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SCOPE OF TAXPAYER AGREEMENTS NARROWED: MARINE ATLANTIC INC. V. THE QUEEN, 2016 TCC 46

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A taxpayer agrees to be bound by the outcome of another appeal involving identical issues. The parallel appeal is eventually decided in light of admissions by the appellant that the taxpayer does not intend to make. Are the taxpayer's hands tied as a result of the agreement, or can the taxpayer seek independent determination by the court of the issues in its original appeal?

Such was the issue to be decided by the Tax Court of Canada in *Marine Atlantic Inc. v. The Queen*, 2016 TCC 46. The taxpayer, Marine Atlantic Inc. ("Marine"), operated a ferry service between Newfoundland and Nova Scotia. The ferry service was an exempt supply for the purposes of HST; the provision of ancillary services on board, such as dining and sales, was not. Marine claimed input tax credits ("ITCs") on the fuel it used during the period, claiming that fuel was a common input to its taxable and non-taxable supplies. The Minister denied those credits, contending that they were used purely in the exempt supply of the taxpayer's ferry service.

Another taxpayer represented by the same counsel, British Columbia Ferry Services Inc. ("BCF"), had also commenced an appeal in respect of the ITCs on its own fuel costs (the "BCF Appeal"). Marine entered into an agreement with the Minister whereby, in exchange for the Minister's consent to hold its appeal in abeyance, it agreed to be bound by the decision in the BCF Appeal as it related to the ITCs available on its fuel expenditures. The BCF Appeal was eventually resolved in favour of the Minister, in part because BCF admitted in the Agreed Statement of Facts that it could not prove that less than 90% of its fuel was used in the provision of the propulsion of its vessels (that function being related to an exempt supply).

Marine notified the Minister of its intention to pursue its appeal on the basis that the BCF Appeal did not fully resolve the ITC issue. Marine contended that because it did not intend to make the admission that more than 90% of its fuel was used in the provision of exempt supplies, the court's finding in the BCF Appeal did not resolve a common issue between the appeals. In other words, BCF's admission had narrowed the issue so that the decision in the BCF Appeal no longer addressed the common question. The Minister sought an order that Marine was bound by the initial agreement, barring Marine from raising an issue at the appeal and striking portions of the Notice of Appeal. It was argued that, in spite of BCF's admissions, the broader issue of whether fuel attributable to taxable and non-taxable activities in any proportion would give rise to ITCs had been argued in the BCF Appeal, and consequently the matter had been property considered.

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Justice Lyons found that the crucial issue was the substance of the agreement between the parties. General principles of contractual interpretation applied to its construction, so the court examined not only the language of the letter agreements exchanged, but also the surrounding objective evidence, such as the pleadings, to determine what the parties intended. Finding that the parties had reached an agreement on the broad issue of whether fuel used in exempt and non-exempt activities was eligible for ITCs, the court looked to the actual conduct of the BCF Appeal. The argument and decision in the BCF Appeal showed that the broader matters had not been fully considered subsequent to BCF's admission, and therefore the issue was no longer a common issue between the appeals.

Certain procedural points were also addressed by the court, which should assist counsel in disputes surrounding similar agreements between taxpayers and the Crown. First, even if the Crown had been correct in its reading of the agreement and the facts, Justice Lyons confirmed that the Tax Court of Canada had no statutory jurisdiction to make a declaratory order or grant specific performance, as sought by the respondent. The Tax Court of Canada is a creation of statute whose powers were limited by Parliament to the ability to "dispose of an appeal from an assessment by dismissing it, allowing it, and vacating the assessment, or referring the assessment back to the Minister for reconsideration and reassessment". There was no statutory authority for the granting of equitable remedies. Further, the inherent jurisdiction of the court to control its proceedings did not extend to the enforcement of an agreement external to the court's processes. Unlike certain procedural agreements governed by tax statutes (for example, an agreement to hold an objection or appeal in abeyance under subsection 225.1(5) of the *Income Tax Act*), an agreement to be bound by another court decision fell outside the jurisdiction of the court.

Secondly, contrary to the Crown's assertions, Marine's conduct in seeking to pursue its rights did not reach the high standard to strike pleadings based on an abuse of process, which requires delay and prejudice. This finding follows from the fact that the court favoured Marine's position that the issues in the appeals were no longer common.

Third, while the court does have the authority to bar a party from raising an issue in certain situations, it did not find sufficient justification to do so in this case.

Finally, the court struck certain exhibits to an affidavit which contained documents subject to settlement privilege, indicating that such documents — however relevant — could not be relied on in showing the context of the parties' agreement.

Tax litigators should note the functional and circumstantial approach taken by the court in interpreting the agreement between Marine and the Crown. Rather than mechanically comparing the stated parameters of each appeal, the court carefully examined the intersection of the agreement with the true conduct of the parallel appeal, including the nature of evidence elicited, admissions made, and reasons given. The court's finding suggests that even where arguments were made that might be applicable to both appeals, the parallel appeal may not be fully dispositive of the common issue by virtue of its particular facts and admissions.

This interpretive approach reflects an understanding that issues to be determined in a given trial can evolve on the basis of factual admissions. The court's appreciation of that point diminishes the possibility that when entering into an agreement to be bound by another decision (for reasons of efficiency, judicial economy, or otherwise), a taxpayer will bind itself to a decision made on the basis of new issues shaped by an unknown factual context.

That being said, the success of the taxpayer in this case and the emphasis of the court on the contractual mechanics of the agreement reinforces the need for counsel to be meticulous in drafting such agreements to ensure that they are not inadvertently excessive in scope.

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CURRENT ITEMS OF INTEREST

Comfort Letter on Limited Partnership Non-Capital Losses for AMT Purposes

A comfort letter originally issued in January 2016 was recently released. The letter addresses legislative amendments originally contained in Bill C-4 (the second Budget 2013 bill). Specifically, these amendments removed the exclusion of non-capital losses from limited partnerships when calculating alternative minimum tax (AMT). These generally favourable amendments apply to 2012 and subsequent taxation years, and also apply to 2006 to 2011 if a taxpayer makes an election in writing to the Minister of National Revenue.

However, the Department of Finance's letter addresses specific taxpayers who have losses from 2003 that do not benefit from the above amendments. As a result, the Department will recommend to the Minister that the election should apply to 2003 and subsequent taxation years so these taxpayers will also benefit from the legislative relief. If the Minister chooses to act upon the recommendation, the proposed amendments may appear in a technical bill in the future.

RECENT CASES

Crown entitled to file inconsistent pleadings in separate appeals by different taxpayers

The appellant corporate taxpayer was a member of a corporate group. The minister reassessed the taxpayer and a second member of that group in relation to the allocation of income and profits between them, and both companies appealed from those assessments. The pleadings filed by the Crown in relation to the appeals were irreconcilable, in that each included a different fact scenario with respect to inter-corporate transactions. The appellant brought a motion to strike the Crown's pleadings on the basis of that inconsistency. The motion was dismissed, with the Tax Court judge holding that the Crown could have a reply in relation to an appeal of one taxpayer that was inconsistent with the reply filed in relation to the appeal of another taxpayer. The appellant appealed from that determination to the Federal Court of Appeal.

The appeal was dismissed. The appellate Court held that, although the two corporations were related persons for purposes of the *Income Tax Act*, they were nonetheless separate persons. Under section 152 of the Act, the Minister is required to assess each taxpayer and, because each taxpayer is assessed separately, inconsistent assessments can result. The Court held that such inconsistent assessments will, where the taxpayers appeal, lead to inconsistent pleadings being filed. The Crown had acknowledged that both the assessments and the pleadings were inconsistent and that it did not seek to have both assessments upheld. In the Court's view, even though the Crown made certain admissions of fact in the pleadings filed with respect to one of the corporations, those admissions would relate only to that corporation's appeal, and not to the appeal of the related corporation. Since the appeals were to be heard on common evidence, the Court held that the way in which any admission of facts would affect the outcome of the appeals was a matter best left to the trial judge who would hear all of the evidence and make a determination as to what facts had been established.

¶49,272, *AgraCity v. The Queen*, 2016 DTC 5006

Business losses incurred by lower-tier partnership available to partners of top-tier partnership

The appellants were limited partners in a top-tier limited partnership which was itself a limited partner in a number of bottom-tier limited partnerships. All of the partnerships had a calendar year year-end. Each of the bottom-tier partnerships incurred business losses from 1996 to 2009. Those losses were allocated to the top-tier partnership at the end of each fiscal period, and to the partners of that top-tier partnership. The minister took the view that since the top-tier partnership had no at-risk amount, business losses incurred by the bottom-tier partnership could not be taken into account when determining the top-tier partnership's business loss. It brought a motion for determination of the question of whether such loss allocation was permitted.

The question was answered in the affirmative. The Court carried out a textual, contextual and purposive analysis of the legislation and concluded that the business loss of the bottom-tier partnership is flowed out to the top-tier partnership and to the partners of the top-tier partnership, and retains its character as a business loss at each step. In the Court's view, a plain reading of subsection 96(2.1) showed that business losses of a bottom-tier partnership that exceed the top-tier partnership's at-risk amount in respect of the limited partnership do not cease to be business losses and are available to be flowed out to the partners of the top-tier partnership. As well, a contextual analysis indicated that if the limited partnership loss did not retain its character as a business loss, other identified provisions of the *Income Tax Act* would be superfluous. Finally, the Court held that Technical Notes issued by the Department of Finance supported the proposition that the purpose of the at-risk rules was not to limit the allocation of losses from business or property to a limited partner, but rather to limit the deductibility of those losses once they had been allocated.

¶49,275, *Green et al. v. The Queen*, 2016 DTC 1018

Tuition fees did not qualify as medical expenses; school did not specifically cater to learning disabilities

The taxpayer was appealing the denial of $18,000 of tuition fees paid to St. George's School of Montreal for her son, that were claimed as medical expenses. The taxpayer's son, J, was born in 1999. There were concerns regarding his speech and language skills, leading to the parents seeking medical help for him at the age of three. Speech and language therapy were recommended. Difficulties continued in elementary school and various assessments were done. In 2008 J was diagnosed with Central Auditory Processing Dysfunction ("CAPD"), meaning he had difficulty processing, discriminating, recognizing, or comprehending auditory information. Recommendations were made in clinical reports such as a personal auditory system and computer based programs to help J, who was tentatively accepted at Vanguard, a school for students with severe learning disabilities. However, his parents were satisfied with his elementary school and he stayed there, following the same curriculum as the other students while receiving additional tutoring. Following elementary school J enrolled in St. George's. The taxpayer testified that St. George's was chosen as it was known to accommodate students with learning disabilities. J did well academically at St. George's, which the taxpayer argued showed the school's success in dealing with J's learning disability. The taxpayer argued that the criteria for qualifying for a medical expense should be interpreted broadly and that a school need not be dedicated solely to students with learning disabilities.

The appeal was dismissed. For tuition fees to qualify as medical expenses the amount paid must be for the care and training of an individual with a mental handicap. As well, a qualified person must certify that such an individual requires the equipment, facilities and personnel specially provided by the school for persons suffering from such a mental handicap. St. George's school prospectus does not refer to special programs for students with learning disabilities and a letter sent to J's parents stated that the school does not cater specifically to students with learning disabilities. St. George's felt its resources were suited to J's needs and that its learning environment nurtured all its students, including those with a broad variety of learning disabilities. St. George's provided enhanced curriculum and resources, but the same school program and curriculum was offered to all its students. Any accommodations provided to J were ancillary to St. George's primary purpose of providing a high school education. While J was diagnosed by a qualified person as suffering from a mental handicap, the clinical reports failed to establish a need for special equipment, facilities, or personnel. The recommendations made for a personal auditory system, computer based programs, and small group learning would benefit most students. The taxpayer failed to meet the necessary criteria to qualify for a medical expense tax credit.

¶49,274, *Leibovich v. The Queen*, 2016 DTC 1016

Minister's consequential assessment held not to be statute-barred

In a reassessment issued in July 2009, the minister included in the taxpayer's income for 2004 some amounts which had initially been reported as received in 2005. The taxpayer filed Notices of Objection for both taxation years. A series of negotiations and resulting correspondence took place between the taxpayer and the Canada Revenue Agency ("CRA") over the subsequent two years. In August 2011 the CRA wrote to the taxpayer with respect to both a settlement offer and the status of reviews undertaken by the Agency. In December 2011 the CRA issued a consequential assessment of the taxpayer's 2005 taxation year, and the taxpayer appealed from that assessment. It took the position that the CRA had, in its letter of August 2011, communicated its decision to vacate its July 2009 reassessment and that the consequential assessment issued in December 2011 was therefore statute-barred.

The appeal was dismissed. The appellant argued that the minister's consequential reassessment issued in December 2011 was statute-barred, both because it was issued after the expiry of the normal reassessment period and because the minister, having vacated the reassessment issued in July 2009, did not have the authority to issue a consequential reassessment. The Court held, following a review of the language in the August 2011 letter sent by the CRA, that the letter did not vacate the July 2009 reassessment, nor did it constitute notification of a decision to vacate. The Court held as well that even if it accepted that the use of the word "vacate" as used in the letter was a reference to vacating under section 165(3), it was clear that any such action on the part of the minister was contingent on the taxpayer accepting a settlement offer from the CRA, which the taxpayer did not do. Finally, the letter was phrased in the future tense, stating that the reassessment "will be vacated". In the Court's view, it was clear from that wording that the assessment had not yet been vacated, and the minister's consequential reassessment issued in December 2011 was therefore not statute-barred.

¶49,273, *Ford Credit Canada v. The Queen*, 2016 DTC 1015

Taxpayer's second bankruptcy tax driven; taxpayer granted conditional discharge

The taxpayer, Mr. Keylock, was a 58-year-old engaged in a real estate consultant business from which very little income was derived. He was also a qualified electrician. He was discharged from his first bankruptcy in February, 2005. On October 26, 2012, a proposal to his creditors was rejected which resulted in his second bankruptcy, in which the unsecured creditors' claims against him amounted to $843,325. Eighty-nine per cent of this involved unpaid income tax and GST. Mr. Keylock applied to the Supreme Court of British Columbia for a discharge from his second bankruptcy

Mr. Keylock was granted a conditional discharge. Mr. Keylock's second bankruptcy was tax driven and he was justly responsible for the fact that his assets did not have a value equal to 50 cents on the dollar. At age 58, moreover, he did not have a long working life ahead of him but he still could make a greater effort than before to find work as a journeyman electrician. In addition he was not enjoying the lifestyle of a high income earner. He was therefore entitled to a conditional discharge upon his payment to the Trustee of $100,000 in full, commencing on January 1, 2016, with minimum monthly payments of $300.

¶49,269, *Re Keylock*, 2016 DTC 5003

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