Tax Notes

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Wolters Kluwer

FIRST HOME SAVINGS ACCOUNTS

— *Wolters Kluwer Canada*

The April 7, 2022, federal Budget introduced a new proposed tax-advantaged registered account to help prospective first-time Canadian home buyers save for the purchase of a new home. Draft legislation was released for comment by the Department of Finance on August 9, 2022, and there the proposals stand. However, since there are only 79 shopping days left until Christmas at the time of writing and the proposals are supposed to come into effect on January 1, 2023, it's likely time to review what we know so far. It's important to be aware, though, that the proposals will likely change to some degree or other when finally passed.

The tax-free First Home Savings Account ("FHSA") will be available to individuals effective January 1, 2023. Trust companies, licensed annuities providers, members of the Canadian Payments Association, and credit unions are permitted to issue FHSAs. As it is a registered plan, the main provisions governing FHSAs are found in proposed new section 146.6 of the *Income Tax Act (Canada)* (the "Act").

Income, losses, and gains in respect of investments held within an FHSA, as well as amounts withdrawn, will not be included in computing income for tax purposes.

A qualifying individual will be eligible to establish an FHSA. This is an individual (other than a trust) resident in Canada who is 18 years of age or older and a first-time home buyer (see below for a discussion on "first-time home buyer"). The lifetime limit is $40,000 (reduced by amounts transferred from an RRSP to an FHSA).

An individual may have an FHSA for a "maximum participation period". This period begins when the individual opens their first FHSA, and ends at the end of the year following the year in which the earliest of the following events occur:

- the 14th anniversary of the date the individual first opened their FHSA,
- the individual turns 70 years old, or
- the individual first makes a qualifying withdrawal from an FHSA.

For example, if a 30-year-old individual first opens an FHSA during 2023, their maximum participation period will end at the end of 2038. However, if that individual makes a qualifying withdrawal from their FHSA during 2028, their maximum participation period will end at the end of 2029.

A "qualifying home" is defined as a housing unit located in Canada. It also includes a share of the capital stock of a cooperative housing corporation, where the holder of the share is entitled to possession of a housing unit located in Canada. However, where the context requires, such a share means the housing unit to which the share relates.

An individual is considered to be a first-time home buyer if at any time in the part of the calendar year before the account is opened or at any time in the preceding four years they did not live in a qualifying home (or what would be a qualifying home if located in Canada) that they owned.

For the purpose of opening an FHSA, individuals who lived in and had an interest in a qualifying home (or what would be a qualifying home if located in Canada), including a beneficial interest, are not considered to be first-time home buyers. An exception is provided for individuals who have a right to acquire less than a 10% interest in the qualifying home.

Conditions

The definition "qualifying arrangement" sets out a number of conditions that must be met for an arrangement to be a qualifying arrangement for the purposes of an FHSA:

- The arrangement must be entered into after 2022, and must be between a qualifying individual and an issuer.
- The arrangement must be one of three types:

  (1) An arrangement in trust with a corporation, licensed or otherwise, authorized under the laws of Canada or a province to carry on in Canada the business of offering to the public its services as trustee;

  (2) An annuity contract with a licensed annuities provider; or

  (3) A deposit with a person who is (or is eligible to become) a member of the Canadian Payments Association or who is a credit union that is a shareholder or a member of a body corporate referred to as a "central" in the *Canadian Payments Act*.
- The arrangement must provide for contributions to be made under the arrangement to the issuer in consideration of, or to be used, invested, or otherwise applied for the purpose of, the issuer making distributions under the arrangement to the holder.
- The issuer and the individual must agree, at the time the arrangement is entered into, that the issuer will file with the Minister of National Revenue an election to register the arrangement as an FHSA. The election must be filed in prescribed form and manner with the Minister and include the social insurance number ("SIN") of the qualifying individual.
- The arrangement must require that it be maintained for the exclusive benefit of the holder. For this purpose, any right of a person to receive a payment out of or under the arrangement only on or after the death of the holder is disregarded.
- The arrangement must prohibit, while there is a holder of the arrangement, anyone who is neither the holder nor the issuer of the arrangement from having rights under the arrangement relating to the amount and timing of distributions and the investing of funds. An arrangement ceases to have a holder on the death of the individual who entered into the arrangement or, if the individual's survivor acquires the individual's rights as holder of the arrangement, on the death of the survivor.
- The arrangement must prohibit anyone other than the holder from making contributions.
- The arrangement must permit distributions to be made to reduce the amount of tax that would otherwise be payable by the holder under proposed section 207.021 of the Act. That section imposes taxes on an "excess FHSA amount" (i.e., excess contributions and transfers from an RRSP). New subsection 207.06(3) will allow the Minister of National Revenue to waive all or part of any such tax that arises as a consequence of reasonable error if other conditions are met.
- The arrangement must provide that the issuer will, when directed to do so by the holder, transfer all or any part of the property held in connection with the arrangement (or an amount equal to its value) to another FHSA of the holder or to an RRSP or RRIF under which the holder is the annuitant.
- If the arrangement is an arrangement in trust, it must prohibit the trust from borrowing for the purposes of the arrangement.

- The arrangement must provide that it ceases to be an FHSA at the end of the holder's (or successor holder's) maximum participation period.
- The arrangement must comply with prescribed conditions. While no specific conditions are anticipated at this time, this provision will allow certain issues that arise in the implementation of FHSAs to be dealt with through regulations, as necessary.

Ceasing To Be an FHSA

The FHSA will cease to be an FHSA at the earliest of the following times:

- the end of the maximum participation period of the last holder;
- the end of the year following the year of death of the last holder;
- when the arrangement ceases to be a qualifying arrangement; or
- when the arrangement ceases to be administered in accordance with the conditions noted above.

Discretion is provided to the Minister of National Revenue to declare a cessation date later than the times listed above. This is generally meant to act as a relieving provision in appropriate circumstances.

Once an arrangement ceases to be an FHSA, it is no longer exempt from tax on its income. The taxpayer who was the holder immediately before the arrangement ceased to be an FHSA is required to include an amount equal to the fair market value of all property of the FHSA in computing their income for the taxation year.

If you do withdraw funds from your FHSA once it has ceased to be an FHSA, the FHSA trustee is obliged to withhold federal income tax from the amount it pays you. For Québec residents, the rate is 5% on amounts up to $5,000, 10% for amounts between $5,000 and $15,000, and 15% for amounts over $15,000. For other Canadian residents, the rate is 7% on amounts up to $5,000, 13% for amounts between $5,000 and $15,000, and 20% for amounts over $15,000. For Canadian residents beyond the limits of any province or outside Canada, the rate is 10% on amounts up to $5,000, 20% for amounts between $5,000 and $15,000, and 30% for amounts over $15,000. For non-residents, the rate will depend on the recipient's country of residence, which may or may not have a tax treaty with Canada. You get credit for the amount withheld when you file your tax return, as with the withholding taxes on salary or wages.

FHSA Deduction Limit

The definition "FHSA deduction limit" determines the amount an individual may deduct in a taxation year, from contributions to an FHSA, in computing the individual's income until the individual has died or their maximum participation period has ended. An individual is also prevented from deducting any contributions that occur after a qualifying withdrawal has been made.

An individual may contribute, or transfer from an RRSP, a combined maximum of $8,000 in a year (see "Transfers to/from an RRSP" below for a discussion on transfers from an RRSP), up to $40,000 in a lifetime. After accounting for RRSP transfers (if any), an individual may deduct any contributions to an FHSA made during the year up to the remaining FHSA deduction limit. An individual may also deduct any previous year's contributions, up to the amount of the maximum annual FHSA deduction limit, to the extent that the contributions exceeded the available maximum FHSA deduction limit in previous years.

An individual may carry forward an amount of unused FHSA deduction limit for FHSA contributions (and transfers from an RRSP). An individual only begins to accumulate an FHSA carryforward once they have opened their first FHSA. The FHSA carryforward is also limited to $8,000, which is the equivalent of a maximum FHSA deduction limit for a single year.

The FHSA carryforward for a particular year is generally equal to:

- the amount that an individual could contribute (or transfer from an RRSP) under the FHSA deduction limit in the previous year ($8,000 plus the previous year FHSA carryforward less any transfers to an FHSA from an RRSP)

less

- actual contributions (or RRSP transfers) to an FHSA during the previous year.

Overcontributions

There is a special tax on an individual's excess FHSA amount. The tax is imposed on a monthly basis and is equal to 1% of the highest excess FHSA amount during each particular month. The tax applies until the excess FHSA amount is eliminated. This tax is generally sufficient to neutralize the tax benefit of overcontributions.

An excess FHSA amount is determined by a formula, which in principle is simply the total of an individual's actual FHSA contributions and transfers (from an RRSP) at a particular time, less the individual's contribution limits at that time.

In contrast to other registered accounts, an individual's contribution limits take into account the ability to carry forward a certain amount of unused contributions from previous years. As a result, it is necessary to calculate an individual's allowable contributions by totaling the actual amounts the individual contributed to an FHSA (including RRSP transfers) in each year, up to the annual limit of $8,000 (plus any FHSA carryforward) and the lifetime limit of $40,000.

An individual's excess FHSA amount is then reduced by the total of all taxable withdrawals and all designated amounts. Designated amounts allow an individual to correct an excess FHSA contribution by essentially reversing a contribution or a transfer from an RRSP.

An amount withdrawn in the year as a designated amount to correct an excess FHSA amount is removed from the FHSA deduction limit, effectively reversing an overcontribution that resulted from a contribution (excluding transfers from RRSPs) to an FHSA. A "designated amount" is defined as an amount, not exceeding an individual's excess FHSA amount at a particular time, that is designated by the individual in prescribed form and manner that is either:

- a transfer to an RRSP, which may only be designated to the extent it does not exceed the total amount the individual transferred from an RRSP to an FHSA prior to the particular time, or
- a withdrawal, which may only be designated to the extent that it does not exceed the total amount of direct FHSA contributions the individual has made.

Under the rules, any income reasonably attributable to deliberate overcontributions will be made subject to the existing advantage rules (the rules for FHSAs largely parallel those for TFSAs) and taxed accordingly. Pursuant to the advantage rules, the tax payable on the income will be 100%.

The CRA will maintain the discretion to waive or cancel all or part of the tax payable in appropriate circumstances.

Withdrawals

For a withdrawal to be considered a qualifying withdrawal, a number of conditions must be met:

- The individual must be resident in Canada and a first-time home buyer;
- The withdrawal must be made via a prescribed form that sets out the location of the qualifying home that the individual intends to occupy as a principal residence within one year of acquisition of the qualifying home;
- An agreement must be in place (before the withdrawal) to purchase or construct the qualifying home before October 1 of the year following the date of the withdrawal; and
- The individual cannot have acquired the qualifying home more than 30 days before the withdrawal is made.

A taxpayer may not make a qualifying withdrawal for a particular qualifying home from an FHSA if the individual used the Home Buyers' Plan in respect of the same home purchase.

Income, losses, and gains in respect of investments held within an FHSA, as well as amounts withdrawn, will not be included in computing income for tax purposes or taken into account in determining eligibility for income-tested benefits or credits delivered through the income tax system (for example, the Canada Child Benefit, the Goods and Services Tax Credit, and the Age Credit). Nor will such amounts be taken into account in determining other benefits that are based on the individual's income level, such as Old Age Security benefits, the Guaranteed Income Supplement, or Employment Insurance benefits.

Withdrawal of amounts that are "designated amounts" are tax-free. A "designated amount" generally means a distribution made under an FHSA in order to reduce an individual's excess FHSA amount. It allows an individual to correct an overcontribution to an FHSA by returning an amount to an RRSP or reversing a direct contribution through a tax-free withdrawal.

Because the investment income within, and withdrawals from, an FHSA are not taxable, interest on money borrowed to invest in an FHSA is not deductible. Also, an FHSA may not be used as security for a loan. An FHSA holder must include in their income the fair market value of any property of the FHSA that is pledged as security for a loan.

A taxpayer who receives benefits out of another person's FHSA is jointly and severally liable for the portion of that other person's tax that is attributable to those benefits. Where there are joint and severally liable taxpayers, a payment by one taxpayer will generally reduce the liability of the other.

If a holder of an FHSA makes a contribution to the FHSA from funds gifted by a spouse or common-law partner, then for future income inclusion purposes (i.e., when amounts are withdrawn from the FHSA), no portion of such contribution would be attributed back to the non-holder spouse who made the gift. However, the ability for amounts to be transferred on a tax-free basis from an individual's RRSP to their FHSA is limited if spousal contributions have been made to the RRSP in the current year or two preceding years.

Transfers to/from an RRSP

An individual may contribute, or transfer from an RRSP, a combined maximum of $8,000 in a year. However, for deduction purposes, amounts transferred from an RRSP to an FHSA are not deductible as FHSA contributions (this is because amounts contributed to an RRSP would generally already have been deductible in accordance with RRSP rules). Accordingly, for the purpose of calculating an individual's FHSA deduction limit, the $8,000 maximum amount is first reduced by transfers from RRSPs made during the year (or RRSP transfers from previous years to the extent that the transfers exceeded the available maximum FHSA deduction limit in previous years).

Transfers may be made to an RRSP or RRIF on behalf of the below individuals, who must be the annuitant:

- the holder of the FHSA,
- a spouse or common-law partner (or former spouse or common law-partner) of the holder of the FHSA who is entitled to the amount after the breakdown of a marriage/relationship, or
- the spouse or common-law partner at the date of the holder's death.

Death

An individual's FHSA deduction limit is nil after their death. After the death of the holder, any individual (including the estate of the holder) who receives a distribution from the FHSA shall include the amount in computing their income for the year.

An election made in accordance with proposed subsection 146.6(12) may in some cases shift the tax liability from the holder's estate to a beneficiary of the estate if conditions are met. This subsection deals with situations in which an amount paid from a deceased holder's FHSA to the holder's estate would have been eligible for a tax-free transfer under proposed subsection 146.6(6) to a survivor (spouse or common-law partner), or would have been taxable to a beneficiary if the amount had been paid directly to the beneficiary from the FHSA, to the extent that the recipient has a beneficial interest under the deceased holder's estate. Under this subsection, the legal representative of a deceased holder's estate and the survivor are allowed to jointly designate (via a prescribed form) to have the FHSA proceeds that were paid to the estate treated as having been transferred under proposed subsection 146.6(6) from the FHSA of the deceased holder to an FHSA, RRSP, or RRIF of the survivor. Alternatively, it allows the legal representative of a deceased holder's estate and the survivor to jointly designate (via a prescribed form) to have the FHSA proceeds that were paid to the estate treated as having been paid directly to the survivor as a beneficiary. In that case, the amount is included in the survivor's income for the year in which the survivor received the payment. The legal representative does not need to include the amount received in computing the income of the estate to the extent that the amount has been designated by either of the methods mentioned above.

Upon the individual's death, the individual's survivor (a spouse or common-law partner) may become the FHSA holder if the individual had designated the survivor to be the successor holder and if the survivor is a qualifying individual. If an individual is designated as a survivor and is not a qualifying individual, they must transfer or withdraw funds as a taxable distribution from the FHSA. Amounts may also be transferred tax-free to the FHSA, RRSP, or RRIF of the spouse or common-law partner, limited to an amount equal to the value of the property less the excess FHSA amount.

Marriage Breakdown

On the breakdown of a marriage or a common-law partnership, an amount may be transferred tax-free directly from the FHSA of one party in the former relationship to the FHSA, RRSP, or RRIF of the other. The transfer is limited to an amount equal to the value of the property less the excess FHSA amount.

Non-Residents

Individuals must be resident in Canada to open or hold an FHSA. Therefore, if they become non-resident, the arrangement will cease to be an FHSA and the individual is required to include the fair market value of all property in the FHSA in their income. Payments made to non-residents are subject to the non-resident withholding tax of 25%.

Non-Qualified Investments

The rules for an FHSA largely parallel those for TFSAs, as does the list of qualified investments.

If an FHSA holds a property that is not a qualified investment, there is a 1% monthly tax added.

The issuer of the FHSA must notify the holder in prescribed form by the last day of February of the following year if the FHSA acquires or disposes of a non-qualified investment, or property held by an FHSA trust becomes or ceases to be a non-qualified investment. This ensures that the holder will be provided with sufficient information to comply with their tax obligations in connection with the non-qualified investment.

CURRENT ITEMS OF INTEREST

Progress of Legislation

Bill C-22, *An Act to reduce poverty and to support the financial security of persons with disabilities by establishing the Canada disability benefit and making a consequential amendment to the Income Tax Act*, received Second Reading in the House of Commons on October 18 and is now under consideration by the Standing Committee on Human Resources, Skills and Social Development and the Status of Persons with Disabilities.

Bill C-30, *An Act to amend the Income Tax Act (temporary enhancement to the Goods and Services Tax/Harmonized Sales Tax credit)*, received Royal Assent on October 18.

Bill C-31, *An Act respecting cost of living relief measures related to dental care and rental housing*, received Second Reading in the House of Commons on October 19 and is now under consideration by the Standing Committee on Health.

2023 EFILE Program and Related Changes

The CRA began accepting EFILE registration renewals for the 2023 program on October 17. If you renew on or after October 17, 2022, you must update your tax preparation software with your newly assigned password. If you do not renew your account on or after October 17, 2022, you may continue to use your current password until January 28, 2023.

As of January 28, 2023, in order to be able to transmit individual and business authorization and cancellation requests, and file T2 returns, you will need to have:

- Renewed your EFILE account;
- Passed suitability screening; and
- Updated your tax preparation software with your newly assigned password.

The CRA has planned a number of important new changes for the upcoming filing season that are designed to enhance the tax-filing experience and improve the safety and security of its systems. When you register or renew your EFILE credentials this fall, you will notice changes to the EFILE registration form that the CRA felt were important to communicate to you separately from its annual conversion message.

Although the definition of an EFILE applicant has not changed, you will be able to enter up to 15 applicants instead of four. You will also be asked to provide the RepID for each applicant on your EFILE registration form. Employees who prepare returns in the course of their employment should not be listed as applicants, unless they otherwise meet the definition of an EFILE applicant. Please ensure you review the definition of an EFILE applicant. These changes will enable the CRA to further automate the EFILE suitability screening process and link applicants to representative credentials to support effective monitoring of EFILE activities and services.

For further details on how to renew your registration for 2023 and recent EFILE program changes, see www.canada.ca/en/revenue-agency/services/e-services/e-services-businesses/efile-electronic-filers/efile-news-program-updates.html.

CRA Relaunching Business Tax Information Newsletter

The CRA is relaunching its Business Tax Information Newsletter, which will be published on a bimonthly basis. The latest edition of the newsletter was published on October 18. For further details, see www.canada.ca/en/revenue-agency/news/e-services/canada-revenue-electronic-mailing-lists/businesses-tax-information-newsletters/businesses-tax-information-newsletters-2022-01.html.

Simplifying the Process for Deducting Federal COVID-19 Benefits Repayment in a Prior Year

As announced in Budget 2021, individuals who received certain federal COVID-19 benefits in 2020 or 2021 and make repayments before January 1, 2023, can request to claim a deduction for all or part of the repayment on their income tax and benefit return for the year they received the benefit or the year they repaid the benefit, or split the deduction between the two returns. The COVID-19 benefits that apply are:

- Canada Emergency Response Benefit ("CERB") from the CRA or Service Canada;
- Canada Emergency Student Benefit ("CESB");
- Canada Recovery Benefit ("CRB");
- Canada Recovery Sickness Benefit ("CRSB"); and
- Canada Recovery Caregiving Benefit ("CRCB").

New Form T1B, *Request to Deduct Federal COVID-19 Benefits Repayment in a Prior Year*, will be available for the 2022 tax year to allow an individual to claim a deduction for the overpayment of federal COVID-19 benefits received in 2020 or 2021 that were repaid in 2022. If an individual received the CERB, CESB CRB, CRSB, or CRCB from the CRA, the amount repaid will be reported in box 201 of their T4A slip. If an individual received the CERB from Service Canada, the amount repaid will be reported on their T4E slip along with other amounts repaid. Service Canada will send recipients a letter showing the amount of CERB they repaid. T4A and T4E slips will be sent to individuals and available in My Account by the end of February 2023.

Individuals can complete Form T1B and submit it with their 2022 return. The form will allow them to choose which tax year(s) they would like to apply the deduction to. Their return(s) for those years will then be automatically reassessed to apply the deduction as part of the filing of their 2022 return. As a result, separate requests to change prior year returns will not be required.

Advisory for Businesses Claiming SR&ED Investment Tax Credits

On October 12, 2022, the CRA issued an advisory to taxpayers about a recent increase in SR&ED claims containing false and/or non-compliant information. The CRA is warning taxpayers to be cautious if they receive an unsolicited offer to help claim SR&ED investment tax credits. For additional information, see www.canada.ca/en/revenue-agency/news/newsroom/tax-tips/tax-tips-2022/advisory-businesses-claiming-sred-investment-tax-credits.html.

New Process for Authorizing Representatives for Business Clients Using the Business Consent Service in EFILE

Last fall, the CRA implemented "Confirm my Representative", a two-step verification process for authorizing a representative via "Represent a Client". In October 2022, this process will also apply to authorization requests submitted through the "Business Consent Service" in certified tax software ("EFILE"). The Business Consent Service is used to request access to business client information only.

After the representative submits an authorization request through certified tax software, the request will go into a "pending" state. The request will not be activated until the business owner or their delegate logs into "My Business Account" and clicks on the "confirm pending authorizations" button in the Authorized Representatives section.

Highlights of the change:

- Your clients will be able to quickly and easily confirm who is able to access their tax information by using the Confirm my Representative service in My Business Account.
- Once your client has registered for My Business Account, they will have to enable email notifications to be notified each time a new representative requests access. Once they receive a request, they can confirm or

deny access in My Business Account.

- Authorization requests submitted through the Business Consent Service in EFILE software will be marked as "pending" for ten business days. If the owner or their delegate doesn't confirm it within this timeframe, the request will be cancelled and a new one will need to be submitted.
- This process of confirming the authorization of a representative will be a one-time action for most business owners.
- This only applies to new authorization requests, including those from a currently-authorized representative if they choose to submit a new request.
- In some exceptional cases, the CRA may still contact a business owner by telephone to verify a representative's authorization.

Steps your clients need to take:

- Make sure your clients are aware that they must register for My Business Account and enable email notifications before you submit your authorization request.
- Business owners who are already registered for My Account do not have to register again for My Business Account. They can sign in to My Business Account using their CRA user ID and password.
- If they don't have a CRA user ID and password, they'll need to create one and for this, they'll need their:
  - Social insurance number;
  - Date of birth;
  - Current postal or zip code;
  - Personal income tax returns from the current and previous year; and
  - Business number.

Once your client has signed up for My Business Account, they will need to add their business number to their account. The business owner will only be allowed to do this if their name and social insurance number match the information the CRA has on file for the business. If they get an error message at this step, they will need to contact the CRA to update their records.

Kilometric Rates for 2022

When claiming travel costs for the medical expense tax credit, the moving expense deduction, and the northern residents deduction, taxpayers can use a simplified method to compute the amount of the claim by multiplying the total distance traveled by a per-kilometre rate. The rates for the 2022 taxation year are now available and are as follows:

Province/Territory	**Cents/km (taxes included)**
Alberta	55.0
British Columbia	58.0
Manitoba	56.0
New Brunswick	59.5
Newfoundland and Labrador	62.0
Northwest Territories	67.5
Nova Scotia	59.5
Nunavut	58.0
Ontario	61.5
Prince Edward Island	58.5
Québec	60.0
Saskatchewan	55.0
Yukon	66.5

Employment Insurance ("EI") Rates for 2023

The Canada Employment Insurance Commission has published the EI contribution rates and limits for 2023.

The 2023 EI premium rate is $1.63 per $100 of insurable earnings ($2.28 for employers). This is the maximum increase permitted by the legislated five-cent limit on annual rate changes.

The 2023 premium rate for Québec residents is $1.27 per $100 of insurable earnings ($1.78 for employers).

The amount of maximum insurable earnings ("MIE") will increase to $61,500 in 2023.

In 2022, the non-Québec premium rate was $1.58, the Québec premium rate was $1.27, and the MIE was $60,300.

Hurricane Fiona Tax Relief

The CRA announced on September 28 that there will be tax relief for individuals, businesses, and charities in the areas impacted by Hurricane Fiona. The due date for returns and balances has been extended to October 31 for all T2/T3 tax returns and GST/HST returns that would normally have been due between September 26 and October 30. There will be no penalty nor interest for late filing if these returns are submitted after September 30.

For taxpayers who were prevented from meeting their tax obligations due to the adverse event, the CRA will review these requests on a priority basis, and will also accept relief requests by telephone through the Individual and Business enquiry lines.

For more information, go to canada.ca/penalty-interest-relief.

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.

Zeifmans LLP v. Canada (National Revenue), 2022 DTC 5100 (Federal Court of Appeal) — RFI May Extend to Related Unnamed Entities Without Judicial Authorization If Not the Target of an Investigation

Background

In 2014, the Canada Revenue Agency ("CRA") commenced an audit of certain members of the Ghermezian family's 2012 and 2013 taxation years. The auditor took many steps to acquire information from the family members, including related party initiative ("RPI") questionnaires; direct requests for further information and an interview; requests for bank statements and other supporting documents; numerous third party requirements for information regarding transaction and banking records from Canadian banks; a requirement for information to certain family members; compliance action through the Department of Justice; an audit letter; and attempts to contact family members' legal counsel and their accountants (Zeifmans LLP, the "Accountants"). The CRA received little substantive response.

On January 30, 2019, the CRA issued a requirement for information ("RFI") under subsection 231.2(1) of the *Income Tax Act* ("ITA") to the Accountants in respect of a long and detailed list of information regarding three individuals of the family (the "Named Persons") and "entities owned, operated, controlled or otherwise connected to the Named Persons" (the "Unnamed Entities"). The Accountants filed a notice of application to the Federal Court for judicial review of the Minister of National Revenue's (the "Minister's") decision to issue the RFI on March 1, 2019.

Issues and Federal Court Decision

The Federal Court considered the following four issues in the course of its judicial review of the RFI:

(1) Was the RFI an "unnamed persons" requirement for information such that the Minister was required to apply for judicial authorization in accordance with subsections 231.2(2) and (3) of the ITA?

(2) Was the RFI imposed on a "person" as required by subsection 231.2(1)?

(3) Was the RFI issued for a purpose other than the administration or enforcement of the ITA?

(4) Was the RFI unreasonable due to lack of clarity or because the Minister did not make enquiries or seek clarification from the CRA audit team prior to its issuance?

The parties agreed that the standard of review in respect of issues (2) to (4) was reasonableness, consistent with the presumptive standard of review for administrative decisions following the Supreme Court's decision in *Canada (Minister of Citizenship and Immigration) v. Vavilov*, 2019 SCC 65 ("*Vavilov*").

However, the Accountants argued that the first issue should be determined on the more stringent standard of correctness, arguing that the first issue fell within the two situations identified by the Supreme Court in *Vavilov*, in which a departure from the presumption of reasonable review is warranted: (1) where a higher standard is evidenced in legislative intent and (2) where the question pertains to the rule of law, such as general questions of law of central importance to the legal system as a whole. The Accountants argued that the obligation to apply for judicial authorization for an RFI in subsection 231.2(2) evidenced a Parliamentary intention for the courts to engage in an enhanced standard of review of correctness in reviewing an RFI. The Accountants further argued that the question of judicial authorization is a question regarding the rule of law, being of central importance to the Canadian legal system.

The Federal Court disagreed, finding that there is no suggestion in section 231.2 that Parliament intended that a decision to proceed without judicial authorization would be subject to review for correctness. Rather, the Federal Court found that the Minister's determination as to whether judicial authorization was required was a question of statutory interpretation and consideration of the facts at hand — matters that fell within the standard of reasonableness in *Vavilov*. The Federal Court further found that the issue was not a question of law of central importance to the legal system as a whole. The Minister's determination to issue the particular RFI in question affected only the taxpayers to whom the RFI was issued, and thus did not impact the administration of the Canadian justice system as a whole:

> The question of whether those related entities are "unnamed persons" for purposes of subsections 231.2(2) and (3) is a matter of statutory interpretation for the Minister, subject to review by the Court. It is not a question of central importance to the legal system as a whole. (para. 21)

In reviewing the RFI on a reasonableness standard, the Accountants relied on the 2004 Federal Court of Appeal decision in *Canada (Minister of National Revenue) v. Toronto Dominion Bank*, 2005 DTC 5140 ("*TD Bank*"), wherein the Court found that it was unreasonable for the Minister not to obtain a judicial authorization in respect of its RFI issued to TD Bank to provide the name of an account holder.

The Federal Court, however, affirmed that the 2005 Federal Court of Appeal decision of Justice Rothstein in *Canada (Customs and Revenue Agency) v. Artistic Ideas Inc.*, 2005 DTC 5165 ("*Artistic Ideas*"), set out the prevailing interpretation of section 231.2, which is that subsections 231.2(2) and (3) must be read together, and that such a reading leads to the conclusion that the Minister is required to apply for judicial authorization to issue a requirement for information to a third party only if the requirement requests information and documents relating to ascertainable unnamed persons for the purpose of verifying compliance by those unnamed persons with their obligations under the ITA.

The Federal Court went on to note that it had consistently adopted the reasoning in *Artistic Ideas* over that of *TD Bank*, including in *Canada (National Revenue) v. Morton*, 2007 DTC 5445 ("*Morton*"); *Canada (National Revenue) v. Advantage Credit Union*, 2008 DTC 6535 ("*Advantage Credit Union*"); *Canada (National Revenue) v. Amex Bank of Canada*, 2008 GTC 1357 ("*Amex Canada*"); *eBay Canada Ltd. v. Minister of National Revenue (2008)*, 2008 DTC 6728 ("*eBay*"); and *London Life v. Canada (Attorney General)*, 2009 DTC 5178 ("*London Life*") — as had the Supreme Court of Canada in *Redeemer Foundation v. Canada (National Revenue)*, 2008 DTC 6474 ("*Redeemer*"). The Federal Court summarized the SCC's comments in *Redeemer* as follows:

> There is no doubt Parliament intended the Minister's powers to obtain information in reliance on section 231.2 to be broad. If a Canadian taxpayer organizes their affairs through corporate or other entities, the CRA is entitled to obtain information related to those entities for the purpose of auditing and verifying the taxpayer's compliance with the ITA. If the entities' books and records are placed in the possession of third parties, the Minister is entitled to require the third party to provide the information requested if the unnamed persons are not subject to audit. The information is required to verify the compliance of the taxpayer being audited and no application for judicial authorization is required (*Redeemer* at para 22). (para. 47)

The Federal Court found that the RFI in this case was not seeking to verify compliance of the Unnamed Entities but rather gather information regarding the Unnamed Entities so as to verify compliance of the family members under audit, and accordingly held that the Minister's determination that no judicial authorization was required to issue the RFI was reasonable.

Federal Court of Appeal Decision

On appeal, the Federal Court of Appeal ("FCA") agreed with the Federal Court that the proper level of review was reasonableness, as set out in *Vavilov*, and that there was no basis in the case at hand to rebut this presumption: section 231.2 does not contain any indicia suggesting a higher standard of review of correctness.

The FCA further agreed with the Federal Court's summary of the law in respect of the requirement for judicial authorization under section 231.2 of the ITA as set out in *Artistic Ideas*, *eBay*, *Redeemer*, *Morton*, *Advantage Credit Union*, *Amex Canada*, and *London Life*. Importantly, the FCA stated that:

> We consider ourselves bound by the interpretation of section 231.2 offered by this Court in *Artistic Ideas* and *eBay*, cases that postdate and differ at a conceptual level and in interpretive result with *Canada (Minister of National Revenue) v. Toronto Dominion Bank*, 2004 FCA 359 . . .. *Artistic Ideas*, *eBay* and its progeny correctly interpret section 231.2. To the extent that Toronto Dominion Bank stands for something different from *Artistic Ideas*, *eBay* and their progeny, it should not be followed. The Federal Court effectively said just that. We agree with the Federal Court for the reasons it gave. (paras. 5, 6)

The FCA additionally considered the Accountants' argument that, as the RFI did not set out a detailed analysis of why a judicial authorization was not required, the Minister had failed to perform a reasonable statutory interpretation of whether judicial authorization was required. The FCA disagreed:

> *Vavilov* tells us that reviewing courts must not insist on the sort of express, lengthy and detailed reasons that, if asked to do the job themselves, they might have provided . . . It tells us that an administrative decision should be left in place if reviewing courts can discern from the record why the decision was made and the decision is otherwise reasonable . . .. In other words, the reasons on key points do not always need to be explicit. They can be implicit or implied. Looking at the entire record, the reviewing court must be sure, from explicit words in reasons or from implicit or implied things in the record or both, that the administrator was alive to the key issues, including issues of legislative interpretation, and reached a decision on them. (paras 9, 10)

In considering the Federal Court's application of the reasonableness standard, the FCA noted that the Federal Court had determined that there was no evidence that the Unnamed Entities in the RFI were a target of investigation by the Minister. The FCA held that as no error of law or palpable and overriding error was present, the Federal Court's determination in this regard was to be respected. On the basis of this finding, the FCA concluded that the Minister's implied reasoning in determining no judicial authorization was required was consistent with the reasoning in *Artistic Ideas*, *eBay*, and their progeny and was therefore reasonable, and set aside the appeal.

— *Ron Dueck*

Deegan v. Canada (Attorney General), 2022 DTC 5098 (Federal Court of Appeal) — Affirmed: Part XVIII of the ITA Does Not Violate Section 8 of Charter as Contemplating Unreasonable Seizures

Background

In 2010, the United States enacted the *Foreign Account Tax Compliance Act* ("FATCA"), which generally requires "U.S. persons" to provide financial information to the American Internal Revenue Service ("IRS"), and further requires non-American financial institutions to enter into direct reporting agreements with the IRS and to provide the IRS with account information who might be "U.S. persons".

In order to mitigate the impact that FATCA would have on Canadian financial institutions, their customers, and the Canadian economy in general, the Canadian government entered into negotiations with the American government, which culminated in the February 5, 2014, conclusion of *The Agreement between the Government of Canada and the Government of the United States of America to Improve International Tax Compliance through Enhanced Exchange of Information under the Convention between Canada and the United States of America with Respect to Taxes on Income and on Capital, 5 February 2014, Can. T.S. 2014 No. 16* (the "Canada-US IGA"). The Canada-US IGA was subsequently implemented into Canadian law through the enactment of the *Canada-United States Enhanced Tax Information Exchange Agreement Implementation Act*, S.C. 2014, c. 20, s. 99 (the "Implementation Act") and sections 263 to 269 of the *Income Tax Act* ("ITA") (the "Impugned Provisions")

The Impugned Provisions require Canadian financial institutions to provide the CRA with certain information regarding the financial accounts of customers whose account information suggests that they might be "U.S. persons", whereupon the CRA is required under the Implementation Act and Canada-US IGA to provide that information to the IRS.

In 2014, the Plaintiffs brought an action against the Crown in Federal Court to challenge the constitutionality of the Impugned Provisions under sections 8 and 15 of the *Canadian Charter of Rights and Freedoms* (the "Charter").

Issues and Federal Court Decision

The Plaintiffs alleged that the Impugned Provisions constituted an unreasonable seizure under section 8 of the Charter, and amounted to discrimination against US persons prohibited under section 15 of the Charter. The Federal Court dismissed the action, finding that (1) while the Impugned Provisions allow for the seizure of account information, such seizures are not unreasonable and thus do not violate section 8 of the Charter, and (2) although the Impugned Provisions distinguish between persons based on their national origin and citizenship, such distinctions are not discriminatory and thus do not violate section 15 of the Charter. As the Plaintiffs' appeal to the FCA was made only on the grounds that the Federal Court was incorrect in respect of its finding regarding section 8 of the Charter, this summary will limit itself to the Federal Court's discussion of section 8.

Standard of Review

In setting out the applicable standard of review, the Federal Court noted that in *Chaoulli c. Québec (Procureur général)*, 2005 SCC 35, the Supreme Court of Canada established that a high degree of deference should be accorded to governmental policy choices which involve complex and difficult factors, including "the prospective nature of the decision, the impact on public finances, the multiplicity of competing interests, the difficulty of presenting scientific evidence and the limited time available to the state" (para. 256). However, it further noted that this deference was qualified by the Supreme Court of Canada's comments in *RJR-Macdonald Inc. c. Canada (Procureur général)*, [1995] 3 S.C.R. 199: "[d]eference must not be carried to the point of relieving the government of the burden which the Charter places upon it of demonstrating that the limits it has imposed on guaranteed rights are reasonable and justifiable" (para. 257).

Did the Plaintiffs Have a Reasonable Expectation of Privacy?

The Federal Court acknowledged that the Supreme Court held in *R. v. Plant*, [1993] 3 S.C.R. 281, that individuals generally expect that their personal financial records will remain confidential, as they are part of the "biographical core of personal information which individuals in a free and democratic society would wish to maintain and control from dissemination to the state" (para. 303). However, the Court further cited both *R. v. McKinlay Transport Ltd.*, 90 DTC 6243 (SCC) ("*McKinlay*"), and *Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)*, [1990]1 S.C.R. 425 (SCC) ("*Thomson*"), for the proposition that taxpayers have a relatively low and diminished expectation of privacy in respect of income tax information and records and documents produced during the ordinary course of regulated activities. This diminished expectation of privacy was found to be further supported by the fact that the banking information to be reported under the Canada-US IGA generally fell within paragraph 1 of Article XXVII of the Canada-US Tax Treaty, which already provides that the Canadian and American competent authorities "shall exchange such information as may be relevant for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes to which this Convention applies . . .". The Court further found that "U.S. persons have only a limited expectation of privacy in the accountholder information at issue on account of their pre-existing legal obligation to provide their banking information to the IRS in accordance with the provisions of FATCA, quite apart from the disclosure requirements of the Impugned Provisions" (para. 304).

Is There a "Seizure" Under the Canada-US IGA?

The Crown conceded that the Impugned Provisions contemplate a "seizure" of accountholder information of US persons for purposes of section 8 of the Charter, and thus the Federal Court made little effort to analyze whether or not this was the case.

Is the Seizure of Information Unreasonable?

The Plaintiffs relied on the criteria set out by the Supreme Court of Canada in *Canada (Director of Investigation & Research, Combines Investigation Branch) v. Southam Inc.*, 84 DTC 6467 (SCC) (*Southam*), in their assertion that seizures under the Impugned Provisions were unreasonable. *Southam* determined that in order to be reasonable:

(a) there must be a system of prior authorization, by an entirely neutral and impartial arbiter who is capable of acting judicially in balancing the interests of the State against those of the individual;

(b) the impartial arbiter must satisfy him-or herself that the person seeking the authorization has reasonable grounds, established under oath, to believe that an offence has been committed;

(c) the impartial arbiter must satisfy him-or herself that the person seeking the authorization has reasonable grounds to believe that something that will afford evidence of the particular offence under investigation will be recovered; and

(d) the only documents which are authorized to be seized are those which are strictly relevant to the offence under investigation.

The Federal Court noted, however, that the criteria enumerated in *Southam* were formulated in the context of seizures made under a statutory provision that was criminal or quasi-criminal in nature, and that what might be reasonable in a criminal context may not be reasonable in a regulatory context. In contrast, the Federal Court noted that the Plaintiffs' action involved income tax legislation and legislation relating to the exchange of information for income tax purposes, and that the Supreme Court held in *McKinlay* that the ITA "is essentially a regulatory statute since it controls the manner in which income tax is calculated and collected" (para. 268):

> Given the regulatory nature of income tax legislation and the scheme that it enacted, the Supreme Court found in *McKinlay Transport Ltd*. that the *Hunter v. Southam Inc*. criteria were ill-suited to determining whether a seizure under a provision of the *Income Tax Act* was reasonable . . . Rather than applying a rigid approach to section 8 of the Charter, the Court held that a flexible and purposive approach should be taken, given that the provision "must be capable of application in a vast variety of legislative schemes" . . . That is, the scope of the Charter right may vary according to the circumstances . . . (para. 271).

The Federal Court noted that this flexible approach was further supported by the Supreme court of Canada in *R. v. Jarvis*, 2002 SCC 73 ("*Jarvis*").

The Legislative Purpose of the Impugned Provisions

The Federal Court noted that the Supreme Court of Canada has established in *Goodwin v. British Columbia (Superintendent of Motor Vehicles)*, 2015 SCC 46, that section 8 of the Charter "permits reasonable searches and seizures in recognition that the state's legitimate interest in advancing its goals or enforcing its laws will sometimes require a degree of intrusion into the private sphere" (para. 314).

In examining "the state's legitimate interest", the Court examined the purpose of the Impugned Provisions, noting that the starting point of this inquiry must be the rationale underlying the enactment of FATCA itself. The Court found that the purpose underlying the enactment of FATCA was its desire to improve US tax compliance. As such, the Court concluded that at one level, the Canada-US IGA was therefore concluded "for the purpose of implementing the obligations to obtain and exchange information with respect to reportable accounts" (para. 73). On this basis, the Plaintiffs argued that the purpose of the Impugned Provisions was therefore "to assist the American government in implementing FATCA and finding American tax evaders and cheats" (para. 75). They contended that "the Impugned Provisions require that Canadian financial institutions transfer the banking information of an indeterminate number of Canadians (potentially in the hundreds of thousands in any one year) to the CRA, without prior judicial authorization or any state oversight, which information will then be handed over to the IRS" (para. 246) and that this amounted to "a massive fishing expedition and a seizure that offends every core precept of the citizenry's [. . .] right to a reasonable expectation of privacy" (para 247).

In contrast, the Crown argued that the primary purpose of both the Canada-US IGA and the Impugned Provisions was "to avoid the potentially catastrophic impact of FATCA on Canadian financial institutions, their customers and the Canadian economy as a whole" (para. 77). The Crown further argued that from this main purpose flowed two secondary purposes: lessening the burden that FATCA would have imposed on Canadian financial institutions and their customers, and achieving the automatic exchange of information from the US to Canada for Canadian taxation purposes in exchange for assisting with the application of FATCA in Canada.

The Federal Court agreed with the purposes espoused by the Crown, which it found were supported by the improved situation that the Canada-US IGA and the Impugned Provisions created for Canadian institutions and residents when compared to the alternative direct application of FATCA. The Court noted that the Canada-US IGA:

- is much shorter and easier to understand than FATCA;
- uses predominantly Canadian terminology and is to be interpreted in accordance with Canadian domestic law, making compliance easier for Canadian financial institutions and individuals;
- directs the exchange of tax information with the IRS to occur under the Canada-US Tax Treaty, thereby providing confidentiality requirements and restrictions under the Canada-US Tax Treaty, which would not be the case under FATCA;
- limits the number of financial institutions that are subject to FATCA's reporting requirements;
- broadens the category of institutions that are not required to conduct due diligence procedures to include First Nations governance bodies, and expands the categories of Canadian financial institutions that are exempted from the reporting requirements of FATCA;
- allows Canadian life insurers to assume that policy beneficiaries are not US persons;

- provides for more generous carve-outs for pre-existing cash value insurance and annuity contracts than would be the case under FATCA;
- contains a broad list of types of accounts that are not to be treated as US-reportable accounts, including RRSPs, RESPs, RDSPs, TFSAs, Registered Pension Plans, Registered Retirement Income Funds, Pooled Registered Pension Plans, the Canada Pension Plan, and Québec Pension Plan;
- removes the FATCA requirement that Canadian financial institutions close any foreign affiliate offices located in a jurisdiction that had not entered into an inter-governmental agreement with the US and whose bank secrecy laws did not permit the sharing of customer information;
- provides assurances from the US Government that Canadian financial institutions will not be required to close accounts held by recalcitrant accountholders or to deny service to their customers;
- provides that administrative errors will not put a Canadian financial institution into non-compliance, thereby reducing the risk of exposure to the 30% withholding tax imposed under FATCA;
- deems Canadian financial institutions to be FATCA-compliant, and provides for an 18-month cure-period in the case of significant non-compliance which is not provided for under FATCA; and
- imposes obligations on the United States in terms of the reciprocal exchange of information, thereby expanding the amount of information that the CRA receives from American authorities.

The Federal Court further noted that it must be reluctant to second-guess the way Canada exercises its prerogative powers in concluding an agreement with another country, and that approximately 100 other countries had entered into an agreement with the United States in efforts to mitigate the consequences of FATCA. Moreover, the Canada-US IGA was entered into contemporaneously with the Organisation for Economic Co-operation and Development ("OECD") development of its "common reporting standard" ("CRS"), which provides a global model for the automatic exchange of financial account information between countries, which model has now also been incorporated into the ITA in Part XIX and more than 100 other countries have committed to do the same in their own domestic tax legislation. While the CRS's reporting requirements are triggered by residency instead of the Impugned Provisions' operation on citizenship, and don't contain a withholding tax penalty as the Impugned Provisions do, they nevertheless require the reporting of largely the same categories of information as required under the Impugned Provisions.

Conclusion

In conclusion, the Federal Court held that in the balance of the Impugned Provisions' purpose to mitigate the harm caused by the direct application of FATCA, the limited privacy interest of individuals over their banking records, the minimal invasiveness of the information sharing, and the enhanced privacy provided to the information as a result of the application of the Canada-US Tax Treaty, the seizure of banking information contemplated by the Impugned Provisions was reasonable and thus not a violation of section 8 of the Charter.

Federal Court of Appeal Decision

On appeal, the FCA was charged with considering one issue: Did the Federal Court err when it concluded that the Impugned Provisions do not contemplate an unreasonable search or seizure for purposes of section 8 of the Charter?

The FCA began its analysis by noting that the Federal Court had performed only a very cursory analysis of whether the Impugned Provisions result in a "seizure", having merely noted that the parties had agreed that the Impugned Provisions resulted in a seizure. The FCA therefore made no finding on this issue.

The Appellants first argued that the Federal Court erred in its determination of the purpose of the Impugned Provisions, and that their true purpose was to assist the United States with administering its tax laws. The FCA noted that this was either a question of fact or mixed law and fact to which deference to the trial court should be given, and found no reviewable error on the part of the Federal Court in its determination that the purpose of the Impugned Provisions was to mitigate the harm that the direct application of FATCA might have to Canadian institutions and the Canadian economy.

The Appellants' second argument, not considered by the Federal Court, was that US persons could potentially face criminal charges in the United States from the seized and shared information which was not merely a regulatory matter and was significantly intrusive to persons' privacy. The Appellants cited *Jarvis*, which differentiated between audit and investigative materials obtained by the CRA. In respect of audit materials, the Supreme Court in *Jarvis* noted that "taxpayers have very little privacy interest in the materials and records that they are obliged to keep under the ITA, and that they are obliged to produce during an audit. . . . [T]here is nothing preventing auditors from passing to investigators their files containing validly obtained audit materials" (para 47). In contrast, with respect to investigative materials, the Supreme Court noted that section 7 of the Charter protects against self-incrimination, and that "when the predominant purpose of a question or inquiry is the determination of penal liability, the 'full panoply' of Charter rights are engaged for the taxpayer's protection" (para. 48). The FCA noted, however, that *Jarvis* characterized the ITA as a regulatory statute even though non-compliance with the statute may lead to criminal charges, and that the Appellants had not established how the predominant purpose test set out in *Jarvis* could apply to the Impugned Provisions. As *Jarvis* was binding on both the Federal Court and the FCA, the FCA concluded that the Federal Court did not err in relying on it in concluding that the Impugned Provisions are regulatory in nature and thus the Impugned Provisions do not intrude significantly on the privacy interests of affected persons simply on the basis that the information may possibly be used for a criminal prosecution.

Finally, the Appellants argued that the Impugned Provisions are harsh or burdensome as a result of the following facts:

- Affected persons may have very few connections to the United States and the United States may not otherwise know about their existence.
- Information will be disclosed about some persons who have no personal connection to the United States. An example was provided of a spouse of a US citizen resident in Canada.
- Affected persons are compelled to provide information to Canadian financial institutions.
- US citizenship is difficult and expensive to renounce or relinquish.
- The provisions are heavy-handed compared to the soft administrative approach of voluntary disclosure programs maintained by the Internal Revenue Service.

The FCA was satisfied that the Federal Court had considered these issues, and reasonably found them to be outweighed by the fact that the Impugned Provisions were enacted within the context of increased international cooperation in the administration of income tax laws, and that the Appellants had not demonstrated that the Impugned Provisions are more intrusive than is necessary to be effective, or that Canada could have achieved a more favourable outcome for affected persons.

Conclusion

The FCA thus held that the Federal Court did not err in concluding that the Impugned Provisions do not violate section 8 of the Charter.

— *Ron Dueck*

Peach v. Canada, 2022 DTC 5101 (Federal Court of Appeal) — Rental Expenses Are Not Deductible If There Is No Pursuit of Profit; Business Expenses Are Not Deductible If They Would Not Be Incurred by a Commercially-Minded Businessperson

Background

In his 2009 to 2011 income tax returns, Mr. Harold Peach (the "Taxpayer") deducted a significant amount of expenses in respect of the rental of certain properties to his sons and his part-time business that he has operated since 1999 without ever earning a profit. In August 2011, the Taxpayer and his wife transferred ownership of one of the rental properties to the son that was renting it; however, the Taxpayer did not report this transfer in his 2011 tax return.

The Minister reassessed the Taxpayer's 2009 and 2010 taxation years on the basis that the rental properties were not a source of income and that the expenses he claimed in respect of his business were not reasonable. The Taxpayer appealed to the Tax Court of Canada and then the Federal Court of Appeal; however, both Courts held that the Taxpayer's rental activities were predominantly personal and did not amount to a source of income and that most, but not all, of his business expenses were unreasonable.

The Minister then reassessed the Taxpayer's 2011 taxation year on the basis, again, that the rental properties were not a source of income and that the expenses he claimed in respect of his business were not reasonable. In addition, the Minister added a taxable capital gain to the Taxpayer's 2011 income in respect of the transfer of the rental property to his son. Again, the Taxpayer appealed to the Tax Court of Canada and the Federal Court of Appeal; however, the Taxpayer submitted that he had better evidence this time and that the facts in 2011 were different than in 2009 and 2010.

One fact in 2011 that was different than those in 2009 and 2010 was that the first reassessment was issued beyond the normal reassessment period for 2011. After the Taxpayer objected to the first reassessment, the Minister issued a second reassessment, which is the subject of the Taxpayer's current appeal.

Issues and Tax Court Decision

There were four issues at the Tax Court in respect of the Taxpayer's 2011 taxation year:

(1) Were the rental properties sources of income?

(2) Are any of the disallowed business expenses deductible by the Taxpayer?

(3) Did the Taxpayer realize a taxable capital gain on the transfer of the rental property to his son and, if so, what was the amount of the taxable capital gain?

(4) Was the Minister entitled to reassess the Taxpayer's 2011 taxation year beyond the normal reassessment period?

Issue 1: The Rental Properties

The Tax Court found that, in 2011, as in 2009 and 2010, the Taxpayer was not pursuing a profit from these rental activities (as he was charging his sons below market value rent) and thus, none of the properties were sources of income.

The Taxpayer presented appraisal reports in the 2011 appeal, which he did not present in the 2009 and 2010 appeals. Unfortunately, the Taxpayer's 2011 appraisals were not appraisals of market value rents but of the fair market value of properties with reference to comparable sales. Although the Taxpayer's appraisals provided some figures regarding market rent for the area, these figures were not supported by any analysis or explanation and the Taxpayer did not call the appraiser as a witness to explain where these figures came from. Thus, the Tax Court found the Taxpayer's evidence to be much less persuasive than the Minister's 2011 appraisals, which, as in the 2009 and 2010 appeals, included supporting analysis and led to the finding that the Taxpayer was charging his sons below market value rent.

Issue 2: The Business Expenses

The Tax Court held that the business expenses that were disallowed by the Minister were unreasonable and therefore not deductible because no "commercially-minded business person", if in the Taxpayer's circumstances, would continue to incur such expenses year after year. The Tax Court noted that the Taxpayer's expenses substantially exceeded his revenues in every year since the business was started in 1999 and that in 2011 specifically, the Taxpayer gained no new clients, deducted over $19,600 of expenses, and earned only $27 in commissions. The disallowed expenses, none of which the Taxpayer could provide a business reason for, included the purchase of an ipod, an Irewards renewal fee, and ExpressPost to his wife and daughter.

Issue 3: The Taxable Capital Gain

The Taxpayer transferred a rental property to his son, a related person with whom the Taxpayer is deemed not to deal at arm's length. Accordingly, for the purpose of computing his income, the Taxpayer is deemed to receive, for the transferred property, proceeds of disposition equal to the greater of the amount his son paid to him and the fair market value of the property at the time.

The Tax Court held that the Taxpayer's taxable capital gain should be calculated using the fair market value used by the Minister because the Taxpayer did not persuade it that the Minister's fair market value was incorrect. The Minister's fair market value was both at the bottom end of the range in the CRA's appraisal and also within the range provided by the Taxpayer's own appraiser. The Taxpayer criticized both appraisals and asserted that the fair market value was substantially less than the value used by the Minister, but failed to provide any evidence supporting this claim.

With regards to the adjusted cost base of the property, the Tax Court found that the Taxpayer established, on a balance of probabilities, that the cost of replacing the windows in 2007 (for which the Taxpayer provided a receipt) should be included in his cost of the property.

Issue 4: Reassessment Beyond the Normal Reassessment Period

The Tax Court held that Minister was permitted to reassess the Taxpayer beyond the normal reassessment period for 2011 because, in filing his 2011 income tax return, the Taxpayer made misrepresentations that were attributable to neglect or carelessness. Specifically, the Taxpayer deducted expenses that were clearly personal, took very little care in properly allocating expenses between capital and non-capital, and recognized that his tax return was difficult to review but did nothing to overcome that difficulty. The Tax Court noted that the Taxpayer decided to prepare his own income tax return and in doing so he was responsible for ensuring compliance with the law, informing himself in respect of that law, and seeking advice if he was uncertain about certain items.

Federal Court of Appeal Decision

At the Federal Court of Appeal, the Taxpayer argued that:

(1) The Minister was not permitted to reassess any part of his income beyond the normal reassessment period because the Minister had the necessary documentation and sufficient time to complete its audit before the normal reassessment period elapsed;

(2) The Tax Court breached its duty of procedural fairness because the judge interfered with his right to make his case by interrupting his cross-examination, directing him as to how he should proceed, and questioning him about his evidence;

(3) The Tax Court incorrectly concluded that the rental properties were not a source of income, based on its misapplication of *Stewart v. R.*, 2002 DTC 6969 (SCC), and the Tax Court's error in preferring the Minister's appraisal reports to his own; and

(4) the Tax Court erred in denying deductible business expenses on the basis of his business judgment, citing *Keeping v. R.*, 2001 FCA 182.

In this appeal, the Federal Court of Appeal was required to review the Tax Court's findings of fact and mixed fact and law on the standard of "palpable and overriding error". In the end, the Federal Court of Appeal found no reviewable error in the Tax Court's decision or in the manner in which the Tax Court judge conducted the trial. Specifically, the Federal Court of Appeal held that:

(1) The reason the Minister did not reassess within the three-year period is irrelevant in finding misrepresentation that is attributable to neglect or carelessness;

(2) The Tax Court judge's questions did not amount to excessive intervention and did not give the impression that she had a closed mind or was no longer impartial; instead the transcript of the Tax Court hearing demonstrated that the judge intervened only to ensure that she fully understood the Taxpayer's evidence and argument, to direct the appellant towards the applicable legal considerations, and to ensure that the proceeding respected basic trial procedures;

(3) The Tax Court properly considered the test from *Stewart*, made no reviewable error in concluding that the rental properties were not a source of income, and had ample evidence to support this conclusion; and

(4) *Keeping* was not an authority for the Taxpayer's argument and that the Tax Court carefully and correctly assessed the reasonableness of the business expenditures against the standard of how a commercially-minded businessperson would act if they were in the Taxpayer's circumstances.

Conclusion

The Tax Court of Canada and Federal Court of Appeal both held that the Minister correctly disallowed the deduction of certain expenses for which the Taxpayer provided no evidence or insufficient evidence to support.

— *Francis Chang*

RECENT CASES

Federal Court Grants Summary Judgment and $10,000 Costs

The Plaintiff sued the Canada Revenue Agency ("CRA") for $10 million in damages for the sale of his farm property by a third-party mortgagee, alleging negligence, fraud, and Charter violations. The Plaintiff conducted illegal marijuana-growing operations on the property from 2002 to 2005, for which he was convicted in 2007, and was charged for the same offence in 2012. He then refinanced the property but defaulted in 2013, resulting in the sale of the farm in 2014. In spite of his marijuana-growing activities, he reported nil income for 2002–2007 and 2012. The CRA began auditing the Plaintiff in 2008. In January 2009, the CRA sent the Plaintiff a T1 notice of reassessment and a GST notice of assessment, the latter to the wrong address. The Plaintiff objected to the T1 reassessment and in 2010 the CRA reduced the amount. The Plaintiff did not object to this reassessment. In September 2012 the Federal Court certified the T1 and GST debts. The following month the CRA registered liens on the property for both debts. It refused to discharge them until the debts were paid. Here, the CRA moved for summary judgment.

The Federal Court granted the motion and imposed costs of $10,000 on the Plaintiff. The Court identified five issues to be resolved. First, the various assessments and reassessments made by the CRA throughout this matter were valid and binding. In particular, the Plaintiff had an opportunity to object to the CRA's 2010 reassessment of his T1 and did not do so. As for the GST, a notice of reassessment had been delivered to the wrong address, but once the CRA was apprised of this, it issued a reassessment consistent with the T1 reassessment and equally binding. Second, the CRA's collection actions were proper and valid. The CRA did not impose the liens before the 90-days-after-an-assessment limitation on collection action; its refusal to lift the liens was a discretionary decision subject to judicial review, but the Plaintiff never sought such review. Third, the Plaintiff's claims of negligence were dismissed because the CRA does not owe taxpayers a duty of care due to their "intrinsically adversarial relationship". Nonetheless, the Court engaged in the so-called Anns/Cooper analysis and found no duty of care. Fourth, the Plaintiff's claims of fraud advanced none of the common-law elements of fraud, not even false representation: an error on the CRA's part, which was rectified upon notice, did not amount to a false representation. Finally, the Court found that there was insufficient evidence that the CRA's actions had a serious and profound effect on the Plaintiff's physical or psychological integrity, which is required for a breach of the life, liberty, and personal security provisions of article 7 of the Charter. Thus, the reassessments were binding and the CRA's collection actions were proper and valid.

Oddi v. CRA

2022 DTC 5096

Tax Court Rejects Due Diligence Defence by Corporate Director

The Appellant was a director of a small diamond-cutting startup who was assessed for unremitted source deductions in 2011 and 2012. He offered a due diligence defence, per subsection 227.1(3) of the *Income Tax Act*, noting that he had asked about the status of remittances at every board meeting ("check the box" questioning), tracing how he tried to recover corporate assets, partly coordinating with the CRA, and explaining that his priority was to get audited financial statements for the company in order to get the company listed on an exchange, not the "tiny" amount of remittances at stake here.

The Tax Court dismissed the appeal. The record established that as early as 2010 the Appellant had been aware of problems obtaining reliable financial statements from the company, but considered that as an "outside" director he had no responsibility for confirming remittances. He exercised no duty of care, diligence, or skill with respect to these matters. The Court found that as early as January 2011 a reasonable director would have sought documentary evidence of the remittances and contacted the CRA in its absence. Moreover, it was clear from the leading case that "outside" directors are equally required to carry out their duties on an active basis. And the Appellant was not as uninvolved in internal corporate affairs as he claimed, serving as treasurer and secretary, being involved in hiring decisions, and signing letters to the CRA from the company. Finally, the Appellant argued that his activities in trying to seize and sell corporate assets amounted to an attempt to cure the failures to remit, establishing his due diligence. The Court rejected his cited authorities, noting that according to one, due diligence was not satisfied by an unsuccessful attempt to cure, and that in the other the director attempted to rectify the situation and resigned when she failed to do so.

Burnett v. The Queen

2022 DTC 1069

FCA Holds That Electronic Tips Incur CPP and EI Obligations for Employer

When a customer paid a tip electronically as part of settling a bill at the Appellant's restaurant, servers received their net portion of the tip as a "due-back" transferred from the employer to the servers' accounts. The CRA assessed the Appellant for due-back amounts in its 2015–2017 taxation years under the *Canada Pension Plan* ("CPP") and the *Employment Insurance Act* ("EIA"). In the Tax Court, the Appellant argued that the due-backs were not "paid" in the sense required by both statutes, so that they constituted contributory salary and wages for purposes of the CPP and insurable earnings for purposes of the EIA. The Tax Court disagreed, holding the Appellant liable for the assessed CRA and EIA premiums.

The Federal Court of Appeal dismissed the appeal. The Appellant raised three grounds of appeal. First, it argued that the phrase "in respect of" employment in the statutes was not broad enough to cover the electronic net tips, which were "an amount paid in respect of the difference between cash received and tips." The Court rejected this argument, agreeing with the Tax Court and the Supreme Court of Canada that the tips were clearly "in respect of" the servers' employment, since they would not have received them if they had not been employed. Second, the Appellant argued the tips were not "paid" in the sense of the Acts and therefore did not incur liability, because this was a "conversion" case, in which it merely converted the electronic tips to cash for the employees, not a "distribution" case in which the employer received the tips and distributed them to the employees, analogizing to *Lake City Casinos Ltd v. MNR*, which involved gratuities to casino employees. The FCA rejected this analogy, noting the agreed fact that the gratuities were never in the employer's possession. Third, the Appellant argued, though not at the hearing, that the Tax Court erred in finding that the restaurant customers intended the electronic tips to be the property of the Appellant. The FCA held that the Tax Court was merely describing the effect of an electronic payment that included a tip, not an erroneous finding of fact made in a perverse or capricious manner, as specified by the *Federal Courts Act*.

Ristorante a Mano Ltd. v. MNR

2022 DTC 5094

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