Tax Notes

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UNNAMED PERSON REQUIREMENT: CRA'S NOT-SO-SECRET WEAPON AGAINST THE UNDERGROUND ECONOMY?

— Jacques Roberge, Wolters Kluwer Canada Limited

The mainstream written and electronic media have recently commented on the Canada Revenue Agency's ("CRA's") "victory" over The Home Depot in its quest to obtain the list and details of The Home Depot's commercial customers (those customers, such as contractors, that benefit from a commercial discount). See, for example, this article from the Financial Post: "Contractors buying from Home Depot, other retailers beware — the CRA is coming after you".[1] Indeed, the Federal Court issued an order last July forcing The Home Depot to provide the details of such customers as well as the amount of purchases they made (an Unnamed Person Requirement or "UPR").[2] The Home Depot had until September to comply and has since informed its clients that they have in fact complied and the clients may be audited by the CRA.

This has been a long process, since the CRA first requested that order in 2016. However, both parties agreed that the Federal Court order would not be issued until the outcome of a similar battle involving RONA, one of The Home Depot's main competitors, was resolved. RONA pushed back and objected to a similar UPR at the Federal Court of Canada[3] and unsuccessfully appealed the unfavourable decision to the Federal Court of Appeal.[4] The Supreme Court of Canada refused to grant leave for a further appeal.[5] It's at this point that The Home Depot also ended their resistance to the issuance of the Federal Court's order.

The denouement of The Home Depot's and RONA's disputes with the CRA gives us a perfect opportunity to review the principles underlying the use of governmental requests for information about "unnamed persons". Many people — including judges — have likened such procedures to "fishing expeditions".

The Benefits for the CRA

These are obviously enormous. The CRA obtains the names and details of persons who, in the RONA and Home Depot cases, are possibly involved in commercial renovation or construction work. The CRA can then easily cross-reference this data with their own files to see if the persons are registered for GST/HST (when the level of purchases from RONA or Home Depot suggest they should be) and if they declared income from construction

[1] https://www.msn.com/en-ca/news/canada/contractors-buying-from-home-depot-other-retailers-beware-%E2%80%94-the-cra-is-coming-after-you/ar-AAJTDGx?ocid=spartanntp.

[2] *Minister of National Revenue v. Home Depot of Canada Inc.*, File #T-551-16, order dated July 25, 2019, rendered by The Honourable Mr. Justice LeBlanc: "The Court's decision is with regard to Motion in writing Doc. No. 4 Result: THIS COURT ORDERS that: 1. The Minister's Motion allowing the Minister's Application, thereby authorizing the Minister to impose on Home Depot the Unnamed Persons Requireemnts [sic] found in the Annex to this Order . . ."

[3] *Ministre de Revenu National c. RONA Inc.*, File #T-2059-15, order dated October 28, 2016.

[4] *Rona Inc. v. Canada (National Revenu)*, 2017 DTC 5069 (FCA).

[5] *RONA Inc. v. Minister of National Revenue*, 2018 CanLII 3412.

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or renovation work. It is well known that there is a significant amount of GST/HST and income tax evasion in these industries, especially where numerous transactions are made in cash.

UPRs are used not only with respect to the construction and renovation industries, but in many others, such as financial institutions and other businesses not related to construction or renovation. It should also be noted that these formal requests for information should not be confused with information that the CRA may routinely obtain about third parties during audits. For example, during an audit of "Company A", the CRA will have access to invoices issued to "A" by many suppliers and this information may be used by the CRA to verify if these suppliers are complying with the tax laws. The UPRs which are the subject of this article are different animals, subject to specific legal requirements which have led to the important judgments we will review herein.

The Legal Framework

For *Income Tax Act* ("ITA") purposes, the authority to obtain taxpayer and related information and the considerations applicable are outlined in section 231.2 of the ITA:

> **231.2 Requirement to provide documents or information** —
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> *(1) Requirement to provide documents or information* — Notwithstanding any other provision of this Act, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of this Act (including the collection of any amount payable under this Act by any person), of a listed international agreement or, for greater certainty, of a tax treaty with another country, by notice served personally or by registered or certified mail, require that any person provide, within such reasonable time as is stipulated in the notice,
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> (a) any information or additional information, including a return of income or a supplementary return; or
>
> (b) any document.
>
> *(2) Unnamed persons* — The Minister shall not impose on any person (in this section referred to as a "third party") a requirement under subsection 231.2(1) to provide information or any document relating to one or more unnamed persons unless the Minister first obtains the authorization of a judge under subsection 231.2(3).
>
> *(3) Judicial authorization* — A judge of the Federal Court may, on application by the Minister and subject to any conditions that the judge considers appropriate, authorize the Minister to impose on a third party a requirement under subsection (1) relating to an unnamed person or more than one unnamed person (in this section referred to as the "group") if the judge is satisfied by information on oath that
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> (a) the person or group is ascertainable; and
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> (b) the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under this Act.

For GST/HST purposes, section 289 of the *Excise Tax Act* ("ETA") provides the corresponding, identical text.

Accordingly, to obtain UPR information, the CRA must first obtain judicial authorization and, crucially, the information must be sought from an *ascertainable group*, and the requirement must be needed to verify compliance by some person or persons with their tax obligations. In other words, an audit must be in process for at least one member of the ascertainable group. Obviously an "unnamed person" would normally not be under audit, but if other members of the ascertainable group are, the unnamed person may become the subject of an audit (meaning an assessment based on the information obtained through the UPR may result). If a judge determines that the foregoing requirements have not been met, the judicial authorization will not be issued.

Although the texts of section 231.2 of the ITA and section 289 of the ETA appear to give very broad authority to the CRA to seek taxpayers' information, jurisprudence draws the line at "fishing expeditions" that do not have a specific purpose (this implies that certain fishing expeditions may nevertheless justify issuing a UPR).

It's in this context that we will review rapidly the findings of the Courts in recent decisions relating to UPRs.

Canada (National Revenue) v. Roofmart Ontario Inc.[6]

This relatively short and recent decision summarizes the current view of the Federal Court, which recognizes that sections 231.2 of the ITA and 289 of the ETA appear to give sweeping powers to request information. It also provides insight into the Federal Court's interpretation of the limitations on such powers. In its UPR request, the CRA asked for the following information and documents:

> [2] The Minister is seeking information about residential and commercial construction contractors who have an account with Ontario Roofmart. Namely, the Minister asks for authorization to issue the Unnamed Persons Requirement seeking the following information and documents:

[6] 2019 DTC 5064 (FC).

(a) The Customers' legal name, business or operating name, contact person, business address, postal code, and all telephone numbers on file;

(b) The Customers' business number, if known;

(c) The Customers' itemized transaction details including invoice date, invoice number, total sales amount, method of payment, and address of delivery, [sic] and

(d) All bank account information for the Customers (including transit, institution, and account numbers) from credit applications and/or otherwise maintained by Roofmart in its records.

For the period January 1, 2015 to June 30, 2018, the information sought was for those customers whose total annual purchase and/or billed amount was $20,000 or greater. For the period from January 1, 2018 to June 30, 2018, the data sought was for customers whose total annual purchase and/or billed amount was $10,000 or greater. The Minister intended to give Roofmart 60 days to comply with the Requirement.

While Roofmart's counsel argued five conditions must be met by the Minister prior to the issuance of a UPR, the Federal Court stated:

> [8] . . . Rather, as set out in the statute, there are only two requirements that must be met:
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> a) Whether the unnamed persons are ascertainable and,
>
> b) Whether, the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under this Act.
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> [9] The Court in *MNR v GMREB* [2007 FCA 346] interpreted the requirement under subsection (b) to include where "the information . . . [is] required for a tax audit conducted in good faith" (paragraph 48).
>
> . . .
>
> [11] I am satisfied that the unnamed persons in this instance are an ascertainable group. In my view, the total annual purchase requirement set out in the Unnamed Persons Requirement is sufficient to establish the target group of residential and commercial contractors among Roofmart's customers. Further, Roofmart maintains records for its customers and their identities are known to Roofmart.
>
> [12] The Respondent further argues that the Minister has not met the requirement set out in s. 231.2(3)(b) of the ITA. It argues that the Minister has not established, nor even alleged, that she is engaged in a tax audit of the target group of unnamed persons. However, the Federal Court of Appeal in *MNR v GMREB* is clear that a good faith tax audit could include a "tax audit project", as opposed to a tax audit of particular individuals already underway (paragraphs 19, 42 – 43).
>
> [13] Based on the information provided in the Blackmore Affidavit, I am satisfied that the Unnamed Persons Requirement is made to verify compliance by the person or persons in the group with any duty or obligation under the ITA and ETA. The evidence provided establishes that the Minister seeks the Unnamed Persons Requirement in order to verify whether Roofmart's commercial customers are compliant with their duties and obligations under the ITA and ETA, namely to: 1) use the requested data to verify whether the Unnamed Persons have filed all of their required income tax returns, payroll remittances and GST/HST returns and 2) to determine whether the Unnamed Persons have properly (a) reported all or any of the income earned on the sale or supply of roofing and building supplies/materials, (b) claimed amounts as business expenses, (c) collected and remitted payroll tax, and, (d) calculated and remitted GST/HST.
>
> [14] In conclusion, in the circumstances of this case and in light of the fact that the requirements of the ITA and the ETA are satisfied, in my view, it is appropriate and in the interests of justice to exercise my discretion in favour of the Minister and to authorize the Minister to impose the Unnamed Persons Requirement on Roofmart.

While the *Roofmart* decision and the decisions rendered against RONA, as well as similar decisions too numerous to outline here, appear to indicate that the CRA has virtually limitless powers (provided the group from which information is sought is ascertainable and the process is part of an audit or audit project), it is encouraging to review an important judgment where the Federal Court balked at granting the judicial authorization, and provided in the process guidelines limiting somewhat the UPR powers of the CRA.

Canada (National Revenue) v. Hydro-Québec[7]

This decision, where the UPR authorization was not granted by the Federal Court, is particularly remarkable because Hydro-Québec did not object to the request from the CRA. Nevertheless, the Court needed to confirm that the legal requirements of section 231.2 of the ITA had been met in order to issue the required authorization. As such, the agreement of Hydro-Québec to provide the requested information had no bearing on the decision. *Canada (National*

[7] 2018 DTC 5096 (FC).

Revenue) v. Hydro-Québec also provides a useful history of the changes made to section 231.2 and of the related jurisprudence. It also demonstrates that the CRA apparently believes it has virtually limitless powers regarding the information it may request.

The Federal Court, on the other hand, saw its role as establishing a balance between the right of the CRA to obtain information and the right to privacy (or the right to keep the state out of individuals' business by regulating searches and seizures). The Court's position may be summarized in the following excerpt from its conclusions:

> [100] This request for authorization illustrates the danger of the reading of subsections (2) and (3) of section 231.2 the applicant is proposing. That reading enables an unlimited invasion of privacy. It is accepted that there is a very low expectation of privacy in business and tax records. But what about hydro consumption by "business" clients of a public utility, which may well include tens of thousands of customers, including residences? I will say it again. *McKinlay* [[1990] 1 SCR 627] recognized the constitutionality of the requirement under the former subsection 231(3) (which is essentially the current subsection 231.2(1)) thanks, in good measure, to the limited scope of subsection 231(3) in the application of common law rules on statutory interpretation by requiring that the application or enforcement of the Act be demonstrated by the existence of a genuine and serious inquiry. The Federal Court of Appeal replaced that requirement with the tax audit conducted in good faith with a genuine factual basis, the audit serving to confirm compliance with the Act. In my view, these requirements must be strictly followed. The sole fact of the applicant being interested in an ordinary phenomenon, such as the transfer of currency abroad (*Fédération des Caisses* [1997 2 CTC 159]) or the underground market is not a tax audit. Perhaps there could be a genuine tax audit conducted in good faith eventually. However, it would be a mischaracterization of the tax audit and would eliminate the conditions in subsection 231.2(3) to pretend that it may include a list of business clients of a public utility.
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> [101] In the end, what the applicant is seeking is an interpretation where the conditions in subsection 231.2(3) would become non-existent. An ascertainable group would then be composed of any individuals and the information that could be required is that which the applicant considers potentially useful. The invasion of privacy would be unlimited. If that is the case, it was not communicated to the Court. Any person in Quebec paying the business rate to Hydro-Québec could be intruded upon by the state. This interpretation would render useless the judicial involvement that Parliament nevertheless considered necessary to be convinced that the preconditions have been met.
>
> [102] In addition to the requirement failing to meet the two criteria required for judicial authorization to be granted, I do not hesitate to exercise judicial discretion in the face of the practically unlimited scope of such a request and a complete lack of consideration for the invasion of privacy and the consequences for all taxpayers involved in the request.

In *Canada (National Revenue) v. Hydro-Québec*, the CRA had requested information on Hydro-Québec's business customers. The Federal Court found that this group was poorly and vaguely defined and that it did not amount to an ascertainable group. The Court also found that a proper link to a tax audit and to tax compliance needs had not been established. The Federal Court recognized that, through evolution of the wording of the legislation and jurisprudence, the courts have recognized that the law authorizes some "fishing expeditions" using sections 231.2 of the ITA and 289 of the ETA. However, as the *Hydro-Québec* case confirms, not all fishing expeditions are permitted, as they must be limited to a clearly ascertainable group and related to a tax audit.

A Tool Against Tax Evasion

There is no doubt that the CRA is using UPRs to identify tax evaders. In an email, CRA spokeswoman Jelica Zdeno said the third-party approach yielded $10.8 million in taxes, $1.5 million in arrears interest, and $2.1 million in penalties in the 2010/11 and 2012/13 taxation years. UPR has also been used against eBay, which was required to supply a list of its Canadian "Power Sellers", thus allowing the CRA to verify if the sellers' income was included in their tax returns.

According to information in some of the documents filed with the courts, the audit of 93 hardware stores in 19 different communities found that 7% of installers were income tax evaders. As a result, it is fair to presume that the CRA expects to identify tax evaders from the information they compelled RONA and The Home Depot to provide.

Any persons fearing that the CRA may discover they have not declared all their income are well advised to consider filing a *Voluntary Disclosures Program* admission to avoid the application of interest and penalties, bearing in mind that such disclosures must be undertaken *before* being advised by the CRA that they are under audit.

In conclusion, it seems most corporations do not object to these UPR requests. Nevertheless, if you are required to supply such information by the CRA, and you choose not to object (a wise decision since the Federal Court liberally authorizes such requests), it's advisable to inform the targeted third parties that they may be subject to audit by the CRA.

The latest changes in the text of the law and the jurisprudence (other than the *Hydro-Québec* case) confirm the sweeping power the CRA has in obtaining third-party information pursuant to sections 231.2 of the ITA and 289 of the ETA. It will, as always, be interesting to see how the use of UPR evolves and the jurisprudence develops.

CURRENT ITEMS OF INTEREST

FATCA Record Sharing Update

According to an article published by the CBC,[1] the CRA sent 900,000 financial account records to the IRS in September 2019. The number of records sent to the IRS has risen substantially from 150,000 in 2014, which is when the information sharing began pursuant to the intergovernmental agreement signed after the US passed the Foreign Account Tax Compliance Act ("FATCA"). To date, 2.6 million records have been shared. However, the CRA did not disclose how many records it similarly received from the IRS.

2019 Ontario Economic Outlook and Fiscal Review

The *2019 Ontario Economic Outlook and Fiscal Review: A Plan to Build Ontario Together* was presented by Finance Minister Rod Philips on November 6, 2019. Though higher than the actual 2018–2019 deficit of $7.4 billion, the projected $9 billion deficit for 2019–2020 is $1.3 billion lower than what was initially estimated in the 2019 Budget that was presented earlier this year. Only three new tax changes were announced as a part of the fiscal update.

First, the government proposes to cut the small business tax rate from 3.5% (on the first $500,000 of active business income) to 3.2%, effective January 1, 2020. The rates will be prorated for corporate taxation years that straddle January 1, 2020. In conjunction with the reduction to the rate a corporation pays on its small business income, the provincial dividend tax credit for non-eligible dividends will be reduced from 3.2863% to 2.9863%, effective January 1, 2020.

Second, the government proposes to reduce the rate of the aviation fuel tax in Northern Ontario from 6.7 ¢/L to 2.7 ¢/L, effective January 1, 2020. The reduction applies to aviation fuel that is purchased within the North. For this purpose, "the North" refers to the districts of Algoma, Cochrane, Kenora, Manitoulin, Nipissing, Parry Sound, Rainy River, Sudbury, Thunder Bay, and Timiskaming. Fuel wholesalers that prepay the aviation fuel tax at the rate of 6.7 ¢/L but sell it to a retailer or consumer in the North at the rate of 2.7 ¢/L can apply to the Ministry of Finance for an adjustment for the tax rate difference.

And third, the government wishes to simplify the administration of the *Gasoline Tax Act* by aligning the computation for interest on refunds with the same timeline as under the *Fuel Tax Act*. Interest will be payable from the date of the refund until the date that the refund is paid.

Fall 2019 Update on Quebec's Economic and Financial Situation

On November 7, 2019, Minister of Finance Eric Girard presented the province's *Update on Québec's Economic and Financial Situation* (the "Fall Update").

Quebec's Economy

Minister Girard emphasized Quebec's economy is performing remarkably well. In 2019, GDP growth will reach 2.4%, up 0.6 percentage points compared to forecasts in the budget of last March. This strong economic performance points to a surplus of $1.4 billion for fiscal 2019-2020. According to the Minister, the government intends to use this surplus to fight climate change, deal with a potential economic slowdown, and reduce the debt. The provincial government's objective of reducing the debt burden to 45% of GDP is forecast to be achieved in the current fiscal year, six years ahead of schedule.

Indexing of Personal Income Tax and Certain Government Fees

Minister Girard announced a 1.72% indexing rate which will apply as of January 1, 2020, impacting the parameters of the personal income tax system, social assistance benefits, and certain government rates. In particular, this indexing of social assistance program benefits will allow the most disadvantaged Quebecers to benefit from additional financial assistance.

The indexing rate will apply to government fees that are not yet subject to an indexing rule or set annually. Indexing reflects the increase in the cost of fee-based services without raising the service user's share of the cost. Indexing will generate additional revenues which will be used to maintain the quality of public goods and services.

[1] https://www.cbc.ca/news/politics/fatca-tax-us-canada-1.5353942.

Spending Highlights and Related Initiatives

Minister Girard announced an additional $857 million will be invested starting this year to accelerate the implementation of the government's commitments made to Quebecers, including:

- the full enhancement of the family allowance as of next January (two years earlier than expected), whereby nearly 679,000 families will receive on average an additional $779 per year;
- the elimination of the additional contribution for childcare and the return to a single reduced rate for subsidized childcare services starting this year (three years earlier than expected), which means that 140,000 families will no longer have to pay an additional fee of $1,100; and
- a significant reduction, starting next spring, in Quebec's healthcare institution parking fees, meaning the first two hours will be free of charge and the maximum rate will be set at an amount varying between $7 to $10 per day depending on the region.

Furthermore, the provincial government is acting on a request from the Québec Ombudsperson by granting social assistance recipients who have not filed an income tax return access to the basic amount under the QST component of the solidarity tax credit by June 2020. In the Fall Update, the Minister also highlighted the fact that the province introduced last June a second level for the supplement for handicapped children requiring exceptional care, which will allow 3,000 families to receive an additional $652 per month.

Initiatives totalling more than $1.4 billion over five years are also planned to meet specific needs of Quebecers, including:

- establishing Partnership 2020-2024, an initiative towards building stronger municipalities and regions;
- implementing the support plan for print media companies (announced last October 2);
- modernizing the taxi industry; and
- extending the electricity discount programs.

Maximum Pensionable Earnings for 2020

The CRA has announced that the maximum pensionable earnings for 2020 will be $58,700. In 2019, the maximum pensionable earnings was $57,400. This is the maximum amount of an employee's income that is subject to contributions to the CPP. The basic exemption will remain at $3,500 in 2020. Increased due to the CPP enhancement, the employee and employer contribution rates for 2020 will be 5.25% in 2020 (up from 5.1% in 2019), and accordingly the self-employed contribution rate will be 10.50%. As a result, the maximum contribution for employees and employers in 2020 will be $2,898 each.

FOCUS ON CURRENT CASES

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

Transactions Not a "Fresh Start" by a Lossco but, Rather, a Monetization of Its Tax Attributes

***Birchcliff Energy Ltd. v. The Queen*, 2019 DTC 5072 (Federal Court of Appeal)**

In *Birchcliff Energy*, the Federal Court of Appeal (the "FCA") applied the general anti-avoidance rule ("GAAR") to prevent the losses and other tax attributes of one company (a lossco) from being used by a company (an amalco) into which the lossco was amalgamated. The FCA held that the overall result of the relevant transactions was that the losses that arose during the lossco's unsuccessful medical supply business were not able to be used in the amalco's oil and gas business because the rules that apply on an amalgamation to determine whether there has been an acquisition of control had been abused.

Summary of the Key Facts

Simplified, the key facts in *Birchcliff Energy* are as follows:

(1) Veracel Inc. ("Lossco") had previously carried on an unsuccessful medical supply business. Before the transactions summarized below, Lossco had accumulated substantial non-capital losses, scientific research and experimental development expenses, and investment tax credits, and Lossco had ceased to carry on its business.

(2) In early 2005, Birchcliff Energy Ltd. ("Old Birchcliff") entered into letter agreements to purchase oil and gas properties in Alberta.

(3) From March 2005 to May 2005, Lossco and Old Birchcliff entered into several agreements designed to permit Lossco's losses and other tax attributes to be used to offset profits generated by the oil and gas properties that Old Birchcliff had committed to acquire.

(4) Instead of Old Birchcliff financing the acquisition of all of the oil and gas properties itself, on May 4, 2005, Lossco sold subscription receipts to the public. Because Lossco was not the company that had committed to acquire the oil and gas properties, conditions were included in the subscription receipts that the funds raised would not be released unless and until Lossco amalgamated with Old Birchcliff. If the amalgamation did not occur, the investors' money would be refunded.

(5) On May 31, 2005, the investors in the subscription receipts of Lossco received Class B common shares of Lossco. Lossco and Old Birchcliff then amalgamated to form Birchcliff Energy Ltd. ("New Birchcliff"). New Birchcliff purchased the relevant oil and gas properties.

(6) On the amalgamation,

(a) The existing/prior shareholders of Lossco (other than the former subscription receipt holders) could receive either non-voting preference shares of New Birchcliff (which shares were to be redeemed for cash shortly after the amalgamation) or common shares of New Birchcliff. The existing/prior shareholders of Lossco that chose to receive common shares of New Birchcliff received a total of approximately 117,000 shares of New Birchcliff.

(b) The investors in subscription receipts of Lossco, who held Class B common shares of Lossco, received 34 million common shares in New Birchcliff.

(c) The shareholders of Old Birchcliff received approximately 20 million common shares of New Birchcliff.

(7) After the amalgamation, losses that had accumulated in Lossco were used in New Birchcliff. The CRA denied the losses.

Loss Streaming Rules Avoided

This case engaged certain loss streaming rules. As it read at the relevant time, paragraph 111(5)(*a*) of the *Income Tax Act* (the "Act") provided that when there was an acquisition of control of a corporation, non-capital losses that arose in taxation years before the acquisition of control could not be carried forward to a post-acquisition of control taxation year unless the corporation carried on the same business after the acquisition of control, and with a reasonable expectation of profit, and only to the extent of income from the same business or a similar business.

Paragraph 256(7)(*b*) provides rules for determining whether there has been an acquisition of control of a predecessor corporation (such as Lossco) when the predecessor amalgamates with another corporation (such as Old Birchcliff). One of those rules, subparagraph 256(7)(*b*)(iii), provides that when two or more corporations amalgamate, control of each predecessor corporation is deemed to have been acquired unless an exception applies. The relevant exception in this case was clause 256(7)(*b*)(iii)(B), which contained a so-called hypothetical shareholding test: if all of the shares of the amalgamated corporation issued to the shareholders of the particular predecessor corporation (such as Lossco) were instead issued to a single hypothetical shareholder, the amalgamation would not cause an acquisition of control of that predecessor (such as Lossco) if the hypothetical shareholder would control the amalgamated corporation (such as New Birchcliff). For purposes of the GAAR analysis, the FCA proceeded on the basis that the hypothetical shareholder exception applied to prevent an acquisition of control of Lossco because the pre-amalgamation shareholders of Lossco (including the new Class B common shareholders of Lossco), aggregated as a single hypothetical shareholder, would control New Birchcliff. In the result, subject to GAAR, the amalgamation did not result in an acquisition of the control that triggered the application of the loss streaming rules to the Lossco tax attributes that were inherited by New Birchcliff following the amalgamation.

Decisions in the Tax Court

In the Tax Court of Canada, the Crown argued that the Class B shares of Lossco issued to the holders of subscription receipts in Lossco should be ignored pursuant to the sham doctrine. The Tax Court summarily rejected this argument because there was no element of deceit with respect to the existence and limited attributes of the Class B shares. In fact, the existence and entitlements of the Class B shares were "so to speak in plain view".

The Crown also argued that there was an acquisition of control of Lossco *before* the amalgamation of Lossco and Old Birchcliff because the Class B shareholders had given a voting proxy to one individual, thereby resulting in the Class B shareholders constituting a "group of persons" that acquired control of Lossco before the amalgamation with Old Birchcliff took place. The Tax Court rejected this submission as well because the proxy arrangement did not give the Class B shareholders "the ability to change the direction of [Lossco] or . . . control of [Lossco]."

The Tax Court did, however, accept that GAAR applied because there had been an abuse of the amalgamation/acquisition of control rules in subsection 256(7) by virtue of the issuance and terms of the Class B shares:

> The artificial insertion of Class B shareholders of [Lossco], persons whose shares' only purpose was to be converted into common shares, and whose shares had such a short existence that they had to be deemed by the plan of arrangement to be created before the amalgamation, is a manipulation of the shareholdings of a predecessor contrary to the object of the rules in subsection 256(7).
>
> Put another way, it would be contrary to the policy of the provision to take account of the Class B shares where the existence of the shares is an ephemeral one at the time of the amalgamation and where the very existence of those shares is predicated on the amalgamation itself occurring. It is only at that instant, the instant where various events are deemed to occur in a sequence, that the new Class B shareholders contribute to the capital stock of the corporation.

The Tax Court did not accept that Lossco's intention was to restart a new business (an oil and gas business) and acquire additional financing through the issuance of the Class B shares. The Court concluded that Lossco instead wanted to monetize its tax losses and other tax attributes.

Decision in the Federal Court of Appeal

Before the FCA, the sole issue was whether there had been an abuse of the provisions of the Act for purposes of GAAR. The Court concluded that clause 256(7)(*b*)(iii)(B) (which contains the hypothetical shareholding test described above) had been abused.

The Court began its analysis by describing the overall result achieved in the series of transactions as follows:

> In this case, there was a series of transactions that were completed which resulted in the non-capital losses that had been incurred in the medical supply business that had been carried on by [Lossco] being used against the revenue from the oil and gas properties that were acquired by [New] Birchcliff. Prior to the amalgamation, [Old Birchcliff] (and not [Lossco]) had the right to acquire these oil and gas properties under an agreement of purchase and sale.

The Court noted that had Old Birchcliff simply acquired the shares of Lossco, the loss streaming rules in subsection 111(5) would have prohibited Lossco's losses from being used after the acquisition of control. By issuing the subscription receipts and then the Class B shares in Lossco prior to the amalgamation of Lossco with Old Birchcliff, the application of the loss streaming rules was avoided. In the Court's view, this was not a situation in which Lossco decided to raise capital so that it could commence a new business (an oil and gas business); instead, investors in the subscription receipts in Lossco were really investing in the shares of New Birchcliff. When the amalgamation occurred, Lossco had no assets and no employees. Contractually, the subscription receipt holders would either receive shares of New Birchcliff or they would receive their money back: "[t]here was no scenario under which [Lossco] would have been allowed to retain the money that had been raised by selling the subscription receipts."

In other words, the series of transactions (including the issuance of the subscription receipts, the issuance of the Class B shares, and the amalgamation) had the same effect as an acquisition of control:

> In this case, the holders of the subscription receipts were either to receive shares of [New] Birchcliff or their money back. The combination of the issuance of the Class B shares of [Lossco] to the holders of the subscription receipts followed immediately by the amalgamation of [Lossco] and [Old] Birchcliff, has the same effect and is equivalent to the holders of the subscription receipts only receiving shares of [New] Birchcliff following the amalgamation of [Lossco] and [Old] Birchcliff. If the holders of the subscription receipts would only have received shares of [New] Birchcliff, there would have been an acquisition of control of [Lossco] on the amalgamation of [Lossco] and [Old] Birchcliff.

Accordingly, the FCA determined that the transactions constituted an abuse of the hypothetical shareholding test in clause 256(7)(*b*)(iii)(B), and the appropriate consequence was to prohibit the use of Lossco's tax attributes by New Birchcliff, as if there had been an acquisition of control that engaged the prohibitions in subsection 111(5), New Birchcliff would not be entitled to use Lossco's losses.

New Birchcliff has filed an application for leave to appeal to the Supreme Court of Canada.

— *Salvatore Mirandola*

British Columbia Supreme Court Grants Rescission, but Questions the Validity of the Precedent It Follows

***Collins Family Trust v. Canada (Attorney General)*, 2019 DTC 5085 (British Columbia Supreme Court)**

Collins Family Trust considers whether rescission may be an appropriate remedy in respect of a trust in the context of a mistake as to the application of the attribution rules in subsection 75(2) and the inter-corporate dividend deduction in subsection 112(1) of the *Income Tax Act* (the "Act"). The Court granted rescission on the basis that it was bound by precedent; the Court noted that Supreme Court of Canada jurisprudence dealing with rectification had seriously undermined the precedent by which the Court was bound, but stated that it was for the British Columbia Court of Appeal to decide whether the precedent was still good law.

The petitioners, Collins Family Trust and Cochran Family Trust, had each structured arrangements between their respective trust, an operating company, and a holding company in order to move cash or earnings from the operating company to the particular trust without creating income tax liability. The arrangements involved deliberately triggering subsection 75(2) to attribute to the holding company dividends paid from the operating company to the trust. The arrangements sought to rely upon the deduction under subsection 112(1) applicable to inter-corporate dividends. An accounting firm had advised the Collins family and the Cochran family to implement the plans.

First, each of the petitioners incorporated a holding company that acquired shares of an operating company. Second, each of the petitioners created a family trust. Third, each holding company loaned funds to the particular family's trust, which the trust used to fund the purchase from the holding company of shares in the operating company, which shares were purchased at their fair market value. Finally, when the operating company paid dividends to the trust, the trust repaid the loan from the holding company and either loaned the balance to the holding company, invested it, or dealt with it elsewise. The plan was based on two provisions that, together, were intended to render the transaction free of income tax liability; in this regard:

> (1) the generally accepted interpretation of subsection 75(2) of the Act at the time the transactions were undertaken was that the trust's dividend income from the operating company would be attributed to the holding company by reason of the receipt by the trust from the holding company of shares of the operating company, which shares could revert to the holding company pursuant to the terms of the trust; and
>
> (2) by virtue of subsection 112(1) of the Act, the holding company would receive the inter-corporate dividend deduction, thereby resulting in no net income to the holding company.

The trusts did not include the dividends as income; rather, each holding company included the dividends in computing its income. The CRA reassessed each trust in respect of the dividends paid on the basis that:

> (1) even though each holding company included the dividends as income pursuant to subsection 75(2), each trust was still required to include the dividends in income pursuant to paragraph 12(1)(*j*) of the Act;
>
> (2) based upon the Tax Court's decision in *Sommerer* (2011 DTC 1162 (TCC)), subsection 75(2) would not apply to shares purchased by the trust from the holding company as the trust paid fair market value for the shares; and
>
> (3) even if subsection 75(2) did apply to attribute the dividends to the Holding Company and paragraph 12(1)(*j*) did not apply to include the dividends in the trusts' income, the GAAR applied because the transactions enabled each trust to withdraw surplus from the operating company without paying tax, which is an avoidance transaction that benefitted the trust and misused or abused subsections 75(2) and 112(1) of the Act.

Following reassessments by the CRA, which were unsuccessfully objected to by the petitioners, the petitioners brought an application to the Court to rescind the transactions.

The petitioners submitted that the Court was bound by *Pallen Trust, Re* (2015 DTC 5061 (BCCA)), which had nearly identical facts. The *Pallen* Court ordered rescission. The petitioners also anticipated the Minister of National Revenue's argument as to GAAR, submitting that *Pallen* could not be distinguished on the basis of GAAR because GAAR was at issue and was considered in *Pallen*. Further, the petitioners noted in any event that GAAR was the Minister's alternative

assessment position, not its primary position.

The Minister submitted, first, that the CRA's decision to audit was based on GAAR, not the *Sommerer* decision, which distinguishes the instant case from *Pallen*. Second, the Minister relied on *Fiducie Financière Satoma* (2018 DTC 1031 (TCC)) for the proposition that the transaction is an abusive tax avoidance. Third, the Minister submitted that an equitable remedy is inappropriate because the petitioners have an alternative remedy under section 23 of the *Financial Administration Act* which permits remission orders. Finally, the Minister submitted that subsequent Supreme Court of Canada jurisprudence undermines *Pallen* (*Jean Coutu Group (PJC) Inc*. (2016 DTC 5134) and *Fairmont Hotels Inc*. (2016 DTC 5135)).

Giaschi J reviewed the case law on equitable rescission in the tax context and determined that equitable remedies are not available to retroactively alter a transaction to achieve a particular tax outcome. However, the Court held that it was bound by *Pallen* because the case had not been expressly overruled, so the Court ordered rescission.

The instant case and *Pallen* had nearly identical facts and identical purposes for the transactions. Similar to Masuhara J in *Pallen*, Giaschi J found that the purpose of the transaction was to shield assets from future creditors and to ensure that no tax would be payable on the transactions. Giaschi J found that both purposes were equally important to the petitioners. Further, both the instant case and *Pallen* were a direct result of the Court in *Sommerer* rejecting the CRA's Interpretation Bulletin IT-369R, which was consistent with the taxpayers' interpretation of subsection 75(2). The Court dismissed the Respondent's submission that the decision to audit was based primarily on GAAR. First, the timing of the reassessment directly coincided with the release of the *Sommerer* reasons. Second, the CRA's reassessment letters make specific reference to *Sommerer* as the primary basis for denying the benefit, and GAAR as an alternative basis.

In *Pallen*, the Court applied the test for rescission as laid out in *Pitt v. Holt* (2013 UKSC 26): a Court may rescind a voluntary disposition where a sufficiently grave mistake makes it unconscionable, unjust, or unfair to leave the error uncorrected. The Court found that rescission was available because (1) the tax implications were basic to the transaction; (2) there was clearly a causative mistake; (3) the gravity of the mistake was significant; and (4) there was no prejudice to a third party affected by the tax plan. Another key determinate was the general understanding of tax professionals that the proper interpretation of subsection 75(2) was that in Bulletin IT-369R, on which the plans were premised.

Giaschi J distinguished the instant case from *Satoma*, which had denied relief. In *Satoma*, the funds had been gifted, so *Sommerer* did not apply, such that subsection 75(2) was applicable. Therefore, in *Satoma* the CRA could only attack the transaction on the basis of GAAR. Further, the trial judge in *Satoma* found that the primary purpose of the transaction was tax avoidance, whereas in the instant case, the purpose was twofold: shielding assets from future creditors and not attracting tax liability, each of which was equally important.

The Court then canvased five cases that appear to supersede *Pallen*.

Fairmont denied a request to rectify directors' resolutions which created unintended tax consequences because the remedy is "designed to correct errors in the recording of terms in written legal instruments", not accord a benefit or avoid an adverse result to the taxpayer based on what the taxpayer would have done had the taxpayer known better. The Court in *Fairmont* addressed the argument that denying rectification would unjustly enrich or create a windfall for the Minister. The Court held that tax consequences flow from "freely chosen legal arrangements, not the intended or unintended effects of those arrangements", regardless of whether the benefit flows to the taxpayer or the public treasury.

Jean Coutu similarly denied a request under article 1425 of the *Civil Code of Quebec* to modify documents underlying a series of corporate transactions effectuated to offset gains and losses from fluctuating exchange rates, but which unintentionally triggered income tax liability. The Court held that retroactively modifying the documents contravened two fundamental tax principles: (1) tax consequences flow from legal relationships or transactions, not parties' motivations; and (2) the Court should not interpret article 1425 as a "catch-all insurance" for taxpayers inadvertently attracting more tax liability than they intended. The Court also noted that the appropriate method to recuperate loss, where the circumstances warrant it, is for the taxpayer to file a claim against the taxpayer's advisors.

In *Canada Life Insurance Company of Canada* (2018 ONCA 562), Canada Life asked the Court to unwind transactions effectuated to offset capital losses and gains accrued in the same year because the CRA did not treat the key transaction as a loss, thereby giving rise to an unanticipated tax liability on the capital gains. The Court rejected both grounds for Canada Life's claim (error correction and rescission). First, the Court cited *Fairmont* for the proposition that the Court cannot exercise its equitable jurisdiction to relieve against a mistake that created unintended tax liability. Second, the Court found that rescission was not available to effectively retroactively plan tax. Van Rensburg J held that impermissible retroactive tax planning is not limited to trying to obtain more favourable results than originally intended, but rather, it also includes attempting to achieve the result originally intended, which was thwarted by

mistake. The judge did not have to determine whether *Pallen* was still good law because the underlying transaction in *Canada Life* was a contract, not a gratuitous transfer.

Harvest Operations Corp. (2017-PTC-AB-1 (ABCA)) involved a series of share acquisitions and reorganizations among related companies which were not implemented properly. The Alberta Court of Appeal held that rectification was not available to "salvage business transactions that could have been executed to achieve a desirable tax result [. . .]". The Court further held that to exercise its equitable jurisdiction would undermine *Fairmont*.

In *BC Trust* (2017 DTC 5017 (BCSC)), the Court denied the petitioner's request for rectification or equitable relief to retroactively allocate trust income to the beneficiary. The Court cited *Fairmont* for the proposition that rectification is not "equity's version of a mulligan".

Giaschi J agreed with the above cases that:

(1) taxpayers should be taxed on what they actually did, not what they intended to do;

(2) retroactive tax planning to achieve the original objective, which was thwarted by mistake, is impermissible; and

(3) the remedy here is against the advisors if the plan failed due to a mistake by the advisors.

Giaschi J also addressed the petitioners' submission that the above case law generally dealt with rectification, whereas the petitioners request rescission. Giaschi J stated that since both are equitable remedies it was not obvious why the remedies of rectification and rescission "should have [. . .] dramatically different results." Further, Giaschi J stated that the principles in *Fairmont* and *Jean Coutu* are principles of general application; they are not, in his view, limited to rectification.

Finally, Giaschi J found that the alternative remedy that the Minister proposed under subsection 23(2) of the *Financial Administration Act* was just one factor that the Court should consider in its discretionary analysis of rescission. Giaschi J cited *5551928 Manitoba Ltd (Re)* (2018 DTC 5102 (BCSC)) for the proposition that the restrictive, uncertain, complex, and slow nature of remission through an Order in Council reduces its weight in the analysis. Further, Giaschi J noted that he did not have enough evidence to determine whether the section 23 remedy was realistic. Therefore, this possible remedy did not change the result.

The Minister filed Notices of Appeal in the British Columbia Court of Appeal on July 24, 2019.

— *Emily Leduc Gagne, Articling Student*

Director Successfully Asserts Due Diligence To Avoid Liability for Employer-Side CPP and EI Amounts

***Hamad v. The Queen*, 2019 DTC 1108 (Tax Court of Canada – Informal Procedure)**

Director's liability cases involving federal payroll taxes normally concern assessments for monies that the corporation withheld from wages but did not remit to the Canada Revenue Agency. The *Income Tax Act* (Canada) (the "Act") provides the Minister with strong enforcement powers over such amounts on the basis that the employer is essentially holding them as trustee for the Receiver General of Canada until the withheld funds are remitted to the CRA.

In this case, the Minister used the director's liability provisions in the Act solely to try to recover amounts that the employer was required to contribute on its own account towards the Canada Pension Plan and Employment Insurance coverage for its employees, rather than amounts that were deducted from employee wages. As discussed below, the Tax Court found that the assessed director exercised due diligence in trying to ensure that the corporation complied with its own CPP and EI obligations and, in coming to this conclusion, did not make a distinction between the standard for due diligence that a director should exercise towards ensuring that the corporation complied with its duty to remit amounts withheld on behalf of the Crown versus ensuring that the corporation satisfied its own CPP and EI liabilities.

The individual whom the Minister assessed in this case was an engineer and one of six directors of a corporation that specialized in research and development associated with hydroelectric turbines. The corporation was part of a related group of companies that relied on provincial funding to support its business operations but became insolvent after its arrangements with the government were terminated following an election. The CRA put in a creditor claim in the bankruptcy proceedings for the corporation's liability for both the unremitted payroll deductions and the corporation's own CPP and EI amounts. The CRA was fully paid on its claim for the employee source deductions since the liability was recognized as a secured claim in the bankruptcy proceedings but did not realize any proceeds in respect of the unsecured claim for the corporation's unpaid CPP and EI amounts.

Director's liability for a corporation's obligation to pay the employer portion of the CPP and EI amounts is created by

sections 21.1 of the *Canada Pension Plan* and 83 of the *Employment Insurance Act*, respectively. Both provisions use the Minister's power to issue assessments against directors for source deductions under subsection 227.1(1) of the Act as the enforcement mechanism for a director's liability in respect of both unremitted EI and CPP source deductions and the corporation's own CPP and EI liabilities. Subsection 227.1(3) expressly provides for a due diligence defence against director's liability under section 227.1, which the individual successfully invoked in this case.

In allowing the appeal, the Tax Court (*per* Favreau J) expressly acknowledged that the failure to remit in this case was solely in respect of employer contributions and not amounts that the corporation withheld from employee wages but did not remit. One might have thought that the reasonable steps that a director might be expected to take to ensure that a corporation has set aside sufficient funds to pay its own liabilities might be different from the steps that he or she would be reasonably expected to take to ensure that the corporation remitted amounts that it had deducted on behalf of the Crown. Nonetheless, the Court went on to examine the facts and apply the law using the same approach that appears in the jurisprudence that considered director's liability in the context of the failure to remit amounts that were withheld from employee wages.

In this case, the particular director had fully identified all secure and unsecured creditor claims once the corporation became insolvent and undertook earnest efforts to keep the corporation going while it tried to restructure its operations. The director invested a substantial amount of his own funds to try to keep the company going and was able to sell the corporation's assets for proceeds that would have been sufficient to fully satisfy the CRA claim along with the claims of the corporation's other secured creditors. In the Court's view, the director's plan for having the corporation discharge its obligation to both remit the payroll source deductions and pay the employer portion of the CPP and EI amounts was thwarted by the "technicality" (as the Court described it) in the *Bankruptcy and Insolvency Act* that the employer portion is not considered a secured claim.

While the outcome in this case seems appropriate in the circumstances, it should also serve as a useful reminder that director's liability for amounts that one normally associates with source deductions is not limited to funds that the corporation withheld from the wages of employees but can also extend to the corporation's debts to the Crown for the employer portion of the statutory contributions to CPP and EI.

— *John Yuan*

Ambiguity in CRA's Income Tax Guide Helps Taxpayer To Successfully Assert a Due Diligence Defence

***Moore v. The Queen*, 2019 DTC 1103 (Tax Court of Canada — Informal Procedure)**

This case, decided under the Tax Court's informal procedure, considered whether the taxpayer could rely on the defence of due diligence to avoid the imposition of a late-filing penalty under paragraph 162(7)(*a*) of the *Income Tax Act* (Canada) (the "Act") for his failure to timely file a Form T1135 (Foreign Income Verification Statement) in respect of his shareholdings in the US parent corporation of his former employer.

From 2003 to 2016, the taxpayer was employed by GE Canada and had acquired shares of its parent through an employee share purchase program. Section 233.3 of the Act requires a taxpayer to file Form T1135 concurrently with his or her tax return for any year that the aggregate cost of all foreign property exceeds $100,000. His shares in the publicly-listed US parent corporation were his only foreign property and 2015 marked the first year in which his cost for his shares exceeded $100,000.

The taxpayer had duly reported all of the dividend income received on the shares and had appropriately reported the value of the employment benefit represented by his employer's matching contribution towards his purchases under the employee share purchase plan.

During his employment with GE Canada, the shares that he acquired through the employee plan were held on his behalf by a company-sponsored administrator. When the taxpayer ceased working for the GE group of companies in 2016 after one of GE Canada's business lines was sold to a third party, he transferred his GE shares into an investment account with a Canadian broker and it was only then that he realized that, based on the cost for the shares, he had an obligation to file Form T1135 starting in 2015. Shortly after filing his 2016 income tax return, the taxpayer wrote to the CRA to inform them that he had failed to file a Form T1135 for 2015. The taxpayer included a duly completed Form T1135 for both 2015 and 2016.

The CRA assessed the maximum $2,500 late-filing penalty under paragraph 162(7)(*a*).

The Tax Court (*per* Justice Boyle) considered whether it was reasonable for the average Canadian to locate and understand the correct information on foreign property ownership based on the information contained in the 2015

version of a T1 individual tax return and the Income Tax Guide for 2015 itself.

In the section of the return where a taxpayer specifies whether or not they owned specified foreign property at any time in the year with a total cost of more than $100,000, the return directs the taxpayer to read about "specified foreign property" in the Income Tax Guide for more information.

The Tax Court found it odd that the table of contents in the 2015 Income Tax Guide did not have a heading for "specified foreign property" and that any additional information about foreign property reporting would be situated under a heading for "Foreign Income". The Tax Court then observed that, while the foreign income section of the guide has a sub-heading for "Shares of a Non-Resident Corporation", there was very little information in that section other than a reference to Form T1135 and the identification of certain types of properties that are not foreign properties that are subject to the reporting obligation. The Tax Court also noted that there was a sub-heading "Shares of a Non-Resident Corporation" under the Foreign Income heading, which would have seemed to be a logical place for the CRA to reference (or reiterate) a possible Form T1135 filing obligation in respect of such shares; instead, the discussion in the guide under that subheading was restricted to the filing obligation in respect of Form T1134, which only applies when a taxpayer owns ten per cent or more of the shares of a non-resident corporation.

The Tax Court referred to the *Home Depot of Canada Inc.* (2009 GTC 970 (TCC)) decision, which applied a due diligence defence in the context of a penalty provision under the *Excise Tax Act* (Canada), and Justice Woods' discussion of the application of such a judge-made due diligence defence in her informal procedure decision in *Douglas* (2012 DTC 1114 (TCC)). In both cases, the Tax Court found that a due diligence defence was available to avoid a penalty provision where the taxpayer had made all reasonable efforts to attempt to comply with the respective rules, notwithstanding the fact that the penalties at issue were imposed under provisions that did not expressly provide for a defence of due diligence.

In addition to the confusing nature of the 2015 Income Tax Guide, the Tax Court noted that while the taxpayer had not followed the formal procedure to obtain relief under the Voluntary Disclosure Program, he had in fact reported and paid all income on the shares and had brought his own error to the CRA's attention.

In the result, the Tax Court held that the due diligence defence applied to the taxpayer and, in *obiter dictum*, questioned why the CRA would pursue the taxpayer in litigation since the taxpayer's conduct was the type of approach that the CRA would presumably want other taxpayers to follow in the event of a failure to comply with an obligation under the Act.

While this is not the first case to consider misleading and erroneous instruction in CRA materials as grounds for granting relief (see: *Douglas* and *Takenaka* (2018 DTC 5055 (FC))), the case appears to fit into a pattern of jurisprudence in which the Tax Court has admonished the CRA for exercising the discretion to pursue penalties and deploy resources against individual taxpayers in circumstances where strict enforcement of the Act would not enhance compliance (see, for instance: *Lipson* (2012 DTC 1064 (TCC)) and *Suissa* (2013 DTC 5158 (FC))).

— Justin Shoemaker

RECENT CASES

Appeal from denial of claim for legal expense deduction dismissed

The taxpayer was involved in three separate legal actions: a matrimonial dispute, a wrongful dismissal action, and an oppression remedy action instituted by his former spouse. All such actions involved his former spouse and the company which was his former employer, and the taxpayer and his former spouse were majority shareholders of that company. In the course of those actions, the taxpayer incurred, and claimed a deduction for, $27,333 in legal fees. Such deduction was denied by the Minister and the taxpayer appealed from that decision to the Tax Court of Canada.

The appeal was dismissed. The Tax Court reviewed each of the legal actions at issue in light of the requirements set out in paragraph 8(1)(*b*) with respect to allowable deductions for legal fees. The Court held that neither the matrimonial dispute nor the defence to the oppression action qualified for a legal fees deduction, as neither involved legal fees incurred for the purpose of recovering income or a right to income. With respect to the wrongful dismissal action, the Court held that while the appellant had successfully litigated a wrongful dismissal suit, he had not, by his own admission, provided any evidence to establish that he had paid legal fees concerning that litigation. The Court concluded, therefore, that no deduction was available with respect to the legal fees incurred, and the appeal from the denial of such deduction was dismissed, without costs.

Barrett v. The Queen

2019 DTC 1149

Appeal from assessment for investment income dismissed and imposition of repeat omission penalties upheld

A reassessment was issued with respect to the taxpayer's 2016 taxation year, to include $22,337 in investment income for that year and to impose penalties for repeated failures to report income. Such investment income had arisen largely from the taxpayer's disposition of a life insurance policy which had been purchased many years previously. The taxpayer appealed from that reassessment to the Tax Court of Canada.

The appeal was dismissed. The Tax Court of Canada held that current rules governing the taxation of life insurance policies provided that an insurance policy holder must report as income the difference between the proceeds of disposition received and the adjusted cost base of the policy. The Court held that, as the appellant was unable to provide evidence with respect to the terms of the policy, the best available evidence was the T5 slip issued by the insurance company, which showed income in the amount of $22,337. It was, in the Court's view, reasonable to assume that the insurance company was familiar with the tax attributes of its products and that the T5 issued reflected those attributes. The appellant was, therefore, held to be in receipt of income in the amount of $22,337 for the 2016 taxation year. The Court then considered the penalty imposed under section 163 for repeated failure to report income. It reviewed the five conditions which must be satisfied in order for such penalty to be imposed, concluding that each such condition had been met and that such penalties were properly imposed.

Greenstreet v. The Queen

2019 DTC 1151

Appeal allowed where legal fees incurred meeting statutory conditions for deduction

The taxpayer brought an action against his former employer for its non-payment of a $1.5 million closing bonus. The former employer responded with a defence to that action, but also brought a separate action against its former employee's family trust. In the course of the litigation, the taxpayer incurred $364,442 in legal fees, for which he claimed a deduction on his tax return. The Minister allowed the deduction in part, but denied a deduction for the $55,552 in legal fees which were attributable to defending the action brought against the family trust. The Minister took the position that such fees were incurred by the trust and not the taxpayer and, in addition, that the expenditure related to legal fees not directed to the recovery of salary or a right to claim salary. The taxpayer appealed from that determination to the Tax Court of Canada.

The appeal was allowed. The Tax Court of Canada held that the question to be determined was the essential nature of the claim involving the taxpayer. The Court concluded that both aspects of the litigation fell within the ambit of section 8(1)(*b*), which provided for the deduction of legal fees incurred. In the Court's view, there was no stand-alone, singular action for alleged behaviour not associated with, or too remote from, remuneration arising from employment. The Court held that both lawsuits were litigated together, resolved contemporaneously, and funded by the taxpayer, and that he was required to pay all legal fees expended in order to recover his closing bonus. Consequently, he was entitled to a deduction for those legal fees expended, and his appeal from the Minister's denial of such deduction was allowed.

Kurnik v. The Queen

2019 DTC 1144

Assessment beyond statutory limit confirmed where capital gain wilfully undervalued

This case is an appeal from a reassessment issued in 2016 with respect to the sale of a vacant lot by the appellant effected in the 2012 fiscal year. The reassessment resulted from the net increase of the taxable portion of the capital gain of $64,269. The issues involved are whether the respondent was justified in assessing beyond the normal prescription period and whether the adjustments made to the taxable capital gain were warranted.

The appeal was dismissed. The Court noted that the appellant declared a capital gain of $98,577 while it should have been $227,113. The Court found this was sufficient to assess beyond the normal assessment period as this is a misrepresentation attributable to neglect or carelessness in accordance with subsection 152(4) of the *Income Tax Act* (the "Act"). The Court added that the Appellant was well aware of the rules regarding the calculation of the adjusted cost base ("ACB") with respect to municipal taxes and interest expenses since he had encountered the same issue with respect to the sale of other vacant lots in taxation years 2001, 2002, and 2003. On this subject, see decision *D'Anjou v. Quebec*, 2008 QCCQ 7197. In the circumstances, the misrepresentation was not due to an involuntary error but attributable to the neglect of the Appellant. Secondly, the Court needed to establish if the lot was held for business purposes during the period for which it was held by the Appellant, i.e., a 16-year period. The appellant argued that the lot had been acquired to be developed into a shopping mall known as Place Armand Viau and that he incurred expenses with respect to this project which was not completed. These include preparation of drawings for the required building, estimates of construction costs, analysis of financing conditions, and estimates of projected rental revenues. These services were provided to the appellant by Gestion Logim inc, the promoter of the project according to the documentation given to potential tenants. However, the evidence is that the project never got off the ground and that the lot remained vacant until it was sold. It was not used by the appellant in any business endeavour and never generated any income. Accordingly, the Court ruled that the lot should be considered as capital property. The Court ruled that the respondent was correct in its calculation of the adjusted cost base and denied the expenses claimed by the appellant. In accordance with subsection 9(3) of the Act, the additional expenses totalling $224,995 were not admissible since these expenses were not incurred to generate income. Furthermore, these are not expenses that may be added to the cost of the lot because they were not incurred to acquire the property or improve it. The Court added that the property taxes and interest expense were not denied by application of subsection 18(2) of the Act but because these expenses were not incurred to generate income.

D'Anjou v. The Queen

2019 DTC 1145

Appeal from denial of taxpayer's claim for rental losses allowed

The taxpayer utilized a property owned by a family member as a vacation rental home, and claimed rental losses in the amount of $28,938 for 2013 and $25,903 for 2014. Those loss claims were denied by the Minister on the basis that the property did not constitute a source of income to the taxpayer, such that expenses incurred in relation to that property were not incurred to earn income from business or property, but were personal expenses. The taxpayer appealed from that determination to the Tax Court of Canada.

The appeal was allowed. The Court held that it was required to determine whether the rental of the property was carried on predominantly for profit rather than as a personal endeavour. In doing so, the Court reviewed the facts of the taxpayer's situation in light of the factors set out in the jurisprudence to determine the commerciality of a taxpayer's endeavour. Evidence provided by the appellant indicated that he had done significant repairs and upgrades in order to make the property a viable rental property and had set up a PayPal account to collect rental payments. The appellant testified that he could cover his costs and make a small profit by renting the property for two months of the year, and that he expected to be in a profit position by year 3. The Court accepted the evidence put forward by the appellant, and noted as well that he had obtained a business number from the Canada Revenue Agency for a rental business and that he stayed at the property only while he was working on it. The factors reviewed convinced the Court that the appellant's predominant intention with respect to the property was to earn a profit, and his appeal from the Minister's denial of rental losses claimed in respect of that property was allowed.

Crockett v. The Queen

2019 DTC 1146

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