SUPREME COURT OF BRITISH COLUMBIA

TYPE OF MISREPRESENTATION DEFINES THE LIMIT OF REASSESSING BEYOND THE LIMITATION PERIOD

Inwest Investments Ltd. v. Canada (National Revenue)
2015 BCSC 1375

KEYWORDS: REASSESSMENTS ■ LIMITATIONS ■ TAX RETURNS ■ PERMANENT ESTABLISHMENT ■ MISREPRESENTATION ■ BRITISH COLUMBIA

Introduction

Inwest Investments Ltd.[51] came before the BC Supreme Court by way of a summary trial application and is one of several recent examples of bad judgment on the part of the CRA in litigating a reassessment with faint hope of success. The court found that the statutory limitation period applied to bar the CRA from reassessing the taxpayer.

The central issue before the court was whether there had been a misrepresentation in the taxpayer's return when it took the position that it did not have a permanent establishment in British Columbia. A finding of misrepresentation attributable to neglect or carelessness would have provided an exception to the limitation period.

The decision is consistent with existing jurisprudence, but applies the analytical framework to the statutory provisions in a way that helps to narrow the issue to the relevant parts of the judicial test and will tend to assist counsel in making more targeted submissions in future cases.

Facts

Inwest Investments Ltd. ("Inwest") was a privately held corporation with headquarters in British Columbia. Its business was the operation of Future Shop through its controlling holdings of 68.4 percent of the common shares of Future Shop Ltd. ("Future Shop"). The shares were held by Inwest and its wholly owned subsidiaries, 438855 British Columbia Ltd. ("438"), 574156 British Columbia Ltd. ("574"), and Wesbild Holdings Ltd. ("Holdings").

During 2001, Inwest and its subsidiaries were in negotiations with Best Buy Inc. ("Best Buy") to sell their interest in Future Shop to Best Buy. The negotiations culminated in Best Buy's offer to purchase the Future Shop shares at a price of $17 per share ("the Best Buy offer"). The offer was agreed to by Future Shop's board of directors in July 2001.

At the time of the board's approval of the Best Buy offer, the Future Shop shares held by the Inwest companies had an accrued and unrealized capital gain of almost

51 *Inwest Investments Ltd. v. Canada (National Revenue)*, 2015 BCSC 1375.

$354 million. Had the sale closed without any preclosing transaction steps, Inwest would have been required to include the taxable capital gain resulting from the sale in computing its income for both federal and BC tax purposes. The BC tax would have arisen by virtue of Inwest's having a business, and therefore a permanent establishment, in British Columbia.[52]

Prior to the sale, Randy Zien, a lawyer with tax-law experience and expertise who was an officer of both Inwest and Future Shop, devised a tax plan that involved a presale tax-deferred rollover of the target Future Shop shares to a new corporation, Wesbild Capital Corporation ("Wesbild"), that would not have a business or a permanent establishment in British Columbia and would have non-resident directors. Thus, according to the tax plan, the subsequent disposition of the Future Shop shares held by Wesbild to Best Buy would be subject to federal tax but not BC tax. As part of the tax-planning process, Mr. Zien also obtained legal advice in respect of the tax plan from a tax lawyer at a national law firm. The tax plan was then put in motion.

On August 9, 2001, Wesbild was incorporated under the Yukon Business Corporations Act,[53] which allows for the appointment of non-resident directors, and its shares were held by Inwest, 438, and 574. Inwest, 438, and 574 then transferred certain Future Shop shares to Wesbild and Holdings on a tax-deferred rollover basis and received Wesbild shares in return. Pursuant to a lockup agreement between the Inwest companies (including Wesbild) and Best Buy, on September 11, 2001 Wesbild deposited its shares with Best Buy's depository. Subsequently, on November 4, 2001, Inwest, Wesbild, and Holdings disposed of their Future Shop shares to a wholly owned subsidiary of Best Buy Canada Ltd. As a result of the disposition, Wesbild realized a capital gain of approximately $336 million in its 2002 taxation year.

Wesbild filed its T2 federal corporate income tax return for the 2002 tax year on April 4, 2003. An initial notice of assessment was issued by the CRA on June 2, 2003, accepting Wesbild's reporting of the capital gain and no payment of BC tax. The 2002 return was identified for audit sometime in early 2008, and the audit started sometime in October 2008. There was little advancement in the audit until 2010, when Wesbild was dissolved under the Yukon Act and its obligations were passed on to its successor, Inwest.[54] The CRA finally issued a notice of reassessment for the 2002 taxation year on December 23, 2011, more than eight years after the original notice of assessment. The CRA issued the reassessment on the basis that Wesbild did have a permanent establishment in British Columbia and therefore the 2002 capital gain was subject to BC tax. Wesbild filed a notice of appeal in the BC Supreme Court on April 16, 2012.

52 Income Tax Act, RSBC 1996, c. 215, as amended, section 13.3 (herein referred to as "the BC Act").

53 Business Corporations Act, RSY 2002, c. 20, as amended (herein referred to as "the Yukon Act").

54 Throughout the discussion that follows, "Inwest" is used interchangeably with "Wesbild."

Appropriateness of Summary Trial

The case came before the court by way of a summary trial application to decide whether the reassessment by the CRA was statute-barred.[55] If the minister of national revenue was statute-barred from reassessing, the issue of the correctness of the reassessment would be moot. Thus, as a preliminary matter, the court had to decide whether the application was appropriate for a summary trial. The BC Supreme Court Civil Rules provide that on a summary trial application, the court may grant judgment on an issue unless the court is unable to find the facts necessary to decide the issues of fact or law, or the court is of the opinion that it would be unjust to decide the issues on the application.[56]

The minister submitted that a summary trial application was inappropriate, considering (1) the amount involved; (2) the potential for the findings of fact on the limitation issue to bear on the correctness issue; and (3) the fact that a determination of the correctness of the return would require an extensive investigation of the facts at trial, thereby resulting in litigation in "slices." Further, the minister argued that the evidence on the limitation issue was "incomplete, conflicting and raise[d] credibility issues."[57] Fitzpatrick J held that the determination as to the appropriateness of a summary trial requires a balancing of the relevant factors, and the amount involved is only one such factor. Further, despite the potential need to conduct extensive findings of fact at trial, the summary trial on the preliminary issue will dictate whether a trial is even necessary, or will at least narrow the issues to be decided at trial. The court also disposed of the minister's submission in respect of the evidence, holding that it is the task of the court to resolve conflicting or inconsistent evidence, although he found no such inconsistency in this case. To conclude, Fitzpatrick J found that it was appropriate to proceed with the summary trial on the limitation issue.

The Limitation Period

The statutory provisions dealing with limitation periods in respect of assessments are contained in section 152 of the Income Tax Act and are adopted for provincial tax purposes in British Columbia pursuant to section 29(1)(d) of the BC Act. Once an assessment or notification has been issued under subsection 152(1), subsection 152(3.1) provides that the normal reassessment period is four years for a mutual fund

55 A summary trial application is not available under the Tax Court of Canada Rules (General Procedure), SOR/90-688a, as amended. However, under rule 58, "Determination of Questions of Law, Fact or Mixed Law and Fact," the court may, on application by a party, grant an order that a question of law, fact, or mixed law and fact raised in a pleading or a question as to the admissibility of any evidence be determined before the trial. The court may grant an order if it appears that the determination of the question before the hearing may dispose of all or part of the proceeding or result in a substantially shorter hearing or a substantial saving of costs.

56 Supreme Court Civil Rules, BC Reg. 168/2009, as amended, rule 9-7(15).

57 *Inwest*, supra note 51, at paragraph 61.

trust or a corporation other than a Canadian-controlled private corporation, and three years in any other case. The reassessment period begins to run after the earlier of the day of sending of a notice of an original assessment and the day of sending of an original notification that no tax is payable by the taxpayer for the year.

However, subsection 152(4) of the Act permits the minister to reassess a taxpayer outside the normal reassessment period in certain circumstances. Subparagraph 152(4)(a)(i) allows the minister to issue a reassessment at any time after the normal reassessment period if the taxpayer or person filing the return has made any misrepresentation that is attributable to neglect, carelessness, or wilful default, or has committed any fraud in filing or supplying any information under the Act.

When a taxpayer objects to a reassessment during the normal reassessment period, the onus is on the taxpayer to rebut all of the minister's assumptions. However, outside the normal reassessment period—for example, when subparagraph 152(4)(a)(i) is invoked—the minister must first prove that he is entitled to reassess; therefore, in such cases, the minister bears the onus of justifying a reassessment on a balance of probabilities.[58] The minister did not allege wilful default or fraud in this case.

The Decision

Fitzpatrick J began by reiterating that the interpretation of taxation statutes must accord with the objectives of "consistency, predictability and fairness so that taxpayers may manage their affairs intelligently."[59] Turning to the objectives of subparagraph 152(4)(a)(i), Fitzpatrick J held that the provisions aim to achieve consistency, predictability, certainty, and finality for the taxpayer and fairness for the minister. The provisions allow the taxpayer to know that its tax burden has been settled and concluded. At the same time, and in limited circumstances, the minister is allowed to reassess "where the taxpayer has not divulged all that he should have, as accurately as he should have, and thereby has denied the Minister the opportunity to assess correctly all of the appellant's liability under the Act in the first instance."[60]

Fitzpatrick J then delved into an extensive review of the case law dealing with subparagraph 152(4)(a)(i), beginning with a review of the jurisprudence on what constitutes a "misrepresentation."[61] The court distinguished between parts of a return that require simply ticking boxes or placing figures, and parts that involve a

58 *Lacroix v. Canada*, 2008 FCA 241, at paragraph 26.

59 *Inwest*, supra note 51, at paragraph 82, quoting from *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, at paragraph 12.

60 *Inwest*, supra note 51, at paragraph 86, quoting from *College Park Motor Products Ltd. v. The Queen*, 2009 TCC 409, at paragraph 13.

61 Fitzpatrick J discussed the following cases, among others: *Nesbitt v. The Queen*, 96 DTC 6588 (FCA) (an incorrect statement that is material for the purposes of the return can be a misrepresentation); *College Park Motor Products*, supra note 60 (inaccurate answers on the return with respect to certain questions as to the liability for tax were misrepresentations); *Ridge Run Developments Inc. v. The Queen*, 2007 TCC 68 (the taxpayer's clearly incorrect interpretation of

consideration of the facts and the taking of a position on whether or not tax is owing and, if so, in what amount.[62] This process of considering the facts and taking a position often involves an interpretation of the law, or of mixed fact and law, in order to arrive at a filing position.

Relying on various authorities and on the French wording of the provision, Inwest submitted that a misrepresentation under subparagraph 152(4)(a)(i) is limited to a misrepresentation of fact, as opposed to one of law or of mixed fact and law. Simply put, where a taxpayer has come to a reasonable, albeit incorrect, position based on the information provided in the return, it cannot be considered a misrepresentation under subparagraph 152(4)(a)(i). Fitzpatrick J rejected Inwest's position that a misrepresentation addressed by subparagraph 152(4)(a)(i) is limited to a misrepresentation of fact alone.[63] Rather, misrepresentations can be in respect of errors relating to the "facts" provided as well as to the "positions" taken by a taxpayer on the return.[64] A filing position will not be a misrepresentation where it involves a determination of law or mixed fact and law and the filing position is reasonable.[65] Further, a difference of opinion between the minister and the taxpayer on the position taken by the taxpayer is not sufficient to amount to a misrepresentation.

The court then looked to Inwest's 2002 return to assess whether there was a misrepresentation. Inwest had indicated "OC," meaning "outside Canada," on line 750 of its 2002 return. The court noted that the inquiry on line 750 regarding the "provincial and territorial jurisdiction" where the taxpayer earned income is not a direct question in respect of a permanent establishment and that the jurisdiction in which a corporation earns income is not always the jurisdiction in which the corporation

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loss carryforward provisions constituted a misrepresentation); *Dalphond v. Canada*, 2009 FCA 121 (incorrectly claiming a capital gains deduction for shares, which was available only if the corporation was a "Canadian-controlled private corporation," was a misrepresentation); and *Gestion Forêt-Dale Inc. v. The Queen*, 2009 TCC 255 (a return filed on the basis that the taxpayer was "connected" when it was not was a misrepresentation).

62 *Inwest*, supra note 51, at paragraph 99.

63 Fitzpatrick J discussed the following cases, among others: *Ver v. The Queen*, [1995] TCJ no. 593 (the allocation of expenses between business and personal is a matter of judgment and not the subject of a misrepresentation within the meaning of subparagraph 152(4)(a)(i)); *Petric v. The Queen*, 2006 TCC 306 (a taxpayer's reasonable position in relying on its own appraisal to arrive at a fair market value is not a misrepresentation entitling the minister to a reassessment under subparagraph 152(4)(a)(i)); *Savard v. The Queen*, 2008 TCC 62 (a taxpayer does not have to include on a return information that is not required in the belief that the CRA might conceivably seek to use such information); *Cameron v. The Queen*, 2011 TCC 107 (in circumstances where it is not clear whether the sale of a residence gave rise to a capital gain or a gain in the nature of trade, the taxpayer's position is not a misrepresentation if it appears to be one that was thoughtfully considered); and *Gestion Fortier Inc. v. The Queen*, 2013 TCC 337 (it is a misrepresentation to claim input tax credits relating to a motor home where it is clear that the motor home was purchased for personal and not commercial purposes).

64 *Inwest*, supra note 51, at paragraph 99.

65 Ibid., at paragraph 126.

has a permanent establishment. Thus, the court concluded that the 2002 return did not contain any misrepresentation *of fact*.[66]

The court then considered the reasonableness of Inwest's position taken on its 2002 return, that it did not have a permanent establishment in British Columbia. The point of contention between the parties was whether the test in *Canadian Marconi*[67] was applicable in determining whether Inwest had a business in British Columbia or whether some broader definition of "business" should apply. Inwest argued that the "level of activity" test in *Marconi* was applicable, and since Inwest had no "fixed place of business" in British Columbia, it had no "business" or "permanent establishment" in the province. The minister argued that a corporation can be conducting a "business" and have a "permanent establishment" pursuant to regulation 400(2), even though it is only generating income other than business income, such as capital gains.[68] Fitzpatrick J, without deciding on the merits of the parties' positions, found that Inwest's position on the issue of permanent establishment was reasonable because it was arguable on the basis of the jurisprudence and the facts, and therefore the filing position in the 2002 return was not a misrepresentation.

Despite finding that there was no misrepresentation, Fitzpatrick J proceeded to discuss whether, in this case, a misrepresentation could be said to have arisen by neglect or carelessness. A misrepresentation cannot be attributed to neglect or carelessness if a taxpayer has exercised care to the standard of a "wise and prudent person" and has a bona fide belief that the position advanced on its return is correct. In coming to a reasonable filing position, a wise and prudent person will consider the facts and law, even after receiving professional advice.[69] A decision to engage or not engage a tax professional will not, in and of itself, be determinative of whether the misrepresentation is attributable to neglect or carelessness.[70]

The court reviewed the evidence of Mr. Zien, which the court found to be credible and uncontradicted, to the effect that as Inwest's in-house counsel he had considered the issue of "permanent establishment." The court found that this was sufficient to establish that he had acted as a wise and prudent person. The sufficiency of the due diligence conducted by Mr. Zien and Inwest was further supported by the fact that they had sought and obtained legal advice from outside counsel and had considered such advice before filing the 2002 return. The court held that the CRA had failed to

66 Ibid., at paragraph 131.

67 *Canadian Marconi v. R*, [1986] 2 SCR 522.

68 Regulation 400(2) provides, in part:

> For the purposes of this Part, "permanent establishment" in respect of a corporation means a fixed place of business of the corporation, including an office, a branch, a mine, an oil well, a farm, a timberland, a factory, a workshop or a warehouse, and
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> (a) where the corporation does not have any fixed place of business it means the principal place in which the corporation's business is conducted.

69 *Inwest*, supra note 51, at paragraph 152, citing *Ridge Run Developments*, supra note 61.

70 *Inwest*, supra note 51, at paragraph 153.

prove that Inwest had acted as less than a wise and prudent person in taking the position it did on its 2002 return.[71]

Inwest's appeal was allowed and the reassessment vacated as being statute-barred.

Comments

The decision in this case gives important guidance on what constitutes a misrepresentation. The court ruled that a finding of misrepresentation does not necessarily follow from the fact that the amount of tax computed on the return differs from the correct amount of tax payable; further analysis is required. The judgment outlines five important principles to be considered in determining whether a misrepresentation has been made:

> (a) a statement of fact on a tax return can be a misrepresentation;[72]
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> (b) a statement of a filing position that, even if that position may be incorrect, involves a determination of law or mixed law and fact will not be a misrepresentation if that filing position is reasonable;
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> (c) the requirement that the filing position is reasonable will involve a consideration of the legal/factual issues and the actions of the taxpayer, including obtaining any professional advice, in the consideration of those issues;
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> (d) the fairness objective of the legislation is achieved if that reasonable filing position is evident from the tax return so that the Minister may consider that position. In turn, the objectives of certainty and finality compel the Minister to consider that filing position within the normal reassessment period; and
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> (e) a difference of opinion between the CRA and the taxpayer is not sufficient to amount to a misrepresentation. Accordingly, if the Minister has a differing opinion on matters of legal interpretation or the legal characterization of the facts, it is obliged to reassess the tax return within the normal reassessment period.[73]

Once it is established that a misrepresentation has been made, it must be determined whether the misrepresentation was attributable to neglect, carelessness, wilful default, or fraud.

As noted in the decision, although the judicial test has two distinct requirements, courts have tended to merge the analysis by considering whether the misrepresentation is attributable to neglect, carelessness, wilful default, or fraud under the first branch of the test.[74] The court in *Inwest*, by contrast, applied the test in a stepwise

71 Ibid., at paragraph 179.

72 However, not all misstatements of facts will be misrepresentations. A misstatement of the fair market value of property, if reasonably arrived at, would not be a misrepresentation, since fair market value determination is as much a statement of opinion as of fact (*Petric*, supra note 63), while a simple arithmetic error, which is clear-cut, is a misrepresentation (*Nesbitt*, supra note 61).

73 *Inwest*, supra note 51, at paragraph 126.

74 Ibid., at paragraph 108.

fashion, isolating the issues and focusing on the relevant facts applicable to each part of the test. In determining whether there was a misrepresentation, Fitzpatrick J first looked to whether there was a misstatement of fact. A misstatement of fact that amounted to a misrepresentation would be sufficient to satisfy the first branch of the test, and the court could then proceed to a determination under the second branch.

If a misrepresentation of fact is not found, the court assesses whether the alleged misrepresentation was a position, in the sense that it was a position based on law or mixed fact and law, taken on the taxpayer's return. If it is a position, the court then determines whether the position was reasonable. A determination of whether the position was reasonable involves considering the facts, the law, and the actions of the taxpayer. A position is reasonable if it is an arguable one for the purposes of subparagraph 152(4)(a)(i). The case suggests that positions involving matters of judgment, characterization, and the determination of issues that are not crystal clear are more likely to be considered reasonable positions.

If it is found that there is a misrepresentation of fact or that the taxpayer's position is an unreasonable one, the analysis proceeds to the second branch of the test. At this stage, the analysis is focused on whether the taxpayer considered the facts and law and arrived at a filing position that it believes, in good faith, to be reasonable. The fact that the taxpayer sought professional tax advice is not in itself determinative, but only one of the considerations in determining whether the taxpayer acted according to the standard of a wise and prudent person.

Another factor in the determination of a question under subparagraph 152(4)(a)(i) is whether the minister has been deprived of "the opportunity to assess correctly all of the appellant's liability under the Act in the first instance."[75] This should be the overarching question, and all the relevant facts should be assessed in light of it. Whether the point at issue is a simple misstatement of fact or a position taken by the taxpayer, keeping this overarching question in mind helps in determining whether the objective of subparagraph 152(4)(a)(i) has been achieved. After all, there can be no misrepresentation unless the minister is misled in the first place.

Ehsan Wahidie

75 *College Park Motor Products*, supra note 60, at paragraph 13.