Tax Notes

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Wolters Kluwer

T1 CHANGES FOR THE 2019 TAX YEAR

— Maureen Vance, CPA, CA, Tax Software Consultant, Wolters Kluwer

Every T1 season brings a new set of changes to the T1 form and schedules. In most cases, these changes are the result of legislative changes — for example, the introduction of pension income splitting starting in 2007. Other modifications are more administrative in nature — the result of the CRA changing their processes or services.

For example, last tax season the CRA converted Schedule 4, *Statement of Investment Income*, to a calculation worksheet. They also eliminated Schedule 12, *Home Accessibility Expenses*, and instructed taxpayers to simply enter the amount of the allowable credit on line 398 of Schedule 1.

In addition, the CRA has tweaked form T183, *Information Return for Electronic Filing of an Individual's Income Tax and Benefit Return*, each year for the past three tax seasons.

This year, their administrative changes have reached a whole new level, as the T1 and supporting schedules have been renumbered. In addition, Schedule 1 has been integrated into the T1 return, the T183 has been changed yet again, and we have significant changes to requesting authorization to represent a client.

These changes have meant a lot of scrambling on the part of the tax software developers to update not only the forms, but also the diagnostics and program help. Similarly, research products, such as *Preparing Your Income Tax Returns*, had to be updated for all of these changes. And tax preparation and accounting firms had to update their own internal documentation to reflect the revised T1.

New Numbering of Federal Lines

Keying fields on the return and on all federal, provincial, and territorial schedules and forms have been renumbered for the 2019 tax year. The CRA has indicated that this will allow them to standardize a system that has had various line numbers added over the years (both three- and four-digit numbers) and eliminate line numbers that are no longer in use. It will also provide more flexibility for adding and removing line numbers in the future.

Approximately 135 line numbers were out of sequence and have been re-sequenced. Existing line numbers of three and four digits were changed to five digits. Lines currently

in the 1000, 7000, 8000 and 9000 ranges were not affected.

Generally, this change consists in adding **00** at the end of the existing number — for example, in the T1 return, line**101** becomes line **10100**. However, certain line numbers completely changed as a result of resequencing. Approximately 21% of the line numbers have been replaced by new line numbers. For example, **Commissions included on line 101 (box 42 from all T4 slips)** was previously line number 102 on the T1. It now becomes line number 10120.

In our WoltersKluwer T1 programs (*Personal Taxprep*, *Cantax*, *iFirm Taxprep*, and *iFirm Cantax*), we have used the line number for specific lines on the T1 or Schedule 1 as the name of a supporting schedule for that specific line. The renumbering of the T1 has meant that these names had to change this year. And I anticipate that it will take a while for our preparers to get used to the new line numbers.

Schedule 1 Removed

In addition, this year the CRA has removed Schedule 1, *Federal Tax*, and integrated the content into pages six and seven of the income tax return.

Step 5 on the T1 previously instructed the preparer to complete Schedule 1.

Step 5 now includes:

Part A — Federal non-refundable tax credits

Part B — Federal tax on taxable income

Part C — Net federal tax

As a result, the T1 return is now eight pages long (not including supporting schedules). The CRA has actually reverted to a T1 design that is closer to what they used prior to 2001, when the non-refundable credits were part of the T1 return itself, not Schedule 1. But with the new design, not only are the non-refundable tax credits part of the T1 return (or "jacket" as us old-timers still call it), but so is the tax calculation.

T183 Changes

Over the past few years, the CRA has made significant changes to the T183, *Information Return for Electronic Filing of an Individual's Income Tax and Benefit Return*, which is the form that taxpayers have to sign to authorize the electronic transmission of their T1 return by a registered Efiler.

Some of the changes arose because of new services being offered by the CRA: the ability to download an electronic notice of assessment ("eNOA") and the ability to transmit a pre-authorized debit agreement ("PAD"). Other changes related to efforts on the part of the CRA to encourage taxpayers to sign up for online mail (eliminating the mailing of notices of assessment and other correspondence).

However, this year's change to the T183 is purely cosmetic — but a welcome one. As part of the redesign of the T183 for the 2017 tax year, the CRA moved the section in which the client has to sign to the middle of the form — creating confusion for some taxpayers, especially as the PAD section also had a line for a signature. The 2019 version of the T183 moves the authorization to Part G at the bottom of the form — a much more logical spot. But again, as the parts on the form have been reorganized, this required changes to any instructions being provided to the taxpayers, such as the T1 transmittal letter, as well as changes to the form help and diagnostics in the T1 software programs.

Authorizing a Representative

One change coming this month that may affect more than just accountants and tax preparers is a change to the way that the CRA processes authorization requests. Previously, a representative would have an individual sign form T1013 to authorize that person or firm to represent them with the CRA. Registered Efilers using approved software could transmit the T1013 data for immediate access to information. Alternatively, the T1013 form could be mailed or faxed to the CRA. And the form could be used to request online access to information as well as in-person or telephone access.

However, starting in February 2020, the existing T1013 form will be discontinued. Forms T1013 (for individuals), RC59 (for businesses), and NR95 (for non-residents) will be combined into one new form called the **AUT-01 Authorize a Representative for Access by Phone and Mail**. This form will only be used to request **offline access** to individual and business tax accounts. This would preclude the use of such online services as Auto-fill my return and Express Notice of Assessment.

Even though the T1013 form is being discontinued, Efilers will still be able to electronically transmit an authorization request using their T1 software.

Instead of printing the T1013 for the clients to sign, the T1 program will now print an Authorization request signature page that the client will sign — similar to what is printed for the electronic filing of a business authorization request in T2 software.

The CRA has indicated that they do not want T1 and T2 software to include the new AUT-01 form. This is to avoid the problems they have encountered in the past with preparers transmitting an authorization request and then also submitting a paper copy of the form (which is treated as a new request).

Individuals that are representatives but do not use T1 Efile software (e.g., individuals preparing returns for their family members), could in the past submit the T1013 to request both online and offline access. However, the new form AUT-01 will only provide offline access, so if they would like online access, they will now have to request access through the Represent a Client portal.

The CRA has indicated that starting in February, you will be able to submit an authorization request for an individual in the same manner as you can currently submit an authorization request for a business. This involves entering the relevant data online, printing out a signature page, having the taxpayer sign the signature page, and then uploading that page using the Submit Documents service in the Represent a Client portal.

And while professional tax preparers may be comfortable with this process, it may be confusing to someone who has registered as a representative so that they can assist a family member with their tax affairs. Of course, on the other hand, these individuals will now have access to the online information much faster than waiting for a form to be processed. And there is also still the option for an individual taxpayer to authorize a representative immediately if they have access to My Account.

All in all, even though there have not been any really significant tax changes this year for individuals, it may prove to be a rather interesting tax season.

A NEW DECK MIGHT QUALIFY FOR HOME ACCESSIBILITY TAX CREDIT

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

A recent Tax Court of Canada decision made national news when a self-represented taxpayer won his appeal over a claim for the home accessibility tax credit ("HATC"). The HATC allows a taxpayer to claim a tax credit for a "qualifying expenditure" of up to $10,000 in respect of an "eligible dwelling" for a "qualifying individual" or "eligible individual". A qualifying individual includes a taxpayer who has attained the age of 65 or is eligible for the disability tax credit, and an eligible individual similarly includes the spouse or common-law partner of the taxpayer who attained the age of 65 or is eligible for the disability tax credit. A qualifying expenditure must be directly attributable to a "qualifying renovation". There are many conditions that must be met for a taxpayer to claim the HATC. But in the case of *Patrie v. The Queen* (2019 DTC 1173), the sole issue was whether the qualifying expenditure and qualifying renovation tests were met.

The taxpayer's claim was for the cost of replacing rickety steps without a railing or landing area that had been used to enter the home since the taxpayer and his wife purchased it in 1989. The taxpayer's 76-year-old wife suffered from reduced mobility, so the renovation was undertaken to replace the steps with wider stairs with a new deck attached. The taxpayer claimed the maximum $10,000 HATC on his 2016 tax return, but the CRA disallowed the credit because, in their view, the renovation was not a qualifying renovation, and even if it were a qualifying renovation, it was primarily made to enhance the value of the house and was therefore not a qualifying expenditure by virtue of paragraph (*g*) under that definition.

Was the Deck a "Qualifying Renovation"?

A qualifying renovation is defined under subsection 118.041(1) as a renovation or alteration that:

(*a*) is of an enduring nature and integral to the eligible dwelling; and

(*b*) is undertaken to

(i) enable the qualifying individual to gain access to, or to be mobile or functional within, the eligible dwelling, or

(ii) reduce the risk of harm to the qualifying individual within the eligible dwelling or in gaining access to the dwelling.

Common sense would indicate that replacing rickety old steps with sturdier and wider steps with railings for a senior with mobility issues would meet the above conditions — no further analysis required. However, the CRA's assessment was based on their view that a deck does not meet the definition of a qualifying renovation. The Minister's argument in support of this position was that the renovation was outside of the prescribed scope of the definition of a qualifying renovation. The evidence indicated that the old steps would be a challenging point of access for someone with compromised mobility. It was factually established that the renovations improved the accessibility, utility, and use of the home for the taxpayer's wife. The deck was constructed with anchors into the home's foundation and with nine cement footings, which satisfied the "enduring nature and integral to the eligible dwelling" criteria. The renovation also satisfied the criteria that require enabling accessibility, mobility, and functionality, and reducing the risk of harm to the taxpayer's wife. Therefore, the renovations met both the conditions required under (*a*) and (*b*) above.

In coming to the above conclusions, Bocock J provided some insightful analysis into the definition of a qualifying

renovation. The requirement that a renovation enable the individual to gain access to, or to be mobile or functional within, an eligible dwelling, is simply a minimum threshold and not an exclusive purpose test. There is no wording in the definition that requires a singular purpose of enhancing accessibility. While there may be collateral benefits of a renovation, there is no restriction (beyond the statutory thresholds) on the basis of realizing any other benefits. Notably, the purposes of gaining access, mobility, functionality, and reduction of harm within and in gaining access to the home are all drafted as separate conditions, so there is no requirement that they all be met. Therefore, if even a single one of these conditions is met, a renovation is a qualifying renovation so long as it is of an enduring nature and integral to the eligible dwelling.

"Qualifying Expenditure": Exclusion for Increasing Home's Value

Paragraph (*g*) of the definition "qualifying expenditure" under subsection 118.041(1) disqualifies renovation costs that are incurred with the primary purpose of increasing or maintaining the value of the eligible dwelling, and the Minister argued that this exclusion applied to the taxpayer's renovation costs. The taxpayer and his wife had no plans to sell the house and continued to reside in the home years later when the case was before the court. Medical opinions, the CRA's acceptance that the taxpayer's wife was a qualified individual, and the taxpayer's assurance that the deck's specifications enhanced utility and mobility, all rebutted the assertion that the primary purpose behind the deck's construction was to enhance the home's value.

Bocock J asserted that the purpose of adding or maintaining value must be primary, so the coincidence of renovations increasing or maintaining the value of the property does not meet this primary purpose threshold. He was also critical of how this exclusion was applied in this specific case:

> If the drain on the federal treasury is too great because of the existing wording, then Parliament can repeal or amend its textually clear provisions. Until then, the Minister and her agents must have some prominent factual basis for asserting a taxpayer's primary economic purpose in undertaking these improvements before this exclusion is invoked.

Some Takeaways

Bocock J's comments provide some helpful guidance on determining whether a renovation might be eligible for the HATC. First, though the CRA may argue that only accessibility-centric renovations are eligible for the credit (e.g., wheelchair ramps, step-in showers, grab bars, etc.), a renovation is eligible for the HATC so long as it satisfies the criteria. Moreover, any of the renovation's ancillary benefits to the occupants should not affect this determination.

Second, any of the criteria under paragraph (*b*) of the definition of a qualifying renovation can be met in order to satisfy that requirement. These conditions require that the renovation be undertaken to enable the qualifying individual to gain access to, or to be mobile or functional within, the eligible dwelling, or reduce the risk of harm to the qualifying individual within the eligible dwelling or in gaining access to the dwelling — meeting any one of these conditions is sufficient.

Last, there must be some factual basis to invoke the exclusion for renovations the primary purpose of which is to increase or maintain the home's value. Not only should the facts indicate that the renovation was made for the purpose of increasing or maintaining the home's value, but they should also indicate that this was the primary purpose.

CURRENT ITEMS OF INTEREST

2019 Travel Rates for Individuals

For claiming travel costs for the purposes of the northern residents' deduction, moving expense deduction, and medical expense tax credit, a taxpayer can use the simplified method to compute these expenses rather than using the detailed method and claiming the actual costs. For transportation costs, the simplified claim is computed on a per-kilometre basis, and the amount per kilometre depends on the province or territory. The rates for using the simplified method for the 2019 taxation year are provided below.

Province or territory	Cents/kilometre
Alberta	48.0
British Columbia	54.5
Manitoba	51.0
New Brunswick	53.5
Newfoundland and Labrador	57.5
Northwest Territories	64.5
Nova Scotia	52.5
Nunavut	61.5
Ontario	57.0
Prince Edward Island	52.0
Quebec	54.0
Saskatchewan	51.0
Yukon	63.5

The 2019 rates for the simplified method of claiming meal expenses are $17 per meal to a maximum of $51 per day, which have not changed from that of prior years.

FOCUS ON CURRENT CASES

This is a regular monthly feature examining recent cases of special interest, coordinated by *John C. Yuan* and *Christopher L.T. Falk* of McCarthy Tétrault LLP. The contributors to this feature are from McCarthy Tétrault LLP, Montreal, Toronto, Calgary, and Vancouver.

Tax Court Finds That a Dividend That Does Not Comply With Provincial Law Is Valid for Tax Purposes

***Kufsky v. The Queen*, 2019 DTC 1157 (Tax Court of Canada)**

This is a case in which, it is respectfully submitted, the Tax Court may have diverged from the commonly accepted principle that tax law is an overlay on the law otherwise applicable. As a result of this principle, tax results are

normally determined in respect of transactions or events once provincial law has been applied to determine the legal results.

This appeal was from a section 160 assessment that was based on dividends purportedly made by the Appellant's corporation to the Appellant. The Appellant maintained that no dividends had been paid to her as the corporation had not complied with the corporate law requirements to pay dividends, that she had provided consideration in the form of services provided for any amounts paid to her or, alternatively, that any amounts paid to her were loan repayments in respect of a loan made by her mother-in-law.

The corporation in question, Mon Refuge Décor Inc., had operated an interior decorating and furnishing consultation business. In running the business, the corporation had employed an internal bookkeeper and an external accountant, but neither the Appellant nor her husband, who was also involved in the business, were particularly familiar with accounting and tax matters. What's more, the couple had fired their accountant of 30 years during the years relevant in this appeal.

Although the business had at one time been successful, following the financial crisis of 2008, the business suffered and ultimately ceased to operate. When the business shuttered, the corporation had a significant unpaid tax debt in respect of its 2008 and 2010 taxation years.

From 2009 to 2011, the corporation had issued T5 slips stating that it had paid dividends to the Appellant in the amounts of $35,000, $15,000, and $35,000, respectively. As the Appellant had not initially reported having received these amounts in her personal tax filings, the former accountant had filed T1 Adjustments Requests on her behalf to report them.

Given that the dividends had been reported as having been paid to the Appellant, the CRA assessed the Appellant in respect of the corporation's tax liability pursuant to section 160 of the *Income Tax Act*.

In her appeal from the assessment, the Appellant contended that the amounts that had been reported as dividends did not represent actual payments to her but, rather, "represented an annual 'balancing of the books' to reconcile the Appellant's use of corporate accounts during the year." She provided evidence that the corporate law requirements for the payment of dividends had not been complied with, and that there had been litigation involving the former accountant's treatment of the amounts in issue as dividends, including the filing by the former accountant of the T1 Adjustments Requests which the Appellant had not signed.

In respect of the issue of whether dividends had been paid, the Appellant testified that corporate resolutions were never passed, as required by section 38 of the *Ontario Business Corporations Act* ("OBCA"), the applicable corporate law provision. Section 38 provides that a dividend must be declared by the directors of a corporation, and that a dividend shall not be declared if there are reasonable grounds for believing that the corporation is or would be rendered insolvent.

Justice MacPhee rejected the argument that dividends had not been paid, finding that even though the provincial law requirements to pay dividends had not been complied with, the dividends were valid for tax purposes. The Tax Court stated that a breach of the OBCA may be punished by penalties or may allow an aggrieved party to sue under that Act, but that "nowhere is it stated that non-compliance with the statute voids a reported dividend for the purposes of a section 160 assessment." Justice MacPhee cited *Larouche* (2010 DTC 5060 (FCA)) as authority that a reported dividend, even if not in compliance with the provincial statute, remains valid for tax purposes.

However, with respect, it is submitted that prior to concluding that purported dividends were valid for tax purposes, the Tax Court should have considered the effect of non-compliance as a matter of provincial law. Had the purported dividends been invalid under provincial law, they could perhaps have been rendered a nullity, in which case there might

not have been a transfer of property to the Appellant, or treated as payments of something other than dividends, which may have enhanced the Appellant's arguments that either: (i) consideration was provided by the Appellant for the amounts in question in the form of services rendered; or (ii) the amounts should have been regarded as loan repayments.

In respect of the Appellant's argument that she had provided consideration for the purported dividend because, in the years in which dividends were reported, she was owed salary, the Tax Court noted that according to the Supreme Court of Canada, the payment of a dividend derives from a shareholder's entitlement to a capital interest in a corporation and not to any consideration the corporation may have received from the shareholder. Accordingly, Justice MacPhee summarily dismissed this argument by the Appellant.

In addition, the Appellant argued that a portion of the amounts paid to her were not dividends but were in fact loan repayments. The Appellant provided evidence that her mother-in-law had transferred money to the corporation so that the corporation could buy a car for the business.

However, Justice MacPhee noted that the amounts had been reported as dividends issued by the corporation and received by the Appellant. Justice MacPhee said that if the Appellant wanted to re-characterize the payments, that would need to be done in an application for rectification, which was outside the Tax Court's jurisdiction.

Justice MacPhee finished by quoting from two cases which he indicated were similar. In *Côte* (2003 DTC 813 (TCC)), the taxpayer had caused his company to pay a dividend to him, but wished to re-characterize the payment as salary. Justice Lamarre Proulx stated that because the taxpayer had chosen to have payments made to him characterized as dividends rather than as salary, he could not then reverse that characterization to escape the application of section 160. In *Gestion André Pomerleau* (2009 DTC 1208 (TCC)), in rejecting a similar attempt to have dividends that were paid viewed by the court as salary, Justice Angers noted the importance of form over subjective intention. While subjective intention may "clarify dealings, it is rarely determinative", Justice Angers stated.

In citing these decisions, Justice MacPhee stated that the Appellant had obtained tax advantages from reporting the payments as dividends. Accordingly, she could not attempt to re-characterize them to escape a section 160 assessment. It is respectfully submitted, however, that the Tax Court should have considered whether as a matter of provincial law the failure to comply with the requirements for the payment of dividends rendered the purported dividends a nullity or meant that they were payments other than dividends.

The Appellants appealed this decision to the Federal Court of Appeal on December 9, 2019.

— *Hilary Smith*

Federal Court of Appeal Confirms Advantage Tax Can Include Subsequent Increases in Value

***Louie v. The Queen*, 2019 DTC 5122 (Federal Court of Appeal)**

The Appellant appealed a decision of the Tax Court of Canada that confirmed a reassessment of tax against her with respect to an "advantage" she received from certain swap transactions. The swap transactions generally involved exchanging publicly-traded stock in the Appellant's TFSA for other publicly-traded stock in either the Appellant's RRSP or Canadian trading account. Stocks transferred into the Appellant's TFSA were transferred at the lowest market price that the stock had traded at on that day. In contrast, stocks transferred out of the TFSA were transferred at the highest market price that the stock had traded at on that day. As a result, the swap transactions significantly increased the proportion of capital stock held in the Appellant's TFSA, the gains from which would generally not be taxable. The

transactions subject to this appeal all occurred prior to October 17, 2009, when amendments to the definition of "advantage" took effect to expressly include swap transactions.

The Tax Court found that the Appellant had received an "advantage" in relation to her TFSA for the 2009 taxation year, but allowed her appeal for the 2010 and 2012 taxation years, concluding that the increase in the fair market value of the Appellant's TFSA in 2010 and 2012 was not attributable, "directly or indirectly", to the swap transactions. The Tax Court held that when considering whether an increase in fair market value is attributable to impugned transactions, the phrase "directly or indirectly" should be interpreted narrowly, because the presence of the phrase "reasonable to consider, having regard to all the circumstances" acts as a constraint on the potential for "directly or indirectly" to operate over-inclusively.

In addition to the Appellant's appeal of the Tax Court's decision in respect of the 2009 taxation year, the Crown cross-appealed the decision on the basis that the Appellant received an advantage in the 2010 and 2012 taxation years.

Dawson JA, in a unanimous decision of the Federal Court of Appeal, dismissed the Appellant's appeal in respect of the 2009 taxation year, holding that:

- the swap transactions were part of a series of transactions;
- the parties to the series of transactions were not dealing at arm's length; and
- one of the main purposes of the series of transactions was to enable the Appellant to benefit from her TFSA's tax-exempt status.

The Appellant argued that all of the relevant transactions had to be preordained in order to qualify as a series of transactions. As such, because the Appellant's decision to carry out future swaps depended on future market prices, the Appellant maintained that the specific transactions could not be planned in advance and, therefore, did not constitute a series of transactions. However, subsection 248(10) broadens the common law meaning of "series of transactions" such that a series is deemed to include any related transaction or event completed in contemplation of the series. Dawson JA affirmed the Tax Court's broad interpretation of what constitutes a series of transactions, finding that the swap transactions effected by the Appellant were part of a series of transactions because the Appellant planned on doing swap transactions with the purpose of achieving the objective of the series, and that although the series of transactions never had a predetermined end point, each of the transactions was completed in contemplation of the series.

The Appellant also argued that the Tax Court committed a palpable and overriding error by finding that the parties to the swap transactions "acted in concert without separate interests as directed 'single-mindedly' by the Appellant." The Appellant also argued that if there was a single mind directing all of the swap transactions from the perspective of the TFSA, it would be the trustee of the TFSA trust, which imposed the technical requirements upon the swap transactions that it would permit. Dawson JA held that paragraph 251(1)(*c*) was applicable. Therefore, it was a question of fact as to whether persons not related to each other were at a particular time dealing with each other at arm's length. On the facts admitted by the Appellant, which generally showed that she alone chose the stocks to be exchanged and the value ascribed to them, Dawson JA concluded that the Tax Court did not err in finding that the Appellant was the single mind directing all of the swap transactions. As such, the parties to the series of transactions were found not to be dealing at arm's length.

Lastly, the Appellant argued that none of the main purposes of the series of transactions was to enable the Appellant to benefit from the TFSA's tax exemption. The Tax Court found that the Appellant completed the series of transactions with the goal of transferring to her TFSA shares traded on the TSX held in her RRSP and in her Canadian trading account. In doing so, the Tax Court held that the Appellant must have intended to benefit from a tax-free sale in and distribution from her TFSA, as opposed to a taxable withdrawal from her RRSP or a taxable gain within her Canadian trading account. Central to the Appellant's argument was the fact that generally the shares in the TFSA had not been sold, so the benefit from the TFSA's tax exemption had not yet been realized. Dawson JA disagreed, holding that although taxable income was not shifted between trading accounts, the result of the Appellant's strategy was to inflate

the value of the TFSA so as to benefit from a (future) tax-free distribution from her TFSA.

On cross appeal, the Crown argued that the Tax Court erred in interpreting the statutory definition of "advantage" by construing too narrowly the phrase "if it is reasonable to consider, having regard to all the circumstances, that the increase is attributable, directly or indirectly, to . . .". Such interpretation would exclude from the scope of an "advantage" any increase in value in a TFSA in subsequent years that is attributable to amounts previously inappropriately shifted into the TFSA due to improper transactions.

Dawson JA held that:

- On a textual analysis, the requirement to base a determination about the source of an increase in the value of a TFSA upon what "it is reasonable to consider, having regard to all the circumstances" does not constrain the broad, textual meaning of the phrase "directly or indirectly".
- Nothing in the statutory context requires or favours a narrow, restrictive definition of "advantage".
- The anti-avoidance purpose of sections 207.01 and 207.05 supports a broad interpretation of "advantage".

Dawson JA allowed the cross appeal, finding that the Tax Court erred in applying a restrictive interpretation of paragraph (*b*) of the definition of advantage. While the increase in value of the Appellant's TFSA in 2010 and 2012 was directly attributable to the performance of the shares held in the TFSA in each year, it was indirectly attributable to the swap transactions, which increased the number of shares in the TFSA and their value.

The Appellant has filed an application for leave to appeal this decision to the Supreme Court of Canada.

— *Steve Marshall*

The Federal Court Declines Jurisdiction in a Judicial Review Application of an Administrative Decision of the CRA

***Westminster Savings Credit Union v. AG of Canada*, 2019 DTC 5135 (Federal Court)**

This decision concerns an application filed by Westminster Savings Credit Union ("WSCU") for judicial review of the Minister's decision reflected in a letter sent by the Canada Revenue Agency (the "CRA") in the context of an audit. In the letter, the CRA took the position that WSCU was not a "credit union" within the meaning of section 123 of the *Excise Tax Act* (Canada) (the "ETA") for the years under audit (2013 to 2016). Section 123 incorporates the definition of "credit union" from subsection 137(6) of the *Income Tax Act* (Canada) (the "ITA"). The effect of WSCU not meeting the "credit union" definition for ETA purposes would be to disqualify WSCU from a GST exemption applicable to supplies of goods and services between two credit unions pursuant to subsection 150(6) of the ETA. However, neither the ETA audit nor the letter referred to above resulted in an assessment for unremitted GST to which WSCU could have objected and, ultimately, appealed to the Tax Court of Canada.

In order to qualify under the ETA (and under the ITA) as a credit union, WSCU had to derive "all or substantially all" of its revenue from sources listed in the ITA. A ruling requested by the CRA in the course of the ETA audit concluded that WSCU might not meet the definition of "credit union" for income tax purposes (and, consequently, for GST/HST purposes) because WSCU's revenues were not primarily from the sources enumerated in the ITA. Following this ruling, the letter was sent by the CRA to WSCU stating that WSCU was not a "credit union" for ETA and ITA purposes.

However, the main issue in this application was whether the Federal Court had jurisdiction to review the qualification of WSCU as a credit union under the ETA. This follows a prior refusal by the Federal Court to grant a motion to the Attorney General to strike WSCU's application for judicial review (*Westminster Savings Credit Union v. Canada (Attorney General)*, 2019 DTC 5047 (FC)).

In respect of the jurisdiction issue, it was noteworthy that WSCU had been subject to an income tax audit shortly after the CRA's letter had been sent and the application for judicial review made. As a result of the income tax audit, the CRA reassessed WSCU for income tax purposes on the basis that it was not a "credit union" for purposes of the ITA, disallowing certain deductions for the 2015 and 2016 taxation years. Accordingly, WSCU was able to object to and, if necessary, appeal to the Tax Court of Canada from the income tax reassessments which were based upon the same determination as to whether WSCU qualified as a credit union under the ITA (and therefore under the ETA).

Relying on applicable case law, including the Supreme Court of Canada decision in *Addison & Leyen Ltd.* (2007 DTC

5365), Manson J stated that judicial review should be a remedy of last resort and should not be available when other recourse is possible before another court or at another time. In this instance, notwithstanding that the judicial review application was in respect of the ETA and the reassessments were in respect of the ITA, the Federal Court found that WSCU had another venue of recourse possible for the same underlying issue before the Tax Court (i.e., does WSCU meet the definition of "credit union" contained in the ITA (and therefore in the ETA)).

In dismissing the application for judicial review, the Federal Court held that the determination as to whether WSCU qualified as a "credit union" should remain the Tax Court's exclusive jurisdiction pursuant to section 18.5 of the *Federal Courts Act*, which is to be interpreted to preclude parallel proceedings in the Federal Court and the Tax Court.

Moreover, the Federal Court found that the letter that related the CRA's finding that WSCU was not a "credit union" for ETA and ITA purposes was not binding on the CRA and, therefore, was not susceptible to judicial review.

The Federal Court's decision helps define the jurisdiction and role of the Federal Court in respect of tax matters. As such, it serves as an important reminder that the Federal Court has a residual jurisdiction over many issues outside of assessments and tax appeals, which jurisdiction will be exercised in certain situations but which remains subject to the Tax Court's exclusive jurisdiction over tax appeals and references regarding tax matters.

— *Nicolas Désy and Anthony Sylvain*

Mixing Business With Pleasure — When Renovating Properties With Both Commercial and Residential Uses Confers a Shareholder Benefit on a Taxpayer

***Wise v. The Queen*, 2019 DTC 1138 (Tax Court of Canada)**

This case deals with the treatment of renovation costs to a combined commercial and residential building owned by a shareholder of the company leasing the commercial space. The key issue was whether the cost of renovations to the commercial space should be considered a shareholder benefit and be added to income of the shareholder by virtue of subsection 15(1) of the *Income Tax Act* (the "Act"). The individual taxpayer appealed from a reassessment for shareholder benefits included in her income during the 2011 and 2012 taxation years.

The building at issue was purchased by the taxpayer and her husband in 2008. From the time of purchase to September 2010, the commercial portion of the building was leased to a medical practice operated by the previous owner of the building. Following the purchase, the taxpayer and her husband renovated the second floor residential apartment at a cost of $170,000 using personal funds.

After the lease to the medical practice ended, a company in which the taxpayer and her son were the principal shareholders and by whom they were employed entered into a five-year lease with an option to renew for five additional years. The lease stipulated that the lessee was required to pay "additional operating costs" that included two-thirds of the cost of repair and routine maintenance for the overall building, but excluded repairs to any structural component of the building, such as the roof, floors, walls, or foundation. The lease did, however, allow the lessee to make or erect alterations or improvements to the building with the lessor's consent. At the time, the taxpayer's spouse was deceased and the taxpayer was the sole owner of the building.

At the commencement of the company's lease, extensive renovations were made to the commercial space costing $457,663 in 2011 and $164,005 in 2012. It was intended that the building would be the flagship location for its mortgage brokering business and that the renovations would hopefully attract new customers. The company paid for these renovations and, for tax purposes, treated the outlays as its cost of acquiring depreciable property, namely Class 13 leasehold improvements.

Against this background, the Minster reassessed the taxpayer to include a shareholder benefit under subsection 15(1) of the Act in respect of the company-paid improvements to the building.

The Tax Court (*per* Smith J) canvassed the jurisprudence involving corporate-funded improvements on property owned or occupied by a shareholder but focused on the case law that supported the notion that, when the corporation pays for improvements to a shareholder-owned property occupied by the corporation, a shareholder benefit will generally only arise if there is still value to the property attributable to the improvements when occupancy of the property

reverts to the owner/shareholder.

Here, the renovations were undertaken at the start of a five-year lease with a corporation having the right to renew for a further five-year term and, therefore, there was no basis to conclude that there was a benefit conferred on the shareholder-owner of the property during the corporation's tenancy.

While the Court acknowledged that some of the improvements, such as ones that were structural, were likely of a permanent character, it was too speculative to try to quantify the residual value to the property owner, particularly since there was no reason to believe that the corporation would not continue to occupy the space into the foreseeable future. In any event, if the Minister was of the view that the property improvements that the corporation funded permanently improved the property, it was incumbent on the Minister to introduce evidence that established the residual value of those improvements at the likely end of the corporation's lease, but the Minister did not do this.

In its reasons, the Court also addressed the Minister's submissions that (i) an arm's length commercial tenant would never have agreed to pay the monthly rent for the property and also been willing to fund improvements that, when amortized over the term of the lease, would be almost two and a half times the cost of rent, and (ii) the renovations to the leased commercial space were expensive relative not only to the amount spent to renovate the residential portion of the property but also relative to the overall valuation of the property post-renovation. The Court noted that it is not its role to second-guess the business decisions of taxpayers. Moreover, the large amount of the expenditures was due in part to difficulties associated with improving a heritage building and the Court found the shareholders' testimony that renovating a heritage building as an iconic flagship office was important to the corporation's business to be persuasive.

This case highlights the confusion that can occur when a property has both business and personal uses by a common owner and where a portion of that property is leased. Properly documenting the separation of costs to improve different aspects of the property seems to be important. Evidence would have to be introduced to prove the residual value of improvements past a lease term to impute a benefit on the appropriate shareholder. It is also relevant that there is a consideration as to the types of costs that a third party might pay for similar leasehold improvements. Finally, the length of the lease will be considered in light of leasehold expenses when deciding who *actually* receives the benefit.

— *Sarah Ferguson*

RECENT CASES

Order issued directing Canada Revenue Agency to follow taxpayer's direction to pay

A property owned by a non-resident mortgagor went into foreclosure and a court order was issued providing for the sale of such property. That order set out the priorities for the payment of net sale proceeds to the first, second, and third mortgagees. The non-resident mortgagor did not, as required by section 116 of the *Income Tax Act* (the "Act"), provide notice of the sale to the Canada Revenue Agency ("CRA"). Consequently, 25% of the purchase price was remitted to the Agency to secure payment of the mortgagor's tax liability. Such amount exceeded such tax liability by more than $150,000, and the mortgagor provided the CRA with a written irrevocable authority and direction to pay those funds to his lawyer in trust. It was common ground that, if the funds were paid to the mortgagor's lawyer in trust, they would be dealt with in accordance with the priorities set out in the order approving sale. An application was made by the second mortgagee to the Court for an order providing that such excess be paid to its lawyer in trust, or into court, to be held and paid out to the second and third mortgagees who had not, owing to the original remittance of funds to the CRA, been paid in full. The CRA took the position that it was compelled to pay the excess funds to the mortgagor as a tax refund.

An order was issued providing that the excess funds be paid to the mortgagor, in accordance with the direction to pay. The Master in Chambers held that the issue for determination was whether the CRA was obligated to pay the excess funds to the mortgagor in accordance with the direction to pay. The Master held that there was nothing in the Act that prevented the CRA from complying with the direction to pay, and that the arrangement made for the

payment of the excess funds to the mortgagor was not a violation of the CRA's governing legislation. Accordingly, the Master concluded that the government of Canada was obligated to pay the excess funds to the mortgagor in accordance with the direction to pay. Alternatively, it was acceptable for the CRA to pay the excess funds into court to the credit of the proceeding, or to the petitioner's lawyer in trust, if agreed.

1074022 B.C. Ltd. v. Li

2020 DTC 5011

Bankrupt's appeal from order in favour of CRA dismissed

The taxpayer made an unsuccessful proposal and was therefore placed into bankruptcy. His debts arose from an assessment by the Canada Revenue Agency ("CRA") in respect of a tax amount owed. However, the CRA failed to file a proof of claim in the bankruptcy within the required time period and the resulting surplus remaining in the bankrupt's estate was then to be paid out to him. The CRA then attempted to file a claim but the bankrupt took the position that, following section 149 of the *Bankruptcy and Insolvency Act*, the CRA could not longer do so. Section 149 provides that, where a creditor does not file a claim within the requisite 30-day period, the trustee can pay out any surplus in the estate to the bankrupt, without regard to the claims of such creditor. The Nova Scotia Supreme Court found in favour of the CRA and the bankrupt appealed from that decision to the Nova Scotia Court of Appeal.

The appeal was dismissed. The Nova Scotia Court of Appeal held that, in the unusual circumstances of the case, section 150 of the *Bankruptcy and Insolvency Act* (rather than section 149) applied. In the appellate Court's view, section 150 applied because it placed no time limit on filing a proof of claim. The Court concluded that such interpretation furthered the objective of equitable treatment of creditors prior to the payment of any surplus to the bankrupt. The bankrupt's appeal was therefore dismissed but there was no order as to costs.

Levick v. CRA

2020 DTC 5004

Minister required to adhere to terms of settlement agreement

In 2015, the corporate taxpayer, which had appealed from certain assessments, entered into a settlement agreement with the Minister of National Revenue with respect to its tax liability for certain taxation years. After the agreement was executed but before reassessments were issued, the Minister obtained new facts, and took the position that one of the reassessments was no longer supported by the facts. The taxpayer brought a successful motion before the Tax Court (2017 DTC 5036), seeking an order allowing its appeal in accordance with the terms of the settlement agreement. The Minister appealed from the Tax Court decision.

The Minister's appeal was dismissed. The Federal Court of Appeal held that the Tax Court did not err in concluding that the appeal should be allowed in accordance with the settlement agreement. The Court held that the general rule was that parties should be bound by the agreements that they make, and that the Crown had entered into the settlement agreement believing that it was in its best interests to do so and so should be required to "live up to its bargain". The Court also considered, and rejected, the Crown's argument that the Tax Court did not, in the circumstances, have jurisdiction to consider the taxpayer's motion. The Crown's appeal from the Tax Court decision was therefore dismissed, with costs to the respondent.

The Queen v. CBS Canada

2020 DTC 5009

Appeal from denial of claim for deduction of professional fees allowed in part

The taxpayer and her spouse were also business partners who were the sole shareholders of a corporation. Following the breakup of their marriage, the two parties entered into litigation over spousal support issues and over the refusal of the taxpayer's spouse to consent to the payment of dividends from their jointly owned company. In pursuing such litigation, the taxpayer incurred professional legal and accounting fees, and claimed a deduction for such fees in her tax return. That deduction was denied on the basis that the fees were not incurred for the purpose of earning income, and the taxpayer appealed from that determination to the Tax Court of Canada.

The appeal was allowed in part. The Tax Court held first that, consistent with the legislation, legal expenses incurred to obtain spousal support were allowable as deductions. Consequently, any such expenses incurred by the taxpayer to obtain support from her former spouse were allowable as deductions. The Court then considered the deductibility of the professional fees incurred in relation to the corporate litigation, and specifically in relation to the oppression application brought by the taxpayer. The Court held that such fees were incurred for two purposes: the first and dominant purpose was to protect the taxpayer's rights as a shareholder of the corporation, while the second purpose was to produce income from the corporation in the form of dividends. The Court concluded that it was reasonable and fair to apportion the professional fees spent on the oppression application between the two purposes. Fees incurred for the purpose of preserving capital assets in the form of the taxpayer's interest in the corporation were not deductible, but those incurred to create income were. The Court estimated that, on the particular facts of the case, approximately 25% of the fees incurred were for the purpose of creating income and that consequently only 25% of such fees incurred were deductible from income. The appeal was therefore allowed to the extent of allowing the taxpayer a deduction for $24,242 in professional fees incurred.

Mader v. The Queen

2020 DTC 1005

Application for judicial review of Minister's refusal to cancel TFSA overcontributions tax and penalties dismissed

The taxpayer made excess contributions to his tax-free savings account ("TFSA") between 2009 and 2013. Several notices were sent to him by the Canada Revenue Agency advising him of his overcontribution position, but the taxpayer did not take steps to remedy those errors until 2018. The CRA assessed an overcontributions tax and the taxpayer applied unsuccessfully for relief from the tax and penalties imposed. He then applied for judicial review of the Minister's decision to deny relief, arguing that he was unaware of the rules governing TFSA contributions and took corrective action as soon as he became aware of his overcontribution position and that, owing to his frequent travel as a member of the Canadian military, he had not, until 2018, received any of the notices sent to him by the CRA.

The application was dismissed. The Federal Court held that while the taxpayer's overcontribution error may have been innocent, the onus was nonetheless on him to understand the law. As well, he had failed to provide the tax authorities with information on his change of residence, making it difficult to contact him. The Court noted that when a notice for the taxpayer was returned to the CRA in 2013 as undeliverable, the Agency contacted the taxpayer's bank to obtain an updated address. In the Court's view, the CRA did what could to be expected of it to contact the taxpayer. The Court noted as well that where the Courts have provided relief from overcontributions tax, the circumstances generally involved a one-time oversight or misdirected funds, which were corrected by the taxpayer at the first available opportunity. Such were not the taxpayer's circumstances, as he intended to make the overcontributions and, as found by the CRA decision makers, did not act quickly in response to the notices of overcontribution. The Court concluded that the decision made was justified, transparent, and intelligible, falling well within a range of possible and acceptable outcomes. Consequently, the taxpayer's application for judicial review was dismissed. There was no order as to costs.

Weldegebriel v. Canada (AG)

2019 DTC 5144

Minister’s requests for information valid and not constituting a violation of Charter rights, and an order for compliance issued

The Minister of National Revenue, acting under sections 231.1 and 231.7 of the *Income Tax Act*, issued two Request for Information (“RFI”) letters to the taxpayers, who were spouses. Such letters requested that the taxpayers complete a questionnaire as part of an audit of their potential offshore holdings which, in the Minister’s view, may not have been properly disclosed. The taxpayers refused to provide the requested information and brought an application for judicial review, challenging the Minister’s right to make such requests. On that application they argued that sections 231.1 and 231.7 were unconstitutional as violating taxpayer rights under sections 7 and 13 of the *Canadian Charter of Rights and Freedoms* (the “Charter”). The Minister also made an application for summary judgment to enforce compliance with the requests for information. Both applications were heard together.

The taxpayers’ application for judicial review was denied and the Minister’s application for summary judgment was granted. The Federal Court of Canada held that the issues for determination were whether the RFIs were issued in respect of the taxpayers or their related entities, and whether their Charter rights were infringed by sections 231.1 and 231.7. On the first issue, the Court held that while it is open to the Canada Revenue Agency (the “CRA”) to request information from an individual regarding both their own finances and those of their connected entities, the jurisprudence is clear that the CRA must be specific about who it is auditing. The Court reviewed the correspondence sent to the taxpayers and held that the RFIs were clearly directed to the taxpayers and were issued in respect of their personal tax returns. The Court concluded, therefore, that the RFIs were sufficiently clear and that the Court was able to issue an order of compliance. On the issue of the alleged violation of Charter rights, the Court held that section 13 of the Charter was not relevant, as such provision required that there be “other proceedings” which did not at present exist. Similarly, on the question of section 7 rights, the Court held that the concerns of the taxpayers were premature, in that the RFIs issued were clearly for the purpose of a civil audit and that there was no evidence that any criminal or penal investigation was underway or forthcoming. In the Court’s view, the sole object of section 7 was to offer protection in “extraordinary or exceptional circumstances” when the impugned legislation was unjust. The Court concluded that a routine civil taxation audit did not rise to that level, especially when weighed against the overall purpose of sections 231.1 and 231.7 in the larger context of Canada’s self-reporting and self-assessing system of taxation. The taxpayers’ applications for judicial review were therefore dismissed and an order was issued granting the Minister’s application for an order of compliance.

Canada (MNR) v. Friedman

2019 DTC 5142

TAX NOTES

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