Tax Notes

June 2023
Number 725

Wolters Kluwer

PROPOSED TRAVEL EXPENSE DEDUCTION FOR TRADESPERSONS

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On March 22, 2023, private members' Bill C-241, *An Act to amend the Income Tax Act (deduction of travel expenses for tradespersons)*, received Third Reading in the House of Commons. Most recently the bill received First Reading in the Senate, so time will tell whether the Senate will approve it. The bill would amend the *Income Tax Act* to allow tradespersons and indentured apprentices to deduct from their income amounts expended for travelling where they were employed in a construction activity at a job site that is located at least 120 km away from their ordinary place of residence. The deduction would be provided by proposed new paragraph 8(1)(*q*.1), which would apply retroactively to 2022 and subsequent years.

Proposed Deduction

The deduction is available to a taxpayer who was employed as a duly qualified tradesperson or an indentured apprentice in a construction activity at a job site that was located at least 120 km away from their ordinary place of residence. There are three additional conditions, all of which must be met in order to claim the deduction:

(i) The taxpayer was required under the contract of employment to pay those expenses;

(ii) The taxpayer did not receive an allowance in respect of the expenses that is not included in computing the taxpayer's income for the year; and

(iii) The taxpayer does not claim the expenses as a deduction or tax credit for the year under any other provision of the *Income Tax Act*.

If the above conditions are met, a taxpayer can deduct amounts they expended in the year for travelling to and from the job site. The legislation does not explicitly specify what kind of expenses would be deductible under the new provision; however, by extrapolating from existing provisions that allow an employee to deduct travel expenses, we might predict what types of expenses would be deductible under the new deduction.

Since the taxpayer must be required under contract to pay these expenses for them to be deductible, a requirement which resembles the requirement under paragraph 8(1)(*h*.1), presumably the CRA would require that the taxpayer obtain a signed copy of Form T2200, *Declaration of Conditions of Employment*, in order to claim the new deduction.

Examples of Travel Expenses That Are Deductible Under Existing Rules

Paragraph 8(1)(*h*) allows an employee to deduct "amounts expended by the taxpayer in the year (other than motor vehicle expenses) for travelling in the course of the office or employment. . .". Deductible expenses under 8(1)(*h*) generally include food, beverage, lodging, and transportation (such as airplane, train, bus, etc.). However, subsection 8(4), which would not apply to proposed paragraph 8(1)(*q*.1) as the section currently reads, prohibits a deduction for food and beverages unless the employer requires the employee to be away for at least 12 consecutive hours from the municipality and metropolitan area (if applicable) of the employer's location where the employee normally reports for work.

Paragraph 8(1)(*h*.1) specifically allows the deduction of ". . . amounts expended by the taxpayer in the year in respect of motor vehicle expenses incurred for travelling in the course of the office or employment . . ." if certain conditions are met. This rule allows an employee to deduct the following:

- fuel (such as gasoline, propane, and oil) and electricity;
- maintenance and repairs;
- insurance;
- licence and registration fees;
- capital cost allowance (by virtue of paragraph 8(1)(*j*));
- eligible interest paid on a loan used to buy the motor vehicle (also by virtue of paragraph 8(1)(*j*)); and
- leasing costs (subject to the limitation under section 67.3).

Paragraph 8(1)(*h*.1) does not list these expenses, but rather it is generally accepted that these types of expenses are deductible. To ascertain whether these same types of expenses would be deductible under proposed paragraph 8(1)(*q*.1), we might need to wait for the CRA to share its views on the matter.

How Does This Compare to the Labour Mobility Deduction for Tradespersons?

These two deductions are similar in name and substance, but they are not identical. The recently enacted Labour Mobility Deduction for Tradespersons ("LMD") under paragraph 8(1)(*t*), which also applies to 2022 and subsequent years, has some key aspects that differentiate it from the new deduction that is currently proposed by Bill C-241.

The LMD allows a taxpayer to deduct eligible temporary relocation expenses, which can include transportation costs, 50% of meals consumed during the trip, and temporary lodging costs. The LMD is limited to the lesser of $4,000 and the employee's total temporary relocation deduction. The temporary relocation deduction as defined under subsection 8(14) is the lesser of the eligible temporary relocation expenses and 50% of the employment income earned at the temporary work location from an eligible temporary relocation. Sparing you the details, one of the main conditions is that an eligible temporary relocation must occur, and this requires (among other things) that the taxpayer reside in temporary lodging. The distance between the taxpayer's ordinary residence and the temporary work location must be at least 150 km greater than the distance between the temporary lodging and the temporary work location. Also, the relocation must be for a duration of at least 36 hours.

To be brief, the criteria for the new deduction proposed by C-241 are much simpler and less restrictive compared to those of the LMD. Also, the new deduction has no dollar limit, unlike the LMD's $4,000 limit. However, the new deduction under paragraph 8(1)(*q*.1) only allows the deduction of amounts expended for traveling to and from the job site, while the LMD (in addition to meals and travel costs) also allows a taxpayer to deduct lodging expenses.

Consider, for example, a tradesperson who works on a construction site in Barrie, ON. If they commute five days per week from their home in Hamilton, ON, then the proposed paragraph 8(1)(*q*.1) deduction may be accessible to them. However, if instead the person were to reside in nearby temporary lodgings in Barrie, rather than commuting on a daily basis from Hamilton, then the LMD may be an option for them to consider with respect to costs incurred. Or perhaps if the person resides temporarily in Barrie for several weeks and incurs substantial lodging costs such that they max out the $4,000 limit on the LMD, they might deduct their lodging costs via the LMD and deduct their other travel costs via the new deduction.

More Guidance to Come?

There are many potential expenses which a taxpayer *might* be able to deduct under this proposed provision — if it gets enacted. However, more certainty could be provided if the CRA were to share its views on what expenses would be deductible. After all, like proposed paragraph 8(1)(*q*.1), the existing deductions for travel costs only vaguely describe what sort of expenses are deductible, but in practice various expenses can be deducted from employment income. Moreover, given that this deduction will apply to 2022 and subsequent years, what instructions would the CRA provide for taxpayers that want to claim this deduction for 2022 (either on a T1 return that has not yet been filed or by adjusting a return that has already been filed)? Similarly, would the Department of Finance propose further amendments in response to Bill C-241's enactment? For example, would paragraph 8(1)(*j*) be amended to allow the deduction of capital cost allowance and auto loan interest in such cases, or would subsection 8(4) be amended to prohibit deducting meal costs where the duration of the trip is less than 12 hours?

Tradespersons who commute long distances to work on a job site may soon enjoy the tax savings from this new deduction. However, some unanswered questions remain.

CURRENT ITEMS OF INTEREST

CRA Reaches a Tentative Agreement with the PSAC Union of Taxation Employees

The CRA and Public Service Alliance of Canada–Union of Taxation Employees (PSAC-UTE) have reached a four-year tentative agreement. The approximately 35,000 PSAC-UTE employees have stopped striking and returned to work as of May 4. The CRA is resuming its operations, but some services may continue to experience delays. The status of various services can be found at: www.canada.ca/en/revenue-agency/corporate/about-canada-revenue-agency-cra/collective-bargaining/labour-disruptions-impact.html.

Budget Bill With Tax Measures Introduced

Bill C-47, *An Act to implement certain provisions of the budget tabled in Parliament on March 28, 2023*, passed Second Reading in the House of Commons on May 2. In addition to many non-tax budget measures, the bill proposes to enact many tax measures, all of which are listed below.

The bill implements certain measures in respect of the *Income Tax Act* and the *Income Tax Regulations* by:

(a) enabling the CRA to use electronic certification of tax and information returns and requiring taxpayers to file electronically in certain circumstances;

(b) doubling the maximum deduction for tradespeople's tools from $500 to $1,000;

(c) providing that any gain on the disposition of a right to acquire Canadian housing property within a one-year period of its acquisition is treated as business income;

(d) excluding from a taxpayer's income certain benefits for Canadian Forces members, veterans, and their spouses or common-law partners;

(e) exempting from taxation any income earned by the Band Class Settlement Trust in accordance with section 24.05 of the Settlement Agreement entered into on January 18, 2023, relating to the attendance of day scholars at residential schools;

(f) providing an additional payment of the Goods and Services Tax/Harmonized Sales Tax ("GST/HST") credit equal to double the amount of the regular January 2023 payment;

(g) providing for automatic, quarterly advance payments of the Canada Workers Benefit;

(h) allowing divorced and separated spouses to open joint Registered Educational Savings Plans ("RESPs") and increasing educational assistance amounts under those plans;

(i) extending, by three years, the ability of a qualifying family member to be the plan holder of an individual's Registered Disability Savings Plan ("RDSP") and expanding the definition of "qualifying family member" to include a sibling of the individual;

(j) allowing defined contribution registered pension plans ("RPPs") to correct contribution errors and requiring that the contributions or refunds are reported to the CRA for the purpose of correcting the registered retirement savings plan ("RRSP") deduction limit;

(k) modifying reporting requirements in respect of reportable transactions, introducing reporting requirements for notifiable transactions, and providing reporting requirements with respect to uncertain tax treatments, as well as extending the reassessment periods applicable to those transactions and creating or modifying penalties for non-compliance with those requirements;

(l) allowing the CRA to share taxpayer information for the purposes of the Canadian Dental Care Plan;

(m) expanding the definition of "dividend rental arrangement" to include "specified hedging transactions" carried out in whole or in part by registered securities dealers;

(n) implementing the Model Reporting Rules for Digital Platforms developed by the Organisation for Economic Co-operation and Development ("OECD");

(o) requiring annual reporting by financial institutions of the fair market value of RRSPs and registered retirement income funds ("RRIFs");

(p) expanding the permissible borrowing by defined benefit pension plans; and

(q) implementing a number of technical amendments to correct mistakes or inconsistencies and to better align the law with its intended policy objectives.

The bill also makes related and consequential amendments to the *Excise Tax Act*, the *Tax Rebate Discounting Act*, the *Air Travellers Security Charge Act*, the *Excise Act, 2001*, Part 1 of the *Greenhouse Gas Pollution Pricing Act*, the *Electronic Filing and Provision of Information (GST/HST) Regulations*, and the *Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations*.

The bill implements certain measures in respect of the *Excise Tax Act* and a related text by:

(a) clarifying that the international transportation of money benefits from GST/HST relief and other special rules in the same manner as a service of internationally transporting other kinds of freight;

(b) permitting a pension entity, in specific circumstances, to claim the pension entity rebate or an input tax credit, or to make the pension entity rebate election, after the end of the two-year limitation period;

(c) specifying that cryptoasset mining is generally not considered a supply for GST/HST purposes; and

(d) ensuring that payment card clearing services are excluded from the definition "financial service" under the GST/HST legislation.

The bill amends the *Excise Act*, the *Excise Act, 2001*, and the *Air Travellers Security Charge Act* in order to implement two measures.

The bill also amends the *Excise Act* and the *Excise Act, 2001* to temporarily cap the inflation adjustment for excise duties on beer, spirits, and wine at 2%, for one year only, as of April 1, 2023.

Finally, the bill amends the *Air Travellers Security Charge Act* to increase the air travellers security charge that is applicable to air travel that includes a chargeable emplanement after April 2024 and for which any payment is made after April 2024.

Progress of Legislation

Bill C-46, *An Act to amend the Federal-Provincial Fiscal Arrangements Act and the Income Tax Act*, received Royal Assent on May 11, 2023.

EFILE News and Program Updates

In circumstances where suspicious activity has been noted on a taxpayer's account and the file has been flagged for possible review, the Client Data Enquiry ("CDE") message "Review — The CRA may review this taxpayer's income tax and benefit return" will be displayed. This is not the only situation where this message is generated.

Discounters should be aware, proceeding with the submission of a T1 tax return in these circumstances may result in non-payment of the T1 refund in the event unauthorised use of taxpayer information has occurred.

In all circumstances, if you receive this message, it is important to advise your client to respond to requests for information from the CRA. Failure to respond to a CRA request may result in additional return processing delays.

GAAR Consultation

The Department of Finance has launched a consultation that seeks views and feedback on proposals released in Budget 2023 to amend the general anti-avoidance rule ("GAAR") in the *Income Tax Act*. In particular, comments are sought with respect to the changes described under the heading "General Anti-Avoidance Rule" in Tax Measures: Supplementary Information and in the related legislative proposals to amend the GAAR in the *Notice of Ways and Means Motion to Amend the Income Tax Act and the Income Tax Regulations*.

The government is interested in all stakeholders' views on these proposals, and interested parties are invited to send written representations to the Department of Finance Canada, Tax Policy Branch at GAAR-RGAE@fin.gc.ca by May 31, 2023.

Following this period of consultation, the government intends to publish revised legislative proposals and announce the application date of the amendments.

Those providing comments are asked to indicate clearly the name of the individual or the organization that should be identified as having made the submission. In order to respect privacy and confidentiality, please advise when providing your comments whether you:

- consent to the disclosure of your comments in whole or in part;
- request that your identity and any personal identifiers be removed prior to publication; or
- wish that any portions of your comments be kept confidential (if so, clearly identify the confidential portions).

Information received through this comment process is subject to the *Access to Information Act* and the *Privacy Act*. Should you indicate that your comments, or any portions thereof, should be considered confidential, the Department of Finance will make all reasonable efforts to protect this information.

FOCUS ON CURRENT CASES

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

Enns V. The King, 2023 DTC 1028 (Tax Court Of Canada): A Widow(er) Is A Spouse For The Purposes Of Section 160 Of The *Income Tax Act*

Background

Marlene Enns (the "Appellant") was the widow of Peter Enns ("Mr. Enns"), who passed away on May 22, 2013. Mr. Enns was the sole annuitant of a registered retirement savings plan ("RRSP") and had designated the Appellant as the sole beneficiary of the RRSP. There was no consideration paid for this designation. Following Mr. Enns' death, the fair market value ("FMV") of the RRSP, amounting to $102,789.52, was paid out to the Appellant. At the time of his death, Mr. Enns had an outstanding income tax liability from his 2004 through 2012 taxation years.

Generally, under section 160 of the *Income Tax Act* (Canada) (the "ITA"), where a person has transferred property to the person's spouse, the transferee and transferor are jointly and severally liable to pay to the Canada Revenue Agency (the "CRA") the amount, if any, by which the FMV of the property at the time it was transferred exceeds the FMV of any consideration given for the property in respect of the transferor's income tax liabilities. Accordingly, the Minister of National Revenue (the "Minister") assessed the Appellant on the basis that she was liable for Mr. Enns' unpaid income taxes. The Appellant appealed the assessment on the basis that upon Mr. Enns' death she ceased being his "spouse" and became his widow, and accordingly, section 160 did not apply.

Issues and Decision

The issue before the Tax Court of Canada (the "Court") was whether the Appellant ceased to be Mr. Enns' spouse for the purposes of paragraph 160(1)(*a*) of the ITA upon his death when she became entitled to the RRSP funds.

Justice Russell considered other decisions where the interpretation of the term "spouse" was at issue. In *Kiperchuk v. R.*, 2013 DTC 1088 (TCC), the Court determined that a marriage is ended by death and that the appellant in that case was no longer the spouse of her former husband upon his death. However, the Court did not specifically consider the meaning of the term "spouse" for the purposes of paragraph 160(1)(*a*) of the ITA.

In *Kuchta v. R.*, 2015 DTC 1229 (TCC), Graham J. undertook an extensive statutory interpretation analysis of section 160 of the ITA. In his textual analysis, he observed that "spouse" is not defined in the ITA and that there are two different meanings of the term: a legal meaning and a colloquial meaning. In his contextual analysis, Graham J. analyzed the use of the term "spouse" throughout the ITA and observed that one use of the term indicates that, in certain circumstances involving the transfer of property on death, Parliament intended that the term "spouse" include a widow(er); however, the other use of the term indicates that Parliament intended the opposite. Finally, in his purposive analysis, Graham J. noted that nothing in the ITA indicates that Parliament had an intention to give relief from subsection 160(1) of the ITA to transfers of property, including funds in an RRSP, upon death to widow(er)s or to recipients who were dependent or co-dependent on the tax debtor. On this basis, Graham J. concluded that for the purposes of subsection 160(1) of the ITA, "spouse" includes widow(er)s.

The appeal in *Kuchta* was originally heard by Jorre J. and was then re-assigned by the Chief Justice to Graham J., who rendered the decision. In *High-Crest Enterprises Ltd v. R.*, 2017 DTC 5057, the Federal Court of Appeal ("FCA") addressed a similar judge substitution situation. A majority of the FCA found the substitute judge's decision to be a "nullity", and that judgment should instead be rendered by the original judge who was seized of the matter and had heard it. On this basis, the Court's decision in *Kuchta* is sometimes questioned, notwithstanding the fact that the decision was not appealed.

Justice Russell found, however, that Graham J. had rendered an extensive, well-constructed, and thought-out analysis addressing the same legal issue. Accordingly, even if *Kuchta* were a nullity, and whether or not the principle of judicial comity applied, the *Kuchta* analysis did not fail to consider legislation or binding authorities which would have produced a different result. Furthermore, the *Kuchta* decision, if followed, would not result in a severe injustice. Accordingly, Justice Russell adopted the analysis in *Kuchta*.

Conclusion

The Court concluded that the Appellant was the spouse of Mr. Enns for the purposes of paragraph 160(1)(*a*) of the ITA and accordingly was jointly and severally liable for Mr. Enns' tax liabilities upon the transfer of the funds from his RRSP to the Appellant.

— *Ashleigh Graden*

Michel Foix, Nicolas Souty, And Sonia Lebel V. The King, 2023 DTC 5013 (Federal Court Of Appeal)

This case dealt with a hybrid sale and the question as to whether subsection 84(2) of the *Income Tax Act* (the "ITA") applied. The Federal Court of Appeal (the "FCA") confirmed that subsection 84(2) of the ITA extends to the indirect distribution of a target's assets in a sale to an arm's length purchaser.

Background

Watch4Net Solutions Inc. ("W4N") was incorporated by Mr. Foix and Mr. Souty in 2000. It was the hybrid sale of this corporation's shares and assets in May 2012 that led to the reassessments that were appealed.

At all times prior to the sale, all of W4N's shares were directly or indirectly owned by Mr. Foix, Mr. Souty, their family trusts, and their holding companies. Mr. Souty held his shares of W4N directly, Mr. Souty's wife, Sonia Lebel, held her shares of W4N as a beneficiary of Fiducie Familiale Nicolas Souty 2007 ("Fiducie Souty"). Mr. Foix held his shares of W4N through Virtuose Informatique Inc. ("Virtuose").

After negotiations with the third-party purchasers (EMC Corporation ("EMC") and EMC Corporation of Canada ("EMC Canada")), a proposed sale of shares of W4N was changed to a hybrid sale of W4N's shares and assets in April 2012.

The steps to accomplish the hybrid sale were complex, however the main steps were:

(1) Trusts for the families of Mr. Foix and Mr. Souty sold shares of W4N to EMC Canada for notes of EMC Canada, later repaid in cash, which ultimately was distributed to various family beneficiaries of the trusts;

(2) W4N sold assets to EMC for consideration that included notes, including two "Capital Dividend" notes totalling $22,000,000 and a "Balance Note" for $19,750,000;

(3) The rest of the shares of W4N were sold directly, or indirectly via the sale of Virtuose's shares, for cash; and

(4) EMC Canada, Virtuose, and W4N amalgamated.

On April 4, 2015, the Minister of National Revenue (the "MNR") issued reassessments with respect to Mr. Foix's, Mr. Souty's, and Ms. Lebel's 2012 taxation year, treating the following amounts received from the sale of shares of W4N and Virtuose as deemed dividends:

(a) for Ms. Lebel — $1,590,705 attributed to her as part of the amount of $2,481,412 received by Fiducie Souty from EMC Canada for the sale of its W4N Class F shares;

(b) for Mr. Souty — $800,450 received from EMC Canada for the sale of his W4N Class D and E shares; and

(c) for Mr. Foix — $800,000 received from EMC Canada for the sale of his Virtuose Class A and C shares.

The appellants appealed these reassessments on the basis that the conditions for the application of subsection 84(2) of the ITA were not met.

Issues and Tax Court Decision

The issue before the Tax Court of Canada (the "TCC") was whether the MNR properly applied subsection 84(2) of the ITA.

The trial judge set out two cumulative conditions in order to determine whether subsection 84(2) of the ITA applied on the facts:

> (1) Were funds or property "distributed or otherwise appropriated in any manner whatever to or for the benefit" of the shareholders of W4N?
>
> (2) If so, did the distribution or appropriation occur "on the winding-up, discontinuance or reorganization" of W4N's business?

In order to find that the first condition was met, the trial judge first gave subsection 84(2) of the ITA a broad scope, stating that courts take a fungible approach to cash and cash equivalents owned by a corporation when they are faced with transactions that are "indirect, structured, simultaneous and inter-related".

After examining the case law, in the trial judge's view, the scope of subsection 84(2) of the ITA is sufficiently large to target "indirect" distributions of funds or property. The trial judge found that the broad interpretation was justified in the case at hand because the appellants, with the assistance of the EMC group, initiated and executed a series of transactions that were all carried out in contemplation of one another to extract W4N's excess cash.

In the trial judge's view, it was clear that the indirect distribution of W4N's funds to the appellants was made possible by the role that the EMC group played as a facilitator.

Despite their testimony to the contrary, the trial judge found that part of the transaction that facilitated the withdrawal of the excess cash was in fact initiated and led by Mr. Foix, Mr. Souty, and their advisors.

To ascertain whether the second condition was also met, the trial judge first construed the word "reorganization" not as a legal term, but as a commercial term that presupposes the conclusion of the conduct of the business in one form and its continuance in a different form.

In applying this test, the trial judge found that W4N's business was reorganized on two occasions. First, W4N reorganized its business and its capital structure in the course of the reorganization that preceded the hybrid sale. Second, W4N's business could no longer be exploited as it was before the amalgamation, because the business was continued by two different entities (EMC and the successor corporation by amalgamation to W4N).

The trial judge found that the second condition was also met in the case of Virtuose because after the hybrid sale and Virtuose's amalgamation with W4N and EMC Canada, the successor corporation ceased to perform its only function, namely, holding W4N shares for Mr. Foix as a holding company. As a result, the trial judge concluded that Virtuose's business was discontinued within the meaning of subsection 84(2) of the ITA.

The TCC denied the appeal and upheld the reassessments.

Issues and Federal Court of Appeal Decision

The appellants appealed to the FCA. The main issues before the FCA were:

> (1) Were funds or property of W4N and of Virtuose owned directly or indirectly by the appellants "distributed or otherwise appropriated in any manner whatever" to or for the benefit of the appellants within the meaning of subsection 84(2) of the ITA despite there allegedly being no impoverishment of the two corporations?
>
> (2) If so, is subsection 84(2) of the ITA sufficiently large in scope to counter the type of distribution or appropriation that took place in this case?
>
> (3) If so, did the distributions or appropriations take place on the reorganization or the discontinuance of their respective businesses?

The FCA answered all three questions in the affirmative and denied the appeals on the basis that the two target corporations in question were impoverished from the indirect distribution of their funds and that the scope of subsection 84(2) of the ITA is wide enough to capture the type of distribution in question when the property being distributed is fungible and a third-party facilitator is involved in the extraction process. Further, the appellants failed to demonstrate that the trial judge erred in concluding that the businesses of the target corporations were reorganized or discontinued for purposes of subsection 84(2) of the ITA. The business of W4N was reorganized when it was split into two, and Virtuose's business was discontinued as it ceased to be a holding company.

Conclusion

The FCA upheld the trial judge's decision that the anti-avoidance language in subsection 84(2) of the ITA relating to "surplus stripping" is sufficiently broad to apply to indirect distributions of fungible property paid to shareholders by a third-party purchaser. The result was that the shareholders were deemed to receive a dividend upon the corporation's business being sold.

This case underscores the importance of carefully considering and understanding the risks involved in hybrid transactions.

— *Keith R. Hennel*

Goldhar V. The King, 2023 DTC 1026 (Tax Court Of Canada): Reasonable Reliance On Professional Advisors May Limit Reassessments Beyond The Normal Reassessment Period And Penalties

Background

David Goldhar (the "Appellant") utilized a complex corporate structure involving corporations and partnerships in Canada, the British Virgin Islands ("BVI"), and Hong Kong to carry on a toy business. He was a Canadian resident at all relevant times, residing in Ontario with his spouse, Marilyn Goldhar ("Ms. Goldhar"). Ms. Goldhar assisted the Appellant with accounting and tax affairs during the relevant taxation years at issue while he travelled for business purposes relating to the toy businesses. The Appellant also hired accountants and lawyers to look after his legal and tax affairs. His accountants filed his tax returns. Transfers of funds were made between various corporations and to the Appellant, including transfers from Beanteek Enterprises Inc. ("Beanteek"), which the Minister of National Revenue (the "Minister") argued were exclusively shareholder benefits. The Appellant took the position that these were valid intercorporate transfers.

The Minister issued a Notice of Reassessment to the Appellant for the 2008, 2009, 2010, and 2011 taxation years (the "Relevant Taxation Years") for unreported shareholder benefits amounting to $5,555,021. Additionally, the Minister assessed penalties of $1,271,946.90.

Issues and Decision

There were four issues before the Tax Court of Canada (the "Court"). The two core issues first addressed were:

(1) whether the Minister correctly reassessed the Relevant Taxation Years to include the unreported shareholder benefits amounting to over $5 million, and

(2) whether the Minister was correct to reassess the Relevant Taxation Years beyond the normal reassessment period pursuant to subparagraph 152(4)(*a*)(i) of the *Income Tax Act* ("ITA").

The other two issues were with respect to penalties:

(1) whether the penalties were properly assessed in accordance with subsection 163(2) of the ITA; and

(2) whether the penalties were correctly applied pursuant to paragraphs 162(7)(*a*), 162(10)(*a*), 162(10.1)(*f*), and 163(2.4)(*d*) of the ITA.

Underlying all four issues was the degree of care that the Appellant and Ms. Goldhar took in addressing tax filing obligations.

The Court dealt with the first two issues together, finding that the Minister could not reassess the Relevant Taxation Years beyond the normal reassessment period and, alternatively, that the amounts were incorrectly computed by the Minister. Subparagraph 152(4)(*a*)(i) allows for reassessment beyond the normal reassessment periods when the taxpayer or person filing the return "has made any misrepresentation that is attributable to neglect, carelessness or wilful default or has committed any fraud." There were no allegations of fraud by the Minister.

The Court found that the Minister did not establish all of the alleged misrepresentations during the Relevant Taxation Years under appeal. The Minister took the position that all of the funds withdrawn from Beanteek were shareholder benefits. The Court found that there was inconclusive evidence on the exact nature of the transactions undertaken by the Appellant and his corporate entities during the Relevant Taxation Years, but that the evidence supported the Appellant's position that these were intercorporate loans or repayments of amounts advanced to his corporations with respect to at least some of the transfers, contrary to the Minister's position that misrepresentations had occurred with respect to all of the transfers. The Court recalculated the amounts owing, had there been misrepresentations, on a balance of probabilities based upon the amounts in evidence, reducing the amount of benefits assessed by $4.4 million.

The Minister was unable to establish, on the evidence, that the misrepresentations were attributable to neglect, carelessness, or wilful default, which is the second part of the test required to satisfy subparagraph 152(4)(*a*)(i). The Appellant and Ms. Goldhar had no accounting background, worked closely with accountants in what the Court determined was a wise and prudent manner, used professionals to file their returns, and sought new advice when they did not believe their tax affairs were being dealt with satisfactorily, which occurred in one instance when the Canada Revenue Agency asked for information about a T1134. Additionally, the Appellant reviewed the returns with his accountants prior to filing. The Court found that the Appellant exercised reasonable care.

Penalties had also been assessed under subsection 163(2) of the ITA.

The burden of proving the facts justifying the penalty is on the Minister. The Minister, therefore, had to establish that the returns filed for the Relevant Taxation Years contained a false statement or omission and the Appellant participated in, assented to, or acquiesced in the making thereof knowingly or in circumstances amounting to gross negligence. The Court found that it was not established that the Appellant failed to report a significant amount of income. The errors or omissions, if any, contained in those returns were not attributable to knowledge or neglect. As a result, no penalties should apply.

The Court also found, on the fourth and final issue as to whether the penalties were correctly applied with respect to foreign reporting on the T1134 pursuant to paragraphs 162(7)(*a*), 162(10)(*a*), 162(10.1)(*f*), and 163(2.4)(*d*) of the ITA, that the Appellant should not have been assessed penalties. While there were some errors made in these forms, the Appellant sought to fix the issues of which he was made aware. The Court held that the Appellant had established that he was diligent in his foreign reporting requirements; the due diligence defence was available to him on the basis of all the facts and his reasonable reliance on his professional advisors; and that there were some admitted facts which invalidated the application of the penalties.

Conclusion

The Court allowed the Appellant's appeal. While there may have been some misrepresentations, totalling about $1.1 million, it was not proven that any such misrepresentations were attributable to neglect, carelessness, or wilful default given the Appellant's reasonable reliance on accountants and lawyers to structure his affairs and file returns. Therefore, the burden to extend the time for reassessment under subparagraph 152(4)(*a*)(i) was not met. Additionally, the Appellant took all reasonable steps to accurately file tax returns and report foreign income, therefore penalties should not have been assessed against him for the Relevant Taxation Years.

— *Ashleigh Graden*

3792391 Canada Inc. V. The King, 2023 DTC 1031 (Tax Court Of Canada) — Non-Resident Status For The Purpose Of The Application Of Subsection 215(1) Of The ITA

Background

David Siscoe is a shareholder of 3792391 Canada Inc. (the "Appellant"). Mr. Siscoe entered into a lease with Sebastiana Trimarchi for premises located in Westmount, Québec (unit 501) which he used as his personal residence. The lease indicates Sebastiana signed the lease in Italy but provided an address in Pincourt, Québec. Further, Sebastiana provided an Italian phone number in the lease. Although Mr. Siscoe was the tenant of unit 501, the Appellant paid the rent on his behalf during the taxation years under appeal.

Part XIII of the *Income Tax Act*, R.S.C. 1985, c.1, 5th supp. (the "ITA"), levies a tax on certain types of income paid to non-residents by a resident of Canada (other deeming provisions may also apply). Paragraph 212(1)(*d*) imposes a 25% tax on gross rental income from real property in Canada owned by the non-resident. In order to ensure the collection of the taxes payable by a non-resident, subsection 215(1) of the ITA requires the Canadian resident to withhold the tax and remit it to the Receiver General of Canada. Under subsection 215(6), a person who fails to withhold and remit may be liable for the tax.

The Minister of National Revenue assessed the Appellant for failure to withhold and remit Part XIII tax payable on rental income received by Sebastiana, the owner of unit 501 during the relevant period, on the basis that Sebastiana was a non-resident.

Issues and Decision

The issue in this appeal is whether the Appellant paid rent to a non-resident person such that it is liable for having failed to withhold and remit the tax payable on the rental income on behalf of the non-resident person.

Residence Status

The Court found that Sebastiana was a non-resident of Canada during the relevant taxation years based on the fact that she did not file any income tax returns and did not have any information returns showing income such as employment or interest income in Canada. Further, the Court noted the absence of relevant ties to property in Canada other than the unit rented to Mr. Siscoe. The Court rejected the Appellant's argument that Sebastiana was a Canadian resident because she provided a Québec address on the lease, since that address had not been the subject of any inquiry and was the same as that of family members living in Canada. Further, when contacted by an auditor regarding her Italian phone number, Sebastiana confirmed she was living in Italy.

Knowledge Requirement for Part XIII Tax

The Appellant also argued that if the payor does not have knowledge that the payee is a non-resident, the payor should not have to bear the consequences of having not complied with Part XIII of the ITA. According to the Appellant, since Mr. Siscoe did not know, and had no reason to believe, that Sebastiana was a non-resident, section 215 of the ITA should not have applied. The Court noted that when the legislator wants to limit a resident's liability to circumstances where they have knowledge or a particular belief, the legislative framework provides the necessary clarity. Given the absence of such wording in section 215 of the ITA, the Court rejected the proposition that the Appellant's knowledge, or the absence thereof, could be used to help fend off the application of Part XIII of the ITA.

Conclusion

The Court stated that subsection 215(6) is devoid of any requirement that the payor have knowledge that the payee is a non-resident. The provision provides in no uncertain terms that where a person has failed to deduct and remit an amount of withholding as required, they are liable for Part XIII tax.

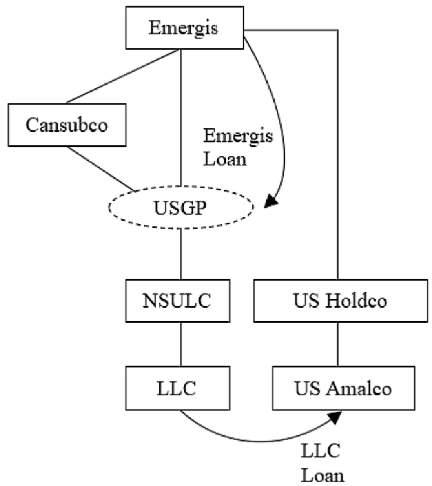
The Court concluded that Sebastiana was a non-resident during the relevant years, and that the evidence left little doubt that the Appellant was indeed in a situation of non-compliance in respect of withholding and remitting the 25% tax payable on the source of rental income that was paid out.

— *Anass Benchekroun*

Emergis Inc. V. Canada, 2023 DTC 5031 (Federal Court Of Appeal) — The Right To Deduct Foreign Non-Business Income Tax Provided In Subsection 20(12) Of The ITA

Background

Emergis implemented the following "tower structure" to acquire a US corporation. A general partnership was formed under the laws of Delaware ("USGP") with Emergis holding a 99.9% interest and a wholly-owned subsidiary of Emergis ("Cansubco") holding the remaining 0.1% interest. USGP incorporated a Nova Scotia unlimited liability company ("NSULC") and USGP was its sole shareholder. USGP and NSULC incorporated a limited liability company under the laws of Delaware ("LLC").



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The funding for the acquisition of the US target corporation flowed from Emergis through the structure as follows: Emergis lent USGP approximately US$267 million ("Emergis Loan"). Interest was payable on the Emergis Loan. USGP used the funds (approximately US$300 million) to subscribe for shares in NSULC. USGP also subscribed for one share of LLC for US$100 and NSULC subscribed for shares of LLC for approximately US$300 million.

Subsection 20(12) of the *Income Tax Act* ("ITA") provides that a foreign non-business income tax is generally deductible except where the tax "can reasonably be regarded as having been paid by a corporation in respect of income from a share of the capital stock of a foreign affiliate of the corporation" (the "20(12) foreign affiliate corporation exception").

Issues and Decision

The issue in this appeal is whether Emergis is entitled to a deduction under subsection 20(12) of the ITA for the taxes paid to the US Government on the interest paid by USGP to Emergis. In particular, the issue is whether the 20(12) foreign affiliate corporation exception applies.

The relevant taxes at issue are the withholding taxes imposed by the US Government on the interest paid by USGP to Emergis and the relevant foreign affiliate of Emergis is LLC. In *Emergis Inc. v. The Queen*, 2021 DTC 1019 (TCC), the Tax Court of Canada ("TCC") held that dividend income received by a subsidiary of a parent corporation (NSULC in this case) could reasonably be regarded as the income in respect of which the parent paid foreign tax (Emergis in this case).

The Federal Court of Appeal ("FCA") rejected this interpretation of subsection 20(12) of the ITA and considered that the income from the shares of LLC was paid to NSULC. The FCA found that there is nothing in the wording of subsection 20(12) of the ITA that explicitly provides that the separate existence of the two corporations (Emergis and NSULC) is to be ignored and that the income of NSULC is to be considered to be the income of Emergis. The wording of subsection 20(12) of the ITA is insufficient to supersede the general rule that the assets and income of a corporation are not the assets and income of its shareholders. Therefore, the FCA determined that there is no basis to conclude that subsection 20(12) of the ITA explicitly provides that NSULC's income from its LLC shares should be treated as the income of Emergis, and hence as the income on which Emergis paid the taxes to the US Government. The FCA concluded that the wording of subsection 20(12) of the ITA supports a finding that the taxes paid by Emergis to the US Government cannot reasonably be regarded as taxes paid by Emergis in respect of income from the shares of LLC.

Conclusion

In this case, the FCA reversed the TCC's decision and denied Emergis the right to deduct the foreign tax paid to the US government under subsection 20(12) of the ITA. This case emphasizes that explicit statutory language is required to supersede the general rule that assets and income of a corporation are not the assets and income of its shareholders. The FCA concluded that the words used in the exception in subsection 20(12) of the ITA are insufficient to supersede this general rule and determined that NSULC's income from its shares of LLC cannot be treated as the income of Emergis for purposes of the subsection 20(12) foreign affiliate exception.

— *Anass Benchekroun*

Werstein A. V. The King, 2023 DTC 1044 (Tax Court Of Canada) — Application Of The Subsection 163(2) Penalty For Knowingly Making False Statements When Filing An Income Tax Return

Background

Mr. Werstein used Fiscal Arbitrator tax preparers and claimed significant fictitious business losses to obtain refunds with respect to tax already withheld from his employment income in 2009 and in three previous taxation years. To promote taxpayer honesty, subsection 163(2) of the *Income Tax Act*, R.S.C., 1985, c.1, 5th supp. (the "ITA") allows the Minister of National Revenue to assess a penalty against a taxpayer who knowingly, or under circumstances amounting to gross negligence, makes a false statement in filing an income tax return. This case is an appeal of the Minister's decision to impose a penalty under subsection 163(2) of the ITA in the presence of false information contained in Mr. Werstein's 2009 income tax return.

Issues and Decision

Mr. Werstein does not deny that his 2009 income tax return contained false statements. The only question in this appeal is whether he is liable for the penalty provided for in subsection 163(2) of the ITA.

Blatantness of the False Statements

Knowledge of a false statement may trigger subsection 163(2) of the ITA in the presence of wilful blindness. A taxpayer who turns a blind eye to the truth and accuracy of statements made in their income tax return is wilfully blind. The knowledge requirement is satisfied when a taxpayer chooses not to make inquiries in circumstances that suggest inquiries should be made. In this case, despite Mr. Werstein's Grade 12 education, the Court found that he did not need extensive financial education or experience to recognize that claiming $320,000 in business losses when he was not operating a business was blatantly false.

Magnitude of the Advantage

Given the false business losses he reported, Mr. Werstein claimed a refund of $25,981. Mr. Werstein knew this refund would be higher than what he usually received, since he had knowledge that it was customary that his refund from year to year was not more than a few thousand dollars. The Court rejected Mr. Werstein's argument that he asked his tax preparer about his income tax return because he "saw big numbers" and signed it under his instructions. The Court found that there was no basis for Mr. Werstein to simply accept the "big numbers" and to sign the return. The warning signs were significant enough that Mr. Werstein's failure to make further inquiries established wilful blindness, making him liable for the penalty provided for in subsection 163(2).

This case is to be distinguished from *Aridi v. The Queen*, 2013 DTC 1189 (TCC), where the taxpayer's line of conduct was that of a wise and prudent person: he asked his accountant questions during a meeting that lasted more than an hour and he questioned him extensively about his income tax return.

Conclusion

In this case, the Court applied subsection 163(2) of the ITA which permits the Minister to impose a penalty on a taxpayer who knowingly, or under circumstances amounting to gross negligence, makes a false statement in filing an income tax return. The Court found Mr. Werstein liable for the penalty because he voluntarily chose to ignore the obvious false statements in his income tax return in order to obtain a substantial refund of taxes withheld from his employment income.

— *Anass Benchekroun*

RECENT CASES

Taxpayer Did Not Act Unreasonably in RRSP SNAFU Due to Bank Mistake

In 2006, the Applicant and his spouse made withdrawals from their RRSPs to finance the purchase of their first home as part of the federal government's Home Buyers' Plan ("HBP"). In 2013 the spouse went into an RBC branch to make a payment into her RRSP to pay off the HBP balance of $13,142. The Applicant stated that RBC mistakenly placed this payment into the spousal account with himself as contributor, with the result that he exceeded his RRSP contribution room. RBC's Spousal Contribution Receipt reflected this interpretation, but the Applicant did not claim the $13,142 on his return that year; his spouse did. What the Applicant did claim was the $13,111 payment he made into his RRSP to settle his HBP debt. Once the Applicant was aware of the situation he requested a waiver under subsection 204.1(4) of the *Income Tax Act*, which the CRA refused; this appeal followed a second refusal.

The Federal Court allowed the application and returned the matter to a different decision maker. The CRA argued the Notices of Assessment it sent the Applicant in 2017 and 2018 should have apprised the Applicant that the CRA believed he was in an overcontribution situation. The Court ran through the calculations and determined the Notices did not reflect the 2013 overcontribution; even given a notation to the effect that an amount enclosed in parentheses is negative, they did not put the Applicant on notice that he overcontributed by $13,142 in 2013. Relief under subsection 204.1(4) also requires that the taxpayer was taking reasonable steps to remedy the excess contribution; the Applicant argued he should not have to remedy a condition that would not exist if the CRA would recognize his claim. The Court held that there was no way to determine what would be a reasonable mitigation given that the CRA misinterpreted the deposit.

Zhang v. AG of Canada

2023 DTC 5027

Taxpayer's Claim for Bad Debts Denied

The Appellant was the sole shareholder and director of a company that rented VHS tapes of movies between 1997 and 2001. The company was dissolved in late 2001. In each of the 2006 and 2007 tax years, the Appellant had claimed a bad debt expense under subparagraph 20(1)(*p*)(i) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "Act") on the basis of alleged debts owed to him by his dissolved company. The Minister denied these claims. The Appellant objected to the Minister's assessments, and in his Notice of Objection also requested the Minister allow deductions for allowable business investment losses under paragraphs 38(*c*) and 39(1)(*c*) of the Act. The Tax Court held that the Appellant had not submitted any evidence upon which it could conclude he had either advanced money to the company or incurred any bad debt. He then appealed to the Federal Court of Appeal.

The appeal was dismissed. In determining whether the Tax Court erred in its conclusion the Appellant failed to prove that he had incurred bad debt expenses or allowable business investment losses, the Court of Appeal observed that subsection 230(1) of the Act requires taxpayers to maintain books and records containing the information necessary to determine the amount of their taxes payable for six years, subject to certain exceptions. In this case, the appellant was assessed in 2010 in respect of the 2006 and 2007 years and was obligated to maintain all records necessary to support his claims. The Court further explained that the expiry of the time periods prescribed in subsection 230(4) of the Act and section 5800 of the *Income Tax Regulations* does not shield or immunize taxpayers from the evidentiary burdens they face in Tax Court proceedings. The Court of Appeal held that maintaining books and records is an ongoing obligation in a self-assessing system and the Appellant's failure to do so also made it impossible for him to meet his evidentiary burden to demolish the Minister's assumptions, and dismissed the appeal.

Dirani v. The King

2023 DTC 5026

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