[11] In total, the loss on the initial position can be reduced by the unrecognized profits at the end of the year in respect of the offsetting position, the successor position, and any offsetting position in respect of the successor position, net of unrealized losses at the end of the year in respect of such positions. See amounts D and E in the formula in proposed subsection 18(19).

[12] Proposed subsections 18(18) and (20).

[13] The specifics of this hedge exception are found in proposed paragraph 18(20)(*a*).

THE ARMOUR GROUP LIMITED V. THE QUEEN, 2017 DTC 1040

— Jason Kujath, Associate, Dentons Canada LLP, Calgary, and Derek Kurrant, Partner, Dentons Canada LLP, Calgary

The Armour Group Limited v. The Queen, 2017 DTC 1040 (TCC), was an appeal of a reassessment that involved a number of complex land transactions between the Armour Group Limited (the "Appellant") and the Province of Nova Scotia (the "Province"). The Minister disallowed the deduction of $2.24 million claimed as a lease cancellation fee by Founders Square Limited ("FSL"), a wholly-owned subsidiary of the Appellant that acted as a bare trustee and held all of its assets for the benefit of the Appellant. The Minister viewed the amount as having been paid by the Appellant to acquire an interest in real property and therefore being an outlay on account of capital, the deduction of which is prohibited by paragraph 18(1)(*b*) of the *Income Tax Act* (Canada) (the "Act").

The issue before the judge, Paris J., was whether this amount was deductible by the Appellant from its business income. Perhaps the most interesting aspect of this decision is that Paris J. applied a strict interpretive approach and considered the new leasehold interest as a capital asset without giving much consideration to the broader context of the transactions. Paris J. held that the transactions undertaken caused a merger of title as the construction of the agreements indicated that the Appellant offset an amount owed to it by the Province to pay for the transfer of the property at issue to another related entity. Paris J.'s decision has been appealed to the Federal Court of Appeal.

The Facts:

In 1983, the Appellant, as lessee, entered into a long-term lease agreement (the "Original Ground Lease") with the Province as the landlord for property in Halifax. The terms of the Original Ground Lease were as follows:

- the Province would own the buildings and any new buildings constructed on the land (the "Property");
- the Province would enter into an Original Ground Lease with FSL until 2064, with annual lease payments of $100,000 for 10 years and a percentage of gross revenue for the remaining years;
- the Province would have a reversionary interest in the Property that would materialize in 2064;
- FSL would build a new development on the site which, when combined with the existing buildings, would contain a total rentable area of 200,600 square feet; and
- the Province would rent 50,000 of the 200,600 square feet of office space from FSL for a term of 30 years.

The space leased by the Province fell below 50,000 square feet and the Appellant brought an action in the Supreme Court of Nova Scotia to enforce the Original Ground Lease. On February 21, 2003, the two parties settled and the Minutes of Settlement provided that the Province was liable to FSL in the amount of $4,456,250, which would include a payment to FSL of $2,056,250 in cash within 7 days of the settlement. The Province also agreed to grant an irrevocable assignable option (the "Option") to FSL or its assignee to purchase the Property, together with an assignment of the Original Ground Lease in favour of FSL and all rights of reversion in the Property for $2,400,000. If FSL or its assignee did not exercise the Option, the Province would pay FSL a lump sum of $2,400,000, which was also the Property's fair market value.

On June 10, 2003, FSL assigned the Option to Armour Development Limited ("ADL"), a wholly-owned subsidiary of FSL, on condition that ADL "upon becoming the owner of the [Property]", would grant FSL a new lease of the property until 2064 (the "Transfer Agreement"). The new lease was to be granted on the same terms and conditions as those contained in the lease between FSL and the Province, except that the rent payable by FSL to ADL would be $10 per year (the "New Ground Lease"). FSL agreed to transfer $160,000 of the $2,400,000 that it was entitled to receive from the Province under the minutes of settlement to ADL, and ADL agreed to provide a promissory note payable to FSL in the amount of $160,000.

On June 11, 2003, FSL and ADL provided the Province with notices that:

(1) FSL had assigned to ADL its rights under the Option "to acquire title to the [Property]" described in the Option, but not in the Original Ground Lease, which FSL stated was being cancelled concurrent with the delivery of the deed to the Property to ADL;

(2) FSL was exercising the option to purchase the Property referred to in the Option except the interest transferred to ADL; and

(3) ADL, as assignee from FSL, was electing to purchase the Property.

On July 22, 2003, FSL and ADL agreed for FSL to surrender the Original Ground Lease to the Province and for the Province to transfer a fee simple interest in the Property to ADL (the "Surrender Agreement"). The Province then deeded and transferred the fee simple interest in the Property to ADL. ADL then entered into the New Ground Lease with FSL to run until July 31, 2064.

The closing agenda for the July 22, 2003, transactions provided that all documents in respect of the transactions would be held in escrow until all documents were delivered, at which time the escrow would terminate, the documents would be released from escrow simultaneously, and the closing would be deemed to have occurred. According to the Surrender Agreement entered into between FSL and the Province, the consideration provided by FSL to the Province for the surrender was "$10.00 and other good and valuable consideration".

The Appellant claimed the amount of $2.24 million as a deductible business expense under section 9 and paragraph 18(1)(*a*) of the Act as a lease cancellation payment. The Minister reassessed the Appellant on the basis that the $2.24 million amount was a capital expense.

Analysis of the Tax Court Decision:

The Appellant argued that the effect of the $2.24 million payment ($2.4 million less $160,000) was to replace income, not capital, because the effect of the amount paid was to relieve FSL of the obligation to pay anything more than nominal rent thereafter. Since the rent that had been payable to the Province was a deductible expense to FSL, the payment made to relieve it of the obligation to pay rent should have also been a deductible expense.

The first issue before Paris J. was whether FSL gave consideration of $2.24 million to the Province for the surrender of the lease. Using base principles of contractual interpretation, Paris J. examined the words of the contract to determine the meaning of the ambiguous terms "other good and valuable consideration". As extrinsic evidence, Paris J. looked to the witnesses called by each party. FSL called its CFO, but failed to call anyone from the Province to verify the claim that the Province demanded that the agreement not specifically mention the details of the additional consideration. Paris J. drew the negative inference that the reason that the officials of the Province who were involved in the relevant transactions were not called was because their testimony would most likely not have been favourable to the Appellant. Accordingly, Paris J. made two findings:

> (1) The Appellant did not show that it gave consideration of $2.24 million to the Province for the surrender of the lease; and
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> (2) FSL paid the $2.24 million to the Province in order to permit ADL to acquire the fee simple interest in the Property, and that the payment was therefore on capital account.

The second finding of Paris J. was made on the basis that in order for ADL to acquire the fee simple interest in the Property, the Province must have had the ability to convey an unencumbered Property. Consequently, for the property to be unencumbered at the time of the disposition of the Option to ADL from FSL, FSL must have nullified the previous lease and the Province's reversionary interest prior to the transfer. Paris J. explained the transfers as follows:

> [50] In my view, upon the proper construction of the agreements that are before me, FSL used the $2.4 million credit under the Minutes of Settlement to pay for the transfer of the Property to ADL. Since, under the Transfer Agreement, FSL transferred to ADL the option to acquire the fee simple interest to the Property, it appears to me that FSL paid the $2.4 million purchase price on ADL's behalf.
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> [51] In exchange, ADL gave FSL the right to enter into a new long-term ground lease of the Property with ADL at a minimal rent.

Justice Paris held that the leasehold interest acquired by FSL in the Property was a capital asset for the purposes of the Act. Consequently, the payment made by FSL, by offset, on behalf of ADL was held to be on capital account. Accordingly, Paris J. dismissed the appeal with costs awarded to the Minister.

Without the full context of the facts at the time of the transaction, of which additional details would have been provided by the provincial officials who did not testify, the sequence of transactions at issue seems to have been an attempt at using a complex approach to solve a simple problem. A different approach to achieve a favourable result would have been for the Surrender Agreement with the Province to have explicitly allocated the payment of the $2.24 million to the termination of the lease. A less favourable but also achievable result may have been for the $2.4 million to have been paid by the Appellant to ADL as prepaid rent, with that amount then deductible over the course of the lease's remaining period.

A factor weighing against the Appellant was the adverse inference drawn by Paris J. due to the Appellant's failure to call witnesses from the Province. Given the ambiguity of the language concerning the consideration in the Surrender Agreement, Paris J. felt it was appropriate to consider external sources to bring light to its proper interpretation. However, between the adverse inference and the Appellant's broad argument that the phrase "other good and valuable consideration" be interpreted to include a monetary sum in addition to the amount of $10.00 explicitly listed in the Transfer Agreement, it is difficult to understand how Paris J. was expected to take the required leap of faith to find that the offset was used as a lease cancellation payment and not a payment on capital account.

Instead, Paris J. had sufficient evidence before him, including the Transfer Agreement's contemplation of a *new* ground lease being granted by ADL to the Appellant after the exercise of the Option by ADL, to find that the Appellant had structured the transactions to occur in a sequence whereby the surrender of the Ground Lease to the Province caused the merger of it with the fee simple title due to operation of law. Accordingly, the Appellant paid the $2.4 million for the transfer of title to the Property on ADL's behalf and received the right to enter into a new agreement in exchange for that payment.

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

Government Releases Proposals Regarding Tax Planning Using Private Corporations

The Department of Finance Canada fulfilled its Budget 2017 promise by launching a consultation on tax planning using private corporations. Draft legislation (with explanatory notes and a white paper) has been released. In brief, the following changes have been proposed:

- The tax on split income will be extended to include adult individuals where the amount received is unreasonable (a test based on the extent of the individual's capital and labour contributions). The types of income subject to the tax will also be extended to include income from debt, gains from the disposition of property from which the income is split income, and second-generation income on amounts that were previously subject to split income tax.
- New rules will crack down on strategies that multiply access to the lifetime capital gains exemption ("LCGE"). Minors will no longer be able to claim the LCGE. Gains that are subject to the extended split income tax are also ineligible for the LCGE, so an individual's eligibility for the LCGE is based upon the labour and capital contribution tests mentioned above. Last, gains accrued while the property was held by a trust are no longer eligible for the LCGE, with some minor exceptions. Regardless of whether the trust flows out the capital gains, or rolls out the property to the beneficiaries who then dispose of it, using a family trust to own a business will disqualify access to the LCGE — this will no doubt disrupt many plans and structures currently in place, including "garden-variety" estate freezes.
- Although no specific amendments have been proposed, the government plans on eliminating a perceived tax deferral advantage from holding passive investments within a private corporation. The government is asking for input from the tax community on how best to achieve this. The white paper provided by Finance suggests making changes to the current system, or replacing it with a new system. Potential replacement systems are also discussed in the white paper.
- Section 84.1 will be amended, and a new section of the Act will be introduced to prevent certain strategies that allow a corporation to convert its regular income into capital gains. If implemented, it appears that these changes will put an end to the so-called "pipeline" arrangements that are currently used to avoid the double taxation that otherwise can arise during the administration of an estate of a small business owner.

Most of the provisions will apply to 2018 and subsequent years. However, the measures targeting conversion of income into capital gains apply to amounts received on or after July 18, 2017. Submissions regarding these proposed rules will be accepted until October 2, 2017, which leaves tax professionals less than 70 days to comprehend the implications of the proposed changes and submit feedback to the government.

CRA Announces Service Improvements for SMBs

Last month, the CRA announced a series of service improvements targeting small and medium businesses ("SMBs") as a result of the *Serving You Better Consultations* conducted in 2016. Over 50 action items were announced, but the most noteworthy changes include:

- Taxpayers will be able to receive security codes via email by obtaining telephone authorization (as opposed to waiting to receive a code in the mail).
- A new mobile app will be created to assist businesses in managing their interactions with the CRA.
- Employers will be allowed to provide T4 slips to their employees in electronic format.
- New businesses will be able to sign up for *My Business Account* and online mail when registering for CRA accounts such as GST/HST and payroll.
- A dedicated telephone service for tax preparers will be launched as a pilot. Calls to this service will be directed to more experienced CRA staff who can address more complex issues.
- Corporations will be able to view the assessed value of their T2 returns and schedules and the CRA-verified capital dividend account balance in *My Business Account*.
- Certain auto-fill functionality will be added to T2 tax return software.
- As previously announced, the time it takes to resolve an objection will be improved.
- A post-audit survey will be launched in order to gather feedback from small businesses regarding their audit experience.

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 Allows Taxpayer To Calculate SR&ED Entitlement Based on 100% of Wages Paid to Owner-Employees Where Owner-Employees Are Remunerated for Non-SR&ED Work Through Dividend Payments

***AG Shield Canada Ltd. v. The Queen*, 2017 DTC 1034 (Tax Court of Canada)**

In this decision, the Tax Court of Canada considered whether a taxpayer was entitled to compute its SR&ED entitlement based on 100% of the wages paid to two owner-employees despite neither owner-employee having devoted 100% of his time to SR&ED eligible activities during the taxation year.

The appellant taxpayer was a corporation engaged in researching, designing, and manufacturing agricultural implements. The taxpayer had two shareholders, brothers Tom and Gary McCrea. Each brother owned 50% of the shares of the taxpayer and acted as the only officers and directors of the taxpayer. During the relevant period, Tom acted as general manager for the taxpayer and Gary was in charge of marketing and sales.

In the taxpayer's 2010 taxation year, Tom and Gary each worked 3,000 hours for the taxpayer. Tom engaged in 1094.5 hours of SR&ED activities and 1905.5 hours of non-SR&ED activities. Gary engaged in 201.5 hours of SR&ED activities and 2,798.5 hours of non-SR&ED activities.

Tom and Gary determined that the taxpayer should pay them for their SR&ED work at an hourly rate of $30 per hour, a rate based on what the taxpayer paid to third parties who performed similar SR&ED work. However, rather than pay each brother in respect of his proportionate share of SR&ED eligible work, the taxpayer paid Tom wages of $26,940

and Gary wages of $11,940, amounts that paid them, in total, at $30 per hour for the aggregate SR&ED work performed by the two of them.

The taxpayer claimed that the wages paid to Tom and Gary were paid solely in respect of SR&ED work and that they were not compensated for any other work they performed for the company. As a result, the taxpayer claimed SR&ED expenditures on the full amount of the wages paid to Tom and Gary under the proxy method for claiming SR&ED expenditures pursuant to clause 37(8)(*a*)(ii)(B) and subsection 37(10) of the Act.

Although each of the two brothers received money from the taxpayer as needed for his own livelihood throughout the year, the taxpayer claimed that such amounts were drawdowns that were subsequently declared as dividends by the taxpayer at the end of the year. In 2010, the taxpayer declared and paid dividends of $62,400, with Tom and Gary each receiving $31,200 as 50% shareholders of the taxpayer.

The CRA did not accept that the wages paid by the taxpayer to the brothers were paid only in respect of their SR&ED work. Instead, the CRA reassessed the taxpayer and made a downward adjustment to the taxpayer's SR&ED claims, reflecting the CRA's assumption that the SR&ED portion of the total salary and wages paid to each brother was equal to the percentage of the SR&ED hours worked by that brother out of the total number of hours he had worked in the year. In Gary's case, Gary engaged in 201.5 hours of SR&ED activities out of the total 3,000 hours he had worked for the taxpayer in the year (6.7%). Therefore, the CRA allowed as eligible SR&ED expenditures only 6.7% of the total $11,940 of salary and wages paid to Gary. The CRA made a comparable adjustment to the SR&ED expenditures claimed in respect of Tom's salary and wages.

The taxpayer appealed, arguing it should be entitled to claim SR&ED expenditures reflecting 100% of the salary and wages it paid to Tom and Gary.

The Tax Court examined a partial agreed statement of facts and concluded that the CRA had accepted that the total wages of $38,880 ($26,940 paid to Tom and $11,940 paid to Gary) were calculated on the basis of the total hours spent by Tom and Gary on SR&ED work. Critically, the CRA did not present any evidence to challenge the reasonableness of the $30 per hour rate, which the evidence of the taxpayer indicated was the rate paid by the taxpayer to arm's length third parties.

On the basis of the record before it, the Tax Court held that there was no factual basis for the CRA's approach to calculating the taxpayer's SR&ED claim on a prorated basis. The Tax Court noted that its conclusion was unaffected by the fact that the $38,880 of remuneration paid to the brothers was not split between them based on the number of hours of SR&ED work performed by each brother and the $30 hourly rate. According to the Tax Court, the method used to split the $38,880 between the brothers did not result in the taxpayer paying Gary an unreasonable hourly rate (of roughly $60 per hour).

The CRA argued that if the Tax Court were to accept that the $38,880 of wages were paid by the taxpayer solely in respect of SR&ED eligible work, then neither Tom nor Gary would have received any compensation for their directorial or managerial duties.

The Tax Court rejected this argument, finding that Tom and Gary were entitled, in effect, to receive their compensation for their directorial and managerial duties through the payment of dividends in lieu of salary and bonus. The Tax Court noted that such a decision did not need to be memorialized in a formal agreement.

To support their reassessment, the CRA cited *Ergorecherche et Conseils Inc*. (98 DTC 1710 (TCC)). In that case, the owners of a company carried out SR&ED activities on six projects but purported to allocate their salary and wages to only the three projects that were SR&ED eligible to the company. The Tax Court in *Ergorecherche* upheld the CRA's reassessment, which spread the owners' salary and wages across all six projects.

The Tax Court in *AG Shield* distinguished *Ergorecherche* stating that, factually, the salary and wages paid to the owners in *Ergorecherche* were calculated on the basis of the company's liquid assets rather than the total hours spent by the employee-owners on specific SR&ED projects (as was the case in *AG Shield*).

The Tax Court's refusal to apply *Ergorecherche* is interesting, because in both *Ergorecherche* and *AG Shield* the Tax Court was faced with a similar issue: is it reasonable to allocate salary on a basis that is inconsistent with the proportion of work performed on SR&ED eligible activities compared to SR&ED ineligible activities.

With respect, the Tax Court's reading of the holding in *Ergorecherche* may be incomplete. In *Ergorecherche* the Tax Court questioned how salary paid on the basis of a business' liquid assets could be paid in respect of SR&ED as required by the definition of "qualified expenditure" in subsection 127(9) of the Act. However, the Tax Court in *Ergorecherche* did *not* preclude the use of a liquid asset-based salary as a means by which a taxpayer might calculate

SR&ED expenditures. Rather, the Tax Court in *Ergorecherche* stated that a taxpayer would have to suggest a rational method for connecting the salary with SR&ED. In *Ergorecherche*, the Tax Court found that, on the facts before it, it was unreasonable to allocate zero salary paid to the specified employees for SR&ED ineligible activities which they had clearly undertaken.

While the Tax Court in *AG Shield* did not apply *Ergorecherche,* the decision in *AG Shield* merely distinguishes *Ergorecherche* and does not appear to overturn the core principle that it is not rational for SR&ED ineligible activities to be completely unremunerated where a specified employee has clearly spent a documented portion of his or her time on such activities. The outcome in *Ergorecherche* may be explained by the fact that the appellant company did not have the benefit of claiming the SR&ED ineligible activities were, in effect, remunerated through a dividend payment as was the case in *AG Shield*.

It may be the case that *AG Shield* will be limited to its facts when it comes to the interpretation of the phrase "in respect of scientific research and experimental development" in the definition of "qualified expenditure" in subsection 127(9). The decision likely should not be read as allowing taxpayers to undertake salary-shifting measures to maximize SR&ED expenditures. On a cursory read of the decision, it might appear that the Tax Court granted the taxpayer some leeway to rationalize the allocation of $38,880 to two individuals based on a single third-party appraisal of the value of hourly SR&ED work at $30 per hour: in *AG Shield*, the Tax Court accepted that Gary could be allocated $11,940 of salary that could be wholly included in the SR&ED computation based on 201.5 hours of work (approximately $59 per hour) despite Tom having been allocated $26,940 of salary based on 1094.5 hours of work (approximately, $25 per hour). While these amounts might be taken as the Tax Court's application of an expansive view of what will be considered to be a reasonable expenditure in respect of SR&ED expenditures, it is important to remember that the CRA did not present any evidence to refute that of the taxpayer about the reasonable hourly rate at which Tom and Gary should have been remunerated.

— *Justin Shoemaker*

Personal Trading by Senior Securities Executive on Income Account

***Foote v. The Queen*, 2017 DTC 1032 (Tax Court of Canada)**

This case considers whether gains realized by a securities trader on the sale of securities in his personal portfolio were on income or capital account. The taxpayer engaged in a number of personal trades of securities, the resulting gains from which he reported as capital gains on his 2009 income tax return. The CRA reassessed the taxpayer to include the full amount of the gains in income. On appeal, Justice Boyle of the Tax Court dismissed the appeal, finding that the taxpayer's personal trading activity generated income from business and therefore was required to be fully included in income.

The taxpayer was the co-head of institutional trading at a large, full-service brokerage firm. In that capacity, the taxpayer was responsible for overseeing traders who facilitated the purchase and sale of securities between institutional clients. During this time, he also had two personal investment accounts which, due to regulatory reasons, were required to be maintained at the same brokerage firm. In February 2009, the taxpayer liquidated all of the securities held in his investment accounts. Over the course of the year, he used the proceeds to engage in numerous transactions of buying and selling securities of 34 issuers costing about $2.5 million. The average hold period for the securities acquired during this time was 50 days, with some securities being held for an even shorter period of time. By the end of 2009, the taxpayer realized a total gain of about $550,000, or 23%.

The Court initially summarized several legal tests used in the prior case law to determine whether a particular gain realized on a securities transaction is on income or capital account. If the gain or loss was realized or sustained from a business or an adventure or concern in the nature of trade, then the particular gain or loss would be on income account. To determine whether the transactions constitute a business, the question is whether the taxpayer was engaged in a scheme for profit making or whether there was merely an enhancement of value. To make such determination, the intention of the taxpayer to either hold the property as an investment or for business purposes at the time the particular property giving rise to such gain or loss was acquired is key. The intention of the taxpayer could be gleaned from:

(i) the frequency of the transactions;

(ii) the duration of the holdings;

(iii) the nature and quantity of the securities held;

(iv) the time spent on the activity;

(v) financing;

(vi) particular knowledge possessed by the taxpayer;

(vii) consistent reporting; and

(viii) intention to acquire for profit.

The Court's decision turned largely on the taxpayer's testimony. The taxpayer testified that he had liquidated his accounts in early 2009 with the intention of paying down his mortgage, but after conferring with his wife and his investment advisor, he changed his mind. He said that he believed the 2008 financial crisis had bottomed out and saw an "unprecedented" opportunity to invest in stocks. His true intention to acquire the securities, the taxpayer contended, was to invest in diversified securities with the potential for 30% returns within a reasonable time frame. The taxpayer also suggested that his position as a co-head of institutional trading did not give him the expertise and experience that would be helpful with his personal trading. His stated intention and experience level contradicted the information disclosed to his investment advisor on his account agreements completed in respect of the investment accounts. In those account agreements, he disclosed, among other things, that he was a sophisticated investor with extensive experience and that his investment objectives included maximizing his total return on speculative securities and short-term trading. The taxpayer dismissed those agreements as something he would have signed and forgotten about.

The Court found the taxpayer's testimony to be "largely if not completely self-serving". His testimony was inconsistent and, at times, argumentative and "intentionally evasive". The Court did not accept that the taxpayer intended to pay down his mortgage only to then engage in subsequent trading because he thought that the market had bottomed out and that it would be a good time to invest. The Court found that the taxpayer's primary intention was to buy securities and to sell them for profit as soon as possible thereafter, or at the very least, that the taxpayer had a secondary intention at the time he bought the securities of selling them for profit. The Court also found that the taxpayer was a sophisticated investor and that his years of experience as a trader served him well to make profitable trades. The taxpayer spent time during the work day reviewing market activity and was able to gather information that was not typically available to the public. The Court noted that the nature of the taxpayer's gains on his personal trades was similar to what the taxpayer had been doing in his investment dealer positions for decades. The regular trading frequency and short holding periods also weighed in favour of finding that the taxpayer sought to buy and sell securities for the purpose of making a profit. The Court dismissed the taxpayer's appeal with costs.

Given the facts and credibility findings of the Court, it is not surprising that the taxpayer was found to be engaged in a business of trading securities or, at the very least, an adventure or concern in the nature of trade. Although Justice Boyle noted that it is possible for a securities trader to realize gains from buying and selling securities on capital account, this decision highlights that where there is similarity between a taxpayer's personal and on-the-job trading activity, combined with frequent trades and short holding periods, there will be an elevated risk that such activity constitutes a business, any gains arising from which will be on income account.

— *Jeremy Ho*

Third-Party Penalty Applicable to Developer and Promoter of Timeshare Donation Tax Credit Scheme

***Ploughman v. The Queen*, 2017 DTC 1033 (Tax Court of Canada)**

The *Ploughman* decision of the Tax Court of Canada concerns the application of third-party penalties under section 163.2 of the *Income Tax Act* (the "Act") to an individual, Mr. Glenn Ploughman, who was involved in a charitable donation tax credit scheme. *Ploughman* confirms, among other things, that a person involved in the creation and promotion of a dubious charitable donation tax credit scheme that is promoted for use by taxpayers can be penalized under section 163.2 of the Act whether or not the person prepared the charitable donation receipts or the tax returns in which the charitable donation credits are claimed. A person that creates and promotes a tax credit scheme that he or she knows (or should know) is invalid under the Act risks being subjected to third-party penalties.

Interestingly, the tax credit scheme at issue in *Ploughman* was the same scheme that gave rise to the Supreme Court of Canada decision in *Guindon* (2015 DTC 5086), in which the Supreme Court held that the third-party penalty provisions of the Act are not criminal in nature and therefore do not trigger *Charter of Rights* protections. In general

terms, the scheme involved the purported creation of timeshare units regarding a resort in the Turks and Caicos Islands. The timeshare units were allegedly transferred to a trust which would in turn transfer the units to taxpayers. The taxpayers would, in turn, donate the timeshare units to a registered charity at fair market value and receive tax receipts which showed donation amounts greater than the cash payments that the taxpayers had made.

In reality, the purported timeshare units had not actually been created, nor had the trust. Nor was there any valid transfer of any timeshare units from the trust to the taxpayers or from the taxpayers to any charity. In the *Guindon* case, Ms. Julie Guindon, a lawyer, was held to be liable for the third-party penalty for issuing a legal opinion that falsely asserted that she had reviewed documents implementing the scheme, when the documents in question did not even exist when she issued her opinion. The question to be decided in *Ploughman* was whether Mr. Ploughman's involvement in the tax credit scheme made him liable for third-party penalties under the Act.

Section 163.2 of the Act provides for two kinds of third-party penalties. First, the "planner penalty" (subsection 163.2(2)) can apply to a third party that "makes or furnishes, participates in the making of or causes another person to make or furnish" a false statement. Second, the "preparer penalty" (subsection 163.2(4)) can apply to a third party that "makes, or participates in, assents to or acquiesces in the making of" a false statement. For either of these penalties the person must have known, or would reasonably be expected to have known but for circumstances amounting to "culpable conduct", that the statement was false. "Culpable conduct" is defined by section 163.2 in a manner similar to the test developed by case law for gross negligence under subsection 163(2) of the Act, that is, conduct that is tantamount to intentional conduct, shows indifference as to whether the Act is complied with, or shows a wilful, reckless, or wanton disregard of the law. A good faith defence may apply by virtue of subsection 163.2(6), which generally applies where the third party relied in good faith on information provided by the person that made the false statement. The good faith defence appears to be intended to protect, for example, tax preparers who rely on their clients to provide complete and accurate information when preparing their clients' returns.

The Minister asserted that both the planner and preparer penalty tests were met in Mr. Ploughman's case due to his extensive involvement in the development and promotion of the tax credit scheme. Mr. Ploughman contended that he was, at least initially, a mere canvasser and that he only learned after the false credit claims had been made that the transactions had not been implemented.

The Court's decision turned largely on its findings of fact regarding the nature and level of Mr. Ploughman's involvement in the scheme and when he learned that the relevant transactions had not actually occurred. On these issues, Mr. Ploughman testified on his own behalf, and the Minister called as witnesses Ms. Guindon and one Lee Goudie, who was a land developer in the Turks and Caicos with an involvement in the development of the scheme. The Court found that none of these three witnesses were reliable or credible and proceeded to base its decision, as much as could be done, on the available documentary evidence.

The Court's analysis of the documents led to a clear conclusion that Mr. Ploughman participated in the making of, or assented to or acquiesced in the making of, or caused the donor taxpayers to make or furnish, statements that he knew, or should have known, were false. As such, both the planner and preparer penalty tests were satisfied. The initial planning for the scheme occurred in the spring and summer of 2001, when Mr. Ploughman connected with Mr. Goudie regarding a resort development financing plan.

Arrangements were made to incorporate a Turks and Caicos company to carry out the development and sell timeshare units to a settlor who would in turn transfer the units to a trust known as the Global Trust of Canada ("Global Trust"). KGR Tax Services Ltd. ("KGR"), a company of which Mr. Ploughman was President and a one-third shareholder, agreed in the summer of 2001 to be the trustee of the Global Trust. The prospective donor taxpayers (who wanted to claim the tax credits) would become beneficiaries of the Global Trust, receive timeshare units, then transfer the units to a charity through an intermediary known as Suntopic International Advisors Ltd. ("SIA"). Although Mr. Ploughman denied in cross-examination that he knew of the existence of SIA until 2004, the full name of that company appeared in Ms. Guindon's legal opinion, issued in September 2001 and addressed to KGR to Mr. Ploughman's attention, at least nine times.

Mr. Ploughman claimed to have no knowledge at all of any issues with the underlying transactions until around March 18, 2002, when a letter signed by him and on KGR's letterhead was issued to the donors advising that some of the documents had not been finalized and recommending that the charitable donation receipts (issued for the 2001 taxation year) not be submitted with the donors' tax returns. On April 5, 2002, allegedly based on verbal assurances that the transactions would be finalized shortly, Mr. Ploughman sent another letter on KGR letterhead to the donors advising that the "issues are in the process of being resolved" and recommending that the donors "go ahead and submit the Charitable Donation receipt". In fact, the transactions were never completed.

The Court considered that Mr. Ploughman was a creator and promoter of the scheme because, although the evidence was not conclusive, and among other reasons, Mr. Ploughman was a significant shareholder and an officer of both KGR and SIA and the correspondence written by him suggested that he was involved in structuring the donation plan. Further, Mr. Ploughman's letter of April 5, 2002, recommended that the donors submit false donation receipts when he knew or should have known that the transactions were not complete. If Mr. Ploughman did not know by late March 2002 that the trust was not properly constituted it was because, in the Court's words, he "buried his head in the sand". Mr. Ploughman similarly either knew or chose not to know about issues with the other transactions. Further, despite Mr. Ploughman's argument that he had relied on Ms. Guindon's legal opinion, Mr. Ploughman could not rely on the good faith defence because, among other reasons, the good faith defence requires reliance on false information provided by the persons that made the false statements (the donors in this case), and Mr. Ploughman had not relied on such information. In any case, in light of Mr. Ploughman's wilful blindness to the truth, his reliance on Ms. Guindon's legal opinion was not in good faith. Consequently, Mr. Ploughman's appeal was dismissed.

— *Theodore Stathakos*

Can Employer-Provided Parking Not Be a Taxable Benefit?

***Smith v. The Queen*, 2017 DTC 1031 (Tax Court of Canada) (Informal Procedure)**

This case was decided under the Tax Court's informal procedure. The taxpayer was a flight attendant who resided in Calgary and was employed in that city by Jazz Aviation LP. The issue before the Tax Court was whether the employer-provided parking pass was a taxable benefit that should be included in the taxpayer's employment income paid by Jazz.

In determining whether an employer-provided parking pass is a taxable benefit for an employee, the jurisprudence has established that the issue is whether, on a balance of probabilities, the primary beneficiary of the parking pass is the employer or the employee.

In the present case, the collective bargaining agreement governing the terms of employment for Jazz flight attendants required Jazz to provide employees with a parking pass for the Calgary airport. The relevant provision in the collective agreement had been in place for more than 20 years and there was no evidence to explain how or why it made its way into the collective agreement at first instance. The annual value of a parking pass that was provided in this case was $504 per year.

Jazz does not require its flight attendants to have a car or driver's license as a condition of employment and allows them to use whichever mode of transportation they want to get to the airport. However, for this particular taxpayer, the use of public transportation (i.e., bus) would have either been impossible in the case of early morning flights, or otherwise impractical due to intervals and/or timing of bus connections from his place of residence. Therefore, in the taxpayer's case, driving to the airport appeared to have been the only feasible transportation choice and, if a parking pass was not provided to him pursuant to the collective agreement, his only option would have been to pay for it out of his own pocket.

Jazz is a subsidiary of Air Canada and it provides the service of connecting domestic Jazz flights to Air Canada international flights. The compensation that Jazz receives from Air Canada for its services is based on the number of on-time departures and, therefore, it is important for Jazz to have flight attendants that arrive to work on a timely basis and can accommodate a flexible work schedule.

To manage its personnel costs, each Jazz flight maintains the minimum number of employees required by law. Consequently, if a flight attendant scheduled to accompany a flight is late or does not report for work, the plane is unable to depart until a full complement of flight attendants is on-board. If the arrival of the Jazz flight to its destination is delayed, any Air Canada flight that the Jazz flight is feeding could also be delayed. To mitigate the risk of a delay of flight departure due to flight attendant numbers, Jazz maintains at all times a number of off-duty flight attendants available for "reserve" duty, whereby they could be asked to report to the airport to join a flight on two hours' notice.

Within this context, the arguments advanced by the taxpayer revolved around the importance to Jazz of having its flight attendants punctually report to work on time and reliably fulfil their obligation to arrive at the airport with two-hours' notice during a 24-hour period when on "reserve duty". The taxpayer also argued that, by supplying the parking passes to its flight attendants, Jazz was able "to further the attainment of its goal of in-time performance and allowed its flight attendants to be more reliable, flexible and punctual."

The Tax Court rejected these arguments, finding that there was no evidence to show a correlation between the reliability of the flight attendants reporting to work on time and whether they arrived to work by car versus other means.

The Tax Court also considered whether Jazz had to provide the parking passes to the flight attendants to discharge its obligations as part of an industry-wide practice or requirement and found that there was no evidence to suggest that this was the case.

As a result, the Tax Court determined that in this case the primary benefit from the parking pass was enjoyed by the taxpayer, as he received the economic benefit of not having to pay $504 annually that he would have otherwise paid for the parking pass if it was not provided by Jazz.

In light of the evidence that was put before the Tax Court, it is hard to see how the Tax Court could come to any other conclusion. It is unfortunate that the parties were unable to shed more light on the reason why either Jazz or the relevant union sought to have the parking passes included as part of the terms of employment, as the reason might have caused the Tax Court to see more benefit for Jazz. For example, since the cost to park at airports in most cities is higher in relation to other parts of the same city, would the assessment of benefit to the employer of providing its employees with parking passes have been different if the employees working elsewhere in the city had easy access to free parking? Would it primarily benefit the employee if the rationale for including the parking passes was to compensate them for having to report to a work location where they would have to pay a premium price for parking for extended periods of time and the alternative of public transportation was not feasible? Maybe. Maybe not.

— *Nicole Platanitis*

RECENT CASES

University entitled to determine full-time or part-time status of student for purposes of education tax credit

The taxpayer, who was living in Canada, was enrolled in an MBA program at the University of Liverpool through its online learning program. The University issued a TL11A information slip for the 2014 tax year which indicated that all of the taxpayer's study months during that year were part-time and none were full-time. The taxpayer claimed the education tax credit in respect of each of those months and her claim was denied on assessment. The taxpayer appealed.

The appeal was dismissed. The appellant took the position that she worked approximately 30 hours per week on her courses, and that the University classified the on-line program as part-time because it required three years to complete, while the equivalent on-campus program was a one-year program. The Tax Court held that, in order to claim an education tax credit with respect to attendance at a university outside of Canada, full-time attendance at that university is required. While it was possible that a student could attend a university full-time when enrolled in distance or online learning, the only issue to be decided was whether the university's classification of the appellant's studies as part-time was correct, or whether her estimate of 30 hours a week qualified her attendance as full-time. The Court held that the University's characterization was objectively determined, well-reasoned, and correct. In the Court's view, the *Income Tax Act* did not contemplate that full-time or part-time characterization of a student's attendance was dependent on the number of hours each week devoted to studies which would, in any case, vary by individual and be unsubstantiated. Rather, as held in the jurisprudence, the question of full-time versus part-time attendance was a matter to be determined by the educational institution, which controls its enrolment and determines the full-time/part-time status of its students according to the course load that is undertaken. The appellant's facts and circumstances did not satisfy the requirements set out in the *Income Tax Act* for the education tax credit.

Archibald v. The Queen

2017 DTC 1055

Lump-sum costs award in lieu of taxed costs awarded to successful appellant

The appellant had successfully appealed from reassessments for its 2003 through 2009 taxation years, which were heard on common evidence. It sought a lump-sum costs award in the amount of $2.7 million (including disbursements), in lieu of taxed costs.

The application for a lump-sum costs award was allowed, in a reduced amount. The Tax Court judge held that, following Rule 147 of the *Tax Court of Canada Rules (General Procedure)*, it had broad discretionary power to determine the amount of costs of all parties to a proceeding, the allocation of those costs, and the persons required to pay such costs. The Court was also empowered to provide a lump sum costs award in lieu of or in addition to any taxed costs. The Court held that, while it was not required to consider the factors set out in Rule 147(3) in determining a costs award, those factors provided a helpful framework for assessing, on a principled basis, whether and to what extent costs should be awarded to a party. The Court reviewed the particular circumstances of the case before it in light of each of those factors, including the result of the proceeding, the amounts in issue, the importance of the issues, whether any written settlement offers were made, the volume of work, the complexity of the issues, and the conduct of the parties. Following that review, it concluded that an award to the appellant of a lump sum in lieu of taxed costs for counsel fees was appropriate. However, the Court was not prepared to accept the recommendations of either the appellant or the respondent as to the quantum of those costs. The Court concluded instead that the factors considered justified a lump-sum costs award to the appellant of $1.1 million (exclusive of disbursements), in lieu of taxed costs. The Court also ordered that the disbursements claimed by the appellant be taxed in accordance with the Rules.

CIT Group v. The Queen

2017 DTC 1050

Taxpayer not entitled to business loss or capital loss deductions relating to alleged loss of his clients upon his dismissal from employment as financial consultant

The taxpayer lost his employment as a financial consultant when his employer was taken over by another consulting firm, Peak. Alleging that he could not find alternative employment, that Peak had stolen his clients, and that he had received no compensation from Peak, he sought to deduct both a business loss and a capital loss allegedly sustained by him resulting from his dismissal from Peak's employment. The Tax Court of Canada dismissed his appeal (2014 DTC 1155 (CCI)) from the Minister's assessment for 2010, disallowing the deduction of both losses. The taxpayer appealed to the Federal Court of Appeal.

The taxpayer's appeal was dismissed. The Tax Court judge concluded, in part, that the taxpayer's claim to deduct a loss representing his loss of anticipated income as a deductible loss on income account was simply not one recognized by the *Income Tax Act* (the "Act"). In the Tax Court judge's view, business loss deductions under that Act require the existence of income against which to make such deductions, and in this case the taxpayer had no income for 2010, but only what he had characterized as the loss of some unrealized "anticipated" income amounting to $14,000. The judge also concluded, in part, that, inasmuch as the taxpayer had never "purchased" his clients at any ascertainable cost, they did not constitute an "asset" capable of being sold by him. As a result, the judge felt that the taxpayer's attempt to equate the "cost" of his clients to an estimate of their equal fair market value was misplaced. In the judge's view, therefore, no capital loss deduction was available to the taxpayer in these circumstances under the provisions of the Act. The judge also observed that what the taxpayer was really attempting to achieve in this case was compensation for the loss of his employment, which was an issue with respect to which the Tax Court had no jurisdiction. The judge's findings contained no errors in law and no errors in his assessment of the facts, so that there was no cause for appellate intervention.

Martin v. The Queen

2017 DTC 5058

Tax return was filed late but Commissioner fettered discretion in denying extension of time

The petitioner's 2012 tax year ended on October 31, 2012. It was seeking a $2.8 million provincial income tax refund under the International Business Activity Program ("IBAP") that was designed to encourage international business in British Columbia. On April 30, 2014, its 2012 tax return was delivered to a courier in Toronto, and it was received on May 1, 2014, in Victoria, British Columbia. Arguing that it was filed a day late, the Commissioner of Taxation made a nil determination with respect to the refund claim. A request for an extension of time was denied on the basis that there were no extraordinary circumstances for the late filing and the request for an extension was not received before the filing-due date. The Minister of Finance confirmed the nil determination. The petitioner, TD, appealed the Minister's decision and sought judicial review of the Commissioner's refusal to extend time. The Chambers judge held that the return had been filed on time and ordered the Commissioner to assess the claim on that basis, and did not find it necessary to deal with the extension of time issue. The Province appealed the determination that the return was filed on time. TD cross-appealed with respect to the refusal of an extension. TD argued that the Commissioner's decision was unreasonable given the inconsequential delay in filing the return, the lack of prejudice, and the harsh result for TD.

The appeal was allowed as well as the cross-appeal. The notice of determination of a nil refund is to be set aside and the request for an extension of time to file the 2012 return is to be remitted to the Commissioner for reconsideration. Under the IBAP legislation, tax returns are to be filed within 18 months after the end of the taxation year (October 31). Under the *Interpretation Act*, the first day of calculation is excluded. The parties agreed that the day on which the triggering event occurs is excluded. The Chambers judge had held that the taxation year ended on October 31 and the first day to be excluded was November 1, 2012, which meant that filing the return on May 1, 2014, was within the time limit for filing. The triggering event was the end of the taxation year, which was October 31, and the proper calculation was to exclude October 31, 2012. The last day for filing the 2012 tax return was therefore April 30, 2014, and not May 1, 2014. Having determined that the return was filed late, TD's cross-appeal regarding the Commissioner's refusal to grant a one-day extension must be considered. The standard of review of the Commissioner's decision is that of reasonableness. The Commissioner erred in holding that the only reason for granting an extension of time is under extraordinary circumstances. While it was open to the Commissioner to look at Ministry of Finance policy statements of other statutes which discuss extraordinary circumstances as a prerequisite for relief, she erred in treating them as binding. Administrative policies are not law. By holding that she was precluded from granting an extension as there were no extraordinary circumstances, she fettered her discretion and reached an unreasonable decision.

TD Bank v. British Columbia

2017 DTC 5048

Appeal from dismissal of action allowed where limitation period not expired

The taxpayer's tax returns were filed by the defendants after the required due date and, as a result, the Canada Revenue Agency denied tax credits which would have been available had the returns been timely filed. The taxpayer suffered damages of approximately $550,000. The Notices of Assessment disallowing the credits were received on April 12, 2010. Notices of Objection were filed but a letter from the Canada Revenue Agency in May 2011 indicated that it intended to confirm the assessments. In July 2011, it did so. In August 2012 the appellant brought an action against the defendants for their failure to file the returns by the due date. The defendants brought a motion for summary judgment dismissing that action, on the basis that the applicable two-year limitation period had expired. The motion was granted, and the taxpayer appealed from that decision.

The appeal was allowed. The appellate Court held that the motion judge's decision to grant summary judgment against the appellant turned on the application of the "discoverability" provision contained in subsection 5(1) of the *Limitations Act*. That provision defines the time at which a plaintiff knew or ought to have known that its proceeding was appropriate. The motions judge held that date to be as early as April 2010, but the Court of Appeal concluded that he had erred in reaching that conclusion. The Court of Appeal held that the proceeding was not appropriate, and the appellant's underlying claim was not discovered, until May 2011, when the CRA responded to the Notice of Objection and advised that it intended to confirm its initial assessments. The jurisprudence provides that it may not be appropriate to bring an action against an expert professional if the claim arose out of the professional's alleged wrongdoing but may be resolved by the professional him or herself without recourse to the courts, rendering the

proceeding unnecessary. On the facts, the appellant's accountants continued to pursue its case with the CRA and, in the appellate Court's view, it would not have been appropriate for the plaintiff to commence a proceeding until those efforts concluded. As well, the ongoing CRA appeal process had the potential to eliminate the appellant's loss and could have resolved the dispute between the appellant and the respondents, making a proceeding unnecessary. Once again, the Court found that it would not have been appropriate for the appellant to commence a proceeding until the CRA appeal process was exhausted in May 2011. The motions judge had consequently erred in holding that the plaintiff's action brought in August 2012 was time barred.

Presidential MSH Corporation v. Marr, Foster et al

2017 DTC 5049

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