Docket: 2015-5487(IT)G

BETWEEN:

JAMES KRUMM,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on September 26 & 27, 2018, at Calgary, Alberta

By The Honourable Justice Henry A. Visser

Appearances:

Counsel for the Appellant:	Matthew Clark
Counsel for the Respondent:	Wendy Bridges

JUDGMENT

The Appeal from the reassessments made under the Income Tax Act for the Appellant's 1997 and 1998 taxation years are dismissed.

Costs are awarded to the Respondent. The parties shall have 30 days from the date hereof to reach an agreement on costs, failing which the Respondent shall have a further 30 days to file written submissions on costs and the Appellant shall have yet a further 30 days to file a written response. Any such submissions shall not exceed 10 pages in length. If the parties do not advise the Court that they have reached an agreement and no submissions are received, costs shall be awarded to the Respondent as set out in the Tariff.

Signed at Ottawa, Canada, this 17th day of January 2020.

"Henry A. Visser"

Visser J.

Citation: 2020 TCC 7
Date: January 17, 2020
Docket: 2015-5487(IT)G

BETWEEN:

JAMES KRUMM,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Visser J.

[1] On August 1, 1997, during what is often referred to as the dot-com boom or the tech bubble, Mr. Krumm entered into an Asset Purchase Agreement pursuant to which he purchased a 50% interest in computer application software (the "**Software**") owned by Intersports Acceleration Corp. ("**IAC**") for $2.8 million, of which $700,000 was payable by cheque and $2.1 million was payable by way of Long Term Promissory Note (the "**Promissory Note**"). Mr. Krumm and IAC also simultaneously entered into a Joint Venture Agreement for the purpose of jointly exploiting the Software by which IAC agreed that it would pay Mr. Krumm a percentage of net sales over a period of years that would aggregate to not less than 200% of the principal sum and all interest payable pursuant to the Promissory Note (the "**Represented Amount**"). The Joint Venture Agreement further provided that if Mr. Krumm did not receive the Represented Amount in revenues then he would be entitled to the difference between the amount received and the Represented Amount from IAC in damages, effectively offsetting the Promissory Note.

[2] In each of Mr. Krumm's 1997 and 1998 taxation years, no income was produced from the Software and Mr. Krumm claimed capital cost allowance ("**CCA**") of $1.4 million in respect of Class 12 software, as a result of which he deducted the full purchase price of the Software in computing his 1997 and 1998 taxable income. Mr. Krumm also claimed interest expense of $10,849 and $76,904 in his 1997 and 1998 taxation years, respectively.

[3] On October 29, 1999, Mr. Krumm sold his interest in the Software to SAMsports.com Inc. ("**SAM"**) in exchange for 875,000 common shares in the capital of SAM with a reported value of $700,000. SAM was a capital pool company which meant, under the applicable rules at the time, it could go public without an underlying business insofar as it undertook a major business transaction within a certain period. After SAM's acquisition of Mr. Krumm's interest in the Software, SAM's board of directors included Mr. Krumm, Mr. Krumm's lawyer (Mr. Dennis Nerland), and Mr. Krumm's lawyer's brother (Mr. Nairn Nerland). SAM ceased operations and liquidated in early 2001 and on January 31, 2001, faced orderly disposition of its assets. IAC was dissolved involuntarily on April 3, 2003.

[4] By Notices of Reassessment dated March 30, 2000, the Minister of National Revenue (the "**Minister**") reassessed Mr. Krumm pursuant to the *Income Tax Act*[1] (the "***Act***") to disallow the CCA and interest claimed by Mr. Krumm in each of his 1997 and 1998 taxation years on the basis, *inter alia*, that his investment in the Software was an unregistered tax shelter pursuant to section 237.1 of the *Act*, and that therefore no deduction was permitted in respect thereof pursuant to subsection 237.1(6) of the *Act*.[2] Following the filing of a Notice of Objection by the Appellant, the Minister further reassessed Mr. Krumm's 1997 and 1998 taxation years by Notice of Reassessment dated October 16, 2001 to apply loss carrybacks from the 2000 taxation year in the amounts of $2,870 and $45,419, respectively. Mr. Krumm has appealed the Minister's reassessments of his 1997 and 1998 taxation years to this Court.

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[1] R.S.C., 1985, c. 1 (5th Supp.), as amended.

[2] As I will discuss further, the alternative arguments raised by the Respondent are subsidiary to the tax shelter issue and are generally moot given my conclusion in respect of the tax shelter issue.

ISSUES

[5] At trial, Mr. Krumm conceded that he had not paid interest on the Promissory Note and advised that he was abandoning his appeal in respect of the deductibility of interest expense in the amount of $10,849 and $76,904 in his 1997 and 1998 taxation years, respectively. As a result, the only issue outstanding is whether Mr. Krumm was eligible to deduct CCA of $1.4 million in each of his 1997 and 1998 taxation years in respect of his purchase of the Software. In this respect, the primary issue in these appeals is whether Mr. Krumm's investment in the Software was a "tax shelter" pursuant to the definition thereof set out in subsection 237.1(1) of the *Act*, and if so, whether he is prohibited from deducting CCA in respect of the Software pursuant to subsection 237.1(6) of the *Act*.

[6] The Respondent also argued that Mr. Krumm's investment in the Software was a tax shelter investment and therefore subject to the restrictions set out in section 143.2 of the *Act* and subsections 1100(20.1) and 1100(20.2) of the *Income Tax Regulations* (the "***Regulations***"). These provisions only apply if there is a tax shelter investment as defined in subsection 143.2(1) of the *Act* and limit the total amount deductible by a taxpayer in respect of the tax shelter investment. As Mr. Krumm did not own his investment in the Software through a partnership (as per paragraph (b) of the definition of "tax shelter investment"), his investment in the Software would only be a tax shelter investment if it was a tax shelter for the purpose of subsection 237.1(1) of the *Act (*as per paragraph (a) of the definition of "tax shelter investment").

[7] For the reasons that follow, it is my view that Mr. Krumm's investment in the Software was a tax shelter for the purposes of section 237.1 of the *Act*. As it is clear that Mr. Krumm's investment in the Software was not registered as a tax shelter and that he did not file the prescribed form containing prescribed information required by subsection 237.1(6) of the *Act* with his 1997 and 1998 income tax returns, it is also my view that Mr. Krumm is prohibited by subsection 237.1(6) of the *Act* from deducting the CCA at issue in these appeals in his 1997 and 1998 taxation years.

[8] As it is my view that subsection 237.1(6) of the *Act* applies to deny Mr. Krumm's CCA in full, it is not necessary in the circumstances of these appeals for me to consider the application of section 143.2 of the *Act* and subsections 1100(20.1) and 1100(20.2) of the *Regulations*.

[9] The Respondent also argued that Mr. Krumm's CCA claim was not reasonable and therefore should be denied in full pursuant to section 67 of the *Act*. However, the Respondent provided little support for this argument at trial and acknowledged that Mr. Krumm and IAC were dealing at arm's length when Mr. Krumm purchased the Software in 1997. While this is an alternative argument that is moot in light of my finding on the other issues in these appeals, in my view the Respondent has not established that section 67 of the *Act* would apply to the purchase price of the Software or the CCA claimed by Mr. Krumm in the circumstances of this case.

BACKGROUND FACTS

[10] The facts in this case are generally not in dispute. The parties submitted a Statement of Agreed Facts (Partial) (the "**SAF**") which is set out at Appendix "A". The parties also submitted a Joint Book of Exhibits[3] which includes, *inter alia*, copies of the relevant agreements governing the relationship between Mr. Krumm and IAC during the years at issue, as well as copies of a valuation report IAC obtained in respect of the Software and other related documents and correspondence.

[11] The Appellant called Mr. Krumm and Mr. Stephen Corbett as witnesses at the hearing of these appeals. I found both Mr. Krumm and Mr. Corbett to be credible witnesses. The Respondent did not call any witnesses.

[12] Before turning to the testimony of Mr. Krumm and Mr. Corbett, I will briefly describe the Software and a valuation report obtained by IAC in respect of the Software. In this respect, I note that the SAF describes the Software as follows at paragraph 5:

> The Software consisted of three products:
>
> a) interactive software for scouting, analysis, and management for all sports;
>
> b) European Standard of Excellence Youth Soccer Training Program; and
>
> c) Bayern Munich Youth Soccer Training Program.

[3] See Exhibit J-1, Joint Book of Exhibits.

[13] Prior to Mr. Krumm's acquisition of a 50% interest in the Software in 1997, IAC owned 100% of the Software and engaged EMC partners to provide it with a valuation report (the "**Valuation Report**") in respect of the Software for the purpose of determining its value in anticipation of selling an interest in it to investors. The Report, dated June 25, 1997, will be discussed further below.

[14] Mr. Krumm is a businessman who resides in Airdrie, Alberta. His primary occupation is as a landman or petroleum land agent with his own company, Heritage Freehold Specialists & Co. Ltd. ("**Heritage**"). Mr. Krumm testified that in 1997 he was interested in investing in the tech industry and was introduced to IAC by Mr. Vladimir Morgun, who was employed as an insurance salesman by Prudential Trust. Mr. Krumm also had his lawyer, Dennis Nerland, assist him in his acquisition of the Software from IAC. He further testified that he had known Mr. Nerland for many years and that Mr. Nerland had assisted him in setting up a family trust in 1985.

[15] Mr. Krumm testified that he had "lots of meetings" with IAC as he did his due diligence on the acquisition of an interest in the Software and that the negotiations were "tough" and a "bitter battle". He also testified that they had not seen the Valuation Report when they started negotiations, but that he did obtain a copy before the negotiations were finalized. He noted that his and Mr. Nerland's focus in the negotiations was to negotiate down the price and to reduce risk going forward, which included insisting on an exit strategy through the development of a public company to develop the Software and take it forward. He testified it was Mr. Nerland's strategy to use the Promissory Note to pay for part of the purchase price of the Software and reduce risk and to enter into the Joint Venture Agreement which provided for a series of payments to encourage performance. Mr. Krumm testified that, although he considered the Promissory Note to be a *bona fide* obligation, he did not make the interest payments that accrued thereon. He testified that he omitted to pay as he not been receiving the payments envisioned under the Joint Venture Agreement and that IAC could sue Mr. Krumm if they really wanted to pursue him for the interest. Eventually, the Promissory Note was settled through a put/call agreement which resulted in it being offset against the liabilities owed by IAC to Mr. Krumm.

[16] Mr. Krumm testified that no one with IAC made verbal representations to him about the Software being a Class 12 asset or that, for cash of $700,000, an investor would earn $2.8 million in tax deductions over two years based on the ability to claim 100% depreciation of the Software, subject to the half year rule.

[17] Mr. Krumm testified that he received a copy of the Valuation Report prior to the purchase of the Software, but that he did not know what the tax opinion in paragraph 51 of the Valuation Report meant. He testified that the Valuation Report did not play any role in his decision to acquire the Software or in his negotiations with IAC. I will discuss various statements made in the Valuation Report below.

[18] Mr. Krumm also testified there were no other investors in the Software and that he was not aware or ever informed by any party that his investment in the Software could be a tax shelter.

[19] Mr. Corbett is a businessman who resides in Calgary, Alberta. Mr. Corbett joined SAM in 1999 as a director and as chairman of the board and CEO to help it commercialize the Software, which was focused on athletic training in various sports, including tennis and soccer. He assumed this role after SAM had acquired the Software from Kr. Krumm and IAC, and was not involved in either Mr. Krumm's acquisition of the Software from IAC or SAM's acquisition of the Software from IAC and Mr. Krumm. He testified that the other directors of SAM in 1999 included Mr. Krumm, Dennis Nerland (Mr. Krumm's lawyer), Nairn Nerland (Dennis Nerland's brother), Jon Constable, Ben Dulley, Dale Christensen and William Warren. Mr. Corbett signed the tax election forms (T2057 and GST 44) on behalf of SAM which were filed in conjunction with the sale by Mr. Krumm of his interest in the Software to SAM on October 29, 1999. Mr. Corbett also testified that while SAM was a viable business and was successful in developing the Software and forging relationships with business and sports organizations for both the development of content and marketing of the Software, the company ultimately failed due to its inability to raise additional capital because of the dot-com bubble crash in approximately the year 2000.

LAW AND ANALYSIS

[20] The legislation and regulations relevant to the taxation years in dispute in these appeals are set out in Appendix "B" hereto. Subsection 237.1(6) of the *Act*, as was applicable at the time, provided as follows:[4]

> **(6) Deductions and claims disallowed** – No amount may be deducted or claimed by a person in respect of a tax shelter unless the person files with the Minister a

[4] Subsection 237.1(6) was amended by 1998, c. 19, subsection 234(4), which made the above revised language applicable after December 1, 1994.

> prescribed form containing prescribed information, including the identification number for the tax shelter.

[21] In essence, subsection 237.1(6) provides that a person may not deduct any amount under the *Act* in respect of an investment in an unregistered tax shelter. As the parties have agreed that the Minister did not issue a tax shelter number with respect to the Software,[5] subsection 237.1(6) will apply to deny all of the CCA claimed by Mr. Krumm in his 1997 and 1998 taxation years if his investment in the Software is found to be a tax shelter.

[22] The definition of "tax shelter" in subsection 237.1(1) was amended by 1998, c. 19, subsection 234(1), and the revised language was made applicable after November, 1994. As such, the definition of "tax shelter" applicable to the taxation years at issue reads as follows:

> "tax shelter" means any property (including, for greater certainty, any right to income) in respect of which it can reasonably be considered, having regard to statements or representations made or proposed to be made in connection with the property, that, if a person were to acquire an interest in the property, at the end of a particular taxation year that ends within 4 years after the day on which the interest is acquired,
>
> (a) the total of all amounts each of which is
>
> (i) an amount, or a loss in the case of a partnership interest, represented to be deductible in computing income in respect of the interest in the property (including, where the property is a right to income, an amount or loss in respect of that right that is represented to be deductible) and expected to be incurred by or allocated to the person for the particular year or any preceding taxation year, or
>
> (ii) any other amount represented to be deductible in computing income or taxable income in respect of the interest in the property and expected to be incurred by or allocated to the person for the particular year or any preceding taxation year, other than any amount included in computing a loss described in subparagraph (i),
>
> would equal or exceed
>
> (b) the amount, if any, by which

[5] See Agreed Statement of Facts (Partial), at paragraph 38.

> (i) the cost to the person of the interest in the property at the end of the particular year, determined without reference to section 143.2,
>
> would exceed
>
> (ii) the total of all amounts each of which is the amount of any prescribed benefit that is expected to be received or enjoyed, directly or indirectly, in respect of the interest in the property by the person or another person with whom the person does not deal at arm's length,
>
> but does not include property that is a flow-through share or a prescribed property.

[23] The parties agree that the mathematical portion of this definition is met in the current case. Rather, the issue is whether the statements and representations set out in the Valuation Report are sufficient to engage the definition of tax shelter in the circumstances of this case. The Respondent argues they are. The Appellant argues they are not, and further argues that the tax shelter rules were not intended to apply to private transactions between two parties, but rather were intended to apply to investments that are marketed to many investors. As such, the Appellant argues that the definition of tax shelter should be interpreted with that purpose in mind.

[24] Both parties referenced *Baxter v. R.*, 2007 FCA 172.[6] In *Baxter*, Justice Ryer of the Federal Court of Appeal considered the application of section 237.1 in the context of an investment by Mr. Baxter, a lawyer, in a licence to use the Trafalgar Index Program, which was computer software used to trade futures contracts. Mr. Baxter paid $50,000 for the licence, of which $17,500 was paid by cheque and $32,500 was paid by way of a promissory note. Mr. Baxter claimed CCA in respect of the licence totalling $50,000 in his 1998 and 1999 taxation years. In determining that Mr. Baxter's investment in the software licence was a tax shelter, Justice Ryer provided the following analysis of the law in this area:

> **Introduction**
>
> 5 In order to facilitate the understanding of my reasons, I will summarize my interpretation of the definition of tax shelter, insofar as it applied to the taxation

[6] See also *Baxter v. R.*, 2007 CarswellNat 3625 (SCC), where leave to appeal to the Supreme Court of Canada was denied.

years that are under consideration in this appeal. The full text of paragraph 237.1(1)(a) is contained in paragraph 29.

6 The definition of tax shelter essentially poses a question in relation to a hypothetical or assumed acquisition of property by a hypothetical or prospective purchaser (a "prospective purchaser"). If there is an affirmative answer to the question, then the property will constitute a tax shelter and a number of consequences will flow from that characterization. The question is to be answered in advance of any actual sale of the property.

7 The question posed by the definition of tax shelter is relatively simple, once one gets to it. However, getting to it is not a simple matter. A number of preliminary matters must be determined.

8 The property contemplated by the definition of tax shelter is each and every property that is offered for sale to prospective purchasers. However, not every property that is proposed to be sold will constitute a tax shelter.

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

10 The subject matter of the statements or representations is essentially a description of an amount that the prospective purchaser would be able to deduct, in computing income in respect of the property, as a consequence of an assumed acquisition of the property, that is to say, if the prospective purchaser had actually acquired the property, whether the amount constitutes the acquisition cost of the property, a cost incurred in order to obtain the property (e.g. a drilling cost incurred to acquire an interest in an oil and gas property in a farm-out transaction) or an amount allocated to the holder of the property (e.g. a loss allocated to partner holding a partnership interest).

11 The definition of tax shelter does not specify the form that the statements or representations must take or the manner in which they must be made. It is clear that there must be a communication to prospective purchasers which would inform them that a deductible amount would become available to each of them as a consequence of an acquisition by any of them of the property that is offered for

sale. Nothing in the definition indicates that the requisite communication must be made in writing.

12 The definition provides no specificity as to whether the communication of the statements and representations must be for any particular purpose or must have any particular effect. It seems obvious that in making the statements or representations, directly or through agents, the prospective vendor of the property would be motivated to encourage or induce prospective purchasers to become actual purchasers. However, because the question that is posed by the definition is to be answered before any actual sale takes place, the impact of the statements and representations on the prospective purchasers is indeterminable and of no relevance.

13 Finally, the question posed by the definition of tax shelter requires the determination of a period of time that ends within four years after the date upon which the prospective purchaser is assumed to have acquired the property.

14 Having regard to these elements, the question posed by the definition of tax shelter is whether, in light of the statements or representations that have been communicated to the prospective purchaser, it may reasonably be considered, that is to say, objectively determined, that at the end of any particular taxation year of the prospective purchaser that ends within the four year period, the amount that has been announced or communicated to be deductible to the prospective purchaser as a consequence of the prospective acquisition of the property equals or exceeds the cost to the prospective purchaser of that property, determined at the end of the particular taxation year in question, less the amount of all "prescribed benefits" expected to be received or enjoyed, directly or indirectly, in respect of that property by the prospective purchaser. This mathematical determination is to be undertaken a maximum of four times, each of which will be at the end of each taxation year of the prospective purchaser that falls within the four year period. If, at any of those times, the answer is determined to be affirmative, then the property will constitute a tax shelter. However, if the answer is negative at all four of those times, then the property will not constitute a tax shelter.

[25] Justice Ryer then proceeded to consider whether the reports provided to Mr. Baxter in their negotiations contained the requisite statements or representations required to support a tax shelter finding:

Factual Background

Marketing of TIP Licences by the Trafalgar Group

…

18 In furtherance of its marketing objectives, the Trafalgar Group sought opinions from EMC Partners, American Appraisal Canada, Inc. and Fraser

Milner. These opinions dealt with a number of aspects of the proposed TIP licence marketing arrangements. In particular:

> a. in correspondence dated October 8, 1998 (an "Appraisal"), EMC Partners advised that the fair market value of the $10,000 TIP licence was in excess of $15,000 and that the Trafalgar Index Program constituted a Class 12 asset for the purposes of the ITA and the Income Tax Regulations, C.R.C., c. 945 (the "ITR");
>
> b. in correspondence dated October 20, 1998 (the "Tax Opinion"), Fraser Milner advised that, subject to certain assumptions that are not in issue in this appeal, a Canadian taxpayer who acquired a TIP licence would be able to deduct the full cost of that TIP licence over two fiscal years;
>
> c. in further correspondence dated October 20, 1998, Fraser Milner advised that the sale of TIP licences to use the Trafalgar Index Program should not attract the prospectus requirements under Ontario securities legislation; and
>
> d. in correspondence dated November 20, 1998 (an "Appraisal"), American Appraisal Canada, Inc. advised that the fair market value of a $10,000 TIP licence was estimated to be $11,700 and that each TIP licence was software for Canadian tax purposes, thus enabling the licensee to deduct the purchase price of a TIP licence against other income sources over a period of two years, in accordance with Class 12 of the ITR.

19 Mr. Allan Peters, an independent sales agent who was marketing TIP licences on behalf of TCL Trafalgar, testified that the promotional materials that were prepared by or on behalf of TCL Trafalgar, the Appraisals and the Tax Opinion were all provided to him, by or on behalf of TCL Trafalgar, for use in his marketing efforts. Mr. Peters further testified that those items were provided by him to some, if not all, of the prospective investors that he contacted. He also testified that he explained the income tax deductibility of the acquisition cost of TIP licences to those prospective investors.

…

Mr. Baxter's Purchase of the Licence

21 Mr. Baxter is a lawyer whose practice included providing income tax advice to small business clients. He received a package of materials with respect to the prospective purchase of a TIP licence from Mr. Burton Langille, an independent sales agent who was marketing them on behalf of TCL Trafalgar. Mr. Baxter reviewed the particulars of the proposed TIP licence investment with Mr.

Bradley Langille, an old friend, who was the brother of the sales agent. Mr. Baxter did not review the Appraisals but did review the Tax Opinion.

22 In evaluating the investment opportunity, Mr. Baxter relied on the business acumen of his friend, Mr. Bradley Langille, who had apparently reviewed the financial aspects of the investment. Mr. Baxter testified that he did not understand the workings of the software but was impressed with the favourable financial projections that were included in the promotional materials. He indicated that he knew that a TIP licence was a Class 12 asset, the cost of which was deductible over a two year period. On December 31, 1998, he executed the three documents (the "License Agreement", the "Promissory Note" and the "Agency Agreement", copies of which were before this Court) that were provided to him by the sales agent.

…

Analysis

The Tax Shelter Issue

…

What is the "property"?

35 The TCC found that the property, for the purposes of the definition of tax shelter, was the actual TIP licence that was acquired by Mr. Baxter. The respondent supported this finding, while the Minister essentially argued that the property was all of the TIP licences that were being offered for sale by TCL Trafalgar. In my view, the position of the Minister is correct.

36 The words "if a person were to acquire an interest in the property" demonstrate that the definition of tax shelter is forward-looking and that the person referred to is a prospective purchaser of the property. This means that the determination of whether any property constitutes a tax shelter must be made in the context of an assumed sale of that property to a prospective purchaser and, therefore, in advance of any actual sale of that property. This conclusion is supported by subsections 237.1(2) and (4), which mandate the acquisition of an identification number before any sale of a property that constitutes a tax shelter is permissible. In the actual circumstances under consideration, "any property" means any of the TIP licences that TCL Trafalgar proposed to market to prospective purchasers.

What constitutes "statements or representations"?

37 A property cannot constitute a tax shelter if no statements or representations are ever made with respect to the amount that a prospective

purchaser would be able to deduct in computing income as a consequence of an assumed acquisition of that property. Accordingly, the existence of statements or representations in connection with a property is a necessary condition to a conclusion that the property constitutes a tax shelter.

38 The Appraisals and the Tax Opinion were prepared in advance of, and in connection with, the proposed marketing of TIP licences by or on behalf of TCL Trafalgar. Each of those items, and in particular the Tax Opinion, addressed the proposed income tax consequences that would arise out of an acquisition of a TIP licence by a prospective investor. Moreover, the Tax Opinion specifically stated that its contents could be shown to prospective purchasers of TIP licences. I have no difficulty in concluding that the statements in the Appraisals and the Tax Opinion that indicated that the acquisition cost of TIP licences would be fully deductible to prospective purchasers over a two year period, constitute statements or representations of the kind required by the definition of tax shelter. Accordingly, I conclude that the existence of statements or representations in connection with the TIP licences has been established.

39 If TCL Trafalgar had prepared and distributed a prospectus or offering memorandum that contained the income tax assertions that were in the Appraisals and the Tax Opinion, it is evident that the requirement for tax representations of the type contemplated by the definition of tax shelter would have been met. The isolation of the tax representations into discrete documents, namely the Appraisals and the Tax Opinion, which were included in the package of promotional materials that were made available to prospective purchasers of TIP licences, cannot prevent a conclusion that the requirement for statements or representations in the definition of tax shelter has been fulfilled.

To whom and by whom must statements or representations be made?

40 The TCC held that statements or representations of the type contemplated by the definition of tax shelter were required to have been made to Mr. Baxter. The respondent supported this finding, while the Minister essentially argued that the definition of tax shelter does not require the statements or representations to be made to any particular or identifiable person. In my view, neither of these propositions is correct.

41 The opening portion of the definition of tax shelter contains a requirement that statements or representations be made in connection with the property. However, the definition does not specify the identity of either the person who must make the statements or representations or the person to whom they must be made. It is not clear whether this apparent imprecision in drafting was deliberate. What is clear is that a property cannot constitute a tax shelter unless statements or representations of the type contemplated by the definition of tax shelter have been made, at some point in time, in connection with the property.

42 Some additional uncertainty might be said to have arisen in the interpretation of the definition of tax shelter because the initial portion of the definition refers to statements or representations, but paragraph (a) of the definition refers only to an amount represented to be deductible. In *Maya Inc. c. R.*, 2003 TCC 502 (T.C.C. [General Procedure]), Dussault T.C.J., at paragraph 13 of his decision, indicated that the amount represented to be deductible for the purposes of paragraph (a) of the definition was the amount that had been "proposed" to the prospective purchaser of the property. I agree with this non-technical approach to the meaning of the word represented and conclude that its use is intended to do no more than convey the notion that the amount that is the subject matter of the statements or representations contemplated by the opening portion of the definitions has been made known to the prospective purchasers of the property in question. To that extent, words such as communicated or announced could also be used to explain what is meant by the word represented in paragraph (a) of the definition of tax shelter. Indeed, the meaning of either of those words appear to be generally consistent with the meaning of the word "annoncé", which appears in the French version of paragraph (a) of the definition.

43 The opening portion of the definition of tax shelter makes it clear that the statements or representations must be made in connection with the assumed acquisition of the property by the prospective purchaser. Paragraph (a) of the definition refers to an amount represented to be deductible in respect of the property and expected to be incurred by the prospective purchaser. Accordingly, I conclude that the statements or representations are required to be made to the prospective purchaser of the property.

44 While neither of the parties to this appeal, nor the TCC in its decision, focused much attention on the identity of the party who must have made the statements or representations, in my view, it would be reasonable to conclude that it must be each person who constitutes a promoter, as defined in subsection 237.1(1) (a "promoter").

45 The Tax Opinion and the Appraisals contained income tax assertions that constituted statements or representations of the kind required by the definition of tax shelter. Those items were provided by or on behalf of TCL Trafalgar to the independent sales agents for use by them in the marketing of TIP licences to prospective purchasers and those items were in fact used by the agents in their marketing efforts. Each of TCL Trafalgar and the independent sales agents was a promoter. It is therefore apparent that the statements or representations in question were made, that is to say announced, communicated or make known, by or on behalf of a promoter to prospective purchasers of the TIP licences. Accordingly, the communication requirements in relation to the statements or representations component of the definition of tax shelter were met.

…

“Reasonably be considered” by whom?

53 The respondent argued that the definition of tax shelter that was applicable to the taxation years in issue in this appeal was further problematic in that it provided no indication as to how the reasonableness requirement of that definition was to be dealt with by the Court. The respondent suggested that the reasonableness requirement might be applied having regard to the “tax knowledge and sophistication” of the person to whom the statements or representations were made.

54 Because of my conclusion that the person referred to in the definition of tax shelter is a prospective purchaser of the property, no consideration of the subjective knowledge of that person would be possible.

55 The respondent also raised the question as to whether the statements or representations that were made could reasonably be considered to have led to the inference or conclusion that the mathematical component of the definition of tax shelter had been met. In that respect, the respondent questioned whether it would be reasonable to accept the oral or written statements or representations of selling agents to that effect. Instead, the respondent argued that it would be more reasonable to rely on the Tax Opinion, which, according to the respondent, should have led to the conclusion that the TIP licences could not constitute tax shelters because the prepaid expense component of the License Fee (being deductible over the ten year period) caused the mathematical component of the definition of tax shelter to be unfulfilled.

56 This argument is a virtual concession on the part of the respondent that the Tax Opinion constitutes the fulfillment of the representational component of the definition of tax shelter. For the reasons previously given, I have concluded that the prepaid expense argument, as the basis for the failure of the mathematical component of the definition, cannot succeed. Indeed, on the question of whether or not the TIP licences that were offered for sale to prospective investors constituted tax shelters, the Tax Opinion does not even raise that argument. Instead, the Tax Opinion concludes that it is because of the assumed absence of representations to potential investors that the TIP licences are not tax shelters.

57 It is incongruous to contend that even though the Tax Opinion advised prospective purchasers of TIP licences that the full acquisition cost of those TIP licences should be deductible over two fiscal years, such advice did not constitute statements or representations to those prospective purchasers that fulfilled the mathematical requirement of the definition of tax shelter. It follows, in my view, that the statements in the Tax Opinion that indicated that the acquisition cost of TIP licences would be deductible to prospective investors over a two year period can reasonably be considered to have lead to the conclusion that the mathematical component of the definition of tax shelter would have been met in relation to prospective purchases of TIP licences by prospective purchasers.

Conclusion

> 58 In the circumstances under consideration, TCL Trafalgar, through its employees and agents, undertook an organized campaign to market TIP licences to the public. An important marketing feature was the favourable income tax deductions that were expected to be available to purchasers of TIP licences. The Tax Opinion and the Appraisals were requested and obtained to provide independent confirmation that the acquisition cost of TIP licences would be fully deductible to prospective purchasers of TIP licences over a two year period. These items were provided by or on behalf of TCL Trafalgar to the independent sales agents, as important marketing tools to be used by them in their sales efforts. The Tax Opinion and the Appraisals, in some instances, were given to prospective purchasers, thereby communicating or announcing to prospective purchasers that if they were to purchase TIP licences, the acquisition cost of those TIP licences would be fully deductible to them over a two year period. Accordingly, in my view, all of the requirements of the definition of tax shelter were met, all of the TIP licences that were marketed by or on behalf of TCL Trafalgar, including the TIP licence that was acquired by Mr. Baxter, were tax shelters and a tax shelter identification number should have been obtained before any of the TIP licences were sold.

[26] In this case, the "property" is the Software owned by IAC which it proposed to sell to investors and ultimately sold to Mr. Krumm.

[27] With respect to statements or representations, I note that IAC engaged EMC partners to provide it with the Valuation Report in respect of the Software for the purpose of determining its value in anticipation of selling an interest in it to prospective investors. The Report, dated June 25, 1997, provided as follows:

> 1. You have requested our opinion as to the fair market value, as at June 25, 1997, of a 100% interest in Intersports Interactive Scouting, Analysis, Management (S.A.M.) Computer System (the Computer Program), an application software program that supports sports coaches in the scouting, analysis and management of teams and athletes.
>
> […]
>
> 4. We understand that you have requested this report for the purpose of determining the value of the Computer Program in anticipation of selling an interest in it to Investors. However, in determining the value of the Computer Program, we have not taken into consideration the terms and conditions of the proposed purchase and of the associated financing except as those they may apply to the definition of the Computer Program and to the definition of the various Company revenue streams and to provide a degree of comfort that the allocation

of gross margins between the Investor and the Company are reasonable and sustainable.

[…]

6. Based on the information provided and documentation reviewed, and subject to the restrictions, qualifications and assumptions noted herein, it is our opinion that the fair market value of the Computer Program as of 25 June, 1997 is not less than $11.2 million (rounded).

7. We are also of the opinion that the Computer Program is application software and is available for use as those terms are defined in the *Income Tax Act*.

[…]

24. The Computer Program is commercially exploitable and, pursuant to the Software Acquisition Agreement, are being distributed to end users now under the overall direction and control of Intersports Acceleration Corp.

[…]

34. Intersports Acceleration Corp. and the Investor will execute an Acquisition Agreement which deals with royalties, marketing and performance targets for sales and revenues to be paid to the Investor and which will cover the terms and conditions of the acquisition of the Computer Program.

35. It is our opinion that part of the proposed Acquisition Agreement constitutes a software acquisition within the normal meaning of that arrangement within the computer services industry and contains the normal provisions to be found in such contracts. In addition, as a result of the above terms and conditions, we viewed the payment obligations of Intersports Acceleration Corp. to the Investor contained in the Software Agreement to be reasonable and conservative.

36. The value of the Computer Programs is based in part upon the terms of the Software Agreement, which includes:

> (a) the sale, in perpetuity, of a portion of all right, title and interest in and to the Computer Program, including the source code and all enhancements, derivatives and modifications thereto;
>
> (b) the obligation of Intersports Acceleration Corp., as developer, promoter and marketer of the Computer Program and its supporting services and products, to provide all necessary equipment, development, support and documentation necessary to successfully market, sell and maintain the Computer Program effectively; and

> (c) the obligation of Intersports Acceleration Corp. to remit the required sales revenues (under the terms of the set forth in the Agreement) to the Investor in the Computer Programs.
>
> […]
>
> 48. Under the terms of the Software Agreement, the Investor is entitled to a fixed percentage of each of the gross margins from the Company's niche market coaching support products and services and a fixed percentage of profits from any sales of the Computer Programs.
>
> […]
>
> 49. In finalising our opinion as to value, we have assumed, in addition to the assumptions noted elsewhere herein, that:
>
> […]
>
> (g) Federal and Provincial income tax laws prevailing at the valuation date will continue to prevail in the foreseeable future (including the proposed changes to the *Income Tax Act* announced by the Minister of Finance on December 1, 1994);
>
> […]
>
> 51. It is our opinion that each of the modules of this Computer Program is application software and that each qualifies as a Class 12 asset for purposes of the *Income Tax Act* and the regulations thereto. Future investment in the Computer Program using provisions of this section of the Act may be compromised somewhat by the terms and conditions of this sale/acquisition.
>
> 52. It is our opinion that each of the modules of the Computer Program is commercially available for use for the purposes of the *Income Tax Act* and the regulations thereto.
>
> 53. It is our opinion, based upon the qualifications, restrictions and assumptions noted herein, that the fair market value of the revenue streams and of the Computer Program as at 25 June, 1997 is not less than $11.2 million.
>
> […]

[28] In my view, it is clear that the Valuation Report contains statements or representations which were made or proposed to be made with respect to the proposed sale by IAC of an interest in the Software to investors. It is also clear that Mr. Krumm received a copy of the Valuation Report from IAC during the negotiations leading up to his purchase of an interest in the Software. Mr. Krumm

has in this case admitted that he received the Valuation Report, so it is clear that the statements or representations set out in the Valuation Report were received by him.

[29] While Mr. Krumm testified that he did not understand or rely on the tax representations set out in the Valuation Report, I note that Justice Ryer determined in *Baxter*, at paragraph 54, that the subjective knowledge of the purchaser is not relevant because the test must be applied in respect of a prospective purchaser prior to any actual sale.

[30] In this case, the Valuation Report specified that the Software was Class 12 property and available for use. It did not, however, explicitly specify that a purchaser could deduct the purchase price of the Software for tax purposes. In this respect, I note that the Valuation Report appears to draw conclusions that were similar to the conclusions described in the EMC Partners Appraisal described in paragraph 18(a) of *Baxter*. I also note that Justice Ryer determined at paragraph 45 in *Baxter* that the Appraisals in that case, which included the EMC Partners Appraisal similar to the Valuation Report in this case, "contained income tax assertions that constituted statements or representations of the kind required by the definition of tax shelter." I find that similarly sufficient assertions are provided in the Valuation Report. It is my view that the tax opinions and representations set out in the Valuation Report were intended to advise a prospective purchaser as to the tax treatment they could expect if a purchase of Software was made. It is also my view that the representations were of sufficient detail such that it could reasonably be considered that a prospective purchaser could deduct the full purchase price of the Software over a two year period.

[31] By providing copies of the Valuation Report to Mr. Krumm, IAC and its agents could each be considered to be a tax shelter "promoter", as defined in subsection 237.1(1) of the *Act*. Accordingly, the communication requirements in relation to the statements or representations component of the definition of tax shelter are met.

[32] Mr. Krumm also argued that the tax shelter rules are intended to apply only to publicly marketed tax shelters and not to private transactions between two parties, as he alleged was the current case. In support of this, he cites a Department of Finance press release announcing past tax shelter amendments[7] and CRA

[7] Canada, Department of Finance, "Measures Limiting the Use of Tax Shelters Announced", News Release 94-112, December 1, 1994.

Technical Interpretation 5-9372.[8] However, it is clear that neither of those documents form part of the law and are not binding on this Court. In addition, it is my view that the current case falls within the descriptions set out therein. The Valuation Report IAC obtained and provided to Mr. Krumm made statements which were intended to recruit any potential investor, including Mr. Krumm, to purchase the Software on the basis of its tax characteristics.

[33] Overall, it is my view that all of the requirements of a tax shelter have been met in the circumstances of this case. IAC obtained and provided the Valuation Report to Mr. Krumm and the Valuation Report contained specific statements and representations regarding the tax status of the Software which would allow a prospective purchaser to know they could deduct the full price of the Software for CCA purposes over a two year period.

CONCLUSION

[34] Based on all of the foregoing, Mr. Krumm's appeals are dismissed.

COSTS

[35] Costs are awarded to the Respondent. The parties shall have 30 days from the date hereof to reach an agreement on costs, failing which the Respondent shall have a further 30 days to file written submissions on costs and the Appellant shall have yet a further 30 days to file a written response. Any such submissions shall not exceed 10 pages in length. If the parties do not advise the Court that they have reached an agreement and no submissions are received, costs shall be awarded to the Respondent as set out in the Tariff.

Signed at Ottawa, Canada, this day of 17th January 2020.

"Henry A. Visser"

Visser J.

[8] Dated April 23, 1990.

APPENDIX "A"

Agreed Statement of Facts (Partial)

MATERIAL FACTS

A. Background

1. The Appellant, James Krumm ("**Mr. Krumm**"), is an individual residing in Canada.

2. In or around 1978 Mr. Krumm obtained a Bachelor of Science from the University of Manitoba.

3. At all material times:

   a) Mr. Krumm was resident in Canada.

   b) Mr. Krumm's occupation was a landman.

   c) Mr. Krumm was employed by Heritage Freehold Specialists & Co. Ltd. ("**Heritage**").

   d) Heritage was owned by Mr. Krumm's holding company, Lancaster Resources Ltd. ("**Lancaster**"),

   e) Vladimir Morgan ("**Mr. Morgun**") was employed as an insurance salesman at Prudential Trust.

   f) Intersports Acceleration Corp, ("**IAC**") was incorporated on October 30, 1996 and was a Canadian-controlled private corporation.

   g) Emc partners was a valuation firm located in Toronto, Ontario ("**Emc partners**").

B. Software

The Software

4. IAC owned an application software program (the "**Software**").

5. The Software consisted of three products:

   a) interactive software for scouting, analysis, and management for all sports;

   b) European Standard of Excellence Youth Soccer Training Program; and

   c) Bayern Munich Youth Soccer Training Program.

Acquisition of Software

6. in or around 1997, Mr. Krumm was introduced to IAC through Mr. Morgun.

7. On August 1,1997, Mr. Krumm acquired a 50% Interest in the Software from IAC,

8. Dennis Nerland with Shea Nerland Calnan LLP, assisted Mr, Krumm with acquiring a 50% interest in the Software.

9. Prior to Mr. Krumm's acquisition of the Software, IAC owned 100% of the Software,

10. Mr. Krumm and IAC entered into an agreement for the purchase and sale of a 50% interest in the Software on or about August 1,1997 (the "**Asset Purchase Agreement**").

11. Mr. Krumm agreed to make an initial cash payment of $700,000 and issue a promissory note in the amount of $2.1 million in favour of IAC (the "**Promissory Note**").

12. The Promissory Note bore 4% per annum interest compounded annually.

13. Mr. Krumm and IAC also entered into an Agreement for the development, support, marketing, distribution and maintenance of the Software on or about August 1,1997 (the "**Joint Venture Agreement**").

14. Mr. Krumm appointed and licensed IAC to be his exclusive world-wide representative and agent to exploit the Software.

15. Mr. Krumm and IAC agreed that Mr. Krumm would not exercise any rights to develop, support, market, distribute or maintain the Software.

16. Mr. Krumm and IAC agreed that IAC would pay to Mr. Krumm a percentage of net sales within 30 days of the end of each month (the "**Distribution**") as follows:

    a) 35% of net sales between the period August 1,1997 and July 31,1998;

    b) 25% of net sales between the period August 1, 1998 andJuly 31,1999;

    c) 15% of net sales between the period August 1,1999 and July 31,2000; and,

    d) 3% thereafter.

17. It was represented to Mr. Krumm that the Distribution would aggregate not less than 200% of the aggregate amount of the principal sum and all interest payable pursuant to the Promissory Note (the "**Represented Amount**").

18. Mr. Krumm and IAC agreed that Mr. Krumm would be entitled to damages from IAC in the event Mr. Krumm did not receive the Represented Amount and that the amount of the damages would equal the Represented Amount.

19. Mr. Krumm and IAC agreed that 30% of any Distribution made to Mr, Krumm would be paid by Mr. Krumm to IAC as a prepayment towards the principal amount payable on the Promissory Note.

20. Mr. Krumm and IAC agreed that, from the Distribution, Mr. Krumm would first make an interest payment to IAC and then make a payment of the principal against the Promissory Note until such time as the Promissory Note was retired.

21. The initial term of the Joint Venture Agreement was 10 years and was renewable for successive five-year terms upon notice given by IAC.

r

Valuation Report

22. IAC engaged Emc partners.

23. Emc partners prepared a valuation report (the "Valuation Report").

Purchase of the Software and subsequent steps

24. Mr. Krumm provided a cheque in the amount of $700,000 dated July 31, 1997 payable to the trust account of Shea Norland Calnan.

25. On April 4,1998, Mr. Krumm subscribed for 550,000 class A common shares of IAC for $200,000.

26. On August 20,1998, IAC transferred the remaining 50% interest in the Software to Intersports Limited Partnership ("**ILP**").

    a) IAC was the principal partner of IIP.

27. On August 20, 1998, ILP sold its interest in the Software to Intersports Software Development Corporation ("**ISDC**").

28. On September 30, 1998, ISDC acquired SAMsports.com Inc. ("**SAM**") in a reverse takeover.

29. On April 30, 1999, ISDC and SAM amalgamated and continued business under the name of Samsports.

30. On October 29, 1999, Mr. Krumm sold his interest in the Software to SAM.

31. SAM agreed to pay a royalty to Mr. Krumm on the net sales of the Software as follows:

    a) 35% until Mr. Krumm received $460,950;

    b) 25% until Mr. Krumm received an additional $2,403,625;

    c) 15% until Mr. Krumm received an additional$2,607,300; and,

    d) 3% thereafter.

32. On November 19,1999, SAM entered into an option agreement giving SAM the option to terminate the royalty payments provided for in the Samsports Agreement.

33. On July 22, 2000, Mr. Krumm entered into a put/catl agreement with IAC (the "**Put/Call Agreement**").

34. Under the Put/Cail Agreement Mr. Krumm acquired the right to require IAC to purchase his shares or his interest in the royalty payments as provided for in the Samsports Agreement for the sum of $2.7 million or to cancel the Promissory Note if the trading price of Mr. Krumm's shares in SAM on December 1, 2004 were less than $2.7 million.

35. SAM liquidated and ceased operations in early 2001 and, on January 31, 2001, faced orderly disposition of its assets.

36. On April 3, 2003, IAC was dissolved involuntarily.

37. The income from Mr. Krumm's interest in the Software, excluding any deduction for capital cost allowance, for 1997 and 1998 was nil.

38. The Minister of National Revenue did not issue a tax shelter number with respect to any part of the sale of the Software or any rights that were acquired in relation to the Software including those contained in the Asset Purchase Agreement, the Joint Venture Agreement and the Promissory Note.

C. Tax Appeal Process

39. In his 1997 and 1998 income tax returns, Mr. Krumm deducted the following amounts in relation to the Software:

	1997	1998
Capital cost allowance ("**CCA**") in respect of class 12 software	$1,400,000	$1,400,000
Carrying charges and interest expense	$10,849	$76,904

40. The Minister initially assessed Mr. Krumm's tax liability for the 1997 and 1998 taxation years by notices dated May 28,1998 and August 20,1999, respectively.

41. By Notices of Reassessment dated March 30, 2000, the Minister reassessed Mr. Krumm's tax liability for the 1997 and 1998 taxation years by disallowing the 1997 business loss, the 1998 business loss and the interest expense in respect of the Software.

42. Mr. Krumm filed notices of objection to these reassessments on June 23, 2000,

43. The Minister reassessed Mr. Krumm for the 1997 and 1998 taxation years by notice dated October 16, 2001 to apply loss carrybacks which are unrelated to the issues in this appeal.

44. Mr. Krumm filed a notice of objection on December 19, 2001.

45. By agreement between the parties, Mr. Krumm's objection was stayed pending the outcome of another appeal before the Tax Court of Canada, *Brown v. R*, 2001 CanLII 788

46. The Minister confirmed the reassessment by notice dated September 23, 2015.

47. Mr. Krumm filed a notice of appeal on December 17, 2015.

Appendix "B"

Legislation

The statutory references in this schedule are to provisions of the *Income Tax Act* or *Income Tax Regulations* as were in force in taxation years 1997 and 1998.

237.1 (1) Definitions - In this section,

"**person**" includes a partnership;

"**promoter**" in respect of a tax shelter means a person who in the course of a business

(a) sells or issues, or promotes the sale, issuance or acquisition of, the tax shelter,

(b) acts as an agent or adviser in respect of the sale or issuance, or the promotion of the sale, issuance or acquisition, of the tax shelter, or

(c) accepts, whether as a principal or agent, consideration in respect of the tax shelter,

and more than one person may be a tax shelter promoter in respect of the same tax shelter;

"**tax shelter**" means any property (including, for greater certainty, any right to income) in respect of which it can reasonably be considered, having regard to statements or representations made or proposed to be made in connection with the property, that, if a person were to acquire an interest in the property, at the end of a particular taxation year that ends within 4 years after the day on which the interest is acquired,

(a) the total of all amounts each of which is

(i) an amount, or a loss in the case of a partnership interest, represented to be deductible in computing income in respect of the interest in the property (including, where the property is a right to income, an amount or loss in respect of that right that is represented to be deductible) and expected to be incurred by or allocated to the person for the particular year or any preceding taxation year, or

(ii) any other amount represented to be deductible in computing income or taxable income in respect of the interest in the property and expected to be incurred by or allocated to the person for the particular year or any preceding taxation year, other than any amount included in computing a loss described in subparagraph (i),

would equal or exceed

(b) the amount, if any, by which

(i) the cost to the person of the interest in the property at the end of the particular year, determined without reference to section 143.2,

would exceed

(ii) the total of all amounts each of which is the amount of any prescribed benefit that is expected to be received or enjoyed, directly or indirectly, in respect of the interest in the property by the person or another person with whom the person does not deal at arm's length,

but does not include property that is a flow-through share or a prescribed property.

(2) Application - A promoter in respect of a tax shelter shall apply to the Minister in prescribed form for an identification number for the tax shelter unless an identification number therefor has previously been applied for.

(3) Identification - On receipt of an application under subsection (2) for an identification number for a tax shelter, together with prescribed information and an undertaking satisfactory to the Minister that books and records in respect of the tax shelter will be kept and retained at a place in Canada that is satisfactory to the Minister, the Minister shall issue an identification number for the tax shelter.

(4) Sales prohibited - No person shall, whether as a principal or an agent, sell or issue, or accept consideration in respect of, a tax shelter before the Minister has issued an identification number for the tax shelter.

(5) Providing tax shelter number - Every promoter in respect of a tax shelter shall

(a) make reasonable efforts to ensure that all persons who acquire or otherwise invest in the tax shelter are provided with the identification number issued by the Minister for the tax shelter;

(b) prominently display on the upper right-hand corner of any statement of earnings prepared by or on behalf of the promoter in respect of the tax shelter the identification number issued for the tax shelter; and

(c) on every written statement made after 1995 by the promoter that refers either directly or indirectly and either expressly or impliedly to the issuance by the Department of National Revenue of an identification number for the tax shelter, as well as on the copies of the portion of the information return to be forwarded pursuant to subsection (7.3), prominently display

(i) where the statement or return is wholly or partly in English, the following:

"The identification number issued for this tax shelter shall be included in any income tax return filed by the investor. Issuance of the identification number is for administrative purposes only and does not in any way confirm the entitlement of an investor to claim any tax benefits associated with the tax shelter."

(ii) where the statement or return is wholly or partly in French, the following:

"Le numéro d'inscription attribué à cet abri fiscal doit figurer dans toute déclaration d'impôt sur le revenu produite par l'investisseur. L'attribution de ce numéro n'est qu'une formalité administrative et ne confirme aucunement le droit de l'investisseur aux avantages fiscaux découlant de cet abri fiscal."

and

(iii)where the statement includes neither English nor French, the following:

"The identification number issued for this tax shelter shall be included in any income tax return filed by the investor. Issuance of the identification number is for administrative purposes only and does not in any way confirm the entitlement of an investor to claim any tax benefits associated with the tax shelter."

"Le numéro d'inscription attribué à cet abri fiscal doit figurer dans toute déclaration d'impôt sur le revenu produite par l'investisseur. L'attribution de ce numéro n'est qu'une formalité administrative et ne confirme aucunement le droit de l'investisseur aux avantages fiscaux découlant de cet abri fiscal."

(6) Deductions and claims disallowed - No amount may be deducted or claimed by a person in respect of a tax shelter unless the person files with the Minister a prescribed form containing prescribed information, including the identification number for the tax shelter.

(6.1) Deductions and claims disallowed - No amount may be deducted or claimed by any person for any taxation year in respect of a tax shelter of the person where any person is liable to a penalty under subsection (7.4) or 162(9) in respect of the tax shelter or interest on the penalty and

(a) the penalty or interest has not been paid; or

(b) the penalty and interest have been paid, but an amount on account of the penalty or interest has been repaid under subsection 164(1.1) or applied under subsection 164(2).

(6.2) Assessments - Notwithstanding subsections 152(4) to (5), such assessments, determinations and redeterminations may be made as are necessary to give effect to subsection (6.1).

(7) Information return - Every promoter in respect of a tax shelter who accepts consideration in respect of the tax shelter or who acts as a principal or agent in respect of the tax shelter in a calendar year shall, in prescribed form and manner, file an information return for the year containing

(a) the name, address and either the Social Insurance Number or business number of each person who so acquires or otherwise invests in the tax shelter in the year,

(b) the amount paid by each of those persons in respect of the tax shelter, and

(c) such other information as is required by the prescribed form

unless an information return in respect of the tax shelter has previously been filed.

(7.1) Time for filing return - An information return required under subsection (7) to be filed in respect of the acquisition of an interest in a tax shelter in a calendar year shall be filed with the Minister on or before the last day of February of the following calendar year.

(7.2) Time for filing – special case - Notwithstanding subsection (7.1), where a person is required under subsection (7) to file an information return in respect of a business or activity and the person discontinues that business or activity, the return shall be filed on or before the earlier of

(a) the day referred to in subsection (7.1); and

(b) the day that is 30 days after the day of the discontinuance.

(7.3) Copies to be provided - Every person required to file a return under subsection (7) shall, on or before the day on or before which the return is required to be filed with the Minister, forward to each person to whom the return relates 2 copies of the portion of the return relating to that person.

(7.4) Penalty - Every person who files false or misleading information with the Minister in respect of an application under subsection (2) or, whether as a principal or as an agent, sells, issues or accepts consideration in respect of a tax shelter before the Minister has issued an identification number for the tax shelter is liable to a penalty equal to the greater of

(a) $500, and

(b) 25% of the total of all amounts each of which is the consideration received or receivable from a person in respect of the tax shelter before the correct information is filed with the Minister or the identification number is issued, as the case may be

(8) Application of sections 231 to 231.3 - Without restricting the generality of sections 231 to 231.3, where an application under subsection (2) with respect to a tax shelter has been made, notwithstanding that a return of income has not been filed by any taxpayer under section 150 for the taxation year of the taxpayer in which an amount is claimed as a deduction in respect of the tax shelter, sections 231 to 231.3 apply, with such modifications as the circumstances require, for the purpose of permitting the Minister to verify or ascertain any information in respect of the tax shelter.

143.2(1) Definitions - The definitions in this subsection apply in this section.

"**expenditure**" means an outlay or expense or the cost or capital cost of a property.

"**limited partner**" has the meaning that would be assigned by subsection 96(2.4) if that subsection were read without reference to "if the member's partnership interest is not an exempt interest (within the meaning assigned by subsection (2.5)) at that time and".

"**limited-recourse amount**" means the unpaid principal amount of any indebtedness for which recourse is limited, either immediately or in the future and either absolutely or contingently.

"**taxpayer**" includes a partnership.

"**tax shelter investment**" means

(a) a property that is a tax shelter for the purpose of subsection 237.1(1); or

(b) a taxpayer's interest in a partnership where

(i) an interest in the taxpayer

(A) is a tax shelter investment, and

(B) the taxpayer's partnership interest would be a tax shelter investment if

(I) this Act were read without reference to this paragraph and to the words "having regard to statements or representations made or proposed to be made in connection with the property" in the definition "tax shelter" in subsection 237.1(1),

(II) the references in that definition to "represented" were read as references to "that can reasonably be expected", and

(III) the reference in that definition to "is represented" were read as a reference to "can reasonably be expected",

(ii) another interest in the partnership is a tax shelter investment, or

(iii) the taxpayer's interest in the partnership entitles the taxpayer, directly or indirectly, to a share of the income or loss of a particular partnership where

(A) another taxpayer holding a partnership interest is entitled, directly or indirectly, to a share of the income or loss of the particular partnership, and

(B) that other taxpayer's partnership interest is a tax shelter investment.

(2) At-risk adjustment - For the purpose of this section, an at-risk adjustment in respect of an expenditure of a particular taxpayer, other than the cost of a partnership interest to which subsection 96(2.2) applies, means any amount or benefit that the particular taxpayer, or another taxpayer not dealing at arm's length with the particular taxpayer, is entitled, either immediately or in the future and either absolutely or contingently, to receive or to obtain, whether by way of reimbursement, compensation, revenue guarantee, proceeds of disposition, loan or any other form of indebtedness, or in any other form or manner whatever, granted or to be granted for the purpose of reducing the impact, in whole or in part, of any loss that the particular taxpayer may sustain in respect of the expenditure or, where the expenditure is the cost or capital cost of a property, any loss from the holding or disposition of the property.

(3) Amount or benefit not included - For the purpose of subsection (2), an at-risk adjustment in respect of a taxpayer's expenditure does not include an amount or benefit

(a) to the extent that it is included in determining the value of J in the definition "cumulative Canadian exploration expense" in subsection 66.1(6), of M in the definition "cumulative Canadian development expense" in subsection 66.2(5) or of I in the definition "cumulative Canadian oil and gas property expense" in subsection 66.4(5) in respect of the taxpayer; or

(b) the entitlement to which arises

(i) because of a contract of insurance with an insurance corporation dealing at arm's length with the taxpayer (and, where the expenditure is the cost of an interest in a partnership, with each member of the partnership) under which the taxpayer is insured against any claim arising as a result of a liability incurred in the ordinary course of carrying on the business of the taxpayer or the partnership,

(ii) as a consequence of the death of the taxpayer,

(iii) in respect of an amount not included in the expenditure, determined without reference to subparagraph (6)(*b*)(ii), or

(iv) because of an excluded obligation (as defined in subsection 6202.1(5) of the *Income Tax Regulations*) in relation to a share issued to the taxpayer or, where the expenditure is the cost of an interest in a partnership, to the partnership.

(4) Amount or benefit - For the purposes of subsections (2) and (3), where the amount or benefit to which a taxpayer is entitled at any time is provided by way of an agreement or other arrangement under which the taxpayer has a right, either immediately or in the future and either absolutely or contingently (otherwise than as a consequence of the death of the taxpayer), to acquire property, for greater certainty the amount or benefit to which the taxpayer is entitled under the agreement or arrangement is considered to be not less than the fair market value of the property at that time.

(5) Amount or benefit - For the purposes of subsections (2) and (3), where the amount or benefit to which a taxpayer is entitled at any time is provided by way of a guarantee, security or similar indemnity or covenant in respect of any loan or other obligation of the taxpayer, for greater certainty the amount or benefit to which the taxpayer is entitled under the guarantee or indemnity at any particular time is considered to be not less than the total of the unpaid amount of the loan or obligation at that time and all other amounts outstanding in respect of the loan or obligation at that time.

(6) Amount of expenditure - Notwithstanding any other provision of this Act, the amount of any expenditure that is, or is the cost or capital cost of, a taxpayer's tax shelter investment, and the amount of any expenditure of a taxpayer an interest in which is a tax shelter investment, shall be reduced to the amount, if any, by which

(a) the amount of the taxpayer's expenditure otherwise determined

exceeds

(b) the total of

(i) the limited-recourse amounts of

(A) the taxpayer, and

(B) all other taxpayers not dealing at arm's length with the taxpayer

that can reasonably be considered to relate to the expenditure,

(ii) the taxpayer's at-risk adjustment in respect of the expenditure, and

(iii) each limited-recourse amount and at-risk adjustment, determined under this section when this section is applied to each other taxpayer who deals at arm's length with and holds, directly or indirectly, an interest in the taxpayer, that can reasonably be considered to relate to the expenditure.

(7) Repayment of indebtedness - For the purpose of this section, the unpaid principal of an indebtedness is deemed to be a limited-recourse amount unless

(a) *bona fide* arrangements, evidenced in writing, were made, at the time the indebtedness arose, for repayment by the debtor of the indebtedness and all interest on the indebtedness within a reasonable period not exceeding 10 years; and

(b) interest is payable at least annually, at a rate equal to or greater than the lesser of

(i) the prescribed rate of interest in effect at the time the indebtedness arose, and

(ii) the prescribed rate of interest applicable from time to time during the term of the indebtedness,

and is paid in respect of the indebtedness by the debtor no later than 60 days after the end of each taxation year of the debtor that ends in the period.

(8) Limited-recourse amount - For the purpose of this section, the unpaid principal of an indebtedness is deemed to be a limited-recourse amount of a taxpayerwhere the taxpayer is a partnership and recourse against any member of the partnership in respect of the indebtedness is limited, either immediately or in the future and either absolutely or contingently.

(9) Timing - Where at any time a taxpayer has paid an amount (in this subsection referred to as the "repaid amount") on account of the principal amount of an indebtedness that was, before that time, the unpaid principal amount of a loan or any other form of indebtedness to which subsection (2) applies (in this subsection referred to as the "former amount or benefit") relating to an expenditure of the taxpayer,

(a) the former amount or benefit is considered to have been an amount or benefit under subsection (2) in respect of the taxpayer at all times before that time; and

(b) the expenditure is, subject to subsection (6), deemed to have been made or incurred at that time to the extent of, and by the payment of, the repaid amount.

(10) Timing - Where at any time a taxpayer has paid an amount (in this subsection referred to as the "repaid amount") on account of the principal amount of an indebtedness which was, before that time, an unpaid principal amount that was a limited-recourse amount (in this subsection referred to as the "former limited-recourse indebtedness") relating to an expenditure of the taxpayer,

(a) the former limited-recourse indebtedness is considered to have been a limited-recourse amount at all times before that time; and

(b) the expenditure is, subject to subsection (6), deemed to have been made or incurred at that time to the extent of, and by the amount of, the repaid amount.

(11) Short-term debt - Where a taxpayer pays all of the principal of an indebtedness no later than 60 days after that indebtedness arose and the indebtedness would otherwise be considered to be a limited- recourse amount solely because of the application of subsection (7) or (8), that subsection does not apply to the indebtedness unless

(a) any portion of the repayment is made with a limited-recourse amount; or

(b) the repayment can reasonably be considered to be part of a series of loans or other indebtedness and repayments that ends more than 60 days after the indebtedness arose.

(12) Series of loans or repayments - For the purpose of paragraph (7)(a), a debtor is considered not to have made arrangements to repay an indebtedness within 10 years where the debtor's arrangement to repay can reasonably be considered to be part of a series of loans or other indebtedness and repayments that ends more than 10 years after it begins.

(13) Information located outside Canada - For the purpose of this section, where it can reasonably be considered that information relating to indebtedness that relates to a taxpayer's expenditure is available outside Canada and the Minister is not satisfied that the unpaid principal of the indebtedness is not a limited-recourse amount, the unpaid principal of the indebtedness relating to the taxpayer's expenditure is deemed to be a limited-recourse amount relating to the expenditure unless

(a) the information is provided to the Minister; or

(b) the information is located in a country with which the Government of Canada has entered into a tax convention or agreement that has the force of law in Canada and includes a provision under which the Minister can obtain the information.

(14) Information located outside Canada - For the purpose of this section, where it can reasonably be considered that information relating to whether a taxpayer is not dealing at arm's length with another taxpayer is available outside Canada and the Minister is not satisfied that the taxpayer is dealing at arm's length with the other taxpayer, the taxpayer and the other taxpayer are deemed not to be dealing with each other at arm's length unless

the information is provided to the Minister; or

the information is located in a country with which the Government of Canada has entered into a tax convention or agreement that has the force of law in Canada and includes a provision under which the Minister can obtain the information.

(15) Assessments - Notwithstanding subsections 152(4) to (5), such assessments, determinations and redeterminations may be made as are necessary to give effect to this section.

67 General limitation re expenses In computing income, no deduction shall be made in respect of an outlay or expense in respect of which any amount is otherwise deductible under this Act, except to the extent that the outlay or expense was reasonable in the circumstances.

Income Tax Regulations

PART XI

Capital Cost Allowances

Deductions Allowed

1100(1) For the purposes of paragraphs 8(1)(*j*) and (*p*) and 20(1)(*a*) of the Act, the following deductions are allowed in computing a taxpayer's income for each taxation year:

(a) rates - subject to subsection (2), such amount as the taxpayer may claim in respect of property of each of the following classes in Schedule II not exceeding in respect of property

[...]

(xii) of Class 12, 100 per cent,

[...]

of the undepreciated capital cost to him as of the end of the taxation year (before making any deduction under this subsection for the taxation year) of property of the class;

[...]

(20.1) Computer Software Tax Shelter Property The total of all amounts each of which is a deduction in respect of computer software tax shelter property allowed to the taxpayer under subsection (1) in computing a taxpayer's income for a taxation year shall not exceed the amount, if any, by which

(a) the total of all amounts each of which is

(i) the taxpayer's income for the year from a business in which computer software tax shelter property owned by the taxpayer is used, computed without reference to any deduction under subsection (1) in respect of such property, or

(ii) the income of a partnership from a business in which computer software tax shelter property owned by the partnership is used, to the extent of the taxpayer's share of such income that is included in computing the taxpayer's income for the year,

exceeds

(b) the total of all amounts each of which is

(i) a loss of the taxpayer from a business in which computer software tax shelter property is used, computed without reference to any deduction under subsection (1) in respect of such property, or

(ii) a loss of a partnership from a business in which computer software tax shelter property is used, to the extent of the taxpayer's share of such loss that is included in computing the taxpayer's income for the year.

(20.2) Computer Software Tax Shelter Property For the purpose of this Part, computer software tax shelter property is computer software that is depreciable property of a prescribed class of a person or partnership where

(a) the person's or partnership's interest in the property is a tax shelter investment (as defined by subsection 143.2(1) of the Act) determined without reference to subsection (20.1); or

(b) an interest in the person or partnership is a tax shelter investment (as defined by subsection 143.2(1) of the Act) determined without reference to subsection (20.1).

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