Docket: 2007-3157(IT)I

BETWEEN:

KRASSIMIR YANKULOV,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeal heard on June 10, 2008, at Hamilton, Ontario

By: The Honourable Justice M.A. Mogan

Appearances:

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| For the Appellant: | The Appellant himself |
| Counsel for the Respondent: | Sharon Lee |

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## JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2004 taxation year is allowed, and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant is entitled to a foreign tax credit of $1,523.65.

Signed at Ottawa, Canada, this 1st day of December, 2008.

"M.A. Mogan"

Mogan D.J.

Citation: 2008 TCC 657
Date: 20081201
Docket: 2007-3157(IT)I

BETWEEN:

KRASSIMIR YANKULOV,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

## REASONS FOR JUDGMENT

**Mogan D.J.**

[1] The Appellant is a professor of molecular genetics at the University of Guelph, Ontario. From September 1 to December 31, 2004, he was a visiting researcher at École Normale Superieure ("ENS") in Lyon, France. For his services, he was paid a salary by ENS-Lyon. When the Appellant filed his 2004 income tax return in Canada, he reported in Canadian dollars an amount which he honestly believed was the equivalent of the salary paid to him in euros by ENS-Lyon. After a reassessment by the Canada Revenue Agency ("CRA"), he was denied a certain amount claimed as a foreign tax credit. He has appealed from that reassessment and elected the informal procedure.

[2] When the Appellant reported his foreign income on his 2004 tax return, and when the first assessment was issued by CRA, there were mistakes on both sides. Those mistakes are best illustrated by reference to Exhibit A-1 which was issued to the Appellant by ENS-Lyon. Exhibit A-1 is a summary of all remuneration paid to the Appellant by ENS-Lyon in the period September to December 2004; all deductions from such remuneration withheld at the source; and certain amounts which the employer (ENS-Lyon) was required to remit as a consequence of employing the Appellant.

[3] Exhibit A-1 is, of course, in the French language and the amounts are expressed in euros. At the hearing of this appeal, the parties agreed that the conversion rate from euros to Canadian dollars for the Appellant's 2004 tax year is 1.5645. A different conversion rate may have been used by the Appellant when reporting income or by CRA when assessing tax but any such different conversion rate is now irrelevant. In Exhibit A-1, the first column shows the total remuneration to be 12,814.62; the second column shows the total of nine source deductions to be 2,156.01, and the third column shows the total remittances by ENS-Lyon from its own purse to be 4,469.13.

[4] When filing his 2004 tax return, the Appellant reported foreign income of $26,886. This amount was not correct. He appears to have reached this amount by adding (in euros, see Exhibit A-1) his total remuneration (12,814.62) plus the remittances by ENS-Lyon from its own purse (4,469.13) for a total of 17,283.75; and by then applying an exchange rate of about 1.555 to reach $26,886 in Canadian dollars. This amount was not correct because his total remuneration was only 12,814.62 euros or $20,028.47 Canadian (using the 1.5645 rate).

[5] CRA first assessed tax on the Appellant as he had filed; and so CRA assessed tax on foreign income of $26,886. The Appellant realized that there was an error and so he filed a Notice of Objection. In response to the Objection, CRA issued a reassessment dated March 29, 2007 (Exhibit A-2 and Reply, paragraph 7) reducing the Appellant's foreign income in 2004 from $26,886 to $16,675. See Exhibit A-2.

[6] What I find remarkable is the method by which CRA concluded that the Appellant's foreign income for 2004 was only $16,675 and not $20,028. See paragraph 4 above. The method is described in Exhibit A-3 which contains copies of certain emails passing between the Appellant and the appeals assessor (Brian Thiessen) in the first 10 days of March 2007. Mr. Thiessen stated in his email:

> Your foreign source employment income will therefore be reassessed as being $16,675.40 [12,814,62 less 2,156,01 = 10,658.61 (net pay – euros) x 1.5645 = $16,675.40].

[7] Coming back to Exhibit A-1, it is perfectly clear that CRA started with the Appellant's total remuneration (12,814.62 euros) and then subtracted the total of all source deductions (2,156.01 euros) to arrive at the Appellant's foreign source employment income (10,658.61 euros). In my opinion, CRA's method is flawed for the following reasons.

[8] As I understand the process for reporting and taxing foreign source income for individuals like the Appellant, (i) the taxpayer includes in his income tax return the Canadian dollar equivalent of his foreign source employment earnings; (ii) the taxpayer estimates the tax payable in Canada on his total income using the relevant rates and claiming a foreign tax credit (section 126) with respect to any income tax paid to a foreign government; and (iii) CRA audits the taxpayer's income tax return and assesses tax determining whether a foreign tax credit is permitted within the terms of section 126 of the *Act* and the terms of any tax treaty with the relevant foreign country.

[9] At all relevant times in 2004, the Appellant was resident in Canada. He was therefore required to report his world income in his 2004 tax return, including his gross earnings of 12,814.62 euros from ENS-Lyon. Under section 126 of the *Income Tax Act*, the Appellant was entitled to deduct from his tax in Canada any amount (up to a certain limit) which he was required to pay in France as a tax on his employment earnings. In other words, referring to Exhibit A-1, if the Appellant included in his world income his earnings of 12,814.62 euros paid by ENS-Lyon, then he was entitled to deduct as a tax credit in Canada those amounts in column two of Exhibit A-1 (source deductions) that could be identified as taxes on his employment income in France.

[10] When CRA, in the reassessment under appeal, subtracted all of the foreign source deductions (2,156.01) from the Appellant's employment earnings (12,814.62) and then applied the Appellant's marginal Canadian tax rate to the remainder (10,658.61 euros or $16,675.40 Canadian dollars), the process for reporting and taxing foreign source income (as I understand it) was nullified. It seems no longer relevant to determine whether a particular source deduction in France was a tax on income or a contribution to a particular fund like the employee's premium for unemployment insurance in Canada.

[11] In the Respondent's Reply to the Notice of Appeal, paragraph 5 identifies three amounts in euros (292.17; 620.86 and 60.86) which can easily be seen in the second column of Exhibit A-1 as particular source deductions. In paragraph 5 of the Reply, these three amounts are added together for a total of 833.28 euros which is an arithmetic error. The accurate total is 973.89 euros. At the commencement of the hearing, counsel for the Respondent acknowledged the error in arithmetic; and agreed that the conversion rate should be 1.5645 to convert euros to Canadian dollars in the late months of 2004.

[12] When the agreed conversion rate (1.5645) is applied to the accurate total of 973.89 euros for the three particular source deductions, the resulting amount is $1,523.65 in Canadian dollars. That amount is the foreign tax credit which the Appellant claims in this appeal. CRA has decreased the Appellant's foreign tax credit to nil apparently because CRA deducted the total of all source deductions (2,156.01 euros) from the Appellant's employment earnings in France.

[13] On the evidence before me, I cannot determine whether the method used by CRA to assess tax for 2004 operates to the financial advantage or disadvantage of the Appellant. At first blush, subtracting all source deductions from the Appellant's foreign employment income seems to help the Appellant. On closer inspection, however, the total of all source deductions is only 17% of the Appellant's foreign employment income. Therefore, 83% of the Appellant's foreign employment income has been subjected to income tax at Canadian tax rates without the benefit of any foreign tax credit.

[14] As indicated in paragraphs 4 and 6 above, I have concluded that the Appellant's foreign employment income for 2004 was $20,028.47 and not $16,675.40. Having regard to the reassessment which is now under appeal (See Exhibit A-2), my conclusion is irrelevant. The only question before me is whether the Appellant is entitled to a foreign tax credit of $1,523.65. See paragraph 12 above.

[15] Ordinarily, the question in appeals like this is whether a particular source deduction in a foreign country is a tax on income or some mandatory contribution to a particular social assistance plan. Because CRA subtracted all nine source deductions from the Appellant's employment earnings in France, such a question is no longer relevant in the mind of CRA. That kind of question is relevant to the Appellant, however, because he does not know whether he is better off or worse off as a consequence of CRA's assessing method. In paragraphs 6 through 10 above, I have expressed my concern with that assessing method.

[16] To resolve this appeal involving a potential foreign tax credit of only $1,523.65, I will comment briefly on the law and the evidence. Section 126 of the *Income Tax Act* places an upward limit on the amount of a foreign tax credit. In argument, there was no suggestion that the Appellant's claim would exceed that upward limit. In the Canada/France Tax Convention, Article II, subsection 3(*b*) states:

> 3. The existing taxes to which the Convention shall apply are in particular:

(*a*) …

(*b*) in the case of France, the income tax, the corporation tax, the tax on wages and salaries (regulated by the provisions of the Convention applicable, as the case may be, to business profits or to income from independent personal services) the solidarity tax on net wealth, and any withholding tax, prepayment or advance payment with respect to the aforesaid taxes, (hereinafter referred to as “French tax”).

The Appellant claims that his three amounts which total 973.89 euros come within the words of 3(*b*) “… any withholding tax”. I conclude that those amounts are within the terms of subparagraph 3(*b*).

[17] In evidence, the Appellant described his status as a visiting researcher at ENS-Lyon, and stated that he had no control over the amounts which were source-deducted from his salary/remuneration. He also produced copies of the emails in Exhibit A-3 which explained how CRA assessed tax on his foreign-source income in 2004. I found the Appellant to be totally credible.

[18] The Appellant has discharged the onus of proving that the assessment is wrong. The Respondent did not lead any evidence from a representative of CRA to prove that the method of assessing tax in the reassessment under appeal (i.e. subtracting all source deductions from gross earnings; imposing a Canadian tax on the remainder; and then denying any foreign tax credit) was more to the Appellant’s advantage than following the process set out in paragraph 8 above. I will allow the appeal and grant the Appellant a foreign tax credit of $1,523.65.

Signed at Ottawa, Canada, this 1st day of December, 2008.

“M.A. Mogan”

Mogan D.J.

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| CITATION: | 2008 TCC 657 |
| COURT FILE NO.: | 2007-3157(IT)I |
| STYLE OF CAUSE: | KRASSIMIR YANKULOV and<br>HER MAJESTY THE QUEEN |
| PLACE OF HEARING: | Hamilton, Ontario |
| DATE OF HEARING: | June 10, 2008 |
| REASONS FOR JUDGMENT BY: | The Honourable Justice M.A. Mogan |
| DATE OF JUDGMENT: | December 1, 2008 |

APPEARANCES:

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| For the Appellant: | The Appellant himself |
| Counsel for the Respondent: | Sharon Lee |

COUNSEL OF RECORD:

For the Appellant:

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| Name: | N/A |
| Firm: | N/A |
| For the Respondent: | John H. Sims, Q.C.<br>Deputy Attorney General of Canada<br>Ottawa, Canada |