Date: 20070430

Docket: A-212-06

Citation: 2007 FCA 172

CORAM: **DÉCARY J.A.**
EVANS J.A.
RYER J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

R. DAREN BAXTER

Respondent

Heard at Toronto, Ontario, on March 22, 2007.

Judgment delivered at Ottawa, Ontario, on April 30, 2007.

REASONS FOR JUDGMENT BY: RYER J.A.

CONCURRED IN BY: DÉCARY J.A.
CONCURRING REASONS BY: EVANS J.A.

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REASONS FOR JUDGMENT

RYER J.A.

[1] This is an appeal from the decision of Bell J. in *R. Daren Baxter v. Her Majesty the Queen* (2006 TCC 230; 2006 D.T.C. 2642), a decision of the Tax Court of Canada (the "TCC"), allowing the appeal of Mr. Baxter against reassessments made under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "ITA"), for the 1988 and 1989 taxation years. Unless otherwise indicated, all statutory references in these reasons are to the corresponding provisions of the ITA for the taxation years under consideration.

[2] In 1998, Mr. Baxter acquired a licence (a “TIP licence”) to use the Trafalgar Index Program, which was computer software used to trade futures contracts. The acquisition cost of the TIP licence was $50,000, which was paid by the delivery of four cheques totalling $17,500 and a promissory note with the principal amount of $32,500. In his income tax returns for the 1998 and 1999 taxation years, Mr. Baxter claimed deductions totalling $50,000 as capital cost allowance in respect of the acquisition cost of the licence.

[3] Two issues were raised in this appeal: whether the TIP licence that Mr. Baxter acquired constituted a tax shelter, as defined in subsection 237.1(1) (a “tax shelter”), in which event the full amount of the capital cost allowance deductions would be denied to him, and whether the promissory note constituted a contingent liability, in which event $32,500 of the capital cost allowance deductions would be denied to him.

[4] For the reasons that follow, I have concluded that the property that Mr. Baxter acquired constituted a tax shelter and that the appeal should be allowed. Because of this conclusion, no consideration of the contingent liability issue is necessary.

INTRODUCTION

[5] In order to facilitate the understanding of my reasons, I will summarize my interpretation of the definition of tax shelter, insofar as it applied to the taxation years that are under consideration in this appeal. The full text of paragraph 237.1(1)(a) is contained in paragraph 29.

[6] The definition of tax shelter essentially poses a question in relation to a hypothetical or assumed acquisition of property by a hypothetical or prospective purchaser (a “prospective purchaser”). If there is an affirmative answer to the question, then the property will constitute a tax shelter and a number of consequences will flow from that characterization. The question is to be answered in advance of any actual sale of the property.

[7] The question posed by the definition of tax shelter is relatively simple, once one gets to it. However, getting to it is not a simple matter. A number of preliminary matters must be determined.

[8] The property contemplated by the definition of tax shelter is each and every property that is offered for sale to prospective purchasers. However, not every property that is proposed to be sold will constitute a tax shelter.

[9] The definition requires that statements or representations must be made, at some time, in connection with the property that is offered for sale. If no statements or representations have ever been made in connection with a property, then that property cannot constitute a tax shelter. Because the property that is contemplated by the definition of tax shelter is a property that is assumed to have been acquired by the prospective purchaser and the statements or representations are required to have been made in connection with that property, it follows that the statements or representations must have been made prior to any actual sale of the property that is offered for sale. Further, while the definition does not specify to whom or by whom the statements or representations must be

made, in my view they must be made to the prospective purchasers of the property by or on behalf of the person who proposes to sell the property.

[10] The subject matter of the statements or representations is essentially a description of an amount that the prospective purchaser would be able to deduct, in computing income in respect of the property, as a consequence of an assumed acquisition of the property, that is to say, if the prospective purchaser had actually acquired the property, whether the amount constitutes the acquisition cost of the property, a cost incurred in order to obtain the property (e.g. a drilling cost incurred to acquire an interest in an oil and gas property in a farm-out transaction) or an amount allocated to the holder of the property (e.g. a loss allocated to partner holding a partnership interest).

[11] The definition of tax shelter does not specify the form that the statements or representations must take or the manner in which they must be made. It is clear that there must be a communication to prospective purchasers which would inform them that a deductible amount would become available to each of them as a consequence of an acquisition by any of them of the property that is offered for sale. Nothing in the definition indicates that the requisite communication must be made in writing.

[12] The definition provides no specificity as to whether the communication of the statements and representations must be for any particular purpose or must have any particular effect. It seems obvious that in making the statements or representations, directly or through agents, the prospective vendor of the property would be motivated to encourage or induce prospective purchasers to

become actual purchasers. However, because the question that is posed by the definition is to be answered before any actual sale takes place, the impact of the statements and representations on the prospective purchasers is indeterminable and of no relevance.

[13] Finally, the question posed by the definition of tax shelter requires the determination of a period of time that ends within four years after the date upon which the prospective purchaser is assumed to have acquired the property.

[14] Having regard to these elements, the question posed by the definition of tax shelter is whether, in light of the statements or representations that have been communicated to the prospective purchaser, it may reasonably be considered, that is to say, objectively determined, that at the end of any particular taxation year of the prospective purchaser that ends within the four year period, the amount that has been announced or communicated to be deductible to the prospective purchaser as a consequence of the prospective acquisition of the property equals or exceeds the cost to the prospective purchaser of that property, determined at the end of the particular taxation year in question, less the amount of all “prescribed benefits” expected to be received or enjoyed, directly or indirectly, in respect of that property by the prospective purchaser. This mathematical determination is to be undertaken a maximum of four times, each of which will be at the end of each taxation year of the prospective purchaser that falls within the four year period. If, at any of those times, the answer is determined to be affirmative, then the property will constitute a tax shelter. However, if the answer is negative at all four of those times, then the property will not constitute a tax shelter.

FACTUAL BACKGROUND

Marketing of TIP Licences by the Trafalgar Group

[15] Promotional materials that were provided to prospective purchasers of TIP licences, including Mr. Baxter, describe the Trafalgar Group as having built a successful business around their ability to create sophisticated tax-assisted investment programs. In 1998, the Trafalgar Group undertook the marketing of the Trafalgar Index Program as "its latest innovative investment product designed by it to seek order in a volatile and uncertain financial world."

[16] The promotional materials described Trafalgar Index Program, which was, essentially, a "day trading" program. The right to use the Trafalgar Index Program was to be made available to prospective investors by means of TIP licences that were to be granted pursuant to agreements that were to be entered into with TCL Trafalgar B.V. ("TCL Trafalgar"), a Netherlands incorporated member of the Trafalgar Group that had licensed the right to use the Trafalgar Index Program from its owner within the Trafalgar Group. The minimum TIP licence purchase was to be $50,000, increasing in increments of $10,000. To facilitate acquisitions of TIP licences by prospective investors, 65% of their acquisition cost was to be financed by the Trafalgar Group. Prospective investors were also to be given the opportunity to enter into an agency agreement with Trafalgar Trading Limited ("Trafalgar Trading"), a Bermuda incorporated member of the Trafalgar Group that would advance $2,000 of initial trading capital per $10,000 of licence fee, to be used for trading purposes, along with the Trafalgar Index Program. An 8% minimum average annual return from the

use of TIP licences in trading activities was to be promised by Trafalgar Trading and guaranteed by TCL Trafalgar.

[17] It is not clear whether the Trafalgar Group was a legal entity or merely a reference to an aggregation of corporations. Some of the promotional materials refer to the Trafalgar Group and certain of the opinions that are described in the following paragraph were addressed to the Trafalgar Group, to the attention of Mr. Edward Furtak. In an income tax ruling request that was made to tax authorities in the Netherlands, Mr. Furtak was described as the beneficial owner of TCL Trafalgar, which was referred to in a securities law opinion, which is the third opinion described in the following paragraph, as a company related to Trafalgar Trading. Regardless of the intricacies of the Trafalgar Group, it is clear that the marketing of TIP licences was actively undertaken by TCL Trafalgar and on its behalf by employees of corporations related to or associated with Mr. Furtak, as well as independent sales agents.

[18] In furtherance of its marketing objectives, the Trafalgar Group sought opinions from EMC Partners, American Appraisal Canada, Inc. and Fraser Milner. These opinions dealt with a number of aspects of the proposed TIP licence marketing arrangements. In particular:

a. in correspondence dated October 8, 1998 (an "Appraisal"), EMC Partners advised that the fair market value of the $10,000 TIP licence was in excess of $15,000 and that the Trafalgar Index Program constituted a Class 12 asset for the purposes of the ITA and the *Income Tax Regulations*, C.R.C., c. 945 (the "ITR");

b. in correspondence dated October 20, 1998 (the "Tax Opinion"), Fraser Milner advised that, subject to certain assumptions that are not in issue in this appeal, a Canadian taxpayer who acquired a TIP licence would be able to deduct the full cost of that TIP licence over two fiscal years;

c. in further correspondence dated October 20, 1998, Fraser Milner advised that the sale of TIP licences to use the Trafalgar Index Program should not attract the prospectus requirements under Ontario securities legislation; and

d. in correspondence dated November 20, 1998 (an "Appraisal"), American Appraisal Canada, Inc. advised that the fair market value of a $10,000 TIP licence was estimated to be $11,700 and that each TIP licence was software for Canadian tax purposes, thus enabling the licensee to deduct the purchase price of a TIP licence against other income sources over a period of two years, in accordance with Class 12 of the ITR.

[19] Mr. Allan Peters, an independent sales agent who was marketing TIP licences on behalf of TCL Trafalgar, testified that the promotional materials that were prepared by or on behalf of TCL Trafalgar, the Appraisals and the Tax Opinion were all provided to him, by or on behalf of TCL Trafalgar, for use in his marketing efforts. Mr. Peters further testified that those items were provided by him to some, if not all, of the prospective investors that he contacted. He also testified that he explained the income tax deductibility of the acquisition cost of TIP licences to those prospective investors.

[20] Mr. Jeffery Dahn, an individual who purchased a TIP licence, testified that a copy of the Tax Opinion was provided to him by Mr. Medric Cousineau, the independent sales agent who sold his TIP licence to him.

Mr. Baxter's Purchase of the Licence

[21] Mr. Baxter is a lawyer whose practice included providing income tax advice to small business clients. He received a package of materials with respect to the prospective purchase of a TIP licence from Mr. Burton Langille, an independent sales agent who was marketing them on behalf of TCL Trafalgar. Mr. Baxter reviewed the particulars of the proposed TIP licence investment with Mr. Bradley Langille, an old friend, who was the brother of the sales agent. Mr. Baxter did not review the Appraisals but did review the Tax Opinion.

[22] In evaluating the investment opportunity, Mr. Baxter relied on the business acumen of his friend, Mr. Bradley Langille, who had apparently reviewed the financial aspects of the investment. Mr. Baxter testified that he did not understand the workings of the software but was impressed with the favourable financial projections that were included in the promotional materials. He indicated that he knew that a TIP licence was a Class 12 asset, the cost of which was deductible over a two year period. On December 31, 1998, he executed the three documents (the "License Agreement", the "Promissory Note" and the "Agency Agreement", copies of which were before this Court) that were provided to him by the sales agent.

The Documents

[23] Under the License Agreement with TCL Trafalgar, Mr. Baxter was granted a TIP licence, which was a non-exclusive, limited-use right to use the Trafalgar Index Program for a term of ten years. Clause 3 of this agreement read as follows:

> **3. License Fee**
>
> 3.1 In consideration for granting the License to the Licensee by TCL Trafalgar, the Licensee shall pay to TCL Trafalgar a License Fee, payable:
>
> (a) as to $4375.00 by way of a cheque or money order dated as of the current date;
> (b) as to $4375.00 by way of a post-dated cheque dated THREE months after the current date;
> (c) as to $4375.00 by way of a post-dated cheque dated SIX months after the current date;
> (d) as to $4375.00 by way of a post-dated cheque dated NINE months after the current date; and
> (e) as to $32,500.00 by way of execution of the Promissory Note.
>
> 3.2 Both the Licensee and TCL Trafalgar hereby acknowledge and confirm that 5% of the License Fee shall be in respect of Maintenance Modifications for the Term.

[24] Under the Promissory Note, Mr. Baxter promised to pay $32,500 to TCL Trafalgar on December 31, 2008, together with monthly interest at the rate of 5%.

[25] Under the Agency Agreement among Mr. Baxter, Trafalgar Trading and TCL Trafalgar, Trafalgar Trading was appointed as the exclusive agent of Mr. Baxter for the purpose of trading S&P 500 contracts, using the TIP licence that Mr. Baxter acquired under the License Agreement, for a period of ten years. Trafalgar Trading agreed to contribute $10,000 of capital to a bank account to be used for the purpose of trading, and covenanted that the Average Annual Return (as defined in the Agency Agreement) generated from the trading activities, over the term of the Agency

Agreement, would be no less than 8%. Trafalgar Trading was entitled to certain fees for each trade and profits from the trading account were to be shared with Mr. Baxter. TCL Trafalgar agreed that if the revenue covenant of Trafalgar Trading was not fulfilled, then Mr. Baxter's obligation to pay the principal amount of the Promissory Note would be limited, pro rata, to the extent that Trafalgar Trading fulfilled its revenue covenant. Clauses 2, 4.1 and 8 of this agreement read as follows:

> **2. Exclusive agent**
>
> 2.1 The parties hereto agree that Trafalgar Trading shall be the exclusive agent of the Licensee for the Term of this agreement to engage in the trading of S&P 500 Contracts using the License.
>
> **4. Contribution of Initial Trading Capital**
>
> 4.1 Trafalgar Trading shall contribute Initial Trading Capital to the Bank Account equal to $2,000 for each $10,000 of License Fee. The Initial Trading Capital shall be deposited in the Bank Account pro rata to payments made by the Licensee in accordance with Sections 3.1 a), 3.1 b), 3.1 c) and 3.1 d) of the License Agreement.
>
> **8. Allocation of Trading Capital**
>
> 8.1 Within 30 days of expiration of the Term of this agreement, the Trading Capital shall be allocated as follows:
> a) an amount equal to the Initial Trading Capital shall be paid to Trafalgar Trading; and
> b) the balance of the Trading Capital shall be paid to the Licensee.
> 8.2 The Licensee hereby directs Trafalgar Trading to pay to TCL Trafalgar, from the amount allocated to the Licensee pursuant to Section 8.1 of this agreement, an amount equal to the unpaid Principal Sum.
> 8.3 Trafalgar Trading covenants that on expiration of the Term of this agreement, the Average Annual Return generated by the Trafalgar Index Program with the Trading Capital shall be no less than eight per cent (8%).
> 8.4 TCL Trafalgar hereby agrees that notwithstanding the provisions of the License Agreement and the Promissory Note, the Licensee's obligation to fulfil the terms of the Promissory Note and of Section 3.1 3) of the License Agreement shall be limited, pro rata, to the extent that Trafalgar Trading fulfills the terms of Section 8.3 of this Agreement.

[26] No application was made pursuant to subsection 237.1(2) for a tax shelter identification number in relation to the TIP licences that were marketed by and on behalf of TCL Trafalgar because TCL Trafalgar took the position that the TIP licences did not constitute a tax shelter.

[27] In his 1998 income tax return, Mr. Baxter reported the acquisition of the TIP licence as a $50,000 equipment addition in a capital cost allowance schedule and claimed $2,500 as a deduction on account of capital cost allowance in respect of that addition and a resulting business loss of $2,500. In his 1999 income tax return, Mr. Baxter claimed $47,500, the balance of the undepreciated capital cost of the TIP licence, as a deduction on account of capital cost allowance and a resulting business loss of $47,500.

[28] By Notices of Reassessment, dated April 22, 2002, the Minister of National Revenue (the "Minister") reassessed Mr. Baxter and denied the capital cost allowance deductions that Mr. Baxter had claimed in his 1998 and 1999 income tax return in respect of the TIP licences.

STATUTORY PROVISIONS

[29] The following provisions of the ITA are relevant to the disposition of this appeal:

237.1. (1) In this section,	**237.1.(1)** Les définitions qui suivent s'appliquent au présent article.
…	[…]
"**promoter**" in respect of a tax shelter means a person who in the course of a business	**« promoteur »** Personne qui, quant à un abri fiscal et dans le cours des activités d'une entreprise:
(*a*) sells or issues, or promotes the sale, issuance or	

acquisition of, the tax shelter,

(*b*) acts as an agent or adviser in respect of the sale or issuance, or the promotion of the sale, issuance or acquisition, of the tax shelter, or

(*c*) accepts, whether as a principal or agent, consideration in respect of the tax shelter,

and more than one person may be a tax shelter promoter in respect of the same tax shelter;

"tax shelter" means any property (including, for greater certainty, any right to income) in respect of which it can reasonably be considered, having regard to statements or representations made or proposed to be made in connection with the property, that, if a person were to acquire an interest in the property, at the end of a particular taxation year that ends within 4 years after the day on which the interest is acquired,

(*a*) the total of all amounts each of which is

(i) an amount, or a loss in the case of a partnership interest, represented to be deductible in computing income in respect of the interest in the property (including, where the property is a right to income, an amount or loss in respect of that right that is represented to be deductible) and expected to be incurred by or allocated

a) émet ou vend l'abri fiscal ou fait la promotion de son émission, de sa vente ou de son acquisition;

b) agit, à titre de mandataire ou de conseiller, en ce qui concerne l'émission ou la vente de l'abri fiscal ou la promotion de son émission, de sa vente ou de son acquisition;

c) accepte, à titre de principal ou de mandataire, une contrepartie relativement à l'abri fiscal.

Au même abri fiscal peuvent correspondre plus d'un promoteur d'abris fiscaux.

« abri fiscal » Bien (y compris, pour plus de certitude, le droit à un revenu) pour lequel il est raisonnable de considérer, compte tenu de déclarations ou d'annonces faites ou envisagées relativement au bien que, si une personne acquérait une part dans le bien, le montant visé à l'alinéa a) serait, à la fin d'une année d'imposition qui se termine dans les quatre ans suivant le jour où la part est acquise, égal ou supérieur au montant visé à l'alinéa b) :

a) le total des montants représentant chacun :

(i) un montant ou, dans le cas d'une participation dans une société de personnes, une perte qui est annoncé comme étant déductible dans le calcul du revenu au titre de la part (y compris, si le bien est un droit à un revenu, un montant ou une perte afférent è ce droit qui est annoncé comme étant déductible) et qui pourrait être engagé ou subie par la personne ou

to the person for the particular year or any preceding taxation year, or

(ii) any other amount presented to be deductible in computing income or taxable income in respect of the interest in the property and expected to be incurred by or allocated to the person for the particular year or any preceding taxation year, other than any amount included in computing a loss described in subparagraph (i),

would equal or exceed

(*b*) the amount, if any, by which

(i) the cost to the person of the interest in the property at the end of the particular year, determined without reference to section 143.2,

would exceed

(ii) the total of all amounts each of which is the amount of any prescribed benefit that is expected to received or enjoyed, directly or indirectly, in respect of the interest in the property by the person or another person with whom the person does not deal at arm's length,

but does not include property that is a flow-through share or a prescribed property.

(2) A promoter in respect of a tax

attribué à celle-ci pour l'année ou pour une année d'imposition antérieure.

(ii) un autre montant qui est annoncé comme étant déductible dans le calcul du revenu ou du revenu imposable au titre de la part et qui pourrait être engagé par la personne ou attribué à celle-ci pour l'année ou pour une année d'imposition antérieure, à l'exclusion d'un montant inclus dans le calcul d'une perte visée au sous-alinéa (i);

b) l'excédent éventuel du montant visé au sous-alinéa (i) sur le total visé au sous-alinéa (ii) :

(i) le coût de la part pour la personne à la fin de l'année, déterminé compte non tenu de l'article 143.2,

(ii) la valeur totale des avantages visés par règlement que la personne ou toute personne avec laquelle elle a un lien de dépendance pourrait recevoir, directement ou indirectement, au titre de la part.

Les actions accréditives et les biens visés par règlement ne sont pas considérés comme des abris fiscaux.

(2) Tout promoteur doit, quant à un abri fiscal, demander au ministre, sur le formulaire prescrit contenant les renseignements prescrits, d'attribuer un numéro d'inscription à cet abri fiscal, sauf si demande en a déjà été faite.

(4) Nul ne peut, que ce soit à titre de principal ou de mandataire,

shelter shall apply to the Minister in a prescribed form for an identification number for the tax shelter unless an identification number therefor has previously been applied for.	émettre ou vendre un abri fiscal, ou accepter une contrepartie relativement à un abri fiscal, avant que le ministre n'ait attribué à cet abri fiscal un numéro d'inscription.
(4) No person shall, whether as a principal or an agent, sell or issue, or accept consideration in respect of, a tax shelter before the Minister has issued an identification number for the tax shelter.	(6) Une personne ne peut demander ou déduire un montant au titre d'un abri fiscal que si elle présente au ministre un formulaire prescrit contenant les renseignements prescrits, incluant le numéro d'inscription attribué à l'abri fiscal.
(6) No amount may be deducted or claimed by a person in respect of a tax shelter unless the person files with the Minister a prescribed form containing prescribed information, including the identification number for the tax shelter.	

THE FINDINGS OF THE TCC

The Tax Shelter Issue

[30] The TCC determined that Mr. Baxter did not acquire a tax shelter because, in its view, no amount was represented to be deductible and expected to be incurred by Mr. Baxter for the purposes of paragraph (*a*) of the definition of tax shelter, with the result that the mathematical requirement of the definition was not met.

[31] The TCC also concluded that the property contemplated by the definition was the specific TIP licence that was purchased by Mr. Baxter, although that conclusion was not essential to its decision.

[32] Finally, the TCC appeared to conclude that the statements or representations contemplated by paragraph (*a*) of the definition of tax shelter must have been made to the particular taxpayer in question. However, the TCC acknowledged, but did not comment upon, the argument of the Minister, which is referred to in paragraph 60 of the TCC decision, that Mr. Baxter "knew from the legal opinions, promotional materials and the documents he signed that his $50,000 investment would be written off over two years as a class 12 capital cost allowance asset".

ANALYSIS

The Tax Shelter Issue

Introduction

[33] The practice with respect to the marketing of tax shelters has been the subject of much commentary by tax lawyers and accountants. An excerpt from an article by Shawn D. Porter entitled "The Tax Shelter Rules – Are We There Yet?" *Report of Proceedings of the Forty-Eight Tax Conference*, 1996 Conference Report Vol. 1 at pages 24:12 and 24:13(Toronto: Canadian Tax Foundation, 1997), is illustrative of a typical tax shelter marketing arrangement.

> Although there was, and continues to be, a significant concern with respect to the breadth of the definition of a promoter, tax shelter reporting is typically undertaken only in those situations involving the sale of property by a party who is clearly a promoter to inactive investors (usually individuals) using some form of offering document and marketing material. The offering document and marketing material often include a tax opinion

> from an accounting or law firm indicating that certain amounts should be deductible. The accounting or law firm could be liable if it were negligent in preparing the tax opinion. In many cases, the offering document and marketing material form the basis of the prospective investor's decision as to whether or not to invest. [footnotes omitted]

The standard of review

[34] It is common ground between the parties that the determination of whether Mr. Baxter acquired a tax shelter is a question of law that is reviewable on a standard of correctness: *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235.

What is the "property"?

[35] The TCC found that the property, for the purposes of the definition of tax shelter, was the actual TIP licence that was acquired by Mr. Baxter. The respondent supported this finding, while the Minister essentially argued that the property was all of the TIP licences that were being offered for sale by TCL Trafalgar. In my view, the position of the Minister is correct.

[36] The words "if a person were to acquire an interest in the property" demonstrate that the definition of tax shelter is forward-looking and that the person referred to is a prospective purchaser of the property. This means that the determination of whether any property constitutes a tax shelter must be made in the context of an assumed sale of that property to a prospective purchaser and, therefore, in advance of any actual sale of that property. This conclusion is supported by subsections 237.1(2) and (4), which mandate the acquisition of an identification number before any sale of a property that constitutes a tax shelter is permissible. In the actual circumstances under consideration,

"any property" means any of the TIP licences that TCL Trafalgar proposed to market to prospective purchasers.

What constitutes "statements or representations"?

[37] A property cannot constitute a tax shelter if no statements or representations are ever made with respect to the amount that a prospective purchaser would be able to deduct in computing income as a consequence of an assumed acquisition of that property. Accordingly, the existence of statements or representations in connection with a property is a necessary condition to a conclusion that the property constitutes a tax shelter.

[38] The Appraisals and the Tax Opinion were prepared in advance of, and in connection with, the proposed marketing of TIP licences by or on behalf of TCL Trafalgar. Each of those items, and in particular the Tax Opinion, addressed the proposed income tax consequences that would arise out of an acquisition of a TIP licence by a prospective investor. Moreover, the Tax Opinion specifically stated that its contents could be shown to prospective purchasers of TIP licences. I have no difficulty in concluding that the statements in the Appraisals and the Tax Opinion that indicated that the acquisition cost of TIP licences would be fully deductible to prospective purchasers over a two year period, constitute statements or representations of the kind required by the definition of tax shelter. Accordingly, I conclude that the existence of statements or representations in connection with the TIP licences has been established.

[39] If TCL Trafalgar had prepared and distributed a prospectus or offering memorandum that contained the income tax assertions that were in the Appraisals and the Tax Opinion, it is evident

that the requirement for tax representations of the type contemplated by the definition of tax shelter would have been met. The isolation of the tax representations into discrete documents, namely the Appraisals and the Tax Opinion, which were included in the package of promotional materials that were made available to prospective purchasers of TIP licences, cannot prevent a conclusion that the requirement for statements or representations in the definition of tax shelter has been fulfilled.

To whom and by whom must statements or representations be made?

[40] The TCC held that statements or representations of the type contemplated by the definition of tax shelter were required to have been made to Mr. Baxter. The respondent supported this finding, while the Minister essentially argued that the definition of tax shelter does not require the statements or representations to be made to any particular or identifiable person. In my view, neither of these propositions is correct.

[41] The opening portion of the definition of tax shelter contains a requirement that statements or representations be made in connection with the property. However, the definition does not specify the identity of either the person who must make the statements or representations or the person to whom they must be made. It is not clear whether this apparent imprecision in drafting was deliberate. What is clear is that a property cannot constitute a tax shelter unless statements or representations of the type contemplated by the definition of tax shelter have been made, at some point in time, in connection with the property.

[42] Some additional uncertainty might be said to have arisen in the interpretation of the definition of tax shelter because the initial portion of the definition refers to statements or

representations, but paragraph (*a*) of the definition refers only to an amount represented to be deductible. In *Maya Inc. v. Canada*, 2003 TCC 502, Dussault T.C.J., at paragraph 13 of his decision, indicated that the amount represented to be deductible for the purposes of paragraph (*a*) of the definition was the amount that had been "proposed" to the prospective purchaser of the property. I agree with this non-technical approach to the meaning of the word represented and conclude that its use is intended to do no more than convey the notion that the amount that is the subject matter of the statements or representations contemplated by the opening portion of the definitions has been made known to the prospective purchasers of the property in question. To that extent, words such as communicated or announced could also be used to explain what is meant by the word represented in paragraph (*a*) of the definition of tax shelter. Indeed, the meaning of either of those words appear to be generally consistent with the meaning of the word "annoncé", which appears in the French version of paragraph (*a*) of the definition.

[43] The opening portion of the definition of tax shelter makes it clear that the statements or representations must be made in connection with the assumed acquisition of the property by the prospective purchaser. Paragraph (*a*) of the definition refers to an amount represented to be deductible in respect of the property and expected to be incurred by the prospective purchaser. Accordingly, I conclude that the statements or representations are required to be made to the prospective purchaser of the property.

[44] While neither of the parties to this appeal, nor the TCC in its decision, focused much attention on the identity of the party who must have made the statements or representations, in my

view, it would be reasonable to conclude that it must be each person who constitutes a promoter, as defined in subsection 237.1(1) (a "promoter").

[45] The Tax Opinion and the Appraisals contained income tax assertions that constituted statements or representations of the kind required by the definition of tax shelter. Those items were provided by or on behalf of TCL Trafalgar to the independent sales agents for use by them in the marketing of TIP licences to prospective purchasers and those items were in fact used by the agents in their marketing efforts. Each of TCL Trafalgar and the independent sales agents was a promoter. It is therefore apparent that the statements or representations in question were made, that is to say announced, communicated or make known, by or on behalf of a promoter to prospective purchasers of the TIP licences. Accordingly, the communication requirements in relation to the statements or representations component of the definition of tax shelter were met.

The mathematical requirement

[46] The mere existence of tax representations is not sufficient to cause a property to be a tax shelter. It must reasonably be considered, having regard to statements or representations that have been communicated to prospective purchasers, that at the end of any particular taxation year of the prospective purchaser that ends within four years after the assumed acquisition of the property by the prospective purchaser, the amount determined under paragraph (*a*) of the definition, namely, an amount represented to be deductible in computing the income of, and expected to be incurred by, the prospective purchaser as a consequence of the assumed acquisition of the property, would be equal or exceed the amount determined under paragraph (*b*) of the definition, namely, the

acquisition cost of the property to the prospective purchaser at the end of the particular taxation year, less any "prescribed benefit" that is expected to be received or enjoyed, directly or indirectly, by the prospective purchaser in respect of the property. This is what I have referred to as the mathematical requirement of the definition of tax shelter. It has been succinctly described in paragraph 30 of the Tax Court of Canada decision in *Maege v. Her Majesty the Queen*, 2006 TCC 117, as follows:

> … the provisions defining "tax shelter" can be reduced to a simple equation: there may be a tax shelter if A > (B – C) where A is the aggregate of deductions against income (including losses), B is the amount of the investment or cost, and C is the amount of prescribed benefits received …

[47] The respondent argued that having regard to the circumstances described in the Tax Opinion, the mathematical requirement of the definition of tax shelter was not met. According to the respondent, the Tax Opinion informed Mr. Baxter that 5% of the License Fee was for "Maintenance Modifications for the Term" and that amount would be regarded as a prepaid expense, which would be deductible over a 10 year period. On that basis, the maximum amount that could have been represented to be deductible in respect of the TIP licence, during the 4 year period after its acquisition, could only be the remaining 95% of the License Fee. In Mr. Baxter's circumstances, so the argument goes, the amount determined under paragraph (*a*) of the definition was 95% of $50,000, that is to say, $47,500, and the amount determined under paragraph (*b*) of the definition was the full amount of the License Fee, that is to say, $50,000, assuming that there was no "prescribed benefit" of the type contemplated by subparagraph (*b*)(ii) of the definition of tax shelter. It followed, according to the respondent, that because the amount determined under paragraph (*a*), that is to say $47,500, was less than the amount determined under paragraph (*b*), that is to say

$50,000, the mathematical requirement to the definition of tax shelter was not met with the result that the TIP licence could not be a tax shelter.

[48] In my view, this argument fails. While it incorrectly focuses on the actual acquisition of a TIP licence by Mr. Baxter, rather than the assumed acquisition of a TIP licence by a prospective purchaser, that is not the reason for the failure. In my view, it cannot be said that the full amount of the License Fee would have constituted the acquisition cost of a TIP licence to a prospective purchaser. Clause 3.2 of the License Agreement stipulates that 5% of the $50,000 License Fee, that is to say $2,500, related to future services that were to have been provided by TCL Trafalgar to the prospective purchaser of a TIP licence. Accordingly, that amount could not have constituted a portion of the acquisition cost of the TIP licence and, therefore, the acquisition cost of that property to the prospective purchaser could only have been the residual amount of $47,500. In my view, it would be unreasonable to believe that the recipient of the future services would not have been required to pay for them. Moreover, nowhere in the Tax Opinion does it say that the cost of a TIP licence to a prospective investor would be determined without deducting the amount of the License Fee that was allocable to the future services that were to be provided in respect of that TIP licence. It follows that, assuming that there was no “prescribed benefit” of the type contemplated by subparagraph (*b*)(ii) in the definition of tax shelter, the amount determined under paragraph (*a*) of the definition would be $47,500 and that same amount would be determined under paragraph (*b*) of the definition. As a result, in my opinion, the mathematical requirement of the definition of tax shelter has been satisfied.

An amount must be "incurred"

[49] The approach of the TCC to the determination of this particular issue is described in paragraph 61 of its decision. In essence, the TCC found that an amount determined under subparagraph (*a*)(i) of the definition of tax shelter must be an amount that is represented to be deductible in computing income in respect of the interest in the property and expected to be incurred by the person. The TCC went further and concluded, in paragraph 62 of its decision, that the representation must have been made to the person who is expected to incur the particular amount. As indicated earlier, I basically agree with these propositions. The TCC went on to conclude that the amount in question was capital cost allowance and, whether or not any amount of capital cost allowance was represented to be deductible, capital cost allowance was not an amount that could be incurred by anyone. It is on this point that I disagree with the TCC.

[50] In my view, in the circumstances of this case, the proper interpretation of the term "amount" in subparagraph (*a*)(i) of the definition is that the amount should be the acquisition cost of the property that is assumed to have been acquired by the prospective purchaser, that is to say, the TIP licence. On this basis, it is readily seen that the second requirement of the provision, namely, that the amount must be expected to be incurred, would also be met as a result of the assumed acquisition of the property. In paragraph 62 of its decision, the TCC states that the "claim for capital cost allowance" is not an amount that can be incurred. While that is correct, insofar as it goes, in my view, a claim for capital cost allowance is merely the statutorily mandated method by which the cost of depreciable property is permitted to be deducted under the ITA and the ITR. In the circumstances

under consideration, the Tax Opinion, which was provided or made available to prospective purchasers of TIP licences, specifically states:

> … a Purchaser will be entitled to claim a deduction of up to 50% of the *acquisition cost* of his or her software in the fiscal year it is acquired and 50% in the following year. [emphasis added]

This supports my conclusion that the TCC's focus on the method by which the assumed acquisition cost of a TIP licence was to be deducted by the prospective purchaser was in error. Potential investors were in fact advised that it was the acquisition cost of the TIP licences that would be deductible. Seen in this light, it is clear that the second part of subparagraph (*a*)(i) of the definition that requires an amount, namely, the assumed acquisition cost of a TIP licence, to be incurred is readily met as a consequence of the assumed acquisition of a TIP licence by the prospective purchaser.

Technical timing issue with tax shelter definition

[51] The respondent argued that there was a "timing" issue in the definition of tax shelter that was applicable to the taxation years in issue in this appeal. The respondent's contention is that the wording of paragraphs (*a*) and (*b*) of the definition of tax shelter, which contain the mathematical requirement of the definition, requires those provisions to be applied in respect of expenditures that are incurred at the end of the four year period that is referred to in the initial portion of the definition. It follows, according to the respondent, that because Mr. Baxter acquired his TIP licence prior to the commencement of the four year period, the amount determined under paragraph (*a*) of the definition must be zero.

[52] The initial premise of this argument conflicts with my earlier conclusion that the definition of tax shelter is forward looking and contemplates an assumed acquisition of the property in question by a prospective purchaser. On that basis, the necessary statements or representations are required to have been made in connection with the assumed acquisition of the property by the prospective purchaser, in advance of any actual purchase of property, and the mathematical formula is required to be applied in respect of the four year period that begins on the date of that assumed acquisition of the property. Viewed in this light, I conclude that the language of the definition of tax shelter does not contain the flaw that has been suggested by the respondent.

"Reasonably be considered" by whom?

[53] The respondent argued that the definition of tax shelter that was applicable to the taxation years in issue in this appeal was further problematic in that it provided no indication as to how the reasonableness requirement of that definition was to be dealt with by the Court. The respondent suggested that the reasonableness requirement might be applied having regard to the "tax knowledge and sophistication" of the person to whom the statements or representations were made.

[54] Because of my conclusion that the person referred to in the definition of tax shelter is a prospective purchaser of the property, no consideration of the subjective knowledge of that person would be possible.

[55] The respondent also raised the question as to whether the statements or representations that were made could reasonably be considered to have led to the inference or conclusion that the

mathematical component of the definition of tax shelter had been met. In that respect, the respondent questioned whether it would be reasonable to accept the oral or written statements or representations of selling agents to that effect. Instead, the respondent argued that it would be more reasonable to rely on the Tax Opinion, which, according to the respondent, should have led to the conclusion that the TIP licences could not constitute tax shelters because the prepaid expense component of the License Fee (being deductible over the ten year period) caused the mathematical component of the definition of tax shelter to be unfulfilled.

[56] This argument is a virtual concession on the part of the respondent that the Tax Opinion constitutes the fulfillment of the representational component of the definition of tax shelter. For the reasons previously given, I have concluded that the prepaid expense argument, as the basis for the failure of the mathematical component of the definition, cannot succeed. Indeed, on the question of whether or not the TIP licences that were offered for sale to prospective investors constituted tax shelters, the Tax Opinion does not even raise that argument. Instead, the Tax Opinion concludes that it is because of the assumed absence of representations to potential investors that the TIP licences are not tax shelters.

[57] It is incongruous to contend that even though the Tax Opinion advised prospective purchasers of TIP licences that the full acquisition cost of those TIP licences should be deductible over two fiscal years, such advice did not constitute statements or representations to those prospective purchasers that fulfilled the mathematical requirement of the definition of tax shelter. It follows, in my view, that the statements in the Tax Opinion that indicated that the acquisition cost of

TIP licences would be deductible to prospective investors over a two year period can reasonably be considered to have lead to the conclusion that the mathematical component of the definition of tax shelter would have been met in relation to prospective purchases of TIP licences by prospective purchasers.

Conclusion

[58] In the circumstances under consideration, TCL Trafalgar, through its employees and agents, undertook an organized campaign to market TIP licences to the public. An important marketing feature was the favourable income tax deductions that were expected to be available to purchasers of TIP licences. The Tax Opinion and the Appraisals were requested and obtained to provide independent confirmation that the acquisition cost of TIP licences would be fully deductible to prospective purchasers of TIP licences over a two year period. These items were provided by or on behalf of TCL Trafalgar to the independent sales agents, as important marketing tools to be used by them in their sales efforts. The Tax Opinion and the Appraisals, in some instances, were given to prospective purchasers, thereby communicating or announcing to prospective purchasers that if they were to purchase TIP licences, the acquisition cost of those TIP licences would be fully deductible to them over a two year period. Accordingly, in my view, all of the requirements of the definition of tax shelter were met, all of the TIP licences that were marketed by or on behalf of TCL Trafalgar, including the TIP licence that was acquired by Mr. Baxter, were tax shelters and a tax shelter identification number should have been obtained before any of the TIP licences were sold.

Would a tax shelter identification number have assisted Mr. Baxter?

[59] It is clear that neither TCL Trafalgar nor any other promoter applied to the Minister for an identification number with respect to the TIP licences that were marketed. The consequence of my finding that the TIP licences that were marketed by or on behalf of TCL Trafalgar were tax shelters is that, by virtue of subsection 237.1(6), Mr. Baxter was precluded from claiming any deduction in respect of the acquisition cost of the TIP licence that he acquired because he was unable to provide the Minister with the prescribed form, including the identification number for the tax shelter, as required by subsection 237.1(6).

[60] It would have been a relatively simple matter for TCL Trafalgar to have obtained an identification number before the marketing of the TIP licences commenced. Indeed, as indicated in paragraph 11 of the Amended Reply to the Notice of Appeal that was filed by the Minister, in certain other computer software marketing arrangements that were undertaken in earlier years by or on behalf of the Trafalgar Group, tax shelter identification numbers were obtained. If an identification number would have been obtained in relation to the marketing of the TIP licences by or on behalf of TCL Trafalgar, Mr. Baxter may well not have been subject to the provisions of subsection 237.1(6). However, that may not have been the end of the matter. While it is not essential to my decision, I note that the existence of an identification number in relation to the TIP licences that were marketed by or on behalf of TCL Trafalgar may well have caused those TIP licences to fall within the definition of computer software tax shelter property, within the meaning of subsection 1100(20.2) of the ITR, with the result that the amount of capital cost allowance that would have been deductible to Mr. Baxter and other purchasers of those TIP licences, would have been limited, pursuant to subsection1100(20.1) of the ITR, to the amount of income from the

business in which those TIP licences were used. Whether these provisions of the ITR were a factor in the decision of TCL Trafalgar not to apply for a tax shelter identification number in respect of the TIP licences that were marketed by or on its behalf is a matter of speculation.

The Contingent Liability Issue

[61] Having reached the decision that the TIP licences that were marketed by or on behalf of TCL Trafalgar, including the TIP licence that was acquired by Mr. Baxter constituted tax shelters, it is unnecessary to deal with this issue.

DISPOSITION

[62] I would allow the appeal with costs in this Court and in the Tax Court of Canada, set aside the judgment of the Tax Court of Canada and reinstate the reassessments of Mr. Baxter for the taxation years under appeal.

"C. Michael Ryer"
J.A.

"I agree.
Robert Décary J.A."

EVANS J.A. (Concurring)

[63] I agree with my colleague, Ryer J.A., that this appeal should be allowed. I agree also with his reasons, subject to the following point concerning that element of the statutory definition of "tax

shelter" requiring that there be "statements and representations made or proposed to be made in connection with the property".

[64] The disposition of the present appeal is based on the fact that representations were made by or on behalf of the promoter to prospective investors. Whether a representation was made to Mr. Baxter himself is not material for determining on the facts of this case if the property was a "tax shelter" within the definition at section 237.1 of the ITA. I agree with this.

[65] I also agree with Ryer J.A.'s statement (at para. 36) that it is clear from the words "if a person were to acquire an interest in the property" that the definition of a tax shelter is "forward looking" and that, consequently, whether any property constitutes a "tax shelter" may be determined before an actual sale has taken place. In my opinion, the forward-looking nature of the definition of a "tax shelter" is also apparent from the reference to "statements or representations made or proposed to be made".

[66] However, my colleague says (at para. 9, for example) that a property cannot be a tax shelter unless a representation is made. In my opinion, it is not necessary to decide this question in a case where representations clearly had been made when Mr. Baxter acquired a licence. Consequently, I would not want to preclude the possibility that there may be circumstances in which property can be found to be a "tax shelter" even though representations have not been made, provided that the promoter proposes to make them.

[67] A promoter of a scheme should be able to obtain a ruling from the Minister as to whether a property is a “tax shelter” on the basis of representations which it proposes to make, even though no such representations have at that time been made. Similarly, I would not want to decide in this appeal whether or not Mr. Baxter had purchased a tax shelter if he had acquired a TIP licence on the basis of Trafalgar’s promotional materials, but before Trafalgar had actually made available to him or other prospective investors a legal opinion representing that the full purchase price of the licence was deductible over two years, provided that Trafalgar proposed to make it available.

”John M. Evans”
J.A.

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

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- and -
R. DAREN BAXTER Respondent

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CONCURRED IN BY: DÉCARY J.A.

CONCURRING REASONS BY: EVANS J.A.

DATED: APRIL 30 2007

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