TAXES & WEALTH MANAGEMENT

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SEASON'S GREETINGS

It is hard to believe that another year is fast approaching a close. It has been an exciting year with a number of changes regarding the composition of the editorial board of Taxes & Wealth Management.

Joining the editorial board in and around mid-year were Kay Leung of Torkin Manes LLP and Lucinda Main of Gardiner Roberts. And now, I am pleased to report that after many years away, Dr. David Kerzner has returned to the publication and resumed his role as an editor of Taxes & Wealth Management.

I would be remiss if I did not remind our readers that David was an original founder of this publication when it was first conceived and titled, *It's Personal*. David is a U.S. and Canada Cross Border tax law expert. David received a Ph.D in law from Queen's University in 2015 and holds two, yes two, LLM's from NYU School of Law. And as I write this note on Remembrance Day in Canada and Veteran's Day in the United States, I am immediately reminded of David's service in the United States Navy, his status as an Honor Graduate of the Marine Corps Combat Schools Camp Lejeune, North Carolina and his National Defense Service Medal, United States Navy. We are all so pleased that David has rejoined the Editorial Board. Welcome back David!

As this is the final edition of Taxes & Wealth Management for 2019, it is also the time that we thank you — the faithful reader — for your support. Without your feedback and readership, we would simply not exist. So, on behalf of the Editorial Board, we thank you! And remember we always welcome your constructive feedback, be it suggestions for articles or commenting upon the quarterly newsletter content.

Not only do we want to express our thanks to you — our readers — there are many people at Thomson Reuters and other behind the scenes personnel that bring this publication to life. Specifically, we thank Alicia Bertrand at Thomson Reuters and the editorial and production teams at Thomson Reuters. And a thanks to my Miller Thomson LLP legal assistant, Jenifer Graham! Without their respective roles and help, this publication would not be possible.

DECEMBER 2019 – ISSUE 12-4

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Finally on behalf of all of us, the editors, the team at Thomson Reuters and our families, we wish each of you and your families a very, very happy holiday season and a Happy New Year!

David W. Chodikoff, Editor in Chief

CRA'S CONTINUING AUDIT PROJECT — REAL ESTATE TRANSACTIONS

By Daniel Kiselbach, Partner, Miller Thomson LLP, and Tom Ghag, Articling Student, Miller Thomson LLP

INTRODUCTION

At the 2019 BC Tax Conference, the Canada Revenue Agency ("CRA") confirmed that one of Canada's greatest pastimes, the buying, building, renovating, and selling of real estate for profit, is a focus of its audit initiatives. CRA auditors have reviewed tens of thousands of transactions across Canada and have assessed millions of dollars in this recent crackdown in the real estate sector. Now, more than ever before, persons engaged in real estate transactions should take such steps as necessary to minimize tax exposure. Being prepared will also be of assistance in the event of a CRA audit. Taxpayers who find themselves caught in a tax audit should obtain legal advice.

PERSONAL RESIDENCE EXEMPTION CLAIMS

It is a common misconception that all sales of residential properties are tax-free. In fact, sales of residential properties are tax-free only when an exemption applies. A transaction may qualify for the personal residence exemption if: (i) the property at issue is the principal residence of the seller; and (ii) the sale gives rise to a capital gain. If the transaction falls within the exemption, a gain realized on the sale of a principle residence may be exempt from capital gains tax, pursuant to provisions of the *Income Tax Act*.

The exemption applies for each year the property is designated as the taxpayer's principal residence. In general, for a property to qualify as a principal residence, it must be ordinarily inhabited for each year in which the exemption is claimed. A detailed definition of "principal residence" appears at section 54 of the *Income Tax Act*. Since 2016, taxpayers have been required to report every disposition of a principal residence in his or her tax returns. The late filing of a designation may result in a penalty assessment.

The CRA has focused attention on the hot Vancouver and Toronto markets, where long-term property prices have risen dramatically. Taxpayers who have incorrectly claimed a personal residence exemption have been assessed significant income tax and arrears interest. In some cases, they may be liable for civil penalties (up to 50% of the tax sought to be avoided) arising from their gross negligence in filing an incorrect income tax return. In cases involving alleged intentional evasion, prosecutors may seek criminal penalties.

PROPERTY "FLIPPING"

Property "flipping" has been another recent area of focus for CRA auditors. "Flipping" is the term often used to refer to the business of buying, building, renovating, and selling a home for profit, without having the requisite intention to inhabit the home. The CRA considers "flipping" to be a business and as a result, the business profit is not subject to the favourable tax rate afforded to capital gains. As such, taxpayers must correctly report any sales income realized on a real estate "flip" as ordinary income.

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PRE-CONSTRUCTION ASSIGNMENT SALES

The CRA has also identified "pre-construction assignment sales" as a fruitful audit area. Pre-construction assignment sales often relate to condominium units purchased by taxpayers from a property developer and sold before construction has completed. In order to identify the names of taxpayers involved in pre-construction assignment sales, the CRA has a practice of issuing "unnamed third-party requirements" to property developers and builders as part of its audit process. Property developers are often required to provide information identifying the taxpayers who have bought condominiums from them prior to construction. The CRA then uses this information to identify taxpayers for audits, to determine whether they have correctly reported the transactions and to issue income tax assessments.

Taxpayers have appealed assessments relevant to real estate flips and pre-construction assignment sales to the Tax Court of Canada with varying degrees of success. The following decision in *DaCosta v. The Queen*[1] is an example.

Two taxpayers, a real estate agent and her 17-year-old granddaughter, entered into multiple pre-construction assignment sales contracts. The CRA reassessed tax on the basis that they failed to report business income (being the gain on the sales of their units) and assessed gross negligence penalties.

[1] (2017 TCC 235 (T.C.C.)

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The court rejected the taxpayers' argument that their profits should receive favourable capital gains treatment on the ground that the taxpayers' original intention was to hold the properties long-term. The court found that this argument was without substance or merit because neither taxpayer had the means to complete the purchases. The court concluded that the taxpayers' primary intention was always to try to sell the condominiums at a profit.

The court also disposed of the taxpayers' appeal respecting the CRA's assessment of gross negligence penalties. The court found that the real estate agent was grossly negligent in failing to report the profit from the transactions and stated that, because of her experience, she must have been aware that profits made from selling real estate were taxable. The court found that her granddaughter was not grossly negligent, and stated that it was reasonable for a 21-year-old (her age at the time the subsequent sale closed) with little tax experience to rely upon her grandmother and father to tell her if she needed to report income on her tax return.

CONCLUSION

The sale of residential real estate is a recent focus of CRA auditors. Taxation of sales of residential properties are often misunderstood, and those who are unprepared could find themselves facing significant financial implications and the stress of an audit. Where the tax treatment of a real estate transaction is in doubt, the best practice is to seek legal advice.

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HOW LONG IS "AWHILE"? *KIRST ESTATE (RE)* AND HOLOGRAPHIC WILLS

By Carolyn Hogan, Associate, Miller Thomson LLP

A recent decision of the Court of Queen's Bench of Alberta, *Kirst Estate (Re),* provides a useful reminder of some of the issues that may arise through the use of holographic wills.

William Kirst (the "Testator") of Calgary, Alberta died in 2010, leaving behind six surviving adult children, one of whom passed away prior to the decision. The Testator was predeceased by his spouse and one son. A handwritten will was discovered amongst the Testator's papers over six months after the Testator's death, which left everything to his surviving children, with the following caveat:

> *Whitehorn can live in the house for awhile, to be determined by Him and his brothers + sisters.*

Whitehorn Kirst was the youngest child of the Testator, and he had never moved out of his parents' house except for brief periods living with girlfriends or while on tour as a musician. Whitehorn lived with the Testator prior to his death. The house was the single largest asset in the estate. Of the four children of the Testator who testified, two took the position that the Court should find a life estate in favour of Whitehorn, as they believed the Testator intended for Whitehorn to remain in the house indefinitely, while two took the position that "for awhile" means a short period of time sufficient to get his affairs in order.

The sole issue before the Court was the interpretation of the phrase "for awhile".

The Testator's will, dated December 1, 1995, handwritten and unwitnessed, was what is known as a "holographic will". As the will was made in 1995, and the Testator died in 2010, the will is governed[1] by the *Wills Act*, which was replaced on February 1, 2012 by the *Wills and Succession Act*.[2] Section 7 of the *Wills Act* provides as follows:

> *A testator may make a valid will wholly by the testator's own handwriting and signature, without formality, and without the presence, attestation or signature of a witness.*

Holographic wills are recognized in most Canadian provinces, including Alberta, Saskatchewan, Manitoba, Ontario, Quebec, New Brunswick, Nova Scotia and Newfoundland. In Prince Edward Island, the legislation only makes direct mention of holographic wills in cases of members of the Armed Forces of Canada or any mariner or seaman when at sea or in the course of a voyage. In British Columbia, a holographic will is not recognized in the *Wills, Estates and Succession Act* except in cases of members of military forces.[3] Also, a will that does not comply with the required formalities in BC is not valid unless the Court orders it to be effective under the legislation, or in certain circumstances where it was otherwise valid in the jurisdiction where it was made or in which the testator was ordinarily resident.

Generally, a valid holographic will must be entirely in the handwriting of the testator and signed by the testator. No other formalities are generally required. Holographic wills may come in numerous forms: perhaps most famously, a farmer in Saskatchewan scratched a valid holographic will into the fender of a tractor he was trapped underneath. The key to most holographic wills, however, is that the will be wholly in the testator's handwriting; as such, a "will kit" with pre-printed material which has not otherwise complied with the formalities of execution will not be a valid holograph will unless the handwritten words can stand on their own (see the Alberta Supreme Court decision in *Austen, Re* (1967), 61 DLR (2d)).

For certain testators who are not otherwise willing or able to obtain legal advice, a holographic will may allow them to have their last wishes respected. Holographic wills may also be useful even in circumstances where legal advisors are involved in the drafting of a formal last will and testament; if the testator is suffering from an illness, a holographic will may be used as a precaution for the interim period before a formal will can be drafted by the legal advisor.

The facts of *Kirst Estate (Re),* however, illustrate the difficulties that may be created by holographic wills that contain clauses that are not obvious and straightforward in their interpretation. Although the Testator may have felt that his instructions were clear, his children disagreed, and the litigation to resolve the dispute ulti-

[1] R.S.A. 2000, C. W-12.
[2] S.A. 2010, c. W-12.2.
[3] S.B.C. 2009, c. 13, s. 58.

mately resulted in anger and resentment amongst the family members.

In interpreting the Testator's holographic will, the Court relied on the fundamental principles of testamentary interpretation recently set out by the Alberta Court of Appeal in *Hicklin Estate v. Hicklin* (Alta. C.A.):[4]

> *First, a will must be interpreted to give effect to the intention of the testator. No other principle is more important than this one.*
>
> *Second, a court must read the entire will…*
>
> *Third a court must assume that the testator intended the words in the will to have their ordinary meaning in the absence of a compelling reason not to do so.*
>
> *Fourth, a court may canvas extrinsic evidence to ascertain the testator's intention.*

The Court in *Kirst* determined that the meaning of "for awhile" could be ascertained from the will itself, by giving the words their natural and ordinary meaning. The Court found that the Testator's intention was to permit Whitehorn to remain in the house, but only for so long as was agreed to by all of the surviving siblings. The gift to Whitehorn was a conditional gift, subject to a condition subsequent that the surviving siblings agree on how long he continues to live at the house. The Court found that the condition was not satisfied, and therefore his entitlement to live in the house ended and he was required to vacate the premises.

Based on the will as written, the decision in *Kirst Estate (Re)* seems to be a correct interpretation of the text. At least two of the Testator's children, however, felt that the Testator's true intention was to create a life estate in favour of Whitehorn. In such circumstances, it is unclear whether the Testator's wishes have truly been respected, or whether they have been frustrated by the Testator's poor choice of wording. Although holographic wills are useful and important estate planning tools and may be convenient in the right circumstances, the decision in *Kirst Estate (Re)* illustrates that they are no substitute for effective legal advice and a properly drafted will.

This article was previously published in the Miller Thomson LLP's Wealth Matters Communique dated October 29, 2019.

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CROSS BORDER ESTATE PLANNING: THE CASE OF THE BOTCHED UP AND BUNGLED IRA

By David S. Kerzner, Ph.D., Kerzner Law

ESTATE PLANNING [NO]

Maxwell was born in Phoenix Arizona and moved to Canada to play professional sports after graduating from the University of Arizona. When his father Duncan died in 2015 (divorced at the time) in Austin, TX, Maxwell was named as the beneficiary of his late father's Individual Retirement Account (IRA). Generally, Duncan's contributions to his IRA were not subject to tax in the US at the time of contribution but were subject to tax at the time of a withdrawal. In 2015, Maxwell was a dual national (US/Canada) residing in Toronto. Duncan was retired and had been an engineer, and at the time of his passing the balance in his IRA was approximately $500,000 held in a money market account with a bank in Dallas. Duncan's professional advisor at the time in Toronto incorrectly told him that as an inheritance the amount was not subject to taxation in Canada at the time of his father's death. On a subsequent audit by the CRA, Duncan was informed that the payout from his late dad's IRA as a beneficiary was subject to a tax rate of approximately 50% or US$250,000.

ALTERNATIVE PLANNING OPTIONS

As a retiree, Duncan could have withdrawn portions of his IRA over time at a greatly reduced rate of US tax so that the balance in whole could have formed part of his estate and been passed to his son Maxwell in Canada tax free. Admittedly, depending on the size of the IRA and the tax bite, it is possible and often desirable to take the whole amount out, but pre-calculations have to apply to exclude potential penalties for premature withdrawals (often not a factor). An inheritance in Canada is regarded as a gift of capital and is not subject to income tax.

Alternatively, Max could have made a trustee to trustee transfer to a new IRA account in the US to treat the IRA as an inherited IRA under the Internal Revenue Code. Under this scenario, Max would be subject to tax both in the US and Canada (with a foreign tax credit to the CRA) on these amounts and entitled to deferral under the Act and Treaty until distributions. The inherited IRA is restricted and no further contributions can be made to it. Under US rules, Max would not have been able to roll over this IRA to a separate IRA either newly created or an existing IRA of Max.

INCOME TAX ACT

Section 56 of the Act provides for the inclusion of certain amounts in a taxpayer's income, including superannuation or pension benefits. Clause 56(1)(a)(C.1) generally applies in respect of withdrawals from a US IRA for Canadian income tax purposes and provides in pertinent part, "any payment out of or under a foreign retirement arrangement established under the laws of a country" will be included in computing the income of the taxpayer for a taxation year. Subsection 248(1) defines a "foreign retirement arrangement" as a prescribed plan or arrangement which is described in section 6803 of the *Regulations* as a plan or arrangement to which subsection 408(a),(b) or (h) of the Code applies. See generally, *Kaiser v. R.*[1]

Cross border mobility carries tax traps both in estate planning and general income tax matters regarding financial products. Differences may arise out of a single or combination of factors including tax and technical regulatory definitions, operating laws, tax rates, timing issues, and characterization issues to name a few. The IRA is one of many potential cross border estate problems avoidable with care. Frequently, relatives leave other paid on death financial products, including annuities to beneficiaries resident in Canada. These products may vary greatly in their complexities in not only tax, but also technical terms under separate sovereign regulation. Attention to detail and scrutiny at the per investment level is the

1 [1994] 2 C.T.C. 2385, 95 D.T.C. 13 (T.C.C.); *McKenzie v. R.*, 2017 TCC 56 (T.C.C. [Informal Procedure])

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only way to become aware of assets waiting for a tax explosion. Such a process is cumbersome, invasive, costly, but of the alternative, well ask Max. No magic bullet, only a rigorous process with the willing can avoid these bungled and botched transfers of wealth.

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OVER-INVOLVED ADULT CHILDREN RUN THE RISK OF INVALIDATING A PARENT'S WILL OR POWER OF ATTORNEY: THE CASE OF *GRAHAM V. GRAHAM*

By Jennifer A.N. Corak, Associate, Miller Thomson LLP, and Shannon Sturgeon, 2019 Summer Student, Miller Thomson LLP

For a will to be valid, not only is it important that formal statutory requirements be satisfied,[1] but the testator (being the person executing the will) must also have testamentary capacity to make the will. In addition, if the testator was coerced into making a will that does not express the testator's wishes, the will can be set aside. Although there is a presumption regarding the validity of a will that has been duly executed with the requisite formalities (after having been reviewed by the testator who appeared to approve of the contents), the presumption will be rebutted by the existence of suspicious circumstances.[2]

Recently, in the case of *Graham v. Graham*,[3] the Ontario Superior Court of Justice considered the validity of a Will and a Power of Attorney in a situation where the testator/grantor's child had significant involvement in the preparation of such Will and Power of Attorney for Property[4] ("POA"), ultimately finding that the Will and POA were both invalid.

Jacqueline Graham ("Jackie") was in poor health when her husband died intestate[5] in October 2015. After his death, Jackie was told that her cancer was terminal and that she was a candidate only for palliative care. She was hospitalized from November 22, 2015 to December 7, 2015, and then returned to the hospital on December 22, 2015 because of a "pain crisis." She received heavy medication on December 22 and 23, 2015 (December 23, 2015 being the day she signed her Will and POA).

Since Jackie's husband's death, her son, Robert, and his wife, Tammy, stepped in to assist Jackie with her day-to-day activities. In mid-December 2015, Tammy undertook to search for and select a lawyer to prepare Jackie's Will and POA.

[1] *Succession Law Reform Act,* R.S.O. 1990, c. S26, subsection 4(1) requires that a valid will is signed by the testator in the presence of at least two signing witnesses. Section 3 of the *Succession Law Reform Act* states that a will is only valid when it is in writing.

[2] *Vout v. Hay*, [1995] 2 S.C.R. 876 (S.C.C.) at paras 26-27.

[3] *Graham v. Graham*, 2019 ONSC 3632 (Ont. S.C.J.).

[4] Although the decision does not explicitly state that this is a power of attorney for property, the facts of the decision appear to support the assumption that it was a power of attorney for property.

[5] To die "intestate" is to die without a will.

On December 23, 2015, one day after Jackie's admission to the hospital, a lawyer, the lawyer's legal assistant, Robert, Tammy and Jackie met to discuss the contents of Jackie's Will and the POA. Robert was named as the estate trustee and sole beneficiary under the Will, as well as the attorney under the POA. Tammy was named alternate estate trustee and alternate attorney. Jackie's other three children were not mentioned in either the Will or the POA.

On January 4, 2016, Robert used the POA to transfer Jackie's house[6] to himself as sole owner for $1.00. On January 8, 2016, Jackie died of cancer.

One of Jackie's other children, Timothy, brought this application to challenge the validity of the Will and POA, claiming: (i) the preparation and execution of Jackie's Will and POA were done in suspicious circumstances; and (ii) Robert and Tammy exerted undue influence on Jackie, such that she felt she had to comply with their wishes.

The parties were satisfied that the Will and POA were duly executed with the requisite formalities. Therefore, the next step was to determine whether suspicious circumstances surrounded the preparation of the Will. The parties agreed that suspicious circumstances may be raised by the circumstances: (i) surrounding the preparation of the Will; (ii) tending to call into question the capacity of the testator; or (iii) tending to show that the free will of the testator was overborne by actions of coercion or fraud.[7]

Justice Sheard found the following factors supported the conclusion that suspicious circumstances existed at the time of the preparation of the Will:

- Jackie was suffering from physical, emotional and mental impairment and was heavily medicated at the time of execution of the Will.
- Until she signed the Will, Jackie had never had a Will and would otherwise have died intestate. Jackie's husband had died intestate, and Jackie would not have made a Will without intervention from Robert and Tammy. The existence of the Will constituted a significant change. Jackie could have made a Will earlier but chose not to do so.
- The reasons Jackie gave the lawyer for excluding her other children were factually incorrect. She was mistaken as to which child was estranged. Jackie falsely believed that Robert and Jackie's daughter had an agreement to share the inheritance, and therefore, there was no need to provide for her in the Will.
- The only reason Jackie had a POA was to transfer the house prior to her death in order to save some money in estate administration tax (also referred to as probate tax).
- Robert and Tammy orchestrated all interactions with the lawyer, including: searching for a lawyer; providing instructions; arranging the meeting; and sitting in on the meeting. They organized all will-making steps and supplied reasons why the other children were excluded.[8]

[6] For the purposes of the application, Justice Sheard was asked to assume that Jackie's estate essentially consisted of the house and its contents.

[7] *Graham v. Graham*, 2019 ONSC 3632 (Ont. S.C.J.) [*Graham*] at para 23.

[8] *Ibid,* at para. 28.

Justice Sheard had no hesitation in finding that suspicious circumstances existed surrounding the making of the Will and the POA. As such, the legal burden shifted to Robert (as the person seeking to uphold the Will) to prove, on a balance of probabilities, that Jackie had testamentary capacity and knew and approved of the Will and POA.[9] He was not only required to show that Jackie had the capacity to communicate her wishes, but also that Jackie's "expressed wishes were the product of a sound and disposing mind."[10] Robert was tasked with establishing, on the evidence, that Jackie:

1. understood the nature and effect of a will;
2. was able to recollect the nature and extent of her property;
3. understood the extent of what she was giving under the Will;
4. remembered the persons that she might be expected to benefit under the Will; and
5. understood the nature of the claims that may be made by persons she excluded from the Will.[11]

Robert was unable to satisfy his evidentiary burden. The following are some factors Justice Sheard considered in reaching this conclusion:

- There was no evidence that Jackie read or was read the Will or the POA.[11]
- There was no evidence she knew the value of her house (which was treated as the extent of her property).[13]
- The evidence was unclear as to how Jackie formed the factual basis for her dispositions. She appeared to have operated with the information given to her by Robert and Tammy. Independent third parties disproved Jackie's mistaken factual beliefs.[14]
- Jackie's mistaken belief regarding the estrangement of the wrong child affected the dispositions.[15] Jackie chose not to provide for this child in the Will solely because of this mistaken belief.
- No witnesses or other evidence from health professionals, the lawyer or independent third parties supported the conclusion that Jackie had testamentary capacity when the Will was executed.[16]

Given the findings referenced above, Justice Sheard did not provide an exhaustive analysis regarding Timothy's claim that Robert exerted undue influence. Justice Sheard did, however, note that a high onus is placed on the person making allegations of undue influence. Justice Sheard was not persuaded that the suspicious circumstances and the influence exerted by Robert and Tammy rose to the level of undue influence. Instead, in providing so much assistance to Jackie, Robert and Tammy took over Jackie's autonomy in a much more subtle way.[17]

The POA was deemed invalid, in large part due to the same circumstances present in the preparation of the Will, and the transfer of Jackie's house to Robert was set aside.

It is also noteworthy that, when a parent transfers property to an independent adult child, there is a presumption of resulting trust.[18] The house transfer was not intended to be a gift to Robert. The house was transferred to save on probate tax but was to be distributed as part of the estate administration process with Jackie's other estate assets. The POA merely enabled this transfer to happen while Jackie was still alive. Since the house transfer was not a gift, Robert took title to it as trustee.

By executing a will, a testator is given the opportunity to have a say in how his or her assets are to be distributed on death. This case emphasizes the importance of implementing the wishes of the testator and not of those around him or her. It also serves as an important note to testators and their beneficiaries. The decision to make a will and the dispositions a testator chooses to make are personal and must be made with a clear mind and free from overbearing influences.

Generally speaking, estate planning lawyers will ask the testator a number of questions during the planning stage that are geared towards assessing the testator's capacity to execute the will and whether the testator is falling victim to undue influence. It is an important part of the process for all individuals but particularly for those who are more vulnerable. Cases such as *Graham v. Graham* demonstrate that such vulnerability may arise as a result of physical, mental or emotional impairment.

This article was previously published in the Miller Thomson LLP's Wealth Matters Communiqué dated September 24, 2019.

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Shannon Sturgeon was a 2019 Summer Law Student at Miller Thomson LLP and will be returning to article in July 2020.

9 *Ibid,* at paras. 30-31. See also *Vout v. Hay*, [1995] 2 S.C.R. 876 (S.C.C.) at paras. 26-27.
10 *Graham, ibid,* at para. 34.
11 *Ibid,* at para. 33.
12 *Ibid,* at para. 37.
13 *Ibid,* at para. 38.
14 *Ibid,* at paras. 39-49.
15 *Ibid,* at paras. 50-53.
16 *Ibid,* at paras 69, 71 and 77.
17 *Ibid,* at para. 90.
18 I.e. subject to evidence to the contrary, the transfer is presumed not to be an outright gift. *Pecore v. Pecore*, 2007 SCC 17 (S.C.C.); *Graham, ibid,* at para. 102 .

FLOW THROUGH SHARE DONATION — A POWERFUL WAY TO MULTIPLY YOUR CHARITABLE DONATIONS

By Tina Tehranchian, MA, CFP®, CLU®, CHFC®, senior wealth advisor and branch manager at Assante Capital Management Ltd.

If there was a way that you could donate $100,000 to a charity at an after-tax cost of only $13,000, rather than the $50,000 after-tax cost of a cash donation, would you consider it?

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WHAT ARE THE TAX ADVANTAGES OF FLOW THROUGH SHARES?

Canada's *Income Tax Act* allows issuers to agree that they will transfer or "renounce" their exploration expenses to individual investors. Companies that have revenue may not wish to do this, since they would want to apply those expenses against their income to reduce or eliminate their own tax liabilities. But junior exploration and mining companies, which usually have no significant revenue, won't need those expenses because it is likely that their exploration expenses exceed their income and they won't be paying any income tax. It therefore makes sense for these types of companies to pass on those expenses to individual investors who will happily apply them against their personal incomes. The higher the income tax bracket of the investor, the higher the tax benefits of investing in Flow Through Shares would be.

If you purchase Flow Through Shares of qualifying companies, you can deduct up to 100% of the cost of the shares from your personal income. Flow Through Shares, however, are deemed to have a cost base of zero. Therefore, if you purchased the share for $1 and sold it for $1, you would have a capital gain of $1. Due to the fact that you will have an income tax deduction of $1 as a result of the purchase of the Flow Through Share, and because only 50% of capital gains is included in your taxable income, you would still have a net after-tax benefit from purchasing Flow Through Shares.

HOW DOES A FLOW THROUGH SHARE DONATION STRATEGY WORK?

Major gift donors to Canadian charities have been using the Flow Through Share Donation gifting format to significantly reduce the after-tax cost of their charitable gifts while ensuring that the charities of their choice receive the full pledge amount immediately on closing, and net of all fees and expenses.

The first structured FTSD gifting arrangement took place in 2007 and received Advanced Tax Rulings from Canada Revenue Agency (CRA) and Revenu Quebec. Since then, billions of dollars have been raised by natural resource companies using the Flow Through Share Donation format, funding exploration and development, while also enabling various Canadian charities to help donors achieve their philanthropic intentions at a fraction of the after-tax cost of a cash donation.

This strategy is available to accredited investors who intend to make major gifts to Canadian charities. Each gifting arrangement is registered as a tax shelter with the CRA and involves a series of simultaneous transactions. The investment banking arm of the FTSD provider first negotiates a bought deal financing with a natural resource company. Using this strategy, the Issuer raises equity capital in the least dilutive manner possible, because the subscriber pays a premium to market price to access the tax benefits.

These transactions typically close within 3 to 4 weeks from announcement. In the meantime, the FTSD provider contacts charities, advisors and investors requesting participation in the deal. The donors who are interested in participating in the deal must have their documentation and financing in place before the deal closes. The donor subscribes to Flow Through Shares thus accessing the Canadian Exploration Expense (CEE) and associated Federal and Provincial investment tax credit benefits and can write off the entire purchase amount against income. The donor then immediately donates the shares to the charity of their choice.

Upon receipt of the shares, the charity immediately sells the shares to pre-arranged institutional investors and the donor receives a charitable donation tax receipt for the full value of the shares donated equal to the net intended gift plus the closing costs. All transaction costs are funded by the donor and paid by the charity, resulting in receipt of the intended gift amount in full.

The format enables the donor to also simultaneously sell some of the shares to the same end buyer that will purchase the shares from the charity at the same price that the shares are sold by the charity according to a deal pre-arranged by the FTSD provider. The donor and the charity receive the proceeds of sale of their shares simultaneously.

WHAT ARE THE BENEFITS OF A FTSD STRATEGY?

This strategy can multiply major gift donations. In all Canadian jurisdictions, a $100,000 gift will cost between $5,000 — $15,000 (5% — 15%) after tax depending on the province. In Ontario the net cost of a personal donation is approximately $12,950, for a donor in the highest marginal tax bracket.

This donation strategy can be as powerful for Canadian Controlled Private Corporations. Corporations have a notional account called the Capital Dividend Account. The non-taxable portion of capital gains can be credited to the CDA and flowed out of the company to the shareholder on a tax-free basis. As a result of income tax changes that were implemented in 2012, capital gains tax is payable on donation of Flow Through Shares to charities. This generates Capital Dividend Account creation of almost $2 per each one dollar of donation, with the amount varying by province.

While the major portion of the deductions are achieved in the first year of the donation, the ability to write off the CDE pool over time continually reduces the cost of giving over future years.

Here is an example of the tax savings on a $100,000 donation using the FTSD strategy versus a cash donation for a donor who is in the highest marginal tax bracket in Ontario:

	Cash Donation	***FTSD Donation***	**After-Tax Savings**
Personal	$49,590	$12,950	$36,640
Corporate — Active Income — Fully Integrated Yr. 1	$44,590	$33,930	$10,660
Corporate — Holdco Income — Fully Integrated Yr. 1	$42,340	$6,814	$35,526

Source: PearTree Canada

FTSD structures use tax incentives available to all Canadians but the market risk normally associated with a Flow Through Share purchase is mitigated by arranging for the immediate sale of the shares, on date of issuance, to an end buyer, at an agreed price, negotiated at arm's length by the FTSD provider. The Advance Tax Rulings by CRA and Revenue Quebec have also confirmed that this strategy works from a tax perspective, so long as the format set out in the rulings is strictly adhered to.

Currently, there are a few providers of the FTSD gifting arrangement in Canada, including PearTree Canada, Oberon, WCPD, and Bertov. It is important for you and your tax advisor to perform due diligence on the providers and ensure that their strategy complies with CRA Advance Tax Rulings and that proper risk management protocols are in place.

A properly structured FTSD gifting arrangement can not only benefit Canada's economy and Northern and Aboriginal communities by increasing investments in mining, oil and gas, renewable energy and energy conservation industries, but can also benefit the charitable sector and help Canadian philanthropists multiply the impact of their donations, by giving more, while maintaining or reducing their after-tax cost of giving.

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THE GILTI TAX: A BRIEF REMINDER AND UPDATE

By Paul Bercovici, LL.B., Principal, Marks Paneth LLP

BACKGROUND

As part of the transition to a territorial or quasi-territorial income tax system, the *Tax Cuts and Jobs Act of 2017* (the "TCJA") added new *Internal Revenue Code* ("IRC") Section 951A. For tax years of "controlled foreign corporations" ("CFCs") beginning after December 31, 2017, IRC Section 951A subjects "United States shareholders" of CFCs to federal income tax on the CFC's "global intangible low-taxed income" ("GILTI").

It is important to note that, unlike the "deemed mandatory repatriation tax" provided for in IRC Section 965, the tax imposed on GILTI is not a "one-time" tax. Unless the law is changed at some point in the future, taxpayers will be required to determine their GILTI inclusion amount on an annual basis.

The GILTI regime operates in a manner similar to the existing subpart F regime[1]. That is, GILTI income inclusions subject certain "United States shareholders" of CFCs to current US federal income taxation, whether or not the amounts are actually distributed to the shareholders. The practical effect of the GILTI provisions is to eliminate deferral of US federal income taxation on certain foreign earnings of "United States shareholders" of CFCs.

Despite the nomenclature, the tax on GILTI income inclusions is not based on the intangible assets owned by a CFC. In an extremely simplified nutshell, the GILTI inclusion amount is equal to a CFC's income in excess of 10% of the CFC's adjusted basis in its tangible fixed assets, increased by the CFC's net interest expense.

The GILTI rules apply to "United States shareholders" of CFCs. For these purposes the term "United States shareholder" means a "United States person" that, directly, indirectly or constructively, owns at least 10% of the total combined voting power of all classes of stock entitled to vote or at least 10% of the total value of all classes of stock of a foreign corporation.[2] The term "United States person" includes individuals, partnerships, "S" corporations, "C" corporations, estates and trusts.[3] A foreign corporation is a CFC if more than 50% of its stock (by vote or value) is owned by "United States shareholders" at any time during the CFC's tax year.[4]

In practice, the actual calculation of the GILTI inclusion amount can be extremely complex. The calculation of a particular "United States shareholder's" GILTI inclusion amount is done in two stages. Stage 1 of the calculation is done at the CFC level. Stage 2 involves the pro rata allocation of amounts relevant to the calculation of the GILTI inclusion amount to "United States shareholders" of the CFC.

For individuals, GILTI income inclusions are subject to federal income tax at ordinary income tax rates. Natural persons who are "United States shareholders" in CFCs are not entitled to the special 50% deduction available to domestic corporations that are subject to the GILTI tax.[5] In addition, natural persons who are "United States shareholders" in CFCs are not entitled to claim deemed paid foreign tax credits for any foreign income tax paid by the CFC.

"United States shareholders" of a CFC who are US citizens or resident aliens are more severely impacted by the GILTI provisions than "C" corporation shareholders. "C" corporation shareholders (as opposed to shareholders who are US citizens, "lawful permanent residents"[6] or resident aliens by virtue of meeting the "substantial presence test"):

i. Are entitled to reduce their GILTI inclusion amount by 50%:[7]

ii. Are subject to a corporate tax rate on GILTI inclusions of 21% (as opposed to a top personal federal income tax rate for individuals of 37%); and

iii. Are entitled to claim foreign tax credits for up to 80% of the foreign income taxes paid or accrued on the GILTI inclusion amounts.[8]

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1 In very basic terms, the provisions of subpart F of the *Internal Revenue Code* subject US persons who are shareholders of CFCs to current US federal income taxation on certain types of income earned by the CFC (generally "passive" income), irrespective of whether such amounts are actually distributed to the shareholder.

2 IRC Section 951(b) and Reg. 1.951-1(g)(1).

3 IRC Sections 957(c) and 7701(a)(30).

4 IRC Section 957(a).

5 IRC Section 250(a)(1)(B). The 50% deduction is to be reduced to 37.5% after 2025.

6 Commonly referred to as "green card holders".

7 See footnote 5.

8 IRC Section 960(d).

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IRS GUIDANCE REGARDING THE CALCULATION OF THE GILTI INCLUSION AMOUNT

Since the passage of the TCJA, the Treasury Department and the IRS have issued proposed and final regulations pertaining to the Section 951A GILTI provisions. The first set of proposed regulations were issued on September 13, 2018 (the "September 2018 Proposed Regulations").[9] The September 2018 Proposed Regulations dealt primarily with the mechanics of computing the GILTI income inclusion amount and the application of certain anti-abuse provisions.

On June 14, 2019 the Treasury Department and the IRS issued final regulations (the "June 2019 Final Regulations")[10] and proposed regulations (the "June 2019 Proposed Regulations")[11] under IRC Section 951A. The June 2019 Final Regulations generally incorporate, with certain modifications, the guidance provided in the September 2018 Proposed Regulations. Some of the more significant changes contained in the June 2019 Final Regulations include the modification of the anti-abuse rules for certain property transactions and the modification of the treatment of domestic partnerships for purposes of determining a domestic partner's GILTI inclusion amount. Amongst other things, the June 2019 Proposed Regulations provide for a "high-tax" exception similar to the exception for subpart F income under IRC Section 954(b)(4).

REPORTING THE GILTI

As mentioned earlier, the calculation of a particular "United States shareholder's" GILTI inclusion amount is done in two stages. Stage 1 of the calculation is done at the CFC level. Stage 2 involves the pro rata allocation of amounts relevant to the calculation of the GILTI inclusion amount to the "United States shareholders" of a CFC.

The stage 1 calculation is done on Schedule I-1[12] of IRS Form 5471.[13] The GILTI tax amounts calculated at the CFC level on Schedule I-1 of Form 5471 are then transposed to Schedule A[14] of IRS Form 8992[15] and Form 8992 itself to calculate a particular shareholder's pro rata share of the CFC's GILTI tax amount. Shareholders who are entitled to claim the IRC Section 250(a)(1)(B) deduction calculate such amount on IRS Form 8993.[16]

For more information see the instructions for each of the relevant forms.

CONCLUSION

The GILTI tax has been referred to by certain commentators as a minimum tax on "above routine" CFC earnings, with "routine" CFC earnings generally meaning a 10% return on a CFC's tangible property. Unlike the IRC Section 965 "deemed mandatory repatriation tax", the GILTI tax is not a "one-time" tax. If applicable to a particular shareholder of a CFC, the GILTI tax is required to be calculated and paid on an annual basis. As noted, the calculation of the GILTI tax can be extremely complex. Undoubtedly, as tax practitioners become more familiar with the intricacies of the GILTI tax provisions, efforts will be made to minimize the impact of the GILTI provisions on shareholders of CFCs. Time will tell as to what planning and structuring mechanisms may be devised in the future to combat the impact of the GILTI provisions.

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9 IRS, Notice of Proposed Rulemaking, REG-104390-18, Guidance Related to Section 951A (Global Intangible Low-Taxed Income).

10 84 FR 29288 — Guidance Related to Section 951A (Global Intangible Low-Taxed Income) and Certain Guidance Related to Foreign Tax Credits.

11 84 FR 29114 — Guidance Under Section 958 (Rules for Determining Stock Ownership) and Section 951A (Global Intangible Low-Taxed Income).

12 Information for Global Intangible Low-Taxed Income.

13 Information Return of U.S. Persons With Respect to Certain Foreign Corporations.

14 Schedule A for U.S. Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI).

15 U.S. Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI).

16 Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI).

WILLS VARIATION: AN UNJUSTIFIED INFRINGEMENT ON TESTAMENTARY AUTONOMY?

By Sarah Fitzpatrick, Associate, Miller Thomson LLP

In *Lawen Estate v. Nova Scotia (Attorney General)*,[1] ("*Lawen*"), the Nova Scotia Supreme Court found that the Nova Scotia dependants' relief legislation violated section 7 of Canada's *Charter of Rights and Freedoms* (the "*Charter*"). Dependants' relief, or wills variation, legislation allows a testator's spouse and children to apply for a court order to vary the terms of the will on the basis that it did not provide adequate maintenance and support for them.

The testator, Jack Lawen, had four children: three daughters and a son. In his will, Mr. Lawen left two of his daughters gifts of $50,000 each and the remainder of his estate to his son. His daughters commenced a dependant's relief action. In response, Mr. Lawen's executor and his son brought an application for a declaration that certain sections of the *Testator's Family Maintenance Act* (Nova Scotia) ("TFMA") that permit claims by independent adult children violated Mr. Lawen's *Charter* rights to freedom of conscience and religion (s. 2(a)) and to life, liberty and security of property (s. 7).

In the TFMA, a *dependant* who can bring an application to vary the terms of the will is the testator's widow or widower or child. *Child* is further defined in a manner that includes adult children.

The case law interpreting the TFMA has adopted the Supreme Court of Canada's decision in *Tataryn v. Tataryn Estate*,[2] which established that the court will consider both the testator's legal obligations during their lifetime and moral obligations when determining whether adequate maintenance and support was made. In the case of an independent adult child, the testator will owe a moral obligation to make provision for them, depending on the size of the estate and absent any circumstances that may negate the obligation. While some provinces have restricted the class of adult children who can bring a dependants' relief claim by legislation, the TFMA permits any adult children to make a claim, without any requirement for them to demonstrate dependency or financial need.

1 *Lawen Estate v. Nova Scotia (Attorney General)*, 2019 NSSC 162 (N.S. S.C).

2 *Tataryn v. Tataryn Estate*, [1994] 2 S.C.R. 807 (S.C.C.).

RIGHT TO LIFE, LIBERTY AND SECURITY OF THE PERSON

Section 7 of the *Charter* protects the right to life, liberty and security of the person. The right to liberty includes decisional autonomy for decisions that affect physical liberty, human dignity, individual autonomy and privacy.

The Court in *Lawen* found that testamentary autonomy, the ability of the testator to dispose of his property as he wishes, was a fundamental personal choice that is protected by section 7. It is a choice that is more than simply an expression of economic or financial interest, and involves a moral choice that is important to the testator's dignity and autonomy.

As the TFMA restricts the testator's testamentary autonomy, it infringes section 7 of the *Charter*.

RIGHT TO FREEDOM OF CONSCIENCE AND RELIGION

Section 2(a) of the *Charter* provides that everyone has the freedom of conscience and religion. The applicants argued that the testator's moral decision of how to dispose of his property should be regarded as a matter of conscience. However, the Court found that testamentary autonomy was not protected under section 2(a) of the *Charter*.

INFRINGEMENT NOT JUSTIFIED UNDER SECTION 1

Where a *Charter* right has been infringed, the infringement may be permitted as a reasonable limit on the right under section 1 of the *Charter*. This requires determining whether there is a pressing and substantial objective for the limitation and whether the means for the limitation are proportional. The Attorney General argued that the purpose of the TFMA was "to prevent hardships and correct injustices, by balancing the legitimate proprietary interest of testators and the legitimate interests of their heirs in respect of family provision". The Court, however, found that there was no pressing and substantial objective achieved by limiting testamentary autonomy by permitting *non-dependent adult children* to make a dependant's relief claim. As there was no pressing and substantial objective, the Court also found that the remaining elements of the section 1 analysis were not met.

The Court concluded by declaring that sections 2(b) and 3(1) of the TFMA are inconsistent with the Constitution of Canada and are of no force and effect to the extent that *dependants* includes non-dependent adult children. Those sections of the TFMA will be read down to exclude non-dependent adult children and, as a result, non-dependent adult children can no longer bring a dependants' relief claim under the TFMA.

The Attorney General is appealing this decision. If the decision is upheld on appeal, it could have implications in other provinces if the same reasoning is adopted, particularly in British Columbia where the wills variation provisions are similar to the TFMA and wills variation claims by non-dependent adult children are frequently made.

This article was previously published in the Miller Thomson LLP's Wealth Matters Communique dated September 10, 2019.

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CANADIAN WESTERN [AHAMED TFSA] V. R: COMPARING THE STANDARDS OF RELEVANCE BETWEEN GAAR AND NON-GAAR CASES

By Hunter Norwick, Articling Student, Miller Thomson LLP

The Tax Court of Canada's ("TCC") recent decision in *Canadian Western Trust Company as Trustee of the Fareed Ahamed TFSA v. The Queen* ("*Canadian Western*")[1] confirms that the Crown's disclosure obligations in non-GAAR[2] cases is more limited than in GAAR cases. It also sends a clear message to taxpayers that the Court will not be enlisted for the improper purposes of skirting procedure and compelling one party to do the research of another.

FACTS

A major advantage of having a Tax Free Savings Account ("TFSA" or "Trust") is that individuals can trade securities without capital gains taxes siphoning away a portion of their profits. But while some trading is allowed, "too much" trading is not. Where this "too much" threshold sits however, is unclear.

The Canada Revenue Agency ("CRA") reassessed the Canadian Western Trust Company ("Appellant") for its 2009 to 2013 taxation years on the basis that the Appellant was being used to generate business income. The Minister alleged that the Appellant was generating business income because it was actively trading securities that were non-dividend, highly speculative, and only owned for brief periods of time. Under section 146.2(6) of the *Income Tax Act* ("ITA"),[3] a TFSA loses its tax-exempt status if it "carries on one or more businesses."

To assist the Appellant in understanding the threshold that separates tax-exempt income from business income, the Appellant brought a motion to compel the Crown to produce documents and answer questions.

"RELEVANCE" IN GAAR VS. NON-GAAR CASES

In *Canadian Western*, Justice Pizzitelli's decision clarifies that the standard of relevance in GAAR cases is more expansive than in non-GAAR cases.

The Appellant requested that the Crown produce un-redacted versions of redacted draft documents obtained from the Department of Finance through an *Access to Information Act* ("AIA") inquiry.[4]

The Appellant argued that "relevancy on discovery must be broadly and liberally construed and wide latitude should be given,"[5] and,

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[1] 2019 TCC 121, 2019 D.T.C. 1085 (T.C.C. [General Procedure]), leave to appeal to FCA requested [*Canadian West*].
[2] General Anti-Avoidance Rule.
[3] *Income Tax Act*, R.S.C. 1985 c 1 (5th Supp).
[4] *Access to Information Act*, R.S.C. 1985, c A-1.

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further, that a document is relevant if it may fairly lead to an inquiry capable of directly or indirectly advancing the Appellant's case or undermining the Crown's.[6] The Appellant mainly relied on *Sullivan on the Construction of Statutes*, 6th edition,[7] as well as an affidavit by a former government official. Both argued that the draft documents of government employees have an impact on the legislative process and that, therefore, their work should be regarded as part of the ITA's legislative history.

Justice Pizzitelli agreed that the threshold for relevancy is low. He also agreed that in GAAR cases the appellant is entitled to be informed of the object, spirit and purpose ("Policy") of the provision the Minister is alleging that the appellant had abused. Nevertheless, the Court held that even if the GAAR principles applied to non-GAAR cases — as the Appellant contended — the Appellant's request would still fail. Justice Pizzitelli's reasoning is summarized in the following syllogism:

> P1: A draft document is only relevant if it was prepared in the context of the taxpayer's audit or considered by officials involved in or consulted during the audit and assessment of the taxpayer.
>
> P2: The draft documents the Appellant requested were prepared outside of the context of the taxpayer's audit and were not considered by officials involved in the audit.
>
> Conclusion: The Crown need not produce the documents.

The basis for P1 as a standard of relevance derives from the Court's assumption that if a document is produced or consulted during an audit, such a document may have informed the Minister's mental process leading up to the assessment or the Minister's understanding of the Policy at issue.[8] The internal finance draft documents, however, were completely independent of the Minister's audit and assessment of the Appellant. Accordingly, these documents are irrelevant.[9]

On a later issue, Justice Pizzitelli reminded the Appellant that this is not a GAAR case and thus a different, and more limited, standard of relevance applies.

The Appellant asked the Minister to set out its assumptions on the Policy underlying section 146.2(6). The Appellant relied on *Birchcliff Energy Ltd. v. R.*,[10] which stands for the proposition that the Minister must disclose the Policy it relied on in assessing a taxpayer. But, as Justice Pizzitelli noted, this requirement only applies to GAAR cases. In non-GAAR cases, requesting the Minister to disclose what it considers to be the Policy underlying a statutory provision is akin to asking for the Minister's legal argument with respect to that provision.

Justice Pizzitelli's holding is consistent with earlier jurisprudence. In *Birchcliff*, the Minister raised the concern that expanding the scope of relevancy for GAAR cases would eventually carry over to non-GAAR cases. Justice Campbell assuaged these concerns by stating that GAAR cases are unique. To assess a taxpayer under a GAAR provision, the Minister must, *inter alia*, identify a Policy and conclude that there has been a breach of said Policy. This is a peculiarity that cannot be reproduced in any other provision of the ITA and, therefore, the Minister can remain confident that "there is no slippery slope."[11]

Nevertheless, as the courts have repeatedly stated, whether a document is relevant is largely determined by a case-by-case, fact-based inquiry.[12] There is no "magic answer."[13] There is no rigid test. In fact, *Canadian Western* leaves open the possibility that draft documents may be considered relevant even in non-GAAR cases.

The Appellant requested that an un-redacted version of the redacted documents be disclosed because the Federal Court of Appeal ("FCA") ruled as much in *Lehigh Cement Ltd. v. R.*[14] The Appellant also requested that the Crown be compelled to confirm the content found in the draft documents. Both requests were rejected.

In *Lehigh*, the FCA upheld the TCC's decision to compel the Crown to disclose internal memoranda concerning the CRA's considerations regarding whether a certain provision in the ITA was a GAAR provision. However, rather than dismissing the Appellant's argument by highlighting that *Lehigh* was a GAAR case, Justice Pizzitelli distinguished *Lehigh* on the basis that the Crown had included an internal memorandum in its list of documents — thereby giving way to speculation that there may be related memoranda — a fact absent in *Canadian Western*.

Thus, an *a contrario* reading of Justice Pizzitelli's decision shows there is still a possibility that taxpayers in non-GAAR cases could compel the Crown to disclose draft documents, provided the Crown takes the first step in determining that those documents are relevant.

PRIORITIZE PROCEDURE OVER CONVENIENCE

Justice Pizzitelli's decision is also a strong rebuke against taxpayers who seek to use the power of the Court as a short-cut to skirt basic procedure and ignore legal mechanisms already available at discovery.

The Appellant had obtained the internal finance documents through an AIA inquiry. If the Appellant was unsatisfied with the redactions, held the Court, it could seek a remedy from the Information Commissioner. If that failed, the Appellant could then bring the matter to the Federal Court. According to Justice Pizzitelli, insofar as these redactions are treated as an issue under the AIA, it is not within the jurisdiction of the TCC to compel the Minister to remove the redactions, especially since the Minister itself does not have that power.

Initially, the Appellant requested that the Crown admit the authenticity and admissibility of the documents. Following the Crown's rejection of that request, the Appellant requested that the Crown be compelled to at least disclose whether the documents were created in the "ordinary course of business"; this would provide a basis for the admissibility of these documents at trial. The Crown rejected these requests on two grounds. First, the Appellant

5 *Baxter v. R.*, 2004 TCC 636 (T.C.C. [General Procedure]) at para. 13.

6 *Teelucksingh v. R.*, 2010 TCC 94 (T.C.C. [General Procedure]) at para. 15.

7 Ruth Sullivan, *Sullivan on the Construction of Statutes*, 6th Edition, (Markham: LexisNexis Canada, 2014).

8 *MP Western Properties Inc. v. The Queen*, 2017 TCC 82 (T.C.C. [General Procedure]) at para. 32 [*MP Western*].

9 *Superior Plus Corp. v. R.*, 2016 TCC 217 (T.C.C. [General Procedure]) at para. 34.

10 *Birchcliff Energy Ltd. v. R.*, 2015 TCC 232 (T.C.C. [General Procedure]).

11 *Supra*, note 8 at para. 15.

12 *MP Western*, supra note 8 at para. 20.

13 *Ibid.*

14 2011 FCA 120 (F.C.A.).

could serve on the Crown a notice to admit pursuant to Rule 130 of the *Tax Court Rules*.[15] Second, whether these documents are admissible is a question for the trial judge to determine.

Justice Pizzitelli agreed with both of these arguments and also added that previous draft versions of the Minister's Policy position are irrelevant — even under the lower standard applicable at discovery — for the reasons summarized above.

Two more requests by the Appellant drew the ire of the Court.

The Appellant requested that the Minister be compelled to answer whether it disputes any of the facts in the Appellant's draft Statement of Facts. The Appellant assumed that since no objections had been raised by the Crown, the Minister had effectively agreed to the draft Statement of Facts. The TCC gave no weight to this argument.

Concluding an Agreed Statement of Facts requires confidential, without prejudice negotiations. The parties have a right to engage in this process and enjoy whatever leverage it provides them. The Court, on the other hand, has no role in this process. Again, the Appellant failed to use the mechanisms that were available to it. The Appellant could have asked more focused questions to the Crown with a view to obtaining an admission, or the Appellant could have served a notice to admit under Rule 130. Justice Pizzitelli, perhaps with some exasperation, noted:

> The Appellants should follow the Rules of the Court in seeking admissions of fact, not undertake a motion to compel as a firm option.[16]

Thus, the Court will not grant relief where such relief could have been obtained through other mechanisms already available to parties.

DO YOUR OWN RESEARCH

One of the Appellant's requests could not have been rescued by any procedural mechanism nor by any order of the Court.

The Appellant requested the production of publicly available CRA documents and Parliamentary transcripts relating to a 1972 amendment that made business income in RRSPs taxable. Understanding what Parliament meant by this amendment would, in turn, assist the Appellant's interpretation of section 146.2(6).

The Court criticized this request as "improper to the point of abusive."

Requiring that the Minister do the Appellant's research for it would place undue hardship on the Minister. The Appellant did not argue these documents were publicly unavailable, only that it was unable to find them despite a "diligent" search. The request was also too vague and broad and as such amounted to a "fishing expedition". The Minister was being asked to exhume documents from almost 50 years ago, recover documents from a wide range of sources, and operate within an undefined timeframe. Intuitively, one can see how such an indeterminate request would be considered too onerous.

[15] *Tax Court of Canada Rules (General Procedure)*, SOR/90-688.
[16] *Canadian West*, supra note 1 at para. 22.

LESSONS LEARNED

The jurisprudence has generated a long list of principles applicable at discovery.[17] Rather than adding to this list, *Canadian Western* confirms simply what was already there: "relevance" in GAAR cases will be interpreted differently, and more broadly, than non-GAAR cases.

Nevertheless, *Canadian Western* does offer at least two practical lessons for the future appellant, namely:

> a) The TCC will not compel the Minister to conduct the taxpayer's research for it. If documents are in the public domain, it is not the duty of the Minister to find them.
>
> b) Parties must prioritize procedure over convenience. Requesting relief from the Court must be the last, not the first, resort.

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CASE COMMENT ON *RYBAKOV*

By Honor Lay, Articling Student, Miller Thomson LLP

INTRODUCTION

This case concerns two Appellants, a husband and wife, who were in the process of appealing individual reassessments against them by the Minister for Part IX taxes under the *Excise Tax Act*[1] (the "ETA"). After the Minister failed to obey a filing deadline, the Appellants brought a motion for judgment in default against the Minister. The Tax Court of Canada (the "Tax Court") denied the motions, finding in favour of the Minister.

FACTS

The Minister issued the first assessment on April 18, 2017. The Appellants filed notices of objection, to which the Minister issued notices of confirmation, on dates not stated in the Reasons.

The Appellants filed notices of appeal on November 22, 2018. Since the amounts in dispute were less than $50,000, the Appellants elected to proceed by way of Informal Procedure, pursuant to the *Tax Court of Canada Act*[2] (the "TCC Act") and the *Tax Court of Canada Rules (Informal Procedure)*[3] (the "IP Rules").[4]

The Minister had 60 days from the transmittal of the notice of appeal to file a reply, unless the Appellant consented to or the Court allowed an extension.[5] On January 28, 2019, the Minister sought the Appellants' consent to extend the deadline, which the Appellants granted, providing another 60-day extension to the Minister until March 13, 2019.

[17] *Ibid*, at para. 9.
[1] R.S.C., 1985, c. E-15.
[2] R.S.C., 1985, c. T-2, at s. 18.3001.
[3] SOR/90-688b.
[4] Section 18.3001 of the TCC Act.
[5] Subsection 18.3003(1) of the TCC Act.

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On February 21, 2019, the Minister requested an additional extension to file the replies, which the Appellants declined, meaning that the March 13, 2019 deadline remained in effect.

On March 11, 2019, two days before the Minister's deadline to submit the replies, the Minister issued notices of reassessment (the "Reassessments") for an amount 65 times greater than the original assessment[6] and "well in excess of $50,000," the threshold for Informal Procedure.[7] That same day, the Appellants each filed amended notices of appeal to address the Reassessments. The Appellants elected to proceed under General Procedure (the "GP Rules"), given that the new amount under dispute surpassed the $50,000 threshold.

Pursuant to GP Rule 57(1), the Minister was required to file a reply to the Appellants' amended notices of appeal 10 days after March 11, 2019. On April 5, 2019, nearly one month after filing the amended notices, each Appellant brought a motion for judgment in default.

The Tax Court heard the motions together on April 29, 2019 and dismissed both for the same reasons in the decision dated October 4, 2019.[8]

THE TAX COURT'S REASONS

The IP Rules Do Not Contemplate Amendments to Pleadings

The Tax Court found that the Appellants were never entitled to apply for default judgment under GP Rule 57(1), having initially elected the appeal to proceed by way of Informal Procedure. The Tax Court pointed out that whereas GP Rules 54 to 57 deal with amendments to pleadings for General Procedure cases, the same is not provided under the IP Rules. [9]

The implication of this lack of symmetry, however, cannot be that taxpayers are only entitled to amend proceedings under General Procedure. There is no authority for the statement that taxpayers under Informal Procedure may not amend their pleadings. In cases such as this, where the Minister has changed position with respect to a taxpayer's liability *after* the taxpayer has already filed a notice of appeal, surely the taxpayer should be equally entitled to amend its position, notwithstanding the taxpayer's decision to opt for Informal Procedure. The suggestion that choosing the Informal Procedure route precludes a taxpayer from responding to new allegations from the Minister strays far from the purpose of Informal Procedure, which is simply to efficiently administer cases below the $50,0000 threshold.[10]

More importantly, both the ETA and *Income Tax Act*[11] allow all taxpayers to amend notices of appeal in circumstances where the Minister has issued a reassessment after the taxpayer has already filed a notice of objection and notice of appeal.[12] Therefore, the Tax Court incorrectly suggests that the right to amend one's notice of appeal is restricted to taxpayers under General Procedure.[13]

The Appellants Attempted to Manipulate the Rules of Procedure

The Tax Court seems to be of the view that the Appellants tried to manipulate the rules of procedure to their advantage. From that perspective, the Appellants started the appeals under the Informal Procedure regime, but then pivoted into General Procedure in order to access GP Rule 57(1), the 10-day restraint on the Minister's reply to amended notices of appeal:[14]

> In the Original Notice of Appeal, the Appellant elected, under paragraph 18.3001(c) of the TCC Act, to have the appeal governed by the ETA IP Rules. She [Mrs. Rybakova] had the right to make that election. In the Amended Notice of Appeal, the Appellant purported to elect to have the GP Rules apply to her appeal.
>
> . . .
>
> It appears the focus was on moving quickly to amend the Original Notice of Appeal, perhaps to start the clock running for the Respondent's reply.

This perspective overlooks the critical fact that it was the Minister's Reassessments which pushed the amount in dispute "well" above the $50,000 threshold, which is the cap on eligibility for Informal Procedure.[15] Justice Monaghan at one point acknowledges that because of the new amount, the appeal *had to* proceed under the rules of General Procedure, pursuant to section 18.30022 of the TCC Act, unless the Appellants had exercised their right to limit the amount to $50,000, which they did not.[16] The normal course is thus to proceed by way of General Procedure where the amount in dispute is $50,000 or more. A fair appreciation of the sequence of events and of the Appellants' choices with respect to procedure must not overlook the Minister's role in precipitating the transition from Informal to General Procedure.

The Minister was Entitled to Another 60-Day Reply Period

The Tax Court's judgment hinges on whether the Minister was entitled to another 60-day reply period upon issuing the Reassessments or whether the Minister was subject to the 10-day reply period, pursuant to GP Rule 57(1).

The normal reply period to a notice of appeal is 60 days, whether the procedure applicable is General or Informal.[17] However, a shorter reply period applies under GP Rule 57(1) where amended pleadings are concerned.[18] As previously established, the Appellants were entitled to rely on this rule once the Minister increased the amount in dispute above the $50,000 threshold.

The only way to justify that the Minister was entitled to a new 60-day reply period is to find, as the Tax Court found, that the amended notices of appeal constituted entirely new appeals and that they were not a continuation of the original appeals.[19] Clearly, however, the Appellants did not instigate a new appeal when they filed the amended notices of appeal. As previously stated, it was the Minister who changed position in the Reassessments; the Appellants merely responded to this new position by amending their appeals.

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6 Paragraph 95.
7 Paragraph 11.
8 *Rybakov v. The Queen*, 2019 TCC 209 (T.C.C. [General Procedure]).
9 Paragraph 27.
10 Tax Court of Canada, *Court Process and Procedures: Income Tax & Excise Tax (GST)*, online: https://www.tcc-cci.gc.ca/tcc-cci_Eng/Process/GST.html#d.
11 R.S.C., 1985, c. 1 (5th Supp.) (the "ITA").
12 Section 302 of the ETA; subsection 165(7) of the ITA.
13 Paragraphs 27-29.
14 Paragraph 69 and 95.
15 Section 18.3001 of the TCC Act.
16 Paragraph 57.
17 See subsection 18.16(1) of the TCC Act, dealing with Informal Procedure; also see GP Rule 44.
18 GP rule 57(1).
19 Paragraph 24.

The Tax Court places great emphasis on the fact that a reassessment renders a previous assessment null and that, once a reassessment is issued, there is no opportunity for the taxpayer to appeal the earlier assessment.[20] Therefore, the argument goes, an amended notice of appeal must restart the clock for the Minister's 60-days to reply to the "new" notice of appeal.

If a taxpayer stands any chance of challenging the Minister's allegations, it goes without saying that the taxpayer must address the Minister's latest reassessment. Reassessments are entirely at the instance of the Minister. If the Minister is of the view that her initial assessment is incomplete or inadequate, it is her exclusive prerogative to do away with her original assessment and issue a reassessment in its place. Indeed, the Minister has three years under the ITA[21] and four years under the ETA[22] after the date of the original assessment of individuals to exercise this prerogative. The fact that a reassessment replaces the original assessment is not the point; what matters is that the taxpayer has no real choice but to respond to the reassessment if he or she has any hope of refuting the reassessment.

The TCC's Alternative Reasoning

The Tax Court sets out an alternative justification for its decision. The Tax Court reasons that even if one takes the view that the amended notice of appeal is a continuation of the original appeal rather than a new appeal, it would follow that the Appellants were still subject to the IP Rules, as they had originally elected, and were thus not entitled to apply for default judgment under the GP Rules:[23]

> . . .having elected to have the ETA IP Rules apply, the Appellant has no right to elect to have the appeal heard under the GP Rules. The only election provided to the Appellant is to have the ETA IP Rules apply. Once that election has been made, those Rules apply unless this Court orders that the GP Rules apply.

The Court will order a case to be "bumped up" from Informal to General Procedure under three circumstances, as set out in the TCC Act:

1. Section 18.3002: on application by the Attorney General of Canada.
2. Section 18.30022: where, before the start of the hearing of the appeal, it appears to the Court that the amount in dispute exceeds $50,000, and the appellant has not elected to limit the appeal to $50,000.
3. Section 18.30024: where the hearing of the appeal has begun, it appears to the Court that the amount in dispute exceeds $50,000, and the appellant has not elected to limit the appeal to $50,000.

Of the three rules above, the third does not apply to the Appellants' circumstance because the hearing had not yet commenced.

With respect to the first rule, no application was made by the Attorney General of Canada, but the Appellant did apply for the order and the Minister consented to the "bump up." The Tax Court nevertheless contends that because the order was not issued by the court until April 17, 2019, the IP Rules were still in effect when the Appellants had moved for default judgment, a right under General Procedure that was not available to the Appellants at that time.[24] The Tax Court does not comment on the unfairness or contradiction inherent in the position of the Minister that she was agreeable to the "bump up" order until she realized it would allow the Appellants to apply for default judgment against her.

The second rule mandates that the Court "bump up" a case to General Procedure at any time before the hearing of the appeal once it has discovered that the amount exceeds $50,000. The Appellants made no such election. Accordingly, the Court was obliged to issue the order and the Appellants were entitled to apply for default judgment as they did.

Put another way, the application of Informal Procedure expired upon the Minister's issuance of the Reassessments. Pursuant to the language of section 18.3001 of the TCC Act, the Informal Procedure only applies where (i) a person has so elected in the notice of appeal; and (ii) the amount in dispute does not exceed $50,000. With respect to (i), the Appellants clearly indicated their intention for Informal Procedure not to apply in their amended notices of appeal. With respect to (ii), the amount in dispute exceeded $50,000. Accordingly, upon the Minister's issuance of the Reassessments, the appeals no longer satisfied the conditions for Informal Procedure.

CONCLUSION

By focusing the issue on the Appellants' amended notices of appeal, this decision draws attention away from the fact that it was the Minister's Reassessments which substantially altered the case under dispute. Furthermore, the Minister changed her position two days before the replies were due and after benefitting from a 60-day extension from the Appellants.

The implication that the Appellants attempted to manipulate the rules of procedure to their advantage is unfair. The Appellants did nothing unusual by initially filing under Informal Procedure. It is administratively efficient — both for the taxpayer and the Minister — to process cases under the IP Rules where the case is eligible. They also did nothing wrong by invoking GP Rule 57(1), which became available to them once the application of the IP Rules no longer properly applied upon the Minister's issuance of the Reassessments. It is also important to note that the Appellants granted the Minister a two-month extension to file the replies and waited fruitlessly several weeks for such response before filing for default judgment.

It is harsh for the Minister to charge the Appellants an amount 65 times greater than originally assessed, only then to argue to deny the Appellants the usual GP Rules afforded to other taxpayers disputing assessments of similar magnitude. It also seems unusually unfair for the Court to endorse such a position.

The Appellants have appealed to the Federal Court of Appeal.

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[20] Paragraph 26.
[21] Paragraph 152(3.1)(b) of the ITA.
[22] Section 298 of the ETA.
[23] Paragraph 67.
[24] Paragraph 70.

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