Tax Notes

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CRA MISSES THE BOAT: *JACKMAN V. THE QUEEN*, 2022 DTC 1057 (TCC)

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Bruce and Nancy Jackman (the "Jackmans") operated a successful marina in Port McNeill on Vancouver Island. They owned the marina through a corporation, C.A.B. Industrial Automotive Supplies Ltd. (the "Corporation"). One of the primary industries in Port McNeill is tourism. Tourists include boaters, whale watchers, fishermen, and kayakers. The marina services many of the needs of the tourists. It also provides services to local businesses.

The Corporation acquired a 36 ft. pleasure craft (the "Pleasure Craft") which was used to market the marina to the owners and operators of smaller marinas in the region and also to their customers. The Jackmans socialized with and entertained clients and potential clients both on and off the Pleasure Craft. They also used the Pleasure Craft to travel to, attend, and entertain in boat shows in British Columbia and Washington.

The Jackmans, with the advice of their accountants, valued their personal use of the Pleasure Craft at $18,000 per year and compensated the Corporation with this amount.

Not surprisingly, the CRA became interested in the use of the corporate-owned Pleasure Craft by the Jackmans. The CRA was not satisfied with the $18,000 annual valuation for the Jackmans' personal use of the Pleasure Craft. The CRA reassessed the Jackmans. The CRA took the position in Tax Court that the Jackmans used their role as shareholders of the Corporation to use its resources to buy the Pleasure Craft so that it would be available to them for their personal use.

The Tax Court Judge Boyle J. concluded that the Jackmans were credible witnesses. The Department of Justice ("DOJ") lawyer agreed that they were credible. The DOJ lawyer did not call any witnesses to contradict the evidence of the Jackmans.

The Tax Court found in favour of the Jackmans. In particular, Boyle J. found, as a matter of fact, that the Jackmans' personal use of the Pleasure Craft was minimal and that the $18,000 per year compensation paid by them to the Corporation was reasonable. In doing so, Boyle J. criticized both the CRA and the DOJ.

Boyle J. reiterated that the CRA is not allowed to second-guess a business' marketing strategy or efforts even if those efforts turn out to be unsuccessful. Boyle J. referred to

paragraphs 49 to 52 of the decision of the former Chief Justice Rip of the Tax Court in *Harris & Son Ltd. v. The Queen*, 2001 UDTC 28. Paragraphs 50 to 52 read as follows:

> [50] The tax authority has no business telling a businessperson how to run that person's business. Advertising expenditures take many forms: radio, television, newspapers (local, provincial, national), sponsorship or ownership of sports teams, tournaments, community events . . . the list is endless. A form of advertising that is beneficial to one business is not necessarily favourable to another business or even a business' competitor. Each business must have the freedom to choose its own form of advertising.
>
> [51] A business may opt to advertise an activity on which its owner (or principal shareholder of the corporation owning the business) has a keen interest or a degree of personal satisfaction. There is no reason why the expense of a particular form of advertising should be disallowed by the fisc solely because of the owner's interest, satisfaction or, as in the appeal at bar, participation in the advertising or remoteness from its business. The fact that an owner of a business (or a director of a corporation) may experience a vicarious satisfaction from the form of advertisement does not necessarily lead to the conclusion that the cost of the advertisement should be disallowed. If the expense of the advertisement, whatever it is, is incurred by the taxpayer for the purpose of gaining or producing income from its business and the expense is reasonable in the circumstances, the expense ought to be deductible in computing income. This is what the Act dictates.
>
> [52] However, when the form of advertising has a significant personal element, the taxpayer has a greater than normal onus to establish that the expense was truly incurred for the purpose of earning income from the business. It is quite possible that an expense may serve the needs of both the business and the shareholder, and, in such a case, one may have to determine the primary purpose of the expense or, perhaps apportion the expense among the business and the shareholder. This was not raised in the pleadings or at trial and I need not consider whether the Act would support such an approach.

At paragraph 18 of the decision, Boyle J. criticized the DOJ as follows:

> [18] While it makes sense that CRA might want to review the use of an expensive pleasure craft by a marina owner operator, it can be noted that in this case the appellants' evidence was very much the same as the detailed answers given in written discovery, and the respondent did not call any witnesses with contrary evidence or bring contradictory evidence with which to challenge the appellants' testimony. Even after the evidence was all before the court, unchallenged even as to credibility, this appeal carried on into its second day for argument. This all appears to have been driven by one or more CRA officials who did not attend for any of the evidence. It is the Department of Justice that represents the respondent Her Majesty the Queen. CRA is not Justice's client in a solicitor-client relationship. That is not changed by any funding agreement between the two departments. The respondent needs to be mindful of that, and perhaps especially so where, as here and is often the case, the "instructing" CRA auditor, litigation agent, or appeals officer does not even attend the evidence portion of the hearing.

From time to time, I have discussed the role of the DOJ in tax disputes with DOJ lawyers. The DOJ is responsible for providing litigation services to the CRA. When a file is assigned to a DOJ lawyer, that lawyer takes instructions from a CRA employee (the "Instructing Employee"). The DOJ "bills" the CRA for its services and the CRA "pays" the DOJ. The DOJ lawyer advises the Instructing Employee on the likely outcome of the tax dispute. However, the Instructing Employee decides whether to settle and whether to proceed to court. The Instructing Employee is able to disregard the advice given by the DOJ lawyer. The Instructing Employee may instruct the DOJ lawyer to take a case to court even if the DOJ lawyer advises the Instructing Employee that the CRA will lose.

The DOJ follows the model followed by the law firms who provide services to private (i.e., not government) clients. However, there is an important difference: the private client pays the law firm's fees. The private client can incur a financial cost if the law firm gives it good advice and the private client does not follow it. The private client has

skin in the game. Sometimes the Instructing Employee does not.

Boyle J. is saying that since the Jackmans were credible and the DOJ lawyer was not able to call witnesses to rebut their evidence, the DOJ and the CRA should not have forced this dispute to go to trial. The DOJ lawyer said that the Instructing Employee made the decision. Boyle J. was not satisfied with this.

Unfortunately, the comments of Boyle J. are not consistent with the manner in which the DOJ sees its role. It is not likely that the DOJ will change its view of its role as a result of this decision. Should changes be made which would deter the Instructing Employee from forcing a file to go to court when the DOJ lawyer warns the Instructing Employee that the CRA will most likely lose in court?

CURRENT ITEMS OF INTEREST

NEW LEGISLATION TO HELP WITH AFFORDABILITY

The Government of Canada introduced two new bills to implement affordability measures that were recently announced (see the headings below).

Bill C-30, *An Act to amend the Income Tax Act (temporary enhancement to the Goods and Services Tax/Harmonized Sales Tax credit*), proposes to temporarily double the GST/HST tax credit (in section 122.5) for six months, which effectively increases the credit by 50% for the benefit year. The increased amounts will be paid as a lump-sum before the end of 2022, pending Parliamentary approval and Royal Assent of the bill.

Bill C-31, *An Act respecting cost of living relief measures related to dental care and rental housing*, proposes to introduce the Canada Dental Benefit for children under the age of 12 and the temporary Rental Housing Benefit. C-31 proposes two consequential amendments to the *Income Tax Act*. The first would ensure that benefits under the *Dental Benefit Act* are not included in income for tax purposes. The second relates to the authorization of information sharing that relates to the administration of the new legislation.

DOUBLING THE GOODS AND SERVICES TAX CREDIT FOR SIX MONTHS

The Government of Canada announced on September 13 that the GST tax credit would be doubled for six months. Currently, for the July 2022 to June 2023 period, eligible individuals can receive up to:

- $467 for singles without children;
- $612 for married or common-law partners;
- $612 for single parents; plus
- $161 for each child under the age of 19.

The proposed extra GST credit amounts would be paid to all current recipients through the existing GST credit system as a one-time, lump-sum payment before the end of the year, pending Parliamentary approval and Royal Assent of the enabling legislation. Recipients would not need to apply for the additional payment, but they must file their 2021 tax return if they have not done so.

CANADA DENTAL BENEFIT

The Government of Canada also announced the new Canada Dental Benefit on September 13. The proposed benefit would provide eligible parents or guardians with direct, upfront tax-free payments to cover dental expenses for their children under 12 years of age.

The target implementation date for the Canada Dental Benefit is December 1, 2022, pending Parliamentary approval and Royal Assent of the enabling legislation, and the program would cover expenses retroactive to October 1, 2022.

The Canada Dental Benefit would provide payments of up to $650 per child per year for families with adjusted net income under $90,000 per year and without dental coverage.

- $650 would be provided for each eligible child if the family's adjusted net income is under $70,000;
- $390 would be provided for each eligible child if the family's adjusted net income is between $70,000 and $79,999; and
- $260 would be provided for each eligible child if the family's adjusted net income is between $80,000 and $89,999.

To access the benefit, parents or guardians of eligible children would need to apply through the CRA. In addition, they would need to attest that:

- Their child does not have access to private dental care coverage;
- They will have out-of-pocket dental care expenses for which they will use the benefit; and
- They understand they will need to provide documentation to verify that out-of-pocket expenses occurred (e.g., show receipts), if required.

Health Canada and the CRA are collaborating closely on an application platform that would deliver payments in a timely fashion. Further details on how and when to apply for the benefit will be communicated in due course.

The Canada Dental Benefit would not reduce other federal income-tested benefits such as the Canada Workers Benefit, the Canada Child Benefit, and the Goods and Services Tax Credit.

TAX RELIEF FOR PRAIRIE LIVESTOCK PRODUCERS

The Livestock Tax Deferral provision allows livestock producers who are forced to sell a significant amount of their breeding herd due to drought or flooding to defer a portion of their income from sales until the following tax year. The income may be at least partially offset by the cost of reacquiring breeding animals, thereby reducing the potential tax burden associated with the original sale.

An initial list of designated regions in Alberta, Saskatchewan, and Manitoba has been authorized for 2022 due to extreme weather conditions. Generally, a final list of designated regions for a particular year is provided later. For further information, see agriculture.canada.ca/en/agriculture-and-environment/drought-watch-and-agroclimate/livestock-tax-deferral-provision.

INTEREST RATES FOR FOURTH CALENDAR QUARTER

The CRA announced the various prescribed interest rates for the fourth calendar quarter — October 1, 2022 to December 31, 2022. These rates apply to amounts owed to the CRA and to any amounts owed by the CRA to individuals and corporations. The rates have increased again for the second time in 2022. The rates for income tax purposes are as follows:

- The interest rate charged on overdue taxes, Canada Pension Plan contributions, and employment insurance premiums will be 7% (up from 6% in the third quarter);
- The interest rate to be paid on corporate taxpayer overpayments will be 3% (up from 2% in the third quarter);
- The interest rate to be paid on non-corporate taxpayer overpayments will be 5% (up from 4% in the third quarter);
- The interest rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans will be 3% (up from 2% in the third quarter); and
- The interest rate for corporate taxpayers' pertinent loans or indebtedness will be 6.45% (up from 5.20% in the third quarter).

FOCUS ON CURRENT CASES

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

4432002 CANADA INC. V. THE QUEEN, 2022 DTC 1071 (TAX COURT OF CANADA) — PARAGRAPH 14(1)(*B*) OF ITA DID NOT PRECLUDE PARAGRAPH 12(1)(*G*) FROM APPLYING TO EARNOUT PAYMENTS MADE UNDER SALES AGREEMENT

Background

4432002 Canada Inc. (the "Appellant") was incorporated on September 5, 2007. Mr. Huet and his common law partner, Ms. Coulombe, owned 51% and 49% of the Appellant's shares, respectively. The Appellant was incorporated for the purpose of holding Mr. Huet's rights in GreenHopper, a project management software he developed in collaboration with his former employer, Pyxis Technologies Inc. ("Pyxis"). In May 2009, the Appellant and Pyxis assigned their rights in GreenHopper to MITT Australia Pty Ltd. ("MITT") via a deed of assignment (the "DOA").

The DOA provided for consideration in the form of lump sum payments and sales-based payments. Additionally, Mr. Huet was required to join MITT as an employee for a minimum of three years. Failure to comply with the employment term would result in reduced payments.

The relevant DOA clauses in the appeal were as follows:

- Clause 7.1 provided for five lump sum payments over three years (the "Lump Sum Payments").
- Clauses 7.3(a), (b), and (c) provided for payments based on 35%, 25%, and 17.5% of software sales, respectively (the "Sales-Based Payments").
- Clause 7.8 provided that the aggregate of the Lump Sum Payments and the Sales-Based Payments could not exceed C$8 million.

The following payments were received by the Appellant under the DOA:

- In August 2009, the Appellant received C$890,400 pursuant to clause 7.1 of the DOA.
- In November 2009, the Appellant received C$269,466 pursuant to clause 7.3(a) of the DOA.
- On May 25, 2010, the Appellant received C$878,823 pursuant to clause 7.3(a) of the DOA.

Mr. Huet terminated his employment with MITT before the end of the three-year period. To avoid the penalty clause, MITT and Mr. Huet executed a deed of amendment ("ADOA") on September 14, 2010.

The relevant ADOA clauses in the appeal were as follows:

- Clause 3.1(c) provided that the Appellant would waive the Lump Sum Payments provided for in clause 7.1 of the DOA.
- Clauses 3.2(a) and (b) provided that the Appellant would receive C$1,615,409 as a prepayment of amounts due under clause 7.3 of the DOA.
- Clause 3.2(d) provided that payments would be made to the Appellant under clauses 7.3(b) and (c) of the DOA subject to reductions for breach of the employment clause.
- Clause 3.2(d)(iii) increased the maximum amount of payments that could be received by the Appellant from C$8 million to US$7.6 million.

On June 28, 2016, the Minister of National Revenue (the "Minister") reassessed the Appellant's 2010 and 2012 taxation years on the basis that the following three payments must be included in the Appellant's income under paragraph 12(1)(*g*) of the *Income Tax Act* (Canada) (the "ITA") (as opposed to paragraph 14(1)(*b*)):

(1) C$878,823 received on May 25, 2010, pursuant to clause 7.3(a) of the DOA.

(2) C$1,615,409 received on December 29, 2010, pursuant to clauses 3.2(a) and (b) of the ADOA.

(3) C$345,145 received on May 27, 2012, pursuant to clause 3.2(d) of the ADOA.

The Minister also reassessed the Appellant's 2012, 2013, and 2014 taxation years to reduce the Appellant's capital dividend account ("CDA") balance.

Issues and Decision

The main issue before the Tax Court of Canada (the "Tax Court") was whether the three payments should be included in the Appellant's income for the 2010 and 2012 taxation years as business income pursuant to paragraph 12(1)(*g*) or paragraph 14(1)(*b*) (as it read before it was repealed as of 2017) of the ITA. Because paragraph 89(1)(*c*.2) of the ITA authorizes the addition of amounts included in income under paragraph 14(1)(*b*) to a taxpayer's CDA, this issue was determinative of whether capital dividends paid by the Appellant during its 2012, 2013, and 2014 taxation years exceeded the balance of its CDA, subjecting the Appellant to Part III tax under subsection 184(2) of the ITA.

Parties' Positions

The Appellant's position was that by disposing of its rights in GreenHopper, it disposed of eligible capital property, a transaction to which paragraph 14(1)(*b*) applies. The Appellant argued that paragraph 14(1)(*b*) takes precedence over paragraph 12(1)(*g*), and accordingly, the additional payments received in 2010 and 2012 must be included in its income under paragraph 14(1)(*b*) and not paragraph 12(1)(*g*). The Appellant further argued that the clauses were "reverse earnouts" to which paragraph 12(1)(*g*)does not apply.

The Respondent's position was that the payments must be entirely included in the Appellant's income under paragraph 12(1)(*g*) of the ITA. Paragraph 12(1)(*g*) provides that sums received by a taxpayer during a taxation year from the use of property or the production resulting therefrom shall be included in computing the taxpayer's income from a business in the year. In the Respondent's view, the payments at issue were based on the production or use of the GreenHopper software.

Analysis

First, the Tax Court considered whether the payments were made under reverse earnout clauses. The Tax Court described reverse earnouts as arrangements where a maximum acquisition price is determined at the closing of a transaction which can be subsequently reduced if certain circumstances do not materialize.

The Tax Court determined that, in this case, neither the DOA nor the ADOA contained any reverse earnout clauses. The Lump Sum Payments and the Sales-Based Payments were made pursuant to normal earnout clauses, whereby the purchase price can be increased if certain financial goals are achieved. There was no situation in which MITT would pay a maximum amount which could then be reduced if certain financial targets were not met.

The Tax Court went on to consider whether the application of paragraph 14(1)(*b*) prohibited the application of paragraph 12(1)(*g*). The Tax Court cited Justice Favreau in *Smith v. R* (2011 DTC 1332) for the proposition that nothing in the wording of paragraphs 12(1)(*g*) or 14(1)(*b*) precluded the application of paragraph 12(1)(*g*) nor suggested that paragraph 14(1)(*b*) should take precedence. The Tax Court held that the fact that the treatment of the cost of an eligible capital asset is subject to paragraph 14(1)(*b*) is irrelevant to the question of whether the income from its production should be subject to paragraph 12(1)(*g*).

The Tax Court concluded that all three payments at issue were clearly received "in relation to the use of a property or the production therefrom" and therefore were to be included in the Appellant's income pursuant to paragraph 12(1)(g). This is because all three payments were effectively made under clause 7.3 of the DOA which provided for payment amounts based on a percentage of software sales (and was not a reverse earnout clause).

The Tax Court distinguished this case from *Brosseau c. R* (86 DTC 1412), cited by the Appellant, wherein the taxpayer had sold his client list for $125,072. Pursuant to the contract, the taxpayer received payments based on professional income produced by his former clientele, but it specified that he would receive a minimum payment of $100,000. In that case, the Tax Court concluded that the $100,000 was not subject to paragraph 12(1)(*g*). Here, the Tax Court determined that the $100,000 payment in *Brosseau* was akin to the Lump Sum Payments received by the Appellant in 2009 (which were not subject to paragraph 12(1)(*g*)), not the three payments at issue.

Conclusion

Having determined that the payments in dispute must be included in the Appellant's income under paragraph 12(1)(*g*) of the ITA, the Tax Court held that the Minister was justified in reducing the Appellant's CDA balance. However, because the Appellant had previously made elections pursuant to subsection 184(3) of the ITA and requested that the elections be held in abeyance pending the outcome of its appeal, the Part III tax did not apply to the Appellant.

— *Caroline Harrell*

BURNETT V. THE QUEEN, 2022 DTC 1069 (TAX COURT OF CANADA) — TAX COURT AFFIRMS THAT DIRECTOR DUE DILIGENCE UNDER ITA INVOLVES DIRECT CONCERN WITH TAX REMITTANCE AND THAT OUTSIDE DIRECTORS MUST STILL EXERCISE OBJECTIVE DEGREE OF CARE, DILIGENCE, AND SKILL

Introduction

On January 19, 2017, the Minister issued two liability assessments pursuant to section 227.1 of the *Income Tax Act* (Canada) (the "ITA") against George Clifford Burnett (the "Appellant") in his capacity as a director of Canadian Noble Cut Diamonds Ltd. ("CNCD"), a corporation incorporated under the laws of British Columbia. Subsection 227.1(1) of the ITA provides that the directors of a corporation can be liable to pay unremitted payroll source deductions and any interest or penalties relating to them, where the corporation has failed to pay such amounts. The assessments were for $36,028.49 and $42,092.80, respectively, of unremitted payroll source deductions by CNCD (with associated penalties and interest) between January 2011 and April 2012.

The Appellant appealed the assessments on the basis that he was not liable for the unremitted payroll source deductions under subsection 227.1(3) of the ITA. Subsection 227.1(3) grants a director protection from liability for a corporation's failure to remit payroll source deductions under subsection 227.1(1) where the director has "exercised the degree of care, diligence, and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances."

Issue

The issue before the Tax Court was whether or not the Appellant could rely on the due diligence defence set out in subsection 227.1(3) of the ITA such that he was not liable for the unremitted payroll source deductions under subsection 227.1(1).

Facts and Background

CNCD's board of directors consisted of three members that met "informally" and around once a month. The Appellant joined the board in August 2010. The other members were Mr. S. Ben-Oliel and Mr. R. Fraser. Mr. Ben-Oliel was president of CNCD, and he managed CNCD's day-to-day diamond cutting business. Mr. Fraser was the Appellant's business associate. The Appellant had been CNCD's Treasurer and Secretary since August 2010, though he did not carry out particular functions for these roles.

Upon joining the CNCD board, the Appellant focused on getting CNCD's accounting and financial records organized and audited, with a view to making CNCD a publicly listed corporation. In 2010 and 2011, CNCD hired first an accounting firm, and then a former Canada Revenue Agency ("CRA") accountant, to try and render audited financial statements, books, and records for the company. Neither the accounting firm nor the former CRA accountant succeeded in putting together such records. The second accountant hired by CNCD, Mr. Grossholz, claimed that he had identified unpaid payroll remittances of approximately $30,000 and had informed "management" — identified by him as Mr. Fraser and Mr. Ben-Oliel — of this liability. The Appellant stated that Mr. Grossholz reported directly to Mr. Fraser.

The Appellant testified that he viewed himself as an "outside" or "independent" director with no alleged involvement in the running of CNCD's business operations. At board meetings, the Appellant would perform — in his words — "check the box" inquiries as to the currency of CNCD's payroll remittances, which Mr. Ben-Oliel would allegedly confirm. Board minutes were not kept, and no meeting notes were submitted as evidence in the Appellant's appeal. The Appellant testified that it was "fundamentally correct" that he had requested Mr. Ben-Oliel to produce accounting and financial records "including records regarding the status of the payroll and GST accounts and proof of payment…".

There was no evidence that the Appellant took further steps upon Mr. Ben-Oliel's repeated failure to produce such records.

Lacking reliable audited financial records, the Appellant and Mr. Fraser caused CNCD's business to cease in April 2012, and Mr. Ben-Oliel was made to resign as CNCD president and director in July 2012. CNCD retained a third accountant to try and recover corporate assets for repayment of CNCD investors. In October 2012, the Appellant received a letter from the CRA regarding CNCD's failure to remit payroll source deductions and the Appellant's liability as director for the outstanding sum. The Appellant claimed that the CRA letter was his "first indication" of problems with CNCD's payroll remittance. The Appellant's efforts to seize corporate assets to pay off liabilities continued then with the CRA in mind, and the Appellant and investors launched a lawsuit against Mr. Ben-Oliel and CNCD. The lawsuit ceased after the plaintiffs were ordered to pay $50,000 into court for costs. The Appellant did not succeed in recovering corporate assets, and in November 2012 and September 2016, the Appellant offered to the CRA the same list of assets that the Appellant had failed to recover. The CRA also failed to locate the assets.

The Appellant repeatedly pointed out the "small" or "tiny" size of the remittances at stake, compared to the large sums with which the business otherwise dealt, as justification for why the remittances never got on his radar as a "material offside liability". The Appellant believed there were more "important things" to focus on in the director meetings than payroll source deductions.

Arguments

The Appellant argued that he had satisfied the due diligence defence by asking about whether the tax remittances were up to date at the board of directors' meetings. The Appellant emphasized that this was sufficient given his role as an "outside director with no involvement in CNCD's business operations". The Appellant submitted that efforts to cure failures to remit were relevant to satisfy the due diligence defence.

The Minister argued that the Appellant had not satisfied the due diligence defence, maintaining that the Appellant's "check the box" questioning at directors' meetings was insufficient to meet the defence standard. The Minister emphasized how the Appellant lacked much, if any, interest as CNCD director in ensuring that remittances were being made.

Law and Decision

The Tax Court relied on a summary of the subsection 227.1(3) due diligence defence set out in *R v. Buckingham*, 2011 DTC 5078. The objective standard of care, skill, and diligence required by the due diligence defence is an objective standard, and the common law notion that a director's management of a corporation should be judged based on their personal skills, knowledge, abilities, and capacities no longer applies. A person who is appointed director is expected to "carry out the duties of that function on an active basis and will not be allowed to defend a claim for malfeasance in the discharge of his or her duties by relying on his or her own inaction." Particular circumstances must be considered against a "reasonably prudent person" standard. Furthermore, the "focus of inquiry" for director due diligence under tax legislation is different than under corporate legislation. Under the ITA and *Excise Tax Act*, a director is not liable for a failure to remit where the director exercised the degree of care, diligence, and skill to prevent such failure that a reasonably prudent person would have exercised in comparable circumstances.

The Tax Court in *Burnett* found that the Appellant had failed to exercise essentially any degree of care, diligence, and skill to prevent CNCD's tax remittance failure that a reasonably prudent person would have exercised in comparable circumstances. The Appellant did not demonstrate any significant concern for proper payroll tax remittances as director. The Appellant's "check the box" exercise at board meetings was not sufficient to demonstrate efforts to prevent timely remittance failure. Although the Appellant claimed that he made monthly requests for financial records, including proof of payroll account payments, he did not once contact, nor is there evidence he asked anyone else to contact, the CRA to confirm the currency of payroll remittances when his requests went unanswered.

The Tax Court found that the Appellant's focus on "materiality" and the "tiny" size of the remittance sums contradicted the due diligence defence, which is based on exercising care, diligence, and skill to prevent remittance failures. Despite awareness of, and concern for, the financial issues with CNCD since the time of his appointment, the Appellant did not demonstrate significant concern for the payroll remittances which were a component of such financial recordkeeping.

The Tax Court emphasized that the objective due diligence defence applies to directors generally. The fact that the Appellant viewed himself as an "outside" director who was not responsible for the management of CNCD or communicating with outside sources was no excuse. The Tax Court was also dubious of the apparent "uninvolved" nature of the Appellant's director role. The Tax Court noted that the Appellant did appear to be involved in the operations of CNCD in a number of ways, citing the size of the corporation, the Appellant's roles as treasurer and secretary, his "internally oriented corporate focus" on the lack of suitable financial records, his involvement in engaging and paying accountants to prepare CNCD's books and records, as well as his signing documents on behalf of CNCD.

The Tax Court distinguished three cases raised by the Appellant to support his position. First, the Appellant relied on *Balthazard*, 2012 DTC 1027, to argue that efforts to *cure* remittance failures go to satisfying the statutory due diligence defence. The Tax Court stated that in that case, amounts had been belatedly remitted by the corporation following demonstrated, constant efforts by the subject director. However, due diligence remains primarily concerned with efforts to prevent remittance failure, not just to cure failure that has already occurred.

Second, the Tax Court distinguished the case *Qian v. R*, 2014 DTC 1024, as "compellingly different" from the Appellant's circumstances. The director in that case was a junior employee acting as director in fear of dismissal from employment, and the director had advised management of the obligation to make the remittances. When the director's advice went unheeded, the director quit her employment. Accordingly, the director successfully appealed her liability assessment. Unlike *Qian*, the Appellant was not 'junior', willingly participated as director, and admitted to clear disinterest in CNCD's payroll tax remittances.

Finally, the Tax Court distinguished *Roitelman v. R*, 2014 DTC 1129, noting that the director in that case demonstrated commitment to ensuring remittance of payroll taxes by training a subordinate to perform the work while the director was away. The subordinate failed to ensure remittances, but they represented to the director that they had been made. That director was found to be as proactive as a reasonably prudent person in comparable circumstances. Unlike *Roitelman*, the Appellant's conduct focused on CNCD's investments and plans to go public, with the Appellant never surpassing "check the box" inquiries about payroll tax.

Conclusion

The Tax Court concluded that the Appellant did not exercise the degree of care, diligence, and skill to prevent CNCD's remittance failures as a reasonably prudent person would in comparable circumstances. Finding that the Appellant did not meet the requirements of the subsection 227.1(3) defence of due diligence, the appeal was dismissed. *Burnett* demonstrates that there is no such thing as an "outside" director's due diligence standard. While the circumstances of a case may impact an objective analysis, it does so on the basis of what a reasonably prudent director, generally, would do in such circumstances. Independent directors should not expect to satisfy tax statute due diligence defences by merely asking and relying on the representations of other directors.

— *Hannah Bourgeois*

TRISKELION PROJECTS INTERNATIONAL INC. V. THE QUEEN, 2022 TCC 63 (TAX COURT OF CANADA) — TAXPAYER ARGUES MINISTER CANNOT DOUBLE COUNT DAYS ACROSS TAXATION YEARS FOR THE 183-DAY RULE TEST WHEN DETERMINING A DEEMED-SERVICES PERMANENT ESTABLISHMENT UNDER CANADA–US TAX TREATY, BUT TAX COURT UNABLE TO ANALYZE ON THE FACTS

Background

Triskelion Projects International Inc. (the "Appellant") is a corporation resident in the United States with a business providing project management services in the construction industry. The Appellant's taxation year was the calendar year. Between March 19, 2015, and March 18, 2016, the Appellant provided its services for a project of a client in Canada (the "Consulting Services"). The Appellant spent 198 days of 2015 and 54 days of 2016 in Canada providing the Consulting Services, earning $621,481 and $181,740 from its services in Canada for the respective periods. The Minister assessed the Appellant for $27,261 of tax under Part I of the *Income Tax Act* (Canada) (the "ITA") and $7,530 of tax under Part XIV in respect of the Consulting Services income earned in Canada in the 2016 tax year.

Under the *Convention Between Canada and The United States of America with Respect to Taxes on Income and on Capital* (the "Canada–US Tax Treaty"), the Contracting State in which a taxpayer is resident is entitled to tax that taxpayer's income. At the same time, where a taxpayer earns income from carrying on business in another Contracting State (the "Source State") through a "permanent establishment" ("PE"), the Canada–US Tax Treaty provides that the Source State is entitled to tax such income of the taxpayer as is attributable to that PE.

Among the ways that a business or enterprise's operations may qualify as a PE under the Canada–US Tax Treaty is the "deemed services PE" rule under subparagraph V(9)(b) of Article V. The "deemed services PE" rule says that an enterprise is deemed to provide services through a PE in a Source State for a particular taxation year where it provides services for an aggregate of 183 days or more in "any twelve-month period" with respect to the same or connected project for customers who are resident of the Source State.

Issue and Decision

The central issue at the Tax Court was whether or not the Appellant had a "deemed services PE" pursuant to Article V of the Canada–US Tax Treaty in Canada in the 2016 tax year. The Appellant would have had a "deemed services PE" for the 2016 tax year if it had performed its services in Canada for "183 days or more in any twelve-month period".

The Minister argued that, pursuant to the Canada–US Tax Treaty, the Minister was allowed to use "any twelve-month period" to determine whether a resident of the US was carrying on business in Canada. In the present case, this meant the Minister could use the 12-month period beginning in March 2015 and ending in March 2016. The Minister maintained that it was an "uncontroverted fact" that the Appellant provided the Consulting Services for over 183 days in Canada during this period, a fact which the Appellant conceded at the appeal hearing.

The Appellant argued that, in determining a "deemed services PE" for the purpose of assessing tax for the 2016 taxation year, the Minister should not be allowed to count "days that have previously been counted toward the 183 [day] calculation" for a "deemed services PE". The Appellant claimed the Minister had already counted certain days when assessing tax for the 2015 taxation year.

The Appellant maintained that the Minister could only count 15 days from 2015 to determine whether the appellant had a "deemed services PE" in Canada for the 2016 tax year. There is a 15-day difference between the appellant's total days spent providing the Consulting Services in Canada in 2015 (i.e., 198 days) and the 183 days that go toward satisfying a "deemed services PE" for the 2015 taxation year. The Appellant claimed that the Minister already counted 183 of the 198 days that the Appellant provided services in Canada in assessing tax for 2015. Accordingly, the Minister

could only attribute an aggregate of 69 days total to the 2016 tax year, which is insufficient for a “deemed services PE” under the Canada-–US Tax Treaty’s Article V subparagraph 9(b) requirement.

The Tax Court declined to address the Appellant’s argument, noting the Appellant “lacked any factual foundation for the argument on which it rested its case”. The pleadings did not allege that the Minister made any assessment of tax for the Appellant’s 2015 tax year, nor that the Appellant was appealing a 2015 assessment. The Tax Court had given the Appellant opportunity at the beginning of the hearing to present additional evidence, but it did not do so.

As a result, the Tax Court had to infer that the Minister did not assess the Appellant for tax in 2015. Since there was no evidence that the Minister actually double-counted days from a 2015 tax year assessment for the purpose of the 2016 tax year assessment, the Tax Court could not comment on the substance of the Appellant’s double-counting argument. In declining to address the argument, the Tax Court cited *AB LLC and another v. Commissioner of the South African Revenue Services*, (2015) 17 International Tax Law Reports 911 at 949-951, a case from the Tax Court of Johannesburg, South Africa, as a contrasting example where a similar argument to the Appellant’s was presented, and addressed by that court, on a fuller evidentiary record.

Conclusion

The Appellant had conceded that it provided consulting services in Canada aggregating 183 days or more between March 19, 2015, and March 18, 2016. Finding the Canada–US Tax Treaty requirements for a “deemed services PE” satisfied, the Tax Court dismissed the appeal.

Although it is not clear whether Justice Spiro would have allowed the appeal if the Appellant had presented proper evidence of a 2015 tax assessment, it is likely that the double-counting of days is necessary when determining a “deemed services PE” in certain situations, such as where a twelve-month period spans two fiscal years, in order to adequately prevent tax avoidance.

— *Hannah Bourgeois*

RECENT CASES

TAX COURT HOLDS PAYMENTS UNDER SASKATCHEWAN POTASH MINING REGULATIONS NOT DEDUCTIBLE FROM CORPORATION’S FEDERAL INCOME TAX

The Appellant conducted potash mining operations in Saskatchewan. These involved mining, transporting, storing, and processing potash for sale. Saskatchewan imposes a base payment (the “Base Payment”) on potash operations under its Potash Production Tax Schedule and a profit tax under its *Potash Production Tax Regulations*. The Appellant sought to deduct its Base Payments in computing its income tax due, and the CRA disallowed this deduction for the 1999 to 2002 taxation years. In Tax Court, the Appellant argued that the Base Payment was deductible under subsection 9(1) of the *Income Tax Act* (the “ITA”) because it was an incident of the Appellant’s income-earning activities and was not excluded under paragraph 18(1)(*a*) because it was made or incurred to gain or produce income. The Respondent argued the Base Payment is only payable after the income-producing process is complete, and that considerable case law establishes that a deduction for income taxes is prohibited by paragraph 18(1)(*a*).

The Tax Court dismissed the appeals. It framed the key question posed by paragraph 18(1)(*a*) as “whether the [Base Payment] was made or incurred for the purpose of gaining or producing income from a business or property”. Interpreting the *Mineral Taxation Act, 1983* and the *Potash Production Tax Regulations*, the Court held that liability for the Base Payment arises only after the income-producing activity to which it applies has been concluded; it requires a realization event. Thus, “the base payment is not incurred by the Appellant for the purpose of gaining or producing

income from its potash mining business; rather, it is a tax that is applied only after the conclusion of the process of earning income from that business" and is not deductible. The Appellant also argued that former ITA paragraph 18(1)(*m*) did not apply to prohibit the deduction. The Court rejected this argument but since its paragraph 18(1)(*a*) holding disposed of the matter, its discussion was *obiter*.

Potash Corporation of Saskatchewan Inc. v. The Queen

2022 DTC 1064

SON WAS NOMINEE FOR HIS FATHER FOR FOREIGN BANK ACCOUNT AND NOT LIABLE FOR REASSESSMENTS

The Appellant appealed reassessments of his 2013, 2014, and 2015 taxation years that imposed penalties for failure to file a Foreign Income Verification Statement (form T1135), and for failing to do so knowingly or with gross negligence. The Appellant argued he was not the beneficial owner of the Bank of China account in question; his father funded and controlled the account, but he could not have it in his own name due to conditions set by the Bank of China. The Appellant never carried out any transactions on the account except under his father's direction. His father kept the bank card and PIN. The Respondent argued that the Appellant had not presented sufficient evidence to prove that his father owned the account.

The Tax Court allowed the appeals. The Court held that the Appellant did not hold beneficial title to the account during the years in question even though it was in his name. The father had clearly stated in 2017 that he was the beneficial owner of the funds in the account. The father was the only one who used the account; the Appellant merely assisted him because the father was not "tech-savvy". The father had also stated in 2017 that he intended the account to pass to the Appellant upon his death. He was the beneficial owner, and the Appellant was his nominee. The Court noted in the alternative that the Appellant had reasonable cause to believe that his father was the beneficial owner.

Chan v. The Queen

2022 DTC 1065

INCORPORATING DIRECTOR'S RESIGNATION INEFFECTIVE BEFORE FIRST SHAREHOLDERS' MEETING

The Appellant was reassessed for unremitted income source deductions and unremitted GST/HST as a corporate director. The Appellant was the sole incorporating director. No other directors were ever elected or appointed and there was never a first meeting of shareholders. Some weeks later, the Appellant submitted a letter of resignation. The Tax Court held that the resignation was not effective: under subsection 115(4) of Ontario's *Business Corporations Act* (the "OBCA"), as a manager of the business he was deemed a director, and under subsection 119(2), a director cannot resign before the first shareholders' meeting unless a successor has been designated. On this appeal, the Appellant argued that a deemed director could be said to be "appointed" for purposes of subsection 119(2).

The Federal Court of Appeal dismissed the appeal. With no binding precedent, the Court conducted a textual, contextual, and purposive analysis. Textually, by the statutes' plain meaning and by the principle of consistent expression (noting many other places in the OBCA where directorship results from a deliberate act), the Appellant's interpretation of "appointment" was not supported. Contextually, the OBCA requires directors to manage the affairs of the corporation and to hold a directors' meeting, among other things — duties a person deemed director under subsection 115(4) might not even be aware of. Finally, the purpose of these OBCA provisions, as stated when

introduced in Parliament, was investor protection; under the Appellant's interpretation, investors could not be assured of continuity of corporate management.

Soulliere v. The Queen

2022 DTC 5084

ATTEMPT TO CLAIM EXPIRED NON-CAPITAL LOSSES AS TERMINAL LOSSES DENIED

The Appellant held a leasehold interest in a school and adjacent grounds (a Class 13 property). It claimed capital cost allowance ("CCA") in its returns for taxation years 1997–2003, resulting in non-capital losses for those years. It tried to claim further such losses in its 2014–2016 taxation years, but the time to carry those losses forward had expired. In 2017, it realized a terminal loss (having sold its interest for $1). After reassessment, it claimed it wanted to carry back the 2017 terminal loss to change the amount of CCA for 1997–2003, as is permitted by paragraph 111(1)(*a*) of the *Income Tax Act* (the "Act"). The issue then became the amount of the capital loss: according to the Appellant, it should be calculated on the basis of its undepreciated capital costs ("UCC"), which it estimated at some $3.5 million; according to the CRA, its UCC was $679,000. The CRA's theory was that the CCA the Appellant claimed for 1997–2003 reduced the UCC of the property, while the Appellant now wants to reduce the CCA. The Tax Court dismissed the Appellant's appeal, stating that "[w]hat the taxpayer proposes appears to me to be unilateral retroactive tax planning."

The Federal Court of Appeal dismissed the Appellant's appeal. It framed the issue as the correct amount of UCC for determining the amount of the terminal loss: that resulting from what the Appellant claimed in 1997–2003, as the CRA urged, or that resulting from the Appellant's proposed change. The crux was the amount of the quantity E, the total depreciation allowed to the taxpayer for property of the class before the time of valuation. The Court engaged in textual, contextual, and purposive analysis of the statute. Textually, E at a time is clearly defined as depreciation claimed before that time, excluding the carryback the Appellant proposed. Contextually and purposively, there was no other provision in the Act that supported the idea that a taxpayer could unilaterally amend a return after filing. The *Clibetre* case, in which the court allowed a carryback, differs in that the expenses sought to be carried back were misclassified.

St. Benedict Catholic Secondary School Trust v. The Queen

2022 DTC 5083

TAX NOTES

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