Tax Notes

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PARENTAL INFLUENCE OR ABDICATION? THE UK COURTS GRAPPLE WITH CENTRAL MANAGEMENT AND CONTROL[1]

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The UK Court of Appeal's decision in *HMRC v. Development Securities plc and others*[2] is noteworthy because it highlights the difficulties that may arise in determining the location of central management and control ("CMC") for wholly-owned subsidiaries/special purpose vehicles ("SPVs"), particularly where the SPV is transitory in nature or formed for the purpose of implementing a single transaction, and is controlled by a parent entity that also proposes the transaction. As part of the commonwealth, the decision may be instructive for Canadian tax purposes.

Background: The Tax Plan and Lower Level Decisions

The tax planning at issue sought to use latent losses on certain subsidiaries and properties (collectively, the "Properties") within a UK group of companies to offset gains elsewhere within the group, while benefiting from indexation relief (i.e., factoring in inflation on a disposition to account for the "true" loss). The group stood to save £8 million.

The steps taken to implement the tax plan may be summarized as follows:

(1) The parent company ("Parent") incorporated new wholly-owned subsidiaries in Jersey (the "JerseyCos"). The JerseyCos had four directors — one was a UK resident and three were residents of Jersey (the "Jersey Directors").

(2) Call options (the "Options") were issued to the JerseyCos entitling them to buy the Properties at an overvalue (i.e., in excess of the fair market value) if certain conditions were satisfied (e.g., that the FTSE Real Estate Total Return Index closed at 2082 or above for at least five consecutive days in a specified period, and approval was obtained from Parent).

(3) The Options were exercised and Parent provided the funds needed to acquire the Properties through capital contributions and share subscriptions.

(4) The Jersey Directors resigned and were replaced by UK-resident directors.

(5) The Properties were transferred to other companies within the UK group.

The tax plan ultimately hinged on the JerseyCos being resident in Jersey when they exercised the Options.

Her Majesty's Revenue and Customs ("HMRC") argued that the JerseyCos' board of directors abdicated their responsibilities and that the relevant decisions for CMC purposes

[1] The authors wish to thank Mark Tonkovich for reviewing a draft of this article.

[2] [2020]EWCA Civ 1705, [*Development Securities*].

were made by Parent in the UK, such that the JerseyCos were resident in the UK.

HMRC succeeded before the First-Tier Tribunal (the "FTT"),[3] which found that the JerseyCos' CMC was in the UK at the relevant time because the Jersey Directors merely followed Parent's instructions, acting as a rubber stamp. Central to the FTT's ruling was the finding that the Jersey Directors were not "actively engaging" in a decision to implement the tax planning by acquiring the Properties at an overvalue. In this regard, at paragraph 423, the FTT stated:

> The Jersey board were not, therefore, actively engaging in a decision to implement the tax planning by acquiring the assets at an overvalue in exercise of their discretion as directors. That decision was made by [Parent] and the directors merely gave their formal approval (as we would say they had undertaken to do from the outset) as they were instructed to do. The directors did not consider for themselves whether the transaction was for the companies' or the parent's benefit as part of a decision making process. There is no evidence that there was any discussion of that at any of the board meetings. Any discussion was confined to the legality position. That there was a benefit was certified to them simply as part and parcel of the "instruction" given to the board. Acting on the basis of such a confirmation is not the same thing as the board considering the issue independently in exercise of their own discretion in active engagement with the substantive decision to be made.
>
> [emphasis added]

The taxpayers appealed to the Upper Tribunal (the "UT"),[4] which reversed the FTT's decision on the basis that the FTT had erred in law in concluding that the Jersey Directors had abdicated their responsibilities. Among other criticisms, the UT determined that the FTT erred (i) in viewing the acquisition of the Properties (at an overvalue) as uncommercial, and (ii) in founding its decision on the Jersey Directors having failed to decline to do something that was improper or inadvisable (i.e., entering into uncommercial transactions by exercising the Options).

The Court of Appeal's Decision

HMRC appealed to the UK Court of Appeal (the "CA") on the grounds that, *inter alia*, the UT mischaracterized the basis on which the FTT reached its conclusion on the JerseyCos' residence. The CA provided a lengthy (see paragraphs 72 – 84) criticism of the UT's reasons for judgment. Essentially, the CA concluded that the FTT properly understood the transactions at issue — its decision did not rest on the duties of the Jersey Directors and was rightly focused on the Jersey Directors' actions. As such, the UT's criticisms of the FTT's decision were not well founded and the CA allowed HMRC's appeal.

Although the decision rejects the UT's reasons for overturning the FTT's decision, it does not (fully) confirm the FTT's reasoning regarding CMC. For example, Lord Justice Nugee makes this clear in the following paragraphs (which were given as part of one of the three sets of concurring reasons, and with the following comments therefore appearing to be *obiter dicta*):

> 94. [. . .] I have very considerable reservations about the FTT's reasoning and would not want this outcome to be seen as an endorsement by me of the FTT's reasoning. [. . .]
>
> 101. Mr Grodzinski [counsel for the taxpayers] said that the FTT's decision was the first time in any case where the local board of directors of a company had actually met, had understood what they were being asked to do, had understood why they were being asked to do it, had decided it was lawful, had reviewed for itself the transactional documents, had been found not to have acted mindlessly, but had nevertheless been found not to have exercised CMC. He submitted that that was a significant departure from the previous case law. That seems to me to be right.
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> 103. [. . .] I do not think the authorities establish that CMC can only be exercised by "actively engaging" with the decision if that means (as it appears the FTT meant) considering for themselves the merits and demerits of a proposal. The question is not why the directors made the decision they did, or how much thought they gave to it, or what they did or did not take, or should or should not have taken, into account. The question is a much simpler one, namely: did they make the decision? [. . .]

[3] [2017] UKFTT 565 (TC).

[4] [2019] UKUT 169 (TCC).

In contrast, Lord Justice Newey (who wrote the most detailed analysis allowing the appeal, and with whom the other two justices agreed for purposes of disposing of the appeal) did not express any views regarding Nugee LJ's reservations, given that full argument had not been made on those points. Further, Lord Justice Richards stated that he had no concerns with the FTT's decision or its reasoning.

Comments

The potential disagreement between the three CA justices on the substantive aspects of the FTT's approach to CMC highlights select difficulties that may arise in applying the CMC test to SPVs, particularly where the SPV is transitory in nature or formed for the purpose of implementing a single transaction, and is controlled by a parent entity that also proposes the transaction. In this regard, there are three key takeaways.

First, the appropriate test for determining the CMC of an SPV remains that established by *De Beers*.[5] The test is premised on analogizing a corporation to an individual. This analogy typically works because a corporation and an individual follow a similar existence: They are born, live, and die. And, drawing from the words of Lord Chancellor Loreburn in *De Beers*:[6] Although a corporation does not eat or sleep, it can keep house and do business. Accordingly, a corporation is resident where its real business is carried on.

However, applying this analogy to SPVs can be challenging. For example, where there is influence from a parent corporation, it can be difficult to draw the line between a board of directors fulfilling its (limited) responsibilities and an abdication of those responsibilities. In this regard, at paragraph 401, the FTT stated:

> [. . .] it does not necessarily follow that CMC of an overseas group company, which has been formed for a specific purpose (whether as part of a tax plan or otherwise), is in the UK if it falls in with the plan of the parent of the group and does what is expected, provided that proper consideration is given to the proposal and the directors are in fact exercising their discretion to exercise CMC of the company.
>
> [emphasis added]

With the FTT's decision now reinstated, uncertainty may exist as to what constitutes "proper" consideration of a proposal or "actively engaging" in a decision when an SPV participates in a tax plan orchestrated by its parent. Accordingly, it will be important to produce evidence establishing that the directors turned their minds to the decision to be made, and then made the decision on behalf of the company.

Second, the FTT and UT confirmed that *HMRC v.Smallwood*[7] is irrelevant for determining CMC of a corporation because it deals with different issues: the residence of a trust under a tax treaty tiebreaker rule and the notion of "place of effective management".[8] As such, *Wood v. Holden*[9] remains the most recent decision from the CA on corporate CMC (prior to *Development Securities*).[10]

Third, this case reminds us that memories can fade and that directors may not be able to provide sufficient testimony as to their actions when questioned years later — stressing the importance of clear supporting documentation.

Following this decision, CMC best practices for SPVs include:

- Ensuring that the board of directors is aware of, and sufficiently understands, the legal test for CMC;

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[5] *De Beers Consolidated Mines Ltd. v. Howe*, [1906] A.C. 455, [*De Beers*].

[6] *Ibid*, at page 458.

[7] [2010] EWCA Civ 778, [*Smallwood*].

[8] *Supra*, notes 2 and 3 at paras. 389 and 66 – 67, respectively.

[9] [2005] EWHC 547 (Ch) and [2006] EWCA Civ 26. This case involved an SPV that was wholly owned by a parent company. The England and Wales High Court (Chancery Division) concluded that the CMC rested with the corporation's board of directors even though it was a wholly-owned subsidiary that was created for specific purposes and carried out said purposes in accordance with the intentions, desires, and influence of its parent.

[10] For examples of the Tax Court of Canada referring to *Wood v. Holden* in regard to CMC, see: *Landbouwbedrijf Backx B.V. v. The Queen*, 2018 DTC 1104 (TCC), rev'd on other grounds 2019 DTC 5143 (FCA), and *Garron Family Trust v. The Queen*, 2009 DTC 1287 (TCC), aff'd 2010 DTC 5189 (FCA) (sub nom. *St. Michael Trust Corp. v. Canada*), aff'd 2012 DTC 5063 (SCC) (sub nom. *Fundy Settlement v. Canada*).

- Recognizing that the CMC test is a factual enquiry and that the courts will examine the surrounding facts (i.e., including before and after the relevant time);
- Taking steps to retain other evidence that supports the consideration given to the decision by the directors, such as emails between directors and meeting minutes evidencing that the directors contemplated the proposals and actually engaged in the decision-making process; and
- Institutionalizing CMC best practices so that they are consistently followed.

Now that corporations have grown accustomed to modernizing their business practices and adopting new technologies in reaction to the COVID-19 pandemic, thought could also be given to how technologies can assist in facilitating and documenting a board's decision-making process. For example, board of directors' meetings could be recorded on video. If the revenue authorities challenge a corporation's residency, a video recording (demonstrating appropriate board activities) should help evidence whether the board gave the requisite consideration to a proposal and ultimately exercised CMC in making the decisions for the company. While this may be impractical for boards that meet regularly and conduct significant amounts of business, it could be useful in the context of an SPV where the board meets only once or twice.

Going forward, it will be interesting to see the treatment this case receives — particularly, to see what weight will be given to Nugee LJ's reservations.

COVID-19 UPDATE

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

Federal

Bill C-14 Receives Royal Assent (May 6, 2021)

Bill C-14, *Economic Statement Implementation Act, 2020*, received Royal Assent on May 6, 2021. The bill enacted two income tax measures. First, it amended the Canada Child Benefit to provide additional support to families with children. Second, the bill amended the definition of "qualifying rent expense" for the purpose of the Canada Emergency Rent Subsidy; this change allows an entity to claim expenses when they are due rather than when they are paid.

Provincial

Alberta

New Wage Subsidy Launched (May 19, 2021)

The new Alberta Jobs Now program will provide businesses and non-profits a grant that covers 25% of an employee's salary for a 52-week period up to a maximum of $25,000 per employee. The grant can be used to cover salary or training costs. Employers who hire persons with disabilities will receive a grant 1.5 times higher than the amount they receive for other new employees. Employers can apply for funding for up to 20 new employees.

Employers can apply at alberta.ca/jobsnow. Employers have until August 31 to apply. A second intake will open on September 15 and close on December 31.

To be eligible for the program, private sector business or non-profit organizations must use the funding to hire unemployed Albertans in a new or vacant position. The new hire must reside and work in Alberta and must not have worked for the employer within the past 90 days.

See alberta.ca/jobsnow for further information.

British Columbia

More Businesses Eligible for Circuit Breaker Business Relief Grant (April 26, 2021)

The Circuit Breaker Business Relief Grant has been expanded to include more than 5,300 hotels, motels, and other short-term accommodations impacted by the April 23 emergency order to restrict travel between BC's regional zones. The grant has also been clarified to include high-intensity fitness facilities that were partially or fully closed because of the provincial health officer's orders issued in November 2020 and updated on March 31, 2021. For further details, see www.gov.bc.ca/business-relief.

Nova Scotia

Expanded Small Business Real Property Tax Rebate Program Opens (May 14, 2021)

More types of businesses are now eligible for the Small Business Real Property Tax Rebate Program, which opened to applications on May 14, 2021. The program has been expanded to include live performing arts organizations and independent retailers with a physical location, such as bookstores or clothing stores.

The Small Business Real Property Tax Rebate Program provides eligible businesses with a one-time rebate of a portion of their paid property taxes. They can choose a rebate of $1,000 or 50% of the commercial real property taxes paid for the final six months of the 2020–2021 tax year.

Small Business Impact Grant Part 3 (May 4, 2021)

The new Small Business Impact Grant Part 3 will provide grants of up to $5,000 for Nova Scotia businesses directly affected by the April 2021 restrictions. Eligible businesses will receive a one-time grant of 15% of their sales revenue for the month of April 2019 or February 2020, up to a maximum of $5,000.

For businesses established after March 15, 2020, the grant amount will be calculated as 15% of the sales revenue for any month from April 2020 to March 2021. The applicant can choose the month.

Businesses must have experienced an average monthly revenue decrease of 30% or more for the period of March 1, 2020, to February 28, 2021, compared to the same time the previous year, or expect at least a 30% decrease in revenues in May 2021 resulting from the new restrictions introduced in April.

Prior recipients of a Small Business Impact Grant in eligible business sectors should have received further instructions in an email. Applications for businesses that did not receive a previous Small Business Impact Grant will be available by May 19.

Ontario

Province Launches New Ontario Tourism and Travel Small Business Support Grant (May 13, 2021)

The Ontario government is providing one-time payments of $10,000 to $20,000 to support eligible small tourism and travel businesses struggling to recover from the impact of the COVID-19 pandemic through the new $100-million Ontario Tourism and Travel Small Business Support Grant.

This grant will support eligible small tourism and travel businesses that did not receive the Ontario Small Business Support Grant, such as travel agents, hotels, motels, resorts, and bed and breakfasts. To qualify, businesses must have fewer than 100 employees and demonstrate they have experienced a minimum 20% revenue decline between 2019 and 2020.

The program officially launched on May 13, 2021. Applications for this grant will close on Friday June 25, 2021.

Saskatchewan

Small Business Emergency Payment Program Extended (April 30, 2021)

The Government of Saskatchewan is extending the Saskatchewan Small Business Emergency Payment program by an additional month to support small businesses province-wide during the global COVID-19 pandemic.

The extended support is available to businesses across the province that were ordered to temporarily close or substantially curtail operations due to public health orders.

The eligibility period is April 1 to 30, 2021, and the program will accept applications until May 31, 2021. Those who have previously applied and received payments through the December to March offering of the program will not need to reapply.

FOCUS ON CURRENT CASES

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

Leonard v. The Queen, 2021 DTC 1027 (Tax Court of Canada)

Facts

The Appellant is an entrepreneur who became acquainted with Mr. Anderson, a real estate developer. The Appellant lent money to Mr. Anderson and invested in equity in Mr. Anderson's development projects throughout the years.

Sometime before 2009, Mr. Anderson acquired two adjoining lots in Hawaii: one lot ("Lot B-3") had a house constructed on it, and the other ("Lot B-2") was undeveloped bare lava rock (collectively, the "Lots"). Both Lots were subject to mortgages to secure debts owed by Mr. Anderson to the Central Pacific Bank (the "Bank"). The mortgage in respect of Lot B-2 (the "Mortgage") secured a debt (the "Debt") evidenced by a promissory note (the "Note") relating to a loan in the amount of $1.5 million.

The economic downturn of 2008 seriously impacted Mr. Anderson. The Appellant understood that Mr. Anderson was unable to repay all of his debts. Mr. Anderson was in default in respect of the Debt, and the Bank commenced foreclosure proceedings in respect of the Mortgage on Lot B-2.

After Mr. Anderson defaulted in April 2007 on the repayment of a $1.5 million loan the Appellant had made to him, Mr. Anderson approached the Appellant with a deal wherein the Appellant could obtain the Lots at a discount as a means of making amends. The Appellant then negotiated with the Bank to acquire the Lots using funds to be lent to him by the Bank. The Tax Court noted that the amount the Appellant paid for the Mortgage, Note, and Debt was $1.3 million, which was a $300,000 discount from the $1.6 million principal and interest then owing. The Appellant acquired Lot B-3 directly from Mr. Anderson and the Mortgage, Note, and Debt directly from the Bank.

After acquiring the Mortgage, Note, and Debt from the Bank, the Appellant did not attempt to dispose of them. The Appellant understood that the actual fair market value of the Lots was far higher than the price he had paid. He anticipated that he would be able to realize a profit by acquiring Lot B-3 by purchase and Lot B-2 by foreclosure. He anticipated that at the judicial sale, someone would purchase Lot B-2 for more than the $1.3 million he had paid to acquire the Mortgage, Note, and Debt. Alternatively, if he was the highest bidder at the judicial sale, he anticipated he could resell Lot B-2 at a profit. However, the Appellant's ability to sell Lot B-2 was delayed until the judicial sale was completed, which did not occur until two years after he purchased Lot B-3 and the Mortgage, Note, and Debt.

At the judicial sale, the Appellant expected Lot B-2 would sell for around $2.2 million, about half of the property's tax-assessed value. To his surprise, he was the highest bidder at $500,000. However, following the judicial sale, the Appellant was unable to sell Lot B-2 quickly in order to repay the Bank. The Appellant subsequently consolidated Lots B-3 and B-2, but this combined lot had not been sold by the commencement of the hearing.

As part of the foreclosure proceedings, a deficiency judgment (the "Deficiency Judgment") in the amount of $1.5 million was filed in favour of the Appellant against Mr. Anderson. The Appellant testified that he never expected to recover anything from Mr. Anderson given the magnitude of debts owed by Mr. Anderson to a number of creditors.

The Appellant deducted the full amount of $1.5 million (the "Loss") in computing his income for his 2011 taxation year, which was the amount of the Deficiency Judgment. The Minister reassessed the Appellant, disallowing the Loss claimed in 2011 and the carry-forward portions of the Loss for the Appellant's 2012, 2013, and 2014 taxation years.

Issues

(1) If there was a loss, was it a capital loss or a loss incurred in respect of an adventure in the nature of trade (i.e., a non-capital loss)?

(2) If there was a loss, when was it realized and what was the amount of the loss?

Positions of the Parties

The Appellant

The Appellant took the position that he was participating in an adventure in the nature of trade in relation to the Mortgage, Note, and Debt. He bought the Mortgage, Note, and Debt with the intention of making a profit, given that the outstanding amount of the Debt was greater than the amount he had paid for the Mortgage, Note, and Debt.

The Crown

The Crown submitted that the Appellant did not participate in an adventure in the nature of trade in relation to the Mortgage, Note, and Debt and that, when the Appellant acquired them, his objective was to hold Lot B-2 as a long-term investment.

The Crown asserted that the Appellant did not incur the Loss, since he continued to own Lot B-2 and he still held a Deficiency Judgment against Mr. Anderson relating to the principal and interest owed in respect of the Debt.

Analysis

A. Adventure in the Nature of Trade or Investment

The Tax Court adopted the approach set out in *Friesen v. The Queen*, 95 DTC 5551 ("*Friesen*"), in which the Supreme Court of Canada stated that a taxpayer must have "a legitimate intention of gaining a profit from the transaction" in order to be carrying on an adventure in the nature of trade. In addition, the Court referred to the factors set out in *Friesen* to be considered when determining whether a transaction involving real estate was an adventure in the nature of trade:

i. The taxpayer's intention with respect to the real estate at the time of purchase and the feasibility of that intention and the extent to which it was carried out. An intention to sell the property for a profit will make it more likely to be characterized as an adventure in the nature of trade.

ii. The nature of the business, profession, calling, or trade of the taxpayer and associates. The more closely a taxpayer's business or occupation is related to real estate transactions, the more likely it is that the income will be considered business income rather than capital gain.

iii. The nature of the property and the use made of it by the taxpayer.

iv. The extent to which borrowed money was used to finance the transaction and the length of time that the real estate was held by the taxpayer. Transactions involving borrowed money and rapid resale are more likely to be adventures in the nature of trade.

The Tax Court also considered the tests enumerated in *Happy Valley Farms Ltd v. MNR*, 86 DTC 6421 (FCTD) ("*Happy Valley Farms*"):

i. The nature of the property sold;

ii. The length of the period of ownership;

iii. The frequency or number of other similar transactions by the taxpayer;

iv. Work expended on or in connection with the property realized;

v. The circumstances that were responsible for the sale of the property; and

vi. Motive.

i. Intention

The Tax Court accepted that the Appellant's testimony highlighted his scheme for profit-making. However, the Tax Court noted that, pursuant to *Ludco Enterprises* (2002 DTC 7583 (FCA)), courts cannot simply rely on the oral assertions of the taxpayers but must objectively determine the nature of a taxpayer's purpose, "guided by both subjective and objective manifestations of purpose". In this regard, the Tax Court found several objective manifestations of the Appellant's intention to make a profit contained in the Appellant's oral testimony, including the fact that Lot B-2, the subject of the Mortgage, was undeveloped land, and that based on previous sales of property in the community, the Appellant predicted that Lot B-2 would sell for $2.2 million at auction, which was significantly more than what he paid for the Mortgage, Note, and Debt.

Both parties agreed that the Appellant had a profit-making intention in relation to Lot B-2. However, the Crown argued that the Appellant intended to make a profit by selling Lot B-2, not by disposing of the Mortgage, Note, and Debt acquired from the Bank. The Tax Court disagreed, stating that the profit-making intention pervaded the entire transaction, from the acquisition of the Mortgage, Note, and Debt from the Bank to the completion of the judicial sale and listing of Lot B-2 for sale. The Tax Court accepted that when the Appellant acquired the Mortgage, Note, and Debt he intended to make a profit either through someone bidding more than he had paid for the Mortgage, Note, and Debt at judicial sale or, if he happened to be the successful bidder in the judicial sale, subsequently selling Lot B-2 for more than he had acquired it.

ii. Nature of Business

The Tax Court held that before purchasing the Mortgage, Note, and Debt from the Bank, the Appellant had not previously purchased distressed debt. Here, the purchase of the Mortgage, Note, and Debt appeared to be the Appellant's first distressed-debt transaction, so this factor did not point to a transaction on income account.

iii. Nature and Use of Property

The Tax Court clarified that the property that should be considered under this factor is the Mortgage, Note, and Debt, not Lot B-2 itself. The Tax Court accepted the Appellant's testimony that he did not expect Mr. Anderson to make monthly interest payments or pay any other amounts in respect of the Debt. Rather, he expected that he would need to sell the Mortgage, Note, and Debt or Lot B-2 for profit. Accordingly, it was highly unlikely that the Appellant would receive income or other investment income by holding the Mortgage, Note, and Debt. This factor therefore pointed toward the transaction being on income account.

iv. Borrowed Money and Length of Ownership

The Appellant used only borrowed money in acquiring the Mortgage, Note, and Debt. In *Friesen*, Justice Major had indicated that transactions involving borrowed money were more likely to be adventures in the nature of trade. This factor, therefore, suggested the Appellant participated in an adventure in the nature of trade.

The Tax Court noted that in *Friesen*, a likely indicator of an adventure in the nature of trade was a rapid resale of the property in question. Here, the Appellant aimed for a rapid resale which did not occur. This was therefore a neutral factor.

v. Work Expended

In this case, the Appellant did very little to realize a return in respect of the Mortgage, Note, and Debt. He simply continued with foreclosure proceedings, which was not indicative of dealing in distressed debt.

vi. Circumstances Responsible for Disposition

While there was a disposition of the Mortgage when it was cancelled (on the closing of the judicial sale), this was not the type of disposition contemplated in *Happy Valley Farms*. This factor, therefore, did not point in either direction.

vii. Weighing of the Factors

The Tax Court concluded that, although the Appellant may have misunderstood some of the technicalities of the foreclosure process in Hawaii, he had a scheme for profit-making which is the first requirement for an adventure in the nature of trade. In weighing the above factors, the Tax Court concluded that the Appellant's acquisition of the Mortgage, Note, and Debt and his subsequent efforts to realize a profit were part of an adventure in the nature of trade.

B. Realization of the Loss

i. Amount of the Loss

The Appellant claimed that he had realized a loss of $1.5 million. The Tax Court disagreed, finding instead that the amount of the Loss was approximately $830,000, which was calculated by subtracting the net proceeds of the judicial sale price, being $470,000, from the amount the Appellant paid for the Mortgage, Note, and Debt, being $1.3 million ($1.3 million – $470,000 = $830,000).

ii. The Realization Principle

An adventure in the nature of trade contemplates the realization principle, which requires the purchase *and sale* of the property. In this regard, the Tax Court was asked to consider whether there had been a disposition of the Debt in order to realize a loss. The Tax Court distinguished between Pre-Auction Debt, being the Debt as secured by the Mortgage until the judicial sale, and Post-Auction Debt, being the debt after the judicial sale and ultimately represented by the Deficiency Judgement.

The Crown argued that the Debt continued to exist — it was simply converted into the Deficiency Judgement. Essentially, the Pre-Auction and Post-Auction Debt were the same debt. The Tax Court considered the factors set out in *General Electric Capital* (2011 DTC 5011 (FCA)) to determine whether the Debt had transformed into a new obligation. These factors are:

(a) The identity of the debtor;

(b) The principal amount of the note;

(c) The amount of interest under the note; and

(d) The maturity date of the note.

The Tax Court concluded that the Post-Auction Debt did not represent a new obligation, so there was no disposition of the Debt in 2011.

Conclusion

This case describes the considerations required when determining whether a taxpayer is participating in an adventure in the nature of trade when engaging in a distressed-debt transaction. The unique facts of this case highlight the extent to which the subjective and objective manifestations of the taxpayer's intentions when entering into the transaction will impact the outcome of the analysis. In the writer's view the decision is correct since the taxpayer cannot be compared to a traditional mortgagee. The facts indicate that the acquisition of the mortgage was part of a profit-making scheme.

— *Alexandra Terrell*

Levett v. Canada, 2021 DTC 5046 (Federal Court)

Background

This case concerned three applications for judicial review of Requests for Specific Exchange of Information ("RFIs") made by the Canada Revenue Agency (the "CRA") to the Swiss Federal Tax Administration (the "Swiss FTA") pursuant to the *Convention between Canada and Switzerland for the Avoidance of Double Taxation with respect to Taxes on Income and on Capital* (the "Treaty"). The applicants were two individuals (the "Individuals"), their spouses (the "Spouses") and a corporation owned by one of the individuals (the "Corporation", and together with the Individuals and the Spouses, the "Applicants").

A CRA auditor (the "Auditor") suspected that the Individuals may have had unreported foreign assets based on information provided by a partner country along with information she gathered herself from online discussion forums. Accordingly, the CRA notified the Individuals that they had been selected for an audit, and requested information and documents from them. Each of the Individuals completed questionnaires for the purposes of the audit but were unable to supply certain requested documents because the documents had been seized by Québec's Autorité des Marchés Financiers (the "AMF") as part of a securities investigation involving the Individuals. While some of these documents were eventually returned to the Individuals and provided to the Auditor, they pertained only to Canadian corporations and assets. The Auditor contacted the AMF to inquire as to how the Individuals may obtain the rest of the seized documents. The Auditor also requested information about the investigation, but the AMF declined to respond. Instead, the AMF gave the Auditor a publicly available AMF Tribunal decision which contained allegations against the Individuals with regard to the existence of bank accounts in Switzerland.

The CRA also contacted each of the Spouses to inform them that an audit had been commenced. During the audit, the CRA sent requests to the Spouses for copies of their lawyers' trust account documents, which were provided by their lawyers. After seeking advice from the Department of Justice, the CRA also requested documents from TD Bank, which the bank provided.

The CRA also commenced an audit of the Corporation after receiving information from the Agence du revenu du Québec that the Corporation had received a $1.3 million loan from a Swiss entity (the "Swiss Entity") ten years prior. The records indicated that the full amount of the loan was still outstanding and the Corporation had never paid any interest to the Swiss Entity.

The CRA sent the RFIs in respect of the Individuals and their Spouses to the Swiss FTA on October 31, 2017, and the RFI in respect of the Corporation on April 19, 2018.

The Law

Under the *Income Tax Act* (the "ITA"), the CRA has several discretionary powers at its disposal to ensure the proper administration and enforcement of the ITA. For example, very generally:

- Section 231.1 allows the CRA to inspect, audit, or examine the books and records of a taxpayer and any document of a taxpayer or of any other person, or examine property of the taxpayer.
- Section 231.2 allows the CRA to, upon giving notice, require that any person provide information or any document to the CRA for any purpose related to the administration or enforcement of the ITA, a listed international agreement, or a tax treaty.
- Section 231.6 allows the CRA to, upon giving notice, require that a person resident in Canada or a non-resident person carrying on business in Canada provide any foreign-based information or document.
- Section 231.7 allows the CRA to seek a court order requiring a person to provide any access, assistance, information, or document sought under section 231.1 or 231.2 if the person was required to do so under section 231.1 or 231.2 and if the information or document is not protected by solicitor-client privilege.

Certain provisions of the ITA also exist to protect the privacy and confidential information of taxpayers. Section 241 of the ITA generally prohibits government officials from sharing taxpayer information with any other person. However, there are exceptions to this rule. In particular, subparagraph 241(4)(*e*)(xii) provides that an official may provide taxpayer information, or allow the inspection of or access to taxpayer information, under and solely for the purposes of a provision contained in a tax treaty with another country.

Article 25 of the Treaty permits the exchange of information between the competent authorities of Canada and Switzerland. Any exchange of information under Article 25 is subject to certain limitations that are set out in Article 25 itself, including that the information must be "foreseeably relevant" to the requesting country's enforcement of its own laws. It is also subject to Article 2 of the *Interpretative Protocol* appended to the Treaty, which provides that an exchange of information must only be requested once a state has pursued all reasonable means to obtain the information itself.

Issues and Decision

The Applicants opposed the RFIs on the following bases, each of which were addressed by Justice St-Louis of the Federal Court of Canada as follows:

1. The CRA illegally sought and obtained from the AMF confidential information concerning the Individuals.

Justice St-Louis determined that Québec's *Act respecting the regulation of the financial sector* does not prohibit the CRA from *seeking* confidential information from the AMF. In any event, the CRA neither sought nor obtained confidential information from the AMF. The Auditor contacted the AMF to ask how the Individuals could retrieve copies of seized information and to inquire as to the status of the investigation, and in response the AMF only provided a publicly available AMF Tribunal decision. The CRA also did not solely rely on the information contained in the AMF Tribunal decision since the audit was also based on unexplained transactions related to the Individuals' Canadian assets and income and information retrieved from the online sources.

2. The CRA acted based on mere undocumented suspicions by the AMF.

Justice St-Louis determined that the AMF's suspicions were not presented by the CRA as more reliable than they were. The CRA had attached the AMF Tribunal decision to the RFIs so that the Swiss FTA could assess the reliability of the information for itself.

3. The CRA illegally sought and obtained privileged and confidential information concerning the Spouses, in violation of their rights to professional secrecy, to solicitor-client privilege, and to be secure against unreasonable search and seizure.

Generally, the CRA is not permitted to issue a coercive request to a third party for taxpayer information that is or may be privileged, as set out by the Supreme Court of Canada in *Canada (Attorney General) v. Chambres des notaires du Québec*, 2016 DTC 5067 ("*Chambres des notaires*"). Justice St-Louis was not satisfied that any of the documents obtained by the CRA, and in particular the trust account documents, were covered by solicitor-client privilege. However, even if they were, the CRA sent the requests directly to the Spouses and the trust account documents were received from the Spouses' counsel. Because the Spouses were informed of the CRA's request, *Chambres des notaires* did not apply. Upon receiving the trust account documents, it was reasonable for the CRA to conclude that either the trust account documents were not privileged to begin with, or that the Spouses waived privilege and allowed their counsel to share the documents with the CRA. The CRA's request for information from TD Bank to confirm the transactions in the trust account documents was also not in violation of *Chambres des notaires* since the underlying information was already provided to the CRA voluntarily from the Spouses' counsel.

Finally, even if the information was in violation of solicitor-client privilege, Justice St-Louis determined that the information was not used to make or support the decision to issue the RFIs.

4. The CRA acted based on irrelevant allegations of facts.

The Applicants argued that the documents seized by the AMF which pertained to Canadian corporations and assets and the fact that the Individuals were suspected by the AMF of violating securities laws were irrelevant for the purposes of the RFIs. Justice St-Louis did not agree that the documents were irrelevant, and even if they were, providing irrelevant information to the Swiss FTA does not affect the reasonableness of the RFIs.

5. The RFIs are invalid because the CRA did not exhaust domestic avenues.

With regard to the RFIs pertaining to the Individuals and the Corporation, the Applicants argued that the CRA could have obtained the information by other means, such as by written request to the Applicants, by exercising its audit or compliance powers under the ITA, or by seeking a compliance order under the ITA. However, Justice St-Louis held that the CRA does not have an obligation to pursue all available domestic means. Instead, under subsection 2(*a*) of the *Interpretative Protocol*, the CRA only needs to pursue "all reasonable means available under its internal taxation procedure to obtain the information."

Justice St-Louis was satisfied that the CRA had pursued all reasonable domestic means available. Many of the powers afforded the CRA under the ITA to obtain information about the Individuals and the Corporation were unavailable in this case because the information was held by a foreign corporation and because the Individuals had denied having any foreign assets or involvement with foreign entities. The Individuals had also provided responses to the questionnaires sent by the CRA, so it was not able to obtain a compliance order. Justice St-Louis also rejected the Applicants' arguments that the CRA could have contacted the person at the Swiss Entity to obtain information. Justice St-Louis held that there was no legal authority to require information from the contact person at the Swiss Entity since he was not a Canadian resident or a person carrying on a business in Canada. The CRA did not even have a legal obligation to contact the person simply because it was provided with the contact information. It was not unreasonable for the CRA to resort to the RFIs since the Corporation's explanation as to why the loan was unpaid was simply that the "lender satisfied with loan [sic]". In the circumstances, it was reasonable for the CRA to conclude that the contact person at the Swiss Entity would either not provide the information requested or provide insufficient or unreliable information.

6. The CRA acted based on allegations of facts which were false and which it knew to be false.

Justice St-Louis disagreed with the Applicants' allegations that the CRA's RFIs were based on false allegations of facts, namely, that it was impossible to obtain the documents seized by the AMF, that the Individuals failed to provide information for the 2014 and 2015 taxation years, and that the CRA exhausted all domestic avenues to obtain the information. There was nothing to indicate that the documents eventually returned by the AMF to the Individuals and provided to the CRA related to foreign activities and the Swiss FTA was aware that the Individuals had not been audited domestically by the CRA for the 2014 and 2015 taxation years. Justice St-Louis also reiterated that the CRA had exhausted all reasonable domestic means available to obtain the information.

7. The RFIs are invalid because the CRA illegally disclosed confidential taxpayer information.

The Applicants argued that the information actually disclosed by the CRA to the Swiss FTA goes beyond what is set out in subsection 2(*b*) of the *Interpretative Protocol* as information that can be divulged and is therefore not covered by the exception to disclosing taxpayer information in subparagraph 241(4)(*e*)(xii) of the ITA. Justice St-Louis did not accept these arguments. The Treaty should be given a broad and liberal interpretation, and the list of information that a competent authority shall provide in connection with a request for information as set out in subsection 2(*b*) of the *Interpretative Protocol* did not prevent the CRA from sharing additional information. Furthermore, Article 25 of the Treaty provides that any information shared between the competent authorities shall be treated as secret and shall not be disclosed to any persons other than those concerned with the assessment and collection of the taxes covered by the Treaty.

The Applicants also initially submitted that the RFIs were *ex parte* proceedings, which triggered a duty on the CRA to provide full and frank disclosure, and that the CRA did not meet its duty because it disclosed only part of the information and context of its audit procedures in a misleading and unfair manner. However, this argument was abandoned at the proceeding and instead the Applicants attempted to argue that there exists a good faith principle in taxation matters that precludes the CRA from making false statements or raising irrelevant facts. Justice St-Louis did

not address the abandoned arguments, and was not convinced that the RFIs contained false, incomplete, or misleading information.

Justice St-Louis concluded that the CRA's decision to issue the RFIs was neither unreasonable nor incorrect and the Applicants did not demonstrate that the CRA failed to comply with the statutory requirements. The applications for judicial review were dismissed.

— Paige Donnelly and Emily Kroboth

Nonis v. Her Majesty the Queen, 2021 DTC 1026 (Tax Court of Canda)

This is a strange case involving David Nonis (the "Appellant") who was the former general manager of the Toronto Maple Leafs. The Canada Revenue Agency attempted to take an extremely expansive view of paragraph 115(2)(*c*.1) of the *Income Tax Act* (the "Act") in order to tax employment income earned by the Appellant, a non-resident of Canada, during a period that he was located exclusively in the United States. Ultimately, Justice Bocock found the Respondent's dizzying logic to be absurd and held in favour of the Appellant.

The Appellant was a non-resident of Canada and a citizen and resident of the United States. The Appellant entered into a written employment agreement (the "Employment Agreement") with Maple Leafs Sports and Entertainment ("MLSE") in January 2013 and an early extension agreement in June 2013 extending the term of his employment until June 2018. In April 2015, MLSE terminated the Appellant's employment without cause. The Employment Agreement stipulated that in such an event, the Appellant would be paid his annual salary for the remainder of the contractual period provided he used his best efforts to seek out other employment and notified MLSE immediately if he secured alternate employment.

Upon his termination, the Appellant returned to the United States. Although no longer performing any employment duties for MLSE, he remained bound by the notification requirements within the Employment Agreement and complied with these requirements.

In his 2013 and 2014 taxation years, the Appellant filed and paid Canadian income tax by pro-rating his employment income over the number of days that he performed services in Canada during the year. For the 2013 and 2014 tax years, this amounted to 39.25% of his employment income. As a result of being terminated from his position and returning to the United States, the Appellant only allocated 37 days in 2015 as being in respect of employment performed in Canada with the balance being allocated to the United States. For his 2016 taxation year, all of the amounts received from MLSE were allocated to the United States.

The Minister's Position

The Minister reassessed the Appellant for the 2015 and 2016 taxation years, on the basis that the income earned by him from MLSE during those years should have been allocated between Canada and the United States in the same proportion as in 2013 and 2014, despite the fact that the Appellant performed duties for only 37 days in Canada in 2015, and did not perform any duties in Canada in 2016. The Minister based the reassessment on the interaction between paragraph 115(2)(*c*.1) of the Act and a number of other provisions of the Act. Paragraph 115(2)(*c*.1) is a deeming provision that applies to items such as signing bonuses and similar items that would otherwise escape Canadian taxation even though they were received, in whole or in part, in respect of services to be performed in Canada.

Specifically, the Minister took the position that paragraph 115(2)(*c*.1) precluded the Appellant from pro-rating the income earned by him from MLSE between days in Canada and days in the United States, although the Minister was willing to accept an apportionment based on the historical split of work days in Canada vs. the United States. The Minister's view was that paragraph 115(2)(*c*.1) applied since the Appellant received amounts in 2015 and 2016 under a contract and the amounts can reasonably be regarded as having been received, in whole or in part, as remuneration from the duties of an office or employment to be performed in Canada.

The Minister's reasoning was that if paragraph 115(2)(*c*.1) applied, then paragraph 115(2)(*d*) would deem the Appellant to be employed in Canada during the year for the purposes of subsection 2(3) of the Act. Once the Appellant was deemed to be employed in Canada for the year, the amount of the Appellant's taxable income earned in Canada from

employment is determined under paragraph 115(2)(*e*) which, by virtue of subparagraphs 115(2)(*e*)(i) and/or (v), requires the full amount of such income to be included in the Appellant's taxable income earned in Canada.

Finally, the Minister argued that if the Appellant had any remedy, it was to be obtained in the United States in the form of a foreign tax credit.

The Appellant's Position

In contrast to the approach taken by the Respondent, the Appellant's position was straightforward. Specifically, the Appellant argued that he should be taxed only on the income earned through duties or services "performed or exercised in Canada" pursuant to subparagraphs 115(1)(*a*)(i) and 115(2)(*e*)(i) of the Act (although it is not clear how the latter provision could apply if the Appellant was not a person described in any of paragraphs 115(2)(*a*) to (*c*.1)). In other words, the proration he had used in his return should be accepted and the Minister's assessment should be vacated.

The Appellant's view was that the purpose of paragraph 115(2)(*c*.1) was to deal with professional athletes and others that receive initial large signing bonuses and then comparatively smaller salaries thereafter. Paragraph 115(2)(*c*.1) serves to ensure that such signing bonuses are included in the recipient's taxable income earned in Canada to the extent that they relate to employment duties to be performed in Canada. The Appellant argued that the salary continuance provided under the Employment Agreement was not a signing bonus, but rather was employment income under a contract of employment and, other than for 37 days in 2015, such employment was not performed in Canada.

The Tax Court's Analysis

Justice Bocock noted that although the Appellant's duties under the Employment Agreement diminished significantly upon termination, the Appellant was still required to comply with the notification requirements stipulated in the Employment Agreement and therefore had not completely severed his contractual ties with MLSE.

Generally, non-residents pay tax only on employment income in Canada where the employment is performed in Canada. The Minister departed from this general rule in its argument. In order to determine which interpretation applied, the Court proceeded to complete a textual, contextual, and purposive analysis of the relevant provisions.

The Court noted that the purpose of subsection 115(1) is a general rule to determine "taxable income earned in Canada" based upon the performance of those services in the relevant jurisdictions. In contrast, the purpose of subsection 115(2) deals with specific situations where the general rule in subsection 115(1) did and does not sufficiently apply to tax the income arising from services performed in Canada. The Court concluded that the legislative purpose of paragraph 115(2)(*c*.1) and subparagraph 115(2)(*e*)(i) was to ensure that a benefit received for entering or forbearing to enter into an agreement that was related to the employment performed in Canada was taxable in Canada. Reading subparagraph 115(2)(*c*.1)(ii) in tandem with 115(2)(*c*.1)(i), it became clear that paragraph 115(2)(*c*.1) was meant to apply to signing bonuses and other payments under a different name that were essentially signing bonuses. Subparagraph (i) covered consideration for entering into a contract or agreement, and (ii) prevented non-capture where a signing bonus was represented as something else.

The Court highlighted that if it accepted the Minister's interpretation that subsection 115(2)(*c*.1) applied in this context, paragraph 115(2)(*e*) would become redundant. This redundancy arose because a non-resident would be deemed to be employed in Canada pursuant to paragraphs 115(2)(*c*.1) and (*d*), which would trigger the inclusion of all of the non-resident's income under clause 115(1)(*a*)(i) and there would be no need for paragraph 115(2)(*e*).

Furthermore, if the Minister's argument was accepted, there would be no distinction in treatment between the compensation paid to an individual for entering into or not entering into an agreement for services to be performed in Canada and the compensation under such contract. This would essentially result in any contract for some portion of services to be performed in Canada by a non-resident to trigger this provision and capture all employment income, regardless of the extent of services the non-resident is actually providing by way of duties performed in Canada.

The Court concluded that the Respondent's asserted interpretation of various aspects of section 115 was absurd and contrary to the general rule and scheme of the Act — that a non-resident is taxed in Canada to the extent the non-resident's duties are performed in Canada under a contract of employment.

The appeal was allowed with costs provisionally awarded to the Appellant subject to written submissions.

— *Mark Jadd and Alexandra Terrell*

CURRENT ITEMS OF INTEREST

Relief for Registered Pension Plans and Salary Deferral Leave Plans Extended

On May 20, 2021, the federal government announced that proposed relief measures for Registered Pension Plans ("RPPs") and deferred salary leave plans ("DSLPs") would be extended. These amendments were initially proposed on July 2, 2020. These proposed amendments to the *Income Tax Regulations* will be modified such that the temporary relief continues to apply.

The proposed extended temporary amendments to the registration rules and other conditions in the *Income Tax Regulations* include:

- adding temporary "stop-the-clock" rules to DSLPs from March 15, 2020, to April 30, 2022;
- removing restrictions that prohibit RPP administrators from borrowing money;
- permitting catch-up contributions to RPPs by April 30, 2022, towards remaining required contributions that otherwise had not been made in 2020 or 2021;
- waiving the requirement that an employee have at least 36 months of employment to qualify for an "eligible period of reduced pay" so that all employees, including new employees, receive unreduced pension coverage; and
- in cases of wage rollback periods, allowing employers to provide pension contributions at 100% of wages prior to rollback.

Tax Relief for Livestock Producers

The Government of Canada released a list of prescribed drought regions in Nova Scotia, New Brunswick, Prince Edward Island, and Québec where livestock tax deferral has been authorized for the 2020 tax year.

The livestock tax deferral provision allows livestock producers in prescribed drought, flood, or excess moisture regions to defer a portion of their 2020 sale proceeds of breeding livestock until 2021 to help replenish the herd. The cost of replacing the animals in 2021 will offset the deferred income, which reduces the tax burden associated with the original sale.

A list and map of these designated regions is available here: www.agr.gc.ca/eng/agriculture-and-the-environment/drought-watch/livestock-tax-deferral-provision/2020-list-of-prescribed-regions/?id=1620138156975.

Budget Bill Tabled in House of Commons

Bill C-30, *Budget Implementation Act, 2021, No. 1*, received Second Reading in the House of Commons on May 27, 2021. The bill proposes to implement certain measures from Budget 2021, the 2020 Fall Economic Statement, Budget 2019, and other recent announcements. All the income tax measures proposed by Bill C-30 are listed below.

Budget 2021 measures:

- Canada Workers Benefit
- Tax Treatment of COVID-19 Benefit Amounts
- Registration and Revocation Rules Applicable to Charities
- Emergency Business Supports and Canada Recovery Hiring Program

Fall Economic Statement 2020 measures:

- Registered Disability Savings Plan — Cessation of Eligibility for the Disability Tax Credit
- Employee stock options
- Agricultural Cooperatives: Patronage Dividends Paid in Shares

Budget 2019 measures:

- Accelerated Investment Incentive for Resource Expenditures
- Accelerated Investment Incentive for Depreciable Property
- Change in Use Rules for Multi-Unit Residential Properties
- Permitting Additional Types of Annuities under Registered Plans
- Contributions to a Specified Multi-Employer Plan for Older Members
- Pensionable Service Under an Individual Pension Plan
- Mutual Funds: Allocation to Redeemers Methodology
- Electronic Delivery of Requirements for Information
- Accelerated Capital Cost Allowance for Zero-Emission Vehicles
- Character Conversion Transactions
- Transfer Pricing Measures
- Foreign Affiliate Dumping
- Cross-Border Share Lending Arrangements

Other recent proposals:

- COVID-19 (childcare expenses and disability supports deduction)
- Temporary Adjustments to the Automobile Standby Charge due to COVID-19
- Time Extensions for Flow-Through Share Issuers
- Zero-Emission Vehicles (Class 56)
- Employee Life and Health Trusts
- Support for Canadian Journalism
- Basic Personal Amounts
- Shared-Custody Parent

Changes to Filing Information Returns Under Ontario *Corporations Information Act*

The process for filing an annual information return under the Ontario *Corporations Information Act* is changing. As of May 15, 2021, Ontario *Corporations Information Act* annual returns will no longer be filed through the CRA. Regarding how to file these information returns in the future, the website for Ontario's upcoming online Business Registry states that an update will be provided when more information is available. See www.ontario.ca/page/ontario-business-registry.

RECENT CASES

Appeals of assessments raised pursuant to s. 160(1) and GAAR application of the ITA allowed

The appeals of the five Appellants relate to the application of section 160 of the *Income Tax Act* (the "ITA") and of the General Anti-Avoidance Rule ("GAAR") to transactions undertaken to increase the after-tax return of the Appellants from a sale of farmland in Brampton (the "farmland") owned by five general partnerships (the "general partnerships"), which were in turn 99.99% owned by the Appellants. The transactions isolated the proceeds and income from the sale of the farmland in a newly incorporated subsidiary of each Appellant. Each Appellant then sold its subsidiary to Wilshire Technology Corporation ("WTC"), a corporation incorporated by an unrelated person to acquire the shares in all the subsidiaries. The Minister of National Revenue (the "Minister") assessed each Appellant under subsection 160(1) of the ITA for the income tax liability of that Appellant's subsidiary (the "underlying tax liability"), the assessments being determined without regard to a deduction for capital cost allowance claimed by each subsidiary that, if allowed, would have reduced each subsidiary's income to nil. The Appellants submitted that the Minister had not established the existence of the underlying tax liability of the subsidiaries for the taxation year, and that even if that liability did exist, three of the four conditions for the application of subsection 160(1) had not been met. In the alternative, the Minister assessed the Appellants under the GAAR. The Respondent submits that the transactions summarized above were avoidance transactions resulting directly or indirectly in an abuse of section 160 of the ITA.

The appeals were allowed. The Court found, bearing in mind that subsection 160(1) comprises two parts, that the questions raised by the positions of the parties are whether the events in issue fall within the scope of part one and, if so, what are the consequences to the Appellants under part two? This requires the interpretation of both parts of subsection 160(1). After a thorough analysis of the facts, evidence, and jurisprudence, the Court ruled that (1) there is a clear connection between the reduction in the property of the subsidiaries and the increase in the property of the Appellants. Consequently, the Judge ruled that the subsidiaries indirectly transferred approximately 82% of the Property to the Appellants. (2) The Court concluded that the Appellants and the subsidiaries were dealing at arm's length at the time of the transfer of the Property from the subsidiaries to the Appellants on December 31, 2006, and, therefore, the condition in paragraph 160(1)(*c*) for the application of paragraphs 160(1)(*d*) and (*e*) is not met. (3) The Court established that with respect to the assessment of the Appellants under subsection 160(2), the foregoing analysis establishes that since the Appellants are appealing the correctness of assessments under subsection 160(2), the burden of proof falls on the Appellants. (4) The Court found that the computer software was not acquired for the purpose of gaining or producing income as required by paragraph 1102(1)(*c*) of the *Income Tax Regulations* and therefore no capital cost allowance can be claimed by the subsidiaries in respect of the computer software. (5) The Court found that the GAAR does not apply to any of the Transactions. Accordingly, the appeals were allowed.

Damis v. The Queen

2021 DTC 1020

Judicial review of denial of interest relief dismissed

The applicant purchased 1,000 units of a hedge fund, donated them to his former school, and claimed a deduction for a charitable donation valued at $1,000,000. On reassessment the CRA disallowed $750,000 of the charitable deduction. The applicant applied for judicial review of the decision but later discontinued the application on the basis of a settlement whereby his request for relief would be reconsidered by the CRA. The applicant submitted a series of requests and the CRA denied his request for relief from interest arrears. The applicant argued that it was unfair of the CRA to have him discontinue his earlier application for judicial review only to reach the same result as before on the reconsideration.

The application was dismissed. The court held that the mere fact that the CRA reached the same conclusion on reconsideration does not mean the reconsideration was not *bona fide* or the CRA approached the matter with a closed mind. It also did not prove the reconsideration was in any other way contrary to the terms upon which the earlier application for judicial review was settled. A reasoned explanation was provided as to why the request for relief was denied. Subsection 220(3.1) provides broad discretion to the Minister to waive all or any portion of any penalty or interest payable, and in the present case, there was no constraint on such discretion. The applicant could not point out any flaws in the decision maker's reasoning. The decision cannot be unreasonable simply because it did not address arguments made at some earlier point by the applicant, especially when those arguments had already been rejected by the CRA. The review of an administrative decision cannot be divorced from the history of the proceedings. The court held that based on the history of the requests for taxpayer relief, including the previous application for judicial review, the decision to deny the request for relief was justified, transparent, and intelligible. The application for judicial review was dismissed with costs.

Simmons v. Canada (AG)

2021 DTC 5024

Gross negligence penalties cancelled

The taxpayer filed her income tax return for the 2010 taxation year, which had been prepared by an accountant, wherein she reported total income of $78,798. The Minister assessed her return as filed. Later, an amended 2010 income tax return was filed by DeMara Consulting Inc. on behalf of the taxpayer for her 2010 taxation year. Unbeknownst to the taxpayer, DeMara was a "de-taxer" group. The total income reported remained the same, but net business losses of $666,447 were claimed in respect of a fictional consulting business, net capital losses of $333,024 (also fictional) were claimed, and finally requests to carry back non-capital losses of $32,566, $39,021, and $50,214 to the taxpayer's 2007, 2008, and 2009 taxation years were made. The Minister reassessed the taxpayer's 2010 taxation year to disallow the business losses, the net capital losses, and the carry-back losses claimed in her amended return, and, pursuant to subsection 163(2) of the *Income Tax Act* (the "Act"), imposed a gross negligence penalty of $139,032. The taxpayer appealed.

The appeal was allowed. The issue was whether the Minister rightfully imposed the gross negligence penalty. The Court must determine if the taxpayer knowingly, or under circumstances amounting to gross negligence, made or participated in, assented to, or acquiesced in the making of a false statement in her amended return. The burden of establishing the facts on a balance of probabilities justifying the penalty is on the Minister. The taxpayer testified she did not know DeMara had filed the amended return and knew nothing about its contents (although she became aware of it later). The Court found she had participated in the making of the false statements found in her amended return by signing a Request for a Business Number form and Business Consent form, although she did not know these and other documents would be used by DeMara to prepare the amended return. However, the Court concluded, on a balance of probabilities, the taxpayer did not knowingly, or under circumstances amounting to gross negligence, make or participate in, assent to, or acquiesce in the making of a false statement in her amended return. Therefore, the Minister did not rightfully impose a gross negligence penalty and the penalty was vacated by the Court.

Bowker v. The Queen

2021 DTC 1014

Application to reopen appeal dismissed

The taxpayer, a tax protester and promoter, was convicted in 2017 of making false statements in her income tax returns, income tax evasion, GST evasion, and counseling fraud. In 2018, the taxpayer was sentenced to 54 months' imprisonment and fines of just over $35,000. The day after her sentencing, she appealed from her convictions and sentence. The conviction appeal was dismissed for want of prosecution in 2019. The taxpayer then sought to reinstate the appeal, contending she did not have notice of the application that resulted in the dismissal and had viable grounds of appeal which were different from those in her original notice of appeal. Prior to bringing the application, the taxpayer took the position that the laws enacted by Parliament were invalid and Canadian courts had no jurisdiction over her.

The application was dismissed. An appeal that has been dismissed other than on the merits can be reinstated. An applicant must satisfy the "heavy onus" of showing it is in the interests of justice to do so. Factors to be considered include the length of delay between the dismissal and the application for reinstatement, the adequacy of the explanation for that delay, whether the applicant contributed to the delay and had a *bona fide* intention to pursue the appeal throughout the proceedings, whether the initial order was made in error or the court was operating under some misunderstanding of the material facts, the effect reinstatement would have on public confidence in the administration of justice, the seriousness of the charges, and the merit of the appeal. Which factors will be of importance in a particular case will depend on the circumstances of that case. The overarching factor is the interests of justice. With respect to the "heavy onus", it does not apply to each individual factor but to the two essential criteria for reinstatement, namely: (a) the earlier disposition was not on the merits; and (b) reinstatement is in the interests of justice. The Court determined, notwithstanding the serious nature of the charges, it was not in the interests of justice to reinstate the conviction appeal for the following reasons: the original notice of appeal was filed almost three years prior and the sole responsibility for the delay rested with the taxpayer; the taxpayer did not have a *bona fide* intention to appeal throughout the time the matter had been before the Court; there was no misunderstanding of material facts by the Court that dismissed the appeal; in light of the taxpayer's conduct, public confidence in the administration of justice would be diminished if she were permitted to recast her grounds and proceed; and the grounds she sought to advance the appeal lacked merit.

R. v. Anderson

2021 DTC 5028

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