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THE EXPANSION OF THE DIVIDEND STRIPPING RULES

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As the dust continues to settle following the release of the Department of Finance's Special Report on "Tax Planning Using Private Corporations Including Legislative Proposals Relating to the Income Tax and Regulations", the implications to various stakeholders are beginning to emerge. One area of concern includes the amended section 84.1 "anti-stripping" rules under the *Income Tax Act* (Canada) (the "Act").

Previous Section 84.1

A fundamental concept in Canadian tax law is that paid-up capital generally may be returned to shareholders tax-free, provided there is sufficient adjusted cost base. Comparatively, retained earnings can only be distributed as a dividend. There is no concept in corporate law that requires retained earnings to be distributed first. However, there are provisions that prevent the artificial creation of paid-up capital.

Section 84.1 was introduced to prevent the removal of corporate surplus that would otherwise be taxed as dividends, or "surplus stripping", on a tax-free basis. In general terms, section 84.1 is an anti-avoidance provision intended to prevent the creation of paid-up capital or the stripping out of retained earnings on account of capital (in contrast to dividend treatment) by means of a reorganization, related party sale, or other transaction. Section 84.1 may also apply to deny the removal of retained earnings free of tax in some cases, to the extent that the adjusted cost base of the shares includes appreciation in value before V-day or amounts for which a transferor has claimed the capital gains deduction in a non-arm's length sale of shares. The application of the provision results in a reduction in the paid-up capital of the shares received and/or a deemed dividend on the disposition of the shares.

Commonly, these anti-stripping rules will not apply:

(1) to dispositions by corporations, given that corporations will generally prefer to receive proceeds in the form of a dividend;

(2) to arm's length dispositions, in circumstances where it is appropriate that the taxpayer received proceeds of disposition; or

(3) to a taxpayer who transfers shares in situations where the corporation whose shares are transferred would not be connected with the purchaser corporation after the disposition.

Amended Section 84.1

The proposed changes to Section 84.1 may have certain unanticipated consequences. For illustrative purposes, it is worth reviewing the examples provided by the Department of Finance in the explanatory notes to the proposed changes. The specific examples provide as follows:

> **Example 1:**
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> This example concerns a taxpayer who acquires a share of a private corporation (Opco) in circumstances where capital gains were realized on previous dispositions of the share by individuals with whom the individual did not deal at arm's length. In the example, the taxpayer is a daughter (D) whose father (F) and mother (M) are also the parents of D's brother (B). There are no other non-arm's length individuals.
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> D acquires a share of Opco for $700,000 from B. To determine the amount of the ACB of her Opco share for the purpose of section 84.1, D refers to the cost of the share ($700,000) and computes the total amount of all capital gains realized from previous dispositions of the share after 1984 by D and by individuals with whom D did not deal at arm's length (i.e., F, M and B). All acquisitions and dispositions of the Opco share are for fair market value.
>
> Previous acquisitions and dispositions of the Opco share in chronological order:
>
> **1. F acquires for $10,000 the Opco share from an arm's length person.**
>
> F's Opco share has a $10,000 cost and ACB.
>
> **2. F disposes of the Opco share to M for $100,000.**
>
> F realizes a $90,000 capital gain ($100,000 - $10,000), M's Opco share has a $100,000 cost and ACB (before applying amended paragraph 84.1(2)(*a*.1)). Because of amended subparagraph 84.1(2)(*a*.1)(ii), the ACB of M's Opco share for the purposes of section 84.1 is reduced to $10,000, computed as follows: $100,000 (ACB otherwise determined) less F's $90,000 capital gain.
>
> **3. M disposes of the Opco share on an arm's length basis to X Corporation for $450,000.**
>
> M realizes a $350,000 capital gain ($450,000 - $100,000).
>
> X Corporation's Opco share has a $450,000 cost and ACB.
>
> **4. X Corporation disposes of the Opco share on an arm's length basis to B for $600,000.**
>
> X Corporation realizes a $150,000 capital gain ($600,000 - $450,000).
>
> B's Opco share has a $600,000 cost and ACB (before applying amended paragraph 84.1(2)(*a*.1)). Because of amended subparagraph 84.1(2)(*a*.1)(ii), the ACB of B's Opco share for the purposes of section 84.1 is reduced to: $160,000, computed as follows: $600,000 (ACB otherwise determined) less $440,000 (i.e., F's $90,000 capital gain + M's $350,000 capital gain).
>
> **5. B disposes of the Opco share to D for $700,000.**
>
> B realizes a $100,000 capital gain ($700,000 - $600,000).
>
> D's Opco share has a $700,000 cost and ACB (before applying amended paragraph 84.1(2)(*a*.1)). Under amended subparagraph 84.1(2)(*a*.1)(ii), the ACB of D's Opco share for the purposes of section 84.1 is reduced to: $160,000, computed as follows: $700,000 (ACB otherwise determined) less $540,000 (i.e., F's $90,000 capital gain + M's $350,000 capital gain + B's $100,000 capital gain).

The amended paragraph 84.1 changes the results that apply under the surplus stripping rules in respect of a disposition of a subject share to a purchaser corporation.

Example 2:

In this example, an individual (D) disposes of a share (the subject share) of a corporation resident in Canada (the subject corporation) to another corporation with which D does not deal at arm's length (the purchaser corporation). After the disposition, the purchaser corporation is connected to the subject corporation under subsection 186(4).

Before the disposition, D has a $700,000 cost and ACB in respect of the subject share and the PUC in respect of the subject share is Nil. However, the ACB of the subject share is reduced under subparagraph 84.1(2)(*a*.1)(ii) to $160,000 from $700,000 (see the prior example for an explanation of this reduction). The reductions to D's ACB concern previous capital gains realized by non-arm's length individuals. (In contrast, D's ACB would have been $700,000 under current paragraph (2)(*a*.1) assuming the individuals did not claim the LCGE.)

D intends to transfer her subject share to her purchaser corporation for $700,000 and wants to know the results under subsection 84.1(1) if she were to receive in return a share of the purchaser corporation with a PUC of $300,000 and $400,000 of non-share consideration.

A. Application of paragraph 84.1(1)(*a*) — PUC reduction (Purchaser Corporation)

Under amended paragraph 84.1(1)(*a*), the increase to the PUC of the class of shares of the purchaser corporation that includes the share issued to D ($300,000, determined without reference to section 84.1) is reduced by $300,000 to Nil. The $300,000 PUC reduction is determined by the formula

$$(A - B) \times C / A$$

where

A is $300,000 (the increase in PUC of all shares of the purchaser corporation determined without reference to section 84.1 (assume there is only one class of shares and the increase is $300,000)).

B is Nil (the amount by which the greater of the PUC of the subject share (Nil) and their ACB ($160,000) exceeds the fair market value of the non-share consideration ($400,000).

C is $300,000 (the increase in the PUC of the particular class of shares determined without reference to section 84.1 as a result of the issuance of the share to D).

Note: There would have been no PUC reduction if current paragraph 84.1(2)(*a*.1) applied because the amount determined under the description B would have been $300,000 based on the $700,000 ACB exceeding by $300,000 the $400,000 of non-share consideration. Therefore, the result of A – B, which is the amount of the PUC reduction, would have been $300,000 - $300,000 = Nil.

B. Application of paragraph 84.1(1)(*b*) — deemed dividend treatment

Under amended paragraph 84.1(1)(*b*), D would be deemed to have received from the purchaser corporation a taxable dividend of $240,000 as determined under the formula

$$(A + D) - (E + F)$$

where

A is $300,000 (the increase in PUC of all shares of the purchaser corporation determined without reference to section 84.1 (assume there is only one class of shares and the increase is $300,000)).

D is $400,000 (the non-share consideration).

E is $160,000 (the greater of the PUC (Nil) and the ACB ($160,000) of the subject share).

F is $300,000 (the purchaser corporation's PUC reduction under paragraph 84.1(1)(*a*)).

> The result is that D is deemed to have received a dividend of $240,000, which is the amount by which the total of the purchaser corporation's $300,000 PUC (otherwise determined) and the $400,000 of non-share consideration she received ($700,000 in total) exceeds the total of D's "hard" ACB of $160,000 and the purchaser corporation's $300,000 PUC reduction under paragraph (1)(*a*) ($460,000 in total). There would have been no deemed dividend under paragraph (1)(*b*) if current paragraph 84.1(2)(*a*.1) applied because the total of $700,000 in the descriptions of A and D ($300,000 of PUC and $400,000 of non-share consideration) would not have exceeded the $700,000 "hard" ACB.

Although lengthy, these examples demonstrate that the implications of the proposed amendments are concerning. Of importance, any previous gain realized in the transaction in which the parties were not dealing at arm's length is not included in the adjusted cost base of the shares for the purposes of section 84.1.

In Example 1 above, under the existing section 84.1 rules, B would have a cost base of $600,000. Under the amended section 84.1 rules, any previous non-arm's length gain is now lost. Specifically, the $90,000 gain of F realized from the sale to M is lost. The gain of M, of $350,000, is also lost. In effect, B would only have a cost base of $160,000. Based on the example, not only is section 84.1 triggered, but other sections of the Act, including section 246.1, should also be considered.

Example 2 also demonstrates that the post-mortem pipeline planning technique, often used to avoid double taxation on the death of a shareholder of a private corporation by extracting corporate surplus at capital gains rates, has been directly targeted with the latest amendments. Despite previous favourable rulings from the Canada Revenue Agency (the "CRA") that the pipeline planning strategy was permissible, there was some indication that the strategy was under CRA scrutiny. In the years leading to the amendments, including most recently at the Canadian Tax Foundation's conference in British Columbia in 2016, the CRA expressed concern about the potential application of subsection 84(2) of the Act to result in a deemed dividend. For practitioners, the new amendments extend well beyond the deemed dividend issue identified by the CRA.

Given the changes described above, from a practical perspective the amended anti-stripping rules introduce new concerns for practitioners. The rules seemingly require a review and determination of the historical ownership of shares. In effect, this introduces a burden on apparently any related-party share purchase and sale transaction. If there is an interposition of a non-arm's length party to a related party transaction, the amended section 84.1 rules would apply.

We also note that the current iteration of the amended section 84.1 anti-stripping rules introduces uncertainty to the return of capital. A return of capital, long thought to be a shareholder's right, should now be carefully reviewed to ensure that none of the amended section 84.1 rules apply.

Finally, much has been written about the possible death of the pipeline planning technique, and the concern should be reiterated. Without the credit of the hard adjusted cost base, taxpayers should consider alternative estate planning strategies, such as estate freezes. However, even an estate freeze transaction is not without risk as taxpayers may run into valuation issues concerning shares.

The amended dividend stripping rules are expansive. Without doubt, more analysis of the amended rules, and their related provisions, is necessary.

TAX EVASION AND TAX AVOIDANCE

— *David C. Nathanson, Q.C., DLA Piper*

> A phrase begins life as a literary expression; its felicity leads to its lazy repetition; and repetition soon establishes it as a legal formula, undiscriminatingly used to express different and sometimes contradictory ideas.
>
> — *Felix Frankfurter*

If ever Justice Frankfurter's quotation were applicable, it is to the expressions "tax avoidance" and "tax evasion", as exemplified recently by the House of Commons Finance Committee in its Report on the CRA. Like the CRA, the Committee has almost conflated the different notions embodied by those two expressions and treats them both as evils to be combatted.

There seems to be little debate on what is meant by "tax evasion". It is the deliberate or intentional action of a person in an attempt, whether successful or not, to not pay the tax owed. This presupposes knowledge by the person that the law is being flouted; thus, tax evasion is an attempt to evade the payment of tax clearly owing under the law. Ironically, such an attempt, where unsuccessful, means that no tax is actually evaded. The attempt at evading tax has been apprehended. The transaction may be described as a foiled attempt to evade tax. Only where the attempt to evade goes undetected, or where detected the result is no recovery, does the attempt deserve to be called tax evasion.

The expression "tax avoidance" is quite another thing. It is generally thought to be tax planning that yields a result that is offensive to most people, whether it is achieved legally or proves to be no more than an unsuccessful attempt to comply with the law. Compliance with the law may be real, in which case the avoidance is successful. Or it may be ostensible only and therefore without its intended efficacy. In either case it is considered to be undesirable, if not wrong, and the word "abusive" is usually attached to it either expressly or implicitly. When reference is made to "tax avoidance", one can virtually take for granted that the person referring to it regards it as "abusive", i.e., somehow not right, whether violative of the law or not (without taking into account the general anti-avoidance rule known by the familiar acronym "GAAR"). GAAR enables a tax result that would otherwise be legally effective to be determined *ex post facto* to be "abusive" and therefore ineffective.

The expression "tax avoidance" deserves to be considered and analyzed a bit more deeply. To begin with, the irony, of course, in referring to "tax avoidance" is that where the planning is ineffective, either apart from GAAR or because of it, no tax has been avoided. In such a case, what is referred to as tax avoidance is more accurately referred to as legally ineffective tax planning. The expression "tax avoidance" where no tax is ultimately avoided misses the mark. In that regard, the expression "tax avoidance" is like the expression "tax evasion" because where it is unsuccessful no tax has been avoided.

There is no justification for using the expression "tax avoidance" pejoratively, i.e., as being implicitly abusive. Tax avoidance is successful tax planning, i.e., it has legal efficacy and is not vitiated by GAAR. Where it is successful (despite GAAR), it is not a bad or offensive thing unless the government considers it to be and Parliament prevents its repetition by an amendment to the statute.

This view is hardly radical. It has been endorsed by the Supreme Court of Canada, for which Madam Justice McLachlin (as she then was) in the case of *Shell Canada Ltd v. The Queen*, 99 DTC 5669, held that taxpayers' legal relationships must be respected and that an "unexpressed legislative intention" should not be read into an otherwise clear statutory provision. She went on at para. 45 to say this:

> [A]bsent a specific provision to the contrary, it is not the courts' role to prevent taxpayers from relying on the sophisticated structure of their transactions, arranged in such a way that the particular provisions of the Act are met, on the basis that it would be inequitable to those taxpayers who have not chosen to structure their transactions that way. . .The courts' role is to interpret and apply the Act as it was adopted by Parliament. . .

> [A] broader and less certain interpretive principle [is not valid]. . . Unless the Act provides otherwise, a taxpayer is entitled to be taxed based on what it actually did, not based on what it could have done, and certainly not based on what a less sophisticated taxpayer might have done.

Taxation in Canadian law depends on the application of statutory provisions to taxpayers' transactions characterized by their valid legal nature. Apart from GAAR, there is no basis for taxation by the exercise of administrative discretion in the absence of a statutory provision permitting it. The general attitude of the courts in Canada to the subject of tax avoidance, apart from GAAR, is informed by the rule of law and the certainty that it brings. With GAAR, the rule of law in tax matters is eroded where a tax-motivated transaction that is also "abusive" takes place. Inasmuch as what is "abusive" is very much in the eye of the beholder, the CRA in the first instance and then the courts are given by GAAR an essentially quasi-legislative role to play in determining when and how a transaction is to be treated under GAAR. They make rules on the spot, expatiating with learned ratiocination on why it applies or it does not and, if it does, how it does.

CURRENT ITEMS OF INTEREST

Government of Canada Considering Issuance of Ultra-Long Bonds

The Government of Canada is considering issuing ultra-long bonds, subject to favourable market conditions, through a re-opening of the 2.75% December 1, 2064 ultra-long bond, using a modified auction process.

To facilitate market preparations for potential ultra-long bond issuances, the Government will consult its primary dealers regarding possible issuance dates and auction sizes. Potential issuance dates during the current quarter will be assessed, and potential issuance dates in future quarters will be communicated through quarterly bond schedules posted on the Bank of Canada's website. If a decision is made to hold an ultra-long bond auction, a Call for Tenders confirming the date and size of the auction will be posted on the Bank of Canada's website.

The CBA/CPA Joint Committee on Taxation Respond to the Proposed Changes to the Voluntary Disclosure Program

The CBA/CPA Joint Committee on Taxation submitted an extensive response to the proposed changes to the Voluntary Disclosure Program announced on June 9, 2017. The submission focuses principally on the proposed changes as they relate to taxes payable under the *Income Tax Act*. However, many of the comments are equally applicable to the proposed changes as they relate to GST/HST or other taxes.

In addition to commenting on the proposed changes, the submission also discusses certain aspects of the current VDP policy which are not affected by the proposed changes, but which the Joint Committee believes the Minister should consider as part of the current proposal to amend the VDP guidelines.

CRA Releases Guide to Common Reporting Standards

The CRA has released a very detailed guide to the Common Reporting Standards, which were implemented by the addition of Part XIX to the *Income Tax Act*. The guide describes the due diligence and reporting obligations that arise under the ITA by virtue of the CRS implementation in Canada.

Drought Regions for 2016 — Livestock Farmers Eligible for Tax Deferral

The final list of designated regions where livestock tax deferral has been authorized for 2016 due to drought conditions in British Columbia, Alberta, Ontario, Quebec, and Nova Scotia is now available. The livestock tax deferral provision allows producers in designated drought regions who are facing feed shortages to defer a portion of their sale proceeds of breeding livestock to the next year. The cost of replacing the animals in the next year offsets the deferred income, thereby reducing the tax burden associated with the original sale. Eligible producers can request the tax deferral when filing their 2016 income tax returns, or, if they have already filed, submit an adjustment request directly to the Canada Revenue Agency.

Department of Finance Canada Launches Second Stage of Consultations on Federal Financial Sector Framework

The Department of Finance Canada launched the second stage of consultations on the renewal of the federal financial sector legislative and regulatory framework prior to the statutory sunset date of March 29, 2019. The Department is seeking views on potential policy measures to support a competitive and innovative sector, to modernize the legislative framework, and to safeguard a stable and resilient sector. The second consultation paper, released August 11, 2017, takes into account the comments and recommendations received from stakeholders through the first stage of consultations, the trends and emerging issues that are actively reshaping the sector, as well as the needs of its users. It builds on the consultation paper released on August 26, 2016, which laid out the landscape of Canada's financial sector and identified key trends that may influence it moving forward.

Submissions should be submitted by September 29, 2017.

Consultations on Canada Negotiating a Free Trade Agreement With the Pacific Alliance

The Government of Canada is seeking the views of the Canadian public and interested Canadian stakeholders on the scope of potential negotiations regarding a possible Free Trade Agreement (FTA) with the Pacific Alliance. All interested parties are invited to submit their views by September 10, 2017.

RECENT CASES

Deemed trust for unremitted withholdings having priority over debtor-in-possession financing

Three related companies engaged in mink farming sought protection under the *Companies' Creditors Arrangement Act*, but later switched to the proposal provisions under the *Bankruptcy and Insolvency Act*. By late 2015 the companies were unable to make a viable proposal and they became bankrupt in early 2016. By that time, the creditor companies had obtained an order for debtor-in-possession (DiP) financing secured in priority to "all other security interests, trusts, liens, charges, and encumbrances, statutory or otherwise" and funds were advanced. A dispute arose as to whether the DiP financing or a deemed trust for employee withholdings had priority, and an application was made to the Court for determination of that question.

The trust for unremitted source deductions was found to have priority over DiP financing. The Court concluded, based on an analysis of the relevant statutory provisions and the appellate jurisprudence, that the deemed trust for income tax withheld from employees of the bankrupt company had priority over the security that the companies gave for DiP financing. The Court's conclusions were based on its analysis of subsections 224(1.2) and 227(4) and (4.1) of the *Income Tax Act*. It held that subsection 224(1.2) creates a priority for amounts owed to the Receiver General "in priority to any . . . security interest" and that subsections 227(4) and (4.1) extend that priority to the deemed trust for unremitted withholdings. The correct contextual interpretation of those provisions, in the Court's view, was to give the deemed trust for unremitted withholdings priority over all security interests, including other federal and provincial statutory deemed trusts. In addition, subsection 227(4.1) indicates that the provisions apply notwithstanding any other provision of any other federal or provincial enactment. The Court held that, as a consequence, such provision expressly overrides section 50.6 of the *Bankruptcy and Insolvency Act*, which is the authority to order DiP financing and security for it priority. The Court concluded that to grant priority to DiP security over the subsection 227(4.1) deemed trust would be to ignore the wording of that provision of the *Income Tax Act*. Finally, the Court noted that subsection 60(1.1) of the *Bankruptcy and Insolvency Act* indicates that a court cannot approve a proposal unless it provides for payment in full of the debt for unremitted withholdings within six months. That provision, in the Court's view, indicated Parliament's intention to give the utmost priority to collection of unremitted withholdings by requiring payment in full under a proposal. Finally, the interpretation of the relevant provisions of the *Income Tax Act* in appellate jurisprudence compelled the conclusion that the Canada Revenue Agency claim for unremitted withholdings had priority over the security for DiP financing with respect to the proceeds of the bankrupt's assets.

In Re: Rosedale Farms

2017 DTC 5079

Appeal from denial of extension of time to appeal allowed

In 2010, the taxpayer sold a condominium property and declared a capital gain arising from that sale, but the Minister reassessed to treat the gain as ordinary income for the year. The taxpayer filed a Notice of Objection but, in January 2016, the Minister confirmed the reassessment. The taxpayer did not file a Notice of Appeal from that confirmation within the 90-day limitation period but, 52 days after the expiry of that period, brought an application for an extension of time to file the Notice of Appeal. That application was dismissed by the Tax Court, and the taxpayer appealed from that dismissal.

The appeal was allowed. The Tax Court of Canada had held that it was not persuaded the taxpayer had, as required by the statute, brought his application as soon as circumstances permitted, or that it would be just and equitable to grant the application. The issue on the appeal, therefore, was whether the Tax Court's conclusions on those questions were correct, and the appellate Court held that they were not. In the Court's view, the issue was the taxpayer's use of time between the expiry of the 90-day appeal period and the filing date of the application for an extension of time, and the determination of that issue required the Court to examine the particular circumstances to determine if the taxpayer acted with diligence appropriate to those circumstances. The appellate Court held that the Tax Court had not directed its mind to the appropriate time period when it considered whether the taxpayer's appeal had been brought as soon as circumstances permitted, and had thereby made an error of law. The Tax Court had asked whether the circumstances permitted the taxpayer to file a notice of appeal during the 90-day period rather than asking whether, once that period had expired, he brought his application for an extension of time as soon as circumstances permitted. The appellate Court held as well that the evidence showed that the taxpayer spent the period between the expiry of the 90-day period and the filing of his application for an extension of time gathering the documentary evidence needed to bring the appeal. As well, the evidence suggested that the application was brought as soon as the necessary documents were in hand. Consequently, the appellate Court was satisfied that the application for an extension of time was made as soon as circumstances permitted, and that there was no conduct on the part of the taxpayer that would make it unjust or inequitable to provide him with the extension of time sought. The taxpayer's appeal was allowed.

Bygrave v. The Queen

2017 DTC 5075

Order to remedy a corporate mistake not available where transaction was not carried out in most tax-effective manner

The petitioner was seeking to remedy a corporate mistake. Otto and Karoline Greither were residents of Germany who jointly owned shares in 627291, a Canadian company. They sought tax advice with respect to their Canadian holdings and were advised in February 2013 to sell their shares to a related company for preferred shares so as to avoid being taxed on a deemed dividend. Karoline died in May 2013. Upon her death, she was deemed to have disposed of her share of 627291 (with a fair market value of $1,951,458) that was taxable Canadian property and capital gains taxes of about $500,000 was paid. Her estate inherited her share and it was thought there would be no further tax upon the sale of that share. The share was sold to a related company, paid for by a promissory note for $1,951,457 and a preferred share of $1. The CRA refused to grant the estate a clearance certificate which is needed when a non-resident sells taxable Canadian property, and instead assessed the estate for over $335,000 on the basis that a deemed dividend had been received. The petitioner was seeking to remedy the documentation of the sale share such that the estate received a preferred share worth $1,951,457 and a promissory note of $1, which would not attract tax. The estate lawyer argued that had he realized there would be tax consequences the way the sale of the share was structured, he would have advised them to take the advice he gave in 2013 to sell the share for a preferred share of $1,951,457 and a promissory note of $1 (exactly the opposite of what was done). The petitioner argued that the Court should exercise its discretionary power to remedy the mistake so as to avoid the additional tax of over $335,000.

The petition was dismissed. A corporate mistake is an error in the conducting of business of a company that results in various events set out in the legislation. The legislation gives the court discretion to modify consequences in law of a corporate mistake but certain criteria must be met. The triggering events for the discretion to be exercised are where the mistake results from (1) a breach of the legislation, (2) a default in compliance with the articles of the company, (3) meetings of the shareholders or directors being rendered ineffective, or (4) consent resolutions being made ineffective. The mistake of not completing a transaction in the most tax-effective manner is not one of those events. One cannot use discretionary remedies for retroactive tax planning.

Greither Estate v. Canada (AG)

2017 DTC 5078

Taxpayer's appeals quashed because of its inability to have its corporate charter revived

Under the provisions of the *Ontario Business Corporations Act*, the corporate taxpayer's charter was revoked on March 27, 2006. In 2011, it filed Notices of Appeal to the Tax Court of Canada from assessments under the *Excise Tax Act* for the reporting periods between January 1, 2001, to December 31, 2001, and from reassessments under the *Income Tax Act* for its 1998 to 2005 taxation years. In an order dated November 18, 2015, the Tax Court gave the taxpayer a specified time frame (i.e., February 12, 2016) by which to have its charter revived or suffer the quashing of its appeals. Its charter was not renewed within that time frame. During a conference call held by the Tax Court with the parties on February 8, 2016, to ascertain the status of the matter, the Court was told: (a) about the taxpayer's prior attempts made to revive its charter back in 2012 and in March 2015; and (b) that the taxpayer was hoping the CRA could help it to change the view of the Minister of Finance of Ontario, who was apparently refusing to consent to the revival of its charter because of its outstanding provincial tax. Following these submissions, the Court subsequently refused to extend the deadline set out in its order of November 18, 2015, on the ground that the taxpayer had made insufficient efforts since that order to have its charter reinstated. As a result, the Court quashed the taxpayer's appeals. The taxpayer appealed to the Federal Court of Appeal, and in the process filed a motion for an order entitling it to introduce new evidence (the "New Evidence").

The taxpayer's appeal and its motion to introduce the New Evidence were dismissed. It was open to the Tax Court to conclude as it did, and this was not really disputed. Instead, the taxpayer's submission was that the Tax Court's decision was made on the basis of inadequate information, insofar as the CRA failed to fairly and candidly disclose all relevant information about its role in the Ontario Minister of Finance's refusal to consent to the revival of the taxpayer's charter. The taxpayer also indicated that it was seeking to contest the position taken by the Ontario Minister of Finance. The New Evidence, moreover, consisted mostly of information and documentation in the taxpayer's possession when it made its representations to the Tax Court, but did not provide much more than what had already been conveyed to the Tax Court by the parties. Nor did it support the taxpayer's bald allegation that the CRA was responsible for blocking the revival of its charter. The foregoing analysis led to the conclusion that appellate intervention in the Tax Court's decision in this case was not justified, in part because the taxpayer had been unable to convince that Court (during the conference call) that it had a serious plan to obtain the Ontario Minister's consent to permit its charter to be revived, and, in part, because it did very little to advance that revival process between the date of the Tax Court's order of November 18, 2015, and the date of the conference call.

1218395 Ontario Inc. v. The Queen

2017 DTC 5076

Appeal from disallowance of legal fees deduction dismissed

The taxpayer incurred legal fees of $115,996. in the 2007 to 2011 taxation years. On assessment, the Minister did not dispute the quantum of such fees, the period during which they were incurred, or their characterization as legal fees. The deduction from employment income claimed by the taxpayer for such fees was, however, disallowed on the basis that the fees were exclusively paid to defend against criminal charges. The taxpayer appealed from those assessments, arguing that any criminal conviction would have resulted in the loss of his employment, that some of the legal fees were incurred to ensure access to pension benefits, and, finally, that the taxpayer's loss of employment would have resulted in the seizure by creditors of five rental properties owing to the taxpayer's loss of creditworthiness.

The appeal was dismissed. Section 8 of the *Income Tax Act* allows the deduction of legal fees incurred where such fees are incurred "to collect, or to establish a right to, an amount owed to the taxpayer" which income, if received, would be employment income. The issue for determination by the Court was whether the expenditure of legal fees for the "preservation" of a taxpayer's employment is sufficient to fall within the terms of that statutory provision, and the Tax Court concluded that it was not. The jurisprudence provides that unless legal fees are incurred to collect amounts owed from employment, they are not deductible. The protection or preservation of a future source of income is not sufficient. As well, even where employment is terminated, legal fees spent to initially defend such termination, or to seek reinstatement, are not deductible under that provision. In the taxpayer's case, there was no salary or wages unpaid or owing and so his appeal could not succeed on that ground. Similarly, a taxpayer is allowed to deduct legal expenses paid to collect or establish a right to a pension, but there was no evidence that legal advice was given concerning the taxpayer's pension rights, and no evidence that proven criminal charges as such would generally impair the taxpayer's pension benefits. There was, therefore, no collection or establishment of a right needed to collect pension benefits in the taxpayer's case that would require the expenditure of legal fees. Finally, the Court held that there was no evidence before it of any ownership interest by the taxpayer in the rental properties and, even if such evidence was provided, objective third party evidence from the lenders with respect to the probable risk of mortgage renewal would be required, and none was provided. The Court concluded that the taxpayer incurred the legal fees solely to protect his future source of income and that the Minister correctly disallowed the deduction of the fees incurred for such purpose.

Geick v. The Queen

2017 DTC 1067

Decision denying a remission order for outstanding tax debt was reasonable

The applicant is seeking judicial review of the decision of the Assistant Commissioner of the Legislative Policy and Regulatory Affairs Branch of Canada Revenue Agency (CRA) which denied his request for remission of his outstanding tax debt. The applicant filed for bankruptcy in 1990 with a tax debt owing of $210,693, which was reduced to $130,555 in June 2008. The applicant is not discharged from his legal obligation to pay his pre-bankruptcy debt but the CRA cannot take collection measures due to a ten-year limitation bar. As of 2016, his tax debt for 1995–1998 was $282,183, but no action has been taken to collect on this aside from withholding credits and refunds as they come due. In May 2014 the applicant requested a remission order in a one page letter with no attachments. He blamed the CRA for his debts and argued financial hardship.

The application for judicial review was dismissed. A remission order is an extraordinary remedy available to provide relief from taxes owing where relief is not otherwise available. The applicant argued that the decision of the Assistant Commissioner was unreasonable. The Assistant Commissioner relied on reports prepared by the CRA field office which recommended denial of the remission request and did not find extreme hardship existed. The letter denying the remission order explained that personal financial difficulties did not constitute extreme hardship and there were no extenuating circumstances to warrant a remission order. The applicant failed to substantiate that there were circumstances beyond his control preventing him from making payments on his tax debt. The applicant took issue with the tax debt but the Tax Court of Canada has exclusive jurisdiction to review the correctness of any assessment and that issue cannot be dealt with in the Federal Court. The applicant's affidavit in support of judicial review contained information that was not before the Assistant Commissioner and it cannot be considered. The applicant argued that information regarding his health was not considered but attempts were unsuccessfully made to contact the applicant during the remission process at which time he could have provided such information. A 2014 credit report showed that the applicant was meeting his financial obligations and had a good credit rating. CRA guidelines state that extreme hardship exists if annual income for the year in which remission is requested is less than the low income cut-offs. For every year but three since 1987, the applicant's income exceeded that amount. All the circumstances were considered, proper procedural methods were followed, and the decision to deny the remission order was reasonable.

Matthew v. AG of Canada

2017 DTC 5070

Taxpayer's counsel provided with authority to execute settlement agreement

Following a series of negotiations, counsel for the taxpayer executed a settlement agreement on the taxpayer's behalf with the Minister of National Revenue. The taxpayer brought a motion before the Tax Court of Canada seeking to invalidate the settlement, on the basis that his counsel had been provided with authority to negotiate, but not to sign any agreement with the Minister. The Tax Court judge dismissed his motion, finding that the express wording of an email sent by the taxpayer to his counsel mandated counsel to negotiate a settlement on the taxpayer's behalf. Pursuant to that mandate, counsel accepted the Minister's settlement offer. The Tax Court judge concluded that the taxpayer's personal signature was not required to execute an agreement signed pursuant to the *Income Tax Act* (the "Act"), where he was represented by counsel. The taxpayer appealed to the Federal Court of Appeal.

The appeal was dismissed. The appellate Court held that, contrary to the taxpayer's assertions, the email sent to him by his counsel outlined the terms of the settlement reached, including all modifications, and the modifications so described were accepted without any form of ambiguity by the taxpayer's email in response. That responding email conferred an express mandate on his counsel to execute the settlement agreement on his behalf and his counsel was entitled to provide, for purposes of executing the agreement, the "consent in writing" referred to in the Act. The

Federal Court of Appeal concluded that the Tax Court judge had not committed any legal error or any palpable and overriding error in her analysis of the governing legal principles and her appreciation of the evidence, and that there was no fault with her conclusions with respect to the agreement's validity and the enforceability of the Minister's reassessments.

Granofsky v. The Queen

2017 DTC 5072

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