2021 TAX DISPUTE RESOLUTION MONTHLY UPDATE

SESSION 3

23 NOVEMBER 2021

LEGAL DISCLAIMER

- Today's session will be a high level overview, for general information purposes, and does not constitute legal advice
- For specific advice relating to the topics discussed today, please contact your legal counsel
- Information in this presentation reflects laws and other relevant standards that are in effect as of the date of the presentation

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DISCUSSION TOPICS

- The precarious future of rescission
- BNS case: Tax court does not rule in the (arrears) interest of fairness
- How to effectively resolve tax disputes

RESCISSION PROGNOSIS

- **High level overview of *Collins Family Trust* in advance of Supreme Court hearing in January 2022**
- **Collins Family Trust application for rescission successful in BC Supreme Court and Court of Appeal**
- **Summary:**
  - Asset protection plan was created, meant to be tax neutral
  - Tax neutrality and asset protection were equal importance
  - Holding company was incorporated that purchased shares of operating company
  - Family trust was created using the holding company as a beneficiary

RESCISSION PROGNOSIS

- Holding company loaned funds to Trust
- Funds used to purchase shares in operating company
- Holding company had option to repurchase shares
- Dividends would be paid from operating company to Trust, which could be loaned to holding company, invested or otherwise deployed by Trust
- Structure depended on ss. 75(2), an anti-avoidance rule that attributes taxable income (thus tax consequences) from one entity to another
- Dividends paid to Trust meant cash in Trust, but tax consequences attributed to holding company
- Holding company claimed ss. 112(1) intercorporate dividend deduction

RESCISSION PROGNOSIS

- **When structure set up, ss. 75(2) was applicable and plan worked**
- **Irrelevant whether Trust acquired property by way of gift or sale – either way, attribution would occur**
- **Years later, interpretation undermined by *Sommerer* case**
- **BC Court of Appeal in *Collins Family Trust* commented:**
  - The interpretation adopted in [*Sommerer*] was contrary to the position consistently taken by CRA prior to *Sommerer*, a position CRA maintained in its submissions before both the Tax Court and the Court of Appeal in *Sommerer*

RESCISSION PROGNOSIS

- **BC Court of Appeal also noted that application judge concluded that CRA would probably not have challenged Trust before *Sommerer*:**
  - In terms of the “aggressive” tax planning, the petitioner countered this characterization by pointing out that the CRA has issued numerous Advance Rulings allowing tax-exempt First Nations Bands to transfer property to a trust and deliberately rely on s. 75(2) to divert income from the trust to the Band to eliminate completely the tax that the trust would otherwise pay. The Crown did not contest this argument. Further, the parties did not argue with any specificity the applicability of GAAR or the other provisions it cited. It is fair to say that the rule is broad and can encompass an extremely wide range of transactions. The decided cases dealing with complex and high structured plans, of which there are many, go both ways, and include surplus strip plans.
  - … I infer from all of the above, that CRA would likely have not contested tax position of the petitioner prior to the *Sommerer* decision.

RESCISSION PROGNOSIS

- **Test for rescission requires: voluntary disposition; and mistake of sufficient causative gravity, such that it would be unconscionable, unjust or unfair to leave mistake uncorrected**
- **After *Sommerer*, but before *Fairmont Hotels* and *Jean Coutu,* Pallen Family Trust sought rescission in the same circumstances as in *Collins Family Trust*, and succeeded**
- **BC Courts continued to uphold the outcome in *Pallen Family Trust* even after *Fairmont Hotels* and *Jean Coutu* narrowed rectification: while rectification (*Fairmont/Jean Coutu*) and rescission are equitable remedies, they have distinct legal tests and each applies to both non-tax and tax-contexts**
- **If you meet the test, you get the remedy**

RESCISSION PROGNOSIS

- **In the Supreme Court of Canada appeal:**
  - Crown would want to see doctrines of rectification and rescission harmonized – rectification does not allow a taxpayer to be relieved of consequences of an intentional plan, thus rectification does not allow for “retroactive tax planning”
  - To-date, equitable rescission has had different test, as mentioned above: there must be a mistake of sufficient gravity and it would be unjust, unconscionable or unfair to leave it uncorrected
  - Under that test, door is open to deal with tax outcomes and reverse them if result falls within a zone of unfairness
  - Issue whether rescission can allow for something that is inconsistent with rectification
  - Crown also argues that taxpayers must be taxed on what they did, and not what they wish they had done

RESCISSION PROGNOSIS

- **Pro-taxpayer argument is that rectification and rescission are different doctrines and they apply in tax and non-tax context**
- **If rectification in tax context must harmonize with rectification generally, rescission in tax context must harmonize with rescission generally – and test for rescission is not contingent on whether there is any "retroactive tax planning"**
- **In Supreme Court filings, counsel for Trust argues that BC Courts concluded purpose of planning was to achieve asset protection without incurring income tax liability on dividends**
- **Asset protection and tax were equally important; tax plan was based on common general understanding of the operation of 75(2) of the ITA, shared by income tax professionals and the CRA**
- ***Sommerer* came along and the interpretation of ss. 75(2) changed**

RESCISSION PROGNOSIS

- **What happened next is CRA ran with new interpretation to attack structures already in existence**
- **Thus, from taxpayer perspective, the new *Sommerer* interpretation was then *retroactively* applied to structures that CRA had not previously attacked using new interpretation, which seems unfair (all the while, CRA balks at retroactive tax planning, of course)**
- **Crown counsel have and will argue that the Trust engaged in aggressive or abusive tax planning, and that equitable remedies should be unavailable to unwind aggressive tax strategies**
- **However, the fact is that BC Courts concluded that CRA would not have assessed Trust but for new *Sommerer* interpretation of ss. 75(2)**

RESCISSION PROGNOSIS

- **Further, if CRA thought structure was GAAR-able, time for assessing Trust was suspicious and, in any case, the GAAR was *never* raised as assessment basis**
- **Without any viable factual matrix to argue that Trust engaged in abusive tax planning, argument about abusive tax planning lacks any air of reality**
- **And again, BC Courts held that asset protection goal was as important as tax – excess cash would be removed from the company and pulled into Trust, which was a goal that was intended to be tax efficient**
- **This conclusion was based on statement of agreed facts filed in BC Courts, and affidavit evidence**
- **No palpable or overriding error of fact that would allow the Supreme Court to consider or reconsider whether there was aggressive tax planning at play**

RESCISSION PROGNOSIS

- **Further, *Pallen Trust* had same facts and Court in that case expressly concluded that there was no aggressive tax planning**
- **In *Pallen Trust*, Court specifically noted that CRA has in advance tax rulings approved of the use of ss. 75(2) as part of a tax efficient scheme**
- **Engagement letter language argument by Crown:**
  - Wording of engagement letter with professional advisors, included usual language that professionals use to protect themselves: opinion was based on professional's understanding of law and CRA administrative practice, which is subject to change, etc.
  - Crown relies on that qualification, framed in typical opinion language that everyone uses, to suggest that the taxpayers voluntarily assumed risk when they structured tax portion of planning and thus they must wear outcome

RESCISSION PROGNOSIS

- Problem with this argument is that this kind of language is standard and, in reality, level of risk as between transaction steps or in different transactions is highly variable
- Opinion language concerning ss. 75(2) was based on what everyone thought was a settled interpretation and “everyone” includes CRA

- **Finally, argument that rescission should not be available where there is an adequate alternative legal remedy available.**
  - Argument is disingenuous
  - Crown has been known to argue that taxpayer could file notice of objection to resolve their issue, which is nonsense – in situation where rectification or rescission would cure issue, notice of objection alone will never work.

RESCISSION PROGNOSIS

- Depending on case, Crown may argue as they did here, that taxpayer could apply for a remission order under *Financial Administration Act*
- However, in circumstances like this in which Crown is fighting rescission, government would never grant remission
- Similarly, Crown may argue that rescission should not be allowed where a taxpayer could sue their advisors instead. However, that is again disingenuous: they argue on one hand that tax opinion included warnings; on the other hand, they argue that the taxpayer should sue their advisors. Both of those positions can’t be right.

BANK OF NOVA SCOTIA V. THE QUEEN

FACTS

- 2013: CRA begins transfer pricing audit (2006 and later taxation years)
- March 13, 2015: Settlement Agreement – transfer price adjustment increases BNS income by $55M
- 2008 taxation year: BNS reported non-capital loss of $3.3 billion
- March 12, 2015: BNS requests that 2008 loss be carried back to 2006

BANK OF NOVA SCOTIA V. THE QUEEN

FACTS (Cont'd)

- Minister accepts BNS request
- Minister assesses arrears interest from April 27, 2007 to March 12, 2015 ($7.9 million)
- BNS position: interest should only accrue until loss became available (i.e. April 28, 2009)

BANK OF NOVA SCOTIA V. THE QUEEN

Para. 161(7)(b): loss deemed applied at latest of four points in time:

I. 1st day following loss year (Nov 1, 2008)

II. Day loss return is filed (April 28, 2009)

III. Day amended return filed under ss. 152(6) – N/A

IV. Day of written request (March 12, 2015)

BANK OF NOVA SCOTIA V. THE QUEEN

CRA position:

- Words of para. 161(7)(b) are clear – Court should defer to ordinary meaning

BNS position:

- Parliament did not intend for interest to accrue when loss is available but taxpayer unaware that loss should be carried back until conclusion of audit
- Assessment as a consequence of transfer pricing adjustment (not written request)

BANK OF NOVA SCOTIA V. THE QUEEN

TCC:

- Wording of provision is unambiguous
- Deemed date is April 11, 2015
- Self-assessing tax system

Takeaways:

- As a consequence of the written request?
- Parliament's intent: anti-fraud provision?

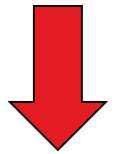
EFFECTIVELY RESOLVING TAX DISPUTES

Overview of TDR Process
Audit, Objection and Court Appeal

AUDIT

AUDITOR

OBJECTION



APPEALS OFFICER

COURT APPEAL

DEPARTMENT OF JUSTICE/ CRA LITIGATION OFFICER

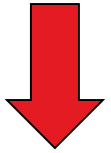
INTRODUCTION

- Approaches to resolution vary at each stage
- Principled basis for settlement
- Atmosphere conducive to settlement
- Costs generally not recoverable, except on Court judgment

AUDIT

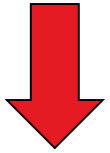
Overview of TDR Process
Audit, Objection and Court Appeal

AUDIT



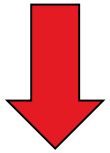
AUDITOR

OBJECTION



APPEALS OFFICER

COURT APPEAL



DEPARTMENT OF JUSTICE/ CRA LITIGATION OFFICER

AUDIT

- Relevance
- Solicitor Client Privilege
- Avoid Aggravating the Auditor

AUDIT

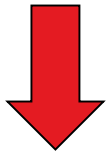
Approaching Settlement

- Likely auditor will raise assessment
- Waive right to object and avoid additional costs of objection and Court appeal
- Is auditor’s position entrenched?
- Might new information, case law or arguments persuade auditor to reduce proposed assessment or not reassess?
- Would it be preferable to present submissions to an appeals officer?

OBJECTION

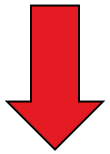
Overview of TDR Process
Audit, Objection and Court Appeal

AUDIT



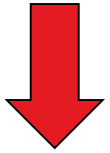
AUDITOR

OBJECTION



APPEALS OFFICER

COURT APPEAL



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OBJECTION

- Appeals Officer mandated to conduct complete, professional and impartial review

OBJECTION

Strategy – Two Options: Negotiate or Appeal

- Make submissions to Appeals Officer and try to negotiate a resolution
- Appeal directly to Court (typically 90 days after notice of objection filed (e.g. para. 169(1)(b) ITA))
- Optimal strategy should be determined in each case

OBJECTION

Reasons to Negotiate with Appeals Officer

- Majority of objections resolved
- Is there an opportunity to settle?
- Avoid significant delay and costs of Court appeal
- Might new information, case law or arguments persuade Appeals Officer to reduce assessment?
- Opportunity to resolve at least some issues

OBJECTION

Reasons to Negotiate with Appeals Officer

- Certain arguments tend to be compelling to an Appeals Officer (e.g. statute barred years, penalty assessments)
- Possible opportunity to address deficiencies in notice of objection
- Is there public disclosure sensitivity?
- More conciliatory and less confrontational approach may be advantageous for future dealings with the CRA

OBJECTION

Reasons to Appeal Directly to Court

- May be tendency to “circle the wagons”, especially if the auditor obtained input from other levels
- Is the position well entrenched (e.g. a published administrative policy)?
- Clear signal that matter is being pursued vigorously, which may enhance atmosphere conducive to settlement
- May be more effective to negotiate with Department of Justice counsel

OBJECTION

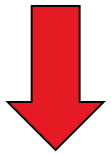
Reasons to Appeal Directly to Court

- Avoid delay associated with dealing with Appeals Officer
- Further assessments could be raised for later years before the dispute gets resolved
- Interest on disputed assessments
- Should the costs associated with negotiating be applied towards litigation and at least potentially recoverable?

TAX LITIGATION

Overview of TDR Process
Audit, Objection and Court Appeal

AUDIT



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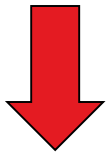
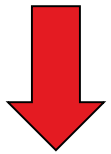
OBJECTION



APPEALS OFFICER

COURT APPEAL



DEPARTMENT OF JUSTICE/CRA LITIGATION OFFICER

TAX LITIGATION

Approaching Resolution

- Atmosphere conducive to settlement
- Costs for Court judgment only
- Main procedural stages
  - ✓ Before reply
  - ✓ After documentary and oral discovery
  - ✓ At settlement conference
  - ✓ Near start of trial

Offer to Settle

- Where judgment more favourable than terms of offer, entitled to party and party costs to offer date and substantial indemnity costs after offer date, where:
  1. written offer of settlement;
  2. is served no earlier than 30 days after close of pleadings and at least 90 days before trial start date;
  3. is not withdrawn; and
  4. does not expire earlier than 30 days before trial start date
     - ✓ *Minister can only accept offers to settle on a principled basis* (only offers that could possibly be accepted by Minister, that would result in assessments supportable on facts and law, can trigger potential cost consequences)

CONCLUSION

- Tax dispute resolution versus tax litigation

UPCOMING WEBINAR

- **Don’t miss our next webinar in the series on January 25. Watch out for an invitation!**