Tax Notes

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GOD, ATHEISM, RELIGION, AND REGISTERED CHARITIES

— *Peter Tomlinson, Analyst, Wolters Kluwer Canada*

The lack of a God is less damning for a prospective religious charity than the lack of a detailed belief system. The Church of Atheism of Central Canada (the "Church") found that out in *Church of Atheism v. Canada (MNR)*, 2019 DTC 5136 (FCA).

The Church is incorporated under the *Canada Not-for-profit Corporations Act* with the following goal:

> The purpose of the Corporation is to preach Atheism through charitable activities, in the City of Ottawa, the provinces of Ontario and Quebec, and whichever province shall from time to time be designated as part of Central Canada by the By-Laws.

The Church applied for registration as a charity under the *Income Tax Act* (the "Act"). The main difference between a non-profit and a charity is that a registered charity can issue official receipts for donations for income tax deduction purposes (and the donors can receive tax credits), while non-profits cannot.

The Church's application was refused by the Minister. The Church's appeal from that decision was heard by the Federal Court of Appeal (the "Court") on November 12, 2019. The Church argued that the common law test governing the advancement of religion as a head of charity is invalid as it is contrary to sections 2, 15, and 27 of the *Canadian Charter of Rights and Freedoms* (the "Charter"). The Court reviewed the Minister's decision on the standard of reasonableness (the Minister's decision being a question of mixed fact and law). In the appeal, the Court had to determine whether the Minister's decision (a) violated the Church's rights and freedoms guaranteed by sections 2, 15, and 27 of the Charter; and (b) was reasonable.

The Law

Subsection 248(1) of the Act defines "charity" to include charitable organizations. "Charitable organization" is defined in subsection 149.1(1) in part as follows:

> (*a*) constituted and operated exclusively for charitable purposes,
>
> (*a*.1) all the resources of which are devoted to charitable activities carried on by the organization itself,

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[. . .]

The Act does not define charitable activities, so the Court reviewed the common law, which recognizes four charitable purposes:

(1) the relief of poverty;

(2) the advancement of education;

(3) the advancement of religion;[1] and

(4) certain other purposes beneficial to the community, not falling under any of the preceding heads (*Commissioners for Special Purposes of the Income Tax v. Pemsel*, [1891]A.C. 531 (H.L.)).

While items (1), (2), and (4) have clear objectives of value to society, religion is seen as inherently valuable to society.

Purposes (3) and (4) are at issue in this appeal. "Advancement" requires active promotion; the Church's primary grievance is the definition of the word "religion". From the Court's judgment:

> [10] For something to be a "religion" in the charitable sense under the Act, either the Courts must have recognized it as such in the past, or it must have the same fundamental characteristics as those recognized religions. These fundamental characteristics are not set out in a clear "test". A review of the jurisprudence shows that fundamental characteristics of religion include that [a] the followers have a faith in a higher power such as God, entity, or Supreme Being; [b] that followers worship this higher power; and [c] that the religion consists of a particular and comprehensive system of faith and worship (*Syndicat Northcrest v. Amseleum*, 2004 SCC 47, [2004] 2 S.C.R. 551, at paragraph 39).

In common law, good and evil, positive and negative actions, and the particulars — or sincerity — of faith do not come into the equation when determining if a belief system is a religion.

The relevant sections of the Charter in dispute are:

> 2. **Fundamental freedoms** — Everyone has the following fundamental freedoms:
>
> (*a*) freedom of conscience and religion;
>
> [. . .]
>
> 15. **Equality before and under law and equal protection and benefit of law** — (1) Every individual is equal before and under the law and has the right to the equal protection and equal benefit of the law without discrimination and, in particular, without discrimination based on race, national or ethnic origin, colour, religion, sex, age or mental or physical disability.
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> (2) *Affirmative action programs* — Subsection (1) does not preclude any law, program or activity that has as its object the amelioration of conditions of disadvantaged individuals or groups including those that are disadvantaged because of race, national or ethnic origin, colour, religion, sex, age or mental or physical disability.
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> 27. **Multicultural heritage** — This Charter shall be interpreted in a manner consistent with the preservation and enhancement of the multicultural heritage of Canadians.

The Charter Arguments

The Court quickly ruled section 15 of the Charter out of contention: ". . . the Courts have recognized that not-for-profit corporations are not individuals for its purposes . . ." and, as a non-profit, the Church does not attract the protection of

[1] While not referred to in the Court's decision, CRA Policy Statement CSP-R06 (October 25, 2002) states, "To advance religion in the charitable sense means to promote the spiritual teachings of a religious body and to maintain doctrines and spiritual observances on which those teachings are based. There must be an element of theistic worship, which means the worship of a deity or deities in the spiritual sense." It may be time to update this statement, but it did not factor into the failure of the Church's case.

section 15. Section 27 is also inapplicable; it "is not a substantive provision that can be violated and is 'relevant only as an aid to interpretation' (*Roach v. Canada (Minister of State for Multiculturalism and Citizenship)*, [1994] 2 F.C. 406 (FCA), 113 D.L.R. (4th) 67, at paragraph 71)."

Section 2(*a*) does protect the rights of atheists and the rights of the Church's members to practise their beliefs in atheism and the Minister cannot interfere with the practice of these beliefs. However:

> [16] . . . the Minister's refusal to register the appellant as a charitable organization does not interfere in a manner that is more than trivial or insubstantial with the appellant's members [sic] ability to practise their atheistic beliefs. The appellant can continue to carry out its purpose and its activities without charitable registration . . .

The Court determined that the Minister's refusal to register the Church as a charity did not violate its Charter rights.

Reasonableness of the Minister's Decision

The Church argued that the advancement of atheism ought to fit in under heading (3) of the four recognized charitable purposes — the advancement of religion. The Minister had found that the Church did not meet any of the three elements established by the jurisprudence to be fundamental to a religion ((a) faith in a higher power, (b) worship of this higher power, and (c) a comprehensive system of faith and worship).

In a small win for the Church, the Court agreed that belief in a higher power was not always required when considering the existence of a religion (nixing elements (a) and (b)); Buddhism was pointed out as a religion without a higher power. The Court's primary concern was the third characteristic of a religion: a comprehensive system of faith and worship.

The Church's system of faith was described thusly: "[W]e believe . . . that our Ten Commandments of Energy are sacred texts because they were created by a wise human being who consists of pure, invisible Energy and has acknowledged Energy's existence". As a system of faith and worship, this was rejected by the Minister:

> [23] . . . [It] provides no detailed information as to the particular and comprehensive system of faith and worship. He [the Minister] found that the appellant's contention that there should not be a requirement that a religion have an authoritative book similar to the Bible was a further indication that the appellant does not have a comprehensive and particular system of faith and worship . . .

It's pretty weak tea from the Church, and the Court agreed with the Minister:

> [24] While I leave open to another day whether the existence of an authoritative text such as the Bible is a necessary requirement, given the scope and vagueness of what was asserted here, it was reasonable for the Minister to deny the appellant under the heading of "advancement of religion".

The Church's final position was that it came within heading (4) of the recognized charitable purposes ("certain other purposes beneficial to the community, not falling under any of the preceding heads"). This was dismissed outright by the Court: "The activities provided by the appellant are for their members only and are not rehabilitative or therapeutic."

The Minister's decision, therefore, was reasonable, because the Church lacked a charitable purpose and did not carry out charitable activities in furtherance of a charitable purpose.

Denouement

The Church's appeal was dismissed, with costs. At this time, the Church has not sought leave to appeal to the Supreme Court.

In *obiter*, the Court noted that registration as a charity under the Act is a privilege and not a right, adding that:

> [26] . . . The privilege of registration as a charity functions as an indirect tax subsidy to encourage the work of registered charities . . . in reviewing applications, the Minister is obliged to look at the substance of the purpose and activities of the applicant to ensure they comply with the requirements in the Act.

Perhaps if the Church had embroidered and expounded its belief system more thoroughy, organized meetings and propagated its message,[2] published a central text, accumulated and studied the vast trove of thought on atheism through the ages — the pre-Socratics looking to "science" to explain natural phenomena, Epicureanism in fourth and third century BCE Greece, the Age of Enlightenment, the French Revolution, Karl Marx and Friedrich Engels, and on to the modern day writers like Christopher Hitchens and Richard Dawkins — the Minister's or Court's decision on the point of religion would have been different.

While being recognized as a religion and breaking new ground was undoubtedly the point of the Church's application for charitable status,[3] the Church could have avoided the issue altogether by pursuing activities such as the relief of poverty or the advancement of education. Ultimately, the Church lost its case based on its lack of homework and good works — in the Court's opinion at least — not on its lack of a god. Its best plan may be not to appeal to the Supreme Court, but to hire legal counsel,[4] compile a beefed-up application for charitable status, and submit that to the Canada Revenue Agency.

INVESTMENT MANAGEMENT FEES, REGISTERED PLANS, AND THE ADVANTAGE RULES

— Cameron Mancell, CFP®, Senior Technical Writer, Wolters Kluwer

Recently, the Department of Finance issued a comfort letter regarding whether the advantage tax under Part XI.01 of the *Income Tax Act* (the "Act") applies to investment fees in respect of registered plans that are paid directly by the holder or annuitant of the plan. Initially, the CRA stated that the payment of the fee is an advantage, and therefore a 100% tax would apply to the amount of the fee paid. The implementation of this policy was delayed, pending a review by the Department of Finance. Though the Department agreed with the CRA's conclusion, it has no tax policy concerns with these types of fee arrangements. Therefore, the comfort letter proposes to exclude these fee arrangements from the definition of an advantage, subject to certain conditions. While a comfort letter does not guarantee that the Act will be amended, the Department of Finance asking the Minister of Finance to do so is a positive development. The advantage rules, the CRA's position, and the comfort letter and its implications are all discussed in greater detail below.

Overview of the Advantage Tax

Part XI.01 of the Act was added in 2009 when the TFSA was introduced. Part XI.01 provides for various penalty taxes, including a tax on advantages under section 207.05. The application of the advantage tax was extended to apply to RRSPs and RRIFs in 2011, and more recently to RESPs and RDSPs in 2017. Sparing you the complex details of the definition of an advantage under subsection 207.01(1), an advantage generally includes:

(a) any benefit, loan, or indebtedness that is conditional in any way on the existence of the registered plan;

(b) a benefit that is the increase in the fair market value of the plan that is attributable to certain kinds of transactions;

(c) a benefit that is income from certain sources (e.g., income from prohibited investments or from a deliberate over-contribution); or

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[2] An online search did not turn up a website for the Church of Atheism of Central Canada (other atheist churches do have websites). While not the alpha and omega of any faith system, an online presence expounding and propagating its beliefs is a good start.

[3] A search of the CRA's list of charities (https://apps.cra-arc.gc.ca/ebci/hacc/srch/pub/dsplyBscSrch?request_locale=en) did not return any charities with the words "atheist" or "atheism" in their name.

[4] The Church had been represented by one of its ministers.

(d) a registered plan strip.

Subsection 207.05(1) provides that a "controlling individual" is liable for an advantage tax in respect of the registered plan that they control. Where the advantage is a benefit, paragraph 207.05(2)(*a*) provides that the amount of the tax is equal to the amount of the benefit — thus it is a 100% tax.

Investment Management Fees Are an Advantage

Generally, investment management fees relate to services of an investment manager for providing custody of securities, maintaining accounting records, collecting and remitting income, and buying/selling securities on the owner's behalf. Where the fees relate to a registered plan, the investment management fees are a liability of the plan and could be paid using funds from that plan, but the holder/annuitant of the plan may instead pay the fees directly to the investment manager. At the 2016 CTF Annual Conference CRA Roundtable, the CRA was asked whether investment management fees with respect to registered plans paid by the holder/annuitant would be considered an advantage that is subject to the 100% advantage tax. The CRA's position is based on the following part of the definition of "advantage" under subsection 207.01(1):

> (*b*) a benefit that is an increase in the total fair market value of the property held in connection with the registered plan if it is reasonable to consider, having regard to all the circumstances, that the increase is attributable, directly or indirectly, to
>
> (i) a transaction or event or a series of transactions or events that
>
> (A) would not have occurred in a normal commercial or investment context in which parties deal with each other at arm's length and act prudently, knowledgeably and willingly, and
>
> (B) had as one of its main purposes to enable a person or a partnership to benefit from the exemption from tax under Part I of any amount in respect of the registered plan . . .

In the CRA's view, the value of a registered plan indirectly increases from the fee being paid by the holder/annuitant. This increase in value is an advantage because, in their opinion, it is not commercially reasonable for an arm's length party to gratuitously pay the expenses of another party, and there is a strong inference that a motivating factor underlying the transaction is to maximize the savings in the plan in order to benefit from its tax exemption. As a result of this new policy, existing fee arrangements would have to change so that the fee is charged directly to the registered plan. Recognizing that investment managers would need to change the fee arrangements with their clients, the CRA stated that it would defer the application of the policy until January 1, 2018. See CRA Doc. 2016-0670801C6 for the full interpretation.

Deferral of Implementation

In CRA Doc. 2017-0722391E5, dated September 15, 2017, the CRA provided an update on the implementation of the new policy. Since the CRA was still working with the investment industry, the implementation was further delayed until January 1, 2019. In CRA Doc. 2018-0779261E5, dated September 28, 2018, the CRA revealed that the implementation would be further delayed because the issue was under review by the Department of Finance. The implementation would be deferred until the review was complete. At the 2018 CTF Annual Conference CRA Roundtable (see Doc. 2018-0785021C6), the CRA reiterated that the policy implementation had been deferred until the Department of Finance completed its review.

The Comfort Letter

After completing its review of the policy, the Department of Finance issued a comfort letter written by Brian Ernewein, Assistant Deputy Minister, Legislation, Tax Policy branch. The Department concurred with the CRA's view that the fee payment could potentially be considered an advantage. However, the letter stated the following:

> Even so, we have no tax policy concerns with respect to the payment of investment management fees directly by the annuitant/holder of the registered plan. It is not evident that plan holders are tax-motivated when entering into arrangements to directly pay the investment management fees of their financial service providers. Generally, the direct payment of fees results in either a net loss, or a negligible gain, for the plan holder.

The letter further states that the Department is prepared to recommend to the Minister of Finance that the Act be amended to exclude such fee payment arrangements from the definition of advantage under subsection 207.01(1). Per the recommendation, paragraph (*b*) of the definition of an "advantage" would be amended so it excludes payments by a controlling individual of a registered plan, not exceeding a reasonable amount of fees described in paragraph 20(1)(*bb*), which is discussed below.

Fees Described Under 20(1)(*bb*)

Paragraph 20(1)(*bb*) allows for the deduction of certain fees (other than commissions) paid to investment counsel, that

> (i) is paid by the taxpayer in the year to a person or partnership the principal business of which
>
> (A) is advising others as to the advisability of purchasing or selling specific shares or securities, or
>
> (B) includes the provision of services in respect of the administration or management of shares or securities, and
>
> (ii) is paid for
>
> (A) advice as to the advisability of purchasing or selling a specific share or security of the taxpayer, or
>
> (B) services in respect of the administration or management of shares or securities of the taxpayer.

Though paragraph 18(1)(*u*) prohibits the deduction of fees paid in respect of an RRSP, RRIF, or TFSA, the fees need only be *described* under paragraph 20(1)(*bb*) according to the comfort letter. CRA Doc. 2005-0124131E5 states that "[a] person's principal business is generally one where more than 50% of the time is spent on that activity or where more than 50% of the gross revenue is generated from that activity." Therefore, for the investment management fees to be exempt from the advantage rules, the principal business of the investment manager must be the provision of investment advice or administration services mentioned above. Moreover, fees paid by the holder/annuitant must be for those specific types of services. Paragraph 4 of Interpretation Bulletin IT-238R2, *Fees paid to investment counsel*, states that whether an investment manager's services meet the principal business requirements is a question of fact. However, the bulletin further states that the following services normally qualify: the custody of securities, the maintenance of accounting records, the collection and remittance of income, and the right to buy/sell on behalf of clients on the person's own judgement without reference to those clients. Paragraph 3 of the same bulletin also states that fees for general financial counselling or planning are not eligible under paragraph 20(1)(*bb*), even if the principal business otherwise qualifies.

Ultimately, affected investment managers must assess whether their principal business is described under paragraph 20(1)(*bb*). Though this letter provided clarity to investment managers and their affected clients, due diligence must be done to ensure that their fee arrangements do not go off-side and trigger a 100% advantage tax to their clients.

CURRENT ITEMS OF INTEREST

CRA Publishes Guidance on Journalism Tax Measures

The CRA has published new guidance on the Budget 2019 measures to support journalism. In order for a journalism organization to qualify for the three distinct budget measures, it must be a qualified Canadian journalism organization ("QCJO"). An eligible organization must be designated by the CRA, and the newly-published guidance describes the application and designation process. The guidance also discusses the journalism labour tax credit, organizations that provide digital news subscriptions, and the process of registering a journalism organization for qualified donee status.

Government Extends Maturation Period for Amateur Athlete Trusts

Currently, where an individual has not competed in an international sporting event as a Canadian national team member for eight years, the amounts held by the amateur athlete trust at the end of the year are deemed to be distributed to the individual athlete at that time. On December 20, 2019, the Department of Finance announced that the government will amend the *Income Tax Act* to extend this deferral period by one year, but only for amateur athlete trusts that were scheduled to mature at the end of 2019. These trusts will now mature at the end of 2020. This announcement does not affect amateur athlete trusts that are scheduled to mature after 2019, and therefore the eight-year period still applies to such trusts.

2020 Automobile Deduction Limits and Expense Benefit Rates for Businesses

The government has published the income tax deduction limits and expense benefit rates for 2020. These rates apply where an automobile is used for business purposes. The only change since 2019 is the limit on the deduction of tax-exempt allowances that are paid by employers to employees who use their personal vehicle for business purposes. For 2020, the rate is increased by one cent to 59 cents per kilometre for the first 5,000 kilometres driven, and to 53 cents per kilometre for each additional kilometre. For the Northwest Territories, Nunavut, and Yukon, the tax-exempt allowance is four cents higher, and will be increased to 63 cents per kilometre for the first 5,000 kilometres driven, and 57 cents per kilometre for each additional kilometre.

All of the other amounts remain unchanged from their 2019 values.

Update on Proposed Employee Stock Option Amendments

The government launched a consultation on proposed changes to the employee stock option deduction rules on June 17, 2019. When the proposals were first announced, the technical backgrounder stated that the government only intends for the $200,000 deduction cap to apply to large, long-established, mature firms. On the other hand, the cap will not apply to growing firms without significant profits. Since the announcement, the government has been accepting consultation submissions on what types of firms ought to be excluded from the deduction limitation.

Minister of Finance Bill Morneau provided an update on December 19, 2019. The consultation closed on September 26, 2019, and the government is reviewing all the input it received. The proposed amendments were originally set to apply as of January 1, 2020, but Morneau stated that the rules will not come into force on that date. Rather, the government will announce further details on how it intends to move forward with these proposals in the 2020 Federal Budget. According to a news release from the Department of Finance, the new coming-into-force date will provide stakeholders sufficient time to review and adjust to the new rules.

Climate Action Incentive Payment Amounts for 2020

The federal government has announced the 2020 Climate Action Incentive payment amounts for residents of four provinces in which the carbon price backstop will apply.

For those provinces that do not meet the federal stringency requirements for 2020 — Ontario, Manitoba, Saskatchewan, and Alberta — the bulk of the direct fuel charge proceeds from the carbon pricing system will be returned to residents of those provinces through Climate Action Incentive payments.

The government has announced the Climate Action Incentive payment amounts for 2020 for the four provinces affected. Individuals will be able to claim these payments through their 2019 personal income tax returns.

A single adult or the "first adult" in a couple will receive: $224 in Ontario; $243 in Manitoba; $405 in Saskatchewan; and $444 in Alberta. A "second adult" in a couple or a first child of a single parent will receive: $112 in Ontario; $121 in Manitoba; $202 in Saskatchewan; and $222 in Alberta. Each child under 18 (starting with the second child for single parents) will receive: $56 in Ontario; $61 in Manitoba; $101 in Saskatchewan; and $111 in Alberta.

The baseline amount for a family of four will be: $448 in Ontario; $486 in Manitoba; $809 in Saskatchewan; and $888 in Alberta.

There is a supplementary Climate Action Incentive payment for people who live in rural and small communities, which increases by 10% the baseline payment amount.

The federal government can impose its carbon price backstop in any province or territory that does not have a carbon pricing policy or whose price falls below that set by the backstop. The backstop is currently $20 per tonne and will rise by $10 per year until it reaches $50 in 2022.

The backstop currently applies in Ontario, New Brunswick, Manitoba, and Saskatchewan, and will apply in Alberta from January. The federal government recently announced that New Brunswick's proposed carbon levy on fuels, to apply from April 1, 2020, meets the federal stringency requirements. Accordingly, the federal fuel charge will no longer apply in that province as of April 2020.

Finance Minister Bill Morneau said:

> Putting a price on carbon pollution is the most effective and efficient way to reduce the greenhouse gas emissions associated with climate change, but Canadians are also concerned about what that price might mean for their own pocketbooks. That's where the Climate Action Incentive payments come in. Most households will receive more money back through these payments than what they will pay out due to federal pollution pricing.

Government Proposes Legislation To Increase Basic Personal Amount

On December 9, 2019, Minister of Finance Bill Morneau introduced a Notice of Ways and Means Motion to increase the basic personal amount ("BPA") for individual taxpayers. Currently, the BPA for the 2020 tax year is $12,298. As promised in its election platform, the minority Liberal government proposes to increase the BPA to $15,000. However, the increase will be gradually phased in beginning with 2020, and finally reaching $15,000 for 2023 — it will be indexed to inflation for 2024 and later years. The government also proposes to increase the spousal or common-law partner amount and the eligible dependant amount by the same amounts as the BPA. A handful of necessary technical amendments to the *Income Tax Act* are proposed as well.

The proposed BPA amounts are as follows:

- 2020: $13,299
- 2021: $13,808
- 2022: $14,398
- 2023: $15,000

To ensure that the enhanced BPA does not benefit higher income taxpayers, the proposed legislation contains an income-tested phase-out. A taxpayer's enhanced BPA amount is reduced if their income is subject to the 29% federal tax bracket ($150,473 for 2020) and is completely phased out once they are in the 33% tax bracket (income over $214,368 for 2020). The enhanced amount is reduced by the proportion of the taxpayer's income over $150,473 that is of $214,368. Taxpayers with income exceeding $214,368 will continue to benefit from the regular BPA, which also continues to be indexed.

FOCUS ON CURRENT CASES

This is a regular monthly 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.

Provisions Implementing the Canada-US Enhanced Tax Information Exchange Agreement Do Not Violate the *Canadian Charter of Rights and Freedoms*

***Deegan v. Canada (Attorney General)*, 2019 DTC 5099 (Federal Court)**

In 2010, the US federal government introduced domestic legislation — the Foreign Account Tax Compliance Act ("FATCA") — designed to force non-US financial institutions to report banking information of certain US-connected persons directly to the US Internal Revenue Service. Non-US institutions that are not compliant with the reporting obligations under the FATCA regime are generally liable for a 30% US withholding tax on US-sourced payments made to the institution.

The US FATCA regime also allows for the US government to enter into agreements with foreign governments whereby, as an alternative to the non-US financial institution reporting data directly to the US government, the information would be collected from the foreign government having jurisdiction over the financial institution and the foreign government would share that information with the US government through an automatic information exchange. The Canada-US Enhanced Tax Information Exchange Agreement ("IGA") is an intergovernmental agreement signed by the US and Canadian governments in 2010 that established the framework for making this type of alternative reporting regime available to Canadian financial institutions. The Canadian government implemented the agreement by enacting sections 263 to 269 as new Part XVIII of the *Income Tax Act* (Canada) (the "Act") in 2014.

This case was a Federal Court action brought by two individuals who were both American citizens as a consequence of having been born in the United States, but also Canadian citizens at birth by virtue of their Canadian parents. Both individuals severed their residential ties with the United States at an early age and had little connection with the United States after leaving the country as children. Even though the United States requires its citizens to file US tax returns after they cease to be a resident of the country, it seems that neither plaintiff had filed US returns at any time since their departure from the United States, likely because they were unaware of their obligation to do so under US law.

The plaintiffs were motivated to initiate a legal challenge of the Canadian IGA due to general privacy concerns and a specific fear that Canada's sharing of the plaintiff's financial information with the US tax authorities would cause the

US government to seek to collect taxes from them or make it difficult for them to travel. When the lawsuit began in 2014, the scope of the plaintiff's legal challenge included both the question of whether the legislation implementing the Canadian IGA violated the *Canadian Charter of Rights and Freedoms* (the "Charter") and whether it was otherwise invalid because it was inconsistent with the Canada-US tax treaty and/or section 241 of the Act. In 2015, the Federal Court issued a decision dismissing the plaintiff's complaint that the Canadian IGA was *ultra vires* the Canada-US tax treaty and section 241 of the Act (see *Hillis*, 2015 DTC 5098) without prejudice to the plaintiff's right to continue litigating the Charter issue. The trial on the Charter question was not heard until January 2019 and, as discussed below, the Federal Court held that the legislation to enact new Part XVIII of the Act did not violate the Charter.

The plaintiffs' Charter challenge was based on the protections guaranteed under section 8 — the right to be secure against unreasonable search and seizure — and section 15 — the right to equal protection and benefit under Canadian law without discrimination based on race, national or ethnic origin, colour, religion, sex, age, or mental or physical disability.

A preliminary issue that the Court addressed before it began its analysis on the alleged Charter breaches was whether the plaintiffs had standing to bring the claims. Even though the plaintiffs were within the category of persons whose financial data might have been covered by the obligations imposed by Part XVIII of the Act, the evidence at the hearing supported a finding that none of the plaintiffs' financial data was collected pursuant to the new provisions because their status as US citizens was not reflected in the relevant financial institution's customer database. The Court thus found that the plaintiffs did not have standing as of right to bring the action. However, because of the public interest in having the Charter issues considered by a court, the Court concluded that the parties had a sufficient connection to the issues raised by the case to be granted public interest standing.

The Court (*per* Mactavish J) began its Charter analysis by considering section 8, the right to protection against unreasonable search and seizure. The jurisprudence establishes that, in the case of the collection of personal data, there are two parts to the inquiry. The Court first has to determine that the impugned action was a seizure of the data and, if it is found to involve a seizure, the inquiry moves to whether the seizure was reasonable.

There was little dispute that the collection of personal financial data pursuant to Part XVIII of the Act constituted a seizure based on prior Supreme Court of Canada jurisprudence. Consequently, the focus of the Court's discussion on section 8 was whether the seizure was reasonable.

The starting point for the Court's evaluation of the reasonableness of a seizure under Part XVIII of the Act was an examination of whether affected persons have a reasonable expectation of privacy from disclosure of their Canadian banking information to the Canada Revenue Agency and, in turn, the US government. The Court noted that the jurisprudence has confirmed that persons should have a low expectation of privacy in regards to information that may be relevant to the filing of a Canadian income tax return, such as the banking records in this case. Moreover, it was the Court's understanding that US-connected persons whose financial information would be collected pursuant to Part XVIII of the Act also have a pre-existing direct obligation to provide that information to the US government under US law. Accordingly, the Court determined that there should be a limited expectation of privacy in respect of the relevant banking records by persons affected by Part XVIII of the Act.

The Court then went on to consider whether, having regard for the limited expectation of privacy of affected persons, the seizure was reasonable. The Court observed that, based on the case law, the standard for what is a reasonable seizure in the context of the Minster's powers under the Act is more relaxed than it would be under a criminal or quasi-criminal context because the purpose of the Act is to enforce tax compliance, not to penalize criminal behavior (*McKinlay Transport Ltd*, 90 DTC 6243 (SCC)). The Court weighed the apprehended "harm" that the IGA and new Part XVIII of the Act was directed at avoiding — the significant financial consequences of a 30% withholding tax and the potential violation of Canadian privacy law for Canadian financial institutions that comply with the direct reporting obligations to the US government under FATCA — and the extent of impairment to privacy rights under the Charter. In the result, the Court found that the seizure of banking information was reasonable in the circumstances.

Next, the Court considered the Charter claim under section 15, the right to equal protection and benefit under

Canadian law. As with section 8, the determination of whether there has been a breach of section 15 involves a two-step inquiry. The first question is whether the relevant provisions draw a distinction between persons based on grounds that are specifically enumerated in section 15 or analogous grounds. If the answer to the first question is affirmative, the second question is whether making such a distinction is discriminatory.

With respect to the first question, the Court found that Part XVIII of the Act draws a distinction on the enumerated ground of national origin, since financial institutions are required to only report the banking information of American-born individuals or American citizens. This treats individuals with American birth places or citizenship differently from non-Americans (*Andrews v. Law Society (British Columbia)*, [1989] 1 SCR 143).

Having found that the legislation drew a distinction on an enumerated ground, the Court then considered whether making the distinction was discriminatory, in the sense of perpetuating historical or other discrimination to that particular group. The Court found that the distinction does not perpetuate any historical or initiated discrimination because US persons have not experienced historical discrimination. Further, the provisions neither send the message that US persons in Canada are less worthy, nor undermine their dignity. The Court compared this situation with the discrimination in *Andrews* where non-Canadian citizens were denied entry into the British Columbia bar, or the discrimination in *Canadian Doctors for Refugee Care* (2014 FC 651) where non-citizens were denied healthcare funding. The Court thus concluded that the Canadian IGA and Part XVIII of the Act did not create burdens or deny advantages to US persons that were discriminatory in nature.

In many ways, the result in this case should not be that surprising, as there can be no doubt that the Act clearly authorizes the Minister to collect banking or other financial information in respect of Canadian taxpayers. The crux of the question before the Court was whether there was anything that offended the Charter, since new Part XVIII of the Act restricted the data collected to those of US-connected persons. But the likelihood of success on the Charter challenge was likely doomed by the fact that the true disadvantage to affected US-connected persons in the circumstances actually derived from their obligations under US tax law and not from the Canadian IGA or the enactment of Part XVIII of the Act. Indeed, the Court cautioned that the Charter is not intended to immunize individuals from "duly-enacted laws of another domestic state of which they are citizens."

— *Emily Leduc Gagne, Articling Student*

Tax Court Uses Novel Analysis of Set-Off of Promissory Notes To Apply Section 160

***Eyeball Networks Inc. v. The Queen*, 2019 DTC 1112 (Tax Court of Canada)**

Section 160 of the *Income Tax Act* (the "Act") allows the Minister to recover a tax debt from a person who received property from a tax debtor. It renders both the tax debtor and the property recipient jointly liable for the tax debt. In order to apply, the parties must not have been dealing at arm's length and the value of the consideration given to the tax debtor by the property recipient must have been less than the fair market value of the transferred property.

In this case, the tax debtor (Oldco) was a corporation that had transferred the majority of its business assets to the appellant, Eyeball Networks Inc., a non-arm's length affiliate. The transfer was part of a corporate reorganization designed to separate Oldco's useful assets from its other assets and put them into a newly-created corporation (i.e., Eyeball Networks).

The issue in the case was whether section 160 could be applied in the circumstances to expose Eyeball Networks to Oldco's historical tax debts. The Minister had assessed Eyeball Networks under section 160 by reasoning that the cumulative effect of the transactions in the reorganization resulted in a "conveyance of . . . property for no value". As discussed below, the Tax Court rejected the Minister's approach but upheld the Minister's assessment on its own analysis. It isolated the final transaction in the reorganization: the set-off of promissory notes. The Court held that the value of the promissory notes, themselves negotiable instruments, were in fact unequal; so that when they were set off against each other, Oldco had transferred valuable property to Eyeball Networks in exchange for worthless

consideration.

Before the reorganization transaction, Oldco carried on an online gaming business that had developed internet-based video-conference technology. Mr. Piche (the sole director, shareholder, and officer of both Oldco and Eyeball Networks) wanted to develop and exploit Oldco's video-conferencing business in a separate company so as not to put off customers by the "unsavoury pedigree" attached to online gaming. He also wanted to "establish a present distinct value" for the video-conferencing technology. Eyeball Networks was created to fulfil this objective and, on the advice of Mr. Piche's tax advisors, the video-conferencing business assets were transferred at the estimated value of $30 million within a multi-step butterfly reorganization.

To set up the transfer, Mr. Piche obtained Oldco shares with a $30 million redemption value and sold them to Eyeball Networks in exchange for Eyeball Networks shares with a $30 million redemption value. Then, Oldco sold the video-conferencing business assets to Eyeball Networks in exchange for Eyeball Networks shares with a redemption value of $30 million. In each of these transfers, the parties elected to file under subsection 85(1).

At that point, Eyeball Networks had the video-conferencing assets as well as Oldco shares with a $30 million redemption value and Oldco had Eyeball Networks shares with a redemption value of $30 million. Next, there was a mutual redemption and cross-cancellation: Eyeball Networks and Oldco each redeemed the shares it owned of the other, issued promissory notes in the amount of $30 million to the other, and finally set off the two promissory notes against each other.

The butterfly reorganization in this case is common. Typically, business assets are transferred from the original corporation to a new corporation in exchange for shares with a redemption value equal to the transferred assets (using a section 85 rollover). Prior to the transfer, the new corporation would have obtained shares of the original corporation with the same redemption value so that after the transfer each corporation would hold shares of the other that could be redeemed and cross-cancelled.

The reorganization was implemented all within the same day: March 19, 2002. At the time, Oldco and Mr. Piche were not anticipating any unassessed tax liabilities for prior periods. And in the Tax Court, the Minister did not suggest that the reorganization was undertaken to make the transferred assets unavailable to satisfy Oldco's potential tax liabilities for preceding years.

The online gaming business was largely inactive following the reorganization. However, the Minister subsequently issued reassessments to Oldco totaling $126,734 for its 2000, 2001, and 2002 taxation years. After Oldco failed to satisfy the debt, the Minister purported to apply section 160 to assess Eyeball Networks.

The "crux of the dispute" was whether section 160 was engaged by this transaction. Specifically, whether there was consideration for the transferred property and what its value would be.

In *Livingston*, 2008 DTC 6233, the Federal Court of Appeal described the four requirements to engage section 160:

(1) the transferor must be liable to pay tax;

(2) there must be a transfer of property "by any . . . means whatever";

(3) the transfer must not be at arm's length; and

(4) the value of the property must be equal to or exceed the value of the consideration given by the transferee.

Requirements 2 and 3 were obviously satisfied. Regarding requirement 1: while Oldco's tax liability was quantified after the transaction, it was exigible at the time of the transaction and so it subsisted. The sole issue was whether requirement 4 was met.

The Minister did not dispute that there was consideration for the asset transfer. Rather, it argued that the redemption and cross-cancellation of the debt on the transaction date nullified the consideration: "before the day was done, Oldco . . . had no subsisting valuable consideration in hand for its transferred assets . . .". The Minister's position was that, as the Court noted it:

> Such a results-based economic reality engages the very purpose of section 160, namely a collection tool designed to prevent the dissipation of a tax debtor's property where, upon transfer to a non-arm's length transferee, no or insufficient consideration is meaningfully tendered and retained by the transferor/tax debtor in respect of the transferred property.

The Tax Court (*per* Bocock J) addressed the Minister's position by embarking on a textual, contextual, and purposive analysis of section 160 to determine whether it would be appropriate to measure the value of the consideration over a period of time, as the Minister sought to do here, rather than at a point in time. The Court ultimately rejected the Minister's approach and determined that the measurement of value must be done at the moment of the transfer.

The Court then initiated its own analysis of the issue. In particular, the Court focused on the value of the consideration that Oldco and Eyeball Networks exchanged on the cross-cancellation of the two $30 million promissory notes that they each issued to pay for the redemption price of their respective preferred shares. The Court reasoned that those promissory notes were negotiable instruments that each owner could have sold for value to an unrelated party. Accordingly, the value of each instrument was not necessarily the $30 million principal amount. In the Court's view, the value of the promissory note issued by Oldco was nominal because it had transferred all of its useful business assets to Eyeball Networks, whereas the promissory note issued by Eyeball Networks was backed by $30 million in assets. The Court reasoned that, if the consideration given by Eyeball Networks for the surrender and forgiveness of its valuable debt payable to Oldco was the surrender and forgiveness of the nominal-in-value debt receivable from Oldco, then Oldco transferred valuable property to Eyeball Networks for deficient consideration.

It seems that the Court's assessment of the value of the Oldco promissory note failed to take into account a critical consideration: prior to the cross-cancellation of the promissory notes, Oldco may not have owned the transferred business assets but it did own the $30 million debt payable from Eyeball Networks, which the Court deemed to be a credit-worthy debtor by virtue of its ownership of $30 million of business assets. In other words, right up until the moment of the cross-cancellation, the value of the Oldco note payable was itself backed by the Eyeball Networks note payable. It's also worth noting that, even though the Court brings up the value of the notes as "commercial instruments", it neglects the importance of expert evidence in determining such things.

Ultimately, one wonders whether the Minister's efforts to be creative in trying to use section 160 to enforce Oldco's tax debts against Eyeball Networks was rooted in the fact that the transfer of assets to Eyeball Networks was a *de facto* liquidation of Oldco that left the Canada Revenue Agency without enough assets in Oldco to satisfy the subsequently assessed tax liabilities. However, it should be noted that subsection 159(2) is a provision in the Act that is designed to allow the Minister to potentially recover tax debts from persons who distributed property on a winding-up or liquidation of a corporation. It would seem that the appropriate recourse for the Minister in this case would have been to consider whether the facts supported a derivative assessment of Eyeball Networks or Mr. Piche for the tax debts of Oldco under subsection 159(2) and, if a case for an assessment under that provision could not be made out, the Minister should have simply moved on.

— *Hilary Smith*

Discontinuation of Appeal of Partnership Determination Did Not Preclude Partners From Challenging That the Determination's Issuance Was Statute-Barred

***Tedesco v. the Queen*, 2019 DTC 5117 (Federal Court of Appeal)**

This Federal Court of Appeal case overturned the Tax Court of Canada's decision (*Stewart*, 2018 DTC 1065) to allow the Minister's motion to strike the appeals of the members of a partnership. The Tax Court had struck the appeals on the basis that allowing them to continue would amount to an abuse of process, since the members' appeals challenged the validity of a partnership determination when the partnership's appeal of the determination had been discontinued. In the Tax Court's view, allowing the members of the partnership to continue their appeals would enable the members

to re-litigate an issue that had already been determined, or deemed to have been determined, as a result of the partnership having discontinued its appeal covering the same issue. As discussed below, the Federal Court of Appeal did not agree.

The taxpayers were members of TSI I Limited Partnership ("TSI"). TSI allocated its 2000 and 2001 losses of $941,840 and $2,193,463, respectively, to its members. In 2006, the Minister relied on subsection 152(1.4) of the *Income Tax Act* (the "Act") to issue partnership determinations determining TSI's losses to be nil for 2000 and 2001. TSI objected and the Minister confirmed the determinations. The Minister subsequently reassessed each of the members of TSI to deny their proportionate share of TSI's 2000 and 2001 partnership losses on the basis that those losses were determined to be nil pursuant to the corresponding partnership determinations.

TSI and each of its members separately filed notices of appeal to the Tax Court: TSI with respect to the partnership determination, and each of the members with respect to the reassessment of such member's tax liability.

TSI's appeal raised two issues: first, whether the 2000 and 2001 partnership determinations were invalid by virtue of having been made by the Minister after the end of the three-year limitation period established by subsection 152(1.4) of the Act; and second, whether the Minister's determination that TSI's 2000 and 2001 losses were nil was correct in substance.

TSI's appeal was further ahead in the litigation timeline than the Tax Court appeals of its members, which were being held in abeyance pending the outcome of the TSI appeal. However, prior to having a hearing in the Tax Court, TSI discontinued its appeal by filing a notice of discontinuance. Subsection 16.2(2) of the *Tax Court of Canada Act* provides that where an appeal in the Tax Court has been discontinued, it is deemed to be dismissed.

As an aside, it is worth observing that TSI initiated the Tax Court appeal of the partnership determinations in its own name even though the combined effect of subsections 152(1.2), 165(1.15), and 169(1) appears to be that a Tax Court appeal of a partnership determination can only be brought by the member of the partnership that is designated pursuant to subsection 165(1.15). Consequently, it is unclear what would have happened had TSI proceeded to have the Tax Court hear its appeal of the partnership determinations. However, both the Tax Court and the Federal Court of Appeal found that the fact that TSI appealed to the Tax Court in its own name was not relevant to its decision on the Minister's motion.

Once TSI's appeal of the partnership determinations was discontinued (and deemed by statute to have been dismissed), the Minister moved to have the notice of appeal of each of TSI's members struck on the basis that, in light of the discontinuance of the TSI appeal of the partnership's determinations, the matters raised by the members' notices of appeal now represented an abuse of process.

Before the Tax Court, the Minister argued that a partnership determination under subsection 152(1.4) is binding upon both the Minister and the members of a partnership due to the operation of subsection 152(1.7) and that, since subsection 16.2(2) of the *Tax Court of Canada Act* deemed the appeal of the TSI partnership determinations to have been dismissed, it would be an abuse of process to allow the members of the TSI partnership to seek to have the Tax Court adjudicate matters relating to the TSI partnership for the same taxation years that were covered by the partnership determination that were the subject of the "dismissed" Tax Court appeal. The Minister further argued that to allow the members of TSI to continue their appeals could result in an outcome where, if the appeals were successful, members of TSI would be allowed to deduct losses that, by virtue of the partnership determinations, did not exist at the partnership level for purposes of the Act.

In allowing the Minister's motion, the Tax Court stated that it was unclear whether subsection 152(1.7) operated to bind the members of TSI in a manner that would prevent them from advancing their argument that the Minister was statute-barred from issuing the partnership determinations. However, after considering the Supreme Court of Canada decision in *Toronto (City) v. C.U.P.E., Local 79 (2003)* (2003 SCC 63) and the Federal Court of Appeal decision in *Scarola v. Canada (Attorney General)* (2003 FCA 157), the Tax Court concluded that the members of TSI were indeed trying to re-argue the same statutory limitation issue that was deemed to have been dismissed by the Tax Court at the partnership level which, in the Tax Court's view, amounted to an abuse of process.

The Federal Court of Appeal reviewed the cases relied upon by the Tax Court and concluded the lower court had erred in its interpretation of both those cases and subsection 16.2(2) of the *Tax Court of Canada Act*.

In the Federal Court of Appeal's view, abuse of process by re-litigation occurs where litigation before a court is, in essence, an attempt to re-litigate a claim that the court has already determined. In the case of TSI's appeal of the partnership determinations, since the statutory dismissal of the appeal did not involve a hearing or a consent judgement, it could not be said that the Tax Court made a finding as to whether the partnership determinations were made within the statutory limitation period. The Federal Court of Appeal stated that subsection 16.2(2) does not go so far as to deem any issues raised in a discontinued appeal to have been determined by the Tax Court and that the *Scarola* decision did not support the Tax Court's interpretation of subsection 16.2(2) as deeming issues in a discontinued appeal to have been adjudicated and dismissed. In the Federal Court of Appeal's view, the portion of the *Scarola* decision relied on by the Tax Court merely stated that, in respect of a discontinued appeal, the same person cannot, except in exceptional circumstances, later attempt to revive that appeal.

The Federal Court of Appeal noted that two indicia of an abuse of process — waste of judicial resources if the same conclusion is reached by different decision-makers and inconsistency between decisions that would undermine the integrity of the judicial system — would not occur in respect of the taxpayers' appeals regarding the statutory limitation period question, since the Tax Court had made no determination in respect of the issue.

The Federal Court of Appeal therefore concluded that to allow the taxpayers to continue with their appeals before the Tax Court would not constitute an abuse of process even though both TSI's appeal and the taxpayers' individual appeals each included the same issue.

This decision sets out in clear terms the Federal Court of Appeal's view that a discontinuance of an appeal in the Tax Court will not deem the issues raised in the discontinued appeal to have been adjudicated against the taxpayer. Of course, if the Tax Court finds that the Minister was statute-barred from issuing one or both of the 2000 and 2001 TSI partnership determinations in the course of deciding one of the Tax Court appeals brought by a member of the TSI partnership, then subsection 152(1.7) of the Act could not apply to make the invalid partnership determination binding on its members and it would be open to the member to challenge the Minister's position on the TSI partnership loss for that year in the context of the Tax Court appeal of the member's own reassessment.

— *Justin Shoemaker*

Tax Court Statute-Bound To Apply an Excessive Penalty

***Wardlaw v. The Queen*, 2019 DTC 1139 (Tax Court of Canada)**

This case involved the Minister's assessment imposing a penalty under subsection 163(2) of the *Income Tax Act* (the "Act") for having filed a tax return that claimed approximately $360,000 of losses from a business that never existed. In the circumstances, the Tax Court found the quantum of the assessed penalty to be harsh in light of the way that the Act requires the amount to be computed and the outcome of that computation in the taxpayer's situation. However, having found that the factual requirements for imposing the penalty were met, the Tax Court did not have any discretion with respect to the quantum of the penalty and it invited Parliament to explore whether the relevant provision should be amended to produce a fairer result in similar circumstances in the future.

Mr. Wardlaw was a high-school educated individual who was licensed as an auto mechanic and presumably earned employment income through that occupation. A friend of the taxpayer made him aware of a tax preparer who was able to secure a large refund for the friend. The taxpayer met with the tax preparer and was enticed by the tax preparer's representation that he too could receive a large refund which could be used as a down payment for a house. The tax preparer completed a tax return for Mr. Wardlaw for 2009 that showed him operating a business in the year which had revenues of $130,000, expenses exceeding $488,000, and a net business loss in excess of $357,000. The taxpayer signed the return, which was accompanied with a request to carry back the portion of the business loss in excess of his other 2009 income to the three immediately preceding taxation years, and the return was filed with the Canada Revenue Agency. The tax preparer was paid an initial $500 fee for preparing the return and would have been

entitled to a further fee of $20,769 had Mr. Wardlaw received the refunds that would have been produced through the loss carrybacks, expected to be approximately $104,000 for the three years in aggregate.

Upon receiving Mr. Wardlaw's return, the CRA undertook a detailed review of the filing. This resulted in the Minister issuing an initial assessment that not only disallowed the business loss (and denied the request to carry back to preceding years) but also applied the gross negligence penalty pursuant to subsection 163(2) of the Act. The combined federal and provincial liability associated with the subsection 163(2) penalty was slightly less than $74,000.

The taxpayer was self-represented in the Tax Court and only appealed the imposition of the gross negligence penalty.

Subsection 163(2) of the Act applies to impose a penalty if a taxpayer knowingly or in circumstances amounting to gross negligence has made a false statement in a return. The Tax Court (*per* Jorre J) canvassed the applicable jurisprudence and, given the facts in this case, focused on the concept of wilful blindness, which the cases have regarded as a way to attribute subjective knowledge to a person. The Court had no difficulty concluding that Mr. Wardlaw was wilfully blind in not making inquiries when the amounts appearing in the tax return prepared by the third party had several "flashing red lights" and there was nothing in the taxpayer's evidence or background to indicate that he would be unable to recognize those flashing red lights.

Having found that the taxpayer was liable for the gross negligence penalty, the Court paused to then reflect on the harshness of the computation of the penalty in Mr. Wardlaw's circumstances. In general, the amount of the penalty under subsection 163(2) is the greater of (i) $100, and (ii) 50% of the difference between the amount of tax that is payable based on the actual facts and the amount that would have been payable if the false statement had been accepted. Thus, the concept underlying the computation is that the taxpayer is liable for a penalty representing 50% of the tax sought to be avoided. However, where the taxpayer's income for the year is reported as "nil", as was the case with Mr. Wardlaw's 2009 tax return, subsection 163(2.1) causes any excess false deduction to become understated income for the year, with the result that much of the "tax sought to be avoided" component of the penalty is computed at the highest marginal tax rate even though the tax benefit associated with Mr. Wardlaw's false statement would have been to obtain refunds of income tax imposed at lower marginal rates over three years. This would explain why the aggregate income tax refund Mr. Wardlaw sought to obtain for the prior taxation years was approximately $104,000 and yet the assessed penalty was almost 70% (rather than 50%) of the tax that would have been recovered.

In the end, the Court recognized that subsection 163(2) does not provide a judge with any discretion to modify the manner in which the gross negligence penalty is computed where it is found to apply. But the Court invited the Department of Finance and the Minister of National Revenue to consider amending the legislation to align the computation with a 50% result.

— *John Yuan*

RECENT CASES

Application for summary judgment denied where trustee not entitled to indemnification

The applicant was the executor of the estate of her former spouse. In the course of administering that estate, she held back funds for income tax obligations of the estate and distributed the balance to the beneficiaries, but did not obtain a clearance certificate from the Canada Revenue Agency prior to making the distribution. The holdback for income taxes was less than what was owed and the executor applied to the Court for summary judgment in her claim for an order requiring the beneficiaries to indemnify her for the outstanding income tax amount owed.

The application for summary judgment was denied. The Alberta Court of Queen's Bench noted that it was required to first determine whether the matter was a suitable one for summary judgment and, following a review of the facts of the case and the applicable case law, concluded that it was. The Court then considered whether the executor was entitled to indemnification from the beneficiaries for the estate's outstanding tax liability. The Court noted that the executor had a statutory obligation to obtain a clearance certificate and that her failure to do so, while not arising from intentional wrongdoing, constituted a breach of her obligations as a trustee. The Court held that both in equity

and under *The Trustee Act*, a trustee is entitled to indemnification where a breach of trust takes place at the instigation or request, or with the written consent of, a beneficiary. In the Court's view, the natural corollary of that principle was that if, as in this case, the beneficiaries did not instigate or request the breach, they could not be obligated to indemnify the trustee. The Court concluded, therefore, that the beneficiaries were under no obligation to indemnify the executor for income tax imposed on her as the result of her failure to obtain a clearance certificate before distributing the estate.

Muth v. Liesch

2019 DTC 5139

Appeal from denial of claim for disability tax credit dismissed

The taxpayer, who had been diagnosed with bipolar disorder and irritable bowel syndrome, made a claim for the disability tax credit ("DTC"). That claim was denied and she appealed from the denial to the Tax Court of Canada.

The appeal was dismissed. The Tax Court reviewed the medical evidence provided in the T2201 certificate prepared by the appellant's physician, and held that the only issue in the appeal was whether or not the cumulative effect of being significantly restricted (being a lesser degree of disability than "markedly restricted") in more than one basic activity of daily living was equivalent or tantamount to being markedly restricted in one such activity. The Court noted as well that the *Income Tax Act* did not provide any express specific direction on how to determine such equivalency. The Court reviewed the medical evidence provided in light of the statutory language and the relevant jurisprudence before concluding that the taxpayer did not qualify for the DTC. In the Court's view, while she undoubtedly faced several physical and mental health challenges, it was unable to conclude that collectively such challenges caused her to require an inordinate or excessive amount of time to complete her basic activities of daily living all or substantially all of the time during the relevant taxation years. Her appeal was therefore dismissed.

Laing v. The Queen

2019 DTC 1170

In income tax proceedings taxpayer not entitled to judicial review of CRA's determination that it was not a "credit union" for income tax purposes

Westminster Savings Credit Union's ("WSCU's") primary business was to act as a credit union. The CRA determined that WSCU was not a "credit union" as defined in subsection 123(1) of the *Excise Tax Act* and in subsection 137(6) of the *Income Tax Act*. The Minister subsequently reassessed WSCU for 2015 and 2016, disallowing certain deductions claimed by it under the *Income Tax Act*, on the grounds that it did not meet the statutory definition of "credit union". WSCU applied to the Federal Court for judicial review.

WSCU's application was dismissed. The Supreme Court of Canada has cautioned reviewing courts against allowing judicial review to be used to "develop a new form of incidental litigation designed to circumvent the system of tax appeals established by Parliament and the jurisdiction of the Tax Court" (see *Canada v. Addison & Leyen Ltd.*, 2007 DTC 5365 (SCC)). WSCU acknowledged that it could appeal the Minister's reassessments in the present proceedings to the Tax Court of Canada. Notwithstanding this admission, however, it also argued that: (a) its judicial review application in these proceedings was limited to whether it met the definition of "credit union" for the purposes of the GST under the *Excise Tax Act* for its 2013 and 2014 reporting periods; and (b) because it could not appeal to the Tax Court in respect of this limited subject matter, section 18.5 of the *Federal Courts Rules* did not prevent the Federal Court from hearing its judicial review application in these proceedings. Regardless of how it framed its application, however, the underlying issue here was the CRA's interpretation and application of the definition of "credit union" in the *Income Tax Act*. Posing this issue as one related more to the *Excise Tax Act* than to the *Income Tax Act* was not determinative — the definition of "credit union" in subsection 123(1) of the *Excise Tax Act* wholly incorporates the *Income Tax Act* definition of the same term. WSCU's argument, therefore, amounted to an attempt to sustain its application despite the available avenue of recourse to the Tax Court. As a result, reviewing the reasonableness of the CRA's determination in this case

would run counter to the Federal Court of Appeal's clear direction in *Walker v. Canada*, 2005 DTC 5719, to avoid parallel proceedings in the Federal Court and in the Tax Court in respect of substantially the same underlying issue.

Westminster Savings v. Canada (AG)

2019 DTC 5135

Taxpayer not entitled to foreign tax credit for contributions made by him to UK National Insurance Scheme

The taxpayer, a resident of both Canada and the United Kingdom, was employed in the UK for several years. He claimed a foreign tax credit ("FTC") for 2016 relating to his mandatory contributions to the UK's national insurance scheme (the "UK Contributions"). On reassessment, the Minister denied the FTC claimed by the taxpayer on the ground that the UK Contributions were not a "tax" qualifying for FTC treatment under subsection 126(1) of the *Income Tax Act* (the "Act"). The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. The UK Contributions were not a levy made for a public purpose and hence not a "tax" as that term was defined by the Supreme Court of Canada in *Lawson v. Interior Tree Fruit & Vegetable Committee of Direction*, [1931] SCR 357. The UK Contributions, therefore, did not qualify for FTC treatment under subsection 126(1) of the Act. Also, the UK Contributions had not yet been subjected to tax in the UK, having been deducted from the taxpayer's income before paying UK tax. As a result, there was no double taxation of those Contributions with respect to which the taxpayer could obtain tax relief in Canada under the Canada–UK Tax Convention. The Minister's reassessments were affirmed accordingly.

Zong v. The Queen

2019 DTC 1164

Appeal from Tax Court decision determining that taxpayer had permanent establishment in Canada dismissed

In 2012, while he was a United States resident, the taxpayer was present in Canada for more than 183 days and carrying on consulting work. An assessment was issued by the Minister of National Revenue in respect of $26,244 in income from such consulting work on the basis that the taxpayer, during the relevant period, was deemed to have a permanent establishment in Canada. He appealed from that assessment to the Tax Court of Canada which dismissed the appeal, finding that the appellant taxpayer had failed to show that the percentage of his revenues from a Canadian source was not more than 50% of the total gross active business revenues of his enterprises during 2012. Consequently, under Article V, Paragraph 9(a) of the applicable tax convention, he was deemed to have had a permanent establishment in Canada. The taxpayer appealed from that decision, arguing that the Tax Court had erred in its conclusions with respect to the sources of such revenue.

The appeal was dismissed. The Federal Court of Appeal held that the standard of review of the Tax Court's decision was that of palpable and overriding error. The appellate Court held that the timing of the receipt of the revenue was relevant and was a matter that the appellant ought to have addressed through his evidence. The Court held that although there was nothing to show why the appellant could not have obtained evidence with respect to the timing of earning of revenue in the United States, the evidence which he provided did not support any finding of when such revenue was earned in the United States. The appellate Court concluded, therefore, that the appellant had not demonstrated any palpable and overriding error on the part of the Tax Court when that Court concluded that there was insufficient evidence to establish that 50% or less of the gross revenue at issue was earned in Canada during the relevant period. The appeal from the Tax Court's decision was therefore dismissed.

Wolf v. The Queen

2019 DTC 5129

Appeal from dismissal of application for judicial review of Minister's denial of remission order dismissed

The taxpayer unsuccessfully sought remission of income tax payable with respect to taxable benefits which he had received under a stock option plan offered by his employer. He applied for judicial review of the decision to deny remission, but his application was dismissed by the Federal Court. He then appealed from that dismissal to the Federal Court of Appeal, arguing that the decision made by the Federal Court did not meet the required reasonableness standard. Specifically, he argued that his situation was similar to that of employees of another company who acquired shares through a stock purchase plan and who were granted remission orders.

The appeal was dismissed. The Federal Court of Appeal first noted that a remission order was an extraordinary remedy granted by the Governor in Council on the recommendation of the appropriate Minister. In the Court's view, remission orders were highly discretionary and were entitled to significant deference on judicial review. The appellate Court held that the decision maker had reasonably found that the appellant's circumstances were not similar to those of the group of employees who had received remission orders. In addition, the required extenuating circumstances were not present, as the appellant had acquired the shares with knowledge that the related employee benefit was to be included as taxable income, and the decision to exercise the option to purchase the shares was within his control. The decision of the Federal Court to dismiss the application for judicial review was reasonable and the appeal from that decision was therefore dismissed.

Fink v. Canada (AG)

2019 DTC 5127

Application for judicial review of denial of interest relief on tax debt dismissed

The taxpayer was the director of a corporation which was reassessed by the Minister of National Revenue in 2009 with respect to its 2003 and 2004 taxation years, with such reassessments resulting in a balance owing of $40,610. The corporation filed a request for relief from the amount owing under subsection 220(3.1) of the *Income Tax Act*, and was granted partial relief of interest amounts assessed. Notwithstanding, no payments were made by the corporation and a section 160 assessment was subsequently issued against the taxpayer in her capacity as a corporate director. She sought taxpayer relief from such assessment but her application was denied. She paid the amount owing but applied for judicial relief of the decision denying taxpayer relief.

The application was dismissed. The Federal Court held that the standard of review for a discretionary decision under subsection 220(3.1) was that of reasonableness and that the decision made met that standard. The Court reviewed the four factors which were to be considered in any application for relief and the reasons provided by the decision maker in denying the taxpayer's application. Based on that review, the Court held that the delay, error, and extraordinary circumstances alleged by the taxpayer did not support a decision to waive the interest payable. The Court concluded that, when the significant discretion possessed by the Minister under subsection 220(3.1) was considered, it was clear that the decision made fell within the range of possible acceptable outcomes and was justifiable, transparent, and intelligible. The application for judicial review of that decision was therefore dismissed.

Chau v. Canada (AG)

2019 DTC 5126

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Toronto ON M2N 6X1
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