http://resource.intelliconnect.ca/resource/scion/document/default/cchca20943c0baac8d21e243d2f94e2c8cdc2?cfu=WKCAN&cpid=WKCA-TAL-IC&uAppCtx=RWI

Tax Notes

Report No.: 661

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BACKDATING OF DIVIDENDS

- –Kevyn Nightingale, CPA, CA (ON), CPA (IL), TEP of MNP, LLPJohn Sorensen, JD, MMus, LLM of Gowling WLG (Canada) LLP

Determining owner-manager compensation can be a fluid exercise. Owner-managers commonly inject or withdraw cash on an as-needed basis and may at times intermingle personal and business expenditures. This practice can create bookkeeping challenges and risk vis-à-vis the CRA.

Establishing shareholder loan balances, bonuses, and dividends at year-end takes time, and certainty about characterizing amounts taken out of a company may not occur until after year end. This timing challenge poses an obvious problem for executing dividend resolutions.

It is not a well-kept secret that some taxpayers may wish to characterize net cash withdrawals or other amounts as dividends for accounting and tax purposes after year end. They ask counsel to draft corporate documents on the basis that the dividend was declared in the prior year. While this practice is common, and the CRA is known not to challenge it, the spectre of inappropriate backdating lurks in the background.

2017 TAX CHANGES

Canadian and US tax law changes created special incentives for payment of dividends in 2017.

In Canada, 2017 was the last year that dividends could be “sprinkled” freely to adult family members without concern for the Tax on Split Income.[1]

The United States implemented broad-ranging tax reform, which included a “Transitional Tax” on most accumulated Earnings and Profits—essentially tax-based retained earnings—of many foreign corporations.[2] The tax is levied on the US shareholder, not on the corporation. And of course, there are many Americans living in Canada who own shares in closely-held Canadian corporations.

Canadian personal taxes and non-resident withholding tax are partially creditable against this Transitional Tax.[3] Americans who wish to generate Canadian tax to offset the Transitional Tax will need dividends paid in 2017.[4]

Because these changes happened in late December, it was generally impracticable for corporations to formalize dividend declarations prior to the end of the calendar year. Yet, Canadian dividends are not generally reportable until February 28 (for those paid to residents) or January 15 (for those paid to non-residents).

Hence, in the window from January 1 to those dates, there is substantial incentive to backdate dividend payments.

RISK

The risk exposure for a tax professional who engages in improper backdating is substantial, including disciplinary action by their professional regulator and third party civil penalties.[5] Irredeemable damage to

one's professional reputation would certainly come bundled with either of these outcomes. Consequently, knowing what is appropriate and approaching with caution is essential.

This risk is heightened with the July 2017 issuance of the Tax on Split Income changes. Dividend-income splitting has been a common practice, so it will likely be subject to enhanced audit attention in the coming years.

The term "backdating" has a negative connotation. However, there is a spectrum of conduct from acceptable to fraudulent. Backdating may be acceptable if performed transparently to memorialize a true agreement after the fact. Backdating is unacceptable where it supports the conclusion that an event occurred at a different time to achieve a legal result dependent on timing. Creating a document to "memorialize" an event after the purported fact is patently fraudulent when the underlying event never actually occurred. The professional must be cognizant of the purpose of a "backdated" document and its effect on third parties. The Canada Revenue Agency is always a third party whose rights may be affected.

However, the "no harm no foul" rule should apply: even if a document was improper, if there was no effect or damage to a third party then there should be no risk to the client or professional. Finally, the risk of detrimental reliance on a "backdated" document and allegations of deception may be mitigated where backdating is express. Express disclosure may be in the form of two dates on the document—the "effective as of" date and the actual date of signing. Although it goes without saying, expressly including effective and actual dates of a document does not cure mischief, like fabrication, but is preferable in a *legitimate* document to help counter allegations of deception.

The term "dividend" is not defined in the ITA, the *Ontario Business Corporations Act*, or the *Canada Business Corporations Act*. The courts have held that a dividend is a payment to shareholders of income or capital gains of a corporation on a *pro rata* basis.[6] A dividend may be declared if the company meets solvency requirements. While a dividend may be declared currently or in advance, corporate law statutes do not contemplate the retroactive declaration of a dividend—at law, a dividend must be declared before it can be paid. There is no legal support for the proposition that a dividend can be backdated or declared retroactively, and the tax law certainly does not envision this.

A possible justification for drafting dividend resolutions after year-end may be that the corporation's tax position is unaffected by timing, since dividends would be paid out of tax-paid capital (there are caveats to this proposition, such as the dividend refund).[7] Further, from the shareholders' perspective, recognizing a dividend in the previous year accelerates their income recognition, whereas recognizing the dividend after year-end would result in a deferral. Consequently, it may be arguable that there is no mischief where a payer participates in an acceleration of income recognition for a recipient, thus "no harm and no foul". However, the timing of income and gains is a planning point and there may be situations in which earlier recognition is preferred. Where a tax advantage is achieved by having a dividend supported by backdating, at the very least the CRA would take the position that the backdating was ineffective retroactive tax planning.

Notwithstanding the CRA's historical restraint, if the question were argued, the courts would be unlikely to accept the legal effect of a dividend declaration made to alter the characterization of an amount already paid where the declaration may constitute retroactive tax planning. From their perspective, the first question is whether the backdating memorializes or fabricates:

> A transaction may, for income tax purposes, properly be documented after the fact where the parties actually agreed, understood or resolved that the transaction would occur in a particular manner, but not where such agreement, understanding or resolution was only reached or passed after the hoped-for effective time of the transaction.[8]

However, the CRA also stated that

> …the Act contains no provision to specifically deal with dating or amending documents retroactively. In order to determine the date a transaction takes place under the Act, reliance is generally placed on the legal documents and the legal rights they create. In the view of the CRA, 'backdating' or altering documents and records is clearly not permitted under any provision of the Act.[9]

It is worth noting that this view was expressed in respect of a revision of a previously documented transaction; the CRA was referencing the rectification process.

These positions can be reconciled: the CRA recognizes that a transaction may be "papered" after the fact, but backdating is improper where it is tantamount to a retroactive characterization or alteration of reality. The courts take the same view: "although not ideal, a share certificate may be prepared and signed after the investment and its acceptance, with no effect on the quality or value of the title represented by the share certificate."[10] However, another court stated "I find unacceptable the notion that a company and its shareholder are entitled, for purposes affecting the rights of third parties, to rewrite history, that is to say, to treat imaginary events as having happened. A legislature has the power to enact deeming provisions. Others do not."[11]

Once again, the views of differing courts can be reconciled: actual agreements can be supported by documents created after the fact; history cannot be rewritten and events cannot be fabricated.

The obvious question is how does a professional serve a client who seeks an after-the-fact characterization of amounts received from a private corporation? If an amount was received by a shareholder at a point in time, without resolutions or book entries to support the payment as a dividend, the later characterization as a dividend could arguably be described as a fabrication (at worst) or retroactive planning. Nonetheless, the reality is that owner-managed businesses may operate in such a way that incurring legal and accounting fees throughout the year is too costly and year-end adjustments are more practical and cost effective.

RECOMMENDED SOLUTIONS

We would recommend an express CRA policy permitting the crystallization of compensation and dividends in an owner-managed business to occur, for example, up to 60 days after fiscal year end (to match the due date for T5 slip filing).[12] This administrative concession would codify the CRA's existing practice.

The downside of that approach is, of course, that the CRA is not bound by its own administrative policy. Creating a binding regime would require legislative amendment. In our view, the necessary legislative drafting would not be complex—a late election to characterize amounts as cash dividends could be limited to Canadian-Controlled Private Corporations. It is possible to impose economic thresholds to ensure that the relief is only obtained by small and mid-sized enterprises for which professional fees would be onerous. We suggest that the potential for abuse is so small that thresholds need not be applied.

In the absence of this guidance, query how a professional should deal with these issues post-year-end: Is it feasible to draft resolutions before year-end without full knowledge of the financial situation? A formulaic approach may be legally effective. For instance: of the amounts disbursed, some proportion is a shareholder loan repayment, some proportion is salary or bonus, and the balance is a dividend (the amount of which is to be established following the calculation of shareholder loan balances and salary/bonus).

While the CRA may not be challenging taxpayers on this practice now, there is always the risk of a change in approach. If this were to happen, what taxpayers and advisors did in the past would become relevant in the future. It is important for tax professionals who serve clients in the small to mid-sized business space to be aware of their procedures and help protect their clients as much as possible.

A ROADMAP OF THE REVISED INCOME SPRINKLING PROPOSALS

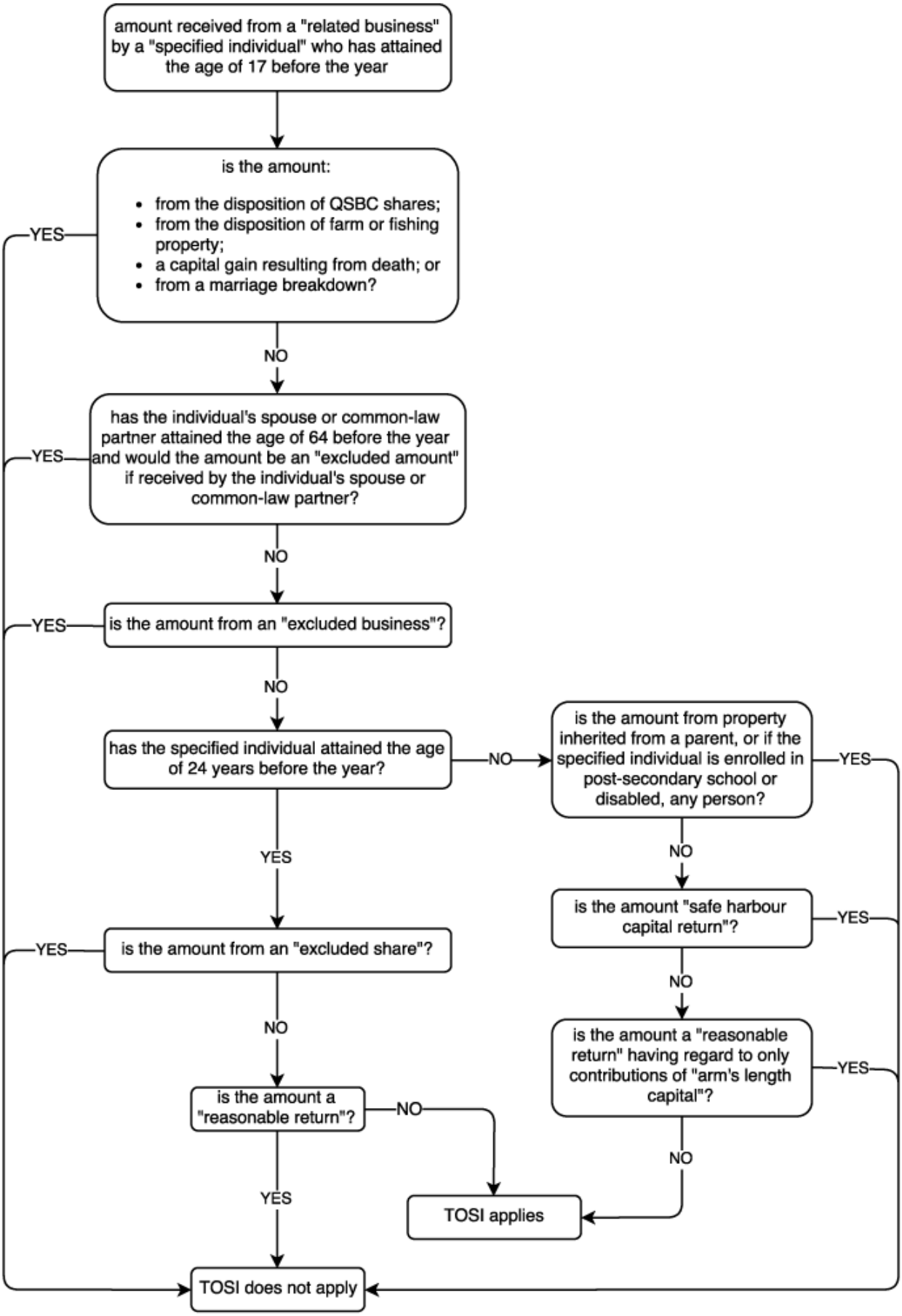
- –Cameron Mancell, CFP®, Analyst, Wolters Kluwer Canada Limited

On December 13, 2017, the government released the long-awaited revised proposals affecting the tax on split income ("TOSI") rules in section 120.4 of the *Income Tax Act* (the "Act").[13] These changes target taxpayers who use their private corporations to "sprinkle" income among their spouse/common-law partner and adult children. The revised rules contain an assortment of exclusions, definitions, and bright-line tests. More exclusions is good for taxpayers because there are multiple lines of defense before TOSI applies, but they also bring about more complexity and tests with varying degrees of subjectivity. When owner-managers

inquire whether these new rules will apply to amounts paid to their family members, the answer will inevitably be “it depends”—one must determine whether any of the numerous exclusions are met.

I have prepared a flow chart to illustrate the various exclusions from TOSI. The chart begins with objective “sure thing” exclusions that can easily be determined, continues with more subjective exclusions that require taxpayers to meet several criteria before being freed from the high tax burden, and finally ends with the last-resort reasonableness test, which is the most subjective and risky option. The excluded amounts in the Act do not follow an orderly hierarchy of application, but the chart is structured under the assumption that taxpayers will find comfort meeting a more certain exclusion before relying on a subjective exclusion. For example, the exclusion by means of a marriage breakdown is much more certain than relying on the reasonableness test. Certain exclusions only apply to taxpayers who are over/under 25, so the logic in the flowchart accordingly diverges based on age.

Every exclusion and definition referred to in the chart has criteria that must be met, so referencing the new legislation as an aid is necessary if using this flow chart as a tool. The various definitions can be found in the proposed amendments to subsection 120.4(1) of the Act. Note that the chart only applies in the context of the new rules applying TOSI to adults, and therefore should not be referenced with respect to amounts received by individuals under 18.


amount received from a "related business" by a "specified individual" who has attained the age of 17 before the year
is the amount:
• from the disposition of QSBC shares;
• from the disposition of farm or fishing property;
• a capital gain resulting from death; or
• from a marriage breakdown?
YES
NO
has the individual's spouse or common-law partner attained the age of 64 before the year and would the amount be an "excluded amount" if received by the individual's spouse or common-law partner?
YES
NO
is the amount from an "excluded business"?
YES
NO
has the specified individual attained the age of 24 years before the year?
NO
is the amount from property inherited from a parent, or if the specified individual is enrolled in post-secondary school or disabled, any person?
YES
NO
is the amount "safe harbour capital return"?
YES
NO
is the amount a "reasonable return" having regard to only contributions of "arm's length capital"?
YES
NO
YES
is the amount from an "excluded share"?
YES
NO
is the amount a "reasonable return"?
NO
YES
TOSI applies
TOSI does not apply

There is a lot to unpack here, and many tax professionals likely spoiled their holidays reviewing the finer details of all these exclusions and the definitions upon which the exclusions rely. The scope of the new TOSI rules has been significantly narrowed when compared to the draft rules released on July 18, 2017, but it is evident in the above chart that narrowing the scope came at the cost of increased complexity. Also, the CRA has stated that its interpretation and application of the rules is expected to change over time based on its experiences with enforcing them. In other words: be prepared for some uncertainty surrounding these new rules for the coming years.

In *Tax Topics* 2389-90, "Private Company Income Splitting Proposal Part 3: The Government Responds", Kevyn Nightingale provided a comprehensive overview of the definitions referred to in the chart, so I will avoid repeating this information. That said, some thoughts on the definitions of "excluded share" and "reasonable return" are discussed below. Again, the full conditions for each exclusion can be found in the proposed amendments to section 120.4 of the Act.

ONE LESS WAY OUT FOR SERVICES BUSINESSES

The definition of an "excluded share" excludes corporations that earn 90% or more of their income from the provision of services. That is, income from a pure service-based business must fall under one of the other exclusions to avoid the application of TOSI. Although the expansion of TOSI targets income splitting on the individual level, the new definition of "excluded share" examines the type of business conducted on the corporate level. Kevyn Nightingale speculates that "the proposal is designed to attack structures where a working spouse incorporates a services business in order to split income with a stay-at-home spouse".[14] Policy intent aside, this exclusion from the exclusion may add uncertainty, since one must make a subjective determination of whether a service-focused business crosses the 90% threshold. Also, a share in a professional corporation (i.e., corporations for accountants, dentists, lawyers, medical doctors, veterinarians, and chiropractors) cannot be an "excluded share".

CLARITY ON THE REASONABLENESS TEST

The CRA has published helpful administrative guidance on how it plans to apply the new rules.[15] With respect to the reasonableness test, the CRA does not intend to apply the test "unless there has not been a good faith attempt to determine a reasonable amount based on the Reasonableness Criteria." A "reasonable return" is an amount that is reasonable having regard to the individual's contributions of capital and labour, risks they assumed, past payments to the individual, and any other relevant factors. In the administrative guidance document, the CRA outlines a myriad of factors it will examine in respect of reasonability:[16]

Labour Contribution	Property Contribution	Risk Assumption	Total Amounts Paid
• The nature of the tasks performed; • Hours required to complete the tasks; • A competitive salary/wage for the tasks in relation to businesses of similar size and industry; • Education, training and experience; • Degree of activities and nature of activities in relation	• The amount of capital contributed to the business; • The amount of loans to the business; • The fair market value of property (both tangible and intangible property) transferred to the business, including technical knowledge, experience, skill, or know-how; • Whether the individual has provided property as collateral for loans or other undertakings;	• Whether the individual is exposed to the financial liabilities of the business, whether through guarantees of mortgages, loans or lines of credit or otherwise; • Whether the individual is exposed to statutory liabilities related to the business; • Extent of the risk that contributions made by the individual to the business may be lost, whether in whole or part;	In determining whether a payment received by the individual exceeds a reasonable amount, account should be taken of other amounts previously paid to the individual. This should generally include any payment of any kind (including salary or other remuneration or compensation, dividends, interest, proceeds, and fees), benefits, and deemed payments (as may be reasonably required in the circumstances).

to those of a business of a comparable nature and size; • Time spent on the activity in comparison to time spent in other activities or undertakings; • Particular knowledge, skills or know-how that the individual possessed; • Business acumen; and • Past performance of functions.	• Whether other sources of capital or loans are readily available; • Whether comparable property are readily available; • Whether property are unique or personal to the individual; • Opportunity costs; and • Past property contributions.	• Whether any risk is indemnified or otherwise limited in the circumstances, whether by agreement or otherwise; • Whether the individual's reputation or personal goodwill is at risk; and • Past or ongoing risk assumption.

The subjectivity of this determination places it at the end of the flowchart as a last-resort exclusion, assuming that the taxpayer did not meet the bright-line tests for the other exclusions. Moreover, where the taxpayer is under 25 years old, reasonability is determined having regard only to the individual's contributions of "arm's length capital".

NEXT STEPS

The government intends to legislate these proposals as a part of the Budget process. Unlike the proposals that were announced on July 18, 2017, the government is not accepting consultation submissions with respect to these heavily-revised tax proposals. Therefore, the final version of these proposals is likely to be introduced as a part of Budget 2018, and included in a bill thereafter.

CURRENT ITEMS OF INTEREST

TRUDEAU AND MORNEAU RESPOND TO US TAX REFORM

Last month, Prime Minister Justin Trudeau spoke at the World Economic forum. In that speech, he said "that Canada won't be slashing taxes and regulatory red tape to compete with Donald Trump's America."[17] Minister of Finance Bill Morneau appears to be concerned for Canada's tax competitiveness: "it will have different impacts on different sectors, so we are looking carefully on it."[18] However, besides these two quotes, there has yet to be any further guidance from the government on how it might (or might not) respond to US tax reforms.

GOVERNMENT ANNOUNCES MEAL AND TRAVEL RATES

The government has announced the 2017 rates used to compute meal and travel expenses for the medical expense tax credit, moving expense deduction, and the Northern residents deduction. With respect to the simplified method for meals, the rates remain at $17/meal and a maximum of $51/day. Regarding the simplified method for claiming travel costs, various rates per kilometre apply with respect to each province/ territory for 2017.

GOVERNMENT ANNOUNCES 2018 AUTOMOBILE DEDUCTION AMOUNTS

The government has announced the various automobile deduction limits and expense benefit rates for 2018. There are two changes that apply as of 2018.

First, the per-kilometre deduction limit for tax-exempt allowances paid to an employee for using their personal vehicle for business purposes is increased by one cent. Therefore, for 2018, the allowance amount is 55 cents/km on the first 5,000 km and 49 cents/km thereafter. For Northwest Territories, Nunavut, and Yukon, these amounts increased to 59 cents/km on the first 5,000 km and 53 cents/km thereafter.

Second, the prescribed rate used to compute the taxable operating expense costs reimbursed to an employee is increased by one cent to 26 cents/km. For taxpayers employed principally in selling or leasing automobiles, the rate is increased by one cent to 23 cents/km.

The following amounts will remain the same in 2018:

- The $30,000 (plus sales taxes) capital cost limit for passenger vehicles;
- The $300 per month interest deduction limit with respect to amounts borrowed to purchase an automobile; and
- The $800 (plus sales taxes) deduction limit of leasing costs with respect to a leased automobile.

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.

WILFUL BLINDNESS IN THE CONTEXT OF THE ACT: PENALTIES LEVIED UNDER S. 163(2) DO NOT REQUIRE AN INTENTION TO CHEAT, MERELY A FAILURE TO INQUIRE

***Bolduc v. The Queen*, 2017 DTC 1124 (Tax Court of Canada)**

This case clarifies the applicable legal test to determine wilful blindness when imputing knowledge for the purposes of subsection 163(2) of the *Income Tax Act* (the "Act"). The test requires only that the Minister establish a failure to inquire by the taxpayer in circumstances that warrant inquiry. The criminal concept of an intention to cheat as a component of wilful blindness does not apply to this provision.

In this case, the taxpayer was assessed in respect of his 2009 tax return after claiming, through a tax preparer, a business loss of $326,127. He applied the loss against his income in 2009 and carried the remainder back every year to 2006. The taxpayer did not carry on a business and had no business income. The CRA denied the loss and levied a penalty pursuant to subsection 163(2) for knowingly making a false statement on his return. On appeal, the Tax Court reversed the CRA's decision and found that the taxpayer made appropriate inquiries of the tax preparer where warranted, bringing himself outside of the definition of wilful blindness and gross negligence for the purposes of subsection 163(2).

The taxpayer worked for Toyota as a production team leader. He had no training in business, accounting, or tax. He had previously used a large commercial tax preparer to prepare his income tax returns, which always included the same items: employment income, RRSP contributions, and tuition credits. The taxpayer had a young family with a child and had recently purchased a house. On the recommendation of his wife's aunt, he decided to engage the services of a smaller, more specialized tax preparer: Solutions 21.

The taxpayer first met representatives of Solutions 21 in 2008. They seemed sophisticated and knowledgeable about tax planning. The representatives offered information about the history of the company and themselves, and promoted their affiliation with TD Bank. On multiple occasions, the taxpayer attended meetings with as many as 50 other people at Solutions 21's offices, which were located in an impressive building.

Solutions 21 first recommended that the taxpayer participate in a charitable donation program for the 2008 tax year. In the program, he donated $2,000 as a part of a group and received a tax receipt that listed a donation amount of $12,000. The taxpayer inquired about the discrepancy and was told that the receipt

reflected the group donation. He confirmed that the charity was legitimate and eligible by referencing the CRA website.

After filing his return, the Minister issued an assessment and the taxpayer received a refund of $7,000. Believing that the refund was too high, the taxpayer made more inquiries. Solutions 21 explained that the refund reflected his family's single-income status, that this was the first year he claimed child tax credits, and that he had made the charitable donation. The CRA reassessed the return and reduced the refund by only $400.

Solutions 21 next suggested that the taxpayer enroll in their "Tiger Concierge Program" for the 2009 year. Through the program, Solutions 21 completed his return and claimed a business loss of $326,127.38. The business loss was used in that year and carried back every year to 2006. The taxpayer inquired as to the reason for the loss and clarified that he did not own a business. Solutions 21 explained that the amount was equal to his income tax deducted in the last four years, and was equivalent to an interest-free loan which he would be required to pay back in four years. He was told that he was eligible for the program as a new homeowner and by virtue of his child tax credits.

Following receipt of the 2009 return, the CRA asked the taxpayer to fill out a business questionnaire, which was filled out by Solutions 21 on his behalf. The taxpayer made inquiries about Solutions 21's use of suspicious wording in the questionnaire and was reassured of their expertise. Nevertheless, he sought a second opinion from an accountant, and was informed that the Tiger Concierge Program was not legitimate. He ceased all communication with Solutions 21 thereafter.

The CRA reassessed the return and disallowed the business loss. It levied a penalty of $42,029 against the taxpayer pursuant to subsection 163(2) of the Act for knowingly making false statements on his return. The taxpayer appealed the assessment to the Tax Court.

Subsection 163(2) requires the Minister to establish on a balance of probabilities that: (1) the taxpayer knowingly made a false statement on his return, or (2) made a false statement under circumstances amounting to gross negligence. In respect of the former, where the Minister cannot prove actual knowledge, establishing wilful blindness is sufficient.

The taxpayer argued that the test to be applied in determining wilful blindness for subsection 163(2) was the criminal concept, which required that the Minister prove either deliberate ignorance of the need to make inquiries, or the intention to cheat in filing the return. The taxpayer argued that neither were present in his case and, as a result, the Minister had not proven knowledge for the purposes of the first part of subsection 163(2). For the same reasons, he argued that he was not grossly negligent.

The Minister argued that the taxpayer had actual knowledge of a false statement because he knew that he was claiming a large business loss when he did not run a business. In the alternative, the Minister maintained that knowledge could be imputed because the taxpayer was willfuly blind and chose not to make inquiries in circumstances in which he knew he should have. The Minister argued that the latter was the correct test for establishing wilful blindness under subsection 163(2).

The Tax Court, *per* D'Auray J, agreed with the Minister regarding the applicable test for wilful blindness in the context of subsection 163(2). After a review of recent jurisprudence from the Federal Court of Appeal, the Court held that wilful blindness can impute knowledge "in circumstances that suggest that an inquiry should be made but the taxpayer decides not to inquire because he knows that the answer may not serve his purposes." The Court held that the criminal requirement of the intention to cheat need not be established under subsection 163(2).

Turning to the case at bar, D'Auray J applied contextual factors established by the Federal Court of Appeal in *Torres* (2014 DTC 1028 (TCC)). She considered the sophistication of both the taxpayer and the tax preparer, the nature of their relationship, and the nature of the advantage obtained by the taxpayer. The Court noted that the taxpayer had no tax or business training. On the other hand, Solutions 21 operated from a professional head office and cultivated a relationship of trust that spanned multiple tax planning ventures, and included a host of other parties that were all known to the taxpayer, including his family. Most importantly, the Court found that the taxpayer made appropriate inquiries at critical junctures in respect of

both tax planning ventures, and followed up every time he perceived a disproportionate or unwarranted advantage. In the circumstances, the Court declined to find wilful blindness and impute knowledge.

With respect to the second part of subsection 163(2), the Court summarized the jurisprudence and noted that gross negligence was largely determined by the existence of wilful blindness. Accordingly, as the Court had already found that the taxpayer did not turn a blind eye to the amounts claimed in his return, it similarly found that his conduct did not otherwise fall under conduct amounting to gross negligence.

This case demonstrates the Court's expectations of taxpayers who delegate their tax planning to tax preparers. In doing so, taxpayers do not shield themselves from the duty to pay attention, nor do they absolve themselves of the burden of ensuring the correctness of their return. There remains a positive obligation on taxpayers to ask questions and make inquiries of the tax preparer in circumstances that warrant them. When false statements are made by tax preparers, the Minister need only establish the taxpayer's failure to exercise such caution, and is not required to prove the high criminal threshold of an intention to cheat.

—Peter Leigh

CONCURRENT CRIMINAL PROCEEDING DOES NOT WARRANT STAY OF TAX APPEAL

***Elbaz v. R*, 2017 DTC 1131 (Tax Court of Canada)**

In this case, the taxpayer was charged with fraud under the *Criminal Code* and sought a temporary stay of his Tax Court appeal pending the outcome of the criminal trial. He argued that the tax proceeding would likely require him to provide evidence, including testimony, that would improperly prejudice his rights in the criminal proceeding. As discussed below, the Tax Court found that, in the circumstances, a stay was not necessary to protect the taxpayer's rights because sufficient safeguards regarding the use of evidence between proceedings already exist under the *Canadian Charter of Rights and Freedoms* (the "Charter"), the legislation, and the common law.

The Minister issued a net worth assessment against the taxpayer on the basis that the increase in the value of the taxpayer's assets did not seem to correspond to his reported income for the relevant period. When issuing a net worth assessment pursuant to subsection 152(7) of the *Income Tax Act* (the "Act"), the Minister has the onus of establishing that there is a discrepancy between the taxpayer's assets and his expenses. The onus then shifts to the taxpayer to explain the discrepancy by identifying the source of his income and showing that it is not taxable.

The taxpayer in this case argued that in order to discharge his onus of proof, he would likely be required to provide potentially incriminating evidence regarding the same facts at issue in the criminal proceeding. Accordingly, the taxpayer argued that he was being forced to choose between his Charter-protected right to remain silent in the criminal proceeding and his right to meet the case against him in the tax appeal.

The taxpayer also raised as a corollary issue that the burden of proof in a Tax Court appeal is higher than the evidentiary standard in a regular civil trial because a tax appeal requires the taxpayer to "demolish" the assumptions of fact in the notices of assessment. The result, he argued, is that tax proceedings are especially prejudicial to subsequent proceedings.

The Tax Court (*per* Smith J) began by identifying the two-stage legal test applicable to a temporary stay of proceedings in the context of parallel proceedings: (1) the court must determine whether there is a real nexus between the two disputes involving the taxpayer; and (2) if there is, the court must then consider the merits of the motion, bearing in mind that a stay is an extraordinary and discretionary remedy that must be based on compelling reasons. In considering this test, the court is granted "broad discretionary considerations" because, even though a temporary stay is an extraordinary remedy, it is still a temporary one and is therefore akin to scheduling or adjourning a matter.

With regard to the first stage of the analysis, the Tax Court rejected the taxpayer's argument that the similar factual and temporal contexts of the two proceedings satisfied the "real nexus" test. Rather, the Court found that the thrust of the "real nexus" test is aimed at the jurisdiction of each court, and that it becomes less problematic the less those jurisdictions overlap. In this case, since the two courts were deciding two separate

and distinct issues (i.e., the remittance of tax vs criminal guilt), each could proceed independently and at the same time even though they involved similar, if not identical, factual contexts.

The Tax Court then turned to the second stage of the analysis and the taxpayer's argument that the Tax Court proceeding would infringe his right to a fair trial in the criminal proceeding. In rejecting this argument, the judge found that sections 7, 11, and 13 of the Charter, along with provisions of the *Evidence Act*, would, if required, avail the taxpayer of use immunity and derivative use immunity with respect to the testimony, if any, provided in the tax appeal. It was also noted that the taxpayer would enjoy complete immunity from having to testify in the criminal proceeding, if he so chose. As a general proposition, these protections are sufficient to prevent incriminating testimony provided in the tax appeal from being used to establish guilt in the criminal proceeding.

The Court also rejected the taxpayer's argument that the burden of proof in the tax context is higher than in other civil trial contexts. The Court explained that although the shifting burden in a tax appeal initially assumes that the Minister's factual assumptions in the notice of assessment are correct, and requires the taxpayer to "demolish" those assumptions, the onus in doing so remains on a balance of probabilities. If the taxpayer can show a *prima facie* case that the factual assumptions are incorrect, the burden then shifts to the Minister to prove that those assumptions were correct, again on a balance of probabilities. While this shifting burden is unique to the tax context, the Court found that the standard of proof remains the civil standard throughout, and that there is nothing particularly prejudicial in its effect.

This case demonstrates that a stay of tax proceedings, even in the face of concurrent criminal proceedings, is the exception and not the rule. Ultimately, the Court in this case was troubled with the vague hypotheticals presented by the taxpayer to ground his argument of prejudice. It found that without more targeted and specific arguments as to the exact nature of the prejudice that would accrue against the taxpayer, motions of this nature could not succeed as a matter of course, as it would have a real impact on the proper administration of justice.

Therefore, taxpayers seeking a temporary stay of proceedings should be prepared to point to the specific prejudice that would accrue against them if the proceedings run concurrently. The taxpayer cannot ground these types of motions in vague assertions of potential prejudice, or the mere perception of unfairness. Absent such specificity, a taxpayer should be prepared to engage in both proceedings at the same time.

—Peter Leigh

SECTION 160 ASSESSMENT VACATED DESPITE LAND REGISTRATION DOCUMENTATION SHOWING NOMINAL CONSIDERATION FOR TRANSFER

***Konyi v. The Queen*, 2017 DTC 1108 (Tax Court of Canada)**

The *Konyi* decision of the Tax Court considered an assessment under section 160 of the *Income Tax Act* (the "Act") arising from a real property transfer from the tax debtor to his spouse. Even though the documentation indicated that the consideration paid for the transfer was nominal, the issue in the case was whether, in fact, the spouse paid sufficient consideration to the tax debtor for the property. Despite some ambiguity and inconsistency in the spouse's evidence, the Court concluded that she did pay fair market value consideration for the transfer. As a result, the section 160 assessment was vacated.

The spouse and the tax debtor were each 50% owners of a property located in British Columbia. On October 31, 2006, the tax debtor transferred his 50% interest in the property to the spouse. At the Tax Court hearing, the parties agreed that, at the time of the transfer, the fair market value of the property transferred was $402,000 and that the tax debtor had an outstanding tax debt of $162,757.19. The conveyancing documents registered in the land titles office indicated that the consideration for the transfer was $1, but according to the spouse and the tax debtor, this was done in order to avoid the property transfer tax.

Under section 160 of the Act, a transferee of property from a tax debtor may be liable to be assessed an amount equal to the lesser of (1) the tax debt of the transferor, and (2) the amount by which the fair market value of the property exceeds the fair value of the consideration paid by the transferee. In order for section 160 to apply, the following four conditions must be met:

(1) there must be a transfer of property;
(2) the parties must not be dealing at arm's length;
(3) the transferor must be liable to pay tax under the Act at the time of the transfer; and
(4) the fair market value of the property transferred must exceed the value of the consideration given by the transferee.

On the facts of the *Konyi* case, only the fourth condition was at issue, and more specifically, whether the taxpayer transferee gave sufficient consideration.

At trial, the spouse asserted that the original 1994 registration of the property in both her name and the tax debtor's name was an error and that it was always intended for the property to be owned only by her. This was apparently an issue that she and the tax debtor had intended to deal with for quite some time, but they had procrastinated in doing so. She also testified that one of the purposes of the transfer was to keep the property from the tax debtor's creditors and the couple knew that, if the transfer was to have the intended creditor-proofing effect, it would have had to have been made for consideration equal to its fair market value to satisfy that objective under debtor-creditor law. As such, the timing of the transfer had to be delayed until the spouse had enough funds available to buy the 50% share of the property from the tax debtor. The spouse and the tax debtor both testified that they reached a verbal agreement in late 2005 or early 2006 under which the tax debtor's half of the property would be transferred to her and she would pay $402,000 as consideration by the end of 2006. The evidence established that a series of payments totalling $400,000 were made by the spouse to the tax debtor in 2006. The spouse also alleged that she gave a promissory note to the tax debtor earlier in 2006 evidencing her debt to the tax debtor in connection with the property.

The Minister asserted that there was no agreement between the spouse and the tax debtor concerning consideration for the transfer, that no promissory note was ever issued in respect of the transfer, and that no payments were made by the spouse to the tax debtor in respect of the property. The Minister also contended that the consideration given by the spouse was only $1—the amount shown in the conveyancing documents registered in the land titles office.

The Tax Court first considered whether there was a genuine contract between the spouse and the tax debtor requiring the spouse to pay market-value compensation for the transfer, as the existence of such an arrangement is necessary to avoid liability under section 160. It must be shown that the parties agreed to all of the essential terms of the agreement, including the consideration to be paid and the terms of payment. It would be inadequate, for example, for the parties to vaguely agree that payment would occur whenever the taxpayer had the funds to pay. On the other hand, it was not necessary that the consideration be paid by the time of the transfer; a legally enforceable contract could contemplate payment after the transfer of the property. Further, although the price must be agreed upon in order to form a contract, it is not necessary to fix the price at a specific identified number; it is sufficient to agree that the property will be transferred for fair market value. The Court in *Konyi* found as fact that the taxpayer and her spouse had agreed that the consideration would be paid by the end of 2006 and that the transfer would occur for fair market value. Although the fair market value of the transferred property does not appear to have been calculated until October 5, 2006—i.e., after the agreement was made, but before the transfer—this did not preclude the formation of an agreement in the Court's view.

The Minister also argued that the spouse did not make payments to the tax debtor for the property because the relevant payments were deposited into the couple's joint bank account. The Tax Court also rejected this argument, as the case law establishes that the existence of a joint account does not imply that the money in the account belongs to both holders of the account. As the tax debtor only had joint bank accounts when most of the payments were made, the payments could not have been made to an account held solely in his name. Further, the spouse made payments after the tax debtor opened his own personal account, at which time the spouse began making payments to that account. There was a $2,000 discrepancy between the payments established in evidence ($400,000) and the purchase price of the property ($402,000) but the taxpayer explained that this was due to a calculation error. Both the tax debtor and the spouse testified that all of the payments were in relation to the property and the Court found their evidence to be credible. On this basis, the Court concluded that although the contemporaneous conveyance documentation indicated that the consideration was $1, this was not an accurate reflection of what was agreed to by the parties.

Finally, the Minister challenged the credibility of the taxpayer's evidence. First, the Minister questioned the spouse's stated rationale on the timing for the transfer by showing that the spouse had sufficient funds before 2006 to pay for the property, so there was no reason to wait until 2006 to do so. The spouse explained that, prior to 2006, she required funds for other purposes, such as paying for stock purchases and for household expenses, which the Court accepted. Second, the Minister highlighted the fact that the spouse and tax debtor could not produce the original promissory note, with the copy adduced into evidence having been drafted in 2012. On this point, the Tax Court found that the creation of a replica promissory note was not intended to mislead anyone, and in any event, the existence or non-existence of a promissory note was not relevant to the substantive issue in the case.

Having accepted the spouse's testimony regarding the existence of a verbal agreement for the transfer of the property, and the connection between the payments made in 2006 and the transfer, the Court concluded that the spouse was not liable for her husband's tax debt under section 160 and the assessment was vacated. The *Konyi* case is another reminder of the importance of credible testimony to a successful Tax Court appeal, particularly where the written documentation is incomplete or inconclusive.

—*Theodore Stathakos*

FORWARD CONTRACT: HEDGE OR ADVENTURE IN THE NATURE OF TRADE?

***MacDonald v. The Queen*, 2017 DTC 1104 (Tax Court of Canada)**

This case concerned the income tax treatment of various cash settlement payments made by the taxpayer in partial and final settlement of a forward contract to sell securities. The taxpayer reported the transaction as one that produced business losses that could be applied against other income. The Minister reassessed the taxpayer to treat those losses as capital losses (that could only be applied to offset capital gains).

The taxpayer was a sophisticated investor. During the 1969 to 1997 period, the taxpayer was employed by a Canadian brokerage firm that was acquired by the Bank of Nova Scotia ("BNS") in 1988. He eventually became the deputy chairman of the BNS brokerage subsidiary before his departure in 1997.

Under the terms of BNS's acquisition of the taxpayer's original brokerage firm, the taxpayer received 183,333 BNS common shares in exchange for his shares of the acquired firm and this was the number of BNS common shares that he held through to 1997.

In 1997, the taxpayer expected the value of BNS shares to decline in the short term and he entered into a forward contract with a Canadian financial institution to sell 165,000 BNS shares with a forward sale date in 2002. The forward contract only allowed for cash settlements between the parties. If the sale price under the forward contract exceeded the closing price for BNS shares on the forward sale date, the counter-party was required to pay the taxpayer an amount equal to the difference multiplied across 165,000 shares. On the other hand, if the closing price for BNS shares on the forward sale date exceeded the sale price under the forward contract, the taxpayer was required to pay the counter-party an amount equal to the difference multiplied across 165,000 shares. It appears that the settlement date was extended beyond the original settlement date several times by mutual agreement, with newly-computed sale prices for BNS shares applicable on each new forward sale date. The forward contract also allowed the taxpayer to elect to early settle some or all of his obligations under the forward contract, which right the taxpayer exercised several times over the term of the contract to discharge his obligations with respect to a portion of the reference shares until final maturity at the end of March 2006. The taxpayer made aggregate settlement payments of $4,294,919, $2,204,065, $5,855,329, and $1,897,442 to the counter-party in 2003, 2004, 2005, and 2006, respectively.

During the term of the forward contract, the taxpayer disposed of approximately 39% of the BNS common shares that he held at the commencement of the contract, but the timing of the sales did not coincide with the dates on which the taxpayer made settlement payments under the forward contract. During the 19 months that immediately followed the March 2006 maturity of the forward contract, the taxpayer disposed of BNS shares representing another 13% of his initial holdings of BNS common shares.

As noted earlier, the taxpayer treated the aggregate payments made to the counter-party under the forward contract as business losses. The Minister reassessed the taxpayer's 2004, 2005, and 2006 taxation years

to treat those losses as capital losses. The tax appeal did not include a reassessment of the taxpayer's income for the 2003 taxation year. Presumably, the 2003 taxation year had become statute-barred from reassessment by the time the Minister was ready to issue the reassessments relating to the settlement payments under the forward contract, but an explanation for the 2003 taxation year being excluded from the appeal is not evident from the reported decision.

The taxpayer's treatment of his losses from the forward contract was based on his view that the transaction was an adventure or concern in the nature of trade and a business by virtue of the extended definition for business under subsection 248(1) of the *Income Tax Act*. As such, his losses from the transaction were business losses. The loss could only be a capital loss if the forward contract could be considered to be a capital property associated with the undertaking but, in the taxpayer's view, this was not the case since the contract was "a tree that bears no fruit". Moreover, the taxpayer submitted that it would be inappropriate to link the income or capital character of his economic gain or loss from the forward contract to the character of his long-term BNS shareholding, since the forward contract was not intended to operate as a hedge of his investment in BNS shares and, as a factual matter, it did not operate as a hedge since any dispositions of BNS shares during the relevant period did not coincide with settlement payments made under the forward contract.

The Minister took the opposite position and alleged that the taxpayer had hedged the BNS shares and that the forward contract was not an adventure or concern in the nature of trade, but rather capital property. In fact, the Minister argued that, for the undertaking to be an adventure or concern in the nature of trade, there had to be a scheme for profit making. The Minster argued that this was not the case for the taxpayer and that the taxpayer's secondary intentions were to obtain tax advantages. The Minister took the position that the intention of the forward contract was to "lock in" an economic gain on the BNS shares, since he had pledged them as security for a loan, and to protect the value of the BNS shares.

The Court (*per* Lafleur J) found that the Minister had to establish that the forward contract was "a hedge against a capital asset, such that the forward contract is treated as a capital asset, with the result that any gains or losses resulting from its settlement will be on capital account."

With respect to whether the transaction was an adventure in the nature of trade, the Court considered whether the forward contract was a "scheme for profit-making". Although the courts have considered multiple factors to make this determination, the Court cited *Canada Safeway Limited* (2008 DTC 6074 (FCA)) in finding that the most determinative factor is whether the taxpayer had "a legitimate intention of gaining a profit from the transaction." The Court found that, in the case of the taxpayer, the intention in entering into the forward contract was to speculate, and profit in, the decline of the price of the BNS shares. At the time of entering into the contract, the taxpayer did not know if he would have to pay the counter-party or the counter-party would have to pay him at the termination date. The taxpayer had a legitimate intention of making a profit and it was not used to "lock in" an economic gain on his then-existing investment in BNS shares. The Court stated that this finding was supported by the fact that the taxpayer did not ever intend to sell his BNS shares and had only sold a small number of his BNS shares over the years to rebalance his investment portfolio.

The Court considered the Minister's argument that, in order for the forward contract to be speculative, the taxpayer "must be exposed to something over and above its actual exposure": *Placer Dome* (2006 DTC 6532 (SCC)). The Minister added that the taxpayer did not speculate because, for the duration of the forward contract, he held more BNS shares than the number of shares subject to the forward contract, thus minimizing his exposure to risk. The Court dismissed this argument by stating that the risk was not related to the BNS shares because the taxpayer had no intention of selling them. Rather, by entering into the forward contract, the taxpayer increased his risk, as he did not know if he would be making or receiving payments under the forward contract.

The Court further dismissed the Minister's argument that, because the taxpayer had pledged the forward contract and the BNS shares as collateral under a loan with TD Bank, the taxpayer had no ability to speculate or make a profit because he was required by the bank to maintain the contract and could not trade the BNS shares. The Court noted that the question was "not whether he had speculated with the BNS shares but whether he had speculated when he entered into the Forward Contract."

The Court then went on to consider whether the forward contract was a transaction on capital account because it hedged a capital asset. The Court identified the BNS shares as the capital assets.

In determining whether a capital asset is being hedged, the Court considered the following factors: (i) the intention to eliminate risk, and (ii) whether the asset alleged to be a hedge is linked to the underlying asset that is subject of the hedge in terms of quantum and timing (*Reference re: Grain Futures Taxation Act (Manitoba)* ([1925] DLR 691)). The Court also considered *George Weston* (2015 DTC 1079 (TCC)) in finding that, to determine whether a hedge occurred, the intention and conduct of the taxpayer must be considered to establish a link between the capital asset and the underlying asset.

On the facts of this case, the Court found that the taxpayer had not hedged the BNS shares, noting that "the facts of this case did not show a link both in terms of quantum and timing between the forward contract and the ownership of the BNS shares or any transaction in respect of the BNS shares." The Court also noted that, since the forward contract was to be cash settled only, the only way the taxpayer could protect himself from a loss would be to sell his BNS shares to cover the losses under the forward contract (i.e., payments to the counter-party). However, the taxpayer did not sell his BNS shares at the same time or at approximately the same time as his cash settlement payments to the counter-party. The Court further found no link between the loan with TD Bank and the forward contract.

On the basis of all the foregoing, the Tax Court allowed the taxpayer's appeal and permitted the taxpayer to treat the losses from the forward contract as business losses in the circumstances of this case.

It is evident that the intention of the taxpayer is an important factor in determining whether to consider the payments from a forward contract as income gains/losses or capital gains/losses. In this case, the intention of the taxpayer regarding the forward contract was an important factor in the Court's finding that the transaction was an investment in the nature of trade and that a hedge had not occurred. The Court in this case put great emphasis on the fact that the taxpayer never had the intention of selling his BNS shares and had only sold a small percentage of his shares to rebalance his investment portfolio. Although several other factors can assist a Court in determining whether a gain or loss on a forward contract should be considered to be on income or capital account, taxpayers should be mindful of their primary intentions of entering into forward contracts or other similar derivative contracts.

—Brianne Paulin, Articling Student

A CLASS CONFLICT OF A DIFFERENT KIND

***The Queen v Repsol Canada Ltd.*, 2017 DTC 5113 (Federal Court of Appeal)**

The narrow issue in this case was the proper classification of a liquefied natural gas regasification facility for capital cost allowance purposes. The taxpayer had treated the facility as Class 43 property (entitled to accelerated capital cost allowance at a 30% rate and qualified for investment tax credits as "qualified property" for the purposes of paragraph 127(5)(a) of the *Income Tax Act* (the "Act")), whereas the Minister took the position that part of the facility should be included in Class 1 (4%) and the rest of the facility should be included in Class 3 (5%). The taxpayer's appeal was allowed in the Tax Court of Canada and, as discussed below, the Federal Court of Appeal affirmed the Tax Court decision.

Regasification is a process that converts liquefied natural gas back to conventional natural gas. At issue in this case was a large-scale, industrial facility that served as both a deep-water pier for receiving ocean tankers delivering liquefied natural gas and a terminal for the storage and regasification of the delivered liquefied natural gas. The property was built at a total cost of approximately $1.2 billion. The facility was built and operated by a partnership formed in 2005 between two Canadian subsidiaries in the Spain-based Repsol group of companies and two corporations in the Irving Oil group of companies. The partnership brought in liquefied natural gas by sea and regasified it into conventional natural gas for transport to the US border through a third-party pipeline that was specifically built to serve the partnership's regasification facility. The liquefied natural gas imports were purchased from a Repsol affiliate company and another Repsol group company purchased the regasified natural gas for distribution into the United States. To suit the potential future needs of the Irving Oil group, the regasification facility was constructed in such a way that it could be altered to accommodate the importation of oil by sea.

The taxpayers in the appeal were the Repsol-group members of the partnership that owned and operated the facility. In their tax returns, the taxpayers claimed their share of the partnership's investment tax credits and business losses for the relevant tax years, which had been computed on the basis that the entire facility was Class 43 property. The Minister recalculated the partnership losses based on the pier portion of the facility being Class 3(h) property and the terminal portion of the facility being Class 1(n) property, thereby reducing the partnership's available capital cost allowance deductions for the taxation years in issue. As noted earlier, the Tax Court allowed the taxpayers' appeals of the Minister's reassessments.

The issue in the case revolved around the interaction of classes 1, 3, and 43 in Schedule II of the *Income Tax Regulations*. However, classes 8 and 29 were also important to the analysis because relevant portions of the Schedule II descriptions of the types of property that come within Class 43 are defined by reference to classes 8 and 29.

It should be noted that the ultimate finding in this case is only of historical significance, as Schedule II of the *Income Tax Regulations* has since been amended to specifically include a liquefied natural gas regasification facility as Class 47 property, which has an 8% capital cost allowance rate and is not eligible for treatment as qualified property for investment tax credit purposes. In fact, since only 37% of the total $1.2 billion cost of the facility had been incurred before the effective date of the Schedule II amendments to create Class 47, the dispute between the Repsol companies and the Minister did not cover almost two-thirds of the partnership's costs for the facility.

The Federal Court of Appeal (*per* Woods JA) began its analysis by considering the Minister's classification of the terminal portion of the facility as Class 1 property. For the purposes of this case, the classification of the terminal as Class 43 property depended on whether it was property described in Class 29 read without reference to the conditions in paragraph (*c*) of Class 29. In accordance with the language used in Class 29, the taxpayer sought to qualify the terminal as Class 43 property on the basis that the terminal was property manufactured by the taxpayer to be used primarily for the processing of goods for sale and that it is property that would otherwise be included in Class 8. However, property that is Class 1 property is expressly excluded from Class 8 property. Therefore, the ultimate issue to be decided in connection with the classification of the terminal was whether it was Class 1 property.

Paragraph (*n*) of Class 1 includes manufacturing and distributing plants acquired primarily for the production or distribution of gas, but expressly excludes property acquired for the purpose of processing natural gas before delivery to a distribution system. The Minister's main position was that the terminal was itself part of a distribution system and, therefore, the exclusion should not apply because distribution was part of the function of the terminal. In support of its main position, the Minister asserted that the *Northern & Central Gas Corp* (87 DTC 5439 (FCA)) case was authority for the proposition that it should not matter whether the gas was delivered by tanker, as a liquid, or by pipeline, and that each method of delivery should form part of the distribution system which each supplied. The Minister also argued that the regasification operations at the terminal were not "processing" which would be an alternative basis for disqualifying the terminal from the particular carve-out.

The Federal Court of Appeal found that the Tax Court had not erred when it determined that the main purpose of the facility was not distribution, but was the processing of liquefied natural gas to render it marketable and that the starting point of the distribution began at the third-party pipeline. The Federal Court of Appeal further disagreed with the Minister's argument that *Northern & Central Gas Corp* requires that all activities carried out after production be treated as distribution activities, noting that the *Northern & Central Gas Corp* decision was limited to the facts of that case, which included the salient fact that the alleged processing activities in that case occurred along a transmission pipeline and the gas entering the processing facility for storage left in a similar state. By contrast, in the present appeal, the gas entering the regasification terminal began in a liquid state and left in a gaseous state and had not merely been stored, but had been made more marketable by this phase transition, the blending activities that occurred at the terminal, and the change in the chemical composition of the gas.

The interpretative issues surrounding the classification of the pier were more straight-forward than those associated with the terminal. The taxpayer's position was that the pier was an integral part of a single property, namely, the regasification facility. Even though the Minister acknowledged that the pier was integral to the operations at the terminal, the Minister's position was that the pier should be treated as a separate

property in light of the fact that there is a separate property description in Class 3 for a property that is a pier (or, rather, jetty). The Minister also argued that the fact that the pier could be repurposed to take deliveries of oil from ocean tankers meant that the pier should be treated as a separate property from the regasification terminal.

The Federal Court of Appeal highlighted the fact that the language in Class 3 indicates that it covers property that is not included in any other class and then went on to uphold the Tax Court's use of the integration principle followed extensively in the case law (see, for example, *Bunge of Canada Ltd.* (84 DTC 6276 (FCA))) to find that the pier was part of the activities necessary and integral to the processing operation, and thus Class 43 property to the partnership.

This case serves as a caution to the potential issues that can arise when trying to categorize depreciable properties into the proper capital cost allowance class, even where there is a classification that appears to unambiguously describe the specific type of property, such as the pier. It reminds us that the proper interpretative approach may require a full consideration of the context and circumstances, taking into account industry practices, the taxpayer's business, and the role of the subject property within that business before making a determination that a particular property falls into a particular capital cost allowance class. Here, the Federal Court of Appeal began by asking whether the facility could be Class 43 property, which brought it to consider whether the facility was property manufactured by the taxpayer to be used primarily for processing activities which would otherwise fall into Class 8. Because Class 8 property expressly excludes Class 1 property, the Court was ultimately left to decide whether the facility was Class 1 property, or whether it was expressly excluded because it fell within the exclusion from that capital cost allowance class for property acquired for the purpose of processing natural gas before delivery to a distribution system. This inquiry turned on the meaning of "processing" and "distribution" within the provision, with the Court deciding that the activities were processing and did not form part of a distribution system. This determination led the Court to hold that the facility (including the integrated pier) could not fall within Class 1 and was properly classified as Class 43 property in accordance with the taxpayer's original filing position for the tax years in question.

—*Justin Shoemaker*

RECENT CASES

GENERAL WAIVER PROVISION IN SECTION 220(2.1) NOT APPLYING TO NOTICES OF OBJECTION

The corporate taxpayer applied to the Minister for a waiver of a notice of objection with respect to a reassessment of its 2000 taxation year. The Minister refused such application on the basis that his discretionary authority under section 220(2.1) of the *Income Tax Act* to provide such waiver did not apply to notices of objection. The taxpayer sought judicial review of that refusal before the Federal Court, and its application was successful, with the Federal Court holding that the Minister's decision was based on an unreasonably narrow interpretation of subsection 220(2.1). The Minister appealed from that decision.

The appeal was allowed. The Federal Court of Appeal held that the issue on the appeal was whether the general waiver provision in subsection 220(2.1) of the *Income Tax Act* was intended to apply to notices of objection, and concluded that the Minister's decision that it was not was both reasonable and correct. The appellate Court reviewed the wording of the objections regime set out in sections 165 to 166.2 and held that such scheme was very detailed and set out specific time limits for objecting. A taxpayer generally has 90 days to make an objection in writing and, if this time limit has expired, the taxpayer may apply to the Minister for an extension of time. The Minister may then grant such an extension where specific conditions are met. The Court noted in particular that the Minister may not extend the time permitted unless an application has been submitted within one year and, in the Court's view, such condition was both strict and intentional. The Court held that the relief sought by the taxpayer was to use the general waiver provision in subsection 220(2.1) in order to engage the objection process without having to comply with its statutory conditions. To apply subsection 220(2.1) in that manner would, however, provide the Minister with a power that was specifically denied by section 166.1(7). Supreme Court of Canada jurisprudence has held that wherever there is a particular enactment and a general enactment in the same statute and the latter, taken in its

most comprehensive sense, would overrule the former, the particular enactment must be operative. Under such "implied exception" rule of statutory interpretation, the general waiver provision could not be applied to override a more specific provision. That principle applied in this case, and the Court concluded that the Minister was right to rely on it.

Canada (MNR) v. ConocoPhillips

2017 DTC 5135

DAMAGES AWARDED TO UNDISCHARGED BANKRUPT FOR PAST LOSS OF EARNINGS TO BE DISTRIBUTED TO CRA

A law firm held an amount in trust that represented payment of a personal injury award to their client, an undischarged bankrupt. Both the client and the Canada Revenue Agency sought payment of the full amount of such funds, the latter pursuant to a Requirement to Pay issued to the law firm. The law firm applied to the Court for direction as to the correct distribution of the funds.

The amount held in trust was ordered to be distributed to the client and to the Canada Revenue Agency. The Supreme Court of British Columbia held first that the law firm was permitted to interplead the funds, as it claimed no beneficial interest in the money and had received claims from two claimants. The Court noted that the amount held in trust represented damages paid for past loss of earning capacity, future loss of earning capacity, cost of future care, non-pecuniary damages, and special damages. The Court reviewed the jurisprudence on the treatment of personal injury awards and concluded, based on that jurisprudence, that such awards are clearly protected from claim by the trustee in bankruptcy and from garnishment by a bank. The CRA had argued that such jurisprudence had no application, as the interpleader hearing was not a bankruptcy hearing. The Court held, however, that the evidence showed that the delay in the bankruptcy proceedings that allowed the CRA to take that position was due in significant part to the injuries suffered by the bankrupt that had led to the damages award. The Court held that, in such circumstances, the principles outlined in the jurisprudence applied, and that to hold otherwise would lead to an unjust result. Consequently, in the Court's view, the awards relating to pain and suffering, cost of future care, and future wage loss were exempt from garnishment by the CRA. However, the amount awarded for past loss of wages was subject to the CRA's claim. The Court ordered that such amount be distributed to the CRA and that the remainder of the funds held by the petitioner be distributed to the client.

Re Paine Edmonds LLP

2017 DTC 5134

PORTION OF SETTLEMENT RECEIVED BY TAXPAYER UPON DISMISSAL FROM EMPLOYMENT A NON-TAXABLE AWARD OF DAMAGES

The taxpayer was discharged from his employment on July 20, 2006. He instituted oppression proceedings and an action for damages against his corporate employer under the provisions of subsection 241(1) of the *Canada Business Corporations Act* but, in a settlement, agreed to accept a confidential amount arbitrarily arrived at (the ”Confidential Amount”) in return for an absolute release on his part. In assessing the taxpayer for 2009, the Minister included the entire Confidential Amount in his income either as a “retiring allowance” under paragraph 56(1)(a) of the *Income Tax Act* (the “Act”), or as an amount compensating him for his loss of income resulting from his employer’s failure to respect his contract of employment. On appeal to the Tax Court of Canada the taxpayer conceded that one half of the Confidential Amount should be included in his income as a “retiring allowance”, but alleged, in essence, that the other half should be excluded as an award of damages unrelated to his employment and paid to him to compensate him for his employer’s abusive conduct.

The taxpayer's appeal was allowed. The evidence indicated that the Confidential Amount paid in this case could only constitute an indemnity in lieu of notice. Nor was it determinative that the taxpayer had characterized the entire Confidential Amount in his tax return as a “retiring allowance”. It is also well established that a taxpayer is entitled to object to an assessment which reflects what he/she has reported

in his/her tax return. In addition, in *Overin v. The Queen*, 98 DTC 1299, the Tax Court of Canada held that not all awards of damages received by a taxpayer fall within the purview of the expression “retiring allowance” in 248(1) of the Act, but only those damages related to the loss of employment. In the present proceedings, moreover, not all of the Confidential Amount paid to the taxpayer was actually related to his loss of employment. The oppression proceedings leading to the payment of that Amount were concerned with obtaining an award for damages arising from the oppressive conduct of the taxpayer’s employer, and the Confidential Amount would never have been paid had those oppression proceedings not been commenced. A portion of the Confidential Amount, therefore, represented an award of damages not subject to tax, and the balance constituted an indemnity in lieu of notice which was subject to tax under the Act. The Minister was ordered to reassess accordingly.

Abenaim v. The Queen

2017 DTC 1142

MOTIONS TO ALLOW AGENT TO REPRESENT INDIVIDUAL AND CORPORATE APPELLANTS DENIED

Two individual and two corporate appellants brought motions seeking leave of the Tax Court for their representation by an agent, in a matter to be heard under the Court's general procedure.

The motions were denied. The Tax Court held that the motion was to be determined pursuant to Rule 30 of the *Tax Court of Canada Rules (General Procedure)*. Rule 30(1) states that a party to a proceeding who is an individual may act in person or be represented by counsel. The Court concluded that it did not have the discretion, under Rule 30(1), to allow an agent to represent an individual, and that such conclusion was supported by the jurisprudence. Under Rule 30(1), an individual can either represent him or herself, or be represented by counsel. Consequently, the motion with respect to the individual appellants was denied. On the question of the representation of the corporate appellants, Rule 30(2) provides that where a party to a proceeding is not an individual, that party shall be represented by counsel except with leave of the Court, and on any conditions that the Court may determine. The Court noted, however, that the question of the right to appear was also addressed in section 17.1 of the *Tax Court of Canada Act*, and that Regulations and Rules made pursuant to a statute could not override that statute. Section 17.1 provided that a party to a general procedure proceeding could appear in person or could be represented by counsel, and that the meaning of counsel was limited to persons who were barristers or solicitors authorized to practice in any of the provinces. The Court carried out an analysis of section 17.1 which led it to hold that a corporation could not appear in person and therefore could not be self-represented. In addition, the Court noted that the person who the corporate appellants sought to have represent them was not an officer, director, or shareholder of either of the corporate appellants and had no connection to either corporation. The Court concluded that, in the general procedure, the only option available to a corporation is to be represented by counsel. Accordingly, the Court concluded that the wording of section 17.1 should be read down to read that "[W]here a party to a proceeding is not an individual, that party shall be represented by counsel." As the person who sought to represent the corporate appellants also did not qualify as "counsel" under the definition provided in section 17.1, he could not represent the corporate appellants in that capacity. The motion with respect to the corporate appellants was also denied.

Masa Sushi et al. v. The Queen

2017 DTC 1147

APPEAL FROM ASSESSMENTS FOR EMPLOYMENT BENEFIT PAYMENTS ALLOWED IN PART

Assessments were issued against former employees or surviving spouses of former employees of Northern Telecom (“Nortel”) for the 2011 taxation year. Those assessments were in respect of distributions made during that year from a health and welfare trust established by Nortel in 1980. In some cases, the amounts distributed related to group term life insurance plans, while in others the amounts pertained to survivor transition benefits. The recipient taxpayers appealed from each of those assessments, arguing that the amounts received were not taxable.

The appeals were allowed in part. The Tax Court of Canada held that the amounts distributed during 2011 represented partial compensation for the termination of the particular benefit plan which had been provided by Nortel to its employees and that the taxability of such compensation was to be determined by an analysis of the language of the particular charging provision of the *Income Tax Act*. Following such analysis, the Court held that while the provision of a group term life insurance benefit would have been taxable to the appellants during their employment, under section 6 of the Act, that provision was not sufficiently broad to capture the distributions paid to them in 2011. Such distributions were therefore not taxable in the year of receipt. The Court concluded, however, that distributions made in relation to survivor benefits were governed by section 56 of the Act. As that section included the phrase "any amount received … on account … of … a death benefit", the distributions received were accordingly to be included in income in the year of receipt.

Scott et al. v. The Queen

2017 DTC 1143

APPEAL DENIED WHERE APPELLANT FAILING TO MEET STATUTORY REQUIREMENTS FOR DEDUCTIONS

The taxpayer was a salesman who worked largely on commission during the 2011 and 2012 taxation years. In computing his income for those years, he claimed employment expenses in a number of categories, including salaries paid to his children for services provided at his home office, other home office costs, motor vehicle expenses, meals and entertainment expenses, and the cost of supplies. He also declared a rental loss for both years, which arose from his rental of a condominium of which he was a joint owner. The 2011 and 2012 returns were initially assessed as filed but the Minister subsequently reassessed both years for unreported rental income and disallowed employment expenses. The taxpayer appealed from the reassessments.

The appeal was dismissed. The Tax Court of Canada reviewed the relevant legislative provisions which indicate that, in order for a taxpayer to claim employment expenses, it is necessary that the taxpayer's terms of employment require that he incur and pay such expenses. In addition, the filing of a Form T2200 prepared by the employer is a statutory condition precedent to the claiming of certain employment expense deductions, and provides evidence of the terms of employment. The Court held that the appellant had failed to meet his burden of proof with respect to claims for a deduction for salaries paid to his children to act as his assistants, as the evidence provided did not show that their services were necessary for the appellant to be able to carry out his employment duties. In addition, no record was kept of the number of hours worked and the appellant admitted that the amount of compensation paid was arbitrarily determined and had no correlation to duties performed. On the issue of home office expenses, the Court held that the appellant had not met either of the statutory conditions necessary for a claim for the deduction of such expenses. The Form T2200 filed indicated that he performed the duties of his employment at home only 20% of the time and he admitted that he did not meet clients at his home. Consequently, no amount was deductible in respect of home office expenses incurred. The Court then reviewed the claims made by the appellant for motor vehicle expenses, meals and entertainment expenses, and the cost of supplies before holding that, in the absence of any receipts, invoices, or other supporting documentation, it could only conclude that the amounts allowed by the Minister were reasonable in the circumstances. Finally, the Court considered the undeclared rental income assessed by the Minister. While the appellant had claimed that the source of the $300 in monthly deposits to his condominium bank account was transfers from his personal bank account, he failed to provide any supporting evidence. The Court concluded that, overall, the appellant had failed to establish, on a balance of probabilities, that he was entitled to the adjustments sought with respect to his 2011 and 2012 taxation years.

Brown v. The Queen

2017 DTC 1148

Footnotes

[1] Proposed amendments to the *Income Tax Act* (Canada) ("ITA"), particularly section 120.4, December 18, 2017.
[2] US Internal Revenue Code ("IRC") §965.
[3] IRC §901, 965(g).
[4] It should be possible to carry back Canadian tax from 2018, but there is as yet no guidance on this question.
[5] ITA section 163.2.
[6] *Marshall v. R.*, 2011 DTC 1353 (TCC).
[7] ITA paragraph 129(1)(a).
[8] CRA View 1991-224 "Redemption of Preferred Shares".
[9] CRA document 2009-0338861E5.
[10] *Beaulieu v. R.*, 2011 DTC 1160 (TCC).
[11] *Clark G. Wood v. MNR*, 88 DTC 1180 (TCC).
[12] Reg. 209.
[13] http://www.fin.gc.ca/n17/17-124-eng.asp
[14] *Tax Topics* no. 2389-90, "Private Company Income Splitting Proposal Part 3: The Government Responds", Kevyn Nightingale.
[15] https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/federal-government-budgets/income-sprinkling/guidance-split-income-rules-adults.html.
[16] *Ibid*.
[17] https://www.theglobeandmail.com/news/politics/trudeau-sends-strong-signal-canada-wont-follow-us-on-tax-cuts-at-davos/article37707544/
[18] http://business.financialpost.com/news/economy/morneau-vows-to-keep-canada-competitive-in-face-of-u-s-corporate-tax-cuts