Docket: 2010-1529(IT)APP

BETWEEN:

M.P.N. HOLDINGS LTD.,

Applicant,

and

HER MAJESTY THE QUEEN,

Respondent.

Application heard on March 15, 2011, at Winnipeg, Manitoba

Before: The Honourable Justice G. A. Sheridan

Appearances:

Counsel for the Applicant:	Paul K. Grower
Counsel for the Respondent:	Larissa Benham

ORDER

The Applicant's application for an extension of time to appeal under paragraph 167(5)(*b*) of the *Income Tax Act* in respect of his 2001 and 2002 taxation years is dismissed, in accordance with the attached Reasons for Order.

Each party shall bear its own costs.

Signed at Ottawa, Canada, this 31st day of March 2011.

"G. A. Sheridan"

Sheridan J.

Citation: 2011TCC181
Date: 20110331
Docket: 2010-1529(IT)APP

BETWEEN:

M.P.N. HOLDINGS LTD.,

Applicant,

and

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REASONS FOR ORDER

Sheridan J.

[1] The Applicant, M.P.N. Holdings Ltd. ("MPN Holdings"), is applying for an extension of time within which to appeal the Notice of Confirmation of the Minister of National Revenue of its 2001 and 2002 taxation years. The application in respect of the 2003 taxation year was withdrawn at the hearing.

[2] The Applicant made its application within the time permitted under paragraph 167(5)(*a*) of the *Income Tax Act*. It remains only for the Applicant to satisfy the criteria for the granting of an extension under paragraph 167(5)(*b*):

> 167(5) No order shall be made under this section unless
>
> …
>
> (*b*) the taxpayer demonstrates that
> (i) within the time otherwise limited by section 169 for appealing the taxpayer
> (A) was unable to act or to instruct another to act in the taxpayer's name, or
> (B) had a *bona fide* intention to appeal,
> (ii) given the reasons set out in the application and the circumstances of the case, it would be just and equitable to grant the application,
> (iii) the application was made as soon as circumstances permitted, and
> (iv) there are reasonable grounds for the appeal.

[3] Even if the Applicant is able to satisfy the above criteria, there is the further issue of whether the Applicant waived its right to appeal.

Facts

[4] After a lengthy audit and negotiation period[1], on March 30, 2007, the Applicant duly signed a document entitled "Waiver of Objection Rights" ("Waiver"), the full text of which reads:

> Canada Revenue Agency (CRA) and MPN Holdings Ltd. (the "Declarant") have agreed upon how one or more audit issues should be (re)assessed as outlined in the CRA's final letter dated March 15, 2007 itemized as follows:
>
> a. Foreign Accrual Property Income from Arden Investments Inc. earned in 2001 as a result of ownership of a 25% participating percentage
>
> b. Reduction in interest expense in Fiscal 2001, 2002, 2003
>
> c. Directors fees disallowed in Fiscal 2001, 2002, 2003
>
> d. *Part XIII on consulting fees paid to Arden Advisors LLC in 2001, 2002, 2003* [Emphasis added.]
>
> e. Capitalization of a portion of the consulting fees to capital assets and eligible capital expenditures in 2001, 2002, 2003
>
> f. Interest waived for period March 1, 2004 to August 31, 2005 on any additional Part I or Part XIII Income Tax for the 2001, 2002, 2003 fiscal periods

	2001	2002	2003
Foreign accrual property Income	$ 258,414	$ -	$ -
Reduction in interest expense	$ 111,612	$ 284,908	$ 301,730
Consulting fee capitalized	$ 270,937	$ 284,058	$ 265,636
Directors fees disallowed	$ 244,377	$ 538,000	$ 369,782
Net Change	$ 885,340	$ 1,106,966	$ 937,148
Part XIII on consulting fees [Emphasis added.]	*$ 90,854*	*$ 142,029*	*$ 138,818*

> *The taxpayer reserves the right to object to the Part XIII if any retroactive change is made to the Canada-US tax convention to provide relief to Limited Liability Companies within the time allowed to file an objection.* [Emphasis added.]

[1] Exhibit R-1, Tabs A, B, C, D and E.

> The Declarant waives the right to object to the CRA's (re)assessment of the above-itemized audit issue(s) for the pertinent taxation period(s).
>
> The Declarant acknowledges that:
>
> 1. the impact of the provisions of subsection 165(1.2) of the *Income Tax Act* or subsection 301(1.6) of the *Excise Tax Act*, as applicable;
>
>   - have been explained; and
>
>   - are understood to mean that no further recourse, including objection and appeal rights to any authority with respect to the (re)assessment of the above referenced issue(s) by the CRA is available upon signing this waiver document;
>
> 2. additional tax, interest and/or penalty, as applicable in addition to that which had previously been (re)assessed, may result from the CRA's (re)assessment of the issues itemized above in accordance with the CRA's final letter referred to above; and
>
> 3. this document is being freely and voluntarily signed.[2]

[5] On May 22, 2007, the Minister issued Notice of Reassessment under paragraph 212(1)(*a*) of Part XIII of the *Act* for the withholding tax, together with interest and penalties thereon, for management fees paid by the Applicant to a non-resident corporation, Arden Advisors LLC.

[6] On August 16, 2007, the Applicant through counsel filed a Notice of Objection in respect of the Part XIII assessment on the following grounds:

> The taxpayer says that the reassessments are incorrect and should be reversed for the following reasons:
>
> 1. Arden Advisors LLC, a Limited Liability Corporation, incorporated in the United States, did not have a permanent establishment in Canada and Article VII of the Canada-US Tax Convention therefore precludes Canada from imposing any withholding taxes on the management fees paid by the taxpayer to Arden Advisors LLC. CRA relies upon The Queen v. Crown Forest Industries Limited 95 DTC 5389 (SCC) for the position that Limited Liability Corporations are not a resident of the U.S. for Treaty purposes and not eligible for Treaty relief, since they are not liable to tax under the U.S. Internal Revenue Code. This position is

[2] Exhibit R-1, Tab F.

> inconsistent with CRA's position that U.S. S-Corps are permitted Treaty relief even though they elect not to be taxed under the Internal Revenue Code. Further, it is the position of CRA that with respect to U.S. partnerships, the partners are the beneficial owners of the income, and therefore CRA looks through the partnership to allow a partner who is resident in the US to claim the benefit of the Canada-US Convention on his share of the partnership income. For instance, see CRA documents 9713120 and 2002-0133747. Given that for US tax purposes, a limited liability corporation is classified as a partnership if it has two or more members, there is no basis to suggest that the intent of the contracting states is other than to accord a limited liability company the same treatment given a partnership under the Convention. Further, the CRA's position ignores the fact that the Crown Forest decision states that tax conventions must be interpreted by reference to the purpose and intention of the parties to the convention. Both Canada and the U.S. apply the Convention to entities that are not generally subject to tax – for instance, see paragraph 1 of Article IV of the Canada – U.S. Tax Convention as to the non-taxable entities included as a "resident". The taxpayer submits that, since Arden Advisors LLC's connecting characteristics with the U.S. are fundamentally the same as the entities that are eligible for Treaty relief, it does fall within the application of the Canada – U.S. Tax Convention.
>
> 2. In the **alternative**, the taxpayer states that it understands that amendments to the Canada-US Tax Convention will be announced shortly and said amendments will provide treaty protection to LLC's. Furthermore, the taxpayer understands that these amendments made (*sic*) be made to apply retroactively to the years in issue. Therefore, the taxpayer requests that this notice of objection be held in abeyance pending the amendments to the Convention.[3]

[7] In September 2007, the amending protocol for the *Canada-U.S. Income Tax Convention* was signed; the amendments were ratified by Parliament in December 2007 to come into effect in January 2011. There is no dispute that the amendments ultimately made were prospective in their application.

[8] On February 2, 2009, the Minister issued a Notice of Confirmation[4] in respect of the Notice of Objection filed by the Applicant.

[9] Some 14 months later, on April 8, 2010, the Tax Court of Canada issued its decision in *TD Securities (USA) LLC v. The Queen*, 2010 TCC 186, one effect of which was to overturn, for the first time, the long-standing position of the Canada

[3] Exhibit R-1, Tab H, paragraphs 1 and 2 at pages 4 and 5.

[4] Exhibit A-1.

Revenue Agency that limited liability corporations were not "liable to tax" in the United States and therefore, not residents of the United States for the purposes of or entitled to benefits under the *Canada-U.S. Income Tax Convention*. The Notice of Appeal in *TD Securities* had been filed on July 17, 2008; the Reply to the Notice of Appeal was filed on October 22, 2008, more than three months before the issuance of the Applicant's Notice of Confirmation on February 2, 2009.

[10] The Applicant happened to learn of the *TD Securities* decision approximately a week after its release through a professional tax news publication. On May 3, 2009, a day before the expiry of the time permitted to seek an extension of time to file a Notice of Appeal under subsection 167(5), the Applicant made this application.

Analysis

[11] Turning first to paragraph 167(5)(*b*), the law is clear that no application may be granted unless the taxpayer can satisfy *all* of the criteria; *Dewey v. Her Majesty the Queen*, [2004] 2 C.T.C. 311 (F.C.A.). Having heard the testimony of Warren Greenspoon, the directing mind of the Applicant, and read the materials filed, I am not persuaded that the Applicant can demonstrate the first of the requirements under paragraph 167(5)(*b*): that within the 90 day-period after the issuance of the Notice of Confirmation on February 2, 2009 it was either unable to act or to instruct another to act in its name; or that it had a *bona fide* intention to appeal. Mr. Greenspoon was a direct and candid witness; on cross-examination, his answers in respect of the paragraph 167(5)(*b*)(i) factors are set out below:

> Q And as you have already advised the Court, M.P.N. did not appeal within 90 days after receiving this notice of confirmation, is that right?
> A That's correct.
> Q You weren't missing any necessary documentation to appeal, were you?
> A No.
> Q It wasn't your emotional or psychological state that prevented you from appealing?
> A No.
> Q Nor was it your physical state that prevented you from taking any action?
> A No.
> Q In fact, the reason M.P.N. didn't appeal within 90 days after receiving this confirmation is because it was believed that an appeal would not be successful, isn't that right?
> A We believed that it would be extremely difficult, we believed that it would be extraordinarily expensive, and we believed that given CRA's longstanding position with regard to treaty benefits to LLCs that it would, it was going to be an enormous challenge.

Q So you essentially weighed the considerations and chose not to appeal, is that right?
A That's correct.
Q And it is only once the TD Securities case came out that M.P.N. decided to appeal, correct?
A That is correct.[5]

[12] While I accept that the Applicant never agreed and continues to disagree with the Minister's interpretation of the *Canada-U.S. Income Tax Convention*, it is clear from the above passage that the Applicant did not intend to avail itself of its right to appeal within the 90-day period following the Confirmation. Counsel for the Applicant contended that the cost of litigation, like a mental or physical impairment, could be a reason for being "unable to act" within the meaning of subparagraph 167(5)(*b*)(i). While that might be so in certain circumstances, the present case is not one of them. The evidence shows that the Applicant considered its options and chose not to act; the anticipated cost of appealing and its belief that success was unlikely provided the basis for what was a decision not to act. From this it follows that the Applicant is equally unable to demonstrate that it had a *bona fide* intention to appeal under the alternate criterion of subparagraph 167(5)(*b*)(i) of the *Act.* The event that triggered the Applicant's intention to appeal was the issuance of *TD Securities* on April 8, 2010 and its anticipated effect on the interpretation of the *Canada-U.S. Income Tax Convention.*

[13] Given my finding in respect of subparagraph 167(5)(*b*)(i), it is not necessary to consider the other criteria. However, even if the Applicant were able to satisfy paragraph 167(5)(*b*), it seems to me that the wording of the Waiver is sufficiently clear to bar the Applicant from appealing the Notice of Confirmation in respect of the Part XIII issue.

[14] The validity of the Waiver itself is not in dispute. The Applicant challenges only the interpretation of the clause pertaining to the waiver of its rights to object and appeal. On cross-examination Mr. Greenspoon said that when signing the Waiver, he understood it to mean that "any change" to the *Canada-U.S. Income Tax Convention*, including a change in its interpretation, would be sufficient to trigger the Applicant's right to object or appeal. Counsel for the Applicant correctly noted that the Waiver was drafted by the Respondent and argued that any ambiguity ought to weigh in the Applicant's favour.

[5] Transcript, page 55, lines 8-25 to page 56, lines 1-12.

[15] Balanced against this consideration, however, is the fact that the Applicant was ably represented by counsel throughout the lengthy period of negotiations leading up to and including the signing of the Waiver. The Waiver documented the parties' agreement as to how the Applicant would be reassessed in respect of the issues itemized therein, including the "Part XIII on consulting fees". The amounts set out in the Waiver were ultimately assessed as agreed for the 2001 and 2002 taxation years[6]. The Applicant had agreed not to object to those reassessments subject only to the proviso that if "any retroactive change is made to the Canada-U.S. tax convention to provide relief to Limited Liability Companies within the time allowed to file an objection". The Applicant further acknowledged that subsection 165(1.2) of the *Act* had been explained and that it understood that upon signing the Waiver "no further recourse, including objection and appeal rights to any authority … is available" in respect of the reassessments. At the time the Waiver was signed, the Applicant's hopes of challenging the Part XIII reassessment were pinned exclusively on the possibility of prospective amendments to the *Convention.* The Notice of Appeal in *TD Securities* was not filed until over a year after the Waiver was signed. As of March 30, 2007, neither party was anticipating the outcome of that appeal or the effect it would ultimately have on the Canada Revenue Agency's historical position on the interpretation of the *Canada-U.S. Income Tax Convention.*

[16] In these circumstances, I am not persuaded that the Waiver is ambiguous, especially in view of the way in which the Notice of Objection to the Part XIII reassessment was drafted. Mr. Greenspoon testified that at the time the Applicant objected to the Notice of Reassessment, he was not aware of the exact nature of the proposed amendments to the *Convention.* While that may be true of Mr. Greenspoon personally, the understanding of the Applicant at the time the Notice of Objection[7] was filed is clearly expressed in the wording of the alternate ground of the objection:

> … the taxpayer [Applicant, in the present matter] states that it understands that amendments to the Canada-U.S. Tax Convention will be announced shortly and said amendments will provide treaty protection to LLC's. Furthermore, the taxpayer understands that these amendments made (*sic*) be made to apply retroactively to the years in issue. Therefore, the taxpayer requests that this notice of objection be held in abeyance pending the amendments to the Convention.

[17] As it turned out, the amendments to the *Canada-U.S. Income Tax Convention* were prospective in application and furthermore, did not come into effect until well beyond the period for filing a Notice of Objection. Thus, the conditions upon which

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[6] Exhibit R-1, Tab G.
[7] Exhibit R-1, Tab H.

the Applicant's right of appeal hinged in respect of the Part XIII reassessment never came into existence. Counsel for the Applicant submitted that the fact that the Respondent considered and disposed of the Notice of Objection filed in respect of the Part XIII reassessment by issuing a Notice of Confirmation ought to bar the Minister from now saying the Applicant had given up its right to appeal that issue. While it seems to me that it would have been procedurally tidier for the Minister to have rejected the Notice of Objection rather than to have issued a Notice of Confirmation in respect of it, I do not see how having done so would alter the substantive effect of the Waiver. The alternate ground of the Notice of Objection was the possibility that the proposed amendments would work in the Applicant's favour; it was with that in mind that the Applicant requested an abeyance pending their ratification. This request was apparently respected by the Minister as it was not until the prospectively effective amendments were in place that the Notice of Confirmation was issued.

[18] For the reasons set out above, I regret to say the Applicant's application for an extension of time to appeal under paragraph 167(5)(*b*) of the *Income Tax Act* must be dismissed. Each party shall bear its own costs.

Signed at Ottawa, Canada, this 31st day of March 2011.

"G. A. Sheridan"

Sheridan J.

CITATION:	2011TCC181
COURT FILE NO.:	2010-1529(IT)APP
STYLE OF CAUSE:	M.P.N. HOLDINGS LTD. AND HER MAJESTY THE QUEEN
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APPEARANCES:

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