Tax Notes

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Wolters Kluwer

WITHHOLDING TAX ON RENT PAYMENTS TO NON-RESIDENTS: THERE IS NO DEFENCE

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In Canada, the two elements the Crown must prove to obtain a conviction for most criminal offences are *actus reus* and *mens rea*. *Actus reus*, the objective element of a crime, is the Latin term for "guilty act". *Mens rea* — Latin for "guilty mind"— is the subjective element, meaning the perpetrator's mental state. In some cases, strict liability is the standard for conviction. This means a person is legally responsible for the consequences of an action even in the absence of fault or criminal intent. The strict liability standard often applies to traffic offenses like speeding. This seems fair: In most cases, a driver is aware a speed limit is in force, as well as of the limit itself. Generally, but not always, due diligence is the only available defence to a crime of strict liability. In order for a due diligence defence to succeed, the persons concerned must prove on balance they did everything possible to prevent the impugned act from happening.

Unless a criminal charge is involved, in taxation matters the onus is on the taxpayer to abide by the law. Taxpayers are aware of the basics of tax: earn income, pay taxes; buy something, pay tax. File a return. Interest will be charged on late payments. Penalties may apply, on a strict liability basis, though in more serious cases the act or omission penalized must be done knowingly or in circumstances amounting to gross negligence.

As always, whether in tax or criminal proceedings, *ignorantia legis neminem excusat* ("ignorance of law excuses no one"). But what about ignorance of the basic facts that turn an otherwise innocent action into a legal liability? This question is at the heart of the Tax Court's recent decision in *3792391 Canada Inc. v. The King*.[1]

Part XIII of the *Income Tax Act* (the "Act") provides for tax to be paid by non-residents who receive property income from Canadian residents and obliges the Canadian residents to withhold and remit that tax. Specifically, paragraph 212(1)(*d*) imposes a 25% tax on gross rent paid for the use or the right to use in Canada any property owned by the non-resident.[2] Subsection 215(1) of the Act requires the Canadian resident to withhold the tax and remit it to the Receiver General of Canada. According to subsection 215(6), anyone who fails to withhold and remit is liable for the tax, as well as for penalties and interest.

David Siscoe is a shareholder of 3792391 Canada Inc. ("3792391" or "the Appellant"), which operates Siscoe Gym. Mr. Siscoe entered into a lease for a residence in Westmount, Québec ("Unit 501"). Although he was the tenant, the Appellant paid the rent on his behalf.

On October 26, 2018, the Minister of National Revenue (the "Minister") assessed the Appellant for the 2011 to 2016 taxation years for failure to withhold and remit Part XIII tax on rental income received by the owner of Unit 501 (Sebastiana Trimarchi, "Sebastiana"), as well as interest and penalties, on the grounds she was a non-resident. 3792391 appealed the assessments to the Tax Court of Canada.

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[1] 2023 DTC 1031.

[2] Section 216 allows a non-resident to elect to pay Part I tax on net rental income from real property in Canada rather than the 25% flat tax withheld on gross rental payments. No such election was made in the present case.

After resolving preliminary issues raised by the parties regarding the pleadings, Madame Justice Gabrielle St-Hilaire addressed the central issue of the appeal: Whether the Minister was correct in imposing Part XIII tax on the Appellant for failure to withhold and remit tax on the amounts it paid as rent to Sebastiana, a non-resident.

Mr. Siscoe first signed a lease for Unit 501 with Anjar Investments Ltd. ("Anjar")[3] in May 1996. Joseph Trimarchi ("Joseph") signed the lease on behalf of Anjar. Mr. Siscoe made the rental payments to Joseph for a period, but then Joseph asked him to start paying the rent to one of his brothers. In 2006, Anjar sold Unit 501 to Sebastiana. Mr. Siscoe testified he was not aware that Sebastiana was the owner of Unit 501 since 2006.

In 2010, Mr. Siscoe entered into a three-year lease with Sebastiana signing as the lessor. In the section identifying the "landlord (lessor)", she entered her address as 439, Boulevard de l'Île in Pincourt. However, in the section for signatures, it appears that Sebastiana signed the lease on May 1, 2010, in Italy (Mr. Siscoe signed the lease 11 days later in Montréal). She also provided a Montréal telephone number and an international number.

Mr. Siscoe testified that he saw Sebastiana in person several times over the years, all in Montréal. In 2011, the Appellant started to pay the rent for Unit 501 on his behalf. Mr. Siscoe stated he was never informed that Sebastiana was living in Italy, or in Canada. Neither 3792391 nor Mr. Siscoe withheld Part XIII tax.

The Appellant maintained it is not liable for Part XIII tax because it rebutted the Minister's conclusion that Sebastiana was a non-resident of Canada during the relevant period. The Appellant argued the evidence is sufficient to demonstrate she was living in Canada. Most importantly, the Appellant submitted that if section 215 is to apply, then the resident Canadian must know the recipient was a non-resident. The Appellant also argued the penalties should be cancelled because Sebastiana hid her non-resident status.

The Respondent submitted that, for subsection 215(6) to apply, there are three requirements:

(i) a resident of Canada has failed to withhold and remit tax;

(ii) on an amount taxable under Part XIII; and

(iii) an amount was paid to a non-resident.

According to the Respondent, liability under subsection 215(6) is not dependent on the taxpayer's knowledge that payments were made to a non-resident.

The Court found the Appellant's actions satisfied requirements (i) and (ii). The outstanding issue was (iii), Sebastiana's residence.

In *Thomson v. MNR*, Justice Rand of the Supreme Court of Canada explained:

> . . . in common parlance "residing" is not a term of invariable elements, all of which must be satisfied in each instance. It is quite impossible to give it a precise and inclusive definition. It is highly flexible, and its many shades of meaning vary not only in the contexts of different matters, but also in different aspects of the same matter. In one case it is satisfied by certain elements, in another by others, some common, some new.[4]

Referring to *Biya v. R*,[5] the Appellant outlined the factors a court might consider in determining residence, then submitted that the Tax Court should conclude Sebastiana was a resident of Canada based on the following:

- She had family in Canada (mother Natalina and brother Joseph lived in Montréal);
- Documentation suggesting Sebastiana had an address in Canada (her address as a shareholder of Anjar indicates a Montréal address, the deed of sale for Unit 501 by Anjar to Sebastiana indicates her address to be in Montréal, and on the 2010 lease Sebastiana indicated she signed in Italy but provided an address in Pincourt, Québec);
- Sebastiana had a bank account in Canada (the rental cheques were deposited in a TD Canada Trust bank account at a branch in Montréal); and
- She had a Canadian social insurance number.

Counsel submitted that the Appellant had successfully rebutted the Minister's assumption that Sebastiana was living in Italy, so that the Respondent now bore the burden of making its case.

Ultimately, Justice St-Hilaire found it more likely than not that Sebastiana was a non-resident of Canada during the relevant taxation years. She referred to the following evidence:

- Sebastiana did not file any income tax returns and did not have any information returns showing income;
- the absence of any links to property in Canada, other than Unit 501, which she owned but rented out;
- an "empty" Equifax report;
- the phone number where the auditor reached Sebastiana in Italy was the same as the number she provided on the 2010 lease;

[3] Anjar has three shareholders: Joseph Trimarchi, Graziella Trimarchi, and Sebastiana.

[4] 2 DTC 812 (SCC) at para. 218.

[5] 2020 DTC 1089 (TCC).

- statements she made to the auditor about living in Italy;
- the addresses she provided on various documents were not the subject of any inquiry and were the same as that of family members living in Canada;
- the application she filed in the Federal Court for judicial review of the Minister's denial of her application for an extension of time to file returns pursuant to section 216 of the Act for 2008 to 2015 (a provision that applies to non-residents); and
- the email correspondence between her and Mr. Siscoe in 2014 and 2015 indicating she had an Italian email address.

Many factors are considered when determining a person's residence, but once a recipient is determined to be a non-resident, it's a much simpler task assessing liability under subsection 215(6): A Canadian resident who fails to withhold and remit on payment to the non-resident is liable for the tax.

The Appellant argued that to impose Part XIII tax on a tenant that has no knowledge the landlord is a non-resident would be unjust, and this cannot be what Parliament intended. Appellant's counsel did concede that the text of subsection 215(6) does not contain a knowledge requirement, but suggested the general obligation to withhold and remit should be interpreted as providing for a defence of due diligence.

While the Court acknowledged jurisprudence has consistently held that a taxpayer can present a due diligence defence with respect to some penalty provisions, Justice St-Hilaire did not agree that a due diligence defence is available for subsection 215(6). To support her position, she quoted Justice Hogan's decision in *J.K. Reed Engineering Ltd. v. R.*:

> Subsection 215(6) of the Act is a charging provision that makes the payer liable for the payee's tax if the payer fails to deduct or withhold at the time of payment tax that is payable by the payee. In contrast, subsection 227(8) of the Act is a penalty provision. A due diligence defence can be mounted against the latter but not the former.[6]

Justice St-Hilaire emphasized there was no suggestion or evidence of due diligence on the part of the Appellant in the case before her.

She agreed with Justice Mogan's comments in *Curragh Inc. v. R.* that "... section 215 is clear and not ambiguous. It does not need any aid to construction."[7] Nevertheless, the judge examined the history of the section back to when it was introduced in 1933 in Bill C-96, *An Act to amend the Income War Tax Act*. The predecessor to section 215 was legislated to support the administration of the charging provision imposing tax on non-residents on the following grounds:

> The difficulty in administering this section [imposing tax on non-residents] has been that although non-residents have been liable for tax on rents and royalties since 1923, in the majority of instances such non-residents apparently have taken every means possible to avoid giving information, filing returns or admitting any liability under the Act, even though they were entitled to credit in their own country with respect to any income tax paid to Canada. By withholding a percentage of the rents and royalties at the source, the non-resident will be anxious to file his return showing his income from Canadian sources, together with any deductions on account of expenses applicable to such Canadian income, in order that the correct amount of his Canadian tax may be determined, as credit against the tax payable will be given for any amounts withheld and adjustments made accordingly.

Justice St-Hilaire was adamant: "There was no knowledge requirement in the withholding provision when it was first introduced and none has been added to the text since. In addition, when the legislator wants to limit a resident's liability to circumstances where they have knowledge or belief, it expressly does so."[8]

Justice St-Hilaire then turned to the penalties imposed on the Appellant. A defence of due diligence is available in relation to the penalties, but taxpayers must demonstrate they exercised a high degree of diligence to comply with their obligations. She determined the Appellant had not taken steps to ensure compliance with its withholding obligations.

Justice St-Hilaire concluded:

> ... subsection 215(6) is devoid of any requirement that the payer have knowledge that the payee is a non-resident. The provision clearly states that where a person has failed to deduct and remit as required, they are liable for Part XIII tax. Having concluded that Sebastiana was a non-resident during the relevant years, and the evidence having shown that the Appellant has failed to withhold and remit the 25% tax payable on the rent

[6] 2014 DTC 1216 (TCC) at para. 17. Note the distinction Justice Hogan makes between a penalty provision and a charging provision.

[7] 94 DTC 1894 (TCC) at para. 24.

[8] *3792391 Canada Inc. v. The King* at para. 42.

> paid to her, the Appellant is liable for Part XIII tax. Further, the Appellant is liable for penalties and interest as provided for by subsections 227(8) and (8.3).[9]

Justice St-Hilaire acknowledged the harshness of subsection 215(6), which captures tenants unaware of any possible liability, but, ". . . in light of the purpose of the scheme. . . subsection 215(6) is meant to apply in a way that imposes liability on the resident payer, such as the Appellant, who has failed to withhold and remit."[10] She dismissed 3792391's appeal without costs.

On one end of the scale, there are criminal offences that require both an act and a guilty mind. In the middle, there are strict liability offences subject to a defence of due diligence. On the other end of the scale are cases like the one confronting the Appellant. Once the *actus reus* is proven — that rents were paid to a non-resident — a Canadian resident who has not withheld and remitted 25% of the gross rent will be liable for those amounts.

Subsection 215(6) does not impose a penalty on the taxpayer; it is a "charging provision", and there is no defence, due diligence or otherwise. Through no fault of their own, innocent tenants are liable for the Part XIII tax owed on rental payments made to non-resident landlords, regardless of whether they had every indication the landlord was a Canadian resident and no reason to inquire further, such as in this case.

CURRENT ITEMS OF INTEREST

International Tax Reform Negotiations

On July 12, 2023, Chrystia Freeland, Deputy Prime Minister and Minister of Finance, issued the following statement regarding ongoing negotiations by the Organisation for Economic Co-operation and Development ("OECD")/G20 Inclusive Framework for a two-pillar plan on international tax reform:

> Canada strongly supports international efforts to end the corporate tax race to the bottom and to ensure that all corporations, including the world's largest corporations, pay their fair share.
>
> Canada's strong and essential social safety net is built on a robust national tax base, which depends on those who do business in Canada paying their fair share of tax. Canada has a clear national interest in the two-pillar plan, which protects against the erosion of Canada's tax base and which will generate additional revenue for Canada.
>
> Canada's priority and preference has always been a multilateral approach. We continue to strongly support the two-pillar plan agreed to in 2021 and we have been actively working with our international partners to bring it into effect. As confirmed in Budget 2023, we are moving ahead with legislation to implement the Pillar Two global minimum tax in Canada, starting at the end of 2023.
>
> Two years ago, we agreed to pause the implementation of our own Digital Services Tax (DST), in order to give time and space for negotiations on Pillar One. But we were clear that Canada would need to move forward with our own DST as of January 1, 2024, if the treaty to implement Pillar One has not come into force.
>
> Yesterday, many countries participating in negotiations in Paris agreed to a further one-year standstill on the imposition of any new domestic DSTs, despite there being no deadline stipulating when Pillar One will come into force. This puts Canada at a disadvantage relative to countries which have continued collecting revenue under their pre-existing DSTs.
>
> Canada does not disagree with the substance of the multilateral treaty that has been negotiated; indeed, we support it fully. However, without any firm and binding multilateral timeline to implement Pillar One, Canada cannot support the extended standstill in today's "Outcome Statement".

New Regulations Issued

The following regulations were published in the Canada Gazette, Part II, Volume 157, Number 14 (www.gazette.gc.ca/rp-pr/p2/2023/2023-07-05/html/index-eng.html) on July 5, 2023:

- SOR/2023-151, *Tax Court of Canada Act — Rules Amending Certain Rules Made Under the Tax Court of Canada Act*;
- SOR/2023-157, *Canada Student Financial Assistance Regulations — Regulations Amending the Canada Student Financial Assistance Act*;

[9] *3792391 Canada Inc. v. The King* at para. 44.

[10] *3792391 Canada Inc. v. The King* at para. 45.

- SOR/2023-148, *Greenhouse Gas Pollution Pricing Act — Order Amending Part 2 of Schedule 1 to the Greenhouse Gas Pollution Pricing Act*;
- SOR/2023-129, *Greenhouse Gas Pollution Pricing Act and the Fuel Charge Regulations — Regulations Amending Part 1 of Schedule 1 to the Greenhouse Gas Pollution Pricing Act*; and
- SOR/2023-130, *Greenhouse Gas Pollution Pricing Act and the Fuel Charge Regulations, No. 2 — Regulations Amending Part 1 of Schedule 1 to the Greenhouse Gas Pollution Pricing Act*.

Annual Processing Review Program

The Canada Revenue Agency's ("CRA's") annual post-assessment review of individual income tax and benefit returns has started. If a tax return is selected for review, the CRA will mail a letter to the taxpayer's authorized representative's office if, when completing the return, the representative indicated that Processing Review letters should be sent to them.

Alternatively, Represent a Client gives authorized representatives online access to the CRA's letters. Electronic filers who are authorized representatives can sign up for online mail in Represent a Client to receive Processing Review letters for their clients. As there are five National Verification and Collections Centres, it is important to send the requested information to the centre indicated in the letter.

Taxpayer Self-Service and Transfer Payments

Since February 2019, payments on an individual tax account that have not been applied to any tax year have been displayed following all other transactions at the end of the online statement of account. These payments can now also be viewed in the new "Available payment(s)" section of the "Accounts and payments" page on My Account for Individuals. Taxpayers and their authorized representatives can use the new self-service "Transfer payment(s)" option in the "Available payment(s)" section to transfer available payments to an existing individual tax balance or to their tax instalments for the current year in real time.

"Transfer payment(s)" cannot be used to transfer a payment to an amount under appeal or to an amount that is not shown on the "Accounts and payments" page on My Account. For these payment transfers, the Canada Revenue Agency ("CRA") will need to be contacted at 1-800-959-8281 (613-940-8495 if calling from outside Canada and the United States). The CRA plans to add the option of transfers to an individual's COVID-19 benefit debt under this service in the future.

Enhanced Mandatory Disclosure Rules in Effect

Canada's enhanced mandatory disclosure rules are a set of reporting requirements which received Royal Assent on June 22, 2023. Enhancements to the rules align with international best practices and aim to better provide the Canada Revenue Agency with information to respond to tax risks. Individuals, corporations, trusts, partnerships, advisors, promoters, and certain non-arm's length parties may be affected.

These rules (*Income Tax Act* sections 237.3 to 237.5) consist of:

- changes to existing reportable transaction rules;
- a new rule to report notifiable transactions;
- a new rule to report reportable uncertain tax treatments; and
- related penalties.

The rules apply to transactions occurring after June 22, 2023, for reportable and notifiable transactions, and tax years beginning after 2022 for reportable uncertain tax treatments. Not complying with these mandatory disclosure rules will result in financial penalties and extended reassessment periods.

Guidance to the mandatory disclosure rules is available at www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/compliance/mandatory-disclosure-rules-overview.html and www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/compliance/mandatory-disclosure-rules-overview/guidance-document.html.

T1 Adjustment Requests

Taxpayers can now make online requests on Change My Return for the application of certain losses:

- carry-back amounts such as capital or non-capital losses; and
- carry-forward amounts such as farming or fishing losses or restricted farm losses.

Taxpayers can also make an online election to split pension income, or use Change My Return to change certain non-resident returns, such as:

- deemed resident returns;
- factual resident returns;
- immigrant returns;
- emigrant returns; and
- section 115 and deemed non-resident returns.

Using ReFILE, taxpayers can now:

- carry back amounts such as capital or non-capital losses; and
- split pension income.

New Grocery Rebate Issued

In Budget 2023, the Government of Canada introduced a Grocery Rebate payment to help with rising costs. The rebate was issued July 5, 2023, alongside the regular GST/HST credit payment to individuals and families who were entitled to receive a GST/HST credit payment for January 2023.

This rebate is expected to offer up to $2.5 billion in targeted inflation relief to approximately 11 million low- and modest-income Canadians and their families. Recipients could get up to an extra $467 for eligible couples with two children; up to an extra $234 for single Canadians without children; and an extra $225 for seniors, on average. Learn more about the rebate at Canada.ca/grocery-rebate.

Period Two of Interim Canada Dental Benefit

Period Two of the Interim Canada Dental Benefit opened July 1. Families with young children can apply for the first or second time to get the dental benefit. Eligible families can get up to $650 per child for dental care services that take place between July 1, 2023, and June 30, 2024. Families may be eligible for the benefit if:

- their child(ren) is under the age of 12 as of July 1, 2023;
- their adjusted family net income is less than $90,000;
- they do not have access to private dental insurance; and
- their dental care expenses are not fully covered by another dental program provided by any level of government.

An additional payment may be available for some children if their dental costs are more than $650 in one of the benefit periods. Learn more about eligibility and how to apply at Canada.ca/dental.

Advanced Canada Workers Benefit Now Year-Round

Part of the Canada Workers Benefit ("CWB") will now be paid out year-round through the Advanced Canada Workers Benefit ("ACWB"). As announced in the 2022 Fall Economic Statement, the CWB will now be available in three payments through the ACWB.

Starting in July 2023, ACWB recipients will receive half of their 2022 CWB allotment in quarterly instalments in July, October, and January. The remaining amount will be reconciled once they file their 2023 tax return next spring. Read more at Canada.ca/canada-workers-benefit.

Three More Provinces Receive the Pollution Price Rebate (Climate Action Incentive)

This July, residents of Newfoundland and Labrador, Nova Scotia, and Prince Edward Island will begin receiving a quarterly pollution price rebate payment. Payments will be issued between July 14 and July 21. Learn more about who is eligible and province-specific payment amounts at Canada.ca/cai-payment.

Ontario Businesses Have Another Way To Pay WSIB Premiums

Starting July 4, 2023, the Canada Revenue Agency ("CRA") and Ontario's Workplace Safety and Insurance Board ("WSIB") are providing Ontario businesses with a new option to pay their WSIB premiums. Ontario businesses with a business number can now report their insurable earnings and make WSIB account payments through their CRA My Business Account. Ontario businesses that do not have a CRA My Business Account and wish to use this service to pay their WSIB premiums can register through the CRA's website at www.canada.ca/en/revenue-agency/services/e-services/digital-services-businesses/business-account.html. Businesses can visit wsib.ca to learn about other options for paying their premiums.

Government of Canada Approves the Collective Agreement Between the CRA and the PSAC-UTE

The Government of Canada has approved the renewed collective agreement between the Canada Revenue Agency ("CRA") and the Public Service Alliance of Canada — Union of Taxation Employees ("PSAC-UTE") for approximately 39,000 employees.

The new collective agreement, ratified by the members of the PSAC-UTE and approved by the Government of Canada, was signed by both parties on June 27, 2023.

This agreement covers a four-year period, from November 1, 2021, to October 31, 2025, inclusively. It takes effect on the day the CRA and the PSAC-UTE signed it. From this date, the CRA will have 180 days to implement the provisions of the collective agreement, including retroactive pay.

IMF Welcomes Canadian Environmental Tax Policies

The International Monetary Fund ("IMF") has welcomed recent environmental tax policies adopted by Canada but has warned policymakers on the country's policy direction.

In its Article IV consultation report for the country, the IMF said, "The government's green subsidies are welcome, although their design could be strengthened."

"Investment tax credits to clean electricity and green energy and technology featured in the 2023 federal budget, plus complementary measures in 2022, as well as the additional production subsidies recently granted to one automaker and now under consideration for another, can all support Canada's transition to a greener economy by helping to incentivize investment in key sectors," the report says.

However, it says:

> Greater international coordination would be desirable, to mitigate the risks of a 'race to the bottom' in which investment-location decisions may be distorted toward jurisdictions able to offer subsidies. Moreover, the current strong focus on electric vehicles — and their batteries in particular — as key to Canada's green industrial development will require a cautious approach given rapid technological change. International experience also suggests that evenhandedness and transparency can best be served by offering a standard, time-bound incentive regime rather than negotiating company-specific packages. And ensuring that subsidies are designed in a WTO-consistent manner is critical to counter geoeconomic fragmentation.

Canada is targeting a reduction in emissions to 40–45% below 2005 levels by 2030, and net-zero emissions by 2050.

The report notes that IMF staff analyses suggest that, while carbon pricing and other policies could produce a 30% reduction in emissions by 2030 relative to 2005, the expeditious implementation of all elements of Canada's Emissions Reduction Plan (including the separate cap on emissions in the oil and gas industry, along with clean electricity regulations) could deliver the 40–45% commitment.

The report also includes recommendations on the housing sector. The report notes, while about half of the surge in house prices during the pandemic was erased during 2022, prices have risen again since the start of the year. The report concludes that more action should be taken by the Government to promote housing supply and address affordability concerns.

Progress of Legislation

Bill C-47, *Budget Implementation Act, 2023, No. 1*, received Royal Assent on June 22. The bill enacted several measures from recent federal budgets and various technical amendments.

Bill C-41, *An Act to amend the Criminal Code and to make consequential amendments to other Acts*, received Royal Assent on June 20. The bill enacted consequential amendments to the *Income Tax Act* and the *Excise Tax Act*.

Bill C-22, *Canada Disability Benefit Act*, received Royal Assent June 22. The bill enacted a consequential amendment to the *Income Tax Act*.

FOCUS ON CURRENT CASES

This is a regular feature examining recent cases of special interest, coordinated by Ron Dueck of Dentons Canada LLP. The contributors to this feature are from Dentons Canada LLP, Montréal, Toronto, Calgary, Edmonton, and Vancouver.

CAE Inc. v. Canada, 2022 DTC 5108 (Federal Court of Appeal): Leave To Appeal Dismissed by SCC May 15, 2023 — Low-Interest Government Loan May Constitute "Government Assistance" Under Subsection 127(9) of the *Income Tax Act*

Background

In 2009, CAE Inc. ("CAE"), a Canadian public company that operates a business of manufacturing, selling, and servicing flight simulators, entered into a loan agreement (the "Agreement") with the Department of Industry Canada ("Industry Canada"). Under the Agreement, Industry Canada had to provide financial contributions between 2009 and 2014 to CAE to perform research and development projects related to flight simulators. In return, CAE was required to reimburse the contributions over 15 annual instalments. The rate of return that Industry Canada would receive was approximately 2.5% on an annual basis. The intention of the financial assistance was to fund CAE's scientific research and experimental development ("SR&ED") activities in relation to the projects.

During the 2012 and 2013 taxation years, the financial assistance that CAE received under the Agreement was $57,084,395 and $59,148,888 respectively (the "Payments"). Of these amounts, $41,003,491 in 2012 and $40,652,951 in 2013 were used by CAE to pay for SR&ED expenses.

In 2016, the Canada Revenue Agency ("CRA") reassessed CAE's 2012 and 2013 tax years on the basis that the amounts that CAE received under the Agreement constituted a form of "government assistance" within the meaning of subsection 127(9) of the *Income Tax Act* ("ITA"). Having concluded that the amounts received constituted "government assistance", the Minister reassessed CAE on the basis that:

- the Payments and amounts used for SR&ED purposes had to be subtracted from the amount of deductible SR&ED expenses;
- the Payments had to be subtracted from the amount of eligible SR&ED expenditures for investment tax credit calculation purposes; and
- the sum of $14,806,939, which was the difference between the Payments and the amount that CAE used to pay for SR&ED expenses (the "Differential Amount"), had to be included in CAE's income for 2012.

Issues and Tax Court Decision

The Tax Court considered the following four issues:

(1) Do the Payments constitute "government assistance" within the meaning of subsection 127(9) of the ITA?

(2) Should the Payments be subtracted from the amount of CAE's SR&ED expenditures for calculating investment tax credits?

(3) Should the Payments be subtracted from the amount of CAE's deductible SR&ED expenditures?

(4) Should the sum of $14,806,939 be included in the calculation of CAE's income for the 2012 taxation year?

Issue 1: Government Assistance

The Court stated that to answer the issues above, it must first determine whether the Payments constitute "government assistance" under subsection 127(9) of the ITA. The Court considered the following four sub-issues to derive its answer:

(A) What are the different forms of government assistance?

(B) What is the test for determining whether a payment made by the government constitutes "government assistance"?

(C) Is the Agreement an "ordinary commercial agreement"?

(D) Were the Payments "received" by CAE within the meaning of subsections 12(1), 127(9), and 127(18) of the ITA?

Sub-Issue A: Forms of Government Assistance

"Government assistance" under subsection 127(9) of the ITA is defined as follows:

> "government assistance" means assistance from a government, municipality or other public authority whether as a grant, subsidy, forgivable loan, deduction from tax, investment allowance or as any other form of assistance other than as a deduction under subsection 127(5) or 127(6); [*emphasis added*]

The Court noted that the form of assistance may exist in "any other form", and as such, the list in the definition is not meant to be exhaustive. The Court also cited the Federal Court of Appeal case *Immunovaccine Technologies Inc. v. The Queen* (2014 DTC 5119), which held that repayable contributions to research projects paid by the government can be "government assistance". Therefore, the Court held that "government assistance" should be given broad meaning such that the Payments may constitute "government assistance".

Sub-Issue B: The Test

The Court referred to the test adopted in the Federal Court of Appeal case *Consumers' Gas Co v. R.* to determine whether a payment constitutes "government assistance". The test is the following: "[I]f payments have been made in exactly the same way and for exactly the same reasons as those made by private companies, i.e. in order to promote the interests of the payer, it is not 'government assistance' under subsection 127(9) of the ITA."

The Court, however, held that this determination is not sufficient. The Court held that to determine whether the test established by jurisprudence is met, the Court must determine whether "the payments were made in order to promote the commercial interest of the payer, that is to say whether they were made pursuant to the 'ordinary commercial arrangement'".

Sub-Issue C: "Ordinary Commercial Agreement"

The Court held that to determine whether the Agreement is an "ordinary commercial agreement", the main terms of the Agreement must be compared to other commercial agreements that were entered into by private companies to obtain financing.

The Court relied on an expert report to conclude that the Agreement was not an "ordinary commercial agreement". The expert, who was an expert in business financing and valuations, was asked whether the payments made under the Agreement were made in the same way and for the same reasons as payments made by other private companies. To answer the question, the expert had to determine whether the Agreement was an "ordinary commercial agreement".

The expert report found that the Agreement was not an "ordinary commercial agreement" for the following reasons:

- The rate of return is one of the main terms of an agreement such as the Agreement. The 2.5% rate of return in the Agreement is significantly lower than the fair market rate of return for a financial instrument whose risk profile is comparable to the Agreement. CAE obtained a $120,000,000 loan in 2010 that was unsecured, had an average term to maturity of 8.5 years, and a combined interest rate of 7.15%.
- The agreement lacks the financial clauses that resemble a commercial agreement of this type.
- There are several terms in the Agreement that are not typically included in a commercial agreement of this type. These terms serve political motives and government actions rather than commercial motives.

As such, the Court held that the Agreement does not constitute an "ordinary commercial agreement".

Sub-Issue D: Were Payments "Received"?

CAE argued that subsections 12(1), 127(9), and 127(18) of the ITA may only apply if the "government assistance" has been "received" by the taxpayer. CAE submitted that it could not have "received" an amount since there was no transfer of ownership of the amount in question. The Court relied on the dictionary definition of the word "received" to conclude that a transfer of ownership is not necessary for there to be a receipt. The Court also found no evidence that Parliament intended a transfer of ownership condition within the meaning of "received" in subsections 12(1), 127(9), and 127(18).

Ultimately, the Court concluded that the Payments constituted "government assistance" under subsection 127(9).

Issues 2, 3, and 4

Because the Court concluded that the payment amounts that CAE received were "government assistance", the Court answered the rest of the issues in the affirmative — that is, the Minister was correct to subtract the Payments from CAE's SR&ED expenditures and include the Differential Amount in CAE's income for 2012. The appeal was therefore dismissed.

Federal Court of Appeal Decision

CAE appealed to the Federal Court of Appeal. The Court released a short, five-paragraph decision stating that the Tax Court judge did not commit a palpable and overriding error warranting the intervention of the Federal Court of Appeal. The Court found that the TCC judge acted correctly in applying the principles of case law. As such, the appeal was dismissed.

Supreme Court of Canada Decision

CAE filed an application for leave to appeal the decision from the Federal Court of Appeal to the Supreme Court of Canada. On May 15, 2023, the application for leave to appeal was dismissed.

Conclusion

The Tax Court of Canada and Federal Court of Appeal both held that the Payments constituted "government assistance" within the meaning of subsection 127(9) of the ITA and as such, the Minister correctly concluded that the Payments had to be subtracted from the amount of SR&ED expenditures and the Differential Amount had to be included in CAE's income for 2012.

— *Shinjin Kang*

Canada (Attorney General) v. 1835898 Alberta Ltd. (Whitecap Energy Inc.), 2023-PTC-AB-2 (Alberta Court of King's Bench): Standing of Attorney General of Canada as Interested Person To Revive Corporation To Permit Issuance of Notice of Reassessment

In this decision, the Attorney General of Canada sought to revive a dissolved Alberta corporation to allow for the issuance of a notice of reassessment. The Court held that the Attorney General had standing to revive the corporation as an "interested person" and there were no limitation concerns with such revival.

Background

The Canada Revenue Agency ("CRA") had audited 1835898 Alberta Ltd., formerly known as Whitecap Energy Inc. ("Whitecap Energy"), a wholly-owned subsidiary of Whitecap Resources Inc. ("WCP"), for its 2013 and 2014 taxation years (the "First Audit"). Pursuant to the First Audit, the CRA seemingly verified Whitecap Energy's allowable capital losses (the "Tax Losses") under the *Income Tax Act* (Canada) (the "Tax Act"), which were carried forward and claimed by Whitecap Energy in its 2017 and 2018 taxation years. Whitecap Energy was wound up and dissolved in 2020, whereby all of its assets and liabilities were transferred to WCP.

Notwithstanding the First Audit, the CRA subsequently audited Whitecap Energy for its 2017 and 2018 taxation years and its claim of the Tax Losses in those years (the "Second Audit"). The CRA proposed issuing notices of reassessment (the "Proposed Reassessments") against Whitecap Energy and presumably denying its claim of all or part of the Tax Losses. However, the Proposed Reassessments could not be issued against Whitecap Energy unless it was revived. For this purpose and on behalf of the CRA, the Attorney General of Canada (the "AG") made an application (the "Application") to the Court of King's Bench of Alberta (the "Court") to have the corporation revived. WCP objected to the Application on the basis that the AG lacked standing to revive the corporation under the *Business Corporations Act* (Alberta) (the "ABCA").

Issues and Decision

The primary issue before the Court was whether the AG qualified as an "interested person" under section 206.1 of the ABCA. Paragraph (*a*) of section 206.1 provides that an interested person includes a creditor of a dissolved corporation. Paragraph (*d*) of section 206.1 provides that an interested person includes a person so designated as an interested person by order of the Court.

The Court highlighted a technical problem in this case: the AG could not be considered a "creditor" of Whitecap Energy until the Proposed Reassessments were issued, but the Proposed Reassessments could not be issued until Whitecap

Energy was revived. As such, the AG could not rely on paragraph 206.1(*a*) of the ABCA to be considered an "interested person" for the purposes of reviving Whitecap Energy pursuant to section 208 of the ABCA. The AG required the Court to designate the AG as an "interested person" under paragraph 206.1(*d*) of the ABCA so the AG could apply to have Whitecap Energy revived, which would allow the CRA to issue the Proposed Reassessments.

Judge W.S. Schlosser analyzed the power of the Court to designate someone as an interested person under paragraph. 206.1(*d*) of the ABCA. Noting there were no precedents directly addressing this matter, the Court determined the designation of an interested person is discretionary and should be exercised judiciously and for a legitimate purpose.

The Court held that the AG had a valid interest in the revival of Whitecap Energy. The valid interest was the conversion of Whitecap Energy's tax liabilities for its 2017 and 2018 taxation years, which arose when taxable income was earned in those years, into tax debts payable to the AG, which would not arise until the Proposed Reassessments were issued. As noted above, this conversion could not occur until Whitecap Energy was revived.

The Court went on to address whether there were any limitations on the Court's power to revive a dissolved corporation. Section 227 of the ABCA permits a person with a claim against a dissolved corporation to sue a shareholder of the dissolved corporation who has received corporate property, but the person must do so within two years of the dissolution of the corporation. The AG noted they did not intend to pursue WCP under section 227 of the ABCA. The AG indicated they intended to pursue WCP under section 160 of the Tax Act, which does not have any limitation period.

In allowing the AG's application and reviving Whitecap Energy, the Court noted that any battle on the merits of the Proposed Reassessments and WCP's liabilities for any of Whitecap Energy's tax liabilities would be waged at the Tax Court of Canada.

Conclusion

This decision clarifies the standing of the AG in seeking the revival of a dissolved corporation, notwithstanding the AG not yet being a creditor of the dissolved corporation. The Court used the discretionary power afforded to it in paragraph 206.1(*d*) of the ABCA to designate the AG as an "interested person". This designation gave the AG the ability to apply to the Court to have Whitecap Energy revived, thus allowing the CRA to issue the Proposed Reassessments. Once the Proposed Reassessments are issued, the CRA may then issue notices of assessment (pursuant to section 160 of the Tax Act) against WCP in respect of Whitecap Energy's unpaid tax debts resulting from the Proposed Reassessments.

— Adam Kotlowitz and Brian Kearl

Deans Knight Income Corporation v. Canada, 2023 DTC 5041 (Supreme Court of Canada): Loss Realization Transactions Subject to GAAR Where Unrelated Party Acquires Rights of Majority Voting Shareholder and Fundamentally Changes Assets, Liabilities, Shareholders, and Business of Lossco

Background

Forbes Medi-Tech Inc. ("Forbes" and the "Appellant") had once been in the business of mineral exploration, but had pivoted in 1992 to carry on a drug research and nutritive food additive business. Following disappointing clinical trials, the Appellant faced cash flow problems and a possible delisting from the NASDAQ due to a resulting share price drop. By November 2007, the Appellant only had enough cash to continue its business for another six months. It also had significant non-capital losses, SR&ED expenditures, and investment tax credits ("ITCs") (the "Tax Attributes").

Accordingly, the Appellant devised a plan to monetize its tax attributes in connection with a restructuring that would allow it to continue as a going concern and remain listed (the "Realization Strategy"). The initial plan, as presented to the Appellant's board of directors, was to transfer all of the Appellant's non-tax assets, liabilities, and shareholders into a new parent company ("Newco") which would inherit the Appellant's public listing. Following the reorganization, the Appellant would be a wholly-owned subsidiary of Newco with tax attributes that could be of value to potential new investors.

In March 2008, the Appellant entered into an Investment Agreement with a venture capital firm, Matco Capital Ltd. ("Matco"), pursuant to which:

- Matco invested $3 million in the Appellant under a debenture that was convertible into 35% of the voting shares and 100% of the non-voting shares of the Appellant (representing a 79% net equity position in the Appellant);
- All of the Appellant's non-tax assets and liabilities (including the debenture proceeds) would be transferred to Newco in a spin-out transaction;
- Matco guaranteed that it would present Newco with a "Corporate Opportunity" to sell the remaining 65% of its voting shares for an amount not less than $800,000 within one year (the "Residual Guarantee");
- The Appellant was required to obtain Matco's consent to any capital reorganization, debt issuance, or pursuing any activity other than the "Corporate Opportunity"; and
- The Appellant's board of directors was to consist of the Appellant's CFO and the managing director of Matco, together with a nominee of Matco.

The amount of the debenture was adjustable based on the realized value of the Appellant's tax attributes (and was in fact adjusted to $2.96 million, representing a valuation of the tax attributes in the amount of approximately 4.5 cents on the dollar) and was immediately assigned to another subsidiary of Newco.

Immediately prior to the execution of the Investment Agreement, the managing director of Matco incorporated a wholly-owned company that purchased a nominal number of shares of the Appellant to ensure that the Investment Agreement would not constitute a unanimous shareholders agreement under corporate law, such that the rights Matco obtained thereunder would not be rights obtained under a "quasi-constitutional" corporate document.

In December of 2008, Matco approached Deans Knight Capital Management ("DKCM") with the opportunity of using the Appellant as a corporate vehicle to carry on DKCM's investment business investing in high-yield debt instruments. DKCM entered into a letter of intent ("LOI") with the Appellant in the same month, pursuant to which:

- The Appellant represented that it would have at least $95 million of deductible tax attributes (which DKCM believed would shelter all of the anticipated investment income for a period of five years);
- DKCM would have the right to appoint four of the Appellant's five directors and further be appointed to manage its business; and
- The Appellant would seek a $100 million initial public offering ("IPO") attributing a net value of $5 million to the Appellant's existing common shares.

Immediately prior to the IPO, Matco had converted its debenture into the promised shares and the Appellant's board of directors was elected to consist of a nominee of Matco and four nominees of DKCM. The Appellant changed its name to Deans Knight Income Corporation ("Deans Knight") and successfully closed the IPO in March of 2009, valuing Matco's shares at approximately $4.2 million. Matco then purchased Newco's remaining voting shares for $800,000, satisfying its obligation to complete the Corporate Opportunity.

The Appellant proceeded to carry on the contemplated debt investment business managed by DKCM for five years, sheltering all of its income with the Tax Attributes that arose prior to Matco and DKCMs involvement in its 2009 to 2012 taxation years (the "Tax Deductions").

Tax Court of Canada

In rendering its decision in 2019, the Tax Court of Canada considered the following issues:

(1) Did Matco obtain a right to obtain a majority of the shares of the Appellant and thereby acquire *de jure* control pursuant to subsection 256(6) and paragraph 251(5)(*b*) of the *Income Tax Act* ("ITA")?

(2) If not, did the series of transactions commencing with the Realization Strategy and culminating in the Tax Deductions (the "Realization Transactions") offend the GAAR under subsection 245(2) of the ITA?

1. Did Matco acquire *de jure* control pursuant to subsection 256(6) and paragraph 251(5)(*b*) of the ITA?

Subsection 256(8) provides that where a person acquires a right referred to in paragraph 251(5)(*b*), and it can reasonably be considered that a main purpose of acquiring that right was to avoid the limitations on the deduction of certain tax attributes, the taxpayer will be deemed to be in the same position in relation to the control of the corporation as if the right had been exercised when it was acquired, including for the purposes of determining whether there has been an acquisition of control. If an acquisition of control results, the taxpayer is prevented from claiming those tax attributes subject to any exception provided for in the rules applicable to the particular tax attributes.

Subparagraph 251(5)(*b*)(i) provides that, for purposes of considering whether a taxpayer controls a corporation, a taxpayer is deemed to have acquired any shares of a corporation which the taxpayer has the right to acquire under a contract "in equity or otherwise, either immediately or in the future and either absolutely or contingently".

The Minister argued that there was no possibility that Matco would not acquire the remaining voting shares if it offered to purchase them for the minimum $800,000, as the Investment Agreement provided that the Appellant would be liable to pay Matco the guaranteed $800,000 if the Appellant chose not to accept such an offer. As such, the Minister argued that the Residual Guarantee should be viewed as a "right" within the meaning of subparagraph 251(5)(*b*)(i).

The Tax Court disagreed, stating that the economics of the Residual Guarantee could not recharacterize what was only a guaranteed offer into a right; the Residual Guarantee did not afford Matco the legal or equitable ability to compel the sale of the remaining voting shares to itself or anyone else. The Tax Court further noted that the evidence did not support a finding that the parties had always intended that Matco would be the purchaser under the Residual Guarantee, or that Matco could only profit under the Investment Agreement if it in fact acquired the remaining shares under the Residual Guarantee.

2. Did the Realization Transactions offend the GAAR under subsection 245(3) of the ITA?

The Tax Court held that as the Realization Transactions resulted in a reduction of the Appellant's taxes in its 2009 to 2012 taxation years, the Realization Transactions resulted in a clear "tax benefit". Similarly, the Tax Court found that the Appellant's primary purpose in effecting the Realization Transactions was to effect a monetization of its Tax Attributes, which was an "avoidance transaction". The primary question entertained by the Tax Court was whether the Realization Transactions amounted to abuse for purposes of subsection 245(4).

The Tax Court noted that pursuant to *Copthorne Holdings* (2012 DTC 5007 (SCC)), a determination of abuse for purposes of subsection 245(4) requires a two-stage analysis: first, a textual and purposive analysis of the provisions giving rise to the tax benefit must be undertaken to determine the object, spirit, and purpose of those provisions; and second, an analysis of whether the impugned transaction or transactions frustrate or defeat the identified object, spirit, or purpose of those provisions.

The Tax Court identified two sets of provisions of the ITA engaged by the Realization Transactions requiring a separate analysis to determine their object, spirit, or purpose:

(a) the acquisition of control provisions under subsection 256(6) and paragraph 251(5)(*b*); and

(b) the tax attribute streaming provisions governing losses under paragraph 111(1)(*a*) and subsection 111(5), and governing SR&ED and ITC deductions under subsections 37(6.1) and 127(9.1).

a. Acquisition of Control Provisions: Object, Spirit, or Purpose

The restriction on loss carryovers in subsection 111(5) is triggered when "control of a corporation has been acquired by a person or group of persons". The Tax Court noted that:

> The acquisition of control test is the means by which Parliament has determined that a loss has notionally been transferred to an unrelated party. . . The Federal Court of Appeal has pointed out that "the notion of control is central to the working of subsection 111(5)". As, such, the test is relevant to the analysis of the object, spirit and purpose of that provision. To ignore it would amount to reading out the test, which is not permitted in interpreting legislation. The word "control" in the Act has long been held to mean *de jure* control. (paras. 103–104)

The Tax Court examined the statutory history of the loss streaming provisions in subsection 111(5). When first introduced as subsection 27(5) in 1958, the loss streaming rules were triggered simply where a person who did not own any shares in a preceding year had acquired more than 50% of a corporation's shares in the next year. In 1963, the rules were amended to further provide that they would also be triggered where a person acquired "control" in any year. When subsection 111(5) was introduced in 1972, the rule continued to apply where an acquisition of "control" had taken place, and further added the same-or-similar-business test. The Tax Court noted that since the introduction of subsection 111(5):

- various provisions have been introduced in the ITA to deem *de jure* control to exist in certain circumstances;
- subsection 256(8) was introduced to expand the concept of *de jure* control beyond a determination based strictly on legal ownership of voting shares "to allow the Minister to look beyond the share registry of the corporation to determine who in substance has control over the voting rights in respect of the shares of a corporation and thus effective control of the corporation" (para. 115); and
- a statutory test for *de facto* control was introduced in subsection 256(6.1), which was adopted for purposes of many provisions in the ITA but was never adopted for purposes of subsection 111(5).

The Tax Court noted that both the *de facto* and the *de jure* control tests were concerned with "the notion of control of affairs of a corporation through control over the board of directors" and "are differentiated only by the breadth of factors that can be looked at to determine who has ultimate control over the board of directors" (paras. 118, 120).

The Appellant argued that the new loss streaming rules introduced in 2013 under section 256.1 (which deem an acquisition of control to have occurred when the value of the interest held by a person or group of persons in a corporation increases to greater than 75% of the value of all of the shares of the corporation) should be viewed as evidence that no such economic test informed subsection 111(5) prior to 2013. On this point the Tax Court disagreed, citing *Oxford Properties* (2018 DTC 5017 (FCA)) for the proposition that "the only way to assess the impact of a subsequent amendment on the prior law is to first determine the legal effect of the law as it stood beforehand and then determine whether the subsequent amendment alters it or clarifies it" (para. 124).

Further, the Tax Court noted that the rationale for the loss streaming provisions in subsection 111(5) has often been expressed amongst practitioners and academics as reflecting a change in the identity of the ultimate economic interests: "In the case of an artificial entity such as a corporation, when its control changes it is essentially regarded as a new taxpayer, because different shareholders then become entitled indirectly to enjoy the benefits of its financial success" (para. 129). However, the Tax Court rejected this view on the basis that this economic interest test was rejected in 1963 and not added back until 2013: "This gives rise to an inference that Parliament did not intend to target substantial equity acquisitions in a loss corporation as a basis for restricting the carryover of its losses" (para. 131). Rather, the Tax Court concluded that:

> It appears that Parliament's aim in choosing the *de jure* control test was to achieve certainty and predictability. This was the conclusion of Iacobucci J. in *Duha Printers (Western) Ltd.* [96 D.T.C. 6323]: "The *de facto* concept was rejected because it involves ascertaining control in fact, which can lead to a myriad of indicators which may exist apart from these sources". (para. 132)

The Tax Court further drew from Iacobucci J. in *Duha Printers* that the *de jure* test is a test of who has "effective or ultimate control of a corporation":

> . . . However, it must be recognized at the outset that this test is really an attempt to ascertain who is in effective control of the affairs and fortunes of the corporation. That is, although the directors generally have, by operation of the corporate law statute governing the corporation, the formal right to direct the management of the corporation, the majority shareholder enjoys the indirect exercise of this control through his or her ability to elect the board of directors. Thus, it is in reality the majority shareholder, not the directors per se, who is in effective control of the corporation. This was expressly recognized by Jackett P. when setting out the test in *Buckerfield's*. Indeed, the very authority cited for the test was the following dictum of Viscount Simon, L.C., in *British American Tobacco Co. v. Inland Revenue Commissioners*, [1943] 1 All E.R. 13, at p. 15:

> The owners of the majority of the voting power in a company are the persons who are in effective control of its affairs and fortunes.

(para. 133)

The Tax Court concluded that "the object, spirit and purpose of subsection 111(5) is to target manipulation of losses of a corporation by a new person or group of persons, through effective control over the corporation's actions" (para. 134). The Tax Court further concluded that this object, spirit, and purpose was equally applicable to the SR&ED and ITC streaming restrictions in subsections 37(6.1) and 127(9.1) given the similar nature in the way in which they operate (para. 87).

Following the Supreme Court of Canada decision *Lipson v. R.* (2009 DTC 5015), the Tax Court noted that abusive tax avoidance will be found where the transaction achieves an outcome the statutory provision was intended to prevent, defeats the underlying rationale of the provision, or circumvents the provision in a manner that frustrates or defeats its object, spirit, or purpose. The Tax Court then considered whether, despite Matco not having acquired *de jure* control, it acquired effective control of the Appellant such that the object, spirit, and purpose of subsection 111(5) was frustrated and the related tax attribute streaming restrictions were circumvented.

The Tax Court concluded that no such abuse existed, as the use of the Appellant's tax attributes against income from the investment business could have been achieved even if the Investment Agreement had not been entered into:

> The Appellant on its own could have arranged with DKCM to raise funds by means of the IPO and to carry on the investment business without the assistance and participation of Matco. To this extent, the transactions agreed to in the DKCM LOI were not dependent on the Investment Agreement. The tax avoidance in this case was achieved essentially because the IPO did not result in an acquisition of control, since the new shareholders were not connected in any way and therefore did not constitute a "group of persons" for the purposes of subsection 111(5). I would again underline the fact that the Respondent has not alleged that the IPO was part of the series of transactions resulted in abusive tax avoidance. (para. 151)

b. Tax Attribute Streaming Provisions: Object, Spirit, or Purpose

The Tax Court's analysis of the object, spirit, and purpose of subsection 256(8) was considerably shorter, quickly concluding that: "The object, spirit or purpose of subsection 256(8), then, is to prevent a taxpayer from circumventing the listed avoidance provisions by acquiring control over shares or share voting rights in order to achieve effective control of the corporation" (para. 138).

The Tax Court rejected the Minister's assertion that Matco enjoyed effective control over the remaining 65% voting shares held by Newco. Matco could not control the votes attached to these shares, nor could it force the sale of them. Therefore, it had not circumvented subsection 256(8) to acquire control over shares or share voting rights in order to achieve effective control of the corporation.

Federal Court of Appeal

The only issue considered by the Federal Court of Appeal ("FCA") was whether the Realization Transactions were abusive under subsection 245(4) of the ITA.

The FCA stated that:

> I agree with the Tax Court's conclusion as to the object, spirit and purpose of subsection 111(5) . . . However, the Tax Court's statement of the underlying rationale of subsection 111(5) lacks clarity. This was evident in the submissions before this Court on what the Tax Court meant by "effective control". I would rearticulate the object, spirit and purpose of subsection 111(5) as follows: it is to restrict the use of specified losses, including non-capital losses, if a person or group of persons has acquired actual control over the corporation's actions, whether by way of *de jure* control or otherwise. I have replaced the term "effective control" with "actual control". In their submissions, the parties assumed that the Tax Court used the term "effective control" as a synonym for *de jure* control. As evident in the Tax Court's reasons at paragraph 144 and in the Court's reference to "manipulation" in paragraph 134, the Court did not intend that "effective control" mean *de jure* control. I have changed the terminology to avoid further confusion. (paras. 71–73)

The FCA found that while the form of control referred to in the text of subsection 111(5) was *de jure* control, the object, spirit, and purpose of the control test in subsection 111(5) in fact includes forms of *de jure* and *de facto* control (para. 83), which it coined "actual control":

> For these reasons, I conclude that the object, spirit and purpose of subsection 111(5) is, at least in part, to restrict the use of specified losses, including non-capital losses, if a person or group of persons has acquired actual control over the corporation's actions, whether by way of *de jure* control or otherwise. (para. 93)

The FCA found that the restrictions imposed on Deans Knight under the Investment Agreement, together with the economics surrounding the Residual Guarantee, made it such that "there was no realistic chance that a Corporate Opportunity would be rejected" by Newco once an offer to purchase the residual shares was made by Matco. The FCA found that this level of certainty as to outcome provided Matco with "actual control" over Forbes, and that this actual control resulted in the Realization Transactions being abusive.

The FCA thus set aside the decision of the Tax Court on the grounds that its finding that there was no abuse was a palpable and overriding error.

Supreme Court of Canada

Reasons for the Supreme Court of Canada ("SCC") were given by the Honourable Mr. Justice Rowe for the majority (being all but the Honourable Justice Madame Côté, whose dissenting reasons are not discussed in this summary due to length).

The issue before the SCC was again whether the Realization Transactions amounted to abuse under subsection 245(4) of the ITA.

1. Object, Spirit, or Purpose of Subsection 111(5)

The SCC affirmed that the correct test for control was and continues to be *de jure* control, and that contrary to the Tax Court's view, subsection 111(5) is in fact concerned with change in the identity of the ultimate economic interests of a corporate taxpayer:

> While the corporation is still the same legal person after an acquisition of control, the identity of those behind the corporation has changed. Section 111(5) functions so that the tax benefits associated with those losses will not benefit a new shareholder base carrying on a new business. . . s. 111(5) serves to delineate the boundaries of s. 111(1)(a) and to promote consistency with other provisions which treat the corporation as, effectively, a new taxpayer following an acquisition of control. (paras. 88, 90)

However, it admonished the Tax Court and FCA for making the mistake of formulating the object, spirit, and purpose of subsection 111(5) as a legal test. The test is *de jure* control. The object, spirit, and purpose is not another type of control test (effective control or actual control), but rather the rationale behind the use of the *de jure* test.

The SCC agreed with the Tax Court that the *de jure* test for control was utilized, as set out in *Duha Printers*, on account of its providing a clearer benchmark and thus predictability. However, it agreed in part with the FCA that the object and purpose of the control test in subsection 111(5) is more than just the *de jure* test:

> However, it does not follow that the provision's rationale is fully captured by the *de jure* control test. Rather, *de jure* control was the marker that offered a roughly appropriate proxy for *most* circumstances with which Parliament was concerned — particularly given that the GAAR exists as a last resort. To ascertain the rationale underlying s. 111(5), more is needed than the simple fact that Parliament settled on *this* test to operationalize its intent.

The SCC went on to analyze the related provisions in the ITA which both extend and restrict the circumstances in which an acquisition of control is acquired. It noted that subsection 256(8) ". . . looks beyond the standard documentation considered under the *de jure* control test. Instead, it assesses legal rights, including contractual agreements. . . More broadly, it demonstrates that the *de jure* control test in s. 111(5) does not, on its own, capture the full range of situations that Parliament sought to target; rather, the test in s. 111(5) is better understood as a rough proxy that seeks to give effect to Parliament's broader aims, while offering a degree of clarity and stability in

most cases" (para. 96). In contrast, subsection 256(7) deems no control to have been acquired in respect of a transfer between related parties.

The SCC then performed a detailed examination into various parliamentary statements and commentary that have accompanied the history of the loss streaming rules. It concluded that the legislative history behind subsection 111(5) illustrates that Parliament's intended purpose was to address a specific mischief and that the rationale for including the loss carryover restriction in the Act has remained consistent:

> . . . the provision has always restricted non-capital loss carryovers upon a change in the locus of control of a corporation from one person or group to another, subject to a continuity of business exception. When a corporation changes hands, and the loss business ceases to operate, the corporation is effectively a new taxpayer who cannot avail itself of non-capital losses accumulated by the old taxpayer. (para. 110)

The SCC concluded that the object, spirit, and purpose of subsection 111(5) is:

> . . . to prevent corporations from being acquired by unrelated parties in order to deduct their unused losses against income from another business for the benefit of new shareholders. Parliament sought to ensure that a lack of continuity in a corporation's identity was accompanied by a corresponding break in its ability to carry over non-capital losses. This is the rationale underlying the provision and properly explains why Parliament enacted s. 111(5). (para. 113)

Seen in light of this rationale, the *de jure* test "is primarily a means of giving effect to Parliament's aim, rather than a complete encapsulation of the aim itself." If the aim were no broader than the strict *de jure* test, the GAAR could never apply to provisions dealing with *de jure* control (para. 116).

2. Were the Realization Transactions Abusive?

The SCC did not dispute the findings of fact of the Tax Court, but found that the findings demonstrated that the Realization Transactions clearly frustrated the object, spirit, and purpose of subsection 111(5) for the following reasons:

- the transactions resulted in the appellant's near-total transformation: its assets and liabilities were shifted to Newco, such that all that remained was an "empty vessel" with tax attributes;
- the appellant's tax attributes were preserved to benefit a new and unrelated party;
- the appellant's shareholder base underwent a fundamental shift such that the transactions resulted in a fundamental change in the identity of the taxpayer; and
- the appellant's new business activity was an unrelated venture planned by DKCM and selected by Matco.

More to the point, the SCC found that Matco achieved the functional equivalent of a *de jure* acquisition of control through the Investment Agreement, while circumventing subsection 111(5), because it used separate transactions to dismember the rights and benefits that would normally flow from being a controlling shareholder. Matco had contracted for the composition of the board of directors and severe restrictions being placed on their powers — rights which may well have amounted to *de jure* control had nominal shares not been issued to Matco's managing director thereby preventing the Investment Agreement from becoming a unanimous shareholders agreement. Further, by requiring Matco's consent to almost all key corporate actions, Matco had gained the functional equivalent of majority voting power prior to it obtaining the remaining 65% voting shares on completion of the Residual Guarantee.

Further, the SCC found that while the Appellant could in theory reject the Corporate Opportunity presented to it by Matco, the acceptance of the corporate opportunity was a "fait accompli"— as the Appellant had been structured for the very purpose of receiving what business Matco decided to put into it, and the economic consequences to the Appellant of rejecting Matco's offer would have been severe. Moreover, the Appellant was prohibited from seeking out any other opportunities than those presented by Matco. The SCC found that:

> In my view, any residual freedom under the Investment Agreement is illusory and merely reinforces how the transactions frustrated the rationale of s. 111(5).

The Court thus found that the result obtained by the Realization Transactions clearly frustrated the rationale of subsection 111(5) and therefore constituted abuse. The FCA's decision was upheld.

Conclusion

The Supreme Court of Canada decision resolved the tension between the Tax Court and FCA decisions, and has provided more certainty regarding the application of the GAAR to subsection 111(5), which will almost certainly apply to the definition of "loss restriction event" enacted in 2013. The final paragraph for the majority is instructive:

> The object, spirit and purpose of s. 111(5) is to prevent corporations from being acquired by unrelated parties in order to deduct their unused losses against income from another business for the benefit of new shareholders. The transactions achieved the very result s. 111(5) seeks to prevent. Without triggering an "acquisition of control", Matco gained the power of a majority voting shareholder and fundamentally changed the appellant's assets, liabilities, shareholders and business. This severed the continuity that is at the heart of the object, spirit and purpose of s. 111(5).

— *Ron Dueck*

RECENT CASES

Adjustment of Statute-Barred Reassessment Upheld

The Appellant appealed from an assessment of his 2020 taxation year that lowered his net capital losses, resulting in a higher income and higher tax. This resulted from the CRA's deducting a net capital loss incurred before the Appellant's bankruptcy in 1994, as required by subparagraph 128(2)(*g*)(i) of the *Income Tax Act* (the "Act"). The Appellant argued that some 25 years after the fact, it was far too late for the CRA to make such a redetermination. He cited subsection 152(1.3) of the Act for the proposition that the CRA's determination of a net capital loss is binding on the taxpayer and the CRA. He did not seek a Notice of Redetermination.

The Tax Court dismissed the appeal. Section 152 only prevents reassessments of the tax, interest, and penalties assessed for a particular year; the CRA may consider the actual facts of a prior year and correct errors of law. Cases such as *Peach v. The Queen* (2020 DTC 1010 (TCC)) were directly on point. Without a Notice of Determination, a statement of net capital losses is not a determination under subsection 152(1.1); nor is it a reassessment subject to the time limitations set out in subsection 152(4).

Gupta v. The King

2023 DTC 1052

Deficient Receipt Justified Denial of Charitable Deduction

The Canadian Humanitarian Trust Arrangement ("CHT Arrangement") was a tax shelter that involved alleged donations of cash and pharmaceuticals to countries in the Global South. A pharmaceutical distributor ("KP") was to purchase the drugs and sell them to an investment company. That company would settle a trust on each contributor to hold the donor's certificate of contribution. The donor would then transfer title to the drugs to a charity, which distributed the pharmaceuticals to the recipient countries. The Appellant claimed a charitable deduction of $14,612 in cash and $44,129 in pharmaceuticals. The CRA disallowed the deduction (later allowing the cash portion). The CHT Arrangement had previously been litigated (*Morrison v. The Queen*, 2018 DTC 1155 (TCC); *Eisbrenner v. Canada*, 2020 DTC 5051 (FCA)), but the Appellant did not agree to be bound by those decisions.

The Tax Court dismissed the appeal. The Court disposed of preliminary matters relating to evidence and onus; it analyzed the *Morrison* and *Eisbrenner* cases, noting their similarity to the present case. It then turned to the Respondent's contentions. It found that the receipt issued to the Appellant by the investment company was deficient because it did not provide a separate issuing address. Given the strict requirements of the *Income Tax Act* for charitable donation tax credits, this was sufficient to dismiss the appeal. However, the Court went on to consider the issue of whether the Appellant had actually made a gift. The photocopied certificate the Appellant introduced into evidence was missing a crucial page; more importantly, there was no evidence KP ever acquired or sold the drugs. This break in the chain was sufficient to hold that the Appellant had no legal title to the drugs.

Parker v. The King

2023 DTC 1053

In Case Involving Delayed Proceedings the Appellant's Request To Allow the Appeals Because of Lack of Procedural Fairness Dismissed

This case involves a complex situation that goes back to appeals filed in 2017 by the Appellants challenging income tax reassessments raised by the Minister for which a decision has not yet been rendered. The judge presiding over the initial appeals had to retire for health reasons. It was then proposed that either a new trial be started or a new judge be named and render the decision based on the information on file, including a sound recording of the initial trial. The Appellants were not satisfied with either proposal and are now, in the current case, requesting the Court to allow the initial appeals on the basis that the delays in proceedings amount to a failure of procedural fairness. They added that they had always acted in good faith and were not responsible for the proceedings being delayed so long.

The request was dismissed. After reviewing all the facts and circumstances, the Tax Court rejected the request on the basis it had no authority to rule about a failure of procedural fairness it allegedly caused itself. The Court found that not finishing the case would be a denial of justice and not the opposite. Furthermore, the Court found the Appellants clearly were partly responsible for the procedural delays and therefore were not in a position to protest them. The Court also stated that the delays, while important, were not that significant and the Court, considering the information available including sound recordings of previous procedures, was justified in issuing an order for a new judge to proceed with the case and render a decision based on the facts of the case. Accordingly, the Appellant's request was dismissed.

SPE Valeur Assurable Inc., et al. v. The King

2023 DTC 1050

Refusal To Cancel Taxes on TFSA Overcontribution Was Reasonable

The Applicant, a Canadian taxpayer who began contributing to his tax-free savings account ("TFSA") in 2014, sought judicial review of a decision of the Minister declining to exercise her discretion to cancel tax imposed upon him related to excess contributions to his TFSA. The Applicant had over-contributed to his TFSA for the 2021 taxation year and the CRA had notified the Applicant of this over-contribution by way of a Notice of Assessment ("NOA"). The NOA identified that the Applicant had over-contributed to his TFSA, resulting in an amount owing to the CRA of $2,710.69. The Applicant's request for cancellation of the tax imposed was denied because the Applicant's circumstances did not constitute a reasonable error and it was the taxpayer's responsibility to withdraw any excess contributions and to keep and review accurate records to ensure they remain within their TFSA contribution room.

The application for judicial review was dismissed. In deciding whether the decision to impose the tax was reasonable, the Court observed that the record before it did not include evidence which would allow the Court to assess the information available to the Applicant on the CRA website related to his TFSA contribution room when he made contributions in 2021. The Court concurred with the deciding officer that it was the responsibility of each TFSA account holder to be aware of the rules and regulations governing TFSAs and to manage their TFSA accordingly, including understanding that the use of brackets represents negative contribution room. The information was therefore within the knowledge, or the means of knowledge, of the taxpayer and the reasoning was intelligible and therefore withstood the reasonableness standard of review.

Keystone v. Canada (AG)

2023 DTC 5047

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