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TAX EVASION: HSBC IS STILL IN THE SPOTLIGHT

By David W. Chodikoff, Editor of *Taxes & Wealth Management,* Tax Partner, Miller Thomson LLP

In early February 2015, the Washington based International Consortium of Investigative Journalists ("ICIJ") released its latest report on the depths of HSBC's involvement with clients in a wide array of illegal activities primarily aimed at hiding hundreds of millions of dollars from national tax authorities. The ICIJ had a team of journalists from 45 countries dig up information on secret bank accounts that were maintained for criminals, drug traffickers, tax dodgers, politicians and celebrities. The documents were initially obtained by the ICIJ from the national French newspaper, Le Monde. The documents demonstrate the nexus between international crime and legitimate business. The latest revelations significantly expand the public's knowledge of what tax authorities have likely known for several years regarding the scope of the HSBC's allegedly and potentially illegal and unethical behaviour.

There are a number of key findings of the journalists' latest Report and they are worth enumerating. According to this Report, HSBC Private Bank continued to offer banking services to clients who had been unfavourably named by the UN, in court documents and in the media as connected to arms trafficking, bribery and blood diamonds. HSBC also acted on behalf of discredited political figures such as former Egyptian President Hosni Mubarak, former Tunisian President Ben Ali and the current President of Syria, Bashar al-Assad. Perhaps the most galling revelation of this latest documentary analysis is the bank's repeated reassurance to its clients that it would not disclose details of accounts to national authorities, "even if the evidence suggested that the accounts were undeclared to tax authorities". Furthermore, the documents indicate that bank employees discussed with clients options to avoid the payment of tax in their home countries. (For a complete review of this report see — www.icij.org/swiss-leaks/banking-giant-hsbc-sheltered-murky-cash-linked-to-dictators-and-arms.)

In pure numbers, there were 60,000 leaked files and the total value of monies held in the bank accounts exceeds an estimated $100 billion for more than 100,000 wealthy clients from around the globe (Martin Arnold,

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"Leaked HSBC files damage bank and lift veil on banking secrecy", Financial Times, February 9th, 2015).

Like everyone that becomes aware of this information, one's immediate reaction is to wonder what are governments "in the know" doing about this situation? The fact of the matter is that this information has been in the hands of a number of governments for sometime ... over years ... in some cases, as much as five years ... as the data, itself, goes back to the 2005 to 2007 period. This data was originally taken from HSBC by an IT engineer, Herve Falciani back in 2007 and was shared with the British and French governments in 2010. Apparently, the French government obtained a concession from the Brits that they would not share the data with other law enforcement agencies. However, we do know that the French Finance Minister at that time, Christine Lagarde (yes, that same person that now heads the IMF), prepared a list of names for other countries of people mentioned in the leaked documents supplied by Mr. Falciani. The list became known in some circles as the Lagarde List and it did lead to the arrest of tax evaders in Greece, Spain, the United States, Argentina and Belgium. However, in Great Britain, Her Majesty's Revenue and Customs authority has recovered more than 135 million pounds but only one individual has been prosecuted. And, as for HSBC ... well, Britain has yet to take legal action against the bank. You can draw your own conclusions.

What about Canada? How are we doing here with the pursuit of tax evaders, especially those with Swiss accounts that have been unearthed by whistleblowers, opportunists and simple thieves? I would suggest that we are doing poorly. To my knowledge, we have yet to see a successful prosecution involving tax evaders with, now not so hidden, accounts overseas. Yes, the Canada Revenue Agency has had success with the Voluntary Disclosure Program and yes, lots of money has been obtained through this program. Just like the current political will of the British government to catch and try tax evaders must be challenged, so too can the same questions be asked of our government. Does it have the political will? Do the agencies and departments have the necessary resources? And if the answers are yes, then where is the evidence because in the end, we, Canadians, all want the same thing. That is, everyone should pay their fair share of tax as determined by policy makers and instituted by the law.

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FOR INTERNATIONAL CLIENTS, WILLS CAN BE AT RISK WHEN IN-DEPTH TAX PLANNING IS MISSED

By David S. Kerzner, Ph.D.

I received a call from a colleague of mine, Deborah, who specialized in U.S. estate and tax planning in the West. She wanted to know if I could help her with an offshore account question for her clients. The family owned a multinational manufacturing company with operations in 40 countries. While assisting her clients to deal with this very serious problem, I became curious about other aspects of the U.S. foreign reporting for group. After some international corporate tax detective work I was astonished to discover that there were massive errors in the group's reporting. Worse, these errors went back many years and, as a result, the statute of limitations had not closed. The family's succession plan, however brilliantly executed was built on a ticking time bomb. Deb's clients would ultimately be ok; however, the same could not be said for another family I was asked to assist some years earlier. The second family had similar problems but chose to ignore my written recommendations. Their private company operations in 25 countries pulled in revenue in the nine figures annually. The IRS ultimately caught up with them, causing irreparable business and family strife.

Both families in the above real stories had wills and trusts. Their estate planning did not prevent existential failures in U.S. international and corporate tax reporting. Another estate

planner recently bragged to me that he was doing wills for a U.S. married individual in Canada with a net worth of $50 million. He said that he had taken care of everything with wills and trusts. I asked him if anyone was taking a careful look at the client's legal structure and returns and he just made some strange noise (sounded like no) on the phone and said he had to go.

The problem is that individuals who have international facts in their families or businesses often have key tax issues that may require core professional competencies other than those dealing with succession planning, such as international tax law, international corporate tax law, and multi-jurisdictional accounting to name a few. To identify these issues for a high net worth client requires a different approach, which I call wealth optimization. Wealth optimization takes a holistic view of a client's tax, legal, and accounting and financial planning issues. Wealth optimization must be by definition a team effort on the part of a client's counsel, accountant, and financial planner. Moreover, depending on the client's particular facts, professionals with special expertise (*e.g.*, transfer pricing), may also need to be included. Wealth management that embraces the benefits of wealth optimization over estate planning is more likely to succeed in identifying a client's tax obligations and needs; to reduce the risk of negligence; and overall assist in the goal of preserving wealth.

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RECTIFICATION: RECENT DEVELOPMENTS AND NOTICE

By Lesley Akst, Associate, Miller Thomson LLP

INTRODUCTION

Rectification is an equitable remedy that allows judicial corrections of a document that, by error in writing, does not reflect the true intentions of the parties. Rectification changes a document's mistaken expression of that intention. Rectification is restorative, versus "retroactive". In terms of timing, it acts from the creation of an instrument forward. Rectification applications are becoming more common as a means of taxpayers' defence against the Canada Revenue Agency ("CRA"). This trend has been growing in large part since the year 2000, due to the leading case of *Juliar v. Canada*.[1]

In *Juliar*, shares in a company were transferred by its owners to their daughters and the daughters' husbands on a tax-deferred basis. One couple decided to transfer shares to a family holding company. The couple received promissory notes from the holding company rather than shares, as the tax advisor mistakenly believed the initial transfer from the father to the daughter involved payment of tax on a capital gain, so that no tax consequences would result irrespective of whether cash, promissory notes, or shares were used. CRA advised the couple that the transactions brought the shares under the umbrella of section 84.1 of the *Income Tax Act*[2] (the "Act") — and a disposition of property resulting in a deemed dividend. CRA consequently assessed the couple for the resulting tax liability. The couple brought an application for rectification, which was allowed on the basis that the intention to defer tax liability was a fundamental aspect of the transaction from its inception. The Minister of National Revenue appealed to the Ontario Court of Appeal, which found that the trial judge did not error in concluding the primary intention of was that of deferring tax liability on the transaction. The Court of Appeal concluded that rectification was the appropriate remedy because, in the absence of the error, the transaction would have been effected under section 85 of the *Act* rather than section 84.1. The Court highlighted that rectification should not be refused simply because the purpose of seeking it is to enable the parties to obtain a legitimate tax advantage, which was their intention at time of executing the instrument.[3]

Since *Juliar*, the courts have explored the evidential requirements of rectification in cases such as *McPeake Family Trust*[4] and *Kanji Family Trust*.[5] In *McPeake* and *Kanji*, the courts emphasized the importance of corroborative evidence, or the presence of more that one source, speaking to the common intention of the parties to avoid the payment of tax at the time the trust's creation. Further exploration of this judicial concept occurred in the Supreme Court of Canada decisions of *Agence du Revenu du Quebec v. Services Enviornnementaux AES Inc., et al.* and in *Agence du Revenu du Quebec v. Jean Riopel, et al.*[6] Here, the Supreme Court upheld the lower Court's decisions that rectification was available to correct documents under Quebec civil law.[7] The above cases stand for the following propositions: 1) the evidentiary requirements of rectification continue to evolve as the courts face new fact scenarios; and 2) the scope of rectification is broad and extends to Quebec civil law.

1 (2000), 50 O.R. (3d) 728 (C.A.) ["*Juliar*"].

2 R.S.C. 1985, c. 1 (5th Supp.), as amended ["*Act*"].

3 *Juliar* at para. 25.

4 2012 BCSC 132 ["*McPeake*"].

5 2013 ONSC 781 ["*Kanji*"].

6 2013 SCC 65 ["*Services Enviornnementaux AES Inc.*"].

7 *Ibid*. at para. 53.

NOTICE IN RECTIFICATION PROCEEDINGS

In terms of notice requirements and rectification, the law remains in a state of flux.[8] Whether one provides notice of an application is governed by the applicable civil procedure rules. In terms of a practice point, it is recommended that one provide CRA and the Department of Justice with notice of rectification applications. However, in the case of *Canada (Attorney General) v. Brogan Family Trust*,[9] the Ontario Superior Court spoke to the issue and found that notice to CRA was not required in that instance.

BACKGROUND FACTS

In *Brogan*, a family trust agreement was settled in 2004. In 2010, the trustees became aware of an error in the trust made by the lawyer who prepared it, which prevented distribution to certain beneficiaries. The trustees retained a tax litigation expert to bring an application to rectify the lawyer's implementation error. The tax litigation expert was of the opinion that notice to the Crown was unnecessary. The application proceeded before McLean J. in November 2010 and was successful. At the hearing, McLean J. was made aware that the Crown was not served.[10]

Just before the rectification order was granted, the trust sold a business related to it. The trust reported the allocation of proceeds to its beneficiaries on its 2010 income tax return, as did the beneficiaries. CRA became aware of the rectification proceedings in the course of a 2012 audit arising from the sale of the business and, in the process, audited the trust. Specifically, CRA became aware of the rectification order in July 2012, and received a copy of the order in August 2012.[11] In May 2013, CRA brought a motion to set aside the rectification order.

To account for the delay in commencing the motion, CRA cited internal office confusion, and the inexperience of the auditor as it related to rectification matters. CRA asserted that the auditor in question did not know the order was obtained without notice until March 2013.[12]

ISSUES BEFORE THE COURT

The issues raised were whether:

1. CRA brought the motion forthwith as required by the rules;
2. CRA had standing to bring the motion as a party affected by the judgment as required by the rules; and
3. the respondent trustees breached a requirement in that CRA should have been served with the rectification application.[13]

The respondent trustees argued that the rectification application was made to correct the lawyer's error, and therefore notice to CRA was unnecessary. The trustees further argued that the delay on CRA's part was unreasonable, and that McLean J. was made aware that CRA was not served with the motion and exercised his discretion to proceed with the application.[14] CRA argued that its interests were affected since the rectification was to reduce tax payable to it and, as a result, it should have received notice of the application. CRA argued that the delay on its part was not inordinate due to the previously mentioned internal confusion. CRA further argued that the contents of its information circulars and common practice dictated that CRA must be provided with notice of all rectification applications.[15]

CONCLUSION AND ANALYSIS

The Court dismissed the motion as it found that CRA was not a party affected by the rectification order. The Court explained that there was no obligation for the trust to file a return until the end of the year when the tax liability could be ascertained, which was after the rectification order was obtained.[16] The Court rejected CRA's argument that tax liability was established at the moment of sale. The Court further commented that to accept CRA's argument would in principle implicate CRA as a tax collector in virtually every proceeding in courts involving damages for several types of proceedings ranging from termination of employment claims, to family law matters or to the sale of a business. CRA did not bring the motion forthwith as required, and the procedural delays were not sufficient reason to allow lateness.[17] In conclusion, the Court found that there was no statutory requirement that CRA be made a party in the proceedings and CRA is only required to be given notice of proposed rectification proceedings when its legal interests might be directly affected by the outcome.[18]

COMMENTARY

The Court's analysis as it relates to when a party is affected by a judgment is interesting. The Court's logic appears to be as follows: 1) liability for tax, if any, is ascertained when a return

8 In *Aim Funds Management Inc. v. Aim Trimark Corporate Class Inc.*, [2009] O.J. No. 2408 (Ont. S.C.J.), the Court granted CRA intervener status, with rights of cross-examination in that rectification proceeding. As well, in *Columbia North Realty Co., (Re)*, 2005 NSSC 212, the Court held that CRA should be provided with notice of the rectification application before the Court. Notwithstanding this, recent case law, as explored in this article, suggests otherwise.

9 2014 ONCS 6354 ["*Brogan*"].

10 *Ibid.* at para. 4.

11 *Ibid*. at para. 6.

12 *Ibid*. at para. 7.

13 *Ibid*. at para. 8.

14 *Ibid*. at para. 10.

15 *Ibid*. at para. 9.

16 *Ibid*. at para. 13.

17 *Ibid*. at para. 18.

18 *Ibid*. at para. 22.

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is filed or when an assessment is issued; 2) liability for tax indicates whether CRA is a creditor, or not; and 3) CRA was not a creditor at the time the application was made before McLean J. and therefore no notice to CRA was required. The Court further commented that CRA has an interest when the order sought affects an instrument made in order to avoid the payment of tax.[19] Therefore, the Court appears to find that CRA is to be provided notice when it is a creditor of the parties seeking rectification, or the instrument to which rectification is sought was made to avoid the payment of tax. This finding is defendable from a practical viewpoint; however, subsection 152(3) of the *Act* contemplates such an argument and provides that liability for tax is not affected by an incorrect or incomplete assessment or the absence of an assessment. The difficulty in this case lies in its timelines. In particular, the rectification order was obtained before the return was filed, and an assessment issued, and occurred in a fashion that is reverse to what is typically seen in rectification proceedings. As a result, the findings of *Brogan* may be unique to its facts.

Principles of natural justice indicate that CRA should receive notice of litigation when its rights are affected. Further judicial consideration of *Brogan* will no doubt refine what scenarios warrant notice to CRA as it relates to rectification applications.

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19 *Ibid.* at para. 15.

THE IMPORTANCE OF DIVERSIFICATION IN THE NEW NORMAL

By Cenk Albayrak, CIM, Investment Advisor, National Bank Financial Ltd.

We have all heard of the old adage "don't put all your eggs in one basket". Business owners live this in their day to day business world by having multiple suppliers and a broad customer or client base, dealing with more than one bank or financial institution that will encourage healthy competition for their business, and having a backup for employees in the event someone falls ill or leaves.

Some of the most successful entrepreneurs are comfortable with the business risk they take every day. It's a level of risk that works for them. Along with your professional occupation, an investment portfolio is an important component of your personal wealth and its contribution to income and financial security can be critical in your retirement years. When it comes to managing your personal wealth, as your circumstances or market opportunities change, so should your level diversification.

Diversification means a lot of things to different people. Diversification in the investment world is an important tool of portfolio management, applied by including allocations to more than one asset class, such as equities and fixed income, as well as within each asset class, depending on the security selection skill of the investment advisor. According to one of the seminal papers on portfolio management by Brinson Hood and Beebower in 1986, asset allocation determines as much as 91% of a portfolios performance over time (Determinants of Portfolio Performance, Journal of Finance, Issue 42). This is very significant to the overall long-term growth of your portfolio. As the array of investment asset classes has expanded from simply equities and fixed income investments, investors have struggled with getting the right weighting in each asset class, given their tolerance for risk. When I began my career as an investment advisor in 1993, the very simple rule of thumb in determining an allocation to equities versus fixed income was to reference the investor's age: take 100 minus your age to determine what percentage in equities you should hold and put the balance in fixed income. As an example, someone who is 40 years old would hold 60% (100-40) in stocks and the remaining 40% in bonds. So, why should I hold guaranteed investments such as GICs or high grade bonds in my portfolio paying only 1% to 3% over the next five years? It's the same reason why you shouldn't start loading up on energy companies that seem cheap right now if you're looking to invest in a well-diversified portfolio.

A HISTORICAL PERSPECTIVE

In June 1952, a 25 year old graduate student named Harry Markowitz published a provocative paper in the *Journal of Finance* that would have a profound impact on Modern Portfolio Theory[1] (MPT). His paper on "Portfolio Selection" received little notoriety at the time, but would help him win the Nobel Prize in Economics in 1990.

Markowitz' paper discussed risk management through diversification. He suggested that in constructing a portfolio of two risky investments with low historical correlation (investments that tend not to move in tandem) an investor could reduce the risk of the overall portfolio. While this seems very practical today, this notion of risk reduction through diversification was very progressive at the time.

Building on Markowitz's work, an Economist named William Sharpe took MPT to the next level with the introduction of the Capital Asset Pricing Model[2] (CAPM). CAPM is a model that

describes the relationship between risk and expected return. It is used in the pricing of risky securities with the underlying premise that investors need to be compensated by the amount of risk taken and the time value of money.

In 1986, Gary P. Brinson, CFA, Randolph Hood, and Gilbert L. Beebower (known collectively as BHB), published their study evaluating the impact of the asset allocation policy decision on pension plans. This is an often cited study that suggests that ". . . greater than 90% of a portfolio's change in returns over time is attributable to asset allocation policy". The implication is that when setting up your investment policy your efforts in getting the long term investment strategy right will bring you the most value; market timing, trying to buy the lows and sell the highs, has not been a worthwhile effort for most investors, historically.

EVOLUTION OF ASSET CLASSES

Since Markowitz and Sharpe won their Nobel prizes in 1990, there has been considerable broadening of the types of investments available to Investors. Asset Allocation decisions have evolved beyond merely Stocks and Bonds to include distinctions between: large & small caps, value & growth, developed & emerging markets, public bonds (which are generally unsecured) & private asset backed debt and traditional and alternative investments. With the broader array of asset classes, investors have struggled to determine the appropriate weightings in each asset class.

ASSET ALLOCATION TODAY

Asset allocation relies on the notion that returns for different asset classes do not move up and down at the same time and we measure how they tend to move together by calculating their correlation. Allocations to investment strategies that reflect good value within their asset class, each supported by careful due diligence to ensure the risks and returns they offer are reasonable and well understood, and with allocations that are not perfectly correlated, will provide diversification across your portfolio. Making these allocations with consideration for each investor's tolerance for risk in the total portfolio will help to optimize risk-adjusted returns.

In recent years, there has been a lot of attention paid to "Tactical Asset Allocation". Tactical asset allocation recommends overweighting or underweighting certain asset classes based on forward looking views. Working with their investment advisor, investors establish their long term asset allocation strategy and use tactical allocation to their allocations within pre-defined ranges (say 5% above or below the long term level) to take advantage of short term market opportunities.

DIVERSIFICATION IN THE NEW NORMAL

With the evolution of asset classes, no longer are you left with choosing from just equities and fixed Income investments. According to Sean Rogister, President of Cortland Credit Group, and Adjunct Instructor of Fixed Income Instruments and Markets at Queen's University Masters of Finance Program: "proper diversification is a matter of understanding the Risk Adjusted Return and the Correlation between and within asset classes".

Table 1 presents correlations among major sub-categories of benchmarks within the various fixed income and equity asset classes over a 10 year period to the end of December 2014. The point to understand here is that not all asset classes move up and down in tandem. The goal to properly diversifying a portfolio is to select investments that do not generally move in complete tandem or in other words have negative correlation to one another.

Table 1
Correlation Among Various Asset Classes Over 10 Years
(using month-end data from Dec/04 to Dec/14)

	Total Return Index					
	US Treasury Bonds	US Corporate Bonds	US High Yield Bonds	S&P 500 Equity	Russell 2000 Equity	MSCI EM USD Equity
US Treasury Bonds	1.00					
US Corporate Bonds	0.49	1.00				
US High Yield Bonds	-0.24	0.57	1.00			
S&P 500 Equity	-0.26	0.31	0.74	1.00		
Russell 2000 Equity	-0.30	0.24	0.72	0.92	1.00	
MSCI EM USD Equity	-0.20	0.41	0.75	0.80	0.74	1.00

Source: Bloomberg, Cortland Credit Group Inc.

The negative correlation between the treasury index and the broad equity index highlights the benefits of asset class diversification – periods of underperformance in equities tend to be offset by positive performance in U.S. Treasury Bonds, with a correlation that falls between -.20 and -0.30 with equity indices provided (S&P 500, Russell 2000 and MSCI EM). The U.S. Corporate Bond index is made up of investment grade bonds, and has provided good returns relative to risk but tend to move closely with Treasury Bonds, as indicated by the correlation of 0.49 between these indexes. When yields on government bonds rise, causing negative investment performance, returns from the credit spread component of investment grade debt have not been sufficient to provide an offset and corporate bond performance have tended to fall as well.

Adding exposures from high yield sectors of the debt markets has been a common tool used by investment advisors in their reach for better returns. High yield bonds make sense from a fixed income portfolio's perspective but less so for a multi-asset class investment strategy. With negative correlation between returns from U.S. Treasury and high yield bond indexes, fixed

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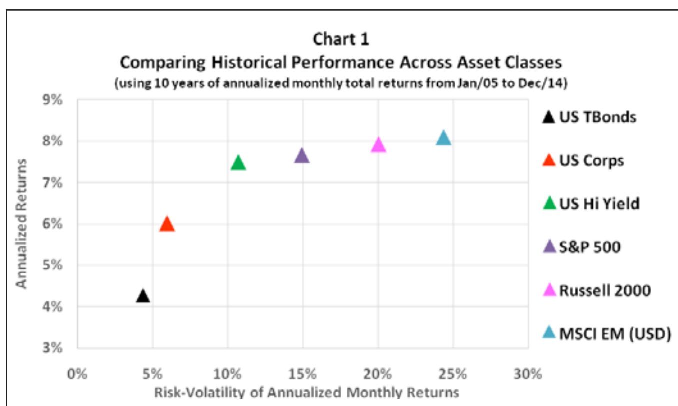
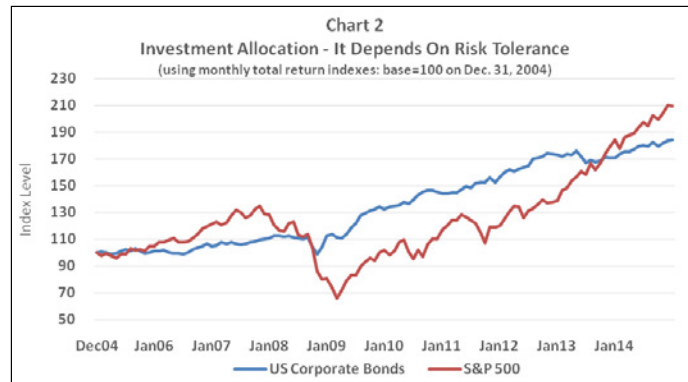
income portfolios have benefited from the negative correlation result of -0.24 for high yield. However, the High Yield Bond index had high correlations of 0.74 to equities (S&P 500), indicating the same factors driving equity performance tend to impact this riskier debt strategy in the same way.

In addition to considering returns between asset classes, we also look at returns relative to risk for each strategy. We use the standard deviation statistic, a measure of volatility, to assess risk. We look at the relationship between returns and volatility as a straightforward tool for comparing asset classes – we want to make sure we are getting good performance for the risk we're taking. Chart 1 below is a historical look at performance of our various asset classes over the last 10 years. Understandably, U.S. Treasury Bonds have been both the lowest performer and least risky asset class. But by adding U.S. Corporate Bonds or U.S. High Yield Bonds to an equity portfolio consisting of U.S. large capitalized, small capitalized and Global companies, you may significantly lower the risk and volatility without a very significant reduction in the potential overall annualized return.



The markets are indeed very different today than in the recent past. Investors need to adapt and change to keep pace; and evolve their views on investing in the current markets to be diversified in general, but they also need to be diversified for the extreme events that could hurt their level of personal wealth. Risk tolerance has to be considered in the overall diversification strategy for any investor.

In Chart 2 there are periods in the past 10 years where bonds handedly outperformed equities. For example from October 2007 to February 2009, the S&P Total Return Index was down over 50%. During this same period, U.S. Corporate Bonds increased 1.6%.



Stocks do not move up continuously forever. Investors need to work with their investment advisor to be more responsive to the change and complexity of the investment landscape. It makes sense to be cautious and conservative following this most recent six-year Bull Run in equities. Proper diversification has been and will continue to be an important investment strategy.

Endnotes

1 Modern portfolio theory contends that diversification of a portfolio across different asset classes with low or negative correlation characteristics will minimize risk.

2 The Capital Asset Pricing Model looks at the relationship between risk and return. In simplest terms, the CAPM says the return on an asset or security is equal to the risk free return of Treasury Bills plus a risk premium.

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THE NEED FOR SPEED: COURT DISPENSES WITH "PERFECT" DISCLOSURE AND SENDS CASE TO TRIAL

By Karen Phung, Associate, Miller Thomson LLP

Recently, the Ontario Superior Court of Justice released a decision that dispenses with "perfect" documentary disclosure and sets higher expectations for "big-time" law firms that deal with paper-heavy lawsuits. The court's message: *More documents do not mean more delays. Make sure your lawyers are ready for trial!*

In *Letang v. Hertz*,[1] the defendants sought an adjournment after the plaintiffs voluntarily disclosed some 465 additional documents just one month before the start of trial. The documents were mainly copies of cheques, cheque stubs, bank statements and a few notes concerning financial calculations. They were disclosed at the suggestion of the pre-trial judge as a way to foster settlement. While the documents demonstrated that the plaintiffs were entitled to an additional $120,000 in damages, they also revealed that the plaintiffs made errors in their damages calculations.

Upon receiving the documents, the defendants immediately brought a motion to adjourn the trial so that they could review the evidence with their expert and conduct further discovery. At the motion, however, Justice Myers refused to grant the adjournment and ordered that the trial begin the following week, as scheduled.

MORE DOCUMENTS DO NOT MEAN MORE DELAYS

Justice Myers found that while 465 documents seemed like a significant amount of information, it actually was not. National firms (including the two reputable Bay Street law firms involved), should routinely deal with cases with tens of thousands of documents. A junior lawyer could probably have reviewed the documents in a few hours. Justice Myers made clear that today's law firms are expected to have sophisticated computer-based procedures to deal with document-heavy cases so that delays are avoided.

IMPERFECT DISCLOSURE IS PERFECTLY ACCEPTABLE

The defendants wanted an adjournment to obtain even more documents that would undermine the plaintiffs' damages calculations and destroy their credibility. Justice Myers found that the same effects could be achieved by simply cross-examining the plaintiffs and their experts on the correct numbers at trial. As Justice Myers put it: "There does not need to be perfect disclosure and perfect discovery on every path and alleyway in order to achieve a fair and just outcome of the case on the merits" (para 18 of decision).

1 2015 ONSC 72.

REJECTING THE "OLD BRAIN THINKING" OF USING MOTIONS AS A DELAY TACTIC

Justice Myers criticized the defendants' failure to act quickly in dealing with the disclosure: "the idea that the defendants can ignore a trial date and sit on material for a month without bothering to call their expert and just deliver another fat motion record to buy 90 days of unlimited discovery time for more fishing for documents is old brain thinking" (para 18). While expressing his disdain for the procedural gamesmanship, incessant delay, and endless discovery that pervades "traditional Toronto motions culture" (para 16), Justice Myers opted for a legal system rooted in proportionality, timeliness and affordability.

LESSON LEARNED AND IMPORTANT CONSIDERATIONS FOR CLIENTS

The important lesson to be learned is that clients should be wary of the lawyers and the law firms they choose. With the growing sophistication of technology and the increasing ability to retain and retrieve information, lawsuits are becoming more and more document heavy. This reality, however, cannot derail the courts' — or our clients' — need for speedy justice.

When choosing a law firm, clients should keep in mind the following qualities that they should look for — and expect — in their lawyers:

- ***They are equipped with the right technology and skills to deal with document-heavy files***. This includes the use of document-management software and having junior lawyers or clerks available to review documents quickly and efficiently. Your lawyer should also have, as a core legal skill, experience and facility in dealing with voluminous client information.

- ***They act quickly and efficiently in the face of unexpected issues (especially on the eve of trial).*** Lawyers cannot bank on getting an adjournment when the unexpected arises, even on the eve of trial. They must be prepared to deal with the unexpected, and do it quickly, because the courts and their clients expect timely justice to be top of mind.

- ***They are capable of dealing with imperfect disclosure.*** Perfect disclosure is non-existent in the age of proportionality and timeliness. Your lawyer must be prepared to deal with this reality as your case proceeds to trial.

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- ***They think long and hard about any motion they bring.*** Exercising delay tactics will not be condoned by the court and is not necessarily in a client's financial or strategic interests. Make sure you have a lawyer who takes the time to explain the strategy, utility and the benefits of bringing a particular motion, because you will likely be on the hook for costs if you lose.

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NOT SO FAST...HOLD THAT REDACTING TAPE

By Nora Kharouba, Student-at-law, Miller Thomson LLP

INTRODUCTION

As a general rule, it would be contrary to the goals of pre-trial documentary discovery if parties were permitted to completely redact the documents they disclosed. This issue was recently addressed in *Dominion Nickel Investments Ltd. v. R.* ("Dominion") where Justice Jorré confirmed that information could only be redacted where it was "clearly irrelevant" to the issues under dispute.[1]

THE CASE

In *Dominion Nickel*, Dominion appealed the Canada Revenue Agency's ("CRA") decision to disallow a charitable donation deduction of $65 million. Dominion brought a motion to compel the CRA to disclose information it redacted in part and in full on several documents, and to compel production of non-disclosed documents during pre-trial discovery pursuant to Rule 81 of the Tax Court Rules (the "Rules").[2] The documents that were entirely redacted contained a cover sheet that displayed the case name.

The CRA defended the motion for production by arguing that the redacted information and non-disclosed documents were irrelevant to the tax appeal and, in addition, should not be disclosed in order to protect privacy.

The motions judge compelled disclosure of much of the redacted information, along with some of the non-disclosed documents. Some information remained redacted as Justice Jorré stated it was "clearly irrelevant" to the tax appeal, such as:

a) Business numbers, social insurance numbers, corporation numbers and the like;

b) Dates of birth;

c) Marital status;

d) Documents covered by solicitor-client privilege;

e) Tax information not related to the particular issue, such as deductions for other expenses; and

f) Bank statements showing the balance of law firm trust accounts.[3]

THE LAW

Rule 81 requires parties to produce a list of the documents of which the party has knowledge at that time that might be relied on at trial. Generally, where a document is relevant, it will have to be produced in its entirety. Only those portions that are "clearly irrelevant" can be redacted. This principle applies equally to all parties to a tax dispute.

Justice Jorré reviewed the law on relevancy and confirmed that the scope of pre-trial discovery is wide in that:

> Relevancy on discovery must be broadly and liberally construed and wide latitude should be given...[d]ocuments that lead to an assessment are relevant...[a] party is entitled to documents that may lead to a train of inquiry that may directly or indirectly advance his case... partial redactions ought not to be encouraged unless necessary.[4]

The CRA unsuccessfully argued that section 241 of the *Income Tax Act* ("*ITA*") precluded it from disclosing the information it redacted.[5] While the implementation of section 241 clearly signifies Parliament's intent to protect privacy in income tax matters, that objective is balanced against the need to disclose information during "any legal proceeding relating to the administration or enforcement of" the *ITA* as contemplated by subsection 241(3)(b). Additionally, the Court raised the implied undertaking rule, which provides that information obtained on discovery may only be used for the purpose of the action in the course of which it was obtained (to limit further disclosure of information), and would help safeguard privacy interests.

For the foregoing reasons, the Court did not agree with the CRA's emphasis on privacy concerns considering the available safeguards and rules to balance between the need to protect

1 *Dominion Nickel Investments Ltd. v R.*, 2015 TCC 14 [*Dominion Nickel*].
2 *Tax Court of Canada Rules (General Procedure)*, SOR/90-688a [*the Rules*].
3 *Supra*, note 1 at para. 51.
4 *Supra,* note 1 at paras. 22, 15, 36.
5 *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.).

privacy and to ensure the efficient and just resolution of tax matters.

ANALYSIS

There appears to be an inconsistency between the act of disclosing a document on a list of the evidence that will be relied on at trial under Rule 81 and the subsequent act of entirely redacting a listed document. Listing a document pursuant to Rule 81 necessarily implies that the document and the contents therein are relevant to the issues in dispute — otherwise, the document would not be disclosed as one to be relied on at trial. It is especially difficult to then argue that a document listed pursuant to Rule 81 be entirely redacted on the basis that the information contained therein is "clearly irrelevant". In fact, the Court held that even where redacted information was likely not useful to the appeal, it was still not considered "clearly irrelevant" such as to justify its redaction. It was because of this that the CRA faced an uphill battle in persuading the motions judge that the redacted documents, especially the entirely redacted ones, should remain that way.

The resolution of evidentiary and procedural issues involves the balancing of a number of competing interests, as in this case between the right to privacy and the right to efficient resolution of matters. It would contrary to the purpose of Rule 81, which is to reduce the cost of litigation by eliminating the necessity of producing all relevant documents automatically, if there were more restrictions on disclosure. The courts could experience an influx of litigation over whether a document or piece of information contained in a document is relevant or not. *Dominion Nickel* reaffirms that the relevancy threshold under Rule 81 is, practically speaking, low and that this is counterbalanced by existing safeguards that help to protect the information disclosed.

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THE TESTAMENTARY TRUST AMENDMENTS

By Sarah Netley, Tax Manager and Guy Desmarais, Partner, Collins Barrow

BACKGROUND

For many years, the use of one or more testamentary trusts, a trust created by will, has been a common tool in estate planning. As each testamentary trust had access to its own set of graduated income tax rates,[1] this provided an opportunity for significant tax savings where beneficiaries were subject to the top personal tax rate.

Budget 2013 introduced the government's concerns with the potential growth in tax-motivated use of testamentary trusts and raised questions of both tax fairness and neutrality when compared to beneficiaries receiving equivalent income directly.[2] As a result, the government opened a consultation process on June 3, 2013, inviting comments from the public on proposed measures to eliminate these tax benefits.[3] Organizations such as the Joint Committee on Taxation of the Canadian Bar Association and the Chartered Professional Accountants of Canada (Joint Committee)[4] and the Society of Trust and Estate Practitioners (STEP),[5] along with others, provided comments as well as alternative measures to the proposed changes.

Despite these submissions the 2014 Federal Budget introduced legislation to eliminate the graduated rate of taxation for testamentary trusts. Draft legislation was released by the Department of Finance on August 29, 2014, which was tabled on October 10, 2014[6] and received royal assent on December 16, 2014[7]. The following provides an overview of some of these changes.

THE LEGISLATIVE CHANGES

The benefits previously afforded to testamentary trusts have been eliminated unless the estate qualifies as a Graduated Rate Estate (GRE) or a Qualified Disability Trust (QDT). Generally, a GRE is an estate of an individual that arose as a result of the individual's death if 1) it is no more than 36 months after death, and 2) no other estate of the individual is considered a GRE.[8] A QDT on the other hand is a testamentary trust whereby an annual election is filed by the trust and at least one beneficiary who is entitled to the disability tax credit (DTC).[9]

1 Subsection 117(2) of the *Income Tax Act*, R.S.C 1985, c. 1 (5th Supp).
2 Jobs Growth and Long-term Prosperity (21 March 2013), online: Government of Canada, www.budget.gc.ca/2013/doc/plan/budget2013-eng.pdf.
3 Consultation on Eliminating Graduated Rate Taxation of Trusts and Certain Estates (3 June 2013), online: Government of Canada, www.fin.gc.ca/activity/consult/grt-itp-eng.asp.
4 2014 Federal Budget Amendments to Trust and Estate Rules.
5 Response to "Consultation on Eliminating Graduated Rate Taxation of Trusts and Certain Estates" (2 December 2013), online: Step Canada, www.step.ca/pdf/TTC122013_TestamentaryTrustSubmissionSTEPCANADA.pdf.
6 Notice of Way and Means to implement certain provisions of the budget tabled in Parliament on February 11, 2014 and other measures (10 October 2014), online: Government of Canada, www.fin.gc.ca/drleg-apl/2014/bia-leb-1014-l-eng.asp.
7 Minister Oliver Welcomes Royal Assent of *Economic Action Plan 2014 Act*, No. 2 (17 December 2014), online: Government of Canada, www.fin.gc.ca/n14/14-179-eng.asp.
8 Subsection 248(1) Graduated Rate Estate.
9 Subsection 122(3).

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Graduated Rate Estates

36-month graduated rate taxation

Where an estate has made a designation in its tax return for the first taxation year ending after 2015, that estate will qualify as a GRE and will be entitled to graduated rate taxation for a period of 36 months after the individual's death. It will be important for practitioners and taxpayers to identify those ongoing estates that arose prior to 2016 in order to ensure the designation is made in the 2016 taxation year. In addition, a decision will have to be made as to whether the estate will continue after the 36-month period and bear tax at the top marginal tax rate or whether it will be wound-up.

Although the Department of Finance believes that a 36-month period is a reasonable amount of time to administer the estate and distribute the assets, there may be some cases where this is not feasible. For more complicated estates, *e.g.*, those that involve non-resident beneficiaries, property located outside of Canada, or have litigious issues, it may not be possible for the trustee(s) to distribute the assets within this time frame. The trustees will have to make a decision as to whether the estate or the beneficiaries incur the tax on any income earned by the estate after the 36-month period. To the extent that the beneficiaries are not in the top personal tax bracket, it may be advantageous to allocate the income rather than taxing it in the estate.

Even where an estate can be administered with 36 months, it may not be beneficial to distribute the assets. Testamentary trusts are not used solely for tax planning purposes but are also used to benefit those individuals who may not be able to or should not control the assets directly. For example, individual beneficiaries may not be able to effectively manage the assets on their own either due to immaturity, mental or physical disability, or as a result of suffering from addictions. Many testamentary trusts also include minors and unborn children/grandchildren as beneficiaries. In these situations there may not be an option to tax the income in the hands of the beneficiaries and the estate may need to bear the higher tax costs.

Benefit of the subsection 164(6) loss carry back

Prior to legislative changes where property was disposed of in the first taxation year of the estate following an individual's death and that disposition resulted in a loss to the estate, the loss could be carried back to the individual's terminal tax return.[10] Under the new legislation, the loss can now only be carried back from a GRE to the terminal return.[11]

This change may result in capital losses being trapped in a non-GRE. Where an individual has multiple wills, only one estate can be designated as a GRE. If the non-GRE does not have any capital gains to offset the losses, those losses may never be utilized. On the other hand, where the terminal tax return included a capital gain as a result of the deemed disposition of property, but the GRE does not incur any capital losses on the disposition of property in the first year following the individual's death, there will be no means of reducing the capital gain previously taxed.

Charitable donations and pension and death benefits

Previously, where a charitable donation was made as a result of an individual's will, the donation was deemed to be made at the time of death and could only be used on the individual's terminal return or the prior year tax return. However, the new legislation deems the donation to be made when the property is actually transferred to the charity. If the estate is a GRE, the donation can be applied to the taxation year of the estate in which the donation was made, a prior taxation year of the estate, or the final two taxation years of the individual.[12] If the estate is not a GRE at the time the donation is made, the ability to apply the donation to prior years will be lost.

The rules applicable to gifting of publicly traded and other certain property will continue to apply. However, in order for these rules to apply, the individual's GRE must acquire these properties at the time of death and subsequently make the gift to the respective charity. To the extent that the GRE can make the donation within the 36-month period, any resulting capital gain on the disposition will be deemed nil.[13]

Finally, the new legislation now limits the estate's ability to pass through a pension benefit and/or death benefit to a beneficiary. This can be done only where the estate qualifies as a GRE.

Taxing income and capital gains distributed to beneficiaries in the trust

Under the current legislation, a trustee can make a designation under subsections 104(13.1) and 104(13.2), which allows the trust to choose to have distributed income taxed in the trust rather than in the hands of the beneficiaries. This was beneficial where the trust paid a lower tax rate than the beneficiaries or where the trust had losses as these losses could not be distributed to the beneficiaries. However, the new legislation now permits the trustee to make such a designation only where the taxable income of the trust will remain nil.[14] Therefore, unless the trust has losses that it can utilize, the designation will not be permitted.

10 Subsection 164(6).
11 Subsection 164(6).
12 Subsections 118.1(5.1) and 118.1(5.2).
13 Subsections 38(a.1), 38(a.2), and subparagraph 39(1)(a)(i.1).
14 Subsection 104(13.3).

Deemed disposition at death of life interest beneficiary

Where a beneficiary of an alter ego trust, a joint spousal/common law partner trust, or spousal/common law partner trusts dies, new subsection 104(13.4) deems the taxation year of the trust to end on the date of death and a new taxation year to begin on the following day. Additionally, the income earned by the trust for that taxation year ending on the beneficiary's death will now be subject to tax in the beneficiary's final tax return, including any capital gains realized on the deemed disposition of property. This could pose significant cash flow problems where the capital beneficiaries of the alter ego/spousal/common law partner trust are different than the beneficiaries of the estate of the deceased individual.

Other Legislative Changes

A number of other legislative changes will have a significant impact on testamentary trusts that do not qualify as a GRE. These changes include elimination of the $40,000 exemption for alternative minimum tax purposes,[15] subjecting estates to the instalment rules where previously taxes owing were only required to be paid 90 days following the year-end,[16] elimination of a non-GRE's ability to allocate investment tax credits to beneficiaries,[17] and requiring non-GREs to use a calendar year-end.[18]

Although a GRE may choose a non-calendar year-end, it may be more beneficial to maintain a calendar year-end. By choosing a calendar year-end the GRE will file four tax returns during the 36-month period compared to only three tax returns filed if the GRE chooses the anniversary date of death of as the year-end. This allows the GRE to access an additional set of marginal tax rates and potentially minimize tax over the 36-month period. Regardless of whether a calendar or non-calendar year-end is chosen, the GRE will be subject to a short taxation year-end.

Qualified Disability Trusts

The other exception to the top rate taxation of trusts is for QDT, which as previously indicated is a testamentary trust, whereby an annual election is filed by the trust and at least one beneficiary (electing beneficiary) who is entitled to the DTC.[19] However, close to 3.3 million[20] people suffer from some form of impairment but do not qualify for the DTC and therefore, cannot benefit from the QDT rules.

The longstanding fiscal policy in Canada is to use testamentary trusts, often referred to as "Henson Trusts", to ensure the well-being of both groups of individuals, *i.e.*, those that qualify for the DTC and those that do not. To date, these have provided long-term stability to individuals while protecting their families' savings and allowed individuals to continue to qualify for provincial and federal benefits.

Effective January 1, 2016, all of the income earned by a non-QDT will be taxed at top marginal tax rates. One option would be for a trustee to distribute and tax that income in the disabled individual's hands, resulting in the loss of important benefits for the disabled individual.

Examples of benefits affected are:

- dollar-for-dollar loss of disability benefits such as the Ontario Disability Support Program (ODSP);
- increases in "rent-geared-to-income", which in Ontario for example, is 30 per cent of taxable income; and
- claw back of tax benefits for the individuals and family members (*e.g.*, refundable medical expense supplement, working income tax benefit, HST credit, Ontario Trillium benefits, child tax benefits), which can in many cases range from 30 per cent to as high as 110 per cent of the income inclusion.

The preferred beneficiary election generally will be of no assistance. It allows income to be taxed in the beneficiary's hands without any entitlement to that income. If applicable, the income arguably should not affect provincial benefits. This election will not apply to the vast majority of circumstances, and in any event it results in the loss of all tax benefits.

The changes will, therefore, cause serious harm to those that do not qualify for the DTC. Families will face either paying tax at almost 50 per cent or the loss of benefits that in some cases will far exceed the income in question. These results are neither reasonable nor fair.

Although a QDT has the advantage of the graduated rate taxation, there will be a claw back of these benefits if the QDT ceases to have a non-electing beneficiary, ceases to be a resident in Canada or makes a capital distribution to a non-electing beneficiary. If any of these triggering events occur in a year, the QDT will be subject to top rate tax on all prior year taxable income that was not distributed to an electing beneficiary. This could result in a significant tax liability to the QDT in the year that the last electing beneficiary dies.

15 Section 127.51.
16 Paragraph 156.1(2)(c).
17 Subsection 127(7).
18 Subsection 249(4.1).
19 Subsection 122(3).
20 Tax Expenditures and Evaluations–2004: Part 2 - Tax Evaluations and Research Reports: The Disability Tax Credit: Evaluation Report, online: Government of Canada, http://www.fin.gc.ca/taxexp-depfisc/2004/taxexp04_4-eng.asp and Canadians in Context – People with Disabilities (19 January 2015), online: Employment and Social Development Canada, http://www4.hrsdc.gc.ca/.3ndic.1t.4r@-eng.jsp?iid=40.

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CONCLUSION

Despite the legislative changes to the taxation of testamentary trusts, there are still benefits to using trusts for estate planning purposes. However, it is advisable that taxpayers review their wills in light of these changes.

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CLAIMING INPUT TAX CREDITS ON GST PAID TO DELINQUENT SUPPLIERS: A REVIEW OF THE FEDERAL COURT OF APPEAL'S DECISION IN *SALAISON*

By Jamie G. Walker, Student-at-Law, Miller Thomson LLP

INTRODUCTION

On December 17, 2014, the Federal Court of Appeal upheld a decision by the Tax Court of Canada which allowed a taxpayer's appeal for input tax credits ("ITCs") that had been previously denied by the Agence du revenu du Québec ("Revenu Québec"). The FCA's decision in *Salaison Lévesque Inc. c. R.*,[1] reaffirms that revenue authorities cannot impose more responsibilities on taxpayers than those required by the applicable legislation and regulations. The decision also has significant implications for taxpayers claiming ITCs for GST paid to placement agencies providing temporary labour services.

BACKGROUND FACTS

The taxpayer, Salaison Lévesque Inc. ("SLI"), is a family-owned business founded in 1967 specializing in the production of various ham products for sale in supermarkets across Canada. The business employed approximately 75 full-time employees, had annual sales between $15-$20 million, had never been the subject of a food recall, and was considered to be a credible organization whose reputation was beyond reproach.

Because the nature of SLI's business involved intense peak periods followed by significant slowdowns, SLI hired four placement agencies (the "Agencies") between 2005 and 2009 to provide temporary labour services during busy periods. As a GST registrant under Part IX of the *Excise Tax Act*[2] (the "ETA"), SLI was required to pay the GST for services rendered by the Agencies and the Agencies were required to remit the tax collected to Revenu Québec. SLI would subsequently claim an ITC on the GST paid to the Agencies pursuant to subsection 169(4) of the ETA. Prior to retaining the Agencies' services, SLI verified the accuracy of the Agencies' GST registration numbers with the REQ [Québec enterprise register].

Following a routine audit by Revenu Québec, it became apparent that the Agencies were involved in a fraudulent scheme whereby they pocketed the QST and GST paid to them by SLI instead of complying with their remittance obligations. Because the nature of the fraud prevented Revenu Québec from locating Agency employees or recovering unpaid remittances, SLI was audited by Revenu Québec and denied $12,443.34 of ITCs for GST paid to the Agencies.

Although the Agencies had provided personnel to SLI, Revenu Québec argued that SLI was not entitled to the ITCs because it did not ensure that the Agencies had the necessary facilities and resources to deliver the personnel they were providing. In other words, Revenu Québec took the position that no real service had been provided to SLI on the basis that the Agencies lacked the necessary "capacities, expertise or material, financial, and human resources" and were not paying their workers the legal minimum wage.[3] The Agencies' invoices were deemed to be "accommodation invoices", whereby an ITC would be claimed on services that had been billed but never actually performed. SLI appealed its assessment to the Tax Court of Canada and argued that it was diligent in its dealings with the Agencies and that Revenu Québec's absence of resources argument was unfounded.

THE TAX COURT OF CANADA DECISION

On February 4, 2014, the Tax Court of Canada (TCC) released a noteworthy decision and allowed SLI's appeal. According to Justice Alain Tardif, there was no evidence that SLI had participated in the Agencies' fraud. Justice Tardif was highly critical of Revenu Québec for erroneously equating unreported resources to a lack of resources and conducting "a minimal, superficial audit"[4] simply because "[Revenu Québec] could not recover the amounts owed by the Agencies".[5] This results-driven approach of attempting to hold SLI liable for their

1 *Salaison Lévesque Inc. c. R.*, 2014 CAF 296.

2 *Excise Tax Act*, R.S.C. 1985, c. E-15.

3 *Salaison Lévesque Inc. c. R.*, 2014 TCC 36, at para. 7.

4 *Ibid.*, at para. 34.

5 *Ibid.*, at para. 37.

Agencies' remittances was fundamentally flawed and involved an incorrect interpretation of the ETA. Based on the Court's finding that the Agencies had provided SLI with supplies, Revenu Québec's conclusion that the Agencies lacked the capacity to carry on commercial activity was ill-founded.

Although the Agencies were nothing more than "...high-level tax delinquents",[6] Justice Tardif found that SLI was not responsible for policing its suppliers to ensure that they complied with their GST remittance requirements. Because SLI had complied with the ETA and the Regulations, Justice Tardif concluded that it was entitled to claim the ITCs:

> [121] For all these reasons, I conclude that the Appellant has shown that it provided ArQ [Revenu Québec] with all the information required by the ETA and the Regulation to become entitled to the litigious ITCs; it cannot lose those ITCs solely because it dealt with staffing Agencies that turned out to be tax delinquents. The appeal is therefore allowed and the assessment cancelled.[7]

THE FEDERAL COURT OF APPEAL DECISION

Revenu Québec appealed to the Federal Court of Appeal (FCA) on the following grounds: (i) that the TCC erred in reversing the burden of proof; (ii) that the TCC incorrectly concluded that SLI had demolished, on a *prima facie* basis, Revenu Québec's assumptions underlying the assessment; and (iii) that the TCC made palpable and overriding errors in interpreting the evidence. There was also a cross-appeal by SLI on the basis that Justice Tardif erred in not granting costs beyond the Tariff amount.

The FCA rejected Revenu Québec's appeal with costs, with the exception of two amounts that had been discussed but not been claimed before the TCC. In considering Revenu Québec's first and second arguments, the Court pointed out that Revenu Québec did not dispute the fact that SLI had paid for services that were rendered. Therefore, the real issue to be determined was whether the TCC was correct in allowing the ITCs for the services provided by the Agencies. The FCA rejected Revenu Québec's position that the initial burden of proof should have fallen on SLI and instead pointed out that the TCC "fully understood that Salaison was required to demolish the presumptions or assumptions formulated by the Minister by making a *prima facie* case and nothing more" [translation].[8] Only after this had been done was Revenu Québec required to prove the merits of its claim, which it was unable to do.

The FCA also rejected Revenu Québec's third argument that the TCC erred in interpreting the evidence. Justice Tardif was entitled to consider all of the evidence in deciding whether to draw a negative inference from the fact that there were no representative witnesses from the Agencies as a result of the fraud. By considering all of the available evidence, the TCC was justified in concluding that the Agencies were carrying on commercial activities and that they had rendered the services to SLI. It was also within Justice Tardif's discretion to determine that the manner in which the Agencies paid, recruited, and declared their employees was irrelevant in determining whether they had actually provided services to SLI. According to the FCA, "the weight to be given to the absence of payroll records or incomplete records depends on the context and on the other evidence adduced at trial" [translation].[9]

The FCA also commented on how Revenu Québec had amended its position on appeal to argue that the "accommodation invoices" were in fact "false invoices". Here, Justice Gauthier distinguished "false invoices" from "accommodation invoices" and held that "'false invoices' had to be interpreted more broadly to include *inter alia* cases in which the purchaser of a supply is not involved in a scheme with the issuer of the invoices, but in which the information appearing on the invoice in question is said to be inaccurate" [translation].[10]

As a result, the FCA concluded that the TCC did not err in concluding that Revenu Québec's position was unfounded and that SLI had discharged its burden of proof. On the issue of the cross-appeal, the FCA ordered the case back to Justice Tardif for a determination of the quantum of costs issue.

IMPLICATIONS

The FCA's decision in *Salaison* sends a strong message to the legal community that revenue authorities, such as Revenu Québec, cannot hold a taxpayer liable for the tax collected but not remitted by suppliers. The future impact of *Salaison* remains to be seen, however, since the Crown has until February 16, 2015 to seek leave to appeal to the Supreme Court of Canada.

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6 *Ibid.*, at para. 60.
7 *Ibid.*, at para. 121.
8 *Supra* note 1, at para. 25.
9 *Ibid.*, at para. 37.
10 *Ibid.*, at para. 14.

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CASES OF NOTE

1057513 Ontario Inc. v. R. (2014 CarswellNat 3578 (T.C.C. [General Procedure]), under appeal to F.C.A.) — Bocock J. — The corporate taxpayer failed to file its income tax returns for taxation years 1997 to 2004. The taxpayer paid dividends to shareholders in those years. Upon receipt of the taxpayer's returns, the Minister assessed Part IV dividend tax, interest and penalties of over $2 million and denied the dividend refund. The taxpayer appealed the reassessment to the Tax Court of Canada and the appeal was dismissed. The Court concluded that the presence of the filing deadline in subsection 129(1) as a requirement, together with the generous time frame for the filing of income tax returns culminating in a dividend refund are not disharmonious with the regime of the *Income Tax Act*. The Court found no ambiguity in the statutory language of subsection 129(1) after a full textual, contextual and purposive analysis. Filing within the deadline is a mandatory condition precedent to receiving the dividend refund. The filing of tax returns is a fundamental duty imposed on taxpayers, and the additional delay with respect to the timing of such filings in relation to the dividend refund provision was characterized as a generous grace period in the circumstances.

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Brent Kern Family Trust v. R. (2014 CarswellNat 4166 (F.C.A.), under appeal to S.C.C.) — Dawson, Stratas and Near JJ.A. — The individual shareholder of a business and holding company arranged his affairs so that the shareholder and the business were the beneficiaries of the Brent Kern Family Trust ("the BK Family Trust"), while the shareholder and the holding company were beneficiaries of a second trust. The shareholder exchanged his common shares in the business and the holding company for preferred shares, sold the shares of the holding company to the BK Family Trust, and sold the shares of the business to the second trust for fair market value consideration. The business declared a dividend in favour of the second trust, which in turn allocated the same amount to the holding company. The holding company declared a dividend in the same amount on the shares owned by the BK Family Trust, which the shareholder claimed was received by the business, and allocated to the shareholder who then lent the amount back to the business. The Minister assessed the BK Family Trust for 2005 and 2006, finding that it had not reported taxable dividends. The BK Family Trust appealed on the grounds that the taxable dividends were attributed back to the beneficiary under subsection 75(2) of the *Income Tax Act*. The trial judge found that subsection 75(2) was not applicable to property transferred to a trust by a beneficiary for valuable consideration and dismissed the appeal. Subsection 75(2) applies universally, absent of intent and subjectivity, but it does not include a genuine transfer for value to a trust by a beneficiary. The trial judge found that the dividend income was not attributable to the business, but instead remained to the benefit, and for the account of, the BK Family Trust. The BK Family Trust appealed the decision of the Tax Court to the Federal Court of Appeal and the appeal was dismissed. The trial judge made no error and properly evaluated the case law with respect to subsection 75(2).

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Hauser v. R. (2014 CarswellNat 4419 (T.C.C. [Informal Procedure]) — Woods J. — The taxpayer moved from Cochrane to Calgary to be closer to work. The taxpayer deducted moving expenses of $17,000 in respect of an "eligible relocation", as defined in subsection 248(1) of the *Income Tax Act*, which requires that the new home is at least 40 kilometres closer to the work location than the old home. The Minister assessed the taxpayer and disallowed the moving expenses. The taxpayer appealed to the Tax Court of Canada and the appeal was dismissed. The distance between the new home and the new work location was 15 kilometres. The taxpayer claimed that the distance between the old home and the new work location was 60 kilometres, whereas the Minister claimed that it was only 40 kilometres when using the normal road route. This would mean that the new home was only 25 kilometres closer to the new work location than the old home, which would not meet the required minimum of 40 kilometres. The Court determined that, although the taxpayer took the longer route to avoid construction, the distance must be determined by shortest route that one might travel to work, as long as it is the normal route used by the traveling public. In this case, the shortest route was 40 kilometres. The use of the term distance in the legislation does not exclude routes under construction, so long as the construction does not take an inordinate amount of time. The benefit of a move is expected to benefit taxpayers over many years, and temporary projects (such as road construction) should not be considered.

ON THE RADAR

Cost of Making Voluntary Disclosure

In Views document 2014-0528451C6 dated February 4, 2015 at the May 2014 Ponoka Liaison Meeting, the CRA was asked to reconsider its position on the deductibility of costs incurred by taxpayers to respond to queries from the CRA, to prepare tax returns, or to make a voluntary disclosure.

Paragraph 60(o) of the *Income Tax Act* allows taxpayers to deduct reasonable fees and expenses incurred and paid for advice or assistance in respect of an objection or appeal even if the expenses are not otherwise deductible (for example, under section 9 or paragraph 8(1)(f)). As explained in paragraph 7 of

IT-99R5, "Legal and Accounting Fees", on an administrative basis, the CRA allows taxpayers to deduct reasonable expenses incurred to respond to inquiries from the CRA, whether or not a formal notice of objection or appeal is subsequently filed. The CRA has reviewed the administrative position and is not prepared to extend it beyond what has already been granted.

CRA document 2012-0437831E5 explains that the CRA does not consider the costs incurred to make a voluntary disclosure to be deductible under paragraph 60(o), nor would they generally be incurred to earn income from a business or property. However, where a taxpayer earns income from a business, the cost of making a voluntary disclosure relating to that business may be deductible as a cost of representation pursuant to paragraph 20(1)(cc).

Restrictive Covenants

In Views document 2014-0547251C6 dated January 14, 2015 at the 2014 CTF Annual Tax Conference Round Table, the CRA was asked to reconsider its position that the allocation in an agreement of $1 of consideration to a restrictive covenant, merely to ensure that the agreement constitutes a legally binding contract, constitutes proceeds for the purpose of paragraphs 56.4(6)(d) and (7)(e) of the *Income Tax Act*

The CRA has reconsidered its earlier response to this question as set out in document 2014-0522961C6, and is now prepared to accept that where a contract relating to granting a restrictive covenant uses words such as "$1 and other good and valuable consideration" simply to ensure that the contract is legally binding, and means in effect that "no more than a $1 worth of consideration" is conveyed by a purchaser for the restrictive covenant, such consideration will not, in and of itself, constitute proceeds received or receivable by the party for granting the restrictive covenant for purposes of paragraph 56.4(6)(e) and paragraph 56.4(7)(d). However, this treatment is subject to the potential application of anti-avoidance rules such as subsection 56.4(10) of the Act.

If more than nominal consideration of $1 is paid for a restrictive covenant under the wording "$1 and other good and valuable consideration", the exceptions set out in subsections 56.4(6) and (7) would not apply because the respective conditions in paragraph 56.4(6)(e) and paragraph 56.4(7)(d) would not be met. In such cases, the amount of proceeds received or receivable by the taxpayer for the restrictive covenant would be taxable as ordinary income under subsection 56.4(2), unless one of the three exceptions in subsection 56.4(3) otherwise applies.

Streaming Partnership Income

In Views document 2014-0547311C6 dated January 14, 2015 at the 2014 CTF Annual Tax Conference Round Table, the CRA was asked if it accepts the streaming of certain types of income (*e.g.*, interest income) to a particular partner of a partnership where the partnership agreement provides for such allocation.

Generally, the CRA has not accepted the streaming of certain types of income, such as interest income, to a particular partner of a partnership, even if the partnership agreement provides for the allocation. It is the CRA's view that the streaming of certain types of income to a particular partner is not acceptable by virtue of subsection 103(1).

The CRA provided the following example to illustrate its position: assume a partnership is made up of two corporate members. Partner A expects to incur losses in excess of its income from the partnership, while Partner B expects to earn income from the partnership, as well as from other sources. A and B agree to amend the partnership agreement so that the interest income of the partnership will be allocated to A and the dividend income (which is deductible under subsection 112(1)) will be allocated to B. The additional interest income allocated to A will not result in taxable income since it can be offset by A's losses from other sources. That interest income, if allocated to B, would have generated additional taxable income to B. As a result of the amendment to the partnership agreement, B's tax payable is reduced. In these circumstances, the CRA would seek to apply subsection 103(1) (and may also apply the GAAR in section 245) to the allocation of income under the amended partnership agreement.

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