THE VALUATION LAW REVIEW

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Taxation Decisions and Legislative and Administrative Developments

The Valuation Law Review is a joint publication of the Canadian Institute of Chartered Business Valuators and Dennis Turnbull and 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 them. Readers are cautioned against relying upon the decision summaries contained therein, which are edited and in outline form only, and are directed to the full report of the reasons of the Court. While every effort is made to include cases that are of precedential value, it is impossible to include every case relevant to valuation issues that may face a reader. Further, legal decisions rendered since the publication of this edition of the Valuation Law Review may change the law set out in this Valuation Law review. Readers are directed to carry out their own further research to ensure the accuracy and completeness of the Valuation Law review entries.

Editor: Dennis Turnbull, CBV

For subscription information please contact:

The Canadian Institute of
Chartered Business Valuators
277 Wellington Street West, 8th Floor
Toronto, Ontario M5V 3H2
Telephone: (416) 977-1117
E-mail: admin@cicbv.ca

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Berg v. The Queen 2012 TCC 406

http://canlii.ca/t/ftxms

2014 FCA 25

http://canlii.ca/t/g2xg2

The Tax Court decision was reviewed in *Valuation Law Review* Vol. 19, Issue 2. The issue at Tax Court was whether Mr. Berg could claim a donation tax credit for the cash portion of his payment for grossly overvalued donated property. The Tax Court allowed the appeal on the basis that Mr. Berg had a donative intent in respect to the cash payment. This was appealed to the Federal Court of Appeal. The appeal was allowed on the basis that Mr. Berg had received consideration back for his payment. This made the facts of his case indistinguishable from those of *Maréchaux* (reviewed in *Valuation Law Review* Vol. 17, Issue 2). The Federal Court of Appeal also found that Mr. Berg had intended to make a profit from participating in the program. He therefore did not have a donative intent.

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Chabad v. Canada (National Revenue)

2013 FCA 196

http://canlii.ca/t/g67mn

Cheder Chabad was a charity running a school for Jewish boys in Toronto. Cheder Chabad was a recipient charity for donation tax programs including the program reviewed by the Tax Court in *Berg v. The Queen* 2012 TCC 406. After a compliance audit the Canada Revenue Agency decided to revoke Cheder Chabad's registration. Cheder Chabad applied to the Federal Court of Appeal requesting that the CRA be stopped from publishing the revocation notice to allow Cheder Chabad time to attempt to sell the donations in kind it had accepted under the programs. While the Court was not willing to grant the requested six months it granted a four month stay on publication.

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Mariano v. The Queen

2015 TCC 244

http://canlii.ca/t/glrs3

The Tax Court hearing involved a pre-arranged "buy-low, donate-high" charitable donation program. The scheme purportedly involved the distribution of computer software licenses to the program participants via a trust. The appellants received donation receipts with amounts from three to eight times greater than their actual costs for the licenses.

The appeals were dismissed for a number of reasons. The Court determined that the appellants intended to profit from participation and did not have donative intent. Additionally the Court concluded that the appellants had never acquired ownership of the licenses and that the trust itself had not been validly established. The Court rejected the appellant's valuation report, considering it unreliable, and agreed with the Crown's valuation conclusions.

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Vine Estate v. The Queen

2014 TCC 64

http://canlii.ca/t/g6384

[2015] 4 FCR 698, 2015 FCA 125

http://canlii.ca/t/gj55c

The issue was the date of death value of all of the issued shares of Leadway Apartments Limited ("Leadway"). Leadway owned two apartment buildings in Toronto. The CRA reassessed the estate claiming that it had undervalued the date of death value of Leadway. Both parties had expert appraisal witnesses at the Tax Court hearing.

The Tax Court judge concluded that Crown's expert report contained too many significant errors and unwarranted assumptions for the Court to place any reliance on it. Additionally the expert's credibility and impartiality had been compromised by his undisclosed access to both the initial CRA appraisal report and the appellant's expert report prior to preparing his own report. The judge concluded that the report was fundamentally flawed and accepted the appellant's value.

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Kossow v. The Queen

2012 TCC 325

http://canlii.ca/t/fsstb

2013 FCA 283

http://canlii.ca/t/g2772

The Kossow Tax Court decision was reviewed in *Valuation Law Review* Vol. 19, Issue 2. This was a levered charitable donation scheme in which Ms. Kossow had received a 25 year interest-free loan to finance the bulk of her cash donations. The Tax Court judge disallowed her entire donated amount, including her personal cash portion, on the basis that the Federal Court of Appeal decision in *Maréchaux* (*Maréchaux v. The Queen*, 2010 FCA 287

reviewed in Vol. 17, Issue 2) was determinative of the issue in this appeal.

Ms. Kossow appealed the decision to the Federal Court of Appeal on the basis that the Tax Court was in error in determining that her case was indistinguishable from *Maréchaux*. The Federal Court of Appeal found that the relevant facts in *Kossow* were so similar to the facts of *Maréchaux* that the Tax Court judge did not err in law in relying on the *Maréchaux* decision.

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Grimes v. The Queen

2016 TCC 280

http://canlii.ca/t/gvxvt

The issue was the fair market value of capital properties deemed to have been disposed of by a trust under the 21-year rule in section 104(4) of the *Income Tax Act*. The properties were shares in a private family company. Both parties entered expert evidence at Tax Court regarding the values of the shares. There were two companies involved, a holding company ("Holdco") and an operating company 100% owned by Holdco. The subject properties were Holdco shares. Amongst other issues the appellant's valuator reduced Holdco's value by an allowance for the hypothetical personal income taxes a notional vendor would pay on the shares' redemption. He also applied a minority discount to the voting share being valued and applied a separate marketability discount to reflect the voting share's lack of liquidity. The Crown's valuator did not make any of these adjustments. He assumed that personal taxes and minority and marketability discounts were not appropriate in a family context.

The judge concluded that the deduction for personal income taxes was not appropriate. She allowed both the minority and marketability discounts but reduced the claimed marketability discount on the basis that it was, to some extent, a double-counting of the minority discount.

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Abbott and Haliburton Company v. WBLI Chartered Accountants

2012 NSSC 210

http://canlii.ca/t/frkdg

2013 NSCA 66

http://canlii.ca/t/fxl0z

White Burgess Langille Inman v. Abbott and Haliburton Co

2015 SCC 23

http://canlii.ca/t/ghd4f

This case involved a review of the standards regarding the admissibility of expert evidence. The plaintiffs started an action for professional negligence against the defendants. The plaintiffs' statement of claim included references to work done by Grant Thornton. An expert in forensic accounting, also with Grant Thornton, entered an affidavit into evidence in respect to the negligence issue. The defendants requested that the affidavit be struck on the grounds that the expert was not independent and unbiased. They argued that she had a conflict of interest because she could not take a contrary view to the conclusions of the Grant Thornton office which had done accounting work on the negligence issue. The motions judge agreed, deciding that the expert lacked the necessary independence to meet the threshold of admissibility because she was in an apparent conflict of interest.

This was appealed to the Nova Scotia Court of Appeal. In the Court's opinion, the motions judge erred in law in finding the expert inadmissible. There was no requirement for a party to demonstrate that its expert witness was independent. The Court allowed the appeal. This was appealed to the Supreme Court of Canada ("SCC").

The SCC said that the threshold requirement for admissibility of expert evidence was low and issues with an expert's lack of independence and impartiality went to the weight to be given to the evidence at trial. The concept of apparent bias was not relevant to whether or not an expert witness would be able to fulfill her duty to the court. The SCC concluded that the motions judge had committed a palpable and overriding error in determining that the expert was in a conflict of interest.

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1207192 Ontario Limited v. The Queen

2011 TCC 383

http://canlii.ca/t/fn18v

2012 FCA 259

http://canlii.ca/t/ft9dg

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Triad Gestco Ltd. v. The Queen

2011 TCC 259

http://canlii.ca/t/fm88z

2012 FCA 258

http://canlii.ca/t/ft83v

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Barrasso v Queen

2014 TCC 156

http://canlii.ca/t/gflv0

These three separate appeals involved similar tax issues. The appellants participated in tax avoidance plans designed to create large artificial capital losses which were used to offset real capital gains. This was done by purchasing high value common shares in a new private company then transferring the common share value to preferred shares issued to the same shareholder.

This resulted in an artificial capital loss on the sale of the now-worthless common shares which was used to offset capital gains the appellants had realized on unrelated transactions.

The CRA disallowed the claimed capital losses using the General Anti-Avoidance Rule in section 245 of the *Income Tax Act*. It was the Crown's position at trial that the underlying rationale of the provisions of the Act that deal with capital losses was to allow a deduction where a taxpayer had suffered a real economic loss on a disposition of property. The series of transactions undertaken by the appellants defeated this policy.

The Tax Court agreed with the Crown in all three appeals. The appellants' acquisition and disposition of the common shares served no purpose except to manufacture a capital loss for tax purposes. The transactions were not executed within the object, spirit, and purpose of the capital loss provisions of the Act and they constitute abusive tax avoidance under subsection 245(4). The appeals were dismissed. The Federal Court of Appeals supported the Tax Court's conclusions.

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Kruger Incorporated v. The Queen

2015 TCC 119

http://canlii.ca/t/gj7xz

2016 FCA 186

http://canlii.ca/t/gscwq

At issue was whether the taxpayer could value foreign exchange option contracts using the mark-to-market valuation basis in computing its taxable income. Kruger Incorporated claimed losses in 1998 from trading in derivatives. The losses resulted from the reduction in value of foreign exchange options held at year end determined on the mark-to-market basis. The Canada Revenue Agency disallowed the claimed losses on the basis that Kruger was not allowed to use the mark-to-market basis in calculating income or losses.

The Tax Court judge ruled that he did not consider the mark-to-market valuation basis appropriate for use in determining income for tax purposes because it went against the realization principle. The judge determined that the mark-to-market method could only be used for income tax purposes if it was specifically permitted by the *Income Tax Act* and Kruger did not fit into the industry categories allowed under the Act.

The Federal Court of Appeal disagreed with the Tax Court's conclusions and allowed the appeal. The Court said that the Tax Court judge treated the realization principle as an overarching principle, an approach which ran counter to the decisions of the Supreme Court in *Canderel* and *Ikea*. These decisions concluded that the realization principle could be discarded when other methods of computing income showed a more accurate picture of income. Had the Tax Court judge used the analysis framework in *Canderel* he would have found that there was no basis on which to reject the appellant's use of mark-to-market accounting.

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Daishowa-Marubeni International Ltd. v. The Queen

2010 TCC 317

http://canlii.ca/t/2b73f

[2013] 3 FCR 51, 2011 FCA 267

http://canlii.ca/t/fn92w

[2013] 2 SCR 336, 2013 SCC 29

http://canlii.ca/t/fxk76

The issue in this case was whether a purchaser's assumption of Daishowa-Marubeni's (Daishowa) future reforestation liabilities embedded in forest tenures should be included as part of the proceeds of sale of the tenures. The Tax Court and Federal Court of Appeal decisions were reviewed in Volume 19, Issue 2, of this publication. Both courts determined that the estimated amount of the assumed liabilities had to be added to the stated sales price to determine the proceeds of disposition on the sales.

Daishowa appealed to the Supreme Court of Canada. The Supreme Court considered the reforestation obligations to be simply a future cost tied to the tenure that depressed the value of the tenure so Daishowa was not required to include the estimated cost of reforestation in its proceeds of disposition for income tax purposes.

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Guindon v. The Queen

2012 TCC 287

http://canlii.ca/t/ft2fk

2013 FCA 153

http://canlii.ca/t/fz581

2015 SCC 41

http://canlii.ca/t/gkfb4

Guindon was an appeal from the first assessment made under section 163.2(4) of the Act. This is the so-called preparer's penalty applicable to persons participating in a misrepresentation by making false statements. Ms. Guindon was assessed a penalty of $546,747 on the basis that she had prepared or helped to prepare 135 charitable donation receipts that she knew, or should have known, constituted false statements that could be used to claim unwarranted tax credits. On appeal to the Tax Court Ms. Guindon submitted that section 163.2 of the Act created a criminal offense which required that she be given charter protection under s.11 of the Charter of Rights and Freedoms ("the Charter"). The Tax Court judge agreed that she had been denied her Charter rights and allowed her appeal. The judge said that had he not agreed with her Charter argument he would have dismissed her appeal because he had determined that she had engaged in culpable conduct and helped prepare false statements.

The Federal Court of Appeal found that since Ms. Guindon had failed to serve the required notice of constitutional question necessary to bring up a Charter issue the Tax Court did not have the jurisdiction to hear her Charter argument. Since the Tax Court judge had ruled that her conduct had been culpable the Federal Court of Appeal set aside the judgment of the Tax Court and found for the Crown.

Ms. Guindon appealed to the Supreme Court of Canada. The Supreme Court concluded that 163.2 was not a penal provision. Its purpose is to promote compliance with the scheme of the Act which is an administrative function. While the amount of Ms. Guindon's penalty was very high for an individual the Supreme Court found that it did not constitute a true penal consequence. The Supreme Court said that Ms. Guindon's actions could not be countenanced in a self-reporting system and dismissed her appeal.

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Ploughman v. The Queen

2017 TCC 64

http://canlii.ca/t/h3j66

Mr. Ploughman was assessed under section 163.2 of the Act for making false statements. He was, in fact, involved in the same donation scheme reviewed in *Guindon v. The Queen*, 2012 TCC 287. Based on the specific facts of the case Mr. Ploughman was found to have engaged in culpable conduct and participated in making false statements. The Tax Court dismissed his appeal.

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Canada v. GlaxoSmithKline Inc.

[2012] 3 SCR 3, 2012 SCC 52

http://canlii.ca/t/ft8fd

This was a very significant Supreme Court of Canada decision that provides guidance for value determinations in transfer pricing issues. The decisions of the Tax Court and the Federal Court of Appeal were reviewed in Volume 17, Issue 2 of this publication. The Supreme Court of Canada decision was reviewed in Volume 19, Issue 2. The Supreme Court remitted the matter back to the Tax Court to take into consideration the effects of a License Agreement and a Supply Agreement on the value of a drug. The case was scheduled to be reheard at the Tax Court in early 2015 based on the Supreme Court's instructions. However, just prior to the hearing, the parties settled and the hearing was cancelled. The settlement terms are confidential.

Editorials

Dennis Turnbull, CBV

The Canadian Legal Information Institute

The Canadian Legal Information Institute (“CANLii”) is a non-profit organization created and funded by the Federation of Law Societies of Canada. CanLII offers free public access to approximately 1.6 million documents from nearly 300 case law and legislative databases. This includes almost all published Canadian court decisions. This edition of the Valuation Law Review includes, along with the citations for the cases being reviewed, the link to the case decisions on CANLii. This allows the decisions to be immediately accessed while the reviews are being read.

Class A Voting Non-Participating Shares/Class B Non-Voting Participating Share Structure—Part 4

As the title shows, this is the fourth editorial on the Class A voting non-participating/ Class B non-voting participating share structure to be included in this publication. The prior editorials were in Volume 13, Issue 2, July 2007, Volume 15, Issue 3, December 2009, and Volume 17, Issue 2, September 2011.

This share structure has been very extensively used in Canadian estate planning and family share situations. As a general observation, practitioners outside of the CRA gave no value to the voting shares on the basis that they had no economic entitlement. The entire company value was allocated to the non-voting shares because they had the only dividend and liquidation rights. I gave my opinion on how these shares should be valued in the editorial in volume 13, Issue 2, July 2007. At that time I was a member of the Vancouver CRA valuation team;

> It is my opinion that the position of allocating the entire value to the Class B shares is not reasonable. This allocation requires the assumption that voting power is of no value to an arm’s length purchaser of the Class B shares and such a purchaser would pay the same price for these shares regardless of the allocation of the votes. Since the timing of both dividend payments and liquidation proceeds (the two economic entitlements held by the Class B shares) are under the control of the voting shareholder it must be assumed, if the entire company value is to be assigned to the Class B shares, that an arm’s length purchaser of the Class B shares is indifferent as to whether or not he can access the economic entitlements underlying his purchase price.

This position generated significant interest as the article *“Valuation and Family-Business Share Structures—Some Musings”* by David Gross from the October 16, 2008 edition of CCH Tax Topics No 1910, showed;

> In recent weeks, there has been a growing buzz about the control premium issue in respect to family-held private corporations. The genesis of this is mainly from the so-called ‘‘Vancouver Control Premium’’ tax file, where the CRA is attempting to assert

> that there is additional death tax exposure based on a substantial control premium, apparently retained as part of an estate freeze.
>
> . . . . We're all on notice. Because of the impact of this issue on standard estate planning structures for family businesses, our Meritas Tax Group recently sought input from two of Canada's leading valuators in this area. Based on these discussions, it appears that even if a family member has only ''thin-voting shares'' — that is, shares which have virtually no rights other than to vote, a control premium may be applicable (stemming from the controlling shareholder's ability to control the business, pay bonuses, and so on), but probably not nearly as high as is apparently being asserted by the CRA in the Vancouver file.

In response to this the CRA proposed a policy in respect to how it would view the valuation of this share structure. This was reviewed in the editorial in Volume 17, Issue 2. As the editorial stated;

> The CRA has finally come up with a position on the issue although it has done so in a decidedly informal manner. On December 17, 2009, the Canadian Tax Foundation released Tax Topics Number 1971-72. This publication reviewed the annual Roundtable question and answer session held with the CRA during the Canadian Tax Foundation Conference in November 2009. One question related to the CRA's position on the valuation of voting non-participating shares. The CRA's response, as the Tax Topics related it, was:
>
> *"Skinny Voting Shares*
>
> *The CRA was asked for its view on the valuation of skinny voting shares (a separate class of shares that have no right to dividends or proceeds on windup but which give the holder voting control). In two Vancouver cases, the CRA had assessed a premium on the value of a company's skinny voting shares (*Lacterman v. The Queen*, 2009- 498(IT)G and 2009-495(IT)G and* Dustan v. The Queen*, 2009-1152(IT)G — both cases have been discontinued). Further, at the 2009 British Columbia Tax Conference, the CRA stated its view that non-participating controlling shares have some value and may therefore command a premium. Of course, as part of a typical estate freeze, over time the freezor's freeze shares are redeemed and the freezor is left with only the skinny voting shares. The CRA stated that, as a matter of fact, the skinny voting shares probably have some value that would generate a premium. However, the CRA stated that it will ''play along'' with the view that the skinny voting shares have no premium value. The CRA referred to the classic movie The Wizard of Oz and stated that if the taxpayer never pulls back the curtain to reveal the Wizard (i.e. a value of the skinny voting shares) then the CRA will proceed on the basis that the shares have no value. However, if the taxpayer pulls back the curtain to reveal the value of the voting shares (i.e. if the value of the shares is demonstrated in a legal proceeding or on a sale for proceeds), then the CRA will assess on that basis."*

However the Wizard of Oz policy did nothing towards getting a consensus since it only bound CRA valuators, not outside practitioners. Additionally this wasn't a valuation policy as much as it was an administrative policy. The CRA stated through the policy that the assumptions it would choose in valuing the share classes would be dependant on the actions of the shareholders rather than being based on a specific valuation methodology or position.

Given the various irreconcilable valuation positions on this issue the only way to arrive at an agreed methodology would be through the guidance of court decisions. As I wrote in the editorial in Volume 15, Issue 3, December 2009;

> As the articles reviewed in this editorial demonstrate, there is currently considerable uncertainty as to how the value of voting non-participating shares should be determined. While there may never be a consensus on the issue some direction may eventually be given by decisions from the Tax Court.

However until recently there has been no guidance from the Tax Court on the issue but in *Grimes v. The Queen* 2016 TCC 280 (***http://canlii.ca/t/gvxvt***) (reviewed in this edition), the court finally gave a ruling to point. The issues in *Grimes* have been greatly simplified for the purpose of this editorial. Details can be found in the case review and the decision.

While there were numerous valuation issues in *Grimes* the one relevant to this editorial was an allocation issue, how to allocate the net asset value of a holding company between two classes of shares, one participating the other non-participating. One class was a single issued Class A participating and voting common share held by a trust. The other class was twelve voting, non-participating, Fifth Preferred Shares with an insignificant redemption/retraction value. These thirteen shares were the only issued voting shares. The preferred shares were owned by the mother of the trust's beneficiaries who was a trustee but was not herself a trust beneficiary.

The issue under appeal was the fair market value of the common share. The value of the preferred shares was irrelevant to the appeal except to the extent that they affected the value of the common share. It was the Crown's position that all of the company value should be allocated to the common share. The Crown's valuator relied on the assumption that the related shareholders would act in concert to obtain the highest price for the common share in an open market transaction. This highest price assumption included the sale of the Fifth Preference Shares along with the common share because a buyer of the common share would require voting control of Holdco. The valuator concluded that the owner of the fifth Preference Shares could not sell them at more than a nominal value because that would be against the best interests of the trust beneficiaries. The net effect of this was the assumption that the preferred shareholder would be willing to give away her shares for no proceeds in order to maximize the common share price.

It was the taxpayer's position that the preferred shares' voting control, even in the absence of a right to any economic entitlement, meant that the preferred shares should be allocated a control premium. The valuator chose a premium of $253,390. This amount was 12.5% of the value of Holdco's assets. The taxpayer's valuator noted that this was, effectively, a minority discount applied to the voting share.

The Tax Court agreed with the taxpayer's position. The judge said that only the trust had been deemed to have disposed of its shares. There was no legal or fiduciary obligation for the trustee to sell her controlling preferred shares of Holdco. The definition of fair market value required that the valuation be based on the assumption that the trust would dispose of its common share arm's length without an accompanying sale of the preferred shares. On this basis the 12.5% control premium applied to the preferred shares was reasonable.

This takes us back to the quote in CCH Tax Topics No 1910;

> Because of the impact of this issue on standard estate planning structures for family businesses, our Meritas Tax Group recently sought input from two of Canada's leading valuators in this area. Based on these discussions, it appears that even if a family member has only ''thin-voting shares'' — that is, shares which have virtually no rights other than to vote, a control premium may be applicable (stemming from the controlling shareholder's ability to control the business, pay bonuses, and so on), but probably not nearly as high as is apparently being asserted by the CRA in the Vancouver file.

This is exactly what happened in the *Grimes* decision. The Tax Court assigned a significant control premium to the non-participating shares even though the shares had no economic entitlement. The Tax Court agreed with Ms. Grimes that the votes attached to the shares had significant value even in the absence of any dividend or redemption rights. If this aspect of the *Grimes* decision is supported by further jurisprudence the valuation community may finally have a generally agreed basis for valuing these share structures. While valuators may differ on case-specific factors affecting the percentage of the premium both the CRA and outside practitioners will at least have some certainty regarding how to approach the allocation problem.

Guindon v. The Queen—The constitutional status of the section 163.2 penalty

Guindon v. The Queen (reviewed in this edition) is a very significant case involving a Supreme Court review of the constitutional status of section 163.2 of the *Income Tax Act*, the so-called planner and preparer penalties. Section 163.2, titled *"Misrepresentation of a Tax Matter by a Third Party,"* became law in 2000. It was designed to penalize, through civil penalties, individuals who promoted or supported what the Department of Finance considered abusive tax programs. Until the passing of 163.2 the Canada Revenue Agency could penalize taxpayers for gross negligence under 163(2) but the Agency could not penalize third parties, the promoters, lawyers, accountants, valuators or other individuals who established or supported such schemes. There are two aspects to 163.2, the planner penalty in 163.2(2) and the preparer penalty in 163.2(4).

Valuators, who faced the potential application of 163.2(2), were concerned with two aspects of the legislation as it was initially proposed. The first was the use of the same gross negligence standard used in 163(2). There were concerns that this could penalize valuators making honest errors of judgment in matters of opinion. As a result of this, and other concerns about the use of the gross negligence standard, the Department of Finance changed this to a culpable conduct standard. The second concern was the so-called reverse onus rules in 163.2(10) which were intended to apply specified ranges of values that a taxpayer's valuator was required to stay within to avoid being potentially caught in the culpable conduct definition. The CRA published it's interpretation of this issue in Third-Party Civil Penalties Information Circular 01-1 which stated, in the *'Special Rules for Valuation Activities'* section;

> 42. Subsection (10) provides a special rule that applies to a statement made by a person who expresses an opinion on the value of a property or service (referred to as the "stated value") or by a person who uses that stated value in the course of an excluded activity. A statement as to the stated value is deemed to be a

> false statement that the person would reasonably be expected to know, but for circumstances amounting to culpable conduct, if the stated value is outside (either higher or lower than) a range of values. This is called the "reverse onus rule," which is more fully described in paragraph 48. However, if the "stated value" is different from the fair market value but is within the range, it may still be a false statement.
>
> 48. As stated in paragraph 42, if the stated value of a property or service lies outside the range, a reverse onus rule will apply, which means the person who made the false statement must establish that the valuation was reasonable in the circumstances, made in good faith, and not based on unreasonable or misleading assumptions.

[Link: ***https://www.canada.ca/content/dam/cra-arc/migration/cra-arc/E/pub/tp/ic01-1/ic01-1-e.pdf***]

There was considerable concern in the valuation community that a reasonably held valuation opinion could put a valuator in jeopardy under the reverse onus rules. However as paragraph 49 of the publication said;

> 49. Until the percentages are prescribed in the regulations, the deeming provision is not effective. This means the CCRA will have to demonstrate that a false statement was made either knowingly, or in circumstances amounting to culpable conduct

The Department of Finance eliminated the problem by choosing not to publish the prescribed percentages in the regulations. However, with these concerns aside, valuators are still potentially exposed to the application of 163.2(2). The *Guindon* case was the first Tax Court review of the constitutional status of section 163.2. Ms. Guindon successfully argued in Tax Court that 163.2 constituted a criminal penalty rather than a civil penalty. She claimed that this triggered constitutional rights which she had been denied. Had that decision prevailed it would have effectively rendered 163.2 pointless since the purpose of legislating 163.2 had been to penalize the specified activities through a civil rather than a criminal penalty. Fortunately for the CRA and the Department of Finance, the Supreme Court of Canada decided that 163.2 was a civil penalty. While *Guindon* concerned the 163.2(4) preparer's penalty the issues of culpable conduct and constitutional status are equally applicable to the 163.2(2) promoter's penalty.

The *Mariano* costs decision

Mariano v. The Queen
2016 TCC 161
http://canlii.ca/t/gsm9p

Mariano v. The Queen, 2015 TCC 244 was yet another appeal from reassessments of charitable donation claims from a buy-low donate-high charitable donation scheme. *Mariano* is reviewed in this edition. The review does not include a discussion of the very unusual costs ruling made by the Tax Court in awarding costs in favour of the Crown.

There were two appellants and five bound appellants in *Mariano* however they were just the tip of the iceberg. The *Mariano* appellants had participated in the Global Learning Gifting Initiative Charitable Donation Program, a massive donation in-kind scheme. As the Tax Court judge said in the costs decision;

> [31] . . . . . there were 16,000 taxpayers who participated in the GLGI program in the 2004 and 2005 years whose objections were not confirmed and that only about 25 taxpayers had launched actual appeals by mid 2015, including the Appellants and 5 other Appellants represented by the same counsel as the Appellants herein who agreed to be bound by this decision, while there were 27,000 additional donors by such later date whose appeals were still at the objection stage.

The Tax Court ordered, subject to some adjustments, costs of $491,137 against the appellants and bound appellants. The judge allocated costs amongst them based on the proportion of the charitable tax credits each had individually claimed in relation to the tax credits claimed by the entire group. Additionally Global Learning Group Inc., the program's promoter, was assigned unlimited liability for costs.

> "2. Each of the Appellants, Bound Appellants and the Promoter shall be jointly and severally liable for costs but that the maximum amount of costs for which each of the Appellants and Bound Appellants are liable for shall be capped; such that each of their liability for costs shall be limited to the proportion that their total Charitable Tax Credits claimed in respect of the Program for all years under appeal herein is to total of all Charitable Tax Credits claimed by all of them combined with respect to the Program for such years under appeal. There shall be no limit to the Promoter's liability for costs."

It has been reported that this is the first time the Tax Court has awarded costs against a person who was not a party to the litigation. The court's very extensive cost order can be accessed through the CANLii link given at the beginning of this editorial. Paragraphs 97 to 103 give the court's reasons for awarding costs against the promoter. Currently an $800,000,000 class action on behalf of the Global Learning Gifting Initiative Charitable Donation Program participants is being pursued against Global Learning Group Inc.

[Link: ***http://www.newswire.ca/news-releases/proposed-class-action-against-global-learning-group-inc-for-sham-charitable-donation-tax-scheme-651092923.html***]

The Meaning of Gift—Part 2

The previous edition of this publication included an editorial titled *"The Meaning of Gift."* It reviewed the jurisprudence to date on how the Tax Court and the Federal Court of Appeal ("FCA") interpreted the word 'gift' in respect to the various charitable donation schemes that the CRA has been challenging for the prior decade. The editorial said, in part;

> "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 statement *"These differing treatment depended on the specific facts of the cases and how the courts defined 'gift' in respect to the purported donations"* is no longer applicable. It was written because of the *Berg* decision which went against the understanding of 'gift' as defined by the FCA in *Kossow* and *Maréchaux*. In those cases the FCA approved the Tax Court's conclusion that when taxpayers participated in for-profit donation schemes neither the taxpayer's own cash nor the other donated properties qualified for donation tax credits if the participants received consideration back for making the gift.

Notwithstanding the guidance given by the FCA in *Kossow* and *Maréchaux*, the judge in *Berg* allowed the taxpayer a deduction for the cash component of his donation in what was a blatant for-profit scheme. The judge came to this conclusion on the basis that although Mr. Berg had intended to profit from his donations, the disallowance of his claim for the donation of timeshare units meant that he was actually impoverished by the amount of his cash donations. This was the situation when the last *Valuation Law Review* was published and, given the uncertainty generated by this decision, readers were advised to review the entire *Berg* decision.

The Crown appealed *Berg* to the FCA (reviewed in this edition) and the FCA reversed the Tax Court decision for two reasons. The first was that, as in *Kossow* and *Maréchaux*, the Court determined that Mr. Berg had received a benefit from making his gift. This was in the form of documents intended to deceive the CRA regarding Mr. Berg's liability for a purported debt he'd claimed to incur in buying the timeshare units. Secondly, the FCA said that it had not been open to the Tax Court judge to conclude that Mr. Berg had the requisite donative intent. Mr. Berg had not intended to impoverish himself through the donation. It was his intent to enrich himself by profiting through his inflated tax credit claims. This lack of a donative intent vitiated any entitlement to donation tax credits. It appears from the FCA *Berg* decision that the facts of specific for-profit donation schemes are now largely irrelevant. An intention to profit from participating in a scheme is alone sufficient reason to disallow the entire claimed donation. This was made clear in *Mariano v. The Queen*, a case reviewed in this edition. *Mariano* involved thousands of taxpayer reassessments that disallowed both the cash donations and the donations in-kind for one of the largest of these for-profit schemes. The Tax Court judge wrote;

> [49] In the end, I cannot see how any person participating in such a scheme, regardless of whether such person had an honest belief in the value of the Licences he expected to receive or not, can argue, based on the manner in which the scheme was marketed and in the makeup and integration of the Transactional Documents that deliver it, that he or she expected none other than to profit from, be enriched or not be impoverished by, such participation, and thus not have the requisite donative intent.
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> [50] The Appellants did not have the donative intent to make the gifts of cash or Licences. This is enough to dismiss the appeals of the Appellants . . . .

Case Reviews

Berg v. The Queen

2012 TCC 406
http://canlii.ca/t/ftxms
2014 FCA 25
http://canlii.ca/t/g2xg2

Mr. Berg participated in a levered donation tax program. He donated 68 timeshare units in the St. Vincent and the Grenadines that he had purchased for $375,000 in cash (the actual fair market value of the timeshare units) and promissory notes for $3,813,000. However the promissory notes, pledge agreements, and guarantee agreements (the "Transaction Documents") were pretenses and did not reflect bona fide obligations. Mr. Berg was never legally required to pay off the promissory notes, a fact he did not disclose until discovery. The Canada Revenue Agency disallowed all of Mr. Berg's claimed charitable donations including the cash portion of his purchase price. He appealed the reassessment to the Tax Court. The only issue at his Tax Court hearing (reviewed in *Valuation Law Review* Volume 19, Issue 2) was whether Mr. Berg was entitled to the charitable tax credits associated with the cash portion of his purchase price.

The crown had argued that Mr. Berg had received a benefit, the Transaction Documents that appeared to legally require Mr. Berg to pay off the notes. These had supported his claim that the entire donation was valid. The Crown argued that these documents, while eventually proven worthless, had value to Mr. Berg when he acquired them. The judge said that the court could only disallow the cash donations if the Crown was able to "demolish" the argument that Mr. Berg had donative intent and said that the Crown had not done this. The Tax Court concluded that Mr. Berg had not received any benefit since the Transaction Documents were shown to be worthless. Based on this conclusion the cash payments met the legal test of being a charitable gift. The Crown appealed to the Federal Court of Appeal (the FCA).

Counsel for Mr. Berg argued at the FCA that no matter how egregious Mr. Berg's behaviour had been in participating in the program the only benefit he received was charitable tax receipts entitling him to a charitable tax credit at least equal to the fair market value of the donated properties. Regardless of his motives in participating Mr. Berg was "impoverished" to the extent of his cash payments so the cash payments fit within the *Friedberg* definition of gift. The Crown took the position that Mr. Berg had received a significant benefit in addition to the charitable tax receipts, namely the provision of the Transaction Documents necessary for the scheme to work. Thus, as per the decisions in *Maréchaux v. The Queen* (reviewed in *Valuation Law Review* Volume 17, Issue 2) and more recently in *Kossow v. Canada*, (reviewed in *Valuation Law Review* Volume 19, Issue 2) Mr. Berg had not made valid gifts.

The FCA started its analysis by stating that the sole question in the appeal was whether the Tax Court judge erred in finding that Mr. Berg made gifts entitling him to tax credits

pursuant to section 118.1 of the Act. The FCA said that it was evident that Mr. Berg understood from the outset that the series of interconnected transactions were designed to mislead tax officials as to the fair market value of the property transferred to the charity. This was done solely for the purpose of receiving inflated tax receipts and claiming inflated tax credits. Nor was there any doubt that Mr. Berg's participation in the scheme was conditional upon him receiving the Transaction Documents to support his inflated claims.

The FCA disagreed with the Tax Court finding that the Transaction Documents had no value. The documents had been clearly of value to Mr. Berg. He'd paid a substantial fee, well in excess of the value of the timeshare units he'd purchased, and the Transaction Documents were part of the package he received in return. Mr. Berg had used these documents to support his initial claim for the inflated tax credits and had continued to rely on them throughout the audit and objection. Although his position became untenable after the examination for discovery this did not change the fact that the Transaction Documents had value when they were delivered to Mr. Berg. The FCA said that *Berg* was indistinguishable from *Maréchaux*, and for that reason the Crown's appeal should succeed.

The FCA said that the Crown was entitled to succeed for a further reason. It was not open to the Tax Court judge to conclude that Mr. Berg had a donative intent. Mr. Berg had not intended to impoverish himself. He had participated in the program solely to enrich himself by making use of falsely inflated charitable gift receipts and he acted from beginning to end in a manner intended to achieve that result. Based on these reasons the FCA allowed the Crown's appeal, set aside the judgment of the Tax Court, and dismissed Mr. Berg's appeals from his 2002 to 2004 reassessments.

Chabad v. Canada (National Revenue)

2013 FCA 196
http://canlii.ca/t/g67mn

A key issue for all of the 'donation in-kind' charitable donation programs was finding a compliant charity willing to accept the donated non-cash properties and provide official income tax donation receipts at the program's greatly inflated claimed fair market values. In some of the schemes, such as the Global Learning Gift Initiative Program (reviewed in *Mariano v. The Queen* in this issue) the charities were specifically established by the scheme's promoters to facilitate the transactions. However, in other cases, such as *Guindon v. The Queen* 2012 TCC 287 and *Berg v. The Queen*, 2012 TCC 406 (both reviewed in this issue) the promoters managed to convince existing legitimate charities to participate. The donation program reviewed in *Berg* utilized Cheder Chabad as the charity accepting Mr. Berg's donations of vacation timeshare units. Cheder Chabad operated a school for boys in the Toronto area and had approximately 180 students. The school taught both secular studies and Jewish studies of the Orthodox Chabad – Lubavitch tradition. Cheder Chabad stated in an affidavit at the Federal Court of Appeal ("FCA") that over 80% of the students at the school receive a partial or full subsidy to cover their tuition costs. The funds to subsidize the tuition largely came from Cheder Chabad's fundraising activities in its capacity as a charity registered under the Income Tax Act.

Cheder Chabad did not limit itself to issuing receipts for just the Berg scheme. The FCA noted that, apart from the vacation timeshares, Cheder Chabad had issued receipts for other donations in kind such as art works and jewelry. The charity issued over $10,000,000 in donation receipts for gifts in kind that it was unable to substantiate. The CRA did a compliance audit of Cheder Chabad and, as a result, issued a notice of a proposal to revoke Cheder Chabad's registration as a charity under the *Income Tax Act*. This would end Cheder Chabad's ability to issue tax deductible donation receipts. Cheder Chabad asked the FCA to prohibit the CRA from publishing a notice of revocation for an additional six months to allow it to try and sell the donations in kind it had accepted. Cheder Chabad submitted that without an orderly liquidation of its assets and the ability to collect tuition fees and to issue donation receipts for the religious instruction component of its curriculum the school might be left without sufficient funds to operate through the current school year. This would result in its closure or in serious disruption of its activities affecting both the students and staff of the school.

While the FCA was not willing to prohibit publication for the requested six months it allowed a four month delay in publication to allow Cheder Chabad to complete the current fall semester. The court said that during this period Cheder Chabad would be expected to proceed with an orderly liquidation of the assets in kind it received as charitable donations. It was also expected to develop an alternative plan to continue the operations of the school after December 31, 2013 without the status of a registered charity under the Income Tax Act.

Mariano v. The Queen

2015 TCC 244
http://canlii.ca/t/glrs3

This appeal involved the denial of claimed charitable donation credits. Douglas Moshurchak was denied credits for claimed charitable donations of $130,250 in cash and $854,805 of in-kind donations during his 2004 and 2005 tax years. Juanita Mariano was denied tax credits for a cash donation of $7,500 and an in-kind donation of $37,544 in her 2005 tax year. The "in-kind" donation for both taxpayers was the claimed fair market value of computer software licenses ("the Licenses").

The Crown identified 5 legal issues related to determining the issue of whether the appellants were properly denied their charitable contributions. Four were considered at trial;

> 1. Did the Appellants make any 'gifts' to Millenium and CCA [the charities later defined] within the meaning of section 118.1? The Respondent says this involves determining whether the Appellants had the "donative intent" to do so, as well as whether a gift was actually made having regard to the other requisite elements of a gift.
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> 2. Is the Global Learning Trust (2004) a valid trust at law? The Respondent challenges the validity of the Trust due to its failure to have "certainties" present or due to the non-exercise of unassignable duties by its Trustee.
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> 3. Is the GLGI Program and all the transactional steps involved in it a "sham"?
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> 4. If 1 and 2 are answered in the affirmative and 3 in the negative, then was the fair market value of the licenses donated what the Appellants claimed?

The appellants argued that the only issue in dispute was the fair market value of the Licences. They claimed these were worth at least the amounts the appellants had claimed for them apart from Mr. Moshurchak's concession that the value of the licenses that he donated in 2005 was only $423,057, not the $812,051 he'd originally claimed.

The charitable donation program ("the Program") was what the judge called a "leveraged donation scheme" which was marketed as a way to make a profit from donating the Licenses to a registered charity. The donated Licenses were six different computer training programs. Three were training courses on how to use various versions of Microsoft Office and three involved highly technical applications for individuals training to become computer hardware technicians. Phoenix Learning Corporation ("Phoenix"), a Bahamian corporation, acquired the Licenses for the Program. They were purchased at arm's length from Infosource Inc. ("Infosource"), a Florida company in the business of developing and selling computer training courses. Phoenix purchased the Licenses in bulk at prices ranging from 13.3 cents to 26.7 cents per Licence and then gifted them to Global Learning Trust ("the Trust"), a Canadian trust. All of the Program participants were made capital beneficiaries of the Trust and were given their Licenses as a capital distributions from the Trust. The participants in turn donated the licenses to a compliant charity, Canadian Charities Association ("CCA"), and received donation receipts based on the claimed fair market values of the Licenses. Program participants were required to make a separate cash donation to another charity, Millenium Charitable Foundation ("Millenium"). Millenium, like CCA, was apparently established as part of the Program. The claimed fair market value of a participant's donated Licenses was at least three times greater than the participant's cash donations to Millenium giving the participants, at a minimum, a combined cash and License donation at least four times greater than their cash outlays.

Infosource entered into various licence agreements with Phoenix from 2004 to 2007 and, by the end of 2006, Infosource had transferred more than 5,000,000 Licences to Phoenix. Infosource's market was mostly in the United States. At all relevant times the licenses sold by Infosource to its non-charity customers were available either online or on CD Roms. The subject Licenses were not in either of these formats.

At trial the appellants argued that the Court should focus on their perspective when they made the cash donations. Their position was that they met the required conditions for making a valid donation; they owned the donated cash, they donated it to a registered charity, they obtained a valid donation receipt; and they claimed the deduction in the appropriate year. The appellants also claimed that they met these conditions in respect to the License donations. The appellants argued that the circumstances behind them obtaining the Licenses, the entire complex donation structure set up by the Program, were irrelevant as was the fact that Millenium and CCA were subsequently deregistered. They argued that all the necessary conditions were met at the times they gifted the cash and the Licenses and the gifts were separate, unconditional, and did not result in any benefit to them other than their desire to make a gift and to obtain the tax advantages that they were entitled to.

The Crown alleged that the appellants participated in the Program in order to obtain a profit from their donations. The intent of the Program was for participants to receive tax refunds from the charitable tax credits which exceeded the amounts of their cash

donations. For example Mr. Moshurchak's 2005 donation receipt from CCA for his License donations was eight times greater than his cash donation to Millenium.

The judge said that there was no dispute that the Act does not define what a "gift" is and referred to the definition given by the Federal court of Appeal in *The Queen v Friedberg*, 92 DTC 6031, at page 6032, (affirmed by the Supreme Court of Canada):

> "[...]a gift is a voluntary transfer of property owned by a donor to a done in return for which no benefit or consideration flows to the donor."

This definition gave the three required elements of a gift; a voluntary transfer of property; the property must be owned by the donor; and there must be no benefit or consideration received back by the donor. While the expectation of receiving a tax receipt from a charity did not per se vitiate any gift, the expectation of an "inflated" tax receipt exceeding the value of the property transferred, or the receipt of any other benefit might vitiate a gift. It depended on whether, in the circumstances of a specific donation, the taxpayer intended to impoverish himself.

The appellants tried to differentiate the cash donations from the License donations to show that they were separate unconnected issues. They argued that the Program had not required them to donate the cash in order to be gifted the licenses from the Trust or to be allowed to donate the licenses to CCA. They argued that the cash donations were independent of the license donations and that they had been impoverished by the amount of cash they'd donated. Additionally, since they believed that the stated values for the Licenses were correct the appellants received no benefit when making the License donations. The Appellants argued that their position was evident from both the intention of the parties, as evidenced from their testimony, as well as the documents the appellants signed in respect to the various transactions.

The judge did not accept this argument. He said, in effect, that the transaction documents and the appellant's own testimony proved the opposite, that they had no donative intent and made the donation with the expectation of profiting from them. The judge went through the various documents authorizing the series of Program steps from the software purchase from Infosource to the issuance of the donation receipts and concluded that the software and cash donations were interrelated and the appellants would not have been made capital beneficiaries of the trust without giving the cash donations.

The appellants had testified that their gifts were motivated by their desire to help others in need. The judge said that while the subjective intention of the appellants must always be considered this was not determinative. The appellants' own evidence was more consistent with an intention of receiving a benefit than making a gift. The evidence from their testimony and documentary evidence strongly suggested that they did not have an intention to impoverish themselves but instead intended to profit from their participation in the program. The judge said that Ms. Mariano was not even aware of the type of property that she had purportedly gifted. She admitted that she would not have donated the cash without receiving the benefit of the tax credits for the gift of the Licenses. The judge said that her subjective intention to receive a benefit was crystal clear from her admissions.

Mr. Moshurchak had testified that his intention was solely philanthropic, a desire to help the needy with no expectation of any benefit except the tax credits which he did not

consider to be a benefit, but an entitlement. The judge said that it seemed incredible that someone with a history of small donations would suddenly make cash donations of $14,250 in one year and $116,000 in another. He said that Mr. Moshurchak seemed to have put little thought or effort into investigating the charities he donated to or the software's ultimate distribution. Mr. Moshurchak had admitted that he and his spouse had commuted their teacher's pension into a lump-sum payout and he was aware the program had been marketed as a way to offset the income tax cost of cashing in a registered pension plan. All of these facts suggested that his subjective intention was not to impoverish himself but to instead profit from his participation in the Program. The judge did not find Mr. Moshurchak's testimony credible.

The judge concluded that the appellants had voluntarily chosen to participate in a leveraged donation scheme. It was marketed as a way to obtain a net tax benefit by the issuance of tax receipts entitling them to tax credits in excess of their actual cash donations. The judge said that he could not see how any person participating in such a scheme expected anything other than to profit from it since the profit potential was the basis of the scheme's marketing. The judge concluded that the appellants did not have a donative intent in make the gifts of the cash or the Licences. This was sufficient to dismiss the appeals however the judge also addressed other aspects of whether the appellants had made valid gifts.

The judge reviewed the ownership of the Licenses and concluded that the appellants had never legally acquired ownership of them. The appellants could not have identified the number or types of Licences they owned, either at the time they executed the deed of gift or at the time they were purportedly accepted as Trust beneficiaries. This was prima facie evidence that the appellants could not have owned the Licences they claimed to have gifted. The judge said it defied common sense to suggest someone could gift a property he could not in any way identify.

The Crown had argued that the Trust itself had not been validly established so there were no distribution of Licences from the Trust to the appellants as capital beneficiaries. After a review of trust law and the specifics of the Trust the judge agreed with the Crown's submission. He determined that none of the participants in the Program were legally established as capital beneficiaries and there had not been a proper distribution of any capital property of the Trust to them. Since the appellants had not received the licenses their claimed donations were not valid gifts.

The final issue considered by the Court was the fair market value of the donated Licenses. Both parties had a qualified valuator give expert testimony. The Crown's expert valued the Licenses using a cost approach, effectively taking the position that the price that Phoenix had paid Infosource for the Licences was their fair market value. This had been an arm's length business transaction and reflected the only comparable asset transaction available to consider, the sale of courseware licences which were not in a CD Rom or online format and had to be converted to such a format at the purchaser's expense.

The appellants' expert valued the Licenses using a market approach based on Infosource's CD Rom and On-line license sales to its regular customers, educational institutions such as district school boards. The valuator used Infosource's 2003 retail price list as the basis of the regular retail prices for the six subject courseware licenses then discounted these list prices on the assumption that Infosource's regular sales

were made at the list price less a discount. He said that this was consistent with the common method of selling similar licences in the ordinary course of business. The valuator did not use the transactions between Infosource and Phoenix as a comparable. He rejected the use of these sales because he assumed the two parties were not at arm's length on the grounds that the sales had a philanthropic rather than a commercial purpose. The judge rejected the appellant's Expert Report (the Report), considering it unreliable. He listed numerous deficiencies he'd found in the Report (note—the section titles are from the decision).

1. The Report valued the wrong asset—The comparable transactions used by the valuator to determine the values of the donated Licenses were Infosource sales of courseware already on CD Rom or online format. The subject Licenses were not on either of these formats but the Report did not reduce the License values to reflect this. The judge said that the Licences could not have the same value as the already converted licenses used as comparables. Additionally, the Report did not consider the expenses an arm's length party would incur in marketing, selling and distributing such products. Infosource had expenditures for rents, salaries, commissions and other business expenses, all of which play a role in marketing, selling and distributing their finished products. The Report's failure to consider any adjustment for these factors rendered the valuation suspect and unreliable.

2. The Report considered the wrong market—The Report relied on notional sales to educational customers, retail transactions with school boards and similar entities that paid market price for the products purchased. No explanation was given why the educational market was used. In the judge's opinion the most relevant market for valuing the donations was not the retail market. It was the charitable donation market, a market created by the Program which acquired millions of licences over a few years for distribution to charitable recipients.

The judge cited *Lockie v the Queen*, 2010 DTC 1121 (Reviewed in *Valuation Law Review* Volume 17, Issue 2) for guidance in determining the appropriate market. *Lockie* involved a leveraged donation program that was based on the charitable donation of school supplies which were purchased wholesale in very large quantities then valued for donation purposes at their individual Canadian retail prices. *Lockie* found that the retail market was not the appropriate market to use and determined that the more appropriate market was the "wholesale" market, the market that had sold the supplies to the donation program. Based on this the judge in *Lockie* used the prices that the program had paid the wholesale suppliers as the fair market value for donation purposes. The *Mariano* judge found the *Lockie* findings relevant to the License purchases and said that, consistent with the *Lockie* findings, the wholesale price paid by Phoenix to Infosource for the unconverted Licenses appeared to be the best comparable price.

3. The Report failed to consider effect of the supply of Licences in the market—The Report valued only the 5,451 Licences donated by the appellants. However the evidence showed that on the dates that the appellants received their Licences hundreds of other Trust capital beneficiaries had also received thousands of licences that they donated to CCA. The Master Licence Agreement allowed the Program to purchase over 5 million Licences by 2007 but no effort had been made in the Report to consider their impact on the fair market value of the appellant's donated Licences.

Moreover the Report made no mention of the impact that possible competitors to Infosource would have had on the valuation. The Report's approach was contrary to the definition of fair market value where buyers and sellers would be informed and supply and demand would be an essential element. The judge said that this omission was fatal to the valuation.

4. The valuation was "devoid of common sense"—The judge said that in the case at hand Licences were purchased by Phoenix for between 13 and 26 cents each and their values increased exponentially in the very short period of time before they were donated. Mr. Moshurchak donated 4,321 Licences in 2005 which would have cost Phoenix, at most, $1,123 based on the highest price paid of 26 cents per Licence. Yet the Report valued them at $423,057.

5. The assumption that Infosource and Phoenix were not dealing at arm's length was unfounded—The judge said that the appellant's valuator had assumed the parties were non arm's length based solely on information provided by a former employee of Infosource. There was no evidence the valuator attempted to contact the owners of Infosource to determine its shareholdings or other facts relevant to determining the issue. The judge said this information was, at best, hearsay. Moreover, the general testimony of the former employee was inconsistent and was not credible.

6. The Report was not impartial—The judge said that an e-mail entered into evidence confirmed that an individual involved in the Program actively advocated for higher prices and had a large role in the preparation of the expert report. The judge said that the e-mail cast doubt on the credibility of the expert report; suggesting that the valuator was tailoring his report to meet the needs of his client and it was not an impartial report contrary to the obligation of expert witnesses to the court.

The judge said that while the Crown's expert report also had flaws he found the report to be more persuasive for what he called "one very basic reason." The Crown's report based its value on the prices that the Licenses could be purchased for on the open market and used the arm's length transactions between Infosource and Phoenix as evidence of that price. It was the judge's view that these sales were the correct comparable transactions. The judge therefore accepted the Crown's valuation report's conclusion of a value of between 13 cents and 26 cents for each license.

As a result of this analysis the Court found that the appellants did not have a donative intent to make any of their gifts, they did not own or transfer the Licenses that they claimed to have donated, and that the Program was a sham. Additionally the Court found the value of each Licence was 26 cents. Based on these reasons, the appeals were dismissed.

Vine Estate v. The Queen

2014 TCC 64
http://canlii.ca/t/g6384

[2015] 4 FCR 698, 2015 FCA 125
http://canlii.ca/t/gj55c

Mr. Stanley Vine died in 2003. At the time of his death he owned all of the issued shares of Leadway Apartments Limited ("Leadway"). Leadway owned a 171-unit rental

property with two apartment buildings in Toronto ("the Wilson Property"). In 2007 the estate was reassessed regarding the fair market value of Leadway. The company value was determined by the fair market value of the Wilson Property. The original date of death return had valued Leadway based on a $9,111,000 value for the Wilson Property. The reassessment assigned a value of $12,000,000 to the Wilson Property. The estate appealed the Canada Revenue Agency's value of Leadway. Both parties had expert appraisal witnesses at the Tax Court hearing. The appellant's witness valued Wilson at $8,595,000, while the Crown's witness gave the property a value of $12,832,000.

This review will not go into details on the appraisal approaches taken by the two experts but will instead focus on the court's comments regarding expert credibility. The appellant's expert capitalized normalized net operating income based on past years and projected revenue for the next year. The Crown's expert used a discounted cash flow calculation based on what he called the principle of "anticipation." Although rent increases in the Toronto rental market were tightly constrained by Ontario rent control legislation the appraiser assumed "dramatic increments" to rent revenues after the valuation date.

Prior to reviewing the two appraisals the Tax Court judge commented on her conclusions regarding the Crown's expert report. She said that she had three observations on his report and testimony. Firstly the report contained too many significant errors and unwarranted assumptions for the court to place any reliance on it. Second, both the expert's credibility and impartiality as a witness and an expert were compromised during his testimony and, third, as a consequence, the judge gave the report no weight.

One issue that the judge said undermined the Crown's expert's "objectivity and impartiality as a witness and a qualified expert and makes his testimony as a whole suspect and unreliable" was his undisclosed access to both the initial CRA appraisal report and the appellant's expert report prior to preparing his own report. The judge said that his independence as an appraiser was compromised once he saw and read both of these other appraisal reports. The judge said that the expert had not disclosed his access to these appraisals in his report as he should have done nor did he reveal this in cross-examination until repeatedly questioned on the issue.

The judge did not agree with assumptions in the Crown's appraisal report. The appraiser assumed a normalized operating income well in excess of what the business was currently realizing in rents even though the properties were under rent control and Leadway could not increase the rents of the tenants in the controlled apartments. The appraiser justified the higher apartment rents by "speculative assumptions" regarding an assumed very high annual turnover of Leadway's tenants. This would allow the rents in the below market apartments to be reset. The appraiser's normalized operating income calculation was based on the hypothetical rent increases allowed from his post-valuation date apartment turnover assumption. This assumption accounted for most of the differences in value between the two reports. The judge said that even if she had given any weight to the Crown's report she would have rejected this part of the analysis. She said that common sense dictated that tenants paying below-market rents would not vacate their units except under exceptional circumstances and they could not otherwise be forced out. The judge called it "interesting" to note that the appraiser suggested that the below-market rents could be attributed to poor management by Leadway rather than a result of rent controls. The judge said that there was no factual

basis for this suggestion and she could not see how better management could have evicted the rent-controlled tenants or encouraged them to leave in an effort to get rents up to market levels.

The judge also had issues with the properties the appraiser chose as comparables. Three of the five were superior to the Wilson Property and, while the expert acknowledged that a downward net qualitative adjustment would be required for each of these three properties to be comparable, the expert's report did not disclose any adjustment for those properties.

The judge reviewed numerous other issues she had with the appraisal and concluded her review of the Crown's report by saying that it contained many unsupported assumptions, inconsistencies, omissions and numerous errors, mathematical and otherwise. The expert was unable, in his testimony, to provide acceptable explanations for such assumptions and inconsistencies and was, overall, a less than objective witness. Although the judge found errors in the appellant's report she found the expert's testimony straightforward and credible. Based on this she accepted the appellant's expert's value conclusion.

Kossow v. The Queen

2012 TCC 325
http://canlii.ca/t/fsstb

2013 FCA 283
http://canlii.ca/t/g2772

2009 CanLII 49589 (SCC)
http://canlii.ca/t/25pv2

Ms. Kossow had participated in a levered charitable donation program involving the donation of Rodin bronze castings. Ms. Kossow donated $160,000 through the program. This was funded with $32,000 of her own cash (20% of the donated amount) and the remainder through an interest-free loan with repayment due in 25 years. The CRA reassessed Ms. Kossow disallowing all of her claimed donations.

The Tax Court decision in this case was reviewed in *Valuation Law Review* Volume 19, Issue 2. The Tax Court judge dismissed Ms. Kossow's appeal on the basis that the Federal Court of Appeal ("FCA") decision in *Maréchaux v. The Queen*, 2010 FCA 287 was determinative. The Tax Court had dismissed Mr. Maréchaux's appeal on the basis that the definition of 'gift' did not allow a donor to receive any consideration in return for making a donation. Mr. Maréchaux had received an interest-free long term loan similar to the loan received by Ms. Kossow. Both the Tax Court and Federal Court of Appeal's *Maréchaux* decisions are reviewed in *Valuation Law Review* Volume 17, Issue 2.

Ms. Kossow appealed the decision to the Federal Court of Appeal ("FCA"). Ms. Kossow appealed on three issues but the only one relevant to this review was whether the Tax Court had been correct in law by concluding that the facts in *Kossow* were not distinguishable from *Maréchaux* so that the Tax Court was bound by the *Maréchaux* conclusion that the appellant had not made any gifts for the purposes of s. 118 of the *Income Tax Act*.

The FCA stated that in *Maréchaux* the courts had dealt with a leveraged charitable donation program which was strikingly similar to the *Kossow* donation program, particularly in that a substantial part of the purported gift was funded by an interest-free loan provided by the promoters on terms that were part of a series of interconnected contractual arrangements. *Maréchaux* stood for two propositions. A long-term interest-free loan is a significant financial benefit to the lender and that a benefit received in return for making a gift will vitiate the gift. The FCA said that it was evident from the facts that the long-term interest-free loans received by Ms. Kossow resulted in Ms. Kossow receiving a significant financial benefit. Ms. Kossow's participation in the program had been conditional upon her receiving these loans. The FCA found that the relevant facts in *Kossow* were so similar to the facts of *Maréchaux* that the Tax Court judge was correct in relying on the *Maréchaux* decision. Based on this the FCA dismissed the appeal. Ms. Kossow filed leave to appeal with the Supreme Court of Canada but leave to appeal was dismissed.

Grimes v. The Queen

2016 TCC 280
http://canlii.ca/t/gvxvt

The appeal resulted from the reassessment of the Ozerdinc Family Trust No. 2 (the "Trust") in respect to its 2011 taxation year. The Minister of National Revenue reassessed the Trust to increase its taxable income by $4,035,242. The reassessment resulted from the application of subsections 104(4) and 104(5.8) of the Act which deemed that 21 years after the Trust was created it disposed of its capital properties at fair market value and immediately reacquired the properties at the same fair market value.

The Trust owned 2,699,900 first preferred shares and one common share of 1634158 Ontario Inc. ("Holdco"), a holding company. Holdco owned 100% of the shares of Site Preparation Limited ("SPL"), a company active in the industrial, commercial and institutional sectors of the construction industry.

The trustees of the Trust filed a notice of objection regarding the reassessment. Both parties agreed that the Trust was subject to the application of the 21-year deemed disposition rules with the deemed disposition day being February 1, 2011. At issue was the determination of the fair market value of the capital property held by the Trust on that date. The Trust engaged one expert witness to testify at the Tax Court hearing. The Crown called two expert witnesses, a CRA employee and an outside expert. The Tax Court judge identified five issues he said it was necessary to examine in order to determine the fair market value of the subject shares.

(1) Which financial statements should be the starting point for the evaluation of the shares of SPL? The internal financial statements of SPL as of January 31, 2011 prepared by the Management ("Internal Statements") or the audited financial statements of SPL as of February 28, 2011 prepared by Raymond Chabot Grant Thornton ("RCGT Statements")?

(2) Should the fair market value of the shares of SPL be reduced by the amount of advances made to a director of SPL ("Directors' Advances")?

(3) Should the fair market value of the shares of Holdco be reduced by the amount of the advances made to a shareholder ("Holdco Advances")?

(4) Should embedded personal income taxes be considered in the fair market value determination of the Holdco shares?

(5) Should a minority and/or marketability discount(s) be applied to the value of the Class A Common Share of Holdco held by the Trust?

Ms. Kathleen Grimes testified at trial. She and her husband, Mr. Ersin Ozerdinc, were the Trust's two trustees. They had been operating SPL since 1990 and were at all material times SPL's key managers. Holdco was created in 2005 as a way to take cash out of SPL through inter-company dividends. Holdco was controlled by Ms. Grimes through her ownership of about 69% of the voting rights.

Ms. Grimes testified regarding the advances in questions 2 and 3 above. $1,144,887 (the Holdco Advances in Question 3) was transferred from Holdco to Ms. Grimes. She said that this money was not advanced to her personally but in her position as a trustee. She testified that there was never any intent to repay these advances.

In respect to the $2,257,132 in shareholders advances from SPL (question 2) Ms. Grimes explained that she and her husband did not receive salaries from SPL but were instead compensated through bonuses. At the end of each fiscal year they decided on their bonus to be paid by SPL. The advances were amounts paid to them during the year and cleared through bonuses at year-end. Therefore these advances were never intended to be repaid.

Valuation of the Shares

While various exhibits were filed at Tax Court in respect of the valuation of the Holdco shares this review will only consider in detail the two expert reports entered at the Tax Court hearing. The appellant's estimate valuation report ("MNP Report") determined a fair market value of $4,727,122 for all of Holdco's issued shares and a fair market value of $3,635,000 for the shares held by the Trust. The respondent's comprehensive valuation report ("Spencer Report") determined a fair market value of $9,056,965 for all of Holdco's shares and a fair market value of $9,056,964 for the shares held by the Trust. Both reports were accepted by the courts as expert reports. This review will consider the main points of agreement and contention between the reports and the judge's analysis. Both reports started by valuing SPL since it was 100% owned by Holdco.

The MNP Report

The MNP report considered the three basic approaches to valuing a business, the asset-based (cost) approach, the income approach, and the market approach. MNP decided that the asset-based approach was the appropriate basis for valuing both SPL and Holdco. Holdco was a passive holding company whose main asset was its 100% interest in SPL. SPL was best valued on an asset basis because it was a construction company dependent on project bidding. It had no significant contracts and had no goodwill.

MNP first determined that SPL has a net shareholder's equity of $6,080,771 on February 1, 2011. $203,549 was added to this to reflect the net increase in value of company-owned land. MNP calculated that there was a $997,080 tax liability on

deferred income. This was deducted from equity along with the $2,257,132 of director's advances that, as noted earlier, Ms. Grimes had testified would not be repaid. There were minor deductions for the cost of selling the land and a loss on investments. Finally $56,000 was added for the amount of accumulated Refundable Dividend Tax On Hand ("RDTOH") discounted by 50%. This resulted in a net value of $3,044,500 for SPL.

MNP replaced Holdco's recorded $200 book value for its investment in SPL with SPL's $3,044,500 fair market value. The $1,144,887 in Holdco shareholder advances that Ms. Grimes had testified would not be repaid were deleted from Holdco's assets. With another minor adjustment this gave Holdco an adjusted asset value of $4,727,122.

The next step was the determination of the value of the Trust's Holdco shares by allocating Holdco's overall corporate value amongst the various share classes. The issued shares were;

1 Class A voting Common Share ("the Common Share")

2,700,000 non-voting $1 First Preferred Shares

12 Voting $1 Fifth Preferred Shares

The Trust owned the 2,699,900 First Preferred Shares and the Common Share. Kathleen Grimes owned the twelve voting Fifth Preferred Shares which gave her voting control of Holdco. MNP valued the First Preference Shares at their $1 per share redemption value for a total value to the Trust of $2,699,900. Mrs. Grimes' twelve Fifth Preferred Shares were allocated their $1 redemption value plus a $253,390 voting control premium. The premium was calculated as 12.5% of the $2,027,122 Holdco value after the allocation of $2,700,000 to the non-voting First Preferred Shares. MNP noted that the control premium on the preferred shares was, in reality, a minority discount imposed on the Common Share. The Common Share was given a value of $1,773,731. This was the residual company value after assigning values to the two classes of preferred shares.

MNP then reduced the value of all of Holdco's shares by deducting an allowance for the hypothetical personal income taxes a notional holder would pay on the shares' assumed redemption. MNP used a personal combined tax rate of 49.53% discounted by 50% for the uncertainty of the timing of redemption. This resulted in a reduction of $669,000 to the value of the First Preferred Shares giving them a final fair market value of $2,031,000. The Common Share value was reduced by $439,000 giving it a value of $1,334,731.

MNP made one final adjustment to the value of the Common Share. MNP said that it was valuing the share on a stand-alone arm's length basis by ignoring the family context and viewing its value apart from the other family shares. In MNP's view this required a marketability discount to reflect the illiquid nature of the share due to its lack of control and the limited market for it on a stand-alone basis. MNP applied a 30% marketability discount based on various empirical studies that had shown marketability discounts ranging from 15% to 45%.

The Spencer Report

The Crown's valuation evidence was entered as the Spencer Report ("Spencer"). The report used the same adjusted net book value method as MNP for both SPL and Holdco.

Spencer valued SPL at $6,267,879 as opposed to MNP's value of $3,044,500. By far the largest single item contributing to this difference was SPL's outstanding Director's advances of $2,257,132 which the MNP report had deducted from SPL's assets on the basis that it would not be repaid. The Spencer Report left the advances in the balance sheet as a company asset. Spencer also made a number of other relatively minor adjustments to SPL's asset and liability book values including management fees, investments, and land values.

The only change Spencer made to Holdco's balance sheet was to replace the $200 book value of Holdco's investment in SPL with SPL's $6,267,879 fair market value. Spencer did not deduct Holdco's $1,144,887 in advances to shareholders from the balance sheet. This resulted in a fair market value of $9,056,965 for all of Holdco's issued shares. The Spencer Report allocated this amount to the various classes of shares on the assumption that all of Holdco's issued shares would be sold in a combined sale and that a purchaser would acquire all of the company shares, both those owned by the Trust and those held by Ms. Grimes. Using this basis Spencer allocated $2,700,000 to the 2,700,000 First Preferred shares, $1 for all of the 12 Fifth Preferred Shares (redeemable at $0.10 per share), and the remaining $6,356,963 to the 1 Class A common share. The Spencer Report did not apply a marketability/ liquidity discount or a control premium to any shares and did not deduct the personal taxes that would have been paid by the shareholders on a disposition. This resulted in the Holdco shares owned by the trust having a total value of $9,056,863.

Analysis

The judge agreed with the asset-based valuation approach used by both parties so her review focused on the areas where the two valuations differed. The judge did a very detailed analysis of the differences between the two valuations and her reasons for deciding on a value. It is not possible to consider this in depth so this review will just do an overview of the significant issues.

Valuation of SPL—The first issue to be resolved was which financial statements to use. This went back to one of the judge's questions at the beginning of the review;

(1) Which financial statements should be the starting point for the evaluation of the shares of SPL: the internal financial statements of SPL as of January 31, 2011 prepared by the Management ("Internal Statements") or the audited financial statements of SPL as of February 28, 2011 prepared by Raymond Chabot Grant Thornton ("RCGT Statements")?

The Spencer report had concluded that the Internal Statements were the most appropriate. Spencer considered that any adjustments based on using the RCGT Statements involved hindsight because the statements were prepared as of February 28, 2011. This was 27 days past the valuation date. The January 31, 2011 Internal Statements were done one day prior to the valuation date.

The MNP Report used the RCGT Statements on the basis that they were audited and therefore the most reliable available. They contained all the correct year-end adjustments and the MNP Report had made adjustments to take them back to the valuation date. The judge accepted the RCGT Statements as the correct financial statements for the valuation calculations. She said that this did not entail hindsight because the auditors had considered the entire fiscal year in preparing the statements, not just the post-valuation date factors.

The next major issue was the treatment of the advances to SPL's Directors and Holdco's shareholders. The judge said that Ms. Grimes testimony had been credible and she accepted that the SPL advances would not be repaid. They were effectively advances on management salaries and were made consistent with prior years' practice. The declaration and payment of offsetting bonuses after the valuation date did not involve hindsight but were instead corroboration of the owner's intent at the valuation date and would be taken into account by prospective purchasers.

Valuation of Holdco—The only valuation issues the Court considered in respect to the overall value of Holdco were the advances to shareholders and MNP's deduction of personal income taxes on an assumed redemption of Holdco's shares. While the judge had not given any value to the SPL director's advances she took the opposite position in respect to the $1,44,887 of shareholder's advances on Holdco's balance sheet as of February 28th, 2011. These advances were not repaid but were instead offset by dividends over a year after the valuation date. The judge said that relying on the dividend offset was an improper use of hindsight on MNP's part regardless of Ms. Grimes testimony that the advances would not be repaid. The judge stated that, at the valuation date, Ms. Grimes would not have sold Holdco at a price that did not reflect the value of the advances. Based on this, she concluded that the advances were worth their face value.

The judge then considered MNP's deduction of personal income taxes from the Holdco share values. These were the assumed taxes that the holders of the shares would pay on a hypothetical share redemption discounted by 50% for timing uncertainty. The judge did a review of case law on the issue and concluded that, on the facts of the case, income taxes should not be taken at the shareholder's level. She based this position on her view that there was no reason to believe that Holdco would be liquidated in the near future.

The next step was the allocation of the overall Holdco corporate value between the three classes of shares. The judge allocated the first $2,700,000 to the 2,700,000 non-voting $1 First Preferred Shares based on their $1 per share redemption price. This left the remaining corporate value to be allocated between the Fifth Preferred Shares and the Common Share. This allocation was of importance because only the Common Share was owned by the Trust. The judge first considered MNP's indirect minority discount applied to the Common Share through the attribution of a control premium to the twelve Fifth Preferred Shares. This discount was based on the assumption that the Common Share should be valued on a stand-alone basis putting the Common Share in a minority position with twelve of the company's thirteen votes held by the Fifth Preference Shares owned by Ms. Grimes.

The Spencer Report did not apply a minority discount to the Common Share. The judge said that the assumptions supporting this position were improper. The most critical assumption was that all of the issued Holdco shares would be sold to allow a purchaser to acquire all of Holdco's voting capital. The Spencer report had assumed that Mrs. Grimes, as part of her responsibility as a trust fiduciary, would be required to sell her control block of twelve Fifth Preferred Shares in order for the Trust to obtain the highest price for its Common Share. The judge rejected this assumption and agreed with MNP's position that only the Holdco shares held by the Trust should be assumed to be sold. She concluded that Ms. Grimes had no legal or fiduciary obligations to sell her voting Fifth Preferred Shares. Using this basis a minority discount was warranted for

the Common Share. The judge did a review of the jurisprudence in respect to minority discounts and, while not citing any specific case as being definitive, concluded that MNP's 12.5% minority discount from the Common Share's value was reasonable.

The judge also rejected the Spencer Report's reasoning for not applying a marketability discount to the Common Share. She said that Spencer had relied on a number of factors such as the asset-based valuation method used to value Holdco, the nature of the assets held by Holdco and the business philosophy of management as reasons not to discount. The judge said that these were all factors relating to Holdco as a company but without any specific reference to the value of the Common Share. It was inappropriate to rely on these factors in determining the appropriateness of applying a marketability discount to the Common Share.

This left only the marketability discount. The MNP Report had considered the factors specifically applicable to a marketability discount on the Common Share. These were the limited market for the share, the absence of a redemption policy, the absence of distributions prior to the valuation date or any assurance of future distributions during the holding period. The judge considered all of these relevant in the determining the appropriateness and quantum of a marketability discount. However the judge noted that MNP had also considered the Common Share's lack of control as a support for the marketability discount. This had already been considered in determining the control premium allocated to the twelve Fifth Preferred Shares. The judge concluded that MNP was double-counting the Common Share's lack of control by also including it in the marketability analysis. For this reason the Court reduced MNP's claimed 30% marketability discount to 15%. Spencer had valued the Common Share at $6,357,000 and MNP had valued it at $1,335,000. The Court determined that the share was worth $2,641,434.

Abbott and Haliburton Company v. WBLI Chartered Accountants

2012 NSSC 210
http://canlii.ca/t/frkdg

2013 NSCA 66
http://canlii.ca/t/fxl0z

White Burgess Langille Inman v. Abbott and Haliburton Co
2015 SCC 23
http://canlii.ca/t/ghd4f

The defendants, WBLI Chartered Accountants and R. Brian Burgess, had acted as external auditors for A.W.A.R.D. Wholesalers and Retailers Distributors Limited ("AWARD") for about 25 years. AWARD was established by the plaintiffs as a bulk buying agent for their various building materials retail businesses. In 2005 the plaintiffs retained the accounting firm Grant Thornton to complete a review engagement of AWARD. In September 2006, partly on the basis of work conducted by Grant Thornton, the plaintiffs commenced an action for professional negligence against the defendants. The plaintiffs had various claims about the AWARD financial statements the most significant being that, between 1995 and 2004, AWARD's managers had misallocated rebates and the defendants had negligently failed to uncover this resulting in $17,000,000 in losses.

The defendants filed a motion for summary judgment. In response, the plaintiffs filed an affidavit by Susan MacMillan, a forensic accounting expert and a partner at Grant Thornton in Halifax. The defendants filed a further motion seeking an order striking out or expunging the affidavit. The defendants argued that the MacMillan affidavit contained opinions that were neither independent or unbiased. The defendants claimed that Ms. Macmillan had a financial interest in the outcome because she was a partner at Grant Thornton and could not take a contrary view to the conclusions of the Kentville Grant Thornton office without exposing her partners to potential liability. The defendants also contended that Ms. MacMillan's opinion violated the standards set up by the accounting profession to minimize conflicts of interest.

The plaintiffs argued that Ms. MacMillan's affidavit met the requirements for admissibility and any concerns that existed regarding independence and impartiality went only to the weight the court would give her evidence. The plaintiffs submitted that the degree of affiliation between Ms. MacMillan and her partners at Grant Thornton did not disqualify her evidence. They further submitted that Ms. MacMillan's affidavit did not contravene her profession's standards for conflicts because the Kentville office of Grant Thornton had not done any work regarding AWARD contemporaneous to the work conducted by Ms. MacMillan.

The motions judge said there were three broad categories on which expert evidence could be attacked, one of which was a challenge that the expert was insufficiently independent and impartial to properly assist the court. There was no disagreement between the parties that an expert's report must be, and must be seen to be, independent and impartial. The judge said that Ms. MacMillan's affidavit fell well short of this requirement. This was a case where the reliability of the expert was so impugned that her evidence did not meet the threshold requirements for admissibility. The work of Grant Thornton formed part of the plaintiffs' statement of claim and case for negligence. When this work was put to the court as evidence Ms. MacMillan would be in an apparent conflict of interest. A reasonable observer would assume that she was constrained from providing a contrary view to that of her partners because it would expose her partners, and therefore herself, to the prospect of liability.

The judge concluded that this was a clear case where a motion to strike remedy was warranted. Ms. MacMillan's affidavit lacked the independence needed to meet the threshold of admissibility. She was in an apparent conflict of interest because of the work done by Grant Thornton. Based on this her affidavit was struck.

This decision was appealed to the Nova Scotia Court of Appeal. The appeal court said that partial witnesses testified in courts every day. If impartiality and independence were necessary attributes for a witness there would be no litigation. It was the job of the trier of fact to find where the truth lay and it was the role of cross-examination to ferret out biases or relationships that might affect the weight of the testimony. In the court's opinion the motions judge erred in law in finding Ms. MacMillan's evidence inadmissible. The sole test used by the judge was whether or not a reasonable observer would see Ms. MacMillan to be independent. This was not the correct test. The Appeal Court said that the four criteria given in the Supreme Court of Canada decision *R. v. Mohan* ([1994] 2 SCR 9, 1994) set the bar for admission of expert evidence. These are (1) relevance; (2) necessity in assisting the trier of fact; (3) absence of an exclusionary rule; and (4) a properly qualified expert.

The Court said that there was no stand-alone requirement for a party to demonstrate that its expert witness is, or appears to be independent. While a trial judge has the residual discretion to exclude expert opinion evidence if the judge concludes that an expert is biased or is acting as an advocate the proffered evidence was entered in the context of a motion for summary judgment. The ultimate probative value of Ms. MacMillan's opinion was for the trier of fact to determine. The Court therefore allowed the appeal and removed the provision striking Ms. MacMillan's affidavit. This was appealed to the Supreme Court of Canada ("SCC") and leave to appeal was granted.

The SCC stated that the process for determining the admissibility of expert opinion evidence is divided into two steps. At the first step, the proponent of the evidence must meet the threshold requirements of admissibility. *Mohan* established the four factors expert testimony must meet. Evidence which does not meet these requirements should be excluded. At the second step, the trial judge must decide whether expert evidence that meets the preconditions to admissibility is sufficiently beneficial to the trial process to warrant its admission.

Expert witnesses have a duty to the court to give fair, objective and non-partisan opinion evidence. There are three related concepts underlying this duty: impartiality, independence and absence of bias. The expert's opinion must be impartial in that it reflects an objective assessment of the questions at hand. It must be independent by being the product of the expert's own judgment, uninfluenced by who has retained him or her or the outcome of the litigation. It must be unbiased in that it does not unfairly favour one party's position over another. The test of this is whether the expert's opinion would change if the expert was retained by the other party. But the Court said that these concepts must be applied to the realities of adversarial litigation. Experts are generally retained, instructed and paid by one of the adversaries. These facts alone do not undermine the expert's independence, impartiality and freedom from bias.

The SCC concluded that preponderant view in Canadian jurisprudence was that an expert's lack of independence and impartiality went to the admissibility of the evidence and to the weight to be given to the evidence if admitted. The SCC said that this approach seemed to be more in line with the basic structure of Canadian law relating to expert evidence and with the importance the jurisprudence has attached to the gatekeeping role of trial judges. However the threshold requirement for admissibility was not particularly onerous and it would be rare that a proposed expert's evidence would be inadmissible for failing to meet it. It is the nature and extent of the expert's interest or connection with the litigation or a party that matters, not just that the interest or connection exists. A mere employment relationship with the party calling the evidence would be insufficient to make the expert inadmissible. An exclusion at the threshold stage of the analysis should occur only in very clear cases in which the proposed expert is unable or unwilling to provide the court with fair, objective and non-partisan evidence. Anything less should not lead to exclusion but should be taken into account in the overall weighing of the evidence.

The SCC said that the concept of apparent bias, the issue in this case, was not relevant to the question of whether or not an expert witness would be unable or unwilling to fulfill her primary duty to the court. When looking at an expert's interest or relationship with a party the question is whether the relationship results in the expert being unable or unwilling to carry out her primary duty to the court to provide fair, non-partisan and

objective assistance. Based on that standard the record amply sustained the decision of the Court of Appeal that Ms. MacMillan's evidence was admissible on the summary judgment application. The SCC agreed with the Court of Appeal which had concluded that the motions judge had committed a palpable and overriding error in determining that Ms. MacMillan was in a conflict of interest that prevented her from giving impartial and objective evidence. The appeal was dismissed with costs.

1207192 Ontario Limited v. The Queen

2011 TCC 383
http://canlii.ca/t/fn18v

2012 FCA 259
http://canlii.ca/t/ft9dg

Triad Gestco Ltd. v. The Queen

2011 TCC 259
http://canlii.ca/t/fm88z

2012 FCA 258
http://canlii.ca/t/ft83v

Barrasso v Queen

2014 TCC 156
http://canlii.ca/t/gflv0

These three appeals involved the reassessments of taxpayers who participated in three separate but very similar tax avoidance transactions. All of the appellants had created artificial capital losses by shifting share values from one class of shares to another. These artificial losses were then used to offset real capital gains.

The appellants incorporated shell companies and purchased the common shares from treasury at very high prices. The companies then issued preferred shares as dividends on the common shares with redemption amounts equal to the entire value of the common shares. This effectively transferred the company value from the common shares to the preferred shares. The common shares were then sold non-arm's length for a nominal amount triggering capital losses based on the common shares' original issuance prices. Since the appellants retained the high redemption value preferred shares they had not suffered any real economic losses.

The Canada Revenue Agency reassessed the taxpayers under section 245 of the Act (the "general anti-avoidance rule" referred to here as the "GAAR") disallowing the claimed capital losses. The taxpayers appealed on the basis that s. 245 was not applicable to these schemes.

Triad Gestco Ltd. ("Triad") and *1207192 Ontario Limited* ("Ontario") involved very similar sequences of events. Since the Federal Court of Appeal ("FCA") preferred the Tax Court's analysis of *Ontario* over the analysis of *Triad*, only *Ontario* will be covered in this review. *Barrasso* will also be reviewed because it had a facts set which the appellant claimed distinguished it from *Triad* and *Ontario*.

Ontario had appealed a reassessment of its 2003 taxation year. The Minister of National Revenue had applied the General Anti-Avoidance Rule ("the GAAR") in subsection 245(1) of the *Income Tax Act* to deny a capital loss of $2,999,900 realized by Ontario on the disposition of the common shares it held in 2022900 Ontario Inc. ("Newco").

In order for the GAAR to apply: there must be:

- a tax benefit resulting from a transaction or series of transactions of which the transaction forms a part; (s. 245(1) and (2));
- the transaction must be an avoidance transaction in that it cannot be said to have been reasonably undertaken or arranged primarily for a bona fide purpose other than to obtain a tax benefit; and
- there must be abusive tax avoidance in that it cannot be reasonably concluded that the tax benefit would be consistent with the object, spirit or purpose of the provisions relied upon by the taxpayer.

Ontario conceded that it had obtained a tax benefit as a result of the series of transactions that gave rise to the capital loss. At issue was whether there was an avoidance transaction, and if so, whether there was abusive tax avoidance. The analysis of these issues was largely driven by the specific facts of the transactions.

Mr. Dan Cross was Ontario's sole shareholder. Just prior to Newco's incorporation in February 2003, Ontario had realized $2,974,386 in capital gains on the sale of an insurance business. Mr. Cross was the sole director of Newco at all material times. Newco was authorized to issue unlimited numbers of common shares and Class A and Class B special shares with the following relevant attributes:

(a) the Class A special shares had no dividend entitlement but had a voting entitlement of 10 votes per share. These shares were redeemable at their stated capital.

(b) the non-voting Class B special shares were entitled to non-cumulative dividends at the discretion of the directors but only while held by the original shareholder. They were redeemable from the original shareholder for $100 per share. For subsequent shareholders the redemption amount was $0.10 per share plus any unpaid dividends. They were retractable for their $0.10 per share stated capital.

(c) the common shares were entitled to dividends at the discretion of the directors in preference to all other classes of shares. Each common share had an entitlement to one vote.

In February 2003, the Cross Family Trust was founded as a discretionary trust. The beneficiaries were Mr. Cross's wife and two children. Mr. Cross controlled the appointment of the trust directors. Also in February 2003, Ontario transferred $3,000,000 in cash and securities to Newco in exchange for 30,000 Newco common treasury shares. This was the first issuance of Newco shares. Immediately after this Newco declared a stock dividend of 1 Class B special share per common share. Ontario received 30,000 Class B special shares which had the 'original shareholder' redemption value of $100 per share and a total paid up capital for all 30,000 shares of $100. The Cross Family Trust subscribed for 10,000 Newco Class A special shares and paid a total of $100 for these shares. This purchase gave the Cross Family Trust voting control of Newco.

The series of transactions ended on February 28, 2003 when Ontario sold its 30,000 common shares in Newco to the Cross Family Trust for $100. The sale resulted in Ontario realizing a $2,999,900 capital loss, the difference between the common shares' issuance price of $3,000,000 and their $100 proceeds. However Ontario's Class B special shares were redeemable at $3,000,000 so Ontario had not suffered an actual loss. All that had happened was that the original $3,000,000 value for the Newco common shares had been transferred to the Newco special shares. Ontario used this capital loss to offset its existing $2,974,386 in capital gains realized from the sale of the insurance business.

The Tax Court judge first considered whether there had been an avoidance transaction. Mr. Cross had stated, and it was accepted by the Court, that the primary purpose of the series of transactions was to creditor-proof his proceeds from the sale of his business. However GAAR may be relevant if any step or steps in the series of transactions are not required to effect the primary non-tax purpose. The judge reviewed each step in the series and said that Ontario had not shown that the issuance of the common shares to Ontario was done as part of the creditor-proofing purpose. This step in the series did not accomplish anything necessary for the stated goal. The protection of Ontario's assets was achieved through the issuance of the Class B special shares to Ontario but it was not necessary for Ontario to first subscribe for common shares and then receive the Class B shares by means of a stock dividend that was paid on the common shares.

Ontario had submitted that the issuance of the common shares had been necessary to transfer the assets to Newco. The judge disagreed, saying that Newco could have issued the Class B shares directly to Ontario in exchange for the $3,000,000 in cash and securities rather than by issuing them as a share dividend on the common shares. In the judge's view the only reason that the appellant acquired the common shares was to allow the value of those shares to be shifted to the Class B shares prior to the disposition of the 30,000 common shares to the Cross Family Trust. This purpose had nothing to do with creditor-proofing and instead was designed to generate a capital loss for Ontario. The judge agreed that all of the other steps in the series of transactions were necessary to achieve the creditor-proofing objective.

The judge next considered whether the unnecessary step of issuing the common shares had resulted in abusive tax avoidance. The Supreme Court of Canada had set out the approach to be followed in making this determination in *Canada Trustco Mortgage Co. v. Canada*, [2005] 2 SCR 601, 2005 SCC 54 where the Court said:

> "44 The heart of the analysis under s. 245(4) lies in a contextual and purposive interpretation of the provisions of the Act that are relied on by the taxpayer, and the application of the properly interpreted provisions to the facts of a given case. The first task is to interpret the provisions giving rise to the tax benefit to determine their object, spirit and purpose. The next task is to determine whether the transaction falls within or frustrates that purpose. The overall inquiry thus involves a mixed question of fact and law. The textual, contextual and purposive interpretation of specific provisions of the *Income Tax Act* is essentially a question of law but the application of these provisions to the facts of a case is necessarily fact-intensive.
>
> 45 This analysis will lead to a finding of abusive tax avoidance when a taxpayer relies on specific provisions of the *Income Tax Act* in order to achieve an outcome that those provisions seek to prevent. . . . . . "

It was the Crown's position in the present case that the underlying rationale of the provisions of the Act that deal with capital losses was to allow a deduction where a taxpayer had suffered a real economic loss on a disposition of property outside of the economic unit of which the taxpayer formed a part. The Crown maintained that the result of the series of transactions undertaken by the appellant defeated this policy. The loss was fabricated by manipulating the value of the Newco common shares which Ontario held for only a few hours. The series of transactions did not result in a true economic loss.

The judge reviewed the Crown's arguments and dismissed them except for the argument that the transactions defeated or frustrated the underlying rationale of paragraph 38(b) of the Act because they did not result in a true economic loss to the appellant. The judge agreed with the Crown that the purpose of paragraph 38(b) is to give tax relief in circumstances where a taxpayer has suffered an economic loss on the disposition of property. The former subsection 55(1) was a tax avoidance provision aimed at the artificial reduction of gains and the artificial creation or increase in losses on the disposition of property. While subsection 55(1) was been repealed the reason for the repeal was Parliament's belief that the repealed provision could be enforced by the application of the GAAR. Based on this the judge found that the Crown had shown that the purpose of paragraph 38(b) was to recognize real economic losses suffered by a taxpayer on the disposition of property. The Crown had also shown that the Act supported the policy of disallowing artificial capital losses.

The judge said it was clear from the way the transactions were structured that there was never any intention that the common shares would represent the true value of Ontario's interest in Newco. Ontario's acquisition and pre-ordained disposition of the common shares to the Trust served no purpose except to manufacture a capital loss for tax purposes. The transactions were artificial and lacked substance with respect to the capital loss provisions of the Act. The judge found that the transactions carried out in this case were not executed within the object, spirit, and purpose of the capital loss provisions of the Act and that they constitute abusive tax avoidance under subsection 245(4). The appeal was dismissed with costs.

Ontario appealed the decision to the Federal Court of Appeal ("FCA"). The FCA said that the Tax Court judge had accepted that the principal objective of Mr. Cross in entering into the transactions was to achieve protection from potential future creditors and that the entire series of transactions had a bona fide non-tax purpose. The FCA then considered whether this plan had within it one or more transactions that had, as their principal purpose, the creation of the capital loss to achieve an admitted tax benefit. The FCA said that the Tax Court judge had correctly noted that there was no evidence that the creditor protection objective required the issuance of the Newco common shares to the Appellant. This absence of evidence on a point on where the onus of proof rested on the appellant led the Tax Court judge to find that the issuance of common shares of Newco to Ontario was not done primarily for a bona fide non-tax purpose.

Ontario argued that the Tax Court had erred in reaching this conclusion because it had proceeded on a purely objective basis without considering Mr. Cross's evidence as to his subjective motivation for the transaction. Mr. Cross followed the plan exactly as it was given to him because it was his understanding that each step was essential to

achieve the goal of creditor protection. The tax benefit was purely incidental and did not displace creditor protection as the reason why Mr. Cross chose to put the entire plan into effect. Since the subjective motivation of Mr. Cross for undertaking every step in the planned series of transaction was to achieve creditor protection every step in the plan must be taken to have had a bona fide non-tax purpose.

The FCA did not accept this argument. It said that the Tax Court followed the correct approach when in determining the purpose of the series of transactions using an objective basis rather than Mr. Cross's subjective motives. In the absence of any evidence that the subset of steps identified by the Tax Court judge were required for creditor protection it was open to him to conclude that their principal purpose was to achieve the admitted tax benefit. The FCA agreed with the conclusions of the Tax Court and dismissed the appeal.

Triad Gestco Ltd. ("Triad") was involved in a tax avoidance scheme very similar to the Ontario scheme and its appeal was also dismissed at Tax Court. However, at the FCA, Triad added a new argument which the FCA considered "novel." Triad argued that to dismiss the appeal would result in unfair double taxation. If the assessment was sustained Triad would be immediately taxable on the capital gain it had tried to defer through the use of the artificial capital loss. However the preferred shares which had been issued to help create the loss would retain their high redemption value and low adjusted cost base. This meant that the capital gain would be taxed again when the preferred shares were eventually sold or redeemed. The FCA observed that it had been many years since the loss was claimed and the preferred shares had not yet been sold. The court said that the owner of the shares was a corporation and could hold the preferred shares indefinitely without any time limitations requiring a disposition.

Mr. Barrasso made a similar argument at the Tax Court. He argued that disallowing his claimed $64,499,767 in capital losses was unfair because the capital gain would be taxed immediately and then he would be taxed again on this amount when he disposed of the preferred shares. While the preferred shares in 1207192 Ontario Limited and Triad Gestco Ltd. were held by corporations which had no deemed disposition requirements Mr. Barrasso would, at the latest, have the capital gain triggered by a deemed disposition on his death. The court said that the fact that the appellant was an individual rather than a company did not change the nature of the claimed capital losses which were no different than the losses disallowed in 1207192 Ontario Limited and Triad Gestco Ltd. and his appeal was dismissed.

Kruger Incorporated v. The Queen

2015 TCC 119
http://canlii.ca/t/gj7xz

2016 FCA 186
http://canlii.ca/t/gscwq

Kruger Incorporated ("Kruger") is a private company with the core business of manufacturing newsprint, coated paper products, and tissue paper. Krueger started purchasing and selling foreign exchange contracts in the 1980s to protect itself from foreign exchange rate volatility. By 1998 Kruger had moved past simple exchange rate hedging and was an active participant in the foreign currency option trading market.

This business was operated as separate enterprise from Kruger's paper business. In 1998 Kruger began to use the mark-to-market method to determine the estimated year end market value of its outstanding foreign exchange contracts. Krueger used this method for both its general financial statements and its income tax filings. Under the mark-to-market method annual income and losses are partly determined based on the year end values of foreign exchange contracts even if the contracts do not mature during the fiscal year. Kruger claimed 1998 foreign exchange losses of $91,104,379 based on the use of the mark-to-market method. The Canada Revenue Agency ("CRA") disallowed the losses because it claimed that Kruger could only claim losses when they were actually realized rather than on the estimated value of its foreign exchange contracts at year end.

Kruger appealed the reassessment claiming that it was allowed to use mark-to-market and, if not, that it was in the business of writing and purchasing foreign exchange option contracts and the contracts were inventory. The inventory argument was made moot by the Federal Court of Appeal's decision regarding the use of the mark-to-market method so the inventory issue will not be reviewed.

The Tax Court defined the mark-to-market method as;

> an accrual method of accounting by which both parties to the option, the option holder/purchaser and the option writer/issuer, recognize and value the option at its market value as at the date of the balance sheet and recognize any changes in market value from the beginning to the end of the period as a gain or loss in the income statement. It is relevant for tax purposes when an option entered into in one taxation year expires in a subsequent taxation year. When a liquid security is traded in an open market, the mark-to-market value is easy to determine by reference to its most recently traded price. When there is no open market or exchange, the mark-to-market value is calculated in accordance with various pricing models.

The Court first determined whether Kruger carried on a business of speculating in foreign exchange currency options separate from its manufacturing business and concluded that Kruger was a currency speculator. Based on this the Court concluded that Kruger was running a currency option business.

The Court next considered whether the mark-to-market basis was appropriate for Kruger's income tax purposes. Expert witnesses testified for both parties regarding foreign currency options. The experts noted that the options Kruger entered into were European-style options. European options are illiquid because they are traded privately and can only be exercised on their expiry date.

Kruger did not calculate its own mark-to-market values, it instead used the values determined by the parties on the other side of the transactions. These were based on various pricing models. Kruger's expert said that banks used the same pricing models to determine value. The Crown's expert disagreed and said that there were a number of models that the banks could choose from and the result would vary depending on which model was chosen. The Crown's expert said that the weakness of the mark-to-market method was that the list of input variables to the models could differ and banks cautioned that the values did not represent the amount at which options could be terminated. In the Crown's opinion this made mark-to-market values unreliable.

Kruger presented expert accounting evidence regarding the application of Canadian GAAP to foreign exchange contracts. The two witnesses agreed that in 1998 the

preferred basis for accounting for foreign exchange contracts was the mark-to-market method. This required that options be valued on the year end balance sheet at their fair market value. One expert referred to International Accounting Standard 39, issued in March 1999, stating that all derivatives were to be measured at fair value at each financial reporting date with the change in value recognized in income in the period.

The expert described four different methods of valuing options to calculate income on option contracts for accounting purposes, the actual realization on the contract (the method that the CRA said Kruger was required to use) and three methods of accrual accounting including mark-to-market. She testified that the difference between the mark-to-market method and the realization method was just a matter of timing. The choice of method did not affect the recognition of the amount of income or losses.

A CRA officer gave evidence on the CRA's policies in respect to mark-to-market accounting. He said that the CRA only allowed financial institutions, investment dealers, and mutual funds to use the mark-to-market method for income tax purposes. The issue for the CRA was the difficulty in verifying the mark-to-market values. The CRA was concerned with non-financial institutions using mark-to-market because the values could not be relied on and the CRA lacked the capability to verify the accuracy of the mark-to-market values.

The Tax Court judge started his analysis with a review of the appropriateness of using the mark-to-market method for income purposes. While the accounting experts agreed it was an appropriate method following GAAR he had to determine whether it was appropriate under the Income Tax Act ("the Act") and whether it provided an accurate picture of Kruger's income for 1998.

The judge reviewed the jurisprudence on the issue, particularly the Supreme Court of Canada cases *Friedberg v. Canada*, [1993] 4 SCR 285, *Friesen v. Canada*, [1995] 3 SCR 103, and *Canderel Ltd. v. Canada*, [1998] 1 SCR 147. He concluded from these decisions that the mark-to-market method could only be used for income tax purposes if it was specifically permitted by the Act. While the Act required financial institutions and investment dealers to use mark-to-market, the Act did not specify that any other class of taxpayer could use mark-to-market accounting for trading in financial instruments.

The judge said that using mark-to-market accounting would compel a taxpayer to include any loss or gain in value of the property at year-end in his income for the year even if the property was not sold. This went against the realization principle which was basic to Canadian tax law. The Court acknowledged that the Act allowed mark-to-market reporting for some businesses but said that Kruger's business did not fall within these guidelines.

The Court was also concerned about the accuracy of Kruger's method of determining value. Kruger used whatever numbers the other side of the transactions determined. Each bank Kruger dealt with formulated its own market values based on its own model by applying inputs that were not necessarily used by other banks. The Court cited an example given by the Crown's expert where two identical contracts, in both amounts and expiry dates, were assigned significantly different values on December 31, 1998. This use of different models by Kruger's counterparties meant that even if the Court found that mark-to-market was the appropriate method for Kruger to use for income

tax purposes it would not have confidence that the method had been properly applied in calculating Kruger's losses on derivative trading in 1998. For these reasons the Tax Court dismissed the appeal.

Kruger appealed to the Federal Court of Appeal ("FCA"). At the FCA Kruger argued that the Tax Court failed to follow the framework set out in *Canderel*. This required a determination on whether valuing foreign exchange option contracts on a mark-to-market basis was appropriate. Essentially the question was, "did it provide an accurate picture of profit?" Kruger argued that, had the Tax Court followed the *Canderel* framework, the Court would have found that the mark-to-market method was appropriate. Kruger argued that the CRA's requirement for mandatory mark-to-market valuations for financial institutions is intended to ensure that income is measured correctly. The Crown argued that the Tax Court did not err in law in concluding that the mark-to-market method did not provide an accurate picture of the appellant's income. In the absence of a specific provision to the contrary profit for tax purposes is only recognized when realized. While mark-to-market accounting is consistent with GAAP the Crown maintained that GAAP did not amount to rules of law. The Tax Court properly concluded that the income generated by the appellant's foreign exchange option contracts had to be recognized on a realization basis.

The FCA said that the issue was whether the foreign exchange option contracts could give rise to a loss or profit in the absence of an actual disposition. This depended on whether the appellant was authorized under the Act to use mark-to-market accounting or whether it was bound to apply the realization principle as the Tax Court had held. The FCA said that it was essential to understand the exact nature of the appellant's business. The Tax Court had found that the appellant carried on a business of speculating on foreign exchange currency options. This type of activity was best reflected by valuing option positions at market. This was the position recommended by GAAP in both Canada and the U.S. as well as by the U.S. Financial Accounting Standards Board.

The Tax Court had held that the realization principle was binding on the appellant because the Court was unable to identify any provision in the Act or regulations which authorized a departure from it. The FCA agreed with the appellant that the Tax Court had treated the realization principle as an overarching principle, an approach which ran counter to the decisions of the Supreme Court of Canada in *Canderel* and *Ikea*. Both of these decisions confirmed that the realization principle could be discarded when other methods of computing income showed a more accurate picture of the taxpayer's income. There was therefore no authority for the Tax Court's proposition that the realization principle applied to the exclusion of mark-to-market accounting unless the Act provided otherwise. Given the uncontested evidence that banks, financial institutions and mutual funds which engage in similar activity to Kruger report their income on the mark-to-market basis with the CRA's approval it was clear that mark-to-market provided a picture of Kruger's income which was as accurate as that which would be determined using the realization principle. The FCA said that, had the Tax Court adhered to the analysis framework in *Canderel*, it would have found that there was no basis on which to reject the appellant's use of mark-to-market accounting. For these reasons the FCA allowed the appeal.

Daishowa-Marubeni International Ltd. v. The Queen

2010 TCC 317
http://canlii.ca/t/2b73f

[2013] 3 FCR 51, 2011 FCA 267
http://canlii.ca/t/fn92w

[2013] 2 SCR 336, 2013 SCC 29
http://canlii.ca/t/fxk76

The Tax Court and Federal Court of Appeal decisions in this case were reviewed in Volume 19, Issue 2, of this publication. That publication included an editorial explaining the issues at trial which said, in part,

> Daishowa-Marubeni International Ltd. involved a basic valuation issue: should a purchaser's assumption of a vendor's liabilities in a sale of property be included as part of the sales price of the property? 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 assumed liabilities. The Federal Court of Appeal made two significant findings on this issue. It ruled that the assumption of liabilities is to be included as part of proceeds and it supported the position that the asset allocation determined by arm's length parties in their sales agreement overrode the Tax Court's conclusions about the fair market value of the properties. The Supreme Court of Canada granted Daishowa leave to appeal.

The Supreme Court of Canada ("SCC") granted leave to appeal in respect to two issues:

1) Were the reforestation liabilities to be included in the proceeds of disposition because the vendor was relieved of a liability or were they integral to the forest tenures?
2) Did it make any difference that the parties agreed to a specific amount for the future reforestation liability?

The SCC started its analysis by stating that the focus of the case was whether the purchaser's assumption of the reforestation obligations arising from Daishowa-Marubeni International Ltd.'s ("Daishowa)" previous harvesting should be included in the sale price of the forest tenure. The Minister had submitted that a forest tenure with reforestation obligations was analogous to property encumbered by a mortgage. The purchaser's assumption of the reforestation obligations, like the assumption of a mortgage, formed part of the sale price and must be included in the vendor's proceeds of disposition. Daishowa, supported by industry interveners, submitted that the analogy to a mortgage was misplaced. A forest tenure with reforestation obligations that had arisen from past harvesting was better compared to property in need of repair. If property is sold the purchaser's assumption of the cost of necessary repairs does not form an additional part of the sale price of the property. Instead the price is reduced to reflect the necessary repair costs. The Minister acknowledged that the vendor in this analogy would not be required to include the estimated repair costs to its proceeds even if the repairs were required by law.

The SCC said it was beyond dispute that the assumption of a vendor's liability by a purchaser could constitute part of the sale price and therefore part of the vendor's

proceeds of disposition. In this case, the reforestation obligations were embedded in the forest tenure because of a policy of the Province of Alberta. Alberta would not approve the transfer of the forest tenures unless a purchaser assumed the reforestation liability. The effect of Alberta's policy was to attach the reforestation obligations to the forest tenure so that the obligations could not be severed from the property. The SCC considered the reforestation obligations to be simply a future cost tied to the tenure that depressed the value of the tenure. A prospective purchaser of the tenure would take into account the income-earning potential of the tenure as well as the expected future costs associated with owning it. The existence of reforestation obligations would decrease the price a prospective purchaser would be willing to pay. The SCC said that, in this case, the record established that the purchaser valued the High Level Division's forest tenure at $31 million less the $11 million estimated cost of future reforestation obligations giving the forest tenure a value of $20 million. To include the full $31 million in DMI's proceeds of disposition would disregard the fact that DMI did not have $31 million of value to sell. The SCC said that this distinguished the reforestation obligations tied to a forest tenure from a mortgage, which does not affect the value of the property it encumbers. The Court concluded that Daishowa was not required to include the estimated cost of reforestation in its proceeds of disposition for income tax purposes.

This resolved the SCC's first question of whether the reforestation liabilities were integral to the tenures. The second question, whether it made any difference that the parties agreed to a specific amount of the future reforestation liability, was moot because of the Court's decision on the first question. Daishowa's proceeds of disposition did not depend on whether the contracting parties agreed to a specific estimate of the cost of those obligations in their sale agreement. Any amount that the parties assigned to the reforestation obligations in the sale agreement was simply a factor in determining the final agreed value of the forest tenures. The SCC reversed the FCA decision and allowed Daishowa's appeal.

Guindon v. The Queen

2012 TCC 287
http://canlii.ca/t/ft2fk

2013 FCA 153
http://canlii.ca/t/fz581

2015 SCC 41
http://canlii.ca/t/gkfb4

The issue in *Guindon* was succinctly stated in the first paragraph of the Tax Court decision;

> [1] The participants in a donation program (the "Program") were to acquire timeshare units as beneficiaries of a trust for a fraction of their value and donate them to a charity in exchange for tax receipts for the actual value of the units. No donation ever took place as the timeshare units never existed and no trust was settled. The Minister of National Revenue (the "Minister"), on the basis that the Appellant made, participated in, assented to or acquiesced in the making of 135 tax receipts that she knew, or would reasonably be expected to have known, constituted false statements that could be used by the participants to claim an unwarranted

> tax credit under the *Income Tax Act* (the "Act"), assessed against the Appellant on August 1, 2008 penalties under section 163.2 of the Act in the amount of $546,747 in respect of false statements made in the context of that donation program. The Appellant appealed the assessment.

The Global Trust Charitable Donation Program (the "Program") had planned to set up a trust to hold timeshare units ("the Units") in the Turks and Caicos Islands. The Program participants would become beneficiaries of the trust and receive Units from the trust in return for a vendor charge of $3,248 per Unit. They were told they could donate the Units to a registered Canadian charity and receive donation receipts for $10,825 for each Unit. However the scheme was a sham and no donations were ever made. The timeshare units did not exist and the trust was never settled.

Ms. Guindon was an Ontario lawyer practising family and estate law. She had never practiced tax law. Notwithstanding her lack of tax experience she agreed to prepare a legal opinion on the Program. She prepared the opinion without reviewing documents that her opinion claimed to rely on. A promotional package which included the legal opinion was provided to potential Program participants in November and December of 2001.

From 1999 to 2004 Ms. Guindon was the President of a small charity registered under the Income Tax Act ("the Charity"). The Charity agreed to be the recipient of the donated Units. This was the only charity involved in the Program. Prior to signing the charitable donation tax receipts, the representatives of the Charity, including Ms. Guindon, were informed verbally by the promoters that the Units had been properly created and that the documentation effecting a gift of the Units from the ostensible donors to the Charity had been completed. None of this was true.

On March 17, 2002, Ms. Guindon met with the promoters and was advised that the legal title deeds to the timeshares had not been finalized. The 2001 donations were therefore invalid since the donors did not have legal title to the claimed Units. Ms. Guindon had general authority to sign tax receipts on behalf of the Charity and had signed many of the 135 tax receipts acknowledging the claimed donation of Units to the Charity. Each of those receipts had stated that the donor had made an in-kind donation of a specified number of Units. However since the timeshare units were never created each receipt contained a false statement.

The CRA disallowed all of the tax credits claimed for the donations. The Minister of National Revenue (the "Minister") also assessed Ms. Guindon with a $546,747 penalty under section 163.2(4) of the *Income Tax Act*. This is the so-called preparer penalty. This section states;

> (4) Every person who makes, or participates in, assents to or acquiesces in the making of, a statement to, or by or on behalf of, another person (in this subsection, subsections (5) and (6), paragraph (12)(c) and subsection (15) referred to as the "other person") that the person knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct, is a false statement that could be used by or on behalf of the other person for a purpose of this Act is liable to a penalty in respect of the false statement.

The Act defines culpable conduct, for the purpose of section 163.2(4) as;

> "63.2(1) The definitions in this subsection apply in this section.
>
> culpable conduct means conduct, whether an act or a failure to act, that
>
> (a) is tantamount to intentional conduct;
>
> (b) shows an indifference as to whether this Act is complied with; or
>
> (c) shows a wilful, reckless or wanton disregard of the law.

Ms. Guindon was reassessed on the basis that she had prepared or helped to prepare the 135 charitable donation receipts. Ms. Guindon appealed the reassessment to the Tax Court of Canada. She submitted that section 163.2 of the Act constituted a criminal offense subjecting her to charter protection under s.11 of the Charter. This is the section of the Canadian Constitution that protects a person's legal rights in criminal and penal matters. She also appealed on the basis that she had not committed culpable conduct as defined under section 163.2(1).

The Crown argued that section 163.2 created a civil penalty which should be applied when a person is found liable on a balance of probabilities. While the Crown had to prove "culpable conduct" the Crown argued that culpable conduct was essentially the same as "gross negligence" under subsection 163(2) of the Act. Subsection 163(2) (not to be confused with 163.2) is a penalty section that allows the CRA to impose a penalty of 50% of the amount of tax avoided or attempted to be avoided by a person who knowingly, or under circumstances amounting to gross negligence, has made or participated in the making of a false statement or omission in a return.

The Crown said that section 163.2 was enacted in response to a report of the Technical Committee on Business Taxation (the "Mintz Report"), which noted that the imposition of broader civil penalties was justified to defend the integrity of the tax system by holding third parties accountable for obviously faulty advice. The enacted version of the penalty provision substituted the words "culpable conduct" for "gross negligence" because of concerns expressed by professional bodies that the penalty could apply in cases where tax professionals made honest errors of judgment or where there was an honest difference of opinion. Parliament defined "culpable conduct" by reference to the types of conduct to which the courts had, in the past, applied civil penalties to under the *Income Tax Act*. The Crown argued that the recommendations of the Mintz Report and the legislative intent as to the meaning of "culpable conduct" were evidence of the civil nature of the penalty. Additionally, on the basis of the Supreme Court's decision in *Martineau v. M.N.R.*, [2004] 3 SCR 737, 2004 SCC 81 the Crown contended that penalties imposed in fiscal matters are, in a system of voluntary reporting, designed to govern the conduct of taxpayers with a view to ensuring compliance with tax law and are civil penalties.

The Crown also argued that Ms. Guindon should be liable to a 163.2(4) penalty because she participated in the making of the tax receipts, Each tax receipt validated the donation of a property that did not exist. Ms. Guindon knew by March 17, 2002, that the Program participants did not have legal title to the Units on December 31, 2001 but did not inform them of the situation. She also personally attempted to convince the CRA that her own donation of timeshare Units was valid. The Crown said that these circumstances showed that Ms. Guindon had been wilfully blind because her conduct was that of a person showing a willful, reckless disregard of the law.

Ms. Guindon submitted that section 163.2 held true penal consequences and thus fell within section 11 of the Charter. Her council cited *R. v. Wigglesworth*, [1987] 2 SCR 541 where the Supreme Court of Canada held that proceedings will be subject to section 11 protection where the consequences include "imprisonment or a fine which by its magnitude would appear to be imposed for the purpose of redressing the wrong done to society at large rather than the maintenance of internal discipline within the limited sphere of activity." Ms. Guindon argued that section 163.2 of the Act attracted the protection of section 11 by its unlimited terms as regards both the magnitude of the punishment and the time limit in which it could be imposed. Also, by expanding liability beyond the taxpayers to third parties, parliament sought to punish and deter wrongdoers and would be wrongdoers. These are principles of sentencing that apply to criminal and quasi criminal penalties, not to matters that are merely civil or administrative in nature.

On the second issue, whether Ms. Guindon was engaged in "culpable conduct," she argued that she had taken reasonable care given the situation she faced and her conduct did not descend to the level of "culpable." She submitted that the burden to be met by the respondent was that of proof beyond a reasonable doubt. This was the standard set by the Criminal Code and resulted from the claimed protection she was entitled to under of section 11(d) of the Charter.

The judge did a lengthy analysis on whether 163.2 of the Act was actually a criminal offense. This is too extensive to be reviewed in detail so only the main points will be considered. The first point the judge covered was the legislative intent in enacting 163.2. He found it significant that the term "culpable conduct" was used rather than "gross negligence." He said that while Subsection 163(2) of the Act is not penal there have been many judgments affirming the penal nature of other provisions using the expression "gross negligence." He felt that 163.2 of the Act set an even higher standard than 163(2) by substituting "culpable conduct" for "gross negligence."

The case the judge found most significant was the Supreme Court decision in *Wigglesworth* where the court ruled that section 11(d) of the Charter did not apply exclusively to criminal proceedings. The Tax Court judge said that the Supreme Court determined that a matter could fall within the ambit of section 11 in two cases, where the matter is by its very nature a criminal proceeding or where the offence involves a sanction that is a true penal consequence. The judge concluded that section 163.2 of the Act attracted the protection of section 11 for both of these reasons. The purpose of 163.2 was to punish an injury done to the public interest. That, based on the judge's interpretation of *Wigglesworth*, made it a criminal penalty. Since the penalty has no set maximum limit its purpose was to "redress a wrong done to society." He said he would have arrived at a different conclusion had the penalty maximum been capped. This conclusion was sufficient to allow Ms. Guindon's appeal.

The judge had said that a review of whether Ms. Guindon had engaged in culpable conduct was only necessary if the penalty was determined to be a civil penalty. Although he had decided that it was not he still chose to review Ms. Guindon's conduct. The judge determined that the evidence demonstrated that Ms. Guindon's had engaged in culpable conduct. She was the professional responsible for the legal opinion concerning the Program and was the administrator of the Charity. She had involved the Charity in the Program. She also signed the charitable donation tax receipts. She wrote

and endorsed a legal opinion which she knew would be part of a promotional package intended for potential participants in the Program. The opinion clearly stated that she had reviewed the principal documents relating to the Program although she had not actually reviewed them. She knew that her legal opinion was flawed and misleading. The court said that her conduct was indicative of either a complete disregard of the law and whether it was complied with or that she was wilfully blind.

By July 9, 2002, at the latest, Ms. Guindon knew that the charitable donations would not be accepted by the CRA. Yet, on June 12, 2003, she made representations to the CRA regarding her own claimed 2001 donation of Units to the Charity. The judge said that she lied to the authorities and this conduct reflected negatively on her character. Ms. Guindon's culpable conduct led the judge to conclude that she would reasonably be expected to have known that the tax receipts were false statements. The 163.2 penalty would therefore have applied to her had he not determined that she was entitled to section 11 Charter rights and had not been given these rights.

The Crown appealed to the Federal Court of Appeal ("the FCA"). At the FCA the Crown argued that the Tax Court did not have the jurisdiction to find that section 11 of the Charter applied to section 163.2 of the Act because Ms. Guindon had failed to serve a required notice of constitutional question at either the Tax Court or at the FCA. This notice must be served on the federal and provincial Attorneys General if an appellant seeks a finding that a section of the Act is invalid, inoperative or inapplicable because of constitutional issues. This notice was required by section 19.2 of the Tax Court's statutory authority, the Tax Court of Canada Act, and, on appeal to the FCA, section 57 of the Federal Courts Act. The Crown had objected at Tax Court to Ms. Guindon raising the Charter argument because of this lack of notice but had been overruled.

The FCA ruled that Ms. Guindon's failure to serve a notice of constitutional question had denied the Tax Court the jurisdiction to consider whether section 163.2 of the Act created a criminal offence. The FCA went further and said that even if Ms. Guindon had been allowed to present the constitutional argument her submission would have failed. In the FCA's view the assessment of a penalty under section 163.2 was not the equivalent of being charged with a criminal offence and did not trigger section 11 protection. The FCA disagreed with the Tax Court's conclusion on this question of law. The FCA said that a self-assessing system requires that taxpayers provide accurate information and conduct antithetical to the proper functioning of this system must be deterred. Compliance is partly done through penalties. Their function is to encourage compliance with the Act. In the FCA's view Section 163.2 seemed directed to maintaining discipline or compliance within a discrete regulatory and administrative field of endeavour rather than redressing and condemning morally blameworthy conduct or a public wrong. This made it a penalty provision rather than an offense.

This left the issue of whether Ms. Guindon had engaged in culpable conduct. The Tax Court had found on the facts that Ms. Guindon's conduct had been culpable and the FCA accepted the Tax Court's conclusion. Based on these reasons the FCA allowed the Crown's appeal, set aside the judgment of the Tax Court, and dismissed Ms. Guindon's appeal.

Ms. Guindon appealed to the Supreme Court of Canada ("SCC") and leave to appeal was granted. The SCC first addressed whether it could review the merits of Ms. Guindon's constitutional issue since neither of the lower courts had received a proper

notice of a constitutional question. In a majority decision the SCC said that it had a well-established discretion to do so and decided that its discretion should be exercised because of the importance of the issue under appeal.

The SCC concluded that 163.2 was not a penal provision. A proceeding is criminal in nature when it is aimed at promoting public order and welfare within a public sphere of activity. Proceedings of an administrative nature are intended to maintain compliance or to regulate conduct within a limited sphere of activity. The Court said that the purpose of 163.2 is to discourage individuals from making false statements on behalf of others or from counseling others to make false statements, therefore its purpose is to promote compliance with the scheme of the *Income Tax Act*. This was an administrative purpose. The process under s. 163.2 did not lead to the imposition of any "true penal consequence." The SCC defined a "true penal consequence" as imprisonment or a fine which, having regard to its magnitude and other relevant factors, was imposed to redress the wrong done to society at large rather than just to secure compliance. A monetary penalty may or may not be a true penal consequence. It will be one when it is punitive in either purpose or effect. Ms. Guindon was assessed a penalty of $546,747. While the SCC conceded that this amount was very high for an individual the Court said that, in the circumstances, it did not constitute a true penal consequence. The Tax Court had determined that Ms. Guindon had participated in preparing 135 false statements. In addition the Tax Court had found that Ms. Guindon was dishonest in her initial legal opinion when she stated that she had reviewed the supporting documents. She then compounded this dishonesty by signing charitable receipts that she should reasonably have known were tainted by her own failure to verify the legal basis of the program. The SCC said that such dishonesty could not be countenanced in a self-reporting system. Based on these findings the SCC dismissed Ms. Guindon's appeal.

Ploughman v. The Queen

2017 TCC 64
http://canlii.ca/t/h3j66

Glenn Ploughman, like Julie Guindon, participated in the Global Trust Charitable Donation Program ("the Program") and, like Guindon, was assessed under section 163.2 of the *Income Tax Act* for preparing false statements. He also appealed his assessment to the Tax Court but his hearing was deferred until the Supreme Court of Canada had released the *Guindon* decision.

The Tax Court first reviewed Mr. Ploughman's involvement in the Program. The judge said that this required a determination of whether Mr. Ploughman was merely a canvasser or marketer for the Program (as he alleged), or whether he participated in the creation of the program or was a promoter (as the Crown alleged).

Mr. Ploughman maintained that his connection to the Program was significantly different from, and substantially less than, that of Ms. Guindon and other individuals who could be described as Program promoters or developers. However the oral and written evidence submitted at the Tax Court hearing indicated otherwise. Lee Goudie, a land developer, was endeavoring to develop a hotel and casino resort in the Turks and Caicos Islands. He testified that it was Mr. Ploughman who suggested that they could

raise funds for the resort development by promoting a charitable donation program based on the donation of timeshare ownership weeks to charities. Mr. Ploughman had knowledge and experience pertaining to charitable donation programs through his past experience with a program similar to the contemplated timeshare program.

Ms. Guindon had provided a compliant charity to accept the timeshare donations. Ms. Guindon testified that it was Mr. Ploughman who had asked her if the charity she was president of would be interested in participating in the Program. Ms. Guindon said that she helped prepare the charitable donation receipts in Mr. Ploughman's office. Each receipt stated that the particular donor had made an in-kind donation of a specified number of timeshare units at the Arawak Inn & Beach Resort. Since the timeshare units were never created each receipt contained a false statement. It was the position of the Crown that Mr. Ploughman participated in, assented to, or acquiesced in the making of the false statements which were embodied in these official receipts.

The judge found Mr. Ploughman's testimony during cross-examination to be evasive, defiant and self-serving. For various reasons, particularly the inconsistencies and contradictions between Mr. Ploughman's testimony and various documents, the judge found that Mr. Ploughman was not a credible witness and his testimony was unreliable. The judge said that he was of the view that Mr. Ploughman's involvement in respect of the Program was greater than he had acknowledged. Mr. Ploughman was a significant shareholder and an officer of two companies which had played important roles in the Program and several documents written by Mr. Ploughman suggest that he was involved in creating or promoting the Program.

The judge reviewed whether Mr. Ploughman knew, or would reasonably have been expected to have known except for circumstances amounting to culpable conduct, that the official receipts contained a false statement. The judge used the standard for culpable conduct established by the Supreme Court in the *Guindon* decision. The judge concluded that Mr. Ploughman's conduct showed an indifference as to whether or not the Act was complied with to the extent that his actions fell within the definition of culpable conduct.

A principal reason for this conclusion was Mr. Ploughman's involvement with the Global Trust ("Global"). Global was an essential component of the structure on which the Donation Program was based. Without Global there was no way the donors could receive the timeshare units that they purportedly donated to the charity. However Global was never legally created. The judge said that Mr. Ploughman should have known this because he was the president and main shareholder of KGR Tax Services Ltd., the trustee of Global. The judge said that if Mr. Ploughman did not know that Global was not a legal trust it was indicative of indifference as to whether the Act was complied with, particularly after March 26, 2002 when he had been told that Global had not been settled as a trust. On April 5, 2002 Mr. Ploughman sent a letter on KGR letterhead to the program's participants recommending that they file their donation receipts with their 2001 tax returns although the donated timeshare units did not exist and Global was not a valid trust. Mr. Ploughman knew, or should have known, about both of these problems.

The judge said that this recommendation was a significant factor in deciding the appeal. Each of the tax donation receipts contained a false statement and, by making this recommendation, Mr. Ploughman was participating in the making of the false

statement. By recommending to the Donors that they file their official receipts with their 2001 income tax returns without first confirming that all the problems with the Donation Program had been resolved, Mr. Ploughman displayed an indifference as to whether the Act was complied with.

Mr. Ploughman had argued that he fell within a provision in the Act which allowed him to escape penalty for what would otherwise be considered culpable conduct. Subsection 163.2(6) of the Act states that a person (referred to as an "advisor") who acts on behalf of another person is not considered to have acted in circumstances amounting to culpable conduct in respect to the false statement if the advisor relied in good faith on information from the other person. Nor is it culpable if, because of such reliance, the advisor failed to verify, investigate or correct the information.

Mr. Ploughman claimed that he'd relied in good faith on the opinion letter signed by Ms. Guindon which, according to Mr. Ploughman, stated that the legal steps pertaining to the Program had been completed, no outstanding issues remained to be finalized, and that the Program was legally constituted. Mr. Ploughman also claimed that he relied on the verbal assurances of Mr. Gordon Kerr (a lawyer in the Turks and Caicos Islands ("TCI")) that government approvals would be issued and the timeshare conversion would be completed before April 30, 2002. Mr. Ploughman submitted that, by reason of subsection 163.2(6), he could not be considered to have acted in circumstances amounting to culpable conduct due to his reliance on these statements.

The Tax Court judge did not accept these arguments. Firstly, in respect to relying on Ms. Guindon's opinion letter, Mr. Ploughman had reason to question the validity of the letter. The letter was strictly a tax opinion which made no comment about the actual status of the Program. Ms. Guindon's tax opinion was, in fact, based on her assumption that the Program had already been legally implemented. Mr. Ploughman had testified that he had read the opinion letter and that he'd read Ms. Guindon's assumption that the necessary implementation documents listed on page 2 of the letter had all been put in place. The first document in the list was the Deed of Trust. The court had already concluded that Mr. Ploughman knew, or should have known, that KGR, as the trustee, had not entered into such a deed. Therefore, he knew, or should have known, that Ms. Guindon could not have reviewed all of the documents in the list and that the assumption that the Donation Program was legally implemented letter was not correct. This should have prompted him to realize that he could not rely on her letter.

Ms. Guindon's letter assumed that the Trustee would distribute the timeshare units from the Global Trust to the donors. However Mr. Ploughman knew, or should have known, that the Global Trust had not been created at the opinion letter date and Mr. Ploughman knew that no timeshare units had been distributed by the Global Trust to the donors before the end of 2001. Since Ms. Guindon's opinion was premised these assumed transactions and Mr. Ploughman knew that those transactions had not been implemented when he sent his letter of April 5, 2002 to the Donors his claimed reliance on the opinion letter was not done in good faith.

Then the judge considered Mr. Ploughman's argument that he relied on the verbal assurances of Mr. Kerr that TCI approval for the timeshare title would be issued before April 30, 2002. Work on getting this approval had started in September 2001 and, when Mr. Ploughman visited Mr. Kerr in March 2002, the process was still being

reviewed by the TCI government. The judge said that Mr. Ploughman should have been well aware that Mr. Kerr had no control over completing the approval because it required steps that had to be taken by TCI government officials. After sending his letter of April 5, 2002 Mr. Ploughman should have been aware of the need to check with Mr. Kerr before the end of April 2002 to confirm that government approval had actually been given. However Mr. Ploughman did not check the approval status. Based on this the judge did not think that Mr. Ploughman acted in good faith when relying on the verbal assurances of Mr. Kerr.

In summary the Tax Court found that Mr. Ploughman was a creator or promoter of the Program. Each of the 135 official receipts filed by the donors with their 2001 income tax returns contained a false statement. When Mr. Ploughman sent his letter of April 5, 2002 to the donors, recommending that they submit their official receipts to the CCRA, he participated in the making of the false statements. His indifference concerning the non-existence of the Global Trust, the non-existence of the timeshare units, the failure to complete the transactional steps needed to legally implement the Program, and his indifference as to whether his recommendation in the April 5, 2002 letter was well founded, showed an indifference as to whether the ITA was complied with and thus constituted culpable conduct. Additionally his reliance on the Guindon opinion letter and the verbal assurances of Mr. Kerr did not satisfy the statutory criteria of subsection 163.2(6) of the ITA, and was not done in good faith. Based on these reasons the Appeal was dismissed.

Canada v. GlaxoSmithKline Inc.

[2012] 3 SCR 3, 2012 SCC 52
http://canlii.ca/t/ft8fd

GlaxoSmithKline was a major transfer pricing case involving the value of ranitidine, the main component of the GlaxoSmithKline drug Zantac. The case was heard by the Tax Court, the Federal Court of Appeal, and the Supreme Court of Canada. The decisions of the Tax Court and the Federal Court of Appeal were reviewed in Volume 17, Issue 2 of this publication. The Supreme Court of Canada decision was reviewed in Volume 19, Issue 2. The Supreme Court remitted the matter back to the Tax Court to take into consideration the effects of the License and Supply Agreements on the ranitidine value. The case was scheduled to be reheard in early 2015 based on the Supreme Court's instructions. However, just prior to the hearing, the parties settled and the Tax Court hearing was cancelled. The settlement terms are confidential.