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# CAN AN ESTATE CLAIM A CAPITAL LOSS FROM SELLING A PERSONAL RESIDENCE?

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Suppose that a person who owns a principal residence passes away. For the purpose of illustration, let's simplify our example and assume that the property is not jointly owned. Subsection 70(5) of the *Income Tax Act* deems the person to have disposed of their principal residence for proceeds equal to its fair market value ("FMV") at that time of, let's say, $1,000,000. Any resulting capital gain will be sheltered by the principal residence exemption. Let's also assume that it takes a while for the estate to sell the home and it remains vacant until it is sold. Inevitably, as a part of the selling process, the estate incurs selling costs of $60,000. If the home sells for $1,000,000, and the property's deemed cost to the estate is $1,000,000, the estate would realize a $60,000 capital loss because of the selling costs. Obviously, the capital loss would be greater if the value of the home declines after the date of death.

But can the estate actually claim that capital loss? Generally, a person cannot claim a capital loss from the disposition of their principal residence. This is because subparagraph 40(2)(*g*)(iii) deems a loss to be nil if it is from a disposition of personal-use property. Under section 54, the wide-reaching definition of personal-use property includes property owned by the taxpayer that is used primarily for the personal use or enjoyment of the taxpayer or for the personal use or enjoyment of one or more individuals each of whom is the taxpayer, a person related to the taxpayer, or, where the taxpayer is a trust, a beneficiary under the trust or any person related to the beneficiary. It seems widely accepted that living in a home constitutes using that property primarily for personal use and enjoyment. Therefore, normally, a person cannot benefit from a loss from a disposition of a personal residence (regardless of whether it is designated as a principal residence) because the property is considered personal-use property.

That said, the concept of use and enjoyment is open to interpretation. In the right circumstances, it may be possible to claim a capital loss from the disposition of a personal residence by an estate. Since the outcome depends on an assessment of personal use and enjoyment, this article reviews key sources related to this concept and some CRA interpretations that directly comment on the example described above.

## "What's the Use?"

In a technical interpretation, the CRA commented on whether a taxpayer could claim a capital loss from selling a personal residence after immigrating to Canada.[1] A Canadian resident who recently immigrated disposed of their home in their prior country. The foreign home remained vacant following their immigration. The CRA declared that the use of the home did not make it inventory or change its use from personal-use property

[1] CRA Document No. 2012-0455621E5.

to property acquired as an adventure in the nature of trade. Regardless of the home remaining vacant until its disposition, the CRA concluded that the home was still personal-use property. Thus, the post-immigration loss from the disposition of the home would be deemed to be nil per subparagraph 40(2)(*g*)(iii). The CRA cited *Solomons v. The Queen*[2] to justify its position.

In *Solomons*, the taxpayer was a realtor who purchased a house with the intention of living in it. After residing in the home while renovations were made, the taxpayer sold the home after renting it for less than one year. The taxpayer attempted to deduct an inventory write-down for the property, but this was rejected on the grounds that the property was personal-use property until it was first rented out:

> The Appellant seems to have assumed that because he wanted to sell the house from the time he closed the purchase in 1989 until he was able to sell it in 1993, it must be considered inventory in his hands during that period. However, he was in exactly the same position as anyone else who, having bought a house for personal use, decided that he could not afford it — he was selling a personal use property. He was never engaged in the business of buying and selling houses, nor was his purchase of this house an adventure in the nature of trade. This is not altered by the fact that he was a realtor.

In *Klotz v. The Queen*, it was found that the definition of personal-use property is not exhaustive (implied by the word "including" in the definition), so the term would exclude any property used to earn income and include everything else.[3] However, in *Plamondon v. The Queen*,[4] the Court disagreed with the broad interpretation from *Klotz*. Rather, the court held that to be considered personal-use property, the property in question must unequivocally be for the use and enjoyment of the taxpayer. There must be a primary use for a specific purpose, and that use must be real and dominant. Commenting on these two cases in a technical interpretation, the CRA stated that it has always considered that to qualify as personal-use property under paragraph (*a*) of that definition under section 54, the property must be owned and actually used primarily for the personal use or enjoyment of the taxpayer or a related person.[5]

Though these sources do not directly address the example of a home sold by an estate, they provide a general framework for ascertaining whether property is used primarily for personal use or enjoyment.

## Favourable Interpretation for Estates

At the 2011 STEP Conference Roundtable,[6] the CRA answered a question pertaining to another common scenario:

> For example, suppose that an individual dies holding a cottage property. The property becomes property of the individual's estate and is not used by any of the beneficiaries. The property is held on the basis that it is to be disposed of when certain matters concerning the estate are resolved (the obtaining of probate, the settlement of possible legal issues, etc.). In the intervening period, the property declines in values. Does any resulting loss now become a capital loss from the disposition of a capital asset rather than personal-use property such that the capital loss is not denied and can be utilized by the estate?

The CRA's response was brief but encouraging. Since a deceased person and their estate are separate persons, the classification of a property to the estate is made on its merits and facts. Where the taxpayer is a trust, which estates are, "personal-use property" is property that is used primarily for the personal use or enjoyment of one or more individuals each of whom is a beneficiary or a person related to a beneficiary. Thus, it must be ascertained whether the property was used primarily for the personal use or enjoyment of the heirs of the deceased or persons related to them during the period following the death and before the sale.

The CRA asserted that the real property in the example was non-depreciable capital property to the estate, assuming that it was not rented or used to earn income. If the cottage held by the estate was not used by any of the beneficiaries or anyone related to them, the CRA deduced that the cottage would not be personal-use property to the estate. Any capital loss realized from the disposition of the cottage would therefore not be deemed to be nil by

[2] 2003 DTC 505 (TCC).

[3] 2004 DTC 2236 (TCC), see para. 62 and 63, affirmed by 2005 DTC 5279 (FCA).

[4] 2011 DTC 1137 (TCC).

[5] CRA Document No. 2013-0513361E5.

[6] Question 10, 2011-0401871C6.

subparagraph 40(2)(*g*)(iii) and accordingly would be available to offset capital gains of the estate. The CRA has also supported this position in at least two other technical interpretations.[7]

Thus, it appears that if a personal residence is not used for any purpose after the person dies (i.e., to earn income or by the beneficiaries for personal use or enjoyment), the estate can claim the capital loss. If this disposition occurs within the estate's first taxation year, and the total of all capital losses exceeds the total of all capital gains, the legal representative could elect under subsection 164(6) to carry the excess capital loss back to the deceased's final year — perhaps to offset a gain from the deemed disposition of the property. Assuming that the gain from the deemed disposition on death is sheltered by the principal residence exemption, taxpayers in effect can enjoy a tax-free capital gain and potentially a tax-deductible capital loss as well — having their cake and eating it too!

# COVID-19 UPDATE

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

## Federal

### Changes to COVID-19 Support Measures (October 21, 2021)

On October 21, 2021, Deputy Prime Minister and Minister of Finance Chrystia Freeland announced the following major changes to the pandemic subsidies that are delivered via the income tax system.

#### Extending the CRHP

First, the government plans to introduce legislation that would extend the Canada Recovery Hiring Program ("CRHP") to May 7, 2022, with the authority to further extend the program via regulations to July 2, 2022. The subsidy rate will also increase to 50%. The government will exercise its existing authority to increase the subsidy rate to 50% for the period from October 24 to November 20, 2021, and contingent on the proposed legislation, the rate will be 50% for subsequent periods. The existing baseline period of March 14 to April 10, 2021, would continue to be used to calculate incremental remuneration. The existing eligibility rules would also continue to apply, including the required revenue decline of more than 10%.

#### Extending the CEWS and CERS

Second, the Canada Emergency Wage Subsidy ("CEWS") and Canada Emergency Rent Subsidy ("CERS") were scheduled to expire on October 23, 2021, but the government can extend these programs to November 20, 2021. The government now plans to extend them to November 20, but they can only be accessed by qualifying under one of the following two new streams:

(a) The Tourism and Hospitality Recovery Program; or

(b) The Hardest-Hit Business Recovery Program.

The government also intends to introduce legislation to extend these programs to May 7, 2022, with the authority for further amendments through regulations to July 2, 2022.

#### Tourism and Hospitality Recovery Program

Though further information on qualifying businesses is forthcoming, eligible organizations in the tourism and hospitality business would generally include hotels, restaurants, bars, festivals, travel agencies, tour operators, convention centres, and convention and trade show organizers.

Eligible organizations must meet both of the following conditions to qualify for this program:

- An average monthly revenue reduction of at least 40% over the first 13 qualifying periods for the Canada Emergency Wage Subsidy (12-month revenue decline); and
- A current-month revenue loss of at least 40%.

[7] CRA Document Nos. 2002-0148955 and 2008-0280751E5.

The 12-month revenue decline would be calculated as the average of all revenue decline percentages for eligible organizations from March 2020 to February 2021 (claim periods 1–13, excluding claim period 10 or 11).

For both the wage and rent subsidies, the maximum subsidy rate will be 75% from October 24, 2021, to March 12, 2022. The wage and rent subsidy rates would continue to be calculated based on current-month revenue losses compared to those of a prior reference period, as under existing rules. The subsidy rates would start at 40% for eligible organizations with a 40% current-month revenue decline, increasing thereafter in proportion to current-month revenue loss up to a maximum rate of 75% for those with a current-month revenue decline of 75% or higher. Both subsidy rates would be reduced by half from March 13 to May 7, 2022.

### Hardest-Hit Business Recovery Program

Certain organizations that do not qualify for the Tourism and Hospitality Recovery Program can potentially qualify for the wage and rent subsidies via the Hardest-Hit Business Recovery Program. To qualify, they must have experienced:

- an average monthly revenue reduction of at least 50% over the first 13 qualifying periods for the CEWS ("the 12-month revenue decline"); and
- a current-month revenue loss of at least 50%.

The 12-month revenue decline is calculated the same as described above for the Tourism and Hospitality Recovery Program. The existing rules will continue to apply for calculating the current-month revenue decline.

The maximum subsidy rate for the wage and rent subsidies would be 50% from October 24, 2021, to March 12, 2022. Both subsidy rates would continue to be calculated based on current-month revenue losses compared to those of a prior reference period. The subsidy rates would start at 10% for eligible organizations with a 50% current-month revenue decline, increasing thereafter on a straight-line basis to a maximum rate of 50% for those with a current-month revenue decline of 75% or higher. Both subsidy rates would be reduced by half from March 13 to May 7, 2022.

Lockdown Support would continue to be available at the current fixed rate of 25% and pro-rated based on the number of days a particular location was affected by a lockdown.

### Public Health Restrictions

In recognition that public health measures could arise and have adverse effects, organizations subject to a public health restriction would be eligible for the wage and rent subsidies as calculated under the Tourism and Hospitality Recovery Program, regardless of sector. More specifically, they qualify if they have one or more locations subject to a public health restriction (lasting for at least seven days in the current claim period) that requires them to cease activities that accounted for at least approximately 25% of total revenues of the employer during the prior reference period. However, in these circumstances, applicants would not need to demonstrate the 12-month revenue decline, only a current-month decline.

### Increasing the Cap for the Rent Subsidy

Currently, monthly expenses that can be claimed under the CERS are subject to a cap of $75,000 per business location and $300,000 in total for all locations. The government proposes to increase the aggregate monthly cap from $300,000 to $1 million, beginning October 24, 2021.

## New Canada Worker Lockdown Benefit

Also, on October 21, 2021, the government announced that it proposes to establish the Canada Worker Lockdown Benefit. It would provide $300 per week in income support to eligible workers who are unable to work due to a local lockdown between October 24, 2021, and May 7, 2022. The new benefit would be:

- $300 per week;
- strictly available to workers whose work interruption is a direct result of a government-imposed public health lockdown;

- available until May 7, 2022, with retroactive application to October 24, 2021, should the situation warrant it;
- accessible for the entire duration of a government-imposed public health lockdown (up until May 7, 2022); and
- available to workers who are ineligible for EI and those who are eligible for EI if they are not paid benefits through EI for the same period.

Individuals whose loss of income or employment is due to their refusal to adhere to a vaccine mandate cannot access the benefit.

The government will provide further details on the benefit in the coming weeks.

### Extending the Sickness and Caregiving Benefits

Also, on October 21, 2021, the government announced that it proposes to extend the Canada Recovery Sickness Benefit ("CRSB") and Canada Recovery Caregiving Benefit ("CRCB") to May 7, 2022, and increase the maximum duration of the benefit by two weeks. This would extend the CRSB from four to six weeks and the CRCB from 42 to 44 weeks.

## Provincial

### Alberta

#### Restrictions Exemption Program (October 7, 2021)

In response to the latest public health actions, the government is providing funding to help offset costs of implementing the Restrictions Exemption Program ("REP") and support training for workers.

Alberta's government proposes to offer a one-time payment of $2,000 to Alberta small and medium-sized businesses that are eligible for and choose to implement the REP, requiring proof of vaccination, a negative test result, or medical exemption. Alberta businesses eligible for the REP Implementation Grant can use the funding as they see fit. The program was announced October 7, 2021, and it is anticipated that application intake for the payment will be open in the next few weeks. More details on the program, including full eligibility criteria and information on where and how to apply, will be shared once finalized.

An additional $1 million will also be available for training to support the safety of workers when implementing the REP. Eligible industry associations across Alberta can use the REP Training Grant to develop or procure training to help workers assess and manage challenging situations that may arise during their daily work. Workers and employers will be able to access this training through select industry associations.

### British Columbia

#### Seasonal Domestic Farm Worker COVID-19 Safety Program (October 5, 2021)

Farms that employed seasonal workers from other parts of Canada are eligible to receive support for some of the costs they incurred to keep their workers safe and ensure British Columbians could enjoy local fruits and vegetables this summer and fall. The B.C. Seasonal Domestic Farm Worker COVID-19 Safety Program offers farmers up to 70% (to a maximum of $2,000) reimbursement for on-farm expenses that helped farms comply with COVID-19 health and safety measures between April 1 and October 31, 2021.

The program compensates expenses for sanitation priorities, such as the purchase, rental, or scheduled cleaning and disinfecting of handwashing stations, bathing and laundry facilities, and bathrooms, portable, or compost toilets, as well as cleaning, disinfecting, and sanitization products used to mitigate the spread of COVID-19. It also offers reimbursed costs for infrastructure expenses that helped workers stay on-farm during their employment period, such as cooking facilities, shelters for shade and rain, and added Wi-Fi access to worker areas.

For the purposes of this program, a seasonal domestic farm worker is defined as a worker who is a citizen or permanent resident of Canada, who is not a permanent employee of the applicant, and does not permanently reside on the applicant's farm. Eligible on-farm improvements must support the employer and the workers to comply with their obligations under the Industrial Camp Order and/or the employer's Infection Prevention and Control Plan or Communicable Disease Prevention Plan. Applications must be received by the Ministry of Agriculture, Food and Fisheries no later than October 31, 2021, and claim forms no later than November 30, 2021. If the maximum program budget of $50,000 is allocated before October 31, 2021, the application intake will close.

More information and application packages for the B.C. Seasonal Domestic Farm Worker COVID-19 Safety Program are available online: www2.gov.bc.ca/gov/content/industry/agriculture-seafood/programs/bc-seasonal-domestic-farm-worker-covid-19-safety-program.

### PST Rebate on Select Machinery and Equipment Extended (September 29, 2021)

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. On September 29, 2021, the government announced businesses will have until March 31, 2022 — an additional six months — to purchase qualifying items like tools, furniture, computers, software, and zero-emission vehicles and charging equipment.

## Manitoba

### Healthy Hire Manitoba Program Extended (October 6, 2021)

The province announced that it is extending the Healthy Hire Manitoba Program to November 15, 2021, and the application deadline to October 30, 2021. Under the Healthy Hire Manitoba Program, local employers can apply for up to $50,000 in provincial support to help cover the wages of new employees who can attest they have been vaccinated or will be vaccinated. Eligible employers will receive a grant equivalent to 50% of wages for a maximum of 10 employees, with a maximum of $5,000 per employee.

### Remote Witnessing and Commissioning (September 29, 2021)

New regulations that establish processes for remote witnessing and commissioning are now in effect. Until spring 2020, most legal documents could only be executed in the physical presence of another person who was authorized to act as a witness. The COVID-19 pandemic created challenges in safely witnessing and commissioning legal documents in person. Temporary orders under the *Emergency Measures Act* addressed these challenges in the short term, but over time it became clear that more permanent remote or virtual witnessing and commissioning options were needed.

Bill 42, the *Remote Witnessing and Commissioning Act*, which became law in December 2020, amended the six statutes included in the temporary order and enabled alternatives to physical attendance on a permanent rather than temporary basis. The new regulations establish processes for the use of videoconferencing as an alternative to in-person attendance when witnessing and commissioning certain legal documents. They include:

- Remote Commissioning Regulation under the *Manitoba Evidence Act*,
- Remote Witnessing Regulation under the *Powers of Attorney Act*,
- Remote Witnessing Regulation under the *Wills Act*,
- Remote Witnessing Regulation under the *Homesteads Act*,
- Remote Witnessing Regulation under the *Real Property Act*, and
- Remote Witnessing Regulation under the *Health Care Directives Act*.

The new regulations will contribute to justice system modernization initiatives and enhance access to justice for people who might otherwise face barriers, such as the requirement to travel to another community when making oaths, affirmations, or statutory declarations, executing a will or a land titles instrument, signing a power of attorney, or acknowledging a signature on a health-care directive.

## Ontario

### WSIB Premiums for 2022 (October 1, 2021)

The Workplace Safety and Insurance Board ("WSIB") is cutting premium rates in 2022 by $168 million. In addition, the government intends to introduce legislation that, if passed, would allow for a significant portion of the WSIB's current reserve, currently valued at $6.1 billion, to be distributed to safe employers. The Ontario government is also proposing to enable the WSIB to work with the Canada Revenue Agency to streamline remittances for businesses. This would reduce administrative costs and burdens by giving businesses an efficient one-stop-shop for submitting payroll deductions. Lastly, closures in low-wage sectors due to the pandemic have resulted in a spike in Ontario's Average Industrial Wage. As a result, the ceiling for worker benefits will be increasing by 9.45%. To prevent some businesses from having to pay thousands of dollars a year in additional premiums, Ontario is capping the growth of premiums to an increase of 3.2% (close to the normal range) through a regulation under the *Workplace Safety and Amendment Act*.

### Details of New Tourism Program (September 27, 2021)

The Ontario Tourism Recovery Program will support tourism businesses that have experienced a loss of at least 50% of eligible revenue in 2020–2021 compared to 2019. Program funding will help successful applicants prepare to reopen safely, develop innovative tourism products, retain and create tourism jobs, and support tourism recovery in their region and throughout Ontario. Successful recipients will have the flexibility to apply funds to any eligible expenses and do what makes the most sense for their businesses. Expenses could include reopening and operating costs such as staff salaries and maintenance, health and safety measures for visitors and workers, tourism product and experience development, or marketing. Applications for this program opened on October 13, 2021. For further details see www.mtc.gov.on.ca/en/awards_funding/OTRP.shtml.

# 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.

## *Paletta International Corporation v. Her Majesty The Queen* and *Angelo Paletta v. Her Majesty The Queen*, 2021 DTC 5109 (Federal Court of Appeal)

### Overview

The Federal Court of Appeal heard a joint appeal by two appellants to set aside two judgments and request that a new trial be ordered on the basis that the hearing before the Tax Court of Canada[1] ("TCC") was undermined by lack of procedural fairness.

For the appellants, the purported transgression in procedural fairness precluded them from adequately responding to a particular issue disclosed by the Minister of National Revenue (the "Minister") since it was not raised by the parties until the end of the trial.

### Background and Facts

The Minister reassessed the appellants' 2007 and 2008 taxation years and disallowed losses and expenses derived from a venture in film distribution. The Minister also disallowed the carryover of those losses to other taxation years.

The tax issues to be decided by the TCC were twofold. First, the Court had to determine if film distribution expenses could be deductible in the circumstances; second, if gains realized on the sale of land were on account of income or capital.

Through a complex series of transactions, Paletta International Corporation ("PIC"), as the sole limited partner of Six Iron Partnership ("Six Iron"), claimed the share of its interest in the losses for its 2007–2008 taxation years. In total, PIC reported a non-capital loss of $96,109,415. The second appellant, Angelo Paletta ("AP"), as a limited partner of Swilcan Bridge Productions Limited Partnership ("Swilcan"), also reported a substantial loss. PIC had invested $8,013,895

[1] *Paletta v. The Queen*, 2019 DTC 1143 (TCC).

in Six Iron as part of a financing structure to acquire a film produced by the Twentieth Century Fox Film Corporation ("Fox") called Night at the Museum. As part of the transactions, Fox and Six Iron entered into a distribution agreement whereby Six Iron would bear the cost of print and advertising expenses ("P&A expenses"). As for AP, the investment structure was essentially identical to the one of PIC. AP invested in Swilcan, which in turn acquired a second motion picture from Fox entitled "The Day the Earth Stood Still". In both sets of facts, and in view of Fox's options, both partnerships relinquished their rights in both motion pictures prior to their commercial releases which resulted in significant losses derived from the P&A expenses.

The TCC concluded that the investments of both PIC and AP (the "appellants") in the Six Iron and Swilcan partnerships were orchestrated and motivated by a tax savings scheme and, as such, were not incurred for the purpose of earning income. More precisely, the TCC found that the losses generated by the P&A expenses borne by Six Iron and Swilcan did not meet the legal threshold to be considered as non-capital losses on the basis that the P&A expenses were not incurred for the purpose of incurring business income and were not allowed as per paragraph 18(1)(*a*) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "ITA").

The TCC determined that the essence of the appellants' participation in both partnerships together with Fox's option agreements to reacquire the motion pictures were a sham. The TCC substantially upheld the reassessments of the appellants.

## The Issue

The Federal Court of Appeal ("FCA") had to determine if the hearing before the TCC was tainted by breaches of procedural fairness which would justify an order for a new trial. For the appellants, this was essential to permit them the opportunity to challenge the Minister's reassessments.

## Decision

The FCA concluded that no reviewable errors had been made by the TCC that would warrant a new trial and the appeals were dismissed.

The appellants argued that the basis for the reassessment, in relation to the disallowed expenses for the film distribution, was not raised by either party and as such, was a contributing factor that led to a breach of procedural fairness during the trial. For the appellants, the TCC's findings of a sham was a new theory and shouldn't have been considered on grounds of procedural fairness. According to the appellants, this new theory was unpled, and raised too late at trial for the appellant to fairly present evidence to counter it. Moreover, ultimately, the lack of procedural fairness for the issue relating to the expenses also contributed to unjustly influence the TCC's findings on the sale of land.

It must be noted that the TCC did raise a concern that the sham theory could open a doorway to a breach of procedural fairness for the appellants, but after having expanded at length on the matter, concluded that there were no such indications.

The FCA did not agree with the appellants' submissions. The FCA concluded that the appellants had ample and adequate opportunity to rebut the Minister's assumptions. These assumptions provided enough detail for the appellants to formulate an adequate response to rebut the Crown's case which relied greatly on the presence of the sham label, in that:

(1) The Minister's assumptions found in the replies left no doubt that Six Iron was to own, control, and exploit the Picture;

(2) It was known to the appellants that Fox would exercise its option to reacquire the Picture (preordained);

(3) Any income derived from the Picture would never be realized while Six Iron had an interest in the Picture. A permanent loss would materialize in favour of the appellants.

The FCA added that clearly, the conduct of the appellants at trial left no doubt that these assumptions were known by them given their efforts to demolish the assumptions of the Crown even in the absence of the term "sham" in the replies. The element of deception in the circumstances, akin to a sham, was more than adequately provided in the replies.

The FCA concluded that no breach of procedural fairness had occurred during the trial and that the application of paragraph 18(1)(*a*) was fully disclosed and part of the proceedings. As to the issue of a breach of procedural fairness in regard to the land issue, the FCA came to the same determination concluding that there was no breach.

The appeals were dismissed with costs.

— *Marc-André Bélanger*

## *Her Majesty The Queen v. Pomeroy Acquireco Ltd.*, 2021 DTC 5110 (Federal Court of Appeal) — Amendment to reply to be allowed if it clarifies the questions in controversy and serves the interest of justice. Refusing Amendment to reply trial judge failed to observe principals of natural justice including right to be heard.

*Pomeroy Acquireco Ltd. v. The Queen* is an appeal by Her Majesty The Queen (the "Crown") of a decision of the Tax Court of Canada ("TCC") (2020 DTC 1087, per Sommerfeldt J.) dismissing a motion seeking leave to file an amended reply pursuant to section 54 of the *Tax Court of Canada Rules (General Procedure)*, S.O.R./90-688a.

### Background

The Minister of National Revenue ("MNR") assessed Pomeroy Acquireco Ltd. (the "Respondent") in regards to various transactions relating to the sale of hotels. The Crown brought an application to amend its reply with proposed amendments on the basis that: i) the transaction was a sham; and ii) the value of the shares of the capital of acquired companies was to be determined by taking into account their latent tax liability, which the Respondent opposed (the "Amendment"). The trial judge disallowed the Amendment and the Crown filed an appeal with the FCA.

### Decision of the FCA

The FCA ruled that the decision to allow an Amendment to a pleading is discretionary and will not be reviewed on appeal unless there is an error of law or a palpable error on a question of mixed fact and law. The FCA ruled that the trial judge made three errors of law in disallowing the Amendment by deciding or stating that:

(i) The Amendment must be vital to the case in order to be allowed;

(ii) He was satisfied that the facts in the existing reply were sufficient to support a sham argument (but nevertheless refused the Amendment); and

(iii) Allowing the Amendment would result in prejudice to the Respondent, not compensable in costs.

The FCA allowed the Crown's appeal permitting the Amendment based on the following:

(i) An amendment to a reply should be allowed if it assists in the determination of the real questions in controversy and serves the interest of justice;

(ii) The trial judge erred in law by deciding that the existing reply was sufficient to support the sham argument, which induced the Crown to concede to the Amendment, but later refusing the Amendment; the trial judge failed to observe the principals of natural justice, which include the right to be heard (and a reasonable opportunity to be heard); and

(iii) The trial judge erred in law by deciding at the same time that the Amendment would be prejudicial to the Respondent and that the existing reply was sufficient to plead the sham argument, these conclusions being irreconcilable.

— *Pierre Saint-Aubin*

## *Yves Mayrand v. Minister of National Revenue*, 2021 DTC 5108 (Federal Court) — Application for judicial review by CRA employee rejected; CRA acted reasonably in refusing to disclose documents protected by the *Access to Information Act*

In *Yves Mayrand v. Minister of National Revenue*, 2021 DTC 5108, Justice St-Louis of the Federal Court considered an application for review under section 41 of the *Access to Information Act*, R.S.C. 1985, c. A-1 (the "Act"), relating to the refusal of the Canada Revenue Agency (the "CRA") to disclose certain records to Mr. Yves Mayrand, (the "Applicant").

The Applicant sought, by his application, to obtain redacted information in the documents sent to him in response to an access to information request concerning his work as an auditor for the CRA. The Minister of National Revenue (the "Minister") invoked subsection 19(1) and paragraph 21(1)(*b*) of the Act to justify the CRA's non-disclosure of information to the applicant. The Court reviewed the redacted information as required by the Act and concluded that the CRA properly applied the exemptions provided for in the Act and reasonably exercised its discretion not to disclose the information.

### Background

In July 2014, the Applicant filed the first of a series of access to information requests for copies of any documents relating to four grievances concerning his work as an auditor for the CRA.

In January 2015, the CRA disclosed the documents to the Applicant, some of which were either partly or entirely redacted. The CRA relied on paragraphs 16(1)(*c*) and 21(1)(*a*) and (*b*) of the Act and subsections 19(1) and 24(1) thereof to justify the redactions. Following delivery, the Applicant submitted follow-up requests and filed a complaint with the Information Commissioner of Canada in order to obtain the requested information, which initiated an investigation.

Subsequent to this investigation, in June 2019, the CRA sent the Applicant the same documents in which additional information was disclosed, removing the redactions made under paragraphs 16(1)(*c*) and 21(1)(*a*) of the Act, reducing those under paragraph 21(1)(*b*) of the Act, and maintaining those under subsections 19(1) and 24(1) of the Act. It is this communication, the fourth between the Applicant and the CRA, that was under review in this case. Included in this communication were 3449 pages, 1563 pages of which were either partly or fully redacted.

### Issues

The issues considered by the Federal Court were:

> (1) the correct standard of review for assessing whether the CRA erred in applying exemptions in the Act to the Applicant's request for information; and
>
> (2) whether the CRA erred in exercising its discretion in relation to the above exemptions.

### Minister's Arguments

The Minister's main argument concerned the standard of review. Essentially, the Minister argued that the applicability of the statutory exemptions is reviewed on a standard of correctness, whereas the exercise of discretion in relation to those exemptions is reviewed on a standard of reasonableness.

The Minister first argued that the Applicant referred to exemptions in the Act no longer in play, and that all current exemptions applied by the CRA were applied correctly.

The Minister thereafter argued that the CRA exercised its discretion reasonably where the Act confers such discretion.

## Applicant's Arguments

Regarding the standard of review, the Applicant submitted that the standard of correctness to be used in analyzing the exemptions to the Act relied upon and that the standard of review to be applied in assessing the exercise of discretion is that set out in *Maple Lodge Farms LTD v. Government of Canada*, [1982] 2 SCR 2 at pages 7 and 8.

He thereafter argued that the CRA was not justified in invoking the application of subsections 16(1), 19(1), and 24(1) on the information requested and in using paragraphs 21(1)(*a*) and (*b*) of the Act to exempt a certain portion of the information requested.

## Decision Rendered by the Federal Court

### A. Standard of Review

The Federal Court agreed with the parties in finding that, in the context of an application for review of a refusal to disclose documents or information, the question of whether an exemption claimed to justify the refusal applies is reviewed on a standard of correctness. Moreover, finding in favour of the Minister, the Court determined that discretionary decisions made by government institutions are reviewed on a standard of reasonableness, based on *Husky Oil Operations Limited v. Canada-Newfoundland and Labrador Offshore Petroleum Board*, 2018 FCA 10. Section 44.1 of the Act further confirms this approach, providing that "[f]or greater certainty, an application under section 41 or 44 is to be heard and determined as a new proceeding" under the subtitle "De novo review".

The Court, in finding that the CRA did not err on a standard of correctness, decided it did not have the remedial power to substitute the CRA's decision and order the disclosure of the redacted passages.

### B. Information Redacted Under Subsection 24(1) of the Act

Regarding the information redacted under subsection 24(1) of the Act, which provides for exemptions based on other statutes, the Court agreed that certain disclosures are prohibited under section 295 of the *Excise Tax Act* and section 241 of the *Income Tax Act*.

Specifically, section 295 prohibits the provision of confidential information, which is defined as "information of any kind and in any form that relates to one or more persons and that is (*a*) obtained by or on behalf of the Minister for the purposes of this [Part IX of the *Excise Tax Act*], or (*b*) prepared from information referred to in paragraph (*a*)". Section 241(1) of the *Income Tax Act* contains an almost identical prohibition.

The information redacted under subsection 24(1) of the Act included documents submitted to the CRA by taxpayers, correspondence between the CRA and said persons, and documents relating to the CRA's audit thereof, all of which the Court determined fell under the above-mentioned prohibitions. Thus, after reviewing the information redacted under this exemption, the Court was satisfied, as submitted by the Minister, that such information fell within the scope of that provision. Accordingly, the Court found no error in the CRA's handling of the information under subsection 24(1) of the Act.

### C. Information Redacted Under Subsection 19(1) of the Act and the Discretionary Power of Subsection 19(2)

Subsection 19(1) of the Act provides that, subject to the three exceptions enumerated in subsection 19(2) and provided hereunder, the head of a government institution shall refuse to disclose any record that contains personal information:

> Where disclosure authorized
>
> (2) The head of a government institution may disclose any record requested under this Part that contains personal information if
>
> (*a*) the individual to whom it relates consents to the disclosure;
>
> (*b*) the information is publicly available; or
>
> (*c*) the disclosure is in accordance with section 8 of the *Privacy Act*.

The Court then relied on the definition of personal information provided for in section 3 of the *Privacy Act* (R.S.C. 1985, c. P21) to find that subsection 19(1) of the Act was properly applied to the information redacted thereunder.

Moreover, the Court found that the CRA acted reasonably in not exercising its discretion under subsection 19(2) of the Act, as none of the situations enumerated in this subsection applied in this case.

### D. Information Redacted Under Paragraph 21(1)(*b*) of the Act

Paragraphs 21(1)(*a*) and (*b*) of the Act provide, *inter alia*, that the head of a government institution may refuse to disclose any records requested under the Act that contain records of advice, recommendations, consultations, or deliberations involving employees of a government institution.

Assessing the principles that emerge from case law, and in particular *Canadian Council of Christian Charities v. Canada (Minister of Finance)*, 99 DTC 5337 (FC) ("*Charities*"), the Court determined that most internal documents that analyze a problem and offer solutions are likely to fall within the scope of paragraphs 21(1)(*a*) or (*b*). Given that the redacted documents were less than twenty years old at the time of the access request, a government institution was involved, and the redacted pages contained accounts of consultations or deliberations, the information was found to be properly redacted such that the CRA properly applied the exemption. The Court also acknowledged, citing the *Charities* case, that its role in reviewing the exercise of discretion is limited.

Accordingly, the Court dismissed the application, denied the Applicant access to the exempted information, and awarded costs in favour of the Minister.

— *Sabrina Kholam*

## *Odette (Estate) v. The Queen*, 2021 DTC 1052 (Tax Court of Canada) — The cash payments made in subsequent repayment of a promissory note did not form part of the consideration for the purposes of paragraph 118.1(13)(*c*) of the ITA

In *Odette (Estate) v. The Queen*, the Tax Court of Canada (the "TCC") held that only the promissory note issued by a private corporation in exchange for shares of its capital that were donated to a private foundation constituted the consideration for the purposes of paragraph 118.1(13)(*c*) of the *Income Tax Act* (the "ITA") and not the cash payments made in subsequent repayment of such promissory note.

### Background

The estate of the late Edmond G. Odette (the "Estate") donated shares of Edmette Holdings Ltd. ("Edmette") to a non-arm's length private foundation. The donated shares were non-qualifying securities as defined by subsection 118.1(18) of the ITA.

A few days later, the shares were purchased for cancellation and the payment of the shares was satisfied by the delivery of a non-interest-bearing demand promissory note issued by Edmette to the private foundation for $17,710,000 (the "Promissory Note"). The Promissory Note was also a non-qualifying security.

Within four to eight months following the donation of the shares, Edmette made cash payments in satisfaction of the Promissory Note to the private foundation.

In the terminal return of the late Mr. Odette, the Estate declared total charitable donations of $17,213,104 in respect of the shares transferred to the private foundation. The Minister of National Revenue reassessed the Estate, disallowing the tax credits claimed in respect of the transfer of the shares to the private foundation.

### Issue

The issue before the TCC was the interpretation of the phrase "any consideration" in paragraph 118.1(13)(*c*) of the ITA and whether it is broad enough to include both the promissory note issued at the time of the purchase for cancellation of the shares as well as the cash payments made thereunder so that the Estate was entitled to the charitable donation tax credit claimed in respect of the gift.

## Decision

The TCC conducted a textual, contextual, and purposive analysis of paragraph 118.1(13)(*c*) of the ITA. In doing so, the TCC noted the importance of reading the provision with regard to the immediate context in which it is found; therefore, it analysed "any consideration" by also looking at "received", "at the time of disposition", and the parenthetical exclusion "(other than a non-qualifying security of any person)".

The TCC found that the terms "received" and "at the time of disposition" in relation to the consideration imposed a timing limitation and that the consideration must be received at the time of the disposition. In the case at bar, the private foundation only received the Promissory Note in return from Edmette on the day of the disposition of the shares and received the corresponding cash payments within four to eight months after the disposition.

The TCC found no support for the Estate's assertion that the cash payments received after the disposition are included in the consideration Parliament was targeting in paragraph 118.1(13)(*c*) of the ITA. The TCC held that if Parliament intended to include consideration received beyond the timeframe of the deemed gift, it would have used clear language to express this intent, such as "received or receivable", used multiple times in the ITA.

The TCC stated that the consideration could not be both the Promissory Note and the corresponding cash payments and that they represent the same value. A promissory note is the promise to pay and the subsequent cash payments satisfy that obligation to pay. In this case, the consideration at the time of the transfer of the shares was only the Promissory Note, not the Promissory Note plus the cash payments.

The TCC noted that the parenthetical exclusion further limits the scope of consideration that Parliament was targeting in paragraph 118.1(13)(*c*) of the ITA in providing that the consideration cannot be a non-qualifying security. In this case, since the Promissory Note is between non-arm's length parties, it is a non-qualifying security and, as a result, the deemed value of the shares under paragraph 118.1(13)(*c*) of the ITA is nil.

The TCC noted that the restriction on non-arm's length transactions under subsection 118.1(13) of the ITA is consistent with Parliament's approach to non-arm's length transactions throughout the ITA. The TCC stated that the restrictions exist because of the difficulty in assessing the value of the donated security and, as such, allowing a donation tax credit where a non-qualifying security (in this case, the shares) is disposed of for another non-qualifying security (in this case, the Promissory Note) would be contrary to Parliament's intent.

In connection with the timing of the disposition contemplated by paragraph 118.1(13)(*c*) of the ITA, the TCC found that the context and purpose of the paragraph supports the interpretation that the consideration must be received when the disposition is made.

First, the TCC noted that under the *Income Tax Regulations* the donation tax receipt must include the amount that is the fair market value of the property at the time the gift was made and that, consequently, this amount had to be determined and given on the day of disposition.

Second, the TCC noted the general intent of Parliament reflected in the Technical Notes to the 2011 amendments to paragraph 118.1(13)(*c*) of the ITA to restrict the credit where the donor is not yet impoverished and the charity is not yet enriched. The TCC held that a non-arm's length promissory note creates no real obligation to pay, stating that non-arm's length parties could artificially enter into similar transactions, claim a donation tax credit, and never make any actual payments. Considering the foregoing, the TCC held that it must be demonstrated that the charity is actually enriched and the donor is actually impoverished. The issuance of the Promissory Note was not convincing for the TCC.

The broad, inclusive interpretation of the words "any consideration" suggested by the Estate, without considering the immediate co-text of paragraph 118.1(13)(*c*) of the ITA, was not accepted by the TCC, as it would defeat or undermine the legislative purpose of the provision. The TCC stated that paragraph 118.1(13)(*c*) of the ITA is intended to be a redemptive provision for taxpayers who meet a strict set of conditions and is not meant to encompass any disposition made at any time.

Finally, the TCC stated that the parties intended to undertake the transactions that transpired; they only had unintended tax consequences. In such a situation, the tax consequences of a transaction follow its legal form and re-characterization is only permissible if the label attached by the taxpayer to the particular transaction does not properly reflect its actual legal effect.

### Conclusion

The TCC concluded that the term "consideration" in paragraph 118.1(13)(*c*) of the ITA is limited to the consideration (i) received at the time of the disposition, and (ii) that is not a non-qualifying security. Considering that the only consideration received by the private foundation at the time of the disposition of the shares was the Promissory Note and that the Promissory Note was a non-qualifying security, the fair market value of the gift under paragraph 118.1(13)(*c*) of the ITA was nil. The appeal was dismissed.

— *Sabrina Gravel*

# CURRENT ITEMS OF INTEREST

## OECD Countries Agree Global Minimum Corporate Tax Rate

On October 8, 2021, 136 countries finalized a tax agreement of historic proportions. Under Pillar One, taxing rights of more than US$125 billion in profits of the largest and most profitable corporations will be reallocated annually. Under Pillar Two, the 15% minimum tax rate will apply to multinational enterprises ("MNEs") with revenue above €750 million and is estimated to generate around US$150 billion in additional global tax revenues annually.

All OECD and G20 counties now support the agreement. The two-pillar solution will be delivered to the G20 Finance Ministers meeting in Washington DC on October 13, then to the G20 Leaders Summit in Rome at the end of October.

## New Confirm Representative Service

On October 18, 2021, the Canada Revenue Agency ("CRA") introduced a new, two-step verification process to make authorizing a representative using Represent a Client more efficient and secure. The new process makes it easier for clients to confirm who has access to their personal and tax information, helping them play an active role in protecting their information. Whether the client is an individual or a business, they can now verify who has access to their personal and tax information by signing in to My Account or My Business Account without waiting for a confirmation call from the CRA.

The new process applies to all new authorization requests submitted through Represent a Client, including when representatives have a new client or when they are requesting a higher level of access to an existing client's information. Representatives who already have a client's authorization and do not need to change their level of access will not be affected. The new process only applies to new authorization requests submitted through Represent a Client. Representatives who use EFILE and certified tax software to submit their clients' returns, including authorization requests, will not be impacted.

For additional information, visit www.canada.ca/en/revenue-agency/services/e-services/e-services-businesses/efile-electronic-filers/efile-news-program-updates.html.

## Ontario To Provide Economic Update

On November 4, Ontario Minister of Finance Peter Bethlenfalvy will present the *2021 Ontario Economic Outlook and Fiscal Review*, which will build upon Budget 2021.

## New Portal for Ontario Corporation Returns

As of May 15, 2021, the CRA stopped accepting returns under the *Ontario Corporations Information Act* because the province was assuming these responsibilities. This affected the filing of Schedules 546 and 548, and Form RC232. However, the province's new filing service only just became available on October 19. Thus, from May 15, 2021, through October 18, 2021, corporations whose annual returns were due during that period were exempt, meaning these corporations did not have to file an annual return for 2021.

Corporations that have an annual return due after October 18, 2021, must file their annual returns, which they can now do directly in the provincial registry. The annual return can be filed by accessing the corporation's registry profile and selecting the "Make Changes" drop-down list, under which there is an option to file an annual return.

For more information, see www.ontario.ca/page/ontario-business-registry#section-6.

## Québec Mini-Budget Announced

Premier François Legault announced that the government will introduce a mini-budget in the month of November. The exact date of the budget is yet to be announced.

# RECENT CASES

## Falcon Project SADI agreement considered as governmental assistance, invalidating SR&ED expenses claims

This case involves the appeal of two income tax reassessments raised against the appellant by the Minister of National Revenue. The issue concerns whether or not monies received under an agreement with Industry Canada, SADI Agreement No. 780-503924 — Falcon Project (the "SADI Agreement"), constituted "government assistance" as defined by subsection 127(9) of the *Income Tax Act* (the "Act") and the impact of this decision on eligible related deductible scientific research and experimental development expenses for income tax purposes. The appellant essentially argued that paragraph 12(1)(*x*) and subsection 127(9) applied only if monies have been "received" as "government assistance". The appellant further argued that to be considered as "received" as "government assistance" there must be a transfer of ownership, and that this is not the case for the appellant as the amounts received were loans and jurisprudence confirms there is no transfer of ownership as a loan has to eventually be repaid. An expert witness concluded that the SADI Agreement differed from normal ordinary business loans significantly in view of the low rate of return for such an "investment". Industry Canada itself considered the SADI Agreement as a "contribution" agreement and not as a loan.

The appeal was dismissed. After reviewing all the facts, expert testimony, and related jurisprudence, the Court concluded the amounts received under the SADI Agreement did qualify as government assistance. Indeed, the Federal Court of Appeal previously concluded that the term "government assistance" must be given a broad meaning. Furthermore, the Court did not accept the arguments of the appellant. The verb "to receive" is not defined under the Act and ordinary dictionary definitions refer to "coming into possession", not to "transfer of ownership"; furthermore, there is no indication or evidence that the legislator intended that such a "transfer of ownership" be required for subsections 12(1), 127(9), and 127(18) to be applicable.

*CAE Inc. v. The Queen*

2021 DTC 1050

## Tax Court holds that loans are investments rather than business activity and constitute capital losses

The appellant, the successful founder of a pipe company, lent money at interest to third parties from the proceeds. Two of these borrowers defaulted. The appellant claimed his losses for the 2010–2014 tax years as losses from a business of lending money, but the CRA reassessed them as investments (i.e., capital losses).

The appeal was dismissed. Given the expansive definition of "business" in subsection 248(1) of the *Income Tax Act*, to determine whether an activity is a business, a court must look at a taxpayer's "overall level of activity" including "the number of transactions, their volume, their frequency, investment turnover, and the nature of the investments themselves." A person claiming to be in business will have "gone about it in an orderly, businesslike way and in the way that a businessperson would normally be expected to do." Under the circumstances, the appellant did not do so. He relied on word-of-mouth advertising only; he purchased unsecured debt and vetted potential borrowers by inviting them to social activities; he failed to negotiate terms with borrowers; and his failure to produce books and records at the hearing permitted the adverse inference that he did not keep business records of his lending activities. These factors all indicated to the Court that he was not conducting a business. Thus, the appellant's losses were on account of capital.

*Kallis v. The Queen*

2021 DTC 1046

## Objection to a request for an order allowing an extension of time to file a response to a notice of appeal rejected

The respondent was required to file its response to the Notice of Appeal by April 16, 2021, but only did so on April 21. Accordingly, the respondent requested the Court issue an order extending the time allowed to file the response to the Notice of Appeal. The appellants objected. The appellants cited three reasons: Firstly, the Québec Revenue agency ("QRA") has thousands of employees and they should know the rules; secondly, they argued that in a previous case, the QRA tried (without success, it seems) to terminate procedures initiated by the appellants on the basis the procedures had been filed outside the allowable time frame; and, finally, they argued that the QRA used unwarranted pressure tactics to get the appellants to agree to the extension of time to file.

Extension allowed. The Tax Court may allow the filing of the response before or after the normal time frame in accordance with section 18.16 of the *Tax Court of Canada Act*. The criteria for granting an extension of time are well known: (1) There has been a constant intention to pursue the appeal; (2) The demand is justified; (3) The respondent suffers no prejudice from the time to file being extended; (4) There is a reasonable explanation for the delay. These are guidelines and each situation is different; the overriding consideration being whether granting an extension of time is in the interest of justice. The Court rejected the arguments of the appellants. The first two arguments were not relevant with respect to the above criteria. With respect to the third argument, the evidence did not support the position that undue pressure was used. The Court found the delay for filing minimal, that there always was an intent to defend the assessment, that extending the filing time did not prejudice the appellants, and that there was a reasonable explanation for the delay. It was obviously in the interest of justice to allow an extension of time to file the response. Accordingly, the order granting the extension of time to file was granted and the appeal was dismissed.

*Jobin v. The Queen*

2021 DTC 1045

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