Dockets: 2009-2839(IT)G
2009-2838(IT)I

BETWEEN:

JOHN F. GROSCKI,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on common evidence on July 10, 11, 12 and 13, 2017, at Toronto, Ontario

Before: The Honourable Mr. Justice Randall S. Bocock

Appearances:

Counsel for the Appellant:	Leigh Somerville Taylor
Counsel for the Respondent:	André LeBlanc

JUDGMENT

IN ACCORDANCE with the Reasons for Judgment attached and a certain consent to judgment referenced below, the appeals in respect of the 2003 taxation year are allowed on the basis that:

1. pursuant to a consent to judgment signed July 10, 2017, no capital gain arose from the Appellant's charitable donation made on December 4, 2003;

2. pursuant further to the consent to judgment dated July 10, 2017, the Appellant made a charitable gift on December 4, 2003 having a fair market value of $21,335.00 and is entitled to claim a charitable donation for such amount in taxation year 2004;

3. the Appellant is entitled to an additional business expense on account of insurance premiums in the amount of $4,010.00;

4. the Appellant was not a legal representative within the meaning of section 159 of the *Income Tax Act*, RSC 1985, c.1, as amended (the "*Act*") and the reassessment dated June 26, 2007 bearing number 9-070626-013963 is therefore vacated;

5. any and all penalties not otherwise conceded are vacated;

6. for clarity, save for any subsequent order regarding costs, if any, the Appellant is entitled to no further relief;

7. the parties may provide written submissions on costs within 30 days of the date of this Judgment in these appeals and asks that the parties address in their submissions, if any, the mixed results in the appeals; and

8. the matters are referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the Reasons for Judgment and above-referenced consent to judgment.

Signed at Toronto, Ontario, this 11th day of December 2017.

"R.S. Bocock"

Bocock J.

Citation: 2017 TCC 249
Date: 20171211
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2009-2838(IT)I

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REASONS FOR JUDGMENT

Bocock J.

I. Introduction

[1] Both these appeals concern the Appellant's, Mr. Groscki's, 2003 taxation year. However, they comprise two quite distinct assessments within that single year.

A. Accountancy Business Assessment

[2] The first reassessment stems from Mr. Groscki accountancy business. Specifically, the Minister of National Revenue (the "Minister") reassessed Mr. Groscki, the sole proprietor of that business, under the *Income Tax Act*, RSC 1985, c.1, as amended (the "*Act*") on the following basis:

a) the addition of $170,000.00 of unreported revenue relating to certain management fees (the "management fees");

b) the disallowance of $47,959.00 of client account receivables as a bad debt allowance (the "bad debts");

c) the disallowance of an insurance expense deduction in the amount of $4,010.00 (the "insurance expense");

B. Section 159 assessment related to Charitable Donation Program

[3] The second 2003 reassessment arises under section 159 of the *Act*. Mr. Groscki was reassessed on June 26, 2007 (assessment number 9-070626-013963) as the legal representative in possession and control of the property of a taxpayer having current or future tax liability, EMI Macao Commercial Offshore Ltd. ("EMI Macao"). These bases of assessment, after much refinement through concessions by Respondent's counsel, allege that Mr. Groscki, as legal representative of EMI Macao:

a) failed to report $538,801.00 of EMI Macao's income (reduced from $1,295,741.00);

b) is jointly liable with EMI Macao for the corresponding unpaid tax liability arising during his possession and control of EMI Macao's property; and/or

c) failed to obtained a clearance certificate and, thereafter, distributed EMI Macao's assets without paying the corresponding tax; and/or

[4] Although there were also distinct grounds for reassessments relating to charitable donations, both in respect of disallowed charitable deductions and alleged allocated capital gains in respect of gifted property, such grounds for appeal concerning those charitable donation issues were the subject of a consent to judgment handed up at the outset of the hearing.

II. Accountancy Business

[5] The Court shall first deal with the reassessment concerning the accountancy business.

a) Management Fees

[6] Mr. Groscki admitted that he did not directly report the management fees under his statement of professional activities or for that matter under any other source of income. The management fees were paid. There was a cheque representing the exact sum paid to him (the "$170,000 fee"). The amount was also

reflected in the general ledger of the accountancy business as drawings to Mr. Groscki. It did not appear plainly in the filed return or schedules. To account for this payment, Mr. Groscki testified that he did "effectively" report the $170,000 fee. He "pre-deducted" it against the otherwise deducted bad debts in the same taxation year, 2003. According to Mr. Groscki, the actual bad debt expense incurred was, in aggregate, $217,959.00, but was recorded as $47,959.00: $217,959.00 less the $170,000 fee.

[7] Mr. Groscki shared his logic and theory with the Court. Since the effect upon net income was the same, Mr. Groscki offset the paid $170,000 fee against the actually deducted bad debts, culminating in a "net" bad debt expense of $47,959.00. This single "netted" amount was, in turn, deducted in line 8590 (bad debts) of his statement of professional activities (T2032). He simply skipped the step of directly reporting the revenue receipt of the $170,000 fee. He further reasoned that because the aggregate sum of $217,959.00 was "abnormally high", reducing it by the $170,000 fee would "normalize" the figure. In testimony, Mr. Groscki said "I filed the bottom line number, it's what the CRA wants".

[8] Mr. Groscki cannot succeed on this ground. Professional fees are income and bad debts are expenses. To suggest the statutory methodology of completing each line may be ignored, provided the "effective result" of net income or taxable income is the same, makes the reporting of income non-compliant, misleading and absurd. In this specific case, Mr. Groscki professional fees would have been reported as $539,217.00 rather than $413,217.00. They were not.

[9] The *Act* requires the reporting of total income or professional fees from all sources; thereafter source income or fees may be reduced by permitted deductions to derive net income or profit, as the case may be. It is an elemental framework which each law, accounting and business student learns when studying the discipline of tax from the first day. To do otherwise ignores the wording of the *Act*, the intention of Parliament and the plain truth. No reader of such a muddled return has half a chance of understanding the statutorily mandated and logical disclosure of actual total, net and taxable income or gross, net or taxable profit of a business or profession where sources of income and deductions are inconsistently and capriciously co-mingled, merged and offset in such an ad hoc fashion.

[10] Undertaking such an activity, when it suits or seems warranted, renders even the "net" or "effective" correctness of reported income or fees contingent upon the accuracy of the "hidden" claimed deduction: in this case the aggregate, but undisclosed bad debt expense of $217,959.00. With such a method, to determine

actual total income or fees, even before net income or profit, one must evaluate deductions which clearly relate to the net or taxable income or profit of a business or profession. Further, as described below, the disallowance of the "hidden" offset expense *ipso facto* renders all of total income or profit, the expense and net income or profit wrong. In short, Mr. Groscki must report the $170,000 fee as professional fees or as some other source of income in the usual method he is legally, logically and practically required to do.

b) Bad Debts

[11] As noted above, Mr. Groscki really deducted $217,959.00 of bad debts as an expense, although he reported only $47,959.00 on his return. His testimony, documentation and logic surrounding the actual bad debts was no more clear than that concerning the $170,000 fee. Therefore, Mr. Groscki cannot prevail on this ground of appeal for the following reasons.

[12] The establishment of a bad debt depends upon a timely determination of uncollectability proximate to the year in which it becomes uncollectible: *Flexi-Coil Ltd*. v. *HMQ*, 96 DTC 6350 (FCA) at page 6351. The only documentary evidence of the bad debts produced by Mr. Groscki on appeal to CRA (in March 2007) and as evidence at trial was an accounts receivable listing for the entire business with terse, single word, hand notations regarding uncollectibility or doubt as to collection (the "A/R list"). Aside from that, no single, distinct client account receivable for which Mr. Groscki claimed a bad debt expense was otherwise reflected by documentary evidence adduced before the Court.

[13] No actual rendered invoice, demand letter, petition or assignment into bankruptcy of any account debtor, legal demand letter, reminder statement, statement of claim or a finalized end of year accounts receivable list was placed before the Court. As such, no reliable evidence existed which established temporally proximate deliberation necessary to ascertain that such accounts had become uncollectible and deductible as bad debts during the 2003 taxation year or reported as an allowance for doubtful accounts in a prior year. Further, the A/R list adduced at the hearing failed to indicate invoice numbers, dates of rendering and/or what portion represented uncollectable actual fees versus interest accrued, but not invoiced.

[14] The sum total of Mr. Groscki's discernible evidence regarding the $217,959.00 of uncollectible accounts receivable was that the A/R list revealed a total in excess of $560,000.00. It actually did not, it was an adding machine tape

attached to the front of the A/R list which did. Therefore, Mr. Groscki believed that the much reduced, but hidden claimed amount of $217,497.00 was reflective of the diminished actual bad debts incurred in 2003 for the accountancy business. Absent nominal, specific evidence regarding the analysis and determination of one single 2003 bad debt claimed, the provisions of the *Act* have not been fulfilled and no bad debt expense may be deducted in 2003: *Delle Donne* v. *HMQ*, 2015 TCC 150 at paragraphs 81 and 82; *Clackett* v. *HMQ*, 2007 TCC 499 at paragraph 6.

[15] The Minister's pleaded assumptions regarding the absence of evidence of uncollectibility and of expended efforts to collect the debts during the 2003 taxation year remain undemolished and operative. Accordingly, there is no "theoretical" offset against the $170,000 fee. For all these reasons, the Minister's reassessment stands and Mr. Groscki's appeal in this regard also fails.

c) Insurance Expense

[16] The Minister disallowed claimed insurance expenses of $4,010.00. Mr. Groscki concedes these represent the personal portion of premiums related to his boat and the personal use portion of his residence. It is uncontested that Mr. Groscki used his house as business and office premises. Mr. Groscki testified that the insurance expense, which was proportionally accurate, was already included in a $30,200.00 allocation of taxable personal benefits to him. Accordingly, he paid income tax personally on the benefit conveyed, but his business was denied the expense which it paid. This vague and general ground for appeal, appeared in the notice of appeal. It was the only denied expense item *per se* within the reassessment.

[17] In contrast, Mr. Groscki was not cross-examined on this insurance expense testimony. The CRA auditor never mentioned it when testifying. The Minister made no assumptions regarding the issue. Notably, the reply does not refer to the denial of the insurance expense at all. Respondent's counsel asserted that Mr. Groscki provided no evidence that the $4,010.00 had been included in the attribution within the T4001 allocating the $30,200.00 as personal benefits to Mr. Groscki.

[18] Proportionally, the insurance expense issue is small when compared to the sizeable and more complex issues before the Court in these appeals. On objection, Mr. Groscki contested it on a consistent basis: it was deducted, but charged back personally. In the Report on Objection, a document before the Court, the CRA acknowledged the consistent assertion that the personal portion of the insurance

premium was added to personal income, but nonetheless disallowed as an expense. Apart from that, the Minister has no assumption to refute Mr. Groscki's own evidence on the issue, albeit somewhat self-serving and vague. Such evidence is a *prima facie* case, begging rebuttal. However, it is marshalled against non-existing assumptions and need not be: *Pollock* v. *HMQ* [1994] 1 CTC 3 at page 5. Therefore, Mr. Groscki meets and exceeds the onus and standard of proof: *Hickman Motors Ltd.* v. *Canada*, [1979] 2 SCR 336 at paragraphs 41 to 43. Accordingly, based on the pleadings, the assessing position taken and testimony, Mr. Groscki shall succeed in his appeal on this ground.

III. Charitable Donation Program and Section 159 Assessment

a) Background of the Charitable Program

[19] The charitable donation program looms behind the section 159 assessment. The factual background of that program, which necessitated much of the offshore business structure at the centre of the section 159 assessment, was described at length by Mr. Groscki during his testimony. The program is also extensively described in the case of *Robert Lockie* v. *HMQ*, 2010 TCC 142. *Lockie* involved the appeal of a taxpayer who participated in the charitable donation program and had the deductibility of his charitable donations denied. Both counsel in this appeal commended *Lockie* to the Court and referenced and portrayed it in their submissions as an accurate reflection of the charitable donation program (the "program").

(i) the basic operational donation program premise

[20] In paragraph 17 of *Lockie*, Justice Webb, as he then was, described the promotion materials of the program as follows:

> The Respondent, in relation to the argument that the Appellant did not have a donative intent, relied mainly on the promotional materials distributed by Charitable Enterprises Inc. ("CEI"). CEI was the promoter of the plan. CEI (or a related company) had approached In Kind Canada ("IKC"), a registered charity, to determine what products charities needed. In Kind Canada is a registered charity that accepts donations of products and distributes these products to other charities. CEI also had access to manufacturers in China who could produce certain products cheaply. CEI was trying to match a need for certain products with its source of low cost products in China. In this case, the match was found for toothbrushes, gel pens, and school packs.

[21] The reference to the "source of low cost products in China" is at the heart of the section 159 assessment in this appeal.

(ii) the difference between cost and retail price of goods

[22] Similarly, Justice Webb accepted, as this Court does, Mr. Groscki's testimony regarding the EMI Group's acquisition of products, the price at which they were sold to donors, in turn, so they could donate the products to charities. This is succinctly described at paragraph 40 of *Lockie*:

> 40. The statement that the charities could not have acquired the products at the same price as CEI is accurate but not complete. The donors (including the Appellant) did not acquire the products at the same price as CEI. John Groscki (who appears to be the owner of CEI and the related companies involved in the transactions) confirmed that the company selling the products to the donors (including the Appellant) marked these items up 3 or 4 or more times from the amount paid by CEI (or a related company) to the manufacturers of the products.

The amount of profit generated by "CEI or a related company" and who received it is at issue in this appeal. The Minister alleges the related company was EMI Macao.

(iii) the twin purposes of CEI

A. The Charitable Purpose

[23] Mr. Groscki, as he did in *Lockie*, also testified extensively before the Court regarding the supply chain of the program. From the late 90's to 2003, Mr. Groscki laid the foundation for the "moving parts" of the program. He identified goods in Canada which were in demand from charities, in turn to be donated. On the charitable side, CEI would procure the products in China and sell them at cost or somewhat above cost ("cost") directly to the donors. IKC, in advance, was to identify the demand for the donations. Upon receipt of the products, they were donated to IKC. The donor would receive a donation receipt from IKC in an amount approximately several times greater than the cost of the goods. Essential to the proper functioning of the program was the consistency and reliability of the quantity, quality and delivery of the product. In this way, IKC acted as the "conduit" for the sale by CEI to the donor on one hand, and, on the other, as the charity capable of issuing the charitable receipt to the donor at several times the "cost" of the product.

[24] To conclude, as Justice Webb said in summary: "at the end of the day… donors (were made) into wholesale … distributors of products (indirectly or directly) to charities": *Lockie* at paragraph 55.

B. The Business Purpose

[25] There was also a collateral secondary object. Mr. Groscki testified that some of the product, once acquired and imported, might be (and some apparently was) sold to merchandisers or retailers as inventory held and marketed on a "for profit" sales basis to consumers in Canada. While an object, it is clear this business end of the operation did not meet much success.

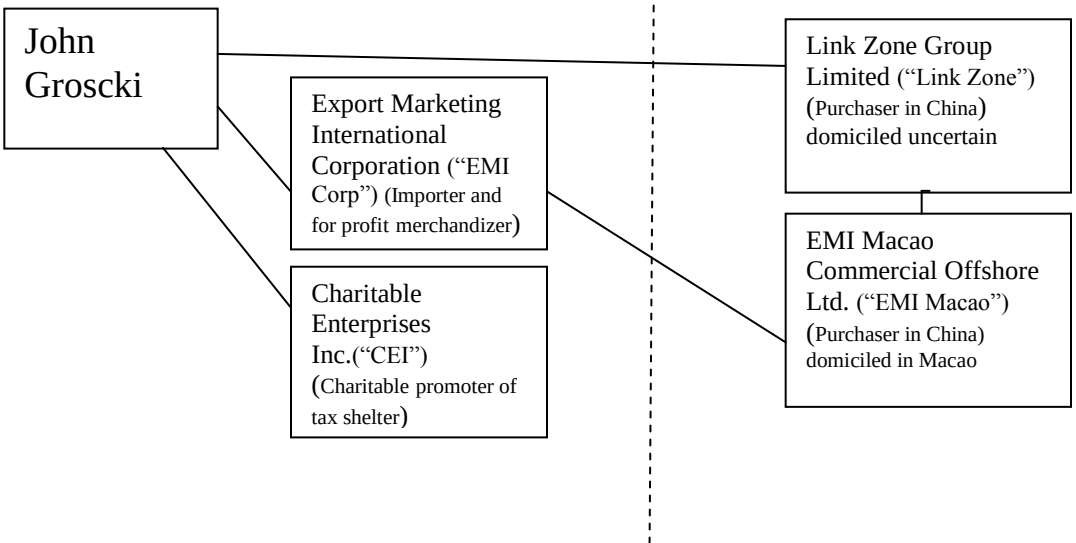
(iv) the demise of the charitable program and the withering business

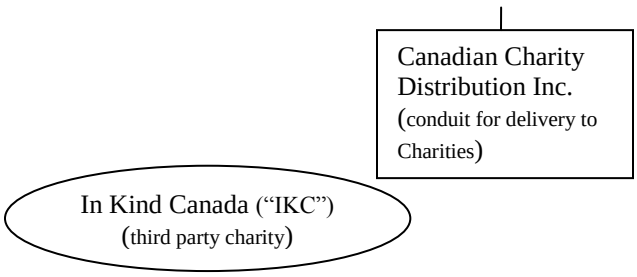
[26] In December 2003, the Government of Canada announced changes to the *Act* which effectively prohibited the acquisition of products at a low wholesale cost and a subsequent charitable donation of products in kind at an increased retail value. At this point, the companies described in the "back office" below, which had acquired the now unsought product (the "stranded product") were effectively precluded from selling to individual taxpayers at "wholesale" prices for subsequent donation at "retail" prices, the latter being several times the former. Similarly, Mr. Groscki credibly testified no measurable quantity of product, beyond comparatively small amounts, was sold to retailers for sale to Canadian consumers.

b) The "back office" of the Program

[27] A flow chart utilized by Justice Webb in *Lockie* described the charitable program within the Canadian links in the chain "after" the ordering, procurement, receipt, payment and shipping of the products above from China. The "before" or Chinese links in that "supply chain" are revealed in the analogous chart below (*with descriptions of the primary purpose of each entity in parentheses*):

The EMI Group





(i) Role of the entities

[28] EMI Corp. was the recipient importer of the goods acquired in China, whether intended for charitable or commercial purposes. With respect to the goods intended for commercial purposes, it appears from testimony, it would simply directly sell to Canadian commercial retailers or merchandizers. With respect to the charitable program, it would receive payment at a "cost" and distribute the goods at a "fair market value" several times in excess of the purchase price, as described extensively in *Lockie* by Justice Webb. In this way, to borrow from Mr. Groscki, these donations would be made "more efficient".

(ii) Operational Results

[29] The critical period in the later months of 2003 represented the busiest time of acquisition activities of Chinese goods undertaken by EMI Macao and Link Zone. The books, records and financial statements detailing the acquisitions of goods in China were not particularly helpful, but the following chart is the approximation of the values of inventory on hand and net income ascertained and assigned by CRA based within its alternative assessment for each of EMI Macao and Link Zone for the period indicated.

Entity	**Period Ending**	**Inventory at Recorded Cost (rounded)**	**Net Income (rounded)**
EMI Macao	January 31, 2004	$490,700.00	$910,300.00

Link Zone	January 31, 2004	$210,300.00	$384,700.00
Total		$700,000.00	$1,295,000.00

[30] The issue of the precise exactitude of these figures, as will be seen below, may have been accurate as to quantity, but otherwise remained critically in issue at trial. The CRA's view is that EMI Macao and Link Zone, as purchasers, acquired and paid for the goods in China. Link Zone and Mr. Groscki are no longer the subject of coincident assessments for unreported income, but such potential assessments figured prominently along with EMI Macao in the audit, appeal and ultimate section 159 assessment levied against Mr. Groscki.

[31] The underlying documentation prepared by EMI Corp's advisors and executed by Mr. Groscki on behalf of all the concerned entities informed the levied assessment by CRA. Two relevant agreements among the parties were as follows:

a) a "disbursement agent agreement" among EMI Macao, Link Zone, EMI Corp. and CEI. Under this agreement, CEI acted as the agent to sell such goods for EMI Macao and Link Zone. EMI Corp. provided administration and support services to effect such sales to donors. Although not a party to this particular agreement, Mr. Groscki was referenced as transfer agent held all donated funds (presumably the cash donation representing the purchase price) until title to the sold goods "is transferred".

b) a "sales agent agreement" between CEI and EMI Macao. There was an identical agreement which substituted Link Zone for EMI Macao. Under this agreement, CEI was authorized to "place orders to sell products from EMI Macao to individuals who wished to donate the products to registered charities". Similarly, the escrow agent, this time not mentioned by name, was required to hold funds in trust until "title to the goods is transferred". The Court is prepared to infer this was Mr. Groscki.

[32] Reflecting EMI Macao's ability to operate in Macao, in October 2003, the special administrative region published a notice stating that EMI Macao was authorized "to practise the activities offshore" in the Special Administrative Region of Macao. Perhaps, the original text in Cantonese and/or translation into Portuguese was clearer as to actual legal intention, but the English must suffice. In any event, this authorization "to practice the activities" was revoked by publication in December of 2004, effective July 21, 2004.

(iii) the stranded products' owner(s), value, location and disposal

[33] In December of 2003, when the legislation was introduced to prevent "buy low, donate high" charitable donation programs, the elaborate "donation and supply system" established by Mr. Groscki came to an effective end. While "for profit" sales were still possible, Mr. Groscki's credible testimony was that EMI Macao and all others were now holding valueless, stranded inventory. Whatever its cost (and its recorded values), the net realizable value of the inventory from "for profit" sales was much less according to Mr. Groscki than the realizable value previously obtained through the "efficient" charitable donation program. Ultimately, it appears certain quantities were imported into Canada. Similarly, there was no consistent evidence regarding the time, duration, or actual dates for the sale or disposal of such inventory.

c) Nature of the section 159 Assessment

(i) The assessment process

[34] The CRA audited the EMI Group, firstly in connection with the charitable donation tax shelter and, thereafter, in connection with the outstanding tax liability of various related companies.

(ii) The audit reports and working papers

[35] The CRA, whose auditor testified at trial, concluded that an alternative assessment of EMI Macao and others was necessary. The necessity of the alternative assessment was not challenged. It was completed by analyzing EMI Macao and Link Zone's inventory on hand and the recorded sales to donors through various filings made by the tax shelter, particularly through a review of the T5003's: Summary of Tax Shelter Information. The T5003's issued to individual "donors" showed sales of approximately $2,443,000.00. Although no clear evidence was led as to whether these values were "cost" or "retail", it was on that basis that the CRA calculated EMI Macao's tax liability and reassessed Mr. Groscki.

(iii) The remaining grounds of reassessment

[36] The quantum of the June 26, 2007 section 159 assessment was patently erroneous on two bases. Section 159 permits the Minister to assess a legal representative for the tax liability owed by the "legally represented" taxpayer. Mr.

Groscki, on the face of the assessment, was plainly assessed for the amount of the alleged "unreported income" of EMI Macao, rather than the commensurate corporate tax liability of EMI Macao. This is patently incorrect. Under section 159, Mr. Groscki, as a legal representative, is not to be liable as taxpayer for the unreported income of EMI Macao, but rather for the ultimate tax liability owing of EMI Macao. At trial, the Respondent also conceded that the amount $1,295,741.00 as income was incorrect for the purposes of the calculating section 159 tax liability which tax liability was conceded by the Respondent to be no more than $375,764.48.

(iv) The operative assumptions

[37] To identify the onus of proof in this particular appeal, the assumptions made and not made by the Minister are informative. Relevant to the section 159 assessment against Mr. Groscki concerning the liability of EMI Macao, the following assumptions were made (*consistent definitions have been added and underlining has been added for emphasis*):

> m) the appellant is the sole shareholders of Link Zone and Export [EMI Corp in these reasons];
>
> n) the shares of EMI [EMI Macao in these reasons] where either held by the appellant, by Link Zone or a combination of both;
>
> o) the appellant is a director of Link Zone, EMI and Export;
>
> p) the appellant is the sole directing mind of EMI, Link Zone and Export;
>
> q) EMI ceased to exist in 2004;
>
> s) Link Zone is the legal representative of EMI;
>
> t) the appellant is the legal representative of Link Zone;
>
> w) in 2003, the profit made from the sale of CEI tax shelter program was $1,295,741;
>
> y) Export failed to report to the Minister the profit made from the sale of the CEI tax shelter program in the amount of $1,295,741;
>
> z) in the alternative, if the business activities were carried on by Export on behalf of Link Zone and EMI as suggested by the appellant, Link Zone and EMI failed to report to the Minister the profit made from the sale of the CEI tax shelter program in the amounts of $384,774 for EMI and $910,967 for Link Zone

[38] It is noted, aside from the foregoing, no assumptions in the reply were made regarding:

(i) the value of EMI Macao's closing inventory as at December 31, 2003;

(ii) the amount of income undeclared by EMI Macao at December 31, 2004; and

(iii) Mr. Groscki's capacity as a fiduciary or "legal representative" of EMI Macao or, more appropriately for pleadings of fact, specific actions or omissions in connection with EMI Macao which support factually such a conclusion of "legal representative" prior to its assumed cessation of existence in June 2004.

(v) The Minister's relevant submissions

[39] Apart from her assumptions, in summary, the Respondent submits the following as reasons and justification for upholding the assessment:

(i) the Respondent has established that EMI Macao had a net profit of $538,00.00 in January 2004;

(ii) EMI Macao ceased to exist in June 2004. Before and after that period, Mr. Groscki acted as legal representative: the only person who could have;

(iii) the inventory on hand, not less than $450,000.00, was held by Mr. Groscki (in possession and control under subsection 159(1)) and was distributed by him (distribution under subsection 159(3)) during the winding up of EMI Macao in his capacity of legal representative; and

(iv) factually, Mr. Groscki's actions fall entirely within the definition of a legal representative in possession and control of EMI Macao's property who, as legal representative:

(1) under subsection 159(1), is jointly liable for EMI Macao's unpaid tax liability during the currency he possessed and controlled the property and/or;

(2) under subsection 159(3), failed to obtain a clearance certificate or pay the tax liability owing prior to distributing the property under his possession and control.

d) The necessary elements of section 159

(i) The statute

[40] A useful excerpt of the relevant subsections of section 159 and the relevant definition section within the *Act* are as follows:

(1) Person acting for another

159 (1) For the purposes of this Act, where a person is a legal representative of a taxpayer at any time,

(a) the legal representative is … liable with the taxpayer

(i) to pay each amount payable under this Act by the taxpayer at or before that time and that remains unpaid, to the extent that the legal representative is at that time in possession or control, in the capacity of legal representative, of property that belongs or belonged to, or that is or was held for the benefit of, the taxpayer or the taxpayer's estate, and

(ii) to perform any obligation or duty imposed under this Act on the taxpayer at or before that time and that remains outstanding, to the extent that the obligation or duty can reasonably be considered to relate to the responsibilities of the legal representative acting in that capacity; and

…

(2) Every legal representative (other than a trustee in bankruptcy) of a taxpayer shall, before distributing to one or more persons any property in the possession or control of the legal representative acting in that capacity, obtain a certificate from the Minister, … , certifying that all amounts

(a) for which the taxpayer is or can reasonably be expected to become liable under this Act at or before the time the distribution is made, and

…

> have been paid … .
>
> Personal liability
>
> (3) If a legal representative (other than a trustee in bankruptcy) of a taxpayer distributes to one or more persons property in the possession or control of the legal representative, acting in that capacity, without obtaining a certificate under subsection (2) in respect of the amounts referred to in that subsection,
>
> (a) the legal representative is personally liable for the payment of those amounts to the extent of the value of the property distributed; …
>
> **248 (1)** In this Act,
>
> …
>
> **legal representative** of a taxpayer means a trustee in bankruptcy, an assignee, a liquidator, a curator, a receiver of any kind, a trustee, an heir, an administrator, an executor, a liquidator of a succession, a committee, or any other like person, administering, winding up, controlling or otherwise dealing in a representative or fiduciary capacity with the property that belongs or belonged to, or that is or was held for the benefit of, the taxpayer or the taxpayer's estate; (*représentant légal*)

(ii) The design of section 159: two distinct vehicles

[41] Although appearing in the same section, subsections 159(1) and the remaining 159(2) and (3) have some distinct features. As described below, these features are not necessarily relevant in this appeal, but they are noted. Generally, these differences may be briefly summarized.

[42] Firstly, the potential liability under 159(1) is joint and several whereas it becomes a "personal liability" under subsection 159(3). Recovery from the taxpayer under subsection 159(1) will diminish the liability of the legal representative. Under subsection 159(3) the liability becomes a singular deemed personal obligation of the legal representative.

[43] Secondly, subsection 159(3) becomes engaged only where a clearance certificate is not obtained. If one is obtained, the legal representative is released to the extent of the value of that property to which the clearance certificate relates. By contrast, this suggests that the value of the property under subsection 159(1) is not relevant, liability accrues to the extent of the tax debtor's liability provided the

other components are present, implying that such possession and control could or ought to have effected payment.

[44] Lastly, and related to the first point, a "distribution" by the legal representative triggers subsection 159(3), subject to the satisfaction of the other common components. As such, reassessment under subsection 159(3), not unlike section 160, may occur "at any time". It is not subject to the normal reassessment period, as is subsection 159(1). This is another contrast.

(iii) Other publications

[45] There is little relevant case law or comparable appealed assessments relevant to the situation where directors have been held liable under the provisions within section 159 as a legal representative. Both counsel alluded to this dearth of authorities in submissions. However, the Minister has weighed in on the topic, offering up a technical interpretation bulletin 9916865 dated September 24, 1999– liability of legal representative (the "IT Bulletin") and Technical Notes, 159(1), October 24, 2012, TN – (the "Technical Note").

[46] The IT Bulletin provides as follows:

> **9916865 – Liability of legal representative**
>
> Reference: 159(1), 159(2), 248(1)
>
> SUMMARY: Liability of legal representative – ITA-159(1), 159(2), 248(1) – Extent of liability of the legal representative of a taxpayer under subsection 159(1) of the *Income Tax Act*.
>
> Our Comments Paragraph 159(1)(a) sets out the circumstances in which a person who is the legal representative of a taxpayer is jointly and severally liable with the taxpayer for unpaid amounts payable under the Act. Pursuant to paragraph 159(1)(a), the legal representative is jointly and severally liable with the taxpayer (i) to pay each amount payable under this Act by the taxpayer at or before that time and that remains unpaid, to the extent that the legal representative is at that time in possession or control, in the capacity of legal representative, of property that belongs or belonged to, or that is or was held for the benefit of, the taxpayer or the taxpayer's estate.
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> Fundamental to section 159 is the definition of "legal representative" found in subsection 248(1) of the Act: "legal representative" of a taxpayer means a trustee in bankruptcy, an assignee, a liquidator, a curator, a receiver of any kind, a trustee, an heir, an administrator, an executor, a committee, or any other like

> person, administrating, winding up, controlling or otherwise dealing in a representative or fiduciary capacity with the property that belongs to or belonged to, or that is or was held for the benefit of, the taxpayer or the taxpayer's estate. Whether a lawyer or a law firm that holds client funds in a trust account for subsequent disbursement in accordance with the client's instructions is a trustee depends on the facts and circumstances of each case.
>
> Thus, the final clause of the definition is properly limited in scope to the kind of persons that precede it, namely, a trustee in bankruptcy, an assignee, a liquidator, a curator, a receiver of any kind, a trustee, an heir, an administrator, an executor, or a committee. In general, the enumerated individuals stand in the place of, and succeed to the interest in property of, another individual or corporation. They represent the interests of, and oversee the legal affairs of, another person. In light of the foregoing, your three questions are answered as follows. 1. In the absence of facts and circumstances that indicate a trustee and beneficiary relationship, it does not appear that the lawyer or law firm acting on behalf of a client in a commercial transaction would be considered to be a "legal representative" as defined in subsection 248(1) of the Act. … However, under subparagraph 159(1)(a)(i), a legal representative's liability is limited to the property in his or her possession or control, in the capacity of legal representative, at the time that an amount becomes payable under the Act.

[47] In turn, the relevant excerpt from the Technical Note provides as follows:

> (say a parent corporation that wound up its subsidiary and acquired its assets)
>
> …
>
> The liability of the legal representative acting in good faith is limited to the property in the possession and control of the legal representative when that person is called upon to make a payment on behalf of the taxpayer, or to any proceeds of disposition and replacement property obtained by the legal representative from that property. … For example, a representative who has a general power of attorney will have broader responsibilities than one whose authority is limited to certain assets of the taxpayer.

e) Analysis and Findings

[48] As a third party liability and collection mechanism, section 159 has critical components which must be present before the provision is engaged. Simplistically these are:

i) the third party must be a legal representative of the taxpayer ("legal representative");

ii) the legal representative must, in that capacity, be in possession and control of the taxpayer's property ("possession and control");

iii) there must be tax liability unpaid before or during such possession and control ("accrued tax liability"); and

iv) further and distinctly from subsection 159(1), before distribution occurs, a clearance certificate must be obtained under subsection 159(2), failing which personal liability for tax accrues to the legal representative for then owing and future amounts of tax under subsection 159(3)("clearance certificate").

[49] There is no factual dispute regarding the non-existence of a clearance certificate or the presence of some amount of tax liability. Mr. Groscki did not obtain a clearance certificate. The alleged tax liability remains unpaid to the maximum of $375,764.48. Therefore, under subsection 159(1), should the components in subparagraphs a), b) and c) above be found to exist, Mr. Groscki would be liable for the tax liability which arose before or during his possession and control. However, since no clearance certificate was obtained, subsection 159(3) is also engaged. Therefore, only the components of "legal representative", "possession and control" in that capacity and an existing or future tax liability must, on balance, exist. These are, within this appeal, the common components for the engagement of subsections 159(1) and 159(3). The severability and distinctiveness of subsections 159(1) and 159(3), otherwise frequently relevant, are not so in this appeal. No certificate was obtained to reduce liability under subsection 159(3), the protective assessment was levied within the normal reassessment period and, therefore, the assessment is not specifically related to either before or after the accrual of the liability because of the absence of a clearance certificate in respect of property allegedly distributed. Although deductively obvious, should the facts when applied to the law, on balance, fail to establish any of these necessary components, the appeal shall succeed.

(i) The meaning of "legal representative"?

[50] The definition of "legal representative" is fundamental to the engagement of the section. It requires action as a fiduciary of a person legally authorized to administer, wind-up, control (as in prohibit or permit) the distribution or dealing with the taxpayer's property. The representation of interests or oversight of legal affairs by the representative must be factually present.

[51] Counsel acknowledged that the application of this definition in the present appeal is factual because of the lack of jurisprudence. Prior to 1997, no stand-alone definition of "legal representative" existed in section 248 of the *Act*. Instead, it was embedded within the broader section 159 as it then existed. A re-examination of the definition and its use in subsection 159(1) is nuanced and open to considerable interpretation, especially to discern if an identified director, under the present circumstances, falls within or remains without. Plainly, the title or role of director is not expressly included in the definition, although many others are. This allows the Appellant to plainly state the inclusion of such capacity was not legislatively intended. Similarly, it harbours the Respondent's contention that, in certain factual circumstances, such as those asserted to be present in this appeal, a director may become "a receiver of any kind", a "liquidator" or "any like person". While any other named "role" within the definition is potentially possible, these are the three highlighted.

[52] In establishing how courts should interpret statutory provisions, and specifically how this Court should interpret taxing legislation, the Supreme Court of Canada in *Canada Trustco Mortgage Co.*, v. *R.*, 2005 SCR 54 at paragraph 10 directed that a textual, contextual and purposive analysis be used. The exercise provides first stress on the text. Then, if warranted by a hint of patent or latent ambiguity or equivocation, context and purpose are next weighed: *Canada Trustco* at paragraph 47.

A. Text

[53] Textually, as noted, the specific term "director" does not appear in the definition section of legal representative. The phrases and terms, "a receiver of any kind", "a liquidator", and "or any like person" and "administering, winding up, controlling or otherwise dealing in a representative or fiduciary capacity with the property" of the taxpayer, do appear. Ambiguity is embedded within the phrase, "or any other like person, administering…" because of the grammatical structure. Formal or received usage mandates a comma should not separate a phrasal clause from its predicate, but should be used to separate a phrase or subordinate clause from the main clause so as to avoid misunderstanding. Further, such usuage over time has changed. Modern convention drops the separation feature of the comma in a list of items greater than two before the conjunction "and" or "or". Which is it? Safely, the question of whether the phrase "or any like person administering…" is simply part of a list or a modifier or limitation of the words preceding is not readily apparent. The omission of the term "director" further muddies the water. Further, in statutory interpretation, the principle of limited class would have one limit the

words “or any other like person” and “otherwise dealing in a representative or fiduciary capacity” to the class of the previously listed and defined terms.

[54] The jurisprudence regarding the definition is not specifically helpful. The closest analysis concerning a director falling within the definition of legal representative approximates, but does not directly answer, the question before the Court. In *Parsons* v. *HMQ*, 1983 CarswellNat 170 (FCTD) at paragraph 100, the Court found that a director was not “any other like person” within the definition as it existed. The failure to include the term specifically in the definition was found to be determinative. However, *Parsons* concerns the declaration of dividends as the “distribution” event. This is precisely what directors from time to time do within their normal director powers. In the present appeal, the alleged conduct is that of liquidation. To further dilute the authoritive impact of *Parsons*, it was overturned on appeal, albeit on unrelated grounds.

B. Context

[55] Does the context of the term “legal representative” within the *Act*, as the Respondent contends in the present case, render a director legal representative? Within the *Act* as a whole, the term legal representative is used frequently and almost exclusively in the context of executors or administrators for deceased taxpayers. The definition itself ends with the term “or the taxpayer’s estate”. Contextually then, this consistent use may suggest the pre-condition of death or, presumably, some form of irrevocable dissolution in the case of a body corporate, although, even then, the latter context is not specifically used within the *Act*. This context suggest express authority conferred by instrument or appointment specifically granting legal authority to distribute, transfer or convey property.

C. Purpose

[56] To identify the overall purpose, an examination of the Interpretation Bulletin and Technical Note is permitted to gain extrinsic insight into the policy purpose of the overall section which uses the definition. In undertaking such an analysis, there remain some undefined definitions in the corporate milieu. The Interpretation Bulletin concerning subsection 159(1) uses of the following words: “these amendments clarify … notwithstanding that the taxpayer may have been “dissolved and liquidated”. Similar wording in the Technical Note discusses a parent corporation winding up and subsuming a subsidiary’s assets. Plainly, this relates to a body corporate. While contextually the words seem limited to estates, guided by the Interpretation Bulletin and Technical Note, such a broad net might

catch a director acting in such a capacity involving circumstances of dissolution and liquidation. Justifiably, a dissolved body corporate or one that "ceases to exist" is roughly analogous to an executor or administrator in the context of a deceased taxpayer.

D. Conclusions

[57] If the present context includes only examples of deceased persons, but the extended purpose is thought to be expanded through the Interpretation Bulletin and Technical Note, then dissolution (or cessation) and liquidation must be considered. The question remains: how legally does a director dissolve a corporation and liquidate the assets of a corporation as a legal representative?

[58] Burrowing deeper away from the present legislation and related commentary unearths somewhat additional informative authority: *Malka et al*. v. *HMQ*, 78 DTC 6144 (FCTD). Helpfully, it deals with the predecessor section to section 159, section 52. In paragraphs 16 and 17 of *Malka*, the Federal Court said:

> 16 The provisions of subsections 52(2) and 52(3) read as follows:
>
> > 52. (2) Every assignee, liquidator, administrator, executor and other like person, other than a trustee in bankruptcy, before distributing any property under his control, shall obtain a certificate from the Minister certifying that taxes, interest or penalties that have been assessed under this Act and are chargeable against or payable out of the property have been paid or that security for the payment thereof has, in accordance with subsection (4) of section 116, been accepted by the Minister.
> >
> > (3) Distribution of property without a certificate required by subsection (2) renders the person required to obtain the certificate personally liable for the unpaid taxes, interest and penalties.
>
> 17 In my view, it would not be reasonable not to consider Charles Malka as a liquidator because he has, in fact, acted like a liquidator. To interpret subsection 52(2) in such a formalistic way that it would not encompass a *de facto* liquidator would be contrary to the provisions of subsection 52(2) even if one had no recourse to the rule of *ejusdem generis*. Indeed, it would give rise to blatant abuses as one would only have to distribute and then the Minister would have nobody to sue for the taxes of the company. It is precisely the de facto liquidators that are the main target of subsections 52(2) and 52(3) as they are the ones that can be the less prone to ask for a certificate.

[59] Factually, in *Malka*, the plaintiffs (two related parties) were assessed under the then operative equivalent of section 159 for tax on the profits of Valient Shoe Import Corp. alleged to be some $355,000.00, yielding taxes of approximately $54,000.00 in one year and $56,000.00 in another. The basis of the relevant assessment was that the Malka(s) had acted as "liquidators" under the then relevant section of the *Act*. In the case, resolutions had been passed to wind up and/or sell assets and shares in an attempt to acquire and use existing losses of a target company. Ultimately, the Court found factually that the actions by the plaintiffs factually accorded with their subsisting and unrevoked corporately authorized authority, intention and objects to wind-up and liquidate Valient Shoe.

[60] While not identical, the previous section 52 and present section 159 are symmetrical enough to warrant a helpfully informative comparative conclusion. A director, under certain circumstances, may become a legal representative where:

(i) additional powers beyond directorship have been legally granted or if not, available and assumed;

(ii) the additional powers allowed the transformed legal representative to legally and factually dissolve (wind-up) and liquidate the corporation; and

(iii) the director liquidated the assets of the body corporate by virtue of those powers.

(ii) The factual circumstances in this appeal: is there dissolution and liquidation?

[61] Using such a framework, Mr. Groscki could not have been such a liquidator given the facts before the Court. The analysis and reasons for this follow.

[62] A "dissolution and liquidation" was not directed by Mr. Groscki. There was scant evidence of corporate authority for Mr. Groscki to undertake such actions *qua* "liquidator" "receiver of any kind" or "or other like person". The actions of another entity under an existing third party ongoing agreement or document deflect rather than attract to Mr. Groscki alleged supplemental authority as "liquidator" through his directorship.

[63] Both logically and legally, the dissolution of a corporation, as assumed by the Minister by virtue of the words "ceased to exist" requires the revocation or

surrender of its constating documents in the jurisdiction of the incorporation or grant. EMI Macao was a British Virgin Islands' company. To that end, there was no evidence of a revocation by the British Virgin Islands of EMI Macao's charter or letters patent. There was no evidence before the Court that such documents (themselves not before the Court) were surrendered or cancelled. What occurred was a revocation, it would appear on an unsolicited and unobserved basis, of the company's territorial licence to operate in Macao. The company was not legally dissolved, struck, wound up or rendered *functus* by the jurisdiction which created it or by its own director acting under resolved corporate action.

[64] For certain, EMI Macao operated after June 2004 outside the lawful licencing requirements of Macao. It likely could not maintain an action in that jurisdiction after that date, but there was no evidence – as a matter of foreign law, admissible as fact - to suggest any seller of goods in Macao or the rest of China refused to deal with the still subsisting EMI Macao after that date. The absence of a licence to operate is not a dissolution or cessation of existence, as assumed by the Minister, under relevant Canadian law. To suggest that it is in Macao, while also unlikely, requires evidence beyond that proved or assumed by the Minister. There was no evidence that EMI Macao "ceased to exist in June 2004".

[65] Additionally, on balance, there was no evidence of "liquidation". What appears to have happened to the "property" to the extent its alleged value is accurate, even at the hands of Mr. Groscki, was not a conjunctive consequence of EMI Macao's revoked status to operate compliantly in Macao. Rather, it was the legislative change in Canada concerning donations of the type previously undertaken by CEI that mandated the shift in the use of business structures and entities. Link Zone and EMI Macao were no longer needed. They were simply omitted from subsequent product acquisitions, to the extent they were any. In effect, the existing business and inventory became stranded and almost valueless because of hugely impactful legislative change. The evidence supports this: EMI Corp and Mr. Groscki advanced the sums to acquire and (reluctantly by then) import the goods directly in order to honour the commitments to suppliers in China. This was not liquidation of EMI Macao arising from dissolution, but merely abandonment. A review of Mr. Groscki's testimony concerning the acquisition, ownership, value, export and import of the assets stresses the contemporaneous need to commercially improvise.

[66] Further, there was no authority for Mr. Groscki to act as liquidator. This marches along with the context and purpose of section 159(1). Legal representatives for estates require some directive, recognizable and informative

document: a will, a trust deed, a grant of administration or letters probate. Some instrument or action must award or grant some authority or at least "colour of right" to "administer assets" in the course of a dissolution, winding up and/or liquidation. The same may be said of corporations. In the context of *Parsons*, the issue was the declaration of dividends, a distribution of surplus income authorized and witnessed by a duly passed corporate resolution. In *Malka*, the authorized winding up and acquisition were present.

[67] One might ask, what form would such documentary or director authority take for a body corporate? For federally incorporated business corporations, liquidation requires a special resolution of its shareholders to appoint and authorize a liquidator: *Canada Business Corporations Act*, RSC 1985 c C-44, subsection 210(3). Business corporations incorporated in Ontario require a court order: *Business Corporations Act*, RSO 1990 C.B. 16, subsections 193 and 207. In such a case, a director may be a liquidator, but the need for a court order remains. There is no evidence such comparative or commensurate authority or direction was conceived or intended, never mind carried out for the British Virgin Island Company, EMI Macao. The legal assertion that a "constructive liquidator" may be created of a director (or officer for that matter) carrying out a triage strategy of a critically damaged business model involving an entire group of companies stretches the text, context and purpose of the expanded definition "legal representative" and the section which employs it, beyond circumstances factually present in this appeal. In short, Mr. Groscki acted within his scope of director or at least not in the expanded capacity of liquidator.

[68] Further, the operative business documents that subsisted show there was no sudden departure from the business model followed by EMI Group long before December, 2003. The disbursement agent and sales agent agreements are just that, agreements. They do not create fiduciary relationships beyond their terms. They do not preclude EMI Corp from dealing directly with Chinese sellers. On close examination, the documents are intended to protect the cash of donors by insuring that the buyer of the goods in China, EMI Macao or Link Zone, was not paid by Mr. Groscki until the goods are imported to Canada and title passes to the donor/distributor. As escrow or transfer agent, Mr. Groscki bore a burden to such parties, contractually. These documents establish such obligations of him and EMI Corp to the donors. No similar "liquidator" or "other like person" document establishes such power, obligation or authority on Mr. Groscki in favour of EMI Macao.

[69] Similarly, the actions by EMI Corp or Link Zone vis a vis EMI Macao cannot impose liability upon Mr. Groscki in the absence his being a legal representative of EMI Macao. Facts underlying that specific "legal representative" status were not assumed by the Minister. Further, for the reasons stated, on balance, such facts were not proven factually for this Court.

(iii) Was there possession and control?

[70] As stated, the presence of possession and control of property of the taxpayer by a legal representative is a separate and necessary component to establishing section 159 liability. Given the finding that Mr. Groscki was not a legal representative, it has become moot. Someone who is not a legal representative, but may nonetheless be in "possession and control" of a tax debtors' property, does not fall within section 159. However, even if such an issue were not now moot, the following considerations would lead the Court away from such a factual finding in the circumstances of this appeal:

a) on balance, it is just as likely that the entity in control and possession of EMI Macao's property was EMI Corp pursuant to its legal agreement to provide administrative services and import the goods acquired by EMI Macao. The Court notes that the Minister has neither assumed nor proven factually that EMI Corp acted in such capacity or that, through that conduct, Mr. Groscki was a "liquidator" within the meaning of legal representative. The fact that Mr. Groscki controlled EMI Corp as "sole directing mind" is not relevant to his direct possession and control of the property of EMI Macao as legal representative.

b) Mr. Groscki's "control" was contractually determined by and subject to the terms of the various agreements described and the obligations contained therein. These existed well before the alleged liquidation and dissolution comprising the critical period and existence of "possession and control"; and

c) there were critical questions concerning the timing and valuation of the property allegedly in Mr. Groscki's possession and control such that the currency of possession and control and the value of such property at that material time were not, on balance, established.

(iv) What was EMI Macao's tax liability?

[71] The tax liability of EMI Macao was ultimately reduced by concession of the Respondent at the commencement of the appeal to a maximum value of $375,764.48. While this underlying liability is irrelevant to this appeal given that Mr. Groscki was not a legal representative exercising possession and control, the following questions remain regarding the methodological reliability of this underlying assessment:

a) the net worth analysis conducted did not consider the impact or input of the "for profit" side of the business undertaken by the EMI Group;

b) in a similar vein, the section 159 assessment reflected a period up to December 2003 or January 2004 (it was not entirely clear from the auditor's testimony), but even the CRA auditor assumed EMI Macao did not cease to exist or was dissolved until June, 2004 (itself an incorrect legal conclusion). Yet, her assessment ended at the very latest in January of 2004 which may have satisfied subsection 159(1), but not necessarily subsection 159(3);

c) the best and most reliable evidence illustrates an inventory value of not greater than $450,000.00. If this were so, as stranded inventory, it is more likely than not that the ultimate tax liability of EMI Macao was considerably lower than the asserted $375,764.48 since sale of that inventory would have yielded a reduced profit; and

d) Mr. Groscki's testimony regarding the value of the inventory and likely profit of EMI Macao, while not entirely convincing, did at the very least give the Court pause regarding the validity of the underlying assessment particularly in light of the errors committed by the auditor both as to tax owing, unreported income and timing when conducting the original alternative, protective assessment.

IV. Conclusion, Summary and Costs

[72] In conclusion and for the reasons expressed, the appeal is granted on the basis that:

a) pursuant to a consent to judgment signed July 10, 2017 no capital gain arose from Mr. Groscki's charitable donation made on December 4, 2003;

b) further to the consent to judgment dated July 10, 2017, Mr. Groscki made a charitable gift on December 4, 2003 having a fair market value of $21,335.00 and is entitled to claim a charitable donation for such amount in taxation year 2004;

c) Mr. Groscki was not a legal representative within the meaning of section 159 of the Act and the reassessment dated June 26, 2007 bearing number 9-070626-013963 is therefore vacated;

d) the Appellant is entitled to an additional business expense on account of insurance premiums in the amount of $4,010.00;

e) given the result in the cause, and for clarity, in light of the separate assessments concerning the single taxation year, all penalties are vacated;

f) save for any subsequent order regarding costs, if any, Mr. Groscki is entitled to no further relief; and

g) the Court shall receive written submissions on costs within 30 days of the date of this Judgment in these appeals and asks the parties specific address in their submissions, if any, the mixed result.

Signed at Toronto, Ontario, this 11th day of December 2017.

"R.S. Bocock"

Bocock J.

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