THIS EXAMINATION CONSISTS OF 6 PAGES

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THE UNIVERSITY OF BRITISH COLUMBIA

PETER A. ALLARD SCHOOL OF LAW

FINAL EXAMINATION – DECEMBER 2022

LAW 407

Section 1

Professor Duff

**TOTAL MARKS:** 100

**TIME ALLOWED:** 3 HOURS

Plus 30 minutes reading time

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**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.

 3. 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.

 4. Please answer each question.

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**Question 1 (40 marks)**

Patrick Lee is a mining engineer who grew up in Ottawa, Ontario, and obtained a Masters of Engineering from Queen’s University in Kingston, Ontario, in April 2019. Upon graduation, Patrick received several job offers, including an offer from Tuk Resources Limited (“Tuk”). Tuk is a public company, with shares listed on the Toronto and New York Stock Exchange, and is based in Vancouver but has mining operations throughout Canada and around the world. Among these mining operations is the Highland Valley Copper (HVC) mine in British Columbia, the largest open-pit copper mine in Canada.

Since Patrick had specialized in the extraction of copper and other minerals used in clean energy technologies, Tuk wanted to hire him to work at the HVC mine. In order to encourage Patrick to accept the offer, Tuk offered him a competitive salary of $120,000 per year, and the option to purchase up to 5,000 common shares at an amount equal to the price at which the shares were trading on the Toronto Stock Exchange on the day that he accepted the position. It also offered him a signing bonus of $20,000, a $10,000 allowance to cover moving expenses, and a mortgage subsidy of $500 per month ($6,000 per year) if he bought a residence within a 60-kilometre radius of the HVC mine.

After visiting the area in May 2019, Patrick accepted the offer commencing July 1, 2019, when Tuk shares were trading at $20 per share on the Toronto Stock Exchange. He also paid $300,000 to buy a condominium in Kamloops (80 kilometres from the HVC mine by car, but within the 60-kilometre radius necessary to qualify for the mortgage subsidy), using a $60,000 gift from his parents as a down-payment and borrowing the remaining $240,000 on the security of a mortgage at a fixed rate of 5% per year. In computing his income for his 2019, 2020 and 2021 taxation years, Patrick did not include any amount in respect of the mortgage subsidy, which Tuk paid directly to Patrick’s bank. In computing his income for his 2019 taxation year, Patrick did not include any amount in respect of the signing bonus (which he used to buy a car), nor the options that he was granted. Although he included the $10,000 allowance for moving expenses that he received in 2019, he deducted $16,000 as moving expenses for that taxation year as follows: $2,000 in travel costs for the visit in May, $1,500 in travel costs in June before commencing the job on July 1, $8,000 to transport household effects, and $4,500 in legal fees and property transfer taxes in respect of the condominium.

When the COVID-19 pandemic struck in 2020, Tuk decided that non-essential mine employees should generally work from home and come to the mine only when necessary. As a result, from April to December, Patrick worked at home for three days a week and commuted to the HVC mine on the other two days. In computing his income for his 2020 taxation year, Patrick deducted 60% of the mortgage interest, property taxes and utilities on his condominium for each of these months. He also deducted motor vehicle expenses to travel to and from the mine on the days that he worked on site, which included gasoline for each trip as well as a percentage of maintenance costs and capital cost allowance in respect

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of his car based on the ratio of the kilometres driven for work-related purposes to all kilometres driven during the year. When he filed his return for the year, he included a signed T2200 form from Tuk certifying the conditions for these deductions were satisfied.

In 2021, Tuk acquired mining rights in Nechalacho, Northwest Territories, where it hoped to develop one of the world’s largest mines for extracting rare earth minerals used in clean energy technologies. That summer, Patrick spent two months working at the mine site, which is located on the north shore of Great Slave Lake, 120 kilometres southeast of Yellowknife (population 20,000), and accessible only by air or boat. In computing his income for his 2021 taxation year, Patrick did not include any amount in respect travel costs from Kamloops to Nechalacho and back, nor board and lodging at the Nechalacho mine site, both which were provided by Tuk.

Although Tuk’s share price decreased in 2019 and 2020, it rose sharply in 2021 based on expected output from the Nechalacho mine. As a result, Patrick exercised the option to acquire 2,000 shares in May 2021 when they were trading at $30 per share and exercised the option to acquire another 3,000 shares in August 2021 when they were trading at $40 per share. When Tuk shares rose to $50 per share in October 2021, Patrick sold 2,000 shares. In computing his income for his 2021 taxation year, Patrick included a taxable capital gain of ½ × 2,000 × ($50 - $20) = $30,000 from the sale of the Tuk shares and deducted interest payments on the line of credit.

You have been asked to review Patrick’s 2019, 2020 and 2021 tax returns in order to determine if he should be reassessed. Specifically, the CRA would like to know:

1. whether Patrick must include any amount in respect of the mortgage subsidy that he received in 2019, 2020 and 2021 [6 marks], or the signing bonus that he received in 2019? [3 marks]
2. which, if any, moving expenses could Patrick deduct in 2019? [8 marks]
3. whether Patrick could deduct the home office expenses and motor vehicle expenses that he claimed in 2020? [8 marks]
4. whether Patrick should have included any amount in respect of travel from Kamloops to Nechalacho and back, or board and lodging at Nechalacho in 2021? [5 marks] and
5. what amounts Patrick should have included in respect of the shares that he acquired and sold in 2021? [10 marks]

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

END OF QUESTION 1

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**Question 2 (40 marks)**

John Skeener is a former Vancouver stockbroker and wine enthusiast. In 2012, John retired from stock broking, sold his West Vancouver home, and paid $600,000 to buy a 12-hectare apricot orchard adjoining Lake Skaha near Penticton, B.C., intending to move there and establish a winery. At the time, regional by-laws required a minimum area of 12 hectares for a residence on property that was zoned for agricultural use. In 2016, however, the by-law was amended to allow waterfront properties to be subdivided for residential purposes, with a minimum lot size of half a hectare.

After buying the orchard, John spent $1.6 million to build a residence on a half-hectare portion of the land, where he and his family moved in April 2014. He also spent $1 million to plant 50,000 “old world” vitis vinifera grape vines on nine of the remaining 11.5 hectares, which he added to the cost of the land for tax purposes.

Since vitis vinifera vines take a few years to become established, John’s first harvest was not until the fall of 2016. By that year, John had constructed a winery on a half-hectare parcel of the land, complete with stainless steel fermentation tanks and French oak barrels for aging. In computing his income for his 2016 taxation year, John did not report any revenue from the winery which had yet to produce any wine, but deducted farming expenses associated with tending and harvesting grapes as well as capital cost allowance in respect of the building (class 1 property) and the wine-making equipment (class 8 property), resulting in a net loss that he deducted in computing his aggregate income. In computing his income for his 2017 taxation year, John again reported no revenue from the winery, but deducted farming expenses and the maximum allowable capital cost allowance in respect of the building and wine-making equipment, resulting in a net loss that he deducted in computing his aggregate income.

In 2018, the winery released its first wines, which John marketed under the name Painted Stone Winery. Although the Bordeaux-style vintages were very well-received, sales were limited, and John again reported a net loss from the winery after deducting farming expenses and capital cost allowance in respect of the building and wine-making equipment, which he deducted in computing his aggregate income for his 2018 taxation year. In that year, the Okanagan region also experienced the worst wildfires on record, which reduced the quality and quantity of the grapes harvested in the fall. In December 2018, John received $50,000 compensation under a crop insurance policy, which he did not include in computing his income for his 2018 taxation year.

In 2019, John decided to construct a tasting room beside the winery in order to promote the winery and generate additional revenue by hosting events. In the same year, Painted Stone also released its first vintage of a premium red wine called Iconic Red, which sold at a substantially higher price than its other wines. Although the winery’s revenues increased significantly in 2019, John again reported a net loss from the business after

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deducting farming expenses and capital cost allowances (including capital cost allowance in respect of the tasting room which was completed in May 2019), as well as a $100,000 payment to the regional municipality for approval to construct the tasting room, which the municipality demanded as a payment in lieu of increased property taxes for the next five years. Despite the loss, 2019 was a good year for wineries in the region as there were few fires and the harvest was bountiful.

In 2020, Iconic Red won numerous awards and accolades and Painted Stone was recognized by the Canadian Vintners Association as Canada’s best new winery of the year, for which John received a plaque and $10,000. Despite this recognition, output decreased on account of the poor harvest in 2018, and John again reported a net loss from the winery after deducting farming expenses and capital cost allowances. In computing his income for his 2020 taxation year, John did not include any amount in respect of the $10,000 that he received from the Canadian Vintners Association.

The next year, output increased substantially as a result of the good 2019 harvest, and Painted Rock finally reported a profit after deducting farming expenses and capital cost allowances. In addition, John decided to subdivide the property, creating four half-hectare waterfront lots that he sold to a developer for $250,000 each. In computing his income for his 2021 taxation year, John attributed $100,000 of the original cost of the land to the lots (2/12 × $600,000) and reported a capital gain of $900,000 (4 × $250,000 - $100,000), in respect of which he claimed the principal residence exemption.

John received a notice of reassessment earlier this year which

1. disallowed the deduction of losses in computing his income from his 2018, 2019, and 2020 taxation years on the alternative grounds that the winery was not a business carried on with a reasonable expectation of profit or that the expenses incurred were not reasonable in the circumstances [10 marks];
2. included $9,500 for his 2020 taxation year as a prize for achievement in a field of endeavour that he ordinarily carried on [8 marks]; and
3. included $900,000 in computing his income for his 2021 taxation year as business income from the sale of the waterfront lots [12 marks].

Please advise John on the merits of this reassessment, referring to relevant statutory provisions and judicial decisions. In addition, if the winery was a business in 2018, 2019 and 2020, please advise whether John should have included any amount in respect of the compensation for crop damage that he received in 2018 [5 marks] and whether he could deduct the $100,000 payment for approval of the tasting room in computing his income or loss from the winery in his 2019 taxation year [5 marks].

END OF QUESTION 2

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**Question 3 [20 marks]**

Please answer **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). Why did the majority conclude that the ITA contemplates the taxation of income from an unspecified source Why did the minority disagree? Why did the Court conclude that the payment at issue was not a retiring allowance subject to tax under subparagraph 56(1)(a)(ii) of the ITA? Why did it conclude that payment was not income from an unspecified source under paragraph 3(a)? Do you agree with the Court’s conclusion? 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 *Stewart* (SCC, 2002). Why did the Court reject a broad use of the reasonable expectation of profit (REOP) test to determine the existence of a business or property as a source of income or loss? What test did the Court adopt instead, and what, if any, role does the Court’s test leave for the REOP test? How does the Court understand the concept of “profit” for the purpose of this test? Do you agree with the Court’s decision? Why or why not?

3. Please explain the facts and decision in *Ludco Enterprises Ltd.* (SCC, 2001). Do you agree with the Court’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)?

**END OF EXAM**