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THE UNIVERSITY OF BRITISH COLUMBIA
FACULTY OF LAW

FINAL EXAMINATION – DECEMBER 2021

LAW 407
Taxation

Section 1
Professor Duff

TOTAL MARKS: 100

TIME ALLOWED: 3 HOURS
Plus 30 minutes reading time

- NOTE:
1. This is an open book examination.
 2. This examination consists of three questions, the third of which involves a choice among three options. Questions 1 and 2 are worth 40 marks each and question 3 is worth 20 marks. The allocation of marks within question 1 and 2 is indicated in square brackets after each sub-question.
 3. Please answer each question.

Question 1 (40 marks)

Jennifer Tan is a certified web designer and computer programmer who graduated with honours from the Toronto's Visual College of Art and Design in the spring of 2018. Like many of her classmates, Jennifer received several job offers at the time, the best of which was from a company called Toutsuite.com ("Toutsuite"), which had developed a computer-based social media management platform that it sold in Canada and around the world. Based in Vancouver, Toutsuite was a Canadian-controlled private corporation (CCPC), most of the common shares of which were owned by the company's founder Bryan Holmes.

According to the offer from Toutsuite, Jennifer would receive an annual salary of \$80,000, including medical and dental benefits, and the option to purchase 10,000 non-redeemable common shares of the company for \$10 each (their fair market value at the time) which had to be exercised within two years. In order to facilitate her relocation to Vancouver, the company also offered to pay Jennifer a signing bonus of \$20,000 and to reimburse any moving expenses up to a maximum amount of \$10,000.

Jennifer received \$20,000 in May 2018 when she accepted the offer, moved to Vancouver the next month in order to start work at Toutsuite, and received an additional \$8,500 in July 2018 after submitting receipts for moving expenses – which included the cost of an economy flight from Toronto to Vancouver, the cost transporting household effects from Toronto to Vancouver, and payments to a Vancouver real estate agent to find her a rental apartment near Toutsuite's office. In computing her income for her 2018 taxation year, Jennifer included the salary that she received from Toutsuite, but did not include any amount in respect of the signing bonus, the option to purchase shares, or the reimbursement of her moving expenses.

Toutsuite released an improved version of its social media management platform in 2019, which was widely recognized as vastly superior to any other product on the market. As a result, the company attracted considerable interest from potential purchasers intending to acquire the platform and integrate it with their own product lines. Although the company's founder and principal shareholder initially rejected all of these offers, a subsequent offer from was too good to refuse and Bryan Holmes eventually agreed to sell his controlling shares to Microworld Corporation ("Microworld") for \$100 per share.

As part of the deal, Toutsuite employees were required to exercise any outstanding options to acquire shares of the company and sell these shares to Microworld. As a result, Jennifer acquired 10,000 Toutsuite shares for \$10 each and immediately sold these shares to Microworld for \$100. In computing her income for her 2019 taxation year, Jennifer reported a capital gain of \$900,000 (taxable capital gain of \$450,000) from the sale of these shares.

With the proceeds from the sale of these shares, Jennifer decided to buy a condominium and move out of the apartment that she had rented since she first moved to Vancouver in 2018. After looking at several buildings, she paid \$1.2 million to purchase a 1,000 square

foot unit in the City's False Creek District, of which she paid \$600,000 in cash and borrowed the remaining \$600,000 on the security of a mortgage. In computing her income for her 2019 taxation year, Jennifer deducted the cost of moving household effects from her rented apartment to the condominium, as well as property transfer taxes on the purchase of the condominium and legal fees to purchase the condominium.

After Microworld acquired control of Toutsuite, it brought in a new management team in order to integrate the company's social media management platform with its own product line. As part of this process, the company offered Jennifer \$50,000 to terminate her employment contract and enter into a separate consulting agreement with Toutsuite under which she would work from home, provide services exclusively to Toutsuite, and receive fixed payments equal to the salary she was receiving excluding medical and dental benefits.

Jennifer accepted the offer in December 2019 and received the \$50,000 payment in January 2020, which she used to purchase furniture and a computer for a home office that she set up in a 150-square foot room in her condominium. In computing her income for her 2020 taxation year, Jennifer did not include the \$50,000 payment that she received from Toutsuite, but reported fixed payments under the consulting agreement as business income, against which she deducted 15% of the mortgage interest, property taxes, condominium fees and utility expenses in respect of the condominium.

You have been asked to review Jennifer's 2018, 2019 and 2020 and 2018 tax returns in order to decide if she should be reassessed. Specifically, the CRA would like to know:

- (1) whether Jennifer must include the payments she received in 2018 in respect of the signing bonus [4 marks] and the reimbursement of moving expenses [4 marks];
- (2) what amount Jennifer must include in respect of the stock options that she was granted in 2018 and exercised in 2019, and in which taxation year? [8 marks]
- (3) whether Jennifer can deduct the moving expenses she sought to deduct in computing her income for her 2019 taxation year? [8 marks]
- (4) whether Jennifer must include the \$50,000 payment that she received in 2020? [4 marks]
- (5) whether the fixed payments that Jennifer received from Toutsuite in 2020 were business income? [6 marks] and
- (6) whether Jennifer could deduct the expenses that she sought to deduct in computing this income? [6 marks]

In addressing these questions, please refer to relevant statutory provisions and judicial decisions.

Question 2 (40 marks)

Cameron McCreedy is a lawyer and sole partner of McCreedy LLP, a Toronto-based law firm that specializes in commercial real estate. Cameron's father Angus died in 2017, at which time Cameron inherited a 25-hectare property near Acton, Ontario (the "Acton Property"), where his father had lived for several years. Under the *Income Tax Act*, (ITA) Cameron's father was deemed to have disposed of the property for proceeds equal to fair market value immediately before his death, and Cameron was deemed to have acquired the property at a cost equal to this fair market value, which was \$775,000 for the residence and subjacent and immediately contiguous $\frac{1}{2}$ hectare and \$50,000 for each of the remaining 24.5 hectares (\$1,225,000 in total).

Although Cameron stayed in the residence for two nights in January 2018 to sort through his father's possessions, he decided to sell the Acton Property instead of retaining it for personal use. After discovering that the land could be zoned as a commercial woodlot, however, he contacted the regional municipality to determine if he could subdivide the property and sell the residence, while retaining the rest of the land as a woodlot. Upon learning that the land could be subdivided but that a residence required at least 5 hectares, Cameron applied to subdivide the Acton Property into a 20-hectare woodlot (the "Woodlot") and a 5-hectare lot on which the residence was situated (the "Acton Lot").

By the time that the subdivision was approved in October 2018, the value of the Acton Lot had increased substantially and Cameron was able to sell it for \$1.25 million, which was \$200,000 more than the sum of its cost for tax purposes (\$1 million) and expenses incurred in order to sell the property (\$50,000). When he filed his tax return for his 2018 taxation year, however, Cameron designated the Acton Lot as his principal residence for the year and did not include any gain in respect of the sale.

After selling the Acton Lot, Cameron spoke with a commercial harvester to develop the Woodlot, but decided that it would be simpler to sell the Woodlot outright rather than operating it himself. In January 2019, he sold the Woodlot for \$1.2 million on closing plus \$1 for each cubic metre harvested over the next year, with a minimum payment of \$200,000. In computing his income for his 2019 taxation year, Cameron reported a capital gain of \$100,000 (taxable capital gain of \$200,000) on the sale of the Woodlot. In computing his income for his 2020 taxation year, Cameron reported another capital gain of \$100,000 (taxable capital gain of \$200,000) in respect of an additional payment, which comprised \$180,000 based on the number of cubic metres harvested and a top up payment of \$20,000 to satisfy the minimum payment of \$200,000.

With the proceeds from the sale of the Acton Lot, Cameron decided to buy an 8-unit apartment building in a rapidly gentrifying area of Toronto that a client had purchased and renovated in order to resell at a profit (the "Apartment Building"). Although the land and the building were each valued at \$600,000 for municipal tax purposes, Cameron insisted

that the agreement should allocate \$1 million to the building and \$200,000 to the land, which the vendor accepted when the deal closed on November 30, 2018 after conferring with his tax advisors.

In computing his income for his 2018 taxation year, Cameron included rental income of \$16,000 against which he deducted management fees of \$400, property taxes of \$600, and capital cost allowance (CCA) of \$40,000 (computed by multiplying the 4% rate for class 1 property by an undepreciated capital cost of \$1 million), resulting in a net loss of \$25,000 which he deducted in computing his aggregate income for the year.

In February 2019, a pipe burst in the Apartment Building, resulting in major flooding and exposing structural deficiencies that had to be repaired at a cost of \$120,000, during which all tenants had to vacate the building for three months. In computing his income for his 2019 taxation year, Cameron included rental income of \$150,000 for the remaining months, against which he deducted management fees of \$5,000, property taxes of \$8,000, \$38,400 in CCA (computed by multiplying the 4% rate for class 1 property by an undepreciated capital cost of \$960,000), and \$120,000 in repair costs, resulting in a net loss of \$21,400 which he deducted in computing his aggregate income for the year.

Cameron recently received a notice of reassessment for his 2018, 2019 and 2020 taxation years which

- (1) disallowed the principal residence exemption on the sale of the Acton Lot and instead included \$200,000 as business income from an adventure or concern in the nature of trade [8 marks];
- (2) included \$200,000 from the sale of the Woodlot as business income from an adventure or concern in the nature of trade in computing his income for his 2019 taxation year [4 marks], and included the additional \$200,000 that he received under the agreement in 2020 as income from property [4 marks];
- (3) deemed Cameron to have acquired the Apartment Building at the assessed value of the land and the building for municipal taxation purposes (\$600,000 each) rather than \$1 million for the building and \$200,000 for the land [6 marks];
- (4) disallowed the deduction of the repair costs on the Apartment Building on the basis that these payments were capital expenses [6 marks];
- (5) reduced the allowable CCA in respect of the building to \$12,000 for 2018 (computed by multiplying the 4% rate for class 1 property by an undepreciated capital cost of one-half of \$600,000 million) and \$23,520 for 2019 (computed by multiplying the 4% rate for class 1 property by an undepreciated capital cost of $\$600,000 - \$12,000 = \$588,000$) [6 marks]; and

- (6) disallowed the deduction of \$2,000 in property taxes in computing Cameron's income from the Apartment Building in 2019 and added this amount to the capital cost of the building on the grounds that this payment was attributable to a period when the building was subject to renovation or alteration [6 marks].

Please advise Cameron on the merits of this reassessment, referring to relevant statutory provisions and judicial decisions.

Question 3 [20 marks]

Please answer one (**and only one**) of the following questions, referring to the facts of these cases, relevant statutory provisions and other cases as necessary to explain your reasons:

1. Please explain the facts and decision in *Schwarz* (SCC, 1986). Do you agree with the Court that the payment at issue was not a retiring allowance subject to tax under subparagraph 56(1)(a)(ii) of the ITA? Why or why not? Do you agree that the payment was not income from an unspecified source under paragraph 3(a)? Why or why not? Might the payment have been taxable as a capital gain from the disposition of property?
2. Please explain the facts and decision in *653021 BC Ltd.* (SCC, 1998). Do you agree that the payment at issue was properly deductible in computing the taxpayer's business income? Why or why not? Do you agree with the Court's explanation of the statutory scheme for the deduction of business expenses and its rejection of prior judicial decisions that disallowed the deduction of fine and penalties? Why or why not? How do you interpret the Court's statement that a breach of the law could be "so egregious or repulsive that the fine subsequently imposed could not be justified as being incurred for the purpose of producing income"? Are there any expenses that are "so egregious or repulsive" that their deduction should be disallowed absent a specific statutory provision like section 67.6 disallowing their deduction?
3. Please explain the facts and decision in *Singleton* (SCC, 2001). Do you agree with the majority's conclusion that the interest expenses incurred by the taxpayer were properly deductible in computing his income? Why or why not? Is the decision consistent with the Court's earlier decision in *Bronfman Trust* (SCC, 1987)? Could the GAAR have applied to disallow the deduction?

END OF EXAM