Tax Notes

February 2021
Number 697

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Wolters Kluwer

# IMPLICATIONS OF CEBA LOAN FORGIVENESS

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

The Canada Emergency Business Account ("CEBA") is a federal support program for businesses and non-profits that are struggling with the pandemic. The program provides government-backed loans to eligible borrowers with non-deferrable expenses. Nearly 800,000 applicants have received CEBA loans, and $32 billion has been disbursed through this program. Initially, the CEBA provided a loan of up to $40,000, of which up to $10,000 is forgivable if the loan is repaid by December 31, 2022. The CEBA was recently expanded to provide an additional loan of up to $20,000, of which up to $10,000 is forgivable under the same repayment terms.

There are immediate and future tax consequences of receiving a CEBA loan. The CRA has published two technical interpretations that discuss its views of how the forgivable portion of CEBA loans should be treated for income tax purposes (2020-0861461E5 and 2020-0862931C6). Based on these documents and the relevant provisions of the *Income Tax Act* (the "ITA"), this article provides a summary of the key income tax implications of receiving a CEBA loan.

## Income Inclusion When Loan Received

Paragraph 12(1)(*x*) of the ITA includes any government assistance in income from a business or property if the assistance is otherwise not included in income. It is the CRA's view that the forgivable portion of the CEBA is an amount that is described under subparagraph 12(1)(*x*)(iv). Accordingly, based on the value of the loan received, the total forgivable amount must be included in income in the year the loan is received by virtue of paragraph 12(1)(*x*). This income inclusion is required regardless of whether a loan is eventually forgiven, but an election and/or a deduction are potential remedies. For example, if a business receives the entire $60,000 CEBA loan in 2020 and subsequently repays the loan after December 31, 2022 (i.e., nothing is forgiven), the taxpayer must still include the $20,000 forgivable portion in income in 2020. However, if a taxpayer enjoys the loan forgiveness by repaying the loan in a subsequent year, there is no further obligation to include an amount in income since the income was recognized in a prior year.

## Election To Reduce Income Inclusion

Although the forgivable portion of a CEBA loan is included in income in the year that the loan is received, a borrower can avoid this income inclusion by electing under subsection 12(2.2) of the ITA. The election can be made where a taxpayer receives an amount that would be included in income by virtue of paragraph 12(1)(*x*) in respect of an outlay or expense (other than an outlay or expense for the cost of property) that is incurred before the end of the following taxation year. These conditions would likely be

met since the purpose of the CEBA is to provide borrowers with capital to pay their employees and other non-deferrable expenses. A taxpayer can elect under subsection 12(2.2) to reduce the amount of the expense by up to the amount of the CEBA loan that is otherwise included in income. As a result, the deductible expense is reduced by the elected amount and the income inclusion under paragraph 12(1)(*x*) is equally reduced.

The election must be made with the tax return for the year in which the outlay or expense is made or incurred. For example, the CRA states in document 2020-0862931C6 that a corporation could avoid the income inclusion under paragraph 12(1)(*x*) by filing the election with its income tax return for its 2020 taxation year to reduce the amount of allowable non-deferrable operation expenses incurred in 2020. Similarly, a corporation could avoid the income inclusion under paragraph 12(1)(*x*) in its 2020 taxation year by filing the election with its income tax return for its 2021 taxation year to reduce the amount of allowable non-deferrable operation expenses incurred in 2021.

## No Forgiveness: Deduction Upon Repayment

The forgivable portion of the loan will not be forgiven if the taxpayer does not repay the loan by December 31, 2022. When the taxpayer eventually repays the forgivable portion of the loan after this date, they can offset the prior income inclusion by a deduction under paragraph 20(1)(*hh*) of the ITA in the year of repayment. The deduction is allowed if the amount was repaid in the year pursuant to a legal obligation to repay an amount that was included in income by virtue of paragraph 12(1)(*x*) or that reduced the amount of an expense under subsection 12(2.2). For example, say that a taxpayer borrowed the maximum $60,000 CEBA loan in 2020, so the $20,000 forgivable portion was included in income for 2020. If the taxpayer repays the entire loan in 2024, no amount of the loan is forgiven due to the timing of the repayment. However, the taxpayer would deduct $20,000 under paragraph 20(1)(*hh*) in 2024.

The timing of the paragraph 20(1)(*hh*) deduction can be complicated if the loan is not entirely repaid in a single year. For example, if a taxpayer borrowed $60,000 in 2020, repaid $40,000 in 2024, and repaid $20,000 in 2025: should the deduction for $20,000 be made in 2024, 2025, or should it be prorated between the two years? According to the CRA's comments in document 2020-0862931C6, the timing and amount of the deduction depend on the intent of the parties.

Where the intent of the parties is that any amount reimbursed by the taxpayer will be applied first in repayment of the portion of the loan that was initially forgivable, the taxpayer could claim a deduction under paragraph 20(1)(*hh*) with respect to the amount reimbursed in the taxation year in which the reimbursement is made, up to the amount included in its income pursuant to paragraph 12(1)(*x*). However, if the intent of the parties is unclear in this regard, the CRA stated that the deduction under paragraph 20(1)(*hh*) should be prorated as follows:

> Deduction under 20(1)(hh) = amount reimbursed in the taxation year x (portion of the loan that was initially forgivable ÷ outstanding balance of the loan on January 1, 2023)

When the loan is fully reimbursed, the total of all prorated deductions under paragraph 20(1)(*hh*) in respect of the loan will equal the income initially included under paragraph 12(1)(*x*).

Based on this guidance, when CEBA repayments are made after 2022, taxpayers may consider consulting the loan agreement and/or their lender to determine the intention regarding repayment. Ideally a taxpayer would want the repayments to first apply to the initially-forgivable portion, if the lender allows it. However, the intention with respect to reimbursement may already be established in the written terms of the loan that have already been agreed upon by the borrower and the financial institution. If the repayment terms will delay the offsetting deduction for borrowers, will financial institutions alter the terms of their existing CEBA loan agreements to allow their borrowers to obtain a better tax outcome? That is probably asking too much. In either case, borrowers can only offset the prior income inclusion once the loan is repaid fully or partially, depending on the intention of the parties.

## Debt Forgiveness Rules

According to CRA document 2020-0861461E5, if the loan is settled for less than its principal amount (minus the forgivable portion), the debt forgiveness rules under section 80 of the ITA can apply in the year of settlement. The rules would apply in respect of the portion of the loan that was not otherwise included in the taxpayer's income under paragraph 12(1)(*x*) when the loan was received. The debt forgiveness rules would reduce certain preferential tax attributes of the taxpayer such as loss carryforwards.

## Summary

The forgivable portion must be reported in the tax return of a CEBA recipient in the year the loan is received. An election to reduce the amount of expenses and the income inclusion under subsection 12(2.2) can be filed with the tax return for the period in which the expenses were incurred if doing so would benefit the taxpayer. A deduction is available when the loan is repaid without forgiveness, but the rules are uncertain. Last, there could be additional consequences if the federal government were to further modify the CEBA program as pandemic-related disruptions continue into 2021.

# COVID-19 UPDATE

*Given the rapidly changing information related to COVID-19 we are providing continuously updated information at https://blog.intelliconnect.ca/*.

## Federal

### CRA Extends Provision for Electronic Signatures to 2021 Tax Season (January 19, 2021)

In March 2020, the CRA announced that electronic signatures on the T183 and T183CORP that meet specific criteria would be accepted as having met the requirements of the *Income Tax Act*. Since the CRA is still pursuing the implementation of electronic signatures for these forms as a permanent measure, the regulatory changes required will not be in place by the start of the upcoming tax season.

Therefore, the CRA is extending the temporary administrative measures currently in place to allow electronic signatures on the T183 and T183CORP for the 2021 tax filing season.

For the CRA to continue to accept an electronic signature from a taxpayer whose identity has been verified by the electronic filer, the electronic signature must be provided in one of the following ways:

- If the taxpayer sends the information return, including the electronic signature, using the electronic address most recently provided by the taxpayer to the electronic filer;
- In person by the taxpayer, in the presence of the electronic filer (e.g., using a stylus or a finger on a tablet); or
- Through an access controlled, secured electronic location, such as a secure website, that is accessible to the taxpayer only because the location of the secure website has been made known to the taxpayer and access has been granted by the electronic filer.

## Draft Proposals To Adjust Certain Deductions for EI and COVID-19 Benefits (January 19, 2021)

The Department of Finance published draft legislative proposals that would adjust the child care expense deduction and disability supports deduction with respect to Employment Insurance ("EI") benefits. Currently, EI and Canada Emergency Response Benefit ("CERB") income are treated differently by these deductions. EI recipients cannot deduct eligible expenses against their EI income, but CERB and other COVID-19 emergency income recipients can. The proposed changes were introduced to harmonize the tax treatments so that federal support recipients are treated equally and fairly for income tax purposes.

The proposals would allow EI recipients to make the same child care expense deductions and disability supports deductions as COVID-19 income support recipients. The amendments will temporarily apply to 2020 and 2021. The amendments also apply to recipients of Québec Parental Insurance Plan ("QPIP") benefits.

## Tax Court Cancels Sittings (January 11, 2021)

Due to the prevalence of COVID-19 in cities where the Tax Court of Canada is scheduled to hold proceedings, the Chief Justice has cancelled all in-person court sittings scheduled between January 18, 2021, and February 12, 2021, inclusive.

Some conference calls scheduled to proceed between January 18, 2021, and February 12, 2021, may also need to be cancelled.

Parties affected by the cancellation of in-person sittings or conference calls will be contacted directly by the registry staff.

The Chief Justice will continue to monitor the situation closely and will reassess the week of February 1, 2021, whether the judicial sittings schedule will have to be further altered.

The court and its registry offices remain open, except for the Hamilton office.

Any questions may be directed to the TCC Registry at 1-800-927-5499 or to the Executive Legal Counsel at (613) 992-0901.

## CRA Begins Issuing T4As to Benefit Recipients (January 11, 2021)

Canadians will begin receiving T4A slips from the CRA with respect to their taxable benefits received under federal COVID-19 support programs. Residents of Québec will receive both a T4A and an RL-1 slip. T4As will be sent out in waves.

If you have questions about the slip, including if you think there may be a mistake or you have received it in error, please contact the CRA by phone at 1-800-959-8281 or, for those outside of Canada and the US, at 1-613-940-8495.

## CERB Repayment Update (January 11, 2021)

To have qualified for the Canada Emergency Response Benefit ("CERB"), an individual's income must have been at least $5,000 in 2019 or in the 12 months prior to applying. In recent weeks there has been controversy surrounding some initial obscurity of this $5,000 income requirement. In early days of the CERB's rollout, the application was unclear regarding whether the $5,000 income threshold was gross or net of deductions. The CRA soon clarified that the income must be net of deductions. However, many individuals with net self-employment income below $5,000 applied for and received the CERB based on their assumption that the income threshold is before deductions — many have now received a letter from the CRA.

The CRA notified 441,000 Canadians via an education letter that they may have been ineligible for the CERB payments they received. These letters were sent if the CRA was unable to verify that the recipient had income of at least $5,000. If a recipient cannot demonstrate that they had enough income, they may have to repay their CERB benefits. The CRA will not apply penalties and interest if the CERB must be repaid, but CERB debt forgiveness is not planned at this time, according to the CBC.

## COVID-19 Benefits Denied for International Travellers (January 11, 2021)

The federal government is taking steps to ensure that COVID-19 support benefits are not available to people who disregard public health advice by travelling abroad. Specifically, these benefits are the Canada Recovery Benefit ("CRB"), the Canada Recovery Caregiving Benefit ("CRCB"), and the Canada Recovery Sickness Benefit ("CRSB"). The Minister of Employment, Workforce Development and Disability Inclusion, Carla Qualtrough, will be proposing legislation so that, retroactive to January 3, 2021, all international travellers who must quarantine upon return to Canada will not be eligible to receive any of these benefits for the period of their mandatory quarantine.

## CEWS and CERS Regulations Enacted (January 6, 2021)

Amendments to the *Income Tax Regulations* (the "Regulations") pertaining to the Canada Emergency Wage Subsidy ("CEWS") and Canada Emergency Rent Subsidy ("CERS") have been published in the Canada Gazette. Most of these changes were previously announced in the 2020 Fall Economic Statement.

The Regulations are amended to prescribe three additional four-week periods under which eligible organizations can receive continued support through the CEWS and CERS: from December 20, 2020, to January 16, 2021 (Period 11); from January 17, 2021, to February 13, 2021 (Period 12); and from February 14, 2021, to March 13, 2021 (Period 13).

The maximum top-up rate for the CEWS applicable to the new periods was increased from 25% to 35%. The base subsidy rate for the CEWS remains at 40%.

The Regulations are amended to provide that the prescribed amount in respect of furloughed employees for Periods 11, 12, and 13 is equal to the greater of two amounts:

- (i) $500, and
- (ii) the lesser of
  - (A) 55% of baseline remuneration in respect of the eligible employee determined for that week, and
  - (B) $595.

The subsidy rates for the CERS remain unchanged for these new periods: a 65% base subsidy and a 25% supplemental Lockdown Support.

Last, an amendment to the Regulations addresses the timing mismatch that has been developing between claim periods (which correspond to fixed 28-day intervals) and reference periods (which correspond to calendar months), which, if left unaddressed, would both result in reference periods being less economically relevant to the related claim period and require eligible entities to wait longer to establish their change in monthly revenues to make a claim. For example, Period 10 ends on December 19, 2020, but requires the applicant to know its revenues for the month of December before making a claim.

To address this issue, the Regulations provide that the reference periods for Period 11 are the same as the ones for Period 10. Consequently, an eligible entity must know its December 2020 revenues to apply for the CEWS or CERS for the claim period that ends January 16, 2021 (i.e., Period 11).

Employers who have been using the "alternative approach" can continue to do so.

## Temporary Adjustment to Standby Charge for 2020 and 2021 (December 21, 2020)

Where an employer provides an automobile to an employee, the benefits derived by the employee from personal use of the vehicle are included in their income for tax purposes by virtue of the operating expense benefit and standby charge. Ordinarily, the standby charge is equal to 2% per month of the automobile's cost or $^{2}/_{3}$ of the lease payment. However, if the automobile is driven primarily for business purposes and the kilometres driven for personal use are not more than 1,667 per 30-day period, or a total of 20,004 kilometres a year, the standby charge can be reduced. In such cases, the regular standby charge is adjusted by a factor equivalent to annual personal kilometres divided by the product obtained by multiplying 1,667 kilometres by the number of months the automobile is available to the employee.

Because of the COVID-19 pandemic, an employee's personal or business use of an automobile could be less when compared to 2019. For example, if an employee's business use dropped significantly but their personal use remained unchanged, they may be unable to qualify for the reduced standby charge.

To remedy this potential issue, the federal government will allow employees to use their 2019 automobile usage to determine whether they use the automobile primarily for business purposes in order to access the reduced standby charge in 2020 and 2021. Only employees with an automobile provided by the same employer as in 2019 would be eligible for this option.

This would also apply to the option to calculate the operating expense benefit as 50% of the standby charge. It is proposed that for 2020 and 2021, employees eligible for the optional calculation of the operating expense benefit, based on their 2019 automobile usage, could use the proposed treatment without notifying their employer. Instead, an employee’s operating expense benefit would be the lesser of either the operating expense benefit determined using the per-kilometre prescribed rate or the optional calculation. Employees unable to meet the business use requirement must calculate the operating expense benefit according to the per-kilometre prescribed rate.

Moreover, the rules pertaining to collecting GST/HST from taxable benefits provided to employees will be unchanged.

The government published proposed legislation to implement these changes. These measures would be effective for the 2020 and 2021 taxation years.

# Provincial

## Alberta

### Small and Medium Enterprise Relaunch Grant Expanded (January 14, 2021)

The Alberta government is expanding the Small and Medium Enterprise Relaunch Grant to allow new businesses to apply. By expanding applications to businesses that started operating between March 1 and October 31, 2020, up to 5,000 more Alberta businesses will be eligible for this funding.

New Alberta businesses impacted by public health orders must demonstrate a 30% reduction of revenue using revenue figures from November or December 2020 compared with any prior month between March to October 2020. The payment is 15% of their monthly revenue, for a maximum of $15,000 in funding available for each business.

For further details, see https://www.alberta.ca/sme-relaunch-grant.aspx.

## British Columbia

### Expanded Access to Business Recovery Grant (December 21, 2020)

The BC government has enhanced the Small and Medium-Sized Business Recovery Grant program to make it easier for businesses to qualify and has increased support for those in the hard-hit tourism sector.

Eligibility changes include:

- instead of requiring a revenue loss of 50% or more, the criteria has been reduced to 30% at the time of application;
- the requirement to list a variety of remittance accounts, like the registration numbers for the goods and services tax, provincial sales tax, and WorkSafeBC, has been removed;
- businesses that have been in operation for the last 18 months are now eligible (reduced from three years);
- applications can now be submitted by sole proprietors; and
- businesses that are temporarily closed or seasonal are now eligible for the program.

The revised application process and eligibility criteria are now in place. Small and medium-sized businesses are encouraged to apply online: https://www2.gov.bc.ca/gov/content/economic-recovery/business-recovery-grant.

## Manitoba

### Bridge Grant Eligibility Expanded and Deadline Extended (January 12, 2021)

The government is extending the Manitoba Bridge Grant application deadline until January 31, 2021, and expanding eligibility to offer financial support and protection for more small businesses through the current public health orders. Eligibility has been expanded for hotels, resorts, lodges and outfitters, travel agencies, janitorial services companies, and owners/operators of licensed passenger transportation businesses that have seen demand for their services impacted by public health orders.

## New Brunswick

### Non-Repayable Grant for Small Businesses (January 5, 2021)

The government announced additional relief for small businesses impacted by COVID-19 in the form of a non-repayable grant.

Through Opportunities New Brunswick, these grants of up to $5,000 will be available for small businesses that have been subject to Orange or Red alert level measures for at least one week between October 10, 2020, and March 31, 2021. This new support program is in addition to the enhancements being made to the Small Business Emergency Working Capital Program that resulted in more than $17 million being distributed to businesses throughout the province.

Further details, such as eligibility requirements and how and where to apply, will be available in the coming weeks.

## Ontario

### The New Ontario Small Business Support Grant (December 21, 2020)

The Ontario government announced the new Ontario Small Business Support Grant, which will provide a minimum of $10,000 and up to $20,000 to eligible small business owners. Small businesses required to close or restrict services under the province-wide shutdown can apply for this one-time grant. There is no restriction on what the support should be used for.

Eligible small businesses include those that:

- Are required to close or significantly restrict services subject to the province-wide shutdown effective 12:01 a.m. on December 26, 2020;
- Have less than 100 employees at the enterprise level; and
- Have experienced a minimum of 20% revenue decline in April 2020 compared to April 2019.

Starting at $10,000 for all eligible businesses, the grant will provide businesses with dollar-for-dollar funding to a maximum of $20,000 to help cover decreased revenue expected as a result of the province-wide shutdown. The business must demonstrate they experienced a revenue decline of at least 20% when comparing monthly revenue in April 2019 and April 2020. This time period was selected because it reflects the impact of the public health measures in spring 2020, and as such provides a representation of the possible impact of these latest measures on small businesses.

Essential businesses that can remain open are ineligible for this grant. More information about the *Ontario Small Business Support Grant* is available at https://news.ontario.ca/en/backgrounder/59788/post-4. Applications will be accepted starting January 15, 2021.

## Saskatchewan

### Re-Open Saskatchewan Training Subsidy Extended (January 7, 2021)

The government announced an extension of the application deadline for the Re-Open Saskatchewan Training Subsidy ("RSTS") from December 31, 2020, to March 31, 2021.

The RSTS was launched on June 18, 2020. The program provides a temporary training subsidy to assist businesses with financial support to train employees as they adjust to the impacts of the COVID-19 pandemic. The RSTS reimburses eligible private-sector employers 100% of employee training costs up to a maximum of $10,000 per business, which will help to re-open businesses safely. Approved training must begin within four months of the RSTS application date and it must be completed within a maximum of four months.

For more information, employers can visit www.saskatchewan.ca/training-subsidy, call 306-964-1005 for Saskatoon and area or 306-787-4677 for Regina and area, or email cansaskjobgrant@gov.sk.ca.

# FOCUS ON CURRENT CASES

This is a regular monthly feature examining recent cases of special interest, coordinated by *Tony Schweitzer* of Dentons Canada LLP. The contributors to this feature are from Dentons Canada LLP, Montreal, Toronto, Calgary, and Vancouver.

## *Canada (Attorney General) v. Utah*: Statutory Interpretation and Judicial Review: Where Do the Twain Meet?

This is a brief comment on a recent decision of the Federal Court of Appeal that has nothing to do with tax, yet may be relevant for future tax cases.

### *Vavilov*

By way of background, in 2019, the Supreme Court of Canada issued three decisions simultaneously: *Canada (Minister of Citizenship and Immigration) v. Vavilov*;[1] *Bell Canada v. Canada (Attorney General)*;[2] and *Canada Post Corp. v. Canadian Union of Postal Workers*.[3] *Vavilov* is the lead case; the other two illustrate how the principles in *Vavilov* apply to particular situations. The three decisions determine when a court hearing a judicial review application must apply the standard of reasonableness and when it must apply the standard of correctness.

### Appeals vs. Judicial Review

An "appeal" is a request for a higher court or authority to reconsider the evidence, perhaps hear new evidence, reconsider the law, and make a fresh decision on the merits.

A judicial review is different: its purpose is not to determine if the decision-maker made the "right" decision; it is to determine if the decision-maker made a "reasonable" decision. A decision can be wrong and still be reasonable. In other words, in many cases, based on the facts and the law, there may be room for more than one conclusion. There may be a range of possible conclusions. If the decision-maker makes a decision that falls within that range, then on judicial review that decision will be upheld, even if the judge hearing the review application would have come to a different decision. Only if the initial decision falls outside the range of possible outcomes will the court quash the decision (in which case the court will almost always either ask the same decision-maker to re-hear the matter or sometimes order that a different decision-maker re-hear the matter; in rare cases the judge may tell the decision-maker what the decision must be).

When a statute gives a person a right to have a matter heard by a particular decision-maker, that person has no right to appeal the decision to a court unless the statute provides that right expressly. There is no inherent, common law, or equitable right to an appeal.

On the other hand, every decision made under a statute is subject to judicial review, even if the statute does not say

[1] 2019 SCC 65.

[2] 2019 SCC 66.

[3] 2019 SCC 67.

so; indeed, even if it says no judicial review is allowed, the decision is still subject to judicial review. That is because every decision must be made under certain guidelines and procedures; a person always has the right to argue that the decision-maker failed to follow them.

## *Vavilov* and Statutory Interpretation

Under *Vavilov*, only in certain, very specific and limited situations can a court hearing a judicial review ask whether the decision is "correct" as a matter of law. But, surprisingly, the mere fact that the decision turned on a matter of statutory interpretation is not one of them. In other words, a decision-maker is entitled to interpret a statue "reasonably"; he or she need not interpret it "correctly".

Having said that, in both *Vavilov* and *Canada Post*, the Court took pains to emphasize that a decision-maker must use the ordinary principles of statutory interpretation. In the latter decision the Court put it this way:

> [42] Where the meaning of a statutory provision is in dispute, the administrative decision-maker must demonstrate in their reasons that they were alive to the "essential elements" of statutory interpretation: "the merits of an administrative decision-maker's interpretation of a statutory provision must be consistent with the text, context and purpose of the provision" (*Vavilov*, at para. 120). Because those who draft statutes expect that the statute's meaning will be discerned by looking to the text, context and purpose, a reasonable interpretation must have regard to these elements — whether it is the court or an administrative decision-maker tasked with the interpretative exercise (*Vavilov*, at para. 118).

So, while a decision-maker can be "wrong", he or she must be wrong after applying the right principles of statutory interpretation and coming up with a reasonable, albeit incorrect, interpretation. The odds of that happening are not very high: one expects that if a decision-maker and a judge each apply the same principles of interpretation to the same words in light of the same facts, they will come to the same conclusion as to the statute's meaning and application to those facts.

## *Utah*

This naturally raises the question: what are the correct principles of statutory interpretation? That brings us to *Canada (Attorney General) v. Utah*.[4]

### Summary

As stated above, this is not a tax case, so it is not necessary to set out all the facts and reasoning. In brief, Mr. Utah sued the Canadian federal government for damages he alleged that he suffered because a federal government officer "failed to process his request for refugee protection in a timely manner".

The government applied to the Federal Court to strike out the action on the basis that it was brought after the expiration of the two-year time limit in the Alberta *Limitations Act*,[5] which applied by virtue of section 39 of the *Federal Courts Act*.[6] Mr. Utah argued that the limitation period started to run only after he became aware that he had suffered damages because of the official's failure, which was less than two years before he sued, so he was still in time.

The Federal Court upheld Mr. Utah's argument and dismissed the Crown's application.[7]

The Court of Appeal reversed that decision and struck out Mr. Utah's action. In doing so, Mr. Justice Stratas, for the Court of Appeal, laid down various rules for statutory interpretation. Under the *Vavilov* trilogy, the Canada Revenue Agency (as well, of course, as the Tax Court of Canada, the Federal Court, and the Federal Court of Appeal) must follow these rules in interpreting and applying any tax statute. Failure to do so may mean that the CRA's decision was unreasonable and subject to judicial review.

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[4] 2020 FCA 224.

[5] R.S.A. 2000, c. L-12.

[6] R.S.C. 1985, c. F-7.

[7] 2020 FC 923.

### The Rules

The first rule is that a decision-maker must search for the "authentic meaning" of the legislation in issue. One does this by looking at the "plain meaning of its words, seeing them in their proper context, and keeping front of mind the purposes the provision is to serve". Mr. Justice Stratas was at pains to emphasize the first point: "In the interpretation of legislation, the text is the starting point".

Moreover, the decision-maker is to do this "neutrally, dispassionately and objectively". Perhaps another way to say this is that "what is not licit is 'reverse-engineering' a desired outcome",[8] that is, figuring out what one wants the interpretation to be and then coming up with reasons as to why it says that.

Perhaps the most interesting part of *Utah* is how strongly Mr. Justice Stratas emphasized that a judge's view of the fairness or unfairness of a situation cannot be allowed to influence a judge's interpretation of a statute (another way of saying that reverse-engineering is not allowed). In particular, Justice Stratas agreed that the two-year limitation period might be "harsh" but that that was irrelevant:

> [15] Harsh the policy might be. But judges . . . cannot meddle with it or refuse to enforce it unless the legislation enacting it is unconstitutional. Nor can judges go through the back door and skew their reasons to get the outcomes they want or cite non-binding sources promoting policies they prefer . . . *Vavilov* . . . (in the context of administrative decision-makers but equally applicable to judges) . . . Judges . . . have no right to smuggle into the task of statutory interpretation their personal views of what is best and then boost their views to the level of law that binds all. Under our constitutional arrangements, that is alone for our legislators, the people for whom we vote.

Indeed, he felt so strongly about this rule that he criticized the Supreme Court of Canada for not following it:

> [27] No Court can pave over a legislature's policy choice by, for example, importing a different policy from another jurisdiction's legislation or from a case discussing another jurisdiction's legislation . . . That would be an improper judicial displacement or amendment of legislation — an improper substitution of judges' views for those of elected legislators. . . .
>
> [28] . . . This principle is so fundamental that lower courts have been known to shun decisions that offend the hierarchy of laws — even those from the highest court in the land: see, e.g., *Edmonton (City) v. Edmonton East (Capilano) Shopping Centres Ltd*. . . . (where the Supreme Court purported to assert a court-made presumption over statutory law), *Entertainment Software Association v. Society of Composers, Authors and Music Publishers of Canada* . . . (where this Court confessed to having to "tip-toe" around it for years), and *Vavilov*, above (which cast aside *Edmonton East*).[9]

### Conclusion

Whether in the context of an appeal or a judicial review of a CRA decision, one must apply the appropriate principles of statutory interpretation. One must start at the beginning and read the text of the statute, not at the back with the result one wants.

— *Joel Nitikman, Q.C., Partner, Dentons Canada LLP, Vancouver*

## *Ralph Abdel Deyab v. The Queen*, 2021 DTC 5001 (Federal Court of Appeal)

In this case, the Federal Court of Appeal found that a taxpayer's failure to maintain a shareholder loan account amounted to carelessness or neglect entitling the Minister to reassess purported shareholder loan repayments as shareholder benefits under subsection 15(1) of the *Income Tax Act* (the "Act") after the normal assessment period under subsection 152(4), but did not amount to the level of intentional conduct or indifference necessary to apply gross negligence penalties under subsection 163(2).

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[8] *Edmonton Police Service v. Alberta (Information and Privacy Commissioner)*, 2020 ABQB 10 at paragraph 427.

[9] Justice Stratas, for the Court, said the same thing in an even more recent decision, *Barkley v. Canada*, 2021 DTC 5007 (FCA) at paragraph 34.

## Background

In December 2005, Mr. Deyab (the "Taxpayer") and his spouse incorporated a Canadian company (the "Company") through which the Taxpayer provided engineering consulting services. Up until that time, the Taxpayer had previously provided these same services through a different Canadian numbered company ("Oldco").

During the years 2007 to 2011 the Taxpayer received over $2.3 million from the Company's bank accounts (the "Shareholder Payments"). The Taxpayer filed his tax returns for the years in question on the basis that the Shareholder Payments were repayments of shareholder loans payable to him. On audit, the CRA determined that the Company did not maintain a shareholder loan account, and reassessed the Taxpayer on the basis that these Shareholder Payments were shareholder benefits conferred on him by the Company under subsection 15(1) of the Act, and further assessed gross negligence penalties under subsection 163(2) of the Act. The notices of reassessment for the taxation years 2007 to 2010 were dated after the expiration of the normal reassessment period under subsection 152(4) of the Act. The Minister asserted that the Taxpayer's decision to not report the Shareholder Payments as income was a misrepresentation attributable to neglect, carelessness, or wilful default.

The Taxpayer objected to and appealed the reassessments, submitting the following evidence in support of his position that the Shareholder Payments were repayments of shareholder loans payable to him by the Company:

- A reconciliation of the Company's shareholder loan account, indicating Company shareholder loans payable to the Taxpayer totalling approximately $4.5 million during the years in question (the "Reconciled Shareholder Loan Account"). The reconciliation was prepared for the Taxpayer's objection to the CRA, and did not reflect the Shareholder Payments at issue in the reassessments.
- Company financial statements recording amounts "Due to Shareholders" for the taxation years in question (the judgement does not indicate what amount was recorded as being due to shareholders, but no suggestion is made that the amount was inconsistent with the Reconciled Shareholder Loan Account).
- Letters from BMO stating that the following transfers had been made to the Company's accounts:

| | Transfers to the Company | | |
|---|---|---|---|
| Year | From Taxpayer | From Undetermined Source | Shareholder Payments |
| 2007 | $1,150,662 | – | $21,336 |
| 2008 | $580,786 | – | $119,012 |
| 2009 | $60,000 | – | $97,009 |
| 2010 | – | $3,000,000 | $2,032,711 |
| 2011 | – | – | $79,711 |

Regarding the $3 million transferred to the Company in 2010, the Federal Court of Appeal noted that neither the Minister nor the Taxpayer provided sufficient evidence to enable the court to determine who had transferred this money to the Company. While the BMO letters stated that over $3 million had been transferred from the Taxpayer and his family to the Company and other personal investment accounts of the Taxpayer and his family, the letters did not provide any details regarding what amounts were transferred to which accounts.

Notably, the Company had not earned any revenue in its 2006 taxation year, and realized net losses for each year from 2007 to 2011 resulting in cumulative losses of over $1.1 million, suggesting that the Company did not have any cash of its own to distribute. However, bank account statements showed that Oldco had a bank account balance of over $4.2 million in 2005, several months prior to the incorporation of the Company. No facts pertaining to what happened to these Oldco funds were reported.

## Tax Court of Canada Decision

In an unreported oral judgement, the Tax Court held that

(1) the Shareholder Payments constituted shareholder benefits under subsection 15(1) of the Act,

(2) the failure to report the Shareholder Payments constituted gross negligence subject to penalties under subsection 163(2) of the Act, and

(3) the Taxpayer failed to provide a credible explanation for the Shareholder Payments, and that the Minister was thereby entitled to reassess the Taxpayer for both the 2011 and the statute-barred years under both subsections 152(4) and 163(2) of the Act, following the 2008 Federal Court of Appeal decision *Lacroix c. R.* (2009 DTC 5029).

The Tax Court found that the Reconciled Shareholder Loan Account setting out the $4.5 million in shareholder loans payable by the Company to the Taxpayer was unreliable as it didn't include the Shareholder Payments at issue, and further stated that the court drew an adverse inference regarding the credibility of the Taxpayer on account of its failure to do so.

## Issues on Appeal

(1) Whether the Tax Court improperly shifted the burden of proof to the Taxpayer in relation to reassessing the statute-barred years and assessing gross negligence penalties;

(2) Whether the Tax Court improperly relied on adverse inferences against the Taxpayer before the Minister had established a *prima facie* case; and

(3) Whether the Tax Court failed to take into account all the evidence before the court in applying the legal test in *Lacroix*.

## Federal Court of Appeal Decision

### Burden of Proof

The transcript of the trial judge's oral reasons indicated that the trial judge had considered the issue of whether the Taxpayer failed to report the Shareholder Payments as income (and concluded that the taxpayer had failed to do so) prior to considering whether the Minister was entitled to reassess the Taxpayer after the normal reassessment period for the Taxpayer's 2007 – 2010 taxation years. The Taxpayer argued that this had the effect of shifting the onus of proof onto the Taxpayer in establishing whether or not the Taxpayer had made a misrepresentation attributable to neglect, carelessness, or wilful default, contrary to the rule established in *Vine Estate v. R.* (2015 DTC 5063 (FCA)) that the Minister has the onus of establishing such misrepresentation.

The court acknowledged that the trial judge should have considered the issue of misrepresentation prior to considering whether the Taxpayer had rebutted the Minister's allegation that the Shareholder Payments were shareholder benefits. However, the court held that the evidence was such that this did not affect the outcome of the trial judge's determination of the statute-barred issue.

While the court acknowledged that the Taxpayer had transferred almost $1.8 million in cash to the Company prior to the Shareholder Payments having been made, and that these amounts could have been advanced as loans, it held that the Company's failure to record these amounts in a shareholder loan account, together with its failure to record the subsequent Shareholder Payments as repayments, meant that the Taxpayer's filing position was unsupportable and amounted to misrepresentation attributable to carelessness or neglect. The court stated:

> [27] Subsection 15(1) of the Act provides the general rule that the amount or value of any benefit conferred by a corporation on a shareholder of that corporation is to be included in the income of that shareholder. If a corporation is repaying an amount payable to that shareholder <u>and records the payment as such</u>, then no benefit would be conferred, and hence, there would be no misrepresentation in not including such amount in the income of the shareholder.
>
> . . .
>
> [40] . . . Mr. Deyab had made a misrepresentation in his tax returns for 2007 to 2010 by not reporting the amounts that were transferred to him and his family by M.D. Consulting, which, based on the evidence as presented, were not, on a balance of probabilities, repayments of amounts due to him. <u>This misrepresentation was attributable to the neglect or carelessness of Mr. Deyab in not properly maintaining a shareholders' loan account</u> that perhaps could have justified the payment of the amounts to him as repayment of his shareholder's loan.

> [41] Maintaining a proper shareholders' loan account would ensure that there is an accurate accounting for all amounts lent by a shareholder to the corporation and repaid by that corporation. This would ensure that amounts that are properly repaid to a shareholder as amounts payable to that shareholder are not included in that shareholder's income as a taxable benefit. In this case, failing to do so has resulted in a considerable tax liability to Mr. Deyab that perhaps could have been avoided. [emphasis added]

### Adverse Inferences

Readers of the case may be inclined to presume that the Taxpayer had submitted the Reconciled Shareholder Loan Account with a view to establishing the existence of the purported shareholder loans payable by the Company to the Taxpayer, and had not included the Shareholder Payments at issue given that the existence of these payments was not disputed — only their characterization. The Taxpayer argued that the trial judge's adverse inference from this, and from the Taxpayer's failure to call any of his tax professionals to the hearing, was thus unwarranted.

The Federal Court of Appeal disagreed, holding that the Minister had established a *prima facie* case thereby entitling the trial judge to draw an adverse inference from the incomplete Reconciled Shareholder Loan Account and the Taxpayer's failure to call his tax professionals to the trial hearing.

### Application of *Lacroix*

The Court affirmed that *Lacroix* establishes that the onuses placed on the Minister under paragraph 152(4)(*a*) and subsection 163(2) are not the same. Both require the Minister to establish its case on a balance of probabilities. However, paragraph 152(4)(*a*) requires the Minister to establish misrepresentation attributable to neglect, carelessness, or wilful default or fraud, whereas subsection 163(2) requires taxpayer conduct amounting to gross negligence. Applying the 2015 Supreme Court of Canada case *Guindon v. R*. (2015 DTC 5086), the court affirmed that gross negligence requires "conduct that is tantamount to intentional acting", and that this is a higher standard than neglect or carelessness.

The Court found that the Tax Court Judge had erred in finding that the Taxpayer's failure to identify the source of the income and show that it is not taxable constituted gross negligence.

> [69] In the circumstances of *Lacroix*, the failure to provide a credible explanation was sufficient to justify the assessment of the gross negligence penalty and the reassessment of the statute-barred years. The comments of this Court in *Lacroix* do not support the conclusion that, in order to set aside a gross negligence penalty, "the taxpayer must [...] identify the source of the income and show that is not taxable".

The Court concluded that the Minister had not established that the Taxpayer knew that the Shareholder Repayments were not repayments of shareholder loans, and thus had not met the onus of establishing intentional conduct amounting to gross negligence as required under *Lacroix*.

## Conclusion

This case emphasizes the need for companies to ensure that they maintain proper journal entries. Even where evidence of unrecorded receipts or payments can be subsequently produced, absent corresponding journal entries, reasonable taxpayer explanations as to the nature of such receipts or payments may be dismissed even where no competing explanation as to the nature of such receipts or payments is adduced by the court.

The case also appears to suggest that taxpayer filing positions made without the benefit of supporting journal entries may be reassessed after the normal reassessment period as "misrepresentations attributable to neglect, carelessness or wilful default"— even where the taxpayer is able to adduce evidence supporting their position that their failure to have made such journal entries was merely a mistake. However, this case further emphasizes the importance of obtaining testimony of professional advisors to support a taxpayer's characterization — and that failure to do so may result in the court fairly drawing an adverse inference from shortcomings in the taxpayer's evidence.

The case provides some respite, however, acknowledging that taxpayers who fail to make proper journal entries may not be *grossly* negligent if they can provide evidence supporting their belief that their filing position was correct, notwithstanding that their belief may have been neglectful or careless without such journal entries.

— *Ron Dueck, Partner, Dentons Canada LLP, Vancouver*

## *Biya v. The Queen*, 2020 DTC 1089 (Tax Court of Canada)

### Introduction

A person's residency for Canadian income tax purposes could have a significant impact on that person's Canadian income tax liability. A person who is a resident of Canada is subject to Canadian income taxation on his or her worldwide income.[1] A person who is a non-resident of Canada is subject only to Canadian income taxation on amounts received from employment in Canada, carrying on business in Canada, and disposing of taxable Canadian property.[2]

Although the term "resident" is not defined in the ITA, the ITA does provide that a person is a resident of Canada if they are "ordinarily resident" in Canada.[3] The Supreme Court of Canada in *Thomson v. MNR*[4] stated that a person is an "ordinary resident" in "the place where in the settled routine of his life he regularly, normally or customarily lives". The purpose of this rule is to ensure that a person who is otherwise a resident of Canada does not cease to be so simply because he or she is absent from Canada temporarily.

### Decision

In *Biya v. The Queen*,[5] Mr. Biya left Canada in 2006 to live and work in Ethiopia and then returned to Canada in 2017. Ultimately, the Court held that he had been ordinarily resident in Canada throughout that period and particularly for the year under assessment, 2013. In finding that the taxpayer was ordinarily resident in Canada, the Court considered the five material factors set out in *The Queen v. Reeder*,[6] and held that the taxpayer's ties with Canada "dominate[d] the analysis". In particular, the Court held that the following ties "overwhelmingly" supported a finding that the taxpayer was ordinarily resident in Canada in 2013:

(a) a very active Canadian bank account;

(b) the fact that the taxpayer was paid in Canada by his Canadian employer (which had headquarters in Toronto and operations in Ethiopia);

(c) ownership of Canadian RRSPs (which the taxpayer contributed to in 2013);

(d) property investment in Toronto (which was mainly rented out to students);

(e) continued membership in the Ontario Health Insurance Plan ("OHIP"); and

(f) a Canadian driver's license.

In concluding that the taxpayer "saw his stays in Canada as his settled routine pattern of life", the Court considered also the fact that he had a large family in Canada, in addition to his ex-wife and three sons (the youngest of whom turned 20 years old in 2013).

The Court did not attribute much significance to the fact that the taxpayer used Canadian credit cards, because credit cards were not available in Ethiopia, nor to the fact that the taxpayer used a Canadian passport, because it made travelling from Ethiopia and throughout the world much easier.

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[1] *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the"ITA") s. 2(1).

[2] ITA s. 2(3).

[3] ITA s. 250(3).

[4] 2 DTC 812.

[5] 2020 DTC 1089 (TCC).

[6] 75 DTC 5160 (FC).

## Comment

The result in *Biya* adds to the uncertainty that surrounds assessing the significance of a taxpayer's ties to Canada in determining whether he or she is ordinarily resident in Canada. It is difficult to distinguish the facts in *Biya* from other cases where the taxpayer has been found not to be ordinarily resident in Canada.

For example, in *Harris-Eze v. The Queen*,[7] the Court found that the taxpayer had given "sufficient and reasonable explanations" for maintaining his ties with Canada and that the following factors were "not overwhelming, substantial or indeed determinative" of the taxpayer's "ordinary" place of residence:

(a) landed immigrant status in Canada;

(b) a Saskatchewan automobile licence for a vehicle that did not meet the emission standards in Long Island, New York (where the taxpayer was living, studying, and working during the years in question);

(c) a Saskatchewan driver's licence;

(d) a Canadian bank account;

(e) insurance in Canada;

(f) Canadian credit cards; and

(g) indebtedness in Canada.

In *Bower v. The Queen*,[8] the Court indicated that the taxpayer's choice of maintaining his Canadian bank accounts and credit cards for the purpose of supporting his daily living in Indonesia (where "the banking system [left] something to be desired") and his choice of maintaining his Canadian trading account and Canadian accidental death and extended health coverage policy were not significant in determining the taxpayer's ties to Canada.

In *Goldstein v. The Queen*,[9] the Court found that although close family ties (other than the taxpayer's spouse and children) and religious ties in Canada established "strong roots in Canada", they did not establish a "customary mode of living" in Canada. In addition, despite the taxpayer's spouse (but not the taxpayer herself) retaining an Ontario driver's licence and OHIP coverage, the Court stated that these factors were "not strong evidence of a customary mode of living in Canada" and that the retention of these ties was likely "a matter of convenience".

So how could a number of seemingly insignificant factors result in Mr. Biya being an "ordinary resident" of Canada? The answer might be gleaned from the fact that the taxpayer supported his ex-wife (who lived permanently in Canada) and three sons (all of whom either lived permanently in Canada or went to university abroad and returned to Canada on school breaks) financially. For instance, in 2013, the taxpayer paid his ex-wife support of $3,000 to $4,000 a month, which was based on her needs and was paid without a written agreement. In addition, the taxpayer paid rent for the Toronto apartment in which his son lived and then helped that son make a down payment on another Toronto condo.

Although it was not mentioned specifically in the Court's reasons, it appears that the taxpayer's ex-wife and three sons were dependent on him financially. As a result of this "dependent relationship" (the full extent of which is unclear from the reasons), it is possible that the taxpayer did not see his lengthy visits to Canada (110 days in 2013) as merely a vacation or holiday to visit his family, but as part of his "settled routine of life" by which he continued to take care of his family while maintaining a life in Ethiopia. If this is the case, then the taxpayer's ties to Canada could be seen not just as mere conveniences to support his life in Ethiopia, but also as necessities to support his taking care of his family.

*— Francis Chang, Articling Student, Dentons Canada LLP, Vancouver*

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[7] 2002 DTC 1620 (TCC).

[8] 2013 DTC 1152 (TCC).

[9] 2013 DTC 1137 (TCC), affirmed 2014 DTC 5027 (FCA).

# CURRENT ITEMS OF INTEREST

## Prescribed Rates for Q1

The CRA announced the prescribed annual interest rates that will apply to any amounts owed to the CRA and to any amounts owed by the CRA to individuals and corporations. These rates will be in effect from January 1, 2021, to March 31, 2021. The rates for income tax purposes are as follows:

- The interest rate charged on overdue taxes, Canada Pension Plan contributions, and employment insurance premiums will be 5%.
- The interest rate to be paid on corporate taxpayer overpayments will be 1%.
- The interest rate to be paid on non-corporate taxpayer overpayments will be 3%.
- The interest rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans will be 1%.
- The interest rate for corporate taxpayers' pertinent loans or indebtedness will be 4.10%.

## 2021 Automobile Deduction Limits and Expense Benefit Rates

On December 21, 2020, the Department of Finance announced the automobile income tax deduction limits and expense benefit rates that will apply in 2021.

The prescribed rate used to determine the taxable benefit of employees relating to the personal portion of automobile expenses paid by their employers will decrease by one cent to 27 cents per kilometre. For people who are employed principally in selling or leasing automobiles, the rate used to determine the employee's taxable benefit will decrease by one cent to 24 cents per kilometre.

All other prescribed amounts for 2021 will remain the same as in 2020. These are as follows.

- The limit on the deduction of tax-exempt allowances paid by employers to employees who use their personal vehicle for business purposes will remain at 59 cents per kilometre for the first 5,000 kilometres driven, and 53 cents per kilometre for each additional kilometre. For the Northwest Territories, Nunavut, and Yukon the allowance is 4 cents higher, and will remain at 63 cents per kilometre for the first 5,000 kilometres driven, and 57 cents per kilometre for each additional kilometre.
- The capital cost limit for passenger vehicles other than zero-emission passenger vehicles will remain at $30,000 before tax, and at $55,000 before tax for eligible zero-emission passenger vehicles.
- The maximum allowable interest deduction for new automobile loans will remain at $300 per month.
- Last, the limit on deductible leasing costs will remain at $800 per month before tax for new leases entered into. For automobiles valued over $30,000, a separate restriction continues to prorate deductible lease costs.

# RECENT CASES

## Corporate taxpayer's sole shareholder and director not permitted to represent it on its appeal to the Tax Court of Canada

The Tax Court of Canada granted DG, the corporate taxpayer BCS's sole shareholder, director, and officer, leave to represent it in its General Procedure appeal to that Court (2018 DTC 1095). DG was not a lawyer. The Crown appealed to the Federal Court of Appeal.

The Crown's appeal was allowed. There are conflicting decisions of the Tax Court on the issue of non-lawyers representing appellants in General Procedure appeals in that Court. Section 17.1 of the *Tax Court of Canada Rules (General Procedure)* provides that a party to a proceeding in that Court may appear in person or be represented by counsel. However, on a proper interpretation of section 17.1, the Tax Court in this case could not find that DG personified BCS, and that he was exercising BCS's right to appear "in person". Nor could that Court grant leave to DG to act as BCS's agent in its appeal before it.

*The Queen v. BCS Group*

2020 DTC 5089

## Whether taxpayers entitled to declaration that they were not the owners of certain corporations

The applicants and their families hold a 50% interest in a successful corporation. Their interests are held through family trusts. A significant tax liability would have arisen on the 21st anniversary of the trust. To defer that tax liability, the applicants rolled the trust assets into a number of family corporations, one for each of their respective children (the "Child Corporations"). The applicants subscribed for controlling shares in each Child Corporation. In 2019, the Canada Revenue Agency reassessed the applicants' income tax returns to increase each of their taxable incomes by approximately $15,000,000. The reassessment was based on the assumption that the applicants held controlling shares in the Child Corporations. In response to the notice of assessment, the applicants brought this application for a declaration that they have never been shareholders of the Child Corporations because, although corporate records show that the applicants received shares, the applicants say they never paid for the shares. The applicants submit that the lack of payment renders the share issuance void because subsection 23(3) of the *Ontario Business Corporations Act* ("OBCA") requires that shares be fully paid for before they can be issued. In addition, the applicants asked to rectify the records of the Child Corporations to reflect that the applicants never held shares in them.

The application was dismissed. The Court dismissed the application on the grounds that it should not assume jurisdiction over the application. The real issue involves the tax assessment and the Tax Court has jurisdiction to interpret and apply subsection 23(3) of the OBCA. Even if it had jurisdiction, the Court would decline the application for a declaration that the shares were not validly issued. There was conflicting evidence whether the applicants paid for their shares but there was no dispute within any of the Child Corporations about shareholdings or any other issue. The Child Corporations are free to adjust their shareholdings to eliminate any controlling interest the applicants are alleged to hold — they did just that after this application was commenced. The absence of a declaration does not prejudice the applicants because they remain free to argue before the Tax Court that they were never shareholders of the Child Corporations. Finally, the Court would also decline rectification. The claim for rectification was based on the alleged failure to pay for the shares. Rectification would not be appropriate because it is available to correct documents which do not reflect the intentions of the parties. The share registers of the Child Corporations do reflect the intention of the parties in 2014 and 2015 to give the applicants controlling shares. Rectification is not available where documents accurately reflect the original intention but the parties want to change that intention because it did not have the anticipated effect.

*Mandel v. 1909975 Ontario Inc.*

2020 DTC 5086

## Whether corporate taxpayer entitled to ABIL and interest expense deductions claimed

Keybrand is a wholly owned subsidiary of B.W. Strassburger Ltd. ("BWS"). Bernhardt Strassburger and his siblings own BWS. Vidabode was a Nova Scotia company incorporated in 2005. Vidabode had developed a new concrete product called Vidacrete, as well as a production system for Vidacrete. An investment in Vidabode was made in 2006 by Twincorp Inc., a company wholly owned by Mr. Strassburger. In the following years, BWS acquired common and non-voting preferred shares of Vidabode and also loaned it money. Mr. Strassburger's mother also acquired non-voting preferred shares of Vidabode. However, Keybrand did not acquire any shares of Vidabode until late 2010. To help finance the operations of Vidabode and certain capital acquisitions, Mr. Strassburger arranged for GE Capital to provide financing to Vidabode. As part of this arrangement, Keybrand, BWS, and another company owned by the Strassburger family guaranteed the debt to GE Capital. Vidabode struggled financially. Between 2005 (its first year of operation) and 2009 (its last year prior to the share purchase in issue), Vidabode incurred more than $17 million in losses. Sometime prior to the summer of 2010, it became clear that Vidabode would not be able to meet its obligations to GE Capital which, as of the end of 2009, were in excess of $15 million. A balloon payment of approximately $3 million was due in September 2010. Vidabode defaulted in making this balloon payment. GE Capital called all of its loans. In order to pay the amount outstanding to GE Capital, Keybrand borrowed $14,452,515 from TD Bank. This money was used to pay the subscription price payable to Vidabode for the shares issued to Keybrand. Vidabode in turn used the funds to pay its debt to GE Capital. A total of 19,343,493 (16,448,428 + 2,895,065) common shares were issued to Keybrand on December 22, 2010. This issue date was, however, one week before Keybrand borrowed the money from TD Bank to pay for these shares. While the effect of subsections 25(3) and (5) of the *Canada Business Corporations Act* ("CBCA") is that shares of a CBCA corporation cannot be issued in exchange for a promissory note or a promise to pay, there is no similar restriction in the *Nova Scotia Companies Act*. There was conflicting evidence concerning the number of common shares of Vidabode that were owned by BWS prior to December 22, 2010. The Tax Court Judge ultimately concluded that prior to Vidabode issuing common shares to Keybrand in December 2010, BWS owned approximately 41% of the common shares of Vidabode. The shares had a par value of one dollar each. However, in its tax return for the year ending April 24, 2011, Keybrand claimed an ABIL of $9,667,636 (one-half of $19,335,272). No explanation was provided for the difference between the amount claimed and what would have been claimed if the adjusted cost base of the 19,343,493 shares acquired by Keybrand had been $1 per share or $19,343,493 in total. The ABIL claim was denied by the Minister, along with Keybrand's claim for a deduction for an interest expense in its taxation year ending April 24, 2011. On appeal, the Tax Court Judge determined that Keybrand and Vidabode were not dealing with each other at arm's length for the purposes of the *Income Tax Act* when Keybrand acquired shares in Vidabode in December 2010, and that Keybrand had not borrowed the money that was used to acquire these shares for the purpose of earning income (2019 DTC 1121). Keybrand appealed further.

The appeal was dismissed. The Court of Appeal found it was more likely than not that Keybrand was the directing mind of both parties to the transaction related to its acquisition of the common shares of Vidabode in December 2010. Consequently, the Tax Court Judge did not err in concluding that Keybrand and Vidabode were not dealing at arm's length when Keybrand acquired shares of Vidabode in December 2010. Furthermore, there was no basis to interfere with the Tax Court Judge's finding that Keybrand did not have a reasonable expectation of income when it acquired the shares of Vidabode and hence that Keybrand did not borrow the money on December 29, 2010, for the purpose of earning income. Accordingly, the appeal was dismissed.

*Keybrand Foods Inc. v. The Queen*

2020 DTC 5087

## Actual date gift made and not date when statutory requirements met determinative for purposes of capital gains exemption

During 2008, the corporate taxpayer disposed of a portion of the lands it owned to a Land Conservancy and to a Land Trust. The Minister denied the taxpayer an ecological gift deduction for 2014 on the ground that the carryforward period within which the deduction could be taken ended in 2013. This in turn was predicated on the Minister's assumption that the gift was made in 2008 and not in 2009 as the taxpayer had contended. The taxpayer initially agreed that the gift was made in 2008 when the gifted property was disposed of. Later, however, the taxpayer contended that it was made in 2009 when all of the statutory requirements for claiming the tax relief associated with it were met — the required certificates and the appropriate receipts were filed with the Minister. The taxpayer's appeal was dismissed by the Tax Court of Canada, which held that the gift was made in 2008 (2019 DTC 1130). The taxpayer appealed to the Federal Court of Appeal.

The taxpayer's appeal was dismissed. The Tax Court judge correctly determined that the question as to when a gift is made and when that gift qualifies for a deduction or exemption under the Act are distinct questions. Clearly the taxpayer's entitlement to the capital gain exemption and the related deduction in this case did not occur until 2009 when all the statutory conditions in 110.1(1)(*d*) and 110.1(2) of the Act were met. However, this did not alter the time when the gift was made, which was in 2008. The Minister's assessment was affirmed accordingly.

*Yellow Point Lodge Ltd. v. The Queen*

2020 DTC 5085

## Grievance awards included in taxpayer's income as income from employment

The taxpayers received monetary awards (the "Awards") following a successful grievance procedure before the Public Service Labour Relations and Employment Board. The Minister included these awards in the taxpayers' income as income from employment. On appeal to the Tax Court of Canada, the taxpayers argued that the Awards constituted damages for personal injury in violation of their rights under their collective agreements, and were thus exempt from tax under the exception in paragraph 81(1)(*g*.1) of the *Income Tax Act*.

The taxpayers' appeals were dismissed. The Court applied the principles set out by the Supreme Court in *Tsiaprailis v. The Queen* (2005 DTC 5119). This analysis led to the conclusions that: (a) the Awards, based on an agreed number of hours, replaced the remuneration amounts that the taxpayers would have received had they been offered and accepted overtime work; (b) those amounts would have been taxable as employment income; and (c) the Awards therefore did not fall within the exception in paragraph 81(1)(*g*.1), and hence were taxable as the Minister had contended. The Minister's assessments was affirmed accordingly.

*Saunders v. The Queen*

2020 DTC 1091

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