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UNTIL DEATH DO THEY PART: TAX ISSUES FOR CANADIANS OWNING AND DYING WITH FOREIGN REAL PROPERTY

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What is a Canadian tax practitioner to do for their clients (or family) who intend to own real property outside of Canada and the US[1] ("Foreign Real Property") until death do they part?

Such holdings, while often a source of joy during a Canadian resident's lifetime, can create some serious tax problems for their estate and their heirs.

In the discussion that follows, we'll try and illustrate this issue and a possible solution using a fictional client named Maria and a number of hypothetical scenarios.

Facts — Maria's Algarve Property

Imagine that when Maria was 25 years old, she immigrated to Canada from Portugal.

Sadly, a number of years later, the last of Maria's parents passed away and left Maria a modest beach home in southern Portugal worth about $100,000 at the time (the "Algarve Property").[2]

Today, Maria is 60 years old and, to keep the illustration simple, let's assume that her estate is comprised solely of the Algarve Property, now worth $1,100,000, and a debt of $100,000 so that Maria's net estate is worth $1,000,000.

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[1] The issues described in this article will generally not be a concern in respect of US real property owned by Canadians on death because of unique features of Article XXIX-B in the Fifth Protocol to the *Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital*, which coordinate US estate tax and Canadian death taxes with one another and thereby can avoid double taxation issues and allow for US cost base adjustments to match those in Canada, provided the taxpayer in question is an individual and the election under Article XIII(7) is properly filed. Several treaties have similar provisions that coordinate a step-up in tax basis, but they only apply where an individual has ceased residency in a particular country — it is our understanding that none (or almost none) of Canada's other tax treaties contain step-up provisions for deemed disposition on death.

[2] Since Maria acquired the beach home by way of a bequest, Maria is deemed under paragraph 69(1)(*c*) of the *Income Tax Act* (Canada) (the "Act") for Canadian tax purposes to have acquired the property at an adjusted cost base ("ACB") equal to its fair market value of $100,000 at that time. It is assumed that for Portuguese tax purposes, Maria is considered to have a tax cost base of $100,000 as well.

Scenario 1 — Sale of Algarve Property

If Maria were to sell the Algarve Property, both Portugal and Canada would have an opportunity to tax the capital gain of $1,000,000 that will be realized on the sale.[3] However, pursuant to Article 13(1) of the Canada-Portugal Tax Treaty,[4] the first right to tax capital gains realized on certain immovable property, including real property, is provided to the country where the immovable is located.[5] Accordingly, since the Algarve Property is located in Portugal, Portugal would have the first right to tax the capital gains realized on the sale of the Algarve Property.

We understand that the capital gains tax in Portugal would be $280,000, being 28% of the $1,000,000 capital gain, leaving Maria with $720,000 to spend.[6]

Although Maria will also be taxable in Canada on the Algarve Property capital gain, to minimize incidents of "double taxation", Canada's income tax system has been designed so that, with respect to certain foreign income and gains, such as gains on dispositions of Foreign Real Property, Canada will provide a Canadian taxpayer with a foreign tax credit to offset taxes paid to a foreign government.[7] The result of the Canadian foreign tax credit system is that a Canadian taxpayer *should* only be required to pay tax on income or gains that qualify for a foreign tax credit at the higher of the tax rates of Canada and the foreign jurisdiction.

For convenience, let's assume that the combined effective Canadian federal and provincial tax rate applicable to capital gains realized by Maria in respect of the Algarve Property is 25%. Because the combined Canadian capital gains taxes will be less than the Portuguese capital gains taxes paid (see calculation above), Maria should be eligible to claim a foreign tax credit for the full amount of Portuguese tax paid by her, with the result that no Canadian tax should be payable by her on the Canadian capital gain.

Scenario 2 — Death of Maria Followed by Sale of the Algarve Property

If instead of selling the Algarve Property while she was alive, Maria was to have died and then her estate sold the Algarve Property, very different tax results would have arisen than those set out in Scenario 1.

These different tax results will arise due to the fact that, while Canada deems:

(1) capital property of a decedent to be disposed of immediately prior to death at the FMV of the capital property which will cause unrealized gains and losses to become realized for Canadian income and capital gains tax purposes; and

(2) the estate of a decedent to have acquired the decedent's capital property at its FMV for purposes of determining the ACB of the capital property transmitted to the estate,[8]

there are no similar deemed disposition rules that apply on the death of an individual in Portugal.

As a result, even though the Canadian capital gains tax was already paid, on a subsequent sale, Portuguese capital gains tax will be payable by Maria's estate or her heirs, as the case may be, since the original cost base of the Algarve Property for Portuguese capital gains tax purposes will not be increased on the death of Maria.

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[3] Both Canada and Portugal have capital gains tax regimes. For simplicity, we have assumed both Canadian and Portuguese capital gains will be calculated by netting the current $1,100,000 fair market value ("FMV") of the Algarve Property against its $100,000 ACB.

Our choice of Portugal to illustrate a non-US international jurisdiction in this article is random. All Portuguese tax and legal matters should be reviewed with professionals qualified to practice in those disciplines in Portugal.

[4] *Convention Between the Government of Canada and the Government of the Portuguese Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, E103231 — CTS 2001 No. 27 ("Canada-Portugal Tax Treaty").

[5] Terms similar to Article 13 of the Canada-Portugal Tax Treaty are common in Canada's treaty network for tax treaties that include capital gains tax provisions.

[6] Dollar amounts ignore costs of sale, stamp taxes in Portugal, etc.

[7] Pursuant to subsection 126(1). The foreign tax credit will not be limited to 15% of the foreign income amount because subsection 20(11) and paragraph (*b*) of the definition of "non-business-income tax" in subsection 126(7) do not apply to a capital gain.

Please note that, based on general international principles Canadian residents will usually be able to claim a subsection 126(1) foreign tax credit with respect to capital gains tax paid in connection with dispositions of Foreign Real Property regardless of whether the Foreign Real Property is situated in a treaty or a non-treaty jurisdiction (see, for example the views of the Canada Revenue Agency as set out in paragraph 1.62 of Income Tax Folio S5-F2-C1).

[8] Pursuant to subsection 70(5).

Furthermore, recall that under both the Canada-Portugal Tax Treaty and general international principles,[9] Portugal has the first right to tax Portuguese real property, such as the Algarve Property. Therefore, if there is to be a solution to this double tax problem, it would be necessary for Maria's estate or her heirs, as the case may be, to look to the Canadian tax authorities for tax relief. Unfortunately, the Act currently contains no provisions to grant foreign tax credits or any other relief to Maria, her estate, or her heirs for tax paid in Portugal on a subsequent disposition of the Algarve Property.

Having now explained how taxation would apply in this scenario, let's illustrate these principles with Maria's facts in mind, but assume that both at the time of death and at the time of the actual sale of the Algarve Property, its FMV is $1,100,000.

Based on the prior example:

(1) upon Maria's death, it is assumed that a $1,000,000 Canadian capital gain will arise giving rise to combined Canadian taxes of $250,000; and

(2) if Maria's estate or heirs were to sell the Algarve property at some time in the future, a $1,000,000 Portuguese capital gain would be realized, giving rise to Portuguese taxes of $280,000.

As mentioned above, in this scenario, the Act provides no ability for Maria, her estate, or her heirs, as the case may be, to claim a foreign tax credit or any other relief in Canada against Portuguese taxes paid on this subsequent sale. As a result, nearly double the tax is payable in respect of the Algarve Property in this scenario than in Scenario 1. In particular, following the payment of total taxes of $530,000, from her original net FMV estate of $1,000,000, Maria's heirs will only be left with **$470,000** compared to the **$720,000** they would have inherited if Maria had died after selling the Algarve Property in Scenario 1.

Maria's situation, as described in this scenario, is likely to become a much more common one in the future. This is because many jurisdictions worldwide that have capital gains tax regimes do not tax unrealized capital gains on death, and more and more Canadians than ever before are inheriting or acquiring and dying with Foreign Real Property.

To our knowledge, there is no justification for such an inequitable tax result.

In fact, Parliament acknowledged the inequity in similar situations impacting both emigrating Canadians owning Foreign Real Property and beneficiaries of Canadian resident trusts that receive distributions of Foreign Real Property. As such, it statutorily fixed these inequities by enacting subsections 126(2.21) and 126(2.22), respectively.[10] In a nutshell, these two subsections allow a foreign tax credit deductible against tax payable on an individual's departure year Canadian tax return that is equal to the foreign taxes on a post-departure gain from a disposition of property, including Foreign Real Property, to the extent of the portion of the property gain that accrued while the individual was a Canadian resident.

The historical explanatory notes in respect of these provisions state, in part, that:

> Subsections 126(2.21) and (2.22) will apply, in most cases, only for taxes paid to countries with which Canada has a tax treaty. Exceptions are provided for taxes imposed by a foreign country on gains on real property situated in that country. *In keeping with the general international principle that the country in which real property is located has the first right to tax gains on that real property, Canada will always provide credit for such taxes*. Similarly, credit for those taxes will be available regardless whether Canada has a tax treaty with the particular country. (Emphasis added.)

In order to enable subsections 126(2.21) and 126(2.22) to operate outside of ordinary statutory limitation periods, consequential amendments were also made to subsection 152(6).

Scenario 3 — Emigration of Maria Followed by Sale of the Algarve Property

So, coming back to Maria, if she emigrated from Canada while still owning the Algarve Property, she would have been deemed to have disposed of the Algarve Property at its $1,100,000 FMV pursuant to paragraph 128.1(4)(*c*), giving rise

[9] *Supra*, footnote 5.

[10] Bill C-22; S.C. 2001, c. 17, s. 117, applicable to the 1996 and subsequent taxation years.

to Canadian deemed capital gains taxes of $250,000.[11]

Assume that some years following emigration, Maria sold the Algarve Property for $1,100,000. As was the case in Scenario 1 and Scenario 2, Portugal would still collect $280,000 in capital gains taxes. However, provided that Maria amends her emigration year personal Canadian tax return as permitted pursuant to the interaction of subsections 126(2.21) and 152(6), she would be able to claim a tax credit and generate a refund of the $250,000 of taxes she paid upon her emigration, thereby eliminating the otherwise inappropriate double taxation.[12]

Subsections 126(2.21) and (2.22) Roadmap for a Fix?

It is worth repeating the highlighted portion of the explanatory notes to subsections 126(2.21) and (2.22) above:

> *In keeping with the general international principle that the country in which real property is located has the first right to tax gains on that real property,* ***Canada will always provide credit for such taxes***. (Even more emphasis added.)

As illustrated by the example involving a sale of the Algarve Property in Scenario 2, this general international principle is currently inapplicable in the event of the death of a Canadian taxpayer such as Maria. Consequently, the Department of Finance's statement above (the "Statement of Principle") is untrue in a situation involving the death of a Canadian taxpayer.

If the Department of Finance can be convinced to find a way to apply the Statement of Principle in post-mortem situations, it shouldn't be difficult to use the roadmap in subsections 126(2.21) and (2.22) to create a similar exception to allow foreign tax credits to be applied against a decedent's terminal year tax return. However, because this new exception needs to apply to property vendors who are an estate or heirs of a decedent, it needs to be designed so that the triggering event for the foreign tax credit is based on the sale by a taxpayer other than the decedent.

Since the Act already contains subsection 164(6), a provision to allow tax pools realized by an estate to be retroactively applied against income reported in a decedent's terminal year tax return, one would think that it should be possible to create a similar rule to allow the foreign tax credits to be retroactively applied against taxes paid or payable by a decedent in accordance with the decedent's terminal year tax return.[13]

As is the case with subsections 126(2.21) and (2.22), consequential amendments should be made to subsection 152(6) to eliminate any time limit on the claim of foreign tax credits against the terminal year deemed disposition tax.[14]

Concluding Thoughts

It is our sincere desire that the Department of Finance will address these inequities by taking steps to amend the Act. Hopefully, the roadmap set out in this article can provide the Department of Finance with a pathway to do so. However, until the Act is amended to resolve this inequity, practitioners should advise their clients who hold property that is subject to foreign taxation, such as Foreign Real Property, of this potential cross-border post-mortem tax-planning pitfall.

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[11] Subject to Maria deferring this tax by posting security acceptable to the Minister of National Revenue and otherwise satisfying the provisions in subsection 220(4.5).

[12] As no interest will be refunded to Maria, the time value of money will still negatively impact Maria's financial situation.

[13] See subsection 164(6), which allows losses realized by an estate to be carried back and applied against income of a decedent in the terminal year tax return of a decedent.

[14] A limitation on time to claim the foreign tax credit would be contrary to the Statement of Principle. Although it is recognized that the ability to claim a subsection 164(6) deduction is currently time limited to the first taxation year of an estate, this time limitation has been the subject of much criticism by writers and legal scholars. Perhaps this is a good time to review the one-year time limitation in subsection 164(6) as well.

CURRENT ITEMS OF INTEREST

Reminder To Renew Access to CRA's Electronic Services

The CRA is reminding its EFILE registrants that they must renew their participation online to maintain their access in the coming year. The CRA conducts suitability screening each year before electronic filing applicants are permitted to electronically file income tax returns on behalf of their clients — this process may take up to 30 business days. If you do not pass the suitability screening process due to outstanding issues by January 28, 2023, you may encounter an interruption in electronic services. Therefore, the CRA is asking everyone to submit their renewals as early as possible to avoid unnecessary delays.

How To Renew

- Make an online request at canada.ca/efile.
- Click on the "EFILE Sign in" button located in the right side menu bar.
- To sign in, you will need your **current** EFILE number and **password**.
- Seconds after submitting your online renewal request, it will be validated and you will receive a confirmation page.
- The confirmation will include your **newly assigned password** and the EFILE Helpdesk responsible for your file.

Once you have successfully renewed your account, you must update your tax preparation software with your newly assigned password to ensure any future transmissions are successful.

Once your renewal request has undergone the suitability screening process, you will receive an email or letter to advise you of the result.

For further details go to www.canada.ca/en/revenue-agency/services/e-services/e-services-businesses/efile-electronic-filers/efile-news-program-updates.html.

Register for the CRA's Free Dedicated Telephone Service

The CRA offers a Dedicated Telephone Service for small and medium-sized income tax service providers across Canada. You can get free technical help simply by registering for this service.

The service connects you with experienced CRA officers from the Income Tax Rulings Directorate who will be able to help you interpret the provisions of the *Income Tax Act*. After reviewing your tax issue, the officers will carefully consider your question and then send you helpful information and guidance. You will generally receive this information within three business days, depending on the complexity of the tax issue. Officers are ready to assist you in both English and French.

While the Dedicated Telephone Service is a valuable technical resource to help resolve your interpretive tax issues, officers do not have access to individual taxpayers' accounts.

If you are interested in using this service, you are invited to fill out a registration form. Please visit the "Help for income tax service providers" webpage (www.canada.ca/en/revenue-agency/campaigns/dedicated-telephone-service.html) for further information about the service, including eligibility criteria and more details on how the service can help you.

CRA Workers To Vote on Whether To Strike

According to various Canadian news sources, more than 35,000 CRA workers, who are members of the Public Service Alliance of Canada and the Union of Taxation Employees ("PSAC-UTE"), will soon begin voting on whether to go on strike. The strike votes will be held between January 31 and April 7. Negotiations apparently broke down over demands for higher wages and remote work policies.

Interest Rates for First Calendar Quarter

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, 2023, to March 31, 2023. For income tax purposes the rates are as follows:

- The interest rate charged on overdue taxes, Canada Pension Plan contributions, and employment insurance premiums will be 8% (up from 7% in Q4 2022).
- The interest rate to be paid on corporate taxpayer overpayments will be 4% (up from 3% in Q4 2022).
- The interest rate to be paid on non-corporate taxpayer overpayments will be 6% (up from 5% in Q4 2022).
- The interest rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans will be 4% (up from 3% in Q4 2022).
- The interest rate for corporate taxpayers' pertinent loans or indebtedness will be 8.00% (up from 6.45% in Q4 2022).

Federal Budget Consultations Begin

The Government of Canada has launched its pre-budget consultations for Budget 2023. Canadians can participate by sharing their ideas at LetsTalkBudget2023.ca until February 10, 2023.

2023 Automobile Deduction Limits and Expense Benefit Rates for Businesses

The Department of Finance Canada announced the automobile income tax deduction limits and expense benefit rates that will apply in 2023.

The following changes to limits and rates will take effect as of January 1, 2023:

- The ceiling for capital cost allowances ("CCA") for Class 10.1 passenger vehicles will be increased from $34,000 to $36,000, before tax, in respect of vehicles (new and used) acquired on or after January 1, 2023.
- The ceiling for CCA for Class 54 zero-emission passenger vehicles will be increased from $59,000 to $61,000, before tax, in respect of vehicles (new and used) acquired on or after January 1, 2023.
- Deductible leasing costs will be increased from $900 to $950 per month, before tax, for new leases entered into on or after January 1, 2023.
- The limit on the deduction of tax-exempt allowances paid by employers to employees who use their personal vehicle for business purposes in the provinces will increase by seven cents to 68 cents per kilometre for the first 5,000 kilometres driven, and to 62 cents for each additional kilometre. For the territories, the limit will also increase by seven cents to 72 cents per kilometre for the first 5,000 kilometres driven, and to 66 cents for each additional kilometre.
- The general prescribed rate used to determine the taxable benefit of employees relating to the personal portion of automobile expenses paid by their employers will be increased by four cents to 33 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 be increased by four cents to 30 cents per kilometre.
- The maximum allowable interest deduction for new automobile loans of $300 per month will remain the same for 2023.

Taxpayer Relief Deadline for Requests Related To 2012

The CRA reminded taxpayers and registrants that they had until December 31, 2022, to make a taxpayer relief request related to the 2012 tax year or reporting period.

Taxpayers that want to ask for penalty or interest relief must send their request within ten years from the end of the calendar year or fiscal period of concern. The CRA may also cancel interest and penalties that accrued within 10 calendar years of the year the taxpayer relief request is made, regardless of the tax year or reporting period in which the debt originated.

The deadline applies to taxpayer relief requests for:

- the 2012 tax year;
- any reporting period that ended during the 2012 calendar year; and
- any interest and penalties that accrued during the 2012 calendar year for any tax year or reporting period.

If a taxpayer is involved in a tax process with the CRA, including an audit, objection, or appeal for the 2012 tax year, or a reporting period that ended in 2012, and they are unsure if they need to make a taxpayer relief request, the CRA recommends that they make a request before the December 31, 2022, deadline.

The taxpayer or their authorized representative can make a request to cancel penalties or interest online using the CRA My Account, My Business Account, or Represent a Client services by selecting "Request relief of penalties and interest" under "Related services".

They can also fill out Form RC4288, *Request for Taxpayer Relief — Cancel or Waive Penalties or Interest*, and send it:

- Online using My Account, My Business Account, or Represent a Client by selecting the "Submit documents" service; or
- By mail to the designated office, as shown on the last page of the form, based on the place of residence.

FOCUS ON CURRENT CASES

This is a regular monthly feature examining recent cases of special interest, coordinated by Ron Dueck of Dentons Canada LLP. The contributors to this feature are from Dentons Canada LLP, Montréal, Toronto, Calgary, Edmonton, and Vancouver.

Howard v. Canada (Attorney General), 2022 DTC 5121 (Federal Court) — Minister's Decision That Taxpayer's TFSA Over-Contribution Was Not a Reasonable Error and Taxpayer Failing To Remove Excess Contribution Without Delay Was Unreasonable

Background

The taxpayer (Ms. Howard) found herself afoul of the contribution limits applicable to her tax-free savings account ("TFSA") for the taxation years 2020 and 2021. As a result, the taxpayer was assessed tax on the excess TFSA amounts of $1,800.00, a penalty of $90.00, and arrears of interest of $5.18. In December 2019, the taxpayer had a guaranteed investment certificate ("GIC") coming due. A financial advisor at Scotiabank advised her to use the proceeds to purchase another GIC and deposit it into a TFSA. She followed that advice and contributed $63,500 to a TFSA and a further $6,000 in January 2020, when the contribution limit came available. The CRA sent the taxpayer a letter dated June 4, 2020 (the "Educational Letter"), informing her that she had over-contributed to her TFSA by $15,000, set out the action she was required to take, and outlined possible future consequences. Since travel during the pandemic was restricted, forcing the taxpayer to stay in the Dominican Republic from January 31, 2020, to June 25, 2021, she was unaware of the Educational Letter until she was able to return to her home in Prince Edward Island in July 2021.

Subsection 207.06(1) of the *Income Tax Act*, RSC 1985, c 1 (5th Supp) (the "ITA"), provides that the Minister of National Revenue (the "Minister") may waive all or part of the tax liability assessed on excess TFSA contributions if the

tax arose because of a "reasonable error" and the individual acted without delay to remove the excess contribution. By letter dated August 1, 2021, Ms. Howard requested relief from the taxes, interest, and penalties. The taxpayer's request for relief was denied on the basis that she failed to remove the excess contribution within a reasonable time frame. The taxpayer then requested an independent second review of the first decision, which review confirmed the first decision on the basis that the taxpayer failed to withdraw the excess contributions within a reasonable timeframe, and that the over-contribution was not made because of a reasonable error — stating that the erroneous advice of her financial advisor was a matter for her to resolve with her bank. The taxpayer applied for judicial review of the second independent decision.

Issues and Decision

The taxpayer challenged the decision on four grounds:

(1) the decision failed to address the fact that the taxpayer's delay in removing the excess contribution was due to her inability to return to Canada due to the pandemic and thus receive the Educational Letter,

(2) the decision failed to address or justify why the over-contribution was not a reasonable error,

(3) the rationale was not transparent as it lacked analysis and justification, and

(4) the decision affects the taxpayer's personal circumstances, yet failed to provide complete and thorough reasons.

The court stated that the applicable test governing the reasonableness of the Minister's decision was set out by the Supreme Court of Canada in *Canada (Minister of Citizenship and Immigration) v. Vavilov*, 2019 SCC 65 ("*Vavilov*"), at para 86, wherein the court stated that "Reasonableness, according to *Dunsmuir*, 'is concerned mostly with the existence of justification, transparency and intelligibility within the decision-making process', as well as 'with whether the decision falls within a range of possible, acceptable outcomes which are defensible in respect of the facts and law'".

Regarding the taxpayer's argument that the Minister failed to address her inability to receive the Educational Letter in a timely manner due to her being unable to return to Canada due to the pandemic, the court looked to *Vavilov*: "The principles of justification and transparency require that an administrative decision maker's reasons meaningfully account for the central issues and concerns raised by the parties" (para. 33). The court found that the taxpayer's inability to receive the Educational Letter was not due to her failing to update her address or not checking her email, and that the CRA failed to perform a meaningful analysis of this fact, thereby rendering the decision unreasonable.

Regarding the taxpayer's second argument that the decision failed to address why the taxpayer's error was not a reasonable error, the court found that the decision failed to analyze why, in the circumstances, the taxpayer's acting on the erroneous advice of her financial advisor did not amount to a reasonable error:

> Here, there is quite simply no chain of analysis at all. All the Court has to assess reasonableness is the conclusion that Ms. Howard's reliance on the advice of a financial advisor does not make the error a reasonable one. As *Vavilov* instructs, it is both the result and the reasoning that must be assessed for reasonableness. When that cannot be done, the decision is not reasonable and cannot stand. (para. 32)

The court further looked to *Connolly v. Canada (National Revenue)*, 2019 DTC 5071 (FCA), wherein the court considered whether third-party advice in respect of an over-contribution to a taxpayer's RRSP was a factor in determining whether a taxpayer had made a reasonable error under subsection 204.1(4). The court stated: "the fact that the error might have been made by a third-party advisor or as a result of erroneous advice given by such advisor does not automatically mean that the error cannot be reasonable."

Conclusion

The court thereby allowed the taxpayer's application and set aside the Minister's decision.

— *Charles Giroux*

Clarke v. Canada Revenue Agency, 2023 DTC 5006 (Federal Court) — Request To Cancel or Waive Penalties and Interest; Accuracy of a Reassessment Cannot Be Addressed on Judicial Review

Background

The taxpayer (Ms. Clarke) submitted a request to the CRA to cancel or waive the penalties and interest with respect to her income tax arrears for the 2010–2015 taxation years (the "First Level Review"). Under subsection 220(3.1) of the *Income Tax Act* (the "ITA"), the Minister has discretion to waive or cancel all or any portion of any penalty or interest otherwise payable. The taxpayer's request was based on alleged CRA error, alleged CRA delay, financial hardship and inability to pay, and her medical conditions. The CRA partially granted the taxpayer's request of the arrears interest assessed in respect of the taxpayer's 2010 and 2011 taxation years. Subsequently, the taxpayer submitted a second level request for relief of late-filing fees, penalties, and interest for her 2012–2016 taxation years (the "Second Level Review"). In a decision, the CRA team leader of the appeals branch of the Taxpayer Relief Centre of Expertise who considered the Second Level Review (the "CRA Appeals Team Leader") agreed to partially grant arrears interest relief due to the taxpayer's medical circumstances and due to CRA processing delays. The CRA Appeals Team Leader found that further relief was not warranted, finding that the taxpayer had sufficient household income to pay the CRA balance owing without causing undue hardship. They also noted that it was beyond the scope of the taxpayer relief provisions to adjust the reassessment.

Issues and Decision

The issue on judicial review was the CRA Appeals Team Leader's determination to only partially grant relief from the interest in the 2010–2011 taxation years and to not grant further relief as the taxpayer requested. The Court applied the reasonableness standard of review set out in *Canada (Minister of Citizenship and Immigration) v. Vavilov*, 2019 SCC 65 ("*Vavilov*").

The taxpayer challenged the Minister's relief determination on two grounds: CRA error and CRA delay.

Regarding the taxpayer's assertion that the CRA had erred in its reassessment, the taxpayer asserted that the relief afforded to her husband should equally apply to her. Following the taxpayer and her husband's appeal of their 2010 and 2011 assessments to the Tax Court of Canada (the "TCC"), the parties reached a settlement agreement. The judgments were identical for the taxpayer's case and her husband's case. The TCC allowed the appeal of the 2011 taxation year and referred the reassessment back to the CRA for reconsideration and reassessment. It is this reassessment with which the taxpayer took issue. The taxpayer argued that the CRA removed interest and penalties from her husband's account but not from hers. In her view, this is an error based on her legitimate expectation that the files would be treated the same way. The taxpayer argued that the CRA "failed in their re-assessment to credit the pre-assessed interest and penalties not owed to the Crown on [her] file in error." However, the court found that the taxpayer's primary request on judicial review amounted to a request for the court to review the CRA's reassessment amount. The court ruled that it did not have jurisdiction to address the accuracy of the reassessment, and that the taxpayer's complaint was not simply identifying a processing error, but would require the Court to determine whether the reassessment was accurate.

Regarding the taxpayer's assertion that the CRA had caused numerous delays that justified relief, the court found that the taxpayer failed to identify with specificity the time periods that related to the CRA's actions that caused the delay. Moreover, the Minister had acknowledged the delays caused by the CRA and granted relief based on these delays, and the taxpayer failed to identify any material shortcomings of the Minister's analysis.

Conclusion

The application for judicial review was dismissed. The Federal Court found it did not have jurisdiction to address the accuracy of a reassessment on judicial review.

— *David Blain*

Christen v. Canada Revenue Agency, 2022 FCA 65 (Federal Court of Appeal) — Motion Record Regarding the Content of the Appeal Book Under the *Federal Courts Rules*

Background

The taxpayer (Ms. Christen) submitted a motion record to the Court regarding the contents of the appeal book. Paragraph 364(2)(*c*) of the *Federal Courts Rules*, S.O.R./98-106 (the "Rules") requires that a motion record contain "all affidavits and other material served by the moving party for use on the motion", but nothing prohibits the moving party from filing a motion record that does not rely on an affidavit. The Registry did not file said motion record because it did not contain an affidavit. The Registry instead sent the taxpayer to the Court for direction.

Issues and Decision

The issue in the motion was the inclusion of four documents in the appeal book. The four documents on which the parties disagreed were among the documents filed with the Federal Court in the matter under appeal; none of the documents were in the record that was before the judge who rendered the decision under appeal. Subsection 343(2) of the Rules requires that "[t]he parties shall include in an appeal book only such documents, exhibits and transcripts as are required to dispose of the issues on appeal." The parties agreed that the general rule is that an appeal book only contains documents that were in the record before the Federal Court. Exceptions to the general rule are rare. The four documents in question were:

- Two motion records concerning a motion by the Canada Revenue Agency (the "CRA") with respect to a judgment and a motion by the taxpayer concerning objections to questions asked during a cross-examination — both motions were dismissed;
- An affidavit from the taxpayer — the taxpayer filed a motion with the Federal Court to add this affidavit to the record, but then withdrew it; and
- A response from the CRA to a motion letter by the taxpayer.

In terms of the two motion records, the taxpayer argued that they were among the documents filed before the Federal Court, but the CRA noted that they were not brought to the attention of the judge. The Court was not convinced that the motion records in question were necessary to the resolution of the issues in dispute in the appeal. However, the decisions that dismissed those two motions were to be part of the appeal book.

As regards the taxpayer's affidavit, the taxpayer stated that this document would help the Court assess her arguments with respect to the issues (i) of the reasonable apprehension of bias with respect to the CRA's Voluntary Disclosures Program (the "Program"), and (ii) of the costs before the Federal Court. However, the Court found that the taxpayer failed to sufficiently support these assertions. Conversely, the CRA relied on the fact that the taxpayer's affidavit was not part of the record before the judge and that the taxpayer withdrew her motion to add it to that record. The CRA also noted that the judge's refusal to consider the affidavit in question was not challenged in the notice of appeal. The Court accepted the arguments of the CRA and concluded that the taxpayer's affidavit was not necessary to the resolution of the issues in dispute in this appeal.

With respect to the response to the motion letter, the taxpayer stated that, as in the case of her affidavit, the document would help the Court assess her arguments concerning the reasonable apprehension of bias in relation to the Program. However, the Court again found that the taxpayer failed to sufficiently support these assertions. The Court was not convinced that this document was necessary to the resolution of the issues in dispute in the appeal.

Conclusion

The Court excluded the four documents in question from the appeal book.

— *David Blain*

Brown v. Canada, 2022 DTC 5117 (Federal Court of Appeal) — A Personal Reason for Conducting an Activity Does Not, In Itself, Result in a Personal or Hobby Element to the Activity

Background

The appellant, Mr. Brown, and his wife, Mrs. Brown, formed a numbered company to operate an art gallery (the "Gallery"). Mrs. Brown and Mr. Ahmadov, a family friend, conducted extensive market research and determined there was a niche for the Gallery in Toronto, although it would take five years and considerable investment to break even. Mr. Brown did not participate in the research.

In the fall of 2009, Mr. Brown secured financing for the Gallery from Rotveil Technologies, the principal of which was Mrs. Brown's brother. Upon opening in April 2010, the Gallery received a warm reception from the art community. At that time, Mr. Brown was working as a lawyer and provided the Gallery with some managerial and administrative services.

In September 2010, Mrs. Brown became unable to perform her managerial duties as a result of illness and pregnancy. At the beginning of 2011, the Gallery's expenses were higher than its revenue and Rotveil Technologies stopped providing funding on an ongoing basis. Accordingly, Mr. Brown entered into an agreement with the numbered company pursuant to which he would provide management services to the Gallery in exchange for an annual management fee equal to 20% of the Gallery's annual revenues in excess of $100,000 per year. The Gallery never had enough revenue to trigger a payment to Mr. Brown.

Mr. Brown claimed non-capital losses in his 2011, 2012, and 2013 taxation years in respect of expenditures made on behalf of the Gallery. The Minister of National Revenue (the "Minister") disallowed the losses on the basis that his management services activity was not a source of income. Mr. Brown appealed the reassessments to the Tax Court of Canada ("Tax Court").

Issues and Tax Court Decision

The issues before the Tax Court were:

(1) Did Mr. Brown have a source of business income pursuant to section 9 of the *Income Tax Act* ("ITA")?

(2) Were the business expenses claimed incurred for the purpose of gaining or producing income from a business and deductible pursuant to paragraph 18(1)(*a*) of the ITA?

(3) Were the business expenses reasonable pursuant to section 67 of the ITA?

The Tax Court set out the two-stage approach to determine whether a taxpayer has a source of income from business or property from *Stewart v. Canada*, 2002 DTC 6969 (SCC) (the "*Stewart* Test"):

(1) Is the activity of the taxpayer undertaken in pursuit of profit, or is it a personal endeavour?

(2) If it is not a personal endeavour, is the source of the income a business or property?

The Tax Court found that, since Mr. Brown only began providing management services to the Gallery because his wife became ill and pregnant, there was a personal element to the activity. Having found that there was a personal element, the Tax Court went on to determine whether Mr. Brown provided management services in a sufficiently commercial manner for the activity to constitute a source of business income. This involved determining whether Mr. Brown's predominant intention was to make a profit from the activity and whether he provided management services in accordance with objective standards of businesslike behaviour.

The Tax Court concluded that Mr. Brown's intention was not to make a profit, but rather to provide services to help Mrs. Brown and to offload the Gallery's expenses to himself, so that it could stay in operation until its revenues were sufficient to pay its expenses.

Having determined that Mr. Brown did not have a source of business income, the Tax Court did not consider the deductibility or reasonableness of the business expenses. The Tax Court dismissed the appeal.

Federal Court of Appeal Decision

Mr. Brown appealed to the Federal Court of Appeal ("FCA"). The issue before the FCA was whether the Tax Court erred in finding that there was a personal element to Mr. Brown's management services activity.

The FCA cited its decision in *Canada v. Paletta Estate*, 2022 DTC 5057, where it confirmed that even where there is no suggestion of a hobby or personal element to the activity, the activity still needs to be carried out in pursuit of profit to be a source of income. It rephrased the *Stewart* Test as follows:

- Is there a personal or hobby element to the activity in question?
- If yes, is the activity being carried out in a commercially sufficient manner to constitute a source of income?
- If there is no personal or hobby element to the activity, is the activity being undertaken in pursuit of profit?

Personal or Hobby Element

The FCA found that the Tax Court erred in its application of the *Stewart* Test by focusing on "Mr. Brown's personal reasons for providing the management services . . . rather than focusing on the activity itself." The FCA analogized to family businesses: when a child takes over an endeavour as a result of their parents' inability to continue, it should not result in a finding that there is a personal element to the endeavour. Similarly, Mr. Brown's decision to provide the management services as a result of his wife's inability to continue to manage the Gallery did not mean that there was a personal or hobby element to his management services activity.

Accordingly, the Tax Court erred in finding that there was a personal element to Mr. Brown's management services activity simply because he undertook the activity as a result of his spouse's inability to continue to manage the Gallery. Since there was otherwise no basis to find that there was any personal or hobby element to the activity, the FCA held that Mr. Brown had a source of income, provided that he was pursuing profit.

Pursuit of Profit

The FCA found that the Tax Court erroneously evaluated expectation of profit rather than intention to profit. The presence of a personal element in an activity will trigger the inquiry into the predominant intention of the taxpayer. However, since the FCA determined there was no personal element to Mr. Brown's activity, the appropriate question was whether Mr. Brown was pursuing profit, not whether he had a reasonable expectation of profit or whether a different business model could have been chosen.

The Crown argued that Mr. Brown did not intend to profit because the arrangement between him and the Gallery did not include a direct reimbursement of the expenses Mr. Brown was claiming. The FCA disagreed, noting that the absence of such a provision in the arrangement does not necessarily lead to the conclusion that Mr. Brown was not pursuing profit.

The FCA concluded that Mr. Brown was pursuing profit. By providing services that allowed the Gallery to continue to operate until it could generate sufficient revenue to cover its expenses, Mr. Brown's intention was to allow the Gallery to generate revenue which, in turn, would generate profit for him.

Conclusion

The FCA allowed the appeal. Because the questions of whether the expenses were deductible and reasonable was not addressed by the Tax Court, the FCA referred the matter back to the Tax Court to determine the amount of the non-capital losses.

— *Caroline Harrell*

1410109 Ontario Ltd. v. The King, 2022 DTC 1096 (Tax Court of Canada) — Gratuity Was Subject To HST Where It Was Non-Negotiable and Pre-Calculated

Background

1410109 Ontario Ltd. (the "Appellant") operated a banquet hall in St. Jacobs, Ontario that hosted weddings and other events. To book an event at the banquet hall, patrons were required to sign a deposit and function contract (the "Contract"). The Contract stated "All Pricing is Subject to 13% HST and 15% Gratuities". One-half of the gratuities were divided among the service staff and the remaining half was split between the chef and the manager. In the event that a patron was dissatisfied with the event, the Appellant resolved the matter with a price reduction of one of the items in the services or food categories, but never the gratuity. On invoices, the Appellant calculated HST on a sub-total of charges that excluded the 15% gratuity.

The Minister assessed the Appellant under the *Excise Tax Act* (the "ETA") for uncollected HST on the basis that HST should have been charged on the 15% gratuity. The Appellant appealed the assessment.

Issue and Decision

The issue before the Tax Court was whether the gratuity was a taxable supply of services under the ETA. Section 165 of the ETA mandates that HST is payable on all supplies of taxable services, subject to certain exceptions. Section 133 of the ETA provides that agreements entered into to provide property or a service are deemed to be a supply of the property or service. Further, section 138 of the ETA deems incidental property or services, supplied together with any other property or service for a single consideration, to be part of the property or service supply.

The Appellant's position was that the gratuity was not a service incidental to the supply because all the services were accounted for in the description of services under the Contract. Thus, the gratuity was not in exchange for any service and was therefore not part of the consideration. Instead, the gratuity was a customary gift from the patrons directly to the staff and the Appellant was simply a facilitator.

The Minister's position was that the gratuity was incidental to and part of the consideration paid for a taxable supply. The Minister highlighted the fact that the gratuity was mandatory, never negotiated or varied, and always paid with the balance of the Contract price.

The Tax Court considered whether the gratuity was obligatory or voluntary. In the United Kingdom, voluntary gratuities are not subject to sales tax (see *NDP Co Ltd. v. Customs and Excise Commissioners*, [1988] VATTR 40) but mandatory gratuities are (see *Potters Lodge Restaurant Ltd. v. Commissioners of Customs & Excise Commissioners*, LON/79/286, No 905 (UK)). The Tax Court outlined that this principle is reflected in the ETA. The ETA defines "consideration" as "any amount that is payable for a supply by operation of law". Thus, while a mandatory gratuity is enforceable by operation of contract law and is therefore "consideration" under the ETA, a voluntary gratuity is not.

The Tax Court then commented on the policy implications of having certain gratuities taxable and others not. Taxing all gratuities would require even cash gratuities to be inclusive of HST and would result in staff paying HST without a way to claim input tax credits. Alternatively, only taxing certain gratuities violates the principle of fiscal neutrality and, in the context of restaurants, results in "operators offering the same service, for the same total price, [finding] themselves having to pay different sums of [sales tax] depending on whether or not they indicate on their bills they are applying a services charge . . . even though the service provided and the consideration given for it are absolutely identical". In light of these considerations, the Tax Court concluded that a distinction in the treatment of mandatory and voluntary gratuities is necessary.

Conclusion

The Tax Court dismissed the appeal and held that the gratuity in question was subject to HST as it was "non-negotiable, pre-calculated and arithmetically correlative to the taxable services". The Tax Court emphasized that the independent payment of a cash tip directly to a server is distinct from the facts of this appeal.

— *Anthony Berlingieri*

David Donaldson v. The King, 2022 DTC 1115 (Tax Court of Canada) — In Times of Financial Crisis, Tax Remittances Are Still Required

Background

Mr. David Donaldson (the "Appellant") was in the business of restructuring corporations. In June of 2006, the Appellant became the Director and Chief Executive Officer of Robyn's Transportation and Distributions Services Ltd. (the "Company"). In June 2010, the Company lost its most important client, resulting in a cash flow crisis. To remain solvent, the Company was forced to fire junior employees, reduce salaries, close truck terminals, sell trailers, and factor accounts receivables. The Appellant, as the strategic decision maker of the Company, prioritized payments to employees, creditors, and service providers instead of remitting net tax, under subsection 323(1) of the *Excise Tax Act* (the "ETA"), and source deductions, under subsection 227.1(1) of the *Income Tax Act* (the "ITA").

For 13 reporting periods, the Appellant failed to remit net tax under the ETA. Similarly, while the Appellant occasionally remitted source deductions, he failed to make remittances for 25 reporting periods under the ITA. The Appellant held regular meetings with the CRA to discuss the arrears of source deductions and attempt to restructure payments. Ultimately, the Appellant was assessed for $122,525.43 (reduced from $150,684.86) under subsection 323(1) of the ETA and $874,446.87 under subsection 227.1(1) of the ITA. The Appellant appealed, arguing the due-diligence defences under subsections 323(3) of the ETA and 227.1(3) of the ITA respectively.

Issues and Decision

Under subsections 323(3) of the ETA and 227.1(3) of the ITA, a director is not liable for the corporation's failure to remit net tax (or source deductions) if the director exercised the "degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances". The issue at the Tax Court of Canada (the "Tax Court") was whether the Appellant met these due-diligence defences.

The Appellant did not argue that he was not liable for the net tax under subsection 323(3) of the ETA. However, the Appellant did argue that: (1) meeting regularly with the CRA to discuss the arrears of source deductions and (2) signing eight source deduction cheques that were to be delivered to the CRA, demonstrated that he was not liable for the source deductions as he exercised the requisite "degree of care, diligence and skill" under subsection 227.1(3).

The Tax Court rejected both arguments. The Tax Court cited *Tozer v. the Queen*, 2018 GTC 5 (TCC), and noted that even in times of serious financial difficulties, corrective measures do not absolve the taxpayer from taking preventative measures. Correcting missed payments of source deductions does not constitute due diligence to prevent the failure to remit those amounts. Thus, the Tax Court concluded that meeting with the CRA did not amount to due diligence.

Turning to the eight source deduction cheques, the Appellant argued that signing each cheque was evidence of due diligence. The eight cheques in question were ultimately never sent to the CRA as they were never countersigned by a second authorized individual. The Appellant signed the cheques, provided them to payroll, and assumed they were countersigned and delivered to the CRA. The Appellant did not conduct any follow-up inquiries. The Tax Court concluded that this course of conduct amounted to negligence, not due diligence, citing *Fengos v. The Queen*, 2014 GTC 71 (TCC), which stated that a "reasonably prudent person is not a person who does not ask questions and who never tries to find out what is happening with regard to remitting net tax".

Conclusion

The Tax Court held that the Appellant did not exercise the degree of care, diligence, and skill to prevent the Company's remittance failures as a reasonably prudent person would in comparable circumstances. The Tax Court referred to the *Canada v. Buckingham*, 2011 DTC 5078 (FCA), decision which states "a director of a corporation cannot justify a defence under the terms of subsection 227.1(3) . . . where he condones the continued operation of the corporation by diverting employee source deductions to other purposes." Finding that the Appellant did not meet the requirements of the due-diligence defence, the appeal under subsection 227.1(1) of the ITA was dismissed in part, while the appeal under subsection 323(1) of the ETA was allowed, in order for the Minister of National Revenue to make the agreed-upon amount adjustment.

Donaldson demonstrates that even when a company faces a financial crisis, it is still required to remit its net tax and source deductions in accordance with the ETA and ITA respectively. To meet the due-diligence defences under subsections 323(1) of the ETA and 227.1(3) of the ITA, preventative measures, rather than corrective ones, should be taken.

— *Anthony Berlingieri*

RECENT CASES

Appeal Partly Allowed Regarding Sales of Properties

The Appellant appealed assessments for three taxation years (2011, 2015, and 2016) on four real properties she owned at various times. The 2011 assessment was beyond the normal reassessment period. The CRA also imposed false statement penalties under section 163.2 of the *Income Tax Act* (the "ITA"). The Appellant had a turbulent, indeed abusive, marriage, and the first property (154 Cortleigh) served the Appellant as a refuge. She claimed it as her principal residence. When it was sold, the CRA asserted that the sale was in the nature of trade and therefore business income. As to the second and third properties (16 and 18 Linda Lane), the Appellant argued that she should get some credit for using a real estate agent in their sale. The issue with the fourth property (109 Lio) was that the Appellant claimed it as her principal residence after she sold the first property, but did not submit the required designation of principal residence forms (T-2019 and T-2092).

The Tax Court allowed the appeal in certain respects and remanded the matter to the CRA. With respect to 154 Cortleigh, the CRA maintained that its sale by the Appellant was in the nature of trade. The Court noted that she used the property intermittently as a refuge from her abusive marriage, and the sales of all her properties were "objectively rooted" in that situation. Thus, she met none of the criteria for a seller in the nature of trade — most importantly, in the Court's view, the circumstances that led to the sales. The property was on account of capital, but was not the Appellant's principal residence. As far as the Appellant maintained that it was, which would entitle her to the principal residence exemption, she offered no documents or evidence, leading the Court to hold that the CRA could reopen the time-barred 2011 year. Finally, the Court held that, though the Appellant was clearly unfamiliar with the ways of business and tax, she did not act with indifference to compliance with the law, so the section 163.2 penalties were deleted. With respect to the Linda Lane properties, the issue was whether the Appellant was entitled to real estate commissions as she argued. The Court reviewed the numbers and noted there was no such commission in the CRA's calculation of proceeds and expenses. Characterizing the commission as an "essential omitted expense", the Court held that even without invoices, credit needed to be given for this amount. With respect to 109 Lio, the issue was that under section 54 of the ITA, two properties can't be one person's/family unit's principal residence, and the Appellant's husband had designated a different property in 2012 and 2013. The Court held that after their divorce the Appellant and her ex-spouse could designate different principal residences. The Appellant failed to submit a T-2019, but under certain circumstances the CRA could accept a late filing per paragraph 220(3.21)(*a*.1).

Nicosia v. The King

2022 DTC 1101

CRA Decision To Suspend Taxpayer's EFILE Privileges Violated *Vavilov* Intelligibility Requirement

Subsection 150.1(2) of the *Income Tax Act* authorizes taxpayers to file their returns electronically (under the so-called EFILE program) if they meet criteria specified by the CRA. After monitoring the Applicant's account since November 2019, the CRA suspended her from EFILE in March 2022. The Applicant sought judicial review, arguing that the decision contained in the CRA's suspension letter was not intelligible or transparent under *Vavilov*.

The Federal Court agreed and remanded the decision to a different CRA officer. Throughout its dealings with the Applicant, the CRA referred to the so-called Criterion 13, which disqualifies applicants from using EFILE if they have "engaged in fraud, dishonesty, breach of trust or other conduct of a disreputable nature." There was evidence the Applicant processed EFILE applications for persons who were specifically excluded from participation ("Excluded Taxpayers"), circumventing an address requirement by using the "care of" indication. The CRA's March 2022 decision letter was clear that the basis of the decision was the Applicant's continuing to e-file returns for Excluded Taxpayers, violating Criterion 13. However, in its submissions the Respondent took the position that the case did not turn on the application of Criterion 13; instead, the Respondent's position was based on the list of Excluded Taxpayers on the CRA website. In the Respondent's view, Criterion 13 had only to do with the manner in which the Applicant e-filed the returns (the "care of" indication); the CRA list was a list of Excluded Taxpayers, which the Respondent took to be criteria "specified in writing by the Minister" pursuant to subsection 150.1(2). However, from the initial suspension of the Applicant to the March 2022 decision letter, the record was clear that the Respondent's analysis relied on Criterion 13. The Respondent's insistence now that Criterion 13 was not implicated in its decision itself raised questions about the intelligibility and transparency of the decision. The decision contained no analysis of how the Applicant's conduct fell under Criterion 13; since Criterion 13 discusses varying kinds of conduct, it was unclear which ones the Respondent was relying on to claim that it addressed the Applicant's conduct.

Virgen v. Canada (AG)

2022 DTC 5112

Tax Court Rebuffs CRA Attempt To Claw Back Pass-Through Renunciation

The Appellant challenged a 2015 reassessment of his 2011 taxation year that disallowed $215,129 of a previously allowed $252,000 deduction for renounced Canadian Exploration Expenses. The Appellant and the CRA agreed that the reassessment was beyond the normal three-year period. The CRA argued that the reassessment was timely under subparagraph 152(4)(*b*)(v) of the *Income Tax Act*. Subsection 66(12.73) states that if a corporation purports to renounce an excess amount, "the corporation shall file a statement with the Minister." Subparagraph 152(4)(*b*)(v) gives the CRA the power to reopen an assessment later than three years if it is made as a consequence of a reduction under subsection 66(12.73). The Appellant argued that the reassessment was not made pursuant to subsection 66(12.73) because it requires the corporation to file a statement (Form T101B) with the Minister ("shall file") that had never been filed. The Respondent maintained that the Appellant's non-filing was "functionally" the same as if it had filed with incorrect amounts.

The Tax Court allowed the appeal. It noted that subsection 66(12.73) did not contain a provision for what happens when the statement is not filed, as happened here. Thus, it engaged in a textual, contextual, and purposive analysis that found reading the section contextually, subsections 163(2.21) and (2.22), penalty provisions cited by the Appellant, did not apply (but by containing the phrase "fails to file a document" showed Parliament could expressly convey its intent, as it did not do here), and that the current version of subsection 66(12.73) eliminated the situation where no statement was filed. Thus, the CRA's reduction failed; because subsection 66(12.73) did not apply, neither did subparagraph 152(4)(*b*)(v).

Wallster v. The King

2022 DTC 1090

Interest Due On Deficient Tax Instalments

Mr. and Mrs. Gagnon are spouses of each other. During the 2019 taxation year, they both paid quarterly tax instalments against estimated income taxes owing on the balance due date April 30, 2020. At the direction of Mr. Gagnon, their holding company declared a dividend in the amount of $600,000 on November 25, 2019, to be paid before December 15, 2019. The result was a recorded dividend of $300,000 each for Mr. and Mrs. Gagnon from and after November 25, 2019. Once the incremental income became known and was paid, the final instalment more than

exceeded all tax liability payable on the balance due date or as advised within the Gagnons' August 2019 instalment reminder. The Minister stated that they under-remitted instalments on the 15th of March, June, and September 2019, and reassessed Mr. and Mrs. Gagnon arrears interest, and also assessed Mr. Gagnon a penalty. The Gagnons appealed, arguing the dividend was not anticipated before the budget chatter in November 2019 concerning the possible alteration of tax treatment of Canadian dividend income. They argue that no interest for arrears should be applied to the amounts owing for the March, June, and September instalments because when those quarterly payments were made, they did not expect to incur a sudden influx of income later in the year. Therefore, it would have been impossible to make instalment payments based on unknown future information.

The appeals were dismissed. If a taxpayer calculates tax liability and remits according to those amounts, and is wrong, interest is due on the deficiency. An insufficient instalment will bear interest to the extent of deficiency. The Gagnons were not asked to do the impossible here. Mr. Gagnon made a deliberate choice to declare the dividend. It was entirely within his control and was neither unavoidable nor extraneously circumstantial. The law does not accommodate a precautionary step in a tax plan, rendered moot by a legislative path not taken. Mr. Gagnon was simply wrong in his prognosis. Parliament did not alter the regime concerning Canadian dividend income on the date anticipated. If it had, Mr. Gagnon would have been correct, his wager paid, and the arrears interest and penalty likely a small price to pay for the return. Taxpayer-authored action born of prediction is not an unforeseen and indiscernible event, just an event which may never happen. The arrears interest and penalty are the costs of that avoidable choice reflecting a deliberate, methodical, provisional, and ultimately unnecessary advance of divided income.

Gagnon et al. v. The King

2022 DTC 1095

Appellant Entitled To Deduct Employment Expenses Under Paragraph 8(1)(*H*)

The Appellant is an industrial engineer who resides in Lakehurst, Ontario with his wife and children. He works at Savage Canada as a Vice President/General Manager. Savage Canada's office and headquarters are located in Lakefield, Ontario. During his employment with Savage Canada, the Appellant's regular place of employment was at Savage Canada's headquarters. The other company in issue, Savage USA, is located in Westfield, Massachusetts. In 2017, Savage Canada asked the Appellant to take on the role of Senior Director of Manufacturing for Savage USA. He performed these additional duties from August 2017 until April 2019. The Appellant was required to spend two to three weeks every month at the Savage USA office in Westfield, Massachusetts, which was approximately an eight-hour drive from the Appellant's home. When he was not working at Savage USA, the Appellant continued his duties with Savage Canada at his regular place of employment in Lakefield, Ontario. The Appellant signed an addendum to his employment contract; the employment contract, as well as the addendum, was between Savage Canada and the Appellant. The Appellant never signed a contract with Savage USA. The addendum sets out that this was an acting position with Savage USA; that the Appellant was responsible for costs related to food, beverage, entertainment, and travel to the Savage USA work site; and the Appellant was to continue his duties and responsibilities with Savage Canada and assume numerous new duties and responsibilities with Savage USA. The Appellant paid lodging, food, and other travel expenses in order to perform his duties for Savage USA. Neither Savage Canada nor Savage USA reimbursed him for these expenses. The Appellant claimed expenses under paragraph 8(1)(*h*) of the *Income Tax Act*. The Respondent denied his claims, leading to this appeal.

The appeals were allowed. Section 8 allows for deductions from income from office or employment. Pursuant to subsection 8(2), expenses not specifically listed under subsection 8(1) are not deductible from employment income. Subsection 8(1) allows for a long list of specific deductions, including travel expenses. An employee can claim a deduction if, among other requirements, the employee was "ordinarily required" to work away from the "employer's place of business or in different places". From August 2017 to April 2019, the Appellant was required to carry on his duties of employment away from his usual place of business. His employer was at all times Savage Canada. Savage Canada paid the Appellant his salary, and the Appellant performed duties for Savage USA at Savage Canada's request. The Appellant was never employed by Savage USA, which is a separate entity from Savage Canada. It was to the

benefit of Savage Canada that the Appellant improved operations at Savage USA. Therefore, in both years before the Court, the Appellant was ordinarily required to carry on the duties of his employment away from his employer's place of business in Canada. Therefore, the Appellant qualifies under the criteria set out in paragraph 8(1)(*h*), and he properly claimed $23,599 and $10,791.28 of employment expenses as deductions in 2017 and 2019, respectively. Under subsection 253(1) of the *Excise Tax Act*, the Appellant was also entitled to a GST rebate of $2,702 for the 2017 taxation year due to the deductibility of the employment expenses under the *Income Tax Act*.

McCullough v. The King

2022 DTC 1092

TAX NOTES

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