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# *BOUSFIELD V. THE KING*: ON ALTERNATIVE ASSESSMENT TECHNIQUES

— *Jacques Roberge, Wolters Kluwer Canada Limited*

*Bousfield v. The King*[1] is a decision of the Tax Court that provides an opportunity to canvas the "alternative assessment techniques" often used to raise assessments against taxpayers. Alternative assessment techniques are sometimes called "arbitrary assessments" or "net worth assessments". However, these three terms have very different meanings.

An arbitrary assessment is an assessment that the Minister issues with little, if any, analysis, usually with the goal of prompting a taxpayer who has failed to file a tax return to do so. By contrast, an alternative assessment technique involves some level of analysis and calculation (often very detailed) in an attempt to determine the taxpayer's income or revenue. A net worth assessment is one type of alternative assessment technique. While net worth assessments are perhaps the most common form of alternative assessment technique, referring to all alternative assessment techniques as net worth assessments is both inaccurate and confusing.

Among other points, the *Bousfield* decision reviews the following:

- use of alternative assessments;
- attacking alternative assessments;
- assumptions of fact in alternative assessment techniques; and
- the Appellant's alternative techniques.

*Bousfield* allows for an in-depth review of alternative assessment techniques because the Canada Revenue Agency ("CRA") used a combination of four alternative assessment techniques, while the Appellant countered with three different ones. Finally, the judge found that none of these seven techniques appropriately reflected the Appellant's income for income tax purposes and related GST obligations and devised his own to finalize a ruling on the case.

## Context

In 2006, 2007, and 2008, the Appellant operated a taxi and transportation business in Regina. He used one vehicle as a taxi. He used one or more other vehicles to provide transportation services to a company owned by his brother. The CRA reassessed him to increase his revenue from the taxi business and the transportation business. The Appellant had recurring late or non-filing of returns and instalment payments. He was an illiterate octogenarian who left most of his tax obligations to an accountant and later to the daughter of this accountant.

[1] 2023 DTC 1002 (TCC).

The CRA audit resulted in assessed unreported revenue totaling $213,164 for the periods of 2006 to 2008 in relation to the taxi business. Other issues involved small adjustments to the Appellant's transportation income and denied expenses. For GST purposes, the audited periods reassessed were those ending between July 1, 2007, and December 31, 2008. In fact, for both income tax issues and GST matters, the Tax Court's conclusion allowed the appeals in part, reducing both the amount of unreported income and GST due. This article, however, will not focus on the adjustments made to the initial assessment, but instead will review the Court's comments on the principles underlying the use of alternative assessment techniques.

## Use of Alternative Assessment Techniques

As stated by the Tax Court, subsection 152(7) of the *Income Tax Act* allows the Minister to issue an arbitrary assessment or assess a taxpayer using an alternative assessment technique. The subsection does not establish a specific technique that must be used.

Alternative assessment techniques should not be the norm — they should be a last resort. That said, although the Minister generally does not use alternative assessment techniques unless a taxpayer's books and records are inadequate to determine the taxpayer's income or revenue, poor books and records are not a prerequisite to applying an alternative assessment technique.

A court does not have to be satisfied that it was necessary for the Minister to use an alternative assessment technique. The Minister can use an alternative assessment technique at any time regardless of the state of the taxpayer's records. Once the Minister assesses under subsection 152(7), subsection 152(8) deems the assessment to be correct subject to being vacated or varied on objection or appeal.

The Tax Court added that while some cases seem to suggest that unreliable books and records are a prerequisite to a subsection 152(7) assessment, a more accurate description is that reliable books and records are one way a taxpayer can attack an alternative assessment technique.

## Attacking Alternative Assessment Techniques

When the Minister determines a taxpayer's income or revenue using an alternative assessment technique, the taxpayer can overcome the assessment:

(a) by showing that the taxpayer's income or revenue can be more accurately calculated using the taxpayer's own books and records;

(b) by accepting that the alternative assessment technique used by the Minister is appropriate but attacking components of the calculation in an effort to reduce the income or revenue;

(c) if the year in question is statute-barred, by showing that the alternative assessment technique used by the Minister is fundamentally flawed;

(d) by presenting a different alternative assessment technique that more accurately calculates the taxpayer's income or revenue; or

(e) by accepting that the alternative assessment technique used by the Minister was appropriate but showing that the income or revenue calculated by the technique was from a non-taxable source.

Unless a year is statute-barred, a taxpayer cannot win by simply showing that the Minister's alternative assessment technique is fundamentally flawed. The Minister will have made assumptions of fact to support the technique, but will also have made an assumption of fact that the taxpayer earned the income or revenue calculated by that technique. It is up to the taxpayer to demolish that assumption. The taxpayer can only demolish the assumption by either showing that the assumed revenue or income was from a non-taxable source or presenting the court with a viable alternative for determining the taxpayer's revenue or income — be it the taxpayer's own records or some other technique.

The Tax Court added if that were not the case, consider what would happen to a taxpayer who earned income but had no books and records and had not filed a tax return. If the taxpayer could win by simply showing that the alternative assessment technique the Minister used to assess them was fundamentally flawed, the assessment would be vacated

and the taxpayer would end up having no income at all for the year. The taxpayer would be rewarded for having failed to comply with their obligations under the *Income Tax Act*.

While this was not the case in *Bousfield*, the Court also noted that the situation is, of course, very different if the year in question is statute-barred. In cases like that, the Respondent would have the burden of proving the taxpayer had unreported income or revenue. If the Court found the alternative assessment technique the Minister used to be fundamentally flawed, then the Respondent could not meet that burden. The taxpayer would not have to show that they had some other amount of income or revenue.

## Assumptions of Fact in Alternative Assessment Techniques

The relationship between assumptions of fact and alternative assessment techniques is of paramount importance. The Respondent is required to set out in the Reply the assumptions of fact the Minister made in reassessing. If the Minister made an assumption but the Respondent failed to include it in the Reply, the Respondent does not enjoy the benefit of the assumption being presumed to be true. If the Respondent wants to rely on the unpled assumption, the Respondent must introduce evidence to support it, just as the Respondent would if he wanted to rely on a fact that the Minister had not assumed.

One of the examples noted in *Bousfield* deals with use of industry averages and Statistics Canada figures. There is nothing wrong with the Minister using an industry average or Statistics Canada figure as the basis for an assumption. In fact, the Minister routinely does so in alternative assessment techniques. The Minister does not have to prove the average or figure is accurate. The Minister simply makes an assumption of fact that the average or figure applied to the taxpayer. It is up to the taxpayer to demolish the assumption.

However, if no related assumption of fact is made, the information obtained from industry averages or Statistics Canada would be considered hearsay *unless* a witness is called from the source Department to explain how the figures were arrived at.

The Court provided the following example.

When conducting a net worth assessment the Minister sometimes relies on Statistics Canada averages to estimate a taxpayer's personal expenses. Say, using those averages, the Minister assumed that a taxpayer spent $1,000 a month on food for himself and his family. The Respondent would not have to call a witness from Statistics Canada to explain how that average had been determined. The Minister would simply make the assumption.

The taxpayer would have to demolish that assumption. He could do that through oral testimony or, better yet, by showing proof of his actual grocery expenditures.

The taxpayer could not, however, demolish the assumption by pointing to a report from Health Canada that said families spent $700 a month on food--unless he called a witness from Health Canada. This is because, unlike the Minister who relied on the Statistics Canada figures to form the basis of her assumption, the taxpayer would be trying to enter the Health Canada report for the truth of its contents.

We'll now summarize the alternative assessment techniques used by the parties in *Bousfield*, starting with the government. In three out of four techniques the Respondent failed to plead an assumption of fact, highlighting the issue discussed above.

### Average Daily Revenue

Ms. Canton (the auditor) reviewed a study on the Regina taxi industry that a consultant had prepared for the City of Regina. Based on her reading of that study, she assumed Mr. Bousfield's taxi earned $800 per day. She estimated the taxi was on the road 343 days per year and derived the Appellant's income from those figures.

The Court had two concerns with this technique. First, while it is clear to the judge that Ms. Canton made an assumption of fact that Mr. Bousfield's taxi earned $800 in revenue per day, 343 days per year, the Respondent did not plead those assumptions of fact in the Reply. This means that the Respondent needed to prove these facts if the Respondent wanted to rely on them. The Respondent failed to do so.

While the judge found Ms. Canton's reasoning for picking 343 days per year to be appealing, in the absence of an assumption, it is nothing more than her opinion. As for the $800 in revenue per day, the judge had no evidence for that figure at all. The Respondent cannot rely on the Regina taxi study. Had the Respondent pled the assumption that Mr. Bousfield earned $800 per day in revenue, Mr. Bousfield would have had to demolish that assumption. Without that assumption being pled, the Respondent cannot use the taxi study as evidence of daily taxi revenues in Regina.

## Average Trip Revenue Technique

Ms. Canton assumed that the average taxi trip in Regina took 20 minutes. She divided a 24-hour day by 20 minutes and concluded that there must have been 72 trips per day. She assumed an average fare of $11.40 per trip. That meant a taxi would have earned $820 per day. She multiplied that figure by the 343 working days she had used in her average daily revenue technique and concluded Mr. Bousfield's taxi had earned $281,260 in revenue each year.

The judge had two concerns with this approach. First, while it was clear that Ms. Canton made an assumption of fact that Mr. Bousfield's taxi earned $11.40 per trip, took 72 trips per day, and drove 343 days per year, the Respondent did not plead those assumptions of fact in the Reply. This means that the Respondent needed to prove these facts if the Respondent wanted to rely on them. The Respondent failed to do so.

In the absence of an assumption, the 343 days per year figure is simply Ms. Canton's opinion. So is the 72 trips per day figure. Even if the Minister had assumed that the taxi took 72 trips per day, the judge did not find that to be a reasonable approach. Ms. Canton essentially assumed that the trips were continuous. She did not build in time for washroom breaks, coffee breaks, travel in an empty taxi to pick up a customer at a specific location, or travel back from a customer's drop-off in an empty taxi.

As for the $11.40 per ride, Ms. Canton was unable to recall where she came up with this figure. It was not from the taxi study.

The judge's second concern was that Ms. Canton assumes that the taxi was driven all night. This conflicts with the Minister's pled assumptions that the taxi operated during the day and evenings on weekdays and only operated 24 hours a day on weekends. None of the witnesses provided reliable evidence regarding the hours and days they drove the taxi.

Accordingly, the Court found that the average trip revenue technique is not an appropriate means of determining Mr. Bousfield's revenue from his taxi business.

## Industry Cash to Non-Cash Ratio

The third alternative assessment technique Ms. Canton used examined the ratio of cash fares to non-cash fares.

At the time of the audit, Ms. Canton worked in the CRA's underground economy unit. Her unit had completed many audits of taxi businesses in Regina. She testified that her unit had determined that, on average, taxis collect 85% of their fares in cash and 15% in non-cash forms of payment. Non-cash fares were run through Capital Cabs. Capital Cabs provides Mr. Bousfield with a monthly accounting of those fares. That accounting is a reliable source.

Ms. Canton calculated that the total revenue from Mr. Bousfield's taxi should have been equal to his non-cash payments received through Capital Cabs divided by 15%. This is a reasonable approach but the judge had two concerns.

The first concern is that, once again, the Respondent did not plead the relevant assumptions of fact in the Reply. Ms. Canton clearly assumed that 85% of the taxi's fares were cash fares but this assumption was not pled. This means the Respondent needed to prove this fact if it wanted to rely on it. Ms. Canton's testimony that this information came from her unit's audit experience is not enough.

The second concern is that the technique assumes that, on average, the mix of cash and non-cash fares would be consistent throughout the day, week, and year. That is not an unreasonable assumption if the taxi operates in a consistent manner, but Mr. Bousfield's taxi did not operate in a consistent manner.

During the school year, the Regina public school board uses taxi drivers to transport some children to school. Various government social service bodies also use taxis to transport children. For simplicity, the judge referred to these as "child trips".

Child trips generally occurred during the daytime, on weekdays, and during the school year. Mr. Hooper (the driver to whom the Appellant leased his cab) drove those shifts. He would pick up the children in the morning, transport them to school, and then return them home at the end of the school day. In the case of younger children, Mr. Hooper had to return them home around noon.

While Mr. Hooper was free to pick up normal fares during the parts of the day he was not making child trips, it was clear child trips made up a significant part of his day. The school board and public service bodies arranged for the child trips through contracts with Capital Cabs. They paid Capital Cabs directly. Therefore, all child trips were non-cash trips.

Over the course of the entire year, child trips made up more than 75% of all non-cash fares. As a result, they had the potential to significantly skew the ratio of cash to non-cash fares. It would be unreasonable to use an industry average that did not involve child trips to determine the revenue of a taxi that frequently took those trips.

Overall, while the judge preferred this technique to the two previous techniques used by Ms. Canton, he had no evidence supporting the ratio of cash to non-cash fares and had serious concerns that the inclusion of the child trips in the non-cash fares may have significantly skewed the results.

### Actual Cash to Non-Cash Ratio

The final technique Ms. Canton used was similar to the previous technique, except instead of using industry averages, she used the ratio of cash to non-cash fares of Mr. Bousfield's taxi itself.

Ms. Canton examined a sample of the white envelopes (the system used by the Appellant to determine his income) Mr. Bousfield had provided to her. She determined what the ratio of cash fares to non-cash fares was based on those envelopes. The percentage of cash fares was slightly lower than the ratio the CRA's industry average suggested. Ms. Canton applied that ratio to the non-cash fares reported by Capital Cabs and determined what the total revenue from Mr. Bousfield's taxi would have been.

Since Mr. Hooper did not use white envelopes, the child trips were not included in the ratio Ms. Canton calculated. However, she did not make any adjustment for the child trips. Instead, she applied the ratio to all non-cash fares. This had the same effect of skewing the outcome described above.

In summary, the judge did not find any of the four alternative assessment techniques used by Ms. Canton to be reliable. In addition, three of the four techniques were neither supported by assumptions of fact nor evidence.

## Appellant's Alternative Assessment Techniques

Mr. Bousfield submitted that the Court should determine his income using one of three alternative assessment techniques: a net worth assessment, a calculation based on estimated hourly taxi revenue, or a modified version of Ms. Canton's actual cash to non-cash ratio technique. These calculations were prepared by an accountant named Loren Wirth. Mr. Wirth assisted Mr. Bousfield during the audit and his objection.

We will not review in detail these presentations and only mention that, again, the Court found none of them to accurately reflect the situation of the taxpayer, generally speaking, because of a lack of evidence.

Accordingly, the Court determined Mr. Bousfield's alternative assessment techniques proposals were inadequate.

While the Court found the Appellant's books and records inadequate, enough evidence was presented to allow the judge to make calculations of his own. In summary, the Court determined Mr. Bousfield failed to report $20,864 of his taxi revenue in 2006. A key element of this finding is that the judge found that 45% of the Appellant's fares were cash fares.

For 2007 and 2008, the judge calculated Mr. Bousfield under-reported his taxi revenue by $25,337 in 2007 and $25,605 in 2008. Accordingly, the Court found Mr. Bousfield's taxi income should be reduced by $45,509, $49,584, and $46,265 in 2006, 2007, and 2008 respectively. With respect to transportation services, the Court reduced Mr. Bousfield's revenue from his transportation business by $2,756 in 2006, $3,072 in 2007, and $4,440 in 2008. Finally, other corrections were made to expenses inappropriately claimed.

## GST Conclusions

Ms. Canton did not conduct the GST audit. Her income tax findings were passed to another auditor. That auditor made three mistakes in reassessing Mr. Bousfield's reporting periods ending between July 1 to December 31, 2007. First, he applied the wrong GST rate. He used 5% instead of 6%. Other mistakes were made that favoured the Appellant. They resulted in lower GST reassessments. That said, in determining the GST that should have been paid on what the Court determined was a reduced amount of revenue, the Court corrected the mistakes made by the auditor. Mr. Bousfield had his GST reduced to a correct amount, not an artificially low one.

## Conclusion

*Bousfield* is a very detailed decision which emphasizes the important relationship between alternative assessment techniques and the pleading of assumption of facts. Once more, it demonstrates that tax matters are never simple and taxpayers are well advised to consult with tax professionals to correctly ascertain their obligations.

# CURRENT ITEMS OF INTEREST

## Federal Budget 2023

The Federal Government of Canada's 2023 Budget was tabled on March 28. An article summarizing tax and related measures announced in the budget will be published in next month's newsletter.

## Updated T2 Guide

The CRA published the 2022 edition of its T4012 T2 Corporation — Income Tax Guide on March 9.

## Parliamentary Budget Officer Examines Corporate Loss Utilization Trends

The Office of the Parliamentary Budget Officer has released a new report that looks at trends relating to corporate loss utilization in the period 2000 to 2020.

The report notes that, during the period, carryback refunds and loss carryforward deductions, on average, reduced corporate income tax ("CIT") by $8 billion, or by 21.6% per year. This was made up of $2.7 billion in CIT carryback refunds and $5.3 billion in loss carryforward deductions.

The report notes:

> During economic downturns, corporations increased their utilization of loss carrybacks. For example, in 2008 the loss carryback refund increased to $6.8bn. For fiscal planning purposes, this stresses the importance of considering how many losses could be generated during downturns and their associated carryback CIT refund.

It warns policymakers that:

> From a fiscal planning perspective, the stock of loss carryforwards represents a fiscal risk, since profitable corporations may utilize some, or all, of their accumulated loss carryforwards to reduce their corporate income taxes payable in that year.
>
> Based on past experience, $12.3bn of the current stock of unused losses could be further used as carryforward deductions in a given year, annually lowering corporate income tax revenues by an additional $1.7 billion, which represents 2.1 per cent of our October 2022 CIT revenue projection.

The report also notes that the effective use of losses varies across sectors, with some sectors taking longer to utilize their losses and carrying forward larger stocks of losses. This could affect the responsiveness of sectors to new tax policy measures, the report recommends.

Specifically, the report says:

> A review of the composition of the stock of loss carryforwards shows that firms carrying forward larger stock of losses are those that have incurred higher amounts of losses during 2000-2020. Firms in the Finance, Mining, Manufacturing and Management of Companies sectors generated collectively more than 55 percent of the total stock of net operating and capital loss carryforwards. Three of these four sectors (the exception being finance) are also those that take the longest to deduct their loss carryforwards and are therefore less likely to respond to changes in tax incentives.

The report notes that the finance and insurance sector carries back the largest average annual amount of losses ($3.2 billion) and received the largest average yearly estimated carryback refund during the period, of $610.9 million.

The report says, from 2000 to 2020, corporations carried forward for income tax purposes, on average, 82.2% of their net operating losses. Of these, 44.8% were later used as carryforward deductions, 37.1% remain to be used, and 18.1% were never used, the report says.

Meanwhile, firms carried forward 88.2% of their capital losses, which, on average, correspond to $17.6 billion in annual loss carryforwards. Of these, 31.0% were used as carryforward deductions, 35.3% remain to be used, and 33.7% were never used, the report says.

## Electronic Signatures — Extension of Temporary Measures T183 / T183CORP / T183TRUST

Electronic signature measures announced in Budget 2021 have not been enacted, and as a result the CRA is extending its administrative measures for electronic signatures on the following forms:

- T183, *Information Return for Electronic Filing of an Individual's Income Tax and Benefit Return*;
- T183CORP, *Information Return for Corporations Filing Electronically*;
- T183TRUST, *Information Return for the electronic filing of a Trust Return*;
- T2200, *Declaration of Conditions of Employment*; and
- T2200S, *Declaration of Conditions of Employment for Working at Home Due to COVID-19*.

In order for the CRA to accept the use of electronic signatures between third parties for these forms, it is expected that identity verification has been performed by the party receiving the signed form and the electronic signature that is incorporated in, attached to, or associated with the form must satisfy the following conditions:

(a) if the electronic signature is applied to the form in person by the individual, it is applied in the presence of the other party using methods such as a stylus or finger on a tablet; and

(b) if the electronic signature is not applied to the form in person by the individual, it is either,

  (i) applied to the form that is then sent to the other party using the electronic address most recently provided to the other party for that purpose, or

  (ii) applied to the form that is then sent to the other party through an access-controlled, secured electronic location, such as a secure website, that is accessible to the individual only because the other party has made that location known and granted access to the individual.

The administrative measures for electronic signature do not extend to the discounting Forms RC71, *Statement of Discounting Transaction*, and RC72, *Notice of the Actual Amount of the Refund of Tax*.

### Electronic Signature in Software — Form T183/T183TRUST

EFILE-certified software applications may include their own electronic signature solutions developed in-house or they may contain third-party solutions integrated into the software. Electronic filers can also offer electronic signature solutions of their own choice that operate or function independently of the EFILE software. As always, it is the taxpayer's choice whether they would like to sign the form traditionally or apply an electronic signature.

You may have noticed that Forms T183/T183TRUST include a date and timestamp (Year/Month/Day and HH/MM/SS). The CRA will accept a date and timestamp that has been automatically populated by the software or manually entered by the taxpayer or electronic filer in instances where an electronic signature has been applied to the form. This will enable the CRA to track the number of instances that these forms are electronically signed for monitoring purposes. This will also support internal tracking and reporting on electronic signature use as the CRA continues to evaluate options for the application of electronic signatures more broadly.

Due to the variety of electronic signature solutions available, with each having their own default settings for displaying date and time, electronic filers may need to adjust the document formatting settings within their electronic signature service account to ensure that the date and time are displayed on the electronically signed T183. Such adjustments to document formatting settings may be needed whether the electronic signature solution is integrated into the software or if it operates independently.

### Third Party Electronic Signature Services — Certificate of Completion

In addition to the electronically signed T183 forms, third-party electronic signature services may also provide a certificate of completion for the electronic signature. Electronic filers should retain this document together with the electronically signed T183 forms in case the CRA requests them as part of their monitoring program. Retaining these certificates of completion will be especially important in the event that the electronically signed copies of the T183 forms do not display the timestamp of the electronic signature.

### Masking of Social Insurance Number ("SIN")

No matter the option used to obtain an electronic signature on the T183, electronic filers must ensure that the method used respects the safety and security of personal and tax information. To that end, the CRA has recommended to software developers that when Form T183 is printed or generated from tax software, the first five digits of the SIN be masked. You will notice that the CRA also follows this practice when generating or displaying notices and statements that contain a SIN.

The CRA encourages you to review the electronic signature options available for these forms. The CRA will continue to provide updates on a regular basis.

## 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. This feature will return next month.

## RECENT CASES

### Tax Court Finds Manufacturer's Efforts To Produce Tractor Constituted Experimental Development

The Appellant was an agricultural equipment manufacturer specializing in tractors. The CRA disallowed its claim for $3,591,220 in scientific research and experimental development ("SR&ED") expenses with respect to seven projects on its 2005 return. The Appellant's goal was to produce a line of high-horsepower 4WD tractors which met Tier II emission standards and were suitable for agricultural and commercial construction. The record detailed the Appellant's efforts to overcome difficulties in fabrication, particularly with respect to a component called the torsional coupler, and the cooling system. The CRA maintained that the Appellant's expenditures were for routine testing, quality control, and/or product development.

The Tax Court allowed the appeal with respect to the one project for which the Appellant provided evidence (project 5). Applying the five criteria set forth in the seminal *Northwest Hydraulic* decision, the Court carefully recounted the evidence and found the following. First, the Appellant addressed a technical uncertainty that gave rise to a system

uncertainty, using known techniques to address a technological risk whose outcome was not reasonably predictable. Second, the Appellant was "focused and methodical in the way it uncovered, recognized, and resolved the issues," isolating a technologically uncertain issue, framing hypotheses, and testing them. Third, the Appellant's process, formulating and testing hypotheses involving individual uncertainties, adopted "the entire scientific method (including intuitive creativity)." Fourth, given that the result was a tractor that was the most powerful on the market by a significant margin, the requirement of a technological advancement was satisfied. Finally, although the Appellant's records were "imperfect and incomplete", they were sufficient for the work, though not for ascertaining the amount of qualified expenditures. Thus the Court used the proxy method specified in the *Income Tax Act*, arriving at a figure of $972,066 of SR&ED expenditures.

*Buhler Versatile Inc. v. The King*

2023 DTC 1015

## Court Invalidates Assessments Solely Based on Variations of the "Due to Shareholder" Account

These appeals relate to assessments raised against the Appellant for taxation years 2010 and 2011. The Appellant was the sole shareholder of a corporation involved in the business of selling collectible coins or other collectibles such as stamps, miniature cars, etc. The assessments were made on the assumption that the difference in the "Due to shareholder" account from the beginning and end of the taxation periods in issue resulted in a benefit being conferred to the shareholder pursuant to subsection 15(1) of the *Income Tax Act*. Accordingly, the Appellant's income was increased by $96,734. At the outset of the proceedings, accounting errors were noticed and this resulted in the assessed amounts being reduced to $36,029.90, as agreed by the Respondent. The Appellant argued he did not receive such sums, and monies he did receive in 2010 and 2011 were reimbursements of funds he had advanced to the company in previous years. The Appellant argued that a benefit cannot be conferred to the shareholder based only on the variation of the "Due to shareholder" account during the taxation year. The Respondent argued that the only relevant analysis is that pertaining to taxation years 2010 and 2011, prior years not being relevant. The Respondent noted that the Appellant did not advance $96,374 during 2011. The Respondent considered that the Appellant artificially increased the "Due to shareholder" account to allow the corporation to pay him tax-free amounts. It therefore considered that the Appellant appropriated $96,374 from the corporation.

The appeals were allowed with costs. The sole issue being considered was whether the Respondent could conclude that a benefit was conferred to the Appellant solely based on the variation during the year of the "Due to shareholder" account. The Court agreed that an erroneous accounting entry does not result in a benefit being conferred. Jurisprudence confirms that a conferred benefit must be real and not a "legal fiction" nor an "accounting fiction" (as added by the Tax Court judge). Accordingly, the Court concluded the first requirement of subsection 15(1) was not met and that a benefit was not conferred to the Appellant. Having reached this conclusion, the Court did not need to address the other requirements needed for subsection 15(1) to apply. Consequently, the Court allowed the Appeal, with costs.

*Houle v. The King*

2023 DTC 1017

## TFSAs Carrying On A Business Trading Qualified Investments Can Be Taxed

The Appellant's 2009-2012 returns were reassessed on the ground that the Appellant carried on a business of trading qualified investments through the TFSA of which it was the trustee. On this appeal, the Appellant argued that under subsection 146.2(6) of the *Income Tax Act,* whose interpretation was the only issue, "buying and selling qualified investments does not constitute carrying on a business." The Appellant invited the Court to apply paragraph 146(4)(*b*), which serves to essentially exempt RRSPs from any tax — even if it carried on a business of trading qualified

investments — to TFSAs. The Appellant further argued that Parliament's only purpose in taxing income from "carrying on a business" was to prevent unfair competition. And it introduced, and argued at length for, a novel test for "carrying on a business" that would have resulted in an entirely new tax structure for TFSAs. The Respondent argued that Parliament's primary purpose was to create "a general-purpose savings account that allows individuals to contribute each year and withdraw funds at any time for any purpose," tax free. It further argued that TFSAs must limit themselves to qualified investments to retain their tax exemption, that the text of subsection 146.2(6) is clear and unambiguous, and that TFSAs are different from registered plans.

The Tax Court dismissed the appeal. Undertaking a textual, contextual, and purposive analysis, it held that "carrying on a business" is broad enough to capture all businesses, including trading in qualified investments. Further, the context of TFSAs' legislation is that of a group of distinct statutory schemes governing different investment products. As for Parliament's primary purpose, the Court quoted the Federal Court of Appeal, which had held that "Tax Free Savings Accounts were designed to allow Canadians to increase their savings by earning tax-free investment income." Parliament's secondary purpose was to place limits on that earning process by including all income from "carrying on a business" as taxable. Parliament could have extended the exemption granted to RRSPs by paragraph 146(4)(*b*), but did not do so. The Court has no power to redraft Parliament's TFSA legislation, which is what the Appellant was inviting it to do.

*Canadian Western Trust Company v. The King*

2023 DTC 1020

## Medical Expenses Claim Denied Because They Were Not Paid by Appellant Himself

The Appellant sought to dismiss a reassessment under the *Income Tax Act* (the "ITA") for the 2018 taxation year, in the return for which he claimed a medical expense credit under section 118.2 in respect of his mother-in-law. The Minister had reassessed the Appellant's 2018 taxation year and disallowed the total amount of medical expenses claimed. The Minister had varied the 2018 reassessment and allowed medical expenses for a dependant in the amount of $607 and allowed a disability tax credit for a dependant in the amount of $8,235. The Appellant had argued that for the purposes of section 118.2, medical expenses in respect of a dependant paid by the Appellant include medical expenses paid by the Appellant and the Appellant's spouse. The Respondent contended that the Appellant himself must have paid the medical expenses claimed for his spouse's mother but such expenses were paid from a bank account over which the Appellant had no authority, ownership, or other right.

The appeal was dismissed. In deciding whether the Appellant's total medical expenses claimed in filing his income return for the 2018 taxation year in respect of the Appellant's mother-in-law were paid by the Appellant in accordance with the requirements set out in paragraph (*d*) of item E of the formula in subsection 118.2(1), the Court observed that the medical expenses in respect of a dependant expected to be included in computing the medical tax credit claimed by an individual must be paid by the individual themself. There was no ambiguity that could be reasonably made from the wording used by Parliament within this provision. The absence of words such as "individual's spouse" and "common-law partner" in 118.2(1), item E, paragraph (*d*) was indicative of the intention not to extend the payment of medical expenses to persons other than the individual claiming the medical credit. The Appellant did not support such payments as required by 118.2(1), item E, paragraph (*d*) and also could not adduce any evidence to establish that the Appellant had any authority over the account in 2018. Hence, the appeal of the reassessment relating to the Appellant's 2018 taxation year was dismissed.

*Andrews v. The King*

2023 DTC 1021

## Taxpayer's Poker Earnings Ruled As Business Income

These are appeals of assessments raised against the Appellant in relation to taxation years 2008, 2009, 2010, 2011, and 2012. Essentially, the assessments added to his income for those years gains made by playing poker, which were considered business income, as well as penalties imposed pursuant to subsection 163(2) of the *Income Tax Act* (the "Act"). Following an agreement between the parties at the outset of the case, the appeals relating to the subsection 163(2) penalties were allowed and the penalties cancelled. The parties also agreed that should the Court consider the poker gains as business income, the Appellant's appeals should be allowed in part so that related business expenses could be deducted. The sole issue was whether gains earned by the Appellant while playing poker qualify as business income for income tax purposes.

The appeals were allowed in part. At the beginning of the hearing, the Respondent requested that the Appellant's demand to bring forward documents be quashed. The Court granted the Respondent's request as the documents sought were not relevant to the specifics of the case itself. The Appellant argued that the Court needed to determine if poker is a game of chance to win a bet or a game of skill. If it is ruled a game of chance the appeals must be allowed and the assessments cancelled pursuant to paragraph 40(2)(*f*) of the Act. The Court stated that gains from a game may be taxable income if they are indeed a source of income. The first step is to determine if the activity of a person is a source of income is to establish whether that activity, in this case poker playing, is done to realize a profit or just a personal undertaking. If the activity can be both a hobby and a business, it is necessary to decide if the activity is made to realize a profit in a sufficiently commercial manner with the objective evidence showing the behaviour of a serious businessperson. Both parties presented expert witnesses who agreed that poker was a game of chance and skill; however, the Appellant's experts disagreed with the Respondent's experts' conclusion that skill was more important than chance. The Court stated that this question, while interesting, was not relevant in determining if the Appellant exploited a commercial business. Contrary to the Appellant's opinion, poker is not a game of the type of "bet" as contemplated by paragraph 40(2)(*f*) of the Act. The Court noted that poker was the Appellant's main source of income during the years in issue. His playing was more than a hobby or playing for fun. The Appellant played to win. He played to earn a living, and as such he was a professional poker player. In fact, the vast majority of his available time was spent playing or learning about poker. The Court found that regardless of his unusual lifestyle, the Appellant behaved like a serious businessman. He avoided playing with certain players; adapted his play to his "bankroll" (available funds) to avoid dangerous situations; and during in-person games, he shared risks, costs, and profits with other persons. His gains allowed him to purchase a $525,000 house and a $37,500 car. Accordingly, the Court found that on a balance of probabilities, the Appellant had the subjective intention of earning a profit from his poker activities and he used his skills and expertise to earn a living playing poker. The Court decided the Appellant's poker gains were business income. Therefore, the Court dismissed the Appeal for 2008 and allowed in part the Appeals for 2009 to 2012, which were referred back to the Minister to reflect the adjustments agreed by the parties at the outset of the case.

*D'Auteuil v. The King*

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**TAX NOTES**

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