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# IS THE *DUKE* FINALLY DEAD? AN ANALYSIS OF THE AUGUST 4 GAAR DRAFT LEGISLATION

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Fundamental wide-ranging changes to the general anti-avoidance rule ("GAAR") were introduced in the 2023 Federal Budget ("Budget 2023"). Unfortunately, these changes, if enacted in their current form, will introduce a large degree of uncertainty into the provision and make it harder and more expensive for taxpayers to challenge a GAAR assessment, valid or not.

In *Canada Trustco* (2005 DTC 5523), the Supreme Court established a three-step framework for determining whether the GAAR applies to a transaction or a series of transactions. This framework was reasserted by the Supreme Court in several cases, including *Copthorne Holdings* (2012 DTC 5007) and *Lipson* (2009 DTC 5015). The first step is to inquire into the existence of a "tax benefit". For there to be a tax benefit, a transaction or series of transactions must result in "a reduction, avoidance or deferral of tax or other amount" or an "increase in a refund of tax or other amount". The second step is to determine whether the tax benefit is an "avoidance transaction" within the meaning of subsection 245(3). The third step is to determine whether the avoidance transaction giving rise to the tax benefit is a "misuse" or "abuse" of the *Income Tax Act* (the "Act") under subsection 245(4). This inquiry involves, first, interpreting the relevant provisions of the Act to determine their object, spirit, and purpose, and second, determining whether the transactions fall within or frustrate the object, spirit, and purposes of those provisions. The existence of abusive tax avoidance must be clear, and if it is not clear, the benefit of the doubt goes to the taxpayer. In addition, the Minister bears the burden of establishing abusive tax avoidance.

There have been significant changes proposed to subsection 245(3) which deals with the effect of a tax motive in determining whether or not a particular transaction is an "avoidance transaction". As noted above, GAAR applies to a transaction only if it is an "avoidance transaction" as defined in subsection 245(3). Previously, the rule looked to whether a transaction (or series) was "undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit." Subsection (3) will be amended to change the "primarily" threshold in the avoidance transaction test to a "one of the main purposes" threshold. It is hard practically to see when this lower threshold will not be met, given that tax is one of the major costs and factors involved in any commercial transaction.

Most transactions will now potentially be included in the scope of the GAAR and there are fundamental changes proposed which arguably will make the application and scope of the GAAR unclear.

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Canada has always been subject to the rule of law. That is, Parliament and the laws they pass are supreme and when interpreting the law, courts look to the wording of the legislation passed by Parliament. This has also been true in tax, with a long line of cases affirming this, one of the most important being the English case of *Inland Revenue Commissioners v. Duke of Westminster*, [1936] A.C. 1, where the Duke arranged to "pay" his gardener via a tax-efficient annuity rather than paying him a salary, which attracted the displeasure of the Commissioners of Inland Revenue. In that case, Lord Tomlin said:

> Apart, however, from the question of contract with which I have dealt, it is said that in revenue cases there is a doctrine that the Court may ignore the legal position and regard what is called "the substance of the matter," and that here the substance of the matter is that the annuitant was serving the Duke for something equal to his former salary or wages, and that therefore, while he is so serving, the annuity must be treated as salary or wages. This supposed doctrine (upon which the Commissioners apparently acted) seems to rest for its support upon a misunderstanding of language used in some earlier cases. The sooner this misunderstanding is dispelled, and the supposed doctrine given its quietus, the better it will be for all concerned, for the doctrine seems to involve substituting "the incertain and crooked cord of discretion" for "the golden and streight metwand of the law." 4 Inst 41 Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so-called doctrine of "the substance" seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable.

The GAAR was enacted partially in response to the Supreme Court of Canada's decision in *Stubart* (84 DTC 6305) that the *Income Tax Act* does not require that a transaction have a business purpose to be effective, and, more generally, for the purpose of combating "abusive" tax avoidance transactions and arrangements which technically comply with the provisions of the Act.

Most notably, the changes introduced in Budget 2023 will now introduce an "economic substance" test into Canadian tax law by enacting subsections 245(4.1) and (4.2), in effect substituting an economic analysis for a legal analysis, at least in the first instance.

Draft subsection (4.1) provides that a transaction "significantly lacking in economic substance" is presumed to be a misuse under paragraph (4)(*a*) or an abuse under paragraph (4)(*b*), while draft subsection (4.2) sets out the meaning of the phrase "significantly lacking in economic substance" and provides a list of a number of factors which will establish that a transaction is significantly lacking in economic substance.

Draft subsection (4.2) reads as follows:

> Depending on the particular circumstances, the following factors establish that a transaction or series of transactions is significantly lacking in economic substance:
>
> (*a*) all or substantially all of the opportunity for gain or profit and risk of loss of the taxpayer — taken together with those of all non-arm's length taxpayers — remains unchanged, including because of
>
> (i) a circular flow of funds,
>
> (ii) offsetting financial positions,
>
> (iii) the timing between steps in a series, or
>
> (iv) the use of an accommodation party;
>
> (*b*) it is reasonable to conclude that, at the time the transaction or series was entered into, the expected value of the tax benefit exceeded the expected non-tax economic return (which excludes both the tax benefit and any tax advantages connected to another jurisdiction); and
>
> (*c*) it is reasonable to conclude that the entire, or almost entire, purpose for undertaking or arranging the transaction or series was to obtain the tax benefit.

Note that this list contains considerable uncertainty itself and is not exhaustive, as while these factors will determine that a transaction is significantly lacking in economic substance, subsection (4.2) does not say that others will not.

Leaving aside the uncertainty in the list, it may be very difficult to determine what the "economic substance" of a transaction is, as well as whether or not a lack of this substance is "significant" in the circumstances. We have agreed interpretations as to what "all or substantially all" (90%) and "primarily" (more than 50%) mean, but what is "significant"?

In the explanatory notes to the August 4 draft legislation, the Department of Finance gave the following example:

> In less abstract terms, a taxpayer moving $100 from a taxable account to a tax-free savings account ***could be argued to lack economic substance***, based on the facts that the taxpayer's opportunity for gain or profit (and risk of loss) hasn't changed and the sole reason for moving the funds to the TFSA was to obtain a tax benefit. As noted in the 2008 Budget documents, the TFSA was introduced "to improve incentives for Canadians to save." As such, while it is possible that a transaction could be implemented which does misuse or abuse the TFSA rules, the taxpayer in this example simply responded to a tax incentive and did precisely what the government intended to encourage. Another factor ***that would rebut a presumption of abuse in this example*** is that, if the GAAR were to take away the tax benefit each time a person transfers funds from a taxable account into a TFSA, that would render the TFSA rules essentially ineffective at achieving their objective and frustrate the intent of Parliament. [emphasis added]

Although perhaps not intended, this example nicely puts its finger right on the key issues with the updated rules. Even though a mundane transfer to a TFSA is totally in accordance with the intent of Parliament and in accordance with the explicit wording of the Act, if the CRA were to allege a significant lack of economic substance as noted that they could in the example above, the presumption is such that GAAR will apply unless the taxpayer is able to overturn this presumption in court, which is quite conceivably a very difficult, if not impossible, onus to overturn. Where is there any "economic substance" of any sort in a TFSA contribution?

Procedurally, although there is often a wide range of divergent economic opinions in many matters and there may be nothing to indicate that the economic analysis and opinion of the CRA is any more accurate than the view of the taxpayer undertaking a particular transaction, the taxpayer will be forced to go to court and presumably employ economists as expert witnesses to try to overturn the presumption with all the disruption and cost that that entails.

Changes have also been proposed to the preamble to emphasize that GAAR will now apply to all tax transactions.

Note that the word used in draft subsection 245(4.1) is that a transaction lacking in significant economic substance is "presumed" to be a misuse or abuse, not "deemed". As such, it is a starting point for the GAAR analysis and a presumption that needs to be rebutted for GAAR not to apply. However, it still appears open for a taxpayer to argue that a particular transaction is not a misuse or abuse based on an analysis of the legislation even if it is determined that the transaction in question does not have significant economic substance. On the flip side, destroying the presumption doesn't necessarily mean that the transaction will not be subject to GAAR.

With the degree of uncertainly that will exist if the draft legislation is passed in its current form, with the GAAR potentially able to overrule all transactions based on an after-the-fact economic analysis, it is hard to see how taxpayers can tell in advance which transactions will be attacked and which will not with any certainty. It also will be interesting to see how the courts react to legislation that, as a starting point at least, gives priority to an economic analysis over the actual wording of a provision that was passed by Parliament. In the past they have taken a very dim view of such, but in the meantime, any transaction, commercial or not, will need to be undertaken with a robust tax risk analysis and perhaps obtaining an advance ruling where the dollar values justify such and the taxpayer has the luxury of time.

To "up the ante" at the same time, draft subsection 245(5.1) will introduce a penalty where the GAAR applies. Draft subsection 245(5.1) states:

> If subsection (2) [GAAR] applies to a person in respect of a transaction or series of transactions that was not disclosed by the person to the Minister in accordance with section 237.3 [reportable transactions] or 237.4 [notifiable transactions], the person is liable to a penalty for each taxation year equal to the amount determined by the formula
>
> $$(A - B) \times 25\% - C$$
> where
>
> A is the tax payable by the person under this Act for the year;
>
> B is the tax that would have been payable by the person under this Act for the year if subsection (2) had not applied in respect of the transaction or series; and
>
> C is the amount of any penalty payable by the person under subsection 163(2), to the extent that the amount is in respect of the transaction or series and did not reduce the penalty payable by the person under this subsection in a preceding taxation year.

The penalty will apply in respect of a transaction or series of transactions only if the transaction or series was not disclosed to the Minister of National Revenue in accordance with section 237.3 or 237.4 and will be 25% of the amount by which a person's tax payable for a taxation year is increased as a result of the application of the GAAR. Element C reduces the amount of the penalty by the amount of any penalty payable under subsection 163(2) in respect of the transaction or series to prevent duplication where the gross negligence penalty in subsection 163(2) applies in respect of the same transaction or series. Where the tax benefit obtained is the creation of a tax attribute (i.e., it is described in paragraph (*c*) of the definition "tax benefit" in subsection 245(1)) that has not been used to reduce tax payable, no penalty would apply until the year in which the tax attribute is used to reduce tax payable (absent the application of the GAAR). In circumstances where an unutilized tax attribute is successfully challenged under the GAAR, the penalty formula would produce a nil result.

Draft subsection (5.2) provides an exception to the penalty. It is intended to be available in circumstances where a taxpayer demonstrates that it would have been reasonable to conclude that a transaction or series would not be subject to the GAAR at the time it was entered into. It provides as follows:

> Subsection (5.1) does not apply to a person in respect of a transaction or series of transactions where the person demonstrates that, at the time that the transaction or series was entered into, it was reasonable for the person to have concluded that subsection (2) would not apply to the transaction or series in reliance on the transaction or series being identical or almost identical to a transaction or series that was the subject of
>
> (*a*) administrative guidance or statements that were published by the Minister or another relevant governmental authority; or
>
> (*b*) one or more court decisions.

In the explanatory notes to subsection (5.2), the Department of Finance explains their interpretation of the exception as follows:

> The exclusion in subsection (5.2) assures the GAAR penalty will not apply to a taxpayer that entered into a transaction (or series of transactions) reasonably relying upon the current state of the case law and administrative guidance from the Minister of National Revenue. In order for this exclusion to apply, the taxpayer must demonstrate that their transaction or series was identical or almost identical to a transaction or series that was the subject of published administrative guidance or a court decision, such that it was reasonable to have concluded that the GAAR would not apply. ***The "identical or almost identical" threshold is quite high and, as a result, using the same tax strategy or entering into a transaction that is merely similar would not be enough to qualify for the exclusion.*** As the test is applied as at the time the transaction was entered into, it could be relied upon even where there are subsequent changes in administrative position or jurisprudence. [emphasis added]

If the Department of Finance interpretation of the threshold required for subsection (5.2) to apply is adopted by the courts, it could effectively mean the exception is irrelevant, as from a practical perspective, virtually no transaction is identical to a previous one and the threshold may be too high to meet.

# CURRENT ITEMS OF INTEREST

## EFILE Electronic Services — 2024 Program

EFILE is an automated service that allows approved tax preparation service providers and discounters to send individual income tax return information to the CRA directly from EFILE-certified tax preparation software. To maintain access to electronic services for the coming year, including receiving emails from the CRA, you must renew your participation online. This will allow you to use the following electronic services:

- Transmission web services for authorizing or cancelling a representative;
- Auto-fill my return service;
- Client Data Enquiry;
- EFILE for Individuals (T1);
- Corporation Internet Filing (T2);
- Trust Internet Filing (T3);
- Foreign reporting transmission web services, such as Forms T1134 and T1135;
- Express Notice of Assessment service ("Express NOA");
- AgriStability/AgriInvest Corporation forms transmission web service;
- ReFILE service;
- Email notifications from the CRA; and
- T1 Special Elections and Returns web services (Forms T217, T2057, T2059, and UHT-2900) (new).

The CRA conducts suitability screening each year before electronic filing applicants are permitted to electronically file income tax returns on behalf of clients. This process may take up to 30 business days, so submit your renewal as early as possible to avoid delays.

If you renew on or after October 16, 2023, you must update your tax preparation software with your newly assigned password. If you do not renew your account on or after October 16, 2023, you may continue to use your current password until January 26, 2024.

As of January 27, 2024, in order to be able to transmit individual and business authorization and cancellation requests and file T2 returns, you will need to have:

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

In order to update its systems for the next filing season:

- As of January 19, 2024, at 11:59 P.M. (ET), the CRA will temporarily stop accepting T3 transmissions; and
- As of January 26, 2024, at 11:59 P.M. (ET), the CRA will temporarily stop accepting T1 transmissions.

Access to the EFILE Electronic Filing Service is limited solely to the purposes of the electronic filing of any return of income. Any other use is prohibited. As an electronic filer, you have to comply with the EFILE procedures that are available at canada.gc.ca/efile. The CRA encourages you to review the criteria for the suitability screening process and familiarize yourself with the information on these pages before using EFILE. Special attention must be made to review your responsibilities as an electronic filer, which include verifying your clients' identity and protecting taxpayer information.

You have to complete Form T183, *Information Return for Electronic Filing of an Individual's Income Tax and Benefit Return*, for each initial and amended T1 return you transmit. Form T183 will be revised for the 2024 filing program. Please ensure that you review the changes made to the form.

If you are also a discounter, you do not need to renew your discounter code. You must electronically submit a new Form RC76, *Application and Agreement to Obtain a Discounter Code/Discounter Direct Deposit Enrolment*, when information previously provided on Form RC75 (discontinued), Form RC76, or Form RC115 (discontinued) has changed.

On the new RC76 form, tick the "Change" box in Part A of the form and provide the applicable updated information.

For additional information, including instructions on how to renew, visit: www.canada.ca/en/revenue-agency/services/e-services/digital-services-businesses/efile-electronic-filers/efile-news-program-updates.html.

## New Canada Pension Plan ("CPP") and Québec Pension Plan ("QPP") Boxes on T4 Slip

Second additional component CPP and QPP contributions begin in 2024. After January 1, 2024, any employee who contributes to the CPP or QPP will make CPP2 or QPP2 contributions if and when their annual income surpasses the first earnings ceiling, the Year's Maximum Pensionable Earnings ("YMPE"). Employers will make a matching CPP2 or QPP2 contribution. The YMPE for 2024 will be made available at the beginning of November 2023.

CPP2 and QPP2 reporting obligations in boxes 16A and 17A start for T4 slips issued for the 2024 tax year. Boxes 16A and 17A should be left blank for T4 slips issued for the 2023 tax year and in any subsequent year when an employee does not make any CPP2 or QPP2 contributions. For more information on the CPP2 or QPP2 contribution rates and calculations, or the CPP enhancements in general, please visit canada.ca/cpp-enhancement.

## Pollution Pricing in Atlantic Provinces

In the Atlantic provinces, Climate Action Incentive payments for 2023-2024 are being disbursed as follows:

- Since the federal fuel charge came into effect as of July 1, 2023, in Newfoundland and Labrador, Nova Scotia, and Prince Edward Island, residents of these provinces will receive three equal quarterly payments (July 2023, October 2023, and January 2024) in the 2023-2024 fiscal year and four payments the year after that.
- Because New Brunswick requested the federal economy-wide carbon price more recently, households in the province will receive their first pollution price rebate payment as a double payment in October, with a second quarterly payment in January 2024. Households in the province will receive four quarterly payments in the 2024–2025 fiscal year.

In jurisdictions where the federal fuel charge is being applied, a 10% supplement is provided to eligible individuals and families residing in small and rural communities in recognition of their increased energy needs and reduced access to cleaner transportation options. The rural supplement will apply as follows in the Atlantic provinces:

- In Prince Edward Island, all residents will be eligible;
- In Newfoundland and Labrador, residents living outside of the Census Metropolitan Area of St. John's will be eligible;
- In Nova Scotia, residents living outside of the Census Metropolitan Area of Halifax will be eligible; and
- In New Brunswick, residents living outside of the Census Metropolitan Areas of Fredericton, Moncton, and Saint John will be eligible.

## Consultation on Tax Filing Experiences of Sole Proprietors

In an effort to improve service to small business owners in Canada, the CRA is holding consultations to learn about the tax filing experiences of sole proprietors. The consultation activities will include virtual sessions, telephone interviews, and an in-person session in the Ottawa-Gatineau area. The sessions and interviews will take place in November 2023.

Participation is by invitation only and is limited to sole proprietors. The participant recruitment process will be managed by a third party. Participation is completely voluntary, and each participant's privacy will be respected. The CRA will share the results following the consultation.

## Mandatory Disclosure Rules (Update) and Businesses – Tax Information Newsletter Released

The CRA recently published the following:

- On October 11, the Mandatory disclosure rules — Guidance was updated once again. See www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/compliance/mandatory-disclosure-rules-overview/guidance-document.html for the latest version of the document.
- On October 19, the latest edition of Businesses – Tax Information Newsletter, Edition 2023-04 was released — the newsletter can be found here: www.canada.ca/en/revenue-agency/news/e-services/canada-revenue-electronic-mailing-lists/businesses-tax-information-newsletters/businesses-tax-information-newsletters-2023-04.html.

## Measures To Protect Canadian Consumers and Grow the Clean Economy

On October 5, the Government of Canada launched consultations to advance measures, including Budget 2023 and Budget 2022 commitments, to protect Canadian consumers by cracking down on predatory lenders faster and reviewing the legislation that regulates Canada's financial institutions, and to support Canada's clean economy. The government is also consulting Indigenous organizations and governments on exempting Indigenous Settlement Trusts from the Alternative Minimum Tax.

**Cracking Down on Predatory Lending Faster:** To protect vulnerable Canadians, the government announced in Budget 2023 that it is cracking down on predatory lending by lowering the criminal rate of interest from 47% APR to 35% APR. The government is exploring how much further the criminal rate of interest should be lowered, as well as additional revisions to the payday lending exemption. The government is seeking feedback by November 30, 2023.

**Upholding the Integrity of Canada's Financial Sector:** As announced in Budget 2022, and required by statute, the government is launching consultations on the federally regulated financial institutions ("FRFI") statutes. The government is seeking feedback by December 4, 2023, on questions including whether technological and geopolitical changes are affecting the financial sector, and whether technical changes are required to protect consumers, national security, and the safety and integrity of Canada's financial sector.

**Defending Canadian Businesses Against Foreign Tax Credit Restrictions:** As committed to in Budget 2023, the government is consulting on the possibility of introducing reciprocal treatment for Canada's Clean Electricity Investment Tax Credit and Clean Technology Investment Tax Credit in light of domestic content restrictions associated with certain tax credits introduced by some foreign countries. To ensure foreign businesses operating in Canada face the same tax treatment as Canadian businesses do abroad, the government invites comments by November 17, 2023, on questions regarding proposals to match other countries' clean economy tax credit domestic content restrictions.

**Carbon Contracts for Difference:** The government is undertaking consultations to advance its Budget 2023 commitment to engage with stakeholders on a potential broad-based approach to carbon contracts for difference. Such contracts could help make carbon pricing more predictable, thereby enabling investment decisions that build a more competitive clean economy in Canada.

**Labour Requirements for Investment Tax Credits:** The government has announced strict labour requirements for the Investment Tax Credits for Clean Technology, Clean Hydrogen, Clean Electricity, and Carbon Capture, Utilization, and Storage. To allow for additional due diligence as these tax credits are finalized, the government confirmed the effective date for the labour requirements will be the date enabling legislation for these labour requirements is first tabled.

**Exempting Indigenous Settlement Trusts from Alternative Minimum Tax:** Following the government's previous consultation on reforming the Alternative Minimum Tax ("AMT"), the government is considering exempting Indigenous settlement claim trusts to ensure they are not unintentionally affected by the AMT. Specifically, the revised AMT would not apply to trusts established to hold funds paid pursuant to a settlement agreement between the Crown and an Indigenous organization, community, or people who hold rights under section 35 of the *Constitution Act, 1982*. Canadians are invited to share their views on this proposal by October 30, 2023.

Feedback can be emailed to Consultation-Legislation@fin.gc.ca. For additional information, visit www.canada.ca/en/department-finance/news/2023/10/government-advances-measures-to-protect-canadian-consumers-and-grow-the-clean-economy.html.

## Kilometric Rates for 2023

When claiming travel costs for the medical expense tax credit, the moving expense deduction, and the northern residents deduction, taxpayers can use a simplified method to compute the amount of the claim by multiplying the total distance traveled by a per-kilometre rate. The rates for the 2023 taxation year are now available and are as follows:

| Province/Territory | Cents/km (taxes included) |
|---|---|
| Alberta | 53.0 |
| British Columbia | 56.5 |
| Manitoba | 54.5 |
| New Brunswick | 57.5 |
| Newfoundland and Labrador | 59.0 |
| Northwest Territories | 70.5 |
| Nova Scotia | 58.0 |
| Nunavut | 67.5 |
| Ontario | 59.0 |
| Prince Edward Island | 56.0 |
| Québec | 57.5 |
| Saskatchewan | 52.5 |
| Yukon | 70.5 |

## Enhanced GST Rental Rebate

On September 14, 2023, the Prime Minister announced the government will introduce legislation to enhance the GST Rental Rebate on new purpose-built rental housing to incentivize construction of homes built specifically for long-term rental accommodation, such as apartment buildings, student housing, and senior residences. On September 21, Bill C-56, *An Act to amend the Excise Tax Act and the Competition Act*, received First Reading in the House of Commons. Bill C-56 introduces amendments to the *Excise Tax Act* to implement the enhancement to the GST Rental Rebate.[1]

This enhancement increases the GST Rental Rebate from 36% to 100% and removes the existing GST Rental Rebate phase-out thresholds for purpose-built rental housing projects. Subject to the passage of Bill C-56, the enhanced GST Rental Rebate will apply to projects that begin construction on or after September 14, 2023, and on or before December 31, 2030, and complete construction by December 31, 2035.

Qualifying new residential units would be those that qualify for the existing GST Rental Rebate and are in buildings with at least:

- four private apartment units (i.e., a unit with a private kitchen, bathroom, and living areas), or at least 10 private rooms or suites (e.g., a 10-unit residence for students, seniors, or people with disabilities); and,
- 90% of residential units designated for long-term rental.

Projects that convert existing non-residential real estate, such as an office building, into a residential complex would be eligible for the enhanced GST Rental Rebate if all other above conditions are met. Public service bodies would also be eligible to access the enhanced GST Rental Rebate.

The enhanced GST Rental Rebate will not apply to individually-owned condominium units, single-unit housing, duplexes, triplexes, housing co-ops, and owned houses situated on leased land and sites in residential trailer parks, but this housing would continue to qualify for the existing GST Rental Rebate where the conditions for the existing rebate are met.

To protect renters from "renovictions", the enhanced GST Rental Rebate will not apply to substantial renovations of existing residential complexes. This is intended to stimulate new supply, not take supply off the market.

[1] To see the Bill, visit www.parl.ca/DocumentViewer/en/44-1/bill/C-56/first-reading.

## Controlling Rising Grocery Prices

On September 14, 2023, the Prime Minister called for major grocery store chains to stabilize grocery prices in the near term. In recent years, the cost of groceries has risen drastically. To address this, the leaders of the largest grocery chains in Canada were called to an immediate meeting in Ottawa to begin discussions toward this goal. The Prime Minister did not rule out the use of tax measures to restore the grocery price stability.

Bill C-56, *An Act to amend the Excise Tax Act and the Competition Act*, which received First Reading on September 21, 2023, proposes to amend the *Competition Act* to enhance competition, particularly in the grocery sector. The proposed amendments will:

- give more power to the Competition Bureau to investigate when industries are behaving unfairly, for example where price fixing or price gouging is occurring, and take enforcement action;
- remove the efficiencies defence to end anti-competitive mergers that raise prices and limit choices for Canadian consumers; and
- empower the Bureau to block collaborations that stifle competition and consumer choice, particularly in situations where large grocers prevent smaller competitors from establishing operations nearby.

## Law Societies Challenge Amendments to *Income Tax Act*[1]

The Federation of Law Societies of Canada has commenced an action in the BC Supreme Court challenging the constitutionality of recent amendments to the *Income Tax Act* implemented by Bill C-47, *An Act to implement certain provisions of the budget*. These amendments require legal counsel to disclose confidential client information to the CRA. The Federation alleges this infringes sections 7 (life, liberty, and security of the person) and 8 (search and seizure) of the *Canadian Charter of Rights and Freedoms* and principles of fundamental justice.

The government has agreed to a 30-day injunction suspending application of the disputed provisions to members of the legal profession, pending a hearing on the Federation's injunction.

## Government Extends CEBA Deadlines

On September 14, 2023, the Prime Minister announced extended deadlines for Canada Emergency Business Account ("CEBA") loan repayments, providing an additional year for term loan repayment, and additional flexibilities for loan holders looking to benefit from partial loan forgiveness of up to 33%.

The CEBA program provided interest-free, partially forgivable loans of up to $60,000 to small businesses and not-for-profit organizations to help cover operating costs during the pandemic.

The repayment deadline for CEBA loans to qualify for partial loan forgiveness of up to 33% is being extended from December 31, 2023, to January 18, 2024. This builds on the previous one-year extension announced in January 2022. For CEBA loan holders who make a refinancing application with the financial institution that provided their CEBA loan by January 18, 2024, the repayment deadline to qualify for partial loan forgiveness now includes a refinancing extension until March 28, 2024.

As of January 19, 2024, outstanding loans, including those that are captured by the refinancing extension, will convert to three-year term loans, subject to interest of 5% per annum, with the term loan repayment date extended by an additional year from December 31, 2025, to December 31, 2026.

Repayment on or before the new deadline of January 18, 2024 (or March 28, 2024, if a refinancing application is submitted prior to January 18, 2024, at the financial institution that provided the CEBA loan), will result in loan forgiveness of $10,000 for a $40,000 loan and $20,000 for a $60,000 loan.

The above changes also apply to CEBA-equivalent lending through the Regional Relief and Recovery Fund.

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[1] Dino, Angelica. "Federation of Law Societies challenges mandatory reporting obligations under the *Income Tax Act*", *Canadian Lawyer*, September 15, 2023.

## 2024 Employment Insurance Premium Rate Confirmed

On September 14, 2023, the Canada Employment Insurance Commission made available the Actuarial Report and its summary for the 2024 Employment Insurance ("EI") premium rate. The rate is set at $1.66 per $100 of insurable earnings for employees and $2.32 for employers who pay 1.4 times the employee rate. This represents an increase from the 2023 EI premium rate of $1.63 for employees and $2.28 for employers.

The cumulative deficit in the EI Operating Account is forecast to be $18.8 billion on December 31, 2024. The seven-year forecast break-even premium rate of $1.66 per $100 of insurable earnings in 2024 brings the EI Operating Account to a near cumulative balance by 2030.

The premium rate in 2024 for residents of Québec covered under the Québec Parental Insurance Plan will be $1.32 per $100 of insurable earnings, while their employers will pay $1.85 per $100 of insurable earnings. The maximum annual contribution for a worker in Québec will increase by $53.19 to $834.24 (up $74.47 for employers to $1,167.94 per employee).

The Commission also announced that the maximum insurable earnings for 2024 will increase to $63,200 from $61,500 in 2023. The maximum annual EI contribution for a worker will increase by $46.67 to $1,049.12 (up $65.34 for employers to $1,468.77 per employee).

## CRA Reaches Tentative Agreement With the PIPSC-AFS Group

On September 16, 2023, the CRA and the Professional Institute of the Public Service of Canada for the Audit, Financial and Scientific Group ("PIPSC-AFS Group") reached a tentative agreement for approximately 16,000 CRA employees. The PIPSC-AFS Group will provide more information on the tentative agreement and ratification process, as well as prepare a ratification package for PIPSC-AFS Group members.

## STEP Canada Tax Technical Committee Submission Re: Alternative Minimum Tax

The Society of Trust and Estate Practitioners ("STEP") (Canada) sent a submission to Finance Canada on September 8, 2023, in response to legislative proposals pertaining to the alternative minimum tax ("AMT") released on August 4, 2023, and the accompanying explanatory notes. To review the submission, visit step.ca/downloads/marketing/eNews/TTC_2023-09-08_Submission_on_AMT_FINAL.pdf.

# 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.

## *Fiera Foods Company v. The King*, 2023 GTC 18 (Tax Court Of Canada) — Appellant Entitled To Claim ITCs

### Background

Fiera Foods Company ("Fiera") operates a food manufacturing business. Over the course of 37 monthly reporting periods, Fiera claimed input tax credits ("ITCs") in respect of harmonized sales tax ("HST") paid by Fiera to several temporary worker agencies.

The Minister reassessed Fiera, disallowing its ITCs on the basis that Fiera failed to establish that the agencies supplied Fiera with temporary workers and collect the information required by subsection 169(4) of the *Excise Tax Act* (the "ETA"). More specifically, the Minister's position was that the agencies could not have provided temporary workers to Fiera because the agencies did not have the employees or the resources to perform that function. Fiera appealed to the Tax Court of Canada (the "Court").

### Issue and Decision

The Court had to decide whether Fiera was entitled to ITCs under subsection 169(1)of the ETA, and if so, whether Fiera was precluded from claiming the ITCs because of paragraph 169(4)(*a*) and the *Information Regulations*.

## Conclusion

To address the issues at hand, the Court was required to employ accepted rules of statutory interpretation as they apply to subsection 169(1), paragraph 169(4)(*a*), and the *Information Regulations*. The Court ultimately found that the agencies provided a supply to Fiera that comprised soliciting and directing temporary workers to Fiera and paying those temporary workers for their services (albeit in cash). The supply was provided by each agency in the course of an "undertaking of any kind whatever" and, therefore, was a taxable supply. Consequently, Fiera was required to pay HST to the agencies.

The Court identified four notable aspects to subsection 169(1) that were relevant to its analysis:

1. That tax in respect of a supply be "payable" by the person that acquired the supply;
2. That tax is payable under any of Division II, Division III, Division IV, and Division IV.1 of the ETA;
3. In order to be eligible to claim an ITC, a person must be a registrant; and
4. That tax is not required to be payable by the recipient to a particular person (subsection 169(1) simply requires that the tax in respect of a supply be payable by the person).

The Court ultimately found that the requirements of subsection 169(1) of the ETA were satisfied by Fiera and it was entitled to claim ITCs with respect to all HST paid to the agencies.

With respect to the issue of whether the agencies could have performed their stated function, the Court noted that the failure of the agencies to treat the temporary workers as employees (and to comply with the requirements of applicable legislation) does not alter the facts that a service was provided by the agencies to Fiera and that Fiera paid the agencies for that service, plus HST.

However, to claim the ITCs, Fiera must have also satisfied the information requirements in paragraph 169(4)(*a*) and the *Information Regulations*. The Court noted that there is no requirement under these provisions regarding the form in which information (including prescribed information) must be contained. Rather, the focus of the provisions is the adequacy of evidence. With respect to its claims for ITCs, the Court ultimately found that Fiera satisfied the requirements of paragraph 169(4)(*a*) and *Information Regulations* and therefore could claim ITCs.

— *Keaton Buchberger*

# *ExxonMobil Canada v. The King*, 2023 DTC 1086 (Tax Court of Canada) — Taxpayers Must Disclose Sufficient Information About Communications to Support a Claim for Solicitor-Client Privilege

This case dealt with the question of what information a taxpayer must disclose to support its claim for solicitor-client privilege and whether the Crown must rely on a taxpayer's word that a document is privileged.

## Background

Solicitor-client privilege is a principle of fundamental justice. It is central to the proper functioning of the legal system, as it allows clients to communicate candidly and in confidence with their lawyers knowing that these communications are protected from disclosure.[1]

Solicitor-client privilege applies to communications:

1. Between a client and a solicitor,
2. Made during the course of seeking or giving of legal advice, and
3. Which are intended to be confidential by the client and the solicitor.[2]

[1] *Solosky v. The Queen*, [1980] 1 SCR 821; *Descôteaux et al. v. Mierzwinski*, [1982] 1 SCR 860; *Lavallee, Rackel & Heintz v. Canada (Attorney General)*, 2002 SCC 61; *Canada (Privacy Commissioner) v. Blood Tribe Department of Health*, 2008 SCC 44.

[2] *Solosky*, *supra* note 1.

Privilege belongs to the client, not to the lawyer, and the decision to claim privilege must be that of the client, not of the lawyer, regardless of the lawyer's view about the validity of the potential claim.[3]

In this case, the taxpayer refused to produce a redacted copy of a letter from a law firm on the basis of solicitor-client privilege. The letter was identified to be "the legal opinion of Fraser Milner Casgrain LLP dated March 5, 2001 reflecting advice provided to the parties of the Alaska Gas Pipeline Project Agreement dated December 5, 2000."

The Crown brought a motion seeking a redacted version of the first page of the letter that showed the law firm's letterhead, the date of the letter, and the name(s) and address(es) so that the client could be identified. The Crown also sought an explanation of the solicitor-client privilege claim.

The taxpayer opposed the motion on the basis that the respondent should accept the taxpayer's word that the letter's addressee was the North American Natural Gas Pipeline Group ("NANGPG"). The taxpayer advised that NANGPG was comprised of Exxon Mobil Corporation (the parent of the taxpayer), BP Exploration (Alaska) Inc., and Phillips Alaska Inc.

### Issues and Decision

The main issue was whether the Crown was entitled to receive a redacted copy of the letter or it had to rely on the taxpayer's word.

The Tax Court Judge concluded that it was "basic professional practice that a document be produced to an opposing party (redacted if/as required), rather than that the opposing party be obliged to accept counsel's word as to the content of the document in lieu of its production". Accordingly, the Judge ordered that the taxpayer was required to produce a redacted copy of the first page of the letter showing the following:

(a) the law firm letterhead;

(b) the date of the letter; and

(c) name(s) and address(es) of the letter's addressee(s).

The Judge also ordered the taxpayer to provide the letter's "re" line (or comparable heading line) to provide a basic description of the substantive content of the letter. The taxpayer was also ordered to pay costs.

### Conclusion

This case sets out that a taxpayer cannot insist the Crown accept its assertion that a document is privileged. The taxpayer must provide a redacted copy of the document over which privilege is being claimed. The redacted copy of the document must contain sufficient information to support the claim over privilege. This will generally include information identifying the author, the recipient, the date of the communication, and the subject matter of communication. If a taxpayer refuses to provide this information, the Crown may bring a motion compelling the taxpayer to provide a redacted copy of the document and costs will likely be awarded against the taxpayer.

— *Gergely Hegedus*

## *Vefghi Holding Corp. v. R.*, 2023 DTC 1081 (Tax Court of Canada) — When Determining Whether Corporations Are Connected, Intervening Trusts Can Cause a Timing Trap

### Background

This case was two jointly heard applications to the Tax Court of Canada regarding a question under Rule 58 of the *Tax Court of Canada Rules (General Procedure)*, (SOR/90-668a). Both applications had similar facts except for a difference in timing that ultimately resulted in differing outcomes for the appellants.

Generally speaking, in each case the appellant was the recipient of a taxable dividend as corporate beneficiary of a trust that had initially received the taxable dividend from an operating corporation. Immediately after the taxable

[3] *Lavallee*, *supra* note 1.

dividend was paid by the operating corporation, the shares of the operating corporation were disposed of to an arm's length buyer.

In the Vefghi Holdings Corp. ("Vefghi") application, the taxable dividend was received by the trust on July 1, 2015. Both Vefghi and the trust had their taxation year-ends on December 31.

In the S.O.N.S. Environmental Ltd. ("SONS") application, the taxable dividend was received by the trust on June 30, 2015. SONS had its taxation year-end on August 31 while the trust had its taxation year-end on December 31.

The appellants took the position that Part IV tax was not payable because the corporate beneficiary in each case was connected (under subsection 186(4) of the *Income Tax Act* ("ITA")) to the operating corporation when the taxable dividends were received by the corporate beneficiary.

The respondent took the position that the time for determining connectedness for a taxable dividend designated by a trust is at the taxation year-end of the trust.

## Issue and Decision

For the purpose of determining whether two corporations are connected, a corporate beneficiary that is designated to receive a taxable dividend pursuant to subsection 104(19) of the ITA will have received that taxable dividend on the same date it was factually received by the trust, provided that it is deemed by subsection 104(19) to be received by the corporate beneficiary in its taxation year in which the trust's taxation year ends.

However, if the taxation year that the corporate beneficiary is deemed under subsection 104(19) of the ITA to receive the taxable dividend is subsequent to its taxation year in which the taxable dividend was factually received by the trust, then it is received by the corporate beneficiary in that subsequent taxation year for the purpose of determining connectedness.

The wording of subsection 104(19) of the ITA does not specifically state when a taxable dividend is received by a beneficiary. The legislation refers to two periods of time:

1. The particular taxation year of the trust in which the trust receives the taxable dividend; and
2. The taxation year of the taxpayer in which the particular taxation year of the trust ends.

The taxpayer is deemed to receive the taxable dividend in its taxation year in which the particular taxation year of the trust ends.

This was not a problem for Vefghi because the corporation and the trust had the same taxation year-end.

In SONS, the taxable dividend was received by the trust in SONS' taxation year ending August 31, 2015.

Subsection 104(19) of the ITA deemed SONS to receive the taxable dividend in its taxation year ending August 31, 2016, because this was the taxation year of the corporation in which the trust's taxation year ended. In other words, SONS taxation year ending August 31, 2016, included the December 31, 2015, trust year-end; therefore, the taxable dividend could not be deemed to have been received in SONS' taxation year ending August 31, 2015.

Given this reasoning, the result is that Vefghi was connected with its payor operating corporation while SONS was not connected with its payor operating corporation for purposes of Part IV tax.

## Conclusion

This case illustrates the timing problems that can arise when complex provisions of the ITA interact with each other. Tax planners will have to be especially aware of the timing of taxable dividends received by a corporate beneficiary where the trust and the beneficiary have different taxation year-ends.

— *James Konopka*

# *O'Brien v. The King*, 2023 DTC 1085 (Tax Court of Canada — Informal Procedure) — Re-Determination of Canada Child Benefit Entitlement Amount Is Invalid if Literal Interpretation Creates Absurd or Illogical Results

## Background

Ms. O'Brien (the "Taxpayer") was a Canada Child Benefit ("CCB") recipient. After her spouse's death in January 2020, her CCB entitlement amount was reduced by a re-determination by the Minister of National Revenue (the "Minister") under subsection 122.62(5) of the *Income Tax Act* (the "ITA"). Subsection 122.62(5) of the ITA requires an individual receiving the CCB to notify the CRA about the death of a cohabiting spouse. It also allows the CRA to re-determine the CCB eligibility amount. The Taxpayer's re-determination was based on her 2018 income, which included her spouse's Ontario Disability Support Program payments (the "ODSP payments") of approximately $24,000.

Even though the ODSP payments were generated by the Taxpayer's spouse, the payments were included in the Taxpayer's income because subparagraph 56(1)(*u*)(ii) of the ITA requires social assistance payments to be reported as income by the spouse with the higher income. In this scenario, the Taxpayer was the higher-earning spouse.

The Taxpayer appealed the Minister's redetermination on the basis that the Minister should not have included the ODSP payments that she reported in her 2018 income for the purposes of re-determining her CCB entitlement under subsection 122.62(5) of the ITA. The Minister, on the other hand, took the position that subsection 122.62(5) required the Minister to consider the ODSP payments when re-determining the CCB entitlement amount.

## Issue and Tax Court Decision

The issue before the Tax Court was whether the Minister was correct to include the Taxpayer's spouse's 2018 ODSP payments of $24,000 in the Taxpayer's income for the purpose of re-determining her CCB entitlement under subsection 122.62(5) following his death in 2020.

The Court held that a key factor in determining the CCB entitlement amount is the "adjusted income" under section 122.6 which is the total income of cohabiting spouses. As a cohabiting spouse's adjusted income increases, their CCB entitlement amount decreases. When determining the adjusted income for CCB entitlement amount purposes, the specific previous year is considered as the reference point and is known as the "base taxation year." The Court held that for the CCB payment period from July 2019 to June 2020, the base taxation year was 2018.

The Court held that the death of the Taxpayer's spouse in January 2020 triggered a re-determination of the CCB entitlement amount under subsection 122.62(5). This provision deems the Taxpayer's adjusted income for the purpose of CCB entitlement re-determination to be the amount of income of the Taxpayer for the year. The Court, citing the 2011 Department of Finance's Explanatory Notes, held that the intent of subsection 122.62(5) is to exclude the income of the deceased spouse when determining the adjusted income for the base taxation year.

The Court stated that the ODSP payments in question were made to the Taxpayer's spouse and they were deemed to be the Taxpayer's income under subparagraph 56(1)(*u*)(ii) solely because the Taxpayer's total income was higher than her spouse's income in 2018. Also, it noted that the ODSP payments ceased when the Taxpayer's spouse died in January 2020. The Court cited the 1982 federal Department of Finance's Explanatory Notes which stated that the purpose of allocating one spouse's income to the other under subparagraph 56(1)(*u*)(ii) was to entitle the spouse to the then-married exemption under paragraph 109(1)(*a*) of the ITA. As such, it held that the allocation of income from the lower income earning spouse to the higher income earning spouse under subparagraph 56(1)(*u*)(ii) was not intended to affect the surviving spouse's entitlement to CCB upon the death of the lower income earning spouse who had generated the social assistance income.

The Court cited the Supreme Court of Canada case *Rizzo & Rizzo Shoes Ltd. (Re 1998)* ([1998] 1 S.C.R. 27), which stated that if a literal interpretation produces illogical or absurd results, it must be set aside. The Court held that illogical and absurd results did arise in this case due to the literal interpretation of the word "income" under subsection 122.62(5) of the ITA. This interpretation included the Taxpayer's 2018 assessed income without excluding the ODSP payments that her decreased spouse generated. The Court stated that the aspect of allotting income to a higher income earning spouse under subparagraph 56(1)(*u*)(ii) unintentionally creates a "profoundly detrimental affect

upon subsection 122.62(5), frustrating both purpose and proper application of that provision". In other words, the Court held that this absurd result deprived the Taxpayer for the purpose of re-determining her appropriate CCB entitlement amount.

### Conclusion

The Court allowed the Taxpayer's appeal. It ordered that the appealed re-determinations be re-determined by calculating the taxpayer's "income" under subsection 122.62(5) by excluding all the ODSP payments that were generated by her deceased spouse but allotted to her.

— *Shinjin Kang*

## *Canada (Attorney General) v. 18335989 Alberta Ltd. (Whitecap Energy Inc.)*, 2023-PTC-AB-2 (Alberta Court of King's Bench) — The Alberta Court of King's Bench May Designate the Attorney General of Canada as an Interested Party Under Paragraph 206.1(*d*) In Order To Revive a Dissolved Corporation for the Purpose of Issuing a Notice of Assessment

### Background

18335989 Alberta Ltd., formerly known as Whitecap Energy Inc. (the "Taxpayer"), was audited by the CRA in its 2013 and 2014 taxation years. The audit verified allowable capital losses and they were claimed by the Taxpayer in its 2017 and 2018 taxation years. The Taxpayer was dissolved in 2020, and all the assets remaining in the Taxpayer were transferred to its sole shareholder, Whitecap Resources Inc.

The CRA audited the Taxpayer's claim of the capital losses for the 2017 and 2018 taxation years. Subsequently, the Attorney General of Canada (the "Attorney General") sought to revive the Taxpayer under section 210 of the *Alberta Business Corporations Act* (the "ABCA") in order to allow the CRA to issue a Notice of Assessment to the Taxpayer. Section 210 of the ABCA allows any "interested person" to apply to the Court within 10 years after the date of dissolution for an order reviving a dissolved corporation. Paragraphs 206.1(*a*) and (*d*) of the ABCA state that an "interested person" in Part 17 includes a creditor of a dissolved corporation and a person designated as an interested person by an order of the Court. The Taxpayer objected to the proposed revival on the basis that the Attorney General did not qualify as an "interested person" under section 210 of the ABCA and lacked standing to revive the Taxpayer under the ABCA.

### Issues And Alberta Court of King's Bench Decision

There were four issues before the Alberta Court of King's Bench:

(1) Is the Attorney General an "interested person" within the meaning of paragraph 206.1(*a*) of the ABCA?

(2) Is the Attorney General appropriately designated by the Court as an "interested person" under paragraph 206.1(*d*) of the ABCA?

(3) Can the Court grant relief based on a subsection of the ABCA that was not pleaded?

(4) If the Court were to allow the revival, would the Court be acting without purpose?

Regarding the first issue, the Court held that the Attorney General was not a creditor under paragraph 206.1(*a*) of the ABCA because no Notice of Assessment had been issued. The Court noted that tax liability doesn't become debt until taxes are assessed and a Notice of Assessment is issued. As such, it found that the Attorney General was not an "interested person" because the Attorney General wasn't a creditor within the plain meaning of paragraph 206.1(*a*).

With respect to the second issue, the Court stated that the Court's power to designate a person as an interested person under paragraph 206.1(*d*) of the ABCA is discretionary and that the discretion must be exercised judicially and for no improper purpose. The Court found that the Attorney General had a valid interest in the revival of the Taxpayer, which was to convert tax liability into debt. It held that this goal could not be accomplished unless the revival was

granted. As such, the Court found that designating the Attorney General as an "interested person" under paragraph 206.1(*d*) of the ABCA would be appropriate.

Regarding the third issue, the Taxpayer objected to the relief being granted under paragraph 206.1(*d*) of the ABCA because the pleading only named paragraph 206.1(*a*) as the basis. The Court observed that Rule 13.6(3)(*r*) under the Alberta *Rules of Court* requires a party to state the provisions of an enactment that may take another party by surprise. However, the Court stated that while some statutes are required to be pleaded, this case did not demand such specific pleading. Since the facts in the pleading supported the relief claimed, the key question was whether 18335898 Alberta Ltd. was taken by surprise.

The Court noted that during the hearing, the Attorney General's status as an interested party under both paragraphs 206.1(*a*) and (*d*) were discussed. Further, the hearing was adjourned for additional submissions on paragraph 206.1(*d*)'s applicability. The Court thus found that there was no element of surprise or unfairness. As such, the Court held that in the absence of a requirement to plead a specific enactment, relief that aligns with the pleaded facts should be accessible, even if an incorrect statute was pleaded initially.

Finally, addressing the fourth issue, the Court held that permitting the revival would not be without purpose. It found that if the Taxpayer was revived, the recourse for the Attorney General would be against the former sole shareholder, Whitecap Energy Inc. It found that if the Attorney General were to pursue Whitecap Energy Inc., it would likely have to proceed under section 160 of the federal *Income Tax Act*, and not under section 227 of the ABCA, and the Tax Court would be the appropriate venue. Therefore, it held that reviving the Taxpayer would be done "not without purpose".

## Conclusion

The Court designated the Attorney General as an interested person under paragraph 206.1(*d*) of the ABCA and allowed the application to revive the Taxpayer.

It will be interesting to see how this case might be considered in the event that the Minister seeks to revive a corporation under other Canadian corporate statutes, as the mechanisms for revival and the discretion afforded to the Courts to grant standing differ considerably.

Both the BC and Saskatchewan Business Corporations Acts provide similar discretion for the Court to designate a person as an interested person for corporate revival purposes. For example, the BC *Business Corporations Act* provides that an application for full restoration of a BC corporation must be made by a "related person", and that a related person includes a person that is ordered by the court to be an "appropriate person". Similarly, section 16-2 of the Saskatchewan *Business Corporations Act* provides that "interested persons" may apply to the Registrar of Corporations to have a dissolved corporation revived, and that "interested persons" includes a person designated as an interested person by order of the Court.

However, the federal and other provincial Business Corporations Acts do not expressly provide for such discretion. For example, subsection 241(9) of the Ontario *Business Corporations Act* provides that the Director may, on the application of an "interested person", revive a dissolved corporation. Subsection 241(9.1) defines "interested person" inclusively as including the directors, officers, and shareholders of the corporation, but it does not provide the discretion for the Court to determine who may otherwise be an interested person. The federal *Canada Business Corporations Act* and the Prince Edward Island *Business Corporations Act* similarly provide inclusive definitions of an "interested person" but do not expressly provide the Courts with discretionary power to otherwise designate an interested person.

Moreover, the Québec *Business Corporations Act*, the Manitoba *Corporations Act*, the *Newfoundland Corporations Act*, the New Brunswick *Business Corporations Act*, the Nova Scotia *Companies Act*, the Yukon *Business Corporations Act*, the Northwest Territories *Business Corporations Act*, and the Nunavut *Business Corporations Act* do not contain the concept of an interested person (or similar person) nor provide the discretion for the court to designate an interested person for the purposes of revival of a corporation.

— *Shinjin Kang*

# *Gaudreau v. The King*, 2023 DTC 1072 (Tax Court of Canada) — No Privilege at Discovery for Tax Memorandums from Accountants

## Background

The Appellant was one of a group of shareholders of an insurance company who sold their interest in the company by way of a hybrid asset and share sale. The Minister reassessed the transaction and applied subsection 84(2) of the *Income Tax Act* (the "ITA") to deem the taxable capital gain reported on the sale of the shares as a taxable dividend, thereby denying the Appellant his claimed lifetime capital gains deduction.

During the examination for discovery, the Appellant revealed the existence of a memorandum prepared by one of the accounting advisory firms for the purchaser, advising the purchaser regarding the tax consequences and risks of the hybrid sale. The Minister requested its production under Rule 95(1) of the *Tax Court of Canada Rules (General Procedure)* (the "Rules"), which states:

> 95(1) A person examined for discovery shall answer, to the best of that person's knowledge, information and belief, any proper question relevant to any matter in issue in the proceeding. . . [emphasis added]

While the Appellant admitted that the memorandum was not subject to solicitor-client privilege, he objected to the relevance of its production on the grounds that it would not provide the Minister with any facts that he did not already have, and that any subjective opinions expressed in the memorandum were akin to the uncertain tax position papers that were held by the Federal Court of Appeal in *BP Canada Energy* (2017 DTC 5028 (FCA)) ("*BP Energy*") to not be subject to production under subsection 231.1(1) of the ITA.

The Appellant submitted a copy of the memorandum to the Court under seal with an affidavit attesting that the memorandum was six pages in length, five of which described the transaction steps as already known to the Minister and one of which contained legal opinions regarding the application of the law, and that the memorandum nowhere considered or addressed subsection 84(2) of the ITA.

## Issue and Tax Court Decision

The Court considered the following two issues in its decision:

> (1) Sealing: Can the Court review the memorandum under seal in order to assess whether the Appellant must produce it to the Minister without the Minister also being able to review it for the purposes of its motion to produce?
>
> (2) Production: Has the Minister established the required relevance for the purposes of the discovery, thus justifying an order directing the Appellant to provide him with a copy of the Memorandum?

On the question of sealing, the Minister argued that to not allow the Minister access to the document to assess its relevance would be a denial of the *audi alteram partem* principle: the Minister's right to know the evidence invoked against her and to contradict it. The Appellant argued that it was already common practice for the Court to assess the sealed document alone, as disclosure to enable the Minister to assess its relevance would render the very objection being considered meaningless.

The Court agreed with the Appellant that if it were to allow the Minster to review the memorandum to assess and argue for its relevance, were the Court to then decide against its production, the Appellant would be harmed as the Minister's representatives would not be able to then erase its contents from their memory. The Court further cited several cases where the Court had reviewed a sealed document to determine the relevance of its production without controversy. However, it noted that whereas in each of these cases the parties had agreed to this approach, in this case the Minister had objected to this approach. Accordingly, the Court decided to follow the approach taken in *Canada v. Atlas Tube Canada ULC* (2018 DTC 5124 (FC)), and make a determination on the issue of production of the memorandum based solely on its review of the Appellant's affidavit attesting to its contents.

On this second question of production, the Appellant argued that the issue at trial was limited to whether subsection 84(2) of the ITA applied to the sale of the shares, and as the memorandum made no mention of subsection 84(2) nor discussed the other provisions of the ITA relied on by the Minister, it was irrelevant. Relying on *BP Energy*, the Appellant argued that the Minister is not entitled to use discovery to conduct a blind search, and that accountants must have the

ability to advise taxpayers of tax risks without the risk of disclosure to the tax authorities discouraging the preparation and communication of their analysis. The Minister argued simply that the question of relevance must be interpreted broadly, and that the memorandum was relevant as it was prepared in the context of the sale and thus had the potential to prove useful in identifying the reasons underlying each of the transactions in question.

The Court cited *Canada v. Lehigh Cement Corporation* (2011 FCA 68) and *Baxter v. R.* (2004 DTC 3497 (TCC)) as providing exemplary summaries of the principle that the question of relevance in discovery under subsection 95(1) of the *Tax Court of Canada Rules (General Procedure)* must be considered broadly and great latitude must be allowed. The Court cited *MP Western Properties Inc.*, (2017 DTC 1047 (TCC)), confirmed by the Federal Court of Appeal (2019 DTC 5012), for the following principles:

Principles supporting relevance of production:

- Relevancy on discovery ought to be "broadly and liberally construed and wide latitude should be given".
- Relevancy at discovery is a lower threshold than that at trial. This is exemplified by Rule 90 which expressly provides that the production of a document at discovery is not an admission of its relevance or admissibility.
- All documents relied on or reviewed by the Minister in making her assessment must be disclosed to the taxpayer.
- Documents that lead to an assessment are relevant.
- Documents in CRA files on a taxpayer are *prima facie* relevant, and a request for those documents is itself not a broad or vague request.
- The examining party is entitled to have any information, and production of any documents, that may fairly lead to a train of inquiry that may directly or indirectly advance their case, or damage that of the opposing party.

Principles supporting irrelevance and no production:

- An indiscriminate request for the production of documents in the hope of uncovering helpful information or the hope of it leading to a train of inquiry is not permitted.
- Earlier drafts of a final position paper do not have to be disclosed, and the mental process of the Minister or their officials in raising the assessments is not relevant.
- A party is entitled to know the position of the other party with respect to an issue of law, but is not entitled to have access to either the legal research or the reasoning by which that position is arrived at.
- Even where relevance is established, the Court has a residual discretion to disallow the production of documents, which discretion requires a weighing of the potential value of the answer against the risk that a party is abusing the discovery process such as where responding to a request would place undue hardship on the answering party, where there are other means of obtaining the information sought, or where "the question forms part of a 'fishing expedition' of vague and far-reaching scope".

The Court looked to the recent Federal Court of Appeal case *Foix v. Canada* (2023 DTC 5013) which upheld the Minister's application of subsection 84(2) to a hybrid sale transaction, noting that the Court in that case examined the intentions of the parties and circumstances surrounding the transactions in reaching its verdict.

The Court then noted that a letter of intent between the vendors (including the Appellant) and purchaser contained a clause providing that "The Buyer and Sellers undertake to work together to optimize the tax situation of the parties involved in this transaction. More specifically, the parties undertake to evaluate the merits of a "hybrid" transaction." This clause appears instrumental in the Court finding that a memorandum prepared for the Purchaser was thus relevant to the application of subsection 84(2), in this case:

> The respondent submits that the principles applicable to the interpretation and application of subsection 84(2) of the Act include, in particular, the need to examine what gave rise to the liquidation as well as the circumstances surrounding the transactions to determine whether funds were distributed or otherwise allocated in "any manner". [para 50, unofficial translation from French judgment]

The Court further concluded that the principles set out in *BP Energy*, which dealt with the exercise of the Minister's discretionary power under section 231.1of the ITA in the context of an audit, were not relevant to the question of relevance under Rule 95. It also rejected the Appellant's argument that the Minister might rely on the memorandum to amend their Response to the Notice of Appeal, noting that the Minister could only do so with the consent of the Appellant as the pleadings had closed.

In response to the Appellant's otherwise compelling argument that an order for production in cases such as this would impair the ability of accountants to advise their clients on tax risks, the Court noted matter-of-factly that there is simply no such thing as accountant-client privilege and as such the argument had no legal basis.

The Court concluded that the memorandum was relevant to the Minister's case that subsection 84(2) applied to the sale in this case, and was thus required to be produced under Rule 95.

### Conclusion

This decision stands in stark contrast to the Court's decision in *632738 Alberta Ltd. v. The King* (2023 DTC 1070), summarized below. Whereas in *632738* the Court stated that:

> . . . solicitor-client privilege is an essential element of our legal system and . . . is close to absolute. The privilege protects all communications, whether written or oral, between a solicitor and a client that are directly related to the seeking, formulating or giving of legal advice, which includes advice as to what should be done in a particular legal context. To the extent that legal advice addresses what could be done, internal documents in respect of that advice, including the development of strategy, the assessment of risk or the consideration of obligations, might be protected by the privilege. (para 60)

In *632738* the Court went so far as to uphold the Appellant's right to claim solicitor-client privilege over communications of its CFO where they may be based on advice received from legal counsel. In contrast, in this case the Court refused to uphold claims of privilege over a memorandum from its accountants which ostensibly served the same purpose to the Appellant it would have coming from legal counsel. As the law stands, legal privilege is near absolute; accounting privilege does not exist.

— *Ron Dueck*

## *632738 Alberta Ltd. v. The King*, 2023 DTC 1070 (Tax Court of Canada) — Near Absolute Privilege at Discovery for Tax Communications from Legal Counsel, Even in Context of Purpose Test Assessment

### Background

The Appellant and its wholly-owned subsidiary ("Subco") were equal partners in a general partnership (the "Partnership"). The Appellant and Subco each had a capital account balance in the Partnership of $15. In connection with a broader series of transactions (the "Transactions"), on February 24, 2011, the Appellant sold its interest in the Partnership to a recently formed limited partnership ("New LP") of which it was the general partner. On the same date, New LP made a $150,000 capital contribution to the Partnership with the result that its capital account balance in the Partnership was $150,015 and Subco's remained $15 — representing a respective 99.99% and 0.01% capital account balance. On February 25, 2011, the Partnership received a payment of $78 million for future services, which it recognized in income for its taxation year ended February 28, 2011. The Partnership allocated $77,992,201 of this income to New LP and $7,799 to Subco — representing a respective 99.99% and 0.01% allocation of income corresponding to their relative capital accounts.

The Minister reassessed the Appellant to include in its taxable income $77,892,210 of the income recognized by the Partnership under subsection 103(1) of the *Income Tax Act* (the "ITA") on the assumption that there were no commercial or non-tax purposes of the Transactions such that the Partnership's allocation of income was made for "the principal reason" of reducing or postponing tax that would otherwise have been payable. The Appellant objected to and then appealed the assessment.

During the examination for discovery on appeal, the sole shareholder, director, and officer of the Appellant ("Mr. T") refused to answer, or in the Minister's opinion inadequately answered, various questions relating to the reasons why the Transactions were entered into, including:

- 28 questions regarding the Appellant's purposes and reasons why the various steps in the Transactions were undertaken, and why various clauses and provisions were used in the legal documentation (the "Transaction Intention Questions"). The Appellant refused to answer these questions on the grounds that the reasons for the Transactions and the contractual terms and drafting were either informed by legal advice or constituted advice from a lawyer, such that those reasons are subject to solicitor-client privilege.
- three questions regarding why the Appellant signed a waiver in respect of the reassessments, why it added certain parties to the waiver, and why it requested changes to certain wording in the proposed waiver (the "Waiver Intention Questions"). The Appellant refused to answer these questions on the grounds that the reasons for signing the waiver and drafting its contents either were informed by legal advice or constituted advice from a lawyer, such that those reasons are subject to solicitor-client privilege.
- two questions regarding the intended operation of certain contractual provisions in the Transaction documentation (the "Contractual-Operation Questions"). The Appellant refused to answer these questions on the grounds that they called for contractual interpretation.
- four questions regarding various factual circumstances such as whether the Appellant had a bank account during certain periods, why certain payments had been made in tranches, and whether due diligence had been conducted on certain entities (the "Factual Questions"). The Appellant refused to answer these questions on the grounds that they were not relevant.

Mr. T further refused to produce documentation relevant to certain undertakings they had made in the course of the discovery, including:

- Documentation received from the chief financial officer of the various entities in the related group of companies in connection with the Series of Transactions over which solicitor-client privilege was not being claimed, together with a list of such documents received over which privilege was being claimed (the "CFO Document Undertaking"). The Appellant refused to provide any such documents on the grounds that any advice that the CFO may have given to Mr. T might have been based on privileged information obtained from counsel, and provided no list of documents over which privilege was claimed.
- Correspondence between the various entities involved in the Series of Transactions relating to certain steps over which solicitor-client privilege was not being claimed, together with a list of such correspondence over which privilege was being claimed (the "Party Correspondence Undertaking"). The Appellant refused to provide any such documents on the grounds that all such documents were subject to common-interest privilege, and provided no list of documents over which privilege was claimed.

As in the above case *Gaudreau*, the Minister brought a motion for an order directing the Appellant to cause its officer to respond to the disputed questions and produce the documents subject to the disputed undertakings under 95(1) of the *Tax Court of Canada Rules* (the "Rules").

## Issue and Tax Court Decision

### Transaction Intention Questions and Waiver Intention Questions

The Minister argued that (1) as subsection 103(1) of the ITA requires a determination of the principal reason for the allocation of income by New LP and thus puts into issue the reason for that income allocation and the purposes or reasons for the Transactions, the Minister is thus entitled to examine the Appellant's officer in respect of those reasons and purposes, (2) the Appellant was misusing solicitor-client privilege in refusing to answer questions about the purposes of the Transactions, and (3) if solicitor-client privilege would otherwise excuse the Appellant's officer from answering questions about the Appellant's mindset, the Appellant implicitly waived that privilege by advising that its mindset was informed by the legal advice it received.

The Court began its analysis by reviewing various case law regarding whether the mindset of the directors, officers, and shareholders can be relevant to a determination of the intention of a corporation. The Court concluded that questions

which seek to explore the state of mind, reasons, purpose, intentions, and understanding of a principal shareholder, director, or officer of a corporation are relevant to a determination of the intention of the corporation itself. As in *Gaudreau*, the Court concluded that the question of relevance under Rule 95 "should be broadly and liberally construed and wide latitude should be given" bearing in mind that relevance at discovery has a lower threshold than at trial.

In considering the Appellant's claim of privilege over the information requested by the Minister in the Transaction Intention Questions and Waiver Intention Questions, the Court noted that the Minister had not focused its arguments on the question as to whether the documents and information over which privilege had been claimed were in fact privileged, and so did not address this issue (para. 81).

Rather, the Minister alleged that the Appellant had implicitly waived solicitor-client privilege over these matters by virtue of its claim that it had implemented the Transactions based on the legal advice it received which was not tax related–thereby putting its reliance on the legal advice at issue in the legal question of its mindset.

The Court looked to *CIBC v. The Queen* (2015 DTC 1235) ("CIBC") for the following principle in determining when a taxpayer can put the legal advice they received at issue in trial (para. 67):

> 58. . . . Waiver does not simply occur once a party discloses the fact it received legal advice before taking a course of action; the privilege-holder must have taken a course of action, relied on legal advice to do so and somehow placed that reliance in issue at trial. . . .
>
> 59. This must be distinguished from a party who simply receives legal advice, forms a particular legal view and then acts. This alone will not lead to implied waiver. There must be reliance on the legal advice and the party must put that reliance in issue. . . .
>
> 61. In short, there is no implied waiver without reliance. A privilege-holder's state of mind must be in issue in a way that makes any legal advice it received relevant, and the privilege-holder must place its reliance on that legal advice in issue as part of its position for trial.

The question was thus: was the Appellant's denial of the Minister's alleged intention, together with its claim that its intentions were formed at least in part by the legal advice they received, sufficient to constitute putting the legal advice in issue as part of its position in defending that it did not have a primary tax intention in entering into the transactions–and thus waive privilege?

The Court agreed that, as indicated in *Gerbro Inc. v. The Queen* (2014 DTC 1136) and *Mahjoub (Re)* (2011 FC 887), "in the context of a tax appeal, solicitor-client privilege may be impliedly waived where a taxpayer relies on legal advice as an element of its appeal." Further, the Court agreed that, as indicated in *Bank Leu AG v. Gaming Lottery Corp*. (1999) 43 CPC (4th) 73 (ONSC), ¶5; aff'd, (2000) 132 OAC 127 and quoted in *CIBC*, "this could occur where the taxpayer puts its state of mind in issue, having received legal advice to help form that state of mind."

However, the Court disagreed that merely objecting to the Minister's assertion of the Appellant's state of mind and its assumptions in regards to that state of mind, was sufficient to constitute putting its state of mind at issue. Relying on the Court's decision in *Imperial Tobacco Canada Limited v. The Queen* (2013 DTC 1103), the Court stated: "merely opposing an assessment based on a statutory provision containing an intention or purpose test does not constitute a waiver of privilege." As solicitor-client privilege can only exist where it informed a taxpayer's course of action, if claiming solicitor-client privilege over documents in respect of an assessment based on a statutory provision containing an intention or purpose test constituted putting the legal advice in issue, solicitor-client privilege would practically not exist in defending against such assessments.

Accordingly, the Court upheld the claim of privilege in respect of answering the Transaction Intention Questions and Waiver Intention Questions.

### Contractual-Operation Questions and Factual Questions

Regarding the Appellant's claim of privilege over the information in the Contractual-Operation Questions, the Minister argued that none of the disputed questions called for an interpretation of a contract or other legal conclusion, nor did they seek irrelevant information.

The Court agreed that the questions put to Mr. T did not require him to interpret the contracts, but were merely probing his state of mind as to their purpose, which is a factual matter. Accordingly, the Court ordered that Mr. T. answer the questions to the extent that they were, in fact, subject to solicitor-client privilege (a secondary defense asserted by the Appellant at the hearing). Regarding the Factual Questions, the Court found that each were properly relevant questions within Rule 95.

### CFO Document Undertaking and Party Correspondence Undertakings

Following its line of thought regarding the Transaction Intention Questions and Waiver Intention Questions, the Court agreed that the Appellant had the right to claim privilege over the documents subject to the undertakings. However, unsurprisingly, the Court found that the Appellant was required to provide a proper list of documents over which privilege was claimed. Quoting the Supreme Court of Canada in *Solosky v. The Queen* ([1980] 1 SCR 821) the Court stated: "privilege can only be claimed document by document, with each document being required to meet the criteria for the privilege . . ." More particularly, the Court looked to CIBC which had considered the question of whether CIBC's Schedule B in its List of Documents contained enough identifying information for certain privileged documents.

> That is not the specific issue in this Motion, which considers whether the Appellant has provided an adequate list of the documents over which it is claiming privilege. Nevertheless, the underlying principles in both situations have certain similarities, and the objective in both situations is to ensure that the party claiming privilege provides "a sufficient description of each record for which privilege is claimed to assist other parties in assessing the validity of the claimed privilege[, as] . . . the objective is to reduce the need for parties to seek recourse to other time-consuming and costly litigation steps, . . . so that claims can be challenged[, tested or assessed] without immediate resort to the courts." (para. 120)

Accordingly, the Court stated that the guidance in Form 82(3) in Schedule I to the Rules was useful in determining the appropriate level of detail to include in a list of documents over which privilege is asserted in regards to an undertaking. Drawing from the guidance in Form 82(3), the Court ordered the Appellant to provide the Minister with a list for each undertaking being objected to containing the following level of detail:

(a) the names of the sender and the recipient of each email (including the name of counsel where such person was legal counsel);

(b) the date of each email, or if there is a large number of emails bundled together, the range of dates covered by the bundle of emails;

(c) if there is a large number of emails, and if the Appellant prefers to continue to refer to the emails as a bundled group, the number of emails in the bundle; and

(d) for each email, the subject line or caption, provided that it is innocuous and does not disclose privileged information.

## Conclusion

This case provides useful guidance to Appellants seeking to claim solicitor-client privilege over responses to discovery questions and undertakings, the level of detail required in making such claims, and the scope of communications that the Court is prepared to consider validly subject to such claims. Perhaps more importantly though, it affirms that claiming solicitor-client privilege in the context of opposing an assessment based on a statutory provision containing an intention or purpose test does not constitute a waiver of privilege.

It's worth noting, however, that the Minister did not challenge the veracity of the Appellant's claims of privilege.

— *Ron Dueck*

# RECENT CASES

## *Res Judicata* Principle Does Not Apply to Formal Demands Presented Pursuant to S. 232.2(3) of the ITA

This case deals with the principle of "*res judicata*" (*chose jugée* in French). More precisely, the issue was whether a decision rendered concerning a formal demand to provide information and judicial review concerning a specific case would also apply to a second demand involving practically identical facts. In other words, did the Federal Court err in applying the principle of *res judicata* to section 231.2 of the *Income Tax Act*? In 2018 (2018 DTC 5082 (FC)), the Minister issued a formal demand for information to Hydro-Québec for, basically, a detailed list of its clients pursuant to subsection 231.2(3). The Federal Court rejected the demand, determining there was no identifiable group for purposes of paragraph 231.2(3)(*a*). Under subsection 231.2(3), a judge may authorize the demand if they are convinced following a declaration under oath that there exists an identifiable group and the supply of information or production of documents is required to ascertain that the members of the group respected their fiscal obligations. This first demand and evidence produced did not contain any information explaining how the commercial clients of Hydro-Québec formed an identifiable group. Therefore, the demand was rejected. The Minister filed another demand in 2019, essentially dealing with the same request, supported by more evidence, which resulted in a 2021 decision rejecting the demand on the basis that the principle of *res judicata* applied in the circumstances.

The appeal was allowed and the matter returned to Federal Court. It is this second case which is under appeal — the argument being whether the Federal Court erred in ruling the principle of *res judicata* applied, meaning the second request formally asking for information to be produced should also be denied. The Federal Court of Appeal ruled that the *res judicata* principle does not apply to authorizations or denial of authorizations rendered pursuant to subsection 231.2(3) and, accordingly, the matter should be returned to the Federal Court to determine if the second demand met the conditions of subsection 231.2(3) and, if that is the case, use its discretion to rule whether the demand to provide information should be accepted or denied.

*MNR v. Hydro-Québec*

2023 DTC 5075

## Denial of SR&ED Claim Overturned on Appeal

The appellant, a food manufacturing business specialized in developing frozen pies mainly for the Canadian and the United States markets, appealed the Notices of Reassessment disallowing scientific research and experimental development ("SR&ED") expenditures and the corresponding investment tax credits ("ITCs") for the 2013, 2014, 2015, and 2016 taxation years (the "Taxation Years") under the *Income Tax Act* (the "Act"). During the Taxation Years, the appellant had carried on various projects and activities aimed at developing new or advancing pre-existing products.

The appeal was allowed. In determining, whether the work the appellant had undertaken with respect to projects 1304, 1306, 1401, 1402, 1501, 1502, and 1602 constituted SR&ED within the meaning of subsection 248(1) of the Act, the Court observed that the evidence adduced met the criteria that this type of work must be a systematic investigation or search that is carried out in a field of science or technology by means of an experiment or analysis, and ensured that such work was undertaken for the purposes contemplated in the Act. The appellant had formulated hypotheses specifically aimed at achieving its various goals. As for the third criterion, whether the process accorded with the scientific method, the CRA's position was that the appellant had relied on a "trial and error" approach by trying various recipes to reach its targets and without attempting to explain or analyze the reason each recipe did not work. The Court disagreed, explaining that the appellant had conducted analyses in order to understand which requirement was not met and modified specific parts of the recipe in order to address the issue. In doing so, the appellant was limited by its clients' demands regarding which ingredients to use. Thus, based on the evidence, the Court allowed the appeal as the appellant had successfully established that the 2013, 2014, 2015, and 2016 SR&ED claims met all five criteria established in *Northwest Hydraulics*.

*Canafric Inc. v. The King*

2023 DTC 1069

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