Federal Court of Appeal

Cour d'appel fédérale

Date: 20130905

Dockets: A-463-12
A-346-12

Citation: 2013 FCA 200

CORAM: **BLAIS C.J.**
SHARLOW J.A.
WEBB J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

THOMAS O'DWYER

Respondent

Heard at Vancouver, British Columbia, on June 5, 2013.

Judgment delivered at Ottawa, Ontario, on September 5, 2013.

REASONS FOR JUDGMENT BY: WEBB J.A.

CONCURRED IN BY: BLAIS C.J.
SHARLOW J.A.

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<u>REASONS FOR JUDGMENT</u>

<u>WEBB J.A.</u>

[1] The Crown is appealing the order of Justice Bocock of the Tax Court of Canada (TCC) striking the Crown's reply to Thomas O'Dwyer's appeal from the assessment of the penalty under the *Income Tax Act,* R.S.C. 1985, c. 1 (5th Supp.), (Act) and his subsequent judgment allowing Thomas O'Dwyer's appeal (2012 TCC 261 and Supplementary Order and Judgment dated October 12, 2012). For the reasons that follow, I would dismiss both appeals.

[2] Thomas O'Dwyer was assessed a penalty under subsection 237.1(7.4) of the Act in the amount of $2,352,500 in relation to certain transactions that occurred in 2006. Accrued interest was also assessed in the amount of $485,312.34. Subsection 237.1(7.4) of the Act provides for the assessment of a penalty if a person sells, issues, or accepts consideration in respect of a tax shelter before the Minister has issued an identification number for such tax shelter.

[3] Thomas O'Dwyer appealed the assessment of the penalty to the TCC. The Crown filed a reply. Thomas O'Dwyer then brought a motion in the TCC to have the reply struck. As noted above, this motion was granted and the Crown has appealed to this Court.

[4] The criticisms of the reply can be described as follows:

(a) the reply does not clearly identify what property is alleged to be the tax shelter;

(b) assuming that the facts as alleged in the reply are true, these facts are not sufficient to find that there was a tax shelter; and

(c) the role that Thomas O'Dwyer is alleged to have played is not clear.

Statutory Provisions

[5] The penalty was imposed under subsection 237.1(7.4) of the Act. The relevant parts of this subsection, in 2006, were as follows:

237.1(7.4) Every person who … whether as a principal or as an agent, sells, issues or accepts consideration in respect of a tax shelter before the Minister has issued an identification number for the tax shelter is liable to a	237.1(7.4) Toute personne qui, […] contrevient au paragraphe (4) est passible d'une pénalité égale au plus élevé des montants suivants :

penalty equal to the greater of	
(a) $500, and	a) 500 $;
(b) 25% of the total of all amounts each of which is the consideration received or receivable from a person in respect of the tax shelter before … the identification number is issued …	b) 25 % de le total des sommes représentant chacune la contrepartie reçue ou à recevoir d'une personne relativement à l'abri fiscal avant […] qu'un numéro d'inscription ait été attribué à l'abri fiscal […]

[6] The penalty can be imposed only if there is a tax shelter as defined in subsection 237.1(1) of the Act. A tax shelter, as so defined, is either a gifting arrangement or a property (in respect of which certain conditions are satisfied). In this case, there is no suggestion that there was any gifting arrangement. Therefore, the only relevant parts of the definition of tax shelter in this case are those parts that relate to a property. The relevant parts of this definition of tax shelter are as follows:

"tax shelter" means	« abri fiscal »
…	[…]
(b) … property (including any right to income) … in respect of which it can reasonably be considered, having regard to statements or representations made or proposed to be made in connection with the … the property, that, if a person were to … acquire an interest in the property, at the end of a particular taxation year that ends within four years after the day on which the … interest is acquired,	b) […] bien (y compris le droit à un revenu), […] pour lequel il est raisonnable de considérer, compte tenu de déclarations ou d'annonces faites ou envisagées relativement […] au bien, que, si une personne devait […] acquérir une part dans le bien, le montant visé au sous-alinéa (i) serait, à la fin d'une année d'imposition qui se termine dans les quatre ans suivant le jour où […] la part, acquise, égal ou supérieur au montant visé au sous-alinéa (ii) :
(i) the total of all amounts each of which is	(i) le total des montants représentant chacun :

(A) an amount, or a loss in the case of a partnership interest, represented to be deductible in computing the person's income for the particular year …, or	(A) un montant ou, dans le cas d'une participation dans une société de personnes, une perte qui est annoncé comme étant déductible dans le calcul du revenu de la personne pour l'année […]
	[…]
would equal or exceed	
(ii) the amount, if any, by which	(ii) l'excédent éventuel du montant visé à la division (A) sur le total visé à la division (B) :
(A) the cost to the person of … the interest in the property at the end of the particular year, determined without reference to section 143.2,	(A) le coût, pour la personne, […] de la part dans le bien à la fin de l'année, déterminé compte non tenu de l'article 143.2,
would exceed	
(B) the total of all amounts each of which is the amount of any prescribed benefit that is expected to be received or enjoyed, directly or indirectly, in respect of the … interest in the property, by the person or another person with whom the person does not deal at arm's length.	(B) la valeur totale des avantages visés par règlement que la personne ou toute personne avec laquelle elle a un lien de dépendance pourrait recevoir, directement ou indirectement, […] au titre de la part dans le bien.

Test for Striking Pleadings

[7] In *R. v. Imperial Tobacco Canada Ltd.*, [2011] 3 S.C.R. 45, the Supreme Court of Canada confirmed that a "claim will only be struck if it is plain and obvious, assuming the facts pleaded to be true, that the pleading discloses no reasonable cause of action", which could also be stated as "the claim has no reasonable prospect of success" (paragraph 17). Therefore, the question in this

appeal is whether, assuming the facts as alleged in the reply are true, the Crown has a reasonable prospect of successfully defending its assessment of the penalty.

[8] In order to have any reasonable prospect of success, the reply must set out the essential facts that would support the assessment of the penalty. If any facts that would be required to assess the penalty are missing, then the assessment of the penalty could not be supported, even if the other facts as alleged are assumed to be true.

Identification of the Tax Shelter

[9] Thomas O'Dwyer submits that the Crown has not identified the property that is alleged to be the tax shelter. In this case, if there is no property, there is no tax shelter.

[10] Paragraph 11 of the reply sets out the facts on which the Minister relied in determining that Thomas O'Dwyer was liable to the penalty referred to above. This paragraph provides in part as follows:

> 11. In determining that the Appellant was liable to a penalty pursuant to subsection 237.1(7.4) of the *Act*, the Minister relied on the following facts:
>
> **The Tax Shelter**
>
> a) Solid Resources #1 Limited Partnership (SRLP) was structured as a limited partnership.

[11] Paragraphs 14, 15 and 16 of the reply each start with the phrase: "SRLP is a tax shelter pursuant to subsection 237.1(1) of the *Act* because…". While the units of the limited partnership are property for the purposes of the Act, the limited partnership itself is not property for the purposes of the Act. Therefore, SRLP (the limited partnership) cannot be a tax shelter. While counsel for the Crown agreed during the hearing of this appeal that the limited partnership cannot be "property" for the purposes of the Act, he argued that "SRLP" was simply referring to the collection of all of the limited partnership interests (which are property as defined in the Act). However, this is not consistent with how the expression was used throughout paragraph 11. For example, the following are some of the subparagraphs which use the expression "SRLP":

> 11….
>
> b) SRLP's first taxation year was from December 15, 2006 to December 31, 2006…
>
> …
>
> e) SRLP's 66 limited partners acquired partnership units in SRLP…

[12] It seems to me that "SRLP" was not intended to mean the collection of the limited partnership units but rather the limited partnership itself. Interpreting "SRLP" as the collection of the limited partnership units would render the two subparagraphs referred to above (as well as most of the other subparagraphs of paragraph 11) meaningless.

[13] However, while stating that "SRLP is a tax shelter" in paragraphs 14, 15 and 16 was not correct, it does not seem to me that this error alone would justify striking the entire reply. The term "SRLP" is used consistently throughout paragraph 11 as a shorthand reference to the limited

partnership (and not the collection of the units of the limited partnership). The error made is in paragraphs 14, 15 and 16 (which is part of the argument). The paragraphs as written may well leave the reader with the impression that the author of those paragraphs was not careful with respect to the use of the term "SRLP" and in identifying the property that is alleged to be the tax shelter. However, it seems to me that when the reply is read in its entirety, it is reasonable to infer that the property that was alleged to be a tax shelter was a unit of the limited partnership. Therefore, although the term "SRLP" was not used correctly in paragraphs, 14, 15 and 16 of the reply and these paragraphs do not correctly identify the property that is alleged to be the tax shelter, these errors would not justify striking the entire reply.

Insufficiency of Alleged Facts Related to the Required Representations

[14] In *Baxter v. The Queen*, 2007 FCA 172, Justice Ryer noted that in order to find that a particular property is a tax shelter (as defined in the Act), it is necessary to find that certain statements or representations were made prior to the acquisition of that property. In particular he stated that:

> 9 The definition requires that statements or representations must be made, at some time, in connection with the property that is offered for sale. If no statements or representations have ever been made in connection with a property, then that property cannot constitute a tax shelter. Because the property that is contemplated by the definition of tax shelter is a property that is assumed to have been acquired by the prospective purchaser and the statements or representations are required to have been made in connection with that property, it follows that the statements or representations must have been made prior to any actual sale of the property that is offered for sale. Further, while the definition does not specify to whom or by whom the statements or representations must be made, in my view they must be made to the prospective purchasers of the property by or on behalf of the person who proposes to sell the property.
>
> 10 The subject matter of the statements or representations is essentially a description of an amount that the prospective purchaser would be able to deduct, in computing income in respect of the property, as a consequence of an assumed acquisition of the property, that is to

> say, if the prospective purchaser had actually acquired the property, whether the amount constitutes the acquisition cost of the property, a cost incurred in order to obtain the property (e.g. a drilling cost incurred to acquire an interest in an oil and gas property in a farm-out transaction) or an amount allocated to the holder of the property (e.g. a loss allocated to partner holding a partnership interest).
>
> ..
>
> 37 A property cannot constitute a tax shelter if no statements or representations are ever made with respect to the amount that a prospective purchaser would be able to deduct in computing income as a consequence of an assumed acquisition of that property. Accordingly, the existence of statements or representations in connection with a property is a necessary condition to a conclusion that the property constitutes a tax shelter.

[15] The required statements or representations must describe the amount that the purchaser of the property will be able to deduct in computing income under the Act if the property is acquired. For limited partnerships, the deductible amount will be the amount of the losses of the limited partnership that the holders of the units of that limited partnership will be able to deduct in computing their income under the Act. It must be reasonable to conclude that, for the purposes of the Act, the total amount that is represented to be deductible within the first four taxation years would equal or exceed the cost of acquiring the property minus the amount of any prescribed benefit (as determined under the *Income Tax Regulations*).

[16] While there are allegations of fact in the reply in relation to the actual revenue of the limited partnership and the expenses actually incurred in 2006, these are not relevant in determining whether there was a tax shelter. In determining whether a property is a tax shelter, the statements or representations made prior to the acquisition of the property in relation to the losses that will be incurred are relevant — not the actual losses subsequently incurred. In order to find that there is a

tax shelter, it is necessary to examine the statements or representations made before the property is acquired.

[17] There are only two references to statements or representations that were made before the units of the limited partnership were acquired by the investors. These are in paragraphs 11 (m) and (r) of the reply and are as follows:

> m) The Offering Memorandum states that the majority of the partnership's expenses would occur in 2006;
>
> …
>
> r) SRLP made statements or representations that would cause an investor to believe that the loss that would be deductible in respect of their partnership interest would exceed the cost to the investor of the partnership interest less the value of the investor's promissory note;

[18] Counsel for the Crown confirmed during the hearing that to the extent that paragraph (r) referred to statements or representations, it was simply a summary of the statements or representations referred to above. It was not intended to refer to any other statements or representations. As a result, the only allegation of fact related to any representation or statement made prior to the purchase of the units of the limited partnership is the allegation contained in paragraph (m).

[19] Assuming that the allegation of fact in paragraph (m) is true, this is well short of what would be required to find that the units of the limited partnership were a tax shelter. The representation that the majority of the partnership's expenses would be incurred in 2006 does not:

(a) provide any indication of the amount of such expenses;

(b) indicate whether such expenses would be deductible in computing income for the purposes of the Act;

(c) provide any indication of the expected revenue of the limited partnership for 2006 (and therefore without knowing the amount of revenue and the amount of expenses it is not possible to determine if there would be a loss for 2006 as determined for the purposes of the Act);

(d) provide any indication of the amount of any anticipated losses as determined for the purposes of the Act; and

(e) provide any indication of whether such anticipated losses will be deductible by the holders of the units of the limited partnership in computing their income for the purposes of the Act.

[20] Therefore, there are no allegations in the reply that the statements or representations that would be required to support a finding that there was a tax shelter were made in this case. As a result, assuming that all of the facts as alleged are true, these facts would not support a finding that the units of the limited partnership were a tax shelter. The claim of the Crown that the penalty was properly imposed under subsection 237.1(7.4) of the Act does not have a reasonable prospect of success and therefore, in my opinion, the reply must either be struck or amended.

[21] The Crown had many opportunities in the TCC to seek leave to amend the reply. Such a request could have been made by a motion filed immediately after the filing of the motion to strike the reply. Such a motion could have been filed before or during the hearing of the motion to strike. It could have been filed during the period of almost two months while the motion was on reserve. The Crown filed no such motion in the TCC even though the Judge raised the issue of amending the reply (see paragraph 25 of his reasons). In this Court, no request for leave to amend the reply was made in the Crown's notices of appeal, or in the Crown's memorandum of fact and law.

[22] During the hearing of the appeals, counsel for the Crown was asked why no leave to amend had ever been sought. No satisfactory answer was offered. Counsel for the Crown, as noted above, confirmed during the hearing that the only statements or representations upon which the Canada Revenue Agency was relying in assessing the penalty were the statements and representations specifically identified in the reply. Since there were no other statements or representations, this could explain why no leave to amend the reply had been sought as there was nothing to add to what was already in the reply.

[23] After counsel for Thomas O'Dwyer had completed his oral submissions, counsel for the Crown made an oral request for leave to amend the reply. This was the first time that any request to amend the reply had been made and it was made when Thomas O'Dwyer had no reasonable opportunity to oppose it.

[24] There are cases where amendments to pleadings are allowed, even at a late stage in a proceeding. Several factors that should be taken into account in deciding whether a particular amendment to a pleading should be allowed are identified in *The Queen v. Canderel Limited*, 93 DTC 5357 (FCA). However, since in this case the only request to amend the reply was made during the oral submissions of the Crown in reply to the submissions of Thomas O'Dwyer and the Crown acknowledged that the only statements or representations that had been made were those already identified in the reply, this is not a case where the request to amend the reply should be granted and I would not grant the request of the Crown to amend the reply.

[25] I would, therefore, dismiss the appeal from the order striking the reply. Since I would strike the reply, I would also dismiss the appeal of the Crown from the order of the Judge allowing Thomas O'Dwyer's appeal from the assessment of the penalty.

<u>The Role of Thomas O'Dwyer</u>

[26] Although the above finding is sufficient to dispose of the appeals, the third criticism of the reply warrants some comments. The penalty under subsection 237.1(7.4) of the Act is imposed if a person "whether as a principal or as an agent, sells, issues or accepts consideration in respect of a tax shelter" before the identification number is issued. In the reply (paragraph 18), the provisions of subsection 237.1(7.4) of the Act are reiterated without identifying what specific role Thomas O'Dwyer is alleged to have played:

> 18. The Appellant is liable for a penalty because he acted as principal or agent to sell, issue or accept consideration in respect of the SRLP tax shelter before the Minister issued a tax shelter identification number, pursuant to subsection 237.1(7.4) of the *Act*.

[27] Every possible combination enumerated in subsection 237.1(7.4) of the Act is included. There is no clear indication of why the penalty was imposed. The above paragraph 18 would include the allegation that Thomas O'Dwyer, as principal, issued units in the limited partnership. However, only the limited partnership could, as principal, issue units in itself.

[28] The penalty can be imposed if a person sells a tax shelter. A person can either sell a property as a principal or as an agent, but not as both at the same time in relation to the same property. Therefore, the Minister should have identified whether Thomas O'Dwyer was assessed the penalty on the basis that he was selling the alleged tax shelter as principal or as an agent, but not as both.

[29] In the reply, it is stated that the Minister relied on the fact that "SRLP's 66 limited partners acquired partnership units in SRLP pursuant to an offering memorandum dated December 15, 2006" (paragraph 11 (g)). This would presumably mean that the units were issued directly to the 66 limited partners. As a result, there does not appear to any basis for the allegation that Thomas O'Dwyer sold any units as principal.

[30] The alleged facts in relation to the role of Thomas O'Dwyer are set out in subparagraphs 11 (bb) to (mm) of the reply. However it is not clear how these alleged facts would lead to the conclusion that Thomas O'Dwyer is liable for the penalty. The only paragraph that purports to

provide the basis for the assessment of the penalty is paragraph 18 and this paragraph does not provide any clear indication of how the alleged facts would result in Thomas O'Dwyer being liable for the penalty.

[31] In setting out the basis upon which the penalty was assessed, the Minister should clearly identify the role that Thomas O'Dwyer is alleged to have played and not simply reiterate every possible permutation or combination that could satisfy the statutory conditions to impose the penalty. Any taxpayer who has been assessed a penalty should know why the penalty was assessed. Simply reiterating the multiple combinations of possibilities that could result in the imposition of the penalty does not tell a taxpayer what specific act (that would result in the imposition of the penalty) he or she is alleged to have committed.

Conclusion

[32] I would dismiss the appeals, with costs.

"Wyman W. Webb"
J.A.

"I agree,
Pierre Blais C.J."
"I agree,
K. Sharlow J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

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