

Tax Topics

October 10, 2023
Number 2689

Is the Duke Finally Dead? An Analysis of the August 4 GAAR Draft Legislation 3

Current Items of Interest 6

International News 7

Recent Cases 10

IS FAIR MARKET VALUE A FACT?

— David H. Sohmer¹

The issue before the Federal Court of Appeal in *Canada v. Preston*² was: “Should an assumption in a reply to a notice of appeal in the Tax Court of Canada be struck out solely on the basis that it is a statement of mixed fact and law?”³ In reassessing the taxpayer, the Minister assumed that “on September 25, 2014. . . the fair market value (“FMV”) of the [property] received by Mr. and Mrs. Preston was \$75,511,267, comprised of the FMV of the Holdco shares of \$67,979,759 and the FMV of the Partnership interest of \$7,531,508.”

The Court held that “[a] statement that an identified property has a particular fair market value at a particular point in time is an assumption (or finding) of fact, notwithstanding that fair market value has a legal definition. Fair market value is predominantly factual [. . .]”⁴. Based on this finding and on the finding that the taxpayer did not demonstrate that the assumption may prejudice or delay the fair hearing of the appeal,⁵ the Court concluded that the assumption need not be struck.

In coming to its conclusion, the Court accepted the definition of fair market value found in the decision of Cattanach J. in *Henderson Estate v. Canada (Minister of National Revenue)*:⁶

The statute does not define the expression “fair market value”, but the expression has been defined in many different ways depending generally on the subject matter which the person seeking to define it had in mind. I do not think it necessary to attempt an exact definition of the expression as used in the statute other than to say that the words must be construed in accordance with the common understanding of them. That common understanding I take to mean the highest price an asset might reasonably be expected to bring if sold by the owner in the normal method applicable to the asset in question in the ordinary course of business in a market not exposed to any undue stresses and composed of willing buyers and sellers dealing at arm’s length and under no compulsion to buy or sell. I would add that the foregoing understanding as I have expressed it in a general way includes what I conceive to be the essential element which is an open and unrestricted market in which the price is hammered out between willing and informed buyers and sellers on the anvil of supply and demand. These definitions are equally applicable to “fair market

¹ David Sohmer is one of the founding shareholders of Spiegel Sohmer Inc. and can be reached at dhsohmer@spegelsohmer.com. I could not have written this article without the invaluable input of my co-shareholder Aaron Rodgers. Thanks also to my associate Jonathan Ethier for assisting a technical dinosaur with citations and formatting.

² *Canada v. Preston*, 2023 DTC 5082 (FCA).

³ *Id.*, at para. 1.

⁴ *Id.*, at para. 47.

⁵ As required by s. 53(1) of the *Tax Court of Canada Rules (General Procedure)*, (SOR/90-688a).

⁶ *Henderson Estate v. Canada (Minister of National Revenue)*, 73 DTC 5471 (FC).

value” and “market value” and it is doubtful if the use of the word “fair” adds anything to the words “market value”.⁷

This definition of fair market value precludes a reasonable lower amount from being the fair market value as long as the highest amount is also reasonable and so renders a contestation effectively futile. The only reasonable interpretation is that fair market value is the most reasonable of reasonable alternatives. This involves subjective assessment and interpretation, which are “the essence of opinion evidence.”⁸

While the author of *Phipson on Evidence* states that “No satisfactory definition of the term ‘fact’ has been or perhaps can be given”,⁹ the following statement is a useful guide as to the distinction between fact and opinion: “A fact is a statement that can be verified. It can be proven to be true or false through objective evidence. An opinion is a statement that expresses a feeling, an attitude, a value judgment, or a belief. It is a statement that is neither true nor false. Or it may feel true for some, but false for others”.¹⁰

Assuming that what is “fair” is what the court finds is the most reasonable, the following statement by Chief Justice Bowman (as he then was) confirms that fair market value is not a fact that can be rebutted by proving it to be false.

One further problem arises in valuation cases of this type. Typically both parties call expert witnesses. In many cases, these witnesses are not divided on any serious question of principle, although occasionally they may differ on the highest and best use of the property being appraised. The major difference usually lies in the choice of comparables used and the positive or negative adjustments to be made to particular comparables based on such factors as location, the timing of the sale, or other physical characteristics of the property. It frequently happens that the judge determines a value somewhere between the opposing positions of the experts, not because of any desire to reach a Solomonian compromise, but because of a recognition that the positions adopted by the experts represent the polarized extreme ends of value. There is a danger that experts, albeit in good faith, may become advocates and their positions may become adversarial. For this reason a disinterested arbiter must often conclude that it is unwise to adopt entirely the position of one or the other and that it is more likely that a fair — I hesitate to use words such as “right” or “correct” in the necessarily imprecise area of valuation — value is likely to be somewhere between the two extremes.¹¹

The core problem is that what is effectively binding arbitration does not fit into the paradigm reflected in the following excerpts from the Supreme Court decision in *Hickman Motors Ltd. v. Canada*:¹²

The Minister, in making assessments, proceeds on assumptions [...] and the initial onus is on the taxpayer to “demolish” the Minister’s assumptions in the assessment [...]. This initial onus of “demolishing” the Minister’s exact assumptions is met where the appellant makes out at least a *prima facie* case [...]. Where the Minister’s assumptions have been “demolished” by the appellant, “the onus . . . shifts to the Minister to rebut the *prima facie* case” made out by the appellant and to prove the assumptions [...].¹³

If a fair value is neither true nor false, nor more likely than not to be true or false, it cannot be proven. The initial onus on the taxpayer to “demolish” the Minister’s assumption by presenting enough evidence to create a rebuttable presumption that the matter assumed is false cannot be met, nor can the subsequent onus on the Minister “to prove” that the assumption is true.

Whether or not fair market value is a question of fact may impact what expert evidence is admissible. The following excerpt from the decision of Boccock J. in *BlackBerry Limited v. The King*¹⁴ casts light on this issue:

[44] The two-step test for determining expert evidence admissibility was initially articulated by the Supreme Court of Canada (“Supreme Court”) in *Mohan* and subsequently clarified in *White Burgess* [...]. The Supreme Court’s direction may be summarized below:

1. **Threshold admissibility:** This step consists of four questions: is the evidence logically relevant; is it necessary to assist the trier of fact; are there other exclusionary rules; and is the expert properly qualified.

⁷ *Id.*, at 5476.

⁸ *Phipson on Evidence*, 19th ed., at para. 33-10.

⁹ *Id.*, at para. 1-11.

¹⁰ Palm Beach State College, Fact or Opinion? — Tutor Hints, URL: <https://www.palmbeachstate.edu/slc/Documents/fact%20or%20opinion%20hints.pdf>.

¹¹ *Western Securities Limited v. The Queen*, 97 DTC 977 (TCC), at page 979.

¹² *Hickman Motors Ltd. v. Canada*, 97 DTC 5363 (SCC).

¹³ *Id.*, at paras. 92–94.

¹⁴ *BlackBerry Limited v. The King*, 2023 DTC 1084 (TCC).

2. Gatekeeper function/Residual discretion to exclude: This step is a cost-benefit analysis of the help and harm of the evidence. Does the probative value outweigh potential prejudice, confusion, and prolonged court time? This can be thought of as an application of the general exclusionary rule. [. . .]

[45] Relevancy at the initial threshold step is usually surmountable. The question is whether the evidence makes "the existence or non-existence of a fact in issue more or less likely than it would be without that evidence," and is judged "as a matter of human experience and logic". [. . .] Evidence that does not meet this threshold is strictly inadmissible.

IS THE *DUKE* FINALLY DEAD? AN ANALYSIS OF THE AUGUST 4 GAAR DRAFT LEGISLATION

— Roderick A. McBey, GJM LL.B. TEP — Senior Technical Writer, Wolters Kluwer Canada

Fundamental wide-ranging changes to the general anti-avoidance rule ("GAAR") were introduced in the 2023 Federal Budget ("Budget 2023"). Unfortunately, these changes, if enacted in their current form, will introduce a large degree of uncertainty into the provision and make it harder and more expensive for taxpayers to challenge a GAAR assessment, valid or not.

In *Canada Trustco* (2005 DTC 5523), the Supreme Court established a three-step framework for determining whether the GAAR applies to a transaction or a series of transactions. This framework was reasserted by the Supreme Court in several cases, including *Copthorne Holdings* (2012 DTC 5007) and *Lipson* (2009 DTC 5015). The first step is to inquire into the existence of a "tax benefit". For there to be a tax benefit, a transaction or series of transactions must result in "a reduction, avoidance or deferral of tax or other amount" or an "increase in a refund of tax or other amount". The second step is to determine whether the tax benefit is an "avoidance transaction" within the meaning of subsection 245(3). The third step is to determine whether the avoidance transaction giving rise to the tax benefit is a "misuse" or "abuse" of the *Income Tax Act* (the "Act") under subsection 245(4). This inquiry involves, first, interpreting the relevant provisions of the Act to determine their object, spirit, and purpose, and second, determining whether the transactions fall within or frustrate the object, spirit, and purposes of those provisions. The existence of abusive tax avoidance must be clear, and if it is not clear, the benefit of the doubt goes to the taxpayer. In addition, the Minister bears the burden of establishing abusive tax avoidance.

There have been significant changes proposed to subsection 245(3) which deals with the effect of a tax motive in determining whether or not a particular transaction is an "avoidance transaction". As noted above, GAAR applies to a transaction only if it is an "avoidance transaction" as defined in subsection 245(3). Previously, the rule looked to whether a transaction (or series) was "undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit." Subsection (3) will be amended to change the "primarily" threshold in the avoidance transaction test to a "one of the main purposes" threshold. It is hard practically to see when this lower threshold will not be met, given that tax is one of the major costs and factors involved in any commercial transaction.

Most transactions will now potentially be included in the scope of the GAAR and there are fundamental changes proposed which arguably will make the application and scope of the GAAR unclear.

Canada has always been subject to the rule of law. That is, Parliament and the laws they pass are supreme and when interpreting the law, courts look to the wording of the legislation passed by Parliament. This has also been true in tax, with a long line of cases affirming this, one of the most important being the English case of *Inland Revenue Commissioners v. Duke of Westminster*, [1936] A.C. 1, where the Duke arranged to "pay" his gardener via a tax-efficient annuity rather than paying him a salary, which attracted the displeasure of the Commissioners of Inland Revenue. In that case, Lord Tomlin said:

Apart, however, from the question of contract with which I have dealt, it is said that in revenue cases there is a doctrine that the Court may ignore the legal position and regard what is called "the substance of the matter," and that here the substance of the matter is that the annuitant was serving the Duke for something equal to his former salary or wages, and that therefore, while he is so serving, the annuity must be treated as salary or wages. This supposed doctrine (upon which the Commissioners apparently acted) seems to rest for its support upon a misunderstanding of language used in some earlier cases. The sooner this misunderstanding is dispelled, and the supposed doctrine given its quietus, the better it will be for all concerned, for the doctrine seems to involve substituting "the incertain and crooked cord of discretion" for "the golden and streight metwand of the law." 4 Inst 41 Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so-called doctrine of

“the substance” seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable.

The GAAR was enacted partially in response to the Supreme Court of Canada’s decision in *Stuart* (84 DTC 6305) that the *Income Tax Act* does not require that a transaction have a business purpose to be effective, and, more generally, for the purpose of combating “abusive” tax avoidance transactions and arrangements which technically comply with the provisions of the Act.

Most notably, the changes introduced in Budget 2023 will now introduce an “economic substance” test into Canadian tax law by enacting subsections 245(4.1) and (4.2), in effect substituting an economic analysis for a legal analysis, at least in the first instance.

Draft subsection (4.1) provides that a transaction “significantly lacking in economic substance” is presumed to be a misuse under paragraph (4)(a) or an abuse under paragraph (4)(b), while draft subsection (4.2) sets out the meaning of the phrase “significantly lacking in economic substance” and provides a list of a number of factors which will establish that a transaction is significantly lacking in economic substance.

Draft subsection (4.2) reads as follows:

(4.2) Depending on the particular circumstances, the following factors establish that a transaction or series of transactions is significantly lacking in economic substance:

- (a) all or substantially all of the opportunity for gain or profit and risk of loss of the taxpayer — taken together with those of all non-arm’s length taxpayers — remains unchanged, including because of
 - (i) a circular flow of funds,
 - (ii) offsetting financial positions,
 - (iii) the timing between steps in a series, or
 - (iv) the use of an accommodation party;
- (b) it is reasonable to conclude that, at the time the transaction or series was entered into, the expected value of the tax benefit exceeded the expected non-tax economic return (which excludes both the tax benefit and any tax advantages connected to another jurisdiction); and
- (c) it is reasonable to conclude that the entire, or almost entire, purpose for undertaking or arranging the transaction or series was to obtain the tax benefit.

Note that this list contains considerable uncertainty itself and is not exhaustive, as while these factors will determine that a transaction is significantly lacking in economic substance, subsection (4.2) does not say that others will not.

Leaving aside the uncertainty in the list, it may be very difficult to determine what the “economic substance” of a transaction is, as well as whether or not a lack of this substance is “significant” in the circumstances. We have agreed interpretations as to what “all or substantially all” (90%) and “primarily” (more than 50%) mean but what is “significant”?

In the explanatory notes to the August 4 draft legislation, the Department of Finance gave the following example:

In less abstract terms, a taxpayer moving \$100 from a taxable account to a tax-free savings account **could be argued to lack economic substance**, based on the facts that the taxpayer’s opportunity for gain or profit (and risk of loss) hasn’t changed and the sole reason for moving the funds to the TFSA was to obtain a tax benefit. As noted in the 2008 Budget documents, the TFSA was introduced “to improve incentives for Canadians to save.” As such, while it is possible that a transaction could be implemented which does misuse or abuse the TFSA rules, the taxpayer in this example simply responded to a tax incentive and did precisely what the government intended to encourage. Another factor **that would rebut a presumption of abuse in this example** is that, if the GAAR were to take away the tax benefit each time a person transfers funds from a taxable account into a TFSA, that would render the TFSA rules essentially ineffective at achieving their objective and frustrate the intent of Parliament. [emphasis added]

Although perhaps not intended, this example nicely puts its finger right on the key issues with the updated rules. Even though a mundane transfer to a TFSA is totally in accordance with the intent of Parliament and in accordance with the explicit wording of the Act, if the CRA were to allege a significant lack of economic substance as noted that they could in the example above, the presumption is such that GAAR will apply unless the taxpayer is able to overturn this presumption in court, which is quite conceivably a very difficult, if not impossible, onus to overturn. Where is there any “economic substance” of any sort in a TFSA contribution??

Procedurally, although there is often a wide range of divergent economic opinions in many matters and there may be nothing to indicate that the economic analysis and opinion of the CRA is any more accurate than the view of the taxpayer undertaking a particular transaction, the taxpayer will be forced to go to court and presumably employ economists as expert witnesses to try to overturn the presumption with all the disruption and cost that that entails.

Changes have also been proposed to the preamble to emphasize that GAAR will now apply to all tax transactions.

Note that the word used in draft subsection 245(4.1) is that a transaction lacking in significant economic substance is “presumed” to be a misuse or abuse, not “deemed”. As such, it is a starting point for the GAAR analysis and a presumption that needs to be rebutted for GAAR not to apply. However, it still appears open for a taxpayer to argue that a particular transaction is not a misuse or abuse based on an analysis of the legislation even if it is determined that the transaction in question does not have significant economic substance. On the flip side, destroying the presumption doesn’t necessarily mean that the transaction will not be subject to GAAR.

With the degree of uncertainty that will exist if the draft legislation is passed in its current form, with the GAAR potentially able to overrule all transactions based on an after-the-fact economic analysis, it is hard to see how taxpayers can tell in advance which transactions will be attacked and which will not with any certainty. It also will be interesting to see how the courts react to legislation that, as a starting point at least, gives priority to an economic analysis over the actual wording of a provision that was passed by Parliament. In the past they have taken a very dim view of such, but in the meantime, any transaction, commercial or not, will need to be undertaken with a robust tax risk analysis and perhaps obtaining an advance ruling where the dollar values justify such and the taxpayer has the luxury of time.

To “up the ante” at the same time, draft subsection 245(5.1) will introduce a penalty where the GAAR applies. Draft subsection 245(5.1) states:

(5.1) If subsection (2) [GAAR] applies to a person in respect of a transaction or series of transactions that was not disclosed by the person to the Minister in accordance with section 237.3 [reportable transactions] or 237.4 [notifiable transactions], the person is liable to a penalty for each taxation year equal to the amount determined by the formula

$$(A - B) \times 25\% - C$$

where

A is the tax payable by the person under this Act for the year;

B is the tax that would have been payable by the person under this Act for the year if subsection (2) had not applied in respect of the transaction or series; and

C is the amount of any penalty payable by the person under subsection 163(2), to the extent that the amount is in respect of the transaction or series and did not reduce the penalty payable by the person under this subsection in a preceding taxation year.

The penalty will apply in respect of a transaction or series of transactions only if the transaction or series was not disclosed to the Minister of National Revenue in accordance with section 237.3 or 237.4 and will be 25% of the amount by which a person’s tax payable for a taxation year is increased as a result of the application of the GAAR. Element C reduces the amount of the penalty by the amount of any penalty payable under subsection 163(2) in respect of the transaction or series to prevent duplication where the gross negligence penalty in subsection 163(2) applies in respect of the same transaction or series. Where the tax benefit obtained is the creation of a tax attribute (i.e., it is described in paragraph (c) of the definition “tax benefit” in subsection 245(1)) that has not been used to reduce tax payable, no penalty would apply until the year in which the tax attribute is used to reduce tax payable (absent the application of the GAAR). In circumstances where an unutilized tax attribute is successfully challenged under the GAAR, the penalty formula would produce a nil result.

Draft subsection (5.2) provides an exception to the penalty. It is intended to be available in circumstances where a taxpayer demonstrates that it would have been reasonable to conclude that a transaction or series would not be subject to the GAAR at the time it was entered into. It provides as follows:

(5.2) Subsection (5.1) does not apply to a person in respect of a transaction or series of transactions where the person demonstrates that, at the time that the transaction or series was entered into, it was reasonable for the person to have concluded that subsection (2) would not apply to the transaction or series in reliance on the transaction or series being identical or almost identical to a transaction or series that was the subject of

(a) administrative guidance or statements that were published by the Minister or another relevant governmental authority; or

(b) one or more court decisions.

In the explanatory notes to subsection (5.2), the Department of Finance explains their interpretation of the exception as follows:

The exclusion in subsection (5.2) assures the GAAR penalty will not apply to a taxpayer that entered into a transaction (or series of transactions) reasonably relying upon the current state of the case law and administrative guidance from the Minister of National Revenue. In order for this exclusion to apply, the taxpayer must demonstrate that their transaction or series was identical or almost identical to a transaction

or series that was the subject of published administrative guidance or a court decision, such that it was reasonable to have concluded that the GAAR would not apply. ***The "identical or almost identical" threshold is quite high and, as a result, using the same tax strategy or entering into a transaction that is merely similar would not be enough to qualify for the exclusion.*** As the test is applied as at the time the transaction was entered into, it could be relied upon even where there are subsequent changes in administrative position or jurisprudence. [emphasis added]

If the Department of Finance interpretation of the threshold required for subsection (5.2) to apply is adopted by the courts, it could effectively mean the exception is irrelevant, as from a practical perspective, virtually no transaction is identical to a previous one and the threshold may be too high to meet.

CURRENT ITEMS OF INTEREST

Measures To Protect Canadian Consumers and Grow the Clean Economy

On October 5, the Government of Canada launched consultations to advance measures, including Budget 2023 and Budget 2022 commitments, to protect Canadian consumers by cracking down on predatory lenders faster and reviewing the legislation that regulates Canada's financial institutions, and to support Canada's clean economy. The government is also consulting Indigenous organizations and governments on exempting Indigenous Settlement Trusts from the Alternative Minimum Tax.

Cracking Down on Predatory Lending Faster: To protect vulnerable Canadians, the government announced in Budget 2023 that it is cracking down on predatory lending by lowering the criminal rate of interest from 47% APR to 35% APR. The government is exploring how much further the criminal rate of interest should be lowered, as well as additional revisions to the payday lending exemption. The government is seeking feedback by November 30, 2023.

Upholding the Integrity of Canada's Financial Sector: As announced in Budget 2022, and required by statute, the government is launching consultations on the federally regulated financial institutions ("FRFI") statutes. The government is seeking feedback by December 4, 2023 on questions including whether technological and geopolitical changes are affecting the financial sector, and whether technical changes are required to protect consumers, national security, and the safety and integrity of Canada's financial sector.

Defending Canadian Businesses Against Foreign Tax Credit Restrictions: As committed to in Budget 2023, the government is consulting on the possibility of introducing reciprocal treatment for Canada's Clean Electricity Investment Tax Credit and Clean Technology Investment Tax Credit in light of domestic content restrictions associated with certain tax credits introduced by some foreign countries. To ensure foreign businesses operating in Canada face the same tax treatment as Canadian businesses do abroad, the government invites comments by November 17, 2023 on questions regarding proposals to match other countries' clean economy tax credit domestic content restrictions.

Carbon Contracts for Difference: The government is undertaking consultations to advance its Budget 2023 commitment to engage with stakeholders on a potential broad-based approach to carbon contracts for difference. Such contracts could help make carbon pricing more predictable, thereby enabling investment decisions that build a more competitive clean economy in Canada.

Labour Requirements for Investment Tax Credits: The government has announced strict labour requirements for the Investment Tax Credits for Clean Technology, Clean Hydrogen, Clean Electricity, and Carbon Capture, Utilization, and Storage. To allow for additional due diligence as these tax credits are finalized, the government confirmed the effective date for the labour requirements will be the date enabling legislation for these labour requirements is first tabled.

Exempting Indigenous Settlement Trusts from Alternative Minimum Tax: Following the government's previous consultation on reforming the Alternative Minimum Tax ("AMT"), the government is considering exempting Indigenous settlement claim trusts to ensure they are not unintentionally affected by the AMT. Specifically, the revised AMT would not apply to trusts established to hold funds paid pursuant to a settlement agreement between the Crown and an Indigenous organization, community, or people who hold rights under section 35 of the *Constitution Act, 1982*. Canadians are invited to share their views on this proposal by October 30, 2023.

Feedback can be emailed to Consultation-Legislation@fin.gc.ca. For additional information, visit www.canada.ca/en/department-finance/news/2023/10/government-advances-measures-to-protect-canadian-consumers-and-grow-the-clean-economy.html.

Kilometric Rates for 2023

When claiming travel costs for the medical expense tax credit, the moving expense deduction, and the northern residents deduction, taxpayers can use a simplified method to compute the amount of the claim by multiplying the

total distance traveled by a per-kilometre rate. The rates for the 2023 taxation year are now available and are as follows:

Province/Territory	Cents/km (taxes included)
Alberta	53.0
British Columbia	56.5
Manitoba	54.5
New Brunswick	57.5
Newfoundland and Labrador	59.0
Northwest Territories	70.5
Nova Scotia	58.0
Nunavut	67.5
Ontario	59.0
Prince Edward Island	56.0
Québec	57.5
Saskatchewan	52.5
Yukon	70.5

INTERNATIONAL NEWS

OECD Launches Pillar Two Subject to Tax Rule MLI

The OECD has announced an agreement among BEPS Inclusive Framework members on a new Multilateral Convention to Facilitate the Implementation of the Pillar Two Subject to Tax Rule ("STTR MLI"), which has newly been opened for signature.

The OECD said the instrument will ensure that multinational enterprises pay a minimum level of tax on a broad range of cross-border intra-group payments, including for services. The Subject to Tax Rule ("STTR") will enable developing countries to tax certain intra-group payments in instances where these payments are subject to a nominal corporate income tax rate below 9%.

The STTR allows source jurisdictions to impose a tax where they otherwise would be unable to do so under the provisions of tax treaties, where the intra-group income is subject to a nominal corporate tax rate below 9%, and where domestic taxing rights over that income have been ceded under a treaty. It applies to interest, royalties, and a specified list of other payments, including all intra-group service payments. These include payments for distribution rights for a product or service; insurance or reinsurance premiums; payments of guarantee or financing fees; rental payments for industrial, commercial, or scientific equipment; and payments for services.

The STTR takes priority over the Global Anti-Base Erosion ("GloBE") Rules — that is, the Income Inclusion Rule ("IIR") and the Under-taxed Payments Rule ("UTPR"). It is creditable under those rules. The measure is designed to help developing Inclusive Framework members to protect their tax base. The STTR applies only if the aggregate sum of income covered by the MLI paid in a fiscal year exceeds €1 million (or €250,000 for jurisdictions with GDP below €40 billion).

The STTR MLI is intended to support countries to efficiently implement the STTR in existing bilateral tax treaties. More than 70 developing Inclusive Framework members are entitled to request inclusion of the STTR in their treaties with Inclusive Framework members that apply corporate income tax rates below 9% to covered payments. Members of the Inclusive Framework that apply nominal corporate income tax rates below 9% to any category of income covered by the STTR MLI have committed to implement the STTR into their bilateral treaties with Inclusive Framework members that are considered as developing countries when requested to do so.

The OECD will be the depositary of the multilateral instrument. As with the BEPS multilateral instrument, when ratifying the new Multilateral Convention, countries will be able to decide which treaties they wish to add the provisions to.

The STTR does not itself impose a tax obligation but allows jurisdictions to impose a tax where they otherwise would be unable to do so under the other provisions of the treaty. Where no bilateral income tax treaty applies, source jurisdictions are already able to impose tax on these payments. The STTR does not apply to income where the source state can already impose an amount of tax that is greater than the STTR rate of 9% under another treaty provision.

The STTR covers payments between connected persons. Two entities will be connected if both entities are under the control of the same person (or persons) either legally (direct or indirect ownership of more than 50% of the interests in the parties) or as a matter of fact and circumstance. Individuals, non-profit organizations, governments, international organizations, and investment funds (subject to conditions) are specifically excluded.

The OECD has released the text of the Convention, along with an explanatory statement.

"Adoption of this new multilateral instrument builds on the Outcome Statement delivered in July towards full implementation of the global tax reform, and reflects how productively and positively the international community is working together to deliver solutions for developing countries," OECD Secretary-General Mathias Cormann said.

Importantly, the Subject to Tax Rule sets out a comprehensive provision to ensure that developing countries are able to "tax back" in instances where payments sourced in their jurisdiction are not taxed at a minimum rate in a partner jurisdiction. The opening of the multilateral instrument for signature marks further progress towards the implementation of the Pillar Two minimum tax, as well as a major further step to stabilize our international tax system and to make it fairer and work better.

The OECD said it is also preparing a comprehensive action plan to support the swift and co-ordinated implementation of Pillar Two, with additional support and technical assistance to enhance capacity for implementation by developing countries.

US Sets Scope of Cryptocurrency Reporting Framework

The US Treasury has recently issued proposed regulations to delineate who has a reporting obligation in respect of cryptocurrency owners' gains and losses. The regulations set out who falls within the scope of the term "broker". These persons will be obligated to provide information about cryptocurrency transactions to enable the US Internal Revenue Service to detect potential non-compliance.

The regulations seek to ensure that only those privy to customer data are required to report (those facilitating cryptocurrency trades). Those players not involved in customer-facing roles, such as Bitcoin mining companies, would fall outside the purview of the rules.

The proposed regulations prescribe that brokers — digital asset trading platforms, digital asset payment processors, and certain digital asset hosted wallets — must file information returns and furnish payee statements on dispositions of digital assets effected for customers in certain sale or exchange transactions.

The regulations would also require real estate reporting persons, who are treated as brokers with respect to reportable real estate transactions, to include on filed information returns and furnished payee statements the fair market value of digital asset consideration received by real estate sellers in reportable real estate transactions. Additionally, these real estate reporting persons would also be required to file information returns and furnish payee statements with respect to real estate purchasers who use digital assets to acquire real estate in these transactions.

UK Amends Legislation for Undertaxed Payments Rule

His Majesty's Revenue and Customs ("HMRC") has announced amendments to its Pillar Two minimum tax legislation for the future implementation of an Undertaxed Payments Rule ("UTPR"). Changes are also proposed to keep the UK's proposed minimum tax regime in line with the latest administrative guidance.

The Government introduced the multinational top-up tax and domestic top-up tax in *Finance (No.2) Act 2023*. These taxes are the UK's adoption of the income inclusion rule ("IIR") and domestic minimum top-up tax rule ("QDMTT") as referenced in the Pillar 2 Global Anti-Base Erosion ("GloBE") rules. These two elements will be introduced for accounting periods beginning on or after December 31, 2023.

The latest announced changes provide for the future implementation of the UTPR, which the UK Government has confirmed will not be introduced earlier than for accounting periods beginning on or after December 31, 2024. The UTPR will ensure that any top-up taxes that are not paid under another jurisdiction's Pillar 2 rules are brought into charge in the UK.

The following amendments have been proposed to implement the UTPR, from a date to be determined in regulations:

- Section 121 will be amended to extend the multinational top-up tax to cover tax under the undertaxed profits rule.
- Section 122 will be amended to expand the chargeable persons from a responsible member to any member of the group.
- Section 123 will be amended to introduce a condition that a person is chargeable to multinational top-up tax where top-up amounts and additional top-up amounts of one or more group members are potentially undertaxed and the relevant member is not an investment entity.

- Section 123A will be added to allow the amount of any undertaxed profits multinational top-up tax charge to be set in accordance with new Chapter 9A.
- Section 124 will be amended to provide for Chapter 9A, which sets out the provisions for determining whether top-up tax amounts are potentially undertaxed and how these amounts should be allocated to UK group members.
- Chapter 9A will be added, which provides for the meaning of “potentially undertaxed” and “untaxed amounts”. Chapter 9A will also set out the steps required to allocate untaxed amounts to qualifying members located in the UK. These steps require the group to determine the number of its employees and the value of its tangible assets located in the UK and other territories that have a qualifying undertaxed profits tax.
- The filing member of the group will be able to elect that a specified member of the group is to be allocated the whole of the tax that is attributable to UK members through the undertaxed profits rule.
- Chapter 9A also will determine the rules for allocating untaxed amounts in respect of joint ventures.
- Schedule 16 will be amended to ensure that the transitional provision also applies to untaxed amounts under the UTPR.
- There will also be consequential amendments to Section 128 (responsible members), Section 257 (meaning of qualifying undertaxed profits tax), Section 259 (country-by-country reports), and Schedule 17 (definitions).

Other amendments would make changes to the existing legislation, to ensure consistency with the OECD model rules and administrative guidance. These amendments will include a non-material constituent entity safe harbour election, HMRC said.

IRS Enhances Drought Tax Support for Livestock Sales

The US Internal Revenue Service (“IRS”) has issued a statement to remind eligible farmers and ranchers forced to sell livestock due to drought of capital gains tax concessions. Taxpayers affected by drought have an extended period of time in which to replace the livestock and defer tax on any gains from the forced sales.

On September 27, 2023, the IRS released Notice 2023-67, which sets out areas eligible for relief. The list includes 49 states, the District of Columbia, two US Territories, and two independent nations in a Compact of Free Association with the United States.

The relief generally applies to capital gains realized by eligible farmers and ranchers on sales of livestock held for draft, dairy, or breeding purposes. Sales of other livestock, such as those raised for slaughter, held for sporting purposes, or poultry, are not eligible.

The sales must be solely due to drought causing an area to be designated as eligible for federal assistance. Livestock generally must be replaced within a four-year period instead of the usual two-year period. The IRS is authorized to further extend this replacement period if the drought continues.

The new Notice announces a one-year extension, giving eligible farmers and ranchers until the end of their first tax year after the first drought-free year to replace the sold livestock. Details, including an example of how this provision works, can be found in Notice 2006-82.

Eligible farmers and ranchers that qualified for the four-year replacement period can avail themselves of the exemption if the applicable region they are in is listed as suffering exceptional, extreme, or severe drought conditions during any week between September 1, 2022 and August 31, 2023, as determined by the National Drought Mitigation Center.

The IRS said:

As a result, eligible farmers and ranchers whose drought-sale replacement period was scheduled to expire on December 31, 2023, in most cases, now have until the end of their next tax year to replace the sold livestock.

OECD Releases Tax Administration 2023 Report

The OECD has published its annual report on Tax Administration. The report provides internationally comparative data on various aspects of tax systems and their administration in 58 advanced and emerging economies, and includes performance-related data, ratios, and trends up to the end of the 2021 fiscal year.

The report says that by the end of 2021, with the global economy fully emerging from the COVID-19 pandemic, tax administrations saw a significant recovery of revenue collection levels and a decline in tax arrear ratios. COVID-19 also accelerated the digital approach to tax collection, boosting compliance levels and reducing administrative burdens.

Tax Administration 2023 compiles a range of tax administration performance indicators and data based on the information provided through the International Survey of Revenue Administrations (“ISORA”). Additionally, this year’s edition draws on data from the Inventory of Tax Technology Initiatives (“ITTI”), presenting information on technology tools and digitalization solutions implemented by tax administrations globally. It includes more than 100 examples of innovations and leading practices, presented by 34 tax administrations worldwide.

The data and indicators showcase the range of challenges faced by tax administrations, with the report aiming to enhance understanding of the changing nature of revenue collection processes.

IRS To Establish Pass-Through Entity Tax Enforcement Unit

The US Internal Revenue Service (“IRS”) has announced plans to establish a special pass-through organization, responsible for oversight of large or complex partnerships and S-corporations.

The new work unit will be housed in the IRS Large Business and International (“LB&I”) division. In addition, the new pass-through area will include the people joining the IRS under the new IRS hiring initiative. As part of larger transformation work underway at the IRS, the IRS last week announced the opening of more than 3,700 positions nationwide to help with expanded enforcement work focusing on complex partnerships, large corporations, and high-income and high-wealth individuals.

Although work will begin on these areas immediately, the new work group will be established late next year, the IRS said.

“This is another part of our effort to ensure the IRS holds the nation’s wealthiest filers accountable to pay the full amount of what they owe,” said IRS Commissioner Danny Werfel.

We are honing-in on areas where we believe non-compliance among our wealthiest filers has proliferated over the last decade of IRS budget cuts, and pass-throughs are high on our list of concerns.

This new unit will leverage *Inflation Reduction Act* funding to disrupt efforts by certain large partnerships to use pass-throughs to intentionally shield income to avoid paying the taxes they owe. These efforts are consistent with our broader commitment to use *Inflation Reduction Act* dollars to end the era of historically low error rates for wealthy and large entities, while making sure middle- and low-income filers continue to see no change in audit rates for years to come.

RECENT CASES

***Res Judicata* Principle Does Not Apply to Formal Demands Presented Pursuant to S. 231.2(3) of the ITA**

This case deals with the principle of “*res judicata*” (*chose jugée* in French). More precisely, the issue being whether a decision rendered concerning a formal demand to provide information and judicial review concerning a specific case would also apply to a second demand involving practically identical facts. In other words, did the Federal Court err in applying the principle of *res judicata* to section 231.2 of the *Income Tax Act*? In 2018 (2018 DTC 5082 (FC)), the Minister issued a formal demand for information to Hydro-Québec for, basically, a detailed list of its clients pursuant to subsection 231.2(3). The Federal Court rejected the demand, determining that there was no identifiable group for purposes of paragraph 231.2(3)(a). Under subsection 231.2(3), a judge may authorize the demand if they are convinced following a declaration under oath that there exists an identifiable group and the supply of information or production of documents is required to ascertain that the members of the group respected their fiscal obligations. This first demand and evidence produced did not contain any information explaining how the commercial clients of Hydro-Québec formed an identifiable group. Therefore, the demand was rejected. The Minister filed another demand in 2019, essentially dealing with the same request, supported by more evidence which resulted in a 2021 decision rejecting the demand on the basis that the principle of *res judicata* applied in the circumstances.

The appeal was allowed and the matter returned to Federal Court. It is this second case which is under appeal — the argument being whether the Federal Court erred in ruling that the principle of *res judicata* applied, meaning the second request formally asking for information to be produced should also be denied. The Federal Court of Appeal ruled that the *res judicata* principle does not apply to authorizations or denial of authorizations rendered pursuant to subsection 231.2(3) and, accordingly, the matter should be returned to the Federal Court to determine if the second demand met

the conditions of subsection 231.2(3) and if that is the case, use its discretion to rule whether the demand to provide information should be accepted or denied.

¶51,150, *MNR v. Hydro-Québec*, 2023 DTC 5075

Denial of SR&ED Claim Overturned on Appeal

The Appellant, a food manufacturing business specialized in developing frozen pies mainly for the Canadian and the United States markets, appealed the Notices of Reassessment disallowing scientific research and experimental development ("SR&ED") expenditures and the corresponding investment tax credits ("ITCs") for the 2013, 2014, 2015, and 2016 taxation years (the "Taxation Years") under the *Income Tax Act* (the "Act"). During the Taxation Years, the appellant had carried on various projects and activities aimed at developing new or advancing pre-existing products.

The appeal was allowed. In determining, whether the work the appellant had undertaken with respect to projects 1304, 1306, 1401, 1402, 1501, 1502, and 1602 constituted SR&ED within the meaning of subsection 248(1) of the Act, the Court observed that the evidence adduced met the criteria that this type of work must be a systematic investigation or search that is carried out in a field of science or technology by means of an experiment or analysis, and ensured that such work was undertaken for the purposes contemplated in the Act. The appellant had formulated hypotheses specifically aimed at achieving its various goals. As for the third criterion, whether the process accorded with the scientific method, the CRA's position was that the appellant had relied on a "trial and error" approach by trying various recipes to reach its targets and without attempting to explain or analyze the reason each recipe did not work. The Court disagreed, explaining that the appellant had conducted analyses in order to understand which requirement was not met and modified specific parts of the recipe in order to address the issue. In doing so, the Appellant was limited by its clients' demands regarding which ingredients to use. Thus, based on the evidence, the Court allowed the appeal as the Appellant had successfully established that the 2013, 2014, 2015, and 2016 SR&ED claims met all five criteria established in *Northwest Hydraulics*.

¶51,149, *Canafriq Inc. v. The King*, 2023 DTC 1069

Amounts Were Incorrectly Included in Computing Appellant's Canadian Investment Fund

The Appellant was a Canadian resident fraternal benefit society and a life insurer that provides fraternal benefits and individual life insurance to its members. For the 2014 taxation year, the Minister of National Revenue reassessed the Appellant to include in the Appellant's Canadian investment fund ("CIF") the amount of its "World Surplus" assets which the Appellant had deducted in computing its CIF. The Minister said that the World Surplus assets were "used or held in the course of carrying on an insurance business". The Minister also reassessed the Appellant to exclude amounts in respect of the accident and sickness ("A&S") business from the Appellant's CIF and deny the Appellant's designation of investment property in respect of the A&S business. The Appellant appealed this assessment.

The appeal was allowed. The Court considered two central issues: (a) did the Appellant correctly include amounts and assets as they relate to the impact of subsection 149(4) of the *Income Tax Act* on the computation of the CIF and on the designation rules in Regulation 2401(2) of the *Income Tax Regulations* ("ITR"); and (b) did the Appellant correctly exclude the amount of World Surplus assets in determining its CIF. On the first issue, the text, context, and legislative history of subsections 149(3) and (4) support a conclusion that the assumption in subsection 149(4) is not relevant in determining the assets and liabilities to be included in determining the Appellant's CIF. Accordingly, the Appellant correctly included A&S business assets and liabilities in computing its CIFs for the 2014 taxation year. The Appellant correctly designated its excess CIF, being \$199,462,344 of investment property, to the A&S business pursuant to Regulation 2401(2)(d). The Appellant was able to designate investment property equal in amount to such additional excess CIF in respect of the A&S business pursuant to Regulation 2401(2)(d). On the second issue, the Appellant did not establish, on a balance of probabilities, that all such World Surplus assets are to be excluded. However, the Appellant did demonstrate that the balance of the World Surplus assets — largely the cash equivalents, bonds, and other fixed term securities, stocks, and other invested assets (partnership interests) held in a segregated account at State Street Bank — were not used or held by the Appellant in carrying on an insurance business. Accordingly, the amounts of \$110,116,000 for the 2013 taxation year and \$217,025,000 for the 2014 taxation year were incorrectly included by the Minister in computing the Appellant's CIF. The appeal was allowed and the Minister was ordered to reassess the Appellant in respect of its 2014 taxation year on the basis that, for the 2013 and 2014 taxation years' CIFs, the World Surplus assets for the CIF are not to be included, and assets and liabilities of the A&S business are to be included. Furthermore, the Appellant was correct in designating investment property in respect of its A&S business

pursuant to Regulations 2401(2)(b) and (d), including any additional excess CIF determined pursuant to Regulation 2401(2)(d).

¶51,163, *Independent Order of Foresters v. The King*, 2023 DTC 1078

Gross Negligence Penalties Upheld on Appeal

The Appellant, a construction electrician with 34 years of experience, had his taxes prepared by BDO Canada LLP through his father from 1998 up to the 2009 taxation year. In 2010, he was referred to Financial Arbitrators and DSC Lifestyles ("Financial Arbitrators") for the preparation of his 2009 tax return. The Appellant signed the 2009 return prepared by Financial Arbitrators without reviewing it. The return indicated "gross business income" of \$87,859.56 and "other expenses" of \$421,008, leading to a purported loss of \$333,418. The claimed loss would eliminate tax withheld from his employment and other sources of income in 2009. A request was made to carry back and apply the remaining portion of the purported loss to the 2006, 2007, and 2008 taxation years. It is undisputed that when signing the return the Appellant saw the anticipated refund of \$20,947.91. The CRA contacted the Appellant seeking documentation to support the reported business income and expenses, but he did not understand the CRA's letter and relied on reassurances from Financial Arbitrators. The Appellant testified that it was only when he received the Notice of Assessment and received a bill owing money, it occurred to him there was a concern. The Appellant appealed this assessment made against him by the Minister of National Revenue for the 2009 taxation year, in which the Minister levied a penalty pursuant to subsection 163(2) of the *Income Tax Act* arising from the fictitious net business loss of \$333,418.

The appeal was dismissed. The sole issue was whether the Appellant knowingly or under circumstances amounting to gross negligence made a false statement in his 2009 return. The Appellant was aware he would be obtaining a refund spanning four years. He chose not to inquire about the \$20,947.91 refund, even though it was significantly larger than any refunds he historically received. Entries on the return used to claim the refund in 2009 were blatant and readily detectable even if he had only glanced at the return. The \$333,418.44 amount was mentioned nine times in the return, the request, and business activities form yet he had no business. He chose not to inquire because he strongly suspected, or suppressed a suspicion, that the inquiry would have provided him with knowledge that the statement in the return was false thereby he would have discovered such inconvenient truth. This amounts to wilful blindness and the knowledge of the false statement is imputed to the Appellant. Failure to review a return at all is sufficient to find that any false statements in the return are made in circumstances amounting to gross negligence, hence justifying the penalty. The Respondent demonstrated on a balance of probabilities that the Appellant knowingly and under circumstances amounting to gross negligence made false statements at the time of filing the return in claiming the substantial business losses and requesting a loss carryback be applied to his previous three taxation years. The Appellant was both wilfully blind and grossly negligent, and the appeal was dismissed with costs payable to the Respondent.

¶51,148, *Fransen v. The King*, 2023 DTC 1068

Crown Can Retain Refunds To Set Off Against Bankrupt's Tax Debt

Darren Kidd was assigned into bankruptcy on November 28, 2011. The proved unsecured claims approached \$300,000.00, including \$52,720.35 in tax debts. On October 1, 2015, the Court issued a Compelling Order, which ordered the CRA to forward all the bankrupt's subsequent years' income tax refunds directly to the trustee and, notwithstanding the discharge of the trustee, they will remain there until further order of the Court or until the bankrupt is granted an absolute discharge. If the bankrupt fails to comply with the Order, the trustee has leave to proceed to its discharge, and creditors' rights to enforce payment will then be reinstated. Kidd filed his return for 2013 in May of 2014, resulting in a tax credit of \$5,395.77. The Minister remitted this sum to the trustee as required. Three years later, the Court ordered this amount to be paid into the estate and allocated to Kidd's outstanding surplus obligation. Kidd did not comply with the Compelling Order, and on April 17, 2018, the trustee obtained its discharge, which lifted the stay pursuant to subsection 69.3(1.1) of the *Bankruptcy and Insolvency Act* ("BIA") and the rights of the creditors were restored. In 2020, the bankrupt filed returns for the 2014 to 2019 taxation years and, in 2021 and 2022, for the 2020 and 2021 taxation years, which resulted in refunds totaling \$31,681.54. The Minister sought to use her right under subsection 164(2) of the *Income Tax Act* to set-off the tax refund credits against its claim of \$52,720.35. The trustee applied to be reappointed and to distribute the funds as follows: (a) \$4,500.00 to the trustee for a file reactivation fee; (b) \$10,830.72 for the balance of Kidd's surplus obligation pursuant to the Compelling Order; (c) a \$2,500.00 penalty for the benefit of the estate; and (d) the balance, \$14,150.82, to be paid to the bankrupt. The trustee argued that the tax clause in the Compelling Order acts as an order under subsection 68(13) of the BIA, which

would permit the trustee to claim the refunds for the estate. The Crown argued that the Compelling Order is not competent to bind the Crown.

The application was dismissed. The Compelling Order does not operate as a subsection 68(13) order. All it purports to do is to intercept the refunds subject to further order of the Court. It is a two-step process. Step one relieves the CRA from an obligation to pay refunds only to the taxpayer, but the refunds do not go directly into the estate. A further order of the Court is necessary, and it would have to take into account the bankrupt's obligations to the estate and the rights of the parties. It is discretionary. The trustee is free to obtain a discharge in circumstances described by the Compelling Order. The trustee can also apply to be discharged at the end of the bankruptcy. The two discharges are not the same. In the former situation, the trustee is discharged, but its obligations are neither extinguished nor released. The trustee remains the receptacle for the tax refunds and is the proper payee rather than the bankrupt, potentially intercepting payments to the extent of the bankrupt's obligations to the estate. The trustee does not wholly exit the stage on an interim discharge. The words in the Order "notwithstanding the discharge of the trustee" are simply a reminder of the effect of subsection 41(10) of the BIA and cannot be read as overriding subsection 69.3(1.1) of the BIA. When the creditor's rights are restored as a consequence of the lifting of the stay, it means that a creditor can resume or initiate proceedings for the amounts proved in the bankruptcy. The discharge of the trustee restores the right of the Crown to use its powers in subsection 164(2) of the *Income Tax Act* to set-off the post-bankruptcy credits against the pre-bankruptcy debt proved by the Crown. Consequently, the Court dismissed the trustee's application, and allowed the Crown to retain the funds and set them off against the bankrupt's tax debt.

¶51,157, *Kidd (Re)*, 2023 DTC 5084

CERB and CRB Matters Remitted for Redetermination Due to Procedural Fairness Breach

The Applicant had sought judicial review of second level review decisions ("Decisions") made by a benefits compliance officer ("Officer") of the CRA. Based on three second-level reviews of the Applicant's eligibility for the Canada Emergency Response Benefit ("CERB"), Canada Recovery Benefit ("CRB"), and Canada Worker Lockdown Benefit ("CWLB"), the Officer determined the Applicant was not eligible to receive any benefits from those programs and held that he must repay the amounts received from the CERB and CRB programs while being ineligible. The Applicant had moved frequently, holding various jobs during the COVID-19 crisis, and had applied for the CERB and received payments of \$2,000 for seven two-week periods between March 15, 2020 and September 26, 2020, and applied for the CRB and received payments of \$1,000 for 21 two-week periods and payments of \$600 for six two-week periods.

The application was allowed. In determining whether the Officer had breached the Applicant's right to procedural fairness, the Court observed that the Applicant had asked for additional time to submit evidence to the Officer and the latter only granted him one additional day, which was not enough time to gather and submit the required evidence. The Court held that granting the Applicant only one additional day (while the original delay was 20 days) when the Applicant had sought additional time to submit evidence not in his possession was a breach of the Officer's duty of procedural fairness. Certainly, the Applicant had no control of the evidence he intended to submit and needed adequate time to obtain that evidence from his prior employer or by alternate means. Since there was a breach to the duty of procedural fairness, the Court did not need to evaluate if the Decisions were reasonable or not and allowed the application for judicial review.

¶51,152, *Mahmoud v. Canada (AG)*, 2023 DTC 5077

CRA Imposed Penalties on Unreasonable Grounds

The Applicant had filed two forms T1135 in 2020, which should have been filed in 2016 and 2017. The CRA assessed the Applicant and imposed penalties and interest of about \$6,000. The Applicant asked the CRA for relief from the penalties and interest, citing medical information relating to both her and her husband. The CRA denied her request, finding that the couple's medical situation did not prevent them from filing the required forms on time. The Applicant submitted a second request and provided additional medical information but a CRA officer refused to reconsider the initial decision denying her relief.

The application was allowed. In determining whether new evidence should be admitted and whether the CRA officer's decision was unreasonable, the Court observed that judicial reviews are conducted on the basis of the evidence that was before the decision-maker, and new evidence is not normally admissible. However, there are exceptions to the general rule: (1) when the new evidence simply provides background information that might help the reviewing judge; (2) when the evidence shows that there was an absence of evidence before the decision-maker on a particular point;

and (3) when the evidence shows defects in the evidentiary record and the new evidence adduced by the applicant fell under the second exception. The evidence about the Applicant's GST filing showed that the CRA officer failed to consider her parallel request for relief (on identical grounds). Similarly, the evidence chronicling her communications with the CRA showed, contrary to the decision of the officer, that she had acted fairly promptly. Further, the medical information provided by the Applicant to the CRA described the long-standing challenges she was experiencing in areas such as decision-making, time management, and accuracy, which made it difficult for her to carry out complex tasks, such as filing tax returns. The Court held that the negative decision on the Applicant's request for relief on her late filing of T1135s was the result of faulty inferences from the evidence that rendered the conclusion unreasonable. The CRA officer's decision did not respond meaningfully to the medical evidence tendered by the Applicant and unreasonably found that the Applicant had failed to act promptly to file her forms. Accordingly, the application for judicial review was allowed.

¶51,155, *Thomas v. Canada (AG)*, 2023 DTC 5079

Failure to Contact Taxpayer by Phone Before Denying Emergency Benefits Was Unreasonable

The Applicant applied for and received benefits under the *Canada Emergency Response Benefit Act* and the *Canada Recovery Benefits Act* between March 2020 and February 2021. When she submitted documents in support of her CRB application, the CRA denied her application on the ground she had not shown that she met the \$5,000 minimum income requirement. She contacted the CRA on numerous occasions by email and telephone, submitting documents and inquiring why she was denied; on December 23, 2021, a supervisor made contact with her and advised that her file had not yet been assigned to a second reviewer. Once assigned, that second reviewer attempted to contact her by phone, leaving a voicemail with contact information. Twenty-one days later, the CRA rejected her application. On the evidence, the second reviewer's voicemail did not leave a substantive message about the need for additional information to support the Applicant's bank statements, or provide a deadline to call back.

The Federal Court allowed the application. It characterized the issue as whether the CRA had provided the Applicant with procedural fairness. Procedural fairness is context specific, and under the unusual circumstances of this case, in which the Applicant had made it clear throughout her dealings with the CRA that she could not understand why she did not meet the income requirement and wanted to talk to the decision-maker, procedural fairness required that the CRA contact her in person, giving her an opportunity "actually to be heard". The Court remanded the case to the CRA for decision by a different officer.

¶51,166, *Ramanathan v. AG of Canada*, 2023 DTC 5081

Appellant Entitled to Deduction of Business Expenses

The Appellant operated a wholesale luxury auto business but the Minister of National Revenue did not agree that the Appellant had a business, and therefore disallowed his business expense deductions. The Appellant had obtained a business plan package from the Alberta Motor Vehicle Industry Council ("AMVIC") and proceeded to complete the checklist for licensing his sole proprietorship (Zed Exports) as an automotive business. With the AMVIC licences in place, the appellant was able to register the sole proprietorship with two online wholesale auto auction dealers. With respect to 2016, the appellant had reported no gross business income and a net loss of \$22,523.83. For 2017, he had reported gross business income of \$67,080 (being US\$52,000 multiplied by an exchange rate of 1.29) and a net loss of \$75,081.16. He then carried back non-capital losses of \$51,256 from 2017 and applied them to his 2014 taxation year.

The appeal was allowed. In determining whether the Appellant carried on a business selling used luxury cars wholesale to dealerships in the 2016 and 2017 taxation years, and if so, whether the Appellant was entitled to deduct the claimed expenses for those years, the Court observed that the litmus test for whether there was an income source continued to be the two-step approach set out by the Supreme Court of Canada in *Stewart*. The Court further observed that the Appellant had taken significant steps toward setting the activity up as a business in 2016. The Court accepted the Appellant's contention that the purchase of the new SUV was a singular deviation from the business plan to deal in used vehicles. Therefore, the commercial nature of the activity remained intact and there was a business source of income in 2016 and 2017. The Court allowed the appeal and held that the Appellant operated a wholesale luxury auto business in 2016 and 2017; and with respect to the 2016 taxation year, the Appellant was entitled to deduct business expenses in the amount of \$3,782.34; and with respect to the 2017 taxation year, the Appellant was entitled to deduct business expenses in the amount of \$5,425.52.

¶51,158, *Zupet v. The King*, 2023 DTC 1073

CRA Reassessments Were Filed After Limitations Period Expired

The Appellants claimed partnership losses with respect to limited partnerships in their 2000 and 2001 taxation years. In 2005, the CRA reassessed them, disallowing the losses. In the sole issue on this appeal, the Appellants argued the reassessments were statute barred. The sole factual question was whether the Appellants filed their partnership information returns ("PIRs") for 2000 and 2001 in 2001 and 2002 respectively, or filed them in the course of a meeting in 2005; only in the latter case would the reassessments be timely.

The Tax Court allowed the appeals and vacated the reassessments. Combing through the voluminous evidence, the Court found numerous indications that the PIRs had been filed in 2001 and 2002, such as dated receipt stamps and correspondence from the CRA's Ottawa office that acknowledged receipt of the PIRs; these went unchallenged by the Respondent. As for the 2005 meeting at which, according to the Respondent, the PIRs were filed, the Court dismissed certain documents put forward by the Respondent to impugn the Appellants' credibility. Fatally, in this "factually complex matter involving a multitude of individuals, corporate entities and a variety of intermingled matters," the Respondent failed to produce a "knowledgeable" witness; with the Appellants' witness "unchallenged, his credibility intact," the Court found factually that the PIRs were filed in 2001 and 2002. Therefore, the reassessments were out of time and the appeals were allowed.

¶51,159, *Tedesco et al. v. The King*, 2023 DTC 1074

Applicant Wrongfully Denied CRB Due to Procedural Unfairness

The Applicant had challenged three decisions that followed a second review of her eligibility to receive the Canada Recovery Benefit ("CRB"), the Canada Recovery Sickness Benefit ("CRSB"), and the Canada Worker Lockdown Benefit ("CWLB"). The Applicant was a self-employed cleaner who had applied for and received the CRB, CRSB, and CWLB for various periods between September 2020 and March 2022. While none of her applications were denied initially, a first reviewer had concluded that the Applicant did not meet the income eligibility requirements for any of these benefit programs because she did not earn net self-employment income of at least \$5,000. The second reviewer had also reached the same determination, hence the present appeal. The Applicant had alleged that her eligibility review was procedurally unfair and the decisions are unreasonable because the CRA did not consider all sources of her income and did not explain to her why the information she provided was insufficient to prove that her net self-employment income met the \$5,000 threshold.

The application was allowed. The Court observed that the Applicant was not aware of the case to meet, and she was not given a full and fair chance to respond. CRA agents had a number of conversations with the Applicant, pointing out that she had claimed net losses from self-employment on her tax returns since 2018. However, the tax returns were not determinative of whether the Applicant met the income threshold as calculated in accordance with the benefits legislation. The Applicant was genuinely unaware she could be eligible for benefits if she was able to demonstrate that she satisfied the income threshold for one of the relevant taxation years, such as the 2019 taxation year, or for any 12-month period preceding each of her applications. The Court concluded that the Applicant was not afforded a full and fair opportunity to show she met the income eligibility requirements for one or more of the benefits she claimed, and thus the application was allowed and the issue of the Applicant's eligibility was referred back to the CRA for redetermination by another officer.

¶51,165, *Brychka v. AG of Canada*, 2023 DTC 5080

Travel or Motor Vehicle Expenses Not Eligible for Deduction from Employment Income

The Appellant was a boilermaker for over 30 years, and the terms of his employment were governed by a collective agreement between his union and the Boilermaker Contractors' Association of British Columbia, together the "Employer". Under the newer collective agreement which governed the period from 2014 to 2020, the Employer reimbursed him for travel by way of an allowance. During the audit, in box 7 of the T2200 for both years, the Employer had affirmed that the Appellant was required to pay expenses for which he did not receive an allowance or reimbursement and described the expenses to be travel expenses in the same amount as the allowances under appeal. In determining whether the travel allowances of \$4,006 and \$6,590 received in the 2014 and 2015 taxation years, respectively, were properly included in income, and whether any amount of travel or motor vehicle expenses was deductible from employment income in those years, section 6 of the *Income Tax Act* sets out the amounts to be included in employment income and paragraph 6(1)(b) deals specifically with allowances for personal or living expenses.

The appeal was dismissed. The Court opined that the collective agreement created administrative ease by obviating the need for receipts and standardizing the reimbursement regime by paying a travel allowance for every trip based on simple mileage using Burnaby City Hall as a general reference point, but also eliminated the specifics which were required in order for the appellant to invoke sections 6 and 8 in the way he sought. Burnaby City Hall had no connection to the Employer's establishment so the allowance received by the Appellant was either unreasonable or fell outside the parameters set out by the provision. With respect to the possible deduction of travel or motor vehicle expenses under paragraph 8(1)(h) or (h.1), Parliament intended for employees to be able to deduct travel/motor vehicle expenses where their allowance was considered unreasonable and included in income; this was not the case here as the Appellant and his counterparts had the discretion to live and base themselves in or outside of BC's Lower Mainland. The Appellant sought to deduct expenses equivalent to the amount of the allowances, which did not shed light on what the actual deductible amounts might be, if any; hence, the appeal was dismissed.

¶51,160, *Nicoll v. The King*, 2023 DTC 1075

TAX TOPICS

Published weekly by Wolters Kluwer Canada Limited. For subscription information, see your Wolters Kluwer Account Manager or call 1-800-268-4522.

For Wolters Kluwer Canada Limited

Email: cservice@wolterskluwer.com

Phone: 1-800-268-4522 or (416) 224-2248 (Toronto)

Notice: Readers are urged to consult their professional advisers prior to acting on the basis of material in *Tax Topics*.

Wolters Kluwer Canada Limited
300-90 Sheppard Avenue East
Toronto ON M2N 6X1
1 800 268 4522 tel
1 800 461 4131 fax
www.wolterskluwer.ca

© 2023, Wolters Kluwer Canada Limited