// THE VALUATION LAW REVIEW

Volume 19, Issue 2
May 2013

Taxation Decisions and Legislative and Administrative Developments

The Valuation Law Review is a publication of the Canadian Institute of Chartered Business Valuators. This issue summarizes taxation law decisions of interest to business valuators. The Valuation Law Review is not intended to provide legal advice and readers should not act on information in the publication without seeking particular advice on matters that are of concern to the reader. Readers are cautioned against relying upon the decision abstracts contained herein, which are edited and in outline form only, and are directed to the full report of the reasons of the Court.

Editor:
Dennis Turnbull, CBV

For subscription information please contact:

The Canadian Institute of Chartered Business Valuators
277 Wellington Street West, 7th Floor
Toronto, Ontario M5V 3H2
Telephone: (416) 977-1117
E-mail: admin@cicbv.ca

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the CICBV.

© Copyright CICBV 2013

THE CANADIAN INSTITUTE *of*
CHARTERED
BUSINESS
VALUATORS™

Page 6

The Queen v. *GlaxoSmithKline Inc.*

Citation: 2012 SCC 52

This is a very significant Supreme Court of Canada decision that provides guidance for value determinations in transfer pricing issues. The issue was the determination of a reasonable arm's length price for ranitidine, a drug used by GlaxoSmithKline in manufacturing Zantac. GlaxoSmithKline paid a non-arm's length supplier a price for ranitidine in excess of the price paid by other Canadian pharmaceutical companies for generic equivalents. While the Tax Court agreed with the Minister that the generic equivalents served as acceptable comparisons for transfer pricing purposes the Federal Court of Appeal (FCA) did not. The FCA concluded that the Tax Court erred by relying on a misinterpretation of the term "reasonable amount" and that a transfer pricing determination had to consider, in addition to the generic comparables, the value to GlaxoSmithKline of licensing and supply agreements granted by GlaxoSmithKline's related international corporate group. The Supreme Court of Canada supported the FCA's position and remitted the case to the Tax Court to be redetermined having regard to the effect of the licence agreement on the value. As part of its decision the Supreme Court set out guidelines on how the Tax Court was to approach the issue of the determination of a reasonable arm's length price for transfer pricing purposes under section 69(2) of the *Income Tax Act*.

Page 10

Daishowa-Marubeni International Ltd. v. *The Queen*

2010 TCC 317
2011 FCA 267

In 1999 and 2000 *Daishowa-Marubeni* (*Daishowa*) sold two of its lumber divisions arm's length. As part of the transaction the purchasers agreed to assume reforestation liabilities imposed on Daishowa by the government of Alberta. The agreed sales prices were net of the estimated amounts of these liabilities. The CRA reassessed Daishowa on the basis that the assumption of the liabilities was part of the consideration it had received for the sales and increased Daishowa's proceeds of disposition by the estimates of the liabilities included in the sales agreements. Daishowa appealed CRA's reassessment arguing that the total proceeds of disposition should be net of the assumed liabilities. The Tax Court agreed with the Minister's position that the assumption of the liabilities constituted consideration but the Tax Court did not agree with the amounts by which the Minister increased the proceeds of disposition of the two sales. The Tax Court accepted Daishowa's argument that the liability amounts stated in the sales agreements were just estimates rather than precisely determined figures and concluded that the stated liability estimates should be discounted to present value. The decision was appealed and cross-appealed to the Federal Court of Appeal (FCA).

The FCA concluded that the Tax Court had made no error in determining that the purchasers' assumption of Daishowa's reforestation liabilities constituted part of the consideration paid for the properties. However the FCA did not agree with the Tax Court's discounting of the estimated future liabilities. The FCA said that the arm's length parties had contractually agreed to specific amounts for the assumed liabilities and Daishowa's proceeds of disposition should have been increased by these amounts.

On June 22, 2012 the Supreme Court of Canada granted leave to appeal. The case has been heard by the Supreme Court. Judgment has been reserved.

Page 16

Transalta Corporation v. *The Queen*

2012 FCA 20

This was an appeal of a Tax Court decision reviewed in *Valuation Law Review — Taxation* Volume 17, Issue 2, September 2011. The appeal was in respect to the allocation of the arm's length purchase price of Transalta Energy Corporation's assets and business. The issue under appeal was the existence, and amount, of goodwill in the sale of a regulated utility. The sales agreement had stipulated $190,000,000 in goodwill. The CRA reassessed Transalta on the basis there was no goodwill. The Tax Court allowed a $140,000 goodwill amount. The Federal Court of Appeal allowed Transalta's appeal and confirmed the original goodwill amount of $190,000,000.

Page 19

Aecon Construction Group Inc. v. *The Queen*

2012 TCC 160

This was a pre-trial motion at the Tax Court. The Crown brought the motion to ask that their proposed expert witness was not disqualified,

by reason of conflict of interest, from testifying for the Crown at a pending trial. Before being retained by the Minister the expert had discussed the issue under appeal with the appellant. Based on an analysis of the facts the motions judge concluded that the expert was not disqualified as an expert witness for the Minister because of conflict of interest.

Page 22

Barkwill et al v. *The Queen*

2012 FCA 34

This was an appeal to the Federal Court of Appeal from an unreported decision of the Tax Court of Canada dismissing six appeals that had been heard together on common evidence. In this case the six appellants took the unusual position of arguing that they should be allowed to establish the fair market value of shares without actually entering valuation evidence or expert evidence in support of their claimed values. Instead they claimed that the RRSP trustees who assigned value to the shares could be trusted to arrive at the correct value because of their adherence to regulatory compliance. The Tax Court did not accept this position and the Federal Court of Appeal agreed with the Tax Court.

Page 24

Kathryn Kossow v. *The Queen*

2012 TCC 325

This was a levered charitable donation scheme similar to *Maréchaux* (*Maréchaux* v. *The Queen*, 2010 FCA 287, reviewed in *Valuation Law Review—Taxation*, Volume 17, Issue 2, September 2011). The donated items were Rodin bronze castings apparently purchased arm's length for $6,000,000 and valued, for donation purposes, at $108,840,000. As part of the transaction the taxpayer had received a 25 year interest-free loan to finance the bulk of the donation. The Tax Court judge disallowed the entire donated amount including the taxpayer's personal cash donation on the basis that the Federal Court of Appeal decision in *Maréchaux* was determinative of the issue in this appeal.

Page 27

Allen Berg v. The Queen

2012 TCC 406

This case is a charitable donation decision where the issue was not the claimed fair market value of the donated property but whether the taxpayer could get a donation tax credit for his actual cash outlay for the property. The taxpayer had conceded that the property was overvalued by the amount in excess of his cash payment. The CRA had disallowed all of the claimed donation amount, including the cash. The Tax Court, after an extensive review of the jurisprudence in respect to the definition of "gift", allowed the appeal.

TWO EDITORIALS

Cases Reviewed in this Edition

This edition reviews a number of tax cases that are significant for valuators. Two have been heard at the Supreme Court of Canada and they offer guidance on how Canadian courts view important tax-related valuation issues.

GlaxoSmithKline Inc. is a major case for valuators involved in transfer pricing determinations. In this decision the Supreme Court of Canada set guidelines on how the Tax Court should approach the determination of what is a reasonable arm's length price for transfer pricing purposes under section 69(2) of the *Income Tax Act*. These guidelines are relevant to valuators because both the Canada Revenue Agency and the Tax Court will almost certainly refer to them in future transfer pricing disputes.

Daishowa-Marubeni International Ltd. involved a basic valuation issue: should a purchaser's assumption of a vendor's liabilities on a sale of property be included as part of the overall sales price of the property when determining the proceeds of disposition? Very simplistically the issue was the sale of timber rights with accompanying future timber reforestation liabilities. The arm's length parties reduced the otherwise determined price for the timber rights by the estimated amount of these liabilities. The Canada Revenue Agency increased the vendor's proceeds of disposition by the amount of the liabilities assumed. The Federal Court of Appeal made two significant findings on this issue. First; it ruled that the assumption of liabilities is to be included as part of proceeds. Second; it strongly supported the position that the asset allocation determined by the arm's length parties in their sales agreement overrode the Tax Court's conclusions about the fair market value of the properties. We have not as yet had the last word on this issue since the Supreme Court of Canada granted Daishowa leave to appeal. Leave was restricted to the consideration of two issues:

1) Are the reforestation liabilities to be included in the proceeds of disposition because the vendor is relieved of a liability or are they integral to and run with the forest tenures?
2) Does it make any difference that the parties agreed to a specific amount of the future reforestation liability?

The case has been heard by the Supreme Court of Canada but, as of the time of this writing, judgment has been reserved.

Transalta Corporation involved the issue of goodwill in regulated industries, in this case an electrical transmission utility. In the past it has been the Canada Revenue Agency's (CRA) position that there is no goodwill in regulated utilities because the rates that utilities can charge and their allowed rates of return are regulated by government bodies. The arm's length sale of Transalta's electrical utility business included a very significant goodwill amount as part of the asset allocation in the sales agreement. The Minister argued at Tax Court that there was no goodwill in the business. The Tax Court disagreed and allowed goodwill but reduced it significantly from the contractual

allocation. The Federal Court of Appeal supported the Tax Court's conclusion on the existence of goodwill but rebuked the Tax Court for determining an amount different than that agreed to between the parties. As a result the CRA's position that there is no goodwill in regulated utilities appears to be no longer viable. Also this decision, along with *Daishowa*, gives very strong judicial support for the acceptance of asset allocations determined by arm's length parties. This may give the CRA reason to reconsider the applicability of section 68 of the Act (the section used in both *Transalta* and *Daishowa*) in situations where the parties are clearly arm's length and there is at least a semblance of hard bargaining.

Aecon was a motion related to conflict of interest where one side's opinion expert had prior discussions with the opposing side on the valuation issue to be considered at trial. The Minister made a pre-emptive motion seeking an order that its expert was not disqualified from being retained by the Minister as an expert witness on the basis of conflict of interest. The Tax Court did a review of the expert's involvement with the appellant and found that there was no conflict. While a motion at Tax Court is not binding on other cases and the motion was determined based on the specific facts of the case the analysis used by the motion judge in arriving at his decision should be of interest to valuators. The case review gives an overview of the Tax Court's analysis but it is worthwhile to read the actual decision.

The Meaning of Gift

The issue of charitable donations has been considered at length in the previous five editions of this publication. Initially these cases involved donated tangible properties such as artwork, various sundries such as school supplies and toothbrushes, and vacation timeshare units. These schemes all shared the weakness of depending on inflated valuations to support the claimed donated amounts and all of these appeals failed at Tax Court. In response to the Tax Court decisions the promoters of these donation programs revised them to include only the donation of cash on the assumption that a donation of only cash could not be challenged by the CRA. The tax advantage was the use of borrowed funds through very long term interest-free loans. The tax credits for the donations could be claimed immediately while the loans, if they were ever paid off, were due decades in the future. Unfortunately for the taxpayers involved in these schemes these cash donations have proved just as vulnerable to reassessment as the prior property donations. The CRA has reassessed the participants in these programs to disallow all of their claimed donations including the cash components paid out of the participants' personal funds. In some cases, such as *Kossow* (reviewed in this edition) and *Maréchaux* (reviewed in *Valuation Law Review—Taxation*, Volume 17, Issue 2, September 2011) the Tax Court dismissed appeals where the taxpayers have attempted to get tax credits for their personal cash donations. However in *Berg* (reviewed in this edition) the Tax Court allowed the appellant to claim his personal cash payment as a charitable donation. These differing treatment depended on the specific facts of the cases and how the courts defined "gift" in respect to the purported donations. In *Berg* the Tax Court thoroughly reviewed the prior jurisprudence involving the interpretation of "gift" for tax purposes. It is recommended that any reader involved in this area read the entire *Berg* decision.

The Canada Revenue Agency recently published a letter giving the Agency's interpretation of the word "gift". This letter says, in part:

> **Document No. 2012-0469971E5**
>
> The term "gift" is not defined in the *Income Tax Act* (the Act) and therefore assumes its common law meaning. Under common law, a bona fide gift is a voluntary transfer of property from a donor, who must freely dispose of his or her property, to a donee, who receives the property given with no right, privilege, material benefit or advantage conferred on the donor or any person designated by the donor in exchange for the donor making the gift. Proposed sections 248(30) to (32) of the Act allow for the recognition of a gift for tax purposes in certain situations where a donor, or a person or partnership who does not deal at arm's length with the donor, receives consideration or other advantages for property transferred. Pursuant to proposed section 248(31) of the Act, the eligible amount of a gift is the excess of the fair market value of the property transferred to a qualified donee over the amount of the advantage provided. A qualified donee is defined in section 149.1(1) of the Act and includes municipalities in Canada registered by the Minister of National Revenue and registered charities.

The full text of the letter can be found at:

www.globalphilanthropy.ca/images/uploads/CRA_View_-Interpretation_of_a_Gift.pdf

CASE REVIEWS

The Queen v. GlaxoSmithKline Inc.
2012 SCC 52

The Tax Court decision of this case was reviewed in *Valuation Law Review—Taxation*, Volume 15, issue 3, December 2009. GlaxoSmithKline Inc. (Glaxo Canada) appealed the Tax Court decision to the Federal Court of Appeal (FCA). The FCA decision was reviewed in *Valuation Law Review—Taxation*, Volume 17, issue 2, September 2011. Both parties appealed the FCA decision to the Supreme Court of Canada (SCC) and leave to appeal was granted on March 24, 2011. Because the background, facts, and technical issues involved in the transactions leading to the initial assessment and the factors considered by the lower courts were explained in detail in the previous *Valuation Law Review—Taxation* editions this review will only give a very brief synopsis of the facts and the basis of the lower court decisions.

Between 1990 and 1993 Glaxo Canada purchased ranitidine, the active pharmaceutical ingredient in the drug Zantac, from Adechsa S. A. (Adechsa), a related non-resident company. Glaxo Canada paid Adechsa a significantly higher price for ranitidine than the price paid by Canadian generic pharmaceutical companies for the same drug. Glaxo Canada, as part of its agreement with Adechsa, signed two agreements, a licensing agreement and a supply agreement. The combined effects of these two agreements set Glaxo Canada's price for ranitidine and enabled Glaxo Canada to purchase ranitidine and market to it under the trademark Zantac.

The *Minister of National Revenue* (the Minister) reassessed Glaxo Canada for the taxation years 1990-1993 pursuant to the then applicable section 69(2) of the *Income Tax Act* (now s. 247(2)) on the basis that the prices Glaxo Canada paid for ranitidine were greater than an amount that would have been reasonable in the circumstances had Glaxo Canada been dealing on an arm's length basis with its suppliers. Before the Tax Court it was the Minister's position that the correct basis for determining an arm's length price was to use the prices paid by Canadian generic drug companies as comparables. Glaxo Canada argued that, in addition to a value determined through a comparison with generic prices, the value of at least some of the rights and benefits it enjoyed under the licence and supply agreements should be factored into the determination of an arm's length price. The Tax Court upheld the Minister's reassessment on the basis that the licence and supply agreements were to be considered independently of the ranitidine pricing issue. Based on this conclusion the Tax Court considered used only the Canadian generic drug prices as comparables.

The FCA found that the Tax Court erred in not considering the licence agreement when determining if the prices paid by Glaxo Canada for ranitidine were reasonable. The FCA concluded that the licence agreement was central to Glaxo Canada's business reality and would have been so even if Glaxo Canada and Adechsa had been arm's length. This was a circumstance which had to be taken into account when determining whether the prices Glaxo Canada paid for ranitidine were reasonable. Glaxo Canada argued that the FCA could decide on the issue of an arm's length price based on the

evidence before that Court. The FCA disagreed and remitted the matter back to the Tax Court for redetermination based on the FCA's reasoning.

The Minister and Glaxo Canada appealed and cross-appealed to the SCC. The Minister appealed on the basis that the FCA erred in determining that the licence and supply agreements should be considered as factors in determining an arm's length price for ranitidine. Glaxo Canada cross-appealed arguing that the FCA's decision to remit the matter to the Tax Court should be overturned and the initial reassessment set aside because Glaxo Canada had satisfied its burden as a taxpayer because it had "demolished" the Minister's assumptions.

The SCC started its analysis by quoting section 69(2) which deems an amount that was paid or payable in situations where the taxpayer has paid to a non-arm's length party more than the amount that would have been reasonable in an arm's length situation. The SCC noted that since section 69(2) does not offer guidance as to how to determine the "reasonable amount" courts, including the SCC, have referred to the Organisation for Economic Co-operation and Development's (OECD) 1979 *Guidelines* and the OECD's 1995 *Guidelines* (the Guidelines). While the Guidelines do not have the weight of law of Canadian statutes the Guidelines contained commentary and methodology pertaining to the issue of transfer pricing and they suggested a number of methods for determining whether transfer prices were consistent with prices determined between parties dealing at arm's length.

The SCC was of the view that it was critical in the determination of the reasonable price for the Tax Court to decide whether the licence agreement was to be included as a factor in the pricing. The Minister had argued at Tax Court that the SCC decision in *Singleton* (*Singleton* v. *Canada*, 2001 SCC 61, [2001] 2 S.C.R. 1046) and *Shell Canada Ltd.* v. *Canada*, [1999] 3 S.C.R. 622, along with the OECD Guidelines, required a "transaction-by-transaction" approach when determining the reasonable transfer price under s. 69(2). It was the Minister's position that the transaction-by-transaction approach was one in which the specific transactions at issue must be considered independent of surrounding circumstances so that the price that Glaxo Canada would have paid for ranitidine could not include any purported value Glaxo Canada received from the licence and supply agreements.

The SCC distinguished *Singleton* from the Glaxo Canada pricing issue. *Singleton* involved the deductibility of interest paid and payable on borrowed money under section 20(1)(c)(i) of the *Income Tax Act*. In *Singleton*, the taxpayer had used funds from his capital account at his law firm to assist in financing the purchase of a home. He then used borrowed funds to replace the funds he was withdrawing from his capital account. The sole issue in that case was whether borrowed money was "used for the purpose of earning income". The SCC concluded that the Tax Court in the *Glaxo Canada* case ignored the difference between section 20(1)(c)(i) and section 69(2). As the SCC pointed out, nothing in section 20(1)(c)(i) entitled a court to search for anything other than the use to which the borrowed funds were put. Section 20(1)(c)(i) did not require a comparison of transactions to determine if an interest deduction was reasonable. By contrast, section 69(2) requires the court to determine whether the transfer price was greater than the amount that would have been reasonable in the circumstances, had the parties been dealing at arm's length. On the same basis, the SCC concluded that *Shell Canada*, which also involved a reassessment under section 20(1)(c)(i) was also inapplicable in the case at hand.

The SCC commented on the Minister's reliance on paragraph 1.42 of the Guidelines to justify the transaction-by-transaction requirement. Paragraph 1.42 provided:

> "Ideally, in order to arrive at the most precise approximation of fair market value, the arm's length principle should be applied on a transaction-by-transaction basis."

The Minister had submitted that paragraph 1.42 required the court to focus only on the particular transaction at issue and therefore did not allow any consideration of any value added by the licence agreement. The SCC was of the view that the paragraph was not as restrictive as the Minister submitted, pointing out that the paragraph also stated:

> ". . . there are often situations where separate transactions are so closely linked or continuous that they cannot be evaluated adequately on a separate basis."

The SCC noted that while a transaction-by-transaction approach may be ideal, the Guidelines themselves recognized that it is not appropriate in all cases. Also the general statement in paragraph 1.15 of the OECD 1995 Guidelines regarding the arm's length principle provides guidance as to when related transactions should be taken into account:

> "Application of the arm's length principle is generally based on a comparison of the conditions in a controlled transaction with the conditions in transactions between independent enterprises. ***In order for such comparisons to be useful, the economically relevant characteristics of the situations being compared must be sufficiently comparable.*** To be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (e.g. price or margin), or that reasonably accurate adjustments can be made to eliminate the effect of any such differences." *[Emphasis added by SCC.]*

Therefore the SCC considered that a proper application of the arm's length principle requires an analysis of the "economically relevant characteristics" of the arm's length and non-arm's length circumstances to ensure they are "sufficiently comparable". Where there is no related transactions or where related transactions are not relevant to the determination of the reasonableness of the price at issue a transaction-by-transaction approach might be appropriate. However the SCC confirmed that the "economically relevant characteristics of the situations being compared" might make it necessary to consider other transactions that impacted the transfer price under consideration.

The SCC concluded that the Tax Court was in error when it found that it was precluded from considering the licence agreement. The SCC held that section 69(2) required an inquiry into all the circumstances of the Canadian taxpayer relevant to the price paid to non-resident suppliers. Such circumstances would include any agreements that might confer rights and benefits in addition to just the purchase of the ranitidine when the agreements were linked to the purchasing agreement. The objective was to determine what an arm's length purchaser would pay for the ranitidine when these rights and benefits were included as part of the purchase.

The Tax Court had found that "it was by virtue of the licence agreement that the appellant was required to purchase its ranitidine from Glaxo approved sources". The parties did not disputed this finding. There were only two approved ranitidine sources, one of which was Adechsa. The business of Glaxo Canada was the secondary manufacturing

and marketing of brand-name pharmaceuticals, including Zantac, which required the use of ranitidine. Therefore, If Glaxo Canada was to manufacture Zantac, it was required to purchase the active ingredient from one of these two sources. The SCC said that this requirement was not the product of the non-arm's length relationship between Glaxo Canada and Adechsa. It arose because the international Glaxo Group controlled the trademark and patent of the brand name pharmaceutical product Glaxo Canada wished to market. An arm's length distributor wanting to market Zantac might well be faced with the same requirement. The effect of this link between the licence and supply agreements was that an entity that wished to market Zantac was subject to contractual terms affecting the price of ranitidine that purchasers of the generic of ranitidine products were not.

The SCC noted that it was relevant that Glaxo Canada's function was primarily as a secondary manufacturer and marketer. It did not originate new products and therefore did not undertake the investment and risk involved in developing new products. Nor did it have the other risks and investment costs which the international Glaxo Group undertook. The prices paid by Glaxo Canada to Adechsa included payment for a bundle of rights and benefits under the licence and supply agreements. Since these prices were set, in part, as compensation to the international Glaxo Group for the rights conferred on Glaxo Canada under the licence agreement, this agreement could not be ignored in determining the reasonable amount paid to Adechsa under s. 69(2) because 69(2) applied to payments for services along with payments for goods. Based on these reasons the SCC concluded that the Tax Court should have considered the license agreement and supply agreement as factors in its review of a reasonable price for ranitidine.

The SCC therefore agreed with the FCA's conclusion that the Tax Court erred in refusing to take account of the licence agreement. A price determined using only the generic comparators did not reflect the economic and business reality of Glaxo Canada and, at least without adjustment, did not indicate the price that would be reasonable in the circumstances had Glaxo Canada and Adechsa been dealing at arm's length. The SCC stated that there were features of the licence agreement and the requirement to purchase from a Glaxo-approved source that added value to the ranitidine over and above the value of generic ranitidine without these rights and benefits. These rights justified some recognition when determining what an arm's length purchaser would be prepared to pay for the ranitidine under the same terms as Glaxo Canada. Since the Tax Court had not addressed this issue, the SCC agreed with the FCA's conclusion that the matter should be remitted to the Tax Court to be redetermined, having regard to the effect of the licence agreement on the prices paid by Glaxo Canada. The SCC stated that whether compensation for intellectual property rights was justified in this particular case was a matter for determination by the Tax Court.

As noted the basis of Glaxo Canada's cross-appeal of the FCC decision was that the FCC was wrong in its decision to remit the case to the Tax Court for redetermination. Glaxo Canada argued that it had satisfied its burden as a taxpayer because it had "demolished" the assumptions of the Minister. The SCC rejected this argument, noting that the FCA had remitted the case back to the Tax Court because the FCA did not feel that the taxpayer had discharged its burden of demonstrating that the prices it paid to Adechsa were reasonable under s. 69(2). The SCC agreed with the reasoning behind the FCA's decision to remit for reconsideration.

The SCC therefore dismissed the Minister's appeal with costs throughout and dismissed Glaxo Canada's cross-appeal with costs at the Supreme Court and remitted the matter to the Tax Court for redetermination.

As part of its decision the SCC offered guidance to the Tax Court on how to approach the issue of the determination of a reasonable price under section 69(2). This guidance is also of interest to valuators engaged in transfer price determinations:

> "[61] I would offer the following additional guidance with respect to the redetermination. First, s. 69(2) uses the term "reasonable amount". This reflects the fact that, to use the words of the 1995 Guidelines, "transfer pricing is not an exact science" (para. 1.45). It is doubtful that comparators will be identical in all material respects in almost any case. Therefore, some leeway must be allowed in the determination of the reasonable amount. As long as a transfer price is within what the court determines is a reasonable range, the requirements of the section should be satisfied. If it is not, the court might select a point within a range it considers reasonable in the circumstances based on an average, median, mode, or other appropriate statistical measure, having regard to the evidence that the court found to be relevant. I repeat for emphasis that it is highly unlikely that any comparisons will yield identical circumstances and the Tax Court judge will be required to exercise his best informed judgment in establishing a satisfactory arm's length price."

> "[62] Second, while assessment of the evidence is a matter for the trial judge, I would observe that the respective roles and functions of Glaxo Canada and the Glaxo Group should be kept in mind. Glaxo Canada engaged in the secondary manufacturing and marketing of Zantac. Glaxo Group is the owner of the intellectual property and provided other rights and benefits to Glaxo Canada. Transfer pricing should not result in a misallocation of earnings that fails to take account of these different functions and the resources and risks inherent in each. As discussed above, whether or not compensation for intellectual property rights is justified in this particular case, is a matter for determination by the Tax Court judge."

> "[63] Third, prices between parties dealing at arm's length will be established having regard to the independent interests of each party to the transaction. That means that the interests of Glaxo Group and Glaxo Canada must both be considered. An appropriate determination under the arm's length test of s. 69(2) should reflect these realities."

> "[64] Fourth, in this case there is some evidence that indicates that arm's length distributors have found it in their interest to acquire ranitidine from a Glaxo Group supplier, rather than from generic sources. This suggests that higher-than-generic transfer prices are justified and are not necessarily greater than a reasonable amount under s. 69(2)."

Daishowa-Marubeni International Ltd. **v.** ***The Queen***
2010 TCC 317
2011 FCA 267

Daishowa-Marubeni International Ltd. (Daishowa) sold two of its timber mill divisions in arm's length transactions in 1999 and 2000. The High Level division was sold to Tolko Industries (Tolko) and the Brewster division was sold to Seehta Forest Products Ltd. (Seehta). Part of the agreement in both sales included a provision for the assumption by the purchasers of Daishowa's reforestation liabilities. The Canada Revenue Agency reassessed Daishowa by including in its proceeds of disposition of timber resource

properties the amount of the estimated reforestation liability, being $11,000,000 in the Tolko sale and $2,996,380 in the Seehta sale. Since both transactions had similar facts and the courts applied similar reasoning to both this analysis focuses only on the Tax Court and Federal Court of Appeal (FCA) reasons for judgment related to the sale of the High Level division.

For the purpose of this review only the Tax Court and Federal Court of Appeal (FCA) reasons for judgments for the sale of the High Level division to Tolko will be reviewed because both sales had similar facts and the Courts applied the same reasoning to both.

The facts of the case are straightforward. Daishowa decided to sell its High Level division in 1999 and, of five bids, from Tolko's was the most favourable. Tolko proposed a purchase price of $180,000,000 plus an amount equal to the estimated value of the net purchased working capital less the estimated amount of the long-term reforestation liabilities of the division. The reforestation liabilities were the future costs of reforestation management to restore the timber properties after they had been cut. The government of Alberta imposes these costs on the holder of forest tenures and requires that these future liabilities be assumed by any purchaser of the tenures.

Daishowa's professional advisors raised concerns that the pricing formula proposed by Tolko would have adverse tax consequences for Daishowa because it set a gross price and then deducted from that price the amount that was estimated to be payable for the long term reforestation liabilities. If the sale was carried out this way the amount allocated to the reforestation liabilities would be included in Daishowa's proceeds of disposition and would be subject to tax. Daishowa was advised that the same end result, without the additional tax liability, could be achieved by restructuring the purchase price and adjustment provisions of the agreement to eliminate the inclusion of Tolko's assumption of Daishowa's reforestation liability in the purchase allocation.

Tolko agreed to revise the terms of its bid. Instead of a stated $180,000,000 gross sales price plus net working capital, the revised contract was for a $169,000,000 gross sales price plus net working capital. The $11,000,000 difference was the amount of the estimated future reforestation liabilities assumed by Tolko and was addressed in the sales contract as:

> "3.2.1 Preparation of Reforestation Statement. DMI estimates in good faith that the aggregate value of the current and long term reforestation liabilities will be $11 million as at the Effective Time (Estimated Amount). Forthwith after the Closing, DMI will prepare the Reforestation Statement setting out the current and long term reforestation liabilities associated with the Division as at the Effective Time and will cause the Reforestation Statement to be audited promptly by the Accountants...."

Daishowa's 1999 income tax return reported a gross sales price of $169,000,000 for the High Level division. The Minister of National Revenue reassessed Daishowa by including the $11,000,000 estimated reforestation liability in the proceeds of disposition and Daishowa appealed the reassessment.

The Tax Court judge identified three issues in the case:

a) whether the Minister properly included in Daishowa's proceeds of disposition the amounts of reforestation obligations assumed by the purchasers in 1999 and 2000.

b) whether these additional assessed proceeds of disposition were properly allocated to timber resource properties; and

c) whether Daishowa was entitled to any deductions in respect of the assumed reforestation obligations.

This review will consider only the issue of whether the Minister properly included the reforestation obligations in Daishowa's proceeds of disposition and, if so, what were the amounts to be included.

Daishowa argued that while it may have received some benefit from Tolko's assumption of the reforestation liabilities, the fair market value of those liabilities was not determinable at the time of closing and therefore no amount in respect of the reforestation liabilities could be included in Daishowa's proceeds of disposition. Alternatively, Daishowa argued that if the fair market value of the reforestation liabilities at the time of closing could be determined, it would be less than the accounting estimates of the liabilities because the $11,000,000 amount in the sales agreement reflected amounts that were to be spent on reforestation over the next 14 years and were not discounted to reflect this fact.

The Minister's argument was that the price in both sales included the assumption of the liabilities as part of the consideration. The transfer of the reforestation liabilities gave Daishowa relief from further obligation to the Province of Alberta. The Minister argued that it was clear that the Tolko offer was for $180,000,000 and was adjusted downwards to take into account the amount of the reforestation liability. The statement of allocation of the purchase price in the final sales agreement gave a value of $20,000,000 for the forest tenures. The Minister argued that the actual price Tolko paid for the tenures was $31,000,000, which was paid as $20,000,000 in cash and $11,000,000 for the assumption of the liability. Daishowa argued that the stated $20,000,000 was the total price paid for the tenures.

The Tax Court first considered the issue of whether the assumption of the reforestation liability constituted consideration to Daishowa. The court concluded that it did. Daishowa had acknowledged that it had received a benefit by the transfer of the liability. The judge pointed out the fact that Daishowa had admitted that "if Tolko had not assumed the appellant's reforestation liability, the amount of cash or other consideration it would have paid the appellant would have increased" and led the judge to remark, at paragraph 24 of his Reasons:

> "[24] Given that acknowledgement and admission, it is difficult to find the assumption of liability is not part of the consideration in the deal notwithstanding Daishowa took great pains to have that element of the deal removed from the definition of purchase price in the final agreement."

The Tax Court then considered whether the exclusion of the liability from the purchase price had the legal effect of removing it from the consideration for the forest tenures and therefore from the proceeds of disposition. The court decided that it did not since allowing the parties to exclude it would be putting form over substance in the interpretation of the contract.

Having concluded that the assumption of the reforestation liability represented part of the consideration paid by Tolko the court addressed Daishowa's position that the value of the benefit was so uncertain as to be unascertainable and therefore should not be included in consideration. The Minister had contended that the parties had agreed to an $11,000,000 amount, even if they had called it an estimate. The Tax Court did not agree with the Minister's position and concluded that the estimate had

not been included in the agreement in the context of determining the sales price of the High Level division but to determine the cash payment amount. There was nothing in the sale agreement that constituted an agreement between the parties that Daishowa received additional consideration of $11,000,000 by Tolko's assumption of the reforestation liability.

While the Tax Court agreed with Daishowa's position that the liability amount was just an estimate the court did not agree with the argument that the actual amount of the liability was so uncertain that it should be excluded entirely from the proceeds of disposition. The Tax Court considered the jurisprudence submitted by Daishowa on this point to be too "overly broad" to interpret the cases as supporting a general principle that if an amount is uncertain it cannot be subject to tax.

However the Tax Court considered the uncertainty of the amount to be a factor to be taken into account. The liability estimate was based on Daishowa's calculation of what would have to be spent over the next several years but the Tax Court noted that it had not been discounted to a present day value. The Tax Court decided that the "fair approach" was to include in proceeds of disposition an amount for the assumption of the liabilities that included the current year's reforestation liability at the time of the sale of $2,057,498 and only 20% of the long-term portion of the liability. The court therefore discounted the estimated long-term liability of $9,238,727 by 80%. This resulted in a total amount of $3,905,244 that the court concluded should be added to Daishowa's stated proceeds of disposition. The Tax Court used the same approach to determine the amount to be included in Daishowa's proceeds of disposition on the sale of the Brewster division to Seehta. Both parties appealed the decision to the FCA.

At the FCA Daishowa argued that the Tax Court judge erred in including Tolko's assumption of the reforestation liabilities in its proceeds of disposition. In the alternative, Daishowa argued that it was entitled to an offsetting deduction equal to the amount included in the proceeds of disposition. In its cross-appeal, the Minister argued that the Tax Court erred in ignoring the values attributed by the parties to the reforestation liabilities pursuant to their respective contracts, adding that it was not open to the Tax Court to arrive at values other than those agreed to by the parties.

The FCA addressed a number of issues, three of which are relevant to this review:

Issue 1 — Did the judge err in concluding that the reforestation liabilities assumed by the purchasers were to be included in Daishowa's proceeds of disposition for the 1999 and 2000 taxation years? If the judge made no error in so concluding, did the parties to the agreements of sale agree to attribute a value to the reforestation liabilities assumed by the purchasers and, if so, what consequences flow from attributing values thereto?

The FCA concluded that the Tax Court had made no error in determining that the assumption of Daishowa's reforestation liability by Tolko constituted consideration that should have been included in Daishowa's proceeds of disposition. The FCA noted that Daishowa had acknowledged in the admitted facts that it received a benefit by Tolko accepting responsibility for the liability. Daishowa had also admitted that if it had retained the liability the sales price for the High Level project would have been higher.

The Tax Court had referred to a definition of "consideration" given by the author of Fridman's *The Law of Contract in Canada*, 4th ed. as "some right, interest, profit, or

benefit accruing to one party or some forbearance, detriment, loss or responsibility, given, suffered or undertaken by the other". The FCA noted that the Tax Court held that an assumption of liability and a promise to indemnify clearly fell within the meaning of the word consideration. This assumption of liability was included in article 3 of the agreement of sale which provided that Tolko would be responsible for the reforestation liability and that it would hold Daishowa harmless in respect of that liability. Based on this the FCA agreed with the Tax Court's conclusion that the assumption of the forestry liability constituted consideration.

The FCA then considered whether the parties had agreed to a value for the reforestation liability. The FCA concluded that a proper interpretation of the sales contract showed that the parties had agreed to attribute a value to Tolko's assumption of Daishowa's reforestation liability and it was therefore not open to the Tax Court to discount the long-term liability by 80%. The FCA stated that although article 3.2.1 of the contract referred to the valuation as an "estimate" all subsequent references to the reforestation liabilities strongly suggested that the amounts were not merely estimates, but actual values. The word "value" was specifically used in connection with the reforestation liabilities referred to in article 3.2.1. Thus, in the FCA's opinion, there was nothing in the contract itself which rendered doubtful the fact that the parties attributed a specific and agreed value with regard to the reforestation liability. The precise quantification by the accountants lent strong support to the view that the reforestation liability was part of the consideration. Based on this the FCA concluded that the true purpose of article 3.2.1 was to determine the "aggregate value of the current and long term reforestation liabilities" and to ensure that the cash portion of the consideration corresponded with the assumption of liabilities portion. The FCA commented:

> "[65] With respect, the Judge appears to have elevated the significance of the words "estimated amount" found at article 3.2.1 to a level which led him to ignore the plain wording of article 3.2.1 in its totality."

The FCA summed up its discussion of this issue by concluding that the provisions of the contract were not ambiguous. The parties agreed to accept $11,000,000 as consideration for the assumption of the appellant's reforestation liability, subject to the specified adjustment procedure. Since the parties had agreed to a value of $11,000,000 for the reforestation liability Daishowa should be held to that amount for income tax purposes.

Issue 2 — Was the trial judge correct in concluding that only 20% of the long-term reforestation liability should be included in the appellant's income as proceeds of sale in the relevant tax years?

On this issue the FCA concluded that, since the parties agreed to attribute a value to the reforestation liability assumed by Tolko, it was not necessary to discuss this question other than to say that the judge erred in including only 20% of the long term reforestation liability in the appellant's income as proceeds of sale for its 1999 taxation year.

Issue 3 — Did the judge err in allocating the $11,000,000 in respect of the reforestation liability to the timber resource property as opposed to allocating it to goodwill?

Daishowa submitted that if additional amounts must be included in its proceeds of disposition for the 1999 taxation year, these amounts should be allocated to goodwill

rather than in respect of the timber resource property transferred to Tolko. The FCA thought that the Tax Court's allocation was correct since it was admitted by the parties that neither Daishowa nor Tolko had attributed any value to goodwill in the sale of High Level and the transfer of the forest tenure.

The FCA stated:

> "[103] The respondent argues that parties cannot reallocate consideration in a transaction "when it suits them for tax purposes" (para. 49 of Respondent's Memorandum of Fact and Law). I agree. Consideration in the form of the assumption of reforestation liability cannot be allocated to anything other than the forest tenure to which it is inextricably linked, given that the reforestation obligation is integral to the transfer of the forest tenure under the FMA . . . . ."

Therefore the FCA had no difficulty in concluding that the assumption of liability by Tolko should be allocated to the timber rights as it constituted an integral part of the transfer of the forest tenure.

The FCA dismissed Daishowa's appeal and allowed the Crown's cross-appeal. The $11,000,000 estimate of the transferred future reforestry liability was added to Daishowa's proceeds of disposition on the sale on the basis that the Tolko's assumption of the liability constituted consideration.

This was a majority decision with one dissenting opinion. The dissenting judge stated:

> "[128] In my view, the Tax Court judge erred in this case by assuming that the assumptions of the reforestation liabilities by the purchasers in the sales transactions at issue were a separate and distinct consideration for the sales of the tenures whose value necessarily had to be added to the proceeds of the disposition of the sales. I am rather of the view that the reforestation liabilities form an integral part of the forest tenures, and though they affect the value of the tenures, they are not a separate consideration of the sale transactions involving the tenures, and should thus not be added to the vendor's proceeds of disposition resulting from those sales."
>
> "[130] The proper approach in these proceedings is to recognize that the reforestation liabilities at issue depress the value of the timber resources properties to which they are inextricably linked, and that consequently the vendor in this case received a lower price on the sale of these properties than it might have otherwise received. On this basis alone, I would allow the appeal and dismiss the cross-appeal."

The FCA decision was appealed to the Supreme Court of Canada. The Supreme Court granted leave to appeal on two issues:

1) Are the reforestation liabilities to be included in the proceeds of disposition because the vendor is relieved of a liability or are they integral to and run with the forest tenures?
2) Does it make any difference that the parties agreed to a specific amount of the future reforestation liability?

The case has been heard by the Supreme Court but judgment has been reserved.

Transalta Corporation* v. *The Queen
2012 FCA 20

This was an appeal and cross-appeal of a decision of the Tax Court of Canada regarding the valuation of goodwill in relation to the sale of a regulated electricity transmission utility. The Tax Court decision was reviewed in *Valuation Law Review—Taxation*, Volume 17, Issue 2, September 2011.

In brief the issue at the Tax Court was the allocation of the purchase price between net tangible assets and goodwill in an $800,000,000 sale of Transalta Energy Corporation's (Transalta) assets and business to AltaLink Limited Partnership (AltaLink) in 2002. In the purchase and sale agreement Transalta and AltaLink allocated approximately $190,000,000 to goodwill and $602,000,000 to net tangible assets. Canada Revenue Agency, relying upon section 68 of the *Income Tax Act*, allocated nothing to goodwill on the basis that no goodwill exists in a regulated industry. Transalta's position was that the value allocation was the result of arm's length hard bargaining and the amounts determined could not be regarded as unreasonable. The Tax Court judge determined his own allocation of the asset values and arrived at a goodwill amount of $140,000,000. Both parties appealed to the Federal Court of Appeal (FCA) and, in an unusually sharp criticism of the Tax Court's decision, the FCA unanimously allowed Transalta's appeal, accepted Transalta's originally claimed goodwill value, and dismissed the Minister's cross-appeal.

The FCA first reviewed the concept of goodwill noting that it has evolved from the former meaning of pertaining to the good name, reputation, and overall customer relations and has now taken on a broader meaning influenced by economic, accounting and valuation theories. The court summarized that goodwill has three characteristics: (a) it must be an intangible; (b) it must arise from the expectation of future earnings, returns or other benefits in excess of what would be expected in a comparable business; and (c) it must be inseparable from the business to which it belongs and cannot normally be sold apart from the sale of the business as a going concern.

Noting that an established reputation; customer satisfaction; a unique product or process leading to a monopolistic position; good or astute management; favourable location; manufacturing efficiency; harmonious labour relations; advertising quality of products; and a good financial standing have all been found to constitute goodwill insofar as they meet these three characteristics the FCA was of the view that, in this case, efficient management by Transalta and the potential for new business opportunities flowing from Transalta's transmission business could be viewed as goodwill. These intangible assets arose from the expectation of future earnings, returns or other benefits in excess of what would be expected in a comparable business. As such they were inseparable from the business to which they belonged and could not be sold apart from the sale of the business as a going concern. Applying this meaning of goodwill the FCA agreed with the Tax Court that the Minister was wrong in law to take the position that no goodwill could exist in a regulated industry.

The FCA noted that the Tax Court had reviewed the individual factors that Transalta had claimed were components of goodwill. While the Tax Court he accepted most of them it concluded that the potential for financial leverage and the potential tax benefit from one of the purchasers being non-taxable were not part of Transalta's goodwill. The Tax Court allocated the amounts attributed to these items to the tangible assets.

The FCA considered whether the Tax Court erred in finding that leverage and the tax allowance were not part of goodwill. The Tax Court judge had excluded the potential for financial leverage from goodwill because he felt the leverage was dependant on the rate of earnings which in turn was based on the net regulatory book value of the tangible assets and was therefore logically part of the tangible asset values. The FCA found that:

> "[62] Contrary to the narrow concept of goodwill applied by the Tax Court judge, goodwill is not limited to the retention or expansion of a customer base. Goodwill will also arise if a business can potentially generate returns in excess of what would be expected in a comparable business. The potential for leverage in the transmission business is an intangible asset which, if prudently used, can potentially lead to additional returns. The fact that Transalta itself did not leverage its investment in its electricity transmission business does not mean that the potential for excess returns resulting from leverage is not one of the intangible assets which it held in that business. The potential for leverage is an intangible asset which can be marketed and sold to potential purchasers of a business who have the ability to use it."

The FCA was of the view that the financial leverage was inseparable from the business, and the potential for leverage could not be sold apart from the sale of the business as a going concern. Based on this the potential for financial leverage held all the characteristics of goodwill and was part of the goodwill sold with the transmission business. The FCA also disagreed with the Tax Court's conclusion that the potential tax allowance benefit of having a non-taxable entity as one of the purchasers did not constitute goodwill. The FCA considered that it was not unreasonable for the parties to the transaction to allocate any value in the tax advantage to goodwill for the purposes of section 68 of the Act. Section 68 sets up a reasonableness test for the purposes of a price allocation so an amount that was not "goodwill" in the legal sense of the concept may still have been allocated to "goodwill" for accounting and taxation purposes if the allocation could be regarded as reasonable. In this case, since the allocation of the potential tax allowance benefit could not be made to the tangible assets, any portion of the premium that could be attributed to the potential tax allowance benefit would receive the same treatment as if it were goodwill for accounting and taxation purposes. In such circumstances, the parties' allocation of the tax allowance to goodwill could be regarded as reasonable for the purposes of section 68 of the Act.

The FCA acknowledged that goodwill was inherently difficult to value and that different aspects of goodwill are given different values depending on the circumstances. For this reason the FCA concluded that the residual approach to valuing goodwill was preferred. This was the method used by both the Minister's expert and Transalta's expert. In choosing this method the FCA said:

> "[70] The fact that some intangible elements that do not constitute "goodwill" in the legal sense may be captured through such a valuation method (note — the residual method) — such as the potential tax allowance benefit — does not mean that the valuation method is wrong or improper. The method simply reflects the fact that these types of intangibles should be treated as goodwill for all practical purposes — including accounting and taxation purposes — even though they may not squarely fall under the legal concept of goodwill."

The next issue the FCA considered was the legal test for "reasonableness" in respect to goodwill allocations for the purposes of section 68 of the Act. The FCA referred to

the *Gabco* test from the decision in *Gabco Limited* v. *Minister of National Revenue* (1968), 68 D.T.C. 5210 (Ex. Ct.):

> "It is not a question of the Minister or his Court substituting its judgment for what is a reasonable amount to pay, but rather a case of the Minister or the Court coming to the conclusion that no reasonable business man would have contracted to pay such an amount having only the business consideration of the appellant in mind."

Noting that the *Gabco* test was used for determining if the deduction of an expense was reasonable for the purposes of section 67 of the Act (*Petro-Canada* v. *Canada*, 2004 FCA 158, 2004 D.T.C. 6329 at para. 62) the FCA thought it was equally applicable was for the purpose of reasonableness under section 68 of the Act. The FCA stated:

> "[75] The concept of reasonableness under section 68 of the Act is similar to that used for the purpose of section 67 of the Act. Consequently, for the purpose of section 68 of the Act, I conclude that an amount can reasonably be regarded as being the consideration for the disposition of a particular property if a reasonable business person, with business considerations in mind, would have allocated that amount to that particular property. In this context, long-standing regulatory and industry practices, as well as auditing and valuation standards and practices, are relevant."

The FCA commented that the fact that the parties to an agreement had made an allocation was not determinative of reasonableness for purposes of section 68 but it was an important fact to consider.

The FCA pointed out that the Tax Court judge had applied a two-tiered process for determining reasonableness under s. 68. The first step was to determine if the agreed allocation in an arm's length transaction was the result of real bargaining. If it was then the agreed allocation was *prima facie* proof of reasonableness. If there was no real bargaining between parties in an equal bargaining position, then the second step was for the court to determine a range of what was reasonable based on the nature of the asset, the industry, the context of the transaction and "other relevant criteria".

Using this process the Tax Court judge concluded that the parties to the transaction had not engaged in real bargaining because the purchaser was indifferent to an allocation of the price to goodwill beyond the net regulatory book value of the tangible assets. As a result of this conclusion the Tax Court judge to proceeded with his own valuation.

The FCA rejected the two-tiered test process used by the Tax Court because was complex. it set out no guiding principles, and it was based partly on form, which allowed the Tax Court judge to substitute his own subjective allocation for that agreed upon by the parties in compliance with industry and regulatory standards. As the FCA saw it:

> "[82] Had the Tax Court judge applied the correct test, and considered whether a reasonable business person, with business considerations in mind, would have allocated the amount of $190,824,476 to goodwill, he would have been compelled to consider industry and regulatory standards, as well as accounting and valuation theory, which all point in the direction of the agreed allocation. That agreed allocation was reasonable precisely because of its compliance with industry and regulatory norms and its consistency with standard valuation theory for regulated businesses and standard accounting principles applied in such industries."

Based on this reasoning the FCA allowed Transalta's appeal and set aside the Tax Court's judgment. Costs were awarded to Transalta.

The Federal Court of Appeals' strong support of the appellant's position on the determination of goodwill in regulated industries is significant for the future tax treatment of this issue. The FCA's overall position on the existence and valuation of goodwill in a regulated business can be summed up in one paragraph from the decision:

> "[8] Because of the very nature and purpose of the regulatory process, the net regulated book value of the regulated tangible assets of the transmission business at issue in this case may reasonably be understood as reflecting the fair market value of those assets. The regulated book value of the regulated assets is one of the bases upon which the regulatory authorities determine the regulatory rate of return. The industry standard allows for the allocation to goodwill of any premium paid above the net regulated book value of those assets. Such a premium can reasonably be understood as the value of the special advantages of the transmission business which allow it to potentially achieve returns in excess of what is deemed by its regulator to be a normal market return. The reasonableness of this long-standing industry practice is supported in this case by the regulatory process itself and by valuation and accounting theory and practice. The allocation of such a premium to goodwill can thus be regarded as reasonable for the purposes of section 68 of the Act."

Aecon Construction Group Inc.* v. *The Queen
2012 TCC 160

This was a pre-trial motion brought by the Minister (Respondent) requesting an order that Graham Farquharson of Strathcona Mineral Services Limited not be disqualified, by reason of conflict of interest, from being retained by the Respondent as an expert witness in a pending Tax Court trial regarding the value of a mining property. The Tax Court judge summarized the issues as:

> "[15] The issues in this motion are:
>
> (a) Should the decision of whether Mr. F be disqualified, by reason of conflict of interest, be left to the trial judge, or can my decision on this interlocutory motion bind the trial judge?
>
> (b) Is Mr. F disqualified as an expert witness for the respondent by reason of conflict of interest?"

At issue in the underlying case is the amount that Aecon Construction Group (Aecon) could deduct as Canadian development expenses under s. 66 of the *Income Tax Act*. In 1993 Aecon, through predecessor corporations, purchased mining properties located near Elson, Yukon. Aecon contended that the fair market value of the property was $32 million at that time while the Respondent claimed that it amounted to no more than $3 million. Both parties plan to call expert witnesses at trial to support their conclusions of value.

At the time of the 1993 purchase of the mining properties Aecon relied on a valuation report prepared by Ross Lawrence of Watts, Griffis and McOuat (Watts). During the course of the Canada Customs and Revenue Agency (CCRA) audit Watts prepared an additional analysis dated September 21, 2000, which was submitted to the CCRA. Aecon also retained Christopher Lattanzi of Micon International Limited as an additional expert.

By June 18, 2001, Aecon had also contacted two senior mining valuation experts, Graham Farquharson of Strathcona Minerals Services Limited and William Roscoe of Roscoe Postle and Associates. Aecon did not retain either of these expert but information on the property was disclosed to both of them.

CCRA's initial valuation analysis of the property was done by Gerry Martin from the business valuations team at the Calgary Tax Services Center. Mr. Martin was assisted by Paul Hawkins & Associates, a mining consulting firm from Calgary. Aecon was reassessed using Mr. Martin's value.

Aecon filed as notice of appeal of the assessment on November 12, 2010. By April 15, 2011 the Minister contacted Mr. Farquharson as a potential witness and learned that he had been previously contacted by Aecon. The Minister also contacted Mr. Roscoe but Roscoe withdrew as a potential expert witness for the Minister a month later, explaining to the Minister:

> "The fact that we received a binder of documents implies there was confidential information in addition to the Watts Firm report. The fact that we invoiced for our work certainly would give the perception of a conflict of our part. Aecon personnel may have notes that reinforce the potential for conflict of interest."

The Minister notified Aecon in September 2011 that it had contacted Mr. Farquharson and that it was the Minister's position that Aecon's prior contact with Mr. Farquharson would not disqualify him from being retained as an expert for the Minister. Aecon disagreed with this position so the Minister brought a motion to determine the issue prior to the trial.

Mr. Farquharson's recollection of his first contact with Aecon was a June 20, 2001 visit by Neil Bacon, Aecon's vice president and controller and Aecon's counsel. They asked Mr. Farquharson if he was able to participate in a review of a mining investment that was in dispute with the CCRA. Mr. Farquharson advised Aecon that he was unlikely to agree with the opinion expressed by Watts because of his previous dealings with Watts in another litigation. After the meeting, Mr. Farquharson sent Mr. Bacon a letter that described how he was on opposite sides with Watts in the previous case.

Mr. Farquharson's last meeting with Mr. Bacon was on July 11, 2001 after Farquharson had reviewed correspondence, files, and diaries provided by Aecon. Before that, on May 2, 2011, Mr. Farquharson had written to Aecon's counsel stating that he "declined to be creative" in respect to counsel's comment that they were expecting him to be creative in their response to the CCRA. Mr. Farquharson believed that the July 11, 2001 meeting resulted in Aecon not having any further interest in discussions with him.

On May 16, 2011, Mr. Farquharson wrote a letter to the Minister's counsel addressing counsel's concerns regarding a possible conflict issue. He wrote that he had never signed a retainer or any agreement to undertake any assignment on behalf of Aecon; had never received any payment from Aecon; did not recall any specific information from Aecon he reviewed but, given the note in his diary, he acknowledged that he must have been given some documentation to review at the initial meeting. He said it may have been the Watts valuation report but he could not recall specifically. He also stated that he did not establish a project file for this matter, he did not recall any request for confidentiality or discuss any specific legal strategy other than the suggestion that he take an approach with which he was not comfortable and that he had not expected to hear anything further on the matter.

The judge hearing the motion started his analysis with a comment on the admission of expert testimony:

> "[16] It is well-known that before expert testimony can be admitted, the expert must be properly qualified as such. That is for the trial judge to decide. According to the Supreme Court of Canada in *R.* v. *Mohan*, [1994] 2 S.C.R. 9, the admission of expert testimony is a two-fold process. First, the witness must be qualified on the basis of the following four criteria, namely: relevance, necessity in assisting the trier of fact, the absence of any exclusionary rule and proper qualifications. Once the evidence is heard on the expert witness' qualifications, the judge is to then rule on the areas he may testify on. In particular, it may be all the relevant areas counsel has moved the Court for the witness to testify to or only some of the areas or none at all."

The judge then stated that, in his opinion, the interlocutory motion was not really about the pre-clearance of an expert but rather about resolving one party's challenge of the retention of a particular expert. If the motion had been about pre-clearance the Court would have been required to consider the four *Mohan* criteria but challenges related to the retention of a particular expert could be resolved by an interlocutory motion. The judge based this conclusion on provisions of the recently amended *Federal Courts Rules*, which read as follows:

> "52.5 (1) A party to a proceeding shall, as early as possible in the proceeding, raise any objection to an opposing party's proposed expert witness that could disqualify the witness from testifying.
>
> (2) An objection may be raised
>
> (a) by serving and filing a document containing the particulars of an basis for the objection; or
>
> (b) in accordance with section 262(2) or subparagraph 263(c)(i) if, in the case of an action, the objection is known prior to the pre-trial conference."

The judge stated that the reason for this rule is to allow a party to enter reasons why a particular expert should be disqualified as early as possible. The underlying policies are to save cost, avoid risk of delay at trial and, globally, to streamline the trial process. Noting that the Tax Court is not yet governed by such a rule the motion judge believed there was sufficient discretion conferred on him to dispose of the matter. The motion judge considered that the Respondent was not asking whether evidence should be admissible or not. It was not a motion for a final determination that Mr. Farquharson was qualified to give opinion evidence at trial. In the motion judge's opinion the question in the motion was therefore not an evidentiary matter that was solely for the trial judge to decide.

Citing *Abbott Laboratories* v. *Canada (Minister of Health)*, 2006 F.C. 340 as the leading authority on whether an expert should be disqualified the judge listed five principles to be considered:

> "– whether the expert knew he or she was receiving confidential information, with the expectation that the information would be maintained in confidence;
>
> – the nature of the confidential information;
>
> – the risk of the confidential information being disclosed

- the risk of prejudice arising to either the party challenging the expert or to the party seeking to retain the challenged expert; and
- the interests of justice and public confidence in the judicial process."

The judge stated that neither party in the motion had been able to clarify the nature of the confidential information that may or may not have been communicated. Mr. Farquharson's affidavit did not disclose whether he had received any confidential information and Aecon did not cross-examine Mr. Farquharson on his affidavit. No evidence was put forward showing that allowing the Minister to retain Mr. Farquharson would prejudice Aecon. The judge decided that, given the evidence presented, he could not conclude that Mr. Farquharson and Aecon shared sufficient information for either one to expect that whatever that information may have been would be kept in confidence or was privileged. Mr. Farquharson was never retained and no confidentiality agreement was signed. Mr. Farquharson did not open a file, did not invoice Aecon, did not received any payment, and was not asked to perform any services.

The judge concluded that the discussions Mr. Farquharson had with Aecon in 2001 were of an informal nature and nothing more than an attempt to see if Mr. Farquharson shared their point of view. However he did not agree with their position and said so early in the discussions when he told Aecon that it was unlikely that Aecon would agree with his firm's method of valuation. The Tax Court did not consider this to be the foundation necessary for Aecon to exclude Mr. Farquharson from being retained by the opposing party and provide his opinion. The judge said that this was not a situation where an expert was motivated into selling his opinion to the highest bidder. Furthermore the judge noted that the courts have long recognized that there is no property in a witness and that the courts should discourage parties from shopping for experts in order to disqualify them from being used by the other side, an issue that was not raised by either party.

Counsel for Aecon had also argued that the respondent would not be prejudiced by Mr. Farquharson's exclusion since the Respondent was in a position to retain a different expert however the judge stated that it was not the court's responsibility to rule on what experts should be retained by either party. The judge therefore concluded that Mr. Farquharson was not disqualified as an expert witness for the Respondent by reason of conflict of interest.

Barkwill et al* v. *The Queen
2012 FCA 34

In this case, six taxpayers tried to establish the fair market value of shares without entering any valuation evidence or expert evidence to support their claimed values. Instead they attempted to show that the RRSP trustees who assigned value to the shares could be trusted to have arrived at the correct value because of their adherence to regulatory compliance.

This was an appeal to the Federal Court of Appeal (FCA) from an unreported decision of the Tax Court of Canada dismissing the six appeals. The cases were heard together on common evidence. The appeals arose from transactions in which the Appellants purchased various shares from a securities dealer for $1 per share and, within a very short period of time, contributed them to their individually directed registered retirement savings plans. The trustees of these RRSPs issued contribution receipts in which the contributed shares were valued in excess of the Appellants' purchase

prices. The Appellants then claimed deductions from their income for their inflated RRSP contributions.

The Minister disallowed the Appellants' claimed RRSP deductions on the basis that their RRSPs had acquired the shares for a consideration greater than their fair market value at the time of their acquisition. The Minister disallowed the deduction entirely for shares of two of the three companies on the basis that they were not a qualified investment as defined in section 146(1) of the *Income Tax Act*. With regards to the shares that were qualified investments the Minister reduced the value of the shares to the amounts the Appellants' paid for them.

Before the Tax Court the issues were: 1) The issues at the original appeal before the Tax Court were the fair market value of the shares at the time they were acquired by the Appellant's RRSPs and 2) whether the Minister was correct that certain shares were not qualified investments. The only issue at the FCA was the question of the valuation of the shares.

Before the Tax Court counsel for the Appellants called only one witness: Mr. Fox. Counsel sought to have Mr. Fox qualified as an expert witness. Mr. Fox was examined and cross-examined on his qualifications and experience. He had extensive experience in the area of regulatory compliance for participants in the securities industry but had no formal qualification in accounting or valuation. The expert qualification sought for Mr. Fox was with respect to "how RRSPs are considered or processed within trust companies and how their value is determined".

Counsel for the Appellants took the position that Mr. Fox was not being called to give opinion evidence as to the fair market value of the shares. He was being called to give evidence as to how RRSP trustees comply with the regulatory requirements. Mr. Fox would be asked how the RRSP trustees established fair market values but he would not be asked to determine any values himself. The Appellant's position was that once it was explained how RRSP trustees were required to determine the values of shares transferred to RRSPs the court would be able to conclude that the whatever values the trustees assigned to the shares was their correct fair market value.

The Tax Court held that Mr. Fox could give evidence of industry practice, based on his personal experience but questioned the relevance of that evidence given that Mr. Fox had no personal knowledge of operations of the trustees in this case. Furthermore the Tax Court refused to qualify Mr. Fox as an expert with respect to share valuations.

Following this ruling Mr. Fox gave evidence as to industry practice. It appears from the FCA decision that the Tax Court had allowed Mr. Fox to give oral testimony but he was not allowed to enter his written report into evidence. According to the FCA Mr. Fox testified that, in the case of publicly traded companies, trustees would value their shares at the prevailing market price. The Minister called no evidence.

The Tax Court dismissed the appeals. On the issue of the fair market value of the shares, the Tax Court rejected the Appellants' argument that the court should accept values based on industry practices because there had been no evidence entered as to the practices of the trustees in question or how they arrived at the claimed fair market values. As a result, the Tax Court found that there was no evidence capable of rebutting the Minister's assumption that the fair market value of the shares was the price originally paid for them by the Appellants.

At the FCA counsel for the Appellants argued that the Tax Court had misunderstood the thrust of the expert evidence to be given by Mr. Fox. The Appellant argued that the issue that Mr. Fox's evidence addressed was the proper method of assessing the fair market value of shares traded in a public market and that the correct method to value the subject shares was to rely on public market trades.

Appellant's counsel cited a number of cases in support of the position that the fair market value of publicly traded shares, absent special circumstances, is the price at which the shares trade in the public market. Counsel argued that Mr. Fox's evidence was intended to show that the RRSP trustees acted in accordance with that line of authority and that Mr. Fox had intended to show the Tax Court records showing public trades of the shares in question at the values at which they were contributed to the Appellants' RRSPs.

The FCA did not accept this argument. Though the Tax Court had not allowed Mr. Fox's report into evidence the FCA was of the view that this did not prejudice the Appellants because Mr. Fox was allowed to testify orally. While he may have had information about market trading in his report he was not asked during his testimony if he had evidence of trading in the shares in question at the material time. He was not asked if that evidence disclosed the price at which the shares sold in those transactions. He was not asked to explain or comment on the business records that were before the Court at the time he gave his evidence. Noting that all of this evidence would have been admissible the FCA said the Tax Court judge could not be faulted for not considering evidence that was not put before him. The FCA also noted that it considered the Fox Report "deeply flawed" and the report's conclusion on fair market value would have been of no use whatsoever to the Tax Court.

The FCA concluded that the Tax Court judge was correct in coming to the conclusion he did on the question of the value of the shares. There was no evidence before him that contradicted the Minister's assumptions as to the fair market value of the shares at the time they were contributed to the Taxpayers' RRSPs. The six appeals were therefore dismissed.

Kathryn Kossow **v.** ***The Queen***
2012 TCC 325

This was an appeal from a reassessment in respect to the Minister's disallowance of claimed charitable donations of cash by Kathryn Kossow (the Appellant) to Ideas Canada Foundation. The Appellant had received a twenty-five year interest-free loans to finance 80% of the amounts she donated. The Canada Revenue Agency disallowed her entire donations including the 20% cash portion from her own funds.

The issue in this levered donation scheme was whether the Appellant was entitled to a charitable donation tax credit under the *Income Tax Act* in respect to the payments she made as a participant in a charitable donation arrangement (the Program) promoted by Berkshire Funding Initiatives Limited (Berkshire) and Talisker Funding Limited. As a participant in the Program from 2000 to 2002 the Appellant made cash donations to the Ideas Canada Foundation (Ideas), a registered charity, totaling $160,000. Her donations were funded through her own cash contribution of 20% of the total donation and 80% from interest-free loans provided by Berkshire Foundation Limited, later renamed Talisker Funding Limited (Talisker). The Appellant's donations were conditional

upon her being approved for the interest-free loan. Ideas was the designated charity on the loan application and the funds from the loans could only be used to make donations to Ideas. From 2000 to 2003 Talisker made more than $160,000,000 in loans to approximately 1,200 program participants.

The Tax Court first outlined how the donation scheme worked. The Program was conceived as a method for individuals to make donations to art organizations which were funded through personal cash and an interest-free loan component. Ideas' role in the Program was essentially as a middleman. Participants would donate cash to Ideas which would, in turn, donate the cash to another charity for the purpose of purchasing artwork. In this case the final recipient charity was the MacLaren Art Centre in Ontario (the MacLaren). The promotional material claimed there was no valuation risk in the donations.

In addition to the participant's personal cash component of 20% of the total donation the Program also required the participants to pay an additional 10% to Talisker. These funds were claimed to be held as a security deposit to be invested by Talisker. The donors received a guarantee that the security deposit investments would meet or exceed a benchmark rate of return. It was intended that the security deposits would, after 25 years, have accumulated a large enough fund to pay off the donor's loans.

The Program required that 88% of the donations to Ideas were to be deposited in an escrow account to be used to fund the purchase of art by the MacLaren. The MacLaren had no control over most of these funds. The MacLaren was required to use the funds to purchase only art made available by art dealers associated with the Program at a price dictated by the art dealers. The art which was planned to be acquired under this Program was 12 sets of Rodin bronzes to be newly cast in Italy. Each set was to be comprised of 51 bronzes for a total of 612 bronzes. The bronzes were purchased on November 30, 2000, by Joan Krawcyk Fine Art Inc. (JKFA) for $6,000,000. The day after signing the purchase agreement JKFA assigned its interest in the contract to another art dealer who immediately transferred it yet again to a third dealer for $108,840,000. On December 1, 2000, the third dealer agreed to sell the bronzes to the MacLaren for $108,840,000. There was no negotiation on the price at any stage in these transactions.

The Tax Court clearly had doubts about the evidence regarding the value of the bronzes:

> "[34] Again on December 1, 2000, Jennings Art agreed to sell the MacLaren Edition of Rodin bronzes to the MacLaren for US $108,840,000. There was no negotiation on the price to be paid by the MacLaren. It was decided by the vendor with the use of a purported "Valuation Summary" prepared by Stewart Waltzer. I refer to the valuation as purported because it was not based in reality. It was prepared before the Rodin bronzes were manufactured; it was based on "numerous suppositions"; and, Stewart Waltzer had not even seen the plasters from which the bronzes would be made."

The Tax Court noted that there was no evidence presented to the court to show that the bronzes even existed. None of the witnesses saw them. The declarations of inspection, supposedly prepared by JKFA, were not entered into evidence, and no documents were submitted that would allow the Court to conclude that the Rodin bronzes were ever manufactured.

There was apparently a dispute between JKFA and the Italian manufacturer and only 10 of the 12 sets of bronzes were claimed to be completed. None of these were landed

in Canada and the MacLaren did not receive any of them. Since the Program was short two sets of bronzes but had funds available for art purchases the art dealers had to arrange for the MacLaren to acquire other artwork. As a result it was arranged for the MacLaren to receive a collection of Henry Moore prints. The vendor of the prints had recently acquired them for US $1,450,000 but the MacLaren was required to purchase them for US $35,000,000.

The Tax Court focused on the financing arrangements that enabled Talisker to provide the funds for the Program participants' interest-free loans. The Tax Court noted that the funds flowed in a circle without the Program participants having any control over them. The money was initially borrowed from Standard Mercantile Bancorp. (the Bank) through so-called daylight loans lasting 24 to 48 hours. The funds were credited to Talisker who had the Bank issue drafts to Ideas in the name of each Program participant. Ideas then directed the Bank to pay 88% of these funds to a law firm to be held in an escrow account in trust for the MacLaren. The 12% retained by Ideas was allocated as 11% to Berkshire for fundraising services and 1% to Ideas. The MacLaren authorized the law firm to pay all amounts received from Ideas to the art dealer handling the bronze purchases except 0.5% of the funds which the MacLaren retained. The art dealer then authorized the law firm to pay the funds to another art dealer who passed the funds to an entity called Wigmore Investments Limited. Wigmore then paid the funds to Talisker in repayment for advances allegedly made to Wigmore by Talisker. Talisker then used these funds, along with money from the cash donations, to pay off the loan to the Bank. This left the Program participants such as the Appellant owing money to Talisker under the interest-free loans but with Talisker free from the initial bank debt it incurred to make the loans to the participants.

The Tax Court started its analysis by reviewing the definition of gift used by the Tax Court in *Maréchaux* v. *The Queen*, 2010 FCA 287 (reviewed in *Valuation Law Review—Taxation*, Volume 17, Issue 2, September 2011). *Maréchaux* also involved long term interest-free loans in a levered donation scheme. In *Maréchaux* the Tax Court and the Federal Court of Appeal agreed with the definition of "gift" used by the Federal Court of Appeal in *The Queen* v. *Friedberg*, 92 DTC 6031 (FCA) at 6032. which stated that, for the purposes of section 118.1:

> "…a gift is a voluntary transfer of property owned by a donor to a donee, in return for which no benefit or consideration flows to the donor"

The Tax Court decision in *Maréchaux* was determined on the issue of consideration received by the donor. Mr. Maréchaux had been granted a long-term interest free loan to finance the bulk of his donated amount. He had also purchased a security deposit intended, through judicious investment, to increase in value sufficiently to pay off his loan at the end of his 20 year loan period. Mr. Maréchaux had also received a put option which guaranteed that the security deposit would be accepted by the lender as payment in full for the loan. Using the put option, at no cost to himself, Mr. Maréchaux paid off the loan very shortly after receiving it. The Tax Court determined that this financial arrangement: the granting of the interest-free loan, the put option, and the security deposit, constituted valuable consideration received by Mr. Maréchaux which resulted in his donation not being a gift as defined by *Friedberg*. Based on this conclusion Mr. Maréchaux's appeal was dismissed by the Tax Court. The Federal Court of Appeal heard Mr. Maréchaux's appeal but found no reviewable error and the appeal was dismissed.

In the present case the Tax Court found that Ms. Kossow's donations to Ideas were not separate from the financing she received from Talisker. Her donations were conditional on her applications for the interest-free loans being accepted. The Tax Court concluded that, as in *Maréchaux*, Ms. Kossow did not make a gift within the meaning of section 118.1 of the Act. The 25 year interest-free loans were "significant benefits" that she received in return for making her donations since she was able to transfer a total of $160,000 to Ideas using only $54,400 of her own money without having to pay interest on a commercial loan for the difference.

The Tax Court conceded that the appellant in *Maréchaux* had received an additional benefit (the put option) that was not available to Ms. Kossow, but the court was of the view that the interest-free loan that she received in return for her donation was a sufficient benefit to demonstrate that her donation did not constitute a gift. The Court quoted the comments made by Woods J. in *Maréchaux* v. *The Queen*, 2009 TCC 587:

> "[35] I would also comment that, even without the Put Option, the financing provided a significant benefit. It is self-evident that an interest-free loan for 20 years provides a considerable economic benefit to the debtor".

The Tax Court considered one additional argument made by Ms. Kossow's counsel. It was argued that a gift is only vitiated where there is evidence of consideration from the donee to the donor. In support of this position counsel relied on the recent decision of the Ontario Court of Appeal in *McNamee* v. *McNamee*, 2011 ONCA 533. In that case the court stated:

> "[31] . It is helpful to remember that the issue is not whether the donor (or, for that matter, the donee) received some benefit from the estate freeze (Mr. McNamee Sr. accomplished his corporate planning; the boys received their common shares). ***The issue is whether the donee has provided any consideration to the donor for the transfer of the shares.*** For the reasons outlined above, the appellant provided no consideration in that regard. The fact that Mr. McNamee Sr. accomplished his corporate planning goals — including capping his value in the company at $2 million, with the right to draw out more if he wished; protection from creditors; and relief from possible tax consequences on his death — do not amount to consideration flowing from the appellant to him." *(Emphasis added)*

With regard to this argument the Tax Court concluded that that Kossow's counsel had taken the statement from *McNamee* out of context and misinterpreted its scope. The statement in *McNamee* was made in the context of a family law matter where there was a disagreement about whether shares received by the husband from his father were part of the matrimonial property. The question revolved around whether the shares had been gifted to the husband by his father. In *Kossow* the Tax Court concluded that the statement made in *McNamee* was not intended to be one of general application; it had to be read in the context of the facts in that particular case.

The appeal was dismissed with costs to the Minister. This decision has been appealed to the Federal Court of Appeal.

Allen Berg* v. *The Queen
2012 TCC 406

At issue was whether the minister was correct in disallowing the deduction of charitable donations claimed by Mr. Berg (the Appellant) totaling $4,206,000 in the tax years 2002 to 2004. The donated properties were timeshare units in St. Vincent & The

Grenadines that the Appellant had acquired as a participant in a charitable donation program (described by the Tax Court as an “inflated charitable donation ruse”). The Canada Revenue Agency (CRA) had disallowed the entire claimed donation; both the cash payments the Appellant had made to Young Island Timeshare Inc. to acquire the units and the claimed fair market value of the units in excess of the cash payment.

In 2002 and 2003 the Appellant entered into a series of pre-determined donation transactions with Young Island Timeshare Inc. and SVG Bancorp. A review of the 2002 transactions illustrates how the scheme was intended to work.

On November 19, 2002 the Appellant purchased 68 timeshare units for a total stated price of $2,420,000. He paid $242,000 of this amount in cash, the remaining $2,178,000 was payable by way of a promissory note in favour of Young Island Timeshare Inc. On the same day, the Appellant executed a pledge agreement pledging the timeshare units to Young Island Timeshare Inc. as security for the Appellant’s obligations under the promissory note. He also entered into a guarantee agreement with SVG Bankcorp under which the SVG Bankcorp would guarantee payment of the Appellant’s obligations under the 2002 promissory note in consideration for the payment of a fee of $508,200. Immediately thereafter Young Island Timeshare Inc. executed a release that freed the Appellant from his liability under the promissory note. On December 6, 2002 the Appellant transferred the timeshare units to a registered charity that issued him a receipt acknowledging the donation of property with a $2,420,000 value. The Appellant claimed this amount as a donation in his 2002 tax year. The Appellant entered into a second series of donation transactions in 2003 that were virtually identical to the 2002 donation transactions, differing only in the amount payable on signing and the amount of the promissory note.

As part of the Agreed Facts the Appellant conceded that while he had claimed a total of $4,206,000 in charitable donations from 2002-2004, the actual fair market value of the donated timeshare units was only $375,950, the portion of the total purchase price that he had personally paid in cash. The Appellant also conceded that he never intended to pay any amount under the promissory notes and that the notes, pledge agreements and guarantee agreements did not reflect bona fide obligations of the Appellant. Furthermore the Appellant conceded that the guarantee fees were not made to relieve him of any obligation under the promissory notes; they were paid solely for the purpose of enabling the Appellant to participate in the donation program. Based on these Agreed Facts the Tax Court determined that the various documents and agreements were just a ruse intended to fool the CRA regarding the actual value of the donated properties.

Given the Appellant’s concession that the donated timeshare units were worth no more than his cash payments the only issue before the court was whether the Appellant was entitled to a charitable donation for his cash payment. The Appellant argued that his having sought an inflated tax credit did not disqualify the cash portion of his payment because he had the requisite donative intent with regard to the cash payment. Besides citing case law that he believed supported his position. He also argued that allowing him to claim the cash portion also met with the intention of parliament’s 2003 proposed changes to the *Income Tax Act* (not yet enacted) relating to “hybrid” charitable donations. Under these changes the value of donated property and the cash donations accompanying them can be considered as separate issues.

The Minister argued that while tax incentives in the form of tax credits do not generally impair donative intent, the benefits received in this case did. According to the Minister the promissory notes, the pledge agreements, and the guarantee agreement created a benefit in addition to the inflated gift receipt. The various financing agreements that allowed the Appellant to eliminate the promissory note obligation at little cost all indicated that he received a valuable benefit sufficient to nullify the donative intent. According to the Minister these benefits were critical in enticing the Appellant to participate in the donation program.

The Tax Court focused its analysis on prior jurisprudence in respect to the meaning of "gift", first citing *Friedberg* v. *R.*, 92 DTC 6031 (FCA). In that case the Federal Court of Appeal (FCA) stated that since the *Income Tax Act* did not define the word gift, the general principles of law with regard to gifts were to be used by the courts. The FCA concluded that a gift was a voluntary transfer of property owned by a donor to a donee, in return for which no benefit or consideration flows to the donor. The Tax Court concluded that Mr. Berg had, at least to the extent of the cash donation, transferred property that fell within the Friedberg definition of "gift".

The Tax Court then reviewed *Paradis* v. *R.* [1997] 2 C.T.C. 2557 TCC. This case involved over-stated gift receipts issued in accordance with a charitable donation program involving paintings. The Tax Court concluded that Paradis confirmed the principle that the issuance of inflated receipts in excess of the actual value of a transferred property did not constitute sufficient consideration to nullify donative intent.

The Minister argued that the Appellant had received a benefit through the various documents and agreements that essentially cancelled the promissory notes that financed approximately 90% of his claimed purchase price for the timeshare units. To support this argument the Minister cited the *Maréchaux* decision (*Maréchaux* 2009 TCC 587, [2010] 2 C.T.C. 2099). In *Maréchaux* the Appellant had received a financing arrangement that eliminated his obligation to pay off the non-cash component of his purchase price. In that case the court concluded that the financing arrangement had a significant fair market value and therefore Mr. Maréchaux received consideration back for his donation that invalidated his entire donation. The Minister claimed that Mr. Berg had received a similar benefit. The Tax Court disagreed with the Minister's position, however, because the Minister had conceded that the transaction documents were just pretenses and were not legally effective documents. On this point the court stated:

> "[36] . . Had the Respondent not admitted that the Transaction Documents were pretenses, then the testimony of the Appellant regarding his view of the legal efficacy of the Discharge in relation to the Transaction Documents, at least at the outset, may have been relevant to the possible existence of a benefit beyond the Inflated Gift Receipts. The Respondent's admission removed that from the Court's purview."

The Minister had also argued that the very small percentage of actual cash donated by the Appellant compared to his total claimed donation (about 10%) vitiated any donative intent by the Appellant. In making this argument the Minister relied on the decision in *Kossow* (reviewed in this edition) to support this argument. The Tax Court also rejected this argument saying:

> "[46] Consistently, the presence of any benefit conferred upon a taxpayer as part of a donation program, beyond that of a tax receipt, will vitiate or nullify donative intent in toto. *Kossow* reaffirms this. On that basis, *Kossow* is consistent with the *Friedberg*

> line of cases. However, *Kossow* does not state that donative intent may be nullified by the sheer magnitude or exaggerated quantum of an inflated charitable gift receipt in the factual absence of some other tangible or potential benefit conveyed upon, or received by, the donor."

In concluding its review of the case law the Tax Court said:

> "[41] In light of this clear line of cases and since factually no benefit beyond the Inflated Gift Receipts were received in the present case, this Court would need to legally determine that the concurrent non-charitable motivation or non-charitable purpose present before the Court is of such magnitude that it rescinds or demolishes donative intent related to the Cash Donation Amount. In short, given the absence of a benefit confirmed on the appellant, the overarching motivation and purpose must nullify the factually existent Cash Donation Amounts, and the gift of them."

The Tax Court concluded that the Appellant had been impoverished to the extent of his cash donation and that the his personal cash donation amount met the legal test of a charitable gift. As a result the Tax Court allowed the appeal.

With regards to costs, which both parties had requested in the event of winning the appeal, the court took the unusual step in not awarding them. The court offered the following statement regarding not awarding costs to the Appellant:

> "i) In self-assessing in the first instance and subsequent dealings with the CRA, the Appellant was not forthright as to the legally binding nature of the Transaction Documents (ultimately agreed to be a pretense) nor in respect of the Inflated Gift Receipts;
>
> ii) the Appellant did not disclose, until after the disc.overy process, either through inadvertence or lack of diligence, the existence of the Discharge;
>
> iii) the Appellant advised the Court at the opening of the Hearing of his withdrawal of the Abandoned Issue, but he had nonetheless negotiated and pursued that very issue, even including it in the partial Agreed Statement of Facts dated only ten (10) days prior to the hearing;
>
> iv) the Appellant's use of the Transaction Documents and Inflated Gift Receipts as a pretense and ruse for the sole purpose of obsfucating CRA's determination of an accurate fair market value for the Transferred Units must be addressed in costs."

This decision has been appealed to the Federal Court of Appeal.