Tax Notes

May 2019
Number 676

Current Items of Interest 3

Focus on Current Cases 4

Recent Cases 9

Wolters Kluwer

PROPOSED STOCK OPTION CHANGES IN BUDGET 2019 — SHIFTING THE GOALPOST

— Ron Choudhury, Miller Thomson LLP

The 2019 Canadian Federal Budget (the "Budget") was released by the Minister of Finance on March 19, 2019. Widely expected to be a budget aimed at the upcoming federal elections, the tax provisions in the Budget were largely limited to technical changes. However, the Budget contained certain surprises in the form of proposals that are being considered for future legislative amendments. One such surprise was in the form of proposed changes to the stock option rules in the *Income Tax Act* (Canada) (the "Tax Act") that will limit the benefit of the favourable employee stock option rules. This article summarizes the proposal and discusses its implications.

Stock Option Proposal

The Canadian government views the policy behind the favourable stock option rules in section 7 of the Tax Act as the promotion of start-ups and growing Canadian businesses. It is unclear whether there are any historic references to this policy rationale or whether this is a new policy rationale developed by the government. In an effort to bolster this policy rationale and deny the benefit of the favourable stock option rules to high-income executives of "large, mature companies", the Budget states the government's intention to propose new measures that will impose an annual $200,000 cap on the value of securities acquired pursuant to an employee stock option grant that will be eligible for tax-preferred treatment under the current employee stock option rules. The Budget also indicated that the new rules will only apply to employees of "large, long-established and mature" businesses. Further details regarding the proposed new employee stock option rules will be released before the summer of 2019 and these new rules will apply on a prospective basis.

Current Rules

The existing employee stock option rules in section 7 of the Tax Act apply when there is an agreement to sell or issue securities that is entered into between a corporation and its employees. Although the rules are extended to certain non-arm's length situations and to issuances of securities by mutual fund trusts, this discussion solely focuses on shares issued by corporations to their employees. Where the rules apply, the grant of an option (i.e., the entering into the agreement) is not itself subject to tax, but an employment benefit is realized upon exercise of the option to acquire the securities. Subsection 7(1) contains multiple provisions dealing with various scenarios where an employment benefit is realized upon the exercise of an option. Subsection 7(1.1) states further that in the

context of options issued by a Canadian-controlled private corporation, the tax arising from the employment benefit is not payable until the time of disposition of the shares obtained upon the exercise of the options.

The benefits of the favourable stock option rules are not limited to section 7 of the Tax Act. Pursuant to paragraphs 110(1)(*d*) and 110(1)(*d*.1) of the Tax Act (and subject to certain conditions being met), the employment benefit realized as a result of the acquisition of the shares issued under an employee stock option plan may be reduced by 50% if the conditions in paragraph 110(1)(*d*.1) are met (for shares issued by Canadian-controlled private corporations only) or the conditions in paragraph 110(1)(*d*) are met (for shares issued by all corporations). These conditions include a two-year holding period (in paragraph 110(1)(*d*.1)) to a multitude of requirements in paragraph 110(1)(*d*), which includes a condition that the exercise price for the shares subject to the option be at least equal to the fair market value of the shares at the time of granting of the option.

The stock option rules have indeed been beneficially received and utilized by employers and employees. These rules allow for the deduction of one-half of the employment benefit if a set of conditions are met, thereby allowing for an employment benefit to be treated in a manner similar to the current treatment of capital gains. Employee stock options are widely used by employers to provide benefits to employees ranging from senior executives to employees making up the rank and file of an organization. It is also true that significant amounts have been realized by high-ranking employees of large organizations with the resultant reduction of taxes.

Policy Concerns

The new system of making law through proposals is problematic and perhaps emblematic in fostering transactions that should ideally not be fostered. The proposals, irrespective of their policy intent, are vague, and perhaps misdirected. While it is true that start-ups and growing businesses should benefit from beneficial tax treatment afforded to their employees, the rules in subsection 7(1.1), which defer taxation until disposition of optioned shares, and the rules in paragraph 110(1)(*d*.1), which allow the 50% deduction from employment income solely upon an employee owning the shares for at least two years, are designed to do just that. By contrast, the rules in subsection 7(1) and paragraph 110(1)(*d*) are more onerous (e.g., tax upon exercise of the option and additional requirements to get the benefits). Accordingly, it is unclear whether the rules are directed at providing beneficial tax treatment for certain employees that will not be available for others, or are yet another means of increasing tax revenue.

The exact rationale behind legislating through prospective decrees is also uncertain. To the extent that the current stock option rules are viewed as unfavourably beneficial to certain taxpayers, it is not clear why the government would not simply introduce legislation rather than proposing to legislate in the near future. Such announcements are bound to spur tax planning transactions (e.g., the implementation of option plans) that may not always make sound economic sense but are nevertheless undertaken to prevent a potential unfavourable set of rules applying to stock option rules in the future.

Issues with Proposal Language

Quite apart from any policy issues, the vagueness of the proposals leaves room for extreme interpretation of these rules and raises questions about the benefit of such announcements. For example, the concept of “long-established and mature” business is unclear. Such terms do not lend themselves to definitions in the Tax Act and it is unclear whether a Canadian-controlled private corporation that may no longer be a start-up or have achieved a certain level of success will be excluded from the favourable stock option rules.

Similarly, it is unclear whether the restrictions will deny the 50% deduction after the first $200,000 of option benefits per year such that the benefit can be staggered over time, or whether the benefits will be taken away altogether after the first $200,000. It is also unclear whether the deduction will be limited to $200,000 or whether the first $200,000 of benefits will be eligible for the deduction (although the language in the Budget seems to point to the latter). The reference to the value of the securities also leaves room for interpretation. In particular, it is unclear whether the value refers to value at the time of the granting of an option, or the value at the time of exercise.

It is expected that a number of the concerns with details and certainty in the stock option proposals will be addressed through the actual draft legislation. However, the declared intent of the rules, i.e., denying or restricting the benefit of the rules to mature businesses, may create drafting issues and gaps in the legislation, leaving the implementation to the vagaries of the Canada Revenue Agency. As it stands, there is no certainty or clarity on the future or utility of the stock option rules in section 7 of the Tax Act or the deductions in paragraphs 110(1)(*d*) and 110(1)(*d*.1).

CURRENT ITEMS OF INTEREST

Budget Bill Tabled

On April 8, 2019, the Minister of Finance tabled Bill C-97, *Budget Implementation Act, 2019, No. 1*. The bill includes certain measures from Budget 2019 plus other measures that were included in the Notice of Ways and Means Motion and were outlined in Tax Topics 2457. The bill is currently undergoing Second Reading.

Ontario Budget Highlights

On April 11, 2019, Ontario Finance Minister, The Honourable Victor Fedeli, tabled the 2019 Ontario Budget. Notable tax measures in the Budget include:

- a new refundable Child Care Access and Relief from Expenses ("CARE") tax credit, which will provide tax relief on a percentage of child care expenses that are eligible for the child care deduction, up to a dollar limit;
- a new non-refundable Low-income Individuals and Families ("LIFT") which is equal to the lesser of $850 and 5.05% of employment income (subject to a phase-out as income exceeds $30,000);
- paralleling the federal CCA measures from the 2018 Fall Economic Statement; and
- eliminating the probate fees on small estates ($50,000 or less) and extending the deadline to file the estate administration tax information returns.

A full overview of all tax measures announced in the Budget can be found in the WK Budget Dispatch.

Newfoundland and Labrador Budget

Newfoundland and Labrador Budget 2019 was tabled on April 16, 2019, by Minister of Finance and President of the Treasury Board Tom Osborne. There are no new taxes or fee increases for 2019. The government announced the continuation of the Search and Rescue Volunteer Tax Credit, which allows eligible volunteers to claim a $3,000 non-refundable tax credit from their provincial income tax return. The Budget also allocated $4 million for the Film Equity Program and renewed the Newfoundland and Labrador Film and Video Industry Tax Credit until 2021.

A full overview of the Budget 2019 measures can be found in the WK Budget Dispatch.

Prescribed Interest Rates for Q2

The CRA has published the prescribed annual interest rates that apply to amounts owed to the CRA and to amounts owed by the CRA to individuals and corporations for the second quarter of 2019. They apply from April 1, 2019 to June 30, 2019. The only rate change from the previous quarter is the rate applicable to pertinent loans or indebtedness, which will be 5.63% in Q2 2019.

Per-Hour Rulings Cost To Increase April 1

On March 27, 2019, the CRA announced that the per-hour fees for advance income tax rulings and pre-ruling consultations will increase effective April 1, 2019. The new federal *Service Fees Act* requires that fees charged by federal

departments and agencies must be adjusted annually for inflation. The rate for the first 10 hours of work on pre-ruling consultations and advance income tax rulings will increase from $100 per hour to $102 per hour, and the rate for subsequent hours will increase from $155 per hour to $158 per hour, plus taxes.

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.

Federal Court of Appeal Considers the Scope of Prejudice Due to Delay

***Akanda Innovations Inc. v. The Queen*, 2018 DTC 5122 (Federal Court of Appeal)**

This is an appeal of a Tax Court of Canada decision to dismiss the taxpayer's motion to extend the time for appealing the Tax Court's default judgment against the taxpayer. The case presented the Federal Court of Appeal with an opportunity to distinguish the test to be applied for setting aside a default judgment from the test to be applied for an extension of time to make an application to set aside a default judgment, which the Tax Court appeared to have comingled. While both tests share the central objective that the interests of justice be served, they have different approaches to achieve this.

The underlying dispute arose when the taxpayer corporation was reassessed for its 2007 to 2010 taxation years to reduce its SR&ED expenditures by more than $6 million and related investment tax credits by approximately $1.5 million. The taxpayer objected to the reassessments and this led to appeals being filed in the Tax Court of Canada. The taxpayer and the Minister agreed to an initial timetable for filing and serving documents and for completing examinations for discovery, but it appears that the taxpayer was having difficulties complying with the deadlines. The taxpayer twice sought and obtained extensions from the Tax Court to extend the time for completing the required steps.

At the time of the second application for an extension of time, the taxpayer was no longer represented by counsel; under the *Tax Court of Canada Rules* (General Procedure) (the "Rules"), a taxpayer that is a corporation must be represented by legal counsel except where specifically allowed on motion to the Court. Consequently, the Court order that allowed the second extension of time also included interim steps that the taxpayer was required to complete to satisfy the Court that the taxpayer was acting to address who would be representing it. More particularly, the order gave the parties until May 31, 2017 to file and serve documents and to September 29, 2017 to complete examinations for discovery. The order also mandated that the taxpayer inform the court by February 10, 2017 of whether it had retained new counsel or would be bringing a motion to allow representation by someone who was not a lawyer; if it did not do so, the order mandated that the taxpayer attend a show cause hearing on March 7, 2017 to determine whether the appeal should not be dismissed for delay. The taxpayer neither retained new counsel nor provided the Tax Court with an update of its intentions by the February deadline and then failed to attend the show cause hearing in March. This led to the Tax Court dismissing the appeals on March 10, 2017, pursuant to subsection 140(1) of the Rules for the taxpayer's failure to appear.

Under subsection 140(2) of the Rules, a party can make an application to set aside or vary a default judgment if the application is made within 30 days of the judgment. Sometime after the Tax Court dismissed the appeals, the taxpayer retained new legal counsel and filed an application to set aside the default judgments on July 25, 2017. But, since the application was being filed more than 30 days after the March 10, 2017, date of the default judgements, the application to set aside the judgments was accompanied by a taxpayer motion under Rule 12 of the Rules seeking an extension of time to bring the application to set aside the default judgments.

The Tax Court dismissed the taxpayer's motion. In its reasons for the decision, the Tax Court acknowledged at the outset that it was deciding a motion for an extension of time under Rule 12 but later indicated that the issue before the Court was whether it should exercise its discretion under subsection 140(2) to set aside a default judgment. Also, the Court's analysis began with an excerpt from earlier jurisprudence that outlined the factors to consider on an

application to set aside a default judgment. The Tax Court did go on to discuss and apply the factors from prior jurisprudence involving applications for an extension of time, but the Tax Court's evaluation of relevant factors seemed to give undue weight to facts that would be more relevant to the question of whether the Tax Court should set aside the default judgment than whether to grant an extension of time. For example, when considering prejudice, the Tax Court focused on the prejudice to the Minister resulting from the taxpayer's delay in completing its discovery steps and, when considering whether the taxpayer had a reasonable explanation for delay, the Tax Court focused on the taxpayer's explanations for delays in completing the steps outlined in the court-mandated timetable.

On appeal, the Federal Court of Appeal reviewed the jurisprudence that outlined the factors for a court to take into account in a motion for an extension of time. More particularly, *Tomas* (2007 DTC 5178 (FCA)) establishes that, in an order to grant an extension of time, the Tax Court must consider the following factors: (1) whether the applicant has a continuing intention to pursue the appeal; (2) whether the appeal has some merit; (3) whether prejudice to the respondent arises from the delay; and (4) whether a reasonable explanation is given for the delay. According to *Hogervost* (2007 UDTC 90 (FCA)) and *Larkman* (2012 FCA 204), an applicant need not satisfy all of the factors; "the overriding consideration is that the interests of justice be served" (*Larkman*).

The Federal Court of Appeal then found that the Tax Court decision on the motion should be set aside for three reasons. First, the Tax Court did not identify the relevant delay as being the period between the April 9, 2017 deadline for making the application to set aside the default judgments and the July 25, 2017, date on which the taxpayer filed its motion. Second, the Tax Court misdirected itself by looking at Crown prejudice and explanations for delay in the context of delays in the main appeal and not in relation to the delay in filing the application to set aside the default judgment. And, third, it was not clear from the Tax Court's reasons for decision that the Tax Court recognized that, based on prior jurisprudence, not all four factors had to be satisfied for the grant of an extension of time.

The Federal Court of Appeal then went on to render its own decision on the motion for an extension of time. Based on the four-factor test, the Court found: (1) the taxpayer had a continuing intention to pursue its application to set aside the default judgments; (2) there was sufficient merit in the taxpayer's application to set aside the default judgments; (3) the Crown suffered no prejudice as a result of the delay from April 9, 2017 to July 25, 2017; and (4) the taxpayer did not provide a reasonable explanation for this delay. Since three of the four factors favoured the taxpayer, the interests of justice supported a finding that the application for an extension of time be granted. Therefore, the Federal Court of Appeal allowed the appeal and granted the taxpayer an extension of time to make its application to set aside the default judgments but left it to the Tax Court to issue a decision on the application.

Once again seized of the taxpayer's application to set aside the default judgments, the Tax Court requested additional written representations from counsel on the issue and disposed of the application without further hearing. In an interim order issued on February 18, 2019, the Tax Court set aside the default judgments and declared that the Appellant had met the applicable factors to be considered on an application to set aside a default judgment.

As noted earlier, the factors for setting aside a default judgment are similar to those that a Court is to take into account when deciding whether to grant an extension as follows, according to *GMC Distribution Ltd.* (2009 GTC 974 (TCC)):

- The application should be made as soon as possible after the taxpayer learns of the judgment;
- Mere delay will not bar the application unless the Crown will suffer irreparable harm or the delay is wilful;
- The taxpayer will need to explain the circumstances which resulted in the default judgment which would justify setting the default judgment aside;
- The taxpayer will need to show that the appeal that was dismissed has merit and this is particularly the case if the delay in bringing the application to set aside the default judgment is long;
- The Court is to consider the relative effect on the taxpayer and the Crown of setting aside the default judgment and of not doing so; and
- The factors are not to be applied in a rigid manner.

According to *Izumi* (2014 TCC 107), the correct and analytical framework is not to apply a rigid set of factors but

rather to consider a more contextual approach; "the 'overriding consideration' should be the relative effect on the persons that will be affected by the decision."

The same judge of the Tax Court (Rossiter CJ) issued the decision that was the subject of the appeal to the Federal Court of Appeal. Following the hearing of the original motion, the Chief Justice appeared disinclined to allow the Tax Court to exercise its discretion. At the time, the Court found the taxpayer's apparent disregard for the Court's specific directions to be inexcusable. But his views seem to have evolved in the meantime. In the interim order, he expressed sympathy with the taxpayer corporation's explanation for why they missed their status hearing, stating: "it appears there was lack of experience in the Tax Court of Canada's matters, a breakdown with their legal counsel and, for whatever reason, a failure to understand or comprehend the Court Order outstanding." He further elaborated in the next paragraph: "the lack of compliance with the Tax Court procedures and process was due to a lack of communication provided by the counsel of record on how the appeal was proceeding." This explanation, combined with the merit of the appeal and the lack of harm suffered by the Minister, were persuasive to him. It appears as if the Chief Justice did not want to deny justice to an appellant merely because that taxpayer's (presumably former) lawyers were inexperienced or disorganized. But it is unlikely he would have been as persuaded had the taxpayer not obtained better counsel.

— *Hilary Smith, Articling Student*

Court Finds Corporation's Cost of Space Trip Resulted in Substantial Benefit to Shareholder

***Guy Laliberté v. The Queen*, 2018 DTC 1132 (Tax Court of Canada)**

In the *Laliberté* case, the Tax Court of Canada held that the taxpayer's trip to the International Space Station ("ISS") gave rise to a substantial benefit conferred on the taxpayer by his family holding company, thus engaging the shareholder benefit provisions in subsections 15(1) and 246(1) of the *Income Tax Act* (the "Act").

The taxpayer, Guy Laliberté, is a well-known businessman who cofounded Cirque du Soleil in 1984. In 2009, the taxpayer took a 12-day trip to the ISS. The trip was part of a "Poetic Social Mission" to raise awareness on the availability of clean pure water, for the benefit of One Drop Foundation, a charity publicly associated with Cirque du Soleil. Cirque du Soleil produced a documentary entitled *Touch the Sky* on the taxpayer's journey, which it used to promote its business.

The $41.8 million cost of the trip was paid for by the taxpayer's family holding company and then charged by it to the top operating company in the Cirque du Soleil corporate group, Creations Meandres Inc. For financial accounting purposes, Creations Meandres Inc. deducted the cost of the trip, less $4 million which was reported by the taxpayer as a shareholder benefit. However, for income tax purposes, no deduction was claimed in respect of the cost of the space trip.

The Minister of National Revenue reassessed the taxpayer on the basis that the full $41.8 million cost of the trip gave rise to a shareholder benefit. Before the Tax Court, the taxpayer argued that the entire $41.8 million cost was deductible by Cirque du Soleil as a marketing or promotional expense and that therefore, there was no shareholder benefit.

The Tax Court found that the "motivating, essential and overwhelmingly primary purpose of the space travel was personal." The Court found that the taxpayer made the decision to travel without consulting Cirque du Soleil and that it was never a possibility that any other Cirque du Soleil official, entertainer, or promoter would take the trip in place of the taxpayer. Boyle J cited numerous facts to support this conclusion, including that:

- the resolution of the family holding company authorizing the payments did not set out a purpose for the taxpayer's trip, nor did it otherwise tie the trip or payment to Cirque du Soleil's business;
- the Space Flight Agreement was between Space Adventures Ltd., on the one hand, and the taxpayer and his family holding company, on the other hand, and was negotiated representing only the interests of the taxpayer and his family holding company, rather than Cirque du Soleil;

- both the cancellation insurance policy and the accidental death and dismemberment policy for the taxpayer while on the trip were taken out and borne by the family holding company, which was also the named beneficiary of the policy;
- no thought was given to the reasonably expected value to Cirque du Soleil of the space trip before it was completed and Cirque du Soleil did not do any analysis or investigation of the value to it of the anticipated media coverage;
- due to the way in which the transactions were structured, which involved a capital contribution to Creations Meandres Inc. in the full amount that Creations Meandres Inc. paid for the space trip, neither Creations Meandres Inc. nor its 20% minority shareholder bore any of the economic cost of the space trip (a reasonable inference from all the evidence was that Cirque du Soleil would not have approved the expense at the time of the trip, and only did so two months after the trip ended when the capital contribution arrangements were agreed upon); and
- in a video of the trip, the taxpayer referred to himself as a "space tourist" fulfilling his personal dream and gave three reasons for making the trip, none of which related to Cirque du Soleil.

While the Court determined that the trip was a personal trip taken by the taxpayer, the Court also determined that:

> . . . genuine, *bona fide* Cirque du Soleil business activities were undertaken by the [taxpayer] while preparing for and during his space trip, and Cirque du Soleil used his space trip to promote itself and some of its activities [. . .].

As stated by the Court:

> Simply put, there is a difference between a business trip which involves or includes personal enjoyment aspects, and a personal trip with business aspects, even significant ones, tacked on. I have found that this space trip falls into the latter category, and the tax consequences to the business income are considered and determined accordingly.

The Court allocated the cost of the trip between deductible business expenses and non-deductible personal expenses (which personal expenses gave rise to a shareholder benefit). While there was very little evidence of the value of the trip to Cirque du Soleil, the Court concluded that an allocation in the range of 0% to 10% of the cost of the trip would be a reasonable charge to Cirque du Soleil. The Court fixed the business-related portion of the cost of the trip at the top of that range, $4.2 million.

Boyle J concluded that approximately 90% of the cost of the trip, being $37.6 million, was a benefit conferred on the taxpayer as a controlling shareholder, thus triggering the benefit provisions in subsections 15(1) and 246(1) of the Act.

This case has been appealed to the Federal Court of Appeal.

— *Jaspreet Kaur*

Lawyer Entitled To Deduct Fees To Store Files From Discontinued Legal Practice

***Tournier v. The Queen*, 2018 DTC 1164 (Tax Court of Canada (Informal Procedure))**

The issue in this case was whether file storage fees incurred by the taxpayer after the discontinuance of her legal practice were deductible business expenses under the *Income Tax Act* (Canada). Consistent with prior jurisprudence, the Tax Court held that such fees were deductible, on the basis that they were incurred by the taxpayer to satisfy her "run off" responsibilities as a practicing member of the legal profession and to mitigate future risks relating to her professional liability.

The taxpayer was a member of the Nova Scotia Barristers' Society and had been a practicing lawyer for over 27 years. In 2012, she moved her client files to storage and briefly continued her legal practice out of a home office before withdrawing completely from private practice in 2013. In her 2015 income tax return, the taxpayer claimed deductions of $57.00 for professional dues and $1,200.00 for file storage fees. The Minister of National Revenue disallowed the file storage fees. The taxpayer appealed the assessment under the Tax Court's informal procedure. For reasons not disclosed in the judgment, the taxpayer did not appear before the Tax Court on the hearing date, but

instead requested that the appeal proceed on the basis of an agreed statement of facts and written submissions.

The Minister took the position that the deduction of the file storage fees was prohibited by paragraph 18(1)(*a*) of the *Income Tax Act*, which provides that no deduction shall be made in computing a taxpayer's income from a business or property for any outlay or expense "except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property." The Minister submitted that the file storage fees did not have an eligible income-earning purpose because they were incurred two years after the taxpayer wound up her legal practice. The Minister referred to the *Pearlman* decision (97 DTC 565 (TCC), aff'd 98 DTC 6657 (FCA)), in which the Tax Court held that a lawyer could not deduct purported business expenses relating to his prior legal practice that were incurred in the first three years after he wound up his legal practice. The Minister also referred to the *Jamieson* decision (2013 DTC 1067), in which the Tax Court held that "being a lawyer is not, in and of itself, a business" and concluded that continuing legal education ("CLE") costs incurred by an in-house legal counsel to maintain his professional certification as a lawyer were not deductible business expenses.

The taxpayer, for her part, took the view that the file storage fees had an eligible income-earning purpose, relying primarily on the principles articulated by the Federal Court of Appeal in *Poulin* (96 DTC 6477). The issue in that case was whether a former real estate broker could deduct damages paid to former clients in connection with a successful civil suit against him for fraudulent misrepresentation, where the payment had been made by the broker three years after the termination of his brokerage business. The Court held that deductibility would not be precluded solely by reason of the timing of the payment, reasoning that the broker "cannot be considered to have ceased his activities as a broker as long as he was engaged in completing the things he had done in carrying on his profession". The Court added, however, that for the payment of damages to have an eligible income-earning purpose, it must "be seen as the unfortunate consequence of a risk that the taxpayer had to take and assume in order to carry on his trade or profession." On the facts in *Poulin*, the Court found that this second requirement had not been met because the broker's fraudulent activities were not integral to his brokerage business, and accordingly concluded that the payment of damages was non-deductible.

The Tax Court accepted the taxpayer's reasoning in this case that her legal services business continued to exist in 2015 notwithstanding her withdrawal from private practice in 2013. During her years in private practice, she had accrued certain file retention, accessibility, and storage responsibilities as well as future risks relating to her professional liability. These ongoing responsibilities and liabilities were "inherent risks of the profession" that extended beyond the temporal period in which she was engaged in providing legal advice. On the basis of the authority in *Poulin*, these ongoing responsibilities and liabilities were "referable and connected to the income earned in previous years", and so the fees paid to satisfy such ongoing responsibilities and liabilities were properly deductible.

The Tax Court's decision in this case is consistent with earlier jurisprudence on the deductibility of business wind-up expenses. See, for examples, *Génier* (2011 DTC 1058: expenses incurred during a five-year search for a purchaser of a retirement home following the discontinuation of a retirement home business); *Langille* (2009 DTC 1431: agricultural production costs incurred following the termination of dairy farm operations and during the piecemeal sale of land over 10 years); *Raegele* (2002 UDTC 94: repair costs for tenant damage to a rental property incurred after the landlord's decision to convert the rental property for personal use); and *Selig* (55 DTC 46: the liability of an innocent purchaser for stolen scrap metal received during the operation of his sole proprietorship that was satisfied following the incorporation of his business).

Interestingly, the Tax Court's decision in *Tournier* is also consistent with the CRA's previous administrative statements regarding the deductibility of:

(i) run-off professional liability insurance premiums (2015-0618981E5 and 2004-0091011E5),

(ii) foreign sales taxes assessed following the cessation of a business (2006-0198331E5), and

(iii) legal fees and damages paid by an estate after the estate's settlement of a dispute following the death of the deceased building contractor (2002-0143315).

In light of the substantial jurisprudential and administrative authority confirming the general deductibility of business wind up costs, the Minister's reticence in *Tournier* is puzzling, especially when one considers the relatively small amount of the deduction at issue. Perhaps the Minister in this case should have been more mindful of the well-established rule

— described as a “basic tax premise” by the Tax Court in *Génier* — that costs incurred in connection with the wind-up of a business are generally deductible business expenses.

— *Kabir Jamal*

RECENT CASES

On judicial review, Minister ordered to re-determine her decision not to reassess corporate taxpayer’s tax following its over-reporting of income

The corporate taxpayer over-reported its income and then asked the Minister of National Revenue (the “Minister”) to reassess its taxes under subparagraph 152(4)(*a*)(i) of the *Income Tax Act*, arguing that the over-reporting error was due to negligence. However, the Minister decided that she did not have discretion under subparagraph 152(4)(*a*)(i) to comply with the taxpayer’s request. The taxpayer applied to the Federal Court for judicial review of the Minister’s decision, arguing in part that this decision was not reasonable.

The taxpayer’s application was granted. The issue in this case was whether the Minister reasonably decided that no discretion existed under subparagraph 152(4)(*a*)(i) of the Act enabling her to reassess the taxpayer’s tax for its 2009 and 2010 taxation years. The Minister’s refusal in this case to reassess such tax was not appealable to the Tax Court of Canada. This meant that the Federal Court had jurisdiction to deal with the matter, despite the taxpayer’s argument that the matter fell within the exclusive jurisdiction of the Tax Court. In addition, the issue in this case involved the Minister’s interpretation of her enabling statute. There was nothing to indicate that, in performing this task, the Minister carried out any textual, contextual, or purposive analysis of the relevant statutory provision. On the reasonableness issue alone, however, the conclusion was that the taxpayer should succeed. The matter was therefore referred back to the Minister for re-determination.

Revera v. Canada (MNR)

2019 DTC 5025

Although the Court ruled that s. 8 Charter rights of the Applicants were violated, the evidence so obtained should not be excluded from trial proceedings

The Applicants were charged with four counts of wilfully evading taxes pursuant to section 239(1)(*d*) of the *Income Tax Act* by making false statements on their income tax returns, and with 24 counts of wilfully obtaining unwarranted tax credits by overstating business expenses in the corporation’s tax returns pursuant to section 327(1) of the *Excise Tax Act*. The criminal charges were laid after what began as a typical audit resulted in the file being transferred to criminal investigations. The criminal investigators obtained search warrants and production orders for records relating to the above-noted offences. The evidence that supported the grounds for the warrants and production order largely came from information learned during the audit. The Applicants now argue that their rights as guaranteed by sections 7 and 8 of the Charter were violated because the auditor improperly used her audit powers to secure the relevant information. The Applicant also raised some additional issues about the execution of the warrants. Crown counsel took the position that there were no Charter breaches.

While rights were violated under section 8 of the Charter, the application to deny the admission of evidence was denied. The Court found that the CRA investigators violated Mr. Mariani’s and MMFL’s section 8 Charter rights when they conducted a thorough search of the data storage units found in the premises at MMFL and at Mr. Mariani’s residence. On the execution of the warrants, the Court ruled that it was reasonable to the investigators to take months to complete the search of computers seized and this breach of section 8 was not made out. Having found a section 8 breach, the Court addressed subsection 24(2) of the Charter to determine if the evidence should be excluded from the trial. Firstly, while all Charter breaches are serious, in this case, the breaches are at the lower end of the continuum. Secondly, the impact of the Charter breach was minimal in the view of the Court, while the judge was mindful of the

increased privacy interest in computers given the vast amount of personal information stored in digital data storage devices. Nevertheless, the scope of what the investigating CRA officers were looking for was limited to material where the privacy interest was arguably reduced. The CRA officers limited their search to banking records, tax forms, invoices, and similar documents. Thirdly, there is a strong societal interest in having these allegations tried on their merits. The judge was mindful, given some of the questions posed during the *voir dire*, that a substantive defence is likely to be launched, but these are serious allegations involving an alleged significant fraud on the public purse. Moreover the material seized is all reliable documentary evidence. Therefore, the Court found that admission of the evidence at the Applicants' trial would not put the administration of justice into disrepute and as such the evidence should not be excluded.

The Queen v. Mariani

2019 DTC 5032

Judicial review confirms reasonableness of redactions on documents obtained under the *Access To Information Act*

This is an application for judicial review pursuant to section 41 of the *Access to Information Act* ("ATIA"). The applicant seeks a review of the decisions from the Canada Revenue Agency ("CRA"), Access to Information and Privacy Directorate ("ATIP Directorate"), denying several Access to Information requests ("AtIRs") for third-party information. The applicant, Bradwick Property Management Services Inc. ("Bradwick"), engaged in business since 2003, with corporations controlled by its accountant, ("Fromstein Corporations") allegedly providing services to Bradwick. The amounts billed by the Fromstein Corporations to Bradwick were not accepted by the CRA, which found that these services were either not rendered or the fees charged for the services were not reasonable. It issued Notices of Reassessment to Bradwick regarding deductions under the *Income Tax Act* ("ITA") and input tax credits ("ITCs") pursuant to the *Excise Tax Act* ("ETA"). The 2014 AtIRs were directed to the CRA and sought information, answers, and documents related to the Notices of Reassessment. Some were granted, others denied, and some of the granted requests were inappropriately redacted in the opinion of the Applicant. Bradwick sought judicial review regarding the redactions made by the ATIP Directorate.

The application was allowed only in respect of information already in possession of the Applicant. Various arguments were presented by the Applicant including one which was presented at the trial and not included in the Notice of Appeal. This dealt with two redacted letters ("First and Second Letters") sent to the Applicant while non-redacted versions of the same letters were publicly issued. The Applicant relied on this to argue that a related third letter to the CRA from Fromstein ("Third Letter"), which was provided to Bradwick in redacted form, should likewise be treated as non-confidential (and produced without redactions) even though it was never made publicly available. The parties and the judge agreed that the standard of review to be applied in the present case is reasonableness where the redaction involved an exercise of discretion, and correctness where there is no discretion. The Court ruled that the restrictions in section 241 of the ITA and in section 295 of the ETA against disclosure of confidential taxpayer information do not apply to publicly available information such as the First Letter and the Second Letter. However, this does not apply to the Third Letter because it is not available to the public. With respect to the other arguments, the Court stated that the Minister maintains a limited discretion to release (or withhold) confidential information. Other provisions within section 241 of the ITA and section 295 of the ETA permit, but do not oblige, disclosure of information. Based on its analysis of the facts and evidence, the Court concluded that the only redactions in issue that are improper are those from the First Letter and the Second Letter. Since these letters were already in the public domain in unredacted form, it was improper to withhold portions of them. Since these are publicly available, there is no reason these should be re-produced. With respect to the other arguments presented, the Court stated that the Minister maintains a limited discretion to release (or withhold) confidential information. Having reviewed the redactions in issue, the Judge found none that withhold information that can reasonably be regarded as necessary to either (i) the administration or enforcement of either the ITA or the ETA, or (ii) determining the amounts owed by Bradwick under either act. It is clear that the redactions were limited to information concerning third parties, and it is apparent that this was the reason for withholding this information. The Court was not prepared to conclude that it was unreasonable for the Minister to fail to recognize the relevance of the redacted information to Bradwick's Notices of Objection. Accordingly, the present

application has merit only in respect of information that is already in the Applicant's possession, and the Respondent is not ordered to alter the redactions made in its various other responses to the applicant's requests in issue.

Bradwick v. MNR

2019 DTC 5031

Motion to stay proceedings pending resolution of related tax appeal allowed

An action in negligence was brought by an estate against the law firm which it had engaged to create a tax planning strategy. Following the implementation of that strategy, an assessment was issued against the estate which resulted in the imposition of tax in the amount of $9 million, and the estate appealed from that assessment. The defendant law firm brought a motion seeking a temporary stay of the negligence action, pending the disposition of the related tax appeal.

The motion was allowed. The Master in Chambers noted that the Court possessed the authority to "stay any proceeding in the court on such terms as are just". He held that there was a substantial overlap of issues in the negligence action and the tax appeal, that the two proceedings shared the same factual background, and that a stay could avoid unnecessary and costly duplication of judicial and legal resources. As well, he held that any delay in the conduct of the negligence action did not result in significant prejudice to the plaintiff such as would outweigh the necessity for a temporary stay. He held that the resolution of the tax appeal would be "quite informative" for the ongoing conduct of the negligence action. The Master concluded that the imposition of a stay, pending the outcome of the tax appeal, would avoid potentially duplicative matters proceeding and potentially different results possibly emerging from two different courts, and that there was no other step or remedy which would achieve the same result. Accordingly, the motion for a stay of the negligence action was granted, pending the decision of the tax appeal before the Tax Court of Canada and any appeals therefrom.

Kaye et al. v. Fogler Rubinoff et al

2019 DTC 5021

TAX NOTES

Published twelve times per year by Wolters Kluwer Canada Limited. For subscription information, see your Wolters Kluwer Account Manager or contact customer service.

For Wolters Kluwer Canada Limited

Email: cservice@wolterskluwer.com *Phone: 1-800-268-4522 or (416) 224-2248 (Toronto)*

Notice: *Readers are urged to consult their professional advisers prior to acting on the basis of material in this newsletter.*

Wolters Kluwer Canada Limited
300-90 Sheppard Avenue East
Toronto ON M2N 6X1
1 800 268 4522 tel
1 800 461 4131 fax
www.wolterskluwer.ca

© 2019, Wolters Kluwer Canada Limited

Wolters Kluwer