Docket: 2011-477(IT)I

BETWEEN:

PAUL HESS,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard and Reasons for Judgment delivered from the Bench
on July 15, 2011 at Winnipeg, Manitoba

Before: The Honourable Justice J.E. Hershfield

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Larissa Benham

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* for the 2002, 2003, 2004, 2005 and 2006 taxation years are allowed, without costs, and the assessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that, and for the reasons set out in the attached Reasons for Judgment, the Appellant was not required to file an information return form T1142 for any of those years.

Signed at Ottawa, Canada this 22nd day of July 2011.

"J.E. Hershfield"

Hershfield J.

Citation: 2011 TCC 360
Date: 20110722
Docket: 2011-477(IT)I

BETWEEN:

PAUL HESS,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT
(Edited from Reasons Delivered from the Bench on July 15, 2011 at Winnipeg, Manitoba)

Hershfield J.

[1] The Appellant received income distributions from a U.S. resident trust that arose from the Last Will and Testament of his great uncle. That is, he was an income beneficiary of a non-resident testamentary trust. The Appellant was assessed penalties for failure to timely file an information return form T1142 in respect of each of his 2002, 2003, 2004, 2005 and 2006 taxation years.

[2] The distributions in Canadian funds were as follows:

- $34,797 in 2002
- $18,728 in 2003
- $18,835 in 2004
- $24,114 in 2005
- $16,575 in 2006

[3] The Appellant did not file income tax returns for any of these years until demands to file were made in respect of his 2005 and 2006 years. The demand to file an income tax return for the 2005 year was issued in June 2008 and for 2006 it was issued in March 2008.

[4] Returns were filed for 2002, 2003 and 2004 on April 15, 2008 even though no demands to file were made in respect of these years.

[5] With respect to the 2005 and 2006 years, returns were filed in July 2008. That is, the return for 2005 was filed approximately one month after the demand was made and for 2006 the return was filed approximately three months after the demand was made. No evidence was offered as to the times stipulated in such demands that returns were required to be filed. Respondent's counsel did not dispute that the returns for those years were filed within a reasonable time after the demands were made. No late filing penalties were assessed in respect of general T1 returns for any of the subject years even those in respect of which demands were made. There was no tax payable in respect of any of the subject years. But for the demands there was no requirement to file Part I returns pursuant to subparagraph 150(1.1) of the *Income Tax Act* (the "*Act*").[1]

[6] The Appellant, a visual artist and a university art professor, testified that between 2002 and 2004 he suffered a detached retina that required several surgical procedures during that period and that resulted in his having to take two leaves of absence from the university. The recovery period from the various surgeries was protracted going into 2005 and 2006 and it included periods where he suffered a loss of vision of up to 85% in one eye. Although I gather that his vision was substantially restored, the problem resulted in his having to change the nature of his professional artistic endeavours and his teaching. His personal issues were compounded by a theft at his art studio and a serious car accident, both occurring during this difficult period.

[7] Still, well before the demands for returns were made, he had gathered his income tax information for all of the subject years and delivered them to his accountant for processing and filing. His accountant, however, sat on such

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[1] The Reply to the Notice of Appeal erroneously states that the Appellant did not file income tax returns for each of the subject years as and when required pursuant to paragraph 150(1)(d) of the *Act*.

materials for some period and the returns were not filed until after the demands were made.

[8] Shortly after filing the returns the Minister of National Revenue (the "Minister") assessed penalties under subsection 162(7) of the *Act*. That section imposes a penalty for failure to file a required information return on time.

[9] As noted, the information return in question here is not the T1 return but rather the T1142 information return form required to be filed pursuant to section 233.6 of the *Act*. That section sets out that a specified Canadian entity (defined by subsection 233.3(1)) must file a prescribed form on the entity's filing-due date for the particular year where the entity is beneficially interested in a non-resident trust in the year and received a distribution of property from that trust.

[10] If the prescribed form required in section 233.6 is not filed by the entity's filing-due date for the particular year, the late filing penalty under subsection 162(7) is $25 a day for each day that the prescribed form is late to a maximum of 100 days. The Minister calculated the penalty as being the maximum amount for each of the years in question on the basis that the filing-due date was June 15 of the year following each taxation year in question as determined under subsection 150(1). The forms were not filed at that time but rather were filed later with the T1 returns which themselves were not late filed.

[11] At this point, I note that considerable time was spent at the hearing trying to determine the nature of the trust. Based on the evidence, I concluded that the trust was formed in the United States as a consequence of the death of the Appellant's great uncle who lived in the United States. It was administered in the United States by a U.S. trustee. It was not a discretionary trust. There was a fixed invested capital amount of the estate that gave rise to income and it was the income that was required to be distributed to the income beneficiary each year.

[12] As well, I note that while there is no question that the subject non-resident trust is a testamentary trust, there is no basis to necessarily conclude that the trust was not an estate. The assumptions in the Reply to the Notice of Appeal ("Reply") are that the trust was an ongoing testamentary trust. That assumption stands unshaken and, in any event, I am satisfied that it was indeed, a testamentary trust. However, I note that a testamentary trust as defined in subsection 108(1) of the

Act[2] means a trust *or estate* that arose on and as a consequence of the death of an individual. That is to say, an assumption that a trust is a testamentary trust does not preclude such trust from being part of the estate of the Appellant's deceased great uncle. Further, there is nothing in the assumptions that would direct me to believe that there was an assumption made by the Minister which paralleled the assumption of counsel for the Respondent. The assertion or assumption of counsel for the Respondent was that the estate had been wound up and that the testamentary trust was not an estate but was rather something else. The assumptions in the Reply, however, only state that distributions were first being made to the Appellant's father and on his father's death the distributions continued to be paid to him in accordance with the terms of the testamentary trust. There is no assumption that the estate had been wound up or that the testamentary trust was a distinct trust administered separate and apart from the estate by, say, for example, being administered by trustees that were not executors.

Analysis

[13] These appeals presented several problems. Since neither the terms of the Appellant's great uncle's will nor the status of his great uncle's estate are in evidence, it is difficult to determine the status of the trust. As I said, there is no assumption made regarding the status of the Appellant's great uncle's estate. I find then that the Respondent should not be able to rely on the argument that the assumed testamentary trust in question is not an estate. As such the subject testamentary trust should be allowed the benefit of the exemption afforded to an estate pursuant to section 233.6 of the *Act* and is accordingly exempt from the filing requirement in that section. Subsection 233.6(1) specifically provides that the Appellant, as a specified Canadian entity who received a distribution from a non-resident trust in which he was beneficially interested, only need file the subject form if the non-resident trust is;

> … (other than a trust that was an excluded trust in respect of the year or period of the entity or *an estate that arose on and as a consequence of the death of an individual*) … [Emphasis Added.]

[14] Affording the Appellant the benefit of this provision is reason enough to allow the appeal in this case. I have no reason to believe that the Appellant did not receive the subject distributions from his great uncle's estate that arose as a consequence of that great uncle's death. As noted, the assumptions of the Minister

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[2] The definition in subsection 108(1) applies for the purposes of *Act* pursuant to the definition of a testamentary trust in subsection 248(1).

did not suggest otherwise and as such the Appellant has satisfied the only burdens imposed on him in this case.

[15] At the hearing and in my reasons given from the bench, I also suggested that the filing of the prescribed forms required to be filed pursuant to section 233.6 in respect of each of the subject years were not late filed. This was based on the filing-due date in section 233.6 being determined by subsection 150(1) as pleaded in the Reply. However, subsection 150(1.1) provides that there is no due date in respect of a year where no tax is payable for the year. That would appear to have saved the Appellant from a late filing penalty. However, section 248 defines the filing-due date as "… the day on or before which the taxpayer's return of income under Part I for the year is required to be filed or would be required to be filed if tax under that Part were payable by the taxpayer for the year." Given that definition of the filing-due date, it does not assist the Appellant to have filed the subject forms with his timely filed T1 returns. I cannot ignore such an express provision in the *Act* even though it was not relied on by the Respondent.

[16] While it is not necessary for me to consider the Appellant's due diligence defense argument I wish to note, as I did in my reasons from the bench, that while the due diligence defense does not protect failures resulting from honest mistakes, some latitude might arguably apply in this case. There was a voluntary disclosure in respect of the 2002, 2003 and 2004 taxation years and there would have been a voluntary disclosure in respect of 2005 and 2006 had the accountant acted more diligently as instructed by the Appellant. Indeed, in *Leclerc v. R.*,[3] this Court referred to voluntary disclosures being mitigating under the Canada Revenue Agency's own administrative practices.

[17] Further, I question whether a prudent person acting reasonably would have taken greater care or acted more diligently in a case such as this where the distributions so clearly arose as a consequence of a death. Should beneficiaries under a will be presumed to know that even though it is true that all estates are trusts, not all testamentary trusts are estates? I am of the view that the distinctions are not so readily apparent in these circumstances to persons of similar background and experience as the Appellant. While ignorance of the law is no excuse, in this case the degree of difficulty associated with compliance lowers the bar somewhat in respect of the application of the due diligence defense in my view. Accordingly,

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[3] 2010 DTC 1209 (TCC).

if it were necessary for me to apply that defense in this case, I might have been inclined to do so.

[18] However, for the reason stated above, that is not necessary. The appeals are allowed, in any event, by virtue of my finding that the filing of the subject forms was not required by the terms of the *Act*.

Signed at Ottawa, Canada this 22nd day of July 2011.

"J.E. Hershfield"

Hershfield J.

CITATION:	2011 TCC 360
COURT FILE NO.:	2011-477(IT)I
STYLE OF CAUSE:	PAUL HESS AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Winnipeg, Manitoba
DATE OF HEARING:	July 15, 2011
REASONS FOR JUDGMENT BY:	The Honourable Justice J.E. Hershfield
DATE OF JUDGMENT:	July 22, 2011

APPEARANCES:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Larissa Benham

COUNSEL OF RECORD:

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Name:

Firm:

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