Tax Notes

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Wolters Kluwer

WHO CAN WAIVE COMMON INTEREST PRIVILEGE?

— *Joel Nitikman, Dentons Canada LLP, Vancouver*

Introduction

As is well known, a communication between a lawyer and her client will be subject to solicitor-client privilege ("SCP") if and only if four conditions are satisfied. There must be:

(1) a communication;

(2) between a lawyer and an existing or potential client;

(3) made in confidence;

(4) for the dominant purpose of receiving or providing legal advice.

If these conditions are met then the communication is subject to or covered by SCP. The privilege belongs to the client. The "privilege" in the term "SCP" is used in the sense of a "right" or "option" and means that the client may choose to keep the communication confidential or may agree to disclose it to third parties.

Where the client chooses to disclose the communication to a third party, it is said that the client has "waived" the privilege. In general, the waiver applies to the entire world, that is, once the client no longer intends to keep the communication confidential from one person, he cannot maintain that confidentiality against anyone.

Common Interest Privilege

As an exception to the "waived against one, waived against everyone" principle, a person who holds SCP over a communication may share that communication with another party and thereby waive SCP against that person without waiving it against the whole world. This is known as "common interest privilege" ("CIP").[1] CIP may arise in a litigation context, where two (or more) parties have a common interest in litigation brought by or against them. Recently, the Federal Court of Appeal clarified that CIP may also arise in a transactional setting, that is, in the course of negotiations between two parties on opposite sides of a commercial transaction.

Who Can Waive CIP?

One issue that arises in the context of CIP is this: if a communication is subject to CIP, who can waive that privilege? More precisely, if one party waives it, is that waiver binding on the other? Or must the parties agree with each other to waive the privilege

[1] CIP may be just one facet of a broader principle known as "limited disclosure" or sometimes "limited waiver". See Hodge M. Malek, ed., *Phipson on Evidence* (19th ed., 2017), section 24-09. A full discussion of that principle would require a separate and lengthier article.

before the waiver is effective against both?

As one article noted recently, in the course of a comprehensive discussion of CIP, this issue is, perhaps surprisingly, unsettled.[2]

UK and Australian Decisions

Where CIP exists among two or more parties, the law is, as noted, somewhat unclear as to whether one party may waive the privilege or whether all must do so. The UK rule appears to be that all parties must do so.[3]

By contrast, Australian decisions have held the rule to be that when one party to a CIP waives, then the court must determine if "fairness in the circumstances" requires the other party to be bound by that waiver.

The Australian "fairness" rule was rejected in a very recent UK decision.[4] However, the Australian courts have now played tit-for-tat. In an even more recent Australian decision, the Court noted the decision in *Accident Exchange*, distinguished it on the facts, and accepted one textbook's position that the general or default rule is that all parties to a CIP must join in the waiver, but that fairness may require that a party who did not waive will be bound by the other party's waiver.[5]

Canadian Decisions

As Marion and Poppel[6] note, a number of Canadian courts have reached the same conclusion as the UK decisions: if there is a CIP then all parties to it must waive the privilege. More precisely, they have held that the fact that one party to the CIP discloses the communication that is covered by the CIP to a third party does not give that third party or anyone else the right to demand that the other party to the CIP disclose the communication.[7] As Marion and Poppel[8] note, the Courts have reached that conclusion without a great deal of in-depth analysis or explanation.

CIP Is a Defence

CIP is not a separate kind of SCP. Rather, it is a defence to an allegation that the party holding the privilege has waived it by disclosing the communication to a second party.

Keeping that in mind, in my view the answer to this issue is not complicated. CIP arises primarily in two situations: the first is where one party holds privilege over a communication and shares it with a second party with whom the first has the required common interest; the second is where the parties' separate lawyers collaborate with each other in creating the communication and then each shares the final product with his or her individual client.

In the first situation, the privilege belongs initially to the first client and is not lost (except as against the second party) when the first shares the communication with the second party. But, most importantly for this discussion, the second party does not obtain SCP over that communication. The privilege continues to belong only to the first party. Accordingly, only that party can waive that privilege. The fact that the second party, in breach of what is probably an implicit term of the agreement, shares that communication with a third party cannot result in the first party being deemed to have waived its privilege. Marion and Poppel[9] note that this reasoning is set out in a leading textbook[10] and suggest that it is "compelling". I would go further and say it is self-evidently correct.

In the second situation, the privilege belongs, mutually (although not jointly) to both clients. Either may waive its privilege, but it hardly seems that such a waiver should result in the other party losing its privilege. Unlike the Australian decision, I would not say that this is based on fairness; it is based on the fundamental point that the

[2] Michael A. Marion and Laura M. Poppel, "Common Ground? The Doctrine of Common Interest Privilege in Canada", Part V, section 1, in Mr. Justice Todd L. Archibald, ed., *Annual Review of Civil Litigation 2018 (Westlaw)*.

[3] See *Winterthur Swiss Insurance Co v. AG (Manchester) Ltd (in liquidation)*, [2006]EWHC 839 (Comm) at paragraph 133.

[4] *Accident Exchange Ltd. v. McLean*, [2018] EWHC 23 (Comm) at paragraph 94.

[5] *Woodings v. WA Glendinning & Associates Pty Ltd.*, [2019] WASC 54 at paragraphs 189-190.

[6] *Supra* note 2.

[7] In addition to the decisions they cite at footnote 344, see *Nette v. Stiles*, 2012 ABQB 290 at paragraph 47; and *Maximum Ventures Inc. v. de Graaf*, 2007 BCCA 510 at paragraph 19 (note: footnote 344 cites *Re Chiang*, but the correct citation for that decision is 2013 ONSC 6753, additional reasons at 2013 ONSC 6908).

[8] *Supra* note 2.

[9] *Supra* note 2.

[10] At footnote 345 of their article they cite the 18th edition of *Phipson on Evidence*, *supra* note 1, at section 24-07. See now the 19th edition, *supra*, at section 24-08.

privilege belongs, as much as a piece of property may belong, to the other party and the actions of the waiving party cannot destroy the privilege owned by the other. (Of course, the communication will now be public, as it has been disclosed by the second party. But the first party can still resist answering questions about the communication.)

It remains to be seen whether a Canadian court will adopt this reasoning in either CIP situation.[11]

A number of tax lawyers from Dentons Canada LLP write commentary for Wolters Kluwer's CANADIAN TAX REPORTER *and sit on its Editorial Board as well as on the Editorial Board for Wolters Kluwer's* INCOME TAX ACT WITH REGULATIONS, ANNOTATED. *Dentons Canada lawyers wrote the commentary for* CANADA–U.S. TAX TREATY: A PRACTICAL INTERPRETATION *and have authored other books published by Wolters Kluwer:* CANADIAN TRANSFER PRICING (2ND EDITION, 2011)*;* FEDERAL TAX PRACTICE*;* CHARITIES, NON-PROFITS, AND PHILANTHROPY UNDER THE INCOME TAX ACT*; and* CORPORATION CAPITAL TAX IN CANADA.

CURRENT ITEMS OF INTEREST

CRA Provides Real Estate Compliance Update

In recent years the CRA has been increasing its compliance efforts with respect to real estate in Ontario and British Columbia. In a recent news release, the CRA reported that in 2018 it assessed $171 million more in gross taxes related to real estate compared to 2017, which is a 65% increase. Penalties assessed in 2018 were over $57 million, which is more than double that of 2017. To further enhance the CRA's compliance efforts, Budget 2019 proposed to provide an additional $50 million (over five years) and another $10 million ongoing to form a Real Estate Task Force that will focus on the Greater Toronto and Greater Vancouver areas.

Draft Legislation for Health and Welfare Trusts

Since 1966, the tax treatment of health and welfare trusts has been provided by the CRA's administrative policies. The rules with respect to employee life and health trusts were enacted in 2010. In Budget 2018, the government announced that it would introduce rules that harmonize the tax treatment of health and welfare trusts with the rules applicable to employee life and health trusts.

Following a consultation with stakeholders in 2018, the government released the draft proposals for further consultation on May 27, 2019. The effect of these amendments will be two-fold. First, the rules will allow existing health and welfare trusts created before 2010 to elect to be treated as employee life and health trusts. The rules will also facilitate tax-free rollovers where assets are transferred to a newly-created trust or two or more trusts are merged. Second, the proposals include several measures intended to improve the existing employee life and health trust rules.

Comments should be submitted by July 31, 2019.

CRA's Statement on *Cameco* Decision

On May 31, 2019, the CRA stated that it would not seek leave to appeal *MNR v. Cameco Corporation* (2019 DTC 5042) to the Supreme Court of Canada. In this decision, the Federal Court of Appeal upheld a decision which found that the Minister may not use its audit powers to require employees of a company to submit to oral interviews. In this statement, the CRA emphasizes the importance of participation in oral interviews to the tax compliance process. Further, as a result of the *Cameco* decision and *BP Canada Energy Company v. MNR* (2017 DTC 5028 (FCA)), the CRA has published policy no. AD-19-02, Obtaining Information for Audit Purposes. With respect to the *Cameco* decision, the policy document provides the following comments:

> The FCA decision does not diminish the responsibilities of owners, managers and other persons on the premises of a business to cooperate and answer questions during the course of an audit. Therefore, CRA officials should continue to request oral discussions and interviews with taxpayers to expedite the audit process. If a taxpayer refuses to be interviewed, the FCA stated that the CRA is free to make inferences and assumptions and to assess on that basis. The Department of Justice should be consulted in these types of situations.

[11] One point to take from this discussion is that, where CIP will be involved, it will be helpful for the parties to have a written agreement setting out how they will act in respect of any material covered by the CIP.

FOCUS ON CURRENT CASES

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

Court Sets Aside CRA's Rejection of Voluntary Disclosure

***4053893 Canada Inc. v. The Queen*, 2019 DTC 5011 (Federal Court)**

In this judicial review application, the Federal Court considered whether it was reasonable for the Canada Revenue Agency ("CRA") to deny a request for relief made by the taxpayer under the voluntary disclosure program on the basis of the CRA's determination that the request was not made voluntarily.

Subsection 220(3.1) of the *Income Tax Act* provides the Minister of National Revenue with the authority to waive or cancel all or a portion of any penalty or interest owed by a taxpayer. The Minister has delegated the discretion under this provision to the CRA, which has set out a number of administrative conditions that must be met for a taxpayer to qualify for relief. The administrative conditions applicable in the taxpayer's case were set out in Information Circular IC00-1R5 (now IC00-1R6). The circular required, amongst other things, that the taxpayer's application have been voluntary.

The taxpayer was a corporation owned by a sole shareholder who acted as the corporation's sole director. The shareholder had not filed his personal income tax returns for any of the 2006 to 2015 taxation years and was contacted about the unfiled returns by the CRA in August 2016.

The CRA alleged that in the course of discussing the shareholder's unfiled returns, the shareholder indicated that the taxpayer corporation was still active, as a result of which the CRA advised the shareholder that he had to file both his personal returns and the taxpayer's corporate returns. At the time, the taxpayer corporation had not filed returns since 2003.

In January 2017, a representative of the taxpayer corporation filed a no-names voluntary disclosure letter notifying the CRA of the taxpayer's failure to file its income tax returns.

Following discussions with the CRA on a no-names basis, in June 2017 the taxpayer filed a completed voluntary disclosure application with the CRA on a named basis. In September 2017, a first-level reviewer with the CRA wrote to the taxpayer denying the voluntary disclosure on the basis that the CRA had already contacted the taxpayer, such that the disclosure was not considered voluntary and, therefore, was not eligible for relief under the administrative policies set out in Information Circular IC00-1R5.

The taxpayer requested a second-level review on the basis that there had been no contact between the CRA and the taxpayer corporation and that the first-level review decision was bereft of detail regarding the purported prior contact.

The second-level reviewer issued a decision letter in January 2018 concluding that the taxpayer did not qualify for relief under the voluntary disclosure program because the application was not voluntary. The second-level reviewer indicated that in conversations in August 2016 between the taxpayer's shareholder and the CRA, the shareholder had been advised that he had to file both his personal and the taxpayer's corporate tax returns.

The taxpayer applied to the Federal Court for judicial review of the second-level reviewer's decision. The Court affirmed that decisions of the CRA concerning the Voluntary Disclosure Program are reviewable on the more deferential standard of reasonableness, rather than correctness, and, as such, decisions of the CRA will not be overturned if they fall within a range of possible, acceptable alternatives that are defensible in respect of the facts and the law, provided that the decision-making process reflects the elements of justification, transparency, and intelligibility.

The Court reviewed the conditions set out by the CRA in IC00-1R5 for determining whether a disclosure is voluntary, noting that the CRA states that a disclosure will not be voluntary if there is an enforcement action against a person related to or associated with the taxpayer and that enforcement action is likely to have uncovered the information that the taxpayer is disclosing.

The Court considered the reasons of the second-level reviewer. The Court concluded that the reviewer's decision that the disclosure was not voluntary was unreasonable on the basis that, while there was enforcement action against a person related to the taxpayer, the second-level reviewer's decision did not disclose a transparent, intelligible, or justifiable basis on which to conclude that it was likely that the enforcement action against the shareholder, a person related to the taxpayer, would have uncovered the taxpayer's failure to file prior year returns. In support of this position, the Court cited the cases of *Worsfold* (2012 DTC 5121 (FC)), *Poon* (2010 DTC 5191 (FC)), and *Matthew Boadi Professional Corporation* (2018 DTC 5013 (FC)), which have held that it is insufficient to simply conclude on the basis of an existing relationship that enforcement action against one taxpayer would uncover information contained in a

second taxpayer's voluntary disclosure. As a result, the Federal Court granted the taxpayer's judicial review application and returned the request for relief under the voluntary disclosure program to the CRA for review by a different reviewer.

Given that in the discussions between the taxpayer's shareholder and the CRA the shareholder was purported to have confirmed that the taxpayer corporation was still active, this judicial review decision may be less a success by the taxpayer than a failure of the CRA to have articulated in its response to the taxpayer the reasons why the CRA was likely to have uncovered the failure by the taxpayer to file prior year returns. In effect, the decision appears to be based upon the CRA's failure to follow the rules of procedural fairness, and the standards of intelligibility and justification in relying on a *pro forma* statement rejecting the application and merely providing a recital of the relevant facts, including that the shareholder was under audit, without articulating why those facts likely would have led to the CRA uncovering the taxpayer's failure to file returns in prior years.

— *Justin Shoemaker*

British Columbia Supreme Court Allows Rectification Where Parties' Intention Was Clear

***Crean v. AG of Canada*, 2019 DTC 5016 (British Columbia Supreme Court)**

When the Supreme Court of Canada decisions in *Fairmont Hotels Inc*. (2016 DTC 5135) and *Jean Coutu Group* (2016 DTC 5134) were released in late 2016, many in the tax community feared that going forward rectification would apply only in circumstances of clear clerical errors. However, this decision is proof that Canadian courts will still apply rectification in circumstances involving a prior definite and ascertainable agreement.

The two individual petitioners, Thomas Crean ("Thomas") and Michael Crean ("Michael"), are brothers who each owned 50% of a holding corporation ("Crean Holdings") which held an operating company that provided funeral and related services. Thomas wished to retire from the business and have his interest transferred to his brother, Michael. The brothers entered into a written agreement in principle allowing for Michael to purchase all of Thomas' interest in the Crean group, "direct or indirect", for a sum of $3,200,000. The agreement in principle stated that "the transaction will be structured, to the extent possible, so that [Thomas] receives capital gains treatment for tax purposes."

The brothers approached a tax advisor regarding the transaction. The advisor devised a plan that involved Michael incorporating a numbered corporation ("Numberco"), and disposing of his shares of Crean Holdings to Numberco on a tax-deferred basis. Under the plan, Thomas would then sell his shares in Crean Holdings to Numberco in exchange for a promissory note issued by Numberco to Thomas. This plan was effected in August 2016, resulting in Michael becoming the sole shareholder of Numberco, and Numberco becoming the sole shareholder of Crean Holdings. However, the tax plan did not take into account the surplus stripping rule in subsection 84.1(1) of the *Income Tax Act*, which prevents individual taxpayers from surplus stripping corporations by converting taxable dividends into capital gains. The consequences of the rule in subsection 84.1(1) deem a dividend equal to the excess of the non-share consideration over the greater of the paid-up capital and the adjusted cost base of the shares sold to be received from the purchasing corporation, where an individual taxpayer disposes of shares of a corporation to another corporation with which the individual does not deal at arm's length in circumstances in which, after the transactions, the two corporations are connected. Thomas and Numberco did not deal at arm's length and, after the transaction was effected, Numberco and Crean Holdings were connected. This resulted in a deemed dividend of approximately $2.7 million to Thomas, denying Thomas the capital gains treatment that was originally agreed to in the agreement in principle.

The petitioners sought rectification of the purchase agreement among Thomas, Numberco, and Crean Holdings on the basis that the purchase agreement did not accord with the agreement in principle for a direct sale of shares and for capital gains treatment for Thomas. The Crown opposed the rectification order on the basis that the petitioners were merely seeking a second chance, with the benefit of hindsight, at drafting the agreement to avoid adverse tax consequences.

At the outset, the Court set out the conditions precedent that must be met before granting rectification:

(1) There must be a "definite and ascertainable" prior agreement;

(2) The agreement must have been in effect at the time the instrument sought to be corrected was executed;

(3) The written instrument must be inconsistent with the prior agreement; and

(4) The precise form in which the written instrument can be amended to carry out the prior agreement must be shown.

The main issue decided by the Court was whether the agreement in principle was sufficient evidence of a true, definite,

and ascertainable agreement. The petitioners argued that a contextual reading of the agreement in principle revealed the parties' true intention for a direct sale of Crean Holdings to Michael. They sought to distinguish the decisions in *Fairmont Hotels* and *Jean Coutu* because in those cases the goal was simply to achieve tax neutrality, whereas in this matter they specifically set out the intention for capital gains treatment, and sought tax advice. Their tax advisor, who appeared before the Court on behalf of the petitioners, admitted to making a mistake by not representing the parties' true intention because he "wasn't thinking clearly" due to extenuating circumstances. In opposition, the Crown argued that there was no "clear, persuasive and cogent" evidence to support the petitioners' claim that the agreement in principle was definite and ascertainable.

The Court agreed with the petitioners, finding that the agreement in principle met the bar and was definite and ascertainable. The Court relied on a contextual and purposive reading of the agreement in principle to find that the phrase "direct or indirect" in the agreement in principle referred to Thomas' direct or indirect interests, rather than the direct or indirect method of purchasing the shares, which is what the Crown argued. The Court, noting that the common, continuing intention of tax neutrality was not relevant, found that the agreement in principle remained in effect when the purchase agreement was signed. The Court accepted that the written instrument was inconsistent with the true agreement as reflected in the agreement in principle, because the petitioners' prior agreement consisted of a direct transfer rather than a transfer to a subsidiary corporation. Of note, the Court explicitly considered the events before and after the execution of the purchase agreement as being relevant at this stage of the analysis. In this case, the petitioners notified the Canada Revenue Agency of the error almost immediately upon being alerted, which was consistent with the existence of a true agreement. The purchase agreement was found to be capable of modification to carry out the agreement in principle, because all that was required to give effect to the petitioners' intention was the substitution of Michael in the place of Numberco in the purchase agreement. This would effect the direct sale that the Court accepted was the true intention of the agreement in principle.

The Court also considered policy considerations in allowing rectification. Firstly, that tax consequences do not flow from tax objectives, but instead from legal relationships and transactions. Secondly, the Court considered the undesirable precedent that would occur if parties could simply point to a common intention to avoid negative tax consequences in order to allow for the amendment of written documents. These policy concerns were not engaged on these facts. The corporations in this case were newly created specifically to accomplish the transaction. Rectification, in this case, did not offend the policy underlying the anti-avoidance provisions in subsection 84.1(1).

The deciding factor in this case was that the brothers could point to a written agreement that set out not only the intention to avoid tax, but to specifically effect a direct transfer of shares from Thomas to Michael that would be effected in a manner that would allow for capital gains treatment for Thomas. The prior agreement was definite and ascertainable. However, the purchase agreement did not reflect the direct transfer. This distinguished this matter from earlier rectification cases in which the petitioners' intention was simply to avoid tax. This case appears to achieve a balance, allowing rectification when there is sufficient evidence that what was actually effected is not what was originally intended, while protecting against the flood of rectification applications where parties could claim an undocumented intention to simply avoid tax.

— *Steve Marshall*

Can a Corporation Be Represented by a Non-Lawyer in a General Procedure Appeal in the Tax Court?

***Sutlej Foods Inc. v. The Queen*, 2019 DTC 1022 (Tax Court of Canada)**

In an appeal under the Tax Court's Informal Procedure, a taxpayer is allowed to be represented by a person who is not a lawyer. This case, on the other hand, involved proceedings under the Tax Court's General Procedure and is a decision on a motion by a corporation and three individuals seeking leave from the Tax Court to allow them to be represented by an accountant in their respective appeals.

Section 17.1 of the *Tax Court of Canada Act* and Rule 30 of the *Tax Court of Canada Rules (General Procedure)* were relevant to the question before the Tax Court. The former provides that a party to a proceeding in the General Procedure may appear in person or be represented by a lawyer. The latter provides that, where a party to a proceeding is not an individual, the party must be represented by a lawyer except with leave of the Court.

The individual appellants were shareholders of the corporate appellant. Their stated reason for wanting permission to have an accountant represent them in their appeals was solely a financial one: the taxpayers asserted that it would be too expensive to retain a lawyer and that the particular accountant, who was the external accountant for the

corporation, was already familiar with the appellants and the matters under dispute in the reassessments under appeal.

Since the relevant provisions expressly provide that an individual who does not want to represent him or herself in a General Procedure appeal must be represented by a lawyer, the Tax Court quickly rejected the individual taxpayers' request for relief in the motion. The Tax Court took a bit longer to consider whether a taxpayer that is a corporation could be represented by a non-lawyer.

The Crown fully opposed the motion on the basis that the Tax Court does not have the jurisdiction to allow non-lawyers to represent any party to a General Procedure appeal. The Crown's position with respect to the corporate appellant is perhaps surprising, since Rule 30(2) seems relatively unambiguous in giving the Court the discretion to allow a party that is not an individual to be represented by a non-lawyer in appropriate circumstances. However, recent Tax Court decisions have created uncertainty on the question of whether the Court's authority under Rule 30 to allow non-lawyer representation is invalid in light of an overriding restriction imposed by section 17.1 of the *Tax Court of Canada Act*. *Masa Sushi Japanese Restaurant Inc.* (2018 DTC 1086) and *Suchocki Accounting Ltd.* (2018 DTC 1073) are Tax Court decisions which held that representation of a corporate taxpayer by a non-lawyer was impermissible because, even though section 17.1 allows a party to a General Procedure appeal to appear "in person", the effect of case law in non-tax contexts is a that a corporation cannot appear "in person". On the other hand, *BCS Group Business Services Inc.* (2018 DTC 1095) is a Tax Court decision which held that section 17.1 of the *Tax Court of Canada Act* should be interpreted to allow a corporation to act "in person" through its authorized representatives.

It should be noted that, like the present case, the *Masa Sushi Japanese Restaurant* tax appeal involved a situation where two corporate appellants sought permission to be represented by their external accountant. By contrast, the *Suchocki Accounting* and *BCS Group Business Services* cases were taxpayer motions to allow representation by the principal shareholder, officer, or director of the corporation. Thus, it seems that these decisions actually raise two separate interpretative issues with respect to section 17.1 of the *Tax Court of Canada Act*: The first question is whether it is legally possible for a corporation to appear "in person" for purposes of a proceeding under the Tax Court's General Procedure. If the answer to the first question is "yes", the second question is whether allowing a corporation to be represented by an external accountant (rather than an internal representative of the corporation, such as the principal shareholder, officer, or director) pursuant to Rule 30(2) would still satisfy the section 17.1 requirement that the corporation appear in person.

The Tax Court (*per* Russell J) in *Sutlej Foods Inc.* considered the prior conflicting Tax Court decisions and decided that the discretion given to the Tax Court in Rule 30(2) was not inconsistent with section 17.1 of the *Tax Court of Canada Act*, preferring the analysis of the Tax Court in *BCS Group Services*. For further support, the Court relied on the direction given by section 12 of the *Interpretation Act* (Canada) for every enactment to be given "such, fair large and liberal construction and interpretation as best ensures the attainment of its objects"; the Court's view was that to adopt an interpretation of section 17.1 of the *Tax Court of Canada Act* that would preclude a corporation from acting in person would compromise the ability of that section to attain its object of promoting access to justice.

After going to some length to satisfy itself that the Tax Court has the jurisdiction to authorize a corporate taxpayer to be represented by a non-lawyer in a General Procedure appeal, the Court did not require nearly as much effort to conclude that this particular case was not an appropriate case for the Court to exercise its discretion. The Court first noted that the corporate taxpayer did not file any evidentiary materials with its motion to support its assertion that it could not afford to retain a lawyer. The Court then observed that the particular accountant would likely be an important witness to the taxpayer's case, and having a representative serve as a witness typically creates issues for all concerned in the conduct of a trial.

The Federal Court of Appeal may soon weigh in on the threshold issue of whether a corporation must be represented by a lawyer in a General Procedure appeal, as the Minister has appealed the Tax Court's decision on the motion in the *BCS Group Services* case. (The corporate taxpayers in the *Suchocki Accounting* case also appealed the Tax Court's decision on their motion but their case was dismissed by the Federal Court of Appeal for procedural delay.)

If the Tax Court's view in this case becomes the accepted position on the question raised in the motion, small corporate taxpayers who believe they have a straight-forward or uncomplicated tax dispute with the Minister might take some comfort in knowing that, with leave of the Tax Court, they might be able to avoid the cost of retaining a lawyer to litigate an appeal under the Tax Court's General Procedure. However, it is important for those corporations to also keep in mind that they need to carefully consider whether they are best served by avoiding representation through a lawyer. Factors that a corporate taxpayer would want to take into account include whether the particular non-lawyer representative can properly navigate pre-hearing procedures, court room procedures, and rules of evidence, and understand tax or other relevant jurisprudence. Moreover, to the extent that the non-lawyer representative's

unfamiliarity with litigation process and procedures creates inefficiencies for both parties in the pre-hearing and trial stages of the litigation, the corporate taxpayer runs the risk of being potentially exposed to additional cost awards in favour of the Crown as a consequence of engaging a non-lawyer as its representative in the appeal, particularly if the taxpayer is ultimately unsuccessful in its appeal.

— *John Yuan*

Evidence of Group Conduct Cannot Be the Minister's Sole Basis for Opening Up a Statute-Barred Year or Imposing Penalties Against a Specific Taxpayer

***Van der Steen v. The Queen*, 2019 DTC 1024 (Tax Court of Canada)**

In this case, the taxpayer was one of hundreds of individuals who purported to make a charitable donation to a registered charity named the Canadian Literacy Enhancement Society ("CLES") and who came to the attention of the Canada Revenue Agency ("CRA") as a consequence of the CRA's audit of CLES and other charitable donation schemes that were organized by CLES's principals. Consistent with the position that the Minister adopted with the other individuals who participated in the same charitable donation scheme, the taxpayer was reassessed to disallow the tax credit in respect of his CLES donation on the basis that the taxpayer lacked the requisite donative intent, since donations made to CLES were usually part of a series of circuitous payments that saw the vast majority of the amount returned to the taxpayer in short order. The Tax Court upheld the Minister's denial of the tax credit, which was not at all surprising given the nature of the CLES-related programs. However, there were two aspects of the case that were somewhat novel and could have application in other contexts.

The first interesting issue was a procedural question that arose as a consequence of the fact that the Minister initially reassessed within the normal reassessment period in March 2008 to disallow the charitable donation tax credit, and then relied on the extended reassessment period under subparagraph 152(4)(*a*)(i) of the *Income Tax Act* (Canada) (the "Act") to issue a further reassessment in May 2009 to impose a penalty under subsection 163(2) of the Act in respect of the taxpayer's participation in the transaction. The taxpayer filed an objection to the initial reassessment but the CRA's correspondence with the taxpayer advised that the subsequent reassessment had the effect of invalidating the prior objection; the CRA's advice was based on the well-established principle from the tax jurisprudence that a subsequent (valid) reassessment causes the prior reassessment to be a nullity. It is assumed that the taxpayer filed an objection to the subsequent reassessment which eventually led to the Tax Court appeal.

The question raised by the sequencing of the reassessments was whether the Tax Court would have jurisdiction to reverse or vary the Minister's adjustments disallowing the charitable donation tax credits (which were implemented under the March 2008 reassessment) if the Court concluded that the subsequent May 2009 reassessment imposing the penalties was invalid because subparagraph 152(4)(*a*)(i) did not apply to allow the latter reassessment to be issued beyond the normal reassessment period. The concern is that the reassessment before the Tax Court was the May 2009 reassessment, and if the Tax Court concluded that the May 2009 reassessment was statute-barred, the March 2008 reassessment disallowing the charitable donation tax credits — which was not formally before the Tax Court — would then become the last valid reassessment for the tax year.

To resolve this conundrum, the Tax Court stated that, if the May 2009 reassessment was invalid, the proceedings would then constitute an appeal of the March 2008 reassessment, citing *Bolton Steel Tube Co. Ltd.* (2014 DTC 1102), a Tax Court decision which held that the Court had jurisdiction to issue a decision in respect of a prior reassessment where a subsequent reassessment was found to be invalid. With respect, the Tax Court's conclusion in *Bolton Steel Tube*, which was appropriate in the context of that case, would not appear to be directly applicable to this case. *Bolton Steel Tube* was a decision on a motion in which the taxpayer was seeking the Tax Court's views on the validity of a reassessment that the Minister issued to implement a settlement reached before the underlying appeal was heard by the Tax Court. The settlement was effected by way of agreement (rather than consent judgment) and, at the time of the motion, the taxpayer had not yet formally discontinued the underlying Tax Court appeal. The taxpayer's position in the motion was that the Minister's reassessment purporting to implement the settlement was not in accordance with the settlement terms and was therefore invalid. The Tax Court agreed with the taxpayer and issued an order to vary the reassessment that was the subject matter of the Tax Court appeal to implement what the Court considered to be the settlement that the parties reached. In substance, the Tax Court's order on the motion was akin to a consent judgment arising from the Tax Court appeal, since it simply varied the reassessment that was technically still under appeal in the Tax Court at the time to conform to the settlement. By contrast, the initial March 2008 reassessment in this case had not

been appealed to the Tax Court. Therefore, it is difficult to see how the *Bolton Steel Tube* decision could apply to support the Court's view in this case that it had authority to issue an order in respect of the March 2008 reassessment if the May 2009 reassessment was found to be statute-barred.

The Court's finding on its jurisdiction over the March 2008 reassessment ended up being a moot point because the Court also found that the Minister was right to deny the charitable donation tax credit in the circumstances and, thus, no change to the adjustments that the Minster implemented through the March 2008 reassessment was warranted. However, it will be interesting to see whether future Tax Court decisions will reach the same conclusion concerning jurisdiction over an earlier reassessment when faced with a situation where the reassessment under appeal is potentially an invalid one.

The second interesting aspect of the case was the Court's views on how the Crown tried to discharge its burden of proof for (i) reassessing beyond the normal reassessment period pursuant to subparagraph 152(4)(*a*)(i), and/or (ii) imposing penalties pursuant to subsection 163(2). It is well-established in the jurisprudence that the Minister has the evidentiary burden of proving the culpability of the taxpayer's conduct for those two provisions and, in this case, the Minister sought to discharge that burden by relying on evidence concerning the participation in CLES charitable donation programs by persons other than Mr. van der Steen.

The CRA's audit of CLES and the charitable donation schemes promoted by the CLES principals led to reassessment proposals being issued to 700 individuals who had participated in the schemes. The CRA auditors had direct contact with approximately 100 of those 700 participants and, through those discussions, the CRA learned about the circumstances that led those individuals to participate in the schemes and claim the associated charitable donation tax credits. The other participants recounted to the CRA auditors that they attended sales presentations where a transaction would be described to them in which the participants would make a donation to CLES, sometimes using borrowings arranged by the CLES principals, and shortly afterwards, the participant would also receive a distribution or other monetary amount from another party as part of the series of transactions. In deciding to reassess beyond the normal reassessment period to impose a penalty in Mr. van der Steen's case, the CRA likely assumed that Mr. van der Steen received the same information concerning the CLES transaction that other individuals received when they attended sales presentations that were hosted by the CLES principals and that he understood the substance of the transaction in the same way as the other 100 participants to whom the CRA auditors spoke. It seems that, prior to reassessing beyond the normal reassessment period to impose the penalty, the CRA did not try to determine Mr. van der Steen's own understanding of the transaction prior to making his donation to CLES.

Because the Tax Court did not have evidence that addressed Mr. van der Steen's specific understanding of the CLES transaction, and in particular whether or not he had an expectation that a significant portion of the donated funds would be indirectly returned to him, the Tax Court held that the Crown did not discharge the evidentiary burden imposed on the Minister to show that Mr. van der Steen's conduct warranted either using subparagraph 152(4)(*a*)(i) to reassess an otherwise statute-barred tax year or imposing a subsection 163(2) penalty in respect of the transaction. It appears that the Crown did not think it was necessary to try to show that Mr. van der Steen attended the same type of a seminar that the other participants in CLES-related transactions attended and, unfortunately for the Minister, the Tax Court was not prepared to infer that Mr. van der Steen likely received information about the true substance of the transaction from the CLES principals showing a circuitous flow of funds at some point in the process before deciding to make the donation.

Having found that the Crown was unable to prove that Mr. van der Steen knew that his donation to CLES would be part of a series of transactions that would see a portion of the amount returned to him, one may wonder how the Tax Court was able to uphold the Minister's denial of the charitable donation tax credit on the basis that Mr. van der Steen lacked the donative intent in making the payment to CLES. The answer lies in the fact that, for the adjustments relating to the disallowance of the tax credits, the taxpayer had the normal evidentiary burden in tax cases to demolish the Minister's assumptions that supported that adjustment. So, even though the Crown was unable to prove that Mr. van der Steen knew that the transaction would produce a circuitous flow of funds to support reassessing beyond the normal reassessment period to impose a penalty, Mr. van der Steen was likewise unable to demolish the Minister's assumption that he was advised by the promoters that he would receive back no less than 70% of the amount he donated.

— *John Yuan*

RECENT CASES

Motion to compel production of documents by respondent Minister dismissed

In 2009, the corporate taxpayer carried out certain conversion transactions necessitated by the announcement in 2006 of a new distribution tax for specified investment flow-through trusts. Those conversion transactions allowed the taxpayer to utilize certain tax attributes, including capital and non-capital losses, investment tax credits, and scientific research and experimental development expenditures, which were claimed on the taxpayer's returns for the 2010 and 2011 taxation years. Such claims were disallowed by the Minister on reassessment, on the basis that the general anti-avoidance rule ("GAAR") applied to the underlying transactions giving rise to such claims. The taxpayer appealed from that reassessment and, in the course of pre-trial proceedings, brought a motion before the Tax Court of Canada seeking an order requiring the respondent Minister to answer certain questions and to produce 18 separate documents related to those questions.

The motion was dismissed. On the motion, the Tax Court of Canada summarized the principles outlined in the jurisprudence with respect to the production of documents in examinations for discovery, particularly in the context of a GAAR case. It noted that the question of whether a particular document ought to be produced at discovery is largely a fact-based, case-by-case inquiry. However, the jurisprudence does provide that, in the context of a GAAR appeal, a document may be relevant if it is disclosed to the taxpayer or because it was "either prepared directly in the context of the audit of the appellant or was considered by CRA officials who were charged with the audit of the appellant or who were consulted regarding the application of the GAAR". The Court then reviewed each of the documents for which the appellant sought production, applying the principles outlined in the jurisprudence. It determined that it should not order production of any of the documents sought, because the particular request was either overly broad, did not meet the criteria set out in the jurisprudence, or was subject to settlement privilege. The appellant's motion was therefore dismissed, with costs of the motion payable to the respondent in any event of the cause.

Total Energy v. The Queen

2019 DTC 1072

Taxpayer permitted to deduct interest on business line of credit after business ceased to exist

From 2002 to 2007 the taxpayer operated a business as a sole proprietor providing accounting services. He ceased to operate this business personally in 2007 when he formed a corporation to pursue his commercial activities. From March 26, 2002, to December 2, 2005, the taxpayer paid his business expenses through a line of credit secured by a mortgage on his home. This line of credit was also used to pay the interest charged by the bank on the line of credit from December 3, 2005, to December 31, 2014 (the "Interest Expense"), after the taxpayer's sole proprietorship had ceased to exist. On reassessment, the Minister refused the taxpayer a deduction for the Interest Expense incurred during 2013 and 2014 on the ground that it had not been incurred in connection with a commercial activity. On appeal to the Tax Court of Canada the taxpayer alleged, in essence, that the deduction of the Interest Expense during 2013 and 2014 was justified under paragraph 20.1(2)(*c*) of the *Income Tax Act* (the "Act").

The taxpayer's appeal was allowed. Under paragraph 20.1(2)(*c*) of the Act, the unpaid balance of borrowed money for use in a taxpayer's business which is outstanding after the business has ceased to exist is deemed to have been used by the taxpayer to earn income from that business. The deduction by the taxpayer of the Interest Expense for 2013 and 2014 was therefore justified in this case under paragraph 20.1(2)(*c*). The Minister was ordered to reassess accordingly.

Moras v. The Queen

2019 DTC 1071

Income tax return filed more than three years after an "estimative" assessment is issued cannot be assessed by the Canada Revenue Agency

This is an application for judicial review of a decision of the Canada Revenue Agency ("CRA"). The Appellant had failed to file its income tax returns for the taxation years 2010 and 2012. The CRA, in accordance with subsection 152(7) of the *Income Tax Act* (the "Act"), issued "estimative" assessments for tax owed in respect of those taxation years. More than three years after these assessments were issued, the Appellant attempted to file his returns for those years. The CRA refused to assess the returns stating it was unable to issue reassessments more than three years after the issuing of the original assessments. The Appellant contends that the normal reassessment period should begin only when the tax return has been filed. A so-called "estimated" assessment would not trigger the three-year period. The Appellant bases its argument on subsection 152(4), which is arguably applicable only to persons having filed returns.

The appeal was dismissed. The Court stated that one of the objectives of section 152 of the Act is to ensure the finality of assessments by outlining precisely the circumstances under which a reassessment may be issued. Thus, Parliament determined the normal reassessment period as generally being a three-year period calculated from the mailing date of the initial assessment and not from the end of the taxation year or filing of a return. Accordingly, the Court did not agree with the Appellant and did not find the decision of the CRA unreasonable. The Court found that subsection 152(4) applies to all assessments whether or not a tax return was filed. If Parliament had wished the law to be different with respect to "estimative" assessments, a term not defined by the legislation and used for convenience purposes only, the law would explicitly say so as is the case with the Quebec *Income Tax Act*. Consequently, the application was rejected.

6075240 Canada Inc. v. Canada (MNR)

2019 DTC 5058

Appeal allowed where Minister not entitled to reassess appellant

In 2003, the taxpayer reported a taxable capital gain from the disposition of a parcel of land and paid tax in the amount of $1.8 million on that capital gain. Following the initial assessment and in the context of an audit of the taxpayer's parent company, the Minister issued a reassessment in 2010 reducing the capital gain to nil, and purporting to refund the taxes paid, including interest of $767,633, for a total amount of $2.577 million. The Minister later reached an agreement to settle an appeal brought by the parent company, following which the Minister issued further reassessments under section 160.1 and subsection 164(3.1) of the *Income Tax Act* (the "Act"), to implement the terms of that settlement. That 2015 assessment sought $1,809,598 in Part I tax on the original taxable capital gain, together with interest. The taxpayer appealed.

The appeal was allowed. The Court first held that the 2010 reassessment was void as having been issued outside the statutory reassessment period and that the 2015 reassessment was void insofar as it purported to implement the terms of an agreement in the context of an appeal to which the appellant was not a party. Consequently, the original 2003 assessment continued to be operative and the appellant had owed and paid the amount of $1.8 million pursuant to that assessment. The remaining issues for determination were whether the Minister was entitled to issue an assessment under section 160.1, which requires taxpayers to repay excess refunds, with interest, and to assess arrears interest under subsection 164(3.1). The Court held that in order for section 160.1 to apply, it was necessary for the taxpayer to have received a refund under a specific provision of the Act in excess of what they were owed. In the Court's view, the 2010 payment made was not made pursuant to a provision of the Act and was not a refund. Rather, it was a payment made in error in that it was made without any statutory authority. It followed that the Minister was not entitled to reassess the appellant under section 160.1. The Court held as well that the statutory conditions for the issuance of an assessment under subsection 164(3.1) had not been met and that the Minister was therefore not entitled to issue such assessment. The taxpayer's appeal from the assessments was therefore allowed, on the basis that the Minister was not entitled to reassess pursuant to section 160.1 and subsection 164(3.1).

984274 Alberta v. The Queen

2019 DTC 1062

Application for declaration allowing stand-alone investment rights under universal life insurance policy dismissed

The applicant entered into a universal life insurance contract with the respondent insurance company. It applied to the Saskatchewan Court of Queen's Bench seeking a declaration that such insurance contract had distinct insurance and investment purposes that would entitle it to deposit premiums, in amounts of its choosing, into a side deposit account with investment options as provided for in the contract. Those investment options would then earn interest at the rate of return stated in the contract. The respondent insurer took the position that the insurance and investment components were linked and that the amount of such investments was therefore limited to investments within the exempt policy criteria set out in the *Income Tax Act* and/or those made to fund future life insurance premiums payable under the policy terms. It argued that the policy was never intended to permit stand-alone investment options unrelated to the core life insurance purpose of the contract.

The application was dismissed. The Court reviewed the relevant contract provisions in light of the principles of interpretation governing insurance contracts and standard form contracts. Based on that analysis, the Court concluded that the policy provided for life insurance and savings within the accrual tax exempt investments contemplated by the contract terms. On a proper interpretation of the contract or policy provisions, the word "premiums" as used in the policies was limited to funds paid or invested to pay current and future costs of insurance, related premium taxes, specified administration fees, and the permitted accrual tax exempt savings. In the Court's view, the policy did not provide for unlimited stand-alone investment opportunities. The application for declaratory relief was therefore dismissed.

Ituna v. Industrial Alliance

2019 DTC 5048

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