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"HE WHO WANTS A ROSE MUST RESPECT THE (COP)THORN(E)"

(A Persian Proverb)

— *Mike Harris, Fraser Milner Casgrain LLP*

On December 16, 2011, the Supreme Court of Canada (the "SCC") released its long-awaited decision in *Copthorne Holdings Ltd. v. The Queen*, 2012 DTC 5007. In a unanimous judgment, the SCC dismissed the appeal of the taxpayer and affirmed the decisions of both the Federal Court of Appeal and the Tax Court of Canada. In reasons written by Justice Marshall Rothstein, the SCC concluded that the transactions in question contravened the general anti-avoidance rule ("GAAR") contained in section 245 of the *Income Tax Act* (the "Act")[1] and were properly reassessed by the Minister of National Revenue ("Minister").

Based on the agreed statement of facts submitted by the parties, the complicated transactions in dispute can be summarized as follows:

VHCC Investment Ltd. was an Ontario corporation, the shares of which were owned by a group of Canadian and non-resident corporations (the "Li Group"). Based on a significant investment by the Li Group, the shares of VHCC Investments Ltd. had a paid-up capital ("PUC") of $96,736,845.

VHCC Investments Ltd. used a substantial portion of its available capital to subscribe for shares of its subsidiary, VHCC Holdings Ltd., whose shares as a result had a PUC of $67,401,279.

At the end of 1991, VHCC Holdings Ltd. was sold to another corporation owned by the Li Group, Copthorne Holdings Ltd. ("Copthorne"). In 1993, a plan was developed to amalgamate VHCC Holdings Ltd. and Copthorne I. Because a vertical amalgamation would result in the loss, for tax purposes, of the PUC in VHCC Holdings Ltd. (by operation of paragraph 87(3)(*a*) of the Act), the plan included an additional step whereby VHCC Holdings Ltd. and Copthorne I would become sister corporations. The plan was implemented and the two corporations were horizontally amalgamated to form a new corporation ("Copthorne II") with a total PUC of $67,401,280 (as the PUC of Copthorne I was nominal).

In 1994, proposed amendments to the foreign accrual property income ("FAPI") provisions of the Act would have resulted in the income of a subsidiary of Copthorne II being treated as FAPI. To avoid this result, the shares of both Copthorne II and VHCC Investments Ltd. were disposed of to L.F. Investments (Barbados) Ltd. ("L.F. Investments"), a Barbados corporation. On January 1, 1995, Copthorne II, VHCC Investments Ltd., and several other corporations were amalgamated to form a new corporation ("Copthorne III"). L.F. Investments received preferred shares with aggregate redemption amount, fair market value, and PUC of approximately $164 million (that being almost entirely attributable to the PUC of Copthorne II and VHCC Investments Ltd.).

142,035,895 of the preferred shares of Copthorne III held by L.F. Investments were redeemed immediately following the amalgamation. The redemption amount, $142,035,895, was less than the PUC of the shares. There was therefore no dividend deemed under subsection 84(3) and as such, no non-resident withholding was required on the amount payable to L.F. Investments.

The Minister reassessed Copthorne III, applying the GAAR to the transactions on the basis that the PUC of the preferred shares should be reduced by $67,401,279. The resulting shortfall in PUC would result in a deemed dividend on the January 1, 1995 redemption in an amount of approximately $58 million. The Minister assessed on the basis that Copthorne III was liable for the 15% non-resident withholding that did not take place on this deemed dividend and assessed tax in the amount of approximately $8.75 million.

Tax Benefit

In determining whether the GAAR applied, the SCC confirmed the framework from *Canada Trustco Mortgage Co. v. The Queen*, 2005 DTC 5523 ("*Trustco*") and first asked whether there was a tax benefit to the taxpayer, with the onus on the taxpayer to rebut the Minister's assumption as to its existence.

The SCC quickly disposed of this question. It observed that when the decision was made to simplify the corporate structure and amalgamate Copthorne I and VHCC Holdings Ltd., the "only question was whether the amalgamation would be horizontal or vertical". It was held that, but for the preservation of PUC, a vertical amalgamation would have achieved the same non-tax goals and objectives. The use of a horizontal amalgamation therefore created a tax benefit, that being the resulting PUC preservation that reduced the deemed dividend upon redemption of the preferred shares.

Avoidance Transaction

The SCC next considered the second element from *Trustco*: whether an avoidance transaction existed. An avoidance transaction is defined in subsection 245(3) as a transaction that, operating alone or as part of a larger series of transactions, results in a tax benefit, and was not undertaken for a *bona fide* non-tax purpose. A key was whether the redemption of shares in Copthorne III was a part of the series of transactions that arose from the sale of VHCC Holdings Ltd. and the subsequent amalgamation with Copthorne I. If not, it could not be said that the tax benefit resulted from the series of transactions that led to the duplication of PUC, meaning that the GAAR would not apply.

The scope of the phrase "series of transactions" is based in the common law[2] and is expanded by statute in subsection 248(10). Crucially in this matter, the statutory definition deems that "related transactions" completed "in contemplation of" the series of transactions are themselves a part of the series of transactions. The question asked by the SCC was whether the redemption was a related transaction completed in contemplation of the prior series of corporate amalgamations and restructurings. The SCC's determination of the scope and meaning of a transaction completed "in contemplation of" a series of transactions was likely the single most anticipated aspect of the *Copthorne* decision.

The SCC held that the necessary link between a related transaction and a series must be more than a "mere possibility" to support a finding that the transaction was completed "in contemplation of" the series. The SCC also agreed with the Federal Court of Appeal that something less than a "strong nexus" is required. The correct test falls between these two standards: a court must consider whether the series was "taken into account" when the decision was made to undertake the related transaction. The SCC described this as the "because of" or "in relation to" test. The SCC also noted the standard of proof, as this question is to be determined on a balance of probabilities.

Importantly, the taxpayer argued that the intervening FAPI rule changes, as well as the several year gap in time between the redemption and the earlier series of transactions, were sufficient to break the alleged series. The SCC agreed that both time and intervening events could, depending on the totality of the circumstances, render the related transaction too remote from the series on a balance of probabilities. On the facts, however, the SCC agreed with the finding of the Tax Court of Canada that there was a strong link between the series of transactions and the subsequent redemption.

It was also argued by the taxpayer that the phrase "in contemplation of" was only intended to apply prospectively; that is, a prior related transaction completed in contemplation of a subsequent series. In other words, subsection 248(10) should only apply to a related transaction that lays the groundwork for a series of transactions that follows. It was argued that to accept any other interpretation would create unreasonable uncertainty for taxpayers in planning their affairs.

The taxpayer provided several sources to support this argument, including academic commentary and a statement from the Canada Revenue Agency that had previously suggested that subsection 248(10) should be interpreted prospectively.

However, the SCC found that this interpretation was not supported by the text of subsection 248(10). It was stated that because the purpose of subsection 248(10) was to expand the definition of a series, a narrow interpretation of the provision was inappropriate. The SCC was also hesitant to reverse its own decision in *Trustco*, where a broad interpretation of subsection 248(10) was adopted. As a result, the SCC confirmed that a transaction undertaken in contemplation of a prior series of transactions was itself deemed a part of the series by subsection 248(10).

Given the conclusion that a series of transactions resulted in a tax benefit, if any transaction in the series was undertaken for a purpose other than a *bona fide* non-tax purpose, that transaction would be an avoidance transaction. The SCC restated its finding above that the decision to transfer the shares of VHCC Holdings Ltd. so that it and Copthorne I could be horizontally amalgamated, rather than vertically amalgamated, had no purpose other than favourable tax treatment. As such, there was an avoidance transaction within the meaning of subsection 245(3).

Misuse or Abuse

The SCC then moved to the final stage of analysis from *Trustco*: the question of whether the avoidance transaction was a misuse or abuse of specific provisions of the Act, or the Act as a whole. Before beginning its analysis, the SCC restated the well-known *Duke of Westminster*[3] principle that taxpayers "are entitled to select courses of action or enter into transactions that will minimize their tax liability", and that there is nothing inherently immoral or inappropriate in utilizing the provisions of the Act in a creative fashion. In doing so, however, a taxpayer's transactions must accord with the object, spirit, and purpose of the Act. The SCC noted that because the application of the GAAR will inevitably introduce uncertainty to taxpayers, the court has a responsibility to conduct an objective, thorough analysis of why a result is or is not abusive. In conducting this analysis, the court must apply a unified textual, contextual, and purposive approach to determine the object, spirit, and purpose of the provision in question. Because obligations of consistency and predictability are normally paramount, the "unavoidable degree of uncertainty" inherent in applying the GAAR requires the Crown to clearly demonstrate the abuse alleged if it seeks to deviate from the result dictated by the plain words of the legislation.

The SCC focused on subsection 87(3) as the provision that might have been abused by the transactions at issue. In reviewing the text of the provision, the SCC stated that the purpose of subsection 87(3) was to ensure that the PUC is not "inappropriately increased" due to an amalgamation. Subsection 87(3) was also considered in the broader context of the PUC grind rules referenced in paragraph (*b*)(iii) in the definition of "paid-up capital" contained in subsection 89(1). The SCC held that because subsection 87(3) "is one provision within this series of grinds, it is reasonable to conclude that it shares the same purpose of precluding the preservation of PUC where such preservation would allow for a withdrawal, without liability for tax, of an amount in excess of the investment made with tax-paid funds".

The taxpayer argued that the purpose of subsection 89(1) is to calculate the PUC in accordance with corporate law stated capital, unless a specific exception exists. It was suggested that the purpose of subsection 87(3) was therefore to prevent a corporate law increase to stated capital upon amalgamation. The SCC agreed that this may be one purpose, but that an additional purpose is found in the cancellation of the PUC of shares held by a parent corporation in a vertical amalgamation. This second purpose precludes the double-counting of the PUC where the PUC reflects the investment of the same tax-paid dollars.

Given that the SCC commented strongly on the Crown's burden of proof to "clearly demonstrate" the abuse alleged, it is interesting that the Crown's submissions were not addressed directly in the written decision. The written reasons instead identify each of the taxpayer's arguments in respect of the potential misuse or abuse (both in terms of identifying the object and spirit of the legislation, and in whether an abuse actually occurred) and establish why the SCC disagreed with the taxpayer's interpretation. While we must assume that the Crown had met its burden of proof, it is not clear from the decision how this burden was satisfied.

Having determined the purpose of subsection 87(3), the SCC briefly considered whether the transactions under review abused subsection 87(3). It was concluded that the sale of VHCC Holdings Ltd. to its parent, such that a horizontal amalgamation with Copthorne I could be performed, was an abuse of subsection 87(3). The transaction was described as "artificially" preserving the PUC and therefore permitting the return of funds not subject to tax in excess of the original $96,736,845 investment. It was held that this was contrary to the object, spirit, and purpose of subsection 87(3).

The taxpayer unsuccessfully argued that a vertical amalgamation would result in "throwing away" the PUC of VHCC Holdings Ltd., and that taking reasonable steps to preserve a valuable tax attribute was not abusive. In response, the

SCC stated that it is the operation of the GAAR that denies the benefit of this asset, and that it was not "thrown away". It does not appear that the SCC fully addressed the point that the taxpayer was making — that tax professionals now face the possibility that steps to preserve a beneficial tax attribute such as the PUC may later be challenged if a transaction not even contemplated at the time later takes advantage of this preservation. A risk-adverse client may consider whether it is preferable to "throw away" the PUC or other beneficial tax attributes to avoid future uncertainty.

Conclusion

Taxpayers and their advisers can take several things away from this important decision. First, consistent with statements made by the SCC in *Trustco*, and for better or worse, it is now clear that the phrase "in contemplation of" can be applied both prospectively and retrospectively when considering whether a related transaction was performed in contemplation of a prior or subsequent series. Second, preservation of existing tax attributes is apparently, at least in respect of section 87 amalgamations, potentially abusive, depending on the subsequent use of the preserved tax attribute. Third, the SCC is cognizant of the uncertainty created by the GAAR, but has concluded that this uncertainty is unavoidable in some circumstances. Fourth, *Duke of Westminster* is at least still alive, but perhaps living under more difficult circumstances. Finally, the GAAR is alive and well — and may be used more rather than less in the future. Phil Jolie of the Canada Revenue Agency (the "CRA") commented on this last point at a panel discussion hosted at the University of Toronto on January 6, 2012. He indicated that the decision should not change the CRA's views of when to apply the GAAR (although this may not be particularly surprising, given that the CRA's position was successful at every level of court).

— *Mike Harris is an associate in the Tax Department with the Edmonton Office of Fraser Milner Casgrain LLP.*

A number of tax lawyers from Fraser Milner Casgrain LLP write commentary for CCH's Canadian Tax Reporter *and sit on its Editorial Board as well as on the Editorial Board for CCH's* Canadian Income Tax Act with Regulations, Annotated. *Fraser Milner Casgrain lawyers also write the commentary for CCH's* Federal Tax Practice *reporter and the summaries for CCH's* Window on Canadian Tax. *Fraser Milner Casgrain lawyers wrote the commentary for* Canada–U.S. Tax Treaty: A Practical Interpretation *and have authored other books published by CCH:* Canadian Transfer Pricing *(2nd Edition, 2011)*; Federal Tax Practice; Charities, Non-Profits and Philanthropy Under the Income Tax Act; *and* Corporation Capital Tax in Canada. *Tony Schweitzer, a Tax Partner with the Toronto Office of Fraser Milner Casgrain LLP, and a member of the Editorial Board of CCH's* Canadian Tax Reporter, *is the editor of the firm's regular monthly feature articles appearing in* Tax Topics.

Notes:

[1] All statutory references are to the Act unless otherwise noted.

[2] See *OSFC Holdings Ltd. v. The Queen*, 2001 DTC 5471 (FCA).

[3] *Commissioners of Inland Revenue v. Duke of Westminster,* [1936] A.C. 1.

INFORMATION CIRCULAR IC99-1, REGISTERED DISABILITY SAVINGS PLANS

On January 10, 2012, the Canada Revenue Agency released Information Circular IC99-1, Registered Disability Savings Plan, dated November 30, 2011. This circular describes the provisions relating to a registered disability savings plan ("RDSP") that are set out in section 146.4 of the *Income Tax Act*. The CRA notes that this circular does not explain the rollover provisions in section 60.02, the joint liability of taxes from deregistration of a non-compliant plan described in section 160.21, or the penalty taxes on the plans under Part XI. The CRA publishes information on these issues in its guide RC4460. The circular describes what an RDSP is, including who can participate, contributions to a plan, payments out of a plan, and qualified investments; the approval process for a specimen plan being offered by an issuer; and the administration of an RDSP. The circular also provides some basic information about the Canada Disability Savings Program. IC99-1 is reproduced in Bulletins and Circulars on CCH Online, and will be in Volume 8 and on DVD in a future update.

TAX INFORMATION EXCHANGE AGREEMENT WITH DOMINICA

The Department of Finance announced that the Tax Information Exchange Agreement ("TIEA") with Dominica entered into force on January 10, 2012. In accordance with the provisions of Article 13 of the TIEA, for tax issues that are liable

to criminal prosecution, the agreement has effect on January 10, 2012. For all other tax matters, the agreement has effect on January 10, 2012 in respect of taxable periods beginning on or after that date or tax charges arising on or after that date. This TIEA is reproduced on CCH Online and on DVD under Tax Treaties and Social Security Agreements/ Tax Information Exchange Agreements.

EMPLOYEE BENEFITS — REIMBURSEMENT OF GAS EXPENSES IN CARPOOLING SITUATION

The CRA was asked whether the reimbursement by an employer of gas expenses incurred by an employee using his or her car to drive colleagues to or from work under a carpooling arrangement would be considered a taxable or non-taxable benefit under s. 6(1)(*a*) of the Act. If the benefit would be taxable, the CRA was also asked how to allocate it between the employee driving his or her car (and receiving the reimbursement from the employer) and the employees who benefited from the transportation. Under the carpooling arrangement, an employee driving a colleague to work is reimbursed for 50% of his or her gas expenses upon presentation of vouchers and an attestation by the colleague who was transported. If the employee drives two or more other employees to work, the employee is reimbursed for 100% of his or her gas expenses subject to the same documentation requirements. The program applies for both business travel and personal travel between the place of work and home.

Car expenses (including gas expenses) incurred by employees for travel between their homes and places of work would be considered personal expenses, not business expenses, even if the car was used in the course of the employer's carpooling arrangement. The portion of the reimbursement related to travel between the residence of the employees and their place of work represents a taxable benefit received by the employees under s. 6(1)(*a*) of the Act. Although the benefit would normally be included in the income of the employee using his or her car and receiving the reimbursement, the CRA would accept a distribution of the benefit between employees using their cars and those employees being transported. The employer and employees would have to agree on a reasonable allocation of the benefit.

— Association de planification fiscale et financière (APFF), 2011 Conference, Federal Taxation Round Table — Question 2, October 7, 2011, Document No. 2011-0411941C6 (French document)

FINANCING EXPENSES — SALE OF INVESTMENTS

Considering that s. 20(1)(*e*) of the Act may allow an issuer of shares, units of a unit trust, or partnership interests to deduct its financing expenses over five years, the CRA was asked these four questions:

(1) If the issuer does not intend to earn property income but instead to realize gains or losses from the sale of its investments, would its financing expenses still be deductible under s. 20(1)(*e*)(i) of the Act?

(2) If a unit trust files an election under s. 39(4) of the Act to have all the gains resulting from the disposition of its investments treated as capital gains, would its financing expenses still be deductible under s. 20(1)(*e*)(i) of the Act?

(3) If the answer in (2) is negative, would those financing expenses be deductible if a minimum portion of the issuance proceeds was invested in an investment generating property income?

(4) Would the answer be different if the investment income did not cover the financing expenses?

The CRA did not have enough information to answer the four questions specifically but provided general comments. No deduction could be claimed under s. 20(1)(*e*)(i) of the Act if there was no source of business or property income. The facts provided by the taxpayer did not allow the CRA to determine whether there was a source of income. Because s. 9(3) of the Act provides that income from a property would exclude the capital gain realized on the disposition of the property, the increase in value of a capital property (as this term is defined in s. 54) would not in itself constitute a source of property income. However, capital property could in particular circumstances be considered a source of property income or be held in the course of a business to generate business income. An election under s. 39(4) of the Act may only be used for a "Canadian security" (see the definition in s. 39(6) of the Act) and may not be used by a trader or dealer in securities, a financial institution, a non-resident, or a corporation whose main business is lending money or purchasing debt obligations (see s. 39(5)).

— Association de planification fiscale et financière (APFF), 2011 Conference, Federal Taxation Round Table — Question 3, October 7, 2011, Document No. 2011-0412061C6 (French document)

WITHHOLDING ON EMPLOYEE STOCK OPTIONS

The CRA was asked the following questions in an employee stock option context:

(1) It was asked what methods were reasonable for withholding source deductions from stock option benefits in a situation where an employee keeps the shares acquired upon exercising a stock option and his or her only income in the year is related to the exercise of the option. Under s. 153(1.01) of the Act, effective on January 1, 2011, employers must find a solution to meet their obligations to withhold and remit the source deductions to the CRA. The source deduction issue in an employee stock option context is under review and the CRA will not comment on any specific situation until the review has been completed.

(2) It was asked if an employee could claim a deduction under s. 110(1)(*d*) of the Act in situations involving a net issue of employee stock option shares, and if so, for how much. The employer would issue to its employees a smaller number of shares to factor in the source deductions and use its own funds to pay the deductions to the CRA. Stock option agreements would need to be modified to give this right to the employer, and it would be only for source deduction purposes. In one case, the employer would issue a net number of shares so that the employee would receive a share value equal to the market value of the shares less exercise price and source deductions. In a second case, the employee would pay the option exercise price and the employer would issue a net number of shares so that the employee would receive a share value equal to the market value of the shares less source deductions. As explained in (1) above, the CRA cannot comment on these situations.

(3) It was asked if granting an employer the right to redeem stock option shares to pay for the source deductions due to the CRA could cause the shares to become non-prescribed by virtue of Regulations 6204(1)(*a*)(iv) and 6204(1)(*b*). If this were the case, the employee would lose the deduction equal to 50% of the employee stock option taxable benefit that may be claimed under s. 110(1)(*d*) of the Act. The CRA confirmed that any shares that were issued under an employee stock option program where the employer was allowed to redeem the shares would not be prescribed shares under the above regulations and would prevent the employee from claiming the deduction.

— Association de planification fiscale et financière (APFF), 2011 Conference, Federal Taxation Round Table — Question 5, October 7, 2011, Document No. 2011-0411951C6 (French document)

RECENT CASES

Minister's decision to deny relief reasonable and procedural fairness not breached

The taxpayer requested a judicial review of a taxpayer relief request that was denied by the Minister for interest and penalties, based on financial hardship under s. 220(3.1) of the *Income Tax Act* for the years 1989 to 2000. The Canada Revenue Agency (the "CRA") had determined that the taxpayer was able to meet her tax obligations as she had sufficient cash flow and equity in her home during the relevant period. The taxpayer argued that: (a) the CRA's reasons for denying relief were not adequate; (b) she should have an opportunity to comment on the CRA's conclusion for denying relief before a decision was made on the matter; (c) the CRA was not entitled to rely on a third-party affidavit to supplement its reasons; and (d) the Minister erred in exercising its discretion.

The taxpayer's appeal was allowed in part, with costs. The Minister did not provide adequate reasons for its decision. However, the rules of procedural fairness do not entitle a taxpayer to further comment before the CRA makes its decision. As to the affidavit, it was not filed to supplement the CRA's reasons and was appropriate. Lastly, without evidence to the contrary, the Minister's decision to deny relief was reasonable.

¶47,913, *Sherry*, 2011 DTC 5168

Jeopardy collection order issued against corporate taxpayer

N was the sole director of a corporation (the "Company") of which the Canada Revenue Agency (the "CRA") believed he and his wife were the shareholders. The Company was the registered owner of N's family home (the "McCulloch Property"). The Minister applied *ex parte* to the Federal Court for a jeopardy collection order against the Company.

The Minister's application was granted. In a previous case, the Federal Court cited the following factors that justify the issuance of a jeopardy collection order: (a) there are reasonable grounds to believe that the taxpayer has acted

fraudulently and has proceeded to liquidate or transfer assets; (b) the taxpayer is evading tax liabilities and has assets that could diminish in value over time; and (c) the tax debt is significant in relation to the taxpayer's income and expenses. In this case, the Company, N, and his wife had engaged in unorthodox conduct in the past to thwart the CRA's tax collection efforts. The McCulloch Property was subject to a questionable mortgage in favour of N's son, and was in the past the subject of a series of non-arm's length transfers for inadequate consideration orchestrated by N and his wife. In addition, they had failed to make proper financial disclosure to the CRA and had been generally uncooperative with the CRA for the past 20 years. Furthermore, N had been declared a vexatious litigant by the British Columbia Supreme Court, the British Columbia Court of Appeal, and the Federal Court with respect to various actions targeted against the Canadian government. As a result, the Minister's tax collection efforts would be jeopardized by any further delay.

¶47,919, *Friends of Googolplexion for Human Rights Inc.*, 2011 DTC 5175

Motor vehicle allowances paid to taxpayer by employer required to be included in income

The taxpayer was the sole shareholder and an employee of a corporation (the "Corporation"). He personally owned three vehicles, only one of which (a Jeep) was insured to be driven commercially. The Minister included in the taxpayer's income for 2004 and 2005, as employment benefits, motor vehicle allowances the Corporation paid to him. The Minister allowed the deduction of motor vehicle expenses claimed for 2004, 2005, and 2006 for the Jeep only, and disallowed the deduction of all other motor vehicle expenses claimed for 2004 to 2006. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. Under s. 6(1)(*b*)(v) and s. 6(1)(*b*)(x), all motor vehicle allowances from employers must be included in employees' incomes, except for allowances that are reasonable. The taxpayer kept no kilometre logbooks for his vehicles and chose not to produce any evidence at his hearing concerning the purposes for which these vehicles were being used. He was therefore unable to show that the allowances he received were reasonable, or that the vehicles other than the Jeep were being used by him during the course of his employment. The Minister's reassessments were affirmed accordingly.

¶47,925, *Paré*, 2012 DTC 1008

Taxpayer not entitled to deduct investment as business investment loss

The taxpayer invested $25,000 into a company ("CGFLP") that promoted itself as an investment entity through which individuals could realize substantial returns on their contributions. CGFLP was later determined to be in violation of British Columbia securities law and, subsequently, went bankrupt. The taxpayer claimed a $25,000 business investment loss ("BIL") for 2006, but the Minister reassessed the taxpayer and determined that he was entitled only to a capital loss.

The taxpayer's appeal was dismissed. The taxpayer failed to establish that his investment qualified as a BIL, or to meet his burden of proof in establishing a *prima facie* case to rebut the Minister's assumptions.

¶47,929, *Allisen*, 2012 DTC 1015

Beneficial ownership of assets and business remained with taxpayer — Gross negligence penalties deleted

The taxpayer and three corporations she incorporated were appealing assessments and gross negligence penalties. The taxpayer was a retired school teacher who had been involved in the rental property business since the 1980s and had begun a tutorial business after retiring. After a family dispute between the taxpayer's mother and brother, the taxpayer incorporated three corporations for which the taxpayer was the majority shareholder. Two of the incorporations were done by legal counsel, while the taxpayer incorporated the third on her own. The taxpayer transferred title of her properties, for no consideration, to one of the corporations without receiving any legal advice. The taxpayer prepared her personal returns, while an accountant filed the corporate returns. She reported and claimed rental and business income and expenses personally, and they were claimed by the accountant on the corporate returns as well. The taxpayer was personally assessed for capital gains on the transfers of property and for shareholder benefits, as well as gross negligence penalties for the double claiming of amounts on the personal and corporate returns. One of the

companies was also reassessed to remove the input tax credits claimed on taxable supplies. The taxpayer argued that she retained beneficial ownership of the properties, and that the conditions for imposing gross negligence penalties were not met, as she was not aware that the accountant was claiming expenses she had personally claimed.

The taxpayer's income tax appeals were allowed, and the appeal under the *Excise Tax Act* was dismissed. There was no taxable disposition on the transfer of the properties to the corporations, as the taxpayer retained beneficial ownership. The corporations held the properties as agents for the taxpayer. As there was no written agreement, one must look to the conduct of the parties. The taxpayer was a credible witness, and she retained full control over the corporations. Invoices were addressed to the taxpayer personally, no corporate rollover forms were filed, all corporate transactions went through her personal account, and she properly reported and claimed the income and expenses personally. The respondent failed to show that the gross negligence penalties should be imposed. Gross negligence penalties are to be applied only where the evidence clearly points to reckless behaviour. The taxpayer was not aware that the accountant had claimed the income and expenses on the corporate returns. She gave the accountant copies of her personal returns, and the accountant lacked professional skill in filing the corporate returns without asking questions about the property transfers. The taxpayer sought professional advice, and while mistakes were made, they were not done knowingly or recklessly. As the taxpayer owned the properties and business, input tax credits claimed by any of the corporations were properly disallowed.

¶47,932, *Fourney*, 2012 DTC 1019

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For CCH Canadian Limited

Susan Peart, C.A., LL.M.
(416) 224-2224, ext. 6434
email: Susan.Peart@wolterskluwer.com

Natasha Menon, Content Product Manager
Tax, Accounting and Financial Planning
(416) 224-2224, ext. 6360
email: Natasha.Menon@wolterskluwer.com

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CCH Canadian Limited
300-90 Sheppard Avenue East
Toronto ON M2N 6X1
416 224 2248 · 1 800 268 4522 tel
416 224 2243 · 1 800 461 4131 fax
www.cch.ca

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