Federal Court of Appeal  Cour d'appel fédérale

Date: 20140515

Docket: A-468-12

Citation: 2014 FCA 129

CORAM: **DAWSON J.A.**
TRUDEL J.A.
NEAR J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

GEOFFREY LAST

Respondent

Heard at Vancouver, British Columbia, on December 12, 2013.

Judgment delivered at Ottawa, Ontario, on May 15, 2014.

REASONS FOR JUDGMENT BY: DAWSON J.A.

CONCURRED IN BY: TRUDEL J.A.
NEAR J.A.

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REASONS FOR JUDGMENT

DAWSON J.A.

I. Introduction

[1] The respondent taxpayer, Geoffrey Last, appealed assessments issued under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (Act) in respect of the 2000, 2001 and 2002 taxation years. Generally, at issue in the appeal was the determination of revenues and expenses from a number of income-earning activities.

[2] For reasons cited as 2012 TCC 352, 2012 D.T.C. 352, a judge of the Tax Court of Canada allowed the appeal and referred the assessments back to the Minister of National Revenue for reassessment on the basis of the Judge's findings.

[3] The Crown appeals from the Court's judgment only insofar as it pertains to the treatment of the proceeds of disposition of certain shares. The taxpayer cross-appeals from the Court's judgment as it pertains to the same share transactions, as well as certain rental income.

[4] For the reasons that follow, I would dismiss both the appeal and the cross-appeal and reserve the issue of costs in this Court.

II. Factual Background

[5] The Canada Revenue Agency assessed the taxpayer under the Act for the 2000, 2001 and 2002 taxation years on income earned from a number of sources. Only two sources are relevant for present purposes: transactions involving the shares of InternetStudios.com,Inc. (ISTO shares) during 2002, and payments received by the taxpayer in 2000 and 2001 on account of renting his condominium on a short-term basis to persons in the entertainment industry (rental income).

[6] In order to understand the issues to be decided on the appeal and the cross-appeal it is helpful first to review the findings of the judge of the Tax Court that give rise to the appeal and cross-appeal.

III. The decision of the Tax Court

[7] At paragraph 3 of her reasons, the Judge summarized in table form the competing positions of the Minister of National Revenue and the taxpayer. It is useful to reproduce these tables (deleting reference to income received from another uncontroversial source):

Income as assessed by the Minister

	2000	2001	2002
Rental Income			$ 69,523.99
ISTO trades – Cap. Gains			$ 601,135.38

Income as per the Appellant

	2000	2001	2002
Rental Income	$ 5,052.80	$ 8,460.29	$ 34,707.90
ISTO trades – Bus. Income			$ 117,414.00

[8] As the Judge observed at paragraph 4 of her reasons, the tables illustrate two unusual aspects of the taxpayer's appeal. First, the Minister treated the proceeds of disposition of the ISTO shares transaction as a capital gain. Notwithstanding that income received on account of capital is treated more favourably under the Act than business income, the taxpayer argued that the proceeds of the share transactions should be taxed as business income. Second, the taxpayer conceded that rental income should be included in his income for the 2000 and 2001 taxation years, even though the Minister had not included such amounts in her assessments.

(i) ISTO share transactions – 2002 taxation year

[9] The taxpayer acknowledged that he realized gains in the amount assessed by the Minister. However, as set out above, he took the position that the gains were business income. This, in his

submission, allowed him to deduct expenses in the amount of $483,721 from the sale proceeds. The taxpayer asserted in the alternative that if the proceeds were found to be on account of capital, the expenses should be added to the adjusted cost base of the ISTO shares.

[10] The Judge found as a fact that the monies expended by the taxpayer were not paid to defray expenses in relation to the ISTO shares. Rather, they were loans made to ISTO. It followed that although these expenses were deductible because they were incurred to earn income from another source (the internet venture), they could not be claimed against the sale proceeds. This finding is not challenged by the taxpayer.

[11] As to the nature of the proceeds received by the taxpayer, the Judge found that they resulted from trading gains and therefore constituted income. The Crown argued that it would be proper for the Court to order the Minister to reassess the income on the basis the gains were business income, so long as the 2002 reassessment did not increase the taxpayer's overall tax liability for the 2002 taxation year.

[12] The Judge disagreed. In her view, the effect of this would be to allow the Minister to reassess beyond the limitation period contained in subsections 152(4) and (4.01) of the Act. In her view, citing the decisions of this Court in *Pedwell v. Canada*, [2000] 4 F.C.R. 616, 257 N.R. 148, and *Canada v. Loewen*, 2004 FCA 146, [2004] 4 F.C.R. 3, the Minister, while generally able to advance new arguments and a new basis of assessment on appeal, cannot do so if it results in an assessment outside of the limitation period.

[13] The Judge found that a reassessment that changed the ISTO gains from capital to business income amounted to a reassessment outside of the limitation period that would be statute-barred unless the taxpayer had made a careless or negligent misrepresentation in his income tax return. The Judge did not accept that the taxpayer had made such a misrepresentation when the Crown's principal argument on the appeal was that the gains were on account of capital. As such, the Judge declined to order that the proceeds be reassessed on that basis.

(ii) Rental income – 2000 and 2001 taxation years

[14] The Judge next considered monies earned by the taxpayer in the 2000 and 2001 taxation years in the respective amounts of $5052.80 and $8460.29. She reasoned as follows:

- The taxpayer did not report this income in his income tax returns and the Minister had not included this income in the assessments at issue.
- The taxpayer acknowledged the income in his amended notice of appeal.
- The parties were in agreement that the amounts should be added to the taxpayer's income.
- The Court was not bound by this agreement.
- This Court has held that a court should give effect to the agreement of the parties, unless the agreement is contrary to the Act (citing *Petro-Canada v. The Queen*, 2004 FCA 158, 319 N.R. 261).
- On the basis of the taxpayer's failure to report the income it was reasonable to conclude that the taxpayer had made a misrepresentation in his income tax returns based on carelessness, neglect or wilful default.

- It followed from the finding of misrepresentation that a reassessment to include this income would not be contrary to the Act because the consequence of the misrepresentation was that the reassessment was not statute-barred.

Therefore, the amounts were to be included in the taxpayer's taxable income.

IV. The issues to be decided in the appeal and cross-appeal

[15] The issue raised in the appeal is whether the Judge erred in law by failing to take into account the additional tax liability that resulted from characterizing the gain realized from the sale of the ISTO shares as business income when answering the ultimate question: whether the taxpayer's tax liability, as assessed, was too high?

[16] The issues raised in the cross-appeal are whether the Judge erred in law by:

i. Failing to require the Minister to remove the taxable capital gain arising from the disposition of the ISTO shares from the taxpayer's income and, failing to prohibit the Minister from including any other amount in the taxpayer's income in respect of the profit from the taxpayer's business of buying and selling shares of ISTO in the 2002 taxation year.

ii. Requiring the Minister to include rental income in the taxpayer's income for the 2000 and 2001 taxation years.

V. The standard of review

[17] It is well-settled law that judges of the Tax Court must be correct when determining questions of law. Questions of fact or mixed fact and law are reviewable for palpable and overriding error, unless they exhibit an extricable question of law. An extricable question of law is reviewed on the correctness standard (*Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235, at paragraph 30).

[18] In the present case, the errors asserted are errors of law that are reviewed on the correctness standard.

VI. Consideration of the issue raised on the appeal

[19] The Crown's argument on the appeal may be summarized as follows. For the 2002 taxation year the Tax Court found that the taxpayer was entitled to additional deductions of $265,070 when calculating his income. These additional deductions were unconnected to the ISTO shares. At the same time, the Tax Court found that the taxpayer's gain on the sale of the ISTO shares, in the amount of $601,135, was business income, not a capital gain. The consequence of this finding was that the taxpayer was required to include in income that portion of the sale proceeds that would not have been included in income if the proceeds were a capital gain. The amount now to be included in income exceeded the additional deductions the taxpayer was entitled to. In the result, the effect of the recharacterization of the ISTO share transaction did not increase the taxpayer's tax liability. Therefore, the taxpayer's appeal for the 2002 year should have been dismissed.

[20] The Crown supports this argument by noting that the issue in a taxpayer's appeal from the Minister's assessment of tax is whether the overall amount of tax assessed is correct (see for example, *Harris v. Canada (Minister of National Revenue - M.N.R.*), [1965] 2 Ex. C.R. 653; aff'd on other grounds [1966] S.C.R. 489).

[21] On the basis of this and similar authorities, the Crown submits that the judgment issued by the Judge did not accord with her findings; having found the share proceeds were business income she was obliged to issue a judgment in accordance with that finding, so long as the overall tax liability of the taxpayer was not increased.

[22] In my respectful view, the Judge did not err as asserted by the Crown. I reach this conclusion for the following reasons.

[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.

[24] This principle was applied by this Court in *Petro-Canada* in the following circumstances. Petro-Canada claimed a deduction of approximately $46 million in respect of the cost of certain seismic data. The Minister reassessed Petro-Canada on the basis that the deduction claimed could

not exceed the fair market value of the seismic data at the time of its acquisition. In the result, the Minister reduced the deduction claimed by Petro-Canada from $46 million to approximately $8 million.

[25] Petro-Canada appealed the Minister's assessment to the Tax Court. Petro-Canada also put in issue on its appeal the Minister's disallowance of certain scientific research and experimental development (SRED) expenses totalling in the order of $700,000. The Crown ultimately agreed the SRED expenses were properly claimed. The parties executed a consent judgment with respect to the SRED expenses, which was given to the Tax Court Judge at the start of Petro-Canada's trial.

[26] In the Tax Court the Crown argued that the cost of seismic data was not properly deductible at all. The Crown did not argue that Petro-Canada should be reassessed to disallow the $8 million deduction allowed by the Minister because, as held in *Harris*, the Crown is not permitted to appeal an assessment.

[27] The Tax Court Judge accepted the Crown's submission that the cost of acquiring the seismic data was not properly deductible and dismissed Petro-Canada's appeal. The Judge also declined to give effect to the consent to judgment. Petro-Canada then appealed to this Court.

[28] Petro-Canada was unsuccessful on appeal with respect to the deductibility of the expense incurred acquiring the seismic data. This Court found that the trial judge correctly concluded that Petro-Canada had been allowed a deduction that exceeded its entitlement. However, the only

consequence flowing at law from that conclusion was that Petro-Canada could not obtain the remedy it sought - an increased deduction for the cost of the seismic data. *Harris* precluded disallowance of the deduction the Minister incorrectly allowed.

[29] Moreover, the Judge's refusal to allow Petro-Canada's rightful claim to the deduction for SRED expenses had the effect of reducing Petro-Canada's seismic data deduction by the amount of the SRED expenses. This was wrong in law because it had the effect of allowing in part a Crown appeal of the seismic data deduction.

[30] The Crown argues that *Petro-Canada* should be confined to its particular facts; namely, those situations where the Crown has consented to judgment on an issue that was not before the trial judge. This is said to flow from a line of cases beginning with *Harris* and including *Anchor Pointe Energy Ltd. v. Canada*, 2007 FCA 188, [2008] 1 F.C.R. 839. These cases affirm the principle that an income tax appeal is from the product of the assessment - the quantum of the assessment.

[31] In my view, *Petro-Canada* is dispositive of the Crown's appeal in this case. The Minister originally assessed the taxpayer's proceeds from the sale of the ISTO shares as a capital gain. By characterizing the proceeds as a capital gain, the Minister set the taxpayer's liability from the source of income that was the ISTO shares. The Tax Court's conclusion that the proceeds of disposition were on account of income, not property, could not result in an increase of the taxpayer's liability from that source because the Minister cannot appeal from her own assessment.

[32] Put another way, the proceeds of disposition on the sale of the ISTO shares were $601,135. Treating the transaction as being on account of business income would increase the taxpayer's taxable income by approximately $300,565. Had the Tax Court simply dismissed the taxpayer's appeal, the taxpayer would have been deprived of additional, unrelated deductions of $265,070. The effect would be to increase the taxpayer's income by the difference between $300,565 and $265,070. This is inconsistent with the principle that the Minister cannot appeal from her own assessment.

[33] I disagree that *Petro-Canada* is inconsistent with cases such as *Harris* and *Anchor Pointe* for the following two reasons.

[34] First, in *Petro-Canada* this Court applied the *Harris* decision in order to reach its result.

[35] Second, the question to be determined in *Anchor Pointe* was whether the Minister was entitled to plead new facts as assumptions of fact when confirming an initial assessment. This is not contrary to any holding in *Petro-Canada*.

[36] Thus, there is no need to confine *Petro-Canada* to its facts.

[37] Finally, the Crown argues that it can advance a new basis or argument in support of the assessed quantum of tax liability. I agree that this is specifically permitted by subsection 152(9) of the Act. However, subsection 152(9) is subject to important limitations. The Minister cannot use subsection 152(9) to reassess outside the time limitations contained in subsection 152(4) of

the Act. As well, the Minister cannot tax an amount exceeding the amount in the assessment under appeal (*Walsh v. Canada*, 2007 FCA 222, 367 N.R. 127, at paragraph 18). It follows that subsection 152(9) of the Act is of no assistance to the Minister in circumstances where the new or additional argument would have the result of increasing the amount of the assessment relating to the ISTO shares.

[38] As I have found no error of law on the part of the Judge, it follows that I would dismiss the appeal.

VII. Consideration of the issues raised in the cross-appeal

(i) The ISTO shares

[39] The Judge concluded that the taxpayer's proceeds from the sale of the ISTO shares was not a capital gain, but was on income account; the taxpayer says that once that finding was made the Judge erred by failing to further find that the taxpayer's net taxable capital gain for the year from the disposition of shares was nil.

[40] This argument is premised on section 3 of the Act, which determines the quantum of income. The income from each of the enumerated sources is net of related deductions. Thus, taxable capital gains are net of allowable capital losses. Similarly, current year losses attributable to the four enumerated sources of income are deductible. The end result of this source by source computation determines a taxpayer's tax liability.

[41] From this process the taxpayer submits that because the Minister did not include in the reassessment for the 2002 taxation year any amount in the taxpayer's income from the source of trading shares, and because the normal assessment period had expired, no amount could be included in the taxpayer's income from this source.

[42] This argument must fail for the following reason.

[43] For the purpose of this argument, the relevant income source is the ISTO shares which were either capital property or inventory. In her assessment, the Minister took the position that the shares were capital property so their sale gave rise to a capital gain. The Judge concluded that the shares were inventory so the sale proceeds were business income.

[44] The consequence of this finding cannot erase the taxpayer's tax liability as a result of the sale of the shares. So long as the taxpayer's tax liability in respect of the sale proceeds does not exceed the amount assessed by the Minister as a capital gain, the tax liability from the source constituted by the shares does not increase. As the taxpayer's tax liability from that source does not increase, the Judge did not err.

[45] Before leaving this issue, it is important to note that at all times the taxpayer knew the proceeds of disposition from the sale of the ISTO shares were in issue. He failed to file a tax return for the 2002 year. On the basis of a review of brokerage statements the Canada Revenue Agency assessed the taxpayer for capital gains earned on the disposition of the shares. The parties agreed upon the amount received by the taxpayer on account of that disposition. After the

assessment, the taxpayer filed an income tax return reporting the sale of shares on capital account. He maintained this position in his notice of objection and in his original notice of appeal. This transaction was always in play and no injustice flows to the taxpayer from including the proceeds of disposition, treated as a capital gain, in his taxable income.

[46] Put another way, the concerns about fairness that animated the courts in decisions such as *Continental Bank Leasing Corporation v. The Queen*, [1998] 2 S.C.R. 298 and *Pedwell* do not arise.

(ii) Rental income for the 2000 and 2001 taxation years

[47] For ease of reference, I briefly repeat the Judge's findings on this issue. The Judge held that the net rental income realized by the taxpayer in the 2000 and 2001 taxation years should be added to the taxpayer's income, even though the Minister had not reassessed the taxpayer to include these amounts in income. In doing so, the Judge found as a fact that the taxpayer had made misrepresentations in his income tax returns by failing to report the income. Those misrepresentations were based on carelessness, negligence or wilful default.

[48] The taxpayer does not dispute the Court's finding with respect to the quantum of net rental income for the years. Rather, he asserts that the Judge erred by:

i. Including the amounts in income, contrary to subsection 152(5) of the Act (which expressly precludes the inclusion of any amounts in computing the income of a taxpayer for a year, after the taxpayer' normal reassessment period in respect of that year has ended).

ii. Ordering the Minister to reassess tax payable on the rental income after the normal reassessment period under subparagraph 152(4)(*a*)(i). This is said to be an error because:

a. The Crown did not plead in its amended reply that there was a misrepresentation in the taxpayer's returns of income; and

b. The issue of misrepresentation was not raised in oral or written argument by either party.

[49] For the following reasons, I have not been persuaded that the Judge erred in law as the taxpayer asserts.

[50] Dealing first with the applicability of subsection 152(5), it is important to situate this issue in its factual matrix. As the Judge noted at paragraph 112 of her reasons, the taxpayer admitted realizing net rental income in 2000 and 2001. Further, at trial the parties agreed that specified amounts should be added to the taxpayer's income for the 2000 and 2001 taxation years on account of this rental income.

[51] I accept the submission of the Crown that implicit in the taxpayer's admission that the amount should be included in income is an admission of the factual element of misrepresentation attributable to carelessness, negligence or wilful default. Without such admission, the rental receipts could not be included in income.

[52] Moreover, had the Minister known that the taxpayer would, on appeal, resile from his admission, the Minister could have reassessed the rental income under subsection 152(4) of the Act and issued a new notice of assessment to that effect. In these circumstances the taxpayer should not be allowed to resile from his admission.

[53] My conclusion that, in the circumstances of this case, an admission of misrepresentation is implicit in the taxpayer's admission that the rental income should be included in income is dispositive of the taxpayer's assertion that the Judge could not apply subsection 152(4) of the Act because the issue of misrepresentation was neither pled nor raised in argument. However, there is also a second basis for disposing of this argument.

[54] The taxpayer did not put in issue before the Judge the argument that he could not be assessed on this income because the normal reassessment period had expired. In the absence of such an allegation, the Crown was not required to plead or establish misrepresentation (*Naguib v. Canada*, 2004 FCA 40, 317 N.R. 88).

[55] As the taxpayer has failed to establish on the cross-appeal any error of law on the part of the Judge it follows that I would dismiss the cross-appeal.

VIII. Conclusion and Costs

[56] As explained above, I would dismiss both the appeal and the cross-appeal.

[57] I would reserve the issue of the costs in this Court. I would do so because there was an interlocutory motion to settle the content of the appeal book. The costs of that motion (including responsibility for disbursements incurred by the over inclusion of documents in the appeal book) were ordered to be reserved to the panel which heard the appeal and cross-appeal. However, at the hearing of the appeal we received no substantive submissions on this issue.

[58] If costs are not agreed, the appellant shall serve and file submissions on the costs of the appeal, cross appeal and interlocutory motion within 14 days of the date of these reasons, such submissions not to exceed 5 pages in length. The respondent shall have 14 days to serve and file responding submissions, such submissions not to exceed 5 pages in length. Thereafter, the appellant has 5 days to serve and file any reply submissions, not to exceed 2 pages in length.

"Eleanor R. Dawson"

J.A.

"I agree.
Johanne Trudel J.A."

"I agree.
D.G. Near J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

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