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ESCROW ARRANGEMENTS IN ACQUISITION AGREEMENTS: WHAT ARE YOU CREATING?

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Introduction

It is common practice in the course of a purchase and sale that a portion of the purchase price consideration is held back or held in escrow as security for breach of representations, warranties, and covenants or pending satisfaction of one or more conditions, such as earnouts, working capital adjustments, filing section 116 certificates, etc.

Generally, under an escrow arrangement, property is transferred to a person and held pursuant to the terms of the escrow arrangement on behalf of the vendor, purchaser, or both parties. The purchaser, for example, may want to withhold 15% of the purchase price for 12 months to be satisfied that there are no material breaches of representations and warranties. The vendor, on the other hand, may believe there is a risk of non-payment of the held back amount and will request that the funds be held in escrow by a third party such as an escrow agent or legal counsel.

These arrangements can be very complex. Non-tax considerations, such as the triggering events for the payment, will likely take priority in settling the terms of the escrow agreement. However, there are many tax-related considerations that practitioners should keep in mind. This article will focus on a few of these tax-related considerations with the goal of bringing to the forefront some issues inherent in these sometimes confusing and often complex arrangements that are possibly overlooked or ignored. First, it is not always clear what legal relationship is created when an escrow agent or one party's law firm holds the escrow property. The tax consequences to the parties will be governed by the nature of the legal relationship. Failure to consider this aspect could lead to a number of unintended tax results and unnecessary confusion. Further, the applicability of section 42 of the *Income Tax Act*[1] (the "Act") in relation to the escrow property as well as some general considerations with respect to escrow arrangements are discussed.

The Legal Relationship

A key question to be asked is what relationship is intended to be created under the escrow arrangement. The legal characterization of an escrow arrangement will determine how the Act will be applied to the property held in escrow and any investment income earned thereon. Possibilities include a trust, an agency, a bailment, or a bare trust relationship.[2] Each of these possibilities imposes special duties and obligations on the parties.[3] It is not possible in the space permitted to explore properly each of these areas in detail. However, a brief and general discussion with respect to trusts and bare trusts will highlight the importance, from a tax perspective, of properly considering what relationship is being created.

In simple terms, a trust exists when one or more persons (the "trustees") hold property for the benefit of one or more persons (the "beneficiaries") through a settlement of property on the trustees by a person (the "settlor").[4] To have a valid trust, three certainties must be present, as Lord Langdale M.R. set out in *Knight v. Knight*[5] and as adopted in common law in Canada:[6]

(1) the settlor must have the intention to settle the property on the trustee(s) of the trust for the benefit of the beneficiaries;

(2) the property that is the subject of the trust must be clearly identified; and

(3) it must be clear who are the beneficiaries of the trust.

Under the Act, a trust is deemed to be an individual[7] and must file returns and pay tax as a separate person in accordance with the Act.

What if a trust is created? This could be problematic from a number of perspectives. From a practical perspective, there are questions such as who the settlor is,[8] who acts as the trustee, and whether the beneficiaries are the vendor, the purchaser, or both. Further, what are the powers and duties of the trustee? From a tax perspective, as mentioned above, this leads to the requirement to file trust income tax returns and for the trust to report any investment income that has been earned. In certain cases, subsection 75(2) of the Act could technically apply to attribute any investment income earned to the settlor. This could lead to a disconnect between who is contractually entitled to the investment income (for example, the vendor) and who is required to report such amounts for tax purposes.

As indicated by other commentators, poorly drafted escrow arrangements have resulted in the income earned in the escrow account being taxable as if the escrow arrangement were in fact a trust.[9] Whether an escrow arrangement creates a trust will depend on all the facts and circumstances, including the terms of the arrangement. It is interesting that, with respect to interest earned on funds deposited with a lawyer by a litigant or litigants for safekeeping and investment, pending a court or settlement establishing its proper disposition, the Canada Revenue Agency ("CRA") considers such income to be income of a trust and recognizes that the beneficial owner is the eventual recipient of the funds.[10]

In contrast to a trust, generally a bare trust exists where a person, the trustee, is merely vested with the legal title to property (the beneficial interest remains with the person who vests legal title in the trustee) and has no other duty to perform or responsibilities to carry out as trustee in relation to the property vested in the trust, other than to convey it to the beneficiary upon demand.[11] The trustee of a bare trust acts like an agent and will not have any independent power, discretion, or responsibility in relation to the trust property other than to follow the directions of the beneficial owner of the property held in trust.[12] Since a bare trust is ignored for tax purposes, the property held by the bare trustee and any income or loss flowing from such property is regarded as belonging to the beneficiary of the bare trust.[13] Further, subsection 104(1) of the Act excludes a bare trust arrangement from the definition of a trust for tax purposes.[14]

If an escrow arrangement is considered to be a bare trust, it is important that the beneficial owner report all the incidents of ownership of the property for income tax purposes, such as the investment income earned on the property. Practically speaking, it may be difficult to determine who the beneficial owner is during the course of the arrangement.

It is important to keep in mind that the legal relationship created can be uncertain if the terms of the arrangement are not clear, leading to difficulties in understanding the parties' duties, responsibilities, and reporting obligations. Practitioners need to determine from the outset what the intentions of the parties are and draft accordingly to avoid any uncertainty and possible bad results. If a trust is intended, all aspects of that arrangement need to be carefully considered. If a trust is not intended, it should be clear that the person holding the escrow property holds it as a bare trustee or agent, for example, and that any income generated on the escrow property is allocated or paid to the vendor, purchaser, or a combination of the two, as the case may be.

Section 42

Section 42[15] of the Act provides rules governing warranties, covenants, and other conditional or contingent obligations given by a taxpayer in respect of the disposition of a property (the "subject property"). The rules in section 42 of the

Act affect only the vendor of a property, not the purchaser. Generally, amounts received or receivable by a vendor, on or before the vendor's filing-due date for the vendor's taxation year in which the vendor disposed of the subject property, as consideration for a warranty or other conditional obligation given or incurred by the vendor that relates to the subject property are included in determining the proceeds of disposition of the subject property.[16] The amount is not included as consideration for the obligation, but is deemed to be received as consideration for the disposition by the vendor of the subject property. The provision also provides generally that an outlay or expense paid or payable by the vendor on or before the vendor's filing-due date for the vendor's taxation year in which the vendor disposed of the subject property under a warranty, covenant, or other conditional or contingent obligation, given or incurred in respect of the disposition of the subject property, shall be treated as a loss from the disposition of the subject property and not as an expenditure under the obligation.[17] Note that if the subject amounts are received or receivable (or are paid or payable, as the case may be) outside of the specified date, a different tax result occurs.[18]

Where an amount of the purchase price is held back by the purchaser to satisfy warranties given by the vendor in relation to the sale of shares, for example, it is possible that separate consideration has been identified for the warranties.[19] In such a case the treatment of the amount for tax purposes is governed by section 42 of the Act.

General Considerations

In addition to the points already raised, there are many other issues to be considered when dealing with escrow arrangements. What amount is to be put in escrow? How long will the escrow arrangement be in place and how will any escrow property be invested?[20] Typically the purchaser would want the escrow property to be invested in low-risk investments to ensure that the principal amount held would always be available to satisfy an indemnity claim.[21] However, if the vendor is entitled to the investment income, the vendor may want the escrow property invested in something that attracts more risk and a higher return. Are there any non-resident issues? Will a section 116 certificate be required? If so, the escrow arrangement should contemplate the potential tax liability to the purchaser until a section 116 certificate is obtained from the CRA.[22]

In relation to what was addressed above, what relationship has been created? Correspondingly, what are the roles of the parties? How is any investment income earned to be distributed and taxed, and who is to report it? Is section 42 of the Act applicable?

The finalized escrow arrangement will be based on decisions made with respect to these issues, as well as issues not addressed in this article that arise with each particular case.

Conclusion

The characterization of the legal relationship created by an escrow arrangement is clearly a fact-specific determination based on the terms of the arrangement decided by the parties. There does not appear to be clear direction from the CRA on the treatment of these arrangements, likely for practical reasons due to their varied nature. Practitioners will have to make an assessment in each case as to what relationship is to be created and govern themselves accordingly. Further, section 42 of the Act should be considered in each instance. One thing is clear however; the parties need to pay close attention to the terms of these arrangements or risk unintended tax consequences and uncertainty.

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Notes:

[1] R.S.C. 1985 (5th Supp.), c. 1.

[2] Of course, whether any one of these relationships is a possible option in a particular case depends on all the facts and circumstances, including the type of property in question and the agreement between the parties involved.

[3] Such as the fiduciary relationship that a trust creates between the trustee and the beneficiary.

[4] Donovan W.M. Waters, Q.C., Mark R. Gillen, and Lionel D. Smith, *Waters' Law of Trusts in Canada*, 4th ed. (Toronto: Thomson Reuters) at pages 3 and 4.

[5] (1840), 3 Beav. 148, 49 E.R. 58 (Eng. Ch.).

[6] *Renehan v. Malone* (1897), 1 N.B. Eq. 506 (N.B.S.C. [In Equity]).

[7] Subsection 104(2) of the Act.

[8] Is it the purchaser, vendor, or both? Also, when does beneficial interest in the property put in escrow pass from one party to the other?

[9] Daniel Lang and Charles Taylor, "Tax Issues in Purchase and Sale Agreements", *Report of Proceedings of the Sixty-Third Tax Conference*, 2011 Tax Conference (Toronto: Canadian Tax Foundation, 2012), 1–52. See also E.G. Kroft, "Tax Clauses in Acquisition Agreements" in *Selected Income Tax and Goods and Services Tax Aspects of the Purchase and Sale of a Business*, 1990 Corporate Management Tax Conference (Toronto: Canadian Tax Foundation, 1991), 9:1–99.

[10] IT-129R, "Lawyers' trust accounts and disbursements", November 7, 1986 at para. 10. Note that in IT-129, at para. 10, the CRA states: "[C]onditional upon waivers being filed by each of the litigants and the lawyer-trustee for the relevant taxation years, the Department will defer assessment of the income until the recipient is finally determined". See also CRA Document No. 9831647, Lawyer's trust account, February 19, 1999, and CRA Document No. 2007-0233761C6, 2007 Step Conference — Question 1 — In-trust accounts.

[11] *Supra* note 4 at page 33. See also: *Peragine v. Her Majesty the Queen*, 2012 DTC 1287 (TCC), a recent case that highlights the existence of bare trust arrangements; Sarah Chiu and Allison Murray, "Bare Trusts: What Are They and How Are They Used?" Vol. 10, No. 3, *Tax for the Owner Manager*, 4 and 5; and CRA Technical Information Bulletin B-068 and Policy Statement P-015 for the CRA's long-held administrative position regarding bare trusts and the *Excise Tax Act*, R.S.A. 1985, c. E-15.

[12] *Peragine v. Her Majesty the Queen*, 2012 DTC 1287 (TCC).

[13] *Ibid*. See also: CRA Document No. 2000-0010998, Bare trust, March 30, 2000; CRA Document No. 2006-0185601C6, 2006 STEP Conference — Question 17, September 11, 2006; CRA Document No. 2006-0174831E5, Transfer to and from a bare trust; CRA Document No. 2007-0251601E5, Filing requirements of a corporate (bare trustee), July 21, 2008; CRA Document No. 2008-0280771E5, Trustee acts as bare trustee; and CRA Document No. 2010-0357491E5, True owner of property.

[14] Under subsection 104(1) of the Act, a trust is deemed not to include an arrangement under which the trust can reasonably be considered to act as agent for all the beneficiaries under the trust with respect to all dealings with all of the trust's property. Further, a transfer of property that creates a change in the legal ownership of property without any change in beneficial ownership is specifically excluded from the definition of "disposition" found in section 54 of the Act.

[15] Section 42 of the Act was recently amended by 2013, c. 13, s. 184(1).

[16] Subparagraph 42(1)(*a*)(i) and subsection 42(2) of the Act and see IT-330R, "Dispositions of capital property subject to warranty, covenant, or other conditional or contingent obligations", September 7, 1990.

[17] Subparagraph 42(1)(*b*)(i) and subsection 42(2) of the Act and see IT-330, "Dispositions of capital property subject to warranty, covenant, or other conditional or contingent obligations".

[18] Subparagraphs 42(1)(*a*)(ii) and (*b*)(ii) of the Act, whereby the amount received or expended by the vendor is deemed to be a capital gain or a capital loss of the vendor from the disposition of a property by the vendor.

[19] Based on the wording of the legislation and IT-330R, "Dispositions of capital property subject to warranty, covenant, or other conditional or contingent obligations", September 7, 1990.

[20] *Supra* note 9.

[21] *Ibid*.

[22] *Ibid*.

CRA RELEASES 2014 INDEXING FACTORS

On November 15, 2013, the Canada Revenue Agency released the 98th edition of its T4127 guide, "Payroll deductions formulas for computer programs". Effective January 1, 2014, the T4127 guide contains the formulas needed by payroll professionals to calculate federal, provincial, and territorial income taxes and CPP and EI deductions. The federal indexing factor for 2014 is 0.9%; therefore, to calculate the indexed income thresholds and personal amounts for 2014, the 2013 amounts should be multiplied by 1.009. The guide states that for 2014, the federal indexing factor of 0.9% also applies to New Brunswick, Northwest Territories, Nunavut, Saskatchewan, and Yukon. The indexing factors for the other provinces are as follows: Alberta, 1.1%; British Columbia, 0.1%; Newfoundland and Labrador, 1.5%; and Ontario, 1.0%. There is no indexing applied to Manitoba, Nova Scotia, and Prince Edward Island.

CAPITAL GAIN ON SALE OF PROPERTY BY NPO

Under paragraph 149(1)(*l*) of the *Income Tax Act* (the "Act"), a club, society, or association (the "club") is exempt from Part I tax if it is "organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit". If the main purpose of the club is to provide dining, recreational, or sporting facilities for its members, subsection 149(5) provides that the club is taxed as a deemed trust on income from property and certain capital gains. Subparagraph 149(5)(*e*)(ii) exempts from tax capital gains on dispositions of property used by the club exclusively for and directly in providing dining, recreational, or sporting facilities for its members. The Canada Revenue Agency ("CRA") was asked if a capital gain realized by a club on the sale of its real property would be taxable under subsection 149(5) in a situation where the club provides recreational and sporting facilities to its members and if it has, in recent years, also reported revenue from bar sales to members and hall rentals to non-members. The CRA stated that it is a question of fact whether or not providing sporting and recreational facilities to its members is the club's main purpose. The CRA considers that the main purpose condition will be met if more than 50% of the club's assets, revenues, time, attention, and efforts are used to provide these facilities to its members. The CRA also considers that the documents of incorporation, bylaws, and the constitution of the club are relevant in determining the main purpose. Only the capital gains from the sale of those assets that are used exclusively and directly to carry out the club's main purpose of providing sporting and recreational facilities to its members would be exempt from tax. However, the CRA noted that as described in paragraph 7 of IT-83R3, "Non-profit organizations — Taxation of income from property, "a club is not deprived of the exemption from the capital gain and loss provisions [of subparagraph 149(5)(*e*)(ii)] by reason only of occasional rental of its property to non-members". The CRA cautioned that if the club's activities involved an active pursuit of rental income from its facilities rather than an occasional rental, the club could cease to qualify as a tax-exempt organization under paragraph 149(1)(*l*).

See also CRA Document No. 2011-0415521I7, "Subparagraph 149(5)(*e*)(ii)" (June 21, 2011).

— External Technical Interpretation, Business and Employment Income Division, April 12, 2013, Document No. 2012-0460901E5

RRSP LIMITS AFTER BANKRUPTCY

The Canada Revenue Agency ("CRA") was asked if a taxpayer who has an undeducted registered retirement savings plan ("RRSP") contribution and who has declared bankruptcy can exclude the undeducted RRSP contribution from property reported in bankruptcy and instead use the deduction after being discharged from bankruptcy. The CRA stated that there is nothing in subsection 146(5) of the *Income Tax Act* (the "Act") regarding deductible RRSP contributions to prevent claiming a deduction after being discharged from bankruptcy for contributions made prior to bankruptcy. However, the CRA suggested that not disclosing this unused tax deduction may put the individual offside the provisions in the *Bankruptcy and Insolvency Act* that require a bankrupt to disclose all property to the trustee.

— External Technical Interpretation, International Division, May 14, 2013, Document No. 2013-0474741E5

RECENT CASES

Expert evidence admissible on limited basis to assist Court in understanding doctrines, history, and principles of Mormon faith

The hearing was centred on whether the taxpayer could submit evidence by way of an expert witness, W, as a qualified expert witness on the Mormon religion. The Minister argued that W was not a "properly qualified" expert and objected. The Court was also asked to determine whether evidence from the Minister's two expert witnesses on Mormonism and American religious history was admissible. The main issue on appeal was whether the taxpayer was a member of a community that was a congregation as defined in subsection 143(4).

The taxpayer's appeal was allowed in part. Expert evidence by W would be admissible on a limited basis to the testimony in respect of the doctrines, history, and principles of the Mormon faith to assist in the tax appeal. In terms of the Minister's expert witnesses, they were each experts in their respective fields, but, as in the case of W, limited in their value to the Court, to Mormonism in general, and to American religious studies.

¶48,561, *Blackmore*, 2013 DTC 1212

Taxpayer did not earn income as part of a congregation and income was properly allocated to him

The taxpayer was reassessed for 2000 to 2004 and 2006 for tax amounts owing under subsections 5(1), 15(1), and paragraph 6(1)(*a*). At issue was whether the taxpayer or the members of his community in Bountiful, British Columbia were liable to pay tax under section 143 as a "congregation". If this provision were to apply, it would mean that there would be a deemed trust in place for the benefit of members of the community for which the income could be allocated. This would effectively allocate the income attributed by the Minister to the taxpayer to be allocated to the members of the Bountiful community. The taxpayer argued that his community met the definition of a "congregation" as its members shared and traded properties in an insular nature with community and church integrated. The Minister argued that there was a lack of proximity in that there were a number of communities that stretched as far as 570 km apart. Moreover, for the fisc, there must be a close proximity to members to cohabit and work on common projects.

The taxpayer's appeal was dismissed. The community of Bountiful did not meet any of the requirements in section 143. The taxpayer failed to provide how to determine who would be included and excluded as a member of the community for purposes of the provision. Gross negligence penalties were properly imposed as little explanation was provided as to the massive misstatement in the taxpayer's income tax returns for the relevant years.

¶48,562, *Blackmore*, 2013 DTC 1213

Payments received based on years of service not received in personal capacity extraneous to employment and were included in income

The taxpayer was appealing the inclusion of amounts received from his former employer Robert Ltd. in his income. Robert Ltd. was controlled by R. The taxpayer had worked as an equipment manager for Robert Ltd. for 14 years until it was sold to CEDA International in 2006. The taxpayer continued to work for CEDA until 2011. In 2006 and 2007, he received amounts totalling $140,000 from Robert Ltd., which were described as bonuses and thanks for his years of service. All of Robert Ltd.'s former managers received payments based on their years of service. The amounts were paid out of Robert Ltd.'s shareholder loan account owed to R. The taxpayer argued the monies were received in a personal capacity.

The appeal was dismissed. "Benefits of any kind whatever" are to be included in employment income if they are received "in respect of, in the course of, or by virtue of an office or employment". The provisions have a very broad application and only the smallest connection to employment is needed for amounts to be included in income. There is a very narrow exception for payments that are wholly extraneous to one's employment and are received in a personal capacity. The amounts the taxpayer received were referenced to his years of service and were not received in a personal capacity. The letter sent to the taxpayer by R indicated that the payments would only be made if the taxpayer continued to work for CEDA. Such a stipulation is a clear indication that the payments were related to his employment. The fact that the taxpayer was not employed by R when the payments were received was irrelevant. All that was required was that the taxpayer received the benefit in respect of employment and it was not necessary that he be an employee of R at the time the benefit was given.

¶48,563, *Shaw*, 2013 DTC 1214

Taxpayer permitted to deduct some of renovation expenses incurred on rental property

The taxpayer acquired a one-half interest in a rental property for $150,000. This interest comprised two rental suites, one of which the taxpayer renovated at a total cost of $36,939 before renting it to his mother. The renovation work consisted of such things as replacing three windows, stripping and replacing multiple layers of paint and paper on the walls, redoing the floors, and replacing electrical wiring. In assessing the taxpayer for 2007, the Minister characterized the entire $36,939 as a capital outlay. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was allowed in part. In general, a deductible expense/capital outlay analysis is governed by the principle that current or deductible expenses are recurring, whereas capital outlays give rise to more durable results that last longer. The quantum of the expenses incurred demonstrates nothing, although a comparison of that quantum with the recent purchase price for the property can provide some indication that a capital expenditure may be involved. Such a comparison in this case led to the conclusion that the $36,939 in issue constituted capital improvements rather than deductible expenses. In this case, however, the taxpayer made expenditures for paint, which are typically current expenses. In addition, there was a strong probability that at least a modest portion of the taxpayer's renovations in this case involved current expenditures. The taxpayer was therefore permitted to deduct $6,000 of the $36,939 in issue as a current expense and to claim a capital cost allowance on the remaining $30,939.

¶48,564, *Drago*, 2013 DTC 1215

Expert opinion on taxation law inadmissible into evidence as it related to interpretation of domestic law

This was an action by the taxpayer against his tax advisers for an unsuccessful tax-planning strategy implemented by the taxpayer that caused him to lose approximately $16 million. The tax plan involved the use of borrowed funds on a short-term basis to create an interest expense, followed by the taxpayer's departure from Canada and becoming a non-resident for tax purposes. The taxpayer argued that due to the negligent advice and/or breach of contract and fiduciary duty of the defendant, the interest deduction was not available. At issue on this application was whether an expert report prepared by a senior tax lawyer and practitioner and provided by the taxpayer was admissible into evidence.

The taxpayer's motion was denied. While the opinion was prepared by a senior practitioner with extensive and specialized experience in taxation law, the expert opinion was not necessary and, further, was not admissible as it related to the interpretation and application of domestic law.

¶48,566, *Walsh*, 2013 DTC 5141

CRA not entitled to enforce total amount of its writ registered against title to taxpayer's matrimonial home following taxpayer's divorce

The taxpayer, R, and her spouse, C, purchased their matrimonial home (the "Home") in 2003. R's parents, S and D, loaned them $35,600 on the strength of a promissory note to assist them with the purchase. S, D, R, and C took title to the Home as joint tenants, and after D died in 2006, each of S, R, and C held a one-third interest in the Home. Following R's statement of claim for divorce and division of matrimonial property filed on September 15, 2011, R filed a certificate of *lis pendens* on title to the Home on October 5, 2011 (the "CLP"). On November 16, 2011, S registered a caveat on title to the Home to secure the $35,600 owed to her under R and C's promissory note. In a consent judgment issued on February 12, 2013, the Court approved a matrimonial property settlement agreement (the "MPSA") between R and C, under which C agreed to transfer his interest in the Home to S and R. At that time, C owed tax of $106,851, which he had not revealed to S and R and, unknown to them, the Canada Revenue Agency (the "CRA") had registered a writ against title to the Home in the amount of $106,851, sometime after R had filed her CLP. After they discovered the CRA writ, R and S, who at that time each held a one-half interest in the Home, applied for a declaration that the CRA writ should be removed from title without any payment to the CRA. The CRA applied for a declaration that its writ could not be removed until it received payment of the full $106,851.

Both applications were dismissed. Section 35 of the *Matrimonial Property Act* stipulates that any instrument registered against title to a property subsequent to a CLP is subject to the claim of the spouse who filed the CLP. At the time R's CLP was filed, she had an undivided one-third interest in the Home, as did each of C and S. R's interest in the Home increased to half after the Court approved the MPSA. However, by failing to reveal his tax debt owing when the MPSA was being negotiated, C was the "rogue" here, and the CRA should not bear the entire burden of this situation, since it had done all that it could to protect its position by registering its writ when it did. However, it would be inappropriate to burden R's interest in the Home with the entire tax of $106,851 owing by C, particularly when such a burden was not provided for in the MPSA. The municipal valuation of the property amounted to $369,500, from which a line of credit in the amount of $120,000 and S's secured debt of $35,600 should both be deducted, leaving a balance of $213,900. Dividing $213,900 by one-third meant that at the time of D's death, the value of the one-third interest in the Home of each of R, C, and S amounted to $71,300. The CRA, therefore, should be entitled to enforce its writ to the extent of C's one-third interest in the amount of $71,300 only. Upon payment of this amount, that writ should then be discharged.

¶48,568, *McCullough-Greiff*, 2013 DTC 5143

Tax Court refused to set down for determination a question proposed by taxpayer respecting Minister's loss determinations

The taxpayers, which were two partnerships, reported business losses for 2001 and 2002, which the Minister disallowed in notices of determination (the "Determinations") issued under subsection 152(1.4) of the *Income Tax Act* ("the Act"). During their appeals to the Tax Court of Canada, the taxpayers proposed for determination, under section 58 of the *Tax Court of Canada Rules (General Procedure)* (the "Rules"), the question of whether the Determinations should be vacated and the appeals should be allowed on the grounds that: (a) the Minister concluded, subsequent to the making of the Determinations, that the taxpayers did not exist as of the end of 2001 and 2002; and (b) the Minister therefore had only one year after reaching this conclusion to reassess the individual members of the taxpayers under subsection 152(1.8) of the Act and failed to do so, so that any attempted reassessments of those members were now statute-barred.

The proposed question was not set down for hearing. Under section 58 of the Rules, questions may be heard if they are raised in a pleading and if their determination may dispose of or shorten all or any part of the appeal. In this case, the statute-barred issue under subsection 152(1.8) of the Act was not raised in any pleading. The taxpayers were therefore seeking to have the Determinations vacated by raising an issue that had nothing to do with their validity, and their validity was the key issue raised in the pleadings. The proposed question, therefore, was, in essence, an attempt, not to deal with the validity of the Determinations, but to challenge possible attempted reassessments of partners that might never even be issued. The question, therefore, could not dispose of the hearing or shorten it and could not be set down for hearing.

¶48,571, *Sentinel Hill Productions IV Corporation*, 2013 DTC 1217

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