Tax Notes

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NEW IN 2019: THE CBCA'S BENEFICIAL OWNERSHIP REGISTER

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Recent amendments to the *Canada Business Corporations Act* ("CBCA"), introducing for each private CBCA corporation (i.e., CBCA corporations other than reporting issuers and publicly listed corporations) (a "CBCA Corporation") a register listing the actual individuals (i.e., physical persons) with significant control in fact over the corporation (the "Register"), including individuals who are beneficial shareholders with significant control, is likely to affect the practice of corporate, business, and tax law in 2019 and beyond. Some of the steps for establishing and maintaining the Register, the potential penalties for non-compliance, and the reasons for these new rules (according to the government, the need to combat tax evasion, money laundering, and terrorism financing), and also some issues relating to interpretation of the rules, will be referred to below.

The amendments were introduced in the late October 2018 federal budget bill, received royal assent on December 13, 2018, and will come into force on June 13, 2019, by which time a CBCA Corporation should have established its Register. Most of the rules will be at new sections 21.1 to 21.4 of the CBCA, and in a nutshell:

(a) define an individual with significant control over a CBCA Corporation (an "ISC") as an individual who is a registered or beneficial owner of, or who has direct or indirect control or direction of, either 25% or more of the voting rights of all of the corporation's outstanding shares or 25% or more of all of the corporation's shares measured by fair market value;
(b) consider two or more individuals to be one ISC if they are joint owners or have an agreement to act jointly;
(c) include as an ISC an individual who has direct or indirect influence that, if exercised, would result in control in fact of the corporation;
(d) require the corporation to at least once per year take reasonable steps to identify its ISCs, and to also record updates within 15 days of having become aware of them by any means; and
(e) if the corporation requests Register-related information from a shareholder, the shareholder then has a positive obligation (rare under the CBCA) to reply accurately and completely as soon as feasible to the best of their knowledge.

As for the content of the CBCA Corporation's Register, it will include:

- the name, date of birth, and last known address of each ISC;
- the day on which each individual became or ceased to be an ISC;
- a description of the ISC's interests and rights in respect of shares of the corporation; and
- the "jurisdiction of residence for tax purposes" of each ISC.

As for who has access to the Register, it seems broad. Although the Register is not public and therefore perhaps can be said to be internal, the Director under the CBCA can request access, and any shareholder or creditor of the corporation or their personal representatives can obtain access so long as they are to use the information therein in connection with “any matter relating to the affairs of the corporation”, including offers to acquire securities of the corporation.

These rules cannot be ignored, as non-compliance has material potential penalties (although the extent of enforcement is not yet known), with corporations or their directors, officers, or shareholders in violation of their obligations being subject to a fine not exceeding $200,000 or six months imprisonment or both.

Non-compliance will be underlined by these new rules requiring the Register to state the annual reasonable steps taken by the corporation to keep the Register up-to-date.

Those with access to the Register include the corporation's creditors, which would presumably include the tax department when there are tax debts, and that access is available at a stage that is well before an examination connected to litigation. Also notable is that the information collected goes beyond the listing, at Schedule 50 of a corporation's annual T2 tax return (submitted to the tax department), of the corporation's 10 largest shareholders holding 10% or more of the corporation's common and/or preferred shares.

So as to help in the interpretation of these new rules in the CBCA, it seems relevant to briefly look at some of the apparent reasons for their enactment.

The federal, provincial, and territorial finance ministers came to an agreement (published in December 2017 on the Finance Canada website) to strengthen beneficial ownership transparency to, among other things, prevent corporations from being misused for tax evasion, money laundering, corruption, and the financing of terrorist activities. This is to be accomplished through the pursuit of legislative amendments "to ensure corporations hold accurate and up to date information on beneficial owners that will be available to law enforcement, and tax and other authorities." The ministers agreed to make best efforts to put forward legislative amendments to bring these changes into force by July 1, 2019. It seems then that this is what prompted the abovementioned new CBCA Register of ISCs and its timeline for taking effect, and although the provinces and territories have not yet introduced similar legislation for corporations subsisting under their corporate legislation, one can surmise that at least some of them will do so soon.

Foreshadowing of these CBCA amendments can also be found elsewhere, and perhaps underlines that a main intended user of the Registers will be Canada's financial institutions. For example, it is noted in the "Beneficial ownership requirements" May 1, 2018 guidance listed on the website of the Financial Transactions and Reports Analysis Centre of Canada ("FINTRAC") that financial institutions must obtain and take reasonable measures to confirm beneficial ownership information of, for example, new clients, that for a corporation the beneficial owners would be seen as the actual individuals who are the ultimate owners or controllers of 25% or more of the corporation, and that the financial institution must search through as many levels of information as necessary (in records such as minute books, articles of incorporation, annual returns, shareholders agreements, and board decisions) to determine the actual individuals. It seems then that one of the purposes of the new CBCA Register of ISCs is to provide an additional useful corporate record to help financial institutions meet their demanding “know your client” requirements. For its part, the tax department has ample ability under its audit powers to obtain information beyond what will be in the Register, which perhaps indicates that it would have been able to get along well enough without the Register.

It seems clear, especially given this FINTRAC guidance, that whether or not there are nominee owners (often referred to in Quebec as prête-nom owners) among the direct and indirect shareholders of the Corporation, the Register is supposed to show the actual individuals (not another corporation, and not a trust or other entity) who ultimately own or control, directly or indirectly, at least 25% of the Corporation in votes or value.

As each CBCA Corporation and its advisors now grapple with interpreting these new rules and monitoring future developments in this area, the following issues seem useful to keep in mind:

- It does not appear useful at this time to try to avoid the new rules by continuing a CBCA corporation into a province or territory through the corporate export-import process, given that the other jurisdictions have provided a commitment to introduce similar legislation.
- What does it mean to have 25% of the "voting rights" attached to "voting shares" of a corporation? In unclear cases, perhaps interpretive assistance can be found in other legislation. For example, Quebec legislation on land transfer tax was recently amended so as to refer to voting shares as being those with "voting rights that may be exercised under any circumstances at the annual meeting of shareholders" of the corporation.

- In unclear cases, how does one know if an individual has "direct or indirect control" or "direct or indirect influence that if exercised would result in control in fact", and how are "interests and rights in respect of shares" to be described? In cases where standard corporate and tax authority on control does not sufficiently assist, perhaps inspiration can be found in other new areas dealing with beneficial ownership (such as British Columbia's new rules for its public registry of real property beneficial ownership, referring to individuals with a "significant interest" in a corporation or trust; the Ontario *Business Corporations Act*'s new rules requiring a register of an Ontario corporation's "ownership interests" in land; or the UK's 2016 rules for their register of people with significant control of private companies and other entities). Furthermore, and given for example FINTRAC's reference to the importance of looking to shareholders agreements and related records to determine beneficial ownership, it seems logical to also look to private equity and related investment agreements that provide, among other things, for options to convert debt and other rights to shares and/or that provide rights relating to major management decisions. Additionally, it seems that if necessary, the Register should include a narrative where a longer or conditional response is warranted. As precedent for such longer answers, look perhaps to the July 2018 draft federal legislation that increases filing requirements, and disclosure requirements as to trust beneficiaries and others, for trust tax returns for years ending after December 30, 2021, regarding which Finance Canada has commented that where, for example, a trust has future beneficiaries, details of the trust should be provided.
- It could be tricky to deal with situations where a trust is a shareholder. For example, for a discretionary family trust holding the non-voting common shares of the corporation, certainly value has to be considered. In the past, there has been a certain unresolved tension on the valuation issue, the standard business valuation view probably being that a discretionary trust interest is speculative and therefore has nil value, but with family law often taking the position that you "cannot trust the trust" and ascribing a kind of financial means and perhaps other rights and obligations to a trust beneficiary with, for example, a history of receiving trust income. Given the new Register for CBCA Corporations, hopefully a narrow interpretation can be cast on the CRA's apparent view that a reasonable method to value a disposed trust interest would be to value the interest as if the trust assets were fully distributed equally among all the discretionary beneficiaries (CRA document no. 2001-0111303, "Beneficiary added to discretionary trust"). Potentially, at least based on that family law-like point of view, value may be with the beneficiaries, rather than, say, the trustees. For Quebec trusts (where art. 1275 of the Quebec *Civil Code* requires an independent trustee, such as a professional), if value is with the trustees, then there may be a need to have a non-family member, the independent trustee, listed as an ISC.
- What is the "residence for tax purposes" of an individual? Can it be argued that the CBCA is a federal statute, and that tax residency from a federal perspective for many purposes does not concern itself with the provincial residence, such that the answer for residency on the Register is Canada or a foreign country? Possibly, but given that many of the provinces and territories are likely to enact a similar register under their respective corporate statute, the question of where in Canada the residence is located likely will have to be addressed.
- When does a matter "relate to the affairs of the corporation" so that a shareholder or creditor can have access to the Register? "Affairs" of a corporation seems to be a very broad term. Note for example that section 146 of the CBCA refers to a unanimous shareholder agreement (a "USA") as dealing with the business and affairs of the corporation, and given for example that it is common for a USA to deal with corporate powers to create debt and obligations, it would seem that a creditor's rights in relation to a debt of the corporation owed or allegedly owed to the creditor relate to the corporation's affairs, and allow access to the Register. If a trade creditor cannot have broad access to the Register, that potentially weakens broad access rights of the tax department and financial institutions.
- In line with the "private issuer" definition under section 2.4 of national securities instrument 45-106, a CBCA Corporation will want to have its shareholders confirm that they are receiving issued shares as the beneficial owner thereof, and this is commonly done at present. The new CBCA amendments raise the question of how much further a CBCA Corporation must go to reasonably determine the individuals with significant control over the corporation.

- The recent CBCA amendments refer to the possibility of future prescribed regulations to flesh out the rules further, mostly as regards possible further exemptions from the rules (beyond the exemption for public corporations), deeming rules for determining ISCs, additional content for the Register, steps for how the Corporation can reasonably obtain ISC information, and the form of the Register and how to prepare and maintain it. (The current lack of a prescribed form does not, however, excuse a CBCA Corporation from complying.) Hopefully there will be regulations and/or additional amendments that clarify and reduce the corporation's burden in collecting ISC information, perhaps relieve corporations seen as "low-risk" from having a Register (for example, corporations with lower levels of revenue and/or assets), and solve some of the interpretive difficulties referred to above.
- The finance ministers stated in their above-mentioned 2017 agreement that increased beneficial ownership transparency would be available also to "law enforcement", so it may be that police services will in the future get express access to the Register. However, there seem to be no specific governmental indications that the rules will be further changed to put the Register in the public domain. Although the UK has had a public register of persons with significant control since 2016, with information analogous to what is called for in the CBCA's Register, contrary to the UK, Canada is a federal state where implementation of a public register for all corporations, incorporated at whatever jurisdiction (federal, provincial, or territorial), would be difficult, and the purpose of providing financial institutions, the tax department, and perhaps the police with useful ISC information seems sufficiently served with a non-public register of the kind just added to the CBCA.

Therefore, each CBCA Corporation is required by mid-June 2019 to establish under newly enacted rules a register of individuals with significant control over the corporation. The rules may change to an extent under future regulations or amendments, and the provinces and territories may enact similar rules for corporations subsisting under their corporate statutes. These are notable developments indeed.

CURRENT ITEMS OF INTEREST

GOVERNMENT PROPOSES TAX RELIEF TO EMPLOYEES WHO ARE OVERPAID

On January 15, 2019, the federal government announced a consultation on proposed rules which will provide tax relief to public service employees who have been overpaid by some fault of the Phoenix pay system. That said, the changes will apply uniformly to all private and public sector employees.

Where an employee is erroneously paid too much in a taxation year, and that overpayment is discovered and rectified in a subsequent taxation year, the employee is required to pay the employer back the gross amount of the overpayment (rather than the amount net of deductions for income tax, CPP, and EI). The employee is then required to recover the deducted amounts directly from the CRA. In other words, an employee is required to pay back more than the net amount that they actually received; this could cause significant financial hardship, especially when the system can also leave a public service employee underpaid.

Currently, if the overpayment is paid back in the taxation year in which it was paid, the employee can pay back the net amount to the employer. The draft tax rules propose to extend this treatment to overpayments that are repaid within three calendar years after the year of the overpayment. Employees will repay the net amount, and instead the employer will recover the deducted amounts from the CRA. A key requirement in the proposed rules is that the amount must have been paid as a result of a clerical, administrative, or system error. Moreover, the employer is required to elect in a prescribed form in order for this repayment provision to apply, and an information return that corrects the overpayment cannot have been issued prior to the election being made. These proposed rules will apply to overpayments made after 2015.

The proposals will accordingly amend the *Income Tax Act*, *Canada Pension Plan*, and *Employment Insurance Act* to this effect. Comments on these proposals must be submitted by February 15, 2019.

GOVERNMENT ANNOUNCES 2019 AUTOMOBILE DEDUCTION AMOUNTS

The federal government has announced the various automobile deduction limits and expense benefit rates for 2019. There are two changes that apply as of 2019.

First, the per-kilometre deduction limit for tax-exempt allowances paid to an employee for using their personal vehicle for business purposes is increased by three cents. Therefore, for 2019, the allowance amount is 58 cents/km on the first 5,000 km and 52 cents/km thereafter. For Northwest Territories, Nunavut, and Yukon, these amounts increased to 62 cents/km on the first 5,000 km and 56 cents/km thereafter.

Second, the prescribed rate used to compute the taxable operating expense costs reimbursed to an employee is increased by two cents to 28 cents/km. For taxpayers employed principally in selling or leasing automobiles, the rate is increased by one cent to 25 cents/km.

The following amounts will remain the same in 2019:

- the $30,000 (plus sales taxes) capital cost limit for passenger vehicles;
- the $300 per month interest deduction limit with respect to amounts borrowed to purchase an automobile; and
- the $800 (plus sales taxes) deduction limit of leasing costs with respect to a leased automobile.

PROGRESS OF LEGISLATION

On December 13, 2018, Bill C-86, *Budget Implementation Act, 2018, No. 2*, received Royal Assent. This enacted many tax measures from Budget 2018.

CRA DOCUMENTS UPDATE

The CRA's registered plans directorate recently published a newsletter: no. 18-1, *Repayment to Registered Pension Plans*.

Income Tax Folios S1-F2-C1, *Qualifying Student and the Education and Textbook Tax Credits*, and S1-F3-C1, *Child Care Expense Deduction*, have been updated with minor revisions to reflect recent legislative changes (see their respective chapter history pages).

FOCUS ON CURRENT CASES

This is a regular 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.

RECTIFICATION GRANTED FOR MISCALCULATED CAPITAL DIVIDEND ACCOUNT BALANCE

***5551928 Manitoba Ltd. (Re)*, 2018 DTC 5102 (Supreme Court of British Columbia)**

This decision provides an example of when rectification continues to be appropriate, post-*Fairmont* (2016 DTC 5135 (SCC)). The petitioner, 5551928 Manitoba Ltd., sought the rectification of a directors' resolution to amend the amount of a declared capital dividend.

The petitioning corporation sold certain properties located in Manitoba on September 15, 2015, and subsequently sought to distribute the maximum amount available in its capital dividend account to its shareholders on a tax-free basis. The corporation's directors executed a resolution declaring a capital dividend in the aggregate amount of $298,092, payable December 31, 2015. Actual payment of the declared capital dividend was then made in two instalments in May and August 2016.

In order to calculate the amount in the corporation's capital dividend account following the sale, the directors of the corporation sought advice from third-party accountants. These third-party accountants admitted that "they incorrectly calculated the capital dividend amount available at the relevant time", by including $184,880 arising from the disposition of eligible capital property at the time of the sale. Under subsection 14(1) and paragraph (*c*.2) of the definition of "capital dividend account" in subsection 89(1) of the *Income Tax Act* (Canada) (the "Act"), such additions to the capital dividend account could only be made at the end of the corporation's taxation year. The issue was one of timing. The accountants mistakenly advised that the entire amount was available for a tax-free distribution in 2015. In actuality, the amount would have been available in 2016, following the end of the corporation's taxation year.

The Canada Revenue Agency identified the timing error and issued a reassessment for further tax payable under Part III of the Act on the basis that the capital dividend account for the corporation was only $113,212 at the time of the dividend. In response to the reassessment, the corporation petitioned the British Columbia Supreme Court for a rectification order. In the alternative, the corporation sought an order that the dividends paid to its shareholders be rescinded *ab initio*.

The Attorney General of Canada opposed the order for rectification, but did not oppose the alternative order for equitable rescission, so long as it contained particular language stating that the dividend resolution be rescinded *ab initio*. However, the corporation continued to seek the contested rectification order because equitable rescission left open various potential tax liabilities for the shareholders that rectification would not. As such, the only issue before the Court was whether rectification was appropriate in these circumstances.

The Court (*per* Branch J) first looked at the governing case law on rectification, including the Supreme Court of Canada's decision in *Fairmont*, which stated:

> [38] To summarize, rectification is an equitable remedy designed to correct errors in the recording of terms in written legal instruments. Where the error is said to result from a mistake common to both or all parties to the agreement, rectification is available upon the court being satisfied that, on a balance of probabilities, there was a prior agreement whose terms are definite and ascertainable; that the agreement was still in effect at the time the instrument was executed; that the instrument fails to accurately record the agreement; and that the instrument, if rectified, would carry out the parties' prior agreement …

The Crown argued that the petitioner did not demonstrate "a prior agreement with definite and ascertainable terms supporting the request for rectification". The Crown did not believe that directing the accountants to distribute the maximum amount of the proceeds from the prior sale that could be distributed to the shareholders tax-free was sufficient to establish a prior agreement with definite and ascertainable terms.

The Court disagreed, holding that (at paragraph 25):

> … there was a definite and ascertainable agreement between the directors to effectively "clean out" the petitioner's capital dividend account. There is no dispute that this was what the directors intended to do, both when seeking the advice of the accountants, and when subsequently passing the Resolution.

The directors' resolution was held to establish an agreement in three ways. First, although it contained an incorrect amount, the recitals of the resolution set out what was believed to be the full amount of the corporation's capital dividend account. Second, the resolution specifically mentioned that the dividend was to be paid from the company's capital dividend account pursuant to subsection 83(2) of the Act. Third, the resolution directed that the necessary paperwork be completed to have the rules set forth in subsection 83(2) of the Act apply to the full amount of the dividend. These three terms, as set out in the resolution, were sufficient to establish that the true agreement was to empty the capital dividend account.

The Court distinguished the facts from those in *Fairmont*, holding that this agreement was clear and that none of the policy concerns of related cases where rectification was not granted existed in this case. This was not a case involving:

(i) a petitioner that was engaged in "bold tax planning",
(ii) a petitioner looking to modify the terms of an agreement because it generated unplanned tax liabilities,
(iii) a petitioner that acted recklessly or without due diligence,
(iv) a petitioner that exercised an error in judgment, or

(v) a concern that the rectification request required the court to wholly rewrite or unwind a complex mechanism or series of business transactions.

The corporation made a calculation error and the proposed rectification order simply substituted the correct figure for the incorrect one.

The Court granted the rectification order as requested, rejecting the Attorney General's argument that alternative remedies, such as: (i) remission orders, (ii) professional negligence suits against the accountants responsible for the miscalculation, or (iii) the ability to treat the excess amount declared as taxable dividends under subsection 184(3) of the Act, should prevent the application of rectification.

This case illustrates that rectification continues to exist post-*Fairmont*, but likely only in very limited circumstances. The Crown has filed a notice of appeal to the British Columbia Court of Appeal.

—*Steve Marshall*

CONTINUED RECKLESS PARTICIPATION IN CHARITABLE DONATION SCHEME DELAYS DISCHARGE FROM BANKRUPTCY

***In the Matter of the Bankruptcy of Patrick Michael Monaghan*, 2018 DTC 5097 (Saskatchewan Court of Queen's Bench)**

In this case, the Saskatchewan Court of Queen's Bench considered the application of the special rule in section 172.1 of the *Bankruptcy and Insolvency Act* (Canada) for applications for a discharge from bankruptcy involving a large personal income tax debt in the context of a bankrupt individual who had incurred his tax debts as a result of his participation in a charitable donation tax scheme.

The taxpayer was a participant in a charitable donation tax scheme operated through a tax shelter referred to as the Global Learning Gifting Initiative program. Between 2004 and 2008 the taxpayer paid approximately $108,000 into the scheme and received donation receipts of approximately $558,580, and claimed donations totalling $700,075 between 2004 and 2014.

The scheme involved participants making a cash payment to a charity and applying to become a beneficiary of a trust. The participants received a donation receipt for their cash payments to the charity. The trust purchased software licences on behalf of its beneficiaries at less than fair market value and distributed the purchased software licences to the trust beneficiaries. Once accepted as a beneficiary of the trust, the participants instructed the trust to donate the distributed software licences to a charity. Each participant who donated his or her software licences received a second charitable receipt at the purported full, fair market value of the software licence so donated.

Although the taxpayer had no indication that there was anything amiss with the tax credits he was claiming as a result of his participation in the scheme during the first few years, the taxpayer received notice from the promoters of the scheme in November 2007 that the Canada Revenue Agency ("CRA") had issued a reassessment proposal to the Global Learning Gifting Initiative.

In February 2008, the taxpayer's 2004 return was reassessed to disallow the $76,990.00 charitable donation that was initially accepted, as filed. Nonetheless, even after the taxpayer had received notice that the CRA had the intention to revoke the charitable status of some of the Global Learning Gifting Initiative program charities and had received the reassessment of his 2004 taxation year denying a significant portion of the claim for that year, the taxpayer continued to participate in the program, donating an additional $61,000 in cash and claiming $512,021 in associated tax credits between 2008 and 2014.

The CRA denied a significant portion of the taxpayer's prior tax credit claims through further reassessments and refused to issue refunds for the majority of the taxpayer's tax credit claims between 2008 and 2014. The taxpayer objected to the reassessments but did not pay the reassessed amounts, although the CRA was able to collect a portion of the outstanding amount through garnishment proceedings.

On April 28, 2017, after the CRA garnished his bank accounts, the taxpayer made an assignment into bankruptcy. The CRA filed a proof of claim in the amount of $419,801.13 ($280,264.28 in income tax liability and $139,536.85 in penalties and interest) amounting to 96% of the total unsecured proven claims in the bankruptcy.

In 2018, the taxpayer applied to the Saskatchewan Court of Queen's Bench for an absolute discharge from bankruptcy, which application, if granted, would allow him to exit bankruptcy with $765,786 in exempt RRSP's still intact.

Subsection 172.1(1) of the *Bankruptcy and Insolvency Act* applies where a bankrupt has $200,000 or more of personal income tax debt representing 75% or more of the bankrupt's total unsecured proven claims. Subsection 172.1(3) provides that on the hearing of an application for a discharge to which subsection 172.1(1) applies, the court shall refuse the discharge, suspend the discharge for a time, or allow the discharge on the condition the bankrupt perform acts, pay moneys, consent to any judgment, or comply with any terms the court may direct.

The Attorney General of Canada opposed the application on behalf of the Minister of National Revenue on the basis of section 172.1 of the *Bankruptcy and Insolvency Act* and sought a 12-month suspension from discharge and an order that the taxpayer pay his bankruptcy estate the sum of $140,132.14 (approximately 50% of the principal income tax debt).

Subsection 172.1(4) of the *Bankruptcy and Insolvency Act* provides a list of four mandatory factors the court must take into account when applying subsection 172.1(3):

(a) the circumstances of the bankrupt at the time the personal income tax debt was incurred;
(b) the efforts, if any, made by the bankrupt to pay the personal income tax debt;
(c) whether the bankrupt made payments in respect of other debts while failing to make reasonable efforts to pay the personal income tax debt; and
(d) the bankrupt's financial prospects for the future.

The Registrar in Bankruptcy of the Saskatchewan Court of Queen's Bench considered a number of prior bankruptcy cases on income tax shelters involving Saskatchewan bankrupts and income tax-driven bankruptcy decisions more generally and applied the four factors in subsection 172.1(3) of the *Bankruptcy and Insolvency Act*.

With respect to the personal circumstances of the taxpayer, the Registrar canvassed the taxpayer's participation in the charitable donation scheme and concluded that the taxpayer had failed to observe the "red flags" in respect of the scheme that popped up when the CRA notified him that they were planning to revoke charitable statuses from certain Global Learning Gifting Initiative program charities. The Registrar also noted the taxpayer's failure to observe a "red flag" when he received his first reassessment in 2008 and concluded he had not acted in a manner that mitigated his risk.

With respect to the efforts made by the taxpayer to pay his income tax debts, the Registrar noted that the taxpayer had admitted that he made no efforts to pay his income tax debt and that all payments to the CRA were a result of garnishments.

With respect to whether the taxpayer made payments towards other debts without making reasonable efforts to pay his income tax debts, the Registrar inferred that the taxpayer had chosen to prioritize the payment of other debts over the tax debt, given that 96% of his total unsecured proven claims in the bankruptcy were income tax liabilities.

And finally, with respect to the taxpayer's financial prospects for the future, the Registrar noted that the taxpayer was not in good health and had little prospect of working again in the foreseeable future.

While the Registrar's analysis under the foregoing factors tended to weigh against allowing the taxpayer's application for discharge, the Registrar also found that the taxpayer's conduct could not be explained by honest misfortune. Instead the Registrar found that the taxpayer had brought on, or contributed to, the bankruptcy by rash and hazardous speculations when he decided to continue participating in the Global Learning Gifting Initiative program in the face of clear notice that the CRA considered the program to be illegitimate. The presence of rash and hazardous speculation is a factor under subsection 173(1) of the *Bankruptcy and Insolvency Act*, which, if present, may allow the court to refuse, suspend, or conditionally grant a discharge.

The Registrar further commented that in her view, the role of the court is to deter taxpayers from ignoring clear directions from the CRA concerning the illegitimacy of a tax shelter.

While the Registrar agreed with the Attorney General that having the taxpayer pay $140,132.14 as a condition of discharge would not have been out of line with the case law, she imposed a one year suspension on his discharge but reduced the amount of the payment to $100,000 given the taxpayer's poor health, age, and the fact that he would be forced to pay further income tax on any amount he withdrew from his RRSP to make monthly payments on the discharge amount.

This case adds to a body of case law that weighs the principles of deterrence and rehabilitation that guide a court's considerations in a section 172.1 bankruptcy. The case should be treated as a cautionary example of how section 172.1 may be applied in the context of a high-tax bankruptcy where the tax debts of a bankrupt arise from knowing or reckless participation in a high-risk tax scheme.

—*Justin Shoemaker*

FCA UPHOLDS GAAR ASSESSMENT IN RESPECT OF COMPLEX TRANSACTIONS THAT ABUSED SECTION 84.1

***Pomerleau v. The Queen*, 2018 DTC 5081 (Federal Court of Appeal)**

In *Pomerleau*, the Federal Court of Appeal (the "FCA") found that the Minister of National Revenue had properly applied the general anti-avoidance rule ("GAAR") to reassess the taxpayer, Mr. Pomerleau. The taxpayer had used a series of transactions that the FCA determined had abused section 84.1 of the *Income Tax Act* (the "Act") to avoid paying tax on the proceeds of share redemptions. The FCA therefore upheld the GAAR assessment in issue, in which the taxpayer had been taxed on the deemed dividend that he would have received had he not circumvented section 84.1.

A GAAR analysis asks three questions:

(1) Was there a tax benefit?
(2) If so, were the transactions giving rise to that benefit avoidance transactions?
(3) And, if so, were these transactions abusive?

The taxpayer acknowledged that he had received a tax benefit as a result of avoidance transactions, so the only issue before the FCA was whether the transactions frustrated the object, spirit, and purpose of section 84.1 as the Tax Court had initially determined.

Many years prior to the transactions at issue, the taxpayer, his mother, and his siblings had acquired their shares in Groupe Pomerleau—the taxpayer's business—in an estate freeze under which they exchanged their Class A shares for Class F shares pursuant to section 85. At that time, they made use of the capital gains deduction in subsection 110.6(2.1). As a result, the adjusted cost base ("ACB") of their Class F shares equalled the full fair market value ("FMV") of the Class F shares at the time of the estate freeze, such that the capital gains that were subject to the capital gains deduction were now reflected in the ACB of the Class F shares.

Some fifteen years after the freeze, the taxpayer wanted to use funds from Groupe Pomerleau to build a chalet for his personal use. With the help of his accountants, he implemented a complex series of transactions intended to accomplish this objective. The transactions had the effect of creating "hard ACB" for purposes of section 84.1 on shares owned by the taxpayer. (Generally, ACB, as described below, that is not attributable to valuation day value or to capital gains exemption claims is "hard ACB" for the purposes of section 84.1.) The plan accomplished this by relying upon "soft ACB", the creation of a capital loss arising from the redemption of the shares to which the "soft ACB" applied, and the addition of the denied loss to another class of shares owned by the taxpayer. (Generally, "soft ACB", for the purposes of section 84.1, is ACB attributable to valuation day value or to capital gains exemption claims.) The transactions that were undertaken are summarized below.

The taxpayer's mother first gave the taxpayer half of her Class F shares. As the taxpayer and his mother are related persons and deemed not to deal with each other at arm's length for purposes of the Act, the ACB of those shares to the taxpayer was deemed to be equal to their FMV: $195,128.

Next, the taxpayer and his sister Gaby each transferred all of their Class F shares of Groupe Pomerleau to a holding company, P Pom Inc., in exchange for Class A shares and Class G shares of P Pom. They used section 85 rollovers and elected at an amount that corresponded to the ACB of the transferred shares (i.e., the Class F shares of Groupe Pomerleau), following which the Class G shares of P Pom had an ACB to the taxpayer and Gaby equal to the ACB of the Class F shares of Groupe Pomerleau that were disposed of, and the ACB of their Class A shares of P Pom was nil.

Gaby then gifted all of the shares she held in P Pom to the taxpayer, triggering the application of paragraphs 69(1)(b) and (c) given that the taxpayer and Gaby are related persons and, therefore, deemed not to deal with each other at arm's length for purposes of the Act. Accordingly, the taxpayer was deemed to have acquired those shares at their FMV, which was $999,184 for the Class A shares and $407,600 for the Class G shares. The ACB of the Class A shares of P Pom held by the taxpayer thus was increased from nil to $999,184.

At this stage, the ACB of the taxpayer's Class G shares was $1,010,328. It reflected an amount on which the capital gains deductions had been claimed by the taxpayer, Gaby, and his mother.

P Pom then redeemed its Class G shares held by the taxpayer for their FMV which equalled their ACB of $1,010,328. Given that the paid-up capital of the Class G shares was $15,700, subsection 84(3) deemed the taxpayer to have received a dividend of $994,628 and to have incurred a capital loss of $994,628. Paragraph 40(3.6)(a) deemed this loss to be nil and paragraphs 40(3.6)(b) and 53(1)(f.2) added it to the ACB of the Class A shares owned by the taxpayer. Accordingly, the ACB of the Class A shares owned by the taxpayer increased from $999,184 to $1,993,812.

Subsequently, the taxpayer transferred his Class A shares of P Pom to Gestion Pierre Pomerleau Inc., yet another holding company, in exchange for Class A shares and Class C shares of Gestion. Again, the taxpayer elected, under section 85, at an elected amount corresponding to the ACB of the Class A Shares of P Pom of $1,993,812, which amount became the ACB of the Class C shares of Gestion. In addition, the paid-up capital of Gestion's Class C shares was set at the same amount, $1,993,812. These shares were then redeemed at their paid capital amount. The taxpayer effectively received $1,993,812 in cash as a return of capital.

As a result, the question before the Court was whether this tax planning, while compliant with the technical provisions of the Act, was abusive in that the taxpayer had received $994,628 on a tax-free basis, subject to the possible application of GAAR. The Minister argued that the planning defeated the underlying rationale of paragraph 84.1(2)(a.1) given that when the taxpayer redeemed $1,993,812 worth of shares, $994,628 of that amount could be traced to amounts on which the capital gains deduction had been claimed by the taxpayer, his sister, and his mother. In this regard, paragraph 84.1(2)(a.1) did not apply because the ACB of the Class C shares of Gestion, which had been redeemed, did not represent an amount on which the capital gains deduction had been claimed but, rather, the loss that had been denied on redemption of the Class G shares of P Pom, which in turn had been added to the ACB of the Class A shares of P Pom pursuant to paragraphs 40(3.6)(b) and 53(1)(f.2).

In respect of the required abuse analysis under GAAR, the FCA noted as follows:

> … the abuse analysis proceeds in two stages. The first stage requires the determination of the object, spirit and purpose of the provisions at issue, and the second is to determine whether the tax benefit obtained frustrates these provisions so construed […]. The object, spirit and purpose of a provision is discerned by way of statutory interpretation[.]

Prior to embarking on its abuse analysis, the FCA reviewed the concepts of paid-up capital and ACB, given that they are fundamental to the application of section 84.1, the provision that the Minister alleged had been abused. In this regard, the FCA noted that the paid-up capital of one share generally is calculated by dividing the total stated capital of that class of shares by the number of issued shares (under paragraph 89(1)(a)). For the purposes of the Act, the paid-up capital is the same for all shareholders holding shares of the same class (and series). On the other hand, the ACB of a share varies from one shareholder to another. The ACB of any property under the Act, including a share, is equal to the price paid in order to obtain it (section 54). Accordingly, if a shareholder acquires the share at a price higher than the average issue price of that class (and series) of shares, that shareholder typically will have an ACB that exceeds the paid-up capital of the share.

Furthermore, the FCA noted that the Act assumes that the cost of acquiring property (i.e., its initial ACB) is paid with amounts that have been subject to tax and that adjustments to ACB result under section 53 only from taxable transactions or events. Accordingly, in the FCA's view, ACB is composed of amounts that have been subject to tax.

The FCA determined that the purpose of section 84.1 is "to prevent amounts which have not been subject to tax from being used … to withdraw corporate surpluses on a tax-free basis" and that "[i]ts specific aim is to prevent paid-up capital from being increased by non-taxed amounts generated through non-arm's length transactions".

In respect of section 84.1 generally and the abuse in this case, the FCA explained as follows:

> [65] Section 84.1 applies when an individual resident in Canada transfers shares in a Canadian corporation (the subject shares) to another Canadian corporation with which the individual does not deal at arm's length and where both corporations are "connected" corporations […] immediately after the transfer. Where the subject shares reflect an accrued capital gains and are transferred at their FMV for newly issued shares (the new shares), paragraph 84.1(1)(a) sets the paid-up capital of the new shares at the greater of the paid-up capital or the ACB of the subject shares. Absent this provision, the paid-up capital of the new shares would be equal to the FMV of the subject shares at the time of the exchange with the result that the holder of the new shares could receive a tax-free distribution up to this FMV upon redeeming the new shares even though only half of the accrued value would have been subject to tax. The underlying logic for that adjustment is that […] the paid-up capital and the ACB of the subject shares will both reflect amounts that have been subject to tax. Accordingly, by providing that the paid-up capital of a new share is equal to the greater of the two, paragraph 84.1(1)(a) preserves the cost assumed by the shareholder while limiting the amounts that may be removed tax-free when redeeming the new shares to those that have been subject to tax.
>
> [66] There exists however two situations where the ACB of a subject share can reflect an amount that has not been subject to tax. Both are addressed in paragraph 84.1(2)(a.1). The first (subparagraph (i)) is where the ACB of a subject share reflects a gain that accrued prior to December 31, 1971 (Valuation-Day), and the second (subparagraph (ii)) is where the ACB of a subject share reflects amounts in respect of which a capital gains exemption […] has been claimed.
>
> [67] In order to prevent these accrued gains and exempt amounts from increasing the paid-up capital of a new share received in the course of a share exchange, paragraph 84.1(2)(a.1) alters the computation of the ACB of the subject share (or share for which it has been substituted) by subtracting these accrued gains and exempt amounts in its calculation. It is this subtraction set out in subparagraph 84.1(2)(a.1)(ii) which was successfully avoided thereby giving rise to the tax benefit.

The FCA determined that the object, spirit, and purpose of section 84.1 is:

> … to prevent amounts that have not been taxed from being used to remove corporate surplus on a tax-free basis. Subsection 84.1(2) achieves this goal by focussing on amounts which although reflected in the ACB of the subject shares were not derived from tax paid funds, and excluding them from the computation of the paid-up capital of the new shares. To this end, subparagraph 84.1(2)(a.1)(ii) requires looking beyond the ACB of the subject shares—or shares for which they were substituted—and asking whether it is made up of amounts on which tax has not been paid.

The FCA found that paragraph 84.1(2)(a.1) was circumvented by the taxpayer's plan, which withdrew $1,993,813 from the corporations in issue, of which $994,628 represented amounts on which no tax had been paid. The FCA stated that "[t]he planned interposition of the deemed dividend provided for in subsection 84(3) and the resulting deemed loss under paragraph 40(3.6)(a) does not alter the fact that the amount of $994,628 continues to represent funds on which no tax was ever paid".

Accordingly, the FCA concluded that the taxpayer had abused the provisions of section 84.1, and, as a consequence, the Minister's GAAR assessment was upheld.

—Hilary Smith, Articling Student

INVALID RENUNCIATIONS OF CANADIAN EXPLORATION EXPENSES TO NON-ARM'S LENGTH SHAREHOLDERS USING THE LOOK-BACK RULE SUBJECT TO PART XII.6 TAX

***Tusk Exploration Ltd. v. The Queen*, 2018 DTC 5073 (Federal Court of Appeal)**

The facts of the case were relatively straightforward and the appeal by the taxpayer to the Federal Court of Appeal turned solely on a question of law.

The taxpayer had purported to renounce Canadian exploration expenses ("CEE") to non-arm's length shareholders using subsection 66(12.66) of the *Income Tax Act* (the "Act"), which is commonly known as the look-back rule. Under subsection 66(12.66), a corporation that has issued flow-through shares may, in the first three months of a particular calendar year, and if certain conditions are met, renounce CEE to its shareholders with an effective date of December 31 of the preceding year, even if the corporation has not yet incurred the CEE, provided that the CEE is incurred at some point in the particular year. In effect, this "backdated" renunciation permits the shareholders to deduct the CEE in their tax returns for the preceding year even though the corporation may not yet have incurred the expense.

Unfortunately for the taxpayer and its shareholders, one of the conditions of subsection 66(12.66) is that the corporation and the shareholder to whom the CEE is purportedly renounced deal with each other at arm's length throughout the particular year. As such, the renunciations at issue were invalid from the outset and reassessments of the shareholders were issued to deny the deductions for the tax year preceding the year in which the CEE was actually incurred. The shareholders were also required to pay interest in connection with the reassessments.

Another consequence of the look-back rule, Part XII.6 tax, may arise depending on when in the particular year the corporation actually incurs the CEE. If all of the CEE that is purported to have been renounced under subsection 66(12.66) is incurred by the end of February of the particular year, then no Part XII.6 tax will apply. But if, at the end of February of the particular year, the amount that the corporation "purported to renounce" in the year exceeds the expenses "made or incurred by the end of the month", then the corporation is required to pay a tax which is calculated based on the prescribed interest rate on tax refunds. This tax applies on a monthly basis, effectively acting as an interest charge to reflect the fact that the shareholders have received a CEE deduction before the CEE was actually incurred.

As the taxpayer had not paid Part XII.6 tax, the Minister assessed the taxpayer for Part XII.6 tax on the basis that all of the CEE had not been incurred for each of the years in issue by the end of February. The taxpayer initially appealed the assessment to the Tax Court, which determined that the tax was payable by the taxpayer. The taxpayer therefore appealed to the Federal Court of Appeal.

The sole issue before the Federal Court of Appeal was whether Part XII.6 tax applies if the purported renunciations of CEE were invalid by reason of having been renounced to non-arm's length shareholders (contrary to paragraph 66(12.66)(d) of the Act) or, as contended by the taxpayer, whether the tax applies only where an insufficient amount of CEE was incurred but the renunciations were otherwise valid. The taxpayer advanced arguments based on both the text and the purpose of Part XII.6.

The taxpayer's textual argument was based on its assertion that the reference in Part XII.6 to amounts that the corporation "purported to renounce" included only "amounts that the corporation validly renounced in the year" but that the corporation ultimately did not actually incur. On this argument, if a renunciation was invalid from the outset because it was made to a non-arm's length shareholder, and was thus contrary to paragraph 66(12.66)(d), then the amount of that invalid renunciation is not to be considered as an amount that the corporation "purported to renounce" for the purpose of calculating the Part XII.6 tax. Only if the renunciation was otherwise valid but the CEE was not incurred on time should the amount of the renunciation be included in the calculation of the amounts that the corporation "purported to renounce". However, as the Federal Court of Appeal noted, the requirement that CEE be incurred is also a requirement of a valid renunciation (under paragraph 66(12.66)(a)). If a renunciation that is invalid by reason of not satisfying paragraph 66(12.66)(a) is considered an amount that the corporation "purported to renounce", then as a matter of logical consistency, so is a renunciation that is invalid by reason of not satisfying paragraph 66(12.66)(d).

The taxpayer also advanced an argument that the purpose of Part XII.6 was not furthered by imposing a tax on the corporation even though the shareholders had paid interest on the increased tax liability arising from the disallowed renunciations. After all, if the shareholders dealt at arm's length with the taxpayer and their CEE deductions were denied because the taxpayer had not incurred the CEE on time, then the shareholders may not have been liable for interest on the increased tax liability because of the rules pertaining to "specific future tax consequences", but as their CEE deductions were denied because of their non-arm's length relationship to the taxpayer, the shareholders were assessed interest. The Federal Court of Appeal rejected this argument as well, noting that the tax does not directly calculate the interest cost arising from allowing shareholders to effectively claim CEE deductions one year earlier than they would in the absence of the look-back rule. In any event, the Court observed that the Act does include provisions that can give rise to "double taxation" in a non-arm's length context where deductions or other tax benefits are claimed contrary to the Act, and that this situation may be one in which the Act is intended to have a punitive effect.

As a result, the Federal Court of Appeal dismissed the taxpayer's appeal. This case provides a reminder to issuers of flow-through shares that the rules governing the renunciation of CEE are technical and unforgiving. Utmost care should be taken that these rules are scrupulously followed before any renunciations are made.

—*Theodore Stathakos*

RECENT CASES

APPEAL FROM INCLUSION IN INCOME OF AMOUNT PROVIDED BY EMPLOYER FOR TRAVEL COSTS DISMISSED

During the 2014 tax year, the taxpayer received from his employer an amount intended to offset personal travel costs between his home in New Brunswick and the pick-up point in Alberta from which his employer provided transportation, at the employer's expense, to a mining work site in Yellowknife. During that year, the taxpayer's actual costs for travel from his home to the pick-up point were $10,383.40 while the allowance received was $5,749.70. The employer refused to provide the taxpayer with a completed Form TD4, Declaration of Exemption—Employment at a Special Work Site, which would have allowed the amount to be excluded from income. Rather, the amount of the allowance was reported on the taxpayer's T4, included in income, and taxed as such. The taxpayer appealed, arguing that the allowance should be exempt from tax based on his work at a remote work site.

The appeal was dismissed. The Tax Court of Canada noted that, generally, all benefits received by an employee from an office or employment are taxable in his or her hands, and that section 6 of the *Income Tax Act* provides an exception to that general rule by allowing certain benefits related to special work sites or remote work locations to be excluded from income, in limited circumstances. The Court reviewed the reasoning of the employer in refusing to issue the TD4 and held that it could not conclude that the employer was acting unreasonably or in bad faith. In order to qualify for the exemption, an allowance paid must be for transportation between the employee's home and the special work site. However, the allowance paid to the appellant was paid for travel between his home and the pick-up point in Edmonton, which was not a special or remote work site. The Court noted as well that the amount of the allowance, which was set at 4.5% of salary, was arbitrary and bore no resemblance to the appellant's actual travel costs. The Court concluded that the appellant's costs in travelling to the pick-up point were essentially personal in nature. The jurisprudence was clear that where such personal costs are paid by an employer, the amount received gives rise to a taxable benefit, which was properly included on the appellant's T4. The appeal was therefore dismissed.

McEachern v. The Queen

2019 DTC 1001

APPELLANT REQUIRED TO FILE T5018 AND PENALTY FOR FAILURE TO FILE PROPERLY IMPOSED

The taxpayer was a partnership in the business of developing and selling residential condominiums in Calgary. It did not employ construction workers directly, but instead hired a general contractor to construct the condo units, which it then sold. The Minister issued an assessment for the 2013, 2014, and 2015 taxation years, which imposed penalties under subsection 162(7) for the taxpayer's failure to file a Form T5018 Summary for each of those years. The taxpayer appealed from those assessments, arguing that no such filing was required.

The appeal was dismissed. The Tax Court of Canada held that the obligation to file a Form T5018 Summary was created by section 238 of the *Income Tax Regulations*. That provision imposed a two-part test, which required the Court to consider whether the appellant had, during the subject reporting period, paid an amount for goods and services rendered on their behalf in the course of construction activities. If so, then the Court was required to determine whether the appellant's partnership business income was derived primarily from those construction activities. If both parts of the test were satisfied, then the appellant was required to file a T5018. The Court reviewed the structure of the appellant's business and concluded that both components of the test set out in Regulation 238 had been met and the appellant was therefore required to file a Form T5018 Summary. The Court then considered whether, as argued by the appellant, a defence of due diligence could be relied upon. While the appellant and the respondent had put forward different fact scenarios the Court held that, under either scenario, the appellant would have been aware of the Canada Revenue Agency's position on the required filing of a Form T5018 Summary, but that it had chosen not to do so. The Court concluded the defence of due diligence was not available and that penalties for the appellant's failure to file a Form T5018 Summary were consequently properly imposed. The appeal was therefore dismissed.

Apex v. The Queen

2018 DTC 1174

WHETHER INCOME RECEIVED BY APPELLANT PROPERLY CHARACTERIZED AS DIVIDEND INCOME

The taxpayer received T5 information slips indicating her receipt of dividend income in the amount of $33,555 and $15,000 for the 2012 and 2013 taxation years, respectively. The dividend payments had been received from a company of which the taxpayer was formerly an employee and a 30% shareholder, but which she had left following a dispute and ensuing litigation with another shareholder. The taxpayer appealed from the assessments for both taxation years, arguing that the amounts received were not all dividend payments, but also represented the payment of her legal fees, salary, and reimbursements.

The appeal was allowed in part. The Tax Court of Canada reviewed the evidence provided with respect to the circumstances in which the disputed payments had been received by the appellant. It held first that, with respect to the $33,555, a bookkeeping error had resulted in the double-counting of $7,000 as both salary and dividend payments during 2012, and that such amount should be deducted from the $33,555, leaving an amount of $26,555. The Court concluded, however, that as there was not sufficient corroborating evidence provided by the appellant in respect of any of the disputed amounts, there was no evidentiary basis on which the Court could characterize the balance of $26,555 as being anything other than dividend payments. With respect to the $15,000 payment during 2013, the Court held that, as there was no specific evidence adduced by the either party concerning that amount, the appealed assessment would stand. The taxpayer's appeal was therefore allowed in part.

Lunot v. The Queen

2018 DTC 1173

APPEALS FROM ASSESSMENTS FOR PART XI.01 TAX ALLOWED IN PART

The taxpayer, who held a tax-free savings account (“TFSA”) as well as a registered retirement savings account (“RRSP”) and a direct trading account (“CDN”), carried out 71 share exchange transactions ("swap transactions") during the 2009 taxation year. Those swap transactions involved the transfer of shares between her TFSA and her CDN and RRSP, and had the result of significantly increasing the total fair market value of her TFSA. The Minister issued an assessment indicating that the taxpayer was liable to Part XI.01 tax for the 2009, 2010, and 2012 taxation years, on the basis that the swap transactions had created an advantage as defined in section 207.01 of the *Income Tax Act* (the “Act”). The taxpayer appealed from the assessments for each of those taxation years.

The appeals were allowed in part. The Tax Court of Canada held that it was required, based on the definition of "advantage" found in section 207.01 of the Act, to determine whether it was reasonable to consider, having regard for all of the circumstances, whether the increase in the total fair market value of the appellant's TFSA was attributable directly or indirectly to a transaction or series of transactions that would not have occurred in an open market in which parties dealt with one another at arm's length and acted prudently, knowledgeably, and willingly. It was also required to determine whether one of the main purposes of the swap transactions was to enable the appellant to benefit from the exemption from income tax under Part 1. Applying that test, the Court determined that the appellant had received an advantage in relation to her TFSA in 2009. Specifically, the Court held that the parties in charge of the RRSP and CDN clearly did not act "prudently, knowledgeably and willingly", as all of the swap transactions were carried out in such a way as to favour the TFSA to the detriment of the RRSP and CDN. The Court concluded, therefore, that the series of swap transactions would not have occurred if the parties had been dealing at arm's length. However, the Court's textual and contextual analysis of the relevant provisions of the Act with respect to the 2010 and 2012 taxation years did not support a conclusion that the definition of "advantage" should be extended such that it would apply to those years. The Court noted that the appellant was not engaging in swap transactions during those years and her TFSA was therefore subject purely to market forces. In the Court's view, it was reasonable to attribute increases in the value of her TFSA during those years, not directly or indirectly to the swap transactions, but to the post-2008 financial recovery. The appeal for the 2009 taxation year was therefore dismissed, and the appeals for the 2010 and 2012 taxation years were allowed.

Louie v. The Queen

2018 DTC 1166

DECEASED TAXPAYER LACKED MENTAL CAPACITY TO EFFECT CERTAIN FILINGS; MINISTER'S REASSESSMENTS BASED ON THOSE FILINGS ACCORDINGLY SET ASIDE AS VOID

A family business, “Dupont”, was owned by the deceased taxpayer, Anna, and her two brothers-in-law, through a holding corporation, “Holdings”. Anna, who had difficulty understanding English, behaved passively throughout a bitter family dispute respecting this family business, and her mental and physical health declined from 1995 until her death on October 5, 2004. She was diagnosed in the fall of 2002 (the “Diagnosis Date”) with breast cancer, and lacked mental capacity after that date. During 2000, and after the Diagnosis Date, a number of filings (the “2003 filings”) on Anna’s behalf were made by Dupont’s accountant relating to her 1998, 2001, and 2002 taxation years. The Minister reassessed Anna based on these 2003 filings (the “Reassessments”). Anna’s estate (the “Estate”) applied, among other things, for an order either vacating the Reassessments, or extending the time for filing notices of objection to them.

The Estate's application was allowed in part. If Anna did not file or grant authority to file some or all of the returns in issue in this case, or if she lacked mental capacity to do so, then there was no need for the Estate to file notices of objection to the reassessments (see *Gyimah v. The Queen*, 2011 DTC 1014 (TCC); *Kanakas v. The Queen*; and *Sanders v. Anglea Building Supply* [1971] QC 1004 (HL)). In fact, Anna did not effect the 2003 filings, and lacked the mental capacity to do so. Conversely they were done without her knowledge, authority, or direction, and the reassessments responsive to them were thus vacated. As a result no objections to the reassessments were necessary. In addition, the Estate’s application for an order extending the time for filing notices of objection to them was also unnecessary, and was dismissed accordingly.

Ntakos Estate v. The Queen

2018 DTC 1167

CONDUCT OF PARTIES LEADING TO COSTS AWARD TWICE TARIFF TO SUCCESSFUL APPELLANT

The corporate taxpayer appealed from an assessment and its appeal was allowed, with costs. The parties were unable to agree on costs and an application was made to the Tax Court of Canada for a determination. The appellant's actual costs in the appeal were $185,014, and the appellant requested a lump sum costs award in the amount of $134,321. The respondent argued for a costs award in accordance with Tariff, plus disbursements.

The appellant was awarded costs equal to double Tariff, plus disbursements. The Tax Court reviewed the factors set out in subsection 147(3) of the *Tax Court of Canada Rules (General Procedure)* which it could consider in awarding costs, including the outcome of the appeal, the amount in issue, the importance and complexity of the issues, the volume of work, any conduct by either party affecting the duration of the proceeding, and any other relevant matters. In applying those factors to the matter before it, the Court held that the appellant was entirely successful in the appeal and that the amount in issue was significant. The proceedings had, in the Court's view, been delayed by the failure of the sole witness for the corporate appellant, who was its shareholder, director, and controlling mind, to provide testimony in a credible, honest, and straightforward manner. The Court held as well that the Minister should not have brought the matter forward to trial. In the Court's view, the position taken by the Minister in assessing the taxpayer was, in light of the relevant statutory provision and the jurisprudence, "simply not supportable". The Court determined that, in light of the delay caused by the appellant and the Minister's conduct, it was appropriate to award costs equal to double the costs set out in the Tariff, plus disbursements. Costs of $19,400, plus disbursements, were therefore awarded to the appellant.

Aitchison Professional Corp. v. The Queen

2018 DTC 1170

APPEAL FROM DENIAL OF CLAIM FOR DISABILITY TAX CREDIT ALLOWED

The taxpayer had been entitled to and had claimed the disability tax credit (“DTC”) for a number of years. However, a determination made by the Minister in September 2016 denied her entitlement to the DTC, effective as from January 2016. The taxpayer filed a Notice of Objection, but the determination was confirmed, and the taxpayer appealed.

The appeal was allowed. The Tax Court of Canada held that, in order to qualify for the DTC, the appellant was required to establish that she had a prolonged and severe impairment in physical or mental functions, resulting in a marked or significant restriction in one or more basic activities of daily living, and that such impairment must be verified, in prescribed form, by a physician. The Court reviewed the statutory requirements and the jurisprudence interpreting those requirements in light of the appellant's evidence, and concluded that she did have a severe and prolonged impairment qualifying her for the DTC, and that the Minister had erred in his determination. The Court held that, as a consequence of severe depression and anxiety, the appellant was largely unable to leave her home, and that such was indicative of a marked restriction in mental functions necessary for everyday life, being a basic activity of daily living. The appeal was allowed and the matter referred back to the Minister for redetermination and reconsideration in accordance with the Court's decision.

Cochrane v. The Queen

2018 DTC 1169

NEW HEARING ORDERED WHERE LANGUAGE RIGHTS VIOLATED

At the hearing in the Tax Court of Canada ("TCC") (2016 UDTC 13), several witnesses and counsel for the intervenor indicated a preference to testify or address the court in French. The judge informed counsel for the intervenor that if his witness testified in French, the hearing would have to be adjourned. Further to a suggestion by counsel, the witness testified in English, using a few words in French where necessary. During the rest of the hearing, some of the other witnesses, as well as counsel for the intervenor, indicated they wanted to speak in French, but the judge asked them to speak in English and steered the testimony and presentation of counsel's arguments back to English. The judge decided the appeal in the taxpayer's favour, and the intervenor appealed the TCC's decision on the ground that the language rights of its witnesses and counsel had been violated. The Federal Court of Appeal allowed the appeal (2017 DTC 5046) and ordered a new hearing before a different judge of the TCC. The taxpayer appealed to the Supreme Court of Canada.

The appeal was dismissed. All persons who appear in federal courts must be able to freely exercise their fundamental and substantive right to speak in the official language of their choice. The federal courts must provide the resources and procedures needed, even where a hearing is conducted in accordance with an informal or simplified procedure. Language rights must be interpreted purposively, in a manner consistent with the preservation and development of official language communities in Canada. Judges are required to participate actively in protecting language rights. They are primarily responsible for upholding language rights; a lawyer's failure to intervene does not release a judge from his or her duties. If a judge asks a person to speak in an official language other than the language of the person's choice, this constitutes a violation of section 14 of the *Official Languages Act*, section 19 of the *Canadian Charter of Rights and Freedoms*, and section 133 of the *Constitution Act, 1867*. The language rights of several individuals who participated in this case were infringed at the hearing in the TCC. The violations were numerous and had an impact on the witnesses and parties, on the conduct of the hearing, and the outcome. Counsel for the intervenor took appropriate steps to assert his own rights as well as the rights of his client and witnesses. His choice to defer to the judge's instructions resulted from the judge's insistence and was not a tactical move. The witnesses did not waive their right to testify in French. Where the language rights of a party or of his or her counsel are not upheld, the appropriate remedy will generally be to order a new hearing, as was done by the Federal Court of Appeal. The Supreme Court agreed, dismissing the taxpayer's appeal and ordering a new hearing before a different judge of the TCC.

Mazraani v. Industrielle Alliance

2018 DTC 5126

MINISTER'S APPLICATION TO COMPEL PRODUCTION OF DUE DILIGENCE REPORT ALLOWED

In the course of an audit of the corporate taxpayer, the Minister issued a Requirement for Information ("RFI") under section 231.7, requiring the taxpayer to provide a due diligence report which had been prepared by its accountants in connection with a transaction it had undertaken. The taxpayer refused to provide the report, arguing that the Minister had not established its relevance and that the report was, in addition, protected by solicitor-client privilege. The taxpayer also took the position that the report was not compellable under the *Income Tax Act* (the "Act"), because compelling its production would impose on the taxpayer an obligation to self-audit. The Minister brought an application before the Federal Court seeking an order requiring the taxpayer's compliance with the RFI.

The application was allowed. The Federal Court noted that, as acknowledged by both parties, the Minister did not have to demonstrate that the requested documentation was relevant, only that it may be relevant. In the Court's view, it was undisputed that the report requested had been prepared for purposes of the transaction that was under audit. It was not necessary that the Minister demonstrate it was relevant to a particular issue under audit. The Court concluded that the Minister's purpose in seeking the report related to the administration or enforcement of the Act and that the information in the report may be relevant to an amount payable by a taxpayer under the Act. The Minister had, therefore, met the low threshold for relevance with respect to an application under section 231.7. On the question of solicitor-client privilege, the Court noted that there are circumstances in which such privilege can apply to documents which had been prepared by a third party, in particular by an accountant. The Court reviewed the circumstances in which the report was prepared before concluding that the dominant or principal purpose when the report was commissioned and generated was to inform the decision of whether to proceed with the transaction and at what price. As such, that purpose was a business purpose and such finding was determinative of the Court's conclusion that the report was not protected by solicitor-client privilege. Finally, the Court considered the taxpayer's argument with respect to a requirement to self-audit. In making that argument, the taxpayer had relied on a decision of the Federal Court of Appeal, but the Federal Court held that compelling the taxpayer to provide the report would not offend the principle outlined in that decision that a taxpayer is not required to self-audit. It also held that the taxpayer had identified no additional basis that would, in the Court's view, warrant the exercise of its discretion to decline to order provision of the report. An order was therefore issued requiring the taxpayer to provide the due diligence report to the Minister within 45 days of the date of judgment.

Canada (MNR). v. Atlas Tube Canada

2018 DTC 5124

APPEAL FROM DENIAL OF BUSINESS DEDUCTION FOR FILE-STORAGE EXPENSES ALLOWED

After practising law for 27 years, the taxpayer ceased to provide legal services in 2013 and became a retired member of the Nova Scotia Barristers Society. As required by the terms of her professional liability insurance, she retained client files and incurred costs to store such files. She deducted the costs of that storage in her return for the 2015 tax year, but such deduction was denied by the Minister, on the basis that the taxpayer had not, as required, incurred those expenses for the purpose of gaining income from business during 2015, and had operated no business during that taxation year. The taxpayer appealed.

The appeal was allowed. The Tax Court of Canada held that the issue for determination was whether the appellant, as a retired member of the Barristers Society with no current business income, was entitled to deduct file storage fees as an expense in relation to client files created during previous tax years when she had such business income and pursued a profit from business. The Court held that during the years in which she provided legal services, the appellant was accruing annually "run-off" responsibilities concerning file retention, accessibility, and, ultimately, future storage obligations and, consequently, she incurred the requirement to expend future sums on storage to earn then current income. In the Court's view, the past accrual of future record keeping services, the file storage, and the need to protect (in the present) her insurance coverage for past legal services all represented the enduring and current provision of legal services beyond the temporal period in which the income from such services was received. The Court concluded that the continuing services provided by the appellant in 2015 were referable and connected to the income earned in previous years and, as such, were properly deductible by her. The respondent Minister had not raised any issue with respect to the reasonableness of the amount of the expenses deducted, and the Tax Court therefore concluded that the taxpayer was entitled to the deduction in the amount claimed.

Tournier v. The Queen

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