Federal Court of Appeal | Cour d'appel fédérale

Date: 20220517

Docket: A-83-21

Citation: 2022 FCA 86

CORAM: **NOËL C.J.**
RENNIE J.A.
LASKIN J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

THE ESTATE OF PASQUALE PALETTA

Respondent

Heard at Toronto, Ontario, on April 4, 2022.

Judgment delivered at Ottawa, Ontario, on May 17, 2022.

REASONS FOR JUDGMENT BY: NOËL C.J.

CONCURRED IN BY: RENNIE J.A.
LASKIN J.A.

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REASONS FOR JUDGMENT

NOËL C.J.

INTRODUCTION

[1] Pasquale Paletta (Mr. Paletta) passed away a few months before his appeal to the Tax Court of Canada could be heard. The appeal was continued by his estate (the Estate) and heard over a period of eighteen days. The Tax Court *per* Spiro J. (the Tax Court) allowed the appeal.

But for Mr. Paletta's failure to include a relatively small part of the amounts in issue in one taxation year, the Estate's appeal was entirely successful.

[2] During his 2000 through 2007 taxation years, Mr. Paletta generated income from a variety of sources approximating 38 million dollars in the aggregate. Almost all of that income ($37 million) was offset by losses that he generated in the course of forward foreign exchange trading (forward FX trading) activities. The first question to be addressed in this appeal is whether the Tax Court properly held that these trading activities gave rise to a source of income in the form of a business despite having found that the trades were not made for profit. If so, the appeal cannot succeed.

[3] If not, the Court will have to decide whether the Minister of National Revenue (the Minister) could reassess the years in issue beyond the normal reassessment period pursuant to subparagraph 152(4)(*a*)(i) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act) and apply the 50% penalty pursuant to subsection 163(2) against Mr. Paletta on the basis that he was grossly negligent in representing his losses as business losses even though they were not.

[4] For the reasons that follow, I would allow the appeal, set aside the Tax Court's conclusion that Mr. Paletta's forward FX trading activities gave rise to a source of income and confirm that the Minister could reopen the taxation years in issue and apply the penalty assessed for the 2000 through 2006 taxation years.

[5] As in most cases involving elaborate tax plans, the facts are not easy to sort out. The panel is grateful to the Tax Court for its meticulous, detailed and accurate marshalling of the evidence and the crucial factual findings that were made. These have greatly facilitated our task in disposing of this appeal.

BACKGROUND

A. *The straddle transactions*

[6] At a high level, the plan involved Mr. Paletta entering into pairs of contracts with certain brokerage firms to simultaneously buy and sell the same amount of foreign currency at different but closely proximate dates in the future (value dates). As the value of currency fluctuates over time, one of the contracts would move into a gain position and the other would move into a loss position. Before the end of the taxation year, Mr. Paletta would realize the loss leg, thereby crystallizing the loss for tax purposes. The gain leg would be crystallized at the beginning of the next taxation year. Using this strategy, Mr. Paletta "straddled" the offsetting contracts by realizing a loss in the first year and the corresponding gain in the subsequent year.

[7] Mr. Paletta repeated these steps each of the years in question, in order to realize target losses in an amount sufficient to offset both the gain realized on the gain leg closed at the start of the year and his income from other sources earned during the year. This effectively allowed Mr. Paletta to defer paying tax indefinitely.

[8] Two other corporations owned or controlled by Mr. Paletta implemented the same strategy, this time generating target losses exceeding $150 million. Their respective appeals are being held in abeyance pending the outcome of the present appeal (Reasons, para. 12).

B. *The reassessments in issue*

[9] The reassessments were issued in 2014, well after the expiration of the normal reassessment period. By these reassessments, the Minister denied the trading losses claimed by Mr. Paletta for the 2000 through 2006 taxation years and assessed the 2007 taxation year, only to deny the loss carry-over of prior years' losses from these activities, while leaving the reported gain for that year untouched. Gross negligence penalties were applied for all years in which trading losses were claimed. The following table reflects the trading losses claimed and refused (Reasons, para. 13):

Taxation Year	**Claimed Losses/Gains**
2000	($6,184,460.89)
2001	($2,150,917.06)
2002	($10,007,726.00)
2003	($6,198,247.76)
2004	($4,294,300.06)
2005	($5,134,923.14)
2006	($21,236,115.40)
2007	$6,444,216.20
Total:	**($48,762,747.11)**

C. *The for-profit theory*

[10] The position of Mr. Paletta during the objection stage and of the Estate before the Tax Court was that the forward FX trading was conducted for profit and that the losses were business losses.

[11] Mr. Paletta's forward FX trades were done in pairs of offsetting forward contracts (forward-forward swaps). He also traded using a combination of options, but to the extent that he did, the options would only replicate the financial return of a forward-forward swap, albeit synthetically. In their pleadings, Mr. Paletta and the Estate after him simply took the position that the trades were made for profit. The precise contention, as revealed during the trial, was that Mr. Paletta intended to profit from the movement in the interest rate differential (*i.e.*, the difference between the interest rate payable on one currency and receivable in the other).

[12] Expert evidence was submitted in support of this idea. One of the experts who testified on behalf of the Estate acknowledged that the value dates of the legs making up Mr. Paletta's swaps were very close to one another, typically, only a few days. However, he explained that this was not unusual because Mr. Paletta traded using extremely large notional amounts (in the hundred millions of dollars, billions in the aggregate). Although the returns were very small, he explained that the extent of the returns was commercially proportional to the risk which was also very small, and opined that "trading appears to have been carried out with the intention of making a profit overall" (Rebuttal Report of Colin Knight to Expert Report of Richard Roland Poirier, subpara. 20(iv); see also paras. 20-26, 102-116, 186, 194, 242-260: Appeal Book, Vol. 16, pp. 5825-5827, 5843-5845, 5860, 5862, 5874-5877).

[13] The Tax Court rejected this theory outright. It held, based on its assessment of the evidence, including the trading pattern over the seven-year period and the fee structure, that Mr. Paletta had no intention to make profits, whether large or minimal.

[14] Specifically, the forward-forward swaps were not entered into to speculate on the interest rate differential, but rather to take advantage of the currency movements in order to create the huge losses and the corresponding gains that had to be generated in order to meet the target loss every year, while effectively hedging all currency risk. The slight economic gains and losses derived from the exposure to the interest rate differential were merely incidental and bore little connection with the gains and losses that Mr. Paletta realized for tax purposes, as evidenced by the following table (Reasons, para. 96):

Trading Cycle	Losses	Gains (Realized the Following Taxation Year)	Net Difference (Economic Profit/Loss)
2000	($5,974,460.89)	$5,974,660.32	$199.43
2001	($8,063,011.19)	$8,030,844.73	($32,166.46)
2002	($9,907,726.75)	$9,912,321.58	$4,594.82
2003	($16,011,042.22)	$16,026,804.80	$15,762.58
2004	($20,467,060.00)	$20,313,547.00	($153,513.00)
2005	($25,231,920.00)	$25,212,680.00	($19,240.00)
2006	($46,485,910.00)	$46,422,000.00	($63,910.00)
2007	($39,998,730.00)	N/A	N/A

[15] To enter into his trades, Mr. Paletta paid fees totalling $770,000, calculated as a percentage of the target loss that he communicated to his brokers for execution through his son Angelo (Reasons, paras. 70-72). In all but one year, the fees paid exceeded the economic gain or loss derived from the swap. Through the achievement of the target loss year after year, Mr. Paletta was able to claim trading losses in an amount sufficient to erase the quasi-totality of his other income (Reasons, paras. 97-100). Although Mr. Paletta decided to “show” a gain of more than $6 million in 2007, this was not inconsistent with his tax avoidance plan since he had cumulated losses from previous trading that were sufficient to offset this trading gain (Reasons, para. 98; see also para. 7, n. 3).

D. *The findings of fact*

[16] In rejecting the Estate's for-profit theory, the Tax Court made a number of findings of fact that need to be emphasized because they are crucial to the outcome of the appeal. The Tax Court found that "the sole purpose of the trading each year was the realization of the target loss for that year" and that "[e]verything, without exception, revolved around the target loss each year and its realization" (Reasons, para. 70). It further found that "no one seeking to make money would engage in the trades undertaken by Mr. Paletta" (Reasons, para. 134) and that there was no commercial or economic reason for those trades (Reasons, para. 128). The Tax Court rejected the opinion offered by Mr. Paletta's expert to the effect that the trading appears to have been carried out with the intention to make a profit "overall" (Reasons, para. 140), repeating that "the only purpose of his trading was tax avoidance" (Reasons, para. 142).

[17] The Tax Court further found that "the only trading strategy used by Mr. Paletta was one designed to ensure immediate loss realization and indefinite gain deferral for tax purposes" (Reasons, para. 143). The Tax Court also found that Mr. Paletta and his son knew from the onset the three basic elements of the plan (Reasons, paras. 101 and 263):

> 1. Before the end of the year, the loss legs of the straddle would be closed out so as to realize the target loss for the year;
>
> 2. Shortly after the start of the next taxation year, the corresponding gain legs would be closed out and realized–they both understood that those gains must be included in computing income for the next taxation year; and
>
> 3. The target loss for the next taxation year would be sufficient to shelter (a) the gains realized earlier in the taxation year and (b) the taxable income that Mr. Pat Paletta anticipated receiving in that year.
>
> (Emphasis in the original; footnote omitted)

[18] The Tax Court later added that "[t]here can be no doubt but that the straddle trading had no business purpose". Instead, "[i]ts only purpose was to allow Mr. Pat Paletta to claim non-capital losses that he could use to offset his taxable income each year" (Reasons, para. 227).

E. *The application of the law to the facts*

[19] Despite having found that Mr. Paletta did not trade for profit or for commercial reasons, the Tax Court held that his trading activities gave rise to a business. Specifically, the Tax Court found that the fact that Mr. Paletta's trading activities could at all times yield negligible gains and losses together with the fact that these activities were by their nature commercial and had no personal element, left it no choice but to hold that a source of income existed. According to the Tax Court, "*Stewart* instructs us clearly that the source analysis in such circumstances must end there" (Reasons, para. 204; referring to *Stewart v. Canada*, 2002 SCC 46, [2002] 2 S.C.R. 645 [*Stewart*]).

[20] The Tax Court added that the Supreme Court in *Walls v. Canada*, 2002 SCC 47, [2002] 2 S.C.R. 684 [*Walls SCC*] confirmed that an intent to profit was not a prerequisite in order for a business to exist when it held that Mr. Walls was engaged in a business, despite the fact that the activity in question was not undertaken for profit and was entirely devoted to the avoidance of tax (Reasons, para. 202). The Tax Court's theory that *Stewart* and *Walls SCC* could be so read was developed without the assistance of the parties as both argued their case at trial on the basis that an intent to profit had to be present before a business could be found to exist.

[21] Although the other arguments raised by the appellant (the Crown) – sham, window dressing, legally ineffective transactions – were ancillary to the source analysis, the Tax Court devoted a good part of its reasons to these issues. The Tax Court made clear that Mr. Paletta correctly represented the legal rights and obligations flowing from his forward FX trading and that the evidence did not support the Crown's contention that the documentation had been fabricated (Reasons, paras. 225 and 255). The Tax Court also relied on the decision of the Supreme Court in *Friedberg v. Canada*, [1993] 4 S.C.R. 285, 160 N.R. 312 [*Friedberg*] to hold that Mr. Paletta could use the realization method to report his trading gains and losses (Reasons, para. 191).

[22] The Tax Court then addressed whether Mr. Paletta made any misrepresentations that would warrant the reopening of statute-barred years and the application of gross negligence penalties. Given the finding that the forward FX trading activities gave rise to a source of income, the Tax Court centred its analysis on whether Mr. Paletta fully reported the gains derived from that source. It found that Mr. Paletta failed to include the gain leg of his trades in his 2002 return thereby making an $8 million understatement of income. The Tax Court went on to find that this understatement was attributable to "conduct tantamount to intentional acting" (Reasons, para. 269) and confirmed that the 2002 taxation year could be reopened in order to assess the understated amount and apply the gross negligence penalty for that year. All the reassessments were otherwise vacated.

[23] The Tax Court concluded its analysis by explaining that although this outcome was not the one it would have liked, binding precedents of the Supreme Court obliged it to reach the result that it did (Reasons, para. 271).

POSITION OF THE PARTIES

A. *The Crown*

[24] The Crown's sole contention in this appeal is that the Tax Court could not hold that Mr. Paletta's forward FX trading activities gave rise to a business given its finding that Mr. Paletta did not intend to profit from his trades. According to the Crown, the Tax Court, in confirming the existence of a business despite this finding, misconstrued binding case law, in particular the pronouncements of the Supreme Court in *Stewart*, *Walls SCC*, *Friedberg* and *Stubart Investments Ltd. v. the Queen*, [1984] 1 S.C.R. 536, 10 D.L.R. (4th) 1 [*Stubart*] (Memorandum of the Crown, paras. 26-73).

[25] The Crown submits that had the Tax Court held that Mr. Paletta's trading losses were not incurred in the course of a business, as it should have, it would then have determined whether, in claiming his losses as business losses, Mr. Paletta made a misrepresentation attributable to neglect or wilful default. The Crown asks that we examine the evidence as it pertains to this issue and make the necessary findings of fact (Memorandum of the Crown, paras. 76-77).

[26] In this respect, the Crown submits that no experienced businessperson in the position of Mr. Paletta could reasonably believe that the trading activities gave rise to a business given that

they were conducted for the sole purpose of avoiding tax. According to the Crown, Mr. Paletta's behaviour in that regard rises to the level of wilful blindness and gross negligence thereby allowing for the reassessment beyond the normal reassessment period and the application of the penalty (Memorandum of the Crown, paras. 78-98).

B. *The Estate*

[27] The Estate, for its part, accepts the Tax Court's conclusion that Mr. Paletta's trading activities were not conducted for profit. It argues, however, that the Tax Court correctly held that these activities nevertheless gave rise to a business for purposes of the Act. In this respect, it focuses on paragraph 53 of *Stewart* and stresses that an intent to profit is irrelevant in light of that decision (Memorandum of the Estate, paras. 40-45). Specifically, Mr. Paletta's trades bear the hallmarks of commerciality in that they were subject to risk, and were made in a market full of large global banks, in a manner consistent with industry norms and through regulated entities subject to oversight (Memorandum of the Estate, para. 39). Relying on the Tax Court's reading of *Stewart* and of the relevant case law, the Estate submits that this is where the analysis should end (Memorandum of the Estate, paras. 32-38 and 46-71).

[28] In the event that Mr. Paletta's trading activities did not give rise to a business, the Estate submits that Mr. Paletta acted as a reasonable person would in reporting his trading losses as business losses (Memorandum of the Estate, paras. 72-81). In this respect, the Estate refers to a series of steps taken by Mr. Paletta with the assistance of his son, Angelo, which show that he handled the issue with care and was neither neglectful nor careless (Memorandum of the Estate, paras. 82-92).

ANALYSIS

[29] As the trial unfolded before the Tax Court and the evidence was presented and appreciated, it became apparent to the Crown that the lead arguments raised in support of the reassessments -- sham, window dressing, ineffective transactions -- could not be supported, but that its alternative argument -- Mr. Paletta's forward FX trading activities did not give rise to a source of income -- could. By the time of final argument, this became the sole ground, all others being relegated to a secondary role in support of the source argument (Reasons, para. 48). Before us, the Crown's case rests exclusively on the source issue.

A. *The source issue*

[30] The concept of source of income is fundamental to the Act. There can be no taxation without income and, absent a specific rule (Division C), there can be no income without a source. Tax in turn can only be determined after income has been computed for the year. The foundational rule for the computation of income is set out in section 3. Section 3 reads in part:

3 The income of a taxpayer for a taxation year for the purposes of this Part is the taxpayer's income for the year determined by the following rules:	**3** Pour déterminer le revenu d'un contribuable pour une année d'imposition, pour l'application de la présente partie, les calculs suivants sont à effectuer :
(a) determine the total of all amounts each of which is the taxpayer's income for the year (other than a taxable capital gain from the disposition of a property) from a source inside or outside Canada, including, without restricting the generality of the foregoing, the taxpayer's income for the year from each office, employment, business and property,	**a)** le calcul du total des sommes qui constituent chacune le revenu du contribuable pour l'année (autre qu'un gain en capital imposable résultant de la disposition d'un bien) dont la source se situe au Canada ou à l'étranger, y compris, sans que soit limitée la portée générale de ce qui précède, le revenu tiré de chaque charge, emploi, entreprise et bien;

[31] Pursuant to section 9 of the Act, the income derived from a business or property source is the "profit" derived therefrom, *i.e.*: the revenues less the expenses incurred to earn them (*Russel v. Town and County Bank,* (1883), 13 App. Cas. 418 at 424, cited in *(PC) MNR v. Anaconda American Brass Ltd.*, 55 D.T.C. 1220; [1955] C.T.C. 311 (J.C.P.C.). The "loss" from a business or property is the result of the reverse equation. Because they are the reverse side of the same coin, the existence of a "profit" or "loss" for tax purposes is subject to the same conditions. In this respect, it is useful to note that no court has ever held that a "profit" or "loss" can arise under section 9 in the absence of an intent to profit, subject to the Tax Court's unique reading of *Stewart* and *Walls SCC*. Section 9 reads in part:

9 (1) Subject to this Part, a taxpayer's income for a taxation year from a business or property is the taxpayer's profit from that business or property for the year.	**9 (1)** Sous réserve des autres dispositions de la présente partie, le revenu qu'un contribuable tire d'une entreprise ou d'un bien pour une année d'imposition est le bénéfice qu'il en tire pour cette année.
(2) . . . , a taxpayer's loss for a taxation year from a business or property is the amount of the taxpayer's loss, if any, for the taxation year from that source computed by applying the provisions of this Act respecting computation of income from that source with such modifications as the circumstances require.	**(2)** […], la perte subie par un contribuable au cours d'une année d'imposition relativement à une entreprise ou à un bien est le montant de sa perte subie au cours de l'année relativement à cette entreprise ou à ce bien, calculée par l'application, avec les adaptations nécessaires, des dispositions de la présente loi afférentes au calcul du revenu tiré de cette entreprise ou de ce bien.

Unless Mr. Paletta's trading gains and losses emanate from a source in the form of a business, they do not come within section 9 and can neither be included nor deducted in the computation of his income pursuant to section 3.

i. Standard of review

[32] The outcome of this appeal turns on the Tax Court's reading of various decisions that were binding on it. Identifying the legal principles established by these decisions gives rise to questions of law with respect to which the Tax Court is entitled to no deference.

ii. Stewart and Walls SCC

[33] Despite finding that Mr. Paletta did not trade for profit, the Tax Court held that the trading losses that he claimed originated from a business. The Tax Court explained that the decisions of the Supreme Court in *Stewart* and *Walls SCC* "obliged" it to hold that the trading activities gave rise to a source of income (Reasons, para. 271). The Tax Court read these decisions as authority for the proposition that where an activity appears to be inherently commercial, it is a source of income even where the activity is not in fact carried on for commercial reasons or with a view to profit. With respect, this is not what *Stewart* and *Walls SCC* stand for.

[34] The Supreme Court in *Stewart* was focused on doing away with the reasonable expectation of profit test (the REOP test). This test originally had a specific statutory underpinning, but became, over time, a broad-based test used in all kinds of situations to determine if an activity gave rise to a source of income or whether the taxpayer is engaged in a personal endeavour, typically in the form of a hobby (*Moldowan v. The Queen* (1977), [1978] 1 S.C.R. 480, 77 D.L.R. (3d) 112). The Court was particularly concerned by the fact that, in applying this test, judges were using hindsight and often second-guessing the business acumen of

the taxpayers concerned, a role for which they were ill-equipped and no better positioned than those whose business decisions they were assessing (*Stewart*, paras. 44-47). More fundamentally, the REOP test, which has no statutory foundation as a stand-alone test of general application, had overtaken the long accepted common law definition of business which simply requires that the activity be undertaken in the pursuit of profit (*Stewart*, para. 38 citing *Smith v. Anderson* (1880), 15 Ch. D. 247 (C.A.), at p. 258; *Terminal Dock and Warehouse Co. v. M.N.R.*, [1968] 2 Ex. C.R. 78, [1968] C.T.C. 78, aff'd [1968] S.C.R. vi, 68 D.T.C. 5316).

[35] The Supreme Court therefore devised a simple two-step test focused on the pursuit of profit that had withstood the test of time remarkably well until the decision under appeal was released:

1. Is the activity of the taxpayer undertaken in the pursuit of profit, or is it a personal endeavour?

2. If it is not a personal endeavour, is the source of income a business or property?

Where the activity contains no personal element and is clearly commercial, no further inquiry is necessary (*Stewart*, para. 60).

[36] *Stewart* teaches that, in the absence of a personal or hobby element, where courts are confronted with what appears to be a clearly commercial activity and the evidence is consistent with the view that the activity is conducted for profit, they need go no further to hold that a business or property source of income exists for purposes of the Act. However, where as is the

case here, the evidence reveals that, despite the appearances of commerciality, the activity is not in fact conducted with a view to profit, a business or property source cannot be found to exist.

[37] The Tax Court read *Stewart* differently. It held that the *Stewart* test effectively did away with the pursuit of profit as a prerequisite for the existence of a business, and that as Mr. Paletta was engaged in what it viewed as a clear commercial activity with no personal element, it was bound to hold that a business existed despite the absence of any profit motive.

[38] This reading is incompatible with what the Supreme Court actually said in *Stewart*. Not only did *Stewart* not oblige the Tax Court to hold that there was a source of income in these circumstances, but it required the Tax Court to come to the opposite conclusion. In *Stewart*, the Supreme Court made it clear that the test being devised was consistent with the traditional common law definition of "business". The word "business" is given an inclusive and expansive meaning under the Act (subsection 248(1)), but is left otherwise undefined. As in such circumstances, the private law -- the common law on the facts of *Stewart* -- fills the gap, the Supreme Court explained that the *Stewart* test gave effect to the common law definition of "business" (*Stewart*, para. 51):

> Equating "source of income" with an activity undertaken "in pursuit of profit" accords with the traditional common law definition of "business", i.e., "anything which occupies the time and attention and labour of a man for the purpose of profit": *Smith, supra,* at p. 258; *Terminal Dock, supra*. . . .

[39] Yet, the Tax Court read *Stewart* as requiring it to equate "source of income" with an activity that is <u>not</u> undertaken in "pursuit of profit" and to provide for a result that conflicts, rather than accords, with the common law definition of "business". This turns *Stewart* on its

head. Contrary to what the Tax Court believed, it could not hold that Mr. Paletta was engaged in a commercial activity in the face of evidence establishing that he had no intention to profit. The objective of the *Stewart* test, which was to reaffirm "pursuit of profit" as the decisive consideration in ascertaining the existence of a business, precludes the possibility that this test could be construed so as to require the recognition of a business in the face of evidence that establishes that profits are not being pursued.

[40] Even if *Stewart* cannot be read as the Tax Court proposes, the Estate submits that the companion case to *Stewart*, *Walls SCC*, can, and indeed must. In this regard, the Estate first relies on the findings of fact made by the Federal Court at trial (at the time, the Federal Court, Trial Division) in *Walls v. R.*, [1996] 2 C.T.C. 14, 96 D.T.C. 6142 [*Walls FC*] to the effect that the activity in that case was undercapitalized and unable to produce a profit (Memorandum of the Estate, paras. 60 and 61). It submits that the Supreme Court's conclusion in *Walls SCC* that a business exists despite these findings confirms that an intention to profit is no longer an essential element.

[41] In advancing this argument, the Estate omits to point out that the trial court's findings on which it relies were made in applying the REOP test, that is through the use of hindsight, and by second-guessing the business judgment of the partners (*Walls FC*, paras. 14-16). The Supreme Court was not bound by these findings as this is the very approach that was proscribed in *Stewart*.

[42] In *Walls SCC*, the Supreme Court was illustrating the application of the *Stewart* test. The case involved the tax-motivated purchase of partnership interests in a storage park operation acquired by the partnership as a going concern. In holding that the partners were engaged in a business, the Court wrote (*Walls SCC*, para. 22):

> Although the respondents in this case were clearly motivated by tax considerations when they purchased their interests in the Partnership, this does not detract from the commercial nature of the storage park operation or its characterization as a source of income for the purposes of s. 9 of the Act. It is a well-established proposition that a tax motivation does not affect the validity of transactions for tax purposes: *Backman v. Canada*, [2001] 1 S.C.R. 367, 2001 SCC 10, at para. 22; *Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622; *Canada v. Antosko*, [1994] 2 S.C.R. 312; *Stubart Investments Ltd. v. The Queen*, [1984] 1 S.C.R. 536, at p. 540. . . .

[43] By this decision, the Supreme Court confirmed the decision of the Federal Court of Appeal (at the time, the Federal Court, Appeal Division) in *Walls v. the Queen*, [2000] 1 C.T.C. 324, 2000 D.T.C. 6025 [*Walls FCA*]. *Walls FCA* reversed *Walls FC*, applying *Tonn v. Canada*, [1996] 1 C.T.C. 205, 96 D.T.C. 6001 (F.C.A.), a decision that sets out the approach that foreshadowed the advent of the *Stewart* test. The important point made in both *Walls FCA* and *Walls SCC* is that the partnership "purchased and maintained an ongoing commercial operation" that continued to operate exactly as it had before (*Walls SCC*, para. 21; *Walls FCA*, para. 1).

[44] The purpose of the exercise in *Walls SCC* was to highlight the failings of the REOP test and show the contrasting result obtained under the *Stewart* test. Applying the *Stewart* test, the Supreme Court held that the operation was a commercial activity, a conclusion that could only be reached if the evidence was consistent with the partners' claim that they intended to profit from this activity.

[45] The Estate makes the distinct but related argument that *Walls SCC* must be read as holding that an activity that is "solely" devoted to the reduction of one's tax is a business for purpose of the Act. It makes this submission, based on its understanding of the facts in *Walls SCC* (Memorandum of the Estate, para. 62-63). This understanding appears to be predicated on the Tax Court's assertion that the activity in *Walls SCC* was "entirely tax motivated" (Reasons, paras. 201-202). I do not believe that to be the case. A closer look at the trial decision in *Walls FC* and the subsequent appeals is necessary in order to make this demonstration.

[46] Applying the REOP test, the Federal Court in *Walls FC* found that the partners had no expectation of profit and therefore were not engaged in a business. Although it could have stopped there, it went on to find that the partners were not engaged in a business on the ground that the "sole" reason for the existence of the partnership operation was to allow the partners to avoid paying taxes (*Walls FC*, para. 18). Applying the *dictum* of this Court in *Moloney v. the Queen*, [1992] 2 C.T.C. 227, 92 D.T.C. 6570 [*Moloney*], to the effect that an activity aimed at reducing one's tax cannot, by itself, give rise to a business, the Federal Court held that this was another reason for holding that the partners were not engaged in a business (*Walls FC*, para. 19).

[47] In the appeals that ensued, neither the Supreme Court nor the Federal Court of Appeal accepted the Federal Court's finding that the "sole" reason for the existence of the partnership was tax avoidance. The Supreme Court found that the activity was "clearly" tax motivated - not "exclusively" tax motivated – a qualification that left ample room for the Court's ultimate conclusion that the partners were engaged in a commercial activity and hence a business (*Walls SCC*, para. 22). Likewise, the Federal Court of Appeal previously found that the partners'

decision to invest in the storage park operation was driven “in part” by favourable tax considerations (*Walls FCA*, para. 1, as cited in *Walls SCC*, para. 16).

[48] Before concluding my analysis of *Walls SCC*, I note that the Supreme Court in that case cites its earlier decision in *Backman v. Canada*, 2001 SCC 10, [2001] 1 S.C.R. 367 [*Backman*]. *Backman* illustrates the point that activities devoted solely to the avoidance of one’s tax cannot give rise to a business under the Act. Although the case focused on whether a partnership had been validly constituted under the applicable partnership legislation, the decision is instructive because, as is the case for a business, partners must have an intent to profit in order for a partnership to exist. In *Backman*, the presumptive partnership was found not to have been validly formed because the partners did not have a view to profit. In coming to that conclusion, the Court adopted the following observation made in *Lindley & Banks on Partnership*, 17th ed. (London: Sweet & Maxwell, 1995), pp. 10 and 11 (*Backman*, para. 23):

> . . . if a partnership is formed with some other predominant motive [other than the acquisition of profit], *e.g.*, tax avoidance, but there is also a real, albeit ancillary, profit element, it may be permissible to infer that the business is being carried on "with a view of profit." If, however, it could be shown that the sole reason for the creation of a partnership was to give a particular partner the "benefit" of, say, a tax loss, when there was no contemplation in the parties' minds that a profit . . . would be derived from carrying on the relevant business, the partnership could not in any real sense be said to have been formed "with a view of profit".
>
> (My emphasis)

[49] The same logic applies here. It is also apparent, given the reasoning in *Backman*, that the Supreme Court would have found that the partnership in *Walls SCC* was not validly constituted had it been of the view that the sole reason for the partnership operation in that case was tax avoidance.

[50] In the end, *Walls SCC* establishes that a commercial activity does not cease to be a business because it is pursued with an intent to profit as well as an intent to avoid tax. It does not stand for the odd proposition that an activity devoted exclusively to the avoidance of one's tax can be a business, and hence a source of income under the Act.

iii. Moloney is the applicable precedent

[51] The Supreme Court in *Walls SCC* went on to explain why the facts in that case bore no resemblance to those in *Moloney*. In the words of the Supreme Court, the activity in *Moloney* was no more than "a circular scheme . . . set up for the sole purpose of obtaining tax refunds with no intention on the part of the taxpayer to carry on the business of marketing a speed reading course . . ." and "a sham set up to appear as though it was commercial in nature where in fact the only activity actually engaged in was that of obtaining tax refunds". The Court went on: "[h]ere, in contrast, the Partnership purchased and maintained an ongoing commercial operation" (*Walls SCC*, para. 21).

[52] As the facts in both *Moloney* and the present case show, an attempt to pass off as a business an activity that is aimed exclusively at avoiding one's tax, will always involve a form of deception because such an activity, if presented for what it is, cannot be viewed as a business.

[53] In *Moloney*, the deception took the form of a sham. In the present case, the Tax Court properly found that the forward FX trading transactions were not shams; they were real and legally effective. However, a sham is not the only way in which tax authorities can be misled. Borrowing the phrase used in *Walls SCC* to describe the activity in *Moloney*, Mr. Paletta's

activity was no less "set up to appear as though it was commercial in nature when in fact the only activity actually engaged in was that of [avoiding tax]" (*Walls SCC*, para. 21). Whether avoiding one's tax is viewed as a personal endeavour, a hobby or placed in a category of its own, it is not a commercial activity pursuant to the test set out in *Stewart*, and applied in *Walls SCC*. That said, where the sole purpose of an activity is the avoidance of one's tax, there is no reason to resort to the *Stewart* test because such an activity is irreconcilable with the existence of a business.

[54] In filing his tax returns for the years in issue, Mr. Paletta represented that he was engaged in a multi-million dollar – sometimes billion – "foreign currency trading" business, when in fact he was not (see for example the "Statement of Business Activities" in Mr. Paletta's tax return for the 2002 taxation year: Appeal Book, Vol. 9, p. 3347). He maintained throughout that he made those trades for profit. The deception was so pervasive that it was not brought to light until all the evidence was in after an eighteen-day trial and months of deliberation. I will come back to this in assessing Mr. Paletta's state of mind in filing his tax return for the years in issue.

iv. Friedberg

[55] The Tax Court pointed to *Friedberg* as the other Supreme Court decision that obliged it to hold that Mr. Paletta had a source of income despite the fact that he had no intention to profit (Reasons, paras. 10 and 271). Mr. Friedberg was engaged in the gold futures trading business. The only issue before the Supreme Court was whether Mr. Friedberg had to report his gains from that source using the mark-to-market method rather than the realization method.

[56] Mr. Friedberg's use of the realization method allowed him to decrease his tax burden by realizing the loss in the first year and the matching gain in the subsequent year, the same way Mr. Paletta did. The contention of the Crown in *Friedberg* was that the mark-to-market method of reporting provided a more accurate reflection of the profits realized from Mr. Friedberg trading activities and that, based on subsection 245(1) of the Act, as it then read, the use of the realization method had the effect of "artificially" reducing his income. The Supreme Court disagreed. It held that Mr. Friedberg reported his losses and gains when they actually occurred and that it was open to him to report his income using the method of his choice.

[57] The Tax Court found, in the present case, that Mr. Paletta "used essentially the same tax plan [as did Mr. Friedberg]" (Reasons, para. 171). Respectfully, the plan was not the same. Mr. Friedberg used the same straddle trading strategy to defer paying tax on the gains realized in the course of his trading activities, but that is where the comparison ends. Specifically, there is no suggestion that Mr. Friedberg did not intend to profit from his trading activities and that he did not have a source of income.

[58] Indeed, the evidence in *Friedberg* went the other way. As was found by the Federal Court of Appeal in disposing of the Crown's earlier appeal (*The Queen v. Friedberg*, [1992] 1 C.T.C. 1, 92 D.T.C. 6031, para. 25), Mr. Friedberg traded in gold futures "primarily to earn profits from his speculation". This finding was in no way disturbed when the Supreme Court subsequently dismissed the Crown's appeal from the decision of the Federal Court of Appeal. The Tax Court's lengthy analysis of *Friedberg* does not allude to this fundamental difference (Reasons, paras. 173-196). While the Tax Court referred to various publications that

were critical of *Friedberg* and of Parliament's failure to counter the tax base erosion concerns arising from this decision until 2017, when subsections 18(17) to 18(23) were enacted, neither *Friedberg* nor these amendments are relevant to the source issue.

[59] The Tax Court's further assertions that the Minister could not reassess Mr. Paletta's pre-2017 taxation years "as though *Friedberg* had never been decided" (Reasons, para. 196) and that "[f]or some reason, the Minister does not appear to fully accept the [*Friedberg*] decision" (Reasons, para. 185) also miss the point. *Friedberg* confirms that the straddle trading strategy can legitimately be used to reduce one's tax when the trades are made in the course of a business, but it can find no application where, as here, there is no source of income to begin with. Mr. Paletta's trading strategy was doomed to fail regardless of *Friedberg* and regardless of the amendments adopted by Parliament in 2017.

v. Stubart

[60] The Tax Court also cites *Stubart*. Although *Stubart* was mentioned in its analysis of the Crown's sham argument, the Tax Court also offered it in support for its conclusion that an activity that is entirely devoted to the avoidance of tax can be a source of income under the Act (Reasons, para. 199 read with para. 228).

[61] *Stubart* stands for the proposition that, absent a sham or a specific provision to the contrary, transactions cannot be invalidated on the ground that they are motivated in whole or in part by tax considerations (to the same effect, see *Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622, 178 D.L.R. (4th) 26, at paras. 36-46). There is, however, no authority for the proposition

that an activity that is solely motivated by the avoidance of one's tax can be regarded as a source of income under the Act. *Moloney,* which I alluded to earlier, stands for the contrary proposition and was binding on the Tax Court. With respect, the Tax Court confuses the two situations when it writes that: "[a]n absence of business purpose, however, does not mean that there was no source of income" (Reasons, para. 199). After all, tax is levied on income and it would be incoherent at the conceptual level if the avoidance of one's tax, a by-product of income, could itself become a source of income. Hugessen J.A. in *Moloney* made this crystal clear when he said at paragraph 1 of his reasons:

> While it is trite law that a taxpayer may so arrange his business as to attract the least possible tax, it is equally clear . . . that the reduction of his own tax cannot, by itself, be a taxpayer's business for purpose of the [Act].

[62] To conclude on the source issue, the Tax Court's finding that Mr. Paletta did not conduct his forward FX trading activities with a view to profit and that his sole purpose was avoiding his own tax leads to the inevitable conclusion that his trades were not commercial in nature and therefore, did not give rise to a source of income in the form of a business. It follows that the tax losses used by Mr. Paletta to offset his income from other sources were properly denied.

B. *Can the years be reopened and if so, is the penalty justified?*

[63] In order to reopen the statute-barred years, it must be shown that Mr. Paletta made a misrepresentation that is "attributable to neglect, carelessness or wilful default" (subparagraph 152(4)(*a*)(i)) and in order to justify the penalty that was levied, the Crown must demonstrate that this misrepresentation was made "knowingly, or under circumstances amounting to gross negligence" (subsection 163(2)).

[64] The Tax Court, being of the view that Mr. Paletta's trading activities gave rise to a business and were properly reported as such, did not consider whether Mr. Paletta was neglectful or grossly negligent in filing his tax returns on this basis. The Crown asks that we consider and decide this issue. The Estate does not oppose this request but argues that, on the facts, Mr. Paletta was neither negligent nor grossly negligent.

[65] Neglect under subparagraph 152(4)(*a*)(i) refers to a lack of reasonable care. The duty of reasonable care is met if the taxpayer has "thoughtfully, deliberately and carefully assesse[d] the situation and file[d] on what [he] believe[d] bona fide to be the proper method"; in other words, "in a manner that the taxpayer truly believe[d] to be correct" (*Regina Shoppers Mall Ltd. v. Canada*, [1990] 2 C.T.C. 183, 90 D.T.C. 6427 (F.C.T.D.); aff'd in *Regina Shoppers Mall Ltd. v. Canada* (1991), 126 N.R. 141, 91 D.T.C. 5101 (F.C.A.); see also *Canada v. Johnson*, 2012 FCA 253, 435 N.R. 361). This test is not disputed by the parties. The Court may also draw inferences of negligence from an omission to verify the validity of a taxpayer's belief (*Robertson v. Canada*, 2016 FCA 303, 2016 D.T.C. 5131, paras. 5 and 6).

[66] In contrast, subsection 163(2) requires that the false statement be made knowingly or in circumstances amounting to gross negligence. This burden can be met either directly or constructively, through a demonstration of wilful blindness (*Wynter v. Canada*, 2017 FCA 195, 2017 D.T.C. 5114 [*Wynter*], para. 16):

> In sum, the law will impute knowledge to a taxpayer who, in circumstances that suggest inquiry should be made, chooses not to do so. The knowledge requirement is satisfied through the choice of the taxpayer not to inquire, not through a positive finding of an intention to cheat.

[67] *Wynter* teaches that although wilful blindness and gross negligence often converge, they are conceptually different. Rennie J.A., writing for this Court, explains this difference as follows (*Wynter*, paras. 18 and 19):

> Gross negligence is distinct from wilful blindness. It arises where the taxpayer's conduct is found to fall markedly below what would be expected of a reasonable taxpayer. Simply put, if the wilfully blind taxpayer knew better, the grossly negligent taxpayer ought to have known better.
>
> Gross negligence requires a higher degree of neglect than a mere failure to take reasonable care. It is a marked or significant departure from what would be expected. It is more than carelessness or misstatements. The point is captured in the decision of this Court in *Zsoldos v. Canada (Attorney General)*, 2004 FCA 338 at para. 21, 2004 D.T.C. 6672:
>
> > In assessing the penalties for gross negligence, the Minister must prove a high degree of negligence, one that is tantamount to intentional acting or an indifference as to whether the law is complied with or not. (See *Venne v. R.* (1984), 84 D.T.C. 6247 (Fed. T.D.), at 6256.)

[68] It can be seen from this that subsection 163(2) imposes a higher threshold with the result that conduct warranting the reopening of statute-barred years pursuant to subparagraph 152(4)(*a*)(i) will not necessarily justify the imposition of a penalty under the former (see for example *Van der Steen v. The Queen*, 2019 TCC 23, 2019 D.T.C. 1024; see also *Venne v. The Queen*, 84 D.T.C. 6247, [1984] C.T.C. 223). The opposite is however true; conduct that justifies the imposition of a penalty under subsection 163(2) will necessarily meet the threshold contemplated by subparagraph 152(4)(*a*)(i).

[69] I therefore begin by asking whether Mr. Paletta, in representing that his losses were incurred in the course of a business even though they were not, acted knowingly or in circumstances attributable to gross negligence.

[70] According to the Crown, this threshold is met because Mr. Paletta was wilfully blind to the legal consequences that flowed from making this false statement. Specifically, the Crown maintains that Mr. Paletta was made aware of the need to inquire, but chose to obfuscate the issue rather than confront it.

[71] In response, the Estate advances six defences:

1. Due to his limited education and understanding of tax matters, Mr. Paletta relied on the advice of his long-standing accountants when they introduced the forward FX trading opportunity to him. He also drew comfort from his prior experience with a similar deferral strategy with his cattle inventory;

2. Mr. Paletta acted as a reasonable person would in obtaining the verbal opinion of tax experts, all of whom comforted him in his belief that his plan was sound;

3. Mr. Paletta did not require formal opinions because he put a lot of faith in the word of lawyers and because his financial exposure resulting from the forward FX trades was minimal;

4. Mr. Paletta did, in fact, obtain written legal opinions on the forward FX trading strategy throughout the course of trading; although these opinions were not addressed to him;

5. Mr. Paletta could also take comfort from the audit conducted by Canada Revenue Agency (CRA; formerly the Canada Customs Revenue Agency) in 2004, which concluded that no further action was required;

6. In any event, Mr. Paletta could reasonably believe that he had a source of income despite the fact that he did not intend to profit from his forward FX trading activities and that tax avoidance was his sole motivation, in light of the reasons of the Tax Court which agreed with this view.

[72] Before addressing these defences, it is useful to recall that from the beginning and throughout these proceedings, the position of Mr. Paletta and the Estate after him was that the forward FX trading activities were conducted for profit. The Tax Court rejected this contention outright. It held that Mr. Paletta had no intention to make profits, large or small, and that his only purpose was tax avoidance. The bottom line is that the statement that Mr. Paletta was trading "for the purpose of earning income" and Angelo Paletta's testimony that "the objective was to make income" were rejected as being contrary to the evidence (Notice of Appeal, Statement of Facts, para. 8; Amended Answer, subpara. 24(b); Transcript of the Examination-in-chief of Angelo Paletta: Appeal Book, Vol. 1 and 21, pp. 93, 148 and 7576). The Tax Court's finding on this crucial point is not challenged by the Estate.

[73] The Estate nevertheless maintains that Mr. Paletta, in presenting his trading activities as a business, acted as a reasonably prudent person would in the same circumstances. His limited education, the faith that he placed in the advice of his long-standing accountants, and the verbal advice received from the three tax lawyers with whom he consulted are said to support that view.

[74] Despite his limited formal education, Mr. Paletta had the qualities that allowed him to fully understand the plan and maximize its use (Reasons, paras. 67-69). Angelo Paletta described

his father as “a wizard with numbers” and as having “a computer brain” and the Tax Court echoed this view (Reasons, para. 265). It further found that Mr. Paletta was deeply interested in all aspects of his business, including the financial side (Reasons, para. 53) and that he and his son knew from the beginning the three basic elements of the plan, none of which was consistent with the theory that profits were being sought (Reasons, paras. 101 and 263).

[75] Stephen Wiseman and Michael Moore, respectively “relationship partner” and tax partner with Taylor Leibow, Mr. Paletta’s long-time accounting firm, brought the plan to his attention in late 1999 or early 2000. Mr. Wiseman was aware that Mr. Paletta had an interest in deferring the recognition of his income for tax purposes based on his prior use of a similar strategy with his cattle inventory. The question whether the plan was acceptable for tax purposes was discussed and Mr. Wiseman had reservations. He viewed the plan as a “new idea”, and believed that the situation was perhaps different from the one in *Friedberg* because Mr. Friedberg was involved in commodities as a dealer. He therefore recommended that Mr. Paletta get legal advice before embarking on the plan (Transcript of the Examination-in-chief of Stephen Wiseman: Appeal Book, Vol. 23, pp. 8181 and 8182).

[76] In late September 2001, Mr. Wiseman renewed his warning about the plan during a meeting with Mr. Paletta and his son. He was aware that Mr. Paletta had already spoken to a tax lawyer about the validity of his plan, subsequent to his initial advice, but “strongly recommend[ed]” that another legal opinion be obtained. Mr. Wiseman gave this advice in the presence of Mr. Moore and papered it in a letter that had annexed to it the CRA’s formal warning on the use of tax shelters (Letter dated October 5, 2011 from Stephen R. Wiseman: Appeal Book,

Vol. 11, pp. 3717-3723). This formal warning specified that the CRA will no longer issue rulings on the fundamental question whether a business exists when dealing with tax shelter arrangements, the very issue with which Mr. Paletta was confronted.

[77] Despite these warnings, Mr. Paletta and his son did not see fit to obtain a formal legal opinion. Angelo Paletta explained that the monetary exposure resulting from the plan was minimal. Rather, they relied on the verbal advice obtained during what can fairly be described as three "off the cuff" consultations with different tax lawyers while visiting law firms on other matters.

[78] The first encounter took place mid-2000 before trading started and the last in the summer or fall of 2001, after Stephen Wiseman's renewed advice to obtain another legal opinion. The Estate offers these encounters as a demonstration that Mr. Paletta acted as a reasonably prudent person would.

[79] The first tax lawyer consulted was John Tobin of Borden & Elliot LLP, in Toronto. Based on the Tax Court's account of the meeting, Mr. Tobin, after mentioning the *Friedberg* case, confirmed that the plan was legitimate. According to the Tax Court, this was the first time that Mr. Paletta and his son heard of the *Friedberg* case (Reasons, para. 62).

[80] The Tax Court's assessment of what took place during the meeting is not consistent with the evidence on this narrow point. As noted earlier, *Friedberg* had been brought to the attention of the Palettas when the plan was first presented to them (Transcript of the Cross-examination of

Stephen Wiseman: Appeal Book, Vol. 23, p. 8203). In addition, Angelo Paletta was cross-examined about the precise circumstances in which the *Friedberg* case came up during his conversation with John Tobin. This is how the exchange went (Appeal Book, Vol. 22, p. 8012):

> Q. Well, I put it to you, Sir, that you put into Mr. Tobin's head in your discussions with him that it was comparable to the Friedberg case, the trades that you were going to do, correct?
>
> A. Yes.

[81] Immediately after this exchange, Angelo Paletta was asked about the question that he put to Jack Bernstein of Aird & Berlis LLP during their verbal consultation in the summer or fall of 2001 (*ibid.*, p. 8013):

> Q. And you asked Mr. Bernstein a similar question, correct?
>
> A. Yes.

[82] The other encounter took place towards the end of 2000. Mr. Paletta and his son met with Jim Love of Love & Whalen while visiting him on other tax matters. Like Messrs. Tobin and Bernstein, Mr. Love confirmed that the plan was fine after mentioning *Friedberg* as the leading case (Reasons, para. 63).

[83] The evidence suggests that in all three cases, Mr. Paletta and his son presented the plan as not being materially different from the one that was in issue in *Friedberg*. Not surprisingly, all three lawyers expressed the view that the plan was legally sound on the basis that *Friedberg* remained good law. However, as explained earlier, the facts in *Friedberg* were fundamentally different as Mr. Friedberg was conducting his trading activities for profit whereas Mr. Paletta's sole purpose was tax avoidance. Had this fundamental difference been brought to the attention of

the tax lawyers, a discussion about the source issue and the relevant case law would necessarily have ensued and a red flag would have been waved. When regard is had to the common law definition of "business" and the binding and plain common sense rule set out in *Moloney* (see para. 61 above), no minimally competent tax lawyer could have sanctioned Mr. Paletta's plan to portray his trades as a business, if informed that he was making these trades not for profit but for the sole purpose of generating tax losses in order to avoid paying taxes.

[84] Had a formal opinion been obtained, all material facts would have been disclosed with the result that the source issue would not have gone unnoticed. Angelo Paletta's claim that the financial exposure involved in the trading did not justify obtaining a formal opinion is not rationally acceptable. The financial exposure resulting from the interest rate differential was indeed minimal, but the tax exposure resulting from the ongoing use that was to be made of the plan was in the millions of dollars at his personal level, and much more if the exposure for the two corporations that participated in the same plan is taken into account. This tax exposure had to be at the forefront of Mr. Paletta's mind since reducing his tax burden was the only reason why he traded during the seven-year period. The other explanation for not seeking a formal legal opinion -- *i.e.*, that Mr. Paletta trusted lawyers at their word or on a handshake -- is no more rational given the high risk that was flagged by his accountants as to the validity of the plan and again, the multi-million dollar tax exposure.

[85] The question that must be asked in the circumstances is why would a knowledgeable business person in the position of Mr. Paletta not cover the risk to which he was exposed by obtaining a formal opinion? The only answer that comes to mind is that Mr. Paletta was

indifferent or wilfully blind to whether his plan complied with the law or not and was content to assume the risk.

[86] The Estate also relies on various legal opinions obtained from his brokers during the course of trading. These opinions were not addressed to Mr. Paletta, and according to his son, neither he nor Mr. Paletta read them. That said, they both understood that the opinions supported their view that the plan was legally sound.

[87] The first opinion is from Fraser Milner Casgrain LLP and is addressed to a promoter of the forward FX trading strategy. The opinion was issued in December of 2002 and confirms the legal validity of the strategy. However, the opinion is given on the premise that the persons who will take up the strategy will do so "for the primary or secondary purpose of gaining and producing income" (see paras. 3.5, 4.5.9 and 4.5.10: Appeal Book, Vol. 11, pp. 3727 and 3741). As such, this opinion could have brought no comfort to Mr. Paletta. On the contrary, it points to the fundamental flaw underlying his plan.

[88] The second opinion is from Bennett Jones and is addressed to a brokerage house. It does not opine on the legal validity of the forward FX trading strategy. Rather, it signals in bold letters that its purpose is to provide rebuttal arguments in response to the legal position adopted by the CRA in challenging this strategy, as outlined in inquiry letters addressed to a number of individual investors (see p. 1 and the caveat set out at p. 6: Appeal Book, Vol. 11, pp. 3755 and 3759). This "opinion" does not purport to pronounce on the legal validity of Mr. Paletta's plan or the validity of any similar plan.

[89] The last opinion is again from Fraser Milner Casgrain LLP. It was issued in December 2004 for the benefit of one of the brokers who traded on behalf of Mr. Paletta. Paragraph 1.9 of this opinion states as an assumed fact: “the client will undertake the spread(s) primarily to earn profits from speculation but may also have an ancillary tax planning purpose in that the client may achieve a deferral of income” (Appeal Book, Vol. 11, p. 3768). Mr. Paletta does not fit that description and this again points to the fundamental flaw in the plan that he embarked upon.

[90] Lastly, the Estate maintains that Mr. Paletta took comfort from the “review for audit” of his 2002 and 2003 taxation years conducted by the CRA in 2004. This review concluded, based on the information that was available at the time, that no further action would be taken with respect to the losses generated by Mr. Paletta. However, had Mr. Paletta consulted the accountants who acted on his behalf during this review and who provided to the CRA officials the relevant working papers, he would have learned that the objective of the review was “[t]o determine if [Mr. Paletta’s] accounting for his unrealized trading losses is acceptable to the [CRA]” and that the conclusion reached after reviewing *Friedberg* was that Mr. Paletta “was accounting for his foreign currency transactions in an acceptable manner” (Audit report, p. 2 and Working Paper no. 199: Appeal Book, Vol. 12, pp. 4388 and 4407). He would also have learned that his accountants were the ones who brought the *Friedberg* decision to the attention of the CRA officials in defending their client’s tax filing position. The decision not to proceed with the audit could provide comfort to Mr. Paletta on the reporting method that he used but not on whether his trading activities could legitimately be portrayed as a business.

[91] Regardless of the five foregoing defences, the Estate relies on the reasons of the Tax Court to argue that Mr. Paletta could reasonably believe that his tax avoidance activities were a business and that he could report his losses on this basis. The Estate does not contend that Mr. Paletta actually relied on the Tax Court's opinion as it was issued *ex post facto*. Rather, the Estate argues that the question whether activities solely devoted to avoiding one's tax qualify as a business under the Act is open to interpretation in light of the Tax Court's reading of *Stewart* and *Walls SCC*. I disagree. The Tax Court's reasons on this point are not only incorrect, they are implausible. As the above analysis shows, the decisions of the Supreme Court do not suggest that avoiding one's tax can be a business under the Act, and the Tax Court's reasons, errant as they are on this point, do not provide a basis for excusing Mr. Paletta's behaviour.

[92] Mr. Paletta and his son were warned that the tax shelter plan they were contemplating could be problematic. Both knew from the beginning that the sole purpose behind the plan was tax avoidance. Rather than addressing the risk head on by obtaining a formal legal opinion, Mr. Paletta chose to ignore it. This behaviour shows at the very least that Mr. Paletta was indifferent or wilfully blind to the legal validity of his plan and that he was only concerned about fulfilling his desire to pay no tax.

[93] The Crown has succeeded in demonstrating that Mr. Paletta was grossly negligent in portraying his trading losses as business losses even though they were not. I therefore find that the penalty set out in subsection 163(2) of the Act was properly assessed.

[94] It follows that the test set out in subparagraph 152(4)(*a*)(i) was also met, and that the Minister validly reopened the seven taxation years in issue.

DISPOSITION

[95] For the above reasons, I would allow the appeal with costs, here and below, set aside the decision of the Tax Court, and refer the reassessments back to the Minister for reconsideration and reassessment on the basis that Mr. Paletta's trading gains and losses are not to be recognized in the computation of his income for the 2000 through 2007 taxation years and that the gross negligence penalties are to be applied for the 2000 through 2006 taxation years.

"Marc Noël"
Chief Justice

"I agree.
Donald J. Rennie J.A."

"I agree.
J.B. Laskin J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-83-21

APPEAL FROM A JUDGMENT OF THE HONOURABLE JUSTICE DAVID E. SPIRO DATED MARCH 25, 2021, DOCKET NO. 2015-2662(IT)G

STYLE OF CAUSE:	HER MAJESTY THE QUEEN v. THE ESTATE OF PASQUALE PALETTA
PLACE OF HEARING:	TORONTO, ONTARIO
DATE OF HEARING:	APRIL 4, 2022
REASONS FOR JUDGMENT BY:	NOËL C.J.
CONCURRED IN BY:	RENNIE J.A. LASKIN J.A.
DATED:	MAY 17, 2022

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