Docket: 2013-770(IT)G

BETWEEN:

KINGLON INVESTMENTS INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Motion heard on April 14, 2014 at Toronto, Ontario

Before: The Honourable Justice David E. Graham

Appearances:

Counsel for the Appellant:	Peter Aprile and Yoni Moussadji
Counsel for the Respondent:	Laurent M. Bartleman

ORDER

The Appellant's motion is granted. The following portions of the Reply are hereby struck:

(a) the phrase "the license based on the representations of its accountant and lawyer who negotiated the terms of the license agreement:" in paragraph 1;

(b) the phrase "was an unregistered tax shelter;" in paragraph 2;

(c) subparagraphs 13(t) to (z) and (bbb) to (hhh);

(d) subparagraph 15(i);

(e) the section reference "237.1" in paragraph 16;

(f) paragraph 17; and

(g) the headings "The Income to be Sheltered From Tax", "Background to the Tax Shelter", "Jackes Acquires the Tax Shelter", "The License was a tax shelter" and "Tax Shelter".

The Respondent shall have 30 days from the date hereof to serve and file an Amended Reply.

Costs of $3,000 on this Motion are awarded to the Appellant.

Signed at Ottawa, Canada, this 5th day of May 2014.

"David E. Graham"

Graham J.

Citation: 2014 TCC 131
Date: May 5, 2014
Docket: 2013-770(IT)G

BETWEEN:

KINGLON INVESTMENTS INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR ORDER

Graham J.

[1] Kinglon Investments Inc. is an Ontario corporation formed by the amalgamation of a company of the same name and a company named Jackes Holdings Inc.[1] Richard Sommers is the controlling shareholder of Kinglon. In computing its income for its taxation years ending August 31, 2006, October 31, 2006, August 31, 2007, August 31, 2008, August 31, 2009 and August 31, 2010, Kinglon claimed over $12 million in capital cost allowance ("CCA") relating to a licence that it purchased from a company named Cardiopharma Inc. to market a heart drug named CardiaPill[2]. The Minister of National Revenue denied the entire CCA claim on a number of grounds. One of those grounds was that the Minister believed that the licence was an unregistered tax shelter. Kinglon has brought a motion under Rule 53(1)(*d*) of the *Tax Court of Canada Rules (General Procedure)* to strike various portions of the Reply relating to the issue of whether the license was a tax shelter.

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1 The amalgamation occurred during the periods in question. For simplicity I will refer to both the pre-amalgamation entities and the amalgamated entity as "Kinglon" as nothing turns on this point.

2 The alternative basis for reassessment that the Respondent is arguing is that no purchase actually occurred. In these Reasons I have chosen to refer to the purchase as if it occurred. I have done this only for ease of reference. My doing so should not be taken as a finding of fact.

Test for Striking a Pleading

[2] The test for striking a pleading is set out by the Supreme Court of Canada in *The Queen v. Imperial Tobacco Canada*, 2011 SCC 42 at paragraph 17:

> … A claim will only be struck if it is plain and obvious, assuming the facts pleaded to be true, that the pleading discloses no reasonable causes of action: *Odhavji Estate v. Woodhouse*, 2003 SCC 69, [2003] 3 S.C.R. 263, at para. 15; *Hunt v. Carey Canada Inc.*, [1990] 2 S.C.R. 959, at p. 980. Another way of putting the test is that the claim has no reasonable prospect of success. Where a reasonable prospect of success exists, the matter should be allowed to proceed to trial: see, generally, *Syl Apps Secure Treatment Centre v. B.D.*, 2007 SCC 38, [2007] 2 S.C.R. 83; *Odhavji Estate*; *Hunt*; *Attorney General of Canada v. Inuit Tapirisat of Canada*, [1980] 2 S.C.R. 735.

Parties' Positions

[3] Kinglon submits that even if the facts pled in the Reply were assumed to be true, it would still be plain and obvious that no tax shelter could exist and thus that the portions of the Reply dealing with the tax shelter argument should be struck. The Respondent takes the opposite position. Alternatively, the Respondent seeks leave to amend the Reply. Kinglon opposes the Respondent being granted such leave.

Tax Shelter

[4] The definition of "tax shelter" is set out in subsection 237.1(1) of the *Income Tax Act*. The relevant portions read as follows:

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

> (i) the total of all amounts each of which is
>
> > (A) an amount … represented to be deductible in computing the person's income for the particular year or any preceding taxation year in respect of … the interest in the property …
> >
> > …
>
> would equal or exceed
>
> (ii) …
>
> > (A) the cost to the person of … the interest in the property at the end of the particular year, …
>
> [emphasis added]

[5] There are a number of elements to this definition. Kinglon accepts that the Respondent has pled sufficient facts that, if those facts were presumed to be true, could support a finding that all but one of the elements of the definition would have been met. The element which Kinglon submits could not be supported arises from the phrase "having regard to statements or representations made or proposed to be made in connection with … the property". The parties both submit that the meaning of that phrase was clarified by the Federal Court of Appeal in *The Queen v. Baxter*, 2007 FCA 172[3]. However, the parties disagree on the manner in which the Court clarified the test.

[6] Counsel for the Appellant referred me to paragraph 9 of *Baxter*:

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

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3 Application for leave to appeal denied: 2007 CarswellNat 3625

> whom the statements or representations must be made, in my view they must be made to the prospective purchasers of the property by or on behalf of the person who proposes to sell the property.
>
> [emphasis added]

[7] Kinglon submits that the foregoing passage makes it clear that to be a tax shelter, not only must statements or representations be made, they must be made by or on behalf of the vendor of the property. Kinglon argues that it is plain and obvious that the facts in the Reply could not support a finding that statements or representations had been made by or on behalf of Cardiopharma.

[8] Counsel for the Respondent referred me to paragraph 44 of *Baxter:*

> While neither of the parties to this appeal, nor the TCC in its decision, focused much attention on the identity of the party who must have made the statements or representations, in my view, it would be reasonable to conclude that it must be each person who constitutes a promoter, as defined in subsection 237.1(1) (a "promoter").

[9] The Respondent submits that paragraph 44 of *Baxter* imports the definition of "promoter" into the definition of "tax shelter". Thus, so long as the statements or representations are made by someone who fits the definition of "promoter", the Respondent submits that a tax shelter exists.

[10] Subsection 237.1(1) defines "promoter" as follows:

> "promoter" in respect of a tax shelter means a person who in the course of a business
>
> (*a*) sells or issues, or promotes the sale, issuance or acquisition of, the tax shelter,
>
> (*b*) acts as an agent or adviser in respect of the sale or issuance, or the promotion of the sale, issuance or acquisition, of the tax shelter, or
>
> (*c*) accepts, whether as a principal or agent, consideration in respect of the tax shelter,
>
> and more than one person may be a tax shelter promoter in respect of the same tax shelter;

[11] The Respondent argues that the facts in the Reply could support a finding that statements or representations had been made by a "promoter".

Issues

[12] In my view, Kinglon is attempting to roll what should be two separate issues into one issue. Kinglon takes a view of the law which differs from that taken by the Respondent and then applies the facts in the Reply to its own view of the law in order to reach its conclusion that the Respondent's position on the tax shelter issue does not have a reasonable prospect of success.

[13] The Court's role in a motion to strike is not, as Kinglon would have me accept, to decide which parties' view of the law is correct. Rather, it is to determine whether the view of the law put forward by the party against whom the motion is brought has a reasonable prospect of success on the assumption that the facts as pled are true. As stated in *Imperial Tobacco* at paragraph 21:

> … Therefore, on a motion to strike, it is not determinative that the law has not yet recognized the particular claim. The court must rather ask whether, assuming the facts pleaded are true, there is a reasonable prospect that the claim will succeed. The approach must be generous and err on the side of permitting a novel but arguable claim to proceed to trial.

[14] However, in Kinglon's case, the Court's job is complicated somewhat by the fact that the Respondent may not have pled sufficient facts to support even her own view of the law. The only practical way to frame the issues is therefore as follows:

(a) Does the Respondent have a reasonable prospect of success in convincing the Court that her view of the law on the tax shelter issue is correct?

(b) If so, if the facts in the Reply were assumed to be correct, does the Respondent have a reasonable prospect of success on the tax shelter issue?

(c) If not, should the Respondent be entitled to amend the Reply?

Does the Respondent's View of the Law Have a Reasonable Prospect of Success?

[15] As set out above, the Respondent relies on paragraph 44 of *Baxter* for her position that the person who must make a statement or representation is the "promoter" of the tax shelter. In my view, it is not plain and obvious that the Respondent cannot succeed on in advancing this view of the law. There is, at a minimum, the appearance of a conflict between paragraphs 9 and 44 of *Baxter*. Paragraph 9 suggests that the statement or representation must be made by or on behalf of the vendor whereas paragraph 44 opens up a potentially broader class of people who could have made the statement or representation[4]. One could conclude from the opening words of paragraph 44 that the issue may not have been fully argued before the Court. The possible ambiguity is arguably amplified by paragraph 41 which states:

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

[16] The parties agree that, in Kinglon's case, the statements or representations in question were made by an accountant and / or a lawyer. It appears that one or both of those individuals was acting on behalf of Kinglon at the time. It is possible that one or both of these individuals may have been acting for Cardiopharma either exclusively or in addition to acting for Kinglon.

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[4] I acknowledge that in *The Queen v. O'Dwyer*, 2013 FCA 200 the Federal Court of Appeal cites paragraph 9 of *Baxter* with approval in considering a motion to strike a Reply relating to a tax shelter. However, the Court does so in the context of determining what information the statements or representations must have contained, not on whose behalf they must have been made. Therefore *O'Dwyer* does nothing to clarify *Baxter*.

[17] Based on the foregoing, I am not prepared at this point in the proceedings to foreclose the possibility that a judge of this Court, upon hearing all of the evidence, could reasonably conclude that:

(a) a tax shelter can exist regardless of who makes the statements or representations so long as they are made to the taxpayer;

(b) a tax shelter can exist in a circumstance where an individual who acts for both the taxpayer and the vendor makes statements or representations to the taxpayer; or

(c) a tax shelter can exist in a circumstance where an individual, acting solely on behalf of the taxpayer, designs a transaction which will have the desired effect, then arranges for a vendor to participate in the transaction and finally makes statements or representations to the taxpayer.

[18] To be clear, I am not endorsing any of the above interpretations. I am merely stating that they are interpretations that a judge of this Court could reach and thus that it is not plain and obvious that the Respondent's view of the law cannot succeed.

Do the Facts as Pled Result in a Reasonable Prospect of Success?

[19] Having concluded that the Respondent's view of the law has a reasonable prospect of success, I must then consider whether, if the facts in the Reply are presumed to be true, the Respondent's argument still has a reasonable prospect of success. The relevant facts are found in the following subparagraphs of paragraph 13 of the Reply:

> (t) Cardiopharma engaged BeachHead Capital Partners Inc.'s [*sic*] (BeachHead) to assist it in raising funds.
>
> (u) BeachHead was a company based in Northport, New York, that describes itself as a North American advisory firm specializing in structured financings and transactions for science and technology.
>
> (v) BeachHead was a sales agent for Cardiopharma.

(w) BeachHead approached Jay Granatstein, an accountant, for assistance in raising funds for Cardiopharma.

(x) Granatstein was Jackes' accountant and Sommers' accountant.

(y) Granatstein approached David Rotfleisch, a lawyer for Sommers, about the opportunities presented to him by BeachHead.

(z) Granastein [*sic*] and Rotfleisch, alone or with others, structured and organized a transaction that would result in the acquisition by Jackes of a license in respect of the CardiaPill drug from Cardiopharma in such a manner as to generate income tax deductions for Jackes and a tax loss in its taxation year ended August 31, 2006.

(bbb) Rotfleisch and/or Granastein [*sic*] made statements or representations to Sommers, the director and sole shareholder of Jackes, as a prospective purchaser that:

1. purchasing the License would result in Jackes being entitled to deduct losses or other amounts, the aggregate of which would, within four years of the date of the acquisition of the License, equal or exceed the cost of the interest acquired by Jackes in the License;

2. the License was a class 44 asset;

3. Jackes would be able to deduct CCA in respect of Jackes' cost of acquiring the License ("License CCA"); and

4. Jackes would be able to deduct the License CCA, which is equal to 25% per year, subject to the half-year rule, on a declining balance basis.

(ccc) Granastein's [*sic*] representations to Sommers and Rotfleisch included preparing pro forma tax returns for Jackes with respect to its purchase of the License.

(ddd) Rotfleisch and/or Granatstein made the above statements or representations to Sommers in the course of their business and, in so doing, were promoting and advising Jackes to acquire the License under the [Exclusive License Agreement ("ELA")] for the associated CCA.

(eee) Rotfleisch and Granatstein were paid or otherwise received consideration in respect of Jackes' acquisition of the License under the ELA.

(fff) No application was made to the Minister for a tax shelter identification number for the License.

(ggg) The Minister has not issued a tax shelter identification number for the License.

(hhh) Neither Jackes nor Kinglon filed with the Minister a prescribed form containing prescribed information, including the tax shelter identification number for the License.

[20] The foregoing assumptions of fact dance around the question of on whose behalf the statements or representations were made. Nowhere does the Reply clearly state either that the statements or representations were made on behalf of Kinglon or that they were made on behalf of Cardiopharma. It suggests that there was a connection extending from Cardiopharma to BeachHead to Mr. Granatstein and Mr. Rotfleisch but it does not actually state that Mr. Granatstein and / or Mr. Rotfleisch made statements or representations on behalf of Cardiopharma. It indicates that Mr. Granatstein was Kinglon's and Sommers' accountant and that Mr. Rotfleisch was Sommers' lawyer and states that they structured and organized the transaction but does not actually state that they did so on behalf of Kinglon or that they made the statements or representations that they made on behalf of Kinglon.

[21] The Respondent appears to have drafted the Reply with the intention of fitting into the definition of "promoter" should that prove necessary without actually committing to any specific aspect of the definition. For example, the Respondent has pled that Mr. Granatstein and / or Mr. Rotfleisch made the statements or representations in the course of a business but has not specified what that business was[5]. Similarly, the Respondent has pled that Mr. Granatstein and Mr. Rotfleisch received or were otherwise paid consideration but has not specified from whom it came[6].

[22] The foregoing lack of specificity was not accidental. Counsel for the Respondent admits that the Respondent was "intentionally non-committal" in

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5 Subparagraph 13(ddd) of the Reply.

6 Subparagraph 13(eee) of the Reply.

drafting the Reply. At the hearing of the motion, counsel was still unwilling to commit to whether the Respondent's position was that the statements or representations were made on behalf of Cardiopharma or Kinglon. Counsel for Kinglon suggested that the Respondent was attempting to wait in the weeds until examinations for discovery in order to see what evidence might emerge to support its various theories of the case. I agree that this is what the Respondent appears to be doing.

[23] Paragraph 22 of *Imperial Tobacco* states:

> … It is incumbent on the claimant to clearly plead the facts upon which it relies in making its claim. A claimant is not entitled to rely on the possibility that new facts may turn up as the case progresses. The claimant may not be in a position to prove the facts pleaded at the time of the motion. It may only hope to be able to prove them. But plead them it must. The facts pleaded are the firm basis upon which the possibility of success of the claim must be evaluated. If they are not pleaded, the exercise cannot be properly conducted.

[24] I understand that the relationship among Mr. Granatstein, Mr. Rotfleisch, Cardiopharma and Kinglon is something exclusively within the knowledge of Kinglon and that it may therefore be difficult for the Minister to state that relationship with any certainty but that is why the Minister has the power to make assumptions of fact when assessing taxpayers.

[25] Since the Respondent has not pled the specific facts necessary to show on whose behalf the statements or representations were made, I am left with no choice but to strike the portions of the Reply dealing with the tax shelter argument. Even if I assume that the facts pled are true, there is insufficient evidence to prove that the license was a tax shelter even on the Respondent's broader interpretation of the law.

Leave to Amend the Reply

[26] The Respondent has requested that, if Kinglon's motion is granted, the Respondent be given 30 days to serve and file an Amended Reply. At this early stage in the proceeding it is difficult to imagine how permitting such an amendment would prejudice Kinglon in a way that could not be compensated by costs on this motion. Kinglon submits that it will not be prejudiced if the

Respondent amends the Reply so long as the Respondent does not add new assumptions of fact to the Reply. For the reasons described in more detail below, I do not believe that the addition of new assumptions of fact would prejudice Kinglon. Therefore, I will grant the Respondent leave to serve and file an Amended Reply.

Comments on Potential Amendments

[27] I would like to address some potential issues that may arise in amending the Reply. In doing so I hope to reduce the likelihood of additional procedural disputes in this matter. My comments are not binding on the Respondent.

(a) Assumptions of Fact: An Amended Reply will need to clearly identify the facts necessary to support the Respondent's view of the law. To the extent that the Respondent wishes to plead alternative bases in support of the assessment, she will also need to clearly identify the facts necessary to support those alternatives. In pleading the facts, the Respondent will have to decide whether it is appropriate to plead them as assumptions of fact or as additional facts. Kinglon is concerned that the Respondent may end up pleading assumptions of fact that were not actually made by the Minister. I do not share this concern. An appellant may overcome the Minister's assumptions of fact by either demolishing them or proving that the Minister did not, in fact, make them (*Loewen v. The Queen*, 2004 FCA 146). By intentionally being non-committal in the Reply, the Respondent has placed herself in a position where Kinglon may find it easier than would normally be the case to convince a judge that the Minister did not, in fact, make a given assumption of fact that appears for the first time in the Amended Reply. The Respondent knows the exact nature of the assumptions made by the Minister and will presumably draft the Amended Reply accordingly while bearing the foregoing increased risk in mind.

(b) "Promoter": The definition of "promoter" is complex and involves a number of different possible permutations. To the extent that the Respondent wishes to rely on one or more aspects of the definition of "promoter", I anticipate that the Respondent will bear in mind the

Federal Court of Appeal's comments in *O'Dwyer* at paragraphs 26, 27 and 31:

> [26] … The penalty under subsection 237.1(7.4) of the *Act* is imposed if a person "whether as a principal or as an agent, sells, issues or accepts consideration in respect of a tax shelter" before the identification number is issued. In the reply (paragraph 18), the provisions of subsection 237.1(7.4) of the Act are reiterated without identifying what specific role Thomas O'Dwyer is alleged to have played:
>
> > 18. The Appellant is liable for a penalty because he acted as principal or agent to sell, issue or accept consideration in respect of the SRLP tax shelter before the Minister issued a tax shelter identification number, pursuant to subsection 237.1(7.4) of the *Act*.
>
> [27] Every possible combination enumerated in subsection 237.1(7.4) of the Act is included. There is no clear indication of why the penalty was imposed. ...
>
> …
>
> [31] In setting out the basis upon which the penalty was assessed, the Minister should clearly identify the role that Thomas O'Dwyer is alleged to have played and not simply reiterate every possible permutation or combination that could satisfy the statutory conditions to impose the penalty. Any taxpayer who has been assessed a penalty should know why the penalty was assessed. Simply reiterating the multiple combinations of possibilities that could result in the imposition of the penalty does not tell a taxpayer what specific act (that would result in the imposition of the penalty) he or she is alleged to have committed.

(c) Reasons: Paragraph 17 of the Reply as it is currently drafted simply refers to the license being a "tax shelter". The definition of "tax shelter" is very broad and complex. I anticipate that the Amended Reply will, at a minimum, identify the manner and, to the extent it is relevant, any alternative manner in which the Respondent believes the license falls within that definition.

Conclusion

[28] Based on all of the foregoing, Kinglon's motion is granted. The following portions of the Reply are struck:

(a) the phrase "the license based on the representations of its accountant and lawyer who negotiated the terms of the license agreement:" in paragraph 1;[7]

(b) the phrase "was an unregistered tax shelter;" in paragraph 2;

(c) subparagraphs 13(t) to (z) and (bbb) to (hhh);

(d) subparagraph 15(i);

(e) the section reference "237.1" in paragraph 16;

(f) paragraph 17; and

(g) the headings "The Income to be Sheltered From Tax", "Background to the Tax Shelter", "Jackes Acquires the Tax Shelter", "The License was a tax shelter" and "Tax Shelter".

[29] The Respondent shall have 30 days from the date hereof to serve and file an Amended Reply.

Costs

[30] In awarding costs, I am mindful not only of the fact that Kinglon has been successful on this motion but, more importantly, that the Respondent made a conscious choice to draft the Reply in a vague manner and to refuse to commit herself to a particular position on the facts. The Minister is given a powerful advantage in tax litigation through the ability to plead assumptions of fact. With

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[7] Contrary to the relief requested in Kinglon's motion, I have not struck the words "Jackes acquired" which appear at the beginning of this phrase as the un-struck balance of the sentence would be meaningless without those words.

that advantage comes the responsibility "… that the facts pleaded as assumptions be complete, precise, accurate and honestly and truthfully stated so that the taxpayer knows exactly the case and the burden that he or she has to meet"[8]. That responsibility was clearly not met by the Respondent in this case. In the circumstances, I do not think that an award of costs in accordance with the Tariff is appropriate. Accordingly, I award costs to Kinglon in the amount of $3,000.

Signed at Ottawa, Canada, this 5th day of May 2014.

"David E. Graham"

Graham J.

8 *The Queen v. Anchor Pointe Energy Ltd.*, 2007 FCA 188 at para 29

CITATION:	2014 TCC 131
COURT FILE NO.:	2013-770(IT)G
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PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	April 14, 2014
REASONS FOR ORDER BY:	The Honourable Justice David E. Graham
DATE OF ORDER:	May 5, 2014

APPEARANCES:

Counsel for the Appellant:	Peter Aprile and Yoni Moussadji
Counsel for the Respondent:	Laurent M. Bartleman

COUNSEL OF RECORD:

For the Appellant:

Name:	Peter Aprile and Yoni Moussadji
Firm:	ATX Tax Law, Toronto, Ontario

For the Respondent:	William F. Pentney Deputy Attorney General of Canada Ottawa, Canada