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The Joint Committee on Taxation of
The Canadian Bar Association
and
Chartered Professional Accountants of Canada

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June 19, 2015

Ms. Alexandra MacLean
Director, Tax Legislation Division, Tax Policy Branch
Department of Finance
L'Esplanade Laurier, East Tower
140 O'Connor Street, 17th Floor
Ottawa, ON K1A 0G55

Dear Ms. MacLean:

Subject: Proposed changes to subsection 152(9)

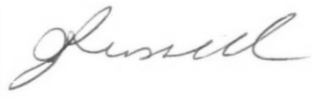
Please see the attached submission in response to the 2015 Federal Budget on the proposed changes to subsection 152(9).

We would like to thank you for your consideration of this matter. A number of members of the Joint Committee and others in the tax community have participated in the discussions concerning our submission and have contributed to its preparation, in particular:

Joel Nitikman (Dentons Canada)
Anthony Strawson (Felesky Flynn)
Ed Rowe (Oslers)

We trust that you will find our comments helpful and would be pleased to discuss them further at your convenience.

Yours very truly,



Janice Russell
Chair, Taxation Committee
Chartered Professional Accountants of Canada

Mitchell Sherman
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Cc: Gabe Hayos, Vice President, Taxation, CPA Canada

Budget 2015 Proposal to Amend Subsection 152(9)
Submission by the Joint Committee on Taxation
June 19, 2015

The Federal Budget released on April 21, 2015 (the "Budget") proposes to amend subsection 152(9) of the *Income Tax Act* (the "Act").[1] The Budget did not contain draft legislation to implement this proposal and normally the Joint Committee comments only on draft legislation. Nevertheless, the Joint Committee felt that this is an important proposal and merited a comment in advance of the amendment being drafted.

The Joint Committee suggests that in drafting the amendment, certain key principles should be observed. To understand why the Joint Committee believes this is important, some background is required.

Continental Bank

The Department of Finance Explanatory Note to current subsection 152(9) states that it was enacted in response to certain comments made in *The Queen v. Continental Bank of Canada*, [1998] 2 S.C.R. 358. The Note states:

> **152(9) Alternative basis for assessment**
> Bill C-72; S.C. 1999, c. 22, s. 63.1
>
> New subsection 152(9) of the Act is intended to ensure that the Minister of National Revenue may advance alternative arguments in support of an income tax assessment after the normal reassessment period has expired. This amendment is proposed in light of remarks by the Supreme Court of Canada in the case of *The Queen v. Continental Bank of Canada* to the effect that the Crown is not permitted to advance a new basis for assessment after the limitation period has expired.
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> The limitations found in paragraphs 152(9)(a) and (b) are intended to import the Court protection afforded to taxpayers that an alternative argument cannot be advanced to the prejudice of the right of a taxpayer to introduce relevant evidence to rebut the argument.
>
> Subsection 152(9) is subject to other limitations in the Act, including subsection 152(5) which prevents the Minister from including amounts in a taxpayer's income which were not included prior to the expiration of the taxpayer's normal reassessment period.

In *Continental Bank* there was only one issue before the Court, namely, the character of the proceeds received by the taxpayer for its disposition of certain assets through a partnership. On

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[1] RSC 1985, c. 1 (5th Supp.), as amended. The Budget also proposes to amend similar provisions in other Federal legislation.

appeal, the Crown wanted to add additional bases (i.e., arguments) in support of its position that the proceeds should be taxed on income account. These arguments included a look-through of the partnership to the assets, which was a different basis than that raised by the Minister in the reassessment. In addressing the Crown's entitlement to raise these additional bases, the Court in *Continental Bank* stated:

> 9 The only **basis** given in the Notice of Reassessment that Revenue Canada issued to the Bank for the 1987 taxation year was that the amount in question was alleged to constitute a "trading gain on sale of Central Capital Leasing's partnership interest". Revenue Canada did not reassess the Bank on any other **basis** including that the Bank sold depreciable leasing assets or was otherwise liable for recapture of capital cost allowance pursuant to s. 88(1) of the Act, as the appellant now alleges for the first time in this Court.
>
> 10 The applicable limitation period under the Act for assessing a taxpayer is four years from the date of issuance of Revenue Canada's Notice of Reassessment (ss. 152(3.1) and 152(4) of the Act). As a result, the latest that the Minister could have reassessed the Bank for the recapture of cost allowance was October 12, 1993. **The Crown is not permitted to advance a new basis for reassessment after the limitation period has expired.** The proper approach was expressed in *The Queen v. McLeod*, 90 DTC 6281 (F.C.T.D.), at p. 6286. In that case, the court rejected the Crown's motion for leave to amend its pleadings to include a new statutory basis for Revenue Canada's assessment. The court refused leave on the basis that the Crown's attempt to plead a new section of the Act was, in effect, an attempt to change the basis of the assessment appealed from, and "tantamount to allowing the Minister to appeal his own assessment, a **notion which has specifically been rejected by the courts**". Similarly, the Federal Court of Appeal has described such attempts by the Crown as "a belated attempt to put the appellant's case on a new footing" (*British Columbia Telephone Co. v. Minister of National Revenue* (1994), 167 N.R. 112, at p. 116). [Emphasis added.]

Subsection 152(9) states:

152(9) The Minister may advance an alternative argument in support of an assessment at any time after the normal reassessment period unless, on an appeal under this Act	152(9) Le ministre peut avancer un nouvel argument à l'appui d'une cotisation après l'expiration de la période normale de nouvelle cotisation, sauf si, sur appel interjeté en vertu de la présente loi:
(a) there is relevant evidence that the taxpayer is no longer able to adduce without the leave of the court; and	a) d'une part, il existe des éléments de preuve que le contribuable n'est plus en mesure de produire sans l'autorisation du tribunal;
(b) it is not appropriate in the circumstances for	b) d'autre part, il ne convient pas que le

the court to order that the evidence be adduced.	tribunal ordonne la production des éléments de preuve dans les circonstances.

Walsh

The leading case on the interpretation of the provision is *Estate of Walsh v. The Queen*, 2007 FCA 222, where the Court said:

> [18] The following conditions apply when the Minister seeks to rely on subsection 152(9) of the Act:
>
> 1) the Minister cannot include transactions which did not form the basis of the taxpayer's reassessment;
>
> 2) the right of the Minister to present an alternative argument in support of an assessment is subject to paragraphs 152(9)(a) and (b), which speak to the prejudice to the taxpayer; and
>
> 3) the Minister cannot use subsection 152(9) to reassess outside the time limitations in subsection 152(4) of the Act, or to collect tax exceeding the amount in the assessment under appeal.

Last

The Budget states that the proposal to amend subsection 152(9) is in response to a recent unnamed case. The tax community assumes that the case is *The Queen v*. *Last*, 2014 FCA 129, leave to appeal refused (SCC). The *Last* case arose in circumstances that were unusual and distinct from those in *Continental Bank*. In *Last* the Minister assessed the taxpayer to reduce the income inclusion attributable to the taxpayer's gain from a sale of shares by treating the gain on capital account rather than on income account and by denying a deduction for certain expenses. The taxpayer argued that the expenses were incurred in connection with the share sale, that the share sale was on income account and, therefore, that the expenses were deductible. The Tax Court found that the expenses were not connected to the share sale, that nevertheless the expenses were deductible from another source of income and commented that the share sale was on income account. The Minister then argued that She should be allowed to assess the share sale on income account, essentially, to "fill the hole" left by the deduction of the expenses, to the extent that the total tax assessed did not increase. The Crown argued that an assessment is the total tax owing for a year and that an assessment cannot be divided up into its constituent parts on a source-by-source basis. The Court rejected this argument, stating:

> [23] *Harris* is authority for the proposition that on appeal from an assessment, the question to be answered is whether the Minister's assessment is higher than it should be. However, *Harris* is also authority for the proposition that a taxpayer's appeal cannot result in an increased assessment. This is because the Act does not give any right of

> appeal to the Minister and any increase to an assessment would in effect allow the Minister to appeal from her own assessment. **This principle is to be applied to each source of income**. [Emphasis added.]

The scenario in *Last*, where the Minister seeks to "fill the hole" created by a loss on the issue before the Court with additional tax on another issue that the Minister had previously assessed in a manner more favourable than available at law, also arose in *Petro-Canada v. The Queen*, 2004 FCA 158. The Court in *Last* relied heavily on that case in concluding that, under the current state of the law, the Minister is not permitted set off its loss on the issue before the Court with additional income relating to a separate issue. The Joint Committee understands that the Department wishes to address this particular circumstance by way of amendment to subsection 152(9). As described more fully in our comments below, the Joint Committee is concerned that an amendment to subsection 152(9) could have unintended reach beyond the circumstances of *Last* and *Petro-Canada*.

The Budget Proposal

In response to the last sentence of the above quotation from *Last*, the Budget proposes to amend subsection 152(9). The Budget states:

> Alternative Arguments in Support of Assessments
>
> An income tax assessment is a calculation of a taxpayer's total tax liability for a particular taxation year. Long-standing jurisprudence has held that on appeal from a tax assessment, the question to be answered is, generally, whether the Canada Revenue Agency's assessment is higher than mandated under the Income Tax Act. The understanding in such an appeal was that, although the total amount from all sources that is assessed cannot increase after the expiration of the normal reassessment period, the basis of the assessment could change. This would allow, for instance, a reduced liability in relation to one item included in the computation of an assessment to be offset by an increased liability in relation to another item.
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> Consistent with this principle, there is a specific provision in the *Income Tax Act* which provides that the Minister of National Revenue may advance an alternative argument in support of an assessment at any time after the normal reassessment period. The purpose of this provision is to allow the Minister to advance an alternative argument after the relevant reassessment period has expired. This process of raising arguments and counter-arguments "in the alternative" is a conventional part of the litigation process.
>
> A recent court decision held that, while the basis of an assessment can be changed after the expiration of the normal reassessment period, each source of income is to be considered in isolation and the amount of the assessment in respect of any particular source of income cannot increase.
>
> Budget 2015 proposes that the *Income Tax Act* be amended to clarify that the Canada Revenue Agency and the courts may increase or adjust an amount included in an

assessment that is under objection or appeal at any time, provided the total amount of the assessment does not increase.

Joint Committee's Comments

In drafting any legislation to implement this proposal, the Joint Comittee's suggestion is that certain key principles must be kept in mind.

152(5)

The Explanatory Note to subsection 152(9) states that it is subject to subsection 152(5). Subject to various exceptions, this latter provision prevents the Minister from reassessing a taxpayer after the expiration of the normal reassessment period (the "NRP") by adding an amount in the computation of income that was not included for purposes of an assessment prior to that expiration. It is noted that subsection 152(5) does not refer to amount of assessed tax; it refers to the inclusion of an amount in the computation of income. The Budget proposal should not override subsection 152(5), as otherwise the integrity of the NRP rules would be degraded severely. Instead, we submit that the existing restrictions on reassessments after the NRP should not be affected by the Budget proposal. Taxpayers are entitled to some finality in their tax affairs and generally should not have to litigate the taxability of an amount of income that was not included for purposes of an assessment prior to the end of the NRP (.Nor should they have to litigate an increased amount of income that was not assessed prior to the end of the NRP simply because the Minister is attempting to "fill a hole" created by a deduction allowed by the Court.

We also suggest that, consistent with the original Explanatory Note, subsection 152(9) be clarified by adding to it the words "subject to subsection 152(5). . . ."

Waivers

Under subparagraphs 152(4)(a)(ii) and (4.01)(a)(ii), the Minister may reassess after the end of the NRP if the taxpayer has filed a waiver, but only to the extent of a matter specified in the waiver. The Budget proposal should ensure that the Minister cannot use amended subsection 152(9) to do an "end run" around the limitation in subparagraph 152(4.01)(a)(ii) so as to permit a matter not specified in a waiver to form the basis for a reassessment that is issued after the NRP.

Misrepresentations, etc.

Under subparagraphs 152(4)(a)(i) and (4.01)(a)(i), the Minister may reassess after the end of the NRP if the taxpayer has, among other things, made certain misrepresentations, but only to the extent it relates to the misrepresentation. As with waivers, the Budget proposal should ensure that the Minister cannot use amended subsection 152(9) to permit a matter that does not relate to a misrepresentation to sustain a reassessment that is issued after the NRP.

Settlement Agreements

A taxpayer and the CRA or Crown may enter into a settlement agreement with respect to a particular issue that is in dispute. Such settlements are a beneficial and indeed, vital, feature of our tax system. The Budget proposal should ensure that the Minister cannot use amended subsection 152(9) to violate the form or spirit of such agreements (for example, by settling on the only issues in dispute and then using amended subsection 152(9) to seek to sustain an assessment that the parties agreed was too high based on some new issue). Taxpayers must be entitled to rely upon settlement agreements with the tax authorities.

Large Corporation Rules

Subsections 165(1.11) to (1.14) and 169(2.1) contain rules that require a "large corporation" to specify certain matters in any Notice of Objection and that prevent the corporation from objecting to or appealing from any assessment if its Objection does not so specify. The Budget proposal must ensure that a large corporation is not caught in a trap whereby the Minister uses amended subsection 152(9) to alter the basis for an assessment and then argues that the taxpayer cannot appeal or that its objection is invalid, because it has not specified that new issue in its Notice of Objection.

Minister cannot appeal own reassessment through the back door

It is a long-standing principle of our tax system that the Minister cannot appeal Her own reassessment. The Budget proposal should respect that principle by ensuring that any amendment to subsection 152(9) does not permit the Minister to amend an assessment simply because the Minister believes that Her initial assessment was wrong and should be improved in some way.

Conclusion

We would be pleased to meet with you to discuss this submission at your convenience.