Docket: 2006-2996(IT)G

BETWEEN:

THE TORONTO-DOMINION BANK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Motions heard on April 18, 2008 at Toronto, Ontario
Before: The Honourable Justice Wyman W. Webb

Appearances:

Counsel for the Appellant:	Ian MacGregor and Pooja Samtani
Counsel for the Respondent:	Donald G. Gibson and Pascal Tetrault

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ORDER

Upon Motion by the Respondent to amend several paragraphs of the Reply;

And upon Motion by the Appellant to strike certain paragraphs (or parts of paragraphs) of the Reply or the Amended Reply;

It is ordered that the Reply filed by the Respondent is amended as set out in the Amended Reply, a copy of which was submitted as part of the Respondent's Motion Record, except that paragraph 28 gg) is stricken from the Amended Reply and the reference to subsection 69(1) is stricken from paragraph 32 of the Amended Reply, and therefore the Amended Reply is as attached hereto as Schedule "A".

Costs of these motions shall be in the cause.

Signed at Halifax, Nova Scotia, this 14th day of May 2008.

"Wyman W. Webb"

Webb J.

Schedule "A"

2006-2996(IT)G

TAX COURT OF CANADA

BETWEEN:

THE TORONTO-DOMINION BANK

Appellant

- and -

HER MAJESTY THE QUEEN

Respondent

AMENDED REPLY

OVERVIEW

In this appeal, the Appellant artificially or unduly created a loss by entering into an elaborate series of transactions (the "Scheme") that ended with the disposition of a new special class (Class E) of shares of a corporation. As part of the Scheme, the Appellant subscribed to Class E shares, which were issued at a low par value and an artifically high subscription price. Substantial dividends were declared and paid on shares in the corporation that were already owned by the Appellant, other than the Class E Shares. These dividends were then immediately returned to the corporation paying them by the Appellant subscribing for additional Class E shares, which were ultimately disposed of at an artifical loss. At the end of the day, the Appellant is seeking to deduct an alleged loss from the disposition of the Class E shares without having legitimately supported the

cost of those shares. The Scheme falls within the four corners of subsection 55(1) of the *Income Tax Act* (the "*Act*"), with the result that the deduction of the loss on the Class E shares is therefore prohibited. In addition, the adjusted cost base of the Class E shares is in issue, and a proper allocation of the proceeds of disposition among all classes of shares in the corporation owned by the Appellant would eliminate or reduce the alleged loss on the Class E shares.

In reply to the Notice of Appeal with respect to a reassessment for the Appellant's 1989 taxation year, the Deputy Attorney General of Canada says:

A. STATEMENT OF FACTS

With respect to the facts stated in Part I of the Notice of Appeal:

1. He admits the facts stated in paragraph 1 of the Notice of Appeal.

With respect to the facts stated in Part II of the Notice of Appeal:

2. He admits the facts stated in paragraphs 2, 3 and 4 of the Notice of Appeal.

With respect to the facts stated in Part III of the Notice of Appeal:

3. He admits the facts stated in paragraphs 1(i) and 1(ii) of the Notice of Appeal. He has no knowledge of, and puts in issue, the facts stated in paragraph 1(iii).

4. He admits the facts stated in paragraphs 2, 3, 4, 6, 7, 8, 10, 11, 12, 13, 14, 15, 16, 17, 33, 34, 40, 41 and 42 of the Notice of Appeal.

5. Deleted.

6. He admits that shares of Oxford were also held by Loford Properties Limited ("Loford Properties") and Kent Holdings Ltd. ("Kent"), but he denies the other facts stated in paragraph 5 of the Notice of Appeal.

7. Deleted.

8. Deleted.

9. He admits the facts stated in paragraph 9 of the Notice of Appeal, but he denies that the offer to purchase was extended on an arm's length basis.

10. Deleted.

11. Deleted.

12. He has no knowledge of, and puts in issue, the facts stated in paragraph 18, and the first sentence of paragraph 19 of the Notice of Appeal.

13. He admits the second sentence of paragraph 19 and paragraphs 20, 21 and 22 of the Notice of Appeal, and says that these actions were all part of the Scheme to artificially inflate the adjusted cost base of the Class D and Class E shares.

14. He admits the facts stated in the first sentence of paragraph 23 and the first and third sentences of paragraph 24 of the Notice of Appeal, and says that these actions were all part of the Scheme to artificially inflate the adjusted cost base of the Class D and Class E shares. He denies the facts stated in the second sentences of paragraphs 23 and 24 of the Notice of Appeal.

15. Deleted.

16. He admits the facts stated in paragraphs 25, 26, 27, 28, 29 and 30 of the Notice of Appeal, and says that these actions were all part of the Scheme to artificially inflate the adjusted cost base of the Class D and Class E shares.

17. Deleted.

18. Deleted.

19. He admits the facts stated in paragraphs 31 and 32 of the Notice of Appeal, and says that these actions were all part of the Scheme to artificially inflate the adjusted cost base of the Class D and Class E shares.

20. Deleted.

21. Deleted.

22. He admits that the Appellant sold the shares of Holdings Ltd., but he denies the other facts stated in paragraph 35 of the Notice of Appeal.

23. He denies the facts stated in paragraphs 36, 37 and 38 of the Notice of Appeal.

24. He admits the facts stated in paragraph 39 of the Notice of Appeal, but says that the Appellant was wrong in doing so because there was no loss.

25. Deleted.

26. Deleted.

27. Deleted.

28. In reassessing the Appellant, the Minister of National Revenue (the "Minister") relied on the following assumptions of fact:

    a) The Appellant, by holding 337,000 shares in Oxford before 1980, held a substantial part of all the issued and outstanding shares of that company;

    b) The other shares of Oxford were held by Kent and Loford Properties;

    c) Donald Love ("Mr. Love") was the chairman of the board of directors and the president of Oxford;

    d) Mr. Love held all the issued and outstanding shares of Kent and he held, with members of his family, all the issued and outstanding shares of Loford Properties;

    e) As part of the series of transactions in issue, 91922 was incorporated on May 11, 1979;

f) On January 15, 1980, the Appellant, Mr. Love, Kent and Loford Properties entered into an agreement to subscribe and own all the issued and outstanding shares of 91922 (the "Agreement");

g) The Appellant disposed of its shares of Oxford to 91922 by way of a tax-free rollover in which he paid $8,138,000 and received as consideration shares of the capital stock of 91922;

h) The Appellant subscribed, for a total consideration of $16,900,000 (or $26 per share), for the following shares of 91922, namely 51,200 common shares, 285,000 Class A shares, 313,000 Class B shares;

i) Kent disposed of 801,555 common shares of Oxford to 91922 and received as consideration an equal number of common shares from the capital stock of 91922;

j) Loford Properties disposed of 173,445 common shares of Oxford to 91922, and received as consideration an equal number of common shares from the capital stock of 91922;

k) The Class A shares of 91922 carry the same rights as the common shares of 91922, except that they are non voting and they can be converted into common shares at the option of the holder, unless they are held by a Canadian bank;

l) The Class B shares of 91922 carry the same rights as the Class A shares of 91922, except that they can be converted at the option of the holder of Class A shares;

m) On October 29, 1980, Oxford merged with 91922 to form Oxford;

n) During the month of July, 1982, it was agreed that Oxford would create two new classes of shares, namely Class D and Class E shares;

o) The subscription price for the Class D and Class E shares was set at $300 per share, which was substantially over their par value of $1 per share;

o.1) The subscription price for the Class E shares, which was used by the Appellant as the adjusted cost base of those shares, was substantially greater than the fair market value of those shares;

o.2) The fair market value of the Classs E shares was $1 per share;

p) The rights attached to the Class E shares were essentially identical to those attached to the common shares, the Class A and Class B shares of Oxford (previously 91922), except that they and the Class A and Class B shares are non-voting;

q) Only the Appellant would subscribe for the Class E shares and only Loford Properties and Kent would subscribe for the Class D shares;

r) On July 29, 1982, Oxford declared and paid dividends of $22,000,000 (or $13.538 per share) on the common, Class A, Class B, and Class C shares. The Appellant's portion of the dividends was $8,800,000 (or 40%) received in respect of its 51,200 common shares, 285,800 Class A shares and 313,000 Class B shares. On the same date the Appellant subscribed for 22,667 Class E shares having a par value of $1 each, at a subscription price of $6,800,100 (or $300 per share). On July 29, 1982, the Appellant owned a total of 22,667 Class E shares;

s) On April 15, 1983, Oxford declared and paid dividends of $27,000,000 (or $16.615 per share) on the common, Class A, Class B, and Class C shares. No dividends were paid in respect of the Class E or Class D shares. The Appellant's portion of the dividends was $10,800,000 (or 40%) received in respect of its 51,200 common shares, 285,800 Class A shares and 313,000 Class B shares. On the same date the Appellant subscribed for 30,667 Class E shares having a par value of $1 each, at a susbscription price of $9,200,100 (or $300 per share). On April 15, 1983, the Appellant owned a total of 53,334 Class E shares;

t) On December 28, 1983, Oxford declared and paid dividends of $10,000,000 (or $5.151 per share) on the common, Class A, Class B, Class C, Class D and Class E shares. The Appellant's portion of the dividends was $4,000,000 (or 40%) received in respect of its 51,200 common shares, 285,800 Class A shares, 313,000 Class B

and 53,334 Class E shares. On the same date the Appellant subscribed for 12,000 Class E shares having a par value of $1 each, at a subscription price of $3,600,000 (or $300 per share). On December 28, 1983, the Appellant owned a total of 65,334 Class E shares;

u) On April 30, 1984, Oxford declared and paid dividends of $12,500,000 (or $6.989 per share) on the common, Class A, Class B, Class C, Class D and Class E shares. The Appellant's portion of the dividends was $5,000,000 (or 40%) received in respect of its 51,200 common shares, 285,800 Class A shares, 313,000 Class B and 65,334 Class E shares. On the same date the Appellant subscribed for 15,000 Class E shares having a par value of $1 each, at a subscription price of $4,500,000 (or $300 per share). On April 30, 1984, the Appellant owned a total of 80,334 Class E shares;

v) On July 30, 1984, Oxford declared and paid dividends of $10,000,000 (or $5.477 per share) on the common, Class A, Class B, Class C, Class D and Class E shares. The Appellant's portion of the dividends was $4,000,000 (or 40%) received in respect of its 51,200 common shares, 285,800 Class A shares, 313,000 Class B and 80,334 Class E shares. On the same date the Appellant subscribed for 10,666 Class E shares having a par value of $1 each, at a subscription price of $3,199,800 (or $300 per share). On July 30, 1984, the Appellant owned a total of 91,000 Class E shares;

w) On October 31, 1984, Oxford declared and paid dividends of $10,000,000 (or $5.398 per share) on the common, Class A, Class B, Class C, Class D and Class E shares. The Appellant's portion of the dividends was $4,000,000 (or 40%) received in respect of its 51,200 common shares, 285,800 Class A shares, 313,000 Class B and 91,000 Class E shares. On the same date the Appellant subscribed for 10,667 Class E shares having a par value of $1 each, at a subscription price of $3,200,100 (or $300 per share). On October 31, 1984, the Appellant owned a total of 101,667 Class E shares;

x) On May 23, 1985, Oxford declared (paid on November 29, 1985) dividends of $20,000,000 (or $10.643 per share) on the common, Class A, Class B, Class C, Class D and Class E shares. Oxford elected the dividends to be capital dividends on the common and the Class D shares. The Appellant's portion of the dividends was $8,000,000 (or 40%) received in respect of its 51,200 common shares, 285,800 Class A shares, 313,000 Class B and 101,667 Class E shares. On May 23, 1985 the Appellant subscribed for 1,816 Class E shares having a par value of $1 each, at a subscription price of $544,800 (or $300 per share). On May 23, 1985, the Appellant owned a total of 103,483 Class E shares;

y) On November 29, 1985, the Appellant subscribed for 24,850 Class E shares having a par value of $1 each, at a subscription price of $7,455,000 (or $300 per share). On November 29, 1985, the Appellant owned a total of 128,333 Class E shares;

z) On December 31, 1985, Oxford declared and paid dividends of $85,000,000 (or $43.683 per share) on the common, Class A, Class B, Class C, Class D and Class E shares. Oxford elected the dividends to be capital dividends on the common and the Class D shares. The Appellant's portion of the dividends was $33,999,991 (or 40%) received in respect of its 51,200 common shares, 285,800 Class A shares, 313,000 Class B and 128,333 Class E shares. On the same date the Appellant subscribed for 113,333 Class E shares having a par value of $1 each, at a subscription price of $33,999,991 (or $300 per share). On December 31, 1985, the Appellant owned a total of 241,666 Class E shares;

aa) In May 1988, Oxford, declared and paid dividends of $2,000,000 (or $0.8971965 per share) on the common, Class A, Class B, Class C, Class D and Class E shares. The Appellant's portion of the dividends was $800,000 (or 40%) received in respect of its 51,200 common shares, 285,800 Class A shares, 313,000 Class B and 241,666 Class E shares. Oxford elected that all the dividends be paid as capital dividends;

bb) Some time between March 8 and November 1, 1988, the Appellant disposed of all its shares of Oxford to Holdings Ltd. by way of tax free rollover and received as consideration shares of the capital stock of Holdings Ltd.;

cc) On December 1, 1988, Loford Properties and the Appellant terminated the Agreement through which they owned all of the issued and outstanding capital stock of Holdings Ltd.;

dd) On December 1, 1988, the Appellant disposed of shares of Holdings Ltd. as follows:

i) Holdings Ltd. redeemed the 51,200 common, 285,800 Class A and 313,000 Class B shares owned by the Appellant at a price of $46.809 per share, for an aggregate purchase price of $30,425,850. An election was made that $14,522,860 be paid as a capital dividend;

ii) Loford Properties purchased the 241,666 Class E shares of Holdings Ltd. owned by the Appellant at a price of $46.809 per share, for an aggregate purchase price of $11,312,150;

ee) On December 1, 1988, the Appellant subscribed for shares in Oxford Properties Canada Limited as follows:

i) 2,000,000 common shares for cash consideration of $3,200,000;

ii) 1,792,000 preferred shares for cash consideration of $36,288,000;

ff) The series of transactions in issue ended on December 1, 1988;

~~gg) Transactions regarding the Class E shares and the shares received in consideration for those shares artificially or unduly created a loss, or increased the amount of loss on their disposition.~~

29. The Appellant, Loford Properties, Kent, Oxford, Oxford Holdings and Mr. Love were acting without separate interest, and at non arm's length, with respect to all transactions involving

the Class D and Class E shares referred above, and any shares received as consideration for their disposition, including their final disposition on December 1, 1988.

29.1 The assumption in paragraph 28(o.2), to the effect that the fair market value of the Class E shares was $1 per share, is incorrect.

29.2 The dividends in the amounts of $85,000,000 and $2,000,000 referred to in paragraphs 28(z) and 28(aa) were paid out of contributed surplus, and were not supported by earnings.

29.3 For the purposes of subsection 55(1) of the *Act*, the series of transactions consists of those transactions involving the acquisition and disposition of the Class E shares, and the payment of dividends thereon, from July 29, 1982 to December 1, 1988.

B. ISSUES TO BE DECIDED

30. Whether the Appellant, as a result of the series of transactions, has artificially or unduly created or increased the amount of loss on the disposition of the Class E shares issued by Oxford to the Appellant, and is therefore caught by the limitation of subsection 55(1) of the *Act*.

31. Whether the adjusted cost base of the Class E shares was $300 per share.

C. STATUTORY PROVISIONS RELIED ON

32. He relies on sections 38, 39, 40, 68, 83, 89, 112, 251, subsections 55(1) ~~and 69(1)~~, and paragraph 53(1)(c) of the *Act*, as amended for the 1989 taxation year.

D. GROUNDS RELIED ON AND RELIEF SOUGHT

32.1 Mr. Love and the Appellant, who were not dealing at arm's length, agreed in advance that substantially all (between 77 percent and 100 percent) of each dividend paid would be immediately reinvested in the company. These immediate reinvestments of the dividends could not reasonably be regarded as an increase in the fair market value of the company, and therefore they do not constitute additions to the adjusted cost base of the Class D and Class E shares under paragraph 53(1)(c) of the *Act*.

32.2 While constantly maintaining their 60 percent to 40 percent shareholding ratio, Mr. Love and the Appellant agreed in advance to an artificially high subscription price for the Class D and Class E shares, which was fixed for a three and a half year period. They were indifferent as to the precise subscription price, regardless of what happened to the fair

market value of the shares of the company in the meantime. Their primary concern was that the subscription price be high, and that the number of shares issued be low.

32.3 After having agreed in advance to an artificially high subscription price for the Class D and Class E shares, Mr. Love and the Appellant agreed to arbitrarily allocate the total proceeds of disposition pro rata among the common, Class A, Class B, Class D and Class E shares. The effect of this arbitrary allocation was that the proceeds of disposition for the Class D and Class E shares was artificially low, because of the high subscription price and the low number of Class D and Class E shares.

32.4 The reason that the Appellant was able to claim a loss on the disposition of the Class E shares is that it subtracted an artificially low figure for the proceeds of disposition from an artificially high figure for the adjusted cost base. To the extent that the proper figure for the proceeds of disposition was higher, and the proper figure for the adjusted cost base was lower, the loss that it was able to claim on the disposition of the Class E shares would have been lower, or eliminated entirely.

32.5 In determining whether the loss on the disposition of the Class E shares is artificial or undue, consideration should be given to the scheme of the *Act*. Paragraph 69(1)(a) provides a mechanism to reduce to fair market value a high non-arm's length acquisition cost, namely the subscription price of the Class D and Class E shares. Section 68 provides a mechanism to properly allocate consideration for the disposition of a particular property, namely the proceeds of disposition for the Class D and Class E shares on the one hand, and the proceeds of disposition for the common, Class A and Class B shares on the other hand.

33. The creation of the Class E shares (or any shares received as consideration for their disposition) was part of the Scheme to artificially or unduly create a loss, or increase the amount of loss, on their disposition with the result that subsection 55(1) of the *Act* eliminates the loss.

34. Deleted.

E. RELIEF SOUGHT

35. He requests that the appeal be dismissed with costs.

Dated at Ottawa, Ontario, this day of 2008.

Deputy Attorney General of Canada
Solicitor for the Respondent

Per: _____
Donald G. Gibson
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Counsel for the Respondent

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AND TO: Al Meghji/Pooja Samtani
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Citation: 2008TCC284
Date: 20080514
Docket: 2006-2996(IT)G

BETWEEN:

THE TORONTO-DOMINION BANK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR ORDER

Webb J.

[1] There are two motions in this matter. The Respondent's motion is to amend several paragraphs of the Reply. The Appellant's motion is to strike certain paragraphs (or parts of paragraphs) of the Reply or the Amended Reply. The objections of the Appellant to the original Reply and the proposed Amended Reply relate mainly to the statements by the Respondent that the Appellant and others involved in the transactions that are the subject of the appeal were not dealing with each other at arm's length and the arguments of the Respondent related thereto. The Appellant has submitted that the Respondent should be prevented from raising the non-arm's length argument as a result of the provisions of subsection 152(9) of the *Income Tax Act* (the "*Act*") or paragraph 53 of the *Tax Court of Canada Rules (General Procedure)* (the "*Rules*"). The Appellant has also raised the question of whether paragraph 28 gg) of the Reply has been properly pleaded as an assumption of fact or whether it is a conclusion of mixed fact and law.

Background

[2] The Appellant was a minority shareholder in Oxford Development Group Ltd. In 1979 a series of transactions was implemented to take Oxford Development Group Ltd. private which included an amalgamation in 1980 of Oxford Development Group Ltd. with a numbered company which continued its operations as "Oxford". Following the privatization of Oxford, the Appellant held 40% of the total issued shares of the amalgamated entity and Mr. G. Donald Love ("Mr. Love"), directly or indirectly (through Loford Properties Limited and Kent Holdings Ltd.), held the balance of the shares of Oxford.

[3] Starting in 1982 Oxford paid dividends to its shareholders. The shareholders, upon receipt of the dividends, would acquire shares of a different class in Oxford. Loford Properties Limited and Kent Holdings Ltd. acquired Class D shares and the Appellant acquired Class E shares. In the table attached to the Notice of Appeal, the dividends that were paid to the Appellant and the amounts that were used to acquire Class E shares of Oxford during the period from 1982 to 1988 are listed. The amounts used to acquire Class E shares (with the exception of the dividend paid in May of 1988) ranged from 77% to 100% of the amount of the dividend received. No part of the dividend received in May of 1988 was used to acquire Class E shares. In 1987 the Appellant exchanged its shares of Oxford for identical shares in Oxford Holdings Ltd.

[4] The transactions in question culminated in a sale of the shares of Oxford Holdings Ltd. by the Appellant on December 1, 1988. The common, Class A shares and Class B shares were redeemed and the Class E shares were acquired by Loford Properties Limited. The Appellant claims that the disposition of the Class E shares resulted in "a capital loss of $61,187,650, which, when subject to the stop loss provisions of section 112(3) of the *Act* was reduced to $52,243,540". The Appellant also reported a capital gain of $4,054,346 as a result of the disposition of the Class A shares of Oxford Holdings Ltd., and reduced its capital loss balance from $52,243,540 to $48,189,193. The Appellant filed its tax return on the basis that it had incurred an allowable capital loss of $32,126,129 (2/3 of $48,189,193).

[5] The Appellant was reassessed in 1994 and its claim for the allowable capital loss of $32,126,129 was denied, although the basis for denying this allowable capital loss was not clear to the Appellant when the reassessment was issued. The Appellant received a letter dated September 20, 1993 from the Canada Revenue Agency ("CRA"), (any reference herein to the Canada Revenue Agency or the CRA shall be interpreted as including the Canada Customs and Revenue Agency and Revenue

Canada Taxation). While this letter set out the proposed adjustment related to the allowable capital loss that had been claimed, no statutory basis for the denial of the loss was identified in the letter.

[6] In a position paper dated March 20, 1997 the CRA stated that "Tax Avoidance recommends that we use the old 245(1) to revise the ACB of the Class E shares to its paid-in capital of $241,666 of the Class E shares, thereby eliminating any loss on disposition of the Class E shares to Loford (in fact resulting in a gain)".

[7] A waiver was also signed by the Appellant in 1994 in respect of the "Determination of the loss on disposition of Oxford Holdings Ltd". It is the understanding of the Appellant that this waiver was provided to allow the CRA time to determine the fair market value of the Class E shares during the period from 1982 to 1988. In 2002 the waiver was revoked by the Appellant. There was no indication at that time whether the CRA had completed its appraisal of the fair market value of the Class E shares.

[8] In the Notice of Appeal filed by the Appellant in 2006, the Appellant assumed that the reassessment was based on subsection 245(1) of the *Act*, as it read prior to its repeal by S.C. 1988, c. 55, s.185 (the "Former Section 245").

[9] Counsel for the Respondent confirmed that the initial reassessment was based on the provisions of the Former Section 245. When preparing the Reply the Respondent abandoned its assessing position based on the Former Section 245 and instead stated that it was reassessing based on the provisions of subsection 55(1) of the *Act* (which has also been repealed) and as an alternate argument that subsection 69(1) of the *Act* (which has not been repealed) applied on the basis that the Appellant and the others involved in the transactions were not dealing with each other at arm's length. The Appellant does not object to the Respondent changing the basis for the reassessment from Former Section 245 to subsection 55(1) of the *Act* but does object to the inclusion of the non-arm's length alternate argument as a basis for the reassessment in the Reply and in relation to the arguments based on the non-arm's length allegations in the Amended Reply.

[10] At the hearing on the motion counsel for the Respondent stated that the Respondent was no longer raising an alternate argument based on subsection 69(1) of the *Act* and was only basing the reassessment on subsection 55(1) of the *Act*. Counsel for the Respondent submitted that the only reason that subsection 69(1) of the *Act* is in the Amended Reply is in relation to the argument to support the reassessment under subsection 55(1) of the *Act*.

[11] The Amended Reply deletes the alternative issue that was in paragraph 31 of the Reply related to whether subsection 69(1) of the *Act* applied and the alternative ground relied on in paragraph 34 and the only references to subsection 69(1) of the *Act* are in paragraphs 32 and new paragraph 32.5. Since the Respondent is no longer taking the position that subsection 69(1) of the *Act* applies, and therefore is no longer relying on this subsection, this subsection should be removed from the list of Statutory Provisions Relied On in paragraph 32 of the Amended Reply.

[12] The following are the paragraphs (or parts thereof) of the original Reply that the Appellant is asking to have stricken from the Reply:

- The words “but he denies the other facts stated in paragraph 5 of the Notice of Appeal” in paragraph 6. (Paragraph 6 of the Reply states as follows: “He admits that shares of Oxford were also held by Loford Properties Limited (“Loford Properties”) and Kent Holdings Ltd. (“Kent”), but he denies the other facts stated in paragraph 5 of the Notice of Appeal.”)

- All of paragraph 9. (Paragraph 9 of the Reply states that “He denies the facts stated in paragraph 9 of the Notice of Appeal.”)

- All of paragraph 29. (Paragraph 29 of the Reply states as follows: “The Appellant, Loford Properties, Kent and Mr. Love were acting without separate interest, and at non arm's length, with respect to all transactions involving the Class E shares referred above, and any shares received as consideration for their disposition, until their final disposition on December 1, 1988.”)

- The reference to section 251 and subsection 69(1) of the *Act* in paragraph 32. (Paragraph 32 of the Reply is in Part C of the Reply – Statutory Provisions Relied On and states as follows. “He relies on sections 38, 39, 40, 83, 89, 112, 251, subsections 55(1) and 69(1), and paragraph 53(1)(c) of the *Act*, as amended for the 1989 taxation year.”)

- All of paragraph 31. (Paragraph 31 of the Reply states as follows: “In the alternative, whether the shares were acquired in non-arm's-length transactions and are deemed by the operation of subsection 69(1) of the *Act* to have been acquired at their fair market value.”)

- All of paragraph 34. (Paragraph 34 of the Reply states as follows: “In the alternative, he says that the shares were acquired in excess of their fair market value in non-arm's length transfers. Subsection 69(1) of the *Act* deems that the shares were acquired by the Appellant at their fair market value, with the result that the loss is reduced to nil.”)

[13] Because the Amended Reply removes the contentious issue of whether the reassessment can be based on subsection 69(1) of the *Act* and in particular deletes paragraph 34 and because the Appellant’s only objections to the proposed amendments relate to the non-arm’s length allegations, I will deal with the arguments of the Appellant to strike in relation to the provisions of the proposed Amended Reply.

[14] The paragraphs (or parts thereof) in the proposed Amended Reply to which the Appellant objects are the following:

- The words “but he denies the other facts stated in paragraph 5 of the Notice of Appeal” in paragraph 6. (The Respondent is not proposing to amend paragraph 6 of the Reply in the proposed Amended Reply.)

- The words “but he denies that the offer to purchase was extended on an arm's-length basis” in paragraph 9. (The Respondent is proposing that paragraph 9 will be amended to read as follows: “He admits the facts stated in paragraph 9 of the Notice of Appeal, but he denies that the offer to purchase was extended on an arm’s length basis.”)

- All of paragraph 29. (The Respondent is proposing that paragraph 29 of the Reply will be amended to read as follows: “The Appellant, Loford Properties, Kent, Oxford, Oxford Holdings and Mr. Love were acting without separate interest, and at non arm's length, with respect to all transactions involving the Class D and Class E shares referred above, and any shares received as consideration for their disposition, including their final disposition on December 1, 1988.”)

- The reference to section 251 and subsection 69(1) of the *Act* in paragraph 32. (The Respondent is proposing to amend paragraph 32 of the Reply to add section 68 to the list of sections in this paragraph. The Appellant does not object to the Respondent adding this section to the list of sections in paragraph 32.)

- All of paragraphs 32.1 to 32.5 (inclusive). (The Respondent is proposing to replace paragraph 31 with the following: "Whether the adjusted cost base of the Class E shares was $300 per share." The Appellant does not object to this change to paragraph 31. The Respondent is proposing to delete paragraph 34 of the Reply and to add the following new paragraphs:

> 32.1 Mr. Love and the Appellant, who were not dealing at arm's length, agreed in advance that substantially all (between 77 percent and 100 percent) of each dividend paid would be immediately reinvested in the company. These immediate reinvestments of the dividends could not reasonably be regarded as an increase in the fair market value of the company, and therefore they do not constitute additions to the adjusted cost base of the Class D and Class E shares under paragraph 53(1)(c) of the *Act*.
>
> 32.2 While constantly maintaining their 60 percent to 40 percent shareholding ratio, Mr. Love and the Appellant agreed in advance to an artificially high subscription price for the Class D and Class E shares, which was fixed for a three and a half year period. They were indifferent as to the precise subscription price, regardless of what happened to the fair market value of the shares of the company in the meantime. Their primary concern was that the subscription price be high, and that the number of shares issued be low.
>
> 32.3 After having agreed in advance to an artificially high subscription price for the Class D and Class E shares, Mr. Love and the Appellant agreed to arbitrarily allocate the total proceeds of disposition pro rata among the common, Class A, Class B, Class D and Class E Shares. The effect of this arbitrary allocation was that the proceeds of disposition for the Class D and Class E shares was artificially low, because of the high subscription price

and the low number of Class D and Class E shares.

32.4 The reason that the Appellant was able to claim a loss on the disposition of the Class E shares is that it subtracted an artificially low figure for the proceeds of disposition from an artificially high figure for the adjusted cost base. To the extent that the proper figure for the proceeds of disposition was higher, and the proper figure for the adjusted cost base was lower, the loss that it was able to claim on the disposition of the Class E shares would have been lower, or eliminated entirely.

32.5 In determining whether the loss on the disposition of the Class E shares is artificial or undue, consideration should be given to the scheme of the *Act*. Paragraph 69(1)(a) provides a mechanism to reduce to fair market value a high non-arm's length acquisition cost, namely the subscription price of the Class D and Class E shares. Section 68 provides a mechanism to properly allocate consideration for the disposition of a particular property, namely the proceeds of disposition for the Class D and Class E shares on the one hand, and the proceeds of disposition for the common, Class A and Class B shares on the other hand.

[15] While the Respondent is proposing to amend several other paragraphs of the Reply, the Appellant is only objecting to the paragraphs (or parts thereof) referred to above.

Fresh Step Rule

[16] The Respondent has stated that the Appellant cannot raise an issue with respect to the non-arm's length allegations being made by the Respondent as the Respondent had made these allegations in the original Reply and the Appellant has taken several steps including the filing of an Answer and discovery examinations. Paragraph 8 of the *Rules* provides as follows:

> 8. A motion to attack a proceeding or a step, document or direction in a proceeding for irregularity shall not be made,
>
> (*a*) after the expiry of a reasonable time after the moving party knows or ought reasonably to have known of the irregularity, or

> (*b*) if the moving party has taken any further step in the proceeding after obtaining knowledge of the irregularity,
>
> except with leave of the Court.

[17] The Appellant stated that it is objecting because the Appellant will be prejudiced in its ability to adduce evidence in relation to the dealings between the Appellant and Mr. Love's companies. The transactions in question were all completed almost 20 years ago. Mr. Mercier, who was the Executive Vice-President, Corporate Banking Group of the Appellant during the relevant time period (1982 – 1988) retired from the Appellant in 1993 and passed away in September 2002. Mr. Love passed away on October 13, 2003. Counsel for the Appellant stated that they were not aware that these two individuals had passed away when the Notice of Appeal or the Answer were filed and only became aware of this following the discovery examinations.

[18] In this case the Respondent is proposing extensive amendments to the original Reply. The original Reply has 36 paragraphs (including the overview paragraph) and paragraph 28 has 33 subparagraphs. Of the 36 paragraphs, amendments are proposed to approximately 28 of these paragraphs (or approximately 78% of the paragraphs). While some amendments are very minor, others, such as deleting the alternative argument based on subsection 69(1) of the *Act*, are substantial. As well the Respondent is proposing to add 8 new paragraphs.

[19] Associate Chief Justice Bowman (as he then was) in *Imperial Oil Limited v. The Queen* 2003 TCC 46, 2003 D.T.C. 179, [2003] 3 C.T.C. 2125 stated that:

> 20 The "fresh step" rule is one that has been part of the rules of practice and procedure in Canada and the United Kingdom for many years.

[20] Justice O'Keefe of the Federal Court in *Vogo Inc. v. Acme Window Hardware Ltd.*, 2004 FC 851 described the purpose of the "fresh step rule" as follows:

> 60 The purpose of the "fresh step" rule is to prevent a party from acting inconsistently with its prior conduct in the proceeding. By pleading in response to a statement of claim, for instance, a defendant may extinguish their right to complain of fatal deficiencies in the allegations made against them. The fresh step rule aims to prevent prejudice to a party who has governed themselves according to the procedural steps taken by the opposing side, where it would be unfair to permit a reversal in approach.

[21] Paragraph 8 of the *Rules* provides that a motion to attack a document cannot

be made in the circumstances described in subparagraphs (a) or (b) **except with leave of the Court.** In this case since the Respondent is proposing to make substantial changes to the Reply, I do not agree that the Respondent would be prejudiced by the Appellant's motion and I choose to exercise the discretion that has been granted to me and I choose to not deal with the Appellant's motion based on paragraph 8 of the *Rules*.

Non-arm's Length Allegations – Subsection 152(9) of the *Act*

[22] The Appellant argued that the provisions of subsection 152(9) of the *Act* do not allow the Respondent to include the references to the Appellant not dealing with Mr. Love and his companies at arm's-length, in the Reply (or the Amended Reply), because the Appellant will now be prejudiced. Given the lapse of time, from the time that the original reassessment was issued to today, and the fact that key witnesses from the Appellant's perspective, are now deceased (namely Messrs. Love and Mercier) and other senior officers who were with the bank in the 1980s are now retired and no longer with the Appellant, the Appellant states that it will be prejudiced in its ability to adduce evidence in relation to these allegations.

[23] Subsection 152(9) of the *Act* provides as follows:

> 152 (9) The Minister may advance an alternative argument in support of an assessment at any time after the normal reassessment period unless, on an appeal under this Act
>
> > (a) there is relevant evidence that the taxpayer is no longer able to adduce without the leave of the court; and
> >
> > (b) it is not appropriate in the circumstances for the court to order that the evidence be adduced.

[24] This subsection was added to the *Act* following the decision of the Supreme Court of Canada in *Continental Bank of Canada v. The Queen*, 98 DTC 6501, 229 N.R. 44, [1998] 4 C.T.C. 77. Justice Sharlow of the Federal Court of Appeal in *The Queen v. Loewen*, 2004 FCA 146, 2004 DTC 6321, [2004] 3 C.T.C. 6 provides a detailed summary of the *Continental Bank* decision, which is as follows:

> 14 Such was the state of the law of Crown pleadings in income tax appeals when the Supreme Court of Canada heard the Continental Bank of Canada appeal. Continental Bank had a leasing subsidiary ("Continental Bank Leasing") which owned certain leasing assets. Those assets were depreciable property in respect of which capital cost allowance had been deducted. If Continental Bank Leasing had

simply sold the depreciable property, it would have been taxable on income resulting from recaptured capital cost allowance. To avoid that result, Continental Bank Leasing transferred the depreciable property in a tax deferred statutory rollover to a partnership of which it was a member. Continental Bank Leasing then transferred its partnership interest to Continental Bank in another tax deferred statutory rollover. The third party acquired the partnership interest from Continental Bank, resulting in a taxable capital gain to Continental Bank.

15 The Minister assessed Continental Bank Leasing on the basis that there was no partnership, and that Continental Bank Leasing had disposed of the depreciable property directly to the third party. As a protective measure, the Minister also assessed Continental Bank on the alternative basis that it had realized income (not a capital gain) on the disposition of the partnership interest. It was apparently understood that the reassessment of Continental Bank would be vacated if the assessment of Continental Bank Leasing was found to be correct. Both assessments were appealed, and the cases were heard together in the Tax Court of Canada, the Federal Court of Appeal, and the Supreme Court of Canada.

16 By the time the case reached the Supreme Court of Canada, the principal debate was whether the partnership was valid as a matter of law. A majority of the Supreme Court of Canada found that the partnership was valid. The result, for Continental Bank Leasing, was that its appeal from the tax assessment was allowed. That meant that the correctness of the assessment of Continental Bank had to be considered (the issue being whether its gain on the disposition of the partnership interest was a capital gain or income). The Court found that Continental Bank had a capital gain.

17 In the Supreme Court of Canada, the Crown presented for the first time a new theory of the entire series of transactions, which was that it was Continental Bank, not Continental Bank Leasing, that transferred the depreciable property to the third party. Justice McLachlin, as she then was, writing for the majority, dismissed this argument for reasons that appear at paragraphs 18 and 19 (recall that the majority had concluded that the partnership was valid):

> [18] [...] The Minister cannot argue that the Bank could not transfer its partnership interest at this stage. The Minister must accept that this transfer took place because his assessment of the Bank was based on the assumption that the Bank disposed of its partnership interest. I agree with Bastarache J. that the Minister's argument that the Bank sold depreciable leasing assets or was otherwise liable for recapture of capital cost allowance pursuant to s. 88(1) of the *Income Tax Act*, R.S.C. 1952, c. 148, as amended, raised for the first time in this Court, cannot be entertained. The Minister should not be allowed to advance a new basis for a reassessment after the limitation period has expired.
>
> [19] On the basis that the Bank disposed of its interest in the partnership, the

> Bank properly reported the proceeds of the disposition of its partnership interest as a capital gain. I would therefore dismiss this second appeal with costs. [...]

18 Justice Bastarache wrote for the minority, which had concluded that the partnership was not valid. He explains at paragraphs 10 to 13 why he concluded that the Crown could not rely on its new theory:

> [10] The applicable limitation period under the Act for assessing a taxpayer is four years from the date of issuance of Revenue Canada's Notice of Reassessment (ss. 152(3.1) and 152(4) of the Act). As a result, the latest that the Minister could have reassessed the Bank for the recapture of cost allowance was October 12, 1993. The Crown is not permitted to advance a new basis for reassessment after the limitation period has expired. The proper approach was expressed in *The Queen v. McLeod*, 90 D.T.C. 6281 (F.C.T.D.), at p. 6286. In that case, the court rejected the Crown's motion for leave to amend its pleadings to include a new statutory basis for Revenue Canada's assessment. The court refused leave on the basis that the Crown's attempt to plead a new section of the Act was, in effect, an attempt to change the basis of the assessment appealed from, and "tantamount to allowing the Minister to appeal his own assessment, a notion which has specifically been rejected by the courts". Similarly, the Federal Court of Appeal has described such attempts by the Crown as "a belated attempt to put the appellant's case on a new footing" (*British Columbia Telephone Co. v. Minister of National Revenue* (1994), 167 N.R. 112, at p. 116).
>
> [11] It was open to the appellant to assess the respondent on the basis that it was liable for the recapture of cost allowance when it issued its Notice of Reassessment on October 12, 1989 or anytime prior to the expiration of the limitation period for reassessment. The appellant did not choose to do so and cannot now be permitted to change its assessment eleven years later. The appellant argued that the liability of the respondent for the assessment pursuant to s. 13(1) is an alternative reason for its previous assessment, not a new assessment or reassessment. According to the appellant, because the liability for recapture under s. 13(1) would arise solely as a consequence of a finding that Leasing, in the Leasing Appeal, was not the vendor of the assets in the sale to Central, a reassessment on this basis is merely a legal conclusion flowing from the proper application of the statute.
>
> [12] To accept this characterization by the appellant would, in effect, create a situation where the Crown is permitted to raise new arguments simply because other arguments failed in the courts below. Unlike the *Minister in Minister of National Revenue v. Riendeau* (1991), 132 N.R. 157 (F.C.A.), the Minister in the present case has never sought to amend, correct or reissue the reassessment of the Bank to include a claim for recapture under s. 88(1)(f) of the Act. Moreover, the appellant's characterization of the argument as an

> alternative one ignores the fact that Leasing and the Bank are two separate taxpayers. What the Minister is seeking to do is to substitute an assessment of one taxpayer for the assessment of another taxpayer because the first assessment did not succeed.
>
> [13] Taxpayers must know the basis upon which they are being assessed so that they may advance the proper evidence to challenge that assessment. Here, it is not clear that there is the proper factual basis to support a reassessment on the basis proposed by the appellant. For example, the value of the goodwill associated with the Bank's leasing business, which was transferred to Central in December 1986, could bear on the appellant's new claim for recapture by the Bank. It is not possible to measure the extent to which the Bank might otherwise be liable for recapture, or the Bank's income for tax purposes, without being able to properly allocate the purchase price paid by Central between goodwill and leasing assets. Because the Bank was not assessed on the recapture, the evidence relating to the allocation of the purchase price was not adduced at trial. To allow the appellant to proceed with its new assessment without the benefit of findings of fact made at trial would require this Court to become a court of first instance with regard to the new claim.
>
> [14] As I stated above, it was not necessary, because of the disposition of the Leasing Appeal, to deal with the issues raised in this case. I would dismiss the appeal with costs.

19 The right of the Crown to present an alternative argument in support of an assessment is now governed by subsection 152(9) of the *Income Tax Act*, which applies to appeals disposed of after June 17, 1999: *Income Tax Amendment Act*, S.C. 1999, c. 22, s. 63.1(2).

[25] In this decision Justice Sharlow also stated that:

> 21 As I read subsection 152(9), the expiration of the normal reassessment period does not preclude the Crown from defending an assessment on any ground, subject only to paragraphs 152(9)(a) and (b). Paragraphs 152(9)(a) and (b) speak to the prejudice to the taxpayer that may arise if the Crown is permitted to make new factual allegations many years after the event.

[26] Leave to appeal the decision of the Federal Court of Appeal in *Loewen* to the Supreme Court of Canada was refused (338 N.R. 195 (note)).

[27] With respect to whether subsection 152(9) of the *Act* applies to a new basis of assessment (as distinguished from a new argument), Justice Rothstein (as he then was) of the Federal Court of Appeal made the following comments in *The Queen v. Anchor Pointe Energy Ltd.*, 2003 FCA 294, 2003 DTC 5512, [2004] 5 C.T.C. 98:

> 37 Subsection 152(9) permits the Minister to rely upon an alternative argument in support of an assessment after the normal reassessment period. There is no suggestion here that Anchor Pointe is no longer able to adduce relevant evidence with respect to the Minister's new basis or argument. Therefore, if the Global decision constitutes a new basis or argument in support of the reassessment, the Minister may rely upon it even though it was not relied upon prior to expiry of the normal reassessment period.
>
> 38 Anchor Pointe tries to distinguish between a new basis of assessment and a new argument in support of an assessment. I do not find that semantical argument productive. The question is whether the Minister is purporting, through reliance on the Global decision, to increase the amount of Anchor Pointe's income that was not included in an assessment or reassessment made within the normal reassessment period.

[28] In *Walsh v. The Queen*, 2007 FCA 222, [2007] 4 C.T.C. 73, 2007 DTC 5441, Justice Richard of the Federal Court of Appeal made the following comments in relation to subsection 152(9) of the *Act*:

> 18 The following conditions apply when the Minister seeks to rely on subsection 152(9) of the Act:
>
> 1) the Minister cannot include transactions which did not form the basis of the taxpayer's reassessment;
>
> 2) the right of the Minister to present an alternative argument in support of an assessment is subject to paragraphs 152(9)(a) and (b), which speak to the prejudice to the taxpayer; and
>
> 3) the Minister cannot use subsection 152(9) to reassess outside the time limitations in subsection 152(4) of the Act, or to collect tax exceeding the amount in the assessment under appeal.

[29] There is no suggestion in this case that the Respondent is attempting to increase the amount of the income of the Appellant to an amount that would be greater than the amount included in the reassessment or to collect tax exceeding the amount that was reassessed.

[30] The Federal Court of Appeal in *Loewen* and *Walsh* did not specifically deal with how paragraphs (a) and (b) of subsection 152(9) of the *Act* should be interpreted. There was no discussion in either case of the specific meaning of these two paragraphs.

[31] The Supreme Court of Canada in *The Queen v. Canada Trustco Mortgage Company*, 2005 SCC 54, 2005 DTC 5523 (Eng.), [2005] 5 C.T.C. 215, 340 N.R. 1,

259 D.L.R. (4th) 193, [2005] 2 S.C.R. 601, stated that:

> 10 It has been long established as a matter of statutory interpretation that "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": see *65302 British Columbia Ltd. v. R.*, [1999] 3 S.C.R. 804 (S.C.C.), at para. 50. The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole. When the words of a provision are precise and unequivocal, the ordinary meaning of the words play a dominant role in the interpretive process. On the other hand, where the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role. The relative effects of ordinary meaning, context and purpose on the interpretive process may vary, but in all cases the court must seek to read the provisions of an Act as a harmonious whole.

[32] It seems to me that the words of paragraphs (a) and (b) of subsection 152(9) of the *Act* are precise and unequivocal. It seems clear that the reference to "relevant evidence" is to relevant evidence that the taxpayer is no longer able to adduce without the leave of the court, and it is not appropriate in the circumstances for the court to order that the evidence be adduced. Because paragraph (b) is linked to paragraph (a) as a result of the use of "and" at the end of paragraph (a), and because paragraph (b) states that "it is not appropriate in the circumstances for the court to order that the evidence be adduced" it seems clear to me that the phrase "without the leave of the court" is intended to modify the type of evidence that the taxpayer is no longer able to adduce. Therefore only evidence that the taxpayer is no longer able to adduce without leave of the court is the type of evidence that is referred to in these paragraphs.

[33] Notwithstanding what appears to be very clear language counsel for the Appellant argued that the intent of the subsection should be examined. In particular, he referred to the Technical Notes released by the Department of Finance when subsection 152(9) was added to the *Act*. The Technical Notes stated as follows:

> New subsection 152(9) is intended to ensure that the Minister of National Revenue may advance alternative arguments in support of an income tax assessment after the normal reassessment period has expired. This amendment is proposed in light of remarks by the Supreme Court of Canada in the case of *The Queen v. Continental Bank of Canada*, [1997] 4 C.T.C. 77 (S.C.C.), to the effect that the Crown is not permitted to advance a new basis for assessment after the limitation period has expired.
>
> The limitations found in paragraphs 152(9)(a) and (b) are intended to import the Court protection afforded to taxpayers that an alternative argument cannot be

> advanced to the prejudice of the right of a taxpayer to introduce relevant evidence to rebut the argument.

[34] The courts have expressed different views on the use of technical notes. In *Silicon Graphics Ltd. v. The Queen*, 2002 FCA 260, 2002 DTC 7112, [2002] 3 C.T.C. 527, the Federal Court of Appeal made the following comments on the use of Technical Notes:

> 50 Of course, Technical Notes are not binding on the courts, but they are entitled to consideration. See *Ast Estate v. R.*, [1997] F.C.J. No. 267 (Fed. C.A.), para. 27:
>
> > Administrative interpretations such as technical notes are not binding on the courts, but they are entitled to weight, and may constitute an important factor in the interpretation of statutes. Technical Notes are widely accepted by the courts as aids to statutory interpretation. The interpretive weight of technical notes is particularly great where, at the time an amendment was before it, the legislature was aware of a particular administrative interpretation of the amendment, and nonetheless enacted it.

[35] Chief Justice Bowman in *Krause v. The Queen*, 2004 TCC 594, 2004 DTC 3265, [2004] 5 C.T.C. 2230 stated as follows:

> 22…I do not think that technical notes to legislation should be taken as determinative. Parliament is supposed to be able to express its intention clearly and unambiguously in the statutory language that it uses. It does not seem appropriate to resolve ambiguities in the statutory language by having recourse to notes written by unnamed officials in the Department of Finance explaining what the Department of Finance thought it was achieving, or what it hoped to achieve. Nonetheless, the practice is fairly well entrenched. In *Glaxo Wellcome Inc. v. R.* (1996), 96 D.T.C. 1159 (T.C.C.), affd (1998), 98 D.T.C. 6638 (Fed. C.A.), the following observation was made at page 1162:
>
> > One must bear in mind that it is Parliament that passes legislation, and it is through the words of that legislation that Parliament speaks. An act of Parliament represents the collective will of Parliament. One cannot be certain that the same can be said of extrinsic materials. To attempt to determine the intent of a statutory provision by reference to a speech delivered by a member of the government, a speech that he or she may well not have written, or by technical or explanatory notes prepared by officials of the Department of Finance, or other budgetary materials, strikes me as a potentially dangerous course of action. Where a court strains to assign to reasonably comprehensible language an extended meaning that conforms to what it conceives, on the basis of extrinsic materials, to be what Parliament was seeking to achieve it runs the risk of crossing the line that separates the

judicial from the legislative function.

. . . . .

The practice today, in my experience, appears to be to refer in argument to virtually anything that may have some bearing, however remote, on the question to be decided - speeches in Parliament, technical notes, explanatory notes, budgetary materials, commission reports, published advance income tax rulings, texts by authors, whether living or dead, articles and speeches by practitioners or academics, interpretation bulletins - all are grist for the mill and the court is left to determine what assistance, if any, can be gleaned from such materials.

The practice is now too well entrenched to be reversed but it is important that the reliability and the utility of such materials be put in their proper perspective and that it be recognized that ultimately the interpretation must be based upon the court's reading of the legislative language itself. In that endeavour such extrinsic aids must be handled with extreme caution. As Sopinka, J. said in *Morgantaler* at p. 484:

> Provided that the court remains mindful of the limited reliability and weight of Hansard evidence, it should be admitted as relevant to both the background and the purpose of legislation.
>
> One should be mindful of the wise observation made by the Earl of Halsbury, L.C. in Hilder v. Dexter, [1902] A.C. 474 (U.K. H.L.), at 477:
>
> My Lords, I have more than once had occasion to say that in construing a statute I believe the worst person to construe it is the person who is responsible for its drafting. He is very much disposed to confuse what he intended to do with the effect of the language which in fact has been employed. At the time he drafted the statute, at all events, he may have been under the impression that he had given full effect to what was intended, but he may be mistaken in construing it afterwards just because what was in his mind was what was intended, though, perhaps, it was not done.

[36] In any event the Technical Note refers to:

the Court protection afforded to taxpayers that an alternative argument cannot be advanced to the prejudice of the **right** of a taxpayer to introduce relevant evidence to rebut the argument.

(emphasis added)

[37] It refers to the right of the taxpayer and not the ability the taxpayer to adduce evidence.

[38] Counsel for the Appellant argued that the phrase “without the leave of the court” in paragraph (a) should be read as a condition subsequent to the first part of this paragraph. Counsel for the Appellant suggested that there is a series of questions that must be asked and answered in order to determine whether or not paragraphs (a) and (b) of subsection 152(9) of the *Act* apply. The first question would be whether there is any relevant evidence that the taxpayer is no longer able to adduce. If the answer to this question is no, then there is no need to read any further and paragraphs (a) and (b) do not apply. If the answer to this question is yes, the next question is whether or not leave of the court would assist the taxpayer in solving this evidentiary problem. In situations such as the one in this case counsel for the Appellant suggested that since the answer to this question would obviously be no, then there is no need to read any further and paragraphs (a) and (b) would apply and the Respondent would not be entitled to raise the alternate argument.

[39] However in my opinion, this interpretation alters the plain meaning of the words “there is relevant evidence that the taxpayer is no longer able to adduce without the leave of the court” significantly and does not take into account that paragraphs (a) and (b) are linked by the word “and” which makes it clear that the evidence referred to in paragraph (a) is evidence that the taxpayer is no longer able to adduce without the leave of the court, and not evidence that the taxpayer is no longer able to adduce for any other reason.

[40] The interpretation proposed by counsel for the Appellant would also lead to, what I believe would be, unintended results. For example if in another situation a taxpayer were to intentionally destroy documents, and the Respondent in that case should attempt to raise a new argument that the taxpayer alleges can only be rebutted by the documents that the taxpayer has destroyed, following the analysis of paragraphs (a) and (b) as proposed by counsel for the Appellant, the Respondent would not be able to raise the new argument because the answer to the first question of whether there is any evidence that the taxpayer is no longer able to adduce will be yes and the answer to the second question of whether leave of the court would assist in this evidentiary problem would be no. It does not seem reasonable to me that, in this example, the Respondent should be prevented from raising the new argument.

[41] I am unable to agree with the interpretation of subsection 152(9) of the *Act* as advanced by counsel for the Appellant.

[42] Reverting back to the plain meaning of the words used in subsection 152(9) of the *Act*, what situations would have been contemplated by paragraphs (a) and (b)? The answer to this question to me is based on the same premise as the one advanced by the counsel for the Appellant in referring to the Technical Notes. What was the intent of this subsection or why was this subsection added to the *Act*? It is accepted in the Technical Notes and in the decision of the Federal Court of Appeal in *Loewen* that subsection 152(9) was added to the *Act* as a result of the decision of the Supreme Court of Canada in *Continental Bank*. Therefore, it seems logical that this provision was added so that the Respondent could, following the addition of this subsection to the *Act*, raise additional arguments that the Respondent would otherwise be prevented from raising as a result of the decision of the Supreme Court of Canada in *Continental Bank*. In the *Continental Bank* case, the new argument was raised at a very late stage of the litigation. The new argument was raised for the first time at the hearing before the Supreme Court of Canada. Assuming that the intention of the provision was to allow the Respondent to raise arguments at any stage of the litigation (whether the appeal is before this Court, the Federal Court of Appeal, or the Supreme Court of Canada), then the question will be whether evidence can be introduced at the appeal stages of litigation, since paragraphs (a) and (b) of subsection 152(9) of the *Act* refer to "evidence that the taxpayer is no longer able to adduce without the leave of the court".

[43] In the *Federal Courts Act* section 53 provides as follows:

> 53. (1) The evidence of any witness may by order of the Federal Court of Appeal or the Federal Court be taken, subject to any rule or order that may relate to the matter, on commission, on examination or by affidavit.

[44] Part 6 of the *Federal Courts Rules* deals with appeals to the Federal Court of Appeal. Paragraph 351 of the *Federal Courts Rules*, which is in Part 6, provides as follows:

> 351. In special circumstances, the Court may grant leave to a party to present evidence on a question of fact.

[45] Therefore the *Federal Courts Rules* contemplate that with leave of the Federal Court of Appeal evidence may be presented before the Federal Court of Appeal. Therefore there is a situation where in an appeal before the Federal Court of Appeal, the taxpayer could be in the position where the taxpayer is no longer able to adduce evidence without leave of the court, but could, with such leave, present evidence.

[46] Subsection 62(3) of the *Supreme Court Act* provides that:

> 62 (3) The Court or a judge may, in the discretion of the Court or the judge, on special grounds and by special leave, receive further evidence on any question of fact, such evidence to be taken in the manner authorized by this Act, either by oral examination, by affidavit or by deposition, as the Court or the judge may direct.

[47] Therefore there are situations where a taxpayer in an appeal before the Federal Court of Appeal or the Supreme Court of Canada could be in a position where the taxpayer can only adduce evidence with leave of the court (and where the applicable statute or rules contemplate that such evidence may be adduced). In finding a meaning for the words of paragraphs (a) and (b) of subsection 152(9) of the *Act*, it is not a question of how often the situation would arise (or has arisen) but whether it is possible in law for the situation to arise. The plain wording of paragraphs (a) and (b) of subsection 152(9) of the *Act* can be given meaning that can be applied in situations that are contemplated by the *Federal Courts Act* and the *Federal Courts Rules* and the *Supreme Court Act*.

[48] As a result, I do not agree with the interpretation of this provision as proposed by counsel for the Appellant and the Appellant cannot succeed in its motion based on subsection 152(9) of the *Act* as this is not a situation where the Appellant is no longer able to adduce evidence without leave of the court. The evidentiary problem of the Appellant is not that the Appellant requires the leave of the court to adduce evidence but that key witnesses are now deceased. This type of evidentiary problem is not the type of evidentiary problem contemplated by paragraphs (a) and (b) of subsection 152(9) of the *Act*.

Non-arm's Length Allegations – Paragraph 53 of the *Rules*

[49] The Appellant also raised the issue of whether paragraph 53 of the *Rules* should apply. This paragraph provides as follows:

> 53. The Court may strike out or expunge all or part of a pleading or other document, with or without leave to amend, on the ground that the pleading or other document,
>
> (*a*) may prejudice or delay the fair hearing of the action,
>
> (*b*) is scandalous, frivolous or vexatious, or
>
> (*c*) is an abuse of the process of the Court.

[50] The Appellant, by its Motion, is requesting that the Respondent accept the

statements by the Appellant that the Appellant and Loford Properties Limited and that the Appellant and Kent Holdings Ltd. were dealing with each other at arm's length, and to strike from the Reply (and the Amended Reply) all of the references to the Appellant and these companies dealing with each other at non-arm's length.

[51] In the Notice of Appeal the facts are described, in part, as follows:

> 3. (i) the Appellant was a minority shareholder in Oxford Development Group Ltd. ("Oxford")…
>
> …
>
> 5. The remaining issued and outstanding shares of Oxford were collectively held by persons at arm's length to the Appellant, namely, Loford Properties Limited ("Loford Properties") and Kent Holdings Ltd. ("Kent")
>
> 6. Mr. G. Donald Love ("Mr. Love"), then Chairman and President of Oxford, was the sole beneficial shareholder of Kent. Mr. Love together with other related parties, was also the sole beneficial shareholder of Loford Properties
>
> …
>
> 9. On December 19, 1979, an offer was extended by 91922 Canada Ltd. to purchase, on an arm's length basis, all of the outstanding shares of Oxford, which offer was accepted by the Oxford shareholders.

[52] At the time of the offer it would appear that the only issued share of 91922 Canada Ltd. was held by Kent Holdings Ltd., which was wholly owned by Mr. Love. Therefore it seems logical that if the Appellant was asserting that the Appellant was dealing at arm's length with 91922 Canada Ltd. and Kent Holdings Ltd. then the Appellant would also be asserting that the Appellant was dealing at arm's length with the person (Mr. Love) who was the sole beneficial shareholder of Kent Holdings Ltd.

[53] The Appellant is asking that the words "but he denies the other facts stated in paragraph 5 of the Notice of Appeal" be stricken from paragraph 6 in the Amended Reply and that the other provisions containing allegations of the parties not dealing at arm's length be stricken from the Amended Reply, because the Appellant will be prejudiced because of the lapse of time and because two of the principal witnesses that could testify with respect to whether the Appellant was dealing with Mr. Love and his companies at arm's length are now deceased.

[54] The Appellant indicates that both Mr. Mercier and Mr. Love are crucial to the question of whether the Appellant was dealing at arm's-length with Mr. Love and his companies. Mr. Mercier passed away in September 2002, and Mr. Love passed away on October 13, 2003. Both of these individuals were deceased prior to the Appellant filing its Notice of Appeal in 2006. Since the Appellant had made the allegation in its Notice of Appeal that the Appellant was dealing at arm's-length with Mr. Love's companies, how was the Appellant planning to prove this allegation?

[55] Since the Appellant made the allegation that it was dealing at arm's length with Mr. Love's companies, the Appellant would have the onus of proof with respect to the facts required to support this allegation. It is illogical to suggest that the Respondent would have the onus of disproving facts alleged by the Appellant.

[56] Justice McIntyre on behalf of the Supreme Court of Canada stated in *Ontario (Human Rights Commission) v. Simpsons Sears Ltd*., [1985] 2 S.C.R. 536 that:

> 28 To begin with, experience has shown that in the resolution of disputes by the employment of the judicial process, the assignment of a burden of proof to one party or the other is an essential element. The burden need not in all cases be heavy -- it will vary with particular cases -- and it may not apply to one party on all issues in the case; it may shift from one to the other. But as a practical expedient it has been found necessary, in order to ensure a clear result in any judicial proceeding, to have available as a "tie-breaker" the concept of the onus of proof. I agree then with the Board of Inquiry that each case will come down to a question of proof, and therefore there must be a clearly-recognized and clearly-assigned burden of proof in these cases as in all civil proceedings. To whom should it be assigned? Following the well-settled rule in civil cases, the plaintiff bears the burden. He who alleges must prove.

[57] In *Pollock v. The Queen*, [1994] 1 C.T.C. 3, 94 DTC 6050, Justice Hugessen, on behalf of the Federal Court of Appeal, made the following comments:

> Where, however, the Minister has pleaded no assumptions, or where some or all of the pleaded assumptions have been successfully rebutted, it remains open to the Minister, as defendant, to establish the correctness of his assessment if he can. In undertaking this task, the Minister bears the ordinary burden of any party to a lawsuit, namely to prove the facts which support his position unless those facts have already been put in evidence by his opponent. This is settled law.

[58] In *Loewen*, *supra*, Justice Sharlow, on behalf of the Federal Court of Appeal, made the following comments:

> 11 The constraints on the Minister that apply to the pleading of assumptions do not preclude the Crown from asserting, elsewhere in the reply, factual allegations and legal arguments that are not consistent with the basis of the assessment. If the Crown alleges a fact that is not among the facts assumed by the Minister, the onus of proof lies with the Crown. This is well explained in Schultz v. R. (1995), [1996] 1 F.C. 423, [1996] 2 C.T.C. 127, 95 D.T.C. 5657 (Fed. C.A.) (leave to appeal refused, [1996] S.C.C.A. No. 4 (S.C.C.)).

[59] The reference by Justice Sharlow to the onus lying with the Crown is with respect to facts alleged by the Crown. In this case, the arm's length dealings are alleged by the Appellant. It does not seem reasonable that the Appellant should be permitted to allege that the Appellant was dealing at arm's length with Mr. Love's companies and the Respondent must be forced to accept this allegation as true when there has been no change in the available evidence from the time that the allegation was made by the Appellant in its Notice of Appeal to the time when the Respondent is amending its Reply. Since the Appellant has made the allegation that the Appellant and Mr. Love's companies were dealing with each other at arm's length, the Respondent should not be prevented from requiring the Appellant to prove this.

[60] It seems difficult to determine how the Appellant is prejudiced by the Respondent referring to the dealings as being on a non-arm's-length basis in this case when the Appellant has alleged the opposite in its pleadings. It seems to me that there are two possibilities in relation to the dealings between parties to a transaction – either the parties are dealing with each other at arm's length or they are dealing with each other at non-arm's length. The Respondent, in alleging that the Appellant was dealing at non-arm's length with Mr. Love and his companies, is simply alleging the opposite of what the Appellant is alleging, which would be the same as simply denying the allegation made by the Appellant.

[61] The Appellant has made the allegation that the Appellant and Mr. Love's companies were dealing at arm's length presumably because the Appellant believed that this was relevant in dealing with a reassessment based on Former Section 245. Former Section 245 read as follows:

> 245 (1) In computing income for the purpose of this Act, no deduction may be made in respect of a disbursement or expense made or incurred in respect of a transaction or operation that, if allowed, would unduly or artificially reduce the income.

[62] The Respondent is now taking the position that the reassessment is based on subsection 55(1) of the *Act* which, prior to its repeal, read as follows:

> 55 (1) For the purposes of this subdivision, where the result of one or more sales, exchanges, declarations of trust, or other transactions of any kind whatever is that a taxpayer has disposed of property under circumstances such that he may reasonably be considered to have artificially or unduly
>
> (a) reduced the amount of his gain from the disposition,
>
> (b) created a loss from the disposition, or
>
> (c) increased the amount of his loss from the disposition,
>
> the taxpayer's gain or loss, as the case may be, from the disposition of the property shall be computed as if such reduction, creation or increase, as the case may be, had not occurred.

[63] Since neither Former Section 245 nor subsection 55(1) of the *Act* included a condition that the taxpayer was dealing with any person at non-arm's length, at the time that the Notice of Appeal was drafted, the issue of whether the Appellant was dealing at arm's length (or non-arm's length) with Mr. Love and his companies would have been a matter of relevance, not a requirement of Former Section 245 (the provision addressed by the Appellant in its Notice of Appeal) and now since there is no longer any argument based on subsection 69(1) of the *Act* applying, the issue of whether the Appellant was dealing at arm's length (or non-arm's length) with Mr. Love and his companies is still only a matter of relevance, although now in relation to subsection 55(1) of the *Act* and not Former Section 245.

[64] Chief Justice Bowman in *Jolly Farmer Products Inc. v. The Queen*, 2008 TCC 124 stated that:

> 10 Mr. Woon argues that the religious practices and beliefs of the shareholders are a relevant consideration in the context of the assumptions considered in their entirety. I am not at present persuaded of their relevancy. How the religious beliefs of the shareholders of the appellant can affect the determination whether the cost of building or acquiring a piece of property or of clearing land has an income earning purpose is not readily apparent to me on the material filed on this motion. However, the relevance may emerge in the context of the evidence as a whole and I prefer to leave the question of relevancy to the trial.

[65] In this particular case the issue of whether the Appellant was dealing at arm's length (or non-arm's length) with Mr. Love and his companies is a matter of

relevance that is best left to the trial judge. It would seem that this issue is just as relevant for the purposes of subsection 55(1) of the *Act* as it would have been for the purposes of Former Section 245 as both provisions are based on the key concept of "unduly or artificially" either creating or increasing a loss or reducing income and neither subsection included any reference to whether parties were dealing with each other at non-arm's length (or arm's length).

[66] However, there is another reason why, in my opinion, the Appellant cannot succeed under paragraph 53 of the *Rules*. The reference to "prejudice" in paragraph 53 of the *Rules* must be read in light of the provisions of subsection 152(9) of the *Act*. As noted by the Federal Court of Appeal in *Loewen* and *Walsh*, paragraphs (a) and (b) of subsection 152(9) of the *Act* "speak to the prejudice to the taxpayer". How can a right to raise an alternative argument that is granted by subsection 152(9) of the *Act*, which has been passed by Parliament, be taken away by a paragraph of the *Rules*, which has not been passed by Parliament? If the prejudice to the taxpayer is not as described in paragraphs (a) and (b) of subsection 152(9) of the *Act*, then the Respondent should not be prevented from raising the alternative argument because of paragraph 53 of the *Rules*. The right that is granted by subsection 152(9) of the *Act* cannot be taken away by the *Rules*.

Paragraph 28 gg) of the Reply

[67] The other objection of the Appellant relates to paragraph 28 gg) of the Reply. This paragraph is part of the assumptions that, according to the Reply (and the Amended Reply), the Minister relied on in reassessing the Appellant and this paragraph provides as follows:

> Transactions regarding the Class E shares and the shares received in consideration for those shares artificially or unduly created a loss, or increased the amount of loss on their disposition.

[68] The Respondent is not proposing to amend this paragraph.

[69] The issue raised by the Appellant in relation to this assumption is whether this statement can be more correctly described as a conclusion of mixed fact and law. The Respondent has stated that the Appellant cannot raise an issue with respect to this paragraph as a result of paragraph 8 of the *Rules* referred to above.

[70] The Reply, which included paragraph 28 gg), was filed on January 9, 2007. Almost seven months later, the Appellant prepared an Answer to the Reply, which is

dated August 2, 2007. The Answer was filed with this Court on August 13, 2007, over seven months after the Reply was filed. As part of the Answer, the Appellant stated in paragraph 7 of the Answer that:

> 7. The Appellant denies the allegations of fact in subparagraphs 28 (ff), (gg) and paragraph 29 of the Reply.

[71] There is no indication in the Answer that the Appellant was objecting to the statement in paragraph 28 gg) as being a conclusion of mixed fact and law. If this was the only issue raised by the Appellant in its Motion, then I would not exercise my discretion in paragraph 8 of the *Rules* given the clear statement by the Appellant in the Answer that dealt specifically with paragraph 28 gg) without raising any concerns about this paragraph.

[72] However in light of the extensive amendments to the Reply proposed by the Respondent and that this is not the only issue raised by the Appellant in relation to the Reply, I will grant leave to the Appellant in this case to raise this issue.

[73] The question of whether this is a proper assumption is based on the decision of the Federal Court of Appeal in *Anchor Pointe Energy Ltd.*, *supra*. The paragraph of the Reply that was in issue in that case was as follows:

> In reassessing, the Minister assumed the following facts:
>
> . . . . .
>
> (z) the seismic data purchased by API, APII, APIII, APIV and APV does not qualify as a Canadian Exploration Expense ("CEE") within the meaning of s. 66.1(6)(a) of the Income Tax *Act* (the "Act").

[74] Justice Rothstein (as he then was) made the following comments on this assumption:

> 26 However, the assumption in paragraph 10(z) can be more correctly described as a conclusion of mixed fact and law. A conclusion that seismic data purchased does not qualify as CEE within the meaning of paragraph 66.1(6)(a) involves the application of the law to the facts. Paragraph 66.1(6)(a) sets out the test to be met for a CEE deduction. Whether the purchase of the seismic data in this case meets that test involves determining whether or not the facts meet the test. The Minister may assume the factual components of a conclusion of mixed fact and law. However, if he wishes to do so, he should extricate the factual components that are being assumed so that the taxpayer is told exactly what factual assumptions it must demolish in order to succeed. It is unsatisfactory that the assumed facts be buried in

> the conclusion of mixed fact and law.

[75] The assumption in paragraph gg) in the Reply in this case is a question of mixed fact and law as the only way to determine whether the transactions artificially or unduly created a loss would be to apply the law to the facts of this case. Counsel for the Respondent indicated that with the decision of *Anchor Pointe Energy Ltd.* in mind, there was no reference to subsection 55(1) of the *Act* in paragraph 28 gg) of the Reply. However, even without a specific reference to subsection 55(1) of the *Act*, it appears obvious that the wording of the assumption matches the wording of subsection 55(1) of the *Act.* Why else would this assumption be relevant? The only way to determine if:

> Transactions regarding the Class E shares and the shares received in consideration for those shares artificially or unduly created a loss, or increased the amount of loss on their disposition

is to apply the law related to the meaning of "artificially or unduly" to the facts. The transactions themselves are facts. Whether the transactions resulted in the Appellant artificially or unduly created a loss, is a question of mixed fact and law.

[76] As a result paragraph 28 gg) is stricken from the Amended Reply.

Conclusion

[77] Therefore as a result the Reply filed by the Respondent is amended as set out in the Amended Reply, a copy of which was submitted as part of the Respondent's Motion Record, except that paragraph 28 gg) is stricken from the Amended Reply and the reference to subsection 69(1) is stricken from paragraph 32 of the Amended Reply.

[78] Costs of these motions shall be in the cause.

Signed at Halifax, Nova Scotia, this 14th day of May 2008.

"Wyman W. Webb"

Webb J.

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