# Recent Developments in Tax Litigation (new Quebec sanctions for GAAR and shams, new Quebec voluntary disclosure rules, recent jurisprudence, CRA and RQ audit powers and rectification of contracts)

## PRESENTED BY THE D'AMICO FAMILY WEALTH MANAGEMENT GROUP & PAUL RYAN FROM RAVINSKY RYAN LEMOINE, LAWYERS


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# Recent Developments in Tax Litigation (new Quebec sanctions for GAAR and shams, new Quebec voluntary disclosure rules, recent jurisprudence, CRA and RQ audit powers and rectification of contracts)

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**Wednesday, January 8, 2020**


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# Recent Developments in Tax Litigation

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# Recent Developments in Tax Litigation

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# Recent Developments in Tax Litigation

## 1. New Quebec Voluntary Disclosure Program

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# 1. New Quebec Voluntary Disclosure Program

- Interpretation Bulletin ADM.4/R8
- In force since December 20, 2019

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# 1. New Quebec Voluntary Disclosure Program

- Essentially, a carbon copy of CRA Program adopted in March 2018

  (2-year anniversary approaching)

- « General Program » and « Limited Program »

- « Intentional element » is the key factor to distinguish between the two

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# 1. New Quebec Voluntary Disclosure Program

- No more anonymous filings
- « Final Product » (including amended declarations and payment) must be ready before opening of DV is accepted
- Advisers who have helped must be denounced

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# 1. New Quebec Voluntary Disclosure Program

| | General Program | Limited Program |
|---|---|---|
| Non-Statute Barred Years | Full interest | Full interest |
| Other Years up to 6 | 50% interest reduction | 50% interest reduction |
| Years 7 to 10 | No interest | 50% interest reduction |
| Years older than 10 | No interest | 50% interest reduction for most recent 10 years |

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# 1. New Quebec Voluntary Disclosure Program

- Certain penalties may be maintained in Limited Program:
  - Late-filing penalties for QST and DAS
  - Possible 59.2.2 LAF penalty

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# 1. New Quebec Voluntary Disclosure Program

**59.2.2.** Every person who fails to report an income equal to or greater than $500 (in this section referred to as "unreported income" ) in the fiscal return filed by that person for a taxation year and has already made such an omission for any of the three preceding taxation years incurs a penalty equal to the lesser of

(*a*) 10% of the unreported income; and

(*b*) the amount determined by the formula $0.5 \times (A - B)$.

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# 1. New Quebec Voluntary Disclosure Program

**59.2.2.** (…)

In the formula in the first paragraph,

(*a*) A is an amount equal to the excess amount that would be determined for the taxation year under the first paragraph of section 1049 of the Taxation Act (chapter I-3) if that section applied in respect of the unreported income; and

(*b*) B is any amount deducted or withheld under section 1015 of the Taxation Act that may reasonably be considered to be in respect of the unreported income.

Notwithstanding the foregoing, no person shall incur, in respect of the same omission, both the penalty under the first paragraph and the penalty under section 1049 of the Taxation Act.

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## 1. New Quebec Voluntary Disclosure Program

- VD may be refused:
  - If any 3rd party under audit for facts that are sufficiently related to the facts disclosed
  - RQ already has information in its possession (even if unknown to the Taxpayer) concerning the Taxpayer

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## 1. New Quebec Voluntary Disclosure Program

- Expect decisions to be rendered very late in the process:
  - Whether the VD qualifies
  - The applicable Program (General vs Limited)
- RQ reserves the right to come back on its acceptance, even after signing an agreement and issuing the required notices of assessment, if new facts come to light

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## 1. New Quebec Voluntary Disclosure Program

- 2nd VD will be considered only in very exceptional circumstances

- No 2nd VD possible, if first one rejected because of incomplete documentation

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## 1. New Quebec Voluntary Disclosure Program

- Long list of exclusions in paragraph 6, including:
  - Declarations by Partnerships and Nonprofits
  - Situations where no tax is payable
  - Late or modified elections
  - Issues with new rules concerning GAAR and shams

# Recent Developments in Tax Litigation

## 2. Recent Jurisprudence on Taxpayer obligation to cooperate with a tax audit

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## 2. Recent Jurisprudence on Taxpayer obligation to cooperate with a tax audit

**231.1 (1)** An authorized person may, at all reasonable times, for any purpose related to the administration or enforcement of this Act,

**(a)** inspect, audit or examine the books and records of a taxpayer and any document of the taxpayer or of any other person that relates or may relate to the information that is or should be in the books or records of the taxpayer or to any amount payable by the taxpayer under this Act, and

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## 2. Recent Jurisprudence on Taxpayer obligation to cooperate with a tax audit

### 231.1 (1) (…)

**(c)** subject to subsection 231.1(2), enter into any premises or place where any business is carried on, any property is kept, anything is done in connection with any business or any books or records are or should be kept, and

**(d) require the owner or manager of the property or business and any other person on the premises or place to give the authorized person all reasonable assistance and to answer all proper questions relating to the administration or enforcement of this Act** and, for that purpose, require the owner or manager to attend at the premises or place with the authorized person.

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# 2. Recent Jurisprudence on Taxpayer obligation to cooperate with a tax audit

## 2.1 *MNR.* v. *Cameco*, 2019 FCA 67

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## 2.1 *MNR.* v. *Cameco*, 2019 FCA 67

- New *Cameco* decision (2019 FCA 67)
  - Bad facts make bad law
  - Transfer Pricing
  - Case before Tax Court for other years
  - Right to only one examination on discovery

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## 2.1 *MNR.* v. *Cameco*, 2019 FCA 67

- Audit for subsequent years
- CRA wants to conduct verbal interviews with 25 employees (including employees of foreign subsidiaries)
- *Cameco* refuses to cooperate, but would have accepted written questions

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## 2.1 *MNR.* v. *Cameco*, 2019 FCA 67

- First level (Federal Court)
  - Request related to Tax Court case for previous years
  - One cannot do indirectly…

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## 2.1 *MNR.* v. *Cameco*, 2019 FCA 67

- Second level (Federal Court of Appeal)
  - Goes much further
  - Verbal interviews during an audit are not mandatory for the Taxpayer

# 2.1 *MNR.* v. *Cameco*, 2019 FCA 67

- On whether the Taxpayer or his employees can be compelled to answer questions:

[12] *Applying the modern approach to statutory interpretation (Re Rizzo & Rizzo Shoes Ltd., 1998 CanLII 837 (SCC), [1998] 1 S.C.R. 27 at para. 21, 154 D.L.R. (4th) 193; Bell ExpressVu Limited Partnership v. Rex, 2002 SCC 42 (CanLII), [2002] 2 S.C.R. 559), **paragraph 231.1(1)(a) cannot be interpreted so as to permit the Minister to compel oral interviews of a taxpayer or its employees concerning its tax liability.** Neither the text, nor the context nor the legislative history of paragraph 231.1(1)(a) supports the Minister's position.*

# 2.1 *MNR.* v. *Cameco*, 2019 FCA 67

- On whether the Taxpayer or his employees can be compelled to answer questions:

[13] *There is a caveat to this, and it arises from paragraph 231.1(1)(d). **If records, of any sort, are the object of the auditor's interest,** Parliament has made clear that questions may be asked, and the assistance of the Court sought, **to compel answers as to the taxpayer's knowledge of their provenance and location.** That is not what is sought in this case.*

[18] ***The power is to "inspect, audit or examine". Neither "inspect" nor "examine" suggests a power to compel a person to answer questions.** To the contrary, their ordinary meaning is one of self-directed inquiry, in this case in respect of "the book and records" of the taxpayer. When two or more words that are capable of analogous meaning are coupled together they take their colour from each other, the more general being restricted to a sense analogous to the less general: R. Sullivan, Sullivan on the Construction of Statutes (6th ed. 2014) at 230 (Sullivan) citing R. v. Goulis, [1981] O.J. No. 637, 233 O.R. (2d) 55, at 61 (C.A.).*

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# 2.1 *MNR.* v. *Cameco*, 2019 FCA 67

- On options available to CRA if Taxpayer or his employees refuse to answer questions:

[28] *I also agree with the Minister that all taxpayers should fully cooperate with reasonable requests arising in the course of an audit. However, the fact that I have concluded that the Minister does not have the power to compel a taxpayer to answer questions at the audit stage does not mean that the audit power has been rendered toothless in the face of recalcitrant taxpayers. It remains open to the Minister to make inferences when no answer is given.* ***The Minister is also free to make assumptions and to assess on that basis. The tax liability arising from the Minister's assessment is statutorily deemed to be valid and binding*** *(subject to appeal or reassessment) (s. 152(8)),* ***and in any appeal in the Tax Court of Canada, the onus rests with the taxpayer to destroy any factual assumptions the Minister has made*** *(Sarmadi v. Canada, 2017 2019 FCA 67 (CanLII) Page: 12 FCA 131 at para. 31). The Minister may also demand that large corporate taxpayers such as Cameco pay 50% of the assessed tax immediately (s. 225.1(7)).*

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# 2.1 *MNR.* v. *Cameco*, 2019 FCA 67

- On options available to CRA if Taxpayer or his employees refuse to answer questions:

[29] *Further, paragraph 231.1(1)(a) is not the only source of the Minister's investigatory powers. The Minister may enter into the business premises of a taxpayer (s. 231.1(1)(c)), seek information and documents from third parties (s. 231.2), examine any property, process or matter relating to the taxpayer or any other person (s. 231.1(1)(b)), enter a dwelling-house with a warrant (ss. 231.1(2), 231.1(3)), authorize a formal inquiry (s. 231.4),* ***and, if necessary, come to the Federal Court to compel the taxpayer to provide any access, assistance, information or document sought by the Minister under section 231.1 or 231.2 (s. 231.7).***

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## 2.1 *MNR.* v. *Cameco*, 2019 FCA 67

- Issues still outstanding:
  - Peremptory demands and Court Orders
  - Written questions?
  - Questionnaire pertaining to foreign accounts and assets

# 2.1 *MNR.* v. *Cameco*, 2019 FCA 67

- Peremptory Demands
- **231.2 (1)** Notwithstanding any other provision of this Act, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of this Act (including the collection of any amount payable under this Act by any person), of a listed international agreement or, for greater certainty, of a tax treaty with another country, by notice served personally or by registered or certified mail, require that any person provide, within such reasonable time as is stipulated in the notice,

  **(a)** any information or additional information, including a return of income or a supplementary return; or

  **(b)** any document.

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## 2.1 *MNR.* v. *Cameco*, 2019 FCA 67

- May 31, 2019 Statement by CRA:
  - CRA in disagreement with *Cameco* ruling, but will not appeal
  - CRA still believes that Taxpayers are under obligation to cooperate and answer questions
  - CRA will otherwise have to use its power to assess based on assumptions or on an arbitrary basis

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# 2. Recent Jurisprudence on Taxpayer obligation to cooperate with a tax audit

## 2.2 « Questionnaire » cases

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## 2.2 « Questionnaire » cases

- Two recent (and contradictory) decisions by Federal Court

- *Cameco* argument apparently not raised in either of the cases

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## *2.2.1 MNR* v. *Lin* (2019 FC 646)

- Taxpayer refuses to complete Questionnaire
- Request by CRA for a Court Order forcing the Taxpayer to answer
- Taxpayer pleads that unclear that he is the real target of the audit, as Questionnaire also seeking information concerning « related entities »
- Federal Court refuses to issue Order

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## 2.2.2 *MNR v. Charles and Claire Friedman* (2019 FC 1583)

- Montreal Taxpayers in their 80's
- Plead same argument as in *Lin*
- Also plead violation of their Charter right against self-incrimination
- Alternatively, seeking Order from Court that anything they provide cannot subsequently be used against them in criminal proceedings

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## 2.2.2 *MNR v. Charles and Claire Friedman* (2019 FC 1583)

- Despite exactly similar letter as in *Lin*, Court reaches opposite conclusion
- Clear that Mr and Mrs Friedman are the main targets of the audit
- Open to Taxpayers to provide incomplete answers concerning other entities (for example, if information not available)
- Possible for CRA to contest at that point

## 2.2.2 *MNR v. Charles and Claire Friedman* (2019 FC 1583)

- File is a regular audit, not a criminal investigation, as the « predominant purpose » is not to initiate criminal proceedings
- Taxpayers' request for Charter protection is premature
- Whether the information provided could ultimately be used against the Taxpayers in eventual criminal proceedings can be decided at that time (if it ever happens)
- In line with Quebec Jurisprudence (*Berger* Case, 2016 QCCA 226)

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## 2.2 « Questionnaire » cases

- More and more of them
- Some direct (mostly CRA's Quebec City TSO)
- Some more general to start (Rimouski, Winnipeg, etc.)

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## 2.2 « Questionnaire » cases

- Various sources of information:
  - Informants
  - Tax Information Exchange Agreements
  - Inbound or Outbound transfers of above $10,000 (including VD cases)
  - Transactions or transfers offshore in Canadian currency

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# 2.2 « Questionnaire » cases

- Difficult balancing act
- T1135 penalties can be very harsh:
  - Minimum $2,500 per year
  - Possibly 5% of capital per year (if gross negligence)
  - Penalties carry interest federally
  - CRA has some discretion as to:
    - Number of years for which penalty will be assessed
    - Type of penalty that will be assessed

# 2. Recent Jurisprudence on Taxpayer obligation to cooperate with a tax audit

## 2.3 Other significant recent cases

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## 2.3 Other significant recent cases

- *MNR* v. *Les Développements Béarence Inc.*, 2019 FC 22
  - In certain circumstances, a Taxpayer under audit cannot be compelled to create new documents, (and incur costs), when the existing documents are sufficient to establish the Taxpayer's obligations under the ITA

## 2.3 Other significant recent cases

- *BP Canada Energy Company v. MNR, 2017 FCA 61*
  - Accountants' worksheets evaluating the tax risks, as required by Securities Commission reporting, not accessible by CRA
  - CRA has to respect its published policies

## 2.3 Other significant recent cases

- *MNR* v. *Atlas Tubes Canada ULC*, 2018 FC 1086
- Accountants' tax due diligence report, upon the acquisition of a corporation, is accessible to CRA
- Under appeal before FCA, as perceived to be in contradiction with *BP Canada* Case

# Recent Developments in Tax Litigation

## 3. New Quebec rules on GAAR, shams, « Specified Transactions » and prête-noms

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## 3. New Quebec rules on GAAR, shams, « Specified Transactions » and prête-noms

- Since 2017 report by « Committee on Public Finance », government of Quebec attempting to « criminalize » tax evasion

- Criminal law is mostly a Federal jurisdiction, so alternative measures had to be found

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## 3. New Quebec rules on GAAR, shams, « Specified Transactions » and prête-noms

- All Proposed legislation now tabled, but not yet adopted:
  - Bill 37 (GAAR)
  - Bill 42 (shams, specified transactions and prête-noms)

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## 3. New Quebec rules on GAAR, shams, « Specified Transactions » and prête-noms

- New consequences apply to:
  - Client
  - Associates of the enterprise (if client is an enterprise)
    - Directors
    - Officers
    - 50% or more Shareholders
  - Other corporations in which some Shareholder owns 50% or more of the issued shares
  - Advisers and/or Promoters (the whole firm!)

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## 3. New Quebec rules on GAAR, shams, « Specified Transactions » and prête-noms

- Two types of consequences:
  - Tax consequences (penalties, extension of time to assess, etc.)
  - Government contracts (« Register of Enterprises Ineligible » - « RENA »)
  - Quebec only at this point, no Federal equivalent

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# 3. New Quebec rules on GAAR, shams, « Specified Transactions » and prête-noms

## 3.1 Consequences for client (GAAR)

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## 3.1 Consequences for client (GAAR)

- GAAR Tax consequences:
  - Time to assess is 6 years instead of 3 years
  - Client « incurs » 50% penalty
- GAAR Other consequences
  - Client, Associates of the Enterprise and some related corporations go on RENA for 5 years
  - Taken into account for AMP authorization

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## 3.1 Consequences for client (GAAR)

- All consequences may be avoided by filing a « Preventive Disclosure » (new Form TP-1079.DI-V since September 2019)
- Retroactive application to all audits commencing more than 59 days after law is adopted
- « Preventive Disclosure » possible for past GAAR issues until then, unless audit already in progress

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# 3. New Quebec rules on GAAR, shams, « Specified Transactions » and prête-noms

## 3.2 Consequences for client (shams)

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## 3.2 Consequences for client (shams)

- Sham Tax Consequences:
  - Time to assess is 6 years instead of 3 years
  - 50% penalty, minimum $25,000
- Sham Other Consequences:
  - Client, Associates of the Enterprise and some related corporations go on RENA for 5 years
  - Taken into account for AMP authorization

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## 3.2 Consequences for client (shams)

- No Preventive Disclosure possible
- Applicable to transactions made after May 17, 2019
- Main issue is what is a sham???

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# 3. New Quebec rules on GAAR, shams, « Specified Transactions » and prête-noms

## 3.3 « Specified Transactions »

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## 3.3 « Specified Transactions »

- Shortcut vs needing new legislation
- List of « Specified Transactions » will be made public and updated periodically
- Mandatory disclosure:
  - By Adviser, who commercializes or promotes the concept
  - By Client who participates in transaction that is significantly similar to a « Specified Transaction »

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## 3.3 « Specified Transactions »

The later of:

- Within 60 days from beginning of transaction (even if not completed)

OR

- Within 120 days of addition to list of « Specified Transactions »

Disclosure is only mandatory if the carrying out of a transaction begins AFTER the date of the addition of a Specified Transaction to the list

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## 3.3 « Specified Transactions »

- Consequences to Client:
  - $1,000 per day penalty (min. $10,000, maximum $100,000)
  - Penalty of 50% of the tax benefit (even if not yet used)
  - Not considered a « Preventive Disclosure »

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## 3.3 « Specified Transactions »

- Could eventually be attacked
- Disguised prohibition to transact?

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## 3.3 « Specified Transactions »

- Nothing on list yet
- RQ is said to consider 30 different types of transactions

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# 3. New Quebec rules on GAAR, shams, « Specified Transactions » and prête-noms

## 3.4 Consequences for Professionals

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# 3.4 Consequences for Professionals

| Category/ Description | Promoter/ Adviser | Penalty | RENA/ AMP Authorization | Possible « Preventive Disclosure » |
|---|---|---|---|---|
| GAAR | Promoter | 100% of fees | YES (if penalty applied) | YES |
| Sham | Adviser and Promoter | 100% of fees | YES (if penalty applied) | NO |
| Specified Transactions (Generic type disclosure) | Adviser or Promoter who commercializes or promotes the operation | $1,000 per day Min. $10,000 Max. $ 100,000<br><br>100% of fees from clients to whom transaction has been commercialized or promoted | NO (unless GAAR or Sham determined to apply) | N/A |

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# 3. New Quebec rules on GAAR, shams, « Specified Transactions » and prête-noms

## 3.5 Questions

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## 3.5 Questions

- Meaning of « *adviser* », « *promoter* » and « *adviser who promotes* »
- What fees are taken into account for penalty to professional?
- What is a sham?

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## 3.5.1 « *Adviser* »

**1079.8.1.** In this Book,

**"adviser"** in respect of a transaction means a person or partnership that provides help, assistance or advice regarding the design or implementation of the transaction, or that commercializes or promotes it;

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# 3.5.2 « *Promoter* »

**1079.9.** For the purposes of this Title and section 1006.1,

**"promoter"** of a transaction or a series of transactions means a person or a partnership in respect of which the following conditions are met:

(*a*) the person or partnership commercializes the transaction or series of transactions, promotes it or otherwise supports its development or the interest it generates;

(*b*) the person or partnership receives or is entitled to receive, directly or indirectly, a consideration for the commercialization, promotion or support, or another person or partnership related to, or associated with, the person or partnership receives or is entitled to so receive such a consideration; and

(*c*) it is reasonable to consider that the person or partnership assumes an important role in the commercialization, promotion or support;

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## 3.5.3 « *Adviser who commercializes*»

- Addressed by RQ at CTF Convention Roundtable in December 2019

- « *Through his behavior, the adviser encourages or favors the use of the transaction, he supports its growth and the interest it generates* »

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## 3.5.4 What fees are considered?

- Addressed by RQ at CTF Convention Roundtable in December 2019
- 100% of fees for series of transactions even if involved only in part of series
- Intent (or absence thereof) will be considered for sham aspect for professionals

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## 3.5.5 Meaning of sham

- Sham concept not much in use since adoption of GAAR
- Will now come back to the forefront

## 3.5.5 Meaning of sham

- Basic jurisprudence
- Sham vs. Recharacterization of legal nature of transaction (ex: lease vs sale, loan vs gift, etc.)
- 4 recent examples with trusts
- 1 recent example involving a purchase with an option to buy back granted to Vendor

# 3.5.5 Meaning of sham

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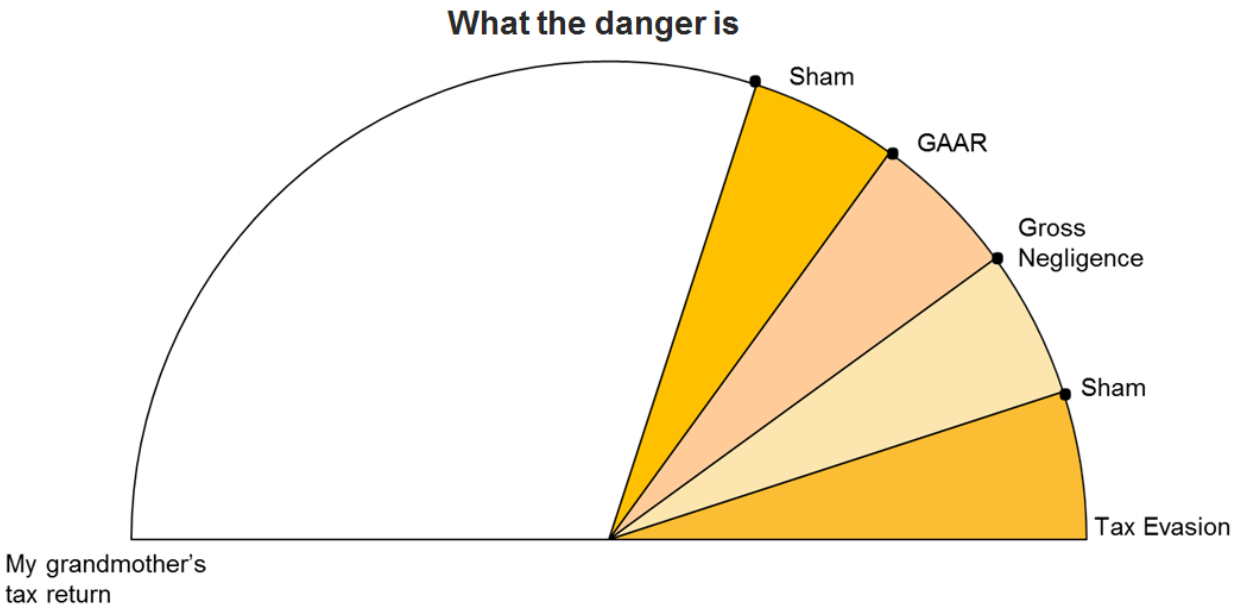
# 3.5.5 Meaning of sham



## 3.5.5 Meaning of sham

- *Common law* concept
- Civil Code has « *simulation* » concept:

1451. *Simulation exists where the parties agree to express their true intent, not in an apparent contract, but in a secret contract, also called a counter letter.*

*Between the parties, a counter letter prevails over an apparent contract.*

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## 3.5.5 Meaning of sham

- « *Prête-nom* » (nominee agreement) is a form of « *simulation* », but usually not a sham
- Sham is an aggravated form of « *simulation* » (intent to deceive the tax authorities)
- « *Mandate* » concept can also be considered, both for « *prête-nom* » and sham purposes

# 3.5.5.1 Basic definition

*Snook* v. *London & West Riding Investments Ltd.*, [1967] 1 All E.R. 518

As regards the contention of the plaintiff that the transactions between himself, Auto-Finance, Ltd. and the defendants were a "sham", it is, I think, necessary to consider what, if any, legal concept is involved in the use of this popular and pejorative word. I apprehend that, if it has any meaning in law, **it means acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create**. One thing I think, however, is clear in legal principle, morality and the authorities . . . that for acts or documents to be a "sham", with whatever legal consequences follow from this, **all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating**. No unexpressed intentions of a "shammer" affect the rights of a party whom he deceived. . . .

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# 3.5.5.1 Basic definition

- Some Court decisions seem to cast a wider net:

*Antle* v. *Canada*, 2010 FCA 280

[20] *In so holding, the Tax Court judge misconstrued the notion of intentional deception in the context of a sham. The required intent or state of mind is not equivalent to mens rea and need not go so far as to give rise to what is known at common law as the tort of deceit (compare MacKinnon v. Regent Trust Company Limited, (2005), J.L.Rev. 198 (CA) at para. 20).* ***It suffices that parties to a transaction present it as being different from what they know it to be****. That is precisely what the Tax Court judge found.*

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## 3.5.5.2 Sham vs Recharacterization of transactions

- Excellent analysis by Owen J. of TCC in *Cameco* (2018 TCC 195) and *Lee* (2018 TCC 230) cases:
  - No sham if Recharacterization made on the basis of facts and terms disclosed in contract
  - Sham if Recharacterization results from « outside facts » discovered by tax authorities

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# 3.5.5.2 Sham vs Recharacterization of transactions

*Cameco Corporation* v. *The Queen*, (2018 TCC 195)

[585] *In Continental Bank Leasing Corp. v. Canada, 1998 CanLII 794 (SCC), [1998] 2 S.C.R. 298 ("Continental Bank"), the Supreme Court of Canada interpreted Estey J.'s comments in Stubart to mean that the* ***"sham doctrine will not be applied unless there is an element of deceit in the way a transaction was either constructed or conducted."***

[586] *The Court in Continental Bank held that the determination of whether a sham exists precedes and is distinct from the correct legal characterization of a transaction.* ***If the transaction is a sham, the true nature of the transaction must be determined from extrinsic evidence (i.e., evidence other than the document(s) papering the transaction). If the transaction is not a sham, the correct legal characterization of the transaction can be determined with reference to the document(s) papering the transaction.***

## 3.5.5.2 Sham vs Recharacterization of transactions

[598] *As observed in Continental Bank, the factual presentation of the legal rights and obligations of parties to a transaction is not the same as the legal characterization of that transaction.* ***Consequently, a sham does not exist if the parties present the legal rights and obligations to the outside world in a factually accurate manner (i.e., in a manner that reflects the true intentions of the parties) but identify the legal character of the transaction incorrectly. For example, calling a contract a lease when its actual legal effect is a sale is not evidence of a sham provided the terms and conditions of the contract accurately reflect the legal rights and obligations intended by the parties.***

- RQ acknoledged this interpretation at the CTF December 2019 Roundtable

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## 3.5.5.3 Recent cases involving Trusts

- *Antle* v. *Canada*, 2010 FCA 280
- *Lee* v. *R.*, 2018 TCC 230
- *Laplante* v. *R.*, 2017 TCC 118
- *Caplan* c. *ARQ*, 2019 QCCQ 3269

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## 3.5.5.3.1 *Antle* v. *Canada*, 2010 FCA 280

- Ultimate sale of shares to a 3rd party:
  - Transfer of shares to discretionary Barbados Spousal Trust (Barbados Trustee)
  - Sale of shares by Trust to Wife (no tax in Canada, high ACB to Wife)
  - Wife sells to 3rd party (no gain)
  - Money finds its way to Husband's Holdco

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## 3.5.5.3.1 *Antle* v. *Canada*, 2010 FCA 280

- All transactions in December 1999
- Trust ended in January 2000

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## 3.5.5.3.1 *Antle* v. *Canada*, 2010 FCA 280

- FCA concludes that Trust was a sham, as no real discretion given to Trustee, who had to follow pre-arranged transactions

## 3.5.5.3.1 *Antle* v. *Canada*, 2010 FCA 280

[19] ***The Tax Court judge found as a fact that both the appellant and the trustee knew with absolute certainty that the latter had no discretion or control over the shares. Yet both signed a document saying the opposite.*** *The Tax Court judge nevertheless held that they did not have the requisite intention to deceive.*

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## 3.5.5.3.2 *Lee* v. *R.*, 2018 TCC 230

- Quebec truffle
- Trust created in Quebec on December 10, 2013 (Trustee is a retired CPA)
- Gift of Preferred Shares to Trust on December 11, 2003 (FMV $18 Million)
- Request for redemption of shares by Trustee on December 12, 2003
- Distribution of $16 Million to Beneficiary of Trust on December 12, 2003 (via promissory note)
- Loan of $18 Million by Trust to Corporation on December 12, 2003, with 4% interest

## 3.5.5.3.2 *Lee* v. *R.*, 2018 TCC 230

- TCC: Trust was not a sham, as Trustee in full control of situation and could have decided otherwise
- Distinguishing factors:
  - Trust and Loan lasted several years
  - Experienced Trustee

## 3.5.5.3.2 *Lee* v. *R.*, 2018 TCC 230

[68] ***The Respondent appears to be applying the concept of sham as a sort of step transaction doctrine to disregard the creation of the Trust. That is neither correct nor appropriate. A sham involves an element of deceit—the parties must intend to give to third parties the appearance of creating between them legal rights and obligations different from the legal rights and obligations, if any, that the parties actually intend to create.*** *An allegation of sham is an allegation that the parties to the alleged sham have been deceitful because they know that the actual legal rights and obligations created by them, if any, differ from the legal rights and obligations presented to the outside world.*

## 3.5.5.3.2 *Lee* v. *R.*, 2018 TCC 230

[69] ***Creating legal (or equitable) relationships to give effect to a tax plan is not the perpetration of a sham***. *In this case, there was no deceit on the part of the Appellant or Mr. Paris regarding the legal relationships created under Québec law.* ***The Deed and other relevant documentation reflect precisely the legal rights and obligations intended by the parties to those documents. Indeed, the tax plan would not work if just one of the steps necessary to implement that plan was not legally effective.***

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## 3.5.5.3.3 *Laplante* v. *R.*, 2017 TCC 118

- Estate Freeze in 2004, with creation of Trust
- Sale of shares in 2008, with substantial gain
- Allocation of significant portions of gain ($75,000 to $375,000) to several Laplante family members
- Donation of allocated proceeds back to Mr Laplante at family Christmas party

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## 3.5.5.3.3 *Laplante* v. *R.*, 2017 TCC 118

- Additional allocation of $4,512.50 to each Beneficiary (fee for services?)
- Minimum tax due by each Beneficiary (approximately $20,000) paid by Mr Laplante; Beneficiaries allowed to keep subsequent refunds

## 3.5.5.3.3 *Laplante* v. *R.*, 2017 TCC 118

- TCC:
  - Amounts reported by Beneficiaries as « *agents* » for Mr Laplante
  - « *Mandate* » agreement hidden from RQ
  - « *Simulation* » as per Civil Code
  - Sham word not explicitly acknowledged
  - 100% of gain taxed in Mr Laplante's hands

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## 3.5.5.3.4 *Caplan* c. *ARQ.*, 2019 QCCQ 3269

- Reorg and creation of Trust in 2011
- Allocations of income to young adult children between 2011 and 2014 (from $30,000 to $55,000 per child per year)
- Funds immediately remitted to Father

## 3.5.5.3.4 *Caplan* c. *ARQ.*, 2019 QCCQ 3269

- Father argued that funds were used by him for the benefit of the children, but no precise evidence

- Father signed « acknowledgement of debt », but wrong date inserted

## 3.5.5.3.4 *Caplan* c. *ARQ.*, 2019 QCCQ 3269

- CQ :
  - Children were acting as « *accommodators* » for Father, either as « *agents* » or as « *prête-noms* »
  - All income attributed to Father
  - « *Simulation* » (no explicit sham conclusion)

## 3.5.5.3.4 *Caplan* c. *ARQ.*, 2019 QCCQ 3269

- If a sham:
  - What is the « *series* »?
  - Which professionals are involved?
  - What fees are at stake?

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## 3.5.5.3.5 *Paletta & al* v. *The Queen*, 2019 TCC 205

- Feature Movies produced by 20th Century Fox
- Partnership created to acquire movies just after completion, but before commercial release
- Substantial « print & advertising » expenses required to be incurred ($82 Million for main movie)

## 3.5.5.3.5 *Paletta & al* v. *The Queen*, 2019 TCC 205

- 20th Century Fox entity has option to re-purchase movie for cost plus P & A expenses (less 3%)
- Option exercised:
  - Substantial business loss for Partnership
  - Corresponding capital gain, with reserve

## 3.5.5.3.5 *Paletta & al* v. *The Queen*, 2019 TCC 205

- CRA claims that option was a sham, as it was pre-arranged and clear to all that 20th Century Fox entity would exercise the option

## 3.5.5.3.5 *Paletta & al* v. *The Queen*, 2019 TCC 205

[243] *In light of all of the above, I find that the Appellants invested in the Six Iron and Swilcan Partnerships solely to avail themselves of the tax savings that the promoters led them to believe they could expect* ***and that they felt secure in the knowledge that Fox had agreed to reacquire the films prior to their commercial release.***

[244] ***Accordingly, I conclude that the options were shams designed to mask the parties' agreement that Fox would reacquire the films prior to their commercial release.***

## 3.5.5.3.5 *Paletta & al* v. *The Queen*, 2019 TCC 205

[245] *Consequently, the P&A expenses allegedly borne by the partnerships were not incurred for the purpose of earning income. Likewise, the financing and other expenses incurred by the Appellants with respect to their partnership interests are not deductible.*

[246] *As a result of this finding, I conclude that the Appellants did not realize a gain of any kind in connection with the disposition of their partnership units because their proceeds of disposition were less than their adjusted cost base. I note that the Respondent conceded this point in the event that I should accept this theory of sham.*

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# 3. New Quebec rules on GAAR, shams, « Specified Transactions » and prête-noms

## 3.6 Prête-noms

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## 3.6 Prête-noms

- Prête-noms that have a tax impact must now be disclosed on Form TP-1079.PN-V
- Box 26 will disappear from CO-17
- Deadline is 90 days after adoption of Bill 42

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## 3.6 Prête-noms

- Penalty of $1,000 plus $100 per day, up to $5,000

- Time to assess tax consequences arising out of prête-nom situation is suspended while Form TP-1079.PN-V is not filed

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## 3.6 Prête-noms

- Administrative exclusion for interest in personal-use real estate (maximum 50% of FMV) held by parent as agent for child, to meet Bank financing requirements

- Small space in section 1 of Form TP-1079.PN-V for reason for prête-nom

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# Recent Developments in Tax Litigation

## 4. Recent Jurisprudence

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# 4. Recent Jurisprudence

## 4.1 *Yared* v. *Karam*, 2019 SCC 62

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## 4.1 *Yared* v. *Karam*, 2019 SCC 62

- Family residence on Dr Penfield Ave. purchased by Family Trust, with money provided by the two spouses ($2,350,000)
- Initial Beneficiaries are the four children
- Trustees are Husband and his mother
- Father has power of « Appointment », including right to appoint new Beneficiaries, including himself

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## 4.1 *Yared* v. *Karam*, 2019 SCC 62

- Wife left Family Residence in June 2014 and died in April 2015, before obtaining a divorce
- **Question**: Does half the value of the house go into Wife's family patrimony?
- Father signed a Deed in July 2016, whereby he renounced his power of « Appointment »

## 4.1 *Yared* v. *Karam*, 2019 SCC 62

- Section 415 of the Civil Code provides that « *the residences of the family or* ***the rights which confer use of them*** » are included in the family patrimony
- Degree of control over the property by one or both spouses and its occupancy as a principal residence are the key factors
- No need to prove intent to avoid family patrimony rules (intent that is relevant is intent to use as a family residence)

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## 4.1 *Yared* v. *Karam*, 2019 SCC 62

- Renunciation to power of « Appointment » by Deed was invalid, as this type of modification to a Trust requires a Court order, under sections 1294 and 1295 of the *Civil Code*

## 4.1 *Yared* v. *Karam*, 2019 SCC 62

Other issues considered:

- No « *lifting of trust veil* » required or possible under section 317 of the *Civil Code* (lifting of corporate veil)
- Court refers to a similar decision concerning a residence held corporately (*D.L.* c. *L.G.*, 2006 QCCA 1125)

# 4.1 *Yared* v. *Karam*, 2019 SCC 62

- Reasonable based on the evidence that value of « *right of use* » was equal to value of property
- Court acknowledges that Trust may have « 150% » obligation (i.e. 50% of value to Wife's Estate and 100% of trust patrimony held for the benefit of the Beneficiaries)
  - Not « fully pleaded » before Supreme Court
  - Modification of Trust, with Court approval, might be a solution

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# 4. Recent Jurisprudence

## 4.2 *Salomon & al v. Matte-Thompson* & al, 2019 SCC 14

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## 4.2 *Salomon & al v. Matte-Thompson* & al, 2019 SCC 14

- Liability of professional (lawyer in this case) for losses incurred by client, with investment adviser referred by lawyer

- Global circumstances need to be analysed

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## 4.2 *Salomon & al v. Matte-Thompson* & al, 2019 SCC 14

- Couple with various businesses
- Long-term relationship with lawyer
- Husband dies in 2003
- Will contains Spousal Trust (objective is to preserve capital for children)
- Wife is Liquidator and Trustee (also two outside Trustees)

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## 4.2 *Salomon & al v. Matte-Thompson* & al, 2019 SCC 14

- September 2003 (i.e. shortly after Husband's death), lawyer refers Wife to *Triglobal:*
  - Friendship with owner Papadopoulos
  - Lawyer has made personal investment with *Triglobal*
  - No « due diligence » (ex: No AMF permit or registration)
- Approximately $1,5 Million invested in offshore funds *iVest* and *Focus*

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## 4.2 *Salomon & al v. Matte-Thompson* & al, 2019 SCC 14

- Sale of remaining business assets in 2006
- Full proceeds of approximately $6 Million invested in *Focus*
- Legal invoices refer to entries for discussions with *Triglobal*

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## 4.2 *Salomon & al v. Matte-Thompson* & al, 2019 SCC 14

- Wife becomes worried in 2006, but regularly reassured by lawyer (many emails filed as evidence)
- One of the outside Trustees recommends at least a partial request for refund
- May 2007: *La Presse* article concerning *Triglobal* problems
- Later in 2007: *Triglobal* out of business and assets frozen

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## 4.2 *Salomon & al v. Matte-Thompson* & al, 2019 SCC 14

- In writing to Mr Papadopoulos to obtain his assistance in reassuring the Wife:
  - Lawyer uses a « *we* » approach
  - Lawyer possibly breaches professional confidence by forwarding Wife's emails to Mr Papadopoulos

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# 4.2 *Salomon & al v. Matte-Thompson* & al, 2019 SCC 14

## Examples of emails by lawyer

**In April 2006**, he responded to concerns expressed by Ms. Matte Thompson regarding the security of the respondents' investments (including in Focus) that he was **"certain that everything [was] ok"**

**In November 2006**, he stated, after informing Ms. Matte-Thompson that he had visited Mr. Bright in Nassau, that the latter "has become resident there in order to manage the Focus, Ivest and structured products funds", concluding that **"[a]ll is well"**

**In July 2007**, he stated, **"[t]he Triglobal returns continue to be excellent and I remain very happy to have my investments performing so well with such controlled risk"**

**In September 2007**, he added, **"I think that the two funds (iVest and Focus) are performing as predicted"**

**In December 2007**, he stated, commenting on Mr. Papadopoulos's latest promises to worried investors, **"FYI. This is good"**

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## 4.2 *Salomon & al v. Matte-Thompson* & al, 2019 SCC 14

- In 2006, lawyer creates a corporation to invoice fees to *Triglobal*, for services allegedly rendered:
  - 2 X $10,000 paid in May and June 2006 (admission that no services; claim by lawyer that it was a « *gift* » to help with the renovation of his apartment)
  - $8,000 in February 2007 (explanation that it was a further « gift », to help pay the tax on the 2 X $10,000)
  - $50,000 invoice issued in September 2007, for which 2 X $5,000 received
  - Lawyer also recovered $50,000 of his personal $70,000 investment

## 4.2 *Salomon & al v. Matte-Thompson* & al, 2019 SCC 14

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- Lawyer and his firm held responsible for losses
  - Bad initial and continuous advice
  - Investments not at all in line with « preservation of capital » objective
  - Potential conflict of interest and breach of client confidentiality obligation

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# 4. Recent Jurisprudence

## 4.3 Rectification and/or Cancellation of Contracts

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## 4.3 Rectification and/or Cancellation of Contracts

- Rectification is a *Common Law* concept and Civil Code is more oriented towards cancellation of erroneous contracts
- *AES* case had introduced a concept similar to rectification in Quebec Law, through an analysis based on « *negotium*» and « *instrumentum* »
- *Jean Coutu* subsequently cautioned that a general intent that no taxes should have resulted is not sufficient, if the contractual documents achieve the contractual objectives that the parties were pursuing
- What is left?

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## 4.3.1 *Canada Life Insurance Company of Canada v. Canada (Attorney General)*, 2018 ONCA 562

- Limited Partnership wishes to create a capital loss to offset a capital gain
- Transfer of « loser » assets through dissolution of Partnership
- As per 98(5) ITA, transfer resulting from dissolution is deemed to be made at tax cost
- No capital loss effectively triggered

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## 4.3.1 *Canada Life Insurance Company of Canada v. Canada (Attorney General)*, 2018 ONCA 562

- Canada Life petitions the Court to modify the transaction to achieve the desired result

- Refused by Ontario Court of Appeal and permission to appeal refused by Supreme Court

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## 4.3.2 *5551928 Manitoba Ltd.(Re)*, 2019 BCCA 376

- Excessive CDA dividend (frequent occurrence)
- Corporation seeks rectification of dividend ($113,212 instead of $298,000)
- CRA would not have contested « *cancellation* », but not willing to concede « *rectification* »

## 4.3.2 *5551928 Manitoba Ltd.(Re)*, 2019 BCCA 376

- Rectification granted
  - Clear intent to regularly distribute CDA when available
  - No aggressive tax planning or improper behavior
  - Tribunal not asked to « re-write » a complex transaction

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## 4.3.3 *Crean* v. *Canada (Attorney General)*, 2019 BCSC 146

- Sale of shares between two brothers

- After dispute, Preliminary Agreement provides that one brother will buy out the shares of the other and that the Vendor will realize a capital gain, on which he will claim the applicable exemption

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## 4.3.3 *Crean* v. *Canada (Attorney General)*, 2019 BCSC 146

- Error by Advisers, who structure transaction as purchase by Corporation held by purchasing brother

- Paragraph 84.1(1) ITA applies: no capital gain and deemed dividend of $2.75 Million to Vendor

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## 4.3.3 *Crean* v. *Canada (Attorney General)*, 2019 BCSC 146

- Parties petition Court to modify transaction into a direct sale between brothers, to reflect their original intention (« *negotium* »)

- Petition granted, as Preliminary Agreement clearly provided for a direct sale between the two brothers

# 4.3.4 Summary

- More and more important to clearly specify the intent in the contractual and/or corporate documentation
- General intent is not sufficient and intent concerning applicable taxes has to be at the core of the consent, an essential component thereof
- Transaction will not be corrected or cancelled, if error is inexcusable
- Courts more and more averse to « aggressive tax planning »

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# Recent Developments in Tax Litigation

## 5. Jail in tax cases

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## 5. Jail in tax cases

- *ARQ c. Leizerovici*, 2017 QCCQ 11252
  - Bad facts make bad law
  - GST/QST side of JGH fraud
  - $65,000 of taxes at stake
  - 18 months of jail, plus maximum 200% fine at both levels

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## 5. Jail in tax cases

- *R. c. Iammarrone*, 2019 QCCQ 7836
  - CRA corrupt auditor
  - 2-year jail sentence

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## 5.1 *ARQ* c. *Leonard*, 2019 QCCQ 6068

- Chartered Accountant involved in clients' scheme to unduly recover GST and QST tax credits
- $3.5 Million at stake
- Personal payments and benefits of between $750,000 and $1,500,000 to Accountant

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## 5.1 *ARQ* c. *Leonard*, 2019 QCCQ 6068

- Accountant involved in creation of corporations
- Accountant was recruiting « prête-noms » to act as shareholders
- Accountant filed countless reports electronically, using different computer locations
- Accountant dealt with audits
- Accountant gradually pleaded guilty (13 days of hearing required)

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## 5.1 *ARQ* c. *Leonard*, 2019 QCCQ 6068

- 36-month sentence
- Fact that Taxpayer is a Chartered Accountant was a major factor

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**Recent Developments in Tax Litigation (new Quebec sanctions for GAAR and shams, new Quebec voluntary disclosure rules, recent jurisprudence, CRA and RQ audit powers and rectification of contracts)**

# THANK YOU!