IT'S PERSONAL

PRESERVING WEALTH FOR PEOPLE AND PRIVATE COMPANIES

Volume 4, Issue 3 – September 2011

Editors: Martin Rochwerg, Miller Thomson
David Chodikoff, Miller Thomson
Hellen Kerr, Thomson Reuters

The September Issue: What is Inside this Issue!

Welcome to the latest edition of It's Personal. This issue features a major round up of the 13th Annual National Conference for The Society of Trust and Estate Practitioners (Canada), ("STEP Canada"), prepared by a recent arrival to the Toronto offices of Carswell, Keira Wong. We also have an unusual piece from a participant in a software tax shelter. Frank Snape, PhD., a successful business person, gives his take on what the savvy and not so savvy investor should consider before investing in a tax shelter. It is a valuable warning.

There are a number of case commentaries from Andrew "Sandy" Robinson, Hadielia Yassiri, Patrick Deziel and Susan Adam Metzler. Miller Thomson's Jack Tannerya highlights the latest concerns for investors in private placements of debt or equity securities of companies. Fraser Mann introduces our readers to Canada's Anti-Spam Legislation. The law is intended to combat both internet and wireless spam and to prevent certain forms of unauthorized activities relating to electronic messaging. Vinay Kholsa of the accounting firm of Bateman, MacKay reminds our readers about the basics of income splitting investment income. It is an important and timely article.

This editor has contributed an article on the topic of whether a worker is an independent contractor or an employee. The subject is one of the most litigated matters before the Tax Court of Canada.

As always, we welcome your constructive feedback. If you have ideas about how we can make this publication more valuable to you, please let us know.

DWC

IN THIS ISSUE

The September Issue: What is Inside this Issue! 1

STEP Canada 2011 National Conference 2-9

Why Bother with a Shareholder's Agreement? 10-12

Taxpayer Relieved: Court Reinterprets Ten Year Limitation on Interest Relief 12-13

Expect Greater Scrutiny and Disclosure When Investing in Private Placements 14-15

Court of Appeal Reverses McNamee: Estate Freeze Shares are a Gift, not Part of Net Family Property 16-17

Canada's Anti-Spam Legislation Moves Closer to Adoption 17-19

Income Splitting Investment Income – Back to Basics 19-22

Tax Shelters: A Participant's Lessons 22-23

Agribrans Purina Canada Inc. v. Kasamekas et al., 2011 ONCA 460 (CanLII) ("Agribrans"): A Case Commentary 24-25

Employee or Independent Contractor: Can We Not Formulate a Single Test, Please! 25-26

Cases of Note 27-28

CARSWELL®

Editors: Martin Rochwerg, Miller Thomson
David Chodikoff, Miller Thomson
Hellen Kerr, Thomson Reuters

carswell.taxnewsletters@thomsonreuters.com

© 2010 Thomson Reuters Canada Ltd.

NOTICE AND DISCLAIMER
All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior written consent of the publisher (Carswell).
Carswell and all persons involved in the preparation and sale of this publication disclaim any warranty as to accuracy or currency of the publication. This publication is provided on the understanding and basis that none of Carswell, the author/s or other persons involved in the creation of this publication shall be responsible for the accuracy or currency of the contents, or for the results of any action taken on the basis of the information contained in this publication, or for any errors or omissions contained herein.
No one involved in this publication is attempting herein to render legal, accounting or other professional advice. If legal advice or other expert assistance is required, the services of a competent professional should be sought. The analysis contained herein should in no way be construed as being either official or unoffical policy of any government body.

Address all subscription enquiries to:

Carswell, a Thomson Reuters business
One Corporate Plaza,
2075 Kennedy Road,
Toronto, Ontario M1T 3V4

Telephone: (416) 609-3800 in Toronto
1-800-387-5164 elsewhere in Canada

Fax: (416) 298-5082

E-mail: www.carswell.com/email

www.carswell.com

STEP Canada 2011 National Conference

Keira Wong, LLB/BMedia, Carswell, a Thomson Reuters business

I. OVERVIEW

The Society of Trust and Estate Practitioners (Canada) held its 13th Annual National Conference (the Conference) on June 2-3, 2011 at the Metro Toronto Convention Centre. The conference was well organized and well attended with approximately 500 delegates from across Canada, the US, the Caribbean, UK, and Australia, representing a broad spectrum of trust and estate professionals and industries. The Conference consisted of excellent presentations, where various practitioners gave their insight and professional perspectives. The concurrent workshops covered a conglomerate of topics, including post-mortem planning and insurance strategies, common-law spousal rights, inbound trusts, contesting a will, disabled beneficiaries, elder law, and the Canadian and international trends regarding the use of private foundations. The panel discussions focused on key new areas of trust and estate law, insurance and tax, trends in tax litigation, US estate tax, and solicitor-client privilege. This article provides a high-level summary of some of the recent developments and other topics of interest to tax professionals that were discussed at the Conference.

The Society of Trust and Estate Practitioners (STEP) is an international organization for trust and estates professionals. Headquartered in London, England, it has more than 16,500 members worldwide in 66 countries. STEP Canada, founded in 1998, has almost 2,000 members with branches in the following cities and regions: Atlantic, Montreal, Ottawa, Toronto, Winnipeg, Calgary, Edmonton and Vancouver. STEP Canada is a multi-disciplinary organization with experienced and senior practitioners in the field, including lawyers, accountants, financial planners, insurance advisors and trust professionals. They provide domestic and international advice on trust and estates, including planning, administration and related taxes.

II. CONFERENCE SESSIONS

1. Income Tax Update (Craig Jones, Felesky Flynn LLP)

The income tax update consisted of a clear and interesting overview of the seven key topics of trust and estate law, insurance and tax. There have been a number of statutory and case law changes in the past 12 months, which continue to make trust and estate law a very challenging area. In the speaker's view, the seven topics discussed will "change the landscape of estate planning practices".

New section 237.3 – Section 237.3 contains the rules for the new Aggressive Tax Planning (ATP) Reporting Regime which was first announced in the 2010 Federal

continued on page 3...

...continued from page 2

Budget. The new regime is intended to help the CRA identify ATP arrangements and potentially abusive tax avoidance transactions, discourage the design and distribution of marketed tax plans, and improve the effectiveness of the GAAR. The new rules have not yet been enacted; they are currently contained in draft legislation. STEP Canada has been very active in connection with these rules, with at least two submissions to the Department of Finance. They can be read at: https://www.securewebexchange.com/step.ca/pressRoom.asp

Peter Sommerer v. Queen[1] **–** This was the first discussion of subsection 75(2), and practitioners are still unsure of the limits of its application. The court held that subsection 75(2) does not apply to a sale of property to a trust by a beneficiary vendor for proceeds equal to fair market value, but only to a settlor or subsequent contributor who could be seen as a settlor. The court arrived at its conclusion by determining that the "conditions" upon which trust property may be held must be established upon creation by the settlor and that a settlor's contribution must be gratuitous. This decision appears to contradict published CRA positions (e.g., Interpretation Bulletin IT-369) and may have implications for various provisions of the *Income Tax Act* (e.g., subsections 107(4.1) and 104(4)). This case has been appealed to the Federal Court of Appeal.

Alberta Trust Audit Initiative **–** This joint initiative between provincial tax authorities and the CRA was created as a result of attempts by taxpayers to gain the benefit of lower Alberta tax rates. Essentially, the CRA is intervening to protect the tax base of other provinces. The CRA concluded that "motivation" is important where the trust was motivated by a desire to avoid a higher provincial tax elsewhere. It is interesting to note that there have been no challenges so far under this initiative.

Alberta v Husky Energy Oil Inc. et al[2] **–** This case involved a refinancing of operations and reorganization to take advantage of a favourable Ontario tax regime. The interest income was not taxable in Ontario if the recipient corporation was resident in Ontario but incorporated outside of Canada. Alberta reassessed, determined the arrangement was abusive under the Alberta GAAR and denied the taxpayer a dividend deduction under subsection 112(1) and an interest deduction under paragraph 20(1)(c).

CRA document 2010-0389551R3 – Historically, subsection 84(2) would not apply if funds or property of a corporation, the shares of which formed part of a deceased's estate, have been distributed or otherwise appropriated in any manner whatever to or for the benefit of the estate on the "winding up, discontinuance or reorganization of its business". However, this CRA ruling appears to reverse the historic interpretation of subsection 84(2). The new inference is "de facto" discontinuance, and the differences between inside and outside basis.

CRA Form T997 (Audit Query Sheet) – This is a high net worth/related party audit initiative, which is not publicly available. The initiative, in the form of a detailed questionnaire, is intended to identify tax avoidance with respect to unlisted companies, private trusts, joint ventures, and partnerships, among others. Form T997 asks for "all tax planning documents", many of which are potentially subject to solicitor-client privilege (see below for a discussion of the future of privilege). The form also asks for a list of all legal and accounting firms used and "all correspondence files with them".

CRA document 2010-03663011I7 – This interpretation document discusses the application of subsection 75(2) where freeze shares are undervalued and taken back. Essentially, this decision is an attempt by the CRA to take the position that a price adjustment clause does not override subsection 75(2).

2. Life Insurance Update (Kevin Wark, PPI Advisory)

The life insurance update covered various current topical issues, including universal life pricing, 10/8 insurance arrangements and the retirement compensation arrangement (RCA) audit program.

Universal Life Pricing

The majority of universal life (UL) insurance sales are based on "level cost of insurance" mortality charges. More premiums are charged in early years, which go into a reserve to subsidize future mortality costs. The level of premium is highly dependent on interest rates that are assumed to be earned on the policy reserves. The most popular methodology is the level cost of insurance charge that remains constant throughout the life of the contract. In 2010, UL prices increased significantly by 10–12% for younger life insured's. Future influences and impacts on product pricing include interest rate and mortality trends, capital requirements, investor expectations and IFRS.

10-8 Strategies

In these types of arrangements, an individual purchases a universal life policy, makes additional deposits into the insurance

continued on page 4...

[1] 2011 CarswellNat 1157 (TCC [General Procedure])
[2] 2011 ABQB 268

...continued from page 3

policy that accrue on an after-tax basis, and takes out a policy loan or independent collateral loan with a loan rate of, say, 10%. The deposits within the insurance policy that support the loan are transferred to a special investment account that earns interest at a rate that is 2% less than the loan rate (i.e., 8%). The borrowed funds are used for income producing purposes, thus making the interest on the loan (at 10%) tax deductible (resulting in a lower after-tax effective interest tax rate). On the other hand, the interest credited to the insurance policy (at a rate of 8%) is tax-deferred and can support additional loans. Because the interest paid on the loan is deductible, whereas the interest earned by the life insurance policy is non-taxable, the taxpayer has increased after-tax cash flow. As discussed at the 2010 STEP Conference, the CRA has been reviewing these programs since October 2008 when the CRA raised concerns that the structure could be an avoidance transaction that may be subject to GAAR. More recent CRA pronouncements have indicated a focus on the "reasonableness" of the loan rate. Discussions continue with the CRA.

Retirement Compensation Arrangements (RCA) audit program

RCAs allow tax-deductible corporate dollars to be deposited into an RCA, on behalf of a private business owner and/or a key employee. No tax is paid by the owner/employee until benefits are received at retirement, although a 50% special refundable tax is paid at the time of the contribution. There has been a significant increase in the number of registered RCAs and refundable tax balances in the past five years. The refundable tax represents a liability for the government with an expected offset from taxes collected on benefits paid by the RCA. However, the CRA is concerned that it is paying back more refundable tax than it is collecting in taxes on benefits being paid out from RCAs. Consequently, the CRA began a pilot audit project identifying a number of concerns with certain RCAs, including lower tax revenues on benefit payments. In May 2010, CRA expanded the audit project, sending inquiry letters to employers and RCA trustees asking a broad range of questions with respect to investments in life insurance policies, side account contributions and tax reporting slips.

3. Trusts and Estates: The Essential Update (Margaret O'Sullivan, O'Sullivan Estate Lawyers)

This presentation was a detailed and captivating guide to recent Canadian case law, including a few international cases and other new developments in trusts and estates, including the following:

Wilson v. Lougheed[3] **–** This case dealt with British Columbia legislation, the *Wills Variation Act,* which is unique to BC as it allows courts to vary a Will. This is a significant case due to its thorough application of the legislation to a spouse's moral obligations in other provinces.

Re Foote Estate[4] **–** This case demonstrated that domicile is very relevant, and that the choice to change domicile must be voluntary and "not dictated by business, debts or health".

New *Wills and Succession Act* in Alberta – This legislation is now enacted and is to come into force likely in early 2012. It repeals several acts and consolidates matters of Wills and succession into one statute. The new legislation contains several important and controversial changes.

Webster-Tweel v. Royal Trust Corp of Canada[5] **–** This case concerned the original location of a trust and whether the law of administration was validly changed when it moved to Alberta from Quebec.

Re Moss (Bankrupt)[6] **–** The court held that an attorney under a general power did not have the authority to make a change to a beneficiary of an insurance policy because the power did not specifically allow for the change. The speaker noted that, in Ontario, changing a beneficiary would also not be in an attorney's power.

McCullough v. Riffert[7] **–** This case concerned a disappointed beneficiary when a deceased died with an unexecuted Will. The issues surrounded the solicitor's alleged negligence and the duty of care with respect to the timeframe for preparing a Will. The court held that the lawyer met the standard of care where the Will was sent out in three days, the deceased attended the meeting, there was no urgency to complete the will and there was no diagnosis of a terminal illness.

McNamee v. McNamee[8] **–** This case concerned an estate freeze and transfer of common shares by a father to his son. The court held that no valid gift of shares existed as the father did not have the necessary donative intent and there was no acceptance by the son of the shares. The son was not aware of the gift and had "unclear knowledge" of his ownership. Therefore, the shares were not "excluded property" under the Ontario *Family Law Act* on the son's marital breakdown.

[3] 2009 CarswellBC 3715 (BCSC)
[4] 2011 CEAG 31,729 Alberta (C.A.)
[5] 2010 CarswellAlta 1609 (ABQB)
[6] 2010 CarswellMan 155 (MBCA)
[7] 2010 CarswellOnt 4886 (Ont.SC)
[8] 2010 CarswellOnt 7316 (Ont.SC)

continued on page 5...

...continued from page 4

Recent amendment to Ontario's *Estate Administration Tax Act, 1998* – On May 12, 2011, three significant changes were made to this legislation, which result in a completely new regime:

1. The Minister of Revenue (not Attorney General) is now responsible for assessment and enforcement. This shows a new desire to enforce the provisions of this legislation.
2. The Minister of Revenue is also to collect prescribed information and new regulations are expected. This will require executors to provide detailed applications of estate certificates and initiate audits.
3. New offence provisions including penalties and prison terms for executors and administrators for non-compliance and for those assisting them. As a result, additional care must be taken when assisting executors, especially as to not make false or misleading statements. There is a much bigger onus, and the maximum fine is twice the amount of tax payable on the estate with two years imprisonment.

Trust Law Reform in Canada – The Uniform Law Conference of Canada (ULCC) is currently preparing uniform draft trustee legislation. In November 2007, STEP Canada hosted a symposium which subsequently acted as a catalyst for the ULCC to take on the project. It struck up a working and drafting group. STEP Canada's National Steering Group in Trust Law Reform continues to monitor progress and provide support and input, and promote trust law reform and implementation of new trustee legislation.

***Kerr v. Baranow* and *Vanesse v. Seguin*[9] –** This case dealt with a resulting trust and unjust enrichment claims by common law spouses. In regards to the quantification of a monetary remedy for unjust enrichment, Cromwell J stated that it should not be based on "minute totting up of the give and take of daily domestic life, but rather should treat claimant as a co-venturer, not as the hired help". This case highlights that where both parties make equal contributions, the monetary remedy should reflect that reality. This appears to be a new more expansive approach by the court.

***Pitt v. Holt* and *Futter v. Futter*[10] –** This is a UK case from the England and Wales Court of Appeal, which is a substantially narrowed view of the rule in *Re Hastings-Bass*. This case concerned court rectification of trustee mistakes. The court held there was not breach of fiduciary duty and no need for the court to apply the rule and set aside. The Court of Appeal left it to the taxpayer to sue tax practitioners when there is an unintended tax result.

The EU Succession Regulation – The objective of this regulation is greater harmonization of legal rules and procedures governing succession. On June 4, 2010, political guidelines for future work were approved, which focused on six key issues. STEP will have a major part in helping Canada reach a similar greater harmonization.

4. Trends in Tax Litigation (Al Meghji, Osler Hoskin & Harcourt LLP)

The presenter discussed the trends in current tax litigation affecting trust and estate practice in an engaging and charismatic manner that made the audience sit up and pay attention. The most significant tax litigation used to be against large corporations; however there has been a dramatic increase in tax litigation concerning high net worth individuals, families and mid-size corporations. The presentation focused on what the courts are saying and where the courts are going with tax avoidance and the GAAR, the new wave of "sham" cases, cases upcoming in the next 12 months and observation of the success of litigated disputes.

GAAR – where it's been and where it's going

In the speaker's view, the GAAR is essentially a "smell test"; what is considered as contravening the GAAR is in the eye of the beholder and the courts will decide based on their own "fiscal morality". In the past, the courts approached the GAAR as a three step process in which it would first indentify the tax benefit, next identify the transaction, and finally, identify the misuse. Now the test seems to be reduced to one step. The courts are reading down the requirement of a tax benefit of the transaction, which has diluted the test and lowered the standard such that now essentially all of the cases are about misuse. Taxpayers have not had a lot of success at winning the argument that there is no tax benefit; most cases have turned on the issue of misuse.

What is misuse and abuse? What are the common themes?

The Crown in most cases, more recently in *Husky* and *Lipson*, couch GAAR in very emotive terms, and "appeal to the prejudices of the judge" and not to the practicality and policy of what is being abused. The courts have now changed that trend by asking for a more deciphered analysis, specification of the applicable section, and reasons as to how it is being misused or abused, which

continued on page 6...

[9] 2011 SCC 10

[10] [2011] EWCA Civ 197, [2011] WLR (D) 84

...continued from page 5

is resulting in more success for taxpayers. The courts have stated that the GAAR is not a tool to fill legislative gaps. As well, proposal letters to the CRA are usually very vague and general. The objective of the letters should force the CRA to articulate their position, as "precision will favour taxpayers". The courts have been more tolerant of individual tax avoidance plans but display a cynicism towards retail plans. Individual plans typically engage the facts of taxpayers more and retail plans are more divorced from the commercial assets of taxpayers. In the speaker's view, a more general approach is a less likely way to succeed, since GAAR reasoning is very intuitive; it is not a deductive process but rather a "feel" for where the background is very important in order to provide a factual context.

"Sham" cases

The *Antle* decision relaxed the requirement of sham. A sham is essentially parties embedded in a series of legal relationships that do not represent reality and that have been carried out in order to deceive. In *Antle*, the Court of Appeal held that the trial judge erred in its decision.

5. The State of US Estate Tax (Carol Fitzsimmons, Hodgson Russ LLP)

The US estate tax rules have changed since the discussion at the 2010 STEP Conference. The US recently passed legislation amending the estate tax that had been set to revert on January 1, 2011 to a $1 million exemption and 55% tax rate. While the new law provides a taxpayer-friendly $5 million exemption and 35% top tax rate, these changes are scheduled to revert on January 1, 2013. The speaker also discussed related issues such as planning opportunities with the new rate and exemption amounts, portability provisions, and how the new rules affect Canadians owning US situs property.

US transfer taxes (gift tax, estate tax and generation-skipping transfer tax) apply to US citizens and US residents for all gratuitous transfers, and to non-US citizens/residents only for gratuitous transfers of US-situs assets. US transfer taxes are based on the value of the assets, and not the appreciation in the asset. This is a significant difference from Canadian law, and the value of assets calculation always results in a larger tax base. Portability of exemptions applies to gift and estate tax exemptions for 2011 and 2012, though it does not apply to the GST exemption. Many issues are involved with portability, such as how it will work with multiple marriages. With respect to estate planning for US citizens in Canada, one option available is to make gifts up to $5 million before 2013.

The speaker concluded that it is still worthwhile to plan for US estate tax on US real estate purchases. The US estate tax is likely to remain in force, though exemption and rates remain uncertain due to the possibility of the rules changing yet again. Planning before the purchase of US real estate is much easier than revising ownership after the purchase, due to the US gift tax on gratuitous transfers of US real property. Even if there were no US estate tax, the use of a trust to own US real property avoids the need for probate in the US, which is time-consuming and costly.

6. Solicitor-Client Privilege (Al Meghji and Mahmud Jamal, Osler Hoskin & Harcourt LLP)

This session focused on privilege, and how it is defined for tax and trust practice purposes. The session also discussed how privilege applies for accountants and other professionals, with the panelists speaking about the Prudential case in the UK and Quebec notary case. There is a robust protection of privilege in Canada, in contrast to the US and the UK. The speakers noted that while there are concerns that privilege should be extended to non-lawyers, the courts have not extended it as of yet. The courts will continue to protect the original concept, and "kick the ball" back to the legislature to take the initiative for any change. For other professions to argue that they require privilege, the best route may be to go to the federal and provincial legislature to lobby for the cause. The speakers reviewed the debate raised by the proposed aggressive tax planning reporting rules, and discussed that tax administrators or policy makers, like the OECD, will continue to attack privilege. The panel mentioned that it may seem unfair that privilege only attaches itself to lawyers, and can be seen as an unlevel playing field between professions.

The session concluded with a focus on how privilege should be applied in the future. Both speakers indicated that there is a trend to break down the notion of privilege; for example, the Department of Justice is utilizing lawyers in its audit programs who are requesting every piece of information. Currently, professionals cover their privilege status by marking documents as privileged; even though the document may eventually be found not to be privileged, the claim will show intent. Similarly, it has been asserted that including other company colleagues in emails may constitute a waiver of privilege, despite the usual disclaimer of privilege placed at the end of the email. Consequently,

continued on page 7...

...continued from page 6

practitioners should show that they are definitely not making a waiver of privilege. The new "normal" now is that the CRA is issuing *requirements* for information, rather than requests for information.

III. WORKSHOPS

1. Post-Mortem-Planning
(Sheila Crummey, McMillan LLP; Marina Panourgias, Deloitte & Touche)

The panel discussed legal and drafting issues, including tax-planning strategies such as subsection 164(6) loss carry-back planning, the "pipeline" strategy including CRA's recent views on subsection 84(2) applications involving this plan, and other relevant matters. The speakers acknowledged that it is a very complex area of estate planning that deals with double taxation issues of private company shares at death.

2. Planning for Families with a Disabled Beneficiary

This session dealt with three presentations involving a variety of key issues such as accessing tax credits and deductions, the treatment of medical expenses, utilizing Registered Disability Savings Plans, and the use of trusts for disabled beneficiaries. This is a growing area for estate practitioners with improvements in the life expectancy of disabled people causing increased concern amongst family members, particularly parents, about their long-term welfare.

Estate Planning for Disabled Beneficiaries
(Gail Black, Miller Thomson LLP)

The speaker gave an overview for how to appropriately and adequately provide for disabled beneficiaries. Disabled beneficiaries are commonly minor children, but can include adult children, spouses, siblings, and parents. Just as the beneficiaries can vary, the nature of the disability will vary, including physical, mental/cognitive/psychological, a mixture of the two, addictions or an inability to manage money. Disabled beneficiaries are entitled to the disability tax credit and/or other tax benefits, and to both provincial and other governmental support. Many clients who have disabled beneficiaries believe that making adequate provisions in their Will is enough, but this is just one aspect of addressing the planning for disabled beneficiaries. The presenter warned that the Will should not be the only legal document to provide for a disabled beneficiary. The client should also consider implementing a plan of decision-making and utilize supportive organizations such as Planned Lifetime Advocacy Network, RRSP/RRIF/RPP designations, companion documentation and RDSPs.

The will should include the appointment of a suitable guardian for a disabled minor child with appropriate provisions to ensure requisite care, including a consideration of whether the child will need to be moved to another community, province or country and the implications thereof. A common concern is determining what portion should be set aside for the disabled beneficiary and for other children who are not disabled, and whether it should this be explained under a term of the Will or in a separate document.

A "Henson" Trust" is commonly used for disabled beneficiaries, but it must not exceed $100,000 in value at any time, with variation allowed if the exempt amount allowed by legislation changes in the future. It may need modification for some beneficiaries; for example, if the spouse is the disabled beneficiary, then a proper spousal trust may be required to avoid a deemed disposition on the testator's death. Further, to avoid probate fees, a direct designation of benefits or use of an alter ego or joint partner trust may be required. Practitioners should watch out for fraudulent conveyances and consider the loss of testamentary trust tax status if the disabled beneficiary is the beneficiary of gifts from an *inter vivos* trust rather than gifts by Will. It was also noted that the implications of taxing income in the trust or in the beneficiary's hands should be considered when dealing with direct designation of benefits to others. The preferred beneficiary election may not be very helpful if one does not want income to appear on the disabled beneficiary's tax return. The investments and powers to consider in a Will are very flexible and include the power to pay for funeral expenses and invest in chattels. Risks are involved as well, such as being subject to creditors, matrimonial claims or death/incapacity before the death of the disabled individual. Also, be aware of the potential conflict of interest between the trustee and beneficiaries on the death of the disabled beneficiary.

Provincial variations on the effect of the Henson Trust to protect governmental benefits for disabled beneficiaries must also be noted. Careful review of the particular provincial/territorial legislation required to modify the Henson Trust is necessary. The speaker mentioned that the Alberta legislation is particularly challenging compared to other provinces. Practitioners should also be aware of the Alberta "look-through" rule, which is not just confined to Alberta, and can apply to testators in another province/territory who provide for disabled beneficiaries who live in *or may be moved to* Alberta, or have guardians in Alberta. RDSPs are also

continued on page 8...

...continued from page 7

useful, but the limit of $200,000 may not be enough to provide for the disabled beneficiary (see below).

RDSP Planning for Families with a Disabled Beneficiary (Jamie Golombek, CIBC Private Wealth Management)

The presenter's enthusiastic and engaging presentation gave a quick overview of RDSP planning. There is a $200,000 lifetime limit available to those under 59 years of age to open, and under 49 years of age to receive, government funds. Since there are complex withdrawal requirements and a ten-year repayment rule, RDSPs are more for long-term planning. However, this rule has been heavily criticized that it adversely affects those with shortened life expectancies. All provinces and territories fully exempt RDSP assets and income, except Quebec which provides a partial exemption. The biggest government benefit is the matching Canada Disability Savings Grants (CDSG), which the speaker noted should be the number one priority over RDSP contributions and is "very beneficial on a grand perspective". While the CDSG is based on family income less than $83,088, it is also based on the age of the disabled beneficiary with respect to what income is considered. Those under 19 years old may not receive the full grant as it will be based on the parent's income; however, 75% of Canadian families file a tax return under $50,000. Finally, the speaker mentioned that both CDSG and Canada Disability Savings Bonds (CDSB) entitlements are retroactive for 10 years (from 2008 forward).

Tax Issues for People with Special Needs (Peter Weissman, Cadesky and Associates LLP)

The speaker reiterated the notion that estate planning for disabled persons is an emerging and complicated area, and that with an aging population, the issues will only become more prevalent. The speaker preferred the term "special needs" as opposed to "disability" as this includes children, elderly and those afflicted with mental and physical disabilities. The foundation for planning for individuals with special needs is the disability tax credit (DTC), which is a non-refundable personal tax credit of approximately $1,700 in 2011 for individuals with an impairment or infirmity. The DTC is not a large credit, but it is a cornerstone that leads to more potential tax savings because other supplements flow from it. For example, for children under 18 years old, there is additional disability supplement of approximately $1,000 in 2011, which is subject to reduction for childcare and attendant care expenses. If an individual is eligible for the DTC, they may also be eligible for other benefits, such as an RDSP, Preferred Beneficiary Election after 1995 (but watch for kiddie tax), and tax-free disability related employment benefits. Health and Welfare Trusts can also be useful, but are risky if they are not set up properly.

When assessing eligibility for the DTC, medical practitioners are required to consider how prolonged the impairment is, how severe the prognosis is, the last diagnosis received, and the therapy received. The taxpayer and medical practitioner must complete Form 2201, which is to be approved by the CRA to conclude eligibility for the DTC. The less tangible and subjective aspects of a disability are the most difficult to ascertain for DTC eligibility and most medical practitioners find it more easy to judge physical impairments.

The Tax Court case of *Tozzi v. The Queen*[11] was cited for determination challenges. In this case, the court did not have jurisdiction to hear the case as there was no tax assessment in dispute, and concluded that the taxpayer could not be a beneficiary of an RDSP. The Department of Finance responded in November 2010 that procedural issues should not be an impediment to the DTC and that legislative amendments will be made so that individuals can appeal a determination concerning their DTC eligibility. There were proposals in the last budget but nothing has been mentioned since that time.

3. Elder Law

This workshop involved legal and medical experts who discussed a variety of planning issues involving elderly clients, such as legislative regimes across Canada, illness, capacity and assessment, trends in financial abuse, challenges facing financial institutions, and tips to consider in estate practices. Kathleen Cunningham introduced a high-level summary regarding elder law issues. She stated that the area of law is more practical than substantive, and looked at capability and vulnerability and their relationship to and dissimilarity from each other. One can be capable but very vulnerable, and another person can be incapable but not vulnerable because they have a support network. Vulnerability is a concept that asks whether the person is at risk or needs help.

Bank and Investment Dealer Issues with Powers of Attorney (Suzanne Michaud, RBC)

The first presentation discussed aspects of bank and investment dealer issues with powers of attorney and what advisors can do to

[11] 2010 CarswellNat 3975

continued on page 9...

...continued from page 8

ensure client wishes are respected and their interests are protected. The panelist stressed that education of the powers, duties and obligations of the attorney is important, and reminded that banks and broker-dealers are separate legal entities governed under different laws and regulatory regimes. Privacy laws preclude sharing of information without client consent, which can be found in the account agreement, or under compulsion of law. It is important to remember that advisors should prepare letters of direction from the client to the attorney to be general, so that all legal entities are covered if seeking information on the activities of a client or an attorney.

Elder Law and the Public Sector (Saara Chetner, Public Guardian and Trustee of Ontario)

The panelist presented elder law from a public sector perspective, and the roles of public guardians (PGs) and trustee officers (TOs) in relation to financial abuse. Language is very important in the range of legislation affecting adults who may be either "incapable" or "vulnerable". The roles of PGs and TOs are governed by provincial law, with the mandates and provincial social services varying greatly. Legislation may be under review or there may be relatively new programs which are contextually different across Canada. Most PGs and TOs have some kind of extra-judicial investigation and financial audit powers. Some only relate to incapable adults at risk of loss or harm as opposed to intervention where any trust property is at risk. The extra-judicial powers may include powers to make decisions to protect individuals, such as freezing bank accounts, which is available in British Columbia but not Ontario. Ontario, like other provinces, has adult protective services legislation such as mandatory reporting in long-term care situations. One problematic aspect is that the onus is on the service provider to report to management but not to the public trustees, which raises the debate about the proper role of government for adults who are vulnerable to abuse or neglect since the criteria for intervention differs across provinces. There is no uniform power of attorney legislation in Canada and there seems to be no apparent desire to progress from the current situation. The panelist noted that some current trends in this area are the reconsideration of "all or nothing" models, the cognitive vs. function tests for capacity or capability, the impact of global initiatives such as the UN Convention on the Rights of Persons with Disabilities, and national and provincial human rights protections.

Mental Incapacity (Dr. Michel Siberfeld, Corporate Health Centre of Rogers Communication Inc.)

The panelist presented a very interesting session on mental incapacity, speaking from psychiatric and medical insight rather than from a legal perspective. First, various mental, dementias and psychotic disorders were described, such as delirium, disordered/disjointed thinking, fluctuating consciousness and types of mental states (sleep vs. awake), disregard of obvious facts, delusions and hallucinations. With respect to delusional mental disorders, the speaker discussed a US case in which a complaint was made against a financial industry worker who told a customer that she chose stock options based on what Jesus Christ told her. After reviewing the worker's investment records, the presiding judge deemed the worker capable because she had a positive investment record, and was achieving results. The judge issued cautions for professionals that ignorance is not incapacity and that physical limitations do not imply incapacity when the person can direct others to compensate. As well, the judge stated that a lack of resources alone is not ground for incapacity, and that those with poor cognitive function can still exercise good judgment. The link between preferences and values in a person's decision making, and the reason given for the choice, has to be clarified by interpretation.

Capacity and undue influence were discussed, with regards to how undue influence is the "back door" if one fails on the capacity issue. The following two theories and their focus were raised: 1) the presumption theory, which focuses on the influencer and the action towards the victim, and 2) the susceptibility theory, which focuses on the victim. The concepts of influence and susceptibility have to do with "dependency", and some elders have "forced" dependency. There is an important need to distinguish between the two concepts of susceptibility to be influenced (to have one's mind turned) and susceptibility to deception (to be deceived irrespective of influence). As a person loses more capacity, they are less susceptible to be influence but *more* easily deceived. Susceptibility to influence should be suspected when a person who lacks personal recourses based on the presence of an illness or deficiency is in serious need of others to meet those needs, or alternatively, when a person without resources depends on others to determine their quality of life.

continued on page 10...

...continued from page 9

IV. ADDITIONAL WORKSHOPS

The Rights of Common Law Spouses (Amy Francis, Legacy Tax + Trust Lawyers; Robert Leckey, McGill University Faculty of Law)

This session looked at the impact of the Québec Court of Appeal decision, *Lola c. Eric*, on the rights of common law or de facto spouses and compared it to the law in other provinces.

Inbound Trusts (James Murdoch, Thorsteinssons LLP; Lisa Wilcox, Scotia Private Client Group)

The panel examined planning options involved in repatriating trusts such as immigrant trusts, and reviewed what practitioners should watch out for on behalf of clients.

Estate Freeze Fundamentals (Brian Cohen, Borden Ladner Gervais LLP; Heather Evans, Deloitte & Touche; James Hutchinson, Miller Thomson LLP)

This workshop discussed the nuts and bolts of implementing an estate freeze, including how to deal with the shares to protect the matrimonial regime. It also covered issues such as typical estate freeze steps and considerations, attribution, preferred shares, best practices in the wake of the *Antle* decision, valuation, mobility, U.S. concerns, net family property regimes across the country, and CRA audits.

Contesting a Will (André Barette, Borden Ladner Gervais LLP; Suzana Popovic-Montag, Hull & Hull LLP; Janine Thomas, Janine A.S. Thomas Law Corporation)

The panel discussed how to prevent a challenge to a will, and important tips for contesting a will.

Insurance Strategies in Post-Mortem Planning (Sandra Bussey, KPMG; Chris Ireland, PPI Advisory)

This session looked at the use of various insurance products and the role they play in post-mortem planning.

Philanthropy: Canadian and International Trends, Use of Private Foundations (Robert Hayhoe, Miller Thomson LLP; Margaret Mason, Bull Housser & Tupper LLP; Hilary Pearson, Philanthropic Foundations Canada)

This workshop discussed the trends, issues and concerns in the world of philanthropy, such as when it is appropriate to create a private foundation and the governance that should be put in place when operating one. ■

Why Bother with a Shareholder's Agreement?

By Andrew ("Sandy") Robinson, Partner, Miller Thomson LLP

If there is not clarity between individuals as to their rights and obligations when they enter into a new business venture, there will probably be confusion and misunderstanding when the business venture flourishes years later.

The importance of parties entering into a shareholder's agreement before they go into business was underscored in a recent decision released by the Ontario Court of Appeal, see *Fedel v. Tan* 93 O.R. (3d) 274 (Ont. SCJ); 2010 ONCA 473, 2010 CarswellOnt 4658 (Ont. CA); Docket 33890 (SCC). That decision also further extended the remedies under the *Ontario Business Corporations Act* (the "*OBCA*") to persons who may not be actual shareholders, but who may have been promised shares.

Joseph Fedel ("Fedel") and Ken Tan ("Tan") were best friends at university. In 1995 they agreed to go into business together. They entered into an oral agreement to import and sell a specific food product (carrageenan). When they started out, they did not have a corporation but carried on business simply as a loose kind of partnership. In 1995 they agreed to incorporate and orally agreed that Tan was to have a 60% interest in the business and Fedel was to have a 40% interest. Tan was to receive the greater share as he was to look after the books and records.

No shareholder's agreement was entered into nor were there written memoranda or letters confirming the oral agreement.

Tan did look after all business arrangements. He consulted with lawyers and accountants and proceeded to incorporate or establish a bewildering number of companies and offshore trusts to own the business. Tan was the sole director of the companies and made himself the sole shareholder. Offshore trusts were established for him and Fedel but shares were never transferred into Fedel's trust. Everything proceeded on a "we are best friends so trust me" basis. Over the years, some of these companies became

continued on page 11...

...continued from page 10

inactive, more trusts were established, and it was unclear who owned what.

The business venture at first struggled but by 2005 it was flourishing. Properties were purchased and the business expanded into manufacturing. Fedel became concerned about where the profits were going. He requested an accounting from Tan. He also requested proof of his ownership.

Tan took the position that Fedel was not a shareholder. He denied that there was ever an oral agreement that Fedel was a shareholder. Tan's position was that the oral agreement was only that Fedel would be employed, and as part of his employment remuneration, he would participate in profit sharing to reflect his contribution.

Fedel commenced an Application in the Ontario Superior Court under the oppression sections of the *OBCA* in which he demanded an accounting and compensation as an aggrieved shareholder. Tan's response was to immediately dismiss Fedel. He filed affidavits saying it was never intended that Fedel would become a shareholder and certainly there was no documentation to support his position that he was a shareholder. Tan challenged the jurisdiction of the Court to hear the case under the oppression sections of the *OBCA*, saying that Fedel was not a "complainant" as defined by the Act.

Section 248 of the *OBCA* provides a remedy for a "complainant" where acts or omissions of a corporation, or the powers of the directors of the corporation, are exercised in a manner that is "oppressive or unfairly prejudicial to or that unfairly disregards the interest of a security holder…" A "complainant" is defined to include a registered security holder or the beneficial owner of a security.

Tan's position was that Fedel was not a "complainant" under section 248 of the *OBCA* because he was not a security holder. No shares had ever been issued to him and he was not a beneficial owner since no trust had been set up to hold shares for him. He stated that Fedel's only remedy, if he had one, was to sue for breach of contract based upon an oral contract, which he denied, and which if it had been made was made more than ten years before.

The Court did not agree with Tan. The Court held that the *OBCA* should be interpreted expansively to protect not only a registered security holder but a party who had a reasonable expectation to become a shareholder. The Court held that a party who had been promised shares, and acted in accordance therewith, was a "beneficial owner" and as such could bring an application as an oppressed party under the *OBCA*.

The corporate structure and the trusts that had been set up by Tan were very confusing. They involved offshore trusts, Ontario companies, and foreign holding companies that were both active and inactive in jurisdictions such as the Cayman Islands, Belize, Jersey and the Philippines. In order to sort out the facts and determine the issues between the parties, the Court had to review transactions for the previous 12 years. To prove his case Fedel was required to search his records for documents and electronic transmissions going back to the time he and Tan met. Volumes of affidavit material and boxes of exhibits were submitted to the Court. In addition, there was oral evidence which took over 15 days to present. In the end Justice Cumming delivered a 38-page written judgment in which he found in favour of Fedel. He accepted Fedel's evidence that it was intended that he be a shareholder. He exercised the discretion given to him under section 248(3) of the *OBCA* to compensate Fedel by awarding damages which he quantified based upon the money taken by Tan from the business venture beyond his 60% interest. Costs were awarded against Tan for the trial in excess of $600,000.

The matter did not end there. Tan appealed to the Court of Appeal primarily on the issue of whether Fedel was a "complainant" under the *OBCA* and Fedel cross-appealed the award of damages. The Court of Appeal dismissed the appeals with minor adjustments. Tan then brought an Application seeking leave to appeal to the Supreme Court of Canada. This was dismissed by the Court in May of 2011.

The time that elapsed from the date Fedel commenced his initial Application until the Supreme Court of Canada finally dismissed all appeals was about 4 ½ years.

The end result was a legal victory for Fedel, but the lesson to be taken away was clear. Parties who go into business together should always enter into a shareholder's agreement even, and arguably especially, when they are entering into a business arrangement with someone they believe they can trust. Without a shareholder's agreement the intention of the parties is always open to interpretation and/or, as shown in the case of Tan, is open to denial.

From a legal perspective, the Fedel decision clarified the law with respect to the oppression sections of the *OBCA*. The provisions of

continued on page 12...

...continued from page 11

the *OBCA* should be read widely rather than narrowly. The definition of a security holder in section 247 of the *OBCA* includes a party who has been promised shares in a company and acts on that promise regardless of whether shares have ever been issued. The oppression sections are intended to introduce equitable principles into corporate law. The Courts will take jurisdiction and grant a remedy applying equitable principles. In choosing a remedy, the Court has a wide discretion to achieve what it believes to be a fair result.

Sandy has over 35 years commercial litigation experience. Sandy can be reached at arobinson@millerthomson.com■

Taxpayer Relieved: Court Reinterprets Ten Year Limitation on Interest Relief

By Patrick Déziel, Associate, Miller Thomson LLP

In early June, 2011 the Federal Court of Appeal ("FCA") released a decision in the case of *Bozzer v. The Queen* ("*Bozzer*")[1] on the topic of discretionary relief from interest owing on outstanding tax debts. The decision overturned a Federal Court ruling[2] that had upheld the Canada Revenue Agency's ("CRA") interpretation of a particular "taxpayer relief" provision. The provision in question provides that a taxpayer can request a waiver of interest on outstanding tax debts, but only where such request is made within ten years after the end of the taxation year in respect of which the interest was payable.

The FCA favoured an interpretation that "taxation year" as used in the provision refers to the taxation year in which the interest accrues, rather than the taxation year in which the original tax debt arose. The effect of this interpretation is essentially that a taxpayer can always apply for relief from interest that accrued within the past ten years, even where the initial assessment leading to the interest accrual was with respect to a taxation year more than ten years past. This article examines the decision and the background to the relevant taxpayer relief provision.

Background

The *Income Tax Act* (the "Act") is, by necessity, a carefully drafted and highly technical piece of legislation. In contrast to other types of legislation, fiscal legislation such as the Act has traditionally been interpreted and applied in a highly technical and at times mechanical fashion, with comparatively little room for equitable interpretations designed to give effect to the perceived spirit of the legislation. With this in mind, it may surprise some to learn that certain provisions of the Act exist "to allow for a common-sense approach in dealing with taxpayers".

Nonetheless, those exact words were used by the Canada Revenue Agency to describe subsection 220(3.1), a "taxpayer relief" provision (formerly known as a "fairness" provision) initially introduced in 1991. The provision was introduced in order to provide the CRA with discretion to grant interest and penalty relief where interest or penalties arose due to circumstances beyond a taxpayer's control. Examples of such circumstances provided by the CRA when the legislation was first released included illness or natural disasters preventing a taxpayer from filing and paying taxes on time. However, a common instance in which relief has been granted in practice is where there has been an unusual delay on the CRA's part, causing excess interest to accrue over time. Interest relief is also commonly provided in the context of the CRA's "Voluntary Disclosure" program, where taxpayers who voluntarily come forward to CRA with overdue tax filings may be provided a degree of relief from interest and penalties.

The legislation did not initially contain the ten-year limitation described above. The only limitation was that relief would only be granted with respect to the 1985 and subsequent taxation years. However, the ten-year limitation was put in place to address administrative concerns relating to verification of claims dating all the way back to 1985. Subsection 220(3.1) currently reads as follows:

> **Waiver of penalty or interest**
>
> (3.1) The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or

continued on page 13...

[1] *Bozzer v. The Queen*, 2011 FCA 186.

[2] *Bozzer v. The Queen*, 2009 FC 199.

...continued from page 12

in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership in respect of that taxation year or fiscal period, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest.

The *Bozzer* Decision

Mr. Bozzer had a tax debt owing to the CRA that arose in 1989-1990. Interest accrued on the tax debt, and in 2005, Mr. Bozzer made a request under the taxpayer relief provisions for a waiver of the accrued interest. The CRA denied the request, on the basis of its position that because the request related to a taxation year more than ten years past, no discretionary interest relief was available.

In his judicial review application to the Federal Court, Mr. Bozzer argued that the CRA's interpretation was incorrect, and that the Minister of National Revenue (the "Minister") has discretion to waive any interest that accrued within the last ten years, regardless of when the tax debt originally arose. He argued that interest accrues daily, irrespective of when the original tax debt arose, leaving no reason to tie accrued interest in one taxation year to the original tax debt. Further, ambiguities in legislation are subject to the "residual presumption" that such ambiguities are to be resolved in favour of the taxpayer. However, Mr. Bozzer failed to convince the Federal Court that the Minister's decision was unreasonable, and the Court upheld the CRA's position that "taxation year" as used in the legislation refers to the year of assessment, not the year in which interest accrued.

The Federal Court of Appeal, however, sided with Mr. Bozzer. The Court held that the Minister's interpretation of the legislation was incorrect, and that the Minister did in fact have discretion to waive any interest that accrued within the last ten years where the circumstances otherwise warranted.

What appeared to sway the Court was an analysis of hypothetical fact scenarios in which the limitation period would apply in an unfair and unreasonable manner, in contrast to the "common sense" approach that the relief provisions were supposed to provide. In particular, the Court considered a scenario in which a taxpayer owed taxes in a particular year, but suffered serious injuries in a car accident prior to filing his or her return for that taxation year. The hypothetical taxpayer was in a coma and endured a long period of recovery and rehabilitation, before finally filing a tax return more than ten years after the accident. In this scenario, interest accruing between the filing due date for the taxation year and the eventual assessment and payment of tax owing for the taxation year could not be waived, according to the CRA's interpretation. Such an interpretation therefore produced an unreasonable result, and the Court preferred the fairer interpretation presented by Mr. Bozzer, which was also more consistent with the purported purpose of the relief provisions.

The Court also noted that the CRA's fear that it would have to verify claims going back more than ten years, in order to waive interest accruing within the last ten years, was not a plausible explanation for the Minister's interpretation of the ten-year limitation. All that is required to calculate interest owing is the amount of the original tax debt, and what payments were made when. No evidence was presented that gathering this information would pose an "administrative problem" for the CRA.

The Federal Court of Appeal's decision was a welcome clarification of the taxpayer relief provisions, resolving an issue that has plagued taxpayers and tax practitioners alike since the introduction of the ten-year limitation in 2005. It remains to be seen whether the CRA will seek leave to appeal the decision to the Supreme Court of Canada. Pending the outcome of any such appeal, the CRA now has a clear mandate to consider using its discretion to waive interest and penalties accruing within the last ten taxation years where circumstances so warrant, regardless of when the initial tax debt arose – a result that, most taxpayers will agree, enables the "common sense" approach to dealing with taxpayers that the legislation was always intended to create.

Patrick is an Associate in the Miller Thomson LLP's Tax and Private Client Services Groups. Patrick can be reached at pdeziel@millerthomson.com ■

Expect Greater Scrutiny and Disclosure When Investing in Private Placements

By Jack B. Tannerya, Partner, Miller Thomson LLP

Introduction

High net worth individuals are often presented with opportunities to invest in private placements of debt or equity securities of companies seeking financing for the growth of their businesses.

If the investor is interested in subscribing for the securities, the issuer or its agent will generally require that the investor submit its cheque, together with a completed subscription agreement for review and potential acceptance by the issuer. Furthermore, unless the investment proceeds from the investor are $150,000.00 or more, the issuer or its agent will also require the investor to indicate how he or she is an "accredited investor" eligible to purchase the securities pursuant to the accredited investor exemption contained in National Instrument 45-106 *Prospectus and Registration Exemptions*.

This requirement generally involves the investor completing an Accredited Investor Certificate by reviewing the definition of "accredited investor" (which is usually attached to the subscription agreement) and checking the appropriate box.

Ontario Securities Commission concerned about improper reliance on Accredited Investor Exemption

On May 13, 2011, the Ontario Securities Commission published OSC Staff Notice 33-735 – *Sale of Exempt Securities to Non-Accredited Investors*.

In the staff notice, the Ontario Securities Commission stated the following 2 findings raised significant investor protection concerns: (i) some issuers (including companies and investment funds) and dealers are improperly relying on the accredited investor exemption to sell exempt securities to individual investors who do not actually satisfy the applicable requirements of the exemption; and (ii) many dealers do not collect adequate "know your client" (commonly referred to as KYC) information to be able to reasonably determine whether the investor is in fact an accredited investor.

Accredited Investors

As a general rule, a company that wants to offer its securities to the public must prepare a detailed disclosure document which provides full, true and plain disclosure about the company and the securities being offered (including the risks of investing in the securities) unless the offering is a private placement. Two commonly used private placement exemptions include: (i) subscriptions for securities with an aggregate subscription price of $150,000.00 or more; and (ii) subscriptions by "accredited investors" (which does not involve a minimum subscription price).

The law assumes that accredited investors do not require the protections offered by a prospectus because accredited investors can: (i) obtain and analyse the information needed to assess an investment without a prospectus; and (ii) sustain the loss of their entire investment.

Although the definition of "accredited investor" set out in National Instrument 45-106 *Prospectus and Registration Exemptions* provides a number of ways one may qualify as an accredited investor, the most commonly relied upon satisfaction criteria are as follows:

- an individual who, alone or together with a spouse, owns financial assets worth more than $1 million before taxes but net of related liabilities
- an individual who alone or together with a spouse, has net assets of at least $5 million
- an individual whose net income before taxes exceeded $200,000 in both of the last two years and who expects to maintain at least the same level of income this year
- an individual whose net income before taxes, combined with that of a spouse, exceeded $300,000 in both of the last two years and who expects to maintain at least the same level of income this year

In its staff notice, the Ontario Securities Commission indicated that it has come to the commission's attention that in assessing whether clients meet the accredited investor definition, some dealers are not making it clear to their clients that the client's

continued on page 15...

...continued from page 14

personal residence or other real estate cannot be included in the valuation of their financial assets (which has a much lower threshold than the net assets test which does include a client's personal residence and other real estate). As a result, these issuers and dealers may be improperly selling exempt securities in reliance on the accredited investor exemption to investors who do not, in fact, meet the definition of accredited investor, contrary to securities laws.

OSC expectations for issuers and dealers selling exempt securities to accredited investors

In its staff notice, the Ontario Securities Commission provided a non-exhaustive list of steps that dealers should take in order to meet their obligations under securities laws when selling exempt securities to an accredited investor. Such steps include:

- adequate training and explanation to chief compliance officers and dealing representatives to ensure they understand the definition of an accredited investor and how to determine whether a client meets the definition
- developing an accurate form for collecting "know your client" information
- explaining the accredited investor definition to clients and ensuring that their "know your client" forms are properly completed
- refraining from selling exempt securities if the dealer does not have sufficient information to determine whether the client qualifies as an accredited investor
- ensuring the exempt security is suitable for the client (as described in Canadian Securities Administrators Staff Notice 33-315 *Suitability Obligation and Know Your Product*)
- the Chief Compliance Officer reviewing the completed "know your client" form to ensure that the information is complete and consistent with that portion of the accredited investor definition to be relied on and that the trade is suitable for the client
- dealers maintaining records to support their reliance on the accredited investor definition, including completed "know your client" forms and the dealing representative's notes
- dealers establishing appropriate policies and procedures to ensure that exempt securities distributed under the accredited investor exemption are distributed only to investors who actually satisfy the relevant criteria

Monitoring

The Ontario Securities Commission indicated its intent to closely monitor the activities of issuers and dealers that sell exempt securities, including conducting compliance reviews of those firms. The Ontario Securities Commission further stated that it will take enforcement proceedings or other regulatory action where issuers and dealers are acting contrary to securities laws by selling exempt securities under the accredited investor exemption to investors who do not actually satisfy the relevant criteria.

Implications for Investors

Given the Ontario Securities Commission's stated expectations for issuers and dealers selling exempt securities to accredited investors, investors interested in subscribing for securities in private placements should now be prepared for more extensive scrutiny concerning their eligibility as an accredited investor which may involve more robust discussions regarding the investor's financial assets, net assets or income.

In addition, given the Ontario Securities Commission's "know your product" comments, investors should expect that even if they clearly qualify as an accredited investor, a dealer may still need to interview the investor extensively to assess whether the exempt security in question is suitable for the investor. This may require more in-depth meetings with the dealer because the dealer will need to understand: (i) the investor's general investment needs and objectives and any other factors necessary for the dealer to be able to determine whether a proposed purchase is suitable (know your client information) and the attributes and associated risks of the securities they are recommending to the investor (know your product).

Jack is a Partner in the Business Law and Capital Markets and Securities Groups. Jack can be reached at jtannerya@millerthomson.com ■

Court of Appeal Reverses McNamee: Estate Freeze Shares are a Gift, not Part of Net Family Property

Hadielia Yassiri, Miller Thomson LLP

Hadielia is an associate in the Tax and Private Client Services Groups. She can be reached at hyassiri@millerthomson.com

In the May 2011 issue of this publication, I wrote about *McNamee*[1], a family law case where the trial judge, Tranmer J., found a transfer of shares to a husband by his father as part of an estate freeze was not a gift and therefore, was not excluded from net family property.

Estate planners can now breathe a sigh of relief. The case was reversed on appeal. Had the *McNamee* decision stood, it would have caused serious repercussions for structuring estate freezes for the purposes of estate and tax planning in terms of family law protection.

In a unanimous decision released in late July 2011, the Court of Appeal refuted the statements of the trial judge regarding what constitutes a gift and found the transfer of the shares was by way of gift. The decision of the Court was written by Blair and Rouleau JJ.A.

Facts

Mr. McNamee (the husband) worked for his father. The father had reluctantly implemented an estate freeze for the purposes of creditor-proofing his business and minimizing taxes. The estate freeze was unusual because the father retained absolute control over corporate affairs and had an unrestricted right to pay himself unlimited dividends. As part of the estate freeze process, the father executed a declaration of gift that attached two conditions to the transferred shares: the shares were not to form part of the net family property of the donee in the event of a marital breakdown; and the shares were to remain the donee's separate property, free from the control of his spouse. The husband and wife became aware that the shares "gifted" only after their separation.

Trial Decision

The trial judge based his conclusion that the transfer of shares to the husband was not a gift on four elements:

1. The transfer was not a gratuitous transfer but was a transfer for consideration;
2. The father did not intend to gift the shares;
3. The father did not divest himself of all power or control over the shares; and
4. The husband did not accept the gift.

Court of Appeal

With respect to the first element, the Court of Appeal disagreed with the trial judge's conclusion. Consideration is the value that flows from a promisee to a promisor as a result of a bargain. Consideration cannot flow where there is no bargain, i.e. if a promisee does not know he is negotiating or passing value to a promisor in an exchange he does not know exists. The Court of Appeal found that the share transaction was completely unilateral on the father's part and the husband had no meaningful input with respect to it. The Court of Appeal emphasized that the issue was not whether the father had received a benefit from the estate freeze but whether the husband provided any consideration for the transfer of the shares.

With respect to the second element, the Court of Appeal found that the trial judge committed an error in law because his analysis of intention conflated intention with underlying motivation or purpose. The father's primary purpose or motivation in transferring the shares to the husband was part of the estate freeze but it does not mean that he did not intend to gift the shares in order to give effect to that purpose. The evidence supported the father's intention to gift the shares. For example, a declaration of gift was executed and he did not sell the shares to the husband.

The third and fourth elements are divestment of power and control by the father and acceptance of the gift by the husband. The wife's counsel submitted that: (1) the father did not divest himself of all power and control over the shares and therefore there was no irrevocable transfer of them to the husband; and (2) the gift fails because the husband was unaware of the conditions attached to it, therefore vitiating his acceptance.

The Court of Appeal did not accept either of these submissions. The fact that the father could affect the value of the shares at any given time has no bearing on whether the shares were transferred

continued on page 17...

[1] *McNamee v. McNamee*, [2011] W.D.F.L. 1379, rev'd 2011 ONCA 533 ("McNamee").

...continued from page 16

as a gift or not. Also, the gift is not invalidated by unknown conditions. The husband clearly knew about and accepted the transfer of the shares. He understood the essential nature of the transaction, which is receipt of shares in the company for no payment, and he willingly accepted title to those shares.

New Trial re Constructive Trust

At trial, In addition to pleading that the shares were not a gift, the wife also pleaded that she was entitled to a beneficial ownership interest in the shares by way of unjust enrichment and constructive trust. The trial judge did not deal with this issue because he believed the shares were subject to equalization. The Court of Appeal ordered a new trial on the issue of the wife's constructive trust claim. ■

Canada's Anti-Spam Legislation Moves Closer to Adoption

By J. Fraser Mann, Partner, Miller Thomson LLP

1. Introduction

Canada's Anti-Spam Legislation (the "Act") is intended to combat internet and wireless spam and to prohibit certain unauthorized activities relating to electronic messages and access to other persons' computers. While the Act was passed in late 2010, it was not proclaimed in force pending the adoption of regulations to clarify certain obligations under the Act.

On June 30, 2010, the Canadian Radio-Television and Telecommunications Commission issued draft regulations (the "CRTC Regulations") which are open for public comment until August 29, 2011. On July 9, 2011, the Department of Industry issued a further set of draft regulations (the "Industry Regulations") which are open for public comment until September 7, 2011.

It is expected that both the Act and the regulations will come into force this fall after the period for public consultation expires.

2. Key Provisions of Act

Commercial Electronic Message

The anti-spam provisions of the Act affect a wide variety of "electronic messages", which are messages sent by any means of telecommunication, including a text, sound, voice or image message. Subject to certain exceptions, they prohibit a sender from transmitting a commercial electronic message to an electronic address, unless: (i) consent to send has been obtained from the individual associated with the electronic address; and (ii) certain requirements to include information in the message are met.

A message is defined by the Act as "commercial" in nature if it encourages "participation in a commercial activity", such as a message that offers to purchase or sell goods or services, offers to provide a business, investment or gaming opportunity or advertises or promotes any such activities.

Consent Required for Sending Commercial Electronic Messages

Unless one of the exceptions referred to below applies, the intended recipient of a commercial electronic message must provide consent to the sending of the message.

A request for express consent must set out the purposes for which consent is sought and meet certain requirements as to the information to be included. The draft regulations discussed below describe the information requirements.

The Act also sets out circumstances in which consent to the sending of messages may be implied. For example, implied consent may arise based on an existing business relationship or an existing non-business relationship.

An existing "business relationship" will arise based on the purchase or lease of a product or service, the acceptance of an investment opportunity or the making of a contract, in each case within two years prior to the sending of a message.

A sender will have an "existing non-business relationship" with a recipient where the sender is a registered charity or a political party or candidate, and the recipient has made a donation or performed volunteer work for the charity, party or candidate in the preceding two years. Such a relationship will also exist where

continued on page 18...

...continued from page 17

the sender is a club, association or voluntary organization (a "CAVO"), and the recipient is a person who is currently, or who was in the preceding two years, a member of such CAVO.

Consent to the sending of a commercial electronic message may also be implied where the intended recipient has published an e-mail address without a notice indicating that the address is not to be used for sending unsolicited commercial messages, and where the intended recipient has disclosed to the sender an e-mail address without indicating a wish not to receive unsolicited messages; in both of these cases, the messages that are sent must be relevant to the recipient's business or official role or capacity.

Information and Form Requirements

The Act requires commercial electronic messages to identify the sender, to set out methods for contacting the sender and to provide a means for opting out of (or "unsubscribing" from) receiving further messages. The means to unsubscribe must be effective for at least sixty days from the date on which the electronic message was sent, be provided at no charge to the recipient and meet certain other requirements described in the draft regulations, as set out further below.

Exceptions

The Act sets out circumstances in which neither the consent requirement, nor the requirement as to the form and content of an electronic message, is applicable. Specifically, neither such requirement applies to messages sent between individuals having a personal or family relationship (as described further below), and interactive two-way voice communications between individuals.

The Act also sets out circumstances in which the consent requirement does not apply, but in which the requirement as to the form and content of a message must still be met. These include a message sent in response to a request for a quote, or a message to send recall or warranty information to a buyer of a product.

Other Prohibitions

The Act prohibits any person from redirecting electronic messages by altering the transmission data unless the sender or the original intended recipient expressly consents to the redirection. A person also may not, in the course of a commercial activity, install a program on another person's computer if its purpose is to collect and transmit certain types of information (i.e. spyware), or after installing a program, activate it to send a message, in each case without the express consent of the owner or authorized user of the computer. The Act provides that a person is considered to expressly consent to the installation of certain types of programs (such as a cookie, HTML code or Java scripts) where the person's conduct is such that it is reasonable to believe that he or she consented to its installation.

Penalties

The Act provides for the possibility of significant penalties. Individuals may be fined up to $1 million and corporations may be fined up to $10 million for each violation under the Act. The Act also provides for a private right of action for individuals who receive commercial electronic messages from a sender who did not have the appropriate consents. Such recipients may also seek statutory damages of $200 for each electronic message sent per day in contravention of the Act, up to a maximum of $1,000,000.

3. Overview of the Draft Regulations under Canada's Anti-spam Legislation

Information Required in Commercial Electronic Messages

Under the draft CRTC Regulations, all commercial electronic messages that are covered by the Act must set out, in a prominent manner, information about the name of the person sending the message, and any other person on whose behalf the message is sent; any different name(s) by which such persons carry on business; and the physical and mailing address, telephone number (which includes access to an agent or voice message system), email address and web address of such persons.

The foregoing information together with the unsubscribe mechanism may be provided by a clear and prominent link to a web page, but in such case, the web page must be accessible by a single click and at no cost to the recipient. The unsubscribe mechanism must also be easy to access and use, as evidenced by a process that takes two or fewer clicks.

Personal Relationship and Family Relationship

The Act provides that if a "family relationship" or a "personal relationship" exists between the sender and the recipient, messages between them (even commercial messages) are not required to comply with the Act.

Under the draft Industry Regulations, a "family relationship" is defined in detail as one arising from a blood relationship, marriage, a common-law partnership or adoption. A "personal relationship" means the relationship, other than in relation to a commercial activity (as defined in the Act), between the sender

continued on page 19...

...continued from page 18

and recipient of a message, if they have had an in-person meeting and, within the previous two years, a two-way communication.

Conditions for Use of Consent

Section 10(2) of the Act provides that a person may seek consent for any activities set out in the Act on behalf of a person whose identity is not disclosed, provided that the person seeking consent complies with the requirements in the regulations. The requirements in the draft Industry Regulations include that where a person has obtained express consent to send a message on behalf of an unknown person, the message must identify the person who obtained the consent and include an unsubscribe mechanism that, in addition to meeting other requirements, allows the recipient to withdraw their consent from any person who was authorized to use the consent or who obtained consent in the first place.

Membership in a Club, Association and Voluntary Organization

For purposes of the provisions of the Act referred to above whereby consent is implied for the sending of messages by a CAVO to a member, the draft Industry Regulations define "membership" as the status of having been accepted as a member of a CAVO in accordance with its membership requirements. The draft Industry Regulations also define a CAVO as a non-profit organization that is organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any purpose other than profit, if no part of its income is available for the personal benefit of any proprietor, member or shareholder of that organization (unless the primary purpose of the organization is the promotion of amateur athletics in Canada).

Further Information

The draft CRTC Regulations and details on how to provide comments to the CRTC are available at: http://www.crtc.gc.ca/eng/archive/2011/2011-400.htm.

The draft Industry Regulations and details on how to provide comments to the Department of Industry are available at: http://www.gazette.gc.ca/rp-pr/p1/2011/2011-07-09/html/reg1-eng.html.

Fraser practices primarily in the areas of technology, procurement, e-health and intellectual property law. Fraser can be reached at fmann@millerthomson.com ■

Income Splitting Investment Income – Back to Basics

By Vinay Khosla, CA, Tax Partner, Bateman MacKay LLP

After the April 30th personal tax filing deadline, many of us realize that we may have paid more income tax on our investment income than we should have had some proactive tax planning been implemented. Income splitting investment income is one legitimate method to potentially reduce a taxpayer and his/her family's overall tax burden. Income splitting represents the method by which one can strategically allocate income from an individual who is in a high tax bracket to an individual in a lower tax bracket. The top marginal personal tax rate in Ontario is 46.41% while the lowest marginal personal tax rate is 20.05%. Hence, the tax savings can be considerable should you successfully shift investment income that would otherwise be taxed at this high rate to someone (usually a family member) who is in a lower tax bracket. In certain situations, the lower income taxpayer may not even earn enough to pay any tax should the basic personal tax credit be sufficient to offset any personal income tax liability. The concept sounds simple enough; however, be forewarned – there are a minefield of complex tax rules to navigate to achieve income splitting success and those rules are not for the faint of heart! Simply gifting income generating assets in the name of a lower income family member can easily run afoul of these rules.

Overview of Attribution Rules

Income splitting investment income is a game of cat and mouse. The proverbial cat is the attribution rules and once caught by these rules, the taxpayer's income splitting objectives are frustrated. If the Income Tax Act's[1] attribution rules are applicable, the investment income that the taxpayer may have declared on the low income family member's tax return is attributed back to the taxpayer. Thus, the higher income taxpayer ends up paying the higher rate of tax notwithstanding the lower income taxpayer's tax return as filed with Canada Revenue Agency ("CRA").

[1] RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this article are to the Act.

continued on page 20...

...continued from page 19

The attribution rules apply where the transferor taxpayer transferred or loaned property to certain related persons that are defined to include a spouse, common-law partner or related minor[2]. A related minor includes the transferor's include minor child, grandchild, niece and nephew[3]. Where the investment income earned on such transferred property is interest income or dividend income, that income is attributed to the transferor. Where the investment income earned on the transferred property is capital gains, the attribution rules are not applicable where the transferee is a related minor. Implicit in these rules is the fact that the attribution rules are not applicable to any type of investment income where the transferee is the transferor's child/grandchild/niece/nephew who is 18 years of age or older.

Attribution Rules and Family Trusts

People are often reluctant to transfer substantial amounts of funds directly in the name of a family member due to the perceived loss of control of those assets. Hence, family trusts are often the vehicle of choice to separate legal ownership from the legal control of such transferred assets. The Act's attribution rules apply similarly to family trusts. One must look to the relationship between the settlor and the family trust's beneficiaries to determine the impact of the attribution rules. If the settlor's spouse, common-law spouse and related minor are allocated interest or dividend income from the family trust, the allocated investment income would be attributed back to the settlor[4]. Capital gains are attributed where the beneficiary is a spouse or common-law spouse of the settlor. Where the income of the trust is taxed in the hands of the trust, that income will not be attributed to the settlor.

An attribution-like pitfall unique to family trusts arises if the trust is deemed to be revocable pursuant to subsection 75(2) of the Act. Subsection 75(2) of the Act states that:

> "Where, by a trust created in any manner whatever since 1934, property is held on condition
>
> (a) that it or property substituted therefor may
>
> (i) revert to the person from whom the property or property for which it was substituted was directly or indirectly received (in this subsection referred to as 'the person'), or
>
> (ii) pass to persons to be determined by the person at a time subsequent to the creation of the trust, or
>
> (b) that, during the existence of the person, the property shall not be disposed of except with the person's consent or in accordance with the person's direction,
>
> any income or loss from the property or from property substituted for the property, and any taxable capital gain or allowable capital loss from the disposition of the property or of property substituted for the property, shall, during the existence of the person while the person is resident in Canada, be deemed to be income or a loss, as the case may be, or a taxable capital gain or allowable capital loss, as the case may be, of the person."

Thus, if the trust is deemed to be revocable, the trust's income is attributed to the settler and income splitting is not achievable. The broad reach of this subsection has been subject to much litigation, CRA commentary and other commentary from the tax community. A review of these rules is beyond the scope of this article and has been recently commented on by others[5]. One can briefly summarize that it is far too easy for a trust to be deemed to be revocable. Any number of seemingly innocuous clauses in a family trust document could result in the application of subsection 75(2) which in turn circumvents the taxpayer's income splitting objectives. A small sample of family trust clauses that may result in the application of subsection 75(2) include:

1. Trustee who was the settlor has the power to appoint additional trustees.
2. Trustee who was the settlor has the power to appoint additional beneficiaries.
3. Trustee who was the settlor has the power the replace the other trustees and/or cause them to resign.
4. An informal "in-trust for" account is established with the absence of a formal family trust document.

Another contemporary issue facing numerous family trusts is the recent focus of a CRA audit initiative reviewing family trusts with a specific focus on their income-splitting objectives. Specifically, CRA is reviewing and challenging the deduction of any trust income allocated to minors. CRA may attempt to take the tax position that the income so allocated are not actually owed to

---

[2] Subsections 74.1(1) and 74.1(2).

[3] Subsection 74.1(2).

[4] Subsection 74.3(1)

[5] Roth, E. and T. Youdan "Subsection 75(2): Is CRA's Interpretation Appropriate?", draft paper presented to the Canadian Tax Foundation's 62nd Tax Conference, 2010.

continued on page 21...

...continued from page 20

the beneficiaries where payments have not been made to the beneficiaries. A successful challenge in this regard may result in the trust paying the income tax at the highest marginal personal tax rate and income splitting is frustrated.

Loans for Fair Market Value Consideration

As previously reviewed, the attribution rules prevent income splitting dividend and interest income with related minors and all types of investment income with spouses. An exception to these attribution rules is where the transferor receives fair market value consideration. Where the transferor receives fair market value consideration, the Act's attribution rules are deemed not to apply[6]. Fair market value consideration for the transferred property includes cash and loans for value or other property. Should the transferor receive debt as consideration for the transferred assets, the attribution rules will be deemed not to apply if the Act's prescribed rate of interest is charged on the loan. The prescribed rate is currently 1%[7] and is as low as it can possibly go. Thus, should taxpayers be interested in such a tax planning opportunity, it makes sense to consider "locking in" the current prescribed rate on the loan between transferor and transferee. The transferee (i.e. spouse or minor related child or family trust with spouse and/or minor related children as beneficiaries) must pay the transferor the prescribed rate of interest no later than 30 days after the calendar year end. Actual payment of interest should take place evidenced by canceled cheque(s) to appropriately withstand CRA scrutiny.

The above tax planning method can be illustrated using an example under the following assumptions:

1. Mr. A's additional investment income is taxed at the highest marginal tax rate.
2. Mr. A's children are taxed at the lowest marginal tax rate. Mr. A has established a family trust with his minor children as the beneficiaries ("the Children's Trust").
3. Mr. A loans the Children's Trust $100,000. In consideration, the Children's Trust issues Mr. A a 20 year promissory note bearing interest at the current prescribed rate of 1%. The interest is payable within 30 days of the end of the year.
4. The Children's Trust invests the $100,000 into a portfolio of bonds earning 5% of interest income.
5. On or before January 30 of the following year, the Children's Trust pay's Mr. A $1,000 in interest pursuant to the terms of the promissory note.

The tax consequences of the above circumstances are as follows:

1. The Children's Trust would earn investment income of $5,000 ($100,000 x 5%). That income would normally be allocated to the children and taxed at their assumed lowest marginal tax rate of 20.05%. Thus, under the above assumptions, the children would pay tax of $1,002 ($5,000 x 20.05%).
2. Mr. A would earn investment income of $1,000 ($100,000 x 1%) on the promissory note from the Children's Trust. That income would be taxed at his assumed highest marginal tax rate of 46.41%. Thus, under the above assumptions, Mr. A would pay tax of approximately $464 ($1,000 x 46.41%).
3. The total tax liability of Mr. A and his children is $1,466 ($1,002 + $464) under this tax planning method.
4. Had Mr. A invested $100,000 on his own account and earned 5% on the invested funds, his tax liability would be approximately $2,320 ($5,000 x 46.41%).
5. Thus, under the preceding assumptions, this tax plan saves Mr. A $854 of tax ($2,320 - $1,466).

The tax savings of this tax planning method increase as the rate of return on the Children's Trust investments increase. Similarly, the tax savings of this tax planning method increase as the amount borrowed by the Children's Trust increases. Finally, the tax savings of this tax planning method increase if the children have no other income; thus, some/all of the tax on the income is offset by the children's basic personal tax credits.

Summary of Investment Income Splitting Solutions

Based on the preceding discussion and analysis, the following summarizes various methods to avoid the application of the attribution rules and achieve the desired investment income splitting:

1. Capital gains earned by certain related minors are not attributed.
2. Interest / Dividends / Capital Gains earned by adult children is not attributed.
3. Interest / Dividends earned by spouse and certain minors is not attributed **IF** there is a loan made at a reasonable rate of interest (prescribed rate).

continued on page 22...

[6] Subsection 74.5(1)
[7] Regulation 4301(c).

...continued from page 21

4. Family Trust allocates interest/dividends/capital gains to lower income adult children.
5. Family Trust allocates capital gains to low-income minor children.
6. Family Trust allocates interest/dividends/capital gains to lower income unrelated minor child (i.e. not children, grand-children, niece/nephew).
7. There is no attribution on "secondary" income. Secondary income is represented by investment income that is earned on investment income that has already been attributed back to the transferor.
8. Contribute to lower income children's Registered Education Savings Plan.
9. Establish and investment accounts of lower income minor children from cash gifts they receive from various holidays, birthdays and other celebrations. Also fund these accounts with amounts received pursuant to the Universal Child Care Benefit program.

In light of increasing CRA audit activity, it is crucial to revisit the attribution rules with a tax professional to ensure compliance with these complicated series of rules prior to implementation of any type of investment income splitting strategy.

Vinay has been a C.A. for 12 years. His practice is both domestic and international. Vinay can be reached at vkhosla@bateman-mackay.com. ■

Tax Shelters: A Participant's Lessons

By Frank Snape Ph.D., Entrepreneur and Businessman

As a successful business person, I have had the opportunity to participate in numerous business ventures in a variety of different industrial sectors.

Some years ago, I was asked to become involved in a computer software company. I was responsible for development. You may recall that our Federal government introduced a new tax incentive regime in the 1990s to encourage the development of a software industry in Canada. As some may know, software development has, and probably will remain, a high risk proposition mainly due to the uncertainty of the market acceptance of the end research and product result. To illustrate this point, I draw your attention to the launch of Word by Microsoft. After two full years of development, Microsoft announced the imminent release of Word. However, it took Microsoft another six years before Word was actually released to the public.

The key elements from an investor's perspective regarding the operation of the software program were deferred tax benefits and the potential of considerable capital gains if the software proved successful in the marketplace.

The company was formed in 1992 by a highly reputable businessman. The company purchased a 4th generation software program that was designed to handle very complex information management applications. The software was attractive because although it handled complex tasks it was user friendly and enabled non-programmers to develop complicated programs in a short period of time.

The company hired top flight lawyers and accountants to ensure legal and financial compliance. I was certainly impressed by the depth of experience of both the law and accounting firms.

The promoter raised 13 million dollars in cash and the developer took back promissory notes from a group of about 240 investors in the amount of 55 million dollars. Part of the funds was earmarked for upgrades to the software, part went to pay some of the purchase price to the USA-based developer and other funds were used for sales and marketing activities. The developer insisted his payment be made to an offshore company – a red flag for the Canada Revenue Agency (CRA).

After I had been working there a number of months, my wife became an investor (limited partner) in the tax shelter.

By 1994, the CRA was vigorously auditing nearly all software tax shelters for a number of reasons. One of the primary factors was the belief that these shelters were shams designed to create the impression of a real business with a real product. However, the CRA alleged that many of these shelters were nothing more

continued on page 23...

...continued from page 22

than a fake artifice to take advantage of capital cost allowance provisions in the Income Tax Act in order to flow losses to the limited partners. The limited partners could then use these losses to ultimately reduce each investor's personal tax.

The audit of the software tax shelter used by the company that I was involved with - ultimately as a consultant - commenced in 1994. My participation with the company began in 1996. The civil audit turned into an ugly special investigation (or criminal investigation) by the CRA.

The conduct of the CRA personnel that I witnessed or was made fully aware of was in one form or another shockingly unprofessional. We had lawyers dealing with all sorts of CRA activities. But the trials and tribulations with the government continued unabated for three years (1994-1997). Toward the end of this period, the company was attempting to go public with a NASDAQ listing while the developer was working on enhancements for the software. Unfortunately, the developer failed to meet his obligations and with allegations of sham and fraud circling the company, funds dried up and the NASDAQ listing became an improbability.

In 1998, the company struggled to survive but it was virtually impossible. In August of 1998, I performed the sad task of laying off the employees and ultimately closing down the company.

As you may have guessed by now, all of the limited partners were reassessed by the CRA. To this day, there are still a couple of cases before the Court involving this software tax shelter. Many of the investors, including my wife, decided that we should take the "last offer" to settle and she did in 2011. Yes, you read it correctly- 2011.

I could spend pages writing about the history of this experience. But I have been told that there are limits in this publication so I will jump to the conclusion of my family's ordeal and share it with you- the reader.

I was shocked and disgusted by the behavior of the officials of the CRA. It was and remains my opinion that certain CRA personnel lied to advance the CRA's agenda. And that agenda was nothing more than to destroy the company and win approval of the proposed reassessments of the limited partners.

The CRA and the Department of Justice (Canada) appear to have unlimited resources and time to spend on a case. It's possible this conclusion applies to all tax cases not just tax shelters. I wonder what it "cost" CRA/Justice - the investor's legal bills over the years have amounted to more than a million dollars.

We wished that we had paid the full assessment immediately when it was issued. At the very least, the interest clock would not have been ticking. As we learned, the interest rate is set every quarter and it is charged on a daily basis on the principal and interest. From our final tally the interest was three times the tax payable. We also learned that by paying we would not have affected our rights- in other words by making the payment it would not have been an admission that the CRA was right.

If you are involved in a tax shelter that has an offshore component, you must exercise extra vigilance not just to protect your interests but because such ventures seem to "naturally" attract the interests of the CRA.

It was clear to me that bureaucrats may not agree with the policies of their political masters. In such situations, as you might have guessed- it is the taxpayer who suffers the consequences.

Finally, we learned that the justice system, when it comes to complex matters of tax, has great difficulty in delivering a fair and equitable result.

I hope that my comments serve as a clear warning to you all.

Our experience was a nightmare. My hope is that our tale gives you- the reader- pause to think before getting involved in any tax shelter. ■

Agribrans Purina Canada Inc. v. Kasamekas et al., 2011 ONCA 460 (CanLII) ("Agribrans"): A Case Commentary

By Susan Adam Metzler, Partner, Miller Thomson LLP

Over the last several years, our trial judges have shown an increasing willingness to impose liability in commercial disputes for what is known as "the tort of unlawful conduct conspiracy" above and beyond liability for breach of contract. The damage awards for having engaged in such tortious conduct are usually much higher than damage awards for having engaged in breach of contract.

In Agribrans, the Ontario Court of Appeal has narrowed the basis upon which a trial judge should make a finding of "unlawful conduct".

The tort of unlawful conduct conspiracy is essentially defined in the following example: A and B act in concert. While their predominant purpose is not to injure C, their conduct was directed at C.

The tort of conspiracy is different: A and B act in concert. Whether they are acting lawfully or unlawfully, their predominant purpose is to cause injury to C.

The facts in the Agribrans case are briefly set out below:

- Ren's was a dealer of Purina.
- Purina terminated the dealership when it was discovered Ren's was engaged in purchase and sale of products with a Purina competitor – contrary to Ren's dealership agreement with Purina.
- W.K. and R.J. set up Raywalt to take over Ren's territory as a Purina dealer. As part of the dealership agreement, Purina agreed not to appoint any other dealer in the Raywalt territory [the former Ren's territory].
- Purina continued to supply product to Ren's to enable Ren's to sell Purina products to Ren's former customers in Raywalt's territory. This arrangement continued for about a month before Purina stopped what it was doing.
- A Purina dealer (McGrath) in a neighbouring territory to Raywalt, began to supply Ren's with Purina product, at dealer prices. This allowed Ren's to continue to sell Purina product in Raywalt's territory. Purina knew of, condoned and approved of the arrangement. Purina provided McGrath with product for resale to Ren's.
- As a result of the above, Raywalt's business was adversely affected and had to cease its operations less than a year later.

The trial judge found Purina, Ren's and McGrath liable to W.K., R.J. and Raywalt for having been engaged in the tort of unlawful conduct conspiracy and awarded sizable damages to W.K., R.J. and Raywalt. In addition, he held that Purina had breached its contract with Raywalt. He also awarded $30,000.00 in punitive damages against Purina.

There was no appeal from the finding of breach of contract. The punitive damage award was upheld. The finding of the liability for the tort of unlawful conduct conspiracy was set aside by the Court of Appeal. The damage award related to the tort was set aside ($2,096,406.00 inclusive of pre-judgement interest). The trial judge also awarded breach of contact damages against Purina in the same amount (not in addition to). The Court of Appeal substituted an award of $198,665.83 for the breach of contact (plus pre-judgement interest).

The central issue before the Court of Appeal was whether or not Purina, Ren's and McGrath had engaged in "unlawful" conduct.

The trial judge concluded that conduct is "unlawful" for purposes of this tort if the defendant in such a case is "not at liberty" or "not authorized" to engage in, whether as a result of law, a contract, a convention or an understanding.

He found:

- Purina had acted unlawfully by breaching its contract with Raywalt and Raywalt's right to exclusivity in its territory;
- McGrath has acted unlawfully by its "unauthorized" activity under McGrath's contract with Purina to effectively set up a sub-dealership with Ren's, and knowing Ren's was operating in a territory that has been assigned exclusively to Raywalt; and
- Ren's had acted unlawfully by acquiring product at advantageous prices available only to authorized Purina dealer, and

continued on page 25...

...continued from page 24

effectively creating a "licensing" relationship with Purina and McGrath to operate within Raywalt's exclusive territory.

The Court of Appeal stated that the trial judge's approach was "simply too broad". To successfully prove the tort of unlawful conduct conspiracy, each of the defendants or conspirators must have acted unlawfully. "The tort is designed to catch unlawful conduct down in concert, not to turn lawful conduct into tortious conduct".

There was no dispute that Purina had acted unlawfully by breaching its contract with Raywalt.

The Court disagreed with the trial judge's conclusion Ren's had acted "unlawfully". Ren's has no contract with Purina or Raywalt. Ren's was entitled to purchase product from McGrath at the best price it could obtain and sell it wherever it could.

The Court disagreed with the trial judge's conclusion McGrath has acted "unlawfully." McGrath has not breached its contact with Purina. The trial judge held McGrath's conduct was a violation of Purina's "standard operating procedures". The Court determined such a violation was not "unlawful".

Justice Goudge, writing the decision for the three-member panel state: "In the commercial world, even highly competitive activity, provided it is otherwise lawful, does not qualify as 'unlawful conduct' for the purposed of this tort."

The Court concluded that since only on of the three alleged conspirators has acted unlawfully, "the finding unlawful conduct conspiracy and the damages flowing from it must be set aside."

It will be very interesting to see in the months and years to come, how trial judges apply this decision and principles articulated to "highly competitive commercial activity".

Susan's practice encompasses both commercial and personal litigation. Susan can be contacted at smetzler@millerthomson.com. ■

Employee or Independent Contractor: Can We Not Formulate a Single Test, Please!

David W. Chodikoff, editor, specializes in tax litigation (civil and criminal). He is a partner at Miller Thomson LLP. David can be reached at dchodikoff@millerthomson.com

Tax issues relating to employment commence with the determination of whether a worker is an employee or an independent contractor. Unfortunately, a single uniform test has yet to be adopted by our courts. Therefore, it should come as no surprise to anyone that the determination of a worker's status remains one of the most litigated subjects before the Tax Court of Canada and the Federal Court of Appeal. What is needed is a court decision that encompasses and solidifies a uniform legal test for this important determination. In the meantime, we do have a number of leading cases that provide us with some guidelines. In this brief article, I highlight some of the principles for making the determination as set out in the leading cases.

The first case that most point to is *Wiebe Door Services Inc. v. MNR* (87 DTC 5025 (FCA)). More commonly referred to as *Wiebe Door*, the facts were straight forward. Wiebe Door was a corporation in the business of installing doors and repairing overhead doors. The company used lots of personnel as door installers and repairers. The company had a plain understanding with all of the workers. Basically, each worker was running his own business and therefore, each worker would be responsible for filing and paying their own taxes, paying as well any monies for worker's compensation, unemployment insurance and the Canada Pension Plan. The facts established that each worker owned his own truck and tools; the workers were paid by the job; the workers worked as they saw fit and could refuse to accept a job; with the exception of picking up a door or parts, the worker did not have to be at the company's place of business. The Tax Court of Canada agreed with the Minister of National Revenue (the "Minister") and concluded that the workers were employees rather than independent contractors. The Tax Court had relied on the "integration test" particularly noting that the work performed by the installers formed an integral part of the company's business and that without the installer the company would be out of business. The corporation applied to the Federal Court of Appeal to review and set aside the decision.

continued on page 26...

...continued from page 25

The Federal Court of Appeal found in favour of the company so that the application was allowed and the matter was referred back to the Tax Court. The Federal Court of Appeal adopted a test based on four principal factors. (This test is also known as the 4 in 1 test.) The test involves examining the whole of various elements – (1) control, (2) ownership of tools, (3) chance of profit, and (4) risk of loss – which constitute the relationship between the worker and employer. The underlying question that must be determined by the Court when deciding upon the relationship between the parties is simply: "whose business is it?"

Some years later, the Supreme Court of Canada in *671122 Ontario Ltd. v. Sagaz Industries Canada Inc*. [2001] 2 SCR 983 had the chance to consider the "proper" test to be used in the determination of whether a person was an employee or an independent contractor. While the crux of the case was on the subject of vicarious liability, Mr. Justice Major, speaking for the court, endorsed the approach adopted by the Federal Court of Appeal in *Wiebe Door* and, in fact, provided a number of additional factors that could be considered in determining whether a worker was in business for himself. Some of these other factors included whether the worker hires his or her own helpers, the degree of responsibility for investment and management held by the worker; and the Court repeated that the factors (including those of the four in one test) did not constitute an exhaustive list. As Justice Major stated: "there is no set formula as to their application. The relative weight of each will depend on the particular facts and circumstances of each one" (paras. 47-48 of SCR judgment).

As one might expect with this seemingly flexible legal approach to the subject, the Courts have been plenty busy adjudicating these types of cases. Subsequent decisions such as *Wolf v. The Queen* (2002) DTC 6853 (FCA)) have offered some further 'clarification' on the application of an overall test to determine worker status. Specifically, the Federal Court of Appeal held that the common (or expressed) intention of the worker and employer was an important factor in determining the ultimate relationship between the parties. Put another way, if the parties have a written agreement, what did the parties agree to?

Three years later, the Federal Court of Appeal had the opportunity to revisit their decision in *Wolf* and clarify its meaning. The case of *Royal Winnipeg Ballet* (2006 DTC 6323 (FCA)) concerned an appeal by the Royal Winnipeg Ballet ("RWB") from a decision of the Tax Court which held that the company's ballet dancers were not independent contractors but employees. There was no written contract between the company and the dancers. However, it was clear that the company and dancers believed that the dancers were independent contractors. Surprisingly, the Tax Court did not give any weight to the intention of the parties. It found that the dancers were employees. The RWB appealed and it was successful.

The Federal Court of Appeal made it clear that it was not correct to disregard the uncontradicted evidence of the parties when it came to their common understanding of their legal relationship even if that evidence was not conclusive. Therefore, the intention of the parties is arguably determinative of the worker's status. In the context of the facts of the RWB case, the Court determined that while the control exercised by the RWB over the dancers over the course of an entire season was extensive, it was not decisive because the same form of control was exercised over guest artists and those guest artists were always considered to be independent contractors.

As a result of these leading cases, the court of first instance - the Tax of Court of Canada – has been left with a wide range of factors to consider for the purpose of determining a worker's status. There is no uniformity. A court can choose to emphasize the nature of the business and attempt to answer the critical question: "whose business is it?" Alternatively, the court can examine the totality of the relationship between the parties and consider all of the factors that constitute the structure of the relationship. Finally, a court can choose to significantly weigh one factor over another given the specific or particular circumstances of the parties.

Until there is some single legal test presumably endorsed by either the Federal Court of Appeal or Supreme Court of Canada, we can all expect to see many more cases dealing with the determination of a worker's status.

DWC ■

Cases of Note

Sommerer v. R, (2011), 2011 TCC 212, 2011 CarswellNat 1157, 2011 D.T.C. 1162 (Eng.), [2011] 4 C.T.C. 2068 (T.C.C. [General Procedure]) (under appeal, court file no. A-188-11) – Cambell J, Miller J. – The parties in this case were the taxpayer and his father who created a private foundation. The father placed 1,000,000 Austrian shillings in foundation, which were replaced by shares of VS. The taxpayer entered into agreement in 1996 with foundation to purchase taxpayer's shares in VS. He wished to keep voting, dividend and subscription rights attached to shares, but was informed this was not possible. After transfer, an agreement was signed which stated that private company's interest in shares regarding voting rights dividends and subscription rights were transferred back to taxpayer. The taxpayer also bought shares of CS, which were transferred to private foundation. Shares of both CS and VS were disposed of by the private foundation. The Minister claimed that trust existed in Austria, and reassessed the taxpayer under the *Income Tax Act* (the Act) for taxation years 1996-2000, attributing capital gains from sale of shares to taxpayer or his wife. The taxpayer appealed reassessments, which was allowed. The shares were transferred in 1996, and rights under agreement were not merely moral but enforceable by trustees. The Board had fiduciary duties towards beneficiaries, although not as extensive as those of common law countries. Section 75(2) of Act could not be used to attribute gains to taxpayer - only the settlor, the taxpayer's father in case at bar, may be person referred to in s. 75(2)(1)(i), and not the taxpayer. The term "property" in first line of section 75 does not refer to shares as substituted property, only property held on condition was Austrian shillings. If property referred to substituted property, more than one person might be subject to attribution rules, with no method of allocation. French version of section 75 did not alter application of section to settlor alone. Subparagraph s. 75(2)(a)(ii) of the Act refers to property passing to be determined by person at time subsequent to creation of trust, which indicates that person is settler. Reversionary interest did not have to be absolute reversionary interest for s. 75(2) to operate.

****

Dierckens v R, (2011), 2011 CCI 169, 2011 TCC 169, 2011 CarswellNat 1498, 2011 CarswellNat 598, 2011 D.T.C. 1136 (Eng.), [2011] 3 C.T.C. 2328 (T.C.C. [Informal Procedure]) – Webb J. – The taxpayer in this case drove a school bus for a school division in Selkirk, Manitoba. After some years, she decided to move from Winnipeg to Selkirk to shorten commute to work. The taxpayer claimed moving expenses of $6,623. The Minister reassessed taxpayer under the *Income Tax Act* (the Act), denying deduction, which the taxpayer appealed and it was allowed. Section 62 of Act and the definition of "eligible relocation" in section 248(1) of Act did not provide any time period within which move must occur following commencement of employment at "new work location". A change of wording in provisions since precedents found that there was no such time restriction could not be construed as adding one. If anything, change of wording to provide that relocation must occur to enable person to be employed suggested less of causal connection between move and commencement of employment than did previous requirement that person had to move by reason of commencing employment. There was no longer any reference to commencement of employment in provisions. There was no reason to read into definition any requirement that person must move within certain amount of time after commencing employment at new work location. The word "new" did not add any time requirement as it was part of term given to location where taxpayer was employed and was not used in determining whether particular relocation was eligible relocation. "New" did not provide limit on time within which person must relocate on basis that work location will, after time, no longer be new. The taxpayer was entitled to deduct moving expenses incurred in computing income.

****

Bozzer v. Minister of National Revenue, (2011) CarswellNat 1758, 2011 FCA 186 (reversing *Bozzer v. Minister of National Revenue (2010), [2010] 3 C.T.C. 137, 362 F.T.R. 29 (Eng.), 2010 CarswellNat 261, 2010 FC 139, 2010 CF 139, (sub nom. Bozzer v. R.) 2010 D.T.C. 5025 (Eng.), 2010 CarswellNat 724* (F.C.)) – Stratas, Trudel and Sharlow JJ.A. – In 2006, taxpayer's second-level fairness request for waiver of interest on tax debt that arose in 1989-1990 was denied on basis that interest was payable in respect of taxation year outside of ten year limitation period set by s. 220(3.1) of *Income Tax Act* (the Act). The taxpayer's application for judicial review was dismissed, the taxpayer appealed and it was allowed. Section. 220(3.1) of Act, referring to interest payable "in respect of a taxation year", could refer to taxation year in which tax debt initially arose or to any taxation year in which

continued on page 28...

...continued from page 27

interest accrued. The precedent relating to transitional provision of Act was distinguishable. A hypothetical scenario examined, where taxpayer was seriously injured just before filing tax return for year in which he failed to remit tax instalments and did not file that return for another ten years due to extremely slow recovery. On the Minister's interpretation, the hypothetical taxpayer could not apply for cancellation of interest accrued on unpaid instalments for initial taxation year. The harsh result was contrary to purpose of section 220(3.1) of Act of administering income tax system fairly and reasonably by helping taxpayers resolve issues that arose through no fault of their own. The taxpayer's interpretation was more consistent with purpose. A limitation period was added to section 220(3.1) of Act in 2004, so as restriction of right previously enjoyed, it was incumbent on Parliament to be clear in imposing restriction and any ambiguity should be resolved in favour of taxpayer. Unlike other sections, section 220(3.1) of Act did not use language clearly suggesting that ten year period ran forward from year in which tax debt occurred. The Minister had authority to cancel interest that accrued during ten taxation years preceding taxpayer's initial fairness request. ■