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THE CRA TFSA AUDIT PROJECT: WHO GETS AUDITED AND WHY?

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INTRODUCTION

In 2009, the federal government introduced the tax-free savings account ("TFSA") program as a means of promoting investment in the Canadian economy and assisting Canadians in saving for the future. Under the TFSA program, individuals over the age of 18 are entitled to contribute annually up to $10,000 (as increased by the proposed federal budget of April 21, 2015) to a TFSA (previously $5,500 for 2013 to 2014 and $5,000 for 2009 to 2012), up to an aggregate contribution limit of $41,000 for 2015 (including the proposed limit). Unlike registered retirement savings plans ("RRSPs"), contributions to a TFSA are not tax-deductible. However, investment returns within a TFSA are generally tax-free and both contributions and returns may be withdrawn from the TFSA tax-free.

The Canada Revenue Agency (the "CRA") is currently engaged in a large-scale audit project of TFSAs, focusing largely on investors who have achieved significant growth in their TFSAs. As a result of this audit project, the CRA has begun issuing a significant number of assessments proposing to: (1) tax income and gains within the TFSA on the basis that it was carrying on a business; or (2) deregister the TFSA on the basis that the TFSA borrowed money or property. Some of the audits are going as far back as the 2009 taxation year, as there is practically no time limit on issuing a TFSA assessment (as the required annual returns for TFSAs are typically not filed and, without a filing, the limitation period never starts).

TFSAS CARRYING ON A BUSINESS

The CRA is specifically targeting TFSAs engaged in active trading. The *Income Tax Act* (the "Act") provides that, if a TFSA carries on a business, it is taxable on the income earned from that business. The CRA says that a TFSA that successfully engages in frequent trading is carrying on a business of trading in securities, and therefore gains from the sale of securities by the TFSA should be taxed as business income.

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To determine whether a TFSA is carrying on a business of trading in securities, the CRA applies factors that have been developed over the years in tax case law for determining whether an individual's or company's gains or losses from dispositions of securities are on income or capital account. The factors are:

(1) frequency of trading transactions;

(2) length of time the securities are owned;

(3) the taxpayer's level of knowledge and experience in the securities market;

(4) whether securities transactions form part of the taxpayer's ordinary business;

(5) the amount of time the taxpayer spends studying the securities markets and investigating potential purchases;

(6) whether securities purchases are financed by debt;

(7) whether the taxpayer has advertised that he or she is willing to purchase securities; and

(8) the nature of the securities, *i.e.*, whether they are income producing or speculative.

The CRA views the size of the TFSA account as an important indicator of whether there is a business of trading. If the maximum contributions have been made from 2009 to 2015, the TFSA will have received $41,000 of contributions. If the current value of the TFSA is, for example, more than $150,000 and there have been a lot of securities trades with short hold periods, factors 1 and 2 will be triggered, and the CRA may also take the position that the extraordinary growth indicates that the person directing the TFSA's investments has a professional level of knowledge of the securities markets and must be spending a significant amount of time on the TFSA's trading (therefore satisfying factors 3 and 5).

Where it is determined that a TFSA is carrying on a business, taxes are imposed on the income earned by the TFSA. Income that is subject to tax within the TFSA includes dividends and interest and the full amount of gains net of losses (without the benefit of the normal 50% inclusion rate).

The Act also provides that the Minister may require that any "specified non-qualified investment income" (*i.e.*, second and subsequent generation income earned on the income from a business carried on by the TFSA) be distributed to and taxed in the hands of the TFSA holder. If secondary income is not distributed within 90 days, a 100% tax is payable on the secondary income pursuant to the advantage rules under the Act. Notwithstanding the provisions of the Act, the CRA has adopted a particularly aggressive position with respect to required distributions where it has determined that a TFSA is carrying on a business. Specifically, the CRA will typically require the withdrawal of all value in the TFSA, except contributions.

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It is arguable that the provisions of the Act respecting the taxation of TFSAs found to be carrying on a business were not intended to prohibit active trading within a TFSA. Rather, the purpose of these provisions is clear: TFSAs should not be permitted to compete on a tax-exempt basis with taxable businesses, as this would constitute an unfair disadvantage to taxable businesses. No unfair disadvantage results, however, from a TFSA trading frequently in marketable securities. Further, it is clear that Parliament intended that TFSAs earn income from marketable securities as investments, which invariably requires buying and selling them from time to time.

The Act also provides that if an RRSP carries on a business, the RRSP is taxable on the income from the business. As the RRSP rules predate those of the TFSAs, the carrying on of business exception for TFSAs was no doubt modeled on the similarly-worded RRSP rule. Yet the CRA has not, as far as we know, sought to tax the gains of RRSPs engaged in frequent trading as business income. This may be because withdrawals from an RRSP are ultimately taxable anyway, while withdrawals from a TFSA are not. However, the different tax treatment of withdrawals should not be relevant to the interpretation and application of virtually identical provisions in the RRSP and the TFSA rules.

There is some case law support for the conclusion that a person trading within an RRSP is not considered to be carrying on a business (*Prochuk v. R.*, 2014 TCC 17; *Deep v. R.*, 2006 TCC 315). However, there have not, to date, been any cases that comment on the meaning of "carrying on a business" with respect to a

TFSA. Broader case law regarding the trading in securities as a business may support the CRA's argument in assessing TFSAs as carrying on a securities trading business.

TFSAS THAT ARE BORROWING FUNDS

The second main area of focus in the CRA's TFSA audit project is TFSAs with negative account balances. The Act prohibits a TFSA from borrowing money or property, with the penalty being loss of tax-free status. The CRA has stated that, where a TFSA has a negative account balance, the TFSA has borrowed funds with the result that the TFSA should be deregistered. Deregistration results in a loss of tax-exempt status and a deemed taxable disposition of the securities in the TFSA.

There are several reasons unrelated to financing as to why a TFSA may have a negative account balance. For example, a negative balance may be the result of a "settlement mismatch". This would occur where, prior to the settlement date for a purchase of securities, the TFSA places an order with its broker to sell securities in order to provide funds to cover the purchase, but the sale settles one or two days after the settlement date for the purchase. The result is that the TFSA account balance goes negative for a short period of time.

The CRA may be incorrect in its position that a negative TFSA account balance generally represents a liability on the part of the TFSA as a borrower to the broker as lender. Case law is clear that a lender/borrower relationship is a contractual relationship, whereby the lender agrees to loan money to the borrower and the borrower agrees to repay the loan. In the context of TFSAs, there is no loan agreement. Rather, because TFSA brokerage accounts are cash accounts (as opposed to margin accounts), lending and borrowing transactions are not permitted by the TFSA's account agreement.

Purchases of securities by a TFSA may occur in one of two ways. Most commonly, a broker may facilitate the sale of securities to the TFSA by someone else. In these cases, the broker acts as an agent for the TFSA in purchasing the securities. Where a debit position occurs as a result of such "agent transactions", it is arguable that the negative TFSA account balance does not represent a loan from the broker to the TFSA, but may indicate that the broker has incurred a cost, as an agent, on behalf of the TFSA and the TFSA is liable to reimburse the broker for this cost in accordance with the principles of agency law.

In other cases, a TFSA may purchase securities from a broker as principal. In these transactions, the broker is selling shares owned by the broker to the TFSA. This will occur, for example, where the broker has acquired shares directly in an initial public offering or new issue, and then resells the shares to the TFSA. Where a debit position occurs as a result of these transactions, the negative TFSA account balance does not represent a loan from the broker to the TFSA. Rather, the relationship is one of purchaser and vendor, and the debit position represents the unpaid purchase price owing by the TFSA to the broker.

In both kinds of transactions, a TFSA account may have a negative balance. However, the negative balance does not necessarily mean that the TFSA has borrowed funds from the broker. Accordingly, there would be no breach of the TFSA rules and no basis on which to deregister the TFSA.

PROBLEMS FOR THE FINANCIAL INDUSTRY

If the CRA issues a tax assessment to a TFSA on one of the bases described above, the trust company that held the TFSA account during the period assessed is liable for the tax if the assessment is upheld. This poses significant problems for the financial industry, as it is common practice for taxpayers to move their TFSA investments from one financial institution to another. As a result, by the time the financial institution receives an assessment from the CRA, the TFSA to which it relates may have been moved to another financial institution. This creates a high degree of uncertainty for the financial industry and may incentivize the use of holdbacks and other limitations on the mobility of TFSAs.

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WHY SHOULD A CORPORATION OWN LIFE INSURANCE?

By Tina Tehranchian, Senior Financial Planner and Branch Manager, Assante Capital Management Ltd.

If you own a business, there are several reasons you would need life insurance in the context of your business. The most common reasons are the following:

Funding a buy-sell agreement – life insurance can provide the funds needed to buy out the interests of a deceased shareholder due to an unexpected death. This ensures that the deceased's survivors are paid in a timely manner and that the business functions smoothly for the surviving owners. In a corporate setting, it would be prudent to document the fact that the proceeds of the life insurance should be used to buy out the interests of a deceased shareholder in a binding shareholders agreement.

Key person protection – Upon the loss of a key employee or shareholder due to premature death, life insurance can provide the capital to maintain the operations of the business and find a replacement for the deceased key individual. The funds can provide the financial cushion needed until a suitable replacement can be found and stability is returned to the operation of the business. The coverage may include not only the cost of finding a replacement for the key person but also direct lost revenue and extraordinary expenses that may arise as a result.

Estate tax liabilities – Upon the death of a shareholder, his shares in the business are deemed disposed by Canada Revenue Agency and estate tax liabilities arise as a result. The good news is that qualifying small business corporation shares are entitled to make use of the $800,000 lifetime capital gains, and if interests in the business are rolled over to a surviving spouse, the tax related to the disposition of shares can also be deferred.

Income replacement – Business income is usually the main source of income for most business owners, and loss of your ability to earn an income due to an accident or sickness can be devastating if you happen to be the breadwinner of your family. Therefore, it is important to assess your personal and business needs at the same time to make sure that there is adequate funding in place to provide income for your family in the event of your death.

TAX ISSUES RELATING TO CORPORATE-OWNED LIFE INSURANCE

A common misconception is that life insurance premiums are tax-deductible for a corporation. The truth of the matter is: except in very isolated circumstances, life insurance premiums are not tax-deductible for a corporation just as they are not when a policy is owned personally.

However, if the premiums for the policy are paid by the corporation, it is generally less costly than paying the premiums personally. This is because personal marginal tax rates are considerably higher than corporate tax rates (for Canadian Controlled Private Corporations). The corporation can pay the premiums itself, or issue a dividend to the shareholder to pay the premiums personally. Since the shareholder will be taxed on the dividend, it means that less cash would be available for the purpose of paying premiums in the shareholders' hands, thus requiring a larger dividend to be issued by the corporation in order to net down to the required amount needed for paying the premiums.

When it comes to the death benefit of a life insurance policy, it is paid out tax-free to the beneficiary of the policy, whether the beneficiary is an individual or a corporation. When a corporation owns a policy, either the corporation itself or a subsidiary corporation would be named as beneficiary. Otherwise, the payment of the death benefit could give rise to a taxable shareholder benefit. Similarly, if a corporation pays the premium on a policy owned by a shareholder, a shareholder benefit would arise.

While a corporation receives insurance proceeds tax-free, these proceeds (except in the case of key person insurance) still ultimately need to end up in the beneficiaries' hands and need to be extracted from the corporation. Fortunately, there is a mechanism called the Capital Dividend Account that allows for the death benefit of a life insurance policy that is received by the corporation on a tax-free basis to be transferred into the hands of shareholders and beneficiaries on a tax-free basis.

A corporation's capital dividend account, or CDA, is a notional account that keeps track of items such as life insurance proceeds and the non-taxable portion of capital gains. If the declared dividends to a shareholder are elected to come from the CDA, they will not be taxable. The CDA is consequently reduced by the amount of such dividends. This election may also apply to deemed dividends that occur when shares are redeemed. An example would be when a surviving spouse decides to wind up the corporation after the death of his/her business owner spouse.

Tax implications of funding and receiving insurance through a corporation are complex and you need to consult a financial advisor who is well-versed in dealing with estate planning issues relating to business owners, as well as your tax and legal advisors to put the right structures and coverage in place.

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HOW TO SUE THE CRA

By Graham Purse, Associate, Miller Thomson LLP

INTRODUCTION

A taxpayer's interaction with the Canada Revenue Agency (the "CRA") can give rise to two distinct legal proceedings. The first is a court proceeding to determine whether the amount of tax assessed is correct. The second is a court proceeding to challenge the behaviour of the CRA's personnel in carrying out their work.[1]

This article is concerned with the second type of court proceeding: instances where the actions of the CRA (or provincial revenue authorities) are called into question. Generally, the taxpayers lose these lawsuits. Many of these types of lawsuits are probably frivolous: CRA personnel are generally reasonable. There are, however, a number of suits in which CRA personnel have engaged in behaviours that are fundamentally incompatible with the rule of law and shock the conscience of the reader.

Only recently have taxpayers had some success against the revenue authorities in civil suits. In these cases, the taxpayer has typically been rendered impecunious. The result is an injustice – a pauper plaintiff fighting Leviathan. These cases are very much manifestations of Thomas Hobbes, Friedrich Hayek and John Rawl's reflections on the coercive power of the state. Only with *Archambault* and *Leroux*, each considered below, does it now appear that courts may be willing to take the CRA and provincial revenue authorities to task for instances of misconduct.

LAWSUIT SHOULD NOT COLLATERALLY ATTACK UNDERLYING ASSESSMENT

It is important to distinguish between taxes assessed and the conduct of the CRA. They are two very different things, although the facts are generally intertwined. While the CRA may act unfairly or even illegally in arriving at an assessment or reassessment of taxes, that conduct is generally not relevant to determining whether the underlying tax liability is valid. A survey of the case law reveals that taxpayers often conflate these issues.

Indeed, in *Main Rehabilitation Co. v. Canada*,[2] the Federal Court of Appeal has explained that section 169 of the *Income Tax Act* (the "ITA"),[3] which provides the statutory basis of appeals to the Tax Court of Canada (the "TCC"), is the vehicle by which the TCC establishes the validity or invalidity of an assessment. The issue on appeal is not the process by which the assessment is established.[4] What is in issue at the TCC is whether amounts can be properly shown to be owing in accordance with the provisions of the ITA.[5] This logic undoubtedly extends to *Excise Tax Act* assessments and reassessments.

1 See Notes to D. Sherman's Annotated Income Tax Act at ss. 171(1).
2 *Main Rehabilitation Co. v. Canada*, 2004 FCA 403.
3 *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.).
4 *Supra* note 2 at para. 8.
5 *Ibid.*

STATUTORY SCHEME AND CONCURRENT JURISDICTION

The case law reviewed herein reveals that civil actions taken against the CRA are generally launched in provincial superior courts. However, there exists concurrent jurisdiction with the Federal Court of Canada. It is important that an aggrieved taxpayer not attempt to commence a civil suit (or attempt to graft the underpinnings of a civil suit) onto a proceeding at the TCC. This is because the TCC lacks the jurisdiction to grant any such relief.

It remains to be seen – although the author is very doubtful of the same – whether conduct so egregious by the CRA would ever come before the TCC that the TCC would vary or set aside an assessment on the basis of the impropriety or misconduct of the CRA. In any case, the jurisdiction of the TCC is specifically circumscribed by the *Tax Court of Canada Act*, which limits the court to the consideration of matters arising, generally speaking, from federal revenue statutes.[6] As such, a decision of the TCC rendered on the basis of CRA impropriety would be an error of law.[7]

Cases against the CRA typically allege negligence and misfeasance. These claims can be brought in either provincial superior court or the Federal Court of Canada. If the claim is brought in a provincial superior court, then the province of residence of the taxpayer would be the appropriate forum in which to launch the claim, unless circumstances would otherwise dictate.

The Supreme Court of Canada has explicitly endorsed concurrent jurisdiction.[8] The *Crown Liability and Proceedings Act* (the "CLPA") provides for concurrent jurisdiction.[9] Under the CLPA, the Crown is liable for damages resulting from torts by servants of the Crown.[10] The *Federal Courts Act*, in turn, provides that the Federal Court has concurrent original jurisdiction in respect of claims for damages under the CLPA.[11]

RECENT CASE LAW

No Duty of Care in Respect of another Taxpayer's Assessment (*783783 Alberta Ltd. v. Canada*)

This case involved a competition between Edmonton's free weekly newspapers. *Vue Weekly* sued the CRA in an attempt to force the CRA to deny deductions to advertisers in its competitor, *SEE Magazine*. This suit was brought on the basis

6 *Tax Court of Canada Act*, R.S.C. 1985, c. T-2, s. 12.
7 As the TCC lacks jurisdiction to grant equitable remedies, a wronged taxpayer would have to look elsewhere for relief.
8 *Canada (Attorney General) v. TeleZone Inc.*, 2010 SCC 62. See, *inter alia*, para. 22.
9 *Crown Liability and Proceedings Act*, R.S.C. 1985, c. C-50, s. 21(1).
10 *Ibid.*, s. 3(b)(i).
11 *Federal Courts Act*, R.S.C. 1985, c. F-7, s. 17(2)(d).

that Conrad Black, SEE Magazine's ultimate owner, had renounced his citizenship.[12]

Section 19 of the ITA enables taxpayers to deduct expenses incurred from advertising in a Canadian newspaper, but not from advertising in a non-Canadian newspaper. In this way, if it could be shown that SEE Magazine was non-Canadian, then the deductions should not be allowed.

Ultimately, the Alberta Court of Appeal (the "ABCA") did not endorse *Vue Weekly's* anti-competitive behaviour. The decision engaged in an analysis of the elements of a negligence action. The ABCA noted that there "was no prior case establishing liability on the part of tax collectors to one group of taxpayers based on the taxes imposed on another group of taxpayers"[13] and "the relationship is not one where the tax assessors should be responsible for protecting taxpayers from losses arising from competitive disadvantages of the type pleaded".[14] The ABCA concluded that policy considerations precluded a private law duty in tort (but see *Leroux*, below) and that the relationship between each taxpayer and the assessor is personal and private.[15]

The ABCA can be commended in this judgment for their practical approach to the problem of tax assessing. It would be practically impossible to assure that tax laws are applied consistently from taxpayer to taxpayer. Further, the plaintiff in this case was actuated by a desire to stymie their market competitor. Even if the arguments of the plaintiff were correct as a matter of law (which was not relevant to the disposition of the case) there is a strong public policy rationale to deny the relief sought.

The Use of Information Obtain in Discoveries (*506913 N.B. Ltd. v. McIntyre*)

In *506913 N.B. Ltd. v. McIntyre*,[16] the taxpayer sought to rely on answers given by a CRA representative in the TCC proceeding at his examination for discovery for a separate civil proceeding. Tax appeals were ongoing in respect of input tax credits under the *Excise Tax Act*.[17]

Normally, and as was the case here, there is an implied undertaking that answers given to questions at examinations for discovery are to be used only in the litigation to which they relate. The plaintiff, however, argued that it was in the public interest to set aside the implied undertaking. Justice Rideout disagreed.[18]

12 *783783 Alberta Ltd. v. Canada*, 2010 ABCA 226, para. 5.
13 *Ibid.*, para. 44.
14 *Ibid.*, para. 45.
15 *Ibid.*, para. 46.
16 *506913 N.B. Ltd. v. McIntyre*, 2012 NBQB 225.
17 *Ibid.*, para. 4.
18 *Ibid.*, para. 26.

Charter Equality Rights Not Infringed by Differing Assessments (*Tennant v. Minister of National Revenue*)

Although not explicitly stated in the judgment, the *Tennant* case[19] appears to involve subsection 15(1) of the ITA – a benefit conferred by a corporation on the taxpayer. The plaintiff taxpayer sued on the basis that, while he was assessed for the benefit, a similarly situated taxpayer who had engaged in a very similar transaction had not been assessed as having received a benefit.

The lawsuit was brought on the basis of section 15 of the *Canadian Charter of Rights and Freedoms*,[20] which provides for equality before and under the law, except to the extent it is circumscribed by section 1. Justice Sanderman held that section 15 was intended to cover differential treatment based on immutable personal characteristics, such as race, religion, sex or disability. The plaintiff failed because he was unable to show that the differing treatment resulted from an immutable personal characteristic.[21]

Tax Court does not have Jurisdiction to Hear Civil Claim (*Ereiser v. Canada*)

As explained, the validity of a tax assessment is separate and apart from any liability of the CRA. In *Ereiser*, the Federal Court of Appeal considered this issue.[22] The Crown had successfully moved to strike a number of paragraphs of Ereiser's Notice of Appeal.

The underlying allegations of fact were this: the CRA officer attempted to have the taxpayer plead guilty to criminal charges, rather than face an assessment nearing $2 million, despite the fact that the taxpayer was never actually the subject of a criminal investigation. There were other abuses by the CRA officers.

Justice Sharlow provided a useful overview of this area of law. She explained that the Federal Court and provincial superior courts will often decline to entertain an application that is a collateral attack on the validity of an assessment.[23] She also used the *Leroux* appeal (related proceedings considered herein) to illustrate that actions against tax officials may raise justiciable issues apart from the correctness of the assessment.[24] The latter is not justiciable in such a forum.

19 *Tennant v. Minister of National Revenue*, 2012 ABQB 108.
20 Part I of the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (UK), 1982, c. 11.
21 *Tennant*, *supra* note 19 at para. 17.
22 *Ereiser v. Canada*, 2013 FCA 20.
23 *Ibid.*, para. 35.
24 *Ibid.*, para. 36.

She arguably provides the clearest, most precise statement of this area of law:[25]

> It may be that in this case, the reassessments under appeal will be found to be valid and correct. In that case, they will represent a correct statement of Mr. Ereiser's statutory obligations under the *Income Tax Act*, and they will not be vacated as part of the statutory appeal process for income tax appeals. However, they will be vacated if they are found to be invalid or entirely incorrect. If they are found to be incorrect in part, they will be vacated and referred back to the Minister for reassessment. But regardless of the outcome of Mr. Ereiser's income tax appeal, it will remain open to him to seek a remedy in the Federal Court or the superior court of a province, depending upon the circumstances, if he has a tort claim or an administrative law claim arising from the wrongful conduct of one or more tax officials.

Faulty Pleadings and Limitations Issues Can Bar an Action (*Foote v. Canada*)

The *Foote* decision[26] stands as an important reminder that pleadings and limitations issues must be considered. In this case, the taxpayer was assessed for underreported income. The CRA's investigation included searches at his home and place of business. Upon declaring bankruptcy, the taxpayer's objections were abandoned.

Much of the claim was struck as challenging the underlying assessment, which was outside of the jurisdiction of the Supreme Court of British Columbia.[27] In the case of the negligence claim, it was struck as the facts to support such a claim were not properly pleaded.[28] As the misfeasance claim related to actions that were limitation barred (the execution of the search warrant in 2007), that claim could not proceed.[29] Ultimately, most of the claim was struck, but the misfeasance action was allowed to proceed.[30]

The CRA Commences Criminal Proceeding against Taxpayer on Invalid Basis (*McCreight v. Canada (Attorney General)*)

This case represents astonishing allegations of misfeasance against the CRA. It is also a warning to professional advisors about the lengths to which the CRA will go. In *McCreight*,[31] the CRA investigated the use of research and development tax credits. The investigation included tax advisers in a large accounting firm.[32] There were wranglings over the retention of seized documents by the CRA.

Ultimately, and somewhat shockingly, Justice Quinn found that the CRA investigator had sworn an information alleging fraud and conspiracy against, *inter alia*, the accountants "primarily to retain possession of the seized documents".[33] The charges were dismissed against the accountants and the corporate taxpayers on the basis of unreasonable delay pursuant to section 11(b) of the Charter.[34] The litigation is ongoing, and the claims for misfeasance in public office, negligence, and abuse of process have been allowed to proceed.[35]

Freeman/Natural Person/OPCA-based Claims are Frivolous (*Sinclair-McDonald v. Her Majesty the Queen*)

This case was bound to fail. The taxpayer, Sinclair-McDonald, asserted that she had waived her rights as a person under the law.[36] The notion that someone can unilaterally waive the state's jurisdiction to tax is risible, but that was the taxpayer's position. She further sought an order that the CRA pay back all taxes collected from her for the past 10 years.[37] This latter position was also incorrect.

It was correctly held that Parliament has the authority to legislate with respect to taxation and that Crown employees cannot be held liable for doing something that they are authorized to do by statute.[38] For these reasons, the statement of claim was struck as frivolous, vexatious, and an abuse of process.[39] For more on the puerility of tax protestor arguments see *Meads v. Meads*.[40]

Damages Assessed against Revenu Québec for Malicious Behaviour (*Archambault v. Revenu Québec*)

The *Archambault* case,[41] currently under appeal, is one example of substantial success in Canada against a revenue authority – in this case Revenu Québec. The case involves successful allegations of bad faith brought against Revenu Québec. Justice Reimnitz held that Revenu Québec acted intentionally and breached the taxpayer's rights under the Québec Charter.[42]

Revenu Québec was held to have withheld the taxpayer's research and development tax credits to put financial pressure on the taxpayer, seized the taxpayer's bank account when it

25 *Ibid.*, para. 38.
26 *Foote v. Canada*, 2013 BCCA 135.
27 *Ibid.*, at para. 8.
28 *Ibid*.
29 *Ibid.*, at para. 16.
30 *Ibid.*, at para. 17.
31 *McCreight v. Canada (Attorney General)*, 2013 ONCA 483.
32 *Ibid.*, para. 3.
33 *Ibid.*, para. 6.
34 *Ibid.*, para. 8.
35 *Ibid.*, para. 74.
36 *Sinclair-McDonald v. Her Majesty the Queen*, 2013 ONSC 4900, para. 1.
37 *Ibid.*, para. 1.
38 *Ibid.*, para. 22.
39 *Sinclair-McDonald*, *supra* note 36 at para. 23.
40 *Meads v. Meads*, 2012 ABQB 571.
41 *Archambault v. Revenu Québec*, 2013 QCCS 5189.
42 *Charter of Human Rights and Freedoms*, C.Q.L.R., c. C-12.

had no right to do so and kept the taxpayer in the dark about proceedings, making a defence difficult or impossible.[43] Justice Reimnitz explained that this case was far from a simple error: it was malicious and intentional.[44]

Damages were assessed at $4,000,000, of which $2,000,000 constituted punitive damages. This is the only case of which the author is aware in which a Canadian revenue authority has been reasonably punished for highhanded abuse.

CRA Owed Duty of Care and Breached that Duty (*Leroux v. Canada Revenue Agency*)

The *Leroux* decision is the second case in which the CRA has been found to be in breach of a legal standard.[45] However, liability was not assessed in this case.

The CRA took the position that it owed no private law duty of care to an individual taxpayer.[46] However, Justice Humphries held that CRA auditors owe a duty of care to taxpayers.[47] This duty includes a duty of care to take reasonable care in assessing penalties.[48] She further explained that the gross negligence penalties, as were considered and assessed in this case evidenced a clear breach of the standard of care.[49] The issues were in fact highly complex.[50]

The taxpayer was ultimately unsuccessful on the basis that no causation was shown, in combination with issues of contributory negligence and failure to mitigate.[51] The case, however, remains important as specifically describing a standard of care owed to the taxpayer.

CHART OF OUTCOMES

Case	Facts	Causes of Action	Result/Disposition
783783	Challenge to correctness of tax assessment against non-party	Alleged private law duty of care in tort owed to plaintiff taxpayer	Fail (no duty owed)
506913 N.B. Ltd.	Taxpayer appealing HST assessments made by CRA. This was separate civil suit	Negligence, abuse of powers, abuse of process and malicious prosecution	**Ongoing**
Tennant	15(1) benefit assessed against taxpayer, but not similarly situated taxpayer	Discrimination contrary to s. 15 of the Canadian Charter (equality rights)	Fail (did not establish immutable personal characteristic as being in issue)
Ereiser	CRA threatens $1.7 million assessment to induce guilty plea to criminal charges	Misfeasance (and administrative law claim)	Fail (action brought in incorrect court)
Foote	CRA investigates for tax evasion and obtains search warrant that CRA employees executed at taxpayer's home and business. No criminal charges laid	Negligence, trespass, breach of privacy, misfeasance in public office, false imprisonment and breaches of ss. 7 (life/liberty) and 8 (search/seizure) of the Charter	Fail (faulty pleadings and limitations issues, except for misfeasance)
McCreight	Taxpayers and advisers were charged with fraud and conspiracy, but charges dropped	Conspiracy, fraudulent and negligent misrepresentation, negligence, malicious prosecution, misfeasance in public office, breach of fiduciary duty and abuse of process, as well as breaches of the Charter	Ongoing (misfeasance in public office, negligence, and abuse of process allowed to proceed)
Sinclair-McDonald	Taxpayer waived her rights as a person under the law and therefore asserts the *Income Tax Act* does not apply to her	Conspiracy, conversion, economic loss of profit and breach of fiduciary duty by CRA employees	Fail (frivolous, vexatious and an abuse of process)
Archambault	Revenu Québec carried out abusive audit	Bad faith, malice, breaches of Québec Charter	Success (but under appeal; taxpayer reputedly now impecunious)
Leroux	Taxpayer assessed for, *inter alia*, unreported income and gross negligence	Negligence and misfeasance in public office	Fail (lack of causation, issues of contributory negligence and failure to mitigate)

43 I would like to thank my colleague Romain Baudemont for his assistance in translating a case summary of the *Archambault* decision into English for me.

44 *Archambault v. Revenu Québec*, *supra* note 41 at para. 699.

45 *Leroux v. Canada Revenue Agency*, 2014 BCSC 720.

46 *Ibid.*, para. 6.

47 *Ibid.*, at para. 305.

48 *Ibid.*, at para. 306.

49 *Ibid.*, at para. 355.

50 *Ibid.*, at para. 348.

51 *Ibid.*, at para. 375.

CONCLUSION

The primary considerations when suing the CRA are as follows: Ensure that the claim is brought in the proper jurisdiction. Ensure that the claim is supportable at law. Ensure that the actions of the CRA are actually highhanded or malicious and there is strong underlying evidence to support such a claim. Ensure that the claim is brought in a timely fashion. Ensure that the claim is does not conflate the issue of the validity of an assessment with the issue of CRA liability. Ensure that the facts and elements necessary to sustain each cause of action are sufficiently pleaded.

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RATES AND THE ECONOMY – A BOND TRADER'S PERSPECTIVE Q2/15 – PREPARING FOR THE RATE HIKE

By Sean Rogister, CEO, Cortland Credit Group Inc.

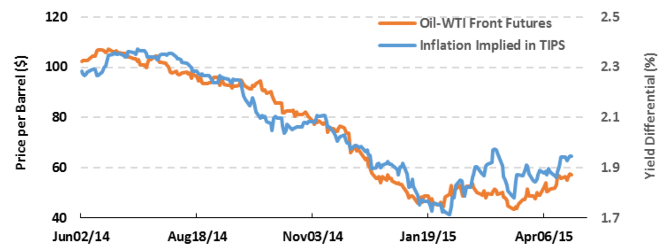
INFLATION AND THE CANADIAN DOLLAR – BOTH CLOSELY TRACKING THE PRICE OF OIL

As the 1st quarter of 2015 opened, the price of oil had the attention of the global capital markets – in the six months prior to the start of the new year, the price for a barrel of the benchmark for this key commodity, West Texas Intermediate (WTI), had fallen by over 50%. The impact was pervasive.

Chart 1 below looks at how closely the inflation risk priced into bond yields is currently tracking the price of oil. For this chart we calculated break-even inflation, defined as the difference between yields in traditional US Treasury bonds and those in US Treasury Inflation Protected Securities (TIPS). The break-even result is used by US Federal Reserve analysts to represent expected inflation, "one of the most important determinants of actual inflation".[1]

The Consumer Price Index (CPI) is a metric derived by the US Bureau of Labor Statistics that tracks "prices paid by urban consumers for a representative basket of goods and services". For TIPS, the principal value of the securities is adjusted by the CPI to offset the loss in purchasing power that comes with inflation and the difference between the yields on these TIPS and traditional Treasury Bonds is the bond market's valuation of implied inflation – it is not supposed to be driven exclusively by the price of oil.

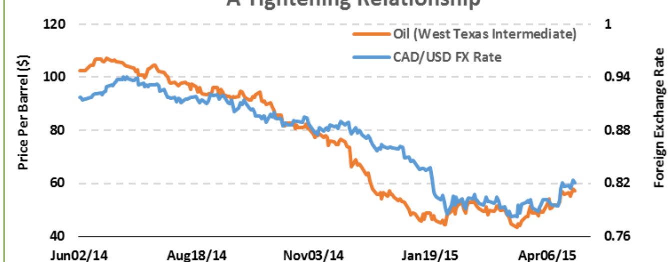
Chart 1
Oil and Expected Inflation: Priced Into US Treasury Yields



Note: Inflation Implied in TIPS = T3.625% Feb15, 2044 yield less TIPS1.375% Feb15, 2044 yield.

In Chart 2, we track the Canadian dollar against the same commodity. The value of our currency is expected to reflect interest rate differentials versus those in other countries, prospects for the economy and many other factors.

Chart 2
Oil and the Canadian Dollar: A Tightening Relationship



Source: Bloomberg

The capital markets price the risks they are most concerned about very quickly into the liquid securities that are our guideposts for value. Normally, break-even inflation and the Canadian dollar trade completely independently of each other; both were falling dramatically as we opened 2015, tracking the same path as the price of oil.

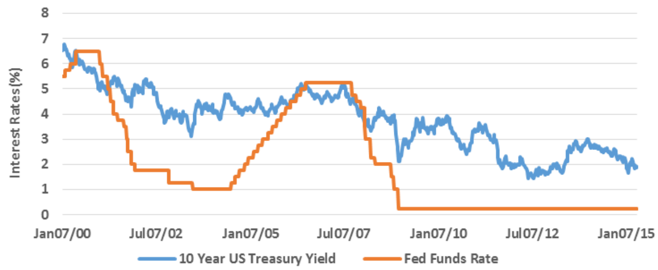
LACK OF PREPARATION FOR HIGHER RATES

As we enter the 2nd quarter, the world is waiting to see the bond market's response when its largest economy begins moving into a tightening monetary policy environment – for the first time in almost 10 years since June 2006. Irrespective of rising expectations for inflation noted above, nominal yields remain at very low levels, by historical standards. Chart 3 tracks yields

1 Mr. James Bullard, President and CEO, Federal Reserve Board – St. Louis, Some Considerations for U.S. Monetary Policy Normalization, 24th Annual Hyman P. Minsky Conference on the State of the US and World Economies, April 15, 2015.

for the on-the-run US 10-year Treasury Note and the Fed Funds Rate (the overnight rate set by the US central bank).

Chart 3
US Interest Rates:
The Fed Funds Rate and 10 Year Treasury Yields



Source: Bloomberg

The Chair of the Federal Reserve's Board of Governors, Janet Yellen, has suggested that a normalized Fed Funds Rate is projected to be 3.75%,[2] a target expected to be reached by the end of 2017.[3] An increase in short-term rates of 350 basis points in 2 ½ years is a significant move and is not yet priced into the prices of North American bonds.

To track capital market predictions of short-term interest rates going forward, we look to the Eurodollar futures contracts traded on the Chicago Mercantile Exchange. Just as other futures contracts are used to hedge forward prices with standardized contracts for delivery of various commodities, Eurodollar futures track three-month money market rates, expiring in March, June, September and December quarters for several years forward. On April 29*th* close, the three-month money market rate forecasted beginning June 2015 was 0.305%, pricing about a 20% probability that the "Fed" will hike rates 25 basis points by then. The September 2015 contract closed at 0.425%, a 70% probability of a hike by then. The forward rate priced into the December 2015 contract was only 1.915%, significantly below the 3.75% target noted above.

The benchmark 10-year US Treasury yield closed at 2.04% on April 29, 2015. To maintain a positively sloped yield curve, with longer term yields trading above money market rates, we can expect bond yields to rise by at least 1.5% over the next 2-1/2 years and by 3.25% if the curve keeps the same slope.

2 At "The New Normal Monetary Policy" research conference on March 27, 2015, Ms. Yellen stated "the median SEP [Summary of Economic Projections], estimate of this longer-run normal rate-that is, the long-run projection of the nominal funds rate less 2 percent inflation – stood at 1-3/4 percent in the FOMC's recent projections".

3 Mr. James Bullard, President and CEO, Federal Reserve Board-St. Louis, Some Considerations for U.S. Monetary Policy Normalization, 24*th* Annual Hyman Minsky Conference, April 15, 2015.

WHAT'S HOLDING YIELDS DOWN IN NORTH AMERICA? EUROPE!

The European Central Bank has promised to buy $70 billion (USD) of government and other debt securities per month for the next two years. In anticipation of this buying pressure sovereign yields in the region have fallen to levels previously considered unimaginable – over half the sovereign bonds issued by Germany and France now trade at negative yields.[4]

Why pay a borrower to take your money? Institutional investors, including banks managing their capital base, those with investment guidelines requiring minimum holdings of government bonds, insurance companies and pensions with long dated obligations to beneficiaries all must ensure they've matched liabilities with assets by duration, irrespective of yield.

Against these alternatives for government debt, current US yields look cheap.

US jobless claims were at the lowest level in 15 years this morning indicating a strengthening labour sector in this economy. Watch for the "Fed" to start talking up monetary policy over the coming months, and for the yields on bonds to move upward as well.

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4 The Telegraph, Negative interest rates put world on course for biggest mass default in history, April 30, 2015.

CASE REVIEW: *THE TDL GROUP CO. v. THE QUEEN*

By Lesley Akst, Associate, Miller Thomson LLP

INTRODUCTION

Interest deductibility pursuant to paragraph 20(1)(c) of the *Income Tax Act*[1](the "*Act*") is a dynamic and evolving area of the law, due to CRA Policy and judicial interpretation of the provision. Much of the analysis focuses on identifying the use and purpose of borrowed money, pursuant to subparagraph 20(1)(c)(i) of the *Act*. In the recent decision of *The TDL Group Co. v. The Queen*,[2] ("*TDL Group*") the Tax Court of Canada ("TCC") examined what evidence is required to satisfy whether

1 *Income Tax Act,* R.S.C. 1985, c.1 (5*th* Supp.) ["*Act*"].

2 2015 TCC 60 ["*TDL Group*"].

borrowed funds were used for an income earning purpose, and specifically within the context of loans from a parent corporation used to acquire additional common shares in a U.S. wholly-owned subsidiary. CRA Policy (IT-533) normally considers interest costs in respect of funds borrowed to purchase common shares to be deductible; however, this is on the basis that there is a reasonable expectation, at the time the shares are acquired, that the common shareholder will receive dividends.[3] CRA Policy, however, qualifies that each situation must be dealt with on the basis of the particular facts involved.[4] *TDL Group* is an instance where the particular facts were unable to meet the above criteria. Exploration of the TCC's evidentiary analysis and application to the legal test follows. It should be noted that this case is under appeal to the Federal Court of Appeal.

THE LAW

Subparagraph 20(1)(c) of the *Act* provides that:

> **(1) Deductions permitted in computing income from business or property.** Notwithstanding paragraphs 18(1)(*a*), 18(1)(*b*) and 18(1)(*h*), in computing a taxpayer's income for a taxation year from a business or property, there may be deducted such of the following amounts as are wholly applicable to that source or such part of the following amounts as may reasonably be regarded as applicable thereto:
>
> …
>
> **(c) Interest** – an amount paid in the year or payable in respect of the year (depending on the method regularly followed by the taxpayer in computing the taxpayer's income), pursuant to a legal obligation to pay interest on
>
> (i) borrowed money used for the purpose of earning income from a business or property (other than borrowed money used to acquire property the income from which would be exempt or to acquire a life insurance policy),
>
> …

The Supreme Court of Canada ("SCC") in *Shell Canada Ltd. v. The Queen,*[5] ("*Shell Canada*") held that paragraph 20(1)(c) has four elements:

(1) the amount must be paid in the year or be payable in the year in which it is sought to be deducted;

(2) the amount must be paid pursuant to a legal obligation to pay interest on borrowed money;

(3) the borrowed money must be used for the purpose of earning non-exempt income from a business or property; and

(4) the amount must be reasonable, as assessed by reference to the first three requirements.

In *Singleton v. The Queen*,[6] ("*Singleton*") the SCC confirmed that the direct use of the borrowed money must first be ascertained. Specifically, Major J. stated:

> Only the third element is at issue in this appeal: the borrowed money must be used for the purpose of earning non-exempt income from a business. The *Shell* case confirmed that the focus of the inquiry is not on the purpose of the borrowing *per se*, but is on the taxpayer's purpose in using the money. McLachlin J. agreed with Dickson, C.J. in *Bronfman Trust* that the inquiry must be centered on the use to which the taxpayer put the borrowed funds.[7]…

In Ludco Enterprises Ltd. et al. v. The Queen,[8]*("Ludco*") it was undisputed that the funds were used to purchase shares and therefore the analysis was whether there was an income-earning purpose in acquiring such shares. In *Ludco* the SCC affirmed it is not necessary that the sole purpose must be to earn non-exempt income and that such purpose may also be an ancillary one.[9]

The SCC elaborated in *Ludco* that the appropriate test for interest deductibility under subparagraph 20(1)(c)(i) is as follows:

> Having determined that an ancillary purpose to earn income can provide the requisite purpose for interest deductibility, the question still remains as to how courts should go about identifying whether the requisite purpose or earning income is present. What standard should be applied? In the interpretation of the Act, as in other areas of law, where purpose and intention behind actions is to be ascertained, courts should objectively determine the nature of the purpose, guided by both subjective and objective manifestations of purpose: … In the result, the requisite test to determine the purpose for interest deductibility under s. 20(1)(*c*)(i) is whether, considering all the circumstances, the taxpayer had

3 IT-533, para. 31.
4 *Ibid.*
5 [1999] 3 S.C.R. 622 at para. 28 ["*Shell Canada*"].
6 2001 SCC 61.
7 *Ibid.* at para. 26.
8 2001 SCC 62.
9 *Ibid*. at para. 52.

> a reasonable expectation of income at the time the investment was made.[10]
>
> Reasonable expectation accords with the language of purpose in the section and provides an objective standard, apart from the taxpayer's subjective intention, which by itself is relevant but not conclusive. It also avoids many of the pitfalls of the other tests advanced and furthers the policy objective of the interest deductibility provision aimed at capital accumulation and investment, as discussed in the next section of these reasons.[11]

Thus, the above legislation and SCC case law confirm the following factors to consider when analyzing whether a taxpayer had a reasonable expectation of income at the time the investment was made, under subparagraph 20(1)(c)(i) of the *Act*:

1) the borrowed money must be used for the purpose of earning non-exempt income from a business or property;

2) the direct use of the borrowed money must first be ascertained;

3) the sole purpose does not necessarily need to be to earn non-exempt income, an ancillary purpose is sufficient;

4) the test must be applied at the time the investment, or the date shares are acquired; and

5) all the circumstances must be considered.

With the above principles in mind, the facts surrounding the *TDL Group* case ensue.

BACKGROUND FACTS

The Appellant TDL Group, appealed a reassessment denying interest deductions regarding its 2002 taxation year totaling $10,094,856 on loans from a parent company, Delcan Inc. ("Delcan"), used to acquire additional shares in a wholly-owned U.S. subsidiary, Tim Donut U.S. Limited ("Tim's U.S."). The interest claimed and denied related to interest paid for the period of March 28, 2002 to November 3, 2002. The Minister of National Revenue (the "Minister") disallowed the deduction pursuant subparagraph 20(1)(*c*)(i) of the *Act* on the grounds that the funds borrowed were not used for the purpose of earning income from a business or property, and in particular, from the U.S. subsidiary shares acquired to borrow the funds.[12]

In terms of the tracing the transactions, Wendy's International Inc. ("Wendy's" the taxpayer's ultimate parent company) loaned $234,000,000 Cdn., to its U.S. subsidiary, Delcan, which then loaned it to the Appellant prior to March 18, 2002, with interest pursuant to a loan agreement and assigned this loan receivable to another affiliate in the corporate group. The Appellant then used the loan from Delcan to purchase 1,840 additional common shares in its already wholly-owned U.S. subsidiary, Tim's U.S. on March 26, 2002, which then made an interest free loan to Wendy's the next day, March 27, 2002 supported by a promissory note of the same date. Effectively, monies that originated with Wendy's were loaned with interest, and found their way back to Wendy's, interest free through a series of transactions.[13] The Appellant led evidence indicating that the promissory note was initially intended to bear interest according to planning memorandums, however, due to concerns that an interest bearing note would have on state taxes in the U.S., and concerns regarding the Thin Capitalization Rules and Foreign Accrual Property Income Rules under the *Act*, it was decided that the loan would proceed on a non-interest basis, pending a resolution of the matter.[14]

In June 2012, Tim's U.S. incorporated a new U.S. subsidiary, Buzz Co., which subsequently changed its name to TD U.S. Finance Co. ("Tim's Finance"). Tim's U.S. then assigned the promissory note to Buzz Co. as payment for its shares in Buzz Co. Thereafter, Buzz Co. issued a demand for payment on the promissory note to Wendy's, which repaid the promissory note in full by issuing a new promissory note to Buzz Co. on November 4, 2002 for the same full amount, with interest – in essence, replacing the non-interest bearing loan with a new interest bearing one.[15] Emphasis should be placed on the fact that the Minister denied the Appellant's interest deduction on its loan from Delcan for the above stated period of March 28, 2002 to November 3, 2002, which aligns with the time that the Appellant's U.S. subsidiary loaned the money back to Wendy's on an interest free basis pursuant to the promissory note.

ISSUES ON APPEAL

The issues raised were whether:

1) the $234,000,000 Cdn. borrowed from Delcan was used by the Appellant for the purpose of earning income from the common shares it acquired in Tim's U.S.; and

2) the amount of interest was reasonable.

10 *Ibid.* at para. 54.
11 *Ibid.* at para. 55.
12 *TDL Group* at para. 2.

13 *Ibid*.
14 *Ibid*.
15 *Ibid*. at para. 3.

The TCC summarized the issues as whether the requisite elements, and specifically elements (3) and (4) as outlined in *Shell Canada* above, were met.[16]

ANALYSIS AND CONCLUSIONS

In framing its analysis, the TCC posed the question: "Can it be said that the Appellant had the reasonable expectation to earn income; either immediate or future dividend income or even increased capital gains as a result of the purchase of shares at the time of such purchase?"[17] The TCC held there was no reasonable expectation to earn income and the sole purpose of the borrowed funds was to facilitate an interest-free loan to Wendy's while creating an interest deduction for the taxpayer. As a result, the appeal was dismissed.

Given the TCC's conclusion, it did not consider arguments regarding whether the interest in question was reasonable.

The TCC focused on the following evidence when arriving at its conclusion:[18]

1) The Appellant was the sole shareholder of Tim's U.S. prior to and at the time of purchasing the additional shares. As well, there was no history of payment of past dividends, partially due to past losses.

2) The evidence of the Appellant's own witnesses, the former CEO, and the former CFO, confirmed the corporate group policy of no returns on investments or dividends, until all capital expenditures were funded.

3) An examination of the 10-year plan revealed a line item for dividends to be paid and zero dividends were planned, nor were there projections on dividends in the 10-year plan.

4) There was no reference of any potential for dividends to be paid in any of the planning memorandums, or resolutions of the directors of the Appellant, Tim's U.S., or Tim's Finance (Buzz Co.).

5) The fact that the funds used to purchase the new shares were instantly loaned to Wendy's without interest for seven months after which funds were paid back in their entirety indicates no obvious expectation that such funds created or were expected to create any income for Tim's U.S., which in turn, would increase its ability to pay dividends or increase the value of its shares for the future income benefit of the Appellant.

16 *Ibid*. at para. 13.
17 *Ibid*. at para. 31.
18 *Ibid*.

6) The funds loaned to Wendy's on an interest free basis were intended to be short-term and a temporary loan at the time of advance.

7) The absence of credible evidence that any portion of the funds invested in Tim's U.S. were used or intended to be used for any other purpose other than to loan monies to Wendy's on an interest free basis at the time of the investment in Tim's U.S. shares.

Along these lines, the TCC commented that the evidence indicated that all members of the corporate group intended and were aware that the money was returning to Wendy's. The TCC highlighted an absence of evidence speaking to funds being used to pay indebtedness of Tim's U.S. to Wendy's or use of the funds for capital expenditures.

The TCC also rejected the Appellant's argument that capital expenditures were made on behalf of Tim's U.S. in 2002 through intercompany loans, whereby the monies loaned to Wendy's from Tim's U.S. purportedly found their way back. The TCC responded to this argument by concluding that, the demand for repayment for all of the initial amount lent to Wendy's under the promissory note and the actual repayment of the full amount, seven months later, was sufficient evidence for the Court to hold that there were no off-setting amounts claimed against Tim's U.S. as a result of any inter-company loan reconciliation.

The TCC emphasized that any repayments on capital expenditures occurring within the life of the new promissory note, versus the original promissory note, were of no assistance.

The TCC further commented that given there was an eligible direct use of the funds, that being the purchase of common shares, there was no need to explore an exceptional circumstances exception within the context of an ineligible use.

The TCC also rejected the Appellant's argument that it always had the subjective intention to earn income from its purchase of the shares because the group plan had always been for Tim's U.S. to charge interest on its loan to Wendy's. The TCC held that the evidence simply did not support such a contention as the loan proceeded on an interest free basis as demonstrated in the original promissory note.

COMMENTARY

Although not cited in the *TDL Group* decision, it appears the TCC is following the evidentiary analysis of *Swirsky v. The Queen*[19] ("*Swirsky*"). In *Swirsky,* the TCC held that Appellant failed to show that his wife had a reasonable expectation of income when she acquired the common shares at issue. In

19 2013 TCC 73; affirmed 2014 FCA 36.

Swirsky, the Court accorded weight to the following factors in its analysis: 1) the company's history of paying dividends prior to the share acquisition, and immediately after the transactions occurred;[20] 2) evidence of consideration regarding the income earning potential of the shares prior to the transaction, in the form of discussion, or any policy or plan in place to pay dividends on those shares after acquisition;[21] and 3) evidence from the wife that at the time she entered into the transactions that there would be dividends on the shares, or evidence that she intended to sell the shares at a profit.[22] The TCC arrived at its conclusion despite dividends eventually being paid on the shares, however, this was after a substantial amount of time had passed since their purchase.[23] Interestingly enough, a similar pattern of facts arose in *TDL Group* as it relates to later paying dividends.[24]

The findings in *TDL Group* and *Swirsky* suggest that when considering interest deductibility, as it relates to common share acquisition, one should consider: 1) the past history of dividend payment; 2) corporate policy and long-term plans of returns on investments and dividends; and 3) the documentation that exists around the date of the share acquisition that would speak to expectation to earn income.

Singleton, *Shell Canada* and *Ludco* state that courts must be sensitive to the economic realities of a transaction and to the general object and spirit of the legislative provision, in this case subparagraph 20(1)(c)(i) of the *Act*. It is appreciated that when a provision is clear and unambiguous, its terms must simply be applied.[25] It appears, however, that the fact driven nature of ascertaining reasonable expectation to earn income at the time of common share purchase is heavily influenced by objective documentary evidence in the form of corporate plans and dividend history, notwithstanding the subjective element of the test outlined in *Ludco*. Further consideration of the provision will prove interesting.

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20 *Ibid*. at paras. 32-36.
21 *Ibid*. at para. 46.
22 *Ibid*. at para. 41.
23 *Ibid*. at para. 47.
24 *TDL Group* at para. 31.
25 *Shell Canada* at para. 40.

U.S. SECURITIES GET HOTTER IF YOU OWE ESTATE TAXES AND PENALTIES, I'M TALKING TO ALL CANADIANS – INVESTORS BEWARE OF THIS TAX TRAP

By David S. Kerzner, Ph.D.

It is no secret between cross-border advisors that executors of Canadians holding certain U.S. equity investments at death can potentially be liable for filing a U.S. estate tax return and to pay U.S. estate tax on these investments. Based on some conversations I had last week, what is shocking is how pervasive the lack of this knowledge is among high net worth investors, their advisors, and large fund managers in Canada.

The U.S. federal estate tax to which a non-resident alien (non-U.S. citizen or U.S. domiciliary) may be subject to is generally imposed only on the decedent's gross estate that is situated in the U.S. at the time of death. While most of us tend to think of U.S. real property and the Florida condo as the big ticket item situated in the U.S. very generally other assets with U.S. situs include in part works of art, and shares of stock if issued by a U.S. domestic corporation (regardless of where the share certificates are located at death). Got a Warhol hanging in your home in Hawaii? Perhaps a framed picture from Bath, Bed, and Beyond may be a more suitable choice for estate tax protection. Own U.S. securities in your brokerage account? Speak to a U.S. tax advisor as you may have estate tax exposure, even if you are a resident and citizen of Canada with no U.S. citizenship, residency or other U.S. ties.

Some advisors tell their clients to take comfort in the Canada-U.S. Tax Treaty, I do not. Amongst other potential relief, the treaty may offer a pro rata unified credit and a small estate exemption. The treaty provides rights that may be available if a Form 706-NA is filed. Moreover, certain relief provided by the treaty requires that the executors of the decedent properly value the worldwide gross estate of the decedent (under U.S. tax rules), which depending on the legal and financial structure of your client may be very costly. Moreover, as a practical matter, I have not yet been to a wake, celebration of life, shiva or otherwise seen or heard of funeral homes providing Form 706-NA and a copy of the treaty with their burial or cremation services. Perhaps they should. I have also seen families rely on their advisors, lawyers and accountants alike, who did not attend to these formalities during the estate administration for any number of reasons, only to have to deal with them years later when penalties were now on the table, and *oy vey*, double taxation! Best is to avoid the mess with proper inter vivos planning. For certain investment assets, a corporation, structured the right way, may be appropriate.

Finally, investors and advisors must realize that the world today is becoming a dramatically different place *vis à vis* taxpayer and investor information. With the OECD ushering in TRACE, Automatic Exchange of Information, and with FATCA, it's not merely that tax authorities will have enhanced information exchange abilities, it's that financial institutions, have begun to re-evaluate their protocols and practices surrounding the U.S. estate obligations of their clients. I was contacted not long ago by a beneficiary of an estate where neither he nor his mother (who had died) had any ties to the U.S., but the investment bank where $7 million of U.S. securities were held froze his late mother's assets until he (as the executor) satisfied their requirements that all estate taxes owing had been paid to the IRS. If you had only called me a few weeks earlier, I tried to console him.

David S. Kerzner, Ph.D. (Law), is the co-author with David W. Chodikoff of the forthcoming book, ***International Tax Evasion in the New Information Age*** and Editor in Chief of ***The Tax Advisor's Guide to the Canada-U.S. Tax Treaty***, practices U.S. cross border tax law in Toronto.

JUSTICE AND CERTAINTY: THE DUTY OF GOOD FAITH AND THE HONEST PERFORMANCE OF CONTRACTS

By Alexandra White, Partner, Miller Thomson LLP

With the case of *Bhasin v. Hrynew*[1] the Supreme Court of Canada has incorporated a broad principle, the duty of good faith, into every contract and contractual dispute that comes before the courts. It also created a new legal duty of honest performance of contracts. The stated goal of the Supreme Court in so doing was to make the law most just, more certain and more consistent.

FACTS

Mr. Bhasin and Mr. Hrynew both sold investment products, specifically education savings plans for a company called Can-Am. The two men were competitors. Mr. Hrynew wanted to take over Mr. Bhasin's business and pressured Can-Am not to renew its contract with Mr. Bhasin. Can-Am appointed Mr. Hrynew as a provincial trading officer to perform an audit that involved him auditing his competitors, including Mr. Bhasin. Mr. Bhasin refused to allow Mr. Hrynew to audit his files and Can-Am threatened him with termination and within a year refused to renew his contract. As the result of the non-renewal of Mr. Bhasin's contract, Mr. Bhasin lost the value of his business and his sales agents were poached by Mr. Hrynew.

TRIAL

The trial judge found that Can-Am was not honest with Mr. Bhasin throughout the events leading up to the non-renewal of his contract. At trial, it was held that Can-Am was liable to Mr. Bhasin for breach of contract and in particular a breach of a duty of good faith performance of its contract with Mr. Bhasin. Mr. Hrynew was found liable for intentionally breaching contract and both defendants were found liable of civil conspiracy.

APPEAL

On appeal, the court found that there was no duty of good faith in the contract between Bhasin and Can-Am, and no implied duty of good faith and overturned the decision on all grounds.

THE SUPREME COURT OF CANADA

The Supreme Court of Canada, in a unanimous decision, reversed the appeal decision and found Can-Am liable for breaching their duty of honest performance of the contract with Bhasin. The Court articulated two new concepts in the law of contract, being: 1) the organizing principle of good faith; and 2) the duty of honest performance.

Canadian law has long recognized the obligation to perform certain types of contract in good faith. These include employment contracts, insurance contracts, tenancy agreements, agreements in the tendering context and other specific types of contracts, particularly those in which there are clear power imbalances. Aside from these specific areas, the Court held that the law with respect to a generalized and independent doctrine of good faith in contract was "unsettled and incoherent".

The Court rationalized its decision by pointing out that considerations of good faith are often at play in contractual interpretation and that a duty of good faith and honesty was recognized at law in Quebec and the United States – two important trade partners with common law Canada.

The Court was clear that good faith is the organizing principle and the common law duty is to perform contractual obligations honestly. The Court acknowledged that the organizing principle of good faith can extend beyond the limits of honest contractual performance and declined to define the limits of the implications of good faith as an organizing principle based on the facts before it.

1 2014 SCC 71.

According to the Supreme Court's decision, it is clear that the duty of honest performance is not a duty of loyalty or a fiduciary duty. It does not include a requirement that one party subordinate his interest to the other. Rather, it is a duty to perform contractual obligations without lying or misleading the other contracting party.

The Court's analysis becomes complicated with respect to the question of whether, and to what extent, contracting parties can vary their obligations under the new duty of honest performance. In the case before the Court, the agreement between the parties contained an "entire agreement" clause. The Court ruled that, because the duty of good faith was a general doctrine of common law, the parties could not exclude it by way of an "entire agreement clause".

However, the Court did allow some wiggle room for contracting parties by stating that the content of the duty of honest performance will be dictated by context and that parties should be free to relax the requirements of the duty of honest performance, so long as they meet its core requirement. It seems that this caveat strives to incorporate a standard of reasonableness into the duty of honest performance. Parties will be free to determine the standards by which honest performance is measured, so long as those standards are reasonable.

CONCLUDING COMMENT

On one hand, it is certain that this change is incremental as the Court suggests. Realistically, it is likely that the public does expect a certain level of honesty in the performance of contracts to be imposed by the courts and one imagines that the number of cases in which the Court rewards a party who knowingly performs a contract dishonestly or in bad faith are rare. However, it is difficult to believe that, at least in the immediate future, this decision will create commercial certainty as it seems bound to create an increase in litigation to determine the boundaries and content of the new organizing principle and duty.

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PROPERTY TAX ASSESSMENTS: WHAT YOU NEED TO KNOW FOR YOUR APPEAL

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

INTRODUCTION

On March 6, 2015, the Divisional Court of Ontario released its decision in *Junvir Investments Ltd. v. Municipal Property Assessment Corporation*[1] and held that the Assessment Review Board (the "Board")[2] did not err in failing to properly determine the current value of the appellant's property. This case is significant not only for its result, but also because it demonstrates that courts are unwilling to overturn decisions by the Board that have some evidentiary basis, no matter how minimal. In order to succeed on an appeal, property owners must point to some error of law in order to overturn a decision by the Board. This article seeks to identify the potential errors of law that property owners can raise on an appeal.

FACTS

Founded in 1953, Junvir Investments Ltd. (the "Appellant") is a third-generation family owned corporation that operates an independent grocery store in central Toronto. Between 1995 and 2003, the Appellant acquired the following four properties with the intention of expanding its operations:

- 446 Summerhill Avenue: a 15,000 sq. ft. grocery store building (the "Building"); and
- 444, 442, and 438 Summerhill Avenue: together comprising a 26-car parking lot adjacent to the Building (collectively, the "Subject Properties").

Between 2005 and 2007, the Appellant expanded the Building to approximately 30,000 sq. ft. in order to add additional room for storage, food preparation, shopping, and a kitchen. In 2005, the Municipal Property Assessment Corporation ("MPAC") provided the Appellant with the following Current Value Assessments ("CVA") for the 2006, 2007, and 2008 taxation years[3] using the cost approach:[4]

1 *Junvir Investments Ltd. v. Municipal Property Assessment Corp.*, 2015 ONSC 1526.

2 The Assessment Review Board is an independent adjudicative tribunal whose main function is to hear appeals from people who believe that properties are incorrectly assessed or classified. The Board also deals with some property tax appeals.

3 *Junvir Investments Ltd. v. Municipal Property Assessment Corp., Region No. 09*, 2014 CarswellOnt 3732, at paras. 106-107.

4 A valuation method in which the market price of a property is calculated by adding the cost of the land and the cost of construction, minus depreciation.

Property	2006 Taxation Year Valuation	2007 Taxation Year Valuation	2008 Taxation Year Valuation
446 Summerhill Avenue	$2,322,000.00	$2,322,000	$4,931,000.00
444 Summerhill Avenue	$632,000.00	$632,000.00	$632,000.00
442 Summerhill Avenue	$574,000.00	$517,000.00	$517,000.00
438 Summerhill Avenue	$409,000.00	$409,000.00	$409,000.00

The Appellant and MPAC disagreed on both the nature of the Building and MPAC's choice of properties for comparable sales. The Appellant took the position that the Building had the characteristics of a grocery store and should be valued using the Grocery Store Model ("GSM").[5] In determining the value of the Building, MPAC applied the income approach using estimates of the Fair Market Rent ("FMR")[6] of commercial retail buildings. The Appellant, on the other hand, proposed two possible valuation methods for the Building: (i) an income approach using estimates of FMR from grocery stores and supermarkets that it asserted were comparable; or (ii) a CVA FMR of the Building, which it produced by applying the GSM.[7]

On March 27, 2014, the Board held that the CVA of the Appellant's four properties was $3,661,000.00 for the 2008 taxation year (the "First Decision").[8] This figure was ultimately reduced to $2,103,000.00 as a result of several factors that negatively affected the Building's value.[9]

On August 26, 2014, the Board issued an amended decision (the "Amended Decision") to correct a typographical error and mathematical miscalculations. The Amended Decision raised the CVA of the Appellant's four properties to $4,288,000.00 for the 2008 taxation year, although this figure was ultimately reduced to $2,730,000.00 as a result of the above-mentioned negative factors.[10] In response, the Appellant appealed both the First Decision and the Amended Decision pursuant to section 43.1 of the *Assessment Act*.[11]

ANALYSIS

On appeal, the Appellant argued that the Board had made the following errors of law with respect to the 2008 taxation year:

1. It erred in law in failing to properly determine the current value of the Appellant's properties;
2. It erred in law in failing to reference similar properties in the vicinity; and
3. It acted without jurisdiction when it amended the First Decision and issued the Amended Decision.

Justice Sachs began her decision by examining the standard of review applicable to decisions by the Board. As a general rule, the standard of review applicable to the Board's decision on questions of law is correctness. Taking into account several recent decisions by the Supreme Court of Canada,[12] Justice Sachs noted that there is a presumption that decisions by tribunals interpreting or applying their home statutes are reviewable on a standard of reasonableness.[13]

In the present case, Justice Sachs held that a standard of review analysis for the Appellant's first and second issues was unnecessary because they involved issues of procedural fairness. In such a case, the question is not whether the decision was "correct" or "reasonable", but simply whether the procedure used was fair. On the other hand, the third issue raised issues of jurisdiction and was reviewable on a standard of correctness.[14]

With respect to the first issue, the Appellant took the position that the Board had erroneously based its decision on only two of the comparable properties submitted for consideration. According to the Appellant, the Board erred by ignoring the eight other comparable properties that the Appellant submitted whose values were not challenged. Justice Sachs disagreed with the Appellant's position and noted that their argument "does not raise a question of law".[15] Crucially, Justice Sachs upheld the Board's decision because:

> This is not a case where the Board's conclusion was unsupported by any evidence or where the Board ignored relevant evidence...[s]uch errors could constitute errors of law.[16]

Justice Sachs took a similar approach in dismissing the Appellant's second issue. Here, Justice Sachs held that the Appellant could not take the position that the Board's decision was wrong because it favoured certain comparable properties over others. It would have been improper for the Divisional Court to overturn a finding of fact by the Board regarding its opinion of the best comparables to use in its analysis.

5 The GSM is an equation used to predict rents for grocery stores (anchor tenants only) based on negotiated rents.
6 The amount of money that a property would command if it were available for leasing at the present time.
7 *Supra* note 3, at para. 11.
8 *Supra* note 3.
9 *Ibid.*
10 *JUNVIR Investments Ltd. v. Municipal Property Assessment Corp., Region No. 09*, 2014 CarswellOnt 11770, at para. 105.
11 *Assessment Act*, R.S.O. 1990, c. A.31.
12 *British Columbia (Securities Commission) v. McLean*, 2013 SCC 67 (S.C.C.).
13 *Supra* note 1, at para. 5.
14 *Ibid*.
15 *Ibid.*, at para. 8.
16 *Ibid.*, at para. 8.

Consequently, the two properties that the Board selected constituted "an ample evidentiary basis upon which to make this finding".[17]

On the third issue, Justice Sachs noted that the Board has jurisdiction to correct a typographical or mathematical error under both the *Statutory Powers Procedure Act*[18] and the Board's own *Rules of Practice and Procedure*.[19] Notwithstanding that leave was not granted on this issue, the Court held that the Board had jurisdiction to amend the First Decision and the Amended Decision in the manner it did.

As a result of the foregoing, Justice Sachs dismissed the appeal and awarded MPAC $14,500.00 in costs for both the appeal and the motion for leave to appeal.

CONCLUSION

The Divisional Court of Ontario's decision in *Junvir* is significant for practitioners of property tax and assessment law for several reasons. It affirms the presumption that the standard of review for the Board's interpretation of the Act is reasonableness. Likewise, it demonstrates that courts will uphold CVAs issued by the Board so long as there is some evidentiary basis to support their decision. Property owners should not assume that they will be successful before the Board or the courts simply because they have amassed a large number of comparable properties in support of their position. Decisions by the Board will be upheld so long as they have considered all of the comparable properties and determined that a property owner's comparables are not sufficiently similar to the property in dispute.

The key lesson from *Junvir* appears to be that courts are only willing to overturn a decision by the Board if one of the following errors of law has been made: (i) where the Board's conclusion is unsupported by any evidence; (ii) where the Board ignored relevant evidence; or (iii) where the Board misapprehended relevant evidence.[20] Moving forward, property owners should structure their arguments around these points in order to maximize their likelihood of success on an appeal.

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17 *Ibid.*, at para. 9.
18 *Statutory Powers Procedure Act*, R.S.O. 1990, c. S.22, s. 21.1.
19 *Assessment Review Board Rules of Practice and Procedure*, A.R.B. Rules, r. 130.
20 Para. 8.

TAX EVASION: LENGTHY INVESTIGATIONS AND/OR DELAYS DO NOT NECESSARILY PREVENT A PROSECUTION

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

For numerous reasons, prosecuting tax evasion cases in Canada is tricky business. However, taxpayers breaking the law should not think that lengthy investigations or delays can be derailed by resorting to the protection of rights guaranteed by the *Charter of Rights and Freedoms*[1] (the "Charter"). A good case in point is *R. v. Dolinski*.[2]

The Applicants were charged with conspiracy to commit fraud and fraud over $5,000 contrary to sections 465(1)(c) and 380(1)(a) of the *Criminal Code*;[3] they were also charged with conspiring to claim a refund or credit, or obtaining or claiming a refund or credit by unlawfully making, participating in, or acquiescing in the making of false or deceptive statements in income tax returns from 1994 to 2004 and from obtaining a refund or credit by falsely claiming a refund or credit in the tax returns for the 1994 to 2004 taxation years, contrary to subsections 239(1.1)(f), 239(1.1)(a) and 239(1.1)(e) of the *Income Tax Act*[4] (the "ITA").

In this matter, the Applicants sought an Order pursuant to the common law and/or section 24 of the Charter for a Stay of Proceedings ("Stay") on the basis that the cumulative pre-charge delay of approximately seven years from when the matter was first assigned for investigation by the Canada Revenue Agency (the "CRA") to the laying of charges violated their rights as guaranteed by section 7 of the Charter.

Section 7 of the Charter provides that: "everyone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice".

In this case, the Applicants argued that the pre-charge delay of seven years was excessive. They maintained that the additional post-charge delay should also be considered. In total, the cumulative delay of more than nine years caused them serious prejudice and specifically, the prejudice of making full answer and defence. Thus, the Applicants submitted that the only remedy in these circumstances that was both just and

1 Part I of the *Constitution Act, 1982*, being Schedule B of the *Canada Act, 1982* (UK), 1982, c. 11.
2 2014 ONSC 681.
3 R.S.C. 1985, c. C-46.
4 R.S.C. 1985, c. 1 (5th Supp.).

appropriate was a Stay because of the violation of their rights to fundamental justice and to be tried within a reasonable time.

The Crown opposed the Application and submitted that the evidentiary record did not demonstrate any actual material prejudice. There was no support for the Applicants' allegations that missing documents, videos or lack of witness memory or missing witnesses would damage the Applicants' ability to mount a full answer and defence. The Crown argued it was all pure speculation as to the potential impact of these assertions by the Applicants. The Crown raised additional arguments, including a response to the Applicants' claim that the proceedings had become oppressive and vexatious; here, the Crown argued that the Applicants failed to establish any ulterior motive or mala fides on the part of the CRA or the Crown in instituting the criminal proceedings.

The Application was heard by the Honourable Justice Beaudoin of the Ontario Superior Court of Justice. In short, a Stay can only be granted in the clearest of cases and this was not such a case that either rendered the proceedings unfair or damaged the integrity of the judicial system. Thus, the Application was dismissed.

Why did the Applicants ultimately fail? There were some good reasons. As the Court so noted, "[case law has demonstrated] that there must be an air of reality that the missing evidence would in fact and in a material way assist the accused". Here, the evidence was simply speculative as to what "might" happen without certain evidence such as missing witnesses. The Applicants were vague and did not establish the actual prejudice of missing witnesses and/or documents. Moreover, the mere passage of time was not in and of itself a reason to grant a Stay. The Applicants could not demonstrate in a meaningful way what effect this delay would have upon the fairness of a trial. The Court also found that there was no evidence of bad faith or ulterior motive. As the Court noted, the lengthy delay could be explained and the file did not lay dormant for any length of time. This was a complex case involving serious offences.

As this case illustrates, seeking an Order to Stay is very, very, difficult. It further informs us that backing up the Applicants' assertions with evidence of a credible nature is crucial to the possible success of the application. This case finally tells us that tax prosecutions can take a very long time and as long as there are good facts to support the length of the investigation process, the pre-charge and post-charge delays, it will be the exception and not the rule for a Court to grant a Stay.

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CASES OF NOTE

Presidential MSH Corporation v. R. (2015 CarswellNat 650 (T.C.C. [General Procedure])) — Graham J. — The taxpayers claimed refunds for taxable dividends paid in 2004, 2005 and 2006 that were denied due to the failure to file tax returns by the deadline required by subsection 129(1) of the *Income Tax Act*. In calculating the taxpayer's refundable dividend tax on hand (RDTOH) balance at end of its 2005, 2006 and 2007 taxation years, the Minister deducted that amount of refunds that the taxpayer had claimed but not received. The taxpayer claimed refunds for taxable dividends paid in each of 2010, 2011 and 2012 taxation years. The Minister denied a portion of the claimed refunds on the basis that, given the deduction of the unsuccessfully claimed refunds, the taxpayer did not have sufficient RDTOH available. The taxpayer appealed and the appeal was allowed. The calculation under paragraph 129(3)(d) required the amount otherwise determined to be reduced by the corporation's "dividend refund" for its preceding taxation year. The plain and ordinary meaning of the definition of "dividend refund" in paragraph 129(1)(a) was ambiguous, as it could indicate either a refund of the amount determined by the formula or the amount determined by formula regardless of whether or not it was actually returned to the taxpayer. The results of a contextual analysis were inconclusive; however, a purposive analysis of the provision conducted in a judgment dealing with the same issue and supporting the taxpayer's interpretation was persuasive and was adopted by the court. The Minister did not explain why the limitation period in subsection 129(1) should be viewed as preventing a delinquent taxpayer from ever claiming a refund in respect of relevant RDTOH. It was clear that Parliament designed the system to promote the integration of corporate and individual taxes and designed the limitation period in subsection 129(1) to punish taxpayers who filed their returns late. The taxpayer's interpretation allowed both of these objectives to be achieved, while the Minister's interpretation required the goal of integration to be sacrificed in order to achieve a greater level of punishment. In the absence of a compelling reason why Parliament would want to do that, the taxpayer's interpretation was more in keeping with the purposes of the *Income Tax Act*.

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TDL Group Co. v. R. (2015 CarswellNat 478 (T.C.C. [General Procedure]), under appeal to F.C.A.) — Pizzitelli J. — The taxpayer, TDL Group Inc., claimed interest deductions in respect of its 2002 taxation year totalling over $10 million on loans from its parent corporation that the taxpayer used to acquire additional common shares in a wholly-owned US subsidiary. The funds used to buy the shares were immediately loaned back to the parent company without interest for seven months and then were paid back in full. The Minister issued a reassessment denying the taxpayer's interest deduction pursuant to subparagraph 20(1)(c)(i) of the *Income Tax Act* on the basis that the borrowed funds were not used for the purposes of earning income from business or property. The taxpayer appealed and the appeal was dismissed. The court concluded that the taxpayer did not have a reasonable expectation to earn immediate or future dividend income or increased capital gains as a result of the purchase of the shares at the time of the purchase. The taxpayer was already the sole shareholder of the US subsidiary. The subsidiary had lost substantial monies in the previous four years prior to the date of purchase and was not in a position financially to pay any immediate or short-term dividends. The fact that the funds used to buy new shares were immediately loaned to the taxpayer's parent company without interest and then paid back in full suggested no obvious expectation that the funds created, or were expected to create, any income for the US subsidiary so as to increase its ability to pay dividends or increase the value of its shares for the future income benefit of the taxpayer. The evidence was ambivalent as to the taxpayer's intent that the loan to the parent company was to be interest bearing. The only purpose of the borrowed funds was to facilitate an interest-free loan to the parent company while creating an interest deduction for the taxpayer.

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Agnico-Eagle Mines Ltd. v. R. (2014 CarswellNat 4379 (T.C.C. [General Procedure]), under appeal to F.C.A.) — Woods J. — The taxpayer, Agnico-Eagle Mines Ltd. (AEM), issued convertible debentures, receiving US dollar denomination. In the 2005 and 2006 taxation years, 142,639 debentures were converted and 1,111 were redeemed for AEM common shares. Due to fluctuations in currency, the principal amount expressed in Canadian dollars had decreased by approximately 40 per cent. The Minister assessed AEM on the basis that it realized deemed capital exchange gains under subsection 39(2) of the *Income Tax Act*. AEM appealed and the appeal was allowed in part. AEM received consideration of US$1,000 on the issuance of each convertible debenture and for its extinguishment. The appropriate translation date for the amount paid out on conversions was when consideration for the common shares was received, which, in this particular case, was the date that the convertible debentures were issued. The consideration was not the principal amount of the debt at the time of the conversions. The issuance of the shares did more than satisfy the debt, as it also satisfied AEM's commitment to issue common shares that was embedded in the conversion right. There were no foreign exchange gains on the conversions, as the same amount was received on issuance as was paid for extinguishment. The amount paid on redemption was based on the principal amount that had decreased in Canadian dollar terms. The terms of the indenture provided that the common shares issued on redemption were in satisfaction of the redemption price that became due and payable on the date of the redemption. The redemption price was US$1,022.68 for each convertible debenture, which was equal to the principal amount plus unpaid interest. The determination of the foreign exchange gain would be upheld only for the redeemed debentures.

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McDonald v. R. (2014 CarswellNat 4236 (T.C.C. [Informal Procedure])) — Campbell J. — The appellant's wife incorporated a company and the appellant managed the company's field operations, while the bookkeeper or the appellant's wife handled the company's financial aspects. The appellant was never formally appointed as a director of the company. The Minister assessed the appellant as a *de facto* director of the company for the period in which the company failed to remit net tax and source deductions under the *Income Tax Act* for the 2005 through 2009 taxation years and under Part IX of the *Excise Tax Act* for June 1, 2008 to April 30, 2009. The appellant appealed the assessment and the appeal was dismissed. The court concluded that the appellant had sufficient control over the corporate affairs to be held liable as a *de facto* director for the company's liabilities to the CRA. The appellant was not in a subordinate role in the corporate affairs and activities of the company compared to his wife and father-in-law, as he played an important and active role in the overall corporate operations. The appellant had prior experience in operating a business and was aware of the necessity of submitting corporate returns and remittances. An individual need not be involved in all facets of management of corporate operations to be a *de facto* director.

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Leroux v. Canada Revenue Agency (2014 BCSC 720 (B.C. S.C.)) — Humphries J. — The taxpayer, Mr. Leroux, was assessed over $600,000 in taxes, interest and penalties. Following an application of the fairness provisions, Mr. Leroux was owed $25,000 for income tax, which was applied against his outstanding GST debt. Mr. Leroux claimed that the CRA auditor had done his GST returns for him as well as auditing them, and that the auditor threatened to impose high tax penalties unless the taxpayer paid him $25,000. As well, as a result of the assessment process, Mr. Leroux claimed that he lost property he wished to develop and opportunities for business, the value of his business and access to credit was impaired, he incurred professional fees and expenses, and suffered injury to his personal and mental health. Mr. Leroux also claimed that the CRA lost several of his documents, improperly classified capital gains as business income, improperly applied GAAP, used an improper valuation system, improperly applied penalties, and improperly rejected an offer for security. The taxpayer brought an action against the

CRA in negligence and misfeasance in public office. The court concluded that the CRA sometimes – but not always – owes a *prima facie* duty of care to a taxpayer under audit. The CRA and its auditors were found to owe Mr. Leroux a *prima facie* duty of care because the audit was focused and intensive, took place over many years, and involved discretionary decisions and huge penalties. However, despite this finding, Mr. Leroux's action was dismissed because he could not prove that his losses were caused by the CRA's negligent conduct. When the income tax judgment was registered, the GST judgment was already in place, and large loans had already been registered against Mr. Leroux's land, on which property taxes were outstanding and owing. Mr. Leroux could did not show a causal link between the CRA's negligence in imposing unjustified penalties for income tax and the impairment of his credit, mortgage difficulties, and the consequent loss of his business and home.

ON THE RADAR

CROWDFUNDING

In document 2015-0579031I7, the CRA provided updated views regarding the income tax implications of crowdfunding, which is a way of raising funds for a broad range of purposes, using the Internet.

The CRA noted that, depending on the facts and circumstances, monies received by a taxpayer under a crowdfunding arrangement could represent a loan, capital contribution, gift, income, or a combination thereof. Since the terms and conditions of these types of arrangements may vary greatly from one situation to another, the CRA evaluates each situation on a case-by-case basis before making a determination on the income tax consequences of a particular crowdfunding arrangement. However, where funds are received by a taxpayer as a result of a crowdfunding arrangement for the development of a new product and that taxpayer carries on a business or profession, the CRA generally considers such funds to be taxable income unless it can be shown that the crowdfunding arrangement otherwise clearly represents a loan, capital contribution or other form of equity. Any reasonable costs incurred by the taxpayer that are related to such a crowdfunding arrangement would likely be deductible in computing that income. The CRA has referred to crowdfunding in Folio S3-F9-C1, *Lottery Winnings, Miscellaneous Receipts, and Income (and Losses) from Crime* under the heading "Gifts and other voluntary payments".

Typically crowdfunding (at least in Canada) does not involve the issuance of securities; however, in some jurisdictions this might be permitted. Some securities regulators in Canada are considering whether changes to existing regulatory rules are needed to better facilitate the raising of equity funds in Canada by way of crowdfunding. When this takes place, the CRA will evaluate the income tax consequences at that time.

MISCELLANEOUS TAXABLE BENEFITS

The CRA recently released several interpretations regarding employee taxable benefits in various situations, three of which are summarized below.

Employer-Provided Footwear

In document 2014-0552421E5, the CRA provided its views regarding whether employer provided footwear is a taxable benefit to an employee. In the situation described, an employer supplies uniforms that are distinctive to employees. The employer does not supply footwear, but requires employees to wear a specific type of black footwear as part of the uniform. An employee can either obtain the footwear through the employer's preferred supplier (*e.g.*, employer pays for the footwear) or purchase the footwear and be reimbursed by the employer. The footwear has no employer identification and is not required for safety or protective measures.

Subject to certain exceptions, employment benefits are generally included in an employee's income under paragraph 6(1)(a) of the *Income Tax Act*. CRA's longstanding position is that clothing is a personal expense if it is regular clothing that can be worn for non-business purposes outside business hours. Therefore, the CRA considers that the employee receives a taxable employment benefit when the employer provides or reimburses the cost of such clothing. An employee does not receive a taxable benefit if the employer provides an employee with a distinctive uniform to wear while carrying out employment duties (*e.g.*, clothing that identifies the employer) or provides an employee with special clothing (including safety footwear and safety glasses) that is designed to protect the employee from hazards associated with the employment.

In this case, since the employer-provided footwear does not appear to fall into one of the above categories, it would be a taxable benefit to the employee.

Cell Phones

In document 2014-0553481I7, the CRA provided its views regarding whether an employee will have a taxable benefit where his or her employer reimburses part of the cost of the employee's cell phone voice and data plan.

Generally, the amount of any reimbursement received by an employee by virtue of employment is included in employment income under paragraph 6(1)(a) of the *Income Tax Act*. However, in the situation considered, since the payment would be for a reasonable basic plan required for employment and the employee is required to provide detailed receipts to the employer, the payment would likely be considered a reimbursement of an employment-related expense and would not be taxable under paragraph 6(1)(a).

Subject to certain exceptions, paragraph 6(1)(b) includes in income amounts received in the year as an allowance for personal or living expenses. For these purposes, the CRA considers an allowance to be any payment that an employee receives without having to account for its use. Consequently, where an allowance is provided to an employee for a plan, it is included in income under paragraph 6(1)(b), even though the employee may be required to use it in the course of carrying out employment duties. However, as noted above, it appears that the employer's payment is a reimbursement and not an allowance.

Generally, where the cost of an employee's asset is paid for by an employer, the fair market value of the asset is considered a taxable benefit for the employee under paragraph 6(1)(a). Therefore, if an employee's cell phone is paid for or replaced by the employer, the fair market value of the phone is considered a taxable benefit for the employee, even if the employee used, lost, or damaged the phone in the course of carrying out his or her employment duties.

Employer-Paid Course

In document 2014-0563251E5, the CRA provided its views regarding whether an employer-paid course is a taxable benefit to an employee in the particular circumstances.

Where an employer pays, in full or in part, for the cost of a course for its employees, the employees would be considered to have received an economic benefit in respect of, in the course of, or by virtue of their office or employment. This benefit would be taxable under paragraph 6(1)(a) unless it could be demonstrated that the employer was the primary beneficiary of the course and the employer and employee dealt at arm's length, or the benefit was excluded by another provision of the Act. If the employer is considered the primary beneficiary, the employee will not be considered to have received a taxable benefit, the amount is not included in the employment income of the employee, and the tuition tax credit would not be available to the employee by virtue of subparagraph 118.5(1)(a)(iii) of the Act.

The CRA generally considers that courses taken to maintain or upgrade employment-related skills are for the primary benefit of an employer, provided that the employee is expected to resume his or her employment for a reasonable period of time after completion of the training. A determination of who is the primary beneficiary of a benefit (*e.g.*, a course) is a question of fact that must be determined on a case-by-case basis. An employer is generally in the best position to make this determination.

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