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WHEN ARE THE PARTIES TO A CIVIL TAX DISPUTE BOUND BY AGREED FACTS FROM A CRIMINAL PROCEEDING?

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The Tax Court's reasons in *McIntrye et al. v. The Queen* (2014 TCC 111) ("*McIntyre*") set out the limited circumstances where parties to a civil tax dispute will be bound by the facts agreed upon in a prior criminal case.

In *McIntyre*, two individuals and their corporation were audited for the 2002 to 2007 tax years and assessments were issued (the "First Reassessments"). The individuals and the corporation were subsequently charged with criminal tax evasion in respect of their income tax filings for these years. As part of a plea bargain, one individual and the corporation pled guilty based on certain agreed facts, and the provincial court imposed sentences accordingly. The other individual was not convicted.

Subsequently, the Minister of National Revenue (the "Minister") issued confirmations to the First Reassessments issued in respect of goods and services tax ("GST") to the corporation, and further reassessments of the corporation and the individuals for income tax (the "Second Reassessments"). In issuing the confirmation and Second Reassessments, the Minister refused to be bound by the agreed facts from the plea bargain in the criminal proceeding. In the Notices of Appeal filed with the Tax Court, the taxpayers argued the reassessments must be consistent with the agreed facts from the criminal plea bargain.

The taxpayers brought a motion under section 58 of the *Tax Court of Canada Rules (General Procedure)* ("Rule 58 motion") for a determination of a question of law or mixed fact and law before the hearing of the appeals. Specifically, the taxpayers asked (1) whether the doctrines of issue estoppel, *res judicata*, and abuse of process prevented the Minister from making assumptions inconsistent with the agreed facts; and (2) whether the parties were bound by the agreed facts in respect of the calculation of certain capital gains, shareholder debts, losses, and shareholder benefits.

The taxpayers argued that it was appropriate to deal with these issues before the hearing, whereas the Crown argued that these issues could not be determined on a Rule 58 motion for several reasons. First, the criminal conviction was reached by way of plea bargain as opposed to an actual trial and, therefore, there were no judicial findings of fact. Second, the agreed facts and plea bargain did not relate to the corporate GST appeal or to the other individual's income tax appeal. Third, the facts (and tax liability) of a criminal proceeding would only prohibit the parties from alleging a lower tax liability in a civil proceeding.

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In dismissing the taxpayers' motion, the Tax Court first considered the applicable test for granting a Rule 58 motion, namely, that there must be a question of law or mixed fact and law, the question must be raised by a pleading, and the determination of the question must dispose of all or part of the proceeding (see *HSBC Bank Canada v. The Queen*, 2011 DTC 1071 (TCC)).

The Tax Court then discussed the general application of issue estoppel in a Rule 58 motion citing *Golden et al. v. The Queen*, 2008 DTC 3363 (TCC), in which the Tax Court made the following comments:

> The doctrine of issue estoppel should only be applied in a tax appeal in this Court in respect of a prior criminal tax evasion conviction in clear cases. It should not be applied indiscriminately once the preconditions are met. The Court should be satisfied that the issue of quantum in each particular taxation year was decided in the criminal proceedings. [emphasis added]

The Tax Court stated that, in criminal prosecutions, where the burden of proof is more onerous, the plea bargain may only address the portion of the facts and quantum of tax that can be fully supported in respect of that higher burden. On the other hand, in a civil tax appeal, where the burden of proof is on balance of probabilities, a more complete quantum of tax (i.e., additional tax owing) may be supported in respect of the lower burden of proof. The wording of Rule 58 states that the Tax Court may determine a question of law, fact, or mixed fact and law, but in this case the Tax Court held that a Rule 58 motion should never be a substitute for a hearing and there should never be a dispute as to the material facts underpinning the question of law in a Rule 58 motion.

Next, in addressing the specific facts in this case, the Tax Court stated that only the first two requirements of a Rule 58 motion were met, finding as follows:

> [35] I agree with the Respondent's analysis of the caselaw. It confirms that prior convictions in criminal proceedings resulting from plea bargains, although a factor that may go to weight in a civil tax proceeding, are not determinative of the relevant facts and issues in a subsequent tax appeal.
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> . . .
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> [38] In *MacIver v The Queen*, 2005 TCC 250, 2005 DTC 654, Justice Hershfield also concluded that a question is best left to the trial Judge where the motion is merely to estop a party from contesting certain facts that will not dismiss an entire appeal. As noted in his reasons, unless such a question can fully dispose of an appeal by finding that issue estoppel applies, a Rule 58 determination could do little more than split an appeal and tie the hands of the trial Judge.

The Tax Court noted that the agreed facts did not address the corporate GST liability or the second individual's income tax liability, dealt only with the 2004 to 2007 tax years, and did not address the imposition of gross negligence penalties. The Tax Court concluded that issue estoppel would not apply because there was not a sufficient identity of issues between the criminal and civil proceedings. It would be unfair, the Tax Court stated, to prohibit the parties from adducing evidence in the civil tax appeals where there had been no introduction and weighing of evidence in the criminal proceeding.

Finally, it should not be overlooked that the Tax Court also closed the door on future estoppel cases where a tax appeal follows a criminal plea bargain. In its decision, the Tax Court noted that there was a distinction between criminal convictions arising from evidentiary findings resulting from a hearing and those convictions arising from plea bargains. The Tax Court held that a subsequent tax appeal cannot constitute issue estoppel where there was a prior criminal conviction resulting from a plea bargain. This finding is based on the fact that a plea bargain is not a trial on the merits with judicial consideration and weighing of evidence and findings of fact. Thus there can be no re-litigation because there was no initial litigation of the criminal charges.

The Tax Court's reasons for denying the Rule 58 motion in *McIntyre* provide further clarity that the parties to a tax appeal are permitted to argue divergent facts in the tax appeal from those agreed upon in a prior criminal conviction resulting from a plea bargain. Furthermore, issue estoppel cannot arise in the context of a civil proceeding in the Tax Court if the agreed facts in a criminal conviction are either not complete or do not arise from a trial where the result is a guilty conviction.

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GENERAL RATE INCOME POOL — PARTIAL ELIGIBLE DIVIDEND AND SAFE INCOME

The Canada Revenue Agency ("CRA") was asked to consider the following situation:

- Opco and Holdco are Canadian-controlled private corporations.
- Holdco held 30% of the Class A shares and Class B preferred shares issued by Opco and was not related to any shareholder. No shareholder was related to Opco.
- The Class A shares were voting and participating. The Class B shares were non-voting, but redeemable at the holder's option, and paid out a 4% annual non-cumulative dividend.
- The fair market value ("FMV") of the Class A shares held by Holdco was $200,000, and the Class B shares held by Holdco had the following attributes:
  - FMV of $600,000;
  - paid-up capital of $200;
  - adjusted cost base of $180,000; and
  - safe income on hand of $75,000.
- Opco's general rate income pool ("GRIP") at year end was $250,000.
- Opco would redeem its Class B shares from Holdco for $600,000.
- Holdco would file a separate taxable dividend election under paragraph 55(5)(*f*) of the *Income Tax Act* (the "Act") with the result that the separate taxable dividend amount would equal the $75,000 safe income on hand allocated to the Class B shares.

The CRA was asked to comment on any possible connection between the dividend designated as an eligible dividend under subsection 89(14) of the Act and the dividend equal to the safe income on hand in the above situation. More specifically, it was asked if Opco could designate the $250,000 total GRIP amount for the deemed dividend calculated under subsection 84(3) of the Act for the redemption of its Class B shares. Since the $75,000 safe income was inferior to the $250,000 GRIP, the CRA was asked if Holdco's GRIP would be increased (and by what amount) because of the redemption. Alternatively, the CRA was asked if Holdco's GRIP would increase by the same amount if Opco designated as an eligible dividend a lower amount of $75,000, corresponding to its safe income.

Regarding the first question, the CRA confirmed that Opco's GRIP would decrease by the portion of the dividend paid to Holdco and designated as an eligible dividend (i.e., $250,000). Holdco's GRIP would increase by the portion of the dividend considered received by Holdco and limited to the $75,000 safe income. In this situation, Holdco's GRIP would increase by a lesser amount than the one by which Opco's GRIP would decrease.

Regarding the second question, Opco's GRIP of Holdco's GRIP would decrease and increase by the same amount of $75,000, corresponding of Opco's safe income. Contrary to the first situation, there would be no imbalance between the reduction of Opco's GRIP and the increase of Holdco's GRIP resulting from the redemption of Opco's Class B shares.

— External Technical Interpretation, Reorganizations Division, February 20, 2014, Document No. 2013-0480051E5

QUALIFIED SMALL BUSINESS CORPORATION SHARES — SHARES HELD FOR AT LEAST 12 MONTHS

The Canada Revenue Agency ("CRA") was asked to consider the following situation:

- Two individual taxpayers, X and Y, had interests in the partnership, P.
- P held all the shares of the Canadian-controlled private corporation, ABC, carrying on an active business.
- X and Y held their interests in P for a period of at least 12 months, and P held the shares in ABC for the same 12-month period.
- P transferred all its ABC shares to the new corporation Newco under subsection 85(2) of the Act and received in exchange Newco shares.
- P was liquidated under subsection 85(3) of the Act, and its partners, X and Y, received Newco shares.
- Within 24 months from the liquidation, X and Y sold their Newco shares to a third party.

The CRA was asked if the Newco shares sold by X and Y to a third party were deemed to have been held during the 24-month period referred to in paragraph (*b*) of the definition of "qualified small business corporation share" ("QSBCS") in subsection 110.6(1) of the Act. If the answer is negative, X and Y could not claim a capital gains exemption on any capital gain realized on the sale of their Newco shares. The CRA confirmed that X and Y would meet the condition in paragraph (*b*) of the definition since the Newco shares were issued as a consideration for other shares (i.e., ABC shares) in accordance with subparagraph 110.6(1)(*f*)(i) of the Act.

In this case, the Newco shares issued to X and Y were deemed to have been owned, before their issuance, by a person not related to X and Y except if issued in exchange for other shares. Since they were issued in exchange of other shares (i.e., ABC shares), the condition in subparagraph 110.6(14)(*f*)(i) of the Act was met and the 24-month holding condition in the definition of QSBCS was also met. Therefore, X and Y qualified for a capital gains exemption on an eventual disposition of their Newco shares. Note that the other conditions of the definition of QCBCS must also be met by the taxpayers.

— External Technical Interpretation, Business and Employment Income Division, March 3, 2014, Document No. 2014-0519071E5

RECENT CASES

Medical expense credit denied for cord blood storage not prescribed by medical practitioner

The taxpayer was appealing the denial of a medical expense tax credit ("METC") for the cost of storing cord blood. Because the taxpayer's family had a history of cancer, the taxpayer chose to collect blood from her baby's umbilical cord after giving birth in 2009. The cord blood was stored at a hemotology lab, Progenics, a for-profit private enterprise, for potential future use in stem cell therapy or as a treatment for illnesses such as leukemia. Neither the taxpayer nor her baby have become ill.

The appeal was dismissed. To qualify for the METC, the expense must be (1) incurred with respect to laboratory or other diagnostic procedure or service together with necessary interpretation; (2) made to maintain health or prevent disease; (3) for the patient; and (4) prescribed by a medical practitioner. The cord blood procedure met the first three

criteria. It was a medical procedure similar to other laboratory services in that it required a doctor to extract the blood and the stem-cell component was then extracted and analyzed at the laboratory. The procedure was done to maintain health; whether or not the blood will ever be used is irrelevant. This is similar to other diagnostic tests done for the prevention or early detection of diseases. As deductions are allowed when procedures are done to maintain health or prevent disease, there need not be a patient at the present time for the credit to be available. However, the procedure was not done at the behest of a medical practitioner, and it cannot be inferred from the obstetrician's actions in extracting the blood that a medical practitioner prescribed the procedure. Therefore, since no doctor prescribed the procedure, the taxpayer's expense was not eligible for the METC.

¶48,728, *Shapiro*, 2014 DTC 1080

Proceeds from Ponzi scheme not interest income but return of taxpayer's money or that of other participants

The Minister reassessed the taxpayer for 2008 to impute interest income of $156,000 stemming from his involvement in what was later discovered to be a Ponzi scheme operated by TransCap Corporation ("TransCap"). The taxpayer received some payments from his investment in the amount of $156,000. The taxpayer argued that those payments were a return of capital, due to the very nature of a Ponzi scheme. The Ministered disallowed that claim and reassessed those amounts as interest income.

The taxpayer's appeal was allowed. The taxpayer was misled to believe that he received those payments as interest. TransCap did not use the taxpayer's money as it had contracted to do, and it was questionable whether TransCap could be considered a "borrower" in the circumstances. Lastly, the taxpayer was simply defrauded and given his money back or that of other participants.

¶48,731, *Roszko*, 2014 DTC 1083

Taxpayer must be pursuing degree at foreign university to qualify for tuition credit

The taxpayer was appealing the denial of a 2011 tuition credit for studies at a university outside Canada. The credit was denied on the basis that the taxpayer was not in a course leading to a degree. The taxpayer was enrolled full-time in the Musician's Institute College of Contemporary Music Audio Engineering Program. This program could lead either to a certificate or to an associate of art's degree that could ultimately lead to a bachelor's degree if combined with one of the Musician Institute's performance programs. The taxpayer pursued the certificate option, but argued he was entitled to the credit as there is no requirement to finish a degree to be eligible for the credit. He also argued that the credit had been allowed in 2012 and that the Minister's rulings must be consistent.

The appeal was dismissed. To be eligible for the credit, the taxpayer must be in full-time attendance at a university outside Canada in a course leading to a degree. In defining what a "university outside Canada" means, case law has held that it means an institution that confers degrees at the bachelor's level or higher. For educational institutions in Canada and for cross-border commuters, credits are available for courses provided at a post-secondary level that are not necessarily at a bachelor's level. Parliament has distinguished between universities and colleges or other post-secondary educational institutions, with the distinction being that universities offer degrees at the bachelor's level or higher. To allow the credit for an associate's degree would make the distinction between universities and other institutions meaningless. Although some of the courses taken by the taxpayer were prerequisites for an associate's degree that could ultimately lead to a bachelor's degree, the taxpayer was enrolled in the certificate program. The certificate program is not a degree program, so the tuition credit was not available. The fact that the Minister allowed the credit in 2012 is irrelevant in determining the treatment for the 2011 year.

¶48,733, *Zailo*, 2014 DTC 1087

Taxpayer permitted some prospecting business expense deductions in excess of those allowed by Minister

The taxpayer alleged that his business consisted of mining activities in the form of prospecting. In reassessing the taxpayer for 2007 and 2008, the Minister disallowed business loss deductions claimed in the amounts of $13,525 and $22,931, respectively. The Minister's position was that the taxpayer's mining activities were a hobby not being carried on in a sufficiently commercial manner to constitute a business, and that, in the alternative, if the taxpayer's mining activities did constitute a business, his deductible business loss deductions for 2007 and 2008 should be restricted to $8,426 and $14,068, respectively, since the deductions claimed by him in excess of those amounts were non-deductible personal or living expenses. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was allowed in part. The taxpayer's prospecting activities were being carried on in a commercial manner pursuant to a well-defined business plan involving significant outlays of time and capital. The fact that he brought his children on his prospecting trips did not adversely affect this conclusion. However, the deductions disallowed by the Minister were justified, since they represented expenditures of a personal nature as the Minister had alleged. The Minister was ordered to reassess accordingly.

¶48,735, *Michaud*, 2014 DTC 1089

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