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PRESERVING WEALTH FOR PEOPLE AND PRIVATE COMPANIES

TAX SCAMS: IT IS NOT CRA CALLING YOU!

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

Lately, we have been receiving numerous calls from panicked taxpayers. These calls all have a number of common elements. First, the caller identifies himself (so far, we have only heard that the callers have male voices) as a Canada Revenue Agency ("CRA") official. Second, the caller tells the person that they owe money to the government. Third, the caller demands immediate cash payment of a specified amount. (Here again, we have heard of demands that range from 'just' a few thousand to tens of thousands of dollars). Fourth, the caller threatens the receiver of the call with a number of possibilities. These include: "we will come to your house with a search warrant"; "we will come to your house to arrest you"; and "we will come to get you to put you in jail for unpaid amounts". Fifth, the callers are highly aggressive and relentless. They will call repeatedly.

The CRA has taken what steps it can to alert taxpayers to this latest scam. However, the "word" is not getting out fast enough. People are still receiving these calls and there can be little doubt that some people are indeed falling prey to this fraud. **It is important to know that the CRA does not operate in this fashion**. There are procedures that must be followed. Taxpayers have rights that are protected by a variety of sources including CRA policy, statutory requirements and common law.

Interestingly enough, the scam is not simply a Canadian phenomena. It was recently reported and a warning was issued by the U.S. Treasury Inspector General for Tax Administration J. Russell George that tax practitioners and taxpayers should be on the lookout for what is obviously a massive telephone fraud being perpetrated by criminals impersonating Internal Revenue Service (IRS) employees. According to the Inspector General, "The phone fraud scam has become an epidemic, robbing [U.S.] taxpayers of millions of dollars of their money"... (See: Accounting Today, Michael Cohn, "Inspector General on 'High Alert' for Tax Scams; Washington, D.C. January 19, 2016). The Inspector General indicated that progress has been made and some persons have been caught and prosecuted. In fact, in the summer, one ringleader in the U.S. was sentenced to more than fourteen years in prison.

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While the exact damage to Canadian taxpayers has not publicly been quantified, we do know that in the United States, the Treasury Inspector General for Tax Administration has reported that there have been over 5,000 victims and they have collectively lost an estimated amount of $26.5 million.

So what should you do if you receive such a call? **Hang up the telephone**. What if they immediately call back? (As they are prone to do). **Hang the phone up again!**

The CRA typically will contact people by mail and not by telephone for unpaid taxes. Moreover, the CRA will not demand payment on the telephone by such methods as asking for your credit card number.

If you think that you owe federal taxes or you actually do owe federal taxes, you should contact the CRA. There is a direct service line and all you have to do is call to get proper answers about your account. If you have an on-line account set up, you can check for yourself.

You should also call your local police department (or division if you reside in a large city) to advise the police of your experience and file a report. Finally, you can turn to your professional advisors such as your chartered accountant and/or tax lawyer for support.

Just remember, protect yourself and share this information with others. We owe it to all Canadians to protect our tax system and by doing so, we protect our society from those that would try to rob us.

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SUMMARIES OF RECENT CRA INTERPRETATIONS OF INTEREST TO PRIVATE CLIENT SERVICES AND WEALTH MANAGEMENT PROFESSIONALS

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INTRODUCTION

This article provides a summary of nine Interpretations which are potentially relevant to private client services and wealth management professionals. The Interpretations were released by the Canada Revenue Agency (the "CRA") at the end of 2015. While the purpose of this article is to provide a useful summary of the Interpretations in question, it is, of course, not a substitute for professional tax and legal advice. It should also be recalled that, in general, unlike court decisions, CRA Interpretations are not binding on courts and do not constitute legally binding statements of matters relating to Canadian tax law. They do, however, provide useful and practical guidance and often explain the CRA's position on matters and questions which may arise from time-to-time in a private client tax and wealth management practice.

Unless otherwise stated, all references to statutory provisions in this article are to the provisions of the *Income Tax Act (Canada)* (the "ITA").

CRA VIEWS 2015-0584261E5: BLOOD RELATIONSHIP–STEP BROTHER

The CRA was asked whether two step-brothers would be considered to have a blood relationship for the purposes of the ITA. In general, two persons are "related" to each other under the ITA if they are subject to a blood relationship. Based on the facts presented to the CRA, each brother in this case was the child of one of the partners to a marriage, but their other respective parents, those not party to the marriage, had no relation of any sort to one another.

The CRA noted that paragraph 252(1)(c) of the ITA broadens the meaning of "child" to include a child of a taxpayer's spouse or common-law partner, and therefore both step-brothers were children of one of the other's parents, as well as their own biological parents. As the step-brothers had the same mother and father for the purposes of the ITA, the CRA's position was that they were connected by a blood relationship under paragraph 251(6)(a) of the ITA, which provides that a blood relationship exists where parties are brothers or sisters.

This Interpretation may be somewhat questionable or problematic, particularly given that there is no specific provision in the ITA which explicitly states that individuals with the same parent or parents are considered brothers or sisters for the purposes of the ITA. The CRA's position in this respect seems to be based on two previous Interpretations, "CRA Views, 9429945–Related and associated" and "CRA Views, Ruling, 2004-0074051R3 – Variation of a grantor trust", which relied on dictionary definitions of the word "brother", which include males that have the same parents or parent. Because the two step-brothers in the Interpretation at issue had the same parents, the CRA concluded that they were related by blood for the purposes of the ITA.

As related persons do not generally deal at "arm's length", the status may have particular implications under the ITA, making this a relevant Interpretation for tax professionals when dealing with blended families.

CRA VIEWS 2015-0596781E5: TRANSFER–RRIF EXCESS TO A LIFE ANNUITY

In this Interpretation, the CRA answered a series of questions relating to the tax treatment of registered retirement income funds ("RRIFs"):

1) Question: when an individual uses RRIF excess amounts to purchase a life annuity, is the offsetting deduction claimed on an individual's tax return equal to the excess amount used to purchase a life annuity?

   Answer: any amount withdrawn from an RRIF in excess of the required minimum withdrawal for a year is referred to as an RRIF excess amount, and any amount withdrawn from a RRIF must be included in income when filing an income tax return. However, when the RRIF excess amount is used to purchase a life annuity, the amount of the excess used to purchase the annuity can be claimed as a deduction. The CRA also pointed out that any future life annuity payments must be included in the taxpayer's income and will be subject to tax in the year they are paid to the taxpayer.

2) Question: is Form T2030 used to directly transfer the excess amount?

   Answer: yes.

3) Question: what is the meaning of partial commutation of a life annuity?

   Answer: A partial commutation of a life annuity occurs where the annuitant converts a portion of their future periodic life annuity payments and receives a lump sum amount in exchange for the portion of the life annuity payments foregone. Any life annuity payments that continue to be paid after receipt of the lump sum amount will be adjusted to take into account the partial commutation.

4) Question: what are the revised minimum withdrawal factors announced in the 2015 Budget?

   Answer: The CRA provided an excerpt from its website to the taxpayer who had asked these questions. The factors which determine the minimum withdrawal amount are based on the age of the RRIF holder, and range from 5.25% for those aged 71, to 20% for those aged 95 and over.

CRA VIEWS 2015-0596611C6: TRANSFER 70(6)

In general, subsection 70(6) of the ITA provides that, so long as certain requirements are met, when property is given to a surviving spouse or transferred to a trust established for the benefit of a surviving spouse following the first spouse's death, that property will not be subject to the deemed disposition and reacquisition of capital property immediately before the first spouse's death under subsection 70(5). At the 2015 conference of the "association de planification fiscale et financière" (the "APFF"), the CRA was asked whether subsection 70(6) would apply to a situation where an individual dies and the executor of his or her estate disposes of some of the assets of the estate and transfers the proceeds of disposition (or a substituted property) to a spousal trust created by the individual's Will.

The CRA responded that subsection 70(6) applies on a property-by-property basis, and that the subsection makes no reference to substituted property. Therefore, any capital property which is transferred to a spousal trust following an individual's death would have to be the *same property* that the individual owned at the time of his or her death, and which would otherwise be deemed to have been disposed of under subsection 70(5).

This Interpretation is a reminder that the CRA will treat property which is sold or otherwise disposed of following an individual's death as having been subject to the deemed disposition and reacquisition under subsection 70(5) of the ITA. This is notwithstanding that proceeds from any such sale or disposition (or property substituted therefore) may be subsequently transferred to a spousal trust established under the terms of the individual's Will for the benefit of a surviving spouse.

CRA VIEWS 2015-0595851C6: INCOME OF A TRUST PAYABLE TO A BENEFICIARY

Generally, paragraph 104(6)(b) of the ITA limits the amount that a trust can deduct from its income for a given taxation year to the amount that has become payable to the beneficiaries of the trust during that year. The question for the CRA in this Interpretation dealt with a trust which, for cash-flow reasons, had income only for accounting purposes and not for tax purposes. This income was then paid out to the beneficiaries of the trust and the CRA was asked at the 2015 APFF conference whether the amount paid out could be deducted from the trust's taxable income for the year.

The CRA responded that it would not accept this deduction, because the difference between a trust's income for tax law purposes and its income for accounting purposes is not considered an amount payable pursuant to subsection 104(24) of the ITA. This Interpretation is, quite simply, a reminder that the provisions of the ITA must be carefully considered when distributing income from a trust to a beneficiary. The ITA's provisions will govern the tax treatment of that income, regardless of cash-flow issues faced by the trust or the treatment of income for accounting purposes.

CRA VIEWS 2015-0595781C6: REIMBURSEMENT OF ATTRIBUTED INCOME

The CRA was asked at the 2015 APFF conference whether, when income is allocated or attributed to a taxpayer under certain provisions of the ITA (for instance under subsections 74.1(1) or 75(2)) there is any sort of obligation on the person who would have paid tax but for the application of one or more of the ITA's attribution rules, to reimburse the person who actually pays the tax. The CRA responded that no provision in the ITA creates any obligation to do so. With respect, this response seems obvious enough that it begs the question as to why it was asked. What would be the point of an attribution rule if the taxes paid on income attributed under one provision were required to be subsequently reimbursed by the person from whom the income was attributed?

The CRA also noted that the ITA did not provide rules that specify the treatment of such a reimbursement should the parties agree to one. This raises the option that persons who are affected by the attribution rules can agree to a reimbursement of tax paid as a result of those rules.

CRA VIEWS 2015-0593091C6: ASSUMPTION OF A DEBT BY A BENEFICIARY OF A TRUST

Again at the most recent APFF conference, the CRA was asked whether subsection 107(2) of the ITA applies to the distribution of a rental property when the beneficiary also assumed a loan secured by a mortgage on the rental property. Generally, subsection 107(2) allows for a tax-deferred "rollout" of property held by a personal trust (at cost) to a beneficiary of the trust, provided there is a resulting disposition of all or any part of the beneficiary's capital interest in the trust.

The CRA responded that this was generally a question of fact. If the initial loan and the assumption of debt by the beneficiary did not impact the status of the trust as a personal trust, then subsection 107(2) should apply. If the debt assumed by the beneficiary was an eligible offset pursuant to the definition of "eligible offset" in subsection 108(1) of the ITA, then the distribution to the beneficiary would reduce the proceeds of disposition of the beneficiary's capital interest.

The CRA's answer may be of assistance to many tax professionals dealing with trust wind-ups and distributions to Canadian-resident beneficiaries, including before a trust's 21st anniversary. Every circumstance involving the potential assumption of a liability by a beneficiary should be considered in relation to the status of the trust in question as a personal trust and with respect to the definition of "eligible offset" in subsection 108(1) of the ITA.

CRA VIEWS 2015-0564351E5: TRANSFER OF RRSP FOR PAYMENT OF CHILD SUPPORT

In this Interpretation, the CRA was asked whether an annuitant could transfer an amount from his or her registered retirement savings plan ("RRSP") to a former spouse's RRSP on a tax-deferred basis under paragraph 146(16)(b) of the ITA where the amount transferred was pursuant to a decree, order or judgment of a competent tribunal or under a written separation agreement to settle a child support claim. In response, the CRA stated that paragraph 146(16)(b) only applies when the transfer of an amount from an annuitant's RRSP to another individual's RRSP relates specifically to a division of property in settlement of rights arising out of, or on the breakdown of, a marriage or common-law partnership. Because payments related to child support or spousal support are separate and distinct from payments related to the division of property upon the breakdown of a marriage or common-law partnership, paragraph 146(16)(b) would not apply when a decision, order or judgment, or written separation agreement, was to settle a child support claim.

This may be an unfortunate Interpretation for many separated couples. The CRA's position means that taxpayers may generally not be able to use transfers of property between RRSPs in order to settle child or spousal support claims arising from the breakdown of a marriage or common-law relationship, but only to settle issues relating to the division of property.

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CRA VIEWS 2014-0527981I7: APPLICATION OF 146.1(2.21) TO DECEASED

Generally, educational assistance payments ("EAPs") can only be made from a registered educational savings plan ("RESP") to or for an individual who is at the time of payment enrolled in a qualifying educational program or a specified educational program. Subsection 146.1(2.21) allows an EAP to be made within six months of an individual ceasing to be enrolled in such a program, provided that other criteria of section 146.1 are met. In that case, subsection 146.1(2.22) deems the EAP to have been made immediately before the cessation of enrollment.

The CRA was asked whether subsection 146.1(2.21) would apply to payments made when the beneficiary under the RESP died within the six month period provided for in that subsection. In its response, the CRA noted that the purpose and scheme of section 146.1 was to encourage long-term savings for post-secondary education and for the payments arising from such savings to be linked to the furtherance of the beneficiary's education. Because this purpose would not be relevant in a situation where the beneficiary had deceased, the CRA was of the view that subsection 146.1(2.21) could not apply to a deceased beneficiary.

The consequences of the CRA's position are quite confined to the particular fact scenario laid out in the Interpretation. Nonetheless, the CRA's interpretation of subsection 146.1(2.21) of the ITA may be an unfortunate result for RESPs whose beneficiaries have deceased.

CRA VIEWS 2015-0605491I7: IN-KIND TRANSFER OF PROPERTY FROM AN RRSP TO AN IPP

The CRA was asked whether an in-kind transfer of property from an individual's RRSP to an individual pension plan, pursuant to paragraph 146(16)(a) of the ITA could be considered a "swap transaction" or an "RRSP strip", thereby giving rise to the 100% advantage tax imposed under Part XI.01 of the ITA. The CRA responded by noting that the definition of a "swap transaction" in paragraph 207.01(1)(a) stipulates that it does not include a payment out of an RRSP in satisfaction of all or part of the RRSP annuitant's interest in the plan, and that the definition of an "RRSP strip" in paragraph 207.01(1)(c) specifically exempts amounts described in subsection 146(16). Therefore the transaction described by the taxpayer would be neither a swap transaction nor an RRSP strip.

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THE NEW RETIREMENT SAVINGS LANDSCAPE IN ONTARIO

By Tina Tehranchian, MA, CFP, CLU, CHFC, Branch Manager and Senior Financial Planner at Assante Capital Management Ltd.

Effective May 2015, The Ontario Retirement Pension Plan Act, 2015 (Bill 56) and the Ontario Pooled Pension Plans Act, 2015 (Bill 57) received royal assent and as a result, two major new initiatives have been introduced that can profoundly affect the retirement savings landscape in Ontario.

POOLED REGISTERED PENSION PLANS

In May 2015, the government of Ontario cleared the way for establishing pooled registered pension plans (PRPPs) in the province by passing legislation that enables companies to offer this new voluntary retirement savings option.

This new legislation allows businesses to offer PRPPs to employees and also make these types of retirement savings plans available to the self-employed. Participation in the PRPP is voluntary for both employers and employees. Employees of companies that decide to offer PRPPs will be automatically enrolled in the plan but can choose to opt out after 60 days. Also, savings in the plan are portable and will belong to the employees.

So far, British Columbia, Alberta, Saskatchewan, Quebec, and Nova Scotia have also passed legislation to implement PRPPs.

While the federal government has spearheaded the creation of PRPPs as a voluntary method of increasing retirement savings, Ontario, in addition to offering PRPPs, has been pushing the establishment of its own public plan, the Ontario Retirement Pension Plan (ORPP).

According to the Ontario government, the motivation for establishing the ORPP is the fact that only 35% of the employees in the province's private sector have a workplace pension plan*, and many people are not saving enough on their own to be able to retire while maintaining their standard of living.

*Source: http://www.ontario.ca/page/ontario-retirement-pension-plan

THE ONTARIO RETIREMENT PENSION PLAN (ORPP)

The ORPP is the new mandatory pension plan program proposed by the government of Ontario as per the Ontario

Pension Plan Act (May 5, 2015), with an effective date of January 1, 2017.

According to the government website on the subject, The Ontario Retirement Pension Plan (ORPP) is intended to provide a **predictable source of retirement income for life** for millions of Ontarians.

The ORPP will be introduced in 2017. This will coincide with the expected reductions in Employment Insurance premiums, helping to minimize the impact on employees and employers.

To help with the adjustment, enrolment of employers and employees in the ORPP would occur in stages, beginning with the largest employers.

Employees and employers will contribute an equal amount, capped at 1.9% each (3.8% combined) on an employee's annual earnings up to $90,000. Earnings above $90,000 (in 2014 dollars) will be exempt from ORPP contributions.

ORPP has been the subject of much debate since it was introduced in the 2014 Ontario budget. The main bone of contention for the critics has been the definition of what constitutes a 'comparable' plan that would exempt employers from participating in the ORPP. The original design for ORPP provided that defined benefit and target benefit pension plans would be considered comparable plans.

However, according to an announcement by the government of Ontario in August 2015, employers that offer defined benefit pension plans (DB pension plans) with a minimum benefit accrual rate of 0.50 % would be considered to have a comparable plan. Employers that offer defined contribution pension plans (DC pension plans) with an employer contribution of at least 4% and combined employer/employee contributions of at least 8% are also considered to have a comparable plan, and would be exempt from the ORPP.

Furthermore, the Ontario government has developed comparability tests for various other types and combinations of DB and DC pension plans and will develop appropriate comparability thresholds for Pooled Registered Pension Plans (PRPP) with equivalent characteristics of a DC pension plan.

IMPLICATIONS FOR BUSINESSES

Employers that offer DB or DC pension plans that do not meet these requirements can choose to make changes to meet the eligibility requirements and be exempt from ORPP participation, or decide to adhere to the ORPP while continuing to offer their employees the added benefit of the workplace pension plan they currently have in place. Employers offering other types of workplace savings plan arrangements such as Group RRSPs or Deferred Profit Sharing Plans (DPSPs) will have to participate in the ORPP unless they decide to convert their plans to a comparable plan that would meet the eligibility requirements.

The requirement for joining ORPP will be phased in based on the size of the company. Larger employers (500 or more employees) will see the obligation to join ORPP take effect in 2017 while medium-sized employers (between 50 and 499 employees) will be given an additional year to comply, and finally, small-sized employers (fewer than 50 employees) will have until 2019. However, employers and employees with workplace pension plans that are or that could be comparable to the ORPP with modifications, as of August 11, 2015, will only be subject to the ORPP in 2020.

Employers do not need to take any action immediately and will be notified in writing early next year by the Ontario Retirement Pension Plan Administration Corporation to determine their participation in the ORPP.

I personally participated in a town hall meeting on the subject of ORPP in the spring of 2015 that was presided by the Honourable Mitzie Hunter, Ontario's Associate Minister of Finance. Based on the tone of the meeting, it seems that the Ontario government is quite intent on implementing the ORPP if it stays in power. On the other hand, Premier Kathleen Wynn has been saying publicly that if the federal government had made the needed overhaul to CPP that Ontario would not need to implement the ORPP. While there is still a long road ahead–including possible changes due to a new Liberal majority coming to power as a result of the October 2015 federal election–and many questions that would need to be answered by the government before ORPP is actually implemented, businesses need to take this seriously and prepare accordingly.

For more details on ORPP, you can visit the following website: https://www.ontario.ca/page/orpp-ontario-retirement-pension-plan#!/

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HOW PHARMACISTS CAN PROTECT THEMSELVES FROM THE CRA IN THE COMING YEARS

By David W. Chodikoff, Partner and Graham E. Purse, Associate of Miller Thomson LLP

The coming months and years may be very uncomfortable for Canada's pharmacists. In the fall of 2014, CRA made a series of court applications in Eastern Canada to obtain disclosure from drug companies about the various incentives they were providing to pharmacists.

This hit the news. In December of 2014, the CBC and Toronto Star reported that the CRA had begun to investigate whether millions of dollars in rebates and gifts had been properly reported for income tax purposes.[1] It was alleged that drug companies and suppliers gave gifts to develop business relationships.

If true, here is the problem: business incentives are treated as business income. Since the *Income Tax Act* has detailed rules that bring income from business into taxable income, a tax liability is created. There are a great number of specific rules in the *Income Tax Act* that may be engaged.

Through knowledge gained from our industry contacts, it is apparent that the scope of the problem is pervasive. Indeed, in some cases, pharmacists have been fired when the pharmacy owner realizes the deception. We expect that Canada-wide the aggregate sums should run into the millions of dollars.

There are, however, sometimes solutions. We were recently able to obtain a complete waiver of all interest and penalties in these circumstances. This helped to minimize the taxes otherwise owing.

As we have learned, there has recently been a wave of letters to pharmacists. Specifically, pharmacists have been receiving correspondence from the CRA urging them to 'fix' their income taxes. We understand that CRA is offering 60 days from the date of receipt of the letter to correct the omissions, or else penalties may be assessed.

Unfortunately, once a pharmacist receives such correspondence it appears unlikely that he or she will qualify for the Voluntary Disclosure program, because of the CRA's administrative position that such a disclosure may no longer be voluntary once the taxpayer is aware that there is an "investigation... set to be conducted". Therefore, this 60 day window is crucial – it will already have passed for many taxpayers, we expect.

What should a pharmacist do if she or he has missed the 60-day window? She or he may get away with it. Our tax system is voluntary. The CRA does not have the resources to audit every single pharmacist. However, given the amount of tax that the CRA knows it is likely entitled to, we expect audits to be widespread.

Like all taxpayers, pharmacists do generally have an obligation to cooperate in providing documents to the auditor. But there are limits. Further, it does not help one's cause to have an abrasive relationship with the auditor. Pharmacists also have an obligation to maintain records. The paper shredder is not an acceptable strategy.

Once an audit is completed, the pharmacist would likely be reassessed (the corporation or the individual pharmacists or both). It is very important to pay careful attention to filing deadlines for objecting to CRA's position. There are a great number of viable arguments that can be made to minimize the impact of a benefit or incentive on audit, depending upon the facts. If the pharmacist is not successful with her or his objection, the matter can be appealed to the Tax Court of Canada. If the amounts in question are low enough, then it may be possible to proceed on an informal basis to minimize professional fees. Opportunities for settlement may present themselves, particularly where the valuation of the benefit (e.g. travel perks) is in issue.

There is some possibility that pharmacists will be pursued by the CRA for gross negligence and, possibly, tax evasion. In the case of gross negligence, penalties can add considerably to a final tax bill. However, a carefully crafted defense strategy can often avoid the application of such penalties. In the case of tax evasion, if any pharmacists are pursued on this basis, then the full criminal law and Charter protections are engaged.

Where does that leave a pharmacist? We expect that there are, and will be many more, very stressed pharmacists and pharmacy owners in the coming months and years. Although taxes will have to be paid that are owing, we have only highlighted a few of the main defence themes. Each case is unique, and opportunities should arise to minimize insofar as possible the tax consequences. As the saying goes, you are obliged to pay your taxes, but you are not obliged to leave a tip.

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1 R. Cuthbertson, CBC News, "Canada Revenue Agency probes pharmacy incentives from drug makers", December 11, 2014. (http://bit.ly/1n7sZ4C); J. McLean *et al*, The Toronto Star, "Drug companies' gifts to pharmacists probed by Ottawa", December 11, 2014. (http://on.thestar.com/1BDDMrP)

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SUMMARIES OF RECENT TAX AND ESTATE COURT DECISIONS OF INTEREST TO PRIVATE CLIENT SERVICES AND WEALTH MANAGEMENT PROFESSIONALS

By Kristen Vandenberg, Student-at-Law, Miller Thomson LLP Toronto (Edited by Rahul Sharma, Associate, Miller Thomson LLP Toronto)

INTRODUCTION

Several notable tax and estates judgments were rendered by courts across the country in the latter part of 2015. These decisions, which may be of interest to private client services and wealth management professionals across Canada, are summarized below.

KUCHTA v. R., 2015 TCC 289

In *Kuchta v. R.,* 2015 TCC 289, at the time of his death, the taxpayer's husband had an outstanding balance payable to the Receiver General in respect of his 2006 taxation year. When the husband's estate failed to pay the amount due, the Minister assessed the taxpayer (being the husband's widow and the beneficiary of his estate) in the amount of $55,592, pursuant to subsection 160(1) of the *Income Tax Act* (Canada) (the "ITA"). In general, as in this case, section 160 of the ITA permits the Minister to assess a person's spouse if the person transferred property to the spouse in spite of amounts payable to the Receiver General. The taxpayer, Mrs. Kuchta, appealed the Minister's assessment, taking issue with the test to be met under subsection 160(1) of the ITA, namely, that (in the circumstances) the transferee must either be the transferor's spouse or common-law partner at the time of the transfer, or a person who has since become the person's spouse or common-law partner.

Mrs. Kuchta's position was that, as of the time of her husband's death, she was no longer his spouse. In Mrs. Kuchta's view, given that her deceased husband's RRSPs were transferred to her immediately after his death, the requirements of the test under subsection 160(1) were not met.

In the circumstances, the Court was asked to determine when the relationship between a deceased and his or her spouse terminates, and whether the meaning of the word "spouse" in subsection 160(1) of the ITA includes a person who was, immediately before a tax debtor's death, his or her spouse. The Tax Court of Canada found that the relationship between the parties must be assessed at the time the transfer of assets took place. The Court also held that widows and widowers are captured within the definition of a spouse for the purposes of subsection 160(1). After conducting a thorough textual, contextual and purposive analysis of subsection 160(1), the Court concluded that the scheme of the subsection 160(1) was broad enough to capture transfers of an individuals' RRSPs following his or her death. Mrs. Kuchta's appeal was accordingly dismissed.

B. (J.) v. C. (S.), 2015 BCSC 2136

In *B. (J.) v. C. (S.),* 2015 BCSC 2136, the parties were common-law spouses who had been together throughout an eight-year relationship. The claimant owned certain real properties at the time that he commenced cohabitation with the respondent. The properties were sold over time and, ultimately, a new property was acquired with $180,000 of the proceeds of disposition and registered in part in the respondent's name. The property was co-owned by the respondent's parents and a family business was run on the property. The claimant asked the court to consider a portion of the equity in the third home which he sold as excluded property under the *Family Law Act*. The issue was whether the property was excluded property under the *Act*, and whether the presumption of advancement applies to non-married co-habiting couples in British Columbia.

The Court excluded the property because it was used in a joint family venture, and this was not a situation where one spouse transferred excluded property into joint tenancy with the other spouse. The Court also found that the presumption of advancement should apply to common-law spouses in the same manner as to married spouses, and should not apply to matrimonial breakdowns under the *Family Law Act,* as it is not consistent with the objectives of that legislation.

LANE ESTATE, RE, 2015 BCSC 2162

Lane Estate, Re, 2015 BCSC 2162 involved a petition by an estate executor for a determination under the *Wills Estates and Succession Act* as to whether any or all of seven handwritten notes represented the intention of the deceased to alter her Will. One of the notes was found with the deceased's Will, while the others were scattered around her home. The notes were all signed, and the deceased was deemed capable. However, they

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were unwitnessed, written on scrap paper, there was no express revocation of the existing Will (or any provisions thereof), and some notes were made at times when the deceased thought she might be dying.

The Court found that the test to be applied pursuant to subsection 58(3) of the *Act* is whether the notes represented a deliberate and final expression of the deceased's testamentary intentions, and found that the test was not met in this case. The factors to be reviewed in this assessment are context-specific and can include considerations such as the presence of the deceased's signature, handwriting, witness signatures, revocation of previous wills, funeral arrangements, specific bequests and the title of the document.

MORRISON v. MORRISON, 2015 ABQB 769

In *Morrison v. Morrison,* 2015 ABQB 769, a beneficiary brought an application seeking direction regarding the ownership of a Registered Retirement Income Fund (RRIF) originally owned by the deceased. Because the testator designated a non-spouse as beneficiary of the RRIF, there was a tax liability to the Estate, leaving it responsible to pay the tax from its other assets. At issue was whether one of the beneficiaries of the estate, the deceased's son, held the RRIF in trust for the estate, as it had been transferred without consideration or intention to make a gift.

The Court found that the son was entitled to keep the RRIF, as the evidence was slightly more likely than not that the deceased had an intention to favour him. However, the Court found it manifestly unfair that the Estate bore the burden of the tax while the son enjoyed the benefit of the RRIF, and that it was unlikely the testator intended to leave insufficient funds to satisfy his bequests to his grandchildren in his Will. Because the necessary threshold for rectification of the Will under s. 39 of the *Wills and Successions Act* could not be met on the evidence of the case, the Court applied s. 8 of the *Judicature Act* and the principles of unjust enrichment to require the son to reimburse the estate for taxes arising from the RRIF.

MATLOCK v. MATLOCK, 2015 SKQB 378

Matlock v Matlock, 2015 SKQB 378 involved a testatrix signing a handwritten alteration to her Will to avoid retaining a solicitor. The alteration did not meet the requirements of the Saskatchewan *Wills Act,* as there was only one witness, rather than the statutorily required two. The Court, however, was satisfied that the alteration reflected the testatrix's testamentary intention, and that this was not a case to direct that the Will be proved in solemn form. Therefore, the Will was ordered to be admitted to probate with the alteration included.

The Court noted that the farther removed the document or writing appears to be from conformity with the formal requirements of the statute, the more difficult it will be to support a finding of testamentary intention. The degree of compliance in this situation led to a finding that the alteration reflected the testatrix's intentions.

Regarding an application requiring that the Will be proved in solemn form, the Court noted that, because the value of the estate was only $90,000, a trial would reduce the amount available to the beneficiaries by a significant amount and this was not an appropriate case in which to order it.

KESSLER ESTATE v. KESSLER, 2015 SKQB 369

The plaintiff in *Kessler Estate v. Kessler,* 2015 SKQB 369 was the executor of his father's estate. He alleged that his sister, who had a power of attorney over their father's financial affairs, wrongfully and habitually breached the fiduciary duty owed to their father as power of attorney by misappropriating his funds for her own use.

The burden was on the daughter to rebut the presumption of resulting trust, and she was unable to do so. By receiving her father's entire estate beyond the cost of his needs, the daughter effectively defeated her father's testamentary intention to divide his estate equally between his two children.

The daughter's actions repeatedly demonstrated self-interest and profit over her duty to act in her father's best interests. Corroboration or convincing evidence is required to establish an intent to make a gift, and the daughter in this case provided little to no evidence to support her arguments.

KAUFMAN ESTATE v. WILSON, 2015 ONSC 6962

In *Kaufman Estate v. Wilson,* 2015 ONSC 6962, an application for direction under s. 39(1) of the *Substitute Decisions Act, 1992* was brought by two attorneys for an elderly woman suffering from dementia. They asked whether they should make certain discretionary payments from the woman's property to her son, her sole surviving beneficiary.

The Court held that it is not authorized to give directions to attorneys on whether and how to exercise their discretion. This reinforced the principle that any risks associated with a decision should rest squarely on the shoulders of the attorneys, and the Court clarified and reminded the attorneys that the fact that trustees and attorneys are expressly permitted to apply for the opinion or advice or direction of the Court does not authorize the Court to exercise discretionary powers on their behalf, thereby shifting the responsibility to the Court. This would go against the wishes of the settlor of a trust or the grantor of a power of attorney. This case accordingly stands for

the proposition that an attorney cannot seek to insulate himself or herself from liability by bringing an application to a court.

HOLLOHAN v. HOLLOHAN, 2015 ONSC 7085

The respondent in *Hollohan v Hollohan,* 2015 ONSC 7085 held title to a property with her mother. She and the applicant entered into a cohabitation agreement/marriage contract in 2009 shortly before they married, which provided that the matrimonial home (the property owned, in part, by the respondent) be excluded from the respondent's net family property for the purposes of equalization upon the breakdown of the marriage. The marriage contract was found to be a valid and enforceable agreement.

In 2013, the parties sold the original property and purchased another property as joint tenants, and the equity from the sale of the first was used to acquire the second. The parties separated in 2014. The home was sold, and half of the net sale proceeds were paid out to the respondent. The issue was which party was entitled to the other half.

The Court found that, because the marriage contract only specified a protected interest in the initial home, this protection did not pass on to successor homes. The general principle that "ownership governs" was applied to find that, as joint tenant, the applicant was entitled to half of the net proceeds remaining from the sale of the property.

MACKAY ESTATE v. MACKAY, 2015 ONSC 7429

MacKay Estate v. MacKay, 2015 ONSC 7429, discussed whether a daughter, being a non-contributing joint bank account holder with her mother, acted as a fiduciary in the operation of the joint account, and breached her fiduciary duty when she paid herself compensation from that account.

The Court found a fiduciary relationship existed, and found that the daughter owed a fiduciary duty to her mother in the management and operation of the account; however, this duty was not breached when the daughter paid herself from the account. The daughter was entitled to compensation for services rendered, including the period following her mother's incapacity. No amount was required to be repaid.

Fiduciary relationships can arise outside of an attorney relationship, and indicia of a fiduciary relationship include when: (1) the fiduciary has scope for the exercise of some discretion or power; (2) the fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests; and (3) the beneficiary is vulnerable to or at the mercy of the fiduciary holding the discretion or power.

Though generally at common law, fiduciaries are not entitled to benefit from their appointment, the rule is not an absolute prohibition and the mother was entitled to arrange her finances as she saw fit. There was evidence the mother had requested care from her daughter in exchange for compensation, known as a "family agreement" for personal service. The amount paid, $119 per week, was not unreasonable.

BETTENS, RE, 2015 NSSC 326

Bettens, Re, 2015 NSSC 326 involved an application under Section 3 of the *Variation of Trusts Act* to vary a testamentary trust. The trust provided that the applicant would receive the trust funds on turning 23, and also provided for a contingent beneficiary if the applicant died before turning 23. The applicant wanted to attend private school in Ontario, and brought an application for early distribution of the funds to pay tuition.

The Court allowed the variation. Though it was somewhat inconsistent with the settlor's intentions, this did not weigh heavily against the applicant, as the proposed variations would have a great benefit. The application was neither opposed to nor consented to by the trustee or the contingent beneficiary. The Court decided the arrangement would not be detrimental to the contingent beneficiary, or to the administration of the trust, while refusing the variation would have been detrimental to the applicant's interests. A prudent adult, motivated by intelligent self-interest and sustained consideration of the expectancies and risks, would be likely to accept the proposal made.

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FINANCE PROPOSES CHANGES TO THE TAXATION OF TRUSTS AND ESTATES AND THE USE OF CHARITABLE DONATION TAX CREDITS BY ESTATES

By: Amanda Stacey, Partner, Rahul Sharma, Associate, Nicole K. D'Aoust, Associate, Miller Thomson LLP Toronto

On January 15, 2016, the Department of Finance released legislative proposals to amend certain new rules in the *Income Tax Act* (ITA) that govern the income tax treatment of testamentary trusts, as well as spousal and similar trusts, which apply for the 2016 and subsequent taxation years. It is understood that these legislative proposals were put forward by

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Finance partly in response to concerns raised by practitioners and other persons and organizations working in the Canadian tax, charities, and private client services industries regarding the new rules. Finance had previously indicated in a letter dated November 16, 2015 (in reply to a submission made by the Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada, as well as other industry leaders) that it was seeking to understand the concerns raised by industry groups in respect of the new rules and the options they identified for addressing them.

Notably, as part of the legislative proposals, Finance is proposing to amend the ITA's rules regarding the use of charitable donation tax credits (CDTCs) by testamentary trusts. The legislative proposals also contain amendments to the ITA's rules relating to trusts and "loss restrictions events" (LREs), which should come as a relief to certain investment trusts.

Finance's January 15, 2016 legislative proposals are summarized below.

NEW ELECTION TO TAX CAPITAL GAIN IN ESTATE

The rules that applied before January 1, 2016 provided that if a trust established for a spouse or common-law partner permitted the deemed disposition of capital property on death to be deferred, this deferral would come to an end upon the death of the surviving spouse or common-law partner. At that time, the trust was required to pay tax on the resulting capital gain.

The new rules (which are currently in effect and which apply after January 1, 2016) provide that the capital gains arising from the deemed disposition on the death of a surviving spouse beneficiary of a spousal or similar trust are to be taxed in the surviving spouse's estate, and not in the trust. The new rules were released in draft form following the 2014 Federal Budget and received royal assent on December 16, 2014.

In general, new paragraph 104(13.4)(b) of the ITA provides that the capital gains tax arising from the deemed disposition upon a surviving spouse's death is to be taxed in the surviving spouse's estate, and not in the trust. Many industry leaders raised concerns regarding the fairness of this provision. Industry leaders were particularly concerned that the provision resulted in considerable inequity when the beneficiaries of a surviving spouse's estate were different from the residuary beneficiaries of the trust which was established for the surviving spouse during his or her lifetime. In blended family situations, for example, the capital gains tax liability arising as a result of a surviving spouse's death was to be borne by his or her estate (thereby diminishing the overall property available for distribution to the beneficiaries of the estate), while the capital property of the trust was available to be distributed to the residuary beneficiaries of the trust with a cost base equal to its fair market value.

The amendments to the ITA proposed by Finance on January 15, 2016 are aimed at remedying the apparent inequity caused by new paragraph 104(13.4)(b), in particular. In this regard, the proposed amendments introduce a new paragraph (104(13.4)(b.1)) to the ITA which limits the application of paragraph 104(13.4)(b) to circumstances involving a surviving spouse who:

1. immediately prior to his or her death, was resident in Canada; and
2. was a beneficiary of a post-1971 spousal or common law testamentary trust, which was created by a Will of a taxpayer who died before 2017.

If these circumstances are met, then the trustee or administrator of the surviving spouse's estate may jointly elect with the trustee of the spousal or common-law partner testamentary trust to have paragraph 104(13.4)(b) of the ITA apply, with the result that the capital gains arising as a result of the surviving spouse's death will be taxed in his or her estate and not in the spousal or common-law partner trust.

There may be compelling tax reasons to make this election for deaths occurring before 2017. It may, for example, be beneficial to make use of the election if there is a capital gain in a spousal trust and, at the time of a surviving spouse's death, he or she had personal capital losses which otherwise could not be used.

The joint election in proposed paragraph 104(13.4)(b.1) of the ITA will only be available for spousal or common-law partner trusts created by the Will of a taxpayer who died before 2017. Otherwise, as was the case before the introduction of the new rules on January 1, 2016, the capital gains tax deemed to be recognized in a spousal or similar trust upon the death of a surviving spouse will continue to be taxed in the trust and not in the estate of the surviving spouse.

MORE TIME FOR TRUSTS TO USE CHARITABLE DONATION TAX CREDITS

Under the rules currently in place and that apply for the 2016 and later taxation years, an estate that is a graduated rate estate (GRE) for the purposes of the ITA (generally, an estate is treated as a GRE for the 36-month period following the particular individual's death), is permitted to allocate CDTCs in any of the following taxation years:

1. the taxation year of the estate in which the donation was made;
2. an earlier taxation year of the estate; or

3. the last two taxation years of the individual before the individual's death.

In general, publicly listed securities and units of mutual funds are exempt from capital gains tax arising on an individual's death if they are donated to charity by the individual's estate following his or her passing. The capital gains tax exemption is only applicable to the taxation year in which the individual is deceased.

Finance's proposed amendments extend the time in which testamentary trusts may take advantage of their ability to allocate CDTCs. While the existing legislation only allows for the allocation to be made within a 36 month period following an individual's death (during which time the individual's estate is a GRE), the proposed changes would extend this period to 60 months. According to Finance's release regarding the proposed amendments, it appears that any CDTCs arising from donations made after the estate ceased to be a GRE would be allocable among either:

1. the taxation year in which the donation was made; or

3. the last two taxation years of the individual.

TRUST LOSS RESTRICTION EVENTS

Currently, when certain commercial or investments trusts are subject to a significant change in ownership (typically when a beneficiary or group of beneficiaries acquires more than 50% of the beneficial interest in the trust), the loss restriction rules in the ITA limit the ability of those trusts to carry losses forwards or backwards. One exception to these LRE rules is a trust which is considered to be an "investment fund," as defined in subsection 251.2(1) of the ITA.

The proposed amendments will revise the ITA's definition of an "investment fund" to allow trusts that are investment funds to more readily establish whether they are in keeping with the definition. More particularly, as a result of the proposed amendments, investment funds should no longer have to consistently track the valuations of the entities in which they invest in order to ensure that they are in compliance with the ITA's requirements. The proposed amendments to the ITA also provide that an "investment fund" will not be subject to a LRE based only on the fact that certain of its issued and outstanding units have been redeemed. Further, the proposed amendments include certain anti-avoidance rules which are intended to ensure that trusts carrying on a business cannot inappropriately claim to be "investment funds" for the purposes of the ITA. On account of proposed amendments to several interrelated subsections of the ITA, there should also be increased options for deferred filing when a trust is subject to a loss restriction event.

CONCLUSION

In general, Finance proposes that the amendments to the ITA released on January 15, 2016 apply to the 2016 and subsequent taxation years. If implemented in the form proposed, the amendments will be a welcome relief to many individuals, families and industry members. As drafted, the proposals provide more flexibility with respect to the taxation of capital gains, as well as the timing for claiming CDTCs. They also restore a perceived sense of fairness to the taxation of spousal and similar trusts.

In the coming months, individuals whose estate plans were developed in contemplation of the new rules currently in effect (and that apply to the 2016 and subsequent taxation years) should contact their advisors to discuss how the amendments could apply to them and their estate planning. Individuals are also encouraged to contact their tax and estate planning advisors with questions relating to how Finance's proposed amendments to the ITA could apply to them and their estate planning, including to planning relating to charitable giving.

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THE NEW QUALIFIED DISABILITY TRUST REGIME

By Rachel Blumenfeld, Partner, Miller Thomson LLP

INTRODUCTION

The qualified disability trust (QDT) was introduced in the 2014 federal budget as one of two entities that are exempt from the proposed top-rate taxation of testamentary trust income; the other entity is the graduated rate estate (GRE), whose first three years also qualified for this exemption). STEP discussed an exemption for trusts for disabled beneficiaries in its December 2, 2013 submission to the minister of finance concerning the government's proposals to limit graduated rates for testamentary trusts (at http://www.step.ca/pdf/TTC122013_TestamentaryTrustSubmissionSTEPCANADA.pdf). Section 122 of the draft technical notes to the new legislation, released in August 2014, stated the following:

> [D]uring the consultation the Government heard from a number of stakeholders that the existing graduated rate taxation of testamentary trusts for the benefit of disabled individuals was an important tool in preserving access by these individuals to income-tested benefits, in particular provincial social assistance benefits. In response to these submissions, graduated rates will continue to be provided in respect of such trusts having

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as their beneficiaries individuals who are eligible for the federal Disability Tax Credit.

Beginning January 1, 2016, a trust that meets the definition in section 122 of the *Income Tax Act* continues to have access to graduated tax rates for income taxed in the trust. This is significant for a beneficiary who receives provincial disability benefits because of the strict limits placed on the amount of income that such an individual can receive. Under the new regime for the taxation of testamentary trusts, all of the income of a trust would likely be allocated out to beneficiaries in order to avoid the top-rate tax in the trust. A recipient of disability benefits might thereby have his or her benefits reduced (or eliminated) if the allocated income exceeded the maximum allowable by the province; in the other hand, if the income were taxed at the top rate in the trust, the value of the assets would be eroded.

QUALIFICATION AS A QDT

To qualify as a QDT, a trust must meet the following requirements:

1) *Arise on and as a consequence of the death of an individual.* Inter vivos trusts for disabled beneficiaries are excluded. A separate insurance trust for a disabled beneficiary arising on the death of a parent, for example, may be a QDT.

2) *Resident in Canada.* The trust must be actually resident in Canada in the taxation year; the deeming provisions in paragraph 94(4)(b) of the *Income Tax Act* do not apply.

3) *Joint election.* The disabled beneficiary (the "electing beneficiary") and the trust (presumably the trustees) must file a joint election with the trust's T3 return in a prescribed form to be a QDT in a taxation year. There appears to be no relief for late-filed elections, which could prove problematic for some individuals with disabilities. Moreover, if the electing beneficiary is mentally incapable, query whether a court-appointed guardian is required to make the election.

4) *Disability tax credit.* The electing beneficiary must qualify for the disability tax credit (DTC), as discussed further below.

5) *One election.* The electing beneficiary can make only one QDT election in a taxation year.

CONSIDERATIONS AND CONCERNS

Named Beneficiary

The QDT rules require that the electing beneficiary or beneficiaries be named in the instrument under which the trust is created. Often, however, a testamentary trust refers to the beneficiaries as "my issue" or "my children," descriptions that appear to be insufficient to meet the QDT definition. A problem might therefore arise if, when a will is created, it is not known whether a child (or a spouse) has or will develop a disability. A Henson trust (a discretionary trust designed to ensure that assets are not considered to be the assets of a beneficiary for the purpose of qualifying for provincial benefits) is commonly created in a will for a specific individual when the condition of the beneficiary is known at the time that the will is created; however, an individual who is the beneficiary of a testamentary trust may become disabled later in life. Such a beneficiary may not be named in the testamentary trust and would likely not be able to benefit from designating the testamentary trust as a QDT.

Eligible for DTC

The electing beneficiary must be eligible for the DTC under section 118.3 of the *Income Tax Act* for his or her taxation year in which the trust year ends. Advisers should be aware that not all recipients of provincial disability benefits qualify for the DTC. For example, if a Henson trust is established in the will of a parent for a disabled child who does not qualify for the DTC, the trust may not be eligible for the graduated rates. If trust income is allocated to the beneficiary, his or her benefits may be at risk.

Only One QDT

In addition, an electing beneficiary can make the QDT election for only one trust for each taxation year. If both parents, or a parent and a grandparent or other relative, have each established testamentary Henson trusts for a disabled person, only one trust can be a QDT. If a parent has established a separate trust to hold life insurance proceeds in addition to the Henson trust for a portion of the residue of the estate, only one of these trusts can be a QDT. Whether the insurance proceeds should instead flow into the estate must be considered in light of provincial probate planning, creditor protection, and related issues.

If an individual is or will be the beneficiary of more than one trust, the trustees of the various trusts must decide which trust will make the QDT election in a particular year. Careful consideration is required during the planning stages to ensure that the trustees are able to communicate with each other and make coordinated decisions, which may be complex in the case of divorced parents, for example. If significant income is expected from one of the QDTs (as a result of an insurance policy, for example), practitioners might consider providing the trustees with the authority to structure the trust investments through a corporation to manage the income paid to the QDT and any other trusts for the disabled beneficiary.

RECOVERY TAX: BEWARE!

The QDT rules include a complex "recovery tax" regime to ensure that a beneficiary who does not qualify for the DTC does not benefit from the graduated rates. The recovery tax applies when

1) none of the beneficiaries at the end of the year is an electing beneficiary for a preceding year,

2) the trust ceases to be resident in Canada, or

3) a capital distribution is made to a non-electing beneficiary.

The third point is perhaps the most significant. When the electing beneficiary dies, the trust is no longer a QDT, and any remaining capital is distributed to the residual beneficiaries. The recovery tax becomes payable on income that was retained in the trust and taxed at graduated rates instead of the top rate. It is therefore extremely important that the trustees keep detailed records of income distributed and retained in the QDT.

CONCLUSION

While the QDT regime will benefit many recipients of the DTC, advisers must be aware that the regime has added significant complexity (and in many cases costs) for families with a disabled child, at both the planning and implementation stages. Clients should be encouraged to review their situation because planning and structures that are currently in place may not adequately address the new legal realities.

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U.S. IMMIGRATION TAX PLANNING – COVERED EXPATRIATES

By Kenneth Lobo, Galia Antebi and Sheryl Shah, Attorneys-at-law, Ruchelman P.L.L.C.

INTRODUCTION

Giving up U.S. citizenship (or green card), requires a formal act of relinquishment in order to be removed from the U.S. tax system. For planning purposes, U.S. persons wishing to relinquish their citizenship (and in certain case, green card) should first determine if they are "covered expatriates," as such status may trigger tax consequences at expatriation and thereafter. Certain planning opportunities exist however those are outside the scope of this article.

Generally, expatriation is effective on the last day of the calendar year of the relinquishment, however, under certain circumstances, termination of U.S. residency may be effective midyear. Following expatriation, individuals should remember to file new withholding certificates with any payor to replace those reflecting U.S. residency status, i.e., Form W-8BEN should replace a previously filed Form W-9.

COVERED EXPATRIATES

Green card holders can only be "covered expatriates" if they are treated as "long-term residents" at the time of the relinquishment of their green card. A green card holder is treated as a long-term resident when he holds a green card for eight taxable years out of the last 15 taxable years. This can happen after as little as six calendar years and two days.

A U.S. citizen or long term resident will be treated as a "covered expatriate" if, at the time of expatriation, he meets any one of three tests:

1. The individual's average annual net U.S. income tax liability for the last five years exceeds $161,000 (adjustable for inflation);

2. The individual has a net worth of $2,000,000 or more;

3. The individual fails to certify, under penalties of perjury, or if required, fails to submit evidence of, compliance with all U.S. Federal tax laws for the last five years.

Due to the third test, less than affluent individuals may be caught by the expatriation rules. Such individuals should consider straightening out their affairs, through the I.R.S.'s offshore voluntary program or otherwise, prior to relinquishing residency.

Exceptions Applicable to U.S. Citizens

Children ages 14 to 18½ may relinquish their U.S. citizenship without being subject to the covered expatriate rules provided that such child has not been a resident of the U.S. under the substantial presence test for more than 10 taxable years.

A dual citizen who has been a U.S. resident under the substantial presence test for no more than 10 years out of the last 15 taxable years will not be subject to the covered expatriate rules if (i) she became a dual citizen of the U.S. and another country at birth, (ii) she will continue to be a citizen of that foreign country after relinquishing U.S. citizenship, and (iii) that foreign country would tax her as a resident.

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Compliance

A covered expatriate must file Form 8854, *Initial and Annual Expatriation Statement*, with his tax return for the year of the expatriation. Failure to file (or filing an incorrect form) may incur a $10,000 penalty. The penalty may be waived if it is shown that the failure was due to reasonable cause and not to willful neglect.

TAXATION OF COVERED EXPATRIATES

Two sets of tax rules apply with respect to covered expatriates: an "exit tax" applicable to the covered expatriate, and a "succession tax" applicable to the recipient of gifts or bequests made by a covered expatriate.

Exit Tax

Under current law (Code §877A), covered expatriates are subject to tax as if they sold their world-wide assets on the day before their U.S. status was relinquished. The deemed sale will be subject to "mark-to-market" rules and gain or loss will be recognized. The taxable gain is reduced (not below zero) by an allowed amount of $693,000 (adjustable for inflation). Generally, any property, that would be included in the taxpayer's U.S. gross estate for estate tax purposes if he died that day as a U.S. person, would be included in this deemed sale, however certain items are excluded, for example, deferred compensation items and specified tax-deferred accounts.

A covered expatriate may elect to defer the payment of the tax due upon expatriation until the year in which the asset is actually sold. However, the deferred tax is subject to interest applicable to underpayments of tax.

The tax basis of any property that was subject to the exit tax is adjusted by the amount of gain or loss recognized.

Succession Tax

Under Code §2801, gifts (in excess of the annual exclusion amount) and bequests made by a covered expatriate to a U.S. person may be subject to tax by the recipient. The tax applies to U.S. recipients, and when the recipient is a foreign trust, a U.S. beneficiary receiving a distribution from the trust will be liable for the tax. This tax is referred to as "succession tax" and it applies to covered transfer, regardless of whether the transferred property was acquired before or after expatriation. The tax rate is the highest applicable gift or estate tax rate at the time of the transfer (currently 40%). The tax is reduced by foreign gift or estate taxes paid (but not foreign income tax) with respect to the transferred property, regardless of whether it was paid by the recipient or the donor/estate. The reporting and tax obligations are deferred until Form 708, *U.S. Return of Gifts or Bequests from Covered Expatriates*, is published. In September 2015 the I.R.S. issued proposed regulations which will apply to covered transfers starting in June 17, 2008, the effective date of the succession tax rules.

Unlike property that transfers in death, covered gifts do not provide the recipient with a step-up in basis, regardless of the expatriation rules. Therefore, the tax basis remains the same in the hands of the recipient as it was in the hands of the donor.

Exceptions

Property that is subject to gift or estate tax by non-residents will not be subject to the succession tax, provided that a timely gift or estate tax return is filed by the donor/estate.

The succession tax is generally not applicable to gifts and bequests to a U.S. spouse or a U.S. charity.

CONCLUSION

Due to the complexity and the graveness of taxation of both expatriates and U.S.-resident recipients of covered gifts and bequests, proper planning is necessary prior to expatriation. Such planning can minimize the total amount of taxes due and, depending on the facts, may even preclude covered expatriate status.

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MANAGING CONFLICTS OF INTEREST IN ASSESSMENT APPEALS

By Jamie G. Walker, Lawyer, Miller Thomson LLP

INTRODUCTION:

The decision of the Ontario Assessment Review Board ("Board") in *Canadian Tire Corp. v. Municipal Tax Equity Consultants Inc.*, [2016] O.A.R.B.D. No. 2 provides the latest insight into conflicts of interest and confidentiality concerns as they arise in the context of assessment appeals. Here, the Board determined that a reasonably informed member of the public would be satisfied that an expert witness had provided a former client's relevant confidential information to a new client in violation of the solicitor-client and/or paralegal-client relationship. Given

the risk of a breach of confidentiality, the expert and their principals were removed from the record and disqualified from providing further legal and consulting services.

Canadian Tire is significant because it affirms the test for determining whether a potential breach of confidentiality warrants the removal of a licensee or firm. Managing confidential information and avoiding conflicts is also essential for reducing cost and delay with respect to property tax disputes.

FACTS:

This case involved assessment appeals by Canadian Tire Corporation ("CTC") for the 2008 and 2012 base years for 162 freestanding "big box" stores across a number of municipalities in the Province of Ontario.

Implementing a novel approach, the Municipal Property Assessment Corporation ("MPAC") and CTC formed a Working Group to encourage without prejudice discussions and negotiations in the hopes of avoiding the need for a hearing. Representatives from CTC, MPAC, MTE Paralegal Professional Corporation ("MTEP"), and several municipalities were required to sign Undertakings of Confidentiality and Non-Disclosure at the outset before reporting to their respective clients. In this context, two briefs containing confidential business information of CTC were disclosed to Group representatives:

- **(i)** *Canadian Tire Corporation Retail Store Economic Life Review*, dated August 20, 2013 ("Brief 1"); and
- **(ii)** *ACS Costing Review*, dated December 15, 2014 ("Brief 2").

As of June 23, 2014, copies of Brief 1 and Brief 2 had been provided to MTEP's representative in the Working Group.

Don Davies ("Davies"), a valuation consultant/expert witness, was employed with AEC International Inc. ("AEC") until January 16, 2015 as a Senior Valuation Consultant and worked on the CTC assessment appeals. On January 21, 2015, Davies joined Municipal Tax Equity Consultants Inc. ("MTEC") just as MTEC and its affiliate MTEP[1] were providing legal and consulting services to several municipalities on those same appeals.

During an exchange of e-mails, counsel for CTC indicated that it would be inappropriate for Davies to continue to work on the CTC appeals without first providing an Undertaking of Confidentiality and Non-Disclosure. Notwithstanding assurances by MTEP and MTEC that Davies would not be working directly on the appeals, counsel for CTC became aware of several e-mail correspondences indicating that Davies was advocating on behalf of the municipalities to MPAC.[2]

After several unsuccessful attempts to resolve CTC's conflict of interest concerns, counsel for CTC advised that MTEP and Davies' continued participation in the assessment appeals was no longer appropriate. Two instances of particular concern were:

- **(i)** Davies' involvement in providing a peer review of an Alternate Dispute Resolution ("ADR") report for another "big box" client to MPAC while working at AEC. Specifically, Davies performed inspections and provided an age-life analysis for several CTC properties cited in the report; and
- **(ii)** Davies' correspondence to MPAC counsel expressing substantive opinions and positions with respect to the CTC assessment appeals.

Counsel for CTC took the position that Davies, MTEC, and MTEP should be disqualified from the proceeding on the basis that Davies worked on the appeals on CTC's behalf, had access to confidential information during his tenure at AEC, was involved in strategic and analytical discussions, and understood what evidence was available to make the case during the course of that work. Counsel for MTEP disagreed that there had been any breach of client confidentiality or disqualifying conflict of interest.

In the resulting standoff, counsel for CTC brought a motion seeking an order that Davies, MTEP, and MTEC be disqualified from participating in the proceeding. Alternatively, CTC sought the Board's direction as to the necessary safeguards, ethical walls, and other precautions to permit Davies, MTEP, and MTEC to participate without breach of confidentiality or ongoing conflict of interest.

Counsel for MTEP took the position that there was no disqualifying conflict of interest. Consequently, MTEP and MTEC could continue to provide legal and consulting services on the CTC assessment appeals with Davies as an expert witness.

DECISION:

The Board first determined that it had the jurisdiction to disqualify a licensee or firm representing a party for having a conflict of interest. Subsections 23(1) and 25.1(1) of the *Statutory Powers Procedures Act*, R.S.O. 1990, c. S. 22 ("SPPA") enabled the Board to make such orders or give such directions as it

1 See: http://www.mte.ca/

2 *Canadian Tire Corp. v. Municipal Tax Equity Consultants Inc.*, 2016 CarswellOnt 278, para. 11.

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considered proper to prevent an abuse of process,[3] determine its own procedures and practices,[4] and make rules governing its own procedures.[5] Rule 3 of the Board's *Rules of Practice and Procedure*[6] also provided the Board with broad powers to do whatever is necessary to effectively and completely adjudicate on any matter before it, including where the Rules do not provide for a matter of procedure.

Citing the decision of Justice Goudge in *Stewart*,[7] the Board held that the Supreme Court of Canada's test in *MacDonald Estate*[8] applied in the assessment context to determine whether there was a risk of breach of confidentiality requiring removal. Although these principles were to be applied cautiously outside the context of solicitor-client privilege,[9] the Board determined that the following four-part test would apply to an expert witness who receives relevant privileged information from one party and is then retained by the opposing representative:

(i) Did the expert receive confidential information attributable to the solicitor-client relationship between the moving party and their counsel, and is this information relevant to the case at hand?

Yes – Davies received relevant confidential information attributable to the solicitor-client and/or paralegal-client relationships between CTC, AEC, and counsel for CTC. Specifically, Davies had:

- inspected properties which formed part of the secondary sales referenced in Brief 1 and wrote a portion of the analysis in Brief 2;[10]
- participated in strategy meetings with paralegals and discussions with valuators at AEC regarding big box assessment appeals;
- worked with confidential information on the CTC appeals and engaged in confidential strategy discussions, as evidenced by Davies' e-mails and docket entries[11] from 2014;
- interacted with an AEC appraiser with respect to the following: engaged formal and informal confidential discussions, peer reviewed reports and performed research regarding economic life issues, peer reviewed the ADR report prepared for another "big box" store, and regularly discussed assignments over lunch with respect to the CTC appeals;
- inspected several CTC big box store properties which were the subject of the appeals;
- received and analyzed actual costs to construct the CTC stores;
- advised AEC that they should consider an age-life valuation analysis for CTC and undertook an analysis of confidential CTC cost data; and
- inspected several CTC big box store properties which were the subject of the appeals and received and analyzed actual costs to construct the CTC stores.

(ii) Did counsel for the responding party receive confidential information?

Yes – MTEP had received confidential information from Davies. MTEP failed to discharge the heavy burden[12] of rebutting the presumption that a reasonably informed member of the public would be satisfied that no confidential information was imparted by Mr. Davies.[13] In particular, Davies' e-mail correspondence strongly indicated that he was advocating as a representative of the municipalities.[14]

(iii) Is there a risk that the confidential information would be used to the prejudice of the moving party?

Yes – a reasonably informed member of the public would not be satisfied that confidential information would not be used to prejudice CTC. Notwithstanding the security and confidentiality protocols implemented by MTEP to insulate written or electronic materials from Davies, these measures were only implemented after CTC counsel's objection to Davies' involvement.[15]

3 *Statutory Powers Procedure Act*, R.S.O. 1990, c. S.22, s. 23(1).
4 *Ibid*, s. 25.0.1.
5 *Ibid*, s. 25.1(1).
6 *Rules of Practice and Procedure*, made under s. 25.1 of the *Statutory Powers Procedure Act*.
7 *Miele (Litigation Guardian of) v. Humber River Regional Hospital*, 2009 ONCA 350, para. 26.
8 *MacDonald Estate v. Martin*, [1990] S.C.J. No. 41, para. 48.
9 *Bortnikov v. Rakitova*, 2015 ONSC 1163, para. 21.
10 *Ibid*, paras. 52-54.
11 *Supra*, note 2, para. 47.
12 *Ibid*, para. 60.
13 *Ibid*, para. 62.
14 *Ibid*, para. 77.
15 *Ibid*, para. 82.

(iv) Is removal from the record the appropriate remedy?

In determining the fourth part of the test, the Board adopted the following four factors cited by Justice Goudge in *Stewart* to determine whether removal was the appropriate remedy:

Factor	Analysis
(i) How the confidential information got into the wrong hands and whether precautions could have been taken by anyone to avoid it	MTEP, MTEC, and their principals knew or ought to have known that Davies had confidential information of CTC. Furthermore, a variety of steps could have been taken to avoid the transfer of confidential information.[16]
(ii) Conduct of counsel upon learning of the problem	The security and confidentiality protocols at MTEP and MTEC were ineffective because Davies had already directly engaged in the appeals and was advocating on behalf of the client municipalities.[17]
(iii) The degree of prejudice the confidential information may cause	CTC could be significantly prejudiced given the fact that Davies was involved in strategic and analytical discussions, understood the available evidence to make the case, and had access to confidential information during the course of his work at AEC.[18]
(iv) The stage of the litigation	The client municipalities had time to retain alternate representation. Furthermore, the costs incurred as a result of the removal of MTEC, MTEP and Davies were not as prejudicial as that to CTC by their ongoing participation.[19]

In light of these factors, the Board ordered the removal of MTEP, MTEC, and Davies from providing legal and consulting services and added that the issue of costs was to be addressed in writing within 60 days.

16 *Ibid*, para. 85.
17 *Ibid*, para. 86.
18 *Ibid*, para. 87.
19 Ibid, para. 88.

CONCLUSION:

Recognizing, avoiding, and managing conflicts or potential conflicts of interest is an essential component to any property tax practice. Paralegals, experts, advocates, appraisers, and counsel should have a general awareness of the following considerations in assessing whether a conflict of interests may exist:

- the immediacy of the interests involved;
- whether those interests are directly adverse;
- whether the issue is substantive or procedural;
- the temporal relationship between the matters;
- the significance of the issue to the immediate and long-term interests of the clients involved; and
- the clients' reasonable expectations in retaining them for the particular matter or representation.

Lawyers[20] and paralegals[21] should also be cognisant of the circumstances in which conflicts can be waived by express or implied consent as opposed to where withdrawal from representation is mandatory. All other licensees or firms should focus on applicability of *MacDonald Estate* and *Stewart* factors, particularly where they are directly or indirectly involved in litigation planning or strategy.

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20 Ontario, *Rules of Professional Conduct*, rr. 3.4-1, 3.4-2, 3.4-3, 3.7-7.
21 Ontario, *Paralegal Rules of Conduct*,: rr. 3.04(3), 3.05.

TAX REASSESSMENT LIMITATION PERIOD IS ACTUALLY 8 YEARS FOR SOME TAXPAYERS: AN AIDE-MÉMOIRE

By Birute Luksenaite, Associate, Miller Thomson LLP

Generally, the "normal" income tax reassessment limitation period is 3 years after the date of sending a notice of an original assessment in the case of individual taxpayers and Canadian-controlled private corporations ("CCPCs") and 4 years after such a date in the case of other types of corporations and mutual fund trusts (per subsection 152(3.1) of the federal *Income Tax Act* (the "***Federal Act***")). The "normal" reassessment

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period can be extended by 3 years in circumstances that are enumerated in section 152(4) of the *Act*. For instance, the "normal" reassessment period can be extended by 3 years for a reassessment that is made as a consequence of a transaction involving a non-resident with whom the taxpayer was not dealing at arm's length (per subparagraph 152(4)(b)(iii) of the *Federal Act*).

Other than in the context of a waiver or misrepresentation as provided in paragraph 152(4)(a), the *Federal Act* does not permit a second extension of the "normal" reassessment period beyond the total 6 or 7 years, as applicable. However, a further extension of the "normal" reassessment period is nevertheless possible under provincial or territory tax legislation.

For example, section 113 of the *Ontario Taxation Act* (the "***Ontario Act***") provides that, if the Canada Revenue Agency (the "**CRA**") makes a reassessment of tax, interest or penalties under Part I of the *Federal Act*, the Ontario Minister of Finance has an obligation to reassess the taxpayer to the extent necessary to provide for consistent treatment of the taxpayer under the *Federal Act* and the *Ontario Act*. The Ontario tax assessment may be issued despite the expiry of the taxpayer's "normal" assessment. The tax legislation of other provinces and territories permit the same result.

With the exception of Quebec and Alberta (for corporate income tax only), all of Canada's provinces and territories are currently members of tax collection agreements ("**TCAs**") with the federal government, entered into pursuant to the *Federal-Provincial Fiscal Arrangements Act,* under which the administration of the provincial and territory tax legislation is delegated to the CRA. It is expected, therefore, that where a provincial or territory tax reassessment is required as a result of a federal tax reassessment, the CRA would generally complete both reassessments concurrently and within the "normal" limitation period. This outcome is not, however, applicable to Quebec and Alberta tax administration, which is not delegated to the CRA.

The provinces of Alberta (for corporate taxation only) and Quebec are not parties to TCAs and they administer their own tax legislation. Subsection 43(1.21) of the *Alberta Corporate Tax Act* (the "***Alberta Act***") and sections 1010.0.2 and 1010.0.3 of the *Quebec Taxation Act* (the "***Quebec Act***") permit their respective minister to issue a reassessment under the *Alberta Act* or the *Quebec Act* within 12 months of a reassessment issued by the CRA or a provincial tax authority. For Quebec and corporate Alberta taxpayers, then, the total limitation period can be as long as 7 or 8 years. This is an important reminder for taxpayers who file taxes in multiple jurisdictions in Canada.

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CANADA REVENUE AGENCY ET AL v. SCHEUER: A CASE COMMENTARY

By Lesley Akst, Associate, Miller Thomson LLP

INTRODUCTION

Increased civil claims are being brought against the Canada Revenue Agency ("CRA"). Allegations include claims of extortion, fraud, and deceit. Several claims involve allegations of misfeasance in public office and negligence, however to be successful with such claims requires the finding of a duty of care. Historically, the Courts have displayed a reluctance to impose a duty upon CRA, with limited exception. The legal analysis as to whether a duty of care is owed in any given situation is layered and infused with policy considerations. This issue was recently explored by the Federal Court of Appeal ("FCA") in *Canada Revenue Agency et al v Scheuer ("Scheuer")*[1], in which the Court generally declined to find that CRA owed a duty of care to the taxpayer. Despite this, the FCA granted the plaintiffs leave to further amend the statement of claim to address non-particularized allegations of bad faith and delay, as liability may attach for such misconduct. Therefore the FCA did not foreclose the possibility of a court finding that the CRA owes a duty of care in this case. A dissection of the FCA's analysis and its interplay with similar case law follows.

BACKGROUND FACTS

The plaintiffs in this matter were Lothar Scheuer and several other Canadian taxpayers who participated in a tax shelter donation program marketed and promoted by the Global Learning Group Inc. ("GLGI"). For the 2004-2006 taxation years, Mr. Scheuer paid various amounts to CLGI, and in turn, GLGI provided Mr. Scheuer with a charitable donation tax receipt, issued by one or more registered Canadian charities in the amounts of $30,047.24, $420,114.91, and $60,053.44, respectively. In filing his personal income tax returns for 2004-2006, Mr. Scheuer claimed charitable donation tax credits based upon the receipts received from GLGI, which credits were then applied to reduce the income tax payable for the applicable taxation year.[2]

The CRA thereafter reassessed Mr. Scheuer's income tax returns for the years in question and disallowed the GLGI charitable donation credits. Consequently, Mr. Scheuer was required to pay income tax in the amounts of $17,623.27,

1 2016 FCA 7 [*"Scheuer FCA"*].

2 *Ibid.* at para 2.

$189,449.81, $12,134.98, plus interest on the tax arrears, for the 2004-2006 taxation years.[3]

Mr. Scheuer and the other plaintiffs subsequently sued, seeking damages suffered as a result of the CRA's negligence in allowing the GLGI program to be marketed to Canadians with its approval.[4]

The history of the legal proceedings in *Scheuer* illustrates the issues grappled with by the prothonotary and the Federal Court Judge, prior to arriving at the FCA.

PROCEEDINGS BEFORE THE FEDERAL COURT

The defendants, CRA, the Attorney General, and the Crown, filed a motion in Federal Court seeking an order striking out the amended statement of claim and dismissing the action pursuant to Rules 221 (1)(a) and (c) of the *Federal Court Rules*[5], which permit a pleading to be struck, with or without leave to amend, on the ground that the pleading discloses no cause of action, or is scandalous, frivolous or vexatious.[6]

In April of 2014, the prothonotary dismissed the motion to strike, with the exception of reference in the pleadings to the Taxpayer Bill of Rights. Such references were stuck on consent on the basis that the Taxpayer Bill of Rights came into effect after the facts giving rise to the action.[7]

In arriving at this decision, the prothonotary relied upon evidence that the actions of the CRA: 1) involved segregating investors in GLGI who were treated differently than other Canadian tax payers; and 2) developed a policy to treat such taxpayers differently. The prothonotary further relied upon findings of fact made in *Ficek v. Canada (Attorney General) ("Ficek")*[8] a case involving another investor in GLGI[9].

The decision of the prothonotary was appealed. The Federal Court Judge dismissed the appeal with costs.[10] Because of the prothonotary's reliance on *Ficek* and its factual findings, the judge conducted most of the analysis, anew, or on a *denovo* basis.[11]

The Federal Court held that the taxpayers pleaded various facts, including their reliance on the tax shelter number issued by the CRA, that might be sufficient to establish proximity by interaction. The Federal Court commented that despite CRA's early awareness of potential issues concerning charitable donations made to GLGI, and the annual reporting by individual tax payers, the CRA confirmed the assessments and did not reassess tax payers until many years later.[12] The Federal Court therefore concluded that the pleadings of the taxpayers provided at least an arguable case of sufficient proximity for a *prima facie* duty of care. In arriving at its conclusion, the Court rejected the argument that the *Income Tax Act*[13] (the "*Act*") eliminated the possibility of finding proximity, and that public policy considerations such as the prospect of indeterminate liability on the part of the CRA, and confidentiality obligations should obviate a duty of care at this stage of the proceedings, without the benefit of a hearing.[14]

The CRA, the Crown, and Attorney General appealed the Federal Court's decision to the FCA. The appeal was heard on November 17, 2015. The below judgment was delivered on January 13, 2016.

ISSUE ON APPEAL

The issue before the FCA was whether the Federal Court Judge erred in refusing to strike the amended statement of claim on the basis that it discloses no reasonable cause of action, and thus whether, on the facts plead, it is arguable that the CRA and thereby the federal Crown, owe a private law duty of care to the plaintiffs, to maintain a negligence claim for damages.

ANALYSIS AND CONCLUSIONS

Test on a Motion to Strike

In framing its analysis, the FCA emphasised the stringency of the test on a motion to strike a claim for disclosing no cause of action. Specifically, the test requires the moving party to show that it is plain and obvious that the pleading discloses no cause of action, or that the claim has no reasonable prospect of success.[15]

The following principles are applicable to such motions: 1) the allegations of fact in the statement of claim must be accepted as proven unless patently ridiculous or incapable of proof; 2) a statement of claim must not be struck merely because it is novel; 3) a statement of claim must be read generously in favour of the plaintiff with allowance for drafting deficiencies.[16] With the above tenets in mind, the FCA considered the case law concerning whether a duty of care exists.

3 *Ibid.* at para 3.
4 *Ibid.* at para 4.
5 SOR /98- 106 *as amended*.
6 *Scheuer FCA* at para 5.
7 *Ibid.* at para 6.
8 2013 FC 502.
9 *Scheuer FCA* at para 7.
10 *Scheuer v. Canada Revenue Agency et al*, 2015 FC 74 ["*Scheuer FC*"].
11 *Ibid.* at para 12.
12 *Ibid.* at para 28.
13 *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.).
14 *Scheuer* FC at paras 29-32.
15 *Scheuer* FCA at para 11.
16 *Ibid.* at para 12.

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Previously Recognised Duty of Care and the Cooper-Anns Test

The test for determining whether a duty of care exists in a given scenario is two-fold and first pronounced by the House of Lords in *Anns v. Merton London Borough Council* [17]. It has since been applied by the Supreme Court of Canada in cases such as *Cooper v. Hobart*[18] (often referred to as the "*Cooper-Anns*" test). Before applying the *Cooper-Anns* test one must first determine whether the duty of care alleged by the plaintiff has been previously recognized in law. If the duty of care or an analogous duty of care has not been previously recognized, then the *Cooper-Anns* test is engaged.[19]

The first part of the *Cooper-Anns* test requires consideration of foreseeability, proximity, and policy. Two questions are posed: 1) was the resulting harm a reasonably foreseeable consequence of the defendant's act; and 2) are there reasons why tort liability should not be recognized in the instant case. The FCA commented that the second line of inquiry weighs factors arising from the relationship between the plaintiff and the defendant.[20]

The FCA emphasized that at the first stage of the test, more than foreseeability is required. Sufficient proximity must also exist between the parties. Therefore it must be just and fair, having regard to the relationship between the parties, to impose a duty of care upon the defendant. Demarcating the proximity of the relationship may involve examining the expectation, representations, reliance and interests involved. If the issue is the defendants alleged failure to act, foreseeability by itself, may not give rise to a duty of care.[21]

At the second stage of the *Cooper-Anns* test, the question remains whether there are policy considerations, outside the relationship of the parties, which may obviate the imposition of a duty of care.[22]

Application of the Tests to the Pleadings

After reviewing the allegations in the amended claim, the FCA summarized that two duties of care were alleged to have been owed and breached by the CRA: 1) the CRA breached a duty of care owed to the plaintiffs when it issued a tax shelter identification number to GLGI; and 2) the CRA breached a duty of care owed to the plaintiffs to warn them of potential issues, including the CRA's concerns relating to the status of the charitable donations credits that resulted from payments made to GLGI and its decision to deny the legitimacy of such credits.[23]

17 [1978] AC 728 [1977] 2 All ER 492, at pages 751-752.
18 2001 SCC 79, [2001] 3 SCR 537 at paragraphs 30-31.
19 *Scheuer* FCA at para 13.
20 *Ibid.* at para 14.
21 *Ibid.* at para 15.
22 *Ibid.* at para 16.
23 *Ibid.*at para 22.

As alluded to above, the FCA then held that the amended statement of claim did not clearly assert an allegation that CRA breached a duty of good faith and/or breached a duty to assess the plaintiffs income tax returns on a timely basis, despite CRA being aware of issues regarding the donations. Such allegations were considered over generalized and non-particular. [24]

Setting aside the issue of the non-particularized allegations, the FCA then analysed whether any of these alleged duties of care, or analogous duties of care, have been recognized in law, because if that is the case, and reasonable foreseeability is established, a *prima facie* duty of care may be presumed.[25]

The FCA rejected the plaintiffs' argument that this claim falls within or is analogous to misfeasance of public office, the obligation on municipalities to take care when inspecting housing developments and executing road maintenance, negligent misstatement, negligent performance of a duty, a duty to warn, or creating "the impression that GLGI operated under its watch".[26] The FCA further stated that there was no recognized category of cases in which CRA owed a duty of care to all Canadians when issuing tax shelter numbers to warn Canadian tax payers that participation in such may lead to the denial of the income tax deductions allegedly available. The FCA reiterated that the performance of statutory duties does not in and of themselves, give rise to a private law duties of care .[27]

In light of the absence of a previously recognized duty of care, the Court proceeded to analyze whether the pleadings, as alleged, met the *Cooper-Anns* test.

In the end, the FCA held that the Federal Court Judge erred in concluding that the allegations contained in the amended statement of claim were sufficient at law, for the purposes of a motion to strike, to assert a *prima facie* duty of care arising by proximity by interaction. Specifically, the FCA found that the lower court failed to give adequate consideration to the applicable provisions of the *Act* and, in particular, to section 237.1. The FCA highlighted that section 237.1(3) provides that the Minister of National Revenue ("Minister") "shall issue an identification number for a tax shelter", once the promoter files a prescribed form containing required information, along with an undertaking concerning the retention books and records of the tax shelter that is satisfactory to the Minister. The FCA further highlighted that section 237.1(5) of the *Act* provides that the promoter must issue a warning on the information returns to each investor, when the return is written wholly or partly in English that "Issuance of the identification number

24 *Ibid.* at para 23.
25 *Ibid.* at paras 24-26.
26 *Ibid.* at paras 27-31.
27 *Ibid.*at para 30.

is for administrative purposes only, and does not in any way confirm the entitlement of an investor to claim any tax benefits associated with the tax shelter." Based on the above, the FCA therefore concluded that tort liability cannot and should not be imposed upon the Minister for issuing a tax shelter identification number, as the Minister's issuance of such is without discretion, and thus no duty of care arises in the circumstances.[28]

In terms of the alleged duty of the CRA to warn the plaintiffs, the FCA assumed without deciding that the Federal Court Judge was correct in finding that there was a sufficiently proximate relationship between the parties. The FCA therefore progressed to the second step of the *Cooper-Anns* test and focused on whether there were residual policy considerations outside the relationship of the parties which would eliminate the duty of care. The FCA expressed concerns that imposing a duty of care in the circumstances would effectively create an insurance scheme for investors at a significant expense to the tax paying public. The FCA added that the written warning required of promoters under the *Act*, is consistent with Parliament's intention that taxpayers participate in tax shelters at their own peril, versus a peril borne by the Canadian taxpayers. The FCA further noted that the amended statement of claim provided that the plaintiffs acknowledged receipt of independent legal opinions, opinions of accountants, and valuation appraisals. The FCA therefore held that issuers of such professional opinions, who received compensation for their services, are better situated to indemnify the plaintiffs in the event of negligence.[29]

The FCA therefore granted the appeal, and ordered the amended statement of claim struck for failing to assert a cognizable cause of action.[30] Leave was however granted to amend the claim to address the overly general and non-particularized allegations of bad faith and delay [31], as the FCA held that liability may attach if public officials act in a manner inconsistent with the proper and valid exercise of their statutory duties.[32]

28 *Ibid.* at para 40.
29 *Ibid.*at para 44.
30 *Ibid.* at para 45.

COMMENTARY

The FCA's analysis in *Scheuer* suggest that a duty of care may be imposed upon the CRA if there is a discretionary element to the alleged act or failure to act. This finding is consistent with previous case law, and in particular that of *Leroux v. Canada Revenue Agency ("Leroux")*[33]. In *Leroux* the British Columbia Supreme Court held that CRA, in fact, owed a duty of care, and breached such, when imposing gross negligence penalties. The Court found that CRA's conduct in characterising Leroux's position as grossly negligent and assessing significant penalties for the purposes of avoiding limitation periods was outside the standard of care expected of honourable public servants. In the end, Mr. Leroux was not successful in his claim as the Court found that he could not demonstrate that his losses were caused by CRA's conduct. Notwithstanding this, the case highlights the principle that if a public official exercises discretion in bad faith or in an improper fashion, liability may attach. These findings align with the rule that government power must only be exercised only for the public good.[34]

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31 *Ibid.*at para 46.
32 *Ibid.* at para 46.
33 2014 BCSC 720.
34 *Odhavji Estate v. Woodhouse,* 2003 SCC 69.

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