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CANADA ROWS BACK ON SMALL BUSINESS TAX REFORM: WHAT WE KNOW SO FAR

— Stuart Gray, Senior Editor, Global Tax Weekly

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Governments do listen sometimes. After causing a "firestorm" of protest from the small business community in Canada over its proposed anti-avoidance legislation, the Canadian Government has announced a series of changes to its plans. The Government's initial draft legislation, and its new plans, revealed over the past couple of weeks, are summarized in this article.

Setting the Scene

Earlier in the year, when these proposals were first detailed, the Government said that tax avoidance by high-income individuals was a major problem. It argued that more stringent rules were needed to prevent these taxpayers from sheltering earnings from salaries using corporate vehicles and other tax-planning techniques.

Finance Minister Bill Morneau observed as he announced the consultation on the draft measures in July 2017,[1] that "[m]any of the richest Canadians are unfairly exploiting the tax rules designed to help businesses thrive."[2]

According to the Government, an increasing number of Canadians are using private corporations in ways that allow them to reduce their personal taxes. It has claimed that in some cases, someone earning C$300,000 (US$236,000) with a spouse and two adult children can use a private corporation to get tax savings that amount to roughly what the average Canadian earns in a year.[3]

"We know that businesses, including small businesses, help grow the Canadian economy. These tax advantages are in place to help these businesses reinvest and grow, find new customers, buy new equipment, and hire more people," he said.[4]

However, he added that: "We want to make sure those rules are used to do just that, and not to give unfair tax advantages to certain — often high-income — individuals."

Morneau also had the wholehearted support of his Prime Minister, Justin Trudeau, on the matter, who said in early September that he intended to "make no apologies" for the Government's approach to taxation.

[1] https://www.fin.gc.ca/activty/consult/tppc-pfsp-eng.asp

[2] https://www.fin.gc.ca/n17/17-066-eng.asp

[3] https://www.fin.gc.ca/n17/17-080-eng.asp

[4] *Supra.*, note 2.

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Trudeau argued:[5] "We are doing more for the people who need it, less for the people who don't. I will make no apologies for this approach. It's what Canadians expect of us when we say we are going to grow the middle class and those working hard to join it."

Speaking during a separate interview later that month in defense of the measures included in the consultation,[6] Trudeau assured small business that "[w]e just want to make sure that people using private corporations don't have benefits that aren't available to average Canadians, and that's where we're making a little tweak."

The Original Proposals

"Tweak", however, would not be a word that the overwhelming majority of business affected by the proposals would use to describe them. Indeed, the proposed tax measures turned out to be some of the most controversial in recent Canadian history. The contents of the consultation paper, which taxpayers were given until October 2 to comment upon (as they did in their thousands), are summarized below.

Income sprinkling

One of the consultation's main focuses was on so-called income sprinkling. According to the Government, income sprinkling involves diverting income from a high-income individual to family members with lower personal tax rates, or to family members who may not be taxable at all. By this method, the owner of a private corporation can "sprinkle" their income between themself, their spouse, and their adult children.

According to the consultation, "This is unfair and inconsistent with a tax system that works for all. Adjustments to the tax rules are required to address these concerns."

In response, the Government proposed a number of measures, which fell into three general categories, as follows.

1. Extension of the tax on split income ("TOSI") rules

A special "tax on split income" ("TOSI") was introduced in 1999 to address sprinkling of certain income to minor children (i.e., individuals under the age of 18 years), known as specified individuals. The rules apply to income from private business arrangements, such as dividends on unlisted shares, or income in the form of a trust or partnership distribution derived from a business or rental activity of a related individual.

The TOSI also denies access to the lifetime capital gains exemption ("LCGE") in respect of the disposition of shares as part of a non-arm's length transaction. In cases where the TOSI applies, the income is subject to top flat-rate personal income taxation in the hands of the minor, and personal tax credits (with the exception of the dividend tax credit and foreign tax credit) are denied with respect to the amounts.

The TOSI does not apply to income received by the specified individual as salary or wages (i.e., employment income), although other rules in the *Income Tax Act* may apply, including a limitation on the deductibility of salary or wages that exceed a reasonable amount.

According to the Government, the current tax rules have proven effective in responding to some, but not all, forms of income sprinkling. It noted that tax benefits of income sprinkling continue to be available with respect to certain arrangements.

The Government proposed to extend the TOSI to apply to certain adult individuals who have amounts included in split income, but generally only to cases where the amount is deemed to be "unreasonable" under the circumstances. In addition, the measures would expand the circumstances in which the TOSI applies, including the types of income that are considered to be split income. The TOSI would not apply to income received by an individual as salary or wages under these plans.

The proposals would necessitate the introduction of a "reasonableness test" for the purpose of determining whether the TOSI applies to a specified individual who is an adult. If a split income amount received by an adult specified individual is reasonable within the meaning of this test, the amount that would otherwise be split income of the individual would be excluded from split income and thus not be subject to the TOSI.

In addition, the Government proposed the introduction of a connected individual test, to determine whether an adult specified individual's income from a corporation would be treated as being split income. Under these rules, a Canadian resident individual with a certain measure of influence over a corporation would be treated as connected with the corporation. This would mean, for example, that adult family members of the "connected individual" who receive dividends on an unlisted share issued by the corporation would be required to determine whether a portion of the amount received is unreasonable.

[5] http://www.cbc.ca/news/politics/trudeau-no-apologies-tax-fairness-1.4273006

[6] http://www.cbc.ca/news/canada/newfoundland-labrador/prime-minister-pierre-trudeau-interview-1.4286195

Additional changes to the TOSI rules would expand the definition of "split income" to include the following:

- Income from certain types of debt obligations;
- Gains from dispositions after 2017 of certain property the income from which is split income; and
- In the case of minor specified individuals and adult specified individuals under age 25, income on property that is the proceeds from income previously subject to the TOSI rules or the attribution rules.

Furthermore, the current exclusion from a minor's split income in respect of certain inherited property (e.g., property inherited from a parent) would be extended to apply to adult specified individuals aged 18–24.

2. Constraining multiplication of claims to the lifetime capital gains exemption ("LCGE")

The Government is concerned about the growing use of family trusts to facilitate arrangements under which the LCGE limits of multiple members of a family may be used to reduce capital gains tax. "Individuals have used these arrangements in a way that permits them to claim the exemption even though they may not have invested in, or otherwise contributed to, the business value reflected in the capital gains they realize on the disposition of property that is eligible for the exemption," it explained.

Three general measures were proposed to address LCGE multiplication. First, individuals would no longer qualify for the LCGE in respect of capital gains that are realized, or that accrue, before the taxation year in which the individual becomes 18 years old. Second, the LCGE would generally not apply to the extent that a taxable capital gain from the disposition of property is included in an individual's split income. Third, subject to certain exceptions, gains that accrued during the time that property was held by a trust would no longer be eligible for the LCGE.

The proposed measures would apply to dispositions after 2017, subject to certain transitional rules.

3. Supporting measures

The following measures were also considered to improve the administration of the income tax rules to address income sprinkling:

- The introduction of tax reporting requirements with respect to a trust's tax account number that are similar to the requirements for corporations and partnerships in respect of their tax account numbers (known as "business numbers").
- The introduction of measures so that the T5 slip requirements (which identify the various types of investment income that residents of Canada have to report on their income tax and benefit returns) with respect to interest amounts apply to partnerships and trusts in the same circumstances in which they apply to corporations.

The consultation paper explained that these measures were intended to ensure that trusts were subject to information reporting rules that were aligned with existing rules for corporations and partnerships, and would apply for the 2018 and subsequent taxation years.

Other elements of the reforms — passive investments and capital gains

The consultation also focused on individuals who gain an unfair benefit by retaining passive investments in a corporation. This enables them to take advantage of the fact that corporate income tax rates are lower than the personal tax rates applicable to higher-income individuals.

The Government therefore sought feedback on possible changes to ensure that the tax treatment of such passive investment income is "fair". Possible approaches to this included the elimination of tax-assisted financial advantages of investing passively through a private corporation, while also ensuring that the lower rates of tax on active business income earned by corporations continue to encourage growth and job creation.

The final issue on which the consultation concentrated was the converting of a private corporation's regular income into capital gains.

Income is normally paid out of a private corporation in the form of a salary or dividends to the principals, who are taxed at their personal income tax rate (subject to a tax credit for dividends). However, only one-half of capital gains are included in income. The Government said this system can therefore result in a significantly lower tax rate on income that is converted from dividends to capital gains.

The Government therefore expressed its intention to amend the tax rules to prevent the surplus income of a private corporation from being converted to a lower-taxed capital gain and stripped from the corporation.

The Backlash

Anti-avoidance legislation is rarely greeted with enthusiasm by taxpayers. But the ferocity of the criticism leveled at these proposals by small businesses suggests that the Government badly underestimated their impact on legitimate small businesses (and not those established merely to shelter income from high personal taxes).

The scale of the opposition to the draft legislation was laid bare by the results of a survey published by the Canadian Federation of Small Business in September 2017. This showed that 94 per cent of the 8,553 small business owners who responded and 95 per cent of tax practitioners polled by the survey were opposed to the Government's proposed reforms.[7]

According to the CFIB, almost all of the business owners surveyed agreed that the proposed changes would "harm middle-class small business owners and their families, rather than close a few loopholes for the wealthy." In addition, 92 per cent said they were concerned that the reforms would create fresh uncertainty for their business, while 88 per cent said they feared it would become harder to grow their business and create jobs.

Responding to the consultation's completion, Dan Kelly, President of the CFIB, said the proposed reforms have "caused a firestorm of reaction from small business owners, which appears to have genuinely surprised our political leaders."[8]

The Climbdown

Evidently, the level of criticism received by the Government throughout the consultation period on the reforms and beyond it has played its part in forcing change. For as September gave way to October, the Government was issuing a more conciliatory tone, assuring businesses that their view will be taken into account. This was emphasized on several occasions by Morneau on his various ministerial visits around the country at this time.

Fortunately for those taxpayers likely to be affected by the anti-avoidance measures, the Government has gone beyond paying mere lip service to their concerns. This was demonstrated by a series of recent announcements that taxation for small businesses will be reduced, and aspects of the anti-avoidance proposals relaxed.

Tax rates

On October 16, the Government said it will lower the small business tax rate from 10.5 per cent to 10 per cent from January 1, 2018. A further rate cut will follow on January 1, 2019, when the rate will fall to 9 per cent.[9] As a result, the combined federal-provincial-territorial average tax rate for small business would be lowered to 12.9 per cent from 14.4 per cent, the Government said, boasting that this would be "by far the lowest in the G7 and fourth lowest among Organisation for Economic Cooperation and Development countries."

While small businesses will have welcomed this announcement, the rates move does in fact represent the Government's second u-turn on the small business tax rate. At the 2015 election, the Liberal Party pledged to reduce the rate to 9 per cent; however, the 2016 Budget deferred any further reductions in the rate.

Income sprinkling

At the same time as announcing the small business income tax reduction, the Department of Finance revealed its intention to move forward with measures to limit income sprinkling using private corporations. However, changes to the initial proposals are designed to ensure "that the rules will not impact businesses to the extent there are clear and meaningful contributions by spouses, children and other family members," it said.[10]

Specifically, the Government will introduce reasonableness tests for adult family members aged 18–24, as well as those 25 and older. These adults will be asked to demonstrate their contribution to the business based on whether they have made a contribution through any combination of the following:[11]

- Labour contributions;
- Capital or equity contributions to the business;
- Taken on financial risks of the business, such as co-signing a loan or other debt; and/or

[7] http://www.cfib-fcei.ca/cfib-documents/rr2447.pdf

[8] http://www.cfib-fcei.ca/english/article/9698-cfib-statement-on-the-end-of-federal-tax-change-consultations.html

[9] https://www.fin.gc.ca/n17/17-097-eng.asp

[10] https://www.fin.gc.ca/n17/data/17-097_1-eng.asp

[11] *Id.*

- Past contributions in respect to previous labour, capital, or risks.

Reflecting on these changes, the Department observed:[12]

> Throughout the consultation period the Government received feedback on the complexity of the proposed measures and potential unintended consequences. The Government also received feedback that the measures could create uncertainty in relation to how amounts received from a family business would be taxed. To address these concerns, the Government will simplify the proposed measures with the aim of providing greater certainty for family members who contribute to a family business. Specifically, the Government will work to reduce the compliance burden with respect to establishing the contributions of spouses and family members including labor, capital, risk and past contributions, better target the proposed rules, and address double taxation concerns.

The LCGE

According to the Department of Finance, a number of contributors to the consultation have identified potential unintended consequences associated with the proposed measures to address the multiplication of the LCGE. For example, concerns were raised on the potential impact on intergenerational transfers of family businesses.

Consequently, the Government also announced that it will not be moving forward with proposed measures to limit access to the LCGE.[13] This proposed measure had been of particular concern for farmers and farming families.[14]

Passive investments

A partial victory for small business followed shortly after. On October 18, the Department of Finance announced that while it was going ahead with changes to limit the tax deferral opportunities related to passive investments, it will seek to ensure that business owners remain able to build a "cushion of savings".[15]

The Finance Department said that during the consultation it heard from business owners that "the flexibility afforded from savings accumulated in the corporation is important to their success." It explained that such savings can be held with the intention of financing an upcoming business expansion or facing contingencies, and are sometimes also used to provide flexibility for dealing with a range of personal circumstances.

The Department informed taxpayers that it will ensure that investments already made by the owners of private corporations — including the future income earned from such investments — are protected. The measures, the Government said, will only apply on a "go-forward basis", by which it presumably means in the future, rather than retrospectively.

The Government will include a passive income threshold of $50,000 per year for future investments. It said that this is equivalent to $1 million in savings, based on a nominal 5 per cent rate of return. The aim is to provide more flexibility for business owners to hold savings for multiple purposes. There will be no tax increase on investment income below this threshold.

The Government also wishes to ensure that incentives remain in place for venture capital and angel investors, and that businesses remain able to save for contingencies or future growths in investment.

The Government said it will examine all deferral benefits from passive investment, and will continue to assess key aspects of the design of the measures. It will consider the appropriate scope of the new tax regime with regard to capital gains, including whether the rules should exclude capital gains realized on the shares of a corporation engaged in an active business.

The changes to passive investment will not apply to income from AgriInvest, which is a self-managed, producer-government savings account that allows producers to set money aside. The investment income from an AgriInvest account is currently treated as active business income, and it is the Government's intention to maintain this approach.

The Government believes that the vast majority of businesses will remain unaffected by these changes. According to the Finance Department, more than 80 per cent of passive income is earned by just 2 per cent of Canadian-controlled private corporations.

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[12] *Id.*

[13] *Id.*

[14] https://www.fin.gc.ca/n17/data/17-100_1-eng.asp

[15] https://www.fin.gc.ca/n17/data/17-099_1-eng.asp

Capital gains

More good news was received by entrepreneurs the very next day, endorsing their campaign against the initial proposals. On October 19, the Department of Finance disclosed that it had decided to ditch plans to prevent the conversion of a private corporation's regular income into capital gains.[16] The Department said that during the consultation on the reforms, the Government had been told by business owners that the changes "could result in several unintended consequences, such as in respect of taxation upon death and potential challenges with intergenerational transfers of businesses."

The Next Steps

The Government has already moved forward with the proposed corporate tax cut for small businesses, tabling a Notice of Ways and Means Motion in the House of Commons for the phased reductions on October 24.[17] The Government estimates that these rate cuts will save SMEs up to $7,500 in federal corporate tax per year.

However, in his speech to Parliament on the Fall Economic Statement,[18] Morneau said that before he could lower taxes for small businesses, he needed to be sure that the benefits would flow to them, "not to . . . the top 1 per cent wealthiest Canadians." Therefore, the Statement set out that the Government would proceed with plans to restrict income sprinkling with revised draft legislative proposals to be released later this year. These are intended to be effective from 2018.

Furthermore, the Government intends to include detailed proposals in Budget 2018 (likely to be announced in the first quarter of next year) for limiting the tax benefits of investing passively in private corporations.

The Statement also confirmed that, as mentioned above, in light of the feedback it received during the consultation period, the Government will not move forward with its plans to either limit access to the LCGE, or prevent the conversion of the surplus income of a private corporation into capital gains.

Changes Welcome, but More Detail Needed

Overall, the Canadian small business community can congratulate itself for being able to change the Government's mind in relation several aspects of its tax avoidance crackdown. If nothing else, these developments show that consultation procedures do have their uses, and that they are not always merely tick-the-box exercises designed to show that governments are seen to be listening when in reality they aren't.

The inclusion of the annual passive income threshold was described by CFIB President Dan Kelly as "good news".

"If administered properly, this change will be helpful in allowing many small firms to continue to use passive income to ride out challenging times, save for investments or set aside money for a leave or retirement," he responded.[19]

However, Kelly added that the $50,000 passive income threshold may be too low for small firms that are saving to grow their business. "Canada has a dearth of medium-sized businesses and the size of the threshold may not be enough to help businesses looking to get to the next level," he explained.

Changes to the capital gains tax aspects of the original proposals were also welcomed by the CFIB, with Kelly noting that the proposals as originally drafted would have made it costlier for small business owners to sell or transfer their business to their children.

Ron Bonnett, President of the Canadian Federation of Agriculture, echoed these sentiments,[20] remarking that both the limit to the lifetime CGT exemption and the rules on conversion to capital gains "would have led to enormous complexity and added costs for intergenerational farm transfers and could've even encouraged farmers to sell their businesses to non-family members."

Yet these alterations are far from a complete victory for small business taxpayers. As Morneau stated in the Commons, the Government is determined that the benefits of lower small business taxation flow only to those who are legitimately in business, and therefore the rules in this area will necessarily become more extensive and complex.

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[16] https://www.fin.gc.ca/n17/17-100-eng.asp

[17] https://www.fin.gc.ca/drleg-apl/2017/nwmm-amvm-1017-l-eng.asp

[18] https://www.fin.gc.ca/n17/17-103-eng.asp

[19] http://www.cfib-fcei.ca/english/article/9732-new-passive-income-rules-a-step-forward-may-be-insufficient-to-help-small-firms-grow.html

[20] https://www.cfa-fca.ca/2017/10/19/rollback-on-proposed-tax-changes-is-good-news-for-farm-families/

What's more, the Government's partial climbdown has created uncertainty. We are yet to see detailed revised proposals in this area. As Kelly observed recently:[21] "More analysis is needed to determine whether the net effect of the package of changes will be positive or negative for entrepreneurs."

CURRENT ITEMS OF INTEREST

Minister Announces Disability Advisory Committee

The Minister of National Revenue, Diane Lebouthillier, has announced that the Disability Advisory Committee is being reinstated. The purpose of the committee is to work with stakeholders to ensure that measures for persons with disabilities under the *Income Tax Act* are fairly administered. The committee will advise the CRA, review the CRA's administrative practices, and provide feedback with recommendations. The Committee includes 12 members, including "people with disabilities, qualified health practitioners, advocates from the disability and Indigenous communities, and professionals from a variety of fields, such as tax professionals and lawyers."

PBO Estimates Revenue From Passive Income Proposals

The Office of the Parliamentary Budget Officer ("PBO") analyzed the fiscal effect of the proposed changes to the taxation of passive income earned by private corporations. This analysis is based on what is discussed in the proposal paper published by the Department of Finance on July 18, 2017, but also takes into account the $50,000 annual exemption that was later announced by the Minister of Finance. The PBO estimates that these tax changes will generate up to $1 billion of revenue in the short term (one to two years after implementation), $3 to $4 billion over the medium term (five to ten years after implementation) and up to $6 billion over the long term. The PBO also estimates that 47,000 CCPCs (or 2.5% of all CCPCs) will be affected.

Government Announces Tax Support for Farmers

On November 6, 2017, the Agriculture and Agri-Food Minister announced new tax relief measures for farmers. First, the initial list of prescribed drought and flood regions for livestock tax deferral for 2017 is now available. Second, the government announced that it would maintain the deferred tax treatment of cash purchase tickets for deliveries of listed grains — this decision came after concluding a consultation on whether to remove the preferential tax treatment that was originally announced in Budget 2017.

Last, the Minister announced tax relief for ranchers affected by bovine tuberculosis ("TB"). Throughout 2016 and 2017, ranchers in Alberta and Saskatchewan were forced to destroy their livestock due to a TB outbreak, and many received compensation as a result. Normally, farmers could defer the tax on the compensation until the following taxation year. However, the government recognized that many ranchers would take more than one year to replenish their herds, and thus is extending the tax deferral for affected farmers. According to the government news release, affected farmers can defer their compensation as follows:

- 2016 and 2017 tax years: no compensation received will be included in income;
- 2018 tax year: 83% of compensation received will be included in income;
- 2019 tax year: 11% of compensation received will be included in income; and
- 2020 tax year: 6% of compensation received will be included in income.

[21] http://www.cfib-fcei.ca/english/article/9742-full-package-of-revised-tax-proposals-require-more-analysis-consultation.html

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.

$4 Million Roof Replacement Held To Be a Current Expense

***AON Inc. v. The Queen*, 2017 DTC 1101 (Tax Court of Canada)**

The issue in this appeal was whether an expenditure of more than $4,000,000 in 2010 and 2011 to replace a large part of a garage roof was a current expense or a capital expenditure. The Tax Court found that the expenditure was a current expense and allowed the appeal.

AON Inc. owned a large parking garage located in Citi Centre Place in Peterborough, Ontario. A part of the roof is covered by three apartment buildings and the remaining part of the roof is a podium deck, accessible to both pedestrians and cars. The podium deck, which is not covered by the apartment buildings, began to deteriorate over time due to exposure to weather and traffic. Approximately 47,000 square feet of the garage roof needed to be replaced, which amounted to about 50% of the total garage roof area. AON began localized repairs in 2004 instead of opting to completely replace the podium deck. In 2009, AON found that it could no longer defer replacing the podium deck due to increased deterioration of the structure of the garage.

The work to completely replace the podium deck slab was carried out in three phases in 2010 and 2011. The work brought some improvements to the parking garage, but it did not increase the number of parking spots, parking rates, garage revenue, or apartment unit rates for tenants of the three apartment buildings located on top of the garage. AON claimed the cost of the repair as a current expense for its 2010 and 2011 taxation years. The Minister disallowed AON's claim as a current expense on the basis that the expenditures were capital in nature, namely depreciable expenditures subject to the capital cost allowance rules.

The Court (per Jorré, J) found that the expenditures in question were made for the purpose of producing income from business as per paragraph 18(1)(*a*) of the *Income Tax Act* (the "Act"). The Court noted, however, that the Act does not specifically define the difference between current and capital expenditures, and has left it to the case law to clarify the distinction. After a review of the abundant jurisprudence on the matter, the Court listed a number of factors that must be considered in determining whether work on a building is a depreciable or current expense.

The Court noted that, though not determinative, it must consider whether the work is of an "enduring benefit" and whether the work creates something that would last for a period of time (*Canadian Reynold Metals Company Ltd.*, 96 DTC 6312 (FCA)). An enduring benefit would likely indicate a capital expenditure. Some of the other factors considered by the Court included:

(1) whether the asset that was being repaired can exist on its own;

(2) whether the repairs would improve the asset (which would point to a capital expense);

(3) the use of more modern technology, which could improve the asset;

(4) the extent of the repair (with larger expenses being more likely to be considered a capital expenditure);

(5) the value of the repair in relation to the asset itself;

(6) the purpose of the work; and

(7) if the work improved the value of the asset as compared to the asset in a good state of repair.

Applying these factors to the facts of the case, the Court found that the repair work on the garage would be enduring since the repaired roof would be "worry free" for 20 to 30 years, which pointed to a depreciable expenditure. The roof, however, could not exist on its own as it is connected to the three apartment buildings on top of it, and to the structure of the garage itself. In addition, the repair work was not made to improve the value of the asset but rather to allow the parking garage to be used for the same purpose as before the repair work. The Court noted, however, that the use of newer techniques to fight the effect of salt on the roof did result in a better roof. Despite this betterment, the Court concluded that there was no improvement to the profitability or purpose of the parking garage, that the scale of the work in relation to the complex was not significant, and that the work was an essential repair. The appeal was allowed, with costs.

— *Brianne Paulin, Articling Student*

The Widening Scope of Discovery: The Tax Court's Rejection of Proportionality Over Relevancy and the Practice of Taking Questions "Under Advisement"

***Burlington Resources Finance Company v. The Queen*, 2017 DTC 1096 (Tax Court of Canada)**

This case relates to substantive and procedural principles in documentary and oral discovery. D'Auray J. spends the majority of her decision clarifying that proportionality is one factor in determining the scope of discovery, but other factors, such as relevancy, continue to play a role. She also makes a brief but important rebuke of the practice of taking questions "under advisement" during oral discoveries, which she classifies as a "quasi-objection" not contemplated by the Tax Court Rules, and a tactic that "needs to stop".

The taxpayer, Burlington, was the financing arm of a group of affiliated companies conducting business related to crude oil and natural gas. Burlington, a Nova Scotia Unlimited Liability Company (an "NSULC"), was the wholly-owned subsidiary of its American parent, BRI.

Burlington issued notes, guaranteed by BRI, to arm's length parties. In exchange, Burlington and BRI agreed that Burlington would pay guarantee fees to BRI. Between 2002 and 2005, Burlington paid approximately $83 million in guarantee fees to BRI. Burlington deducted the fees in computing its income pursuant to section 9 of the *Income Tax Act* (the "Act.)

The Minister argued that the guarantee fees were duplicative because Burlington's status as an unlimited liability company made the guarantees redundant. The Minister relied on paragraphs 18(1)(*a*) and 20(1)(*e.1*) to argue that the guarantee fees were not incurred for the purpose of earning income, but rather to obtain a tax benefit.

Furthermore, the Minister argued that the terms and conditions of the fees would not have been agreed to by arm's length parties, and relied on paragraphs 247(2)(*a*) and (*c*) to reduce the amount claimed by Burlington to nil. The Minister also alleged that Burlington failed to make reasonable inquiries in order to determine an appropriate arm's length transfer price for the guarantees, and relied on subsection 247(3) to impose transfer pricing penalties. The total amount in dispute was $21,179,800, although additional amounts might be in issue in subsequent years as the bonds continue to mature until 2031.

At Burlington's examination for discovery, counsel for the Minister asked 4122 questions; Burlington took 1700 "under advisement", and ultimately refused to answer 1200. Generally, Burlington argued that it would be too onerous and disproportionate to answer the refused questions. According to Burlington, in order to respond to all of the Minister's questions, it would need to conduct an exhaustive search of roughly 12,000 boxes of potentially relevant information stored at facilities in Texas, Oklahoma, and Alberta. Compounding the difficulty was that Burlington kept no centralized index to facilitate searching the boxes. Burlington's affiant explained that, "if the [Minister] got everything they wanted, it would take months if not years to produce [this] colossal amount of information."

The Minister submitted that in this case, due to the complexity of the issues and the amount of tax at stake, the questions and the information sought were necessary to make out its case at trial, and to justify the imposition on Burlington.

The Court began its analysis by reference to Rule 4(1) of the *Tax Court of Canada Rules* (General Procedure): "[t]hese rules shall be liberally construed to secure the just, most expeditious and least expensive determination of every proceeding on its merits." Imbued in this principle is the notion that all potentially relevant information in the possession, power, or control of one party is properly within the scope of that party's discovery obligations. The corollary is that the adverse party can properly ask questions related to the information, and request that the underlying documents be produced.

On the other hand, Canadian courts, including the Supreme Court of Canada, have more recently begun to expound the principle that proportionality should temper a party's discovery obligations. Indeed, in *Hryniak v Mauldin* (2014 SCC 7), Karakatsanis J. called on courts to actively manage the legal process in line with the principle of proportionality.

Burlington argued that the recent jurisprudence supported its contention that proportionality has replaced relevancy as the key driving principle in discovery. It submitted that complying with the Minister's requests would be so onerous, time-consuming, and expensive that it would offend the principle.

The Minister argued that the recent jurisprudence does not suggest that proportionality has replaced relevancy as the prime determinant of the scope of discovery. Rather, it argued that the two are competing principles, to be applied differently in different situations.

D'Auray J. accepted the Minister's position, finding,

> . . . I am not persuaded that the costs, time, and effort involved for Burlington to respond to any relevant questions would be disproportionate, given the amount of money involved which according to the Respondent is close to $100 million, the importance of the case and the complexity of the issues. Proportionality must not defeat the purposes of discovery, particularly in an appeal such as this. Where the issues are complex and fact based and where the amount at stake is considerable, both parties should be able to fully prepare for trial and know their case.
>
> Therefore, I will address proportionality in the following manner. If I find a question relevant, blanket concerns of proportionality will not override the need to respond and to look for documents relying upon the indexes. However, if I am convinced that a question is marginally relevant, and there are proportionality concerns, I may order Burlington not to answer the question, I will analyze each situation on its own merits.

Before proceeding to apply the above finding to Burlington's refused or non-responsive answers, D'Auray J. commented on the 1700 questions taken "under advisement" by Burlington's counsel.

Where a party objects to a question during oral discovery, Rule 107 requires the objector to briefly state the reason for the objection. This allows the party asking the question to attempt to reformulate, reframe, or narrow the question in order to meet the objection. The practice of taking a question "under advisement" allows the party being discovered the opportunity to evade the question during discoveries while not immediately giving a reason for doing so.

D'Auray J. remarked that the practice amounts to a "quasi-objection", and is simply a tactic used to buy time in order to reflect on how to later refuse to answer the question. She noted that the tactic is not contemplated by Rule 107, and that cost consequences may attach where the tactic hinders an examination. D'Auray J. was clear: "the practice of using the quasi-objection 'under advisement' needs to stop."

The *Burlington* case is instructive to taxpayers, especially regarding the potential costs associated with litigation, or the potential for the scope of documentary discovery to extend to affiliated or parent companies. *Burlington* shows that the court will not necessarily intervene to limit either. In cases where the amount of tax in dispute is high and the issues complex, taxpayers can expect the costs and scope of discovery to increase in proportion to those factors. Furthermore, where a party intends to limit the scope of discovery by refusing to answer questions at discoveries, *Burlington* clarifies that the refusing party can no longer rely on the tactic of taking questions "under advisement", and should be prepared to provide contemporaneous reasons for its refusals.

— *Peter Leigh*

Discharge Applications in Tax-Driven Bankruptcies: Rehabilitation Versus Deterrence

***Binning (Re)*, 2017 DTC 5096 (Saskatchewan Court of Queen's Bench)**
***Paton (Re)*, 2017 DTC 5098 (Saskatchewan Court of Queen's Bench)**

In two cases decided by Registrar Thompson of the Saskatchewan Court of Queen's Bench, the Registrar considered the application of the factors set out in section 172.1(4) of the *Bankruptcy and Insolvency Act* ("BIA") when considering the discharge of two consumer bankrupts in tax-driven bankruptcies.

The 2009 amendments to the BIA introduced new provisions to deal specifically with discharge applications in tax-driven consumer bankruptcies. Provisions were added to the BIA to separately govern the discharge of bankrupts with federal or provincial personal income tax debt over $200,000.

Section 172.1(4) provides that, on application for a discharge, the court has three options: (i) refuse the discharge, (ii) suspend the discharge for a period of time, or (iii) impose conditions on the bankrupt. The court can exercise its power to suspend a discharge and impose conditions on the bankrupt concurrently, but it does not have the jurisdiction under this section to discharge a bankrupt unconditionally.

In considering the terms of discharge of a bankrupt under section 172.1, the court is required to take into account

(a) the circumstances of the bankrupt at the time the personal income tax debt was incurred;

(b) the efforts, if any, made by the bankrupt to pay the personal income tax debt;

(c) whether the bankrupt made payments in respect of other debts while failing to make reasonable efforts to pay the personal income tax debt; and

(d) the bankrupt's financial prospects for the future.

The following provides a brief overview of the Registrar's analysis under section 172.1(4) in each of these two cases. The contrasting dispositions underscore the difference between the treatment of a truly honest but unfortunate debtor, and a debtor who has taken no significant steps to address his or her debts. As the Registrar noted in *Binning (Re),* a bankrupt's income tax liability is considered more egregious than other forms of debt because it is a liability that accrued as income was earned and should be taken care of from the earned income, and not out of future income.

Pursuant to section 172.1(4), the Registrar first examined the circumstances of the bankrupt at the time the personal income tax debt was incurred.

In *Binning (Re)*, the bankrupt tax debtor was a self-employed drywall installer who owed $581,807.07 in personal income taxes constituting over 85% of his aggregate unsecured liabilities. As the bankrupt was self-employed, he was responsible for the payment of subcontractors with whom he worked, and for his own tax filings.

In contrast, the bankrupt tax debtor in *Paton (Re)* was an elderly individual living on Old Age Security and Canada Pension Plan payments. The bankrupt was a recurrent late-tax-filer and between 1996 and 2014 accrued $733,481 in unpaid liabilities for personal income tax and corresponding penalties. The Registrar noted that, over the course of those years, the bankrupt suffered personal hardship, losing two family members and his father, having a son convicted in the United States and placed in a maximum security penitentiary, and suffering serious health issues. These hardships contributed to his failure to file tax returns on time.

Second, the Registrar considered the efforts the bankrupts made to pay the personal income tax debt. Binning was found not to have made any significant efforts to pay his personal income tax debt, having made only inconsequential payments over time and failing to make the payments promised pursuant to a consumer proposal under the BIA. Binning admitted to having anger issues, a gambling habit costing approximately $24,000 a year, and to being a poor record keeper.

Paton, on the other hand, had made significant payments over the course of many years. Remarkably, he had paid approximately 250% of the principal owed. The Registrar also noted the bankrupt's cooperation with the bankruptcy trustee and his willingness to address his debts. The bankrupt had previously sold the family farm to pay prior income tax debt. By the time of the hearing, he had also realized on assets in order to pay creditors, assisted the trustee in locating documents needed to realize on accounts receivable, and paid $175 into the estate despite living only on CPP and OAS.

Third, the Registrar considered whether the bankrupt made payments in respect of other debts while failing to make reasonable efforts to pay the personal income tax debt. Binning was found to have spent $24,000 a year on gambling, but had not made any other payments. Paton did purchase assets while there was outstanding debt, but had sold the assets with proceeds going to the bankruptcy estate.

Finally, the Registrar considered each individual's financial prospects for the future. At the time of the hearing, Binning was 52 years old, was self-employed as a drywaller, and was in good health. He had acquired a corporation that was generating some income and was working to overcome his gambling problem. The bankruptcy trustee assessed Binning's ability to pay at $300 a month. Paton, however, was found to have no reasonable prospects of complying with a payment order. He was elderly, in ill health, no longer worked, and was reliant on income from OAS and CPP.

The Registrar noted that Canadian courts have consistently taken the view that a bankrupt with significant tax liability is presumed to have conducted himself or herself inappropriately. The Registrar considered cases both pre-dating and post-dating the 2009 amendments to the BIA and noted the distinction between an unfortunate event overtaking the bankrupt and the bankrupt's indifference to obligations.

The Registrar found that Binning was not an honest but unfortunate debtor and could have paid his income tax debt had he paid more attention to his business records and not gambled. In opposition to the discharge, the Minister of National Revenue sought a $200,000 payment from the bankrupt and a 36- to 48-month suspension. Largely in keeping with the precedents submitted by the parties, the Registrar ordered the discharge to be suspended for a relatively long period of 48 months in keeping with Minster's request, and imposed conditions, including the requirement to make a payment of the greater of $30,000 or the amount of surplus income available over the 48-month term.

Applying a similar analysis in *Paton (Re),* the Registrar found that Paton was in fact an honest but unfortunate debtor and "atypical for a section 172.1 bankrupt". His good faith efforts to pay his debts were noted by the Registrar, as well as the fact that he had suffered punishment by enduring years of garnishments by the Canada Revenue Agency. At the discharge hearing, the Minister sought a "long suspension" (although no specific suspension period was noted in the decision) but did not seek a particular amount for payment. The Registrar relied on *Re Farr* (2014 DTC 5105 (SKQB)), a case involving a similarly aged pensioner with health issues who had made efforts to pay his debts and had put off bankruptcy for years until he was unable to work and the Canada Revenue Agency began to garnish his pension income. Farr's discharge was suspended for one year. Farr had paid a total of 128% of the principal portion of his debt but was never able to overcome the interest on the tax debt. Ultimately, the Registrar suspended Paton's discharge from bankruptcy for six months with no further conditions.

These cases illustrate the vastly different results that can occur when section 172.1 is applied to different fact patterns, and the interplay between the mandatory factors under section 172.1(4) and the Court's interest in balancing the principles of rehabilitation and deterrence under the BIA.

— Sharon Kour

FCA Finds Tax Plan Not Abusive Under GAAR as Alternative Transaction Would Lead to Same Result

***Univar Holdco Canada ULC v. The Queen*, 2017 DTC 5119 (Federal Court of Appeal)**

Univar is a decision in which the Federal Court of Appeal (the "FCA") addresses the issue of whether GAAR applied to a series of transactions that were undertaken by a non-resident to extract surplus from a Canadian company without incurring withholding tax under Part XIII of the *Income Tax Act* (the "Act").

The Tax Court of Canada had previously found that the transactions that had been undertaken were abusive, and subject to GAAR. The FCA allowed the appeal, overturning the lower court's decision. In its reasons for judgment, the FCA discusses how subsequent legislative amendments and alternative transactions should be considered in a GAAR analysis.

CVC Capital Properties, a UK private equity firm, had acquired substantially all of the shares of Univar NV, a Netherlands company, in an arm's length transaction. Univar NV had a lower-tier subsidiary, Univar Canada Ltd., with significant surplus. Prior to the acquisition by CVC of the Univar NV shares, CVC had planned to extract Univar Canada's surplus shortly after it acquired the Univar NV shares. As intended, a series of transactions was undertaken soon after the acquisition to allow CVC to extract the surplus without triggering a deemed dividend under section 212.1.

By way of context, as noted by the FCA, Part XIII imposes a withholding tax on dividends paid (or deemed to be paid) by a corporation resident in Canada to a non-resident shareholder. Having regard to this withholding tax on dividends, as explained by the FCA:

> Section 212.1 [. . .] was introduced to prevent a non-resident person from indirectly extracting from Canada accumulated surplus in a Canadian corporation (Targetco) in a non-arm's length transaction [. . .]. Without section 212.1 [. . .], a non-resident person could sell the shares of Targetco to another Canadian corporation (with which the vendor does not deal at arm's length) for non-share consideration and realize a capital gain that would not be taxable in Canada as a result of an applicable tax convention. Section 212.1 [. . .] would, however, convert what would otherwise have been a capital gain into a deemed dividend to the extent that the amount paid exceeds the PUC of the shares that are transferred.

As noted by the FCA, however, section 212.1 does not apply to arm's length transactions. Further, at the time of the transactions in question, subsection 212.1(4) provided that section 212.1 did not apply in respect of a disposition by a non-resident corporation of shares of a subject corporation to a purchaser corporation that immediately before the disposition controlled the non-resident corporation.

Having regard to the exception to section 212.1 in subsection (4), the corporate group was reorganized shortly after CVC acquired the Univar NV shares. Pursuant to the reorganization, a Canadian resident corporation became the parent corporation of the US parent company of Univar Canada. Accordingly, the new Canadian resident corporation was able to acquire the shares of Univar Canada in transactions governed by subsection 212.1(4), such that, subject to the possible application of GAAR, the extraction of Univar Canada's surplus could be undertaken without the imposition of Canadian withholding tax (relying upon the new Canadian resident corporation's high PUC shares and debt). The parties relied upon the provisions of the Canada-US treaty to exempt capital gains that arose in the course of the reorganization from tax in Canada.

Both the Minister and the taxpayer agreed that there was a tax benefit in avoiding Part XIII tax and that there was an avoidance transaction pursuant to subsections 245(1) and (3), respectively. The sole issue was whether the avoidance transaction was abusive under subsection 245(4).

In determining that GAAR applied, the Tax Court had concluded that the transactions were abusive for two main reasons. First, the TCC had relied on subsequent amendments to subsection 212.1(4), enacted approximately nine years after the transactions were undertaken, the result of which was that the exception under subsection 212.1(4) would no longer have applied to the transactions undertaken in this case. In light of this, the Tax Court held that the transactions were inconsistent with the overall object, spirit, and purpose of the provisions at the time at which the transactions were undertaken. Second, the Tax Court rejected the taxpayer's position that the transactions were not abusive because a series of different transactions, whereby CVC could initially have established a Canadian resident corporation with high PUC and/or debt to directly acquire the shares of Univar Canada, could have achieved the same result without it being abusive. The Tax Court stated that the alternative transactions were not relevant in considering the transactions that had actually been undertaken.

The FCA disagreed with both of these conclusions of the lower court.

The FCA, relying upon two decisions of the Supreme Court of Canada (*Canada Trustco* (2005 DTC 5523) and *Copthorne Holdings Ltd*. (2012 DTC 5007)), stated that the first step in determining whether an avoidance transaction is abusive is to determine the object, spirit, and purpose of the provisions that give rise to the benefit. The FCA held that it was not the purpose of section 212.1 to prevent the removal from Canada of surplus by an arm's length purchaser of a Canadian corporation where, as in this case, the Canadian corporation had generated the surplus prior to the acquisition. Furthermore, the FCA stated that the subsequent amendments to subsection 212.1(4) that prevented other taxpayers from carrying out the same transactions did not suggest that the transactions were abusive when carried out prior to those amendments.

In disagreeing with the Tax Court on the second point, the FCA reviewed the alternative transaction and concluded that it was a relevant consideration in the analysis of whether the transaction that was undertaken was abusive:

> In my view, **the alternative means** by which the same result could have been realized is a **relevant consideration** in determining whether or not the avoidance transaction was abusive. [. . .]
>
> [. . .] Whether the surplus of the Canadian corporation is removed by completing the alternative transactions described [. . .] above or by completing the transactions that were done in this case, the same surplus is removed from Canada. Therefore, in my view, these transactions do not frustrate the purpose of section 212.1 [. . .]. [emphasis added]

The FCA noted that the wording of section 212.1 and the possibility of an alternative transaction highlights a clear distinction between an arm's length and a non-arm's length sale of shares, and that section 212.1 was not intended to prevent an arm's length purchaser of a Canadian corporation from extracting the surplus which, in effect, is what had occurred in this matter.

Read narrowly, the decision may benefit only those taxpayers that undertook similar transactions prior to the amendments to subsection 212.1(4). However, viewed more broadly, the decision is important in its determination that subsequent amendments to a provision of the Act are not necessarily relevant in determining the object, spirit, or purpose of the provision prior to the amendments. Furthermore, the FCA confirmed the relevance, in determining whether transactions undertaken are abusive under GAAR, of alternative transactions that were not abusive that could have achieved the same result.

At the time of writing this comment, leave has not been sought to appeal the decision to the Supreme Court of Canada.

— *Yaroslavna Nosikova*

RECENT CASES

Accused taxpayers not entitled to stay of proceedings based on allegation that Crown had engaged in excessive post-charge delays in prosecuting their cases

Charges under the *Criminal Code* (paragraph 380(1)(*a*)), the *Excise Tax Act* (paragraph 327(1)(*c*)), and the *Income Tax Act* (paragraph 239(1)(*d*)) were laid against the individual accused and the accused corporations in the Provincial Court of Nova Scotia. All of the accused applied for a stay of proceedings for post-charge delay based on the principles respecting delay set out by the Supreme Court of Canada in *R. v. Jordan*, 2016 SCC 27.

The application by the accused persons was dismissed. In *R. v. Jordan*, the Supreme Court of Canada held that delays in prosecuting beyond 18 months for Provincial Court trials are presumptively unreasonable. However, presumptively unreasonable delay can be rebutted by the Crown establishing exceptional circumstances. Delay for purposes of a *Jordan* analysis means net delay, which must be calculated by assessing what portion of the total delay is attributable to the defence as a result of defence waiver, unavailability, and conduct of the case, since the defence should not be allowed to benefit from its own delay-causing conduct (see *R. v. Cody*, 2017 SCC 31). In the present proceedings, the trial was originally expected to take 15 days, but 36 days were ultimately needed. But for defence unavailability, however, the evidence-taking process in these proceedings would have concluded by November 18, 2016, so that the following seven months actually taken had to be deducted from the total delay. As a result, the net delay in this case was 19 months, which was just over the *Jordan* ceiling. Conversely, the complexity of the case constituted an exceptional circumstance which rebutted the presumption of unreasonable delay. In addition, the accused were not anxious to achieve a timely conclusion to their trial. Their application for a stay of proceedings was denied accordingly.

R. v. Spears

2017 DTC 5121

Application for rectification of land transfer transactions allowed in part

The applicant owned two parcels of land, the first being a parcel which was leased to a corporation owned by the applicant and the second a parcel on which the applicant's home was located (the "home property"). In July 1998 transfers of both parcels of land were carried out, and the applicant believed that those transfers were made to a corporation owned by his son. However, the transfers were actually made to the son personally, and the applicant sought a rectification order to remedy that error. He argued that his intention had been to make such transfers to the son's corporation and that a mistake, of which no one was aware, was made by the solicitor who drafted the relevant documents. His application was opposed by the Attorney General.

The application was allowed in part. The Court of Queen's Bench reviewed the principles governing the equitable remedy of rectification as outlined in Supreme Court of Canada jurisprudence. Those principles provide that, in order for the remedy of rectification to be provided, it is necessary that there be a prior agreement whose terms are definite and ascertainable, that such prior agreement have been still in effect at the time the impugned instrument was executed and that, at the time of such execution, the impugned instrument failed to accurately record the agreement. Finally, it is necessary that, if rectified, the agreement would carry out the prior agreement. The Court reviewed the evidence provided by the applicant and his son, as well as the documentary evidence relating to the transfers. The Court was satisfied, on the basis of that evidence, that the necessary conditions for issuance of a rectification order had been met with respect to the transfer of the first parcel of land. In the Court's view, however, there was insufficient evidence to support the issuance of such an order with respect to the home property. A rectification order was therefore issued only with respect to the documents evidencing the transfer of the first parcel of land.

Buyting v. Canada (AG)

2017 DTC 5122

Appeal from rectification order held to be moot

Three subsidiaries of the corporate taxpayer had amalgamated under provincial corporations legislation, with the intent of creating a tam "bump". However the manner in which the transactions were structured failed to achieve that objective. The corporate taxpayer sought and obtained a rectification order with respect to that amalgamation transaction. The Attorney General appealed, but did not seek a stay of the order, and five weeks after the issuance of the rectification order the taxpayer implemented the plan of arrangement provided for in that order. The Attorney General pursued the appeal, arguing that the rectification order should be set aside and the steps taken pursuant to that order cancelled.

The appeal was dismissed. The Ontario Court of Appeal held that it had the authority, where it determined that the applicant was not entitled to rectification, to order the cancellation of the certificate of arrangement obtained by the taxpayer and to reinstate the certificate of amalgamation. However, in determining whether to exercise that authority, the Court must consider whether the Director had issued a certificate pursuant to the rectification order, whether the appellant could reasonably have sought a stay of that order pending appeal, whether there was third party reliance on such certificate, and, finally, whether there were special circumstances which would justify the exercise of the Court's power to cancel the certificate. The Court concluded that the Attorney General had both the means and the opportunity to seek a stay, but did not, and that there was evidence that third parties had relied on the financial consequences of the plan of arrangement implemented pursuant to the rectification order. Finally, there was no fraud or other special circumstances such as would justify the exercise of the Court's power to cancel the certificate of arrangement, and the appeal was quashed.

Slate Management v. AG of Canada

2017 DTC 5120

Order issued finding respondent in contempt of Court

In 2016, the Canada Revenue Agency (the "CRA"), in order to conduct an audit, issued a Requirement letter to the taxpayer, seeking the production of documents and records relating to her business. Such Requirement letter, which was sent by registered mail, was issued pursuant to section 231.2 of the *Income Tax Act*. The taxpayer did not provide the required information or otherwise comply with the Requirement, and the CRA sought and obtained a Compliance Order to compel her to provide such access. The taxpayer did not obey that order, and the Minister of National Revenue applied for an order finding the taxpayer in contempt of Court.

An order finding the respondent in contempt of Court was issued. The Federal Court held that a person may be found in contempt of court for disobeying an order of the Court, and that a finding of contempt must be based on proof beyond a reasonable doubt. In order to find the taxpayer in contempt, the Court must be satisfied that she had both received and was aware of the Compliance Order, and that she had truly failed to comply with that Order. The Court concluded that, on the evidence, the minister had established both elements. The taxpayer had not appeared before the Court or respected any Court orders, and had not provided any of the documents or records set out in the Compliance Order since its issuance eight months earlier. The Court was satisfied beyond a reasonable doubt that the respondent was guilty of contempt of court. An order was issued finding the respondent taxpayer in contempt of Court, imposing a fine, and requiring that she provide the information and documents set out in the Compliance Order within a period of 30 days, failing which a term of imprisonment for 30 days would be imposed.

MNR v. Blake

2017 DTC 5118

Appeal from assessment for director's liability dismissed

The taxpayer was the director of a company which had failed to remit both payroll withholdings and goods and services tax amounts as required. The minister issued assessments against the taxpayer as a director of that company, under both the *Income Tax Act* and the *Excise Tax Act*, and the taxpayer appealed. He acknowledged that the company had failed to make remittances as required and that the amounts were owed, and he did not put forward a due diligence defence. Rather, the taxpayer argued that the preconditions for a director's liability assessment under both statutes had not been met, in that the minister had not, as required, made a good faith attempt to determine and seize corporate assessments to satisfy the liability. The taxpayer argued that there were corporate assets available to seize and that he had so informed the minister, who failed to act on that information.

The appeal was dismissed. The Court held that the good faith test set out in the jurisprudence imposed an obligation on the minister to act without any ulterior or improper motive and that the onus was on the respondent to show that such obligation had been met. The Tax Court reviewed the steps undertaken by the Canada Revenue Agency in connection with the corporation's outstanding remittances and concluded that the respondent had met that onus. The Court held that, while it was possible that the Canada Revenue Agency could have done more to ensure collection from the corporation, the Court's role was not to look at what the CRA could have done or whether the steps taken were reasonable. Rather, the Court was required to determine whether the CRA acted in good faith, and the evidence before the Court supported the conclusion that the CRA did so, based on the information available to it at the time.

Tjelta v. The Queen

2017 DTC 1114

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