Dockets: 2007-4851(IT)G,
2006-3734(IT)G

BETWEEN:

H. GLENN FAGAN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on May 18 and 19, 2011, at Calgary, Alberta.

Before: The Honourable Justice François Angers

Appearances:

Counsel for the Appellant:	Jehad Haymour Dan Misutka
Counsel for the Respondent:	Gregory Perlinski Marta Burns

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* in respect of the 1992 taxation year is allowed in part and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment and the Minutes of Settlement signed by the parties. The Respondent is entitled to 75% of her costs.

Signed at Ottawa, Canada, this 14th day of December 2011.

« François Angers »

Angers J.

Citation: 2011 TCC 523
Date: 20111214
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2006-3734(IT)G

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H. GLENN FAGAN,

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Respondent.

REASONS FOR JUDGMENT

Angers J.

[1] Appeal number 2006-3734(IT)G of the appellant was the subject of an application under section 173 of the *Income Tax Act* (the "*Act*"), which application was held in abeyance pending the hearing of the second appeal numbered 2007-4851(IT)G. By consent of the parties, both appeals have now been joined and will be referred to as one appeal.

[2] H. Glenn Fagan (the "appellant") is appealing a reassessment for his 1992 taxation year dated October 29, 1999. In reassessing the appellant, the Minister of National Revenue (the "Minister") disallowed Canadian exploration expenses (CEE), Canadian development expenses (CDE) and Canadian oil and gas property expenses (COGPE) that had been renounced by 991274 Ontario Ltd. (991) pursuant to the terms of a flow-through share subscription agreement concluded between the appellant and 991. The Minister also disallowed $33,909 of the $50,500 addition to the appellant's cumulative CEE account in respect of his investment in seismic data acquired for exploration purposes for use by the Compton Resource Corporation 1992/1993 Oil and Gas Investment Fund (Compton).

[3] At trial, counsel for the respondent informed the Court that the Minister has now allowed the appellant to claim, in respect of his 1992 taxation year, the addition

to his cumulative CEE in the amount of $33,909 pertaining to his investment in Compton.

[4] Counsel for both parties also informed the Court that Minutes of Settlement had been signed between them regarding some of the issues raised by their respective pleadings, with the caveat that the Minutes of Settlement were to become applicable only to the extent that the respondent was successful on the remaining unresolved issues argued before this Court.

[5] The first issue has to do with whether the Minister, in this instance, has reassessed the appellant for his 1992 taxation year by virtue of a waiver given under the *Act*.

[6] If the Minister is not precluded from reassessing, the second issue raised is whether he could reassess the appellant with respect to the related resource expenses without reassessing 991, the flow-through corporation.

[7] Additionally, the respondent submitted, in the alternative, that the appellant made a misrepresentation or committed fraud as envisioned by subparagraph 152(4)(*a*)(i) of the *Act* by filing a waiver with an intent to deceive the auditor, and that, as a result the Minister is, pursuant to subsection 152(4) of the *Act*, not precluded from reassessing for the appellant's 1992 taxation year. In closing arguments, neither party argued this alternative submission before the Court, assuming, I presume, that the evidence would not support such a finding by this Court. I assume, therefore, that this argument is abandoned.

Facts

[8] The appellant has been a chartered accountant since 1977 and was a partner at Coopers Lybrand from 1975 to late 1998. One of his partners at Coopers Lybrand, Mr. Brian Foley, informed the appellant and a number of the firm’s partners in its Toronto office of the opportunity to invest in an oil and gas joint venture (the “Sierra Joint Venture”) with an Alberta company called Sierra Trinity Inc. (Sierra).

[9] Mr. Foley was knowledgeable and experienced in this area, having himself invested in similar ventures as had some of his partners in the firm’s Calgary office. Mr. Foley fully explained to the appellant how such an investment worked. The appellant and his other partners were concerned and nervous about possible risks and liability in excess of an insured amount associated with such a venture. It was therefore decided that a flow–through company would be created for the purpose of

adding extra protection against such risks. The Ontario company, 991, was incorporated by Mr. Foley on June 12, 1992 for that very purpose. The appellant understood that 991 was to be responsible for paying the resource expenses for the 991 shareholders and that 991 was a flow-through company.

[10] The appellant and six of his partners, including Mr. Foley, subscribed for shares in 991. The appellant subscribed for 105,000 shares at an issue price of $1 per share. On July 22, 1992, the Board of Directors of 991 passed a resolution to enter into a flow-through share agreement with the shareholders. By this agreement 991 undertook to incur within 24 months CEE, CDE and COGPE and to renounce them to the shareholders in accordance with the *Act*. The flow-through share agreement was entered into on September 1, 1992.

[11] On September 2, 1992, 991 entered into a joint venture agreement with Sierra. The agreement indicated that Sierra's joint venture program was for the purpose of "the ownership and operation, and acquisition of petroleum and natural gas interests and the exploration, development and production activities associated with such interests." 991 was therein referred to as the participant and Sierra as the operator. The agreement stated that the joint venture program was to be conducted by the operator and that the participant was to advance the funds required for the program. 991 was issued quarterly reports and statements indicating its share of the costs of the activities undertaken by Sierra.

[12] On September 23, 1992, 991 filed with the Canada Revenue Agency (CRA) the company's Flow-Through Share Information form (T100) in which it indicated that between September 1, 1992 and August 31, 1994, it anticipated receiving $970,000 in CEE, $80,000 in CDE and $105,000 in COGPE and renouncing the same amounts.

[13] On March 31, 1993, 991 filed its Summary of Renunciation of CEE, CDE and COGPE and Allocation of Assistance form (T101) in which it indicated that between September 1, 1992 and December 31, 1992, it incurred and was renouncing $885,782 in CEE, $25,032 in CDE and $70,705 in COGPE. A T101 Supplementary slip was issued to the appellant and it showed that, effective December 31, 1992, 991 was renouncing to him $80,526 in CEE, $2,276 in CDE and $6,428 in COGPE for his 1992 taxation year.

[14] In his 1992 income tax returns, the appellant deducted $92,175.60 in exploration and development expenses from his income. In his 1992 Resource Expense Pools schedule he indicated more specifically, that in 1992 he was

deducting $90,850 in CEE, $682.80 in CDE and $642.80 in COGPE. It was also indicated in the schedule that the appellant had made two additions to his CEE pool in 1992, the first being in the amount of $50,500 (Compton) and the second, added by way of the T101 being in the amount of $80,526 (991).

[15] At some point in time, the Minister decided to audit Sierra. In his report, the auditor determined that, despite his investigation, Sierra failed to prove that its seismic data were being used in a way that would qualify it as giving rise to CEE.

[16] During the audit, the auditor, Mr. Robert Dunbar, assembled a list of all of Sierra's joint venture participants, including 991 and also shareholders of 991. His report also indicates that the Minister was not going to reassess Sierra, but instead reassessments were issued to the individual investors disallowing their investment in the Sierra Joint Venture. Mr. Dunbar stated that he reviewed 991's permanent documents and likely its 1992 and 1993 income tax returns and chose not to audit or reassess 991. Also, he stated that he was aware that the Sierra Joint Venture's CEE deducted by the shareholders of 991 had been renounced by 991 and not by Sierra. Mr. Dunbar also stated that he never advised 991 that the renounced expenses were being disallowed.

[17] In a letter to the appellant dated April 4, 1996, Mr. Dunbar proposed disallowing the addition of $80,527 to the appellant's 1992 CEE on the basis that he was unable to determine any business purpose for the seismic data the appellant acquired through the joint venture with Sierra. Mr. Dunbar requested additional information before issuing a proposed reassessment, and due to the proximity of the date at which the appellant's 1992 taxation year would become statute-barred and in order to provide the appellant more time to make representations, he included a waiver with respect to the normal reassessment period.

[18] The original wording of the waiver provided by the CRA defined the waiver for the appellant's 1992 taxation year as being:

> . . . in respect of: calculation of income, net income, taxable income and taxes payable with respect to expenditures for seismic data.

[19] A similar letter was sent by the CRA, through Mr. Dunbar, to the other six investors of 991, including Mr. Foley. On April 17, 1996, Mr. Foley wrote to all the investors of 991 suggesting that it would be in their best interest to agree to the CRA's request that they provide a waiver, but he proposed an amended waiver that

would specifically limit Revenue Canada to the Sierra Joint Venture and not include other joint ventures. The amended waiver states that it is:

> . . . in respect of:
>
> Calculation of income, net income, taxable income and taxes payable with respect to expenditures for seismic data, pertaining to the taxpayer's participation in the 1992 Sierra Trinity Inc. Joint Venture.

[20] In his letter, Mr. Foley has also advised the investors that a lawyer had been retained on their behalf to advise them on how and in what format these waivers should be filed. Mr. Foley added that the amended waiver's limiting of the reassessment to the Sierra Joint Venture probably would prevent the Minister from reassessing the investors of 991 as the renouncement in their case came from 991 and not Sierra. He did acknowledge, though, that this discrepancy was a technical one and that the real substance was the deductions that the investors had taken and that were being challenged.

[21] As for the appellant, his understanding was that the waiver was formulated in such a way as to ensure that it did not relate to his investment in Compton. He also stated that the object of the waiver was to buy all of the investors time to make additional representations to the Minister about the Sierra Joint Venture expenses, and it was assumed or hoped that, since there was concern with the wording of the waiver in that it pertained to the Sierra Joint Venture and not 991, it would not be right to reassess them and that it would not be necessary to do so. In cross-examination, despite the apparent problem with the wording of the waiver, the appellant indicated that he was aware that the difficulty the Minister had with his 1992 tax return was with respect to the exploration deductions obtained from 991 by way of the Sierra Joint Venture and the $80,527 CEE addition.

[22] Upon receipt by the CRA, through Mr. Dunbar, of the amended waiver, Mr. Dunbar thought the waiver to be acceptable even though he was aware that the expenses related to a renunciation of resource expenses to the appellant by 991 and not Sierra. He reviewed it with his supervisor to ensure that the amendment did not create any problems with respect to the scope of the waiver and was told not to worry about it.

[23] On April 26, 1996, the appellant wrote to the CRA to inform them that he had retained a lawyer to represent him with respect to income tax matters relating to the 1992 Sierra Joint Venture. He testified that he viewed this authorization as enabling this lawyer to represent him with regard to the Sierra Joint Venture, but not

necessarily with respect to the 991 renunciation, because there was a disconnect between the investment in the Sierra Joint Venture and the renouncement figure.

[24] In a letter dated May 9, 1996, the lawyer retained by the appellant and the other investors in 991 wrote to the three auditors involved in the file, enclosing the amended waiver and referring in this letter to the CRA's concern regarding the investors in the Sierra Joint Venture.

[25] On February 4, 1999, the Minister wrote a letter to the appellant and repeated the proposal to disallow the appellant's 1992 CEE, CDE and COGPE deductions with respect to Sierra Trinity Inc. The adjustments were later confirmed, and on April 12, 1999 the appellant signed a Letter of Authorization appointing Mr. Haymour to represent him with respect to all income tax matters relating to his participation in the Sierra Joint Venture. The unamended waiver was revoked on April 15, 1999. The revocation was received by the CRA on August 17, 1999, and a Notice of Reassessment was issued on October 29, 1999. The appellant was not surprised by the reassessment.

[26] Counsel for the appellant argues that the waiver did not authorize the Minister to reassess with respect to the appellant's 1992 renounced expenses because the waiver specifically limits the reassessment to the appellant's participation in the 1992 Sierra Joint Venture and the appellant did not participate in the 1992 Sierra Joint Venture. It is further submitted that the Minister may well have understood that the appellant had deducted amounts renounced to him by 991, but, the Minister nevertheless proposed to reassess the appellant in respect of seismic data that the Minister suggested the appellant had acquired. Both the appellant and the Minister believed that the real issue that the CRA had to address was the renunciation by 991. It is further submitted that by filing the amended waiver the appellant cannot be taken to have agreed to an invalid reassessment.

[27] Counsel for the appellant relied on a number of decisions by various courts that establish that a technical defect in a waiver will not invalidate it, while a substantive one will. It is submitted that the uncertainty contained in the appellant's waiver is not a technical but rather a substantive defect, which invalidates it. Counsel also referred to cases that establish that where the taxpayer and the Minister have a common understanding of the subject matter of the reassessment, even if the waiver is worded imperfectly, it will be valid. The appellant's position is that there was no such common understanding between him and the Minister. Counsel further argues that the Minister's approval of the amended wording in the waiver, without

ascertaining the appellant's intention, supports his position that there was no common understanding between them.

[28] The appellant also submits that seismic data is classified under CEE and not under CDE or COGPE. The waiver refers to reassessment only with respect to expenditures for seismic data, and in this case the Minister also reassessed the appellant's CDE and COGPE, which suggests that the Minister was making it up as he went along.

[29] Counsel for the respondent has also relied on a number of cases, some of which were the same as those submitted by counsel for the appellant. On the basis of these cases, it is submitted that the appropriate approach is to ascertain the intention of the parties as expressed in the waiver together with any relevant circumstances for which evidence is available; technical defects do not invalidate a waiver where circumstances show that both parties knew what was in issue; given the nature of a waiver, a matter specified in a waiver must involve a substantial issue between the parties, and in determining what is reasonably related to a matter specified in a waiver, the view of an objective observer with knowledge of all the pertinent facts rather than the subjective view of either party is considered reasonable; a waiver provides the benefit of time to both parties; and finally, the purpose of a waiver is to allow the continued analysis of the matter at issue; the description of the matter cannot be expected to be perfect at the stage of drafting the waiver and the reassessment must relate to the transaction or matter which is the source of the disagreement between the parties and concerning which the taxpayer agreed to sign a waiver.

[30] In reviewing the facts of this case in light of the above approach, counsel for the Minister submitted that an appellant who pleads the nullity of a waiver must be able to demonstrate some prejudice, which the facts of this case do not do. Counsel further submits that the word "participation" found in the waiver is broad in scope and refers to the various documents submitted at trial in which the shareholders of 991 are referred to as "participants" in the 1992 Sierra Joint Venture. Counsel finally submits that when the waiver was amended, that waiver then applied to the entire T101 at issue, which covered all of the CEE, CDE and COGPE deductions.

[31] Subsection 152(4) of the *Act* provides that the Minister may not reassess a taxpayer's income tax after the taxpayer's normal reassessment period unless certain conditions are met, one of which is the filing of a waiver in prescribed form on the taxpayer's behalf:

> **152(4) Assessment and reassessment [limitation period]** -- The Minister may at any time make an assessment, reassessment or additional assessment of tax for a taxation year, interest or penalties, if any, payable under this Part by a taxpayer or notify in writing any person by whom a return of income for a taxation year has been filed that no tax is payable for the year, except that an assessment, reassessment or additional assessment may be made after the taxpayer's normal reassessment period in respect of the year only if
>
> (*a*) the taxpayer or person filing the return
>
> . . .
>
> (ii) has filed with the Minister a waiver in prescribed form within the normal reassessment period for the taxpayer in respect of the year.
>
> [Emphasis added.]

[32] Subsection 152(4.01) further provides that, where a waiver is filed, the Minister may reassess the taxpayer's income tax only to the extent that the reassessment can reasonably be regarded as relating to a matter specified in the waiver:

> **152(4.01) Assessment to which paragraph 152(4)(*a*), (*b*) or (*c*) applies** -- Notwithstanding subsections (4) and (5), an assessment, reassessment or additional assessment to which paragraph (4)(*a*), (*b*) or (*c*) applies in respect of a taxpayer for a taxation year may be made after the taxpayer's normal reassessment period in respect of the year to the extent that, but only to the extent that, it can reasonably be regarded as relating to,
>
> (*a*) where paragraph (4)(*a*) applies to the assessment, reassessment or additional assessment,
>
> . . .
>
> (ii) a matter specified in a waiver filed with the Minister in respect of the year . . .
>
> [Emphasis added.]

[33] I have reviewed the jurisprudence that has analyzed and applied the waiver provisions and particularly the principles that have been established for determining whether a reassessment can be reasonably regarded as relating to the matter specified in the waiver.

[34] The principle that the intentions of both parties as to the basis of the waiver must be ascertained by analyzing the contents of the waiver as well as the relevant

circumstances was established in the Federal Court, Trial Division's 1992 decision in *Solberg (S.J.) v. Canada*, [1992] 2 C.T.C. 208. In that case, the Court found that the reference to Part III was inserted in the waiver by mistake and was only a technical defect that did not invalidate the reassessment of Part I tax. Justice Reed stated the following at pages 2, 3 and 14:

> 11 After considering the arguments presented to me I have concluded that the reference to Part III in the waiver was inserted by mistake. I reach this conclusion on the following grounds: there is no evidence that the dispute between the taxpayer and the Department involved a Part III election; Part III only applies to a corporate taxpayer and this could not in any event be applicable to the plaintiff's personal tax liability . . .
>
> 12 Further explanation is required with respect to the first reason set out above. As noted, there is no evidence from either party concerning the circumstances surrounding the waiver. A lack of evidence is often a telling consideration in assessing the factual conclusion which should be drawn. While it is understandable that the defendant's files may lack notes and other indicia of the events of 1980-84, it is highly unlikely that if a Part III election had been in issue, there would be no documentary evidence of that fact. No evidence of any such election was produced either by the plaintiff or by the defendant. This is a telling consideration. Even more telling is the fact that a Part III tax liability only applies to a corporate taxpayer, which this plaintiff is not.
>
> 13 Having concluded that the reference in the waiver to Part III was an error, I must then consider whether the waiver is invalid for the purposes of reassessing the taxpayer for Pat I tax. I am not prepared to so conclude. In my view, the error is a technical defect which does not impair the substance of the waiver. The appropriate approach to the interpretation of the waiver is to seek to ascertain the intention of the parties as expressed in that document together with any relevant circumstances for which evidence is available. This is consistent with the approach taken in interpreting taxing statutes themselves, see, for example, *Stubart Investments Ltd. v. the Queen*, [1984] 1 S.C.R. 536, [1984] C.T.C. 294, 84 D.T.C. 6305 at pages 315-16 C.T.C. (D.T.C. 6323).
>
> 14 In my view, it is clear for the reasons set out above that what the Minister was seeking to have extra time to consider and what the taxpayer intended to agree to when he signed the waiver, was the reassessment of the adjusted cost base of the shares for the purpose of determining the tax payable by the plaintiff as a result of the capital gain arising out of the disposition of those shares. This conclusion is supported by the fact that when the Minister did send a notice of reassessment to the taxpayer on that basis the notice of objection which the taxpayer sent back made no reference to Part III tax as being the real issue between them. That notice replied to the reassessment on its merits.

> 15 The defect created by inserting "III" in the waiver form instead of "I" is comparable to the defect dealt with by Mr. Justice Joyal in *CAL Investments Ltd. v. Canada, supra*. In that case the corporation had not affixed its corporate seal despite the express provision in the waiver form requiring it to do so. Mr. Justice Joyal held that the taxpayer could not use that defect to invalidate the waiver and that the waiver was not a nullity because of that defect. He pointed out that the requirement that a corporate seal be used was directory only, not mandatory and that it was for the benefit of the Minister. The Minister could therefore rely on the waiver if he chose to do so even if no seal had been affixed.
>
> 16 In this case the admonition that the appropriate Part of the *Income Tax Act* be identified in the waiver form is equally directory and not mandatory. Indeed. I note that the text of subparagraph 154(4)(a)(ii) specifically states that a waiver once signed allows for the assessment of tax "under this Part", that is under Part I. I agree with counsel's argument that, unlike the defect in the *CAL Investments* case the instruction that the relevant Part of the *Income Tax Act* be identified in the waiver is not merely for the Minister's benefit. It is for the benefit of both the Minister and the taxpayer. Nevertheless I cannot conclude that a mistake in this identification results in the waiver being a nullity when it appears from the text of the waiver as a whole and from the surrounding circumstances to the limited extent that evidence of such exists in this case, that both parties knew what was in issue. No prejudice arose to the plaintiff as a result of the mistake.
>
> [Emphasis added.]

[35] *Solberg* was followed in a number of decisions at the trial and appeal levels. See *Holmes v. The Queen*, 2005 TCC 403. That decision also referred to the importance of extrinsic evidence in the analysis of a section 152 waiver and it was stated that the absence of evidence may influence the Court's finding just as strongly as its presence. (see para. 12 of the decision). Extrinsic evidence was used by the courts to help determine the validity of a waiver in *Guerette v. R.*, [1996] 1 C.T.C. 2780; *Mitchell v. The Queen*, 2002 FCA 407; *Mah v. The Queen*, 2003 TCC 720, and *Brown v. The Queen*, 2006 TCC 381. Justice Mogan stated in *Brown* that a waiver is not a contract whose interpretation must exclude extrinsic evidence and that, on the contrary, relevant surrounding circumstances play an important role in its interpretation. Here is what he said at paragraphs 15 and 26 of his decision:

> 15 There would be some merit in the Appellant's argument if it could be said that he was surprised by the adjustments made to his 1996 income in the reassessment under appeal. Having regard to all of the related and concurrent documents, however, I am satisfied that the Appellant could not reasonably have been surprised by the adjustments to his 1996 income made in the reassessment under appeal. Indeed, the amounts set out in the CRA form T7W-C ("explanation of changes") which Exhibit R-1, Tab 7 are the same amounts which appear on page 5

> of the letter dated March 13, 2000 (Exhibit R-1, Tab 5) which CRA sent to the Appellant with a copy to Mr. MacIvor. That letter preceded the signing of the waiver.
>
> . . .
>
> 26 In my opinion, a waiver is not a contract between a taxpayer and Revenue Canada, excluding extrinsic evidence as to its interpretation. Quite the contrary. Relevant surrounding circumstances are important to determine whether a subsequent reassessment falls within the stated terms of a waiver.
>
> [Emphasis added.]

[36] In *Mah*, referred to above, the taxpayer had exchanged shares for other shares and later redeemed some of the shares acquired in that exchange. Justice Rip (as he then was) held that where the waiver specified that it was with respect to the taxpayer's "share exchange," the Minister could not reassess the taxpayer on the basis of her redemption of those same shares. Justice Rip stated that the phrase "in respect of" used in the waiver limits the scope of the waiver to the matter specified and the items that necessarily flow from, or are normally connected with, the matter specified, and that a share exchange and a share redemption are not so connected. I reproduce below paragraphs 12, 13, 14 and 16 of his decision:

> 12 In *Stone Container* I disagreed with the taxpayer and held that the phrase "in respect of" limited the application related to the matter specified and the calculation for any items that necessarily flow from, or are normally connected to, the matter specified. Taxable income is connected to the federal abatement by virtue of the mechanical application of section 124 and a recalculation of the abatement is connected with, and necessary [*sic*] flows from, a recalculation of taxable income. This is not the situation in the appeal at bar.
>
> 13 In *Stone Container* I was concerned with the phrase "in respect of" in the waiver form. In the case at bar, I am also concerned of the language of subparagraph 152(4.01)(*a*)(ii) and whether that provision authorizes the reassessment in issue on the basis that "it can reasonably be regarded as relating to a matter specified in the waiver". The phrase "in respect of" in the standard form of waiver limits the application of the waiver to the matter specified and, by virtue of subparagraph 152(4.01)(*a*)(ii), any other matters that can reasonably be regarded as relating to the matter specified. In other words, the phrase "in respect of" in the waiver is simply an expression of the reasonable relationship required by subparagraph 152(4.01)(*a*)(ii). It is quite clear that the Minister cannot base a reassessment on a substantive issue that is not specified in a waiver or cannot be regarded as relating to the substantive issue that is specified in the waiver.

> 14 In *Pedwell v. Her Majesty the Queen*, [2000 DTC 6405 (F.C.A.), para. 24.], Rothstein, J. explained that
>
> > . . . taxation is transaction-based (or perhaps deemed transaction-based) and if more than one transaction is to form the base of assessment, the assessment must reflect that fact. Where the basis of the Minister's assessment is one transaction, the Court cannot, *expost* [*sic*] *facto*, broaden the scope of the assessment to include other transactions.
>
> . . .
>
> 16 In the case at bar, unlike the facts in *Stone Container*, subsection 84(3) is not in any way related to subsection 86(2) by virtue of a mechanical application of the provisions of the *Act*. There is no relationship between these two provisions whatsoever, except that in the present case, Ms. Mah happened to trigger them both in the same year. A capital gain triggers an inclusion of income pursuant to subsection 86(2) of the *Act* and a deemed dividend triggers an inclusion of income under subsection 84(3) of the *Act*, these are two totally separate and discrete substantive issues.
>
> [Emphasis added.]

[37] The jurisprudence also suggests that where a complication, such as a wording technicality, exists in a waiver, an objective or common-sense approach may help to determine whether the matter specified in the waiver can be reasonably found to relate to the matter that was assessed (see *D.R. Bailey v. M.N.R.*, [1989] 2 C.T.C. 2177). In *Chafetz v. The Queen*, 2005 TCC 803, Mr. Justice Miller of this Court found that a common-sense interpretation of the waivers led to the finding that CEE could reasonably be found to relate to its predecessor CEDE (Canadian Exploration and Development Expenses) in the relevant time period. At paragraph 19 he wrote:

> 19 If I am not prepared to accept either party's stated intention of the meaning of the matter specified, it is for me to determine objectively what those words mean. Given the very nature of a waiver, a "matter specified" in a waiver must involve a substantial issue between the parties. As indicated in the oft-cited case of *Solberg v. Canada*, where both parties know what is at issue, a technical error will not invalidate the waiver. It is also clear (see *Mah v. Canada*) that the Minister cannot base a reassessment on a substantial issue that is not specified in the waiver. These cases lead me to conclude that, in determining the matter specified, I should seek the substantive issue. This interpretation of "matter" accords with *Black's Law of* [*sic*] *Dictionary* interpretation being "a subject under consideration".

[38] The Federal Court of Appeal affirmed Justice Miller's decision, stating that the test was an objective one and that it had been applied correctly (2007 FCA 45, paragraph 7).

> On the basis that the appellants and Mr. Holmes had different intentions concerning the scope of the waiver, Justice Miller considered how the reference in the waiver to "Canadian Exploration and Development Expense" should be interpreted objectively. This was the correct legal test. The application of the law to the facts of this case is a question of mixed fact and law; absent a more general extricable question of law, the Judge's decision is reviewable only for palpable or overriding error: *Housen v. Nickolaisen*, [2002] 2 S.C.R. 235, 2002 SCC 33.
>
> [Emphasis added.]

[39] It has also been held that a defect in the wording of a waiver will not necessarily invalidate it. (See *Cal Investments Ltd. v. R.*, [1990] 2 C.T.C. 418, *Solberg* (*supra*), *Placements T.S. Inc. v. R.*, [1994] 1 C.T.C. 2464, *Gestion B. Dufresne Ltée v. R.*, [1998] 4 C.T.C. 2551, affirmed by the Federal Court of Appeal at 99 DTC 5614.) In *Mitchell v. The Queen*, 2002 FCA 407, Justice Sexton provided a useful overview of the jurisprudence analyzing waivers that contained some kind of defect, in either form or content. At paragraphs 34 to 37 he wrote:

> 34 It is further conceded by Revenue Canada that in the past their practice has been to accept as valid waivers, prescribed forms which have been altered, and documents which are not in the prescribed form. Further, it is clear that Revenue Canada has taken the position that there can be a valid waiver even though the waiver may contain vital information which is erroneous. In this connection I refer to the following cases.
>
> 35 Firstly, in *Gestion B. Dufresne Ltée v. the Queen* (1998), 98 D.T.C. 2078, a case involving the treatment of a deemed dividend as a capital gain, Dufresne Ltée filed a waiver with respect to the normal reassessment period but misstated the year. It referred to the 1990 taxation year instead of 1991, the relevant year in question. As a result, Dufresne Ltée contended that the waiver was not valid. The court held that the plaintiff did not adduce any evidence to support the allegation that the waiver did not intend to apply to the 1991 taxation year, as it was signed in 1994 and could not have applied to the 1990 year because the limitation period had already expired. Thus, the court characterized this error as a careless mistake. Therefore, despite the fact that this waiver contained incorrect information, the Minister was willing to argue that it was valid. In our case, all of the correct and necessary information was included in the letters, yet still the Minister refused to accept the letters as valid waivers.

> 36 Secondly, *Placements T.S. Inc. v. The Queen*, [1994] 1 C.T.C. 2464, 94 D.T.C. 1302 involved the attribution rules under s. 56(4) of the *Income Tax Act* as they applied to the purchase of property. The appellant signed a waiver in which there was a discrepancy between the contents of the waiver and the issue under appeal. The waiver related to the land and the assessment under appeal related to the building. [This statement appears to be erroneous. In *Placements*, the waiver stated that it applied to the capital gain on the disposal of the right to purchase.] Thus, there was a substantive error in the waiver. The court held, however, that the taxpayer was not surprised by the assessment and that the reassessment reasonably related to the matter for which the waiver was issued.
>
> 37 Thirdly, in *Solberg (S.J.) v. Canada*, [1992] 2 C.T.C. 208, 92 D.T.C. 6448, the taxpayer signed a waiver of the four-year time limit for reassessment for the taxation year 1979 pursuant to subparagraph 152(4)(a)(ii) of the *Income Tax Act*, but later objected to reassessment because the waiver only covered tax under Part III of the act, while the reassessment concerned Part I. The Federal Court, Trial Division held in *Solberg* that the reference to Part III in the waiver was inserted by mistake, but was a technical defect only and did not impair the substance of the waiver. The appropriate approach to the interpretation of the waiver is to seek to ascertain the intention of the parties as expressed in that document together with any relevant circumstances for which evidence is available. The court concluded that the waiver was not a nullity as a result of the mistake because it appeared from surrounding circumstances and from the text of the waiver as a whole that both parties knew what was in issue. This approach taken by the court in *Solberg* should be applied to our fact situation."
>
> [Emphasis added.]

[40] The cases referred to above also confirm that a reassessment can reasonably be regarded as relating to the terms of the waiver if the evidence shows that the taxpayer was not surprised by the basis of the reassessment or if the basis of the reassessment was known to both parties. In other words, the Courts have found that, in such circumstances, affirming the validity of the waiver will not result in prejudice to either party.

[41] In *Solberg* (*supra)* it was held that the appropriate approach is to ascertain the intention of the parties with respect to the subject matter of the reassessment by analyzing the content of the waiver together with any relevant circumstances. The ambiguity which is raised by the appellant stems from the fact that he was not a participant in the 1992 Sierra Joint Venture because he was not a direct investor as he invested via 991. The Minister's position is that the appellant was an indirect participant.

[42] The Minister's first letter (April 4, 1996) regarding the proposed reassessment of the appellant describes the matter giving rise to the proposed reassessment as "seismic data acquired by yourself . . . through a joint venture operated by Sierra Trinity Inc." and goes on to say: "We are proposing to deny your Canadian exploration expense addition . . . of $80,527." Although the Minister has failed to describe with precision the exact mechanism of the appellant's investment in the Sierra Joint Venture, it appears to me to be sufficiently clear that the subject matter of the reassessment was the seismic data expense and its amount.

[43] The subject matter of the proposed reassessment was likely clear to the appellant when Brian Foley wrote a memorandum to him and the other investors on April 17, 1996 saying that he believed that each of them had received a letter from Revenue Canada indicating that Revenue Canada required information concerning "this investment". There is no certainty as to whether Mr. Foley was referring to the Sierra Joint Venture or the 991 investment, but the context of the letter, which was a follow-up with the shareholders regarding the Minister's request for information about the seismic expenses, suggests that he was referring to the Sierra Joint Venture even if the investment was indirect. In my opinion, the reference to "this investment" was clear to the appellant even though he was not a direct investor in the Sierra Joint Venture.

[44] In the same memorandum, Mr. Foley indicated that he was enclosing an amended waiver that specifically limited Revenue Canada to the Sierra Joint venture and included no other joint ventures. The appellant testified that he believed that the added wording was to distinguish between the reassessments concerning his two investments, the other one being Compton. The memorandum also explained that the wording of the waiver was merely technical and that the real substance was the deductions the investors had taken. That letter demonstrates that the substance of the matter that gave rise to the reassessment was understood by the investors, including the appellant, or was at least clarified for them.

[45] When the appellant, on April 26, 1996, wrote a letter of authorization stating that he had retained counsel to represent him, he said it was "with respect to income tax matters relating to the 1992 Sierra Trinity Joint Venture". The language used appears to indicate that the appellant understood that his income tax matter was connected with the Sierra Joint Venture, and the authorization was valid as his counsel was authorized to act on his behalf in dealing with the CRA with respect to that matter.

[46] In his cross-examination, the appellant stated that his understanding was that the authorization enabled his counsel to deal with the CRA only regarding the Sierra Joint Venture and not in relation to the renunciation from 991, because there was a "disconnect" between the renounced expenses at issue and the Sierra Joint Venture. The difficulty with his explanation is that, if such were the case, the authorization would have only enabled counsel to tell the CRA that the appellant was not a member of the Sierra Joint Venture because, given the appellant's position, there would have been no other link between the appellant and the Joint Venture. The auditor, Robert Dunbar, testified that counsel never told him that the appellant was not an investor in the Sierra Joint Venture. I acknowledge that his testimony was objected to as being hearsay, but it is nevertheless reliable if one considers counsel's letter to the CRA dated May 9, 1996 in which he refers to the appellant as an investor in the Sierra Joint Venture, as a joint venturer and as a member of the joint venture. Counsel also wrote that he was going to forward waivers for "all members of the Joint Venture" and attached a schedule that lists the appellant as one investor whose waiver was forwarded.

[47] The appellant has, with respect to the years 1996 to 1999, consistently referred to his participation in the Sierra Joint Venture. In authorizing counsel Jehad Haymour to represent him, he wrote to the CRA on April 12, 1999 that it was with respect to all income tax matters relating to his participation in the Sierra Joint Venture. The appellant continued to make the ambiguous statement in which he essentially represented himself to the CRA as being a participant in the Sierra Joint Venture. All of the above suggests that the term "participation" was regarded as broad enough to truly describe the appellant's situation with respect to the Sierra Joint Venture, and that he was a participant in one way or another.

[48] It has been held that where the matter reassessed is normally connected with or flows from the matter specified in the waiver, the waiver will validate such a reassessment (see *Mah*, *supra*). In the present fact situation, what was reassessed was the seismic expenses that the appellant had received from his flow-through company, 991. 991 carried on no operations of its own either within or outside of the joint venture, hence these expenses could only have been incurred by 991 through its joint venture with Sierra. The appellant was a shareholder of 991 and 991 was in the joint venture with Sierra. Expenditures for seismic data pertaining to the appellant's connection with the Sierra Joint Venture were essentially the matter specified in the waiver. There appears, therefore, that there is a normal connection between the matter specified in the waiver and the matter that was the subject of the reassessment or that the appellant's reassessed seismic data expenses flowed from the Sierra Joint Venture which was specified in the waiver.

[49] Other decisions referred to earlier confirm the use of an objective and common-sense approach to ascertaining the meaning of the terms of the waiver. The word "participation" is defined in Black's Law Dictionary, 8th Edition, as, essentially, "taking part" in something:

> 1. The act of taking part in something, such as a partnership, a crime, or a trial.
>
> 2. The right of an employee to receive part of a business's profits; profit-sharing. See joint participation . . . .

[50] The words "participate" and "participation" are defined in the Oxford Dictionary as, generally, "to be involved in" or "taking part in something":

> Participate
>
> 1. to be involved; take part: Thousands participate in a nationwide strike.
>
> 2. (participate of) archaic have or possess (a particular quality): both members participate of harmony.
>
> Participation
>
> - the action of taking part in something: participation in chapel activities.

[51] The words "participate" and "participation" are defined by the Merriam-Webster Dictionary as, generally, "to have a part or share in something":

> Participate
>
> 1. to possess some of the attributes of a person, thing, or quality
>
> 2. a: to take part
> b: to have a part or share something
>
> Participation
>
> 1. the act of participating
>
> 2. the state of being related to a larger whole.

[52] These dictionary definitions, from an objective standpoint, can have a sufficiently broad meaning to capture the appellant's situation with respect to the

Sierra Joint Venture. The appellant and his accounting partner, Brian Foley, testified that their initial intention was to invest directly in the Sierra Joint Venture and that 991 was set up to shield them against risks. In addition, the phrase "participation in" was used liberally by the appellant, his accounting partner and his counsel and was understood as describing the situation adequately with respect to the 1992 seismic data expense issue. If such had not been the case, one would have expected the appellant, after receiving Mr. Dunbar's letter of April 4, 1996, to notify the CRA that he had no connection with any seismic data purchases. It seems to me that the subject matter of the reassessment was clear to the appellant despite the defective description of the facts.

[53] It has been held that the purpose of a waiver is to address a hurried situation in which the limitation period is running out and that the drafting of the waiver cannot be expected to be perfect (see *Placements T.S. Inc.*, *supra*, because the issues that are the subject of reassessment are still being investigated. Despite the defective description, I find that the true substantive matter regarding the purpose of the waiver and the reassessment was clear to all parties. The appellant was certain as to what part of his 1992 income tax the Minister intended to reassess and he agreed to that reassessment by signing the waiver.

[54] The appellant acknowledged that he was disappointed but not surprised by the confirmation of the CRA's adjustments in the Notice of Reassessment of October 29, 1999 issued in respect of the appellant's 1992 taxation year.

[55] I conclude that the terms of the waiver are in line with the reassessment of the appellant's 1992 CEE. Although the Minister also reassessed the appellant's CDE and COGPE, these items were clearly left out of the waiver and were never part of the initial proposal to reassess following which the appellant signed the waiver. The Minister is not, according to the terms of the waiver, entitled to reassess these latter two items.

Is there an obligation on the Minister to audit and assess 991 before he can challenge the renunciation and reassess the appellant?

[56] The appellant's position is that, quite apart from the waiver issue, the Minister was wrong to reassess the CEE that he obtained by way of renouncement from 991, because the Minister did not first audit or reassess 991.

[57] The appellant argues that subsections 66(12.6) to 66(12.75) of the *Act* provide a complete code for dealing with resource expense renouncement and reduction. Under that code:

a) resource expenses remain the expenses of the corporation for the purposes of the renunciation and any challenges to that renunciation; and
b) a mechanism is contained in the code, in subsection 66(12.73), illustrating how such resource expenses are to be challenged.

[58] The appellant argues that subsections 66(12.6), (12.62) and (12.64) provide that a flow-through share corporation may renounce resource expenses to a taxpayer if certain requirements are met. One of the requirements is set out in subsection 66(12.68), which requires that the corporation file a T100 (Flow-Through Share Information form) and a T101 (Summary of Renunciation of CEE, CDE, COGPE, etc.) as referred to in subsection 66(12.7). The appellant's position is that these requirements are imposed upon the corporation to ensure that the Minister can properly identify when and by whom renunciations are made and who claimed the relevant deductions.

[59] The appellant further argues that under subsections 66(12.61), 66(12.63) and 66(12.65), the specific resource expenditures that are renounced are deemed to have been incurred by the taxpayer and, "shall, except for the purposes of that renunciation, be deemed on and after the effective date of the renunciation, never to have been [CEE, CDE or COGPE] incurred by the corporation". These provisions evidence the need to look at the corporation in challenging the renunciation. The wording "except for the purposes of that renunciation" clearly provides that for the purposes of such renunciation and any challenges to the renunciation, the expenses are the corporation's. If the tax authorities want to challenge the renunciation, which is what the Minister is doing in the appellant's case, the Minister must review what the corporation did. Had Parliament wanted the review of the renunciation to look only at the shareholder, the words "expect for the purpose of that renunciation" would not be needed here. Statutory construction principles require that this phrase not be ignored.

[60] The appellant submits that this approach is also consistent with the manner in which these expenses are accounted for tax purposes. Under sections 66.1, 66.2 and 66.4, the resource expenses that the corporation incurs are added to its cumulative CCE, cumulative CDE and cumulative COGPE accounts. The added amounts may be larger that what is renounced. Once renounced, the cumulative CEE, CDE and COGPE amounts are reduced by the renounced amounts. If the amounts renounced

are not proper amounts renounced to the shareholder, the Minister is still required to determine what tax treatment these amounts are to have in the hands of the corporation.

[61] The appellant further argues as follows:

(a) It is also important to note that the definition of CEE is broad, but only certain types of CEE that are referred to in subsection 66(12.66) qualify for renunciation under subsection 66(12.6). So even if the renunciation is denied for certain CEE amounts, these amounts could still be valid CEE of the corporation that remain in the corporation's cumulative CEE account. If an audit of the corporation is not carried out, the denied renouncements do not get reinstated in the accounts of the corporation.

(b) The provisions in subsections 66(12.71) and (12.6) direct that the corporation may only renounce such amounts as it would have been entitled, but for the renunciation, to deduct itself.

(c) Subsection 66(12.73) provides instruction with regard to what a corporation must do when it renounces excess resource expenses – it requires the corporation to file a statement so that the Minister may reduce the excess renounced amounts.

[62] The appellant's argument is that, in light of the above provisions, to challenge expenses the Minister is required to carry out a review of the expenses incurred by the corporation, and if the expenditures are not of a nature that can be renounced to the shareholders, then the Minister must determine what treatment is to be given to those expenditures in the hands of the corporation. The corporation is also required to file forms where excess expenses were renounced and is afforded the opportunity to challenge the denial of such expenses independently of any challenge by the shareholders.

[63] The appellant states that in his case the Minister was required to first audit 991 in order to determine if the resource expenses were of the type that could be renounced to its shareholders, and, if they were not, the Minister had to determine how those expenses were to be treated in the hands of 991. The CEE that were denied to the appellant could still qualify as valid expenses of 991 that it could deduct itself. The Minister was also required to advise 991 of any reduction in its resource expenses that were available for renunciation and to demand the relevant statement under subsection 66(12.73).

[64] The appellant relies on the Tax Court's 2005 decision in *Forsberg v. The Queen*, 2005 TCC 591, which, he states, is authority for the proposition that it is the audit of the corporation in the first instance that gives the Minister the basis for challenging the renunciation. The appellant quotes paragraph 9 of the decision, where Justice Paris states that a taxpayer cannot be bound by a reassessment of another taxpayer.

[65] The appellant states that *Forsberg* illustrates that any assessment reducing renounced amounts in the context of flow-through shares is, or is akin to, a derivative assessment whereby it is the auditor's assessment of another (e.g., the corporation) that gives rise to the assessment against the flow-through shareholder. The appellant states that, as with the section 160 transferor-transferee joint liability assessment, a flow-through shareholder is entitled to challenge an assessment issued against the corporation regarding the renounced expenses. However, the assessment or determination must first be made against the corporation. In *Forsberg*, the Court referred to the Federal Court of Appeal's decision in *Gaucher v. The Queen*, 2000 DTC 6678, 2000 F.C.J. No. 1869 (QL), involving a section 160 assessment, in support of this position. The appellant also relies on *Mickleborough v. The Queen*, 99 DTC 471, a case in which an audit resulted in a revised CEE allocation schedule and a subsequent reassessment of the taxpayer, to which the taxpayer objected.

[66] The appellant's argument is that these cases establish that the Minister first had to audit and reassess 991, and produce a revised allocation schedule under subsection 66(12.73). If this is not required, section 66 (12.73) and certain wording in subsections 66(12.61), (12.63) and (12.65) are rendered redundant and 991 is denied both the right to challenge the Minister's determination and its entitlement to reinstate the relevant resource expenses on its books.

[67] The respondent takes the position that the Minister was not required to reassess 991 before reassessing the appellant. The result of a valid renunciation is that a flow-through shareholder is entitled to claim deductions for expenses incurred by the principal business corporation as though they had been incurred by the shareholder. Subsections 66(12.61), (12.63) and (12.65) deem those expenses to have never been expenses of the corporation. Once the expenses are renounced, there remain no more expenses in the corporation for the Minister to disallow. The phrase "except for the purposes of that renunciation" contained in subsection 66(12.61) pertains only to renunciation issues, such as whether the corporation is a principal business corporation, whether the shares were true flow-through shares, or whether proper consideration was paid. Accordingly, the corporation has no direct interest in

an appeal when the Minister denies the deduction of the renounced expenses. The decision *Ressources Orco Inc. et al. v. The Queen*, 95 DTC 5132 of the Federal Court, Trial Division establishes that regardless of any change to the tax position of the flow-through shareholder, the tax position of the corporation will be preserved.

[68] The respondent argues that no prejudice occurred to either the appellant or the corporation as a result of the Minister's decision to reassess the appellant without first reassessing the corporation. The respondent relies on this Court's 1995 decision in *Donat Flamand Inc. v. M.N.R.*, [1995] 2 C.T.C. 2590, in support of the position that the assessment of the appellant could be made without the reassessment of the corporation and that any amounts that flow from the corporation's reassessment are subject to review in the appellant's appeal.

[69] The respondent refers to the *Forsberg* decision (*supra*), decision which held that it would be contrary to the principle of natural justice if the taxpayer was not permitted to challenge the basis of an assessment against him, which basis was essentially the assessment of the flow-through corporation that had renounced expenses to the taxpayer. The opposite should hold true as well.

[70] Finally, the respondent argues that there is no provision in the *Act* requiring the Minister to reassess the flow-through corporation before reassessing its shareholder. Although subsection 66(12.73) envisions remedies where the corporation has renounced more than it is entitled to renounce, it is not stated to be a condition precedent to reassessing a shareholder. Subsection 66(12.73) envisions an audit of the T101 that would examine the amounts renounced, and allows the corporation to make adjustments, failing which, it will face a revision by the Minister. The subsection pertains to a dispute between the corporation and the Minister, not between a shareholder and the Minister, and has no relevance to this appeal.

[71] The flow-through share and renounceable expense program with respect to resource expenses is contained generally in subsections 66(12.6) to 66(12.75) of the *Act*. Subsection 66(12.6) describes renounceable CEE in the context of flow-through shares. It reads as follows:

> 66(12.6) Where a person gave consideration under an agreement to a corporation for the issue of a flow-through share of the corporation and, in the period that begins on the day the agreement was made and ends 24 months after the end of the month that includes that day, the corporation incurred Canadian exploration expenses, the corporation may, after it complies with subsection (12.68) in respect of the share and before March of the first calendar year that begins after the period, renounce,

effective on the day on which the renunciation is made or on an earlier day set out in the form prescribed for the purposes of subsection (12.7), to the person in respect of the share the amount, if any, by which the part of those expenses that was incurred on or before the effective date of the renunciation (which part is in this subsection referred to as the "specified expenses") exceeds the total of

(*a*) the assistance that the corporation has received, is entitled to receive or can reasonably be expected to receive at any time, and that can reasonably be related to the specified expenses or to Canadian exploration activities to which the specified expenses relate (other than assistance that can reasonably be related to expenses referred to in paragraph (*b*) or (*b.1*)),

(*b*) all specified expenses that are prescribed Canadian exploration and development overhead expenses of the corporation,

(*b.1*) all specified expenses each of which is a cost of, or for the use of, seismic data

(i) that had been acquired (otherwise than as a consequence of performing work that resulted in the creation of the data) by any other person before the cost was incurred,
(ii) in respect of which a right to use had been acquired by any other person before the cost was incurred, or
(iii) all or substantially all of which resulted from work performed more than one year before the cost was incurred, and

(*c*) the total of amounts that are renounced on or before the date on which the renunciation is made by any other renunciation under this subsection in respect of those expenses,

but not in any case

(*d*) exceeding the amount, if any, by which the consideration for the share exceeds the total of other amounts renounced under this subsection or subsection (12.601) or (12.62) in respect of the share on or before the day on which the renunciation is made, or

(*e*) exceeding the amount, if any, by which the cumulative Canadian exploration expense of the corporation on the effective date of the renunciation computed before taking into account any amounts renounced under this subsection on the date on which the renunciation is made, exceeds the total of all amounts renounced under this subsection in respect of any other share

(i) on the date on which the renunciation is made, and
(ii) effective on or before the effective date of the renunciation.

[72] Subsection 66(12.61) provides that where a corporation renounces CEE under subsection 66(12.6), those expenses shall be deemed never to have been CEE of the corporation, except for the purposes of the renunciation. Subsection 66(12.61) reads as follows:

> 66(12.61) Subject to subsections (12.69) to (12.702), where under subsection (12.6) or (12.601) a corporation renounces an amount to a person,
>
> (*a*) the Canadian exploration expenses or Canadian development expenses to which the amount relates shall be deemed to be Canadian exploration expenses incurred in that amount by the person on the effective date of the renunciation; and
>
> (*b*) the Canadian exploration expenses or Canadian development expenses to which the amount relates shall, except for the purposes of that renunciation, be deemed on and after the effective date of the renunciation never to have been Canadian exploration expenses or Canadian development expenses incurred by the corporation
>
> [Emphasis added.]

[73] Renounceable CDE in the context of flow-through shares are described in subsection 66(12.62) and the effect of their renunciation is described in subsection 66(12.63). Renounceable COGPE were described in subsection 66(12.64) (repealed in 1997) and the effect of their renunciation was described in subsection 66(12.65).

[74] Subsection 66(12.73) provides a set of rules:

> 66(12.73) **Reductions in renunciations** - Where an amount that a corporation purports to renounce to a person under subsection (12.6), (12.601) or (12.62) exceeds the amount that it can renounce to the person under that subsection,
>
> (*a*) the corporation shall file a statement with the Minister in prescribed form where
>
> (i) the Minister sends a notice in writing to the corporation demanding the statement, or
>
> (ii) the excess arose as a consequence of a renunciation purported to be made in a calendar year under subsection (12.6) or (12.601) because of the application of subsection (12.66) [expenses in the first 60 days of the year] and, at the end of the year, the corporation knew or ought to have known of all or part of the excess;

(*b*) where subparagraph (*a*)(i) applies, the statement shall be filed not later than 30 days after the Minister sends a notice in writing to the corporation demanding the statement;

(*c*) where subparagraph (*a*)(ii) applies, the statement shall be filed before March of the calendar year following the calendar year in which the purported renunciation was made;

(*d*) except for the purpose of Part XII.6, any amount that is purported to have been so renounced to any person is deemed, after the statement is filed with the Minister, to have always been reduced by the portion of the excess identified in the statement in respect of that purported renunciation; and

(*e*) where a corporation fails in the statement to apply the excess fully to reduce one or more purported renunciations, the Minister may at any time reduce the total amount purported to be renounced by the corporation to one or more persons by the amount of the unapplied excess in which case, except for the purpose of Part XII.6, the amount purported to have been so renounced to a person is deemed, after that time, always to have been reduced by the portion of the unapplied excess allocated by the Minister in respect of that person.

[Emphasis added.]

[75] Two other subsections are of relevance. Subsection 152(4.3) of the *Act* provides that where the result of an assessment or a decision on an appeal is to change a balance of a taxpayer for a taxation year, the Minister may or, where the taxpayer so requests in writing, shall, reassess the taxpayer within a prescribed period. Subsection 152(4.3) provides as follows:

152(4.3) Notwithstanding subsections (4), (4.1) and (5), where the result of an assessment or a decision on an appeal is to change a particular balance of a taxpayer for a particular taxation year, the Minister may, or where the taxpayer so requests in writing, shall, before the later of the expiration of the normal reassessment period in respect of a subsequent taxation year and the end of the day that is one year after the day on which all rights of objection and appeal expire or are determined in respect of the particular year, reassess the tax, interest or penalties payable, or redetermine an amount deemed to have been paid or to have been an overpayment, under this Part by the taxpayer in respect of the subsequent taxation year, but only to the extent that the reassessment or redetermination can reasonably be considered to relate to the change in the particular balance of the taxpayer for the particular year.

[76] Subsection 160(1) of the *Act* sets out the circumstances under which a transferee of property in a non-arm's length situation may be held jointly and severally liable with the transferor for the transferor's income tax debt and also

provides that nothing in that subsection shall limit the transferor's tax debt to the Minister under any other provision of the *Act*. Subsection 160(1) reads as follows:

> 160(1) **Tax liability re property transferred not at arm's length** - Where a person has, on or after May 1, 1951, transferred property, either directly or indirectly, by means of a trust or by any other means whatever, to
>
> (*a*) the person's spouse or common-law partner or a person who has since become the person's spouse or common-law partner,
> (*b*) a person who was under 18 years of age, or
> (*c*) a person with whom the person was not dealing at arm's length,
>
> the following rules apply:
>
> (*d*) the transferee and transferor are jointly and severally liable to pay a part of the transferor's tax under this Part for each taxation year equal to the amount by which the tax for the year is greater than it would have been if it were not for the operation of sections 74.1 to 75.1 of this Act and section 74 of the *Income Tax Act*, chapter 148 of the Revised Statutes of Canada, 1952, in respect of any income from, or gain from the disposition of, the property so transferred or property substituted therefor, and
> (*e*) the transferee and transferor are jointly and severally liable to pay under this Act an amount equal to the lesser of
>
> . . .
>
> but nothing in this subsection shall be deemed to limit the liability of the transferor under any other provision of this Act.

[77] I have reviewed the cases submitted by the parties and a few other decisions in which it was held that the Minister has no obligation to concurrently reassess taxpayers that appear to be connected in some fashion.

[78] In *Ressources Orco*, *supra*, the facts involved denied resource expenses that had been renounced by the plaintiff corporations in favour of their flow-through shareholders. The shareholders appealed to the Tax Court, while, at the same time, the corporations asked the Federal Court's Trial Division to issue a declaratory judgment with respect to certain questions regarding resource expense determination. The corporations wanted to obtain such a judgment as they felt that the shareholders were not in the best position to argue for the validity of the expenses in the Tax Court, as only the corporations possessed the relevant evidence. The Federal Court refused to grant a declaratory judgment as it found that, although the corporations and the shareholders shared a common intention, only the shareholders had a tax liability. Justice Noël stated the following, at page 5135:

> I note that in any case the plaintiffs have no direct interest in this determination. Whatever the outcome of the proceedings in the Tax Court of Canada or the action at bar, the plaintiffs' own tax position will be preserved. As far as the plaintiffs are concerned, the Minister's actions only have impact on the calculation of their respective incomes. Under s. 66(12.61), (12.63) and (12.65), the expenses which were the subject of the renunciation were deemed to have been incurred by the investors, and correspondingly these expenses were deemed never to have been incurred by the plaintiffs. The effect of this presumption was reversed in the case at bar pursuant to s. 66(12.73) up to the amount of the expenses disallowed by the Minister. Therefore as a result of the adjustments made by the Minister, the disallowed expenses reverted back to the plaintiffs for tax purposes and they are free to deduct them in the computation of their respective income if they choose to do so.
>
> [Emphasis added.]

That decision was affirmed by the Federal Court of Appeal (189 N.R. 195).

[79] In *Donat Flamand Inc.*, *supra*, this Court confirmed that only an assessed taxpayer can appeal his own assessment (at page 2601):

> Counsel for the appellants also referred to the decisions in *Nova Ban-Corp v. Tottrup, et al.*, [1989] 2 C.T.C. 304, 89 D.T.C. 5489 (Fed. T.D.) and *Hart, R et al v. M.N.R.*, [1986] 2 C.T.C. 63, 86 D.T.C. 6335 (Fed. T.D.)
>
> Those decisions hold that only the assessed taxpayer may appeal his or her assessment, and that another person who feels aggrieved by the amount of tax owing may not appeal it on behalf of the taxpayer. Here, however, as counsel for the appellants pointed out, we do not have an appeal of a third party's assessment, but a request for a decision as to the affairs of a third party which affect the assessment of another person. The issue is not the determination of the amount of an assessment, but of whether or not a designation is valid.

That decision was affirmed by the Federal Court, Trial Division ([2001] 3 C.T.C. 130).

[80] In *Gaucher* (*supra*), Rothstein J.A. (as he then was) held that it is a basic rule of natural justice that, barring a contrary statutory provision, a person who is not a party to litigation cannot be bound by a judgment between other parties, even if the original assessment of the primary taxpayer remains binding on that taxpayer:

> 6 . . . It is a basic rule of natural justice that, barring a statutory provision to the contrary, a person who is not a party to litigation cannot be bound by a judgment between other parties. The appellant was not a party to the reassessment proceedings between the Minister and her former husband. Those proceedings did not purport to impose any liability on her. While she may have been a witness in those proceedings, she was not a party, and hence could not in those proceedings raise defences to her former husband's assessment.
>
> 7 When the Minister issues a derivative assessment under subsection 160(1), a special statutory provision is invoked entitling the Minister to seek payment from a second person for the tax assessed against the primary taxpayer. That second person must have a full right of defence to challenge the assessment made against her, including an attack on the primary assessment on which the second person's assessment is based.
>
> 8 This view has been expressed by Judges of the Tax Court. See, for example, *Acton v. The Queen* (1994), 95 DTC 107 at 108 *per* Bowman T.C.C.J.; *Ramey v. The Queen* (1993), 93 DTC 791, at 792 *per* Bowman ,T.C.C.J.; *Thorsteinson v. M.N.R.* (1980), 80 DTC 1369, at 1372 *per* Taylor, T.C.C.J. While the contrary view was expressed in *Schafer (A.) v. Canada*, [1998] G.S.T.C. 7, at 7-9 (appeal dismissed for delay (August 30, 1999), A-258-98 (F.C.A.)), I am of the respectful opinion that such view is in error. It seems to me that this approach fails to appreciate that what is at issue are two separate assessments between the Minister and two different taxpayers. Once the assessment against the primary taxpayer is finalized, either because the primary taxpayer does not appeal the assessment, or the assessment is confirmed by the Tax Court (or a higher court if further appealed), that assessment is final and binding between the primary taxpayer and the Minister. An assessment issued under subsection 160(1) against a secondary taxpayer cannot affect the assessment between the Minister and the primary taxpayer.

[81] In the Federal Court of Appeal decision in *Petro-Canada v. The Queen*, 2004 FCA 158, that Court confirmed that, once validly renounced, exploration expenses are deemed to have been incurred by the shareholder:

> 15 The Phillips JEC was obliged by contract to renounce to Petro-Canada the first $46,500,000 of Canadian exploration expenses it incurred in 1991, and the first $69,750,000 of Canadian exploration expenses it incurred in 1992. Under the *Income Tax Act* as it then read, the result of a valid renunciation was that the shareholder would be entitled to claim income tax deductions for Canadian exploration expenses incurred by the joint exploration corporation, as though the expenses had been incurred by the shareholder.

[82] In the Tax Court's 2005 informal procedure decision in *Forsberg*, *supra*, the facts involved, first, a reassessment of the flow-through corporation to disallow its

renunciation of CEE to the appellant on the grounds that they were not CEE but rather CEDOE (Canadian Exploration and Development Overhead Expenses) since they had been paid to a person connected with the corporation, and second, a corresponding reassessment of the appellant denying him the expenses that had been renounced. The corporation objected to its reassessment, but it was confirmed. The corporation did not appeal its reassessment, but the appellant appealed his, on essentially the same grounds as those raised in the corporation's objection. The Minister's position was that the appellant could not challenge the reassessment of the corporation and that the determination of the corporation's expenses was binding on the appellant. Justice Paris held that the appellant had a right to challenge independently of the corporation the Minister's characterization of the corporation's expenses because the relationship between the reassessment of the flow-through corporation and the consequential reassessment of the taxpayer bore a resemblance to primary and secondary assessments under section 160. The courts have confirmed that, in the context of a section 160 assessment, the secondary taxpayer may challenge the primary taxpayer's assessment. Justice Paris states at paragraphs 8 and 9 of his reasons:

> Furthermore, the relationship between the reassessment of Thurlow and the consequential reassessment of the appellant bears a certain resemblance to that between a primary and secondary tax debtor in the case of a derivative assessment under section 160 or section 227.1 of the Act, since the tax liability of one taxpayer is dependent on an assessment which has been issued against the other. In such a situation the Federal Court of Appeal in *Gaucher v. The Queen*, 2000 DTC 6678 said, at paragraph 6:
>
> > . . . It is a basic rule of natural justice that, barring a statutory provision to the contrary, a person who is not a party to litigation cannot be bound by a judgment between other parties. ...
>
> *A fortiori*, in the absence of a statutory provision to the contrary, a taxpayer cannot be bound by a reassessment of another taxpayer. In this case, given the interrelationship of the reassessments of Thurlow and the appellant, it would be contrary to the rules of natural justice to prevent him from challenging the basis for the assessment against Thurlow on which his own reassessment is based.

[83] In *Hawkes v. R.*, [1997] 2 C.T.C. 133, a case in which the appellant argued that the Minister had to assess similar taxpayers identically, the Federal Court of Appeal held that while such a practice would be desirable, the Minister had no duty to do so:

> 7. I would first observe that this Court in no way condones inconsistent assessments or conflicting information being provided to taxpayers as is virtually

admitted to have happened here. Such conduct must surely be avoided if at all possible if taxpayers are to perceive the system as fair, equitable, and reasonable in application, a system with which they are expected to cooperate voluntarily.

8. It is quite another matter, however, to say that the Minister must always be bound by his own mistakes. I do not understand that to be the established law.

9. This Court had occasion recently to review the law in respect of inconsistent assessments concerning the same taxpayer and as between different taxpayers. In *Ludmer et al v. H.M.* [95 DTC 5311] this Court considered earlier jurisprudence and confirmed the basic principle that it is the duty of the Minister to assess, and if necessary reassess, taxpayers' returns so as to apply correctly the law to the facts. If the taxpayer disagrees with any particular assessment he or she has the right to appeal to the Tax Court of Canada where the law and the facts can be fully reviewed and a further appeal may be brought to this Court. Thus the fact that the Minister has assessed one return of a taxpayer in a different way from another return, or has assessed two taxpayers involved in similar activities differently, is not proof that any particular assessment is incorrect. That is a matter for determination on appeal.

. . .

14. Counsel for the appellants laid considerable stress on a decision of the Tax Court of Canada in *Labelle v. H.M.* [96 DTC 1115] In that case the Tax Court judge held that because the Minister had treated a certain prize in accountancy as a prize "recognized by the general public" within the meaning of section 7700 of the *Income Tax Regulations*, in respect of one taxpayer, he must assess another taxpayer on the same basis. The learned Tax Court judge stated:

> The Minister must make assessments pursuant to the Act, and for this reason the manner in which another taxpayer is assessed is normally not relevant. However, when an assessment requires that the Minister exercise an element of subjective appreciation, it seems to me that this cannot be the rule.

While I am somewhat puzzled by the reference to "an element of subjective appreciation" this decision must, at best, be confined to its particular circumstances. In that case the dispute was not over the characterization of one taxpayer's activities as compared to another, but rather the characterization of a prize whose essential nature was unrelated to any particular taxpayer. With respect, I find it unnecessary to comment further on the decision other than to say that I do not find it in any way authoritative in respect of the issues before us. The other decision strongly relied on was that of the Trial Division of this Court in *Riddell et al v. H.M.* [95 DTC 5530]. In that case the reassessment by the Minister

> was attacked, *inter alia*, with respect to his refusal to permit Mr. Riddell to deduct certain interest payments from his personal income tax where those payments had been made by his company. According to the evidence the Revenue Canada auditor in charge of his file was advised by his superior as follows:
>
> > In these types of situations, it has been our Policy (as approved by the previous Chief of Audit Review) to allow the shareholder the deductions as if he had paid them himself.
>
> Yet the reassessment was not made on this basis. The learned Trial Judge held that the Minister was obliged to apply the policy as so stated "in a fair and even handed manner". If other taxpayers in the same situation were being permitted to make this type of deduction that advantage must be extended to Mr. Riddell as well. As the learned judge said:
>
> > It is not open to the Minister to exercise his discretionary power to implement policy in an arbitrary and capricious fashion.
>
> The learned judge went on to rely on a decision I rendered in the Trial Division, *Aurchem Exploration Ltd. v. Canada,* [(1992), 7 Admin. L.R. (2d) 168] where I had quashed a discretionary decision of the mining recorder of the Whitehorse mining district, Yukon. With respect, I am not prepared to apply the *Riddell* decision in the present case. The *Riddell* decision seems to have turned on inconsistency in the departure from the "policy" of the Minister in the exercise of his "discretion". Whatever the merits of that characterization may have been in *Riddell,* as I have indicated here the function being performed by the Minister in reassessing the appellants was a function of applying the law and the facts to make an assessment, an assessment which was open to full appeal as to its correctness in law and fact. No issue of policy or discretion was involved. . . .
>
> [Emphasis added.]

[84] The last case I will refer to is the Federal Court of Appeal decision in *Canadian Marconi Co. v. Canada*, [1991] 2 C.T.C. 352, where that Court confirmed that, in the absence of a waiver or an allegation of fraud or misrepresentation, the Minister is prohibited from reassessing a taxpayer outside of the normal reassessment period even if the taxpayer requests to be assessed.

[85] After having reviewed the above cases as well as the relevant sections of the *Act* referred to above, I cannot subscribe to the appellant’s argument that the phrase "except for the purposes of that renunciation" contained in subsections 66(12.61), 66(12.63) and 66(12.65) essentially means that, as soon as the flow-through expenses are challenged by the Minister, they revert to the corporation. I would agree with the respondent’s position that this phrase pertains to situations involving questions of

whether the flow-through corporation has the status of principal business corporation or whether the taxpayer is truly a flow-through shareholder. If what the appellant suggests were actually the case, there would be no need for subsection 66(12.73) of the *Act*, which says that where a corporation renounces expenses in excess of the amounts it is entitled to renounce, that corporation must inform the Minister so that appropriate adjustments in the expense balances can be made.

[86] Subsection 152(4.3) of the *Act*, which deals with consequential assessments, provides that where the result of an assessment or a decision on an appeal is to change a balance of a taxpayer for a taxation year, the Minister may or, where the taxpayer so requests in writing, shall, reassess the taxpayer within a prescribed period. The appellant's argument is that if the corporation is not reassessed prior to the reassessment of its flow-through shareholders, the corporation will lose the expenses that should, upon the expenses being denied to the shareholders, revert to the corporation. The above subsection (152(4.3)) of the *Act* contains no principle or policy whereby a related tax return of the same or a different taxpayer will automatically be reassessed in a manner consistent with the reassessment of another tax return or with a court ruling. The Minister, in my opinion, is not obligated to reassess a taxpayer even if another reassessment or decision affects that taxpayer's tax balances (see *Canadian Marconi*, *supra*).

[87] The appellant referred to cases that state that the reassessment of flow-through expenses is comparable to a derivative assessment under subsection 160(1). That subsection provides that the primary and secondary taxpayers will be jointly and severally liable for the same taxes and, even where the secondary taxpayer is able to succeed in defeating the derivative assessment by challenging the primary assessment, the primary assessment remains binding on the primary taxpayer. This appears to be in line with the case law establishing that, although it is desirable that he do so, the Minister has no obligation to reassess similar or related amounts on different taxpayers' returns identically (see *Hawkes*, *supra*).

[88] There are cases, as pointed out by the appellant, where the facts show that the flow-through corporation was assessed prior to the reassessment of the shareholders. These cases are not authority, though, for imposing such a prior assessment obligation on the Minister. These cases do suggest, however, that the Minister should not arbitrarily deny exploration expenses without having a look at the corporation. The facts of this case indicate that the Minister examined the information of Sierra Trinity Inc., which is the corporation that carried out the operations of the joint venture, and considered whether the expenses were permissible. 991 had no separate expenses from those of the joint venture.

[89] I agree with the appellant that subsections 66(12.6) to 66(12.75) of the *Act* contain a complete code with respect to the renouncement of resource expenses, but, in my opinion, there are in that code no instructions, express or implied, that require the Minister to reassess the flow-through corporation prior to reassessing the shareholders. I do not think that whether or not 991 was reassessed would make any difference to the appellant's tax situation, for the result would still be that he would be denied the same amount of CEE. A taxpayer may only appeal his own tax assessment. This Court cannot order that the denied CEE revert to 991.

[90] The appeal is allowed in part and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the reasons set out above and the Minutes of Settlement signed by the parties. The respondent is entitled to 75% of her costs.

Signed at Ottawa, Canada, this 14th day of December 2011.

« François Angers »

Angers J.

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