Tax Topics®

December 17, 2015
Number 2284



# SOME NOTEWORTHY CASES DECIDED IN 2015

*— The Honourable Donald G.H. Bowman, Q.C., Former Chief Justice of the Tax Court of Canada, Counsel with Dentons Canada LLP*

I propose to summarize a few of the interesting or significant cases that were decided in 2015. Jurisprudentially, 2015 was a vintage year that produced a bumper crop of cases that are either interesting or important. I do not necessarily agree with the decisions in every case. In no particular order, some of the cases are:

## *Kuchta v. The Queen*, 2015 T.C.C 289

This Tax Court of Canada case was heard by Justice Gaston Jorré but decided on the transcript by Justice Graham (Can they do that?). The question was whether property left by will by a deceased spouse to his wife attracted subsection 160(1). If a husband gives property to his wife when he owes taxes, the CRA can pursue the wife to the extent that the value of the property exceeds any consideration given by the wife. Here the property was given by will to the deceased's wife.

It was argued by the wife that, at the time the transfer took place--after the death of the spouse the marriage had ended. Technically, this is a point. Also, it was arguable that the transfer could not have been made by the deceased spouse, who had moved involuntarily to a Higher Court, but by the executors. In a learned albeit lengthy judgment, Graham J. considered the various *indicia* throughout the *Income Tax Act*. They admittedly point in different directions, like the man who jumped on his horse and rode off madly in all directions. Nonetheless, Graham J. arrived, in my view, at the right commonsensical conclusion. It simply would not have made sense if a man who owes taxes gives his property to his wife before he dies, subsection 160(1) is invoked, but if he leaves it to her by will, section 160 is excluded. Occasionally the man on the Clapham omnibus comes to the rescue.

## *684761 B.C. Ltd. v. The Queen*

The next case of interest is *684761 B.C. Ltd. v. The Queen*, 2015 DTC 1228. The case, decided by former Chief Justice Rip, has provided clarity to the question of the difference between an "additional assessment" and a reassessment. The CRA issued a "reassessment" of the taxpayer's 2008 taxation year and an "additional assessment" of penalties under subsections 163(1) and 163(2) but no additional tax.

The appellant argued that the "additional assessment" was in reality a reassessment, which has the effect of vacating the previous reassessment. Justice Rip disagreed and I agree with his Honour. For years taxpayers and their advisors, if they have nothing more significant to do with their time, have been fretting and stewing about the difference

Wolters Kluwer

between a "reassessment" and an "additional assessment". I should have thought that the difference was obvious. For starters the additional assessment (*cotisation supplémentaire*) is called just that. It does not annul the prior assessment or reassessment and it does not tax the same amount again.

The judgment of Rip J. is a welcome clarification of a provision of the income tax law that should not have needed clarification.

## *Barejo Holdings ULC v. The Queen*

The next interesting case is one decided by Justice Patrick Boyle of the Tax Court of Canada, *Barejo Holdings ULC v. The Queen*, 2015 DTC 1216. The issue, expressed simply, is whether two contracts, entitled "Notes", issued by affiliates of two Canadian banks to St. Lawrence Trading Inc., an open ended investment fund under the laws of the British Virgin Islands, are "debt" ("*créance*") for the purposes of the *Income Tax Act*. The case is interesting because "debt" is not defined in the *Income Tax Act* and, in a bilingual, bijural common law/civil law system such as Canada, has no general federal meaning. "Debt" but derives its meaning from the provincial law that applies to the relationship that the provincial law governs. Add to this the fact that in seeking to determine what meaning if any can apply federally, the law of a civil law province such as Québec may be considered.

Justice Boyle in 38 pages produced an erudite dissertation on the meaning of "debt" and concluded that these Notes did indeed constitute "debt". It was not an easy decision. What is to be taken from the decision is that, in determining whether an instrument is "debt" or something else created by the instrument, Justice Boyle analyzed the other cases in which the Supreme Court of Canada had to consider the meaning of undefined terms such as "manufacturing and processing" or "partnership".

If you are seeking a learned discussion of what is a "debt" in the Canadian *Income Tax Act*, I suggest you read this judgment. It is an intellectually challenging masterpiece in the reconciliation of inconsistencies in the parliamentary legislative scheme.

## *Birchcliff Energy Ltd. v. The Queen*

Two cases that are worthy of note are *Birchcliff Energy Ltd. v. The Queen*, 2015 DTC 1198 (currently under appeal), a decision of Hogan J. of the Tax Court of Canada, and *Mariano v. The Queen*, 2015 DTC 1209, an appeal heard on common evidence with the appeal of *Douglas Moshurchak*, decided by Pizzitelli J. of the Tax Court of Canada.

One of the first things that strikes me with increasing force is that reasons for judgment of the Tax Court of Canada, and possibly other courts, are becoming longer and longer. The *Mariano* and *Moshurchak* decision (discussed below) were 51 pages in length and *Birchcliff* was 43 pages long.

*Birchcliff* involved a claim to deduct over $16,000,000 in losses incurred by a predecessor corporation which was amalgamated with the appellant. The facts are complex, but an essential part of the Crown's argument was that control of the predecessor company had been acquired by a group of persons immediately before the amalgamation and the amalgamated company did not carry on the business that gave rise to the losses.

I shall not summarize all of the facts in this complex case beyond noting that:

a. There was an issue of credibility with respect to the appellants' witnesses;

b. There was unquestionably a tax motivation in that the appellants wanted to acquire a loss company as part of the reorganization; and

c. Despite the Crown's argument that there was a sham involved in the complex restructuring that was carried out, Hogan J. found there was no sham and that claims of sham were effectively not issues.

It is refreshing that Hogan J. has effectively rejected the doctrine of sham. The Crown in recent years, based on some *obiter* in the Federal Court of Appeal, has gotten carried away in labelling every treatment they do not like as a "sham". It is high time the courts vigorously slapped down the Crown's excessive use of the concept of sham by

awarding high costs against the Crown when it throws up the sloppy and spurious doctrine of sham. I have dealt at greater length with the trend below.

Hogan J. rejected the notion that a "group" of persons acquired control of the predecessor company. Why then did the appellants lose? GAAR. He found the transaction abusive.

The case contains an extensive discussion of abuse. The following revealing statement appears:

> [110] In my opinion, the "abusive" nature of the transactions considered in Copthorne is less apparent than the abuse found to exist with regard to the transactions in the instant case. I note that the series of transactions giving rise to the benefit in Copthorne was carried out over a long period of time. It was also unclear that the series was completely planned when the first steps were taken. This did not prevent the Supreme Court from looking at the situation at the starting point of the series of transactions, when Copthorne was the parent corporation of VHHC.

I would not have decided *Birchcliff* in the same way as the Tax Court of Canada.

## *Mariano v The Queen* and *Moshurchak v. The Queen*

Two noteworthy cases are *Mariano* and *Moshurchak*, decisions of Pizzatelli J. They involved a claim for charitable receipts for the donation of software to a trust. My only comment is on two aspects of the decisions:

a. Was there a "gift"? This required the existence of a "donative intent" and an "impoverishment" of the donor; and

b. Was the arrangement a "sham"?

Catchy phrases such as "donative intent" or "impoverishment" have had from time to time a fashionable run in tax jurisprudence. For example, "reasonable expectation of profit" ("REOP") was a faddish concept used by the CRA as a mindless weapon against taxpayers for a number of years after an unfortunate dictum of Dickson J. of the Supreme Court of Canada in 1977 in *Moldowan v. The Queen*, 77 DTC 5213. Fortunately, the concept of REOP has been given a decent burial.

The concept of "donative intent" has become inextricably comingled with the notion of "impoverishment". For example, Pizzitelli J. said at paragraph 21 of the *Mariano* judgment:

> [21] It is also clear from the above that the expectation of receiving or actual receipt of a tax receipt itself from a charity does not per se vitiate any gift. The tax advantage resulting from claimed donation receipts is, after all, not the "benefit" contemplated by Friedberg and other case law above mentioned. This does not mean, however, that the expectation of an "inflated" tax receipt exceeding the value of the property transferred or the receipt of any other benefit does not vitiate a gift; all of which will depend on whether, in the circumstances, the taxpayer intended to impoverish himself.

It is certainly not a matter of donative intent. Getting a charitable receipt from a charity that is commensurate with the value of the gift is all right, but getting an inflated receipt somehow destroys the "donative intent" or maybe the "impoverishment". The jurisprudence is a little muddled on this point.

Let us talk then about "sham". The Crown now seems to toss in "sham" every time it does not like a transaction.

The Court also found that there was "deceit" and therefore a "sham". This is a *non sequitur* and quite unnecessary for the decision. The term sham appears in many of my judgments but in not one did I ever base a decision on a finding of sham. Isn't it time the courts got rid of the capricious concept of sham? Labelling a transaction as a "sham" is simply an excuse for a lack of analysis.

## *Superior Plus Corp. v. The Queen*

A case that deserves a brief comment is *Superior Plus Corp. v. The Queen*, 2015 DTC 1124 and 2015 DTC 5118, even though it deals only with a refusal by both parties to answer questions on discovery and to produce documents

containing tax advice. Ultimately it boiled down to whether questions relating to the departmental "policy" (whatever that means – a nebulous and enigmatic concept about how the CRA applies or interprets a taxing statute) are "relevant". The motions judge, Hogan J., and the Federal Court of Appeal held that they were relevant on an examination for discovery, but they reserved the final decision on relevancy to the trial judge. The decision is not surprising. The relevancy threshold in an examination for discovery is low.

The importance of the *Superior Plus* case, however, in that the least on discovery the "policy" determined by the CRA in interpreting or applying the taxing statute may be relevant in attacking an assessment made under section 245. The Supreme Court of Canada in *Nowegijick* has said in *obiter dictum* that in some cases departmental interpretation of a taxing statute may be of some importance, but most judges cite the comment and then go blithely on ignoring it. The *Superior Plus* case opens the door to a host of inquiries. What does a practitioner or a judge do if he or she obtains information that an assessment is contrary to or inconsistent with some "policy" of the CRA? Is the answer different if the "policy" relates to section 245? Why should the same considerations not apply if the assessment is contrary to departmental policy in respect of, say, section 67 or section 55 or section 103? Suppose the policy of the CRA relates to some indeterminate and amorphous interpretative practice not relating to any specific section of the *Income Tax Act* but to a general aversion that the CRA feels for such practices as loss trading or dividend stripping. And, who has the onus of proving the policy and the breach of or adherence to that policy?

We all know that our taxing statutes contain no humour and no equity. But in venturing into the uncharted waters of departmental policy are we not raising something far more sinister and frightening--a Kafkaesque secretiveness?

*A number of tax lawyers from Dentons Canada LLP write commentary for Wolters Kluwer's* Canadian Tax Reporter *and sit on its Editorial Board as well as on the Editorial Board for Wolters Kluwer's* Income Tax Act with Regulations, Annotated. *Dentons Canada lawyers also write the commentary for Wolters Kluwer's* Federal Tax Practice *reporter and the summaries for Wolters Kluwer's* Window on Canadian Tax. *Dentons Canada lawyers wrote the commentary for* Canada–U.S. Tax Treaty: A Practical Interpretation *and have authored other books published by Wolters Kluwer:* Canadian Transfer Pricing *(2nd Edition, 2011);* Federal Tax Practice*;* Charities, Non-Profits, and Philanthropy under the Income Tax Act*; and* Corporation Capital Tax in Canada. *Tony Schweitzer, a Tax Partner with the Toronto office of Dentons Canada LLP and a member of the Editorial Board of Wolters Kluwer's* Canadian Tax Reporter*, is the editor of the firm's regular monthly feature articles appearing in* Tax Topics.

# CURRENT ITEMS OF INTEREST

## Ministry of Finance Releases Bill-C2, an Act To Amend the Income Tax Act

On December 9, 2015, the Minister of Finance, Bill Morneau, introduced Bill C-2. This bill will enact the proposed changes presented to Parliament in the Notice of Ways and Means on December 7, 2015. Primarily this bill seeks to reduce the second income tax bracket from the current 22% to 20.5% and to introduce a new high rate of tax of 33% to be applied on all personal taxable income over $200,000. It will also reduce the annual contribution limit for the tax free savings account from the current $10,000 per year to its previous level of $5,500 with indexation. These changes will all take effect from January 1, 2016.

The detailed provisions and the accompanying Explanatory Notes can be found in Wolters Kluwer Special Report No. 087H, which will be available to all subscribers of the *Canadian Tax Reporter* (print, DVD, and online). Copies of the Special Report may be ordered by calling (416) 224-2248 (toll-free 1-800-268-4522), by faxing (416) 224-2243 (toll-free 1-800-461-4131), or by emailing cservice@wolterskluwer.com.

## Revenue Canada Releases 2016 Indexed Personal Income Tax and Benefit Amounts

Certain personal income tax and benefit amounts are indexed annually to inflation using the Consumer Price Index as reported by Statistics Canada. Most of these changes become effective January 1, 2016; however, the GST credit will take effect on July 1, 2016. The new rates and amounts reflect an indexation increase of 1.3%. The new rates and amounts can be found at: http://www.cra-arc.gc.ca/nwsrm/fctshts/2015/m12/fs151208-eng.html

## New Form T1135 Released

The 2015 Federal Budget proposed to "simplify the foreign asset reporting system" for taxpayers holding less than $250,000 of specified foreign property by revising form T1135 — *Foreign Income Verification Statement*. The 2015 version of form T1135 has now been released and is available for download from the CRA web site as a regular PDF or as a fillable PDF.

The form has been redesigned to implement a two-tier information reporting structure for specified foreign property. Part A is a new, simplified reporting method for taxpayers who held specified foreign property with a total cost of less than $250,000 throughout the year. This reporting method allows taxpayers to tick the box for each type of property they held during the year, rather than providing details for each property. Taxpayers must also identify the top three countries in which these assets are located (based on maximum cost), as well as the total income and gain or loss from all specified foreign property.

Part B, the current detailed reporting method, will continue to apply to those taxpayers who, at any time during the year, held specified foreign property with a total cost of $250,000 or more.

Interestingly, the CRA has indicated that while the 2015 version of the T1135 is required for tax years ending after 2014, administratively, they will also accept this new version of the form for previous years. Therefore, taxpayers can use the simplified method when filing the T1135 for prior periods provided they meet the requirements.

# RECENT INCOME TAX INTERPRETATIONS

This is a regular feature summarizing recent noteworthy income tax interpretations issued by the Minister of National Revenue. Copies of these interpretations can be found in the Wolters Kluwer online Federal Income Tax service, under Window on Canadian Tax.

## Child Care Expenses – Fees Paid to Immigration Lawyer and Service Canada

The CRA confirmed that the processing fees paid to Service Canada for a labour market opinion and the immigration fees paid to an immigration lawyer to hire a live-in child care provider are child care expenses for the purpose of claiming a child care expense deduction under s. 63(1) of the Act.

— *External Technical Interpretation,* ¶13,197

## Deduction of Private Health Services Plan Premiums by Sole Proprietors

The CRA confirmed that a sole proprietor having a private health services plan ("PHSP") covering him, his spouse, and their children could deduct from his business income the maximum dollar limit of his plan even if his spouse was a sole proprietor and had a separate PHSP covering her, her spouse, and their children, and had deducted the maximum dollar limit of her plan from her business income.

It was assumed that both plans provided the same type of coverage for the same individuals but that they were separate and distinct plans. An individual cannot claim a deduction for a PHSP premium if it is already claimed by another individual but this is not the case here, since two premiums under two separate PHSPs are claimed by two different proprietors.

— *External Technical Interpretation,* ¶13,199

## Deductibility of Marijuana Used for Medical Purposes

The CRA confirmed that marijuana purchased by an individual from a licensed producer under the *Marijuana for Medical Purposes Regulations* ("MMPR") qualifies as a deductible medical expense. This is the case even if a technical amendment to s. 118.2(2)(*u*) of the Act has yet to be enacted to recognize the validity of the MMPR.

— *External Technical Interpretation,* ¶13,203

# RECENT CASES

## Defendant accounting firm's liability for negligent tax advice limited under limitation terms of its engagement agreement

In the course of divorce proceedings the plaintiff/appellant F's lawyer R, engaged the defendant EY to provide US tax advice for F. The contract with EY (the "Engagement Agreement") was not signed by F personally, but by R with F's knowledge. After a divorce settlement with F's former husband had been reached, and incorporated into a court order, it was discovered that F had an unexpected US tax liability of more than $500,000. She accordingly sued EY in the Supreme Court of British Columbia for negligence in its provision of US tax advice, and such negligence was effectively conceded by EY at trial. EY argued, however, that its liability to F was limited to the amount of the $15,314 fee that F had paid it, in accordance with the limitation of liability provisions in the Agreement (the "Limited Liability Provisions"). In awarding F $15,314 in damages, the trial judge concluded, in essence, that: (a) R's firm entered into the Engagement Agreement with EY not only in her firm's own right, but as F's agent; and (b) F was therefore a party to that Agreement (despite her argument to the contrary), and was thus bound by it, and in particular, by its Limited Liability Provisions which were not unconscionable, especially in light of the fact that F was being independently advised by R. F appealed to the Court of Appeal for British Columbia.

F's appeal was dismissed. F was specifically referred to in the Engagement Agreement and her identity and circumstances were made known to EY. In addition EY provided its advice solely for her benefit as an individual, and with her knowledge and approval, as the trial judge found. Accordingly, on balance, R bound the plaintiff, as her principal, to the entire Engagement Agreement. However, F also raised the public policy ramifications of the Limited Liability Provisions at the trial level, so that the trial judge erred in failing to address this issue. F was therefore free to raise the issue at the appellate level. That said, it could not be argued that the public policy in favour of holding professionals to a high degree of diligence was a sufficiently powerful or "overriding" policy consideration to justify a refusal to enforce the Limited Liability Provisions in this case. (The "overriding" test was set out by the Supreme Court in *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways*) 2010 SCC 4). Also, as desirable as it might be to hold the accounting profession to a high standard of care, the giving of erroneous tax advice in the circumstances of this case did not amount to conduct that was so reprehensible that it would be contrary to the public interest to allow EY to avoid liability. Had the Legislature taken a different view, it could have inserted a provision in the *Chartered Professional Accounts Act* similar to the one in the *Legal Profession Act* which prohibits lawyers from limiting their liability for negligence.

¶49,214, *Felty v. Ernst & Young LLP*, 2015 DTC 5120

## Taxpayer not ordered to produce additional documents – it provided all the information within its power to do so

The taxpayer, ACMS, was a member of the Amdocs Group of companies that provided software and related services in over eighty countries to communications, media and entertainment service providers. ACMS provided IT services to telecommunication companies. It was subject to three audits for its 2011 and 2012 taxation years: a transfer pricing audit ("TPA"), a domestic audit, and a FAPI audit. The TPA was being conducted to determine if ACM was at arm's length when it carried out its cross-border transactions involving non-resident corporations. The MNR was satisfied with the information provided for the domestic and FAPI audits. Of the sixteen queries for information for the TPA, three remained outstanding. The MNR was seeking a compliance order requiring ACMS to provide documentation regarding the three queries. It was seeking: (1) a detailed functional organizational chart for all Amdocs entities involved in transactions with ACMS, (2) detailed working papers and financial statements related to management fees charged to ACMS by Amdocs Management Limited, and (3) detailed working papers and financial statements for Amdocs to support back office charges made to ACMS. The MNR argued that the documents provided by ACMS were not detailed enough to enable it to carry out the audit. ACMS contended that it provided all the information it was able to obtain, that the organizational chart asked for did not exist, and that the MNR had all the documentation necessary to conduct the audit.

The application for a compliance order was dismissed. A compliance order may be made if the Court is satisfied that the party who is requested to give the information is required to do so and does not provide it and that there is no solicitor-client privilege. The determination as to what documentation is needed is to be made by the minister. The minister is entitled to seek documentation it deems necessary to carry out an audit. There was no solicitor-client issue involved and the MNR established that ACMS did not provide the documentation that was sought. The issue to be determined is whether ACMS is required to provide the information. ACMS provided all the information it was able to obtain. It had no further details or working papers beyond that which it provided to the MNR. The information sought by the MNR either did not exist or was not in the power, possession or control of ACMS. The MNR was seeking specific information completed in a particular way and it did not exist and one cannot compel someone to produce something that does not exist. ACMS must provide all reasonable assistance unless it is unable to do so. ACMS made all reasonable efforts to obtain the information and the Court will not exercise its discretion to order ACMS to provide information that it does not have in its possession or control or that may not even exist.

¶49,212, *MNR v. Amdocs Canadian Managed Services Inc.*, 2015 DTC 5117

## Decision of Tax Court on required disclosure on discovery upheld

The Canada Revenue Agency issued assessments for the taxpayer on the basis of the loss-streaming rules and the general anti-avoidance rule ("GAAR"), and the taxpayer appealed from those assessments. In the course of the litigation, both the taxpayer and the minister sought disclosure of certain information and/or documents from the other party. The Tax Court held that the minister was required to disclose the information sought, but that the taxpayer's information and documents were protected by solicitor-client privilege. The minister appealed from that decision.

The appeal was dismissed. The Court held that the issues before the Tax Court gave rise to mixed issues of fact and law and that consequently that decision would stand in the absence of a legal error on an extricable question of law or a palpable and overriding factual error. On the first issue of the disclosure required of the minister, the Court held that no legal or factual error had been committed. The Tax Court's decision to compel the production of the refused documents and responses was attributable to the fact that the GAAR was invoked in circumstances where a change in the underlying policy of the *Income Tax Act* was in issue. A previous decision of the Federal Court of Appeal had held that information pertaining to the policy of the *Income Tax Act,* even where it is not taxpayer-specific, can be relevant on discovery. The Tax Court judge had therefore not inappropriately expanded the test for relevance at discovery. On the issue of disclosure by the taxpayer, the minister had argued that the taxpayer was subject to the doctrine of implied waiver with respect to solicitor-client privilege. The taxpayer had waived such privilege with respect to a legal opinion which supported its arguments while claiming privilege on those which did not. The minister argued that in doing so the taxpayer was attempting to present a misleading picture through selective disclosure. The appellate Court held, however, that the unfairness and inconsistency alleged by the Crown would arise only if the taxpayer introduced the disclosed opinion in evidence at trial. In that event, it would be left to the trial judge to determine whether solicitor-client privilege had thereby been waived, and the appellate Court held that no finding on that issue should be made before it became necessary. Consequently, the Crown's argument for disclosure could not succeed at this stage of the proceedings.

¶49,213, *The Queen v. Superior Plus Corp.*, 2015 DTC 5118

## Taxpayer derived income from property – small business deduction properly denied

The taxpayer was appealing a Tax Court decision that denied it a small business deduction. The taxpayer carried on a mini-storage business and the trial judge determined that its customers paid for storage space. A small business deduction is available to income earned from an active business carried on by a corporation. The trial judge found that the taxpayer was carrying on a specified investment business which is a business whose principal purpose is to derive income from property. The taxpayer argued it was deprived of procedural fairness as the trial judge ignored deficiencies in the Minister's assumptions of fact.

The appeal was dismissed. In determining the principal purpose of the taxpayer's business, one must determine on an objective basis what the customers were paying for. They were paying for storage space and any services provided to the taxpayer's customers such as snow removal were support for the property income received. The character of the income earned was rental income from property. The trial judge properly held that the taxpayer was carrying on a specified investment business and was not entitled to the small business deduction. Before trial the taxpayer unsuccessfully brought a motion to strike the Minister's assumptions. The taxpayer had the opportunity to challenge the Minister's assumptions and failed to do so. The trial judge correctly found that the reply allowed the taxpayer to know the case it had to meet. There was no error of law in the judge's analysis nor was there any palpable and overriding error.

¶49,210, *0742443 BC Ltd. v. The Queen*, 2015 DTC 5115

**TAX TOPICS**

Published weekly by Wolters Kluwer Limited. For subscription information, see your Wolters Kluwer Account Manager or call 1-800-268-4522 or (416) 224-2248 (Toronto).

*For Wolters Kluwer Limited*

Tara Isard, Senior Manager, Content
Tax & Accounting Canada
(416) 224-2224 ext. 6408
email: Tara.Isard@wolterskluwer.com

Natasha Menon, Senior Research Product Manager
Tax & Accounting Canada
(416) 224-2224 ext. 6360
email: Natasha.Menon@wolterskluwer.com



Wolters Kluwer Limited
300-90 Sheppard Avenue East
Toronto ON M2N 6X1
416 224 2248 · 1 800 268 4522 tel
416 224 2243 · 1 800 461 4131 fax
www.wolterskluwer.ca

PUBLICATIONS MAIL AGREEMENT NO. 40064546
RETURN UNDELIVERABLE CANADIAN ADDRESSES TO CIRCULATION DEPT.
330–123 MAIN ST
TORONTO ON M5W 1A1
email: circdept@publisher.com