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Tax Notes

Report No.: 675

Date: April, 2019

2019 FEDERAL BUDGET: MEASURES IN-BRIEF

On March 19, 2019, the 2019 Federal Budget was released, proposing many new tax changes and announcing that a few others are yet to come. Detailed commentary from Dentons Canada LLP, the budget documents, and webinar information are all available at https://wolterskluwer.ca/learning/federal-budget/. Below is a brief overview of the tax changes that were announced in the budget.

PERSONAL TAX MEASURES

The budget introduced the refundable Canada Training Credit, which will refund up to 50% of a taxpayer's eligible tuition costs, subject to a notional limit that accumulates at a rate of $250 per year.

The home buyers' plan ("HBP") is augmented through an increase in the withdrawal limit from $25,000 to $35,000 annually per taxpayer. As well, the HBP is extended to individuals who become separated during the year and have lived separately for 90 days during the year, provided they do not continue to reside in a home owned and occupied by a new spouse or common-law partner.

A taxpayer who owns a multi-unit residential property will be able to elect to not have the deemed disposition rules apply to a change in use.

Certain registered plans will allow investments in advanced life deferred annuities and variable payment life annuities.

Budget 2019 proposes to remove the time limitation on the period that an RDSP may remain open after a beneficiary becomes ineligible for the DTC, and to eliminate the need in future years for a medical certification for the beneficiary to remain eligible for the DTC.

Budget 2019 proposes to amend the *Income Tax Act* to clarify that an individual is considered to be the parent of a child in their care for the purpose of the Canada Workers Benefit, regardless of whether they receive financial assistance from a government under a kinship care program.

Medical cannabis products sold by a licensed cannabis retailer for medical purposes will qualify for the medical expense tax credit.

Budget 2019 prohibits a strategy where an employee commutes their employer-sponsored pension to an IPP sponsored by the employee's own CCPC.

The Budget proposes that a TFSA holder will be joint and severally liable for tax owing from carrying on a business in their TFSA.

BUSINESS TAX MEASURES

The government announced its intention to limit the use of the current stock option deduction rules and align the tax treatment of employee stock options with that of the United States. This change will only affect employees of large, long-established, mature firms. Going forward, the government proposes a $200,000 cap. More information will be provided in summer 2019.

The government plans to continue to consult with business owners to develop new proposals that facilitate inter-generational business transfers.

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Budget 2019 proposes several tax incentives to help the Canadian media. First, qualified Canadian journalism organizations will be given tax-exempt and qualified donee status, so they can issue charitable donation tax receipts. Second, these types of organizations will also be eligible for a refundable tax credit on labour costs with respect to newsroom employees. Third, the Budget proposes a temporary 15% non-refundable tax credit for digital news subscriptions, for up to $500 in annual costs incurred after 2019 and before 2025.

Budget 2019 also proposes to:

- introduce a temporary 100% CCA write-off for zero-emissions vehicles;
- remove the taxable income phase-out for the expenditure limit with respect to a CCPC's enhanced SR&ED investment tax credit;
- clarify that the transfer pricing rules apply in priority to the application of other rules in the *Income Tax Act*; and
- expand the foreign affiliate dumping rules to apply to a CRIC that is controlled by a non-resident individual, trust, or non-arm's length group of persons—currently the rules apply to a CRIC that is controlled by a non-resident corporation.

EXCISE TAX MEASURES

Budget 2019 proposes that excise duties on edible cannabis products, cannabis extracts, and cannabis topicals will be imposed at a flat rate based on the THC content in the product.

Budget 2019 proposes to make human ova and *in vitro* embryos zero-rated supplies.

Currently, supplies of foot-care devices that are ordered by a licenced podiatrist or chiropodist are not zero-rated. Budget 2019 proposes to extend the zero-rated treatment to apply in these circumstances.

Budget 2019 proposes to make multidisciplinary medical services exempt from the GST/HST.

CURRENT ITEMS OF INTEREST

CRA TOLD TO IMPROVE DEBT COLLECTION PROCESSES

Canada's Taxpayers' Ombudsman has published a new report on the CRA's debt collection process and urged that greater, clearer information be made available to taxpayers.

The Ombudsman's review began in February 2017. It was triggered by complaints from taxpayers alleging that the CRA was taking legal actions—such as garnishing wages or freezing bank accounts—without notice.

It is the CRA's policy to make at least one attempt at giving legal warning to a taxpayer prior to taking legal action. The legal warning is a statement, either in writing or given orally, that advises the taxpayer that the CRA can take legal action if an amount owed is not paid in full or if a binding payment arrangement is not made with the CRA.

The Ombudsman found that only a small number of taxpayers do not receive a legal warning prior to the CRA taking legal action to collect a debt. However, it also concluded that taxpayers often lack understanding about the consequences of non-payment of a debt.

As a result, the Ombudsman recommended that the CRA update its policies to ensure that all relevant information is given to taxpayers when they are issued a legal warning, and update the information available to taxpayers on the collection process. The CRA should also update its internal and external messaging, to ensure that all debt payment and collections-related terminology is clearly and consistently defined and used.

The Ombudsman also argued that the CRA should shorten the validity period of the legal warning from 365 days to 180 days. The CRA should make information available to taxpayers on the requirements for a binding payment arrangement and send confirmation letters to taxpayers who make such arrangements, it said.

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More broadly, the Ombudsman recommended that the CRA should conduct a review of the processes, policies, and information regarding payment arrangements. It should also regularly review its payment and collection policies and procedures, to ensure that they align with a service approach that is consistent with the Taxpayer Bill of Rights.

The Ombudsman, Sherra Profit, said:

> A debt collection process that is fair means respecting the taxpayer right to complete, accurate, and clear information. This means the CRA looking at the information it provides from the taxpayer perspective.
>
> The CRA has the obligation to collect debts. And, taxpayers have the right to understand that process. They have the right to understand whether the payment arrangement they have made is legally binding such that the CRA will not proceed with legal action if they are making their payments.
>
> It is important [that] the CRA ensures its legal warnings in debt collection are clear. The consequences need to be explained in a way that is understood by the taxpayer.

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.

ACCOUNTING FIRM'S DUE DILIGENCE REPORT ORDERED PRODUCED TO THE CANADA REVENUE AGENCY

***MNR v. Atlas Tube Canada ULC*, 2018 DTC 5124 (Federal Court)**

The *Atlas Tube* case is another interesting and important case that explores the boundaries of solicitor-client privilege in the context of a document generated by a non-lawyer, and the document production powers of the Canada Revenue Agency (the "CRA") in the context of a document that contains information of the type typically found in tax accrual working papers.

In *Atlas Tube*, the Minister of National Revenue brought an application under section 231.7 of the *Income Tax Act* to force Atlas Tube to produce a draft due diligence report (the "Report") prepared by an accounting firm. In March 2012, Atlas Tube's parent company ("Parent") had acquired an Ontario company ("Target"), which itself was the parent company of another Ontario company and a US holding company. A number of transactions took place after the acquisition, including the transfer to Atlas Tube of a successor (by amalgamation) of Target. This transfer resulted in Atlas Tube owing $90 million dollars (the "Debt") to the transferor of Target's successor.

In the course of these transactions, the accounting firm was engaged by Parent to prepare the Report. The Report described and explained the tax attributes of Target and one of its subsidiaries, including the availability of non-capital losses and the material tax exposures for the previous four years of one of Target's subsidiaries. In evidence, Parent explained that Parent engaged the accounting firm to prepare the report on the recommendation of its lawyers. It is not entirely clear, however, whether the Report (rather than simply information contained therein) was ever actually provided to the lawyers.

The CRA decided to audit Atlas Tube's taxation year which included the acquisition, and sought production of the Report to assist with the CRA's review of the reasonableness of the interest expense on the Debt and certain valuation issues. Atlas Tube refused to produce the Report, and the CRA ultimately brought its application under section 231.7.

Atlas Tube made four arguments in support of its refusal to produce the Report. First, Atlas Tube argued that the CRA had not established that the Report was relevant to the determination of Atlas Tube's tax liability. The Court rejected this argument, citing earlier case law that had established that if the CRA is conducting a genuine inquiry into the tax liability of a taxpayer, relevance is established if the document in question "may be relevant" to the determination of the taxpayer's tax liability, even if the document is not relevant with respect to any particular issue under audit. Despite the suggestion that the Report did not contain certain

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information relevant to the valuation issues the CRA was considering in its audit, the low judicial threshold of relevance was nevertheless met.

Second, Atlas Tube argued that the Report was protected by solicitor-client privilege. The Court reviewed the principles set out in the leading case, *Redhead Equipment* (2016 DTC 5098 (SKCA)), in relation to whether privilege applies to a document generated by a third party (a non-lawyer). As determined in *Redhead Equipment*, privilege applies if the communication is “in furtherance of a function essential to the solicitor-client relationship or the continuum of legal advice provided by the solicitor”. The Court agreed that the Report had dual purposes—to assist Parent to make its business decision as to whether to proceed with the acquisition, and to assist in the provision of legal advice on how to structure the acquisition—but found that the former predominated at the time that the Report was commissioned. Also, the Court concluded that the Report’s analysis went well beyond a function relevant to the provision of legal advice; instead, the Report contained independent accounting opinions that could not be characterized as prepared for the purpose of obtaining legal structuring advice. Accordingly, the Report was not protected by privilege.

Third, Atlas Tube relied on the recent case *BP Canada Energy Company* (2017 DTC 5028 (FCA)) to argue that production of the Report (which, again, described material tax exposures of one of Target’s subsidiaries) amounted to impermissible forced self-audit. In *BP Canada*, the Federal Court of Appeal held that the CRA does not have a general and unrestricted right to obtain tax accrual working papers from taxpayers, in part because forcing a taxpayer to produce such materials amounts to requiring the taxpayer to audit itself. In *Atlas Tube*, the Court distinguished *BP Canada* on the basis that the CRA admittedly sought the materials in issue in *BP Canada* as a “roadmap” to facilitate future audits. In contrast, in *Atlas Tube*, the Report was requested “in the context of an active audit of particular issues”. As a result, forced production of the Report did not violate the principle that a taxpayer is not required to self-audit.

Finally, Atlas Tube argued that the Court should exercise its residual discretion not to order production of the Report because the Report dealt with tax attributes of companies other than Atlas Tube itself and with taxation years that pre-dated the year of acquisition of Target. The Court summarily rejected this argument, having already determined that the low judicial threshold of relevance was met and that *BP Canada* did not apply in this case.

Atlas Tube has appealed the Court’s decision to the Federal Court of Appeal. It will be interesting to read the appellate court’s further thoughts on the circumstances in which privilege can protect the work product of an accounting firm, and the scope of *BP Canada*.

—Salvatore Mirandola

QUEBEC COURT OF APPEAL FINDS “QUEBEC YEAR-END SHUFFLE” ABUSIVE

***Développements Iberville Ltée v. Quebec Revenue Agency*, 2018 DTC 5131 (Quebec Court of Appeal)**

The central issue in this appeal was whether the trial judge erred in finding that the Quebec GAAR (which is virtually identical to the federal GAAR) applied in respect of interprovincial tax planning that, but for the Quebec GAAR, allowed the taxpayers to avoid substantially all of the Quebec provincial tax that would otherwise have been payable on capital gains and recapture of depreciation realized in Quebec.

A number of related companies were controlled by Sylvan Adams and his family. These companies, referred to collectively as the “Iberville Group”, included 4317653 Canada (“431”) and 6482651 Canada (“648”). The members of the Iberville Group were in the business of developing, owning, and operating shopping centres.

Between 2004 and 2006, the Iberville Group undertook a series of transactions related to the sale of several shopping centres to arm’s length parties. Subject to the Quebec GAAR, the transactions had allowed the Iberville Group to avoid the payment of virtually all Quebec taxes that would otherwise have been payable on capital gains in the amount of $728,851,976 and recapture of depreciation in the amount of $67,063,573.

The planning employed a tax strategy known as a Quebec Year-End Shuffle (or “Q-YES”) and, in this case, involved the transfer of shopping centres on a rollover basis to subsidiary limited partnerships, and then a transfer on a rollover basis of units of the limited partnerships to 431 and 648, such that the gains and recapture of depreciation were deferred.

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The planning worked generally by having both 431 and 648 select different fiscal year-ends for federal (and Ontario) purposes, where a February 28, 2006, year-end was chosen, and for Quebec purposes, where a March 19, 2006, year-end was chosen. On March 1, 2006, after the federal (and Ontario) year-end but prior to the Quebec year-end, 431 and 648 acquired units in two Ontario limited partnerships with business income, such that under the provincial allocation rules for the year ending March 19, 2006, substantially all of the income of 431 and 648 was allocated to Ontario rather than to Quebec.

While the details of the Q-YES planning are not clearly set out by the Court of Appeal, presumably the capital gains and recapture that resulted from the sales by the subsidiary limited partnerships of the shopping centres were not subject to Ontario tax because the capital gains and recapture were brought into income for federal (and Ontario) purposes for the year ending February 28, 2006, at which time there would have been no allocation to Ontario.

The Quebec Revenue Agency assessed the taxpayers in respect of the transactions, applying the Quebec GAAR to include in income for Quebec purposes the capital gains on the sale of the shopping centres and the recapture of depreciation.

At the trial level, the Court of Quebec upheld the assessments on the basis of the Quebec GAAR, following which the taxpayers appealed to the Quebec Court of Appeal. On appeal, the taxpayers admitted that the transactions gave rise to a tax benefit and that they were avoidance transactions. However, the taxpayers maintained that the transactions were not abusive within the meaning of the Quebec GAAR, notwithstanding that the transactions had no real commercial purpose and were solely intended to eliminate or vastly reduce provincial tax.

In ruling that the transactions were subject to the Quebec GAAR, the Quebec Court of Appeal determined that, in the circumstances, the establishment of different fiscal periods for provincial and federal purposes ran contrary to the intended purposes of the Quebec *Taxation Act* and the applicable rules and regulations, the purpose of which is to ensure an equitable distribution of the provincial tax burden on a corporation carrying on business in more than one province. Also, the Court of Appeal determined that the rollover transactions were abusive in the circumstances because they were undertaken to eliminate rather than simply defer tax (i.e., provincial tax). As stated by the Court of Appeal:

> The Appellants knew that no tax would be payable in Quebec because (theoretically) it was payable in Ontario upon application of the allocation formula, but because of the different fiscal periods, no tax would ultimately be paid in Ontario.

The Quebec Court of Appeal disagreed with the BC Court of Appeal in *Veracity Capital Corporation* (2017 DTC 5005), which had rejected the notion that the formula for allocating income between provinces necessarily allocated 100% of the income amongst the provinces. The Quebec Court of Appeal stated that:

> Literally and arithmetically, the allocation regulation provides what is basically a simple ratio of Quebec revenue to total revenue. … [I]t is strange to assume as it appears the BCCA has done, that the total of all such fractions for all provinces where a company carries on business would be less than 100%. Total numerators would equal the denominator on a literal analysis. There is simply no room for a "gap".

It is noteworthy that the Quebec Court of Appeal contrasted this case with *Imperial Oil Ltd.* (2004 DTC 6044 (FCA)), where different year ends were also at issue but no abuse was found, stating that:

> [I]n *Imperial Oil Ltd. v. Canada*, loans between companies with different year-ends allowed them to take advantage of a loophole and avoid tax. The judgment is of little solace to the Appellants as the loans were observed to be "ordinary commercial transactions with no artificial elements, undertaken for both tax and non-tax purposes". […] Of significance for present purposes is that lender and borrower had different year-ends. <u>They were two distinct corporations so that the factual underpinning of the case is wholly different from the present case where different fiscal year-ends were put in place for the same corporation</u> and this, for the sole purpose of taking advantage of the Q-YES. [emphasis added]

Leave to appeal to the Supreme Court of Canada has been sought. Given the different approaches taken to the provincial allocation provisions by the Quebec Court of Appeal in this case and by the BC Court of Appeal in *Veracity*, it will be interesting to see how the Supreme Court of Canada, if leave is granted, and future courts deal with any provincial tax planning that seeks to rely upon legislative "gaps" in the tax regimes of Quebec and the other provinces.

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—*Yaroslavna Nosikova*

FEDERAL COURT UPHOLDS MINISTER'S REFUSAL TO RECOMMEND REMISSION OF TAX ON STOCK OPTION PLAN EMPLOYMENT BENEFIT

***Fink v. The Queen*, 2018 DTC 5123 (Federal Court)**

The taxpayer in this case applied for judicial review of the Minister's decision to refuse to recommend the remission of tax payable in respect of a stock option plan employment benefit assessed under section 7 of the *Income Tax Act* (the "Act"). The taxpayer's application was primarily based on his contention that his circumstances were substantially identical to those of the former employees of a company named SDL Optics, Inc., who in 2007 and 2008 had received a remission order in connection with the tax payable on their stock purchase plan employment benefits. As the Court found that the taxpayer's circumstances were different from those of the former SDL employees; that the Minister's decision fell within the range of possible, acceptable outcomes which were defensible in respect of the facts and the law; and that the taxpayer was accorded procedural fairness, the taxpayer's judicial review application was dismissed. It should be noted that the taxpayer has appealed this decision to the Federal Court of Appeal.

In 2004, the taxpayer participated in a stock option plan offered by his employer. The stock option plan entitled him to purchase 75,000 of his employer's shares for $0.95 on a date of his choosing up to September 27, 2007. In March 2007, the taxpayer exercised the option when the market price of his employer's shares was $13.70 per share. He was later assessed for a taxable benefit in the amount of $956,250 ($12.75 per share) based on the difference between the purchase price and the market price on the date of the purchase. The taxpayer objected to the assessment, then appealed it to the Tax Court of Canada, arguing that his shares were not worth as much as had been assumed by the Minister because, among other reasons, their sale was subject to numerous blackout periods. Eventually, the taxable benefit was reduced by consent by 30% to $648,000. The taxpayer had, however, sold his shares in 2011 for $3.05 ($228,750 in total) realizing a capital loss of $419,250. Under the Act, he was not permitted to deduct the capital loss to offset any of the taxable employment benefit and was therefore still required to pay tax on the total benefit of $648,000.

The taxpayer made a request to the Minister of National Revenue for a remission of the tax and interest in respect of the stock option plan employment benefit. Section 23(2) of the *Financial Administration Act* provides that the Governor in Council may, on the recommendation of the appropriate Minister, remit any tax (including interest payable thereon) where the Governor in Council considers that the collection of the tax is unreasonable or unjust or that it is otherwise in the public interest to remit the tax.

Based on remission orders granted by the Governor in Council to others (SDL employees) who were unable to deduct capital losses from taxable employment benefits received from stock purchase plans, the taxpayer submitted that the tax payable on his stock option plan employment benefit should also be remitted. The Minister refused to recommend that the Governor in Council remit the tax because, among other reasons, the taxpayer had participated in a stock option plan and not a stock purchase plan as had the SDL employees. The SDL employees' stock purchase plan required them to purchase shares at specified points in time whereas the taxpayer in this case could choose when to exercise his option (and thus realize the taxable benefit). Other reasons given by the Minister included the following:

(1) the taxpayer had already agreed to a reduction of the benefit in connection with the Tax Court appeal and the remission process should not be used as an additional or parallel step to the appeal process; and

(2) there were no extenuating circumstances as the taxpayer acquired the shares knowing that this would trigger a taxable benefit, then made an investment decision to hold and sell the shares.

Two main categories of arguments were advanced by the taxpayer in his judicial review application. He firstly argued that the Minister's decision was unreasonable. He also argued that the Minister failed to exercise procedural fairness.

Regarding the reasonableness of the decision, the taxpayer contended that the Minister failed to consider the substantial similarities between the stock purchase plan of the SDL employees and his stock option

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plan. This argument was rejected as the Court was satisfied that there were material differences between the plans, including the taxpayer's control over the timing of the purchase. Public statements made by the Minister in connection with the SDL employees' remission order were clear that the relief was warranted for stock purchase plans with specific features. It would be unreasonable to conclude that the Minister intended for anyone unable to offset a capital loss against a stock option employment benefit to be entitled to remission order relief. The taxpayer also argued that there was no indication that the Minister considered the eight mandatory conditions that had been applied to decide whether someone qualified for an SDL remission order. However, the Court noted that the taxpayer would not have met all of these conditions in any event and, if they had been considered by the Minister to be binding in denying the taxpayer's application, the Minister would have improperly fettered his discretion.

Regarding procedural fairness, the taxpayer argued that he had a legitimate expectation, based on the issuance of the SDL remission orders and the Minister's public statements related to them, that a particular process would be followed and a particular result reached. He contended that if the Minister thought that his stock option plan was not sufficiently similar to the stock purchase plan in the SDL situation, then the Minister should have contacted him to discuss the issue and provide additional information regarding the SDL remission orders. This argument was also rejected. A "legitimate expectation" does not give rise to substantive rights, and in any case, the Court was not persuaded that the Minister was obliged to inform the taxpayer about the Minister's concerns regarding the differences between his stock option plan and the SDL stock purchase plan. The taxpayer was permitted to provide arguments and evidence to the Minister before a decision was made and, in the Court's view, this process was sufficiently fair from a procedural perspective.

As a result, the Federal Court dismissed the taxpayer's application for judicial review. Whether or not this decision is upheld by the Federal Court of Appeal, the Federal Court's decision provides a reminder that taxpayers who receive taxable employment benefits from the exercise of stock options, and choose to hold the shares, take a substantial risk that they will be required to pay tax on unrealized income should the value of the shares decline after they are acquired.

—*Theodore Stathakos*

TAX COURT OF CANADA CONFIRMS THAT SECTION 207.05 ADVANTAGE TAX IS CONSTITUTIONAL

***Hunt v. The Queen*, 2018 DTC 1139 (Tax Court of Canada)**

This case supports the assertion that the granting of ministerial discretion to the Minister of National Revenue to provide relief from tax does not amount to an improper delegation by Parliament of its taxing authority.

The taxpayer had purchased common shares of a privately held corporation following an estate freeze, which shares the taxpayer transferred into his Tax Free Savings Account ("TFSA"). The Minister subsequently assessed the taxpayer under section 207.05 on the "advantage" received by the taxpayer arising by reason of the transfer of the shares to his TFSA. The tax assessed equaled 100% of the appreciation of the shares while they were held in the TFSA. In response, the taxpayer brought a motion claiming that section 207.05 of the *Income Tax Act* was unconstitutional on two grounds: (1) as a violation of section 53 of the *Constitution Act*; and (2) as an infringement on the provincial power to make laws respecting "Property and Civil Rights" pursuant to subsection 92(13) of the *Constitution Act*.

Pursuant to the "advantage tax" regime, section 207.05 imposes a 100% tax rate in respect of certain defined advantages arising from the abuse or misuse of the provisions governing TFSAs (as well as other registered plans). However, the rules also include section 207.06, which allows the Minister to provide full or partial relief from the tax imposed. The taxpayer argued the Minister's ability to provide this discretionary relief amounted to an improper delegation by Parliament of its taxing authority.

The Court first addressed the taxpayer's argument that section 207.05 is unconstitutional as a violation of section 53 of the *Constitution Act*. The parties agreed that Parliament alone has the power to impose a tax. However, they disagreed as to how sections 207.05 and 207.06 should be interpreted and whether they should be read together. The taxpayer argued that sections 207.05 and 207.06, when read together, give

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the Minister the discretion to set the tax rate at any rate between zero and 100%. According to the taxpayer, this amounted to an implied delegation of the right to set the tax rate, which is contrary to section 53 of the *Constitution Act*. On this point, the Crown disagreed, arguing that each of sections 207.05 and 207.06 are independent and stand-alone provisions—section 207.05 is a charging provision and section 207.06 is a relieving provision. The Crown further argued that since the time at which section 207.05 was enacted, it has clearly been Parliament's intention to treat section 207.05 as an anti-avoidance rule designed to prevent specified transactions considered a misuse or abuse of the TFSA exemption. The manner in which the Minister exercises the discretion under section 207.06 to waive or cancel the tax imposed by section 207.05 is not a basis for declaring section 207.05 to be unconstitutional.

The Court agreed with the Crown, holding that:

> […] the words of both 207.05 and 207.06 are clear […] each represents a separate stand-alone provision, the first a detailed provision that sets a tax rate of 100 percent on the advantages it clearly defines in 207.01, in regard to detailed transactions it clearly sees as misusing or abusing the TFSA tax exemption regime, with detailed and specific exceptions and, the second, a discretionary ability of the Minister to waive or cancel all or any portion of such 100 percent tax. Section 207.05 makes no reference to being subject to 207.06 to suggest they must be read together and section 207.06 clearly contemplates the 100 percent tax has already been assessed in the first line thereof […]

The Court concluded that there was no improper delegation to set the tax rate, which had been set by Parliament at 100% on "advantages" arising when certain conditions precedent trigger the tax. The Court noted also that sections 207.05 and 207.06 follow separate appeal and administrative regimes. If a taxpayer disputes that there is an "advantage" that has been assessed under 207.05, the taxpayer may appeal the assessment to the Tax Court of Canada. However, if the taxpayer disagrees with the exercise of the Minister's discretion or failure to exercise discretion under 207.06, that appeal would occur at the Federal Court.

The taxpayer also advanced an argument that the administrative acts of the Canada Revenue Agency ("CRA") suggested that the CRA's policy was to treat itself as empowered to set the rate of tax applicable to any advantages received. As support, the taxpayer cited a decision letter in which a CRA officer exercised discretion to impose a tax at the highest marginal combined federal/provincial rate, rather than the 100% rate under section 207.05. The Court held that considering whether to reduce the advantage tax in a particular matter is not the same as committing to exercising the option in all circumstances. The taxpayer failed to bring proof of any fixed CRA policy and, even if the taxpayer had been successful in establishing a fixed policy, the Court held that it would not have been offensive for the CRA to have adopted policies or guidelines on the exercise of the CRA's discretion, so long as they did not limit the powers in contravention of section 207.06. Informing the public of policies or guidelines would only assist taxpayers in making representations for relief.

The Court held that sections 207.05 and 207.06 are unambiguous and that there was thus no need to undertake an analysis of the purpose or intent of the legislation. Although it was ultimately unnecessary for the Court to reach its decision, the Court found that the provisions clearly have an anti-avoidance purpose of protecting the integrity of the TFSA regime, which otherwise does not tax income growth within a TFSA. Thus, the purpose of the impugned provisions was clear and reinforced the plain meaning of the provisions. The Court held that:

> […] the provisions of section 207.05 do not violate section 53 of the *Constitution*. The clear language of both 207.05 and 207.06 do not support the Appellant's view that the two must be read together so as to result in an implicit delegation of the authority to set the tax rate. The provisions are clear, were properly passed by Parliament into law, having been amended and extended through several Budgets since the date of inception, and are constitutionally valid in this regard.

The taxpayer's second argument was that section 207.05 infringed on the right of provincial legislatures to legislate in relation to "Property and Civil Rights" under subsection 92(13) of the *Constitution Act*, which grants provincial legislatures the exclusive right to make laws in relation to property and civil rights in the province. On this point, the taxpayer argued that:

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> […] section 207.05, in pith and substance, falls within the provincial jurisdiction of property and civil rights under subsection 92(13) of the *Constitution* and is not saved by the ancillary powers doctrine on the basis the 100 percent tax rate is a confiscation of property and is not necessary to the effective exercise of the Federal taxation power as it overreaches or goes beyond what is necessary to meet the aims of the Federal section.

The taxpayer advanced two main arguments on this issue:

(a) that the effect of the 100% tax on the increase in fair market value of a TFSA constituted a confiscation of property and thus the purpose of section 207.05 was predominantly within the provincial sphere of property and civil rights; and
(b) that section 207.05 is not properly characterized as a revenue-raising measure and hence its purpose is not predominantly taxation.

The Crown disagreed, arguing that section 207.05 "is in pith and substance taxation within Parliament's competence under subsection 91(3) of the *Constitution* and is *intra vires* notwithstanding any incidental effects it may have on property and civil rights."

The Court found no basis for finding that the advantage tax constituted a "confiscation", as the taxpayer failed to provide a legal basis for its position and had wrongly conflated the severity or high rate of taxation with legal confiscation or seizure. Moreover, the Court found that the scope of the advantage tax is limited and that there is no attempt to regulate any class of property or any industry related to property. As such, the impugned legislation does not have the regulation of property as its main purpose. Although the provisions have the effect of requiring that the taxpayer transfer some of its property to satisfy its tax debt, this is only an incidental effect of any taxation law. Relying on the Supreme Court of Canada's decision in *Canadian Western Bank* (2007 SCC 22), this incidental effect did not result in the provisions being unconstitutional.

The Court also disagreed with the taxpayer's argument that the provisions were not predominantly revenue-raising measures and thus were not in pith and substance taxation. The Court held that:

> […] a provision to protect the integrity of a taxation provision, be it to tax, provide an incentive or create a disincentive, is no less a legitimate provision relating to Parliament's broad powers to raise revenue within subsection 91(3), which section not only empowers Parliament to raise revenue "by any mode" but also by "any system" of taxation.

In summary, the Court concluded that section 207.05 was constitutional. The taxpayer was unsuccessful in convincing the Court that the discretionary power given to the Minister to reduce or eliminate the advantage tax amounted to an improper delegation by Parliament of its power to set the rate of tax.

As this decision has been appealed, it will be interesting to see whether the appellate court takes a similar view in respect of the advantage tax regime.

—*Steve Marshall*

RECENT CASES

APPEAL FROM DECISION ALLOWING IMPOSITION OF MARK-UP BY PROVINCIAL LIQUOR AUTHORITY DISMISSED

The appellant was a microbrewery operating in the province of Nova Scotia. As a condition of permitting the microbrewery to sell its own beer on-site, the Nova Scotia Liquor Corporation ("NSLC") required it to remit a monthly "retail sales mark-up allocation" ("RSMA") on beer that it sold, sampled, or gave away. The microbrewery brought an application arguing that the RSMA was invalid as it constituted a tax, and that the imposition of such tax was not within the statutory authority of the NSLC. Its action was dismissed, with the applications judge finding that the RSMA was, in pith and substance, a proprietary charge and not a tax, and was therefore within the authority of the NSLC to impose. The microbrewery appealed from that decision.

The appeal was dismissed. The Nova Scotia Court of Appeal reviewed the structure of the statutory system for the regulation of liquor sales within the province of Nova Scotia and the regulatory provisions on which the policy making power of the NSLC was based. Based on that review, it found that the sale and

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distribution of liquor within the province could only be done through the NSLC, which had the sole discretion to determine the manner of such sale. The NSLC's authority included the ability to set prices for the sale of liquor at a microbrewery and to provide that the sale price could include a mark-up. The Court rejected the appellant's argument that it received nothing for the RSMA which it paid, finding that the appellant had been provided with the ability to sell beer in the province and that, without the licences and permits issued by the NSLC and the appellant's compliance with them, it could not have done so. The Court concluded as well that the fact that the appellant was obligated to agree to the terms set by the NSLC to obtain authority to manufacture and sell beer did not affect the ability of the NSLC to impose the RSMA. The appellate Court also reviewed the jurisprudence referred to by the applications judge to support his conclusions, and held that the applications judge did not err in his finding that the RSMA was a proprietary charge. In the Court of Appeal's view, had the applications judge found otherwise, his decision would have been in conflict with a significant body of authoritative case law. The appeal from the decision of the applications judge was therefore dismissed.

Unfiltered Brewing v. NSLC and AG of Nova Scotia

2019 DTC 5019

RECTIFICATION ORDER ISSUED WHERE TRANSACTION DOCUMENTATION NOT REFLECTING INTENTIONS OF TAXPAYERS

The petitioners, who were brothers, had entered into an Agreement in Principle that called for the sale of shares from the first brother to the second and was intended to result in capital gains treatment for the vendor of the shares. However, the transaction structure implemented by their tax adviser, which was documented in a Purchase Agreement, resulted in the application of section 84.1 of the *Income Tax Act* (the “Act”), and a resulting deemed dividend in the amount of $2.7 million to the share vendor. The brothers and their corporations applied for rectification of that Purchase Agreement. They argued that a mistake was made in the recording of their agreement and that the Purchase Agreement and related promissory note did not accord with their prior Agreement in Principle for a direct sale of shares between the brothers, which would result in capital gains treatment for the share vendor. The application was opposed by the Attorney General of Canada.

A rectification order was provided. The Supreme Court of British Columbia held that rectification was a discretionary equitable remedy and that, in order for a rectification order to be granted, four conditions precedent must be met. Specifically, the petitioners were required to show the existence and content of a "definite and ascertainable" prior agreement, to show that such agreement was in effect at the time the instrument sought to be corrected was executed, that the written agreement was inconsistent with the prior agreement, and, finally, to show the precise manner in which the written document could be amended to carry out the prior agreement. The petitioners, as the parties seeking rectification, bore the onus of proof, on a balance of probabilities. The Court reviewed the principles set out in appellate jurisprudence on the issue of rectification and noted that rectification was a remedy designed to correct errors in written legal instruments, which functioned to amend the legal instrument but not the agreement itself. Rectification is limited to cases where a written instrument has incorrectly recorded the parties' antecedent agreement. If, by mistake, a legal instrument does not accord with the true agreement of the parties, the Court may exercise its equitable jurisdiction to rectify that mistake. The Court is therefore required to assess the legal instrument and the true agreement of the parties. If there is an inconsistency between the two, the Court may exercise its equitable jurisdiction to rectify the legal transactions. Rectification is not available, however, simply because a transaction has resulted in adverse tax consequences. The Court considered the series of events leading to the implementation of the impugned transaction and held that the principal issue was whether the Agreement in Principle was sufficient evidence of a true, definite, and ascertainable agreement. The Court reviewed the history of the agreements and transactions reached and implemented before concluding that the Agreement in Principle set out a sequence of proposed transactions that were definite and ascertainable. Further, in the Court's view, such Agreement was still in effect when the Purchase Agreement was executed, and the petitioners had met the burden of showing, on a balance of probabilities, that such Purchase Agreement did not accurately record and was inconsistent with the prior Agreement in Principle between the parties. As well, the Court held that the Purchase Agreement could be modified

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to give effect to the true agreement between the parties. Finally, the Court concluded that there were no policy reasons not to provide a rectification remedy, as such remedy did not run afoul of the intention behind section 84.1 of the Act. The petition was granted and rectification of the Purchase Agreement in the manner sought by the petitioners was ordered.

Crean v. Canada (AG)

2019 DTC 5016

APPLICATION FOR JUDICIAL REVIEW OF MINISTER'S REFUSAL TO RE-APPROPRIATE TAX CREDITS ALLOWED

The taxpayer had failed to file returns for the 2006 and 2007 taxation years and was eventually subject to notional assessments for those years, followed by collection actions. The outstanding returns were subsequently filed and the difference between the amount of tax owed and the greater amount that had been collected was equal to certain statute-barred credits. In 2015, and again in 2017, the taxpayer requested that the Minister re-appropriate those statute-barred credits and apply them to its outstanding payroll balance, but both requests were denied. In denying the taxpayer's requests, the Minister's delegate concluded that there were no extraordinary circumstances that prevented the timely filing of the returns in question. The taxpayer sought judicial review of the decisions denying relief.

The application was allowed. The Federal Court held that Ministerial decisions under section 221.2 of the *Income Tax Act* were reviewable on a standard of reasonableness. The Court first reviewed the factors set out in the taxpayer's request and those that were considered in the Minister's decision. It noted that the ability of a corporate taxpayer to continue as a going concern, if raised in a request for re-apportionment under section 221.2(2), was a factor that should be weighed by the Minister. As well, the Minister was required to have regard for whether denial of the request might possibly result in the Minister's inability to collect outstanding tax arrears from a taxpayer. It was clear from the record that the taxpayer was suffering from financial hardship; however, the Court held that there was no indication that the factor of financial hardship had been considered in denying the taxpayer's request. In the Court's view, that finding rendered the decision unreasonable because it was not apparent or transparent that the taxpayer's financial hardship was a factor in the decision making process, and the decision was therefore to be set aside. In addition, the Minister's failure to consider the factor of financial hardship constituted a fettering of her discretion. While the taxpayer had sought an order in the nature of mandamus, which would compel the Minister to re-appropriate the tax credits, the Court held that there were no unusual or exceptional circumstances that necessitated the issuance of such an order. The Court concluded that the appropriate remedy, in the circumstances, was to allow the application for judicial review and return the matter for redetermination by another delegate of the Minister.

Forbes Painting and Decorating Ltd. v. Canada (AG)

2019 DTC 5014

APPEAL FROM REASSESSMENT INCLUDING UNREPORTED TIP AMOUNTS IN INCOME DISMISSED

The taxpayer worked as a slot attendant in a casino. He reported employment income from such work but did not report as taxable income substantial gratuities which he had received through a pooled tip arrangement. The Minister reassessed to include such amounts in income and, in addition, to impose penalties for gross negligence under subsection 163(2) of the *Income Tax Act* (the “Act”). The taxpayer appealed from both the reassessment of income and the assessment of penalties. While he did not dispute the amount of tip income received, he argued that such income was not taxable income, as the original source of income was casino winnings, which were not subject to tax, and that such amounts retained their non-taxable nature when distributed as tips.

The appeal was dismissed. The Tax Court of Canada held that, as the appellant did not dispute the amounts in issue, the only issues for determination were whether such amounts constituted employment income and whether the appellant was properly subject to gross negligence penalties. On the first issue, the Court

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held that the amounts received by the taxpayer were clearly gratuities, and that sections 5 and 6 of the Act specifically provided that such amounts were to be included in computing a taxpayer's income for the year. As well, the jurisprudence supported the conclusion that the gratuities received were to be reported as income from employment. The appellant's argument that casino winnings which were then paid as tip amounts retained their non-taxable character was, in the Court's view, not tenable. Rather, the Court held that when the casino winnings were paid over to an employee of the casino as a thank you or in appreciation of the services received by a patron, the nature of the amount changed from being non-taxable to a taxable amount in the hands of the employee. On the issue of penalties, the Court held that the appellant was an intelligent and well-educated individual with varied experience in the financial services industry. Despite the material amounts of income involved, the appellant had made no effort to ascertain the proper tax treatment of those amounts, either from a professional tax adviser or from the Canada Revenue Agency. Rather, he simply adopted the interpretation which was most favourable to his circumstances. Such conduct, in the Court's view, amounted to gross negligence, for which penalties were properly imposed. The appeal from the assessment and the imposition of penalties was therefore dismissed.

Xia v. The Queen

2019 DTC 1028

APPEAL FROM TAX COURT DECISION DENYING PRE-HEARING ACCESS TO DOCUMENTS DISMISSED

The appellants, which were all members of the same corporate group, entered into a series of transactions intended to give them access to the losses and tax credits of two insolvent companies. The Minister reassessed to deny such losses and credits and the taxpayers appealed. In the course of the appeal, the taxpayers requested certain documents involving communications between the Canada Revenue Agency and the Department of Finance relating to loss utilization or loss trading. Some documents were provided in redacted form, and the taxpayers brought motions before the Tax Court seeking to compel production of un-redacted documents and other documents. Such motion was allowed in part and the taxpayer appealed to the Federal Court of Appeal from the portion of the decision refusing them access to certain documents, arguing that such decision contained errors of law and of mixed fact and law.

The appeal was dismissed. The appellate Court reviewed the reasons of the Tax Court with respect to each category of documents, as well as its outline of the principles applicable to pre-hearing disclosure in tax appeals and the related jurisprudence. The Federal Court of Appeal concluded, based on that review, that the Tax Court had refused disclosure of certain documents primarily because it concluded that they were not relevant and, in addition, because they contained information of other taxpayers which was protected from disclosure by section 241 of the *Income Tax Act*. The Tax Court also refused disclosure of a broad range of correspondence between government departments on the basis that such request was overly broad, and of vague and far-reaching scope. In the appellate Court's view, the Tax Court had not made a reviewable error in reaching its conclusions with respect to either the relevancy of the documents sought or the overly broad nature of the appellant's requests. As well, the appellate Court held that the jurisprudence relied on by the taxpayer to compel production did not apply on the facts of the taxpayer's case. The Tax Court had not made any reviewable error, and the appeal from its decision was therefore dismissed.

Madison Pacific v. The Queen

2019 DTC 5012

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