Tax Notes

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WHAT IS THE EFFECT OF A NIL ASSESSMENT?

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Introduction

Everyone knows that what appear to be the easiest questions, often asked by children, are the hardest to answer: why do good things happen to bad people, or *vice versa*? Is there life after death? What is the legal effect of a nil assessment?

Alright, probably the last of these is not something a child might ask you. But, as the Court discovered in *Canada v. 984274 Alberta Inc.*,[1] it is a difficult question to answer. Unfortunately, and with due respect, my opinion is that Chief Justice Noël for the Court answered it incorrectly.

Facts

984274 Alberta Inc. ("984") is an Alberta corporation all the shares of which are owned by Henro Holdings Corporation ("Henro"). Henro owned some land in Alberta. In 2002, Henro purported to roll some of its land to 984 under section 85.[2] Only "eligible property" as defined by subsection 85(1.1) can be so rolled. On the rollover the parties elected at Henro's cost. 984 then sold the land immediately to an arm's length party and realized a gain of $7,904,475, a taxable capital gain of $3,952,238, and, in its 2003 taxation year ended March 31, was liable for Part I tax of $1,809,598.

By Notice of Assessment dated June 23, 2003 (the "2003 Assessment") the Minister of National Revenue (the "Minister") assessed 984 for its 2003 taxation year in the amount of $1,809,598.[3] No balance was owing as 984 had paid the tax prior to being assessed.

On June 17, 2009, at the Minister's request, 984 purported to sign a waiver for its 2003 taxation year, pursuant to subparagraph 152(4)(*a*)(ii), which waiver was limited to the question of whether 984 would be entitled to a refund of its Part I tax if the Minister determined that Henro's land had been inventory and not capital and hence not eligible for a rollover.[4] I say "purported" to sign a waiver because 984 was a Canadian-

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[1] 2020 DTC 5070 (FCA), rev'ing 2019 DTC 1062 (TCC) per Justice Smith.

[2] All statutory references are to the *Income Tax Act*, RSC 1985, c. 1 (5th Supp.), as amended (the "Act").

[3] Although not stated in the parties' Statement of Agreed Facts, paragraph 11 of the FCA's reasons states that a notice of reassessment was issued for the 2003 taxation year on October 23, 2003 (the "2003 Reassessment"), which left the 2003 Assessment unaltered and acknowledged full receipt of the tax payable for the year. See also paragraph 53 of the reasons.

[4] Subsection 85(1.1) does not include real property inventory in the definition of "eligible property".

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controlled private corporation. As such, its normal reassessment period ("NRP") for its 2003 taxation year expired three years after June 23, 2003, pursuant to paragraph 152(3.1)(*b*). But subparagraph 152(4)(*a*)(ii) states that a waiver must be filed (if at all) "within the normal reassessment period for the taxpayer in respect of the year". It would appear, therefore, that the waiver was a nullity.[5]

On January 22, 2010, the Minister reassessed Henro to deny the rollover as well as subsequent capital dividends paid by Henro. Henro objected to this reassessment. The Minister confirmed the reassessment and Henro appealed it to the Tax Court of Canada.

On March 23, 2010, without 984 requesting it, the Minister issued a "reassessment" to 984, reducing its 2003 capital gain to nil. I say "reassessment" but in fact it was a notification that no tax was payable (the "Nil Assessment"). Essentially, the Minister was predicting that Henro would be denied the rollover, the consequence of which would be that 984's cost base in the land would be its full fair market value ("FMV"),[6] so that 984 had no gain when it sold the land and hence owed no Part I tax.

On July 20, 2010, again without 984's request, the Receiver General of Canada paid a refund to 984 of $2,577,231, being the $1,809,598 plus interest of $767,633.

On July 22 and 23, 2014, the Minister and Henro, pursuant to subsection 169(3), entered into a Settlement Agreement, to which 984 was a signatory. The Settlement Agreement provided that the Minister would reduce Henro's business income for its 2003 taxation year by $7,904,475, while increasing 984's 2003 income to include a capital gain for the same amount, exactly as 984 had filed initially and been assessed under the 2003 Reassessment.

On March 23, 2015, the Minister purported to reassess (the "2015 Reassessment") 984 for its 2003 taxation year in the amount of $3,259,418, being Part I tax of $1,809,598 on the taxable capital gain, refund interest of $767,633 pursuant to subsections 160.1(1) and (3), and arrears interest of $682,187, pursuant to subsection 164(3.1), calculated from July 30, 2010[7] to March 23, 2015.

984 objected to the 2015 Reassessment and ultimately appealed it to the Tax Court of Canada. The crux of the debate was whether 984 had to pay the arrears interest of $682,187. That had not been addressed in the Settlement Agreement and, apparently, came as an unpleasant surprise to 984.

Justice Smith held that the 2015 Reassessment was invalid as having been issued after 984's normal reassessment period. The Minister appealed to the Federal Court of Appeal, which allowed the appeal.

The FCA's Reasons

It is self-evident from the following paragraph of the Chief Justice's reasons that he was not disposed to decide the case in 984's favour — indeed it is clear that he thought 984 was simply gaming the system and trying to keep money that it owed as tax:

> [51] It is readily apparent that no settlement agreement could have been reached without the respondent being a party to this agreement and agreeing to be taxed on the capital gain realized in 2003. However, now that its parent, Henro, has reaped the benefit of this agreement, the respondent, with Henro's necessary approval, refuses to honour its part of the bargain and pay back the tax and related interest refunded to it in 2010.

At the end of this article I will refer back to this paragraph.

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[5] See paragraph 14 of the FCA's reasons.

[6] Paragraph 16 of the FCA's reasons states that 984's cost base would be equal to the land's FMV under section 69. I do not think that is correct: paragraph 69(1)(*c*) applies to deem a taxpayer to have a cost base equal to a property's FMV only when it receives that property "by way of gift, bequest or inheritance or because of a disposition that does not result in a change in the beneficial ownership of the property". In this case, even in the absence of paragraph 69(1)(*c*), 984's cost base would have been the land's FMV simply because it would have paid that much for the land under the sales agreement with Henro.

[7] It is not clear why the arears interest was calculated from July 30 instead of July 20 when the Receiver General paid the refund to 984.

Are Assessments That Are Out of Time Void or Voidable?

The first issue addressed by the Chief Justice was the status of the 2010 reassessment, what I have labelled the Nil Assessment. Was it null and void as having been issued outside of 984's NRP for its 2003 taxation year? The Chief Justice viewed this issue as being "instrumental" because if the Nil Assessment were null and void, then 984 would have paid its Part I tax pursuant to the (still) valid 2003 Reassessment, it would not have made an "overpayment" as defined by subsection 164(7), and the Minister could not have the right to recover an "excessive refund" or claim arrears interest on the excessive refund under subsections 160.1(1), 160.1(3), and 164(3.1).

In a previous decision, *Freitas v. The Queen*,[8] Justice Webb for the Court held, at paragraphs 21–23, that the taxpayer had the right to object to and ultimately appeal from a reassessment issued after the taxpayer's NRP for the taxation year in issue because the taxpayer chose not to dispute the validity of the reassessment. In other words, the FCA held that a reassessment issued after the NRP is voidable at the taxpayer's election and not void *ab initio*.

I recall that when this decision was issued I knew it was wrong. And the Chief Justice confirmed my thought at paragraph 55, holding that Justice Webb had "manifestly overlooked" a long line of cases holding that an assessment issued beyond the NRP is void and not voidable, regardless of subsection 152(8).

Nil Assessments

Many years ago, President Thorson of the Exchequer Court told us that an "assessment" is the Minister's determination of the amount of tax for which a taxpayer is liable.[9] In this context "amount" does not include zero or nil. We know this because in some provisions the Act refers both to an "assessment" (which by the definition of that word in subsection 248(1) includes a "reassessment" but does not include an "additional assessment", which is a separate concept) and a "notification that no tax is payable". The latter concept has been given the term "nil assessment", but it bears emphasizing that it is not an assessment at all — it is a piece of paper notifying the taxpayer that no tax is owing under a particular part of the Act for a particular taxation year.

In my opinion, a nil assessment has, essentially, only one legal effect: it starts the clock running on various limitations in the Act, including a taxpayer's NRP.[10] Beyond that, it is a nothing: a taxpayer cannot object to or appeal from a nil assessment. Contrary to paragraph 59 of the Chief Justice's reasons, this is not because "it assesses no tax"; it is because subsections 165(1) and 169(1), the provisions that authorize a taxpayer to object or appeal, apply only to "assessments". Unlike subsection 152(3.1), those provisions do not refer to nil assessments. Hence, a taxpayer may not object to or appeal from a nil assessment.[11]

Moreover, the Act does not prohibit the Minister from issuing a nil assessment after the NRP, so that, really, the first issue addressed above (void or voidable) could not have applied to the Nil Assessment (although it certainly applied to the 2015 Reassessment).[12] The opening words of subsection 152(4) state:

> 152(4) The Minister may at any time make an assessment, reassessment or additional assessment of tax for a taxation year, interest or penalties, if any, payable under this Part by a taxpayer or notify in writing any person by whom a return of income for a taxation year has been filed that no tax is payable for the year, except that an assessment, reassessment or additional assessment may be made after the taxpayer's normal reassessment period in respect of the year only if . . .

[8] 2018 DTC 5064 (FCA).

[9] In *Pure Spring Co. Ltd. v. MNR*, 2 DTC 844 (Ex Ct.) at 498, he stressed that the assessment operation, as distinct from the exercise of a discretionary power, was solely administrative and referred to the statement of the Chief Justice of Australia in *Federal Commissioner of Taxation v. Clarke* (1927), 40 CLR 246 at 277, that "an assessment is only the ascertainment and fixation of liability". Then, at page 500 [C.T.C. at p. 198], he defined assessment as follows: "The assessment, as I see it, is the summation of all the factors representing tax liability, ascertained in a variety of ways, and the fixation of the total after all the necessary computations have been made." In *Dezura v. MNR*, 3 DTC 1101 (Ex. Ct.) at 15, he said: "The object of an assessment is the ascertainment of the amount of the taxpayer's taxable income and the fixation of his liability in accordance with the provisions of the Act." And in *Morch v. MNR*, 49 DTC 649 (Ex. Ct.) at 335 , he described an assessment as "an important administrative act within the exclusive function of the Minister".

[10] Other limitation periods that begin on the issuance of a nil assessment are found in clause 80.04(6)(*a*)(ii)(A), paragraph 111(4)(*e*), and the opening words of subsection 142.6(8). This is not a complete list.

[11] There is a long judicial and legislative history on the issue of whether a taxpayer may appeal from a nil assessment. See *Consoltex Inc. v. The Queen*, 92 DTC 1567 (TCC). There does not appear to be any point in re-hashing it here, as the matter is now firmly settled in the negative. See *Interior Savings Credit Union v. The Queen*, 2007 DTC 5342 (FCA), at paragraph 17.

[12] As recognized by the Chief Justice at paragraph 64 ("Given that the 2010 reassessment was a nil assessment, validly issued beyond the normal reassessment period").

The paragraphs following these opening words set out various time limitations, but the last clause in the opening words makes it clear that those limitations apply only to an assessment, not to a nil assessment. This might seem strange but, after all, why go to the trouble of prohibiting the Minister from issuing a nil assessment after the NRP when that would have no legal effect anyway?

Perhaps, most importantly, as the Chief Justice noted at paragraph 56, by subsection 248(2) the "tax payable" for a given taxation year is the amount of tax to be paid "as fixed by assessment or reassessment" (but not by a nil assessment). It would seem from this that a nil assessment does not fix the tax liability at nil nor does it define the tax payable as nil. But in fact the FCA has said that it does. See the discussion of *Wesbrook*[13] below.

What Is an Overpayment?

Subsection 164(7) states:

> 164(7) *Definition of "overpayment"* — In this section, "overpayment" of a taxpayer for a taxation year means
>
> (*a*) where the taxpayer is not a corporation, the total of all amounts paid on account of the taxpayer's liability under this Part for the year minus all amounts payable in respect thereof; and
>
> (*b*) where the taxpayer is a corporation, the total of all amounts paid on account of the corporation's liability under this Part or Parts I.3, VI or VI.1 for the year minus all amounts payable in respect thereof.

Tax "Liability" v. Tax "Payable"

It will be noted that subsection 164(7) does not refer to an assessment. It refers to a taxpayer's "liability" and the amounts paid "on account of" and "payable in respect of" that liability. How does one know what amount is owing in respect of a taxpayer's "liability", a word not defined in subsection 248(1)? Subsection 152(3) tells us that a taxpayer's liability for tax "is not affected by an incorrect or incomplete assessment or by the fact that no assessment has been made". In other words, a taxpayer is liable to pay tax as income is earned. Let us call that the taxpayer's "theoretical liability". It is a fixed number that never changes — whatever the taxpayer's liability would be if his or her entire return were reviewed by the Supreme Court of Canada, is his or her liability under subsection 152(3).

That is different than the "tax payable", which as noted above is defined by subsection 248(2) to mean the "tax payable by the taxpayer *as fixed by assessment*". This is the amount that one must pay to the Receiver General as shown on a notice of assessment.

But as discussed above, a nil assessment is not an "assessment". In theory, therefore, one would think that a nil assessment does not come within subsection 248(2) and does not fix the amount owing at nil. Furthermore, subsection 152(8), which deems an assessment to be final and binding unless overturned on an objection or appeal, does not refer to a nil assessment.

Nil Assessments Cannot "Give Rise To" an Overpayment

If that is the correct understanding of a nil assessment, that it does *not* fix at nil either a taxpayer's liability or his or her tax payable, then it follows that the Chief Justice was wrong at paragraphs 61 and 62 in stating that "where taxes have previously been paid on account of tax liability for a given year, a notice that no tax is payable *can give rise to an overpayment*" (emphasis added). It is correct that paying more tax than the amount for which you are liable theoretically creates an "overpayment" because subsection 164(7) refers to the taxpayer's liability, not the "tax payable"; however, that overpayment cannot *arise from* or *because of* the nil assessment: it is not the nil assessment that "gives rise to" the overpayment: there would be an overpayment even without the nil assessment. At most the nil assessment alerts one to the fact that there has been an overpayment. The Technical Notes quoted in paragraph 62 avert to this by stating that a nil assessment "indicates" that there has been an overpayment.

Nil Assessments Cannot Replace a Previous Assessment

Thus far in his reasons the Chief Justice had been (mostly) correct. Where he went wrong (at least in theory, and subject to the discussion of *Wesbrook* below), with respect, was in the following paragraph:

> [65] When as here, a notice that no tax is payable is issued after an initial assessment or reassessment has been issued (subsection 248(1) provides that the word "assessment" includes a reassessment), **it replaces the**

[13] *The Queen v. Wesbrook Management Ltd.*, 96 DTC 6590 (FCA).

> **prior assessment and reduces the "tax payable" for the year to nil**. In this case, the tax payable by the respondent for its 2003 taxation year was fixed by the 2003 reassessment at $1,809,598 which amount was paid upon filing the return for that year. The subsequent issuance of the nil assessment in 2010 had the effect of reducing the tax payable all the way from the amount that had been paid to zero. Yet, it remains that an amount had been paid by the respondent in respect of the 2003 taxation year. It follows that an "overpayment" within the defined meaning set out in paragraph 164(7)(*b*) did result from the issuance of the nil assessment. [Emphasis added]

This is wrong: a nil assessment cannot replace a previous assessment because, as we have seen, it does not fix the amount of "tax payable" under subsection 248(2). It follows that even if the Nil Assessment had been issued prior to the end of 984's NRP for its 2003 taxation year, there would have been no "overpayment" when 984 paid its Part I tax under the 2003 Assessment (or the 2003 Reassessment).

Wesbrook — A Nil Assessment *Does* Fix Liability at Nil(?)

One might say, "But wait, you just finished saying that subsection 164(7) does not define an 'overpayment' in terms of an assessment, only in terms of a theoretical liability. So even if we ignore the Nil Assessment and the Chief Justice's comments in paragraph 65, why can one not say that Henro had an invalid rollover, 984 had no gain, and there was an overpayment, despite the 2003 Reassessment and the Settlement Agreement to the contrary?"

Ah, good question. The answer comes from yet another FCA decision, *Wesbrook*, *supra*. In that case the Court held that while under subsection 152(3) a taxpayer has a theoretical liability that exists independently of any assessment, when an assessment (including more importantly, as in that case, a nil assessment) is issued, it "fixes" the liability at the amount stated in the assessment (or at nil).[14] By subsections 152(8) and 248(2), "nil" then becomes the "tax payable". The key passages are these:

> [13] The difficulty which the Minister faces in this case and which renders the foregoing propositions irrelevant is that 466 was both assessed and reassessed in respect of its 1988 taxation year and, there being no question of fraud or misrepresentation, no further reassessment could be issued to 466 after March 9, 1992. **While an assessment is by no means a condition of liability to pay tax, an assessment, once issued, and unless and until varied by competent authority, has the effect of fixing the liability for tax**. See *Terra Nova Properties Ltd. v. Minister of National Revenue*:
>
>> The fallacy that underlies the appellant's contention, in my view, is the failure to distinguish between the **actual amount of the taxpayer's income tax liability for a particular year as imposed by the substantive provisions of the Act, on the one hand, and, on the other hand, the determination of that amount by the Minister's assessment thereof**, while it remains in force, by the judgment of the Tax Appeal Board, while it remains in force, or by the judgment of this Court, while it remains in force, or, ultimately, by the Supreme Court of Canada. The actual liability is a constant amount that does not change as long as the facts and the substantive law remain unchanged. The assessed amount as varied by judicial decision, **which is the amount which the Minister and all others concerned are bound to assume to be the actual amount of the liability**, can change from time to time by virtue of new assessments or judicial decisions. Per Jackett P. at page 86. [Emphasis added.]
>
> [14] This is equally the result of subsection 152(8). . . .
>
> 15 Once, as is the case here, an assessment can no longer be varied or vacated on objection or appeal and no further reassessment can be issued, the last assessment is deemed valid and is binding on both the taxpayer and the Minister. That is the case with the reassessment of 466 issued on July 4, 1989.

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[14] In an earlier article I suggested that this is wrong: the liability never changes: an assessment can fix only the tax payable. See "The Crown's Reply to Notice of Appeal: What May She Plead and When May She Plead It?" (2003), vol. 16, no. 1, *Canadian Petroleum Tax Journal*, footnote 22 and accompanying text. See also my Letter to the Editor, 60 *Can. Tax J.* 529 (2012).

Either Way, There Was No Overpayment

If I am wrong and *Wesbrook* is correct, if subsections 152(8) and 248(2) apply to a nil assessment, it would follow that the Chief Justice's subsequent discussion of whether a nil assessment is an "assessment" for purposes of subparagraph 164(1)(*a*)(iii) was unnecessary. If a nil assessment can (contrary to my theory) fix a taxpayer's liability at nil, surely it must do that within the taxpayer's NRP. In this case, the Nil Assessment was issued beyond the NRP, the taxpayer paid the amount owing under the 2003 Reassessment, so that there was no "overpayment" and hence nothing to refund.

Therefore, whether my theory of the effect of a nil assessment is right or the effect ascribed to it by the Chief Justice and the FCA in *Wesbrook* is correct, in either case there could not have been an overpayment.

Reading Words Into the Act? Normally We Don't Do That

But even if that is all wrong, in my view, the Chief Justice was wrong to answer his next question, whether the Nil Assessment fell into subparagraph 164(1)(*a*)(iii), in the affirmative. That provision refers to an "assessment". It would be vastly surprising if, having referred to nil assessments in subsections 152(3.1) and (4), Parliament deliberately did not refer to them in subparagraph 164(1)(*a*)(iii) on the basis that they were already included in the word "assessment". That would contradict most principles of statutory interpretation. Essentially, it would read the words "or notification that no tax is payable" into subparagraph 164(1)(*a*)(iii). Generally, this is unacceptable.[15]

Furthermore, the purpose of that subparagraph is to allow all parties to know how much of a refund the taxpayer is entitled to receive and the Receiver General is authorized to pay. In this case it seems very odd that the Receiver General could be authorized to pay out a refund on the basis of a nil assessment issued after the NRP expired in respect of a valid reassessment on which tax had already been paid. If that were the case, then the Minister could always (because there is no prohibition against issuing nil assessments at any time) issue a nil assessment and create an overpayment for a taxation year that is many years in the past. One doubts that that was the Act's intention (and one doubts that the Minister really wants such power, because now taxpayers will request that and apply for judicial review when it is not granted). Furthermore, the Minister could then claim an excess refund of that overpayment, with arrears interest.

Markevich

As the Chief Justice noted at paragraph 76, 984 made an alternative argument: if (contrary to its main argument) a nil assessment is an "assessment" for purposes of 164(1)(*a*)(iii), then in 2010, 984 got the refund to which it was entitled and there was never a valid reassessment (the 2015 Reassessment being void) that "unentitled it" to that refund, so there was no "excess refund" under 160.1(1). That provision states:

> 160.1(1) *Where excess refunded* — Where at any time the Minister determines that an amount has been refunded to a taxpayer for a taxation year in excess of the amount to which the taxpayer was entitled as a refund under this Act, the following rules apply:
>
> (*a*) the excess shall be deemed to be an amount that became payable by the taxpayer on the day on which the amount was refunded; and
>
> (*b*) the taxpayer shall pay to the Receiver General interest at the prescribed rate on the excess (other than any portion thereof that can reasonably be considered to arise as a consequence of the operation of section 122.5 or 122.61) from the day it became payable to the date of payment.

The Chief Justice disagreed with the alternative argument. As it is difficult to summarize his reasons why, I will reproduce the relevant paragraph:

> [77] This argument could be compelling (compare *Bulk Transfer Systems v. Canada, 2005 FCA 94, 59 D.T.C. 5192, paras. 19-21*) were it not for the decision of the Supreme Court in *Markevich v. Canada, 2003 SCC 9, [2003] 1 S.C.R. 94 [Markevich]* according to which no prior reassessment is needed in order for the Minister to determine that a taxpayer has received a refund in excess of the amount to which it was entitled. Indeed, *Markevich* makes it clear that an excessive refund can be assessed even if the power to issue a reassessment for the year pursuant to subsection 152(4) has expired.

[15] See paragraph 16 of *Markevich* (2003 DTC 5185 (SCC)), discussed below, where the Court said that "[r]eading extra words into a statutory definition is even less acceptable when the phrases which must be read in appear in several other definitions in the same statute".

To say this as gently as I can, it is difficult to understand this paragraph. In *Markevich* (2003 DTC 5185 (SCC)), the taxpayer was assessed for income tax, never objected to the assessment, and never paid the tax. Many years later, the Crown attempted to collect the tax and accrued interest. The Court held that nothing in the Act either expressly or implicitly provided either a fixed statute of limitations for collecting a tax debt nor provided an unlimited right to collect such a debt. As a result, collection after six years was prohibited by section 32 of the *Crown Liability and Proceedings Act*.[16] Nothing in that decision refers to the nature of an assessment or nil assessment or the conditions under which a refund may be paid or recovered. Indeed, the word "refund" does not appear in the Court's reasons.

Conclusion

The long and short of this case is that 984 was assessed for and paid tax in 2003. In 2010, the Receiver General, without 984 requesting it and under nothing more than the Nil Assessment, paid 984 its money back. Another five years later the Crown tried to recover that payment, plus arrears interest. 984 was never entitled to receive the 2010 payment because it had not made an "overpayment": it had paid the tax owing under the only valid assessment that ever existed in the case: the 2003 Reassessment. The 2010 payment to 984 was not a "refund" for purposes of the Act; it was simply a payment to which 984 was not entitled and for which the Crown could sue in provincial court.

Alternatively, assuming (a) my theory is wrong, so that, (b) *Wesbrook* is correct and a nil assessment can fix both the liability and the tax payable, and that (c) one can ignore the fact that the Nil Assessment was issued beyond the NRP, so that (d) the 2010 payment was a "refund" of an overpayment, then the 2010 payment was the correct amount of refund: the Nil Assessment fixed 984's liability at nil and no valid, subsequent, reassessment ever fixed that liability at any other amount (this is so clearly wrong that it hurts me to write it, but there is no escaping this conclusion if one accepts, as one should not, that a nil assessment, issued after the NRP, can fix a tax liability and the tax payable at nil and that subparagraph 164(1)(*a*)(iii) applies to that nil assessment).

Gaming the System?

As noted at the start of this article, Chief Justice Noël evidently took a very dim view of 984 in trying to keep the 2010 payment, or at least of trying to pay it back without arrears interest. One might say, and good for him, because 984 got to keep the 2010 payment for a number of years and earn income on that money.

But I note this: any such income that 984 earned was taxable. By contrast, the arrears interest that 984 now has to pay is not deductible. Assuming that 984 earned the same amount of income as it must now repay as interest, the net effect is that 984 is worse off for having received the 2010 payment than to have never received it at all. To take a simple example, if 984 received a $1,000 refund and earned $200 of income on it that was taxable at 50%, then it earned a net $100, so it has $1,100 in its pocket. If it must now repay the $1,000 with non-deductible interest of $200, then it must repay $1,200. It is $100 short.

I note also that the Statement of Agreed Facts attached to Justice Smith's reasons refers to numerous letters going back and forth from 984's counsel to the Department of Justice. The letters are not attached, but it may be that 984 offered to return the 2010 payment, without having to pay interest on it. If so, that offer appears to have been rejected, hence the court proceedings.

National Importance?

Tax issues are not constitutional questions, not criminal issues, not tort issues. Few tax issues can be said truly to be of "national importance"; hence, the Supreme Court of Canada grants leave to few tax cases. If 984 seeks leave to appeal, is this matter of sufficient "national importance" to warrant leave?

In my view it is. The Minister issues nil assessments all the time. There is a specific regime enacted to deal with those that apply to losses.[17] This suggests that they are not real assessments and do not come within any provision that refers to an "assessment" unless mentioned therein specifically. The FCA's various decisions have thrown a monkey wrench into our understanding of the effect of nil assessments, grant the Minister new powers (and concomitant duties) under subparagraph 164(1)(*a*)(iii), and expose taxpayers to claims for payments with interest long after the expiry of an NRP. In *Markevich* the Court said this about limitation periods:

[16] R.S.C. 1985, c. C 50. This decision was reversed by the enactment of subsections 222(3), (4), and (5).

[17] Subsections 152(1.1), (1.2), and (1.3).

[19] The appellant's submission that the rationales for limitation periods militate against their application to tax collection cannot be correct. As noted above, limitation provisions are based upon what have been described as the **certainty, evidentiary, and diligence rationales**: see *M. (K.), supra*, at para. 29. The certainty rationale recognizes that, with the passage of time, **an individual "should be secure in his reasonable expectation that he will not be held to account for ancient obligations"**: *M. (K.), supra*, at para. 29. The evidentiary rationale recognizes the desire to preclude claims where the evidence used to support that claim has grown stale. The diligence rationale encourages claimants "to act diligently and not 'sleep on their rights'": *M. (K.), supra*, at para. 30.

[20] Each of the rationales submitted as applicable to there being no limitation periods affecting collection are in fact just the opposite and are directly applicable to the Minister's collection of tax debts. If the Minister makes no effort to collect a tax debt for an extended period, at a certain point **a taxpayer may reasonably come to expect that he or she will not be called to account for the liability, and may conduct his or her affairs in reliance on that expectation**. As well, a limitation period encourages the Minister to act diligently in pursuing the collection of tax debts. In light of the significant effect that collection of tax debts has upon the financial security of Canadian citizens, it is contrary to the public interest for the department to sleep on its rights in enforcing collection. It is evident that the rationales which justify the existence of limitation periods apply to the collection of tax debts. [Emphasis added]

In my view, the Supreme Court of Canada should grant leave (if 984 applies for it) to explain how these principles fit with the FCA's decision in 984's case. In my view, they do not.[18]

COVID-19 UPDATE

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

Federal

Speech From the Throne (September 23, 2020)

Her Excellency the Right Honourable Julie Payette, Governor General of Canada, delivered the Speech from the Throne on September 23, 2020. The speech opened the second session of the 43rd Parliament and outlined the government's agenda. The Speech only provided a brief description of each objective, but further details on the upcoming changes will follow when the government releases an update to its *COVID-19 Economic Response Plan* this fall. It will outline the government's economic and fiscal position, provide fiscal projections, and include new measures to implement the objectives included in the Throne Speech.

The Throne Speech presented several tax-related objectives; the government had previously committed to implementing some of these, but several of these objectives are new. These tax objectives are:

- extending the Canada Emergency Wage Subsidy right through to next summer and working with businesses and labour to ensure the program meets the needs of the health and economic situation as it evolves;
- identifying additional ways to tax extreme wealth inequality, including by concluding work to limit the stock option deduction for wealthy individuals at large and established corporations, and addressing corporate tax avoidance by digital giants;
- acting to ensure web giants' revenue is shared more fairly with Canadian creators and media, and requiring them to contribute to the creation, production, and distribution of our stories, on screen, in lyrics, in music, and in writing;

[18] Interestingly, in an Australian decision released at about the same time, *Auctus Resources Pty Ltd v. Commissioner of Taxation*, [2020] FCA 1096, the Court held that, due to a gap in the relevant legislation, the Commissioner could not recover a tax refund paid by mistake to the taxpayer. The Court did not seem to have any qualms about allowing the taxpayer to slip through the legislative gap and keep the refund.

- bringing forward a Disability Inclusion Plan, which will have a better process to determine eligibility for government disability programs and benefits (this may affect eligibility for the disability tax credit);
- introducing free, automatic tax filing for simple returns to ensure citizens receive the benefits they need;
- continuing to put a price on pollution, while returning the revenue to individuals; and
- launching a new fund to attract investments in making zero-emissions products, and cutting the corporate tax rate in half for these companies to create jobs and make Canada a world leader in clean technology.

The Speech also announced some non-tax objectives that will result in new direct support to individuals and businesses. These include:

- working to target additional financial support directly to businesses which must temporarily shut down as a result of a local public health decision;
- expanding the Canada Emergency Business Account to help businesses with fixed costs;
- improving the Business Credit Availability Program;
- increasing Old Age Security once a senior turns 75, and boosting the Canada Pension Plan survivor's benefit;
- introducing further support for industries that have been the hardest hit, including travel and tourism, hospitality, and cultural industries like the performing arts;
- introducing a new Canadian Disability Benefit modelled after the Guaranteed Income Supplement for seniors; and
- transitioning the CERB to the EI system and the new Canada Recovery Benefit.

CEWS Update — Furloughed Employees

The federal government is proposing to extend the current treatment of furloughed employees under the CEWS for the current four-week period, from September 27 to October 24, 2020. This means employers who qualify for the wage subsidy can continue to claim up to a maximum benefit of $847 per week per employee to support remuneration of their furloughed workers until October 24, 2020.

Government Tables Legislation To Enact COVID-19 Recovery Benefits

Bill C-2, *COVID-19 Economic Recovery Act*, was introduced on September 24, 2020. It proposes to create three new temporary Recovery Benefits to support Canadians who are unable to work for reasons related to COVID-19. It also makes consequential amendments to the *Income Tax Act* and the *Income Tax Regulations*. The proposed benefits are:

- A Canada Recovery Benefit ("CRB") of $500 per week for up to 26 weeks, for workers who are self-employed or are not eligible for EI and who still require income support. This Benefit would support Canadians who have not returned to work due to COVID-19 or whose income has dropped by at least 50%. These workers must be available and looking for work, and must accept work where it is reasonable to do so;
- A Canada Recovery Sickness Benefit ("CRSB") of $500 per week for up to two weeks, for workers who are sick or must self-isolate for reasons related to COVID-19. This Benefit supports the Government's commitment to ensure all Canadian workers have access to paid sick leave; and
- A Canada Recovery Caregiving Benefit ("CRCB") of $500 per week for up to 26 weeks per household, for eligible Canadians unable to work because they must care for a child under the age of 12 or family member because schools, day-cares, or care facilities are closed due to COVID-19 or because the child or family member is sick and/or required to quarantine.

Canadians can apply for the CRB, CRSB, and CRCB through the Canada Revenue Agency ("CRA") for one year up until September 25, 2021.

Certain Deadlines Extended Pursuant to Ministerial Order

Pursuant to the *Time Limits and Other Periods Act (COVID-19)*, the Minister of National Revenue made a Ministerial Order to extend certain deadlines for income tax and GST/HST purposes.

For the purposes of the *Income Tax Act*, the order temporarily extends:

(1) The time limit for the filing of certain prescribed forms for the purposes of the Scientific Research and Experimental Development Tax Incentive Program (expenditures and investment tax credit) for a maximum of six months beginning on or after March 13, 2020 and not beyond December 31, 2020.

(2) The time limits on the Minister's ability to make an assessment, reassessment, or additional assessment, which would otherwise have expired on or after May 20, 2020, for a maximum of six months and not beyond December 31, 2020.

(3) The time limit by which the Minister may grant an extension of time to a taxpayer to file a Notice of Objection to an assessment, which would otherwise have expired on or after March 13, 2020, for a maximum of six months and not beyond December 31, 2020.

(4) The time limit by which a taxpayer or registrant may apply to the Tax Court of Canada for an extension of time to object to an assessment, which would otherwise have expired on or after March 13, 2020, for a maximum of six months and not beyond December 31, 2020.

For the purposes of the *Excise Tax Act*, the order temporarily extends:

(1) The time limits on the Minister's ability to make an assessment, reassessment, or additional assessment of a registrant's GST/HST return or of certain amounts of GST/HST payable, penalties, rebates, or interest, which would otherwise have expired on or after May 20, 2020, for a maximum of six months and not beyond December 31, 2020.

(2) The time limit by which the Minister may grant an extension of time to a registrant to file a Notice of Objection to an assessment, which would otherwise have expired on or after March 13, 2020, for a maximum of six months and not beyond December 31, 2020.

(3) The time limit by which a registrant may apply to the Tax Court of Canada for an extension of time to object to an assessment which would otherwise have expired on or after March 13, 2020, for a maximum of six months and not beyond December 31, 2020.

All provisions made under this Ministerial Order will cease to apply on the earlier of December 31, 2020 or the day on which the order that enacted the provision is repealed.

Tax Treatment of US Economic Income Payment Program

In a new technical interpretation (2020-0851811I7), the CRA was asked whether amounts received by a permanent resident of Canada under the US Economic Income Payment Program would be included in income for Canadian tax purposes. The CRA stated that it would likely not be included in income because the amount is considered an advanced payment of a 2020 refundable tax credit, and therefore is likely not income from a source under the *Income Tax Act*.

CRA Resumes Certain Activities

The CRA is beginning to resume additional activities, and as a result will begin calling taxpayers again. This September, the CRA will:

- Begin calling those who may owe in order to pursue payment arrangements;
- Reconnect with those who may owe to re-evaluate their financial situation, discuss payment options, and offer a payment arrangement where possible;
- Contact certain taxpayers to help them meet their tax obligations (e.g., the CRA may offer to assist with tax return preparation or send letters to those who may lose benefits because they have not filed a tax return);
- Begin contacting clients if the CRA needs clarification or supporting documents related to their tax and benefit return.

Government Announces Extension of Rent Relief for Small Businesses

The Canada Emergency Commercial Rent Assistance ("CECRA") for small businesses will be extended by one month to help eligible small businesses pay rent for September. All provinces and territories continue to participate in this initiative and collaborate with the federal government to provide rent supports to those small businesses most in need. Current CECRA application deadlines will also be extended to accommodate this extension. The government announced this will be the final extension of this program as the government explores options to support small businesses as they face the ongoing challenges of the COVID-19 pandemic.

Guidance on International Income Tax Issues Raised by the COVID-19 Crisis

The application of the guidance, which began on March 16, 2020, was extended from June 29, 2020, to September 30, 2020. Section I.-B. (income tax residency of corporations) has been updated to address a possible issue with corporate residency requirements as it relates to the surplus calculations of a foreign affiliate of a Canadian-resident corporation. Section VI, *Non-resident employer certification*, has been added to address a possible issue for non-resident employers whose non-resident employees may have had to remain in Canada for an extended period as the result of the travel restrictions. The guidance has also been updated generally to make it more readable and consistent with existing government writing style. None of these changes indicate a change in policy or approach of the CRA in applying the guidance.

Greater Flexibility and Extension of the CEBA

The federal government has announced that the application deadline for the Canada Emergency Business Account ("CEBA") is extended from August 31 to October 31, 2020.

Moreover, the government is working with financial institutions to make the CEBA program available to businesses with qualifying payroll or non-deferrable expenses that have so far been unable to apply due to not operating from a business banking account. Further details on these changes will be released in coming days, including a new business account opening process through which qualifying businesses will be able to apply.

Provincial

British Columbia

New Increased Employment Incentive

As part of BC's Economic Recovery Plan, the BC Increased Employment Incentive is a refundable tax credit for employers that encourages the creation of new jobs for BC workers or increases in payroll for existing low- or medium-income employees.

The tax credit is calculated at 15% of the amount that the employer's qualifying BC remuneration exceeds the employer's base BC remuneration.

For further information on eligibility, qualifying remuneration, and how to apply, see https://www2.gov.bc.ca/gov/content/taxes/employer-health-tax/employer-health-tax-overview/increased-employment-incentive, and for a technical backgrounder see https://www2.gov.bc.ca/gov/content/taxes/employer-health-tax/employer-health-tax-overview/increased-employment-incentive/technical-backgrounder.

New PST Rebate on Select Machinery and Equipment

The BC PST Rebate on Select Machinery and Equipment is a temporary provincial sales tax ("PST") program to help corporations recover from the financial impacts of COVID-19.

The program acts like a refund but is separate from the existing PST refund process. Under this temporary program, corporations can apply to receive an amount equal to the PST they paid between September 17, 2020 and September 30, 2021 on qualifying machinery and equipment.

For further information on eligibility, qualifying machinery and equipment, and how to apply, see https://www2.gov.bc.ca/gov/content/taxes/sales-taxes/pst/rebate-machinery-equipment, and for a technical backgrounder, see https://www2.gov.bc.ca/gov/content/taxes/sales-taxes/pst/rebate-machinery-equipment/technical-backgrounder.

Deadlines Extended for Tax Credits

As part of BC's COVID-19 supports, the deadline to apply for some provincial income tax credits — Training Tax Credit for Employers, Book Publishing Tax Credit, Film and Television Tax Credit, Mining Exploration Tax Credit for Corporate/Personal Income Tax, Production Services Tax Credit, Interactive Digital Media Tax Credit. and Scientific Research & Experimental Development Tax Credit — for claims required to be made March 13, 2020 or later is extended to six months from he original due date or to December 31, 2020, whichever is earlier.

The BC mining flow-through share ("MFTS") tax credit eligibility period is being extended from 24 months to 36 months for 2019 and

2020 flow-through share purchases. This is the eligibility period during which an expenditure must be incurred by the issuer in order to be renounced in favour of flow-through shares. This extension aligns the eligibility period for the BC MFTS tax credit with the temporary federal timelines for flow-through shares.

Province Confirms Tax Measure Implementation Dates, Deferral Deadlines for Businesses

BC is delaying implementation dates to April 2021 for changes to provincial sales tax ("PST") and the province's carbon tax. A scheduled increase in April 2020 from $40 to $45 per tonne of carbon dioxide equivalent ("tCO2e") had been paused until at least October as part of the COVID-19 Action Plan. Upon review, the BC government has decided the carbon tax rate will remain at its current level of $40 per tCO2e until April 2021, when it will increase from $40 to $45 per tCO2e. The carbon tax will increase to $50 per tCO2e in April 2022.

The implementation of two other planned tax changes is also being delayed until April 2021. This includes the elimination of the PST exemption for carbonated beverages that contain sugar, natural sweeteners, or artificial sweeteners, and the addition of new PST registration and collection requirements for e-commerce businesses located outside BC. In addition, the employer health tax ("EHT") 2020 quarterly instalment dates are being extended as follows:

- December 31, 2020 (original instalment date was June 15, 2020);
- January 31, 2021 (original instalment date was September 15, 2020); and
- February 28, 2021 (original instalment date was December 15, 2020).

The 2020 EHT filing and balance due date will remain March 31, 2021.

Effective March 23, 2020, as part of BC's COVID-19 Action Plan, the filing and payment due dates for the following sales taxes were extended to September 30, 2020, along with the 2019 EHT filing and balance due date:

- PST;
- hotel tax, also known as municipal and regional district tax;
- tobacco tax;
- motor fuel tax; and
- carbon tax.

The provincial government announced that these administrative deferrals are not being extended further.

Manitoba

Wage Subsidy Program Further Extended

The Manitoba government has further extended its Back to Work in Manitoba Wage Subsidy Program by two months until December 31. The government also announced that employers can now rehire students previously hired through the Manitoba Summer Student Recovery Jobs Program, Canada Summer Job Program, and Green Team Program. The province confirmed new start-up companies are eligible, providing they have a business number.

Wage Subsidy Program Enhanced

The Manitoba government is enhancing its Back to Work program to support more Manitoba businesses in bringing back their employees to increase their operations and the services provided throughout the province. The Back to Work Manitoba Initiative supports the province's economic recovery by encouraging private sector or non-profit employers to bring back laid-off employees or make new hires. The program will reimburse 50 per cent of wage costs (up to $5,000) per employee hired or re-hired between July 16 and October 31, 2020.

The enhanced program will now allow businesses, not-for-profit organizations, or charities to receive a subsidy for another 10 full or part-time employees, in addition to the current total of 10. By doubling the amount of subsidized employees to 20, the maximum level of financial support available to employers increases from $50,000 to $100,000.

The program is open to applicants of the Summer Student Recovery Jobs Program and Back to Work This Summer Program to make any

additional hires. However, positions already receiving funding through other federal or provincial government programs are ineligible.

The application deadline is October 1. Employers will be required to provide proof of payment of wages by January 4, 2021. Program details and the application form are available online at www.gov.mb.ca/covid19/restartmb/btwmp.html.

Québec

Time Limit Suspension for Court Proceedings Lifted

The Chief Justice of Québec and Minister of Justice lifted the previously suspended time limits for civil and penal proceedings, effective September 1, 2020. Also, the time limit for case protocol filing before September 1, 2020, is extended by 45 days, unless the parties agree otherwise.

Saskatchewan

Provincial Training Allowance and Skills Training Benefit Programs Repayment To Resume

The Provincial Training Allowance and Skills Training Benefit Programs overpayment moratorium is scheduled to end September 30, with repayments anticipated to resume in October 2020.

FOCUS ON CURRENT CASES

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

Casolino v. The Queen, 2020 GTC 14 (Tax Court of Canada)

Background

Mr. Edlpidio Casolino was the sole owner of 706177 Ontario Inc. operating as JEMM painting ("JEMM"), which was a commercial painting business. Mr. Casolino obtained a line of credit through the Bank of Montreal ("BMO") in order to run his business. JEMM was responsible for paying the line of credit, and if JEMM was unable to pay the line of credit, it was Mr. Casolino's responsibility to pay the line of credit.

On December 15, 1999, a second mortgage (the "Second Mortgage") in the amount of $125,000 was registered on the matrimonial home (the "Property") of Mr. Casolino and his wife, Janice Casolino (the "Appellant"). This mortgage was put in place to guarantee the payment of the operating line of credit of JEMM.

On August 25, 2000, the Second Mortgage was increased to $192,500. The Tax Court of Canada (the "Tax Court") found that this amount was incurred solely on behalf of JEMM's commercial painting business, and was first the responsibility of JEMM and then of Mr. Casolino.

Both JEMM and Mr. Casolino were unable to pay the amounts owing under the line of credit. The parties remortgaged the property for $422,500, in part to pay off the line of credit to BMO. As part of the refinancing, the Property was transferred to the Appellant's name on February 11, 2003 (the "Transfer") as this was a requirement of the bank.

As a result of the Transfer, the Minister of National Revenue (the "Minister") assessed the Appellant pursuant to subsection 325(1) of the *Excise Tax Act* (the "ETA"). This provision allows the Minister to assess someone who receives a transfer of property from his or her spouse at the time the spouse has a tax debt. The Minister is permitted to assess the amount by which the fair market value of the consideration provided for the property by the transferee is less than the fair market value of the property that is transferred at the time of the transfer.

At the time of the Transfer, Mr. Casolino owed taxes of $69,174.90, the fair market value of the Property was $630,000, and there was a joint mortgage on the Property in the amount of $237,706 and a business line of credit on the Property in the amount of $184,791.

The Respondent's position was that half of JEMM's debt should be attributed to the Appellant since it was secured by way of a mortgage on the Property. It argued, therefore, that the half of the equity transferred by Mr. Casolino to the Appellant was $98,073.50, which

exceeded the amount of taxes owing by Mr. Casolino of $69,174.90, and that the appeal should be dismissed.

Tax Court Decision

The Tax Court did not agree with the Respondent's position that half of JEMM's debt was attributable to the Appellant. The Tax Court also found that the Appellant's ownership in the home should not be reduced by the line of credit of $184,793 even though it was registered on the Property as it was first the responsibility of JEMM and then the responsibility of Mr. Casolino. This is because the Appellant took sole responsibility for the line of credit at the time the Property was transferred to her. The Tax Court found that the Appellant provided consideration for the transfer of the Property by taking responsibility for the line of credit. The Tax Court allowed the appeal on the basis that she provided consideration of $184,793 for the assumption of the line of credit.

Conclusion

In summary, the Tax Court found that the Appellant's equity in the Property should not be reduced by the business line of credit even though the business line of credit was registered on the Property. This was because the line of credit was the responsibility of JEMM and Mr. Casolino. The Tax Court also found that the Appellant provided consideration for the Transfer of the Property by assuming sole responsibility for the line of credit when the Property was transferred to her. This case demonstrates that the assumption of debt can be a form of consideration provided by a taxpayer for the transfer of property.

— *Gergely Hegedus*

Mamdani Family Trust, 2020 DTC 1068 (Tax Court of Canada)

Introduction

The recent case of *Mamdani Family Trust v. The Queen* (2020 DTC 1068) adds yet another judgment to the list of cases in which taxpayers have failed to persuade the courts that a dividend may hold differing values in the hands of disparate taxpayers for the purpose of an assessment under subsection 160(1) of the *Income Tax Act* (RSC 1985, c. 1 (5th Supp.) (the "ITA")).

The Mamdani Family Trust (the "Trust") received dividends from Global Equity Fund Ltd. ("Global") at times when Global was liable to pay one or more amounts under the ITA. As a result, the Trust was assessed under subsection 160(1) in respect of the amounts owed by Global. There was no dispute as to whether subsection 160(1) would apply; rather, this case focused on the value of the dividends to be used when calculating the subsection 160(1) liability. As such, the issues were:

- When determining the fair market value of the transferred property, for the purposes of subparagraph 160(1)(*e*)(i) of the ITA, should the amount of income tax payable by the transferee, by reason of the receipt of the transferred property, be taken into consideration?
- Should the Tax Court of Canada disregard the decision of the Federal Court of Appeal in *Gilbert*?

In exploring these issues, *Mamdani* expands the jurisprudence by interpreting expert evidence regarding the fair market value of the dividends and further clarifying the time when a dividend is valued.

Justice Sommerfeldt followed the Federal Court of Appeal decision in *The Queen v. Gilbert* (2008 DTC 6295 (FCA)), and determined that in calculating the subsection 160(1) liability, the value of the dividends paid by Global should not be discounted for the tax paid by the Trust (*Mamdani* at para 35).

Background and Jurisprudential History

Justice Sommerfeldt's conclusion was grounded in the *ratio* of *Gilbert* (at paras 21–22 cited in *Mamdani* at para 35):

> [W]here, for the purposes of subsection 160(1) of the ITA, the transferred property is a dividend, the amount that should be assessed under that subsection is "the amount that the Minister could have seized in the hands of the corporation had the transfer not been effected." Consequently, "the fair market value must be assessed by considering that the property is still in the hands of the transferor, . . ." and by ignoring "the fiscal consequences" (i.e., tax implications) for the transferee. [footnotes not reproduced]

Mamdani is factually similar to *Gilbert*: both cases consider the fair market value of a dividend in the context of a subsection 160(1) assessment. The appellant in *Mamdani* argued that *Gilbert* was incorrect and that expert evidence was necessary to inform the Court of

the true value of the dividends. Justice Sommerfeldt allowed the expert evidence; however, he determined that even if *Gilbert* was wrong he would not have been persuaded by the expert evidence.

The reasoning in *Gilbert* and consequently *Mamdani* is further supported by previous cases dealing with the nature of dividends. *Algoa Trust v. The Queen* (93 DTC 405 (TCC) at para 39) established that

> When the shareholder receives a dividend it is not as a result of any consideration he or she gave the corporation and which the corporation is obliged to pay for investing. When a shareholder purchases shares he is not purchasing an income right. A shareholder receives a dividend solely because the right to a dividend is an attribute of owning shares.

Algoa Trust has since been recognized as the leading case for the application of subsection 160(1) to dividends — see *Addison & Leyen Ltd. v. Canada*, 2006 DTC 6248 (FCA) at para 60, cited in *Gilbert* at para 15. In *Neuman v. Minister of National Revenue* (98 DTC 6297 at para 57) the Supreme Court, referring to the dissenting reasons of LaForest J. in *McClurg v. Minister of National Revenue* (91 DTC 5001 (SCC)), found that no consideration can be given for payment of a dividend: "a dividend is a payment which is related by way of entitlement to one's capital or share interest in the corporation and not to any other consideration."

The definition of fair market value was also critical to the analysis. The appellants in both *Mamdani* and *Gilbert* relied on the definition provided in *Henderson Estate and Bank of New York v. Minister of National Revenue* (73 DTC 5471 (FCC) at 5476, aff'd 75 DTC 5332 (FCA)), which has seen continued use in *Nash v. Canada* (2005 DTC 5696 (FCA)):

> [T]he highest price an asset might reasonably be expected to bring if sold by the owner in the normal method applicable to the asset in question in the ordinary course of business in a market not exposed to any undue stresses and composed of willing buyers and sellers dealing at arm's length and under no compulsion to buy or sell. I would add that the foregoing understanding as I have expressed it in a general way includes what I conceive to be the essential element which is an open and unrestricted market in which the price is hammered out between willing and informed buyers and sellers on the anvil of supply and demand.

Analysis

Justice Sommerfeldt found that determining the fair market value of a dividend is not informed by any doctrine or precedent in the jurisprudence (*Mamdani* at para 27). He reasoned that if a corporation, before declaring a dividend, sells the income stream that would otherwise be represented by the dividend, the corporation is not actually selling a dividend; furthermore, a corporation is not in the position to sell a dividend after it has been declared. Justice Sommerfeldt used *Gilbert*, *Neuman*, and *Algoa Trust* to support his analysis.

This reasoning exposes a potential incongruence between the construction of subsection 160(1) and the definition of fair market value given in *Henderson*. It is within this gap that the appellant tried to assert its argument. Subsection 160(1) implies that there must be a fair market value for transferred property. The definition of fair market value in *Henderson* suggests that there must be a market and market forces must act upon assets. Justice Sommerfeldt's analysis effectively reasons that there is no market for dividends because they cannot be sold before or after being issued. However, this potential incongruence can be reconciled: an asset that cannot be sold to a buyer (i.e., there is no market for it) is worth as much as the vendor values it. In this case, the dividends in the hands of Global are worth the declared amount (the transferor of a dividend literally declares its value) and in the absence of a market for dividends, market forces cannot act to discount the value of a dividend.

Leaving this potential incongruence aside, Justice Sommerfeldt proceeded by determining that the fair market value of a dividend is a function of timing (citing *Gilbert*; *Hewett v. The Queen*, 97 DTC 561 (TCC), aff'd 98 DTC 6003 (FCA); and *Bergeron v. The Queen*, 2003 DTC 1491 (TCC)). For the purpose of subsection 160(1), the time for valuation is immediately before the transfer, when the property is still in the hands of the transferor. Tax payable by the dividend recipient cannot affect the value in the hands of the transferor because the liability to pay tax on a dividend does not arise until after it has been received by and belongs to the dividend recipient (i.e., after the time of transfer) (*Mamdani* at para 34, citing *Banner Pharmacaps NRO Ltd. v. The Queen*, 2003 DTC 5642 (FCA), at para 6). As a result, the appeal was dismissed and the value of the dividends was not discounted for tax paid by the Trust arising from the dividends.

Double Taxation Argument

The appellant made an alternative argument that applying subsection 160(1) to the full amount of the dividends would result in double tax because the dividends were already taxed under subsection 82(1) in the hands of the Trust. Justice Sommerfeldt followed jurisprudence establishing that the policy against double taxation was not helpful in this case because subsection 160(1) is not a taxing or

charging provision (*Mamdani* at para 36, citing *Algoa Trust* at paras 41, 49). The tax payable by Global, which resulted in the subsection 160(1) liability of the Trust, was a separate liability from the tax arising on receipt of the dividends. Thus there was no double tax.

Although the result is harsh, Parliament has not taken action to resolve this harshness despite continued pressure from the judiciary.

Conclusion

Determining the fair market value of dividends is an odd concept particularly because dividends, by their nature, lack a conventional market. Yet subsection 160(1) uses the fair market value of a dividend in calculating the liability of a dividend recipient. The *Mamdani* decision will hopefully add some clarity or at least some weight to the jurisprudence behind the principle that, for the purpose of subsection 160(1), dividends are valued in the hands of the transferor immediately before transfer. Justice Sommerfeldt followed *Gilbert* because it is a leading case built on the jurisprudence establishing the nature of dividends and their valuation. Any attempt at overturning *Gilbert* would have a much greater chance of success in the Federal Court of Appeal because of its precedential value.

— *James Konopka*

Rogers Enterprises (2015) Inc. v. R., 2020 DTC 1067 (Tax Court of Canada)

Rogers is the latest case of the Tax Court of Canada dealing with the general anti-avoidance rule ("GAAR"). Between 1981 and 1991, a number of insurance policies insuring the life of Mr. Ted Rogers were issued to various private corporations within the Rogers group. Initially, the policyholder of each policy was also the beneficiary of the policy. Over time, the policyholder of a number of the policies changed and, in all cases, CGESR Limited ("CGESR") became the beneficiary.

When Mr. Rogers died in 2008, life insurance proceeds aggregating $102 million were paid to CGESR and that amount was added to the capital dividend account ("CDA") of CGESR.

In 2009, CGESR paid $10 million of dividends to a corporation and almost $10 million to a trust, electing to treat these dividends as capital dividends. CGESR also redeemed a portion of its preferred shares held by a corporation (ESRIL 98), electing to treat the resulting almost $92 million of deemed dividends as capital dividends. This increased ESRIL 98's CDA by the same amount. ESRIL 98 then paid dividends totaling close to $50 million to its shareholder ESRL, electing to treat those dividends as capital dividends. CGESR and ESRIL 98 were part of subsequent transactions that resulted in them being amalgamated into Rogers Enterprises (2015) Inc. ("RE 2015").

In 2015, the Minister issued Notices of Determination to CGESR for its taxation year ended September 30, 2010 and to ESRIL 98 for its taxation year ended December 31, 2009. The Minister relied on GAAR to determine that $42 million of dividends paid by CGESR to ESRIL 98 were taxable dividends rather than capital dividends, that $42 million of the dividends received by ESRIL 98 from CGESR were taxable dividends and deductible under subsection 112(1) of the *Income Tax Act* (the "ITA"), that ESRIL 98's CDA balance at December 31, 2009 was reduced by $42 million, and that CGESR's CDA was nil following the payment of dividends to ESRIL 98. RE 2015 filed appeals to the Notices of Determination.

RE 2015 conceded that the transactions undertaken were a series for the purposes of section 245 of the ITA. Therefore, the issues before the Court were: (1) whether a tax benefit resulted, directly or indirectly, from the series of transactions, and (2) if there was a tax benefit, whether it was reasonable to consider there had been a misuse of the provisions of the ITA or an abuse having regard the provisions of the ITA as a whole.

In regard to the existence of a tax benefit, the Crown argued that tax benefits arose from the increase in CDA amounts, from the reduction of income that would otherwise have arisen had the dividends been taxable dividends rather than capital dividends, and from the avoidance of Part III tax.

The Court conducted an in-depth analysis of the definition of "tax benefit" as defined in subsection 245(1) of the ITA. It rejected the Crown's argument that an increase in CDA is "an increase in . . . [an] other amount under this Act". Instead, it concluded that the wording of that portion of the definition refers only to an increase in a refund of tax or an increase in a refund of another amount under the ITA. The court supported its conclusion with an analysis of the wording of the "tax benefit" definition in its entirety, a review of the Explanatory Notes of the Department of Finance, and a review of the comments of the Supreme Court of Canada on the meaning of a "tax benefit" in *Canada Trustco*,[1] among other things.

[1] *The Queen v. Canada Trustco Mortgage Company*, 2005 DTC 5523 (SCC).

The Court rejected the Crown's submission that the reduction in the computation of income that resulted from electing a dividend to be a capital dividend rather than a taxable dividend, amounted to a "tax benefit". Presumably the Crown took this position because there was no reduction in tax. That is, the dividends, even if treated as taxable dividends, would not have resulted in tax because a deduction under subsection 112(1) would have been available. The Court noted that although the concept of income is relevant for the purpose of the definition of "tax consequences" in subsection 245(1) of the ITA, it is not a relevant concept in the definition of "tax benefit".

In respect of whether there had been a benefit from avoiding the imposition of Part III tax to ESRIL 98, the Court cited Justice Bonner in *McNichol*[2] in respect of the requirement to identify a norm or standard against which the tax reduction or avoidance is to be measured. The Court noted that a comparable normative transaction is often not readily apparent, as in this particular case. In any event, as the amount of capital dividend paid by ESRIL 98 to ESRL was less than ESRIL 98's CDA account, even after excluding the capital dividend it received from CGESR, the Court concluded that there had not been an avoidance of Part III tax.

The Court also rejected the Crown's position that a tax benefit had been enjoyed because the Part I tax of the ultimate shareholders will be reduced in the future when they receive capital dividends rather than taxable dividends. On this point, the Court cited *Wild*[3] where the Federal Court of Appeal, in conducting a GAAR analysis, distinguished between the creation of the potential for a tax-free distribution of a corporation's retained earnings and the realization of that potential. Such potential does not result in a tax benefit under GAAR. Therefore, the Court held that the future reduction of Part I tax by the ultimate shareholders was not a "tax benefit" in the years under appeal.

In respect of whether there had been a "tax benefit" in the form of avoidance of Part III tax by CGESR, the Crown's position was hypothetical. That is, it assumed that CGESR would have paid the same amount of capital dividends (actual or deemed) even if it had insufficient CDA to do so. In *Copthorne*,[4] the Supreme Court indicated that if a taxpayer's situation is to be compared with an alternative arrangement, that alternative arrangement must be one that might reasonably have been carried out but for the existence of the tax benefit. In the current matter, the Court thought it unlikely that CGESR would have made capital dividend elections when it had insufficient CDA to do so.

On finding that no "tax benefit" resulted from the transactions, the Court allowed RE 2015's appeal. However, in case his view is ultimately determined to be mistaken, Justice Sommerfeldt proceeded to consider whether there had been an avoidance transaction and, if so, whether the avoidance was abusive.

RE 2015 had previously conceded that if the transactions resulted in a "tax benefit", then each transaction was an avoidance transaction. Therefore, the Court had only to decide whether or not there was an abusive transaction. In considering the purpose of the provisions, the Court provides an excellent outline of the legislative history of the CDA provisions and those pertaining to life insurance policies. Of interest is Justice Sommerfeldt's conclusion that some of those legislative changes resulted in a change in the object, spirit, and purpose of the provisions. Also of interest is his finding that the Crown's statement of intent or purpose of the legislation was inconsistent between its examination-for-discovery answers and its written submissions to the Court. In any event, the Court was not satisfied that the Crown had adequately explained the purpose of the relevant provision, making it difficult to satisfy the Minister's burden to establish that a tax benefit was abusive. Therefore, the Court held that there was not a misuse of the provisions, nor was there abusive tax avoidance.

The *Rogers* case is a must-read case for those interested in the determination of the existence of a "tax benefit" under the GAAR provisions, particularly where the reduction of balances rather than tax are involved.

— *Cheryl Gibson*

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[2] *McNichol v. The Queen*, 97 DTC 111 (TCC).

[3] *1245989 Alberta Ltd. v. Attorney General of Canada and Perry Wild v. Attorney General of Canada*, 2018 DTC 5067 (FCA).

[4] *Copthorne Holdings Ltd. v. Her Majesty the Queen*, 2012 DTC 5007 (SCC).

1455257 Ontario Inc. v. Her Majesty The Queen, 2020 DTC 1048 (Tax Court of Canada)

Overview

In *1455257 Ontario Inc. v. Her Majesty the Queen*,[1] the Tax Court of Canada considered an appeal from an assessment made under section 160 of the *Income Tax Act* (Canada) (the "Act"). Section 160 authorizes the Minister of National Revenue (the "Minister") to recover a tax debt from a person who has received property from a non-arm's length tax debtor for inadequate consideration.

The appellant, 1455257 Ontario Inc. (the "Appellant"), received a transfer of $998,460 from 1473661 Ontario Limited ("661") in 2003 for no consideration. Mr. Enrico Lisi ("Mr. Lisi") was the sole shareholder, director, and officer of both the Appellant and 661 such that the two corporations were not dealing at arm's length.

The Minister assessed the Appellant pursuant to section 160 for an amount of $702,374.01, being the lesser of the amount transferred and 661's tax liability. The assessment was made on the basis that 661 transferred funds to the Appellant when 661 had a tax liability in respect of its 2000 taxation year.

Issues

The issues before the Court were (i) whether 661 had a tax liability in respect of its 2003 taxation year or any preceding taxation year when it transferred property to the Appellant, and (ii) whether the Minister's calculation of interest accrued on 661's tax liability was correct. In determining 661's tax liability, the Court considered whether non-capital losses available to 661 with respect to its 2002 taxation year ought to have been carried back to reduce its income for the 2000 taxation year.

The appeal was dismissed, with the Court finding that the loss carryback was not made and therefore 661 had a tax liability in respect of the taxation year in which the property was transferred and that the Minister's calculation of interest was correct.

Legal Framework

In *Livingston v. R.*,[2] the Federal Court of Appeal set out the criteria for the application of section 160 of the Act:

(1) There must have been a transfer of property;

(2) The transfer must be made between persons not dealing at arm's length;

(3) The fair market value of the property transferred must have exceeded the fair market value of the consideration given by the transferee; and

(4) The transfer was made by a person who had a liability under the Act in or in respect of the taxation year in which the property was transferred or any preceding taxation year.

The parties agreed on the first three criteria. Regarding the fourth criteria, the Appellant's position was that 661 did not have a tax liability with respect to its 2000 taxation year because non-capital losses incurred in 2001 and 2002 were, or ought to have been, carried back, thereby reducing 661's taxable income for its 2000 taxation year.

Loss Carry-back

661 incurred non-capital losses as a partner in the Grosvenor Services 2000 Limited Partnership ("Grosvenor LP") for its 2001 and 2002 taxation years. These losses were carried back to reduce its income for the 2000 taxation year. Following an audit and subsequent settlement of Grosvenor LP, 661's losses for the 2001 taxation year were reduced and its losses for the 2002 taxation year were increased. This change resulted in 661 having additional unused losses for its 2002 taxation year which formed the basis of the dispute.

Pursuant to paragraph 111(1)(*a*) of the Act, a taxpayer may carry non-capital losses back three years in computing taxable income. The Respondent took the position that the Minister could, but was not required to, reassess 661's taxation year to apply the unused losses and that 661 did not request that the unused losses be carried back to its 2000 taxation year within the required period and in prescribed form. The Appellant took the position that the prescribed form was not required.

[1] 2020 DTC 1048 (TCC).

[2] 2008 DTC 6233 (FCA).

Pursuant to subsection 152(6) of the Act, to request carryback a taxpayer must file a prescribed form on or before the tax return due date for the particular taxation year. In the present case, 661 did not file the prescribed form as required by subsection 152(6) nor did it make a written request for carryback in any other form.

The Appellant submitted that it was impossible to comply with the requirement to file on or before its tax return due date because it was notified by the Canada Revenue Agency (the "CRA") of the determination of Grosvenor LP's losses more than a year after the due date. However, the Appellant asked that the Court interpret 661's original loss carryback request from 2002 to 2000 as an "implied request to carry back all losses available from 2002 to the extent needed to eliminate and/or reduce to the maximum extent possible 661's 2000 income."[3] In considering the Appellant's position, the Court looked to the CRA's internal policy for applying subsection 152(6).

The auditor on the Appellant's file testified that the CRA will give taxpayers an opportunity to amend their loss application "when an internally generated adjustment results in an increase to income and a loss of another year has been applied to that year."[4] The auditor stated that the CRA would send the taxpayer a T7W-C form and then expect the taxpayer to advise the CRA whether to amend their loss application. Based on Mr. Lisi's testimony, no direction was given to the CRA regarding how the unused 2002 losses should be applied subsequent to the Grosvenor LP settlement. As such, the Court concluded that there was insufficient information for the Minister to apply the 2002 unused losses to the 2000 taxation year. Consequently, the Court concluded that 661 had a tax liability in respect of 2003 or a preceding taxation year when it transferred property to the Appellant.

Calculation of Interest

An assessment made under section 160 is subject to interest. However, in computing the amount of interest applicable to a section 160 assessment, the Appellant argued that the period commencing after the date of the transfer of property to the date of the section 160 assessment should be excluded. The Appellant's position was that the use of the phrase "in or in respect of the taxation year in which the property was transferred or any preceding taxation year" in paragraph 160(1)(*e*) meant the liability is the amount that includes interest and penalties for the period that ends at the end of the taxation year in which the transfer occurred. The Appellant also argued that the French phrase in paragraph 160(1)(*e*), "pour une de ces années", mandated a more restrictive interpretation of the provision.

The Court disagreed with the Appellant and found that there was no ambiguity in the legislation nor was there any conflict in case law. In *Nowegijick v. The Queen*,[5] the Supreme Court of Canada made it clear that the words "in respect of" are words of the widest possible scope. Further, in *Montreuil v. R*,[6] the Court found that the English and French versions of paragraph 160(1)(*e*) have the same meaning because the word "pour" is equivalent to "in respect of".

Based on the wording of subsection 160(1), the Court held the Appellant's assessment under section 160 was subject to any interest on the amount of tax owed by the transferor in respect of the taxation year in which the transfer occurred and any prior taxation year including interest accrued from the date of transfer to the date of the section 160 assessment.

Conclusion

- Per paragraph 111(1)(*a*) of the Act, a taxpayer may carry non-capital losses back three years in computing taxable income. However, the taxpayer must request that such losses be carried back. The Court was unwilling to find an implied request to carry back losses where the taxpayer failed to give direction to the CRA regarding how the unused losses should be applied. Practitioners are advised to support all requests in writing, and where possible, ensure that receipt of such written requests is acknowledged by responsible CRA officials.
- An assessment made under subsection 160(1) of the Act is subject to any interest on the amount of tax owed by the transferor in respect of the taxation year in which the transfer occurred and any prior taxation year.

— *Caroline Harrell*

[3] *Supra* note 1 at para 40.

[4] *Ibid.* at para 52.

[5] 83 DTC 5041 (SCR).

[6] 95 DTC 138 (TCC).

Insurance Institute of Ontario v. M.N.R., 2020 UDTC 41 (Tax Court of Canada)

Background

In *Insurance Institute of Ontario v. M.N.R.*, 2020 UDTC 41, Justice Graham of the Tax Court of Canada (the "Tax Court") weighed in on the proper interpretation and application of the test set out by the Federal Court of Appeal (the "FCA") in *1392644 Ontario Inc. v. The Queen* ("*Connor Homes*"), 2013 UDTC 28, to determine whether a worker is an employee or an independent contractor.

The appellant, the Insurance Institute of Ontario (the "Institute"), is a non-profit organization that provides professional and continuing education to professionals in the insurance industry in Ontario. Peter Barlow ("Mr. Barlow") worked with the Institute as an instructor from January 1, 2015, to March 31, 2018. The various contracts entered into between the Institute and Mr. Barlow clearly set out that Mr. Barlow was an independent contractor. However, the Minister of National Revenue disagreed with this characterization and issued a ruling in which it concluded that Mr. Barlow was an employee. The Institute challenged this characterization in its appeal of the ruling.

Issues

In this appeal, the Court considered the following three issues:

(1) How should the test set out in *Connor Homes* be applied when a payor and a worker share a common intention as to the nature of their relationship?

(2) Do the factors that are to be considered in applying that test include what is known as the "integration test"?

(3) Under the *Connor Homes* test, was Mr. Barlow an employee or an independent contractor?

Legal framework

Interpretation of *Connor Homes*

In *Connor Homes*, the FCA set out a two-step test to determine whether a worker is an employee or an independent contractor. The first step is to ascertain the subjective intent of each party to the relationship, which may be determined through the written contractual relationship the parties have entered into or by the actual behaviour of each party."[1] The second step is to "ascertain whether an objective reality sustains the subjective intent of the parties"[2] by applying the factors set out in the FCA's decision in *Wiebe Door Services Ltd. v. The Queen*, 87 DTC 5025 "*Wiebe Door*") and the Supreme Court of Canada's decision in *671122 Ontario Ltd. v. Sagaz Industries Canada Inc.*, 2001 UDTC 316 ("*Sagaz*"). The Institute argued that for the first step to mean something, the results of the first step must affect the application of the second step. Meanwhile, the Crown argued that the second step involves nothing more than the application of the *Wiebe Door* and *Sagaz* factors and is entirely independent of the results in the first step.

[1] *Connor Homes*, at para 39.

[2] *Ibid.*, at para 40.

While the Tax Court found evidence to support both interpretations, it ultimately agreed with the Institute's interpretation of the *Connor Homes* test, reasoning that if the outcome of the first step had no bearing on the second step, then it was unclear what purpose the first step served. Justice Graham found further support for his reasoning in the Tax Court and FCA decisions in *Porotti v. The Queen*.[3]

Justice Graham concluded that the second step of the *Connor Homes* test should be applied as follows:

> (1) Where the payor and the worker do not share a common intention, their relationship will be the relationship indicated by the *Wiebe Door* and *Sagaz* factors.
>
> (2) Where the payor and the worker share a common intention:
>
> > (a) If the *Wiebe Door* and *Sagaz* factors are consistent with that common intention, then their relationship will be the relationship that they intended;
> >
> > (b) If the *Wiebe Door* and *Sagaz* factors are completely inconsistent with that common intention, then their relationship will be the relationship indicated by those factors; and
> >
> > (c) If the *Wiebe Door* and *Sagaz* factors are inconsistent with that common intention but the parties nonetheless act and carry on their relationship in a manner that is similar to what one would expect from their intentions, then their relationship will be the relationship that they intended.

Integration Test

The "integration test" is one factor that has historically been considered in determining whether a worker is an employee or an independent contractor. Generally, it asks whether the worker's services are integral to the payor's business. The Crown argued that the integration test was a relevant factor in this case since the Institute could not offer courses without instructors. However, the Tax Court disagreed and found that this factor has since been reformulated in jurisprudence to instead ask whether the worker is performing services as a person in business on their own account.

Application of *Connor Homes*

To answer the third and final issue, Justice Graham applied the *Connor Homes* test to the facts in this appeal.

Common Intention

Justice Graham found that the parties agreed that the Institute and Mr. Barlow shared a common intention that Mr. Barlow be an independent contractor. Given this intention, Justice Graham went on to determine whether this characterization was consistent with the *Wiebe Door* and *Sagaz* factors.

Control

Justice Graham found that the control factor neither favoured an employee relationship nor an independent contractor relationship. On the one hand, the Institute could not compel Mr. Barlow to teach a specific course or teach at any given time. Mr. Barlow had control over how he taught the curriculum. He was free to teach elsewhere and to use the lessons he specifically prepared for the courses he taught for the Institute. However, the Institute did exercise some control over the marking system used for evaluation and had the right to audit and view Mr. Barlow's classes if there was a complaint from a student.

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[3] *Porotti v. The Queen*, 2014 UDTC 36 (TCC), aff'd 2016 DTC 5025 (FCA).

Ownership of Tools

Justice Graham also found the ownership of tools to be a neutral factor in this case. Mr. Barlow worked from his basement and used his own laptop, internet connection, and headset (which he specifically purchased for the purposes of teaching). He prepared and maintained ownership of all of his slides, handouts, and worksheets used in his lessons. At the same time, the Institute provided the textbook and student resource guide and insisted that Mr. Barlow grant it ownership of any mid-term exam questions he prepared. The Institute also provided the facilities for in-person classes and coordinated online lessons through its website.

Chance of Profit

Mr. Barlow earned a fee based on the number of students who registered for his course. He may have been permitted to hire an assistant or subcontract work to another instructor, although it is unlikely that he would have done so. Justice Graham stated that if he were applying this factor from a purely objective standpoint, he would have concluded that the facts favoured an employment relationship. However, the test set out by Justice Graham required him to consider whether the Institute and Mr. Barlow acted and carried on their relationship in a manner that was consistent with their common intention that Mr. Barlow work as an independent contractor. While Justice Graham determined that Mr. Barlow did not have a true ability to profit, he found that Mr. Barlow could increase his effective earnings through up-front investment and efficiencies in a manner similar to that of an independent contractor, and maximized the frequency of his contracts with the Institute. Once he had established himself as an instructor, he was able to develop teaching materials that acted as precedents allowing him to maximize his hourly rate. Justice Graham noted that this is behaviour one would expect of an independent contractor.

Risk of Loss

Mr. Barlow's expenses incurred for his tools were predominantly expenses he would have incurred anyway in his personal life. Again, Justice Graham stated that, applied from a purely objective standpoint, this factor favours an employment relationship. While Justice Graham determined that Mr. Barlow only faced a relatively minor risk of financial loss, this was nonetheless consistent with the parties' intention that he be an independent contractor. Mr. Barlow was not paid for cancelled classes despite the time he spent preparing, and made less money if fewer students enrolled than anticipated. Although Mr. Barlow enjoyed steady work from the Institute, the Institute had no obligation to continue to work with him.

Conclusion

Because Mr. Barlow and the Institute shared a common intention that Mr. Barlow work as an independent contractor, Justice Graham applied the lower standard when considering whether an independent contractor relationship existed between the two parties. Justice Graham concluded that Mr. Barlow was an independent contractor because Mr. Barlow's level of control, ownership of tools, risk of loss, and chance of profit were similar to what one would expect from an independent contractor. Mr. Barlow's affairs were conducted in an entrepreneurial and business-like manner. Accordingly, the Tax Court allowed the Institute's appeal.

While there is no shortage of case law on the employee vs. independent contractor issue, this case is the most recent one in which the Tax Court provided clarity on the proper interpretation and application of the two-step test in *Connor Homes*. From previous case law, it is generally well-accepted that where the payor and worker do not share a common intention as to their relationship, the *Wiebe Door* and *Sagaz* factors are to be used objectively. However, in circumstances where the parties have a common intention as to their relationship, this case provides guidance on the degree to which those factors are relevant and determinative.

— Paige Donnelly and Monika Kolodziej

Penate v. The Queen, 2020 GTC 10 (Tax Court of Canada)

Background

Karla Penate (the "Appellant") was the sole director and shareholder of a roofing company called Delphina Enterprises Ltd. (the "Company"). Upon commencing business activities in 2008, the Appellant promptly hired a general office manager, Ms. Sibrian, who recommended hiring an outside accountant to, among other things, complete annual income tax and GST/HST returns. The Appellant subsequently hired Hernandez Financial for this purpose.

In 2010, the Company began experiencing financial difficulties. After learning from Hernandez Financial in early 2011 that there were GST/HST deficiencies in 2010, the Appellant and Ms. Sibrian hired an experienced full-time bookkeeper to specifically address the issue of GST/HST remittances. While the Company should have been able to meet its annual GST/HST filing obligations, the Appellant experienced ongoing sexual harassment from some of the contractors for whom the Company completed roofing jobs. Even after a roofing job was completed, the sexual harassment made collecting payment from the contractors difficult or impossible, leading to cash-flow problems and unremitted GST/HST from 2010 to 2012. The Appellant enlisted the support of her brother as an estimator to combat the sexual harassment, but he faced racial discrimination from some homeowners, causing the Appellant to hire a male Caucasian estimator in his place.

The Appellant eventually resigned as a director on November 1, 2013 and transferred ownership of the business to her brother. The Appellant's brother invested $40,000 into the business and had secured a large contract in June 2014, but the Canada Revenue Agency (the "CRA") seized the Company's corporate accounts, forcing the Company to cease operations completely.

Pursuant to subsection 323(1) of the *Excise Tax Act* (Canada) (the "ETA"), the directors of a corporation are jointly and severally, or solidarily, liable, together with the corporation, to pay unremitted GST/HST to the CRA. Accordingly, the Minister of National Revenue assessed the Appellant for unremitted net GST/HST of the Company pursuant to subsection 323(1), plus interest and penalties, for the reporting periods from January 1, 2010 to December 31, 2012 (during which time the Appellant was a director of the Company).

Tax Court Decision

The issue contemplated by the Tax Court of Canada (the "Tax Court") was focused solely on whether the Appellant could successfully rely on the due diligence defence under subsection 323(3) of the ETA, which states,

> A director of a corporation is not liable for a failure under subsection (1) where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

The Tax Court looked to *Canada v. Buckingham* for the requirements needed to rely on the defence under subsection 323(3) of the ETA.[1] The standard of care, skill, and diligence required under subsection 323(3) is the objective standard. The Appellant must establish that she turned her attention to the GST/HST remittances and that she exercised her duty of care, diligence, and skill with a view to preventing a failure by the Company to remit these amounts. The Tax Court also emphasized in its decision that "what is required is that the directors establish that they were specifically concerned with tax remittances and that they exercised their duty of care, diligence and skill with a view to preventing a failure by the corporation to remit the concerned amounts."[2] The Tax Court also recognized that there may be certain "exceptional circumstances" where a director may still establish the defence of due diligence where the business is carried on knowing a failure to remit may be likely.[3]

The Tax Court found that there was nothing in the facts to suggest that the Company was not carrying out roofing contracts or that it was operating in an unfavourable economy, and found no evidence that any GST/HST remittances were diverted to assist the Company during its financial difficulties. The Appellant indeed made the issue of remittances her first priority. The problems that the Appellant and the Company faced pertained to sexual harassment and racial discrimination: the Appellant was unable to collect payment on the Company's completed subcontracts unless she acquiesced to sexual harassment, and racial discrimination prevented her brother from fulfilling his duties as estimator.

The Tax Court found that, notwithstanding the sexual harassment and racial discrimination, the Appellant and Ms. Sibrian made several attempts to collect payments and make the required GST/HST remittances. The Appellant and the office manager engaged Hernandez

[1] *Canada v. Buckingham*, 2011 DTC 5078 (FCA) at para 40.

[2] *Ibid,* at para 52.

[3] *Worrell v. The Queen*, 98 DTC 1783.

Financial at the outset to attend to income tax and GST/HST returns and, later on, an experienced bookkeeper to attempt to collect payments. A student from a local university was hired to replace the bookkeeper when she was unsuccessful at collecting payments, and to reduce the Company's costs. A male Caucasian estimator was hired to address both the racial discrimination and sexual harassment issues so that the Appellant could avoid attending remote business locations to meet with contractors. The Appellant even had some of her employees agree to work for free for a period of time to free up cash for GST/HST remittances. Although the Appellant and Ms. Sibrian pursued loans to make the remittances, their applications were refused.

Conclusion

In summary, the Tax Court found that the defence of due diligence pursuant to subsection 323(3) of the ETA was available to the Appellant because of the exceptional facts involving sexual harassment and discrimination, which prevented the Company from collecting on key contracts. The Tax Court allowed the appeal.

In one of the first tax decisions with facts of this nature, the *Penate* decision suggests that directors are not expected to subject themselves to sexual harassment or force themselves into potentially dangerous situations to meet their remittance obligations under the ETA (and similar provisions in the *Income Tax Act* (Canada)). The existence of sexual harassment and racial discrimination may be an example of "exceptional circumstances" where the due diligence defence is still available to a director who continues to carry on business knowing that a future failure to remit is likely. However, directors seeking to rely on the defence in such circumstances should nonetheless be prepared to demonstrate that they were specifically concerned with and otherwise made clear attempts to fulfill their remittance obligations.

— *Paige Donnelly and Monika Kolodziej*

CURRENT ITEMS OF INTEREST

Prescribed Interest Rates for Q4 2020

The CRA published the prescribed annual interest rates that will apply to any amounts owed to the CRA and to any amounts owed by the CRA to individuals and corporations. These rates will be in effect from October 1, 2020, to December 31, 2020. The only change from the previous quarter is the rate applicable to corporate taxpayers' pertinent loans or indebtedness, which is 4.18% in Q4 (down from 4.27% in Q3). All other rates for income tax purposes remain as follows:

- The interest rate charged on overdue taxes, Canada Pension Plan contributions, and employment insurance premiums will be 5%.
- The interest rate to be paid on corporate taxpayer overpayments will be 1%.
- The interest rate to be paid on non-corporate taxpayer overpayments will be 3%.
- The interest rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans will be 1%.

CRA Increases Flat Amount for Meal Claims, and Meal Benefits or Allowances

The CRA has increased the amount that employers can use to determine whether an overtime meal or allowance or the meal portion of a travel allowance is taxable, from $17 to $23. The CRA has also increased the rate at which transport employees and other individuals can claim meal expenses, using the simplified method (a flat rate per person), from $17 to $23 per meal. Thus, this increase also applies to individuals who claim meal expenses using the simplified method for moving expenses, medical expenses, or the northern residents deduction. However, the CRA news release does not state whether the daily maximum for the simplified method will increase from $51 to $69 per person (i.e., up to three $23 meals per day).

These increases are effective immediately and retroactive to January 1, 2020. The $17 limit was last updated in 2009.

RECENT CASES

Minister's GAAR assessment based on alleged breach of loss streaming rule vacated

At no time did MMV Financial have *de jure* voting control of the corporate taxpayer MMV, although it held a general security interest over the assets of MMV as security for its loan to MMV. MMV was not profitable. An interim receiver was appointed, it sold its significant assets to a third party, and ceased carrying on its original business, although it still had accrued non-capital losses from that business. It commenced a new business, and sought to deduct from its income from that new business its accrued non-capital losses from its original business. Relying on the GAAR, the Minister, on reassessment, disallowed the deduction of MMV's accrued non-capital losses from its original business on the ground that the "loss streaming rule" in subsection 111(5) of the *Income Tax Act* had been abused. That rule states, in essence, that where control of a corporation has been acquired by a person or group of persons, no non-capital losses from a taxation year ending before that time are deductible by the corporation for a taxation year ending after that time, with certain exceptions. On the taxpayer's appeal to the Tax Court of Canada, the Minister argued, in essence, that if the taxpayer were permitted the deductions that it was claiming, it would be using business losses from its original business to shelter income from its new business, which was contrary to the object, spirit, and purpose of the subsection 111(5) loss streaming rule.

The taxpayer's appeal was allowed. The existence of a financial covenant given by the taxpayer in favour of MMV Financial did not mean that MMV Financial had *de jure* control of the taxpayer. Nor was there any evidence that MMV Financial ever acquired *de facto* or effective control over the taxpayer. The loss streaming rule was therefore inapplicable in this case, and the Minister was ordered to reassess accordingly.

MMV Capital Partners v. The Queen

2020 DTC 1060

Expenses incurred by taxpayer in winding up his pension plan during course of marital dispute not deductible as business expenses

At all material times, the taxpayer operated a management consulting service as a sole proprietorship. His marital relationship broke down, and he subsequently made an assignment into bankruptcy. This resulted in an order by the Superior Court of Justice Family Branch requiring, among other things, that one half of the amount accrued in his Individual Pension Plan ("IPP") be transferred to his spouse. In order to comply with this order, the taxpayer incurred legal, accounting, and other professional fees in the amount of $33,653, which the Minister disallowed as a business expense deduction subsequently claimed by the taxpayer. The taxpayer appealed to the Tax Court of Canada.

The appeal was dismissed. Fees involved in the winding up of an IPP could not be considered as having been incurred in the normal course of income-earning operations. In this case, the legal, accounting, and other professional fees were incurred by the taxpayer to comply with the terms of a court order to wind up the taxpayer's IPP, and to transfer 50% of its value to the taxpayer's spouse. These fees were not incurred for the purpose of earning income for the taxpayer's IPP, or for the taxpayer himself. Hence they were not deductible as a business expense, and the Minister's assessment was affirmed accordingly.

Burley v. The Queen

2020 DTC 1049

The required high degree of negligence required to impose penalties under s. 163(2) not met

The appellants were former spouses who claimed fictitious business losses and capital losses on their 2010 tax returns prepared and filed by DeMara Consulting Inc. on residential rental properties they owned in Medicine Hat, Alberta. The nature of the losses was similar to those claimed by other clients of DeMara Consulting, which had promoted a program called "The Remedy" to clients in an effort to reduce taxes payable to nil. The appellants were assessed penalties under subsection 163(2) of the *Income Tax Act* for knowingly or in circumstances amounting to gross negligence making or participating in, assenting to, or acquiescing in the making of the false statements in the returns prepared and filed by DeMara.

The appeal was allowed and assessments vacated; costs to the appellants. Neither the knowledge nor gross negligence requirements of subsection 163(2) were satisfied for either appellant. In the case of Mr. Rattai, the judge would have found him to have been wilfully blind and grossly negligent, given he had received an email with the proposed filing position, but took no steps to do anything other than pay. There were multiple warning signs that should have alerted him to make inquiries. However, the first required element for the requirements of the subsection to be met, namely that a false statement had been made, had not been proven by the Crown as the copy of his return filed with the court as evidence was missing key pages. In the case of Mrs. Rattai, her return was not missing pages, but the evidence indicated that she had not received the email with the proposed filing position and the dealings between DeMara Consulting and the Rattais were all via her former husband. She had not seen anything that DeMara prepared and was unaware of what transpired. Accordingly, the required high degree of negligence, tantamount to intentional acting or indifference as to whether the law is complied with or not, had not been met.

Rattai v. The Queen

2020 DTC 1051

Decision of Ontario Energy Board returned to that Board for reconsideration

The appellant, Hydro One Networks Inc. ("HONI"), was an electric utility corporation regulated by the Ontario Energy Board (the "OEB"). Future tax savings of $2.595 billion arose after HONI's ultimate shareholder (the Province of Ontario) made a public offering of its indirect parent company's shares in 2015. In a rehearing decision, the OEB ordered — as it had in its original decision — that 38% of the future tax savings (roughly $900 million) should be used to reduce HONI's revenue requirements with the result that HONI's customers would pay lower rates. HONI had argued at all material times that the total $2.595 billion in future tax savings should have been allocated to its shareholders. HONI appealed to the Ontario Superior Court of Justice Divisional Court.

The appellant's appeal was allowed. The OEB's rehearing panel had been directed to reconsider the OEB's original decision in light of all the evidence and argument the original panel and the reviewing panel had heard. The rehearing panel did not do this. Instead it applied a standard of reasonableness to the original decision. A failure to apply the correct legal test was clearly an error in law. Hence the decision of the rehearing panel was not correct and had to be quashed. However, even if the standard of review had been the more deferential reasonableness standard, the rehearing panel's decision still could not be upheld. The matter was therefore remitted to a new panel of the OEB for reconsideration.

Hydro One v. Ontario Energy Board

2020 DTC 5065

Taxpayer successfully appeals reassessment of business income from restaurant operated by her spouse

Mrs. Tong was a nurse. She had been deducting losses from the operation of a restaurant she owned (but which was operated by her husband, Mr. Tong) every year since 2003. The Minister reassessed Mrs. Tong's 2011 and 2012 taxation years, increasing her income by $58,489 in 2011 and $59,999 in 2012 on the basis she had unreported business income from the restaurant. The reassessments also imposed penalties. At the end of each day, Mr. Tong took the restaurant's cash receipts home to pay his salary (and his children's salaries) and business expenses. Any shortfall of cash to pay expenses (or expenses only payable by cheque or direct withdrawal) was supplemented by funds from a BMO account in Mrs. Tong's name for the restaurant business. The Minister believed that all deposits in the BMO account represented business income. The Tongs stated that some of those deposits included funds transferred from their personal joint accounts and those funds did not represent restaurant revenues. Mrs. Tong objected to the reassessments but the Minister confirmed them. Mrs. Tong appealed.

The appeal was allowed. The premise of the Minister's case was that significant cash sales were not recorded in the restaurant's books and records and the resulting cash was used to pay some of its expenses. However, the evidence established that some expenses the Minister assumed were paid in cash from sales were paid from the BMO account. The evidence also established that significant deposits to the BMO bank account were not from sales, but from the couple's joint bank accounts. The restaurant's original cash register summaries for each day matched the numbers in Mr. Tong's sales journal and the amounts reported by Mrs. Tong as gross revenues from the business. Mr. Tong's evidence was consistent with the documents and he maintained his position under cross-examination. While the evidence regarding cash withdrawals was less convincing, the Minister bore some of the onus of establishing there were unreported sales (the Minister accepted that all expenses were valid). Based on the evidence, the Court was satisfied on a balance of probabilities that Mrs. Tong did not have unrecorded sales or unreported income, and her appeal was allowed. The reassessments were referred back to the Minister for reconsideration and reassessment.

Tong v. The Queen

2020 DTC 1045

Director's resignation invalid pursuant to Ontario Corporation Law

This is a director's liability case. The appellant worked for his father's food truck business in Windsor without any ownership of the corporation. The business fell into receivership and in 2010 the father incorporated another business, Metro 2010, to continue its operation. At the time the new business was incorporated, the father told the appellant to sign papers which made him the sole director of Metro 2010, the corporation involved in this appeal. The father assumed the management of all the operations of Metro 2010. The appellant was assessed in 2014 for unremitted income tax source deductions under section 227.1 of the *Income Tax Act* and for unremitted net GST under section 323 of the *Excise Tax Act*. The appellant argued that the assessment was invalid because it was issued more than two years after his resignation as director in 2010. The respondent argued that the appellant never resigned and that if he did, the provisions of the *Business Corporations Act of Ontario* ("BCAO") prevented the resignation from taking effect with the consequence that he continued to be a director and the assessments are timely.

The appeal was dismissed. The sole issue was whether or not the appellant ceased to be a director in December 2010 after allegedly submitting his resignation. The court's decision was based on its interpretation of the relevant provisions of the BCAO and position of the parties thereon. Subsection 119(2) of the BCAO states: "Until the first meeting of shareholders, the resignation of a director named in the articles shall not be effective unless at the time the resignation is to become effective a successor has been elected or appointed". Since there was never a first meeting of shareholders, the respondent submitted that the appellant's resignation never became effective, validating the assessment. The appellant countered that subsection 115(4) (which states that "where all of the directors have resigned or have been removed by the shareholders without replacement, any person who manages or supervises the management of the business and affairs of the corporation shall be deemed to be a director for the purposes of this Act") resulted in his father being the director and not him. The court disagreed, stating that sequentially, the deeming of a person managing a corporation to be director pursuant to subsection 115(4) only comes into effect if all the directors have resigned or been removed. Since the appellant's resignation could not come into effect by virtue of subsection 119(2), it follows that an essential precondition to the deeming under subsection 115(4) did not exist and the appellant's father could not have become a deemed director pursuant to subsection 115(4). Furthermore, the court considered that "deeming" a director did not mean the director was "appointed" for application purposes of subsection 119(2). Accordingly, the appeal was dismissed.

Soulliere v. The Queen

2020 DTC 1044

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