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COMMENTARY

TAX COURT ALLOWS HOUSE FLIP APPEAL, FINDING TAXPAYER RELIED ON ACCOUNTANT'S ADVICE

By Chris Canning at Thorsteinssons LLP.

October 8, 2020

The Tax Court of Canada recently released its decision in *Hansen v. The Queen*, 2020 TCC 102, the latest in a quickly growing body of caselaw dealing with "house flips". The case dealt with a taxpayer, Mr. Hansen, who had sold five properties in six years, between 2007 and 2012. Mr. Hansen had claimed the principal residence exemption in respect of all five sales. The Tax Court's decision is particularly interesting because it illustrates the different burdens of proof on the Canada Revenue Agency (the "**CRA**") for justifying reassessments of "statute-barred years" and gross negligence penalties in the context of house flips.

As additional background, Mr. Hansen and his family lived in each of the five properties for under a year. Mr. Hansen testified that he made improvements to each home to suit his family and that in each case, they had compelling reasons to sell and move on to the next home. Perhaps most importantly, Mr. Hansen also testified that he informed his accountant of all the property transactions, including his intentions for each property and the reasons for sale, and that the accountant advised the principal residence exemption applied. His accountant corroborated his testimony at trial.

Statute-Barred Years

In this case, three of the five property sales occurred between 2007—2010, and these years were outside the "normal reassessment period", as defined by subsection 152(3.1) of the *Income Tax Act* (Canada) (the "**Act**") — commonly known as statute-barred years. In order to reassess a statute-barred year, the CRA must prove that (1) the taxpayer made a misrepresentation in his or her tax return; and (2) this misrepresentation was attributable to neglect, carelessness, wilful default, or fraud.

The Tax Court cited longstanding caselaw that there is no negligent misrepresentation where, at the time of filing the return, the taxpayer carefully considered his or her position and filed on a basis that he or she believed, in good faith, to be correct. This is the case even if the CRA disagrees with the taxpayer's position, and even if the taxpayer's position is ultimately found to be incorrect by the Tax Court.

Here, the Tax Court found that Mr. Hansen had carefully assessed his situation and filed his returns based on a reasonable and honest belief that he was entitled to claim the principal residence exemption. The Tax Court emphasized the involvement of Mr. Hansen's accountant as strong evidence that Mr. Hansen took the necessary steps to file his tax returns on a reasonable basis. As a result, the Tax Court held that the CRA was not entitled to reassess Mr. Hansen for the statute-barred years, and overturned those reassessments.

Gross Negligence Penalties

The Tax Court upheld the CRA's recharacterization of the sales of Mr. Hansen's properties in 2011 and 2012 (which were not statute-barred) from capital gains to business income. That determination largely depended on the circumstances surrounding those sales—the two homes were always intended to be temporary stays because the Hansens had purchased another lot and were waiting to build a new home there.

The Tax Court then considered whether to uphold the gross negligence penalties the CRA imposed on these two sales. Under subsection 163(2) of the Act, gross negligence penalties apply when a taxpayer knowingly, or under circumstances amounting to gross negligence, has made a false statement or omission in his or her tax return.

The Tax Court emphasized that "gross negligence" implies a high level of misconduct, and found that Mr. Hansen's conduct was, to the contrary, that of a reasonable person. Once again, Mr. Hansen's reliance on his accountant was key. The Tax Court gave weight to the evidence that Mr. Hansen had provided his accountant with all the necessary information prior to the accountant advising that the principal residence exemption applied. The Tax Court therefore overturned the gross negligence penalties.

Conclusion

The key takeaways from this decision are:

1. In recharacterizing the proceeds of property sales from capital gains to business income, the CRA will often point only to the number of sales and the length of time the property was held, but these are not the only factors. In this case, with five sales in six years, the taxpayer was still able to achieve significant success.
2. There is significant scope for a taxpayer to succeed on statute-barred years and gross negligence penalties even if the taxpayer fails on the characterization of the property sale. These issues should always be carefully considered in any case involving a relatively short time-frame between purchase and sale of a house.
3. Reliance on an accountant in filing tax returns can carry significant weight in this type of case. Taxpayers should provide their accountant or other tax advisor with all relevant information regarding real estate transactions prior to completing their tax returns, and consider doing so in writing (or at least retaining notes from meetings or calls) for evidentiary purposes. Calling those advisors to testify at trial and provide supportive testimony, if necessary, could also be critical.

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KEEY RECENT CORPORATE TAX DEVELOPMENTS

The following article is excerpted from the October 2020 Corporate Tax Monthly Update available on *Taxnet Pro^{TM}* by Ryan Keey (MAcc, CPA, CA) Senior Tax Writer at Thomson Reuters.

CASE LAW COMMENTARY

Increase in CDA balance did not give rise to a "tax benefit" — *Rogers Enterprises (2015) Inc.*, 2020 CarswellNat 3427 (TCC): The Court concluded that a serious of transactions resulting in an increase in the taxpayer's CDA by the full amount of life insurance proceeds received (i.e. the addition was not offset by the adjusted cost basis of the policy) did not give rise to a "tax benefit" such that the GAAR did not apply. As proposed in Budget 2016, applicable to deaths that occur after March 21, 2016 the amount added to a corporation's CDA in respect of life insurance proceeds is reduced by the adjusted cost basis of *any* policyholder's interest in the policy (i.e., not just the adjusted cost basis of the recipient of the insurance proceeds). Formerly, it was possible to include the full amount of the death proceeds of a life insurance policy in a corporation's CDA where the corporation was the beneficiary of the policy holder, but another taxpayer was the policyholder. In simplified terms, the transactions at issue in *Rogers* utilized this feature of the rules to include the full amount of the proceeds of a life insurance policy, $92M, in the taxpayer's CDA. The Crown argued that the series of transactions gave rise to a "tax benefit"[1]on the basis that the increase in the CDA balance in excess of the adjusted cost basis of the policy fell within the ambit of the phrase "an increase in . . . [an] other amount under this Act,". Rejecting this assertion, the Court interpreted the relevant portion of the "tax benefit" definition as meaning "an increase in a refund", commenting that "[i]f the Crown's interpretation were correct, one would expect that the word "an" would have appeared before the phrase "other amount," or that the word "another" would have been used rather than the word "other""[2]. Among five other reasons given for rejecting the Crown's interpretation of the "tax benefit" definition, the Court cited the 1998 Technical Notes, which read:

> Generally, for the purposes of section 245, a transaction, to be an avoidance transaction, must result in a "tax benefit". This expression is defined as a reduction, avoidance or deferral of tax or other amount payable under the Act or an increase in a refund of tax or other amount under the Act. The references in this definition to "other amount payable under this Act" and "other amount under this Act" are intended to cover interest, penalties, the remittance of source deductions, and other amounts that do not constitute tax.

Applying its preferred interpretation of the "tax benefit" definition to the facts of the case, the Court concluded that a "tax benefit" had not arisen, stating:[3]

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1 ITA 245(1).

2 Para. 31.

3 Para. 39. See also The *Arnold Report* 185, "An Increase In A Tax Attribute Is Not A Tax Benefit", CTF, Sept. 17, 2020, in which Brian Arnold comments: "In my 2018 report on the [FCA's decision in *Wild*] I argued that an increase in a tax attribute ([PUC] in the *Wild* [[2019] 3 C.T.C. 1 (FCA) (reversing [2017] 4 C.T.C. 2103 (TCC))] case) could not be a tax benefit for purposes of the GAAR until the increase was used to reduce, avoid, or defer tax. . . I also argued in my report on *Wild* that the definition of "tax benefit" in [ITA]

> *To constitute a tax benefit*, it is insufficient that there be a reduction in the computation of income. Rather, in this context, *a reduction of tax is required*. Admittedly, in many situations a reduction in the computation of income will generally result in a reduction of tax. However, in this particular situation, where capital dividends (actual or deemed) aggregating [$92M] were paid. . ., although those capital dividends were not included in computing the recipient corporation's income, there was no less tax paid than if those dividends had been taxable dividends, which would have been included (pursuant to [ITA 82(1)]) in computing the income of the recipient corporation, but which would have been deductible (pursuant to [ITA 112(1)]) in computing the taxable income of the corporation. In other words, whether the dividends in question were capital dividends or taxable dividends, there would have been no tax payable. Thus, while there was a reduction in income, there was no reduction in tax. Therefore, the reduction in the computation of income did not constitute a tax benefit. [emphasis added]

The Court further held that there was no "tax benefit" related to the avoidance of Part III tax (additional tax on excessive CDA elections) since the member of the Roger's group that paid the capital dividend at issue had a sufficient CDA balance to cover the capital dividend paid even if the CRA's assessing position had been correct. Finally, the Court held that the tax payable by the ultimate individual shareholders had not been reduced since the "excessive" CDA had not yet been paid out to the individual shareholders.

"In case" its position on that the transactions did not give rise to a tax benefit was "mistaken", the Court further considered whether the transactions were abusive.[4] After analyzing the history of the CDA definition and amendments thereto, the Court ultimately concluded that the transactions were not abusive on the general basis that the 1977 amendments to the definition which created the relevant tax planning opportunity were intentional. In particular, at paragraphs 94-97 and 131, the Court stated:

> It is. . . significant that, in 1977, although Parliament had previously used the phrase "adjusted cost basis to a policyholder" (or words to that effect) in several instances in [ITA 148], in amending the [CDA definition in ITA 89(1)(b)], Parliament chose to use the phrase "adjusted cost basis of the policy ... to the corporation. . . ." This appears to have been a deliberate choice on the part of Parliament. The [CDA and "adjusted cost basis" definitions] are highly technical and very complex, such that one would expect that the wording of those definitions should play a significant role in determining the underlying policies of the definitions. Thus, it is my view that, before 1977, the legislative policy underlying the Reduction Provision in the [CDA definition] was that any premiums paid by anyone in respect of a life insurance policy were to be taken into consideration in determining the portion of the proceeds paid under the policy to a corporate beneficiary that could be added to the capital dividend account of that beneficiary. After the 1977 amendment, the underlying legislative policy was that premiums paid by the corporate beneficiary, together with the other factors listed in the definition of the "adjusted cost basis" of the life insurance policy to that beneficiary (and not to the policyholder), were to be taken into consideration. While there were a number of amendments to the [CDA and "adjusted cost basis" definitions] between 1977 and 2015, in my view, during that period, the legislative policy underlying the Reduction Provision in the definition of "capital dividend account" remained the same. During that period there were several occasions when Parliament considered concerns in respect of the method of calculating a corporation's [CDA] in the context of the receipt of life insurance proceeds. . . [S]ome of those concerns were dealt with, or arose in the context of, the introduction and subsequent repeal of the life insurance capital dividend account and the introduction of rules relating to LIA policies and 10/8 policies. Each of those concerns resulted in amendments to the [CDA definition] and yet, on none of those occasions did Parliament see fit to amend the portion of the Reduction Provision that is relevant to these Appeals and that, throughout the period from 1977 to March 21, 2016, continued to refer to the adjusted cost basis of the particular life insurance policy to the corporation.
>
> To summarize, I am not satisfied that the Crown has adequately explained the purpose of the Reduction Provision as it read in 2008 and 2009. I accept that from January 1, 1972 to March 31, 1977, the purpose of the Reduction Provision was to exclude an amount equal to the aggregate premiums paid in respect of a life insurance policy from the portion of the proceeds of the policy that a corporate beneficiary was allowed to add to its [CDA]. However, I am not persuaded that the purpose remained the same after March 31, 1977, when the key phrase in the Reduction Provision was amended to read ". . . the adjusted cost basis of the policy . . . to the corporation. . . ." As the Crown has not satisfactorily identified the purpose of the 2008-2009 version of the Reduction Provision, particularly its key phrase (as it then read, i.e., ". . . the adjusted cost basis of a policy referred to in subparagraph (i) or (ii) to the corporation. . ."), I am of the view that this is one of those, perhaps rare, situations where the underlying rationale of the Reduction Provision in 2008 and 2009 was no broader than the text itself.

With respect, it seems questionable to suggest that Parliament could have intended for the CDA balance of a corporation to be increased by the full amount of life insurance proceeds received in any normal circumstances.[5]

245(1) was flawed and had been flawed since the GAAR was enacted in 1988 and that the government should amend the definition to fix the flaw. . . *Rogers* dealt with this issue head-on and came to the same conclusion that I and others have come to: *an increase in a tax attribute is not a tax benefit* . . . In [*Roger's*], for the taxpayer, the question is whether to continue to wait or go ahead and pay the capital dividends. If the Crown does not appeal, the risk with respect to the application of the GAAR when the dividends are received by the individual shareholders may be reduced somewhat because it is likely that another Tax Court judge would agree with Justice Sommerfeldt's decision [(i.e. that the transactions were not abusive)]. However, it also seems likely that, in that event, the Crown would appeal that decision to the [FCA]. Therefore, whether the Crown appeals this decision or a subsequent decision when the dividend is paid, it would be a brave tax adviser that would give a clean opinion that the [FCA] would not overturn the Tax Court's decision that the transactions were not abusive [emphasis added]."

[4] Para. 58.

[5] In other words, the pre-2016 planning opportunity seems to have been

FCA affirmed that GAAR applied to CDA doubling-up transactions — *The Gladwin Realty Corporation*, 2020 CarswellNat 3733 (FCA) (affirming 2019 CarswellNat 752 (TCC)): The trial court held that the GAAR applied to a series of transactions (described in the 2019-4 edition of this article) that attempted to utilize ITA 40(3.1) and (3.12) (gain and loss deeming rules related to a partnership interest with a negative ACB) to effectively add the same gain to the CDA account twice (ITA 89(1)"CDA"(a)(i)(A) and (a)(ii)(A) have since been amended to thwart such planning). The excessive CDA balance otherwise created in this case had not yet been paid out to the individual shareholders. As was a relevant factor in the *Rogers* case discussed above, the FCA commented at paragraph 47 that "it is now established that the modification of tax attributes, such as an increase in a taxpayer's CDA, does not give rise to a tax benefit unless and until a capital dividend is paid out of that account to a recipient capable of benefiting from its tax-free character".[6] However, in this case, "[f]aced with the parties' desire to obtain a resolution in this matter and the absence of a tax benefit, counsel for the appellant made the undertaking (now fulfilled) that a dividend be paid to non-corporate shareholders so as to allow the matter to be resolved at this juncture. With the agreement of the Crown, the Court agreed to conduct the abuse analysis on the basis that a tax benefit arose by reason of such a dividend having been paid".[7] In finding the series of transactions to be abusive, the FCA reasoned as follows (paras. 69-70, 82-85):

> I agree with the appellant that [ITA] 40(3.1) operated exactly as it should when regard is had to its underlying rationale. . . I also agree with the appellant, based on the binding decisions that it cites. . . that in conducting the abuse analysis, the Court must give effect to the transactions as they unfolded, and refrain from assessing the abuse on the basis of the overall result achieved. What must be shown is that the provisions used to achieve this result, when construed with a focus on their object, spirit and purpose, reveal a clear underlying rationale that was frustrated by the series of transactions. As explained below, I am satisfied that this demonstration has been made. . .
>
> [T]he strategy [employed in this case] is highly reminiscent of the one used in [*Triad Gestco Ltd.*]. Like here, *Triad Gestco* implemented a series of transactions designed to avoid tax altogether on a substantial capital gain arising from the sale of a commercial property. It did so by generating a loss commensurate with the anticipated gain. The method used was a "value shift", the effect of which was to isolate in two distinct classes of shares the tax attributes reflecting the high [FMV] of the underlying property and its low cost so that they inversely mirrored each other. By disposing of the shares that carried the desired tax attributes, i.e. low FMV and high cost, while retaining permanently the shares that carried the inverse tax attributes, i.e. high FMV and low cost, *Triad Gestco* was able to generate the planned loss and use it to offset the gain without ever being exposed to tax on the corresponding capital gain embedded in the other class of shares. . . Like *Triad Gestco*, the appellant managed to isolate and use for the benefit of its shareholders the upward impact that the deemed gain had on its CDA in circumstances where it continues to hold, but will never have to contend with the negative CDA balance resulting from the corresponding deemed loss that had to be elected in the process. *In both cases, the undesirable tax attributes that had to be created in order to obtain the tax benefit were isolated from the desirable ones and left to be forgotten without ever having any repercussion. As in Triad Gestco but in the reverse order, the gain was used to obtain the tax benefit and the negative impact of the corresponding loss will never be felt. This defeats the rationale that underlies the CDA regime because it allowed for the payment of a $12,000,000 capital dividend in circumstances where the $12,000,000 deficit that had to be created in the process will never be accounted for.* Specifically, the extra $12,000,000 that was distributed tax-free will never be offset by the qualifying amounts that would have to be renounced on a go-forward basis in order to make up the deficit. This is not to say that this balance must be attained perfectly or always. However, a plan that deliberately sets out to create a permanent [$12M] CDA deficit in order to extract a commensurate tax-free dividend breaks the integrity of the CDA regime the same way as the strategy used in *Triad Gestco* broke the integrity of the capital gains regime. The use that was made of [ITA] 40(3.1) and 40(3.12) in order to achieve this result amounts to a plain misuse as these provisions were used so as to defeat altogether the CDA neutral application envisioned by their underlying rationale. The extra [$12M] capital dividend that was paid and the permanent CDA deficit of [$12M] that was created in the process fully account for the over-integration identified by the Tax Court judge in the course of his reasons (Reasons para. 86). [emphasis added][8]

SR&ED claim denied — *Indusol Industrial Control Ltd.*, 2020 CarswellNat 3731 (TCC): The taxpayer developed a 3D electronic marine navigation system for commercial vessels. Over the years, the 3D navigation system was improved to include more features, including a draught information system ("DIS"). A prototype of the 3D navigation system with DIS capabilities was available by 2010. During the taxation year at issue (2012), the activities undertaken by taxpayer involved writing DIS implementation specifications and getting the DIS technology approved. The Court held that although some incremental advancements achieved in the 2012 taxation year, there was no technological advancement within the meaning of the SR&ED criteria[9].

available as a result of a "legislative gap" (from a GAAR case terminology perspective).

6 *1245989 Alberta Ltd.*, 2018 FCA 114 [Perry Wild].

7 Para. 49.

8 See also Ummat, "FCA Dismisses Gladwin Realty's Appeal of TCC GAAR Loss", *Tax Disputes Case Law Weekly Update* (Taxnet Pro), Sept. 16, 2020 and Chow et al., "Current Cases", *The Definitive Guide to Owner Manager Taxation* (CTF), draft paper submitted Sept. 17 ("It is interesting to hear that the [FCA] agreed with the taxpayer's position that [ITA] 40(3.1) and 40(3.12) operated exactly as they should have. We have, however, heard from the Supreme Court that planning into a specific anti-avoidance rule may be abusive. . . Planning is very fact specific and every case may be different. In particular, when undertaking CDA planning, the object and spirit of the provisions of the CDA Mechanism should be observed. Having said that, planning considerations to pay out a capital dividend prior to the realization of losses should fall within the realm of acceptable tax planning as confirmed by the Federal Court of Appeal decision of *Gladwin*. This point may be particularly relevant for loss planning in this economic climate".

9 Para. 107.

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RECENT GOVERNMENT PUBLICATIONS

NEW and UPDATED INCOME TAX FOLIOS

Two newly published Income Tax Folios were released by the CRA for comment, effective October 9, 2020:

- S4-F14-C1, Artists and Writers, replacing and cancelling Interpretation Bulletin IT-257R, Canada Council Grants; Interpretation Bulletin IT-504R2, Visual Artists and Writers; and Interpretation Bulletin IT-525R, Performing Artists.
- S5-F3-C1, Taxation of a Roth IRA, replacing and cancelling Income Tax Technical News, Issue No. 43 — September 24, 2010 and refers to Article XVIII of the Canada-U.S. Treaty.

The comment period for both Chapters ends on **January 9, 2021**. Suggestions about the structure or content of the Chapters or the folios in general may be emailed to folios@cra-arc.gc.ca. Tax or benefits questions will not be responded to through this forum. Visit the Contact information page for the CRA services available to have tax or benefits questions addressed. Any changes to the Chapters resulting from this review will be published in an updated Chapter and reflected in the corresponding Chapter History.

On October 9, 2020, the following Income Tax Folios were updated:

- S1-F1-C2, Disability Tax Credit. The history of updates to the Chapter as well as any technical updates from previously cancelled interpretation bulletins can be viewed in the Chapter History page of the corresponding Income Tax Folio.
- S7-F1-C1, Split-receipting and Deemed Fair Market Value. The history of updates to the Chapter as well as any technical updates from previously cancelled interpretation bulletins can be viewed in the Chapter History page of the corresponding Income Tax Folio.

SUPREME COURT APPEALS

The Supreme Court of Canada appeals tables on *TaxPartner* and *Taxnet Pro* have been updated through the S.C.C. *Bulletin of Proceedings* dated October 9, 2020.

Leave to appeal was dismissed with costs on October 1, 2020 in *Barejo Holdings ULC v. Canada*, 2020 FCA 47, [2020] 4 C.T.C. 67 (FCA) (SCC file 39190).

The *Notices of Appeal to Federal Court of Appeal Filed* table has been updated on *TaxPartner* and *Taxnet Pro* for appeals filed through October 9, 2020.

NEWS RELEASE

THE MINISTER OF NATIONAL REVENUE ANNOUNCES THE APPOINTMENT OF THE NEW TAXPAYERS' OMBUDSPERSON

Reproduced below is a Canada Revenue Agency news release dated October 1, 2020.

> Today, the Honourable Diane Lebouthillier, Minister of National Revenue, announced the appointment of the new Taxpayers' Ombudsperson, Mr. François Boileau, effective October 5, 2020. This appointment was made via an open, transparent and merit-based process.
>
> Mr. Boileau holds a Bachelor of Civil Law Degree from the University of Ottawa and a Bachelor's degree in Political Science from the Université de Montréal and is the former French Language Services Commissioner of Ontario. For nearly 30 years, as a senior executive, he has developed expertise as an ombudsperson, as well as in oversight, investigation, and governance.
>
> The Minister would like to thank the previous Taxpayers' Ombudsman, Ms. Sherra Profit, for her dedication to her work and taxpayers during her tenure.
>
> Effective immediately, the title for this position is changed from Taxpayers' Ombudsman to Taxpayers' Ombudsperson. The Office of the Taxpayers' Ombudsperson (OTO) operates to enhance the CRA's accountability and service to the public. The OTO upholds taxpayers' service rights as outlined in the Taxpayer Bill of Rights and reviews complaints from taxpayers to ensure a fair resolution.
>
> **Quotes**
>
> "The Office of the Taxpayers' Ombudsperson plays an integral role to ensure taxpayers receive fair and independent resolution of complaints arising from service provided by the Canada Revenue Agency. I am delighted that Mr. François Boileau has been appointed and look forward to collaborating with him."
>
> — The Honourable Diane Lebouthillier, Minister of National Revenue
>
> "I am honoured to be appointed as the next Taxpayers' Ombudsperson. I look forward to working with the Canada Revenue Agency to ensure the taxpayer service rights are upheld for all Canadians, especially to our most vulnerable populations."
>
> — François Boileau, Taxpayers' Ombudsperson
>
> **Quick facts**
>
> - Mr. François Boileau is the third person to be appointed Canada's Taxpayers' Ombudsperson since the position was established in 2008.
> - The Office of the Taxpayers' Ombudsperson (OTO) examines and reviews complaints from taxpayers if they feel their service rights have not been respected by the CRA.
> - Taxpayers are encouraged to go through the CRA's redress mechanisms before reaching out to the OTO.
> - Mr. Boileau will assume his position on October 5, 2020.

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CASE LAW UPDATE

MCNEELEY, M. et al. v. R.

Tax Court of Canada (General Procedure)
Russell J.
September 29, 2020
Citation: 2020 CarswellNat 4070, 2020 TCC 90

Tax — Income tax — Special rules — Employee benefit plans — Taxpayer B founded D Corp. and B's mother settled employee stock trust — Trust subscribed for 2,950 common shares of D Corp. at their aggregate fair market value — D Inc. was incorporated and became D Corp.'s wholly-owned subsidiary, and Trust exchanged its shares for equal number of D Inc. common shares — In 2012, Trust distributed 3,356,415 shares to various beneficiaries, including B and taxpayer C — Trust elected to apply s. 107(2.1) of *Income Tax Act* in respect of distribution of shares to beneficiaries other than B, reporting taxable capital gain, and filed on basis that B was deemed to have received his distribution of shares at their nominal adjusted cost base — Beneficiaries sold their shares to numbered company for $8,745,760 and B sold his shares to numbered company in exchange for shares of numbered company — Trust distributed remaining shares to 227 beneficiaries including taxpayer M and B and elected to apply s. 107(2.1) to distribution, reporting taxable capital gain — B sold his shares to numbered company for $423,991 and 226 other beneficiaries including M and excluding C sold their shares to numbered company for $2,512,248 — Minister of National Revenue reassessed M, C and B for 2012 taxation year — Reassessments reflected conclusion that M, C, and B had received their corporate shares from trust that constituted employee benefit plan (EBP) and should have reported fair market value of received shares as income from office or employment — M, C and B appealed — APPEALS DISMISSED — There was limited jurisprudence regarding EBPs — Section 248(1) provides definition of EBP and parties concurred that none of clauses (a) through (e) of definition were relevant to these appeals — EBP definition provides carve-out from EBP that excluded any payment that would not have been taxable were s. 6 read without ss. 6(1)(a)(ii) and 6(1)(g), would not be required to be included in computing recipient's taxable income — Trust in these appeals was EBP — As paragraph (a) of s. 108(1) "trust" definition excludes EBP trusts from any and all references to "trust" in s. 107, while at same time certain provisions of s. 107 constituted basis for prescribed trusts, it would seem no EBP could currently be prescribed trust — Neither paragraph (a.1) of s. 108(1) "trust" definition, nor any presumed presumption favouring EBP rules over prescribed trust rules, effected conclusion that Trust was EBP trust and as such could not also be prescribed trust — At all material times B was ranking employee of operating company and one of Trust's three trustees — There was no documentation or *viva voce* evidence corroborating intention that B was to end up with approximately 70 percent of shares after distribution — Evidence failed to establish that in unanimously making 2012 decisions regarding distribution of shares to B, none of trustees took into consideration any aspect of B's work contributions over twelve immediately preceding years qua D Corp.'s ranking employee — There was inadequate evidence to support B's proposition that per parenthetical carve-out in EBP definition, paragraph 6(1)(a) would not have applied to his two distributions, and that accordingly his two share distributions would not have been taxable on income account.

THE QUEEN v. LUX OPERATING LIMITED PARTNERSHIP et al.

Federal Court of Appeal
Webb J.A. (Pelletier and Near JJ.A. concurring)
October 6, 2020
Citation: 2020 CarswellNat 4127, 2020 FCA 162

Tax — Income tax — Partnership — Miscellaneous — Administration and enforcement — Miscellaneous — Minister issued notices of determination indicating that two partnerships had nil business losses because partnerships were not valid — Taxpayers, as designated partners of purported partnerships, appealed — Taxpayers' applications for determination of whether Minister could, having at all times concluded that no partnership existed, issue valid notices of determination under s. 152(1.4) of *Income Tax Act* in respect of purported partnership was granted with negative answer — Minister appealed — APPEAL ALLOWED — Answer to question was neither unqualified yes nor unqualified no — Validity of determination made under s. 152(1.4) of Act and hence validity of related notice of determination would depend on final conclusion of court with respect to whether purported partnership existed at relevant time — Tax Court judge erred by essentially confining himself to conflicting interpretations proposed by parties — Question was premature as validity of determinations could not be decided until issue of whether purported partnerships were partnerships was finally resolved — Minister's position was not accepted that, even if purported partnerships were finally ruled not to be valid, determinations would still be valid determinations for each purported partnership — Minister's determinations were that Canadian net business loss for each fiscal year was nil — While one of bases in support of determinations disallowing losses was that purported partnership was not valid, determinations were restricted to determination that business losses were nil — Determination that Minister must make was of income or loss "of partnership" and if there was no valid partnership, then there could be no determination of loss or income of whatever arrangement was between parties — If there were never any partnerships, there would be no member of partnerships referred to in s. 165(1.15) of Act and hence no right of appeal under that provision — Plain meaning of s. 152(1.8) of Act was simply that Minister, if listed court made final conclusion that partnerships did not exist, then had right to reassess any taxpayer involved, with taxpayer then having own rights of objection and appeal — If Tax

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Court concluded that partnerships were valid, there did not seem to be any reason why determinations would not be valid, subject to right of court to examine merits of determination and decide whether losses were nil — If there were no valid determinations, notices of appeal purporting to be from these determinations would not be valid and so issue of partnership validity would have to be considered in reassessments and appeals of each investor — It would be more efficient and consistent with purpose of provisions to determine existence of partnership in current underlying appeals, resulting in only one process for each partnership — Key question that needed to be answered before validity of determinations could be addressed was whether partnerships existed.

McCARTHY TÉTRAULT COMMENTARY UPDATE TO *CANADA TAX SERVICE*, RELEASE 1705

The commentary to the following provisions has been updated for the noted reasons:

- **7:** updated to reflect recent case law and CRA publications and proposed amendments;
- **94.1; 94.2:** updated to reflect recent case law;
- **124:** updated to reflect recent case law, CRA publications, and amendments to related provisions; and
- **153:** updated to reflect the addition of 153(3.1) by S.C. 2019, c. 29 (Bill C-97), the addition of 153(1.02), (1.03), and (1.04) by S.C. 2020, c. 5 (Bill C-13), the addition of Regulation 111, and to reflect recent CRA Guidance and CRA publications.

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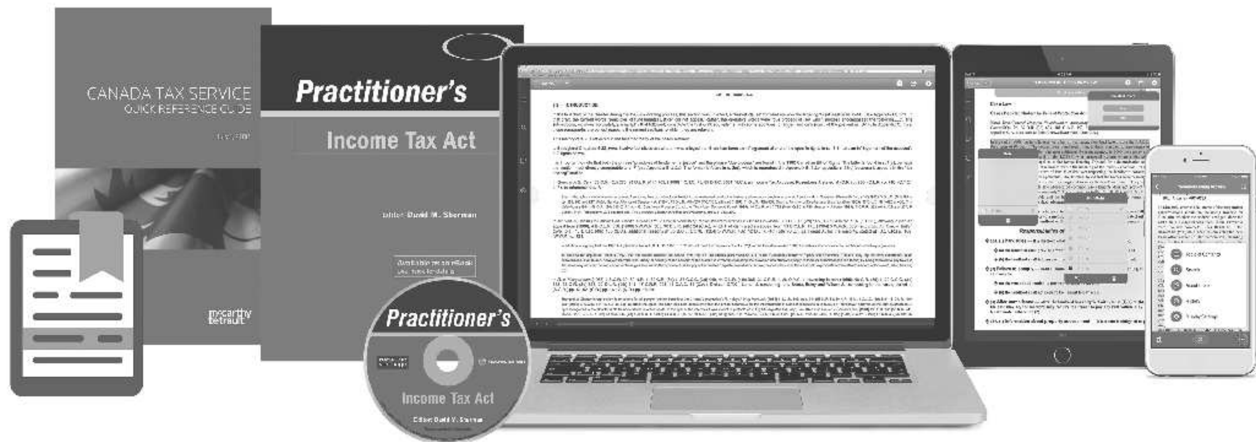

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