Docket: 2004-4455(IT)G

BETWEEN:

JOHN D. MCKELLAR,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on March 12 and 13, 2007 at Toronto, Ontario

Before: The Honourable Justice E. Rossiter

Appearances:

Counsel for the Appellant:	Barry S. Wortzman Gaynor Roger
Counsel for the Respondent:	Margaret J. Nott

JUDGMENT

The appeal from the reassessments made under the *Income Tax Act* for the 1992, 1993 and 1994 taxation years are allowed with costs and the reassessments are referred back to the Minister for reconsideration and reassessment in accordance with the attached Reasons for Judgment.

Signed at Vancouver, British Columbia, this 17th day of May, 2007.

"E. P. Rossiter"

Rossiter, J.

Citation: 2007TCC266
Date: 20070517
Docket: 2004-4455(IT)G

BETWEEN:

JOHN D. MCKELLAR,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Rossiter, J.

Issue

[1] The issue before this Court is whether it can be said that the Appellant acted reasonably in claiming partnership losses he incurred in a Bahamian partnership known as The Group of Eighteen ("Partnership") in 1992, 1993 and 1994 respective tax years or, put another way, whether the Appellant in claiming the Partnership losses for his share of the Partnership in 1992, 1993 and 1994 income tax years, exercised care that would have been exercised by a wise and prudent person.

Facts

[2] This case was preceded by *Bernick v. R.*, [2003] 4 C.T.C. 2494 affirmed in part [2004] 3 C.T.C. 191 (F.C.A.) where Miller, J. discussed in detail the factual background. During 1992, 1993 and 1994, the Appellant was a partner in the Partnership which was made up of 1,800 partnership units – 1620 held by a Mr. Bernick and the balance held by 7 other partners including the Appellant who held 36 units. The Partnership owned certain securities being a British Gas International Finance Zero Coupon Bond with maturity value of $7.5 million U.S. ("U.K. Bond") and several Japanese Fire and Marine Insurance Convertible Bonds with a maturity value of 147 million Yen ("Fire and Marine Bonds"). The ¨Partnership" disposed of the U.K. Bond and the Marine & Fire Bonds (collectively the "Bonds") over the three years in question and claimed losses of $2,264,770 U.S.,

$2,366,331 U.S. and $1,706,529 U.S. respectively. The market value of a zero coupon bond before its maturity date is apparently less than its value at maturity because it cannot yield a return to the purchaser unless it is purchased at a discount. The market value of the UK Bonds in early September 1992 was 9.34% of its maturity value, or US $700,500 and the market value of all the Bonds acquired was approximately US $1,800,000 or $1,000 per partnership unit outstanding. The losses were based on an initial cost expressed and calculated on the basis of the maturity value of the Bonds on the Partnership Financial Statements; the Bonds were shown as having a cost value equal to the maturity value. These losses were divided up proportionally among The Group of Eighteen individual partners. The amount of losses attributable to the Appellant in 1992 was $54,772 (Cdn); in 1993 $72,499 (Cdn); and in 1994 $34,425 (Cdn). The Appellant claimed these losses in his individual tax returns for 1992, 1993 and 1994 and received an assessment from the Respondent accordingly.

[3] After the *Bernick* decision the Respondent conducted an audit of the Appellant and did a reassessment of his 1992, 1993 and 1994 taxation years. The Appellant filed a Notice of Objection and ultimately a Notice of Appeal which now comes before this Court.

[4] The reassessment of the Appellant by the Respondent was statute barred and the Respondent now seeks to rely upon the exception in subsections 152(4) and 152(4.01) of the *Income Tax Act* ("*Act*").

[5] Mr. Graeme Jones, a Canadian Chartered Accountant and also a partner in the Partnership and holder of 36 units, provided an audit opinion that the 'financial statements present fairly, in all material respects, the financial position of the Partnership as at December 31, 1992 and the results of its operations and the changes in its financial position for the period then ended in accordance with generally accepted accounting principles'. Mr. Jones provided to each of the partners the reported Partnership losses which related to them individually and which could be offset against other incomes. The Appellant claimed his share of the reported Partnership losses.

[6] The Appellant gave evidence on his own behalf. His evidence concentrated mainly on his law practice, his experience as a lawyer involved in financial matters and how he came to be an owner of units in the Partnership.

[7] The Appellant had been called to the Bar of Ontario in 1959 achieving Queens Counsel in 1973. He was a partner in a law firm in Toronto known as Weir

& Foulds, LLP, from 1965 to 2004 and indeed was Chairman of the firm for many years. He was associated with the firm on a contract basis from 2004 to the date of trial.

[8] In terms of the Appellant's law practice, his knowledge of financial matters and exposure to corporations and financial statements, much of this information came forth through cross-examination by the Respondent's counsel.

[9] The nature of the law practice of the Appellant was basically described as a solicitor's practice with an emphasis on leasing, real-estate, some wills and estates, estate planning and some corporate including legal work for charities but he was not a specialist in tax. The Appellant did some general corporate law such as providing advice in the buying and selling of assets; corporate resolutions; commercial leasing; corporate governance; entrepreneur business law; questions of risk obligations and environmental. He acknowledged that he did know a little about tax and he had no background or experience in accounting however he was able to generally understand financial statements. He did provide some tax advice when dealing with the issue of buying or selling shares or assets and he did provide some tax information when doing estate planning but he usually referred the client to a tax specialist whether it be legal or accounting. He testified that his own firm did not have a tax specialist. He testified that he annually prepared his own income tax returns.

[10] As Chairman of Weir & Foulds he was not responsible for signing off on Financial Statements for the practice each year but he may have signed them for bank purposes - he certainly did not approve the statements. He described the Financial Statements of the law firm as basically "cut and dry" – the Financial Statements were shown to all the partners. He did not remember the presentation of the Financial Statements to the Partnership meetings.

[11] The Appellant had extensive experience as a member of Boards of Director of corporations including chairperson whether they be charitable corporations or otherwise. He described his duties and responsibilities as a Director to basically include the purchase of assets, deal with issues of employees, dividends, future direction of the company, current government issues and receive financial statements, have the financial statements discussed and if any questions, present those questions to the appropriate individuals, whether it be the auditor or the appropriate vice-president within the company. The duties as a director with respect to a charity were not unlike that of being a director of a corporation.

[12] The Appellant testified he had given speeches/lectures to various law organizations/associations including the Canadian Tax Foundation where he spoke on amendments to the *Income Tax Act* as they related to charities and how they would affect the general practitioner but he did not recall the specific amendments. He also gave legal advice to the Canadian Tax Foundation on their own charitable registration and how they should obtain it. The tenor of the Appellant's evidence was that he was a corporate counsel familiar with corporate Financial Statements and the nuances of same and with the duties and obligations of Directors of corporations.

[13] In terms of the establishment of the Partnership, the Appellant testified that he had known Mr. Bernick for about 30 years in a professional relationship. He had acted for him in a number of real estate matters and provided him with advice in wills and estates. Mr. Bernick had described to him his wish to invest in a long term international bonds off-shore and asked the Appellant if he had any connections in the Bahamas. The Appellant advised him he knew a Bahamian lawyer Mr. E.P. Toothe whom he considered to be a fair and reasonable person and he suggested that Mr. Bernick use Mr. Toothe. The Appellant followed up with contact with Mr. Toothe and told him about Mr. Bernick asking him to look after Mr. Bernick directly. He believed Mr. Toothe had called Mr. Bernick directly. The Appellant was not involved with the exchange between them or specifically with the Partnership. Mr. Toothe eventually became operations manager for the Partnership.

[14] The Appellant testified that he became an investor of the Partnership at the request of Mr. Bernick. Mr. Bernick thought it was a good investment and the Appellant felt that Mr. Bernick would be hurt if he did not invest because he was his lawyer for many years and the Appellant felt, knowing Mr. Bernick, that there was little risk and some gain. He was not involved in the day to day operation of the Partnership. The whole investment was based on his trust in Mr. Bernick – he felt Mr. Bernick was an astute investor. His only concern was that Mr. Bernick thought these long term bonds were good investments. He himself did not do any research into the assets or what covenants there may or may not have been or if they were long term bonds. The Appellant had known that Mr. Bernick and another person close to Mr. Bernick were making a similar investment so he relied upon his long term standing relationship with Mr. Bernick as well as Mr. Bernick's long standing knowledge of the bond market. He thought it was a fair price for him to pay for the units, it was a fair price given the risk involved and the prospect for profit.

[15] The Appellant testified that when he became a partner he acquired approximately 36 units (out of a total of 1800 units) at a $1,000 each for a total of $36,000. His interests later were expressed in terms of 2% in 1992 but then were

reduced to 1.3889% in 1994. When he became a partner in the Partnership he made suggestions with respect to the terms of the Partnership agreement documentation, method of closing, the actual closing of the transaction and a variety of resolutions. The bill to the Partnership by the Appellant's firm and the docket entries of the Appellant in relation to the bill were introduced into evidence.

[16] The Appellant testified he was not involved in the preparation of the financial statements. He testified they were completed by Mr. Jones. He said he knew Mr. Jones previously and dealt with him for many years and knew him to be a knowledgeable tax accountant in Toronto, Ontario. He received the Financial Statements of the Partnership and the statement of losses each year as prepared annually by Mr. Jones. He did not really understand how the losses were calculated but he assumed the total loss of the Partnership was allocated as per the units. He had spoken to Mr. Jones about the losses and it seemed he could claim in excess of his investment in terms of losses. Mr. Jones said it was "okay" to claim the losses for Canadian income tax purposes but it really was a tax deferral. As far as the Appellant could determine the Canadian losses were fine as Mr. Jones had given an unqualified report in his audit on the Partnership in each of the three years, 1992, 1993 and 1994. Mr. Jones prepared supplementary documents in terms of loss statements and advised the Appellant that the losses were the result of the difference in treatment between partners buying partnership interest in a partnership and the partnership buying assets. The Appellant did not ask Mr. Jones for his comments in writing; he did not put anything in writing to Mr. Jones; and Mr. Jones, in turn, did not present anything in writing to the Appellant. The Appellant said he felt he was very satisfied with the result because it lowered his taxes and that he did not know what the Partnership paid for the Bonds. The Appellant said that all he was interested in was what he would have to pay tax on, what the Partnership did or did not do was really of minor interest to him.

[17] As to what other steps the Appellant took when he was presented with the Partnership Balance Sheet, the Appellant did not ask Mr. Jones what was meant by the phrase "at cost". He assumed it was the purchase price of the units. He did remember discussing the difference between "at cost" and "maturity value" of the Bonds. He did believe he spoke to Mr. Bernick about it and Mr. Bernick said that this was the way things were done and all was satisfactory. He acknowledged that he received his investment of $36,000 U.S. back within 1 year after he made the investment in September 1993 and received an additional $8,000 U.S. in July 1994. He testified he had acted reasonably and he had no intention of misleading CRA. He testified he did not keep formal copies of his income tax returns as filed but he did keep his working papers for 1992 and 1993 and he prepared similar working papers

in 1994 but he could not locate them. He did not believe he included the Partnership Financial Statements with his income tax returns as provided by Mr. Jones of 1992, 1993 and 1994 but he did believe he did include a statement of losses for each year.

[18] Mr. Jones was called to give evidence by the Respondent. He said he was asked by Mr. Toothe as to whether he would conduct an audit of the Partnership. The Financial Statements were actually prepared by Mr. Toothe as per the partnership agreement for the Partnership and they were given to Mr. Jones with some documents to support the transactions for each period in question. Mr. Jones testified that he conducted an audit for the 1992, 1993 and 1994 taxation years. Mr. Jones confirmed that as part of the audit he gave an unqualified opinion in each particular year that the Financial Statements fairly presented the financial information relative to the Partnership and that he was satisfied that he was able to express his unqualified opinion. It was Mr. Jones' opinion that it was appropriate to use those losses generated on the Bonds sales using Bahamian GAAP for Canadian tax calculations.

[19] In describing how he became involved as an investor in the Partnership, Mr. Jones testified that he was contacted by Mr. Bernick who said that there may be an investment opportunity with a good return. He looked at the statement done by Mr. Toothe as to the inventory in investments and he decided to join the Partnership at the time because he knew Mr. Bernick had lots of expertise in this type of security and it looked like a good investment. He did not realize what the profit could be until he saw Mr. Toothe's Financial Statement in 1992. In the Financial Statements the purchase price for the units were certainly less than their market value or the inventory shown at cost and on realization of these securities there would be a profit. The cost figure related to the maturity value of the bonds. When he reviewed the Financial Statements he asked Mr. Toothe if the statements were prepared in accordance with GAAP. Mr. Toothe said these were done by a Mr. Darryl Butler in the Bahamas who followed the Bahamian GAAP. Mr. Toothe had told him that he (Mr. Toothe) had spoken to Mr. Butler and Mr. Toothe was told that the GAAP in the Bahamas allowed the Partnership to use maturity value as the cost. He never contacted Mr. Butler.

[20] Mr. Jones testified that a loss was suffered given how the bonds were shown on the books because Bahamian GAAP used the maturity value for cost purposes.

[21] Although Mr. Jones did not specifically recall having discussions with Mr. McKellar or other partners after they received their respective statement of losses, he was not in the position to dispute anything that Mr. McKellar had

testified to in this regard. In particular he was not in a position to dispute the advice that was suggested by Mr. McKellar that Mr. McKellar had received from him, to the effect that it was correct to use the Financial Statements in calculating Canadian tax income, and this would have been the type of advice which he would have given at the time if he had been asked. He testified it would have been fair and reasonable for the partners to rely upon his statement of losses that he had prepared.

Analysis

[22] Subsection 152(4) of the *Act* states in part as follows:

> Assessment and reassessment. The Minister may at any time make a ... reassessment ... of tax for a taxation year ... except that a ... reassessment ... may be made after the taxpayer's normal reassessment period in respect of the year only if
>
> (a) the taxpayer ....
>
> (i) has made any misrepresentation that is attributable to neglect carelessness or wilful default or has committed any fraud in filing the return ...

[23] Subsection 152(4.01) of the *Act* states in part as follows:

> **Assessment to which par. 152(4)(a) ... applies.** Notwithstanding subsection (4) ..., an ... reassessment ... to which paragraph (4)(*a*) ... applies in respect of a taxpayer for a taxation year may be made after the taxpayer's normal reassessment period in respect of the year to the extent that, but only to the extent that, it can reasonably be regarded as relating to,
>
> (a) where paragraph (4)(*a*) applies to the ... reassessment,
> (i) any misrepresentation made by the taxpayer ... that is attributable to neglect, carelessness or wilful default or any fraud committed by the taxpayer ...

[24] Here there is no issue with respect to whether or not a misrepresentation occurred. The misrepresentation was effectively admitted by the Appellant. The only issue is whether or not the misrepresentation is attributable to neglect or carelessness by the Appellant as described in section 152(4.01) of the *Act*. There is no allegation of wilful default or fraud.

[25] In considering section 152(4.01) the burden rests upon the Respondent on the balance of probabilities to establish that the misrepresentation by the Appellant was

attributable to the Appellant's neglect or carelessness. In *Fukushima v. R.*, [1999] 2 C.T.C. 2312, (T.C.C.), Sarchuk, J. stated:

> [16] The Minister is required to prove at a minimum that an error has been made by the taxpayer and while it may have been made in good faith, it was nevertheless not one which a normally wise and cautious taxpayer would have committed. This principle must be considered in the context of the taxpayer's experience with accounting and tax matters and capacity to fully understand the details of a provision of the *Act*. ...

[26] Bonner, J. in *Jencik v. Canada*, [2004] T.C.J. No. 202 (T.C.C.) stated:

> [5] ... The Minister's right to reassess for 1994 to 1998 (the "statute barred years") was therefore dependant on the Appellant having made misrepresentations attributable to neglect, carelessness or wilful default or having committed fraud as set out in subparagraph 152(4)(*a*)(i) of the *Act*. It is settled law that the onus is on the Respondent to establish that such misrepresentations were made.
>
> ...
>
> [11] The well-known rule *Johnston v. M.N.R.*,]1948] S.C.R. 186 which places on the taxpayer the onus of establishing that facts as found or assumed or assessment are incorrect does not apply in appeals from statute-barred reassessments unless the Minister first establishes facts which show that he was entitled to reassess when he did.
>
> [12] ... The onus which rested on the Minister included proof of the factual elements of that premise.
>
> [13] I should add that the onus encompasses not only proof of the falsity of the Appellant's representations regarding his business income but also proof that they were attributable to neglect, carelessness or wilful default as pleaded.

[27] The applicable test or what must be proven has been discussed on a number of occasions.

[28] In *Canada v. Regina Shoppers Mall Ltd.*, [1991] F.C.J. No. 52 (F.C.A.), MacGuigan, J. stated in part:

> ...
>
> Where the Act is unclear, or the characterization of the facts doubtful, the Trial Judge correctly stated that "the care exercised must be that of a wise and prudent

> person and ... the report must be made in a manner that the taxpayer truly believes to be correct."

[29] Further, expressed in another way by Lamarre, J. in *Petric v. Canada*, [2006] T.C.J. No. 230 (T.C.C.) stated:

> 40 ... However, where the issue is whether the Minister should be allowed the benefit of an exception to the application of the limitation period, it must be shown that the taxpayer made a misrepresentation in filing his or its tax return. In the case at bar, I am of the view that unless it can be said that the appellants' view of fair market value was so unreasonable that it could not have been honestly held, there was no real misstatement.

[30] Finally, Rip, J. (as he then was) in *Markakis v. The Minister of National Revenue,* 86 DTC 1237 (T.C.C.) stated in part at page 1238 as follows:

> ... Therefore, the notices of reassessment for these years can only stand if the Minister first can establish that Mr. Markakis has made a misrepresentation in each of the three years that is attributable to neglect, carelessness or wilful default or committed a fraud in filing his return for the year or in supplying any information under the *Act* ...

Rip, J. continued at page 1240:

> To assess beyond the four-year limit as set out in subsection 152(4) the Minister must establish a taxpayer made a misrepresentation that is attributable to neglect, carelessness or wilful default, or that the taxpayer committed a fraud in filing his income tax return. It is not enough to suggest a misrepresentation or fraud. The Minister's evidence was not sufficient to meet his onus under subsection 152(4) and consequently I must find that Mr. Markakis cannot be said to have made a misrepresentation in 1976.

[31] Given that there was a misrepresentation by the Appellant, the question is whether this representation was attributable to the Appellant due to the Appellant’s carelessness or neglect. The evidence is clear what the Appellant did or did not do in the course of claiming these tax losses. The Appellant did his own income tax annually. The Appellant made his investment at the request of a client Mr. Bernick, in whom he had confidence in terms of his investment strategies and whom he had known for many years. He looked at the investment and felt it was a reasonable investment and he felt he could make a reasonable return. He was not involved in the management of the Partnership; he only looked at some of the legal issues when the Partnership was originally formed.

[32] After the first year when the 1992 Financial Statements were made available to the Appellant, he noted that they were given what is known as a "clean audit"- that there is an unqualified opinion provided by a Chartered Accountant, Mr. Graeme Jones, a person whom the Appellant knew professionally for many years and whom he described as a well versed tax accountant in Toronto, Ontario. According to the Appellant, he specifically questioned Mr. Jones on the propriety of the losses. Mr. Jones provided to the Appellant not only the Financial Statements with an unqualified opinion but also Mr. McKellar's specific statement of losses which he could use in the particular tax year. Mr. McKellar inquired of Mr. Jones about the basic propriety of these losses and was reassured they were appropriate according to the opinion of Mr. Jones. He also made similar inquiries to the person who was the back-bone of the entire Partnership, Mr. Bernick, and he received additional assurances.

[33] What would a wise and prudent person have otherwise done? I am of the view that the Appellant's course of conduct herein is consistent with that of a wise and prudent investor. He consulted a Professional. He consulted with persons whose expertise and opinions he respected. The burden upon the Respondent was not discharged; the Respondent has not established on the balance of probabilities that a wise and prudent person, on the facts of this particular case would have done anything other than what Mr. McKellar had done. If Mr. McKellar did not consult a Chartered Accountant or a tax professional or did not at least take the step of consulting someone who knew their way around these types of investments such as Mr. Bernick, then the burden would have been likely discharged. However Mr. McKellar took these steps, *albeit*, he consulted with someone who had as much to lose as he did, who had a vested interest in the investments because they held the same number of shares as he did, but then again, that person had as much to lose as he did on the investment by giving improper tax advice. As it turned out he (Mr. Jones) did lose as much as the Appellant as per his own evidence.

[34] Of particular importance in this particular case is the evidence of Mr. Jones. He was the only witness called by the Respondent and relied upon to assist the Respondent in discharging the burden coupled with the cross-examination of the Appellant. Mr. Jones gave evidence which did not help the Respondent in any manner whatsoever in discharging the burden.

[35] The cross-examination of Mr. Jones by the Appellant's counsel basically slammed the door shut on the Respondent discharging the burden the Respondent carried. Mr. Jones confirmed the evidence of the Appellant in terms of:

a) preparation of the Partnership Financial Statements;

b) preparation of the individual statement of losses for each of the partners;

c) how the losses occurred in terms of using *Bahamian GAAP* vs. *Canadian GAAP*;

d) advice he provided or would have provided to each of the partners on claiming the losses of individual tax returns;

e) his own unqualified audited opinion of the Partnership Financial Statements in each of the three years, 1992, 1993 and 1994.

[36] In many ways the Appellant was a very good witness for his own cause. He was succinct and to the point; he appeared knowledgeable in many areas; he was also a very smooth witness however, his presentation in many aspects, was not impressive to me.

[37] The Appellant only answered the specific question when it was presented without expansion and tried to narrow down the question by asking questions of counsel of the Respondent. The Appellant remained very much in control during the entire time giving his evidence. When he appeared to want to, he was vague and not sure of certain things and he avoided giving direct answers when direct answers were required. The Appellant would not even admit to the obvious comment - $1,800,000 was paid for 1800 units of the Partnership when the units were priced at a $1,000. When asked as to whether or not the cost referred to the maturity value he stated – "I still don't know the cost". This is what the whole case is about. This is what the litigation has been about for years and indeed what was litigated in *Bernick supra* at both the trial and on the appeal. There are certain aspects of the Appellant's evidence which did not ring true; there were certain aspects in which the Appellant was avoiding the obvious; there are certain aspects of the Appellant's evidence in which he tried to play down his business acumen. The Appellant was obviously a very senior corporate counsel in Toronto, Ontario, with a very significant practice, which would have involved a sufficient knowledge of reading and reviewing Financial Statements that he would understand the implications of or at least be aware if there was an issue in relation to how the losses were presented in the Financial Statements of the Partnership. However, he did take those steps which a wise and prudent person would do. I think Mr. McKellar did what he had to do in order to appear that he was not careless and

neglectful. I find the Appellant's conduct was such that he was not careless and not neglectful. As a result of the foregoing, notwithstanding my concerns with respect to some of the manner in which the Appellant gave evidence, I find the Respondent has failed to discharge the burden**.** This burden was certainly an onerous burden given the age and circumstances of this case but it might have been discharged if Mr. Bernick, Mr. Toothe and/or Mr. Butler had been called to give evidence to explain the strategies behind the investment, the preparation of the Financial Statements, the accounting advice sought and given, and the communications between/amongst themselves including the Appellant in terms of the losses incurred by the Partnership claimed by the Appellant.

[38] In any event I find the Respondent has failed to discharge the burden. The exception under subsection 152(4.01) of the *Act* is not available to the Respondent in the case at bar. The appeal is allowed with costs in favour of the Appellant.

Signed at Vancouver, British Columbia, this 17th day of May, 2007.

"E. P. Rossiter"

Rossiter, J.

CITATION:	2007TCC266
COURT FILE NO.:	2004-4455(IT)G
STYLE OF CAUSE:	JOHN D. MCKELLAR AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	March 12, 2007
REASONS FOR JUDGMENT BY:	The Honourable Justice Eugene Rossiter
DATE OF JUDGMENT:	May 17, 2007

APPEARANCES:

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