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Income Tax Disputes Involving Loss Years: Pitfalls, Foibles, and Possible Reforms

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PRÉCIS

Deux principes de longue date peuvent compliquer la résolution des différends fiscaux impliquant des pertes, soit la « règle relative à une cotisation néant » et le « principe de *New St James* ». La règle relative à une cotisation néant interdit à un contribuable de s'opposer à un avis de cotisation précisant qu'il n'a aucun impôt à payer — y compris tant pour les années déficitaires que les années rentables au cours desquelles le revenu est entièrement compensé par des reports. Le principe de *New St James* prévoit, essentiellement, que les années déficitaires ou les années sans impôt à payer ne deviennent jamais frappées de prescription.

Parce que la règle relative à une cotisation néant et le principe de *New St James* peuvent empêcher le règlement rapide d'un différend sur les soldes de pertes fiscales, le Parlement a modifié la Loi de l'impôt sur le revenu en 1977 afin de permettre au ministre du Revenu national d'envoyer, dans certaines circonstances, un avis de détermination de perte (ADP) pour une année d'imposition donnée. La procédure d'opposition ou d'appel d'un ADP est essentiellement la même que pour un avis de cotisation, et un ADP faisant l'objet d'une opposition ou d'un appel devient obligatoire pour le ministre et le contribuable.

L'existence toutefois d'un système parallèle mais distinct pour résoudre les différends sur les pertes laisse des brèches qui créent divers pièges procéduraux pour les contribuables. Les contribuables pris dans ces pièges peuvent se retrouver à perdre leurs droits d'opposition ou d'appel relativement à des rajustements de revenu contestés, à voir resurgir des questions fiscales qui étaient frappées de prescription, ou être tenus de payer des intérêts accumulés sur des dettes fiscales éteintes. L'auteur de cet article explore certains de ces pièges et montre comment ils se produisent et ce qu'un contribuable peut faire pour les éviter. Il aborde aussi la question de savoir si le

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temps est venu de réformer la règle relative à une cotisation néant ou le principe de *New St James*, ou les deux, afin de permettre la résolution plus rapide par la Cour canadienne de l'impôt des différends relatifs aux pertes. Il propose également plusieurs réformes possibles.

ABSTRACT

Tax disputes involving losses can be challenging to resolve owing to two longstanding principles, commonly known as "the nil assessment rule" and "the *New St James* principle." The nil assessment rule bars taxpayers from objecting to assessments that result in no tax being payable—including both loss years and profitable years where income is completely offset by carryovers. The *New St James* principle provides, essentially, that loss years or years with no tax payable never become statute-barred.

Because the nil assessment rule and the *New St James* principle can prevent the resolution of disputes over tax loss balances in a timely manner, Parliament amended the Income Tax Act in 1977 so as to allow, in certain situations, for the issuance by the minister of national revenue of a notice of determination of losses (NODL) for a given taxation year. Once issued, a NODL can be objected to or appealed in basically the same manner as an assessment and, subject to any objection or appeal, becomes binding upon the minister and the taxpayer.

However, the existence of a parallel but distinct system for resolving loss disputes leaves gaps that result in a range of procedural traps for taxpayers. Taxpayers caught in these traps can potentially end up losing their rights to object to or appeal disputed income adjustments, reviving statute-barred issues, or being required to pay arrears interest on extinguished tax debts. This article explores some of these traps, showing how they arise and what a taxpayer might do to avoid being caught by them. It also discusses whether the time has come to reform the nil assessment rule and/or the *New St James* principle so as to allow disputes involving losses to be resolved more readily by the Tax Court of Canada, and proposes several possible reforms.

KEYWORDS: LOSSES ■ CARRYOVER ■ OBJECTIONS ■ ASSESSMENTS ■ DISPUTES ■ TAX COURT OF CANADA

CONTENTS

INTRODUCTION

If a taxpayer incurs business losses, those losses can often be used to shelter taxable income in other years. Consequently, tax losses have "value" that can give rise to difficult disputes with revenue officials over their quantum and timing.[1] However, disputes involving losses are not always easy to resolve expeditiously, owing in part to two longstanding tax principles—the nil assessment rule and the *New St James* principle.

The nil assessment rule bars taxpayers from objecting to assessments that result in no tax being payable. Consequently, if the minister of national revenue[2] audits a loss year and issues a notice of reassessment reducing the amount of the loss, the taxpayer cannot object or appeal. Rather, the taxpayer must wait—potentially several years—until it attempts to carry over and deduct the disputed loss in another year in which tax is payable. If the carryover is then refused, the taxpayer can object to or appeal the minister's assessment of that year and dispute the denial of the prior year's loss at that time.

Similarly, if a taxpayer uses loss carryovers to completely offset disputed amounts of income in another year, the nil assessment rule can, in some circumstances, prevent the taxpayer from objecting to or appealing the resulting reassessments. Instead, the dispute over the income inclusions would be recast as a dispute over the amount of losses available for carryover, which again would be subject to objection or appeal only in some future year in which tax was payable.

The *New St James* principle provides, essentially, that the minister can audit and reassess loss years even after the expiry of the "normal reassessment period" as

1 According to the Department of Finance, non-capital loss and capital loss carryovers reduced corporate income taxes by a projected $8.49 billion in 2018. (Comparable data for personal income tax were not available.) See Canada, Department of Finance, *Report on Federal Tax Expenditures—Concepts, Estimates and Evaluations 2019* (Ottawa: Department of Finance, 2019), at 35-36 (www.fin.gc.ca/taxexp-depfisc/2019/taxexp19-eng.asp).

2 This article deals primarily with the assessment of federal income tax under the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"), as administered by the Canada Revenue Agency (CRA) on behalf of the minister. However, the comments largely apply, mutatis mutandis, to separately administered provincial income tax regimes as well.

defined in section 152 of the Income Tax Act.[3] Loss balances do not become statute-barred until they are carried over and deducted in another taxation year in which tax is payable, and that year becomes statute-barred.

Because of the nil assessment rule and the *New St James* principle, disputes over loss balances can potentially remain open for extended periods of time, during which records may be lost, memories may fade, or witnesses may become unavailable—all of which works to the detriment of the taxpayer who ultimately bears the burden of proof. The ongoing uncertainty can create many other challenges for taxpayers by making it more difficult, for example, to attract capital or a potential acquiror.

To assist taxpayers in these situations, in 1977 Parliament enacted subsections 152(1.1) through (1.3) ("the loss dispute provisions"). Under these provisions, if the minister disputes a loss reported by a taxpayer, the taxpayer can require the minister to issue a notice of determination of losses (NODL) for that taxation year. Once issued, a NODL can be objected to or appealed in basically the same manner as a reassessment. Subject to any such objection or appeal, a NODL is binding upon the minister and the taxpayer after the expiry of the normal redetermination period (which is the same length of time as the normal reassessment period, but starts from the date of issuance of the NODL).[4]

While the loss dispute provisions address some of the challenges caused by the nil assessment rule and the *New St James* principle, the existence of a parallel but distinct system for resolving loss disputes leaves gaps that can result in procedural obstacles and traps for taxpayers, including

1. the loss of the right to object to or appeal disputed income adjustments,
2. an obligation to pay arrears interest on extinguished tax debts,
3. the revival of issues relating to statute-barred years, and
4. the duplication of proceedings.

This article explores examples of these situations, showing how they arise and what a taxpayer might do to avoid being caught by them. It also invites a discussion about whether the time has come to reform the nil assessment rule and/or the *New St James* principle so as to allow disputes involving losses to be resolved more readily by the Tax Court of Canada.

The discussion that follows briefly describes the regime in the Act for carrying over losses, traces the origins of the nil assessment rule and the *New St James* principle, and provides an overview of the loss dispute provisions. Then several scenarios are described in which the application of these various provisions and concepts can

3 Supra note 2, subsection 152(3.1). Unless otherwise stated, statutory references in this article are to the Act. The *New St James* principle is derived from a 1964 decision of the Tax Appeal Board, discussed in the text below at note 28 and following.

4 See *Perfect Fry Company v. The Queen*, 2007 TCC 133; aff'd 2008 FCA 218, at paragraphs 43-44.

cause undesirable consequences, along with a discussion of how such consequences might be avoided. The article concludes with some suggestions for possible reform.

LOSS CARRYOVERS

The Act recognizes five broad categories of losses that can be carried over and applied in other taxation years: non-capital losses, net capital losses, restricted farm losses, farm losses, and limited partnership losses.[5] Specific rules and limitations apply to the various categories; net capital losses, for example, can generally be carried over only to offset capital gains (subsection 111(1.1)),[6] while limited partnership losses, inter alia, are limited to a taxpayer's "at-risk" amount in a limited partnership (paragraph 111(1)(e)).

The Operative Provision

Subsection 111(1) is the operative provision of the Act for loss carryovers. Paragraph 111(1)(a) allows a taxpayer to deduct from taxable income such portion as the taxpayer may claim of its "non-capital losses for the 20 taxation years immediately preceding and the 3 taxation years immediately following the year." In other words, non-capital losses can be carried forward to a maximum of 20 years or back 3 years. Paragraphs 111(1)(b) through (e) deal with the other categories of losses.

Subsection 111(3) imposes two additional constraints:

1. Losses in a particular year can only be deducted once. For example, if a taxpayer has $100,000 of losses in 2010 and carries forward and deducts $75,000 of those losses in 2011, only $25,000 of the 2010 losses will be available for deduction in subsequent years.
2. For each category of loss, a taxpayer must deduct the earliest losses available first. For example, if a taxpayer has $100,000 of losses in 2010 and another $100,000 in 2011, and wishes to carry forward $50,000 of losses in 2012, the taxpayer must use the losses from 2010, not 2011.

Subsection 111(1) requires a taxpayer to "claim" a loss carryover in order to utilize the loss. Unlike current-year losses, which are automatically deducted from income, loss carryovers are elective and apply only if a taxpayer chooses to claim the deduction. Moreover, as explained by the Federal Court of Appeal in *CCLI (1994) Inc. v. Canada*,[7] losses are "claimed" on a year-by-year basis; for example, if a taxpayer

5 A discussion of these various categories falls beyond the scope of this article. A useful overview appears in the CRA's *Interpretation Bulletin* IT-232R3 (Archived), "Losses—Their Deductibility in the Loss Year or in Other Years," July 4, 1997.

6 An exception to this rule applies in the case of "allowable business investment losses," a form of capital loss that can be used to offset all income (paragraphs 3(d) and 38(c)).

7 2007 FCA 185.

decides to carry back a certain amount of losses from 2013 to 2010, the minister cannot, on his or her own initiative, substitute losses from another taxation year. This can have important consequences with regard to statute-barred years. If a taxpayer carries losses over from a loss year to a profitable year and the profitable year becomes statute-barred, and the minister subsequently determines that the taxpayer did not have sufficient losses in the loss year to carry over, the minister cannot deduct losses from another loss year to make up the disallowed amount. In the absence of a misrepresentation by the taxpayer attributable to negligence, or another ground on which to reopen the statute-barred year, the minister has no recourse, and the taxpayer is entitled to use its losses from other years as it sees fit.[8]

The Assessing Provisions

Section 152 contains various provisions that either require or permit the minister to assess or reassess taxpayers claiming a loss carryover. As noted by the Federal Court of Appeal in *Canada v. Agazarian*, the provisions are not easy to follow—indeed, Létourneau JA remarked that

> [t]he legislative provisions under scrutiny are a mess. With all respect to the contrary opinion, I do not think that they lend themselves to a literal interpretation. They are in such a state of disarray that the literal interpretation leads to incongruous results whether one adopts the appellant's or the respondent's position.[9]

Loss carryforwards are generally claimed like other deductions from income or taxable income. A taxpayer claims the carryforward as a deduction in its tax return for the year in which the deduction is claimed. If a taxpayer wishes to carry forward a loss after filing its original return, the taxpayer can either file an amended return, which the minister will generally review and process if the normal reassessment period has not passed (subsection 152(4)),[10] or object to the original assessment based on its tax return and claim the carryforward on objection.[11]

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8 This is what occurred in *CCLI*, ibid. For additional commentary on this decision, including a historical discussion of the origin of the "claim" requirement in subsection 111(1), see David Wentzell, "'Timing is Everything'—How a Taxpayer Got Double Value from Its Losses" (2007) 55:3 *Canadian Tax Journal* 717-20.

9 *Canada v. Agazarian*, 2004 FCA 32, at paragraph 54.

10 See Ian Crosbie, "Amended Returns, Refunds, and Interest," in *Tax Dispute Resolution, Compliance, and Administration in Canada* (Toronto: Canadian Tax Foundation, 2013), 27:1-33; and Daniel Sandler and Allison Backler, "(Can't Get No) Satisfaction? Look Beyond the Fairness Provisions," in *Report of Proceedings of the Seventieth Tax Conference*, 2018 Conference Report (Toronto: Canadian Tax Foundation, 2019), 33:1-30.

11 If a taxpayer chooses this latter option, the objection will have to be filed within the usual time limits and in accordance with the other requirements set out in section 165.

Loss carrybacks, in contrast, are generally claimed for a particular year only after the taxpayer has already filed a tax return and been assessed for that year.[12] To oblige the minister to process such requests, paragraph 152(6)(c) provides as follows:

> (6) Where a taxpayer has filed for a particular taxation year the return of income required by section 150 and *an amount is subsequently claimed by the taxpayer* or on the taxpayer's behalf *for the year as . . .*
>
> (c) *a deduction . . . under section 111 in respect of a loss for a subsequent taxation year*, . . .
>
> *by filing with the Minister, on or before the day on or before which the taxpayer is, or would be if a tax under this Part were payable by the taxpayer for that subsequent taxation year, required by section 150 to file a return of income for that subsequent taxation year, a prescribed form amending the return, the Minister shall reassess the taxpayer's tax for any relevant taxation year* (other than a taxation year preceding the particular taxation year) *in order to take into account the deduction claimed* [emphasis added].

The "prescribed form" mentioned at the end of subsection 152(6) is form T1A (for individuals), T2A (for corporations), or T3A (for trusts), which have been issued administratively by the Canada Revenue Agency (CRA).

As can be seen, paragraph 152(6)(c) requires the minister to process a loss carryback claim and to reassess the prior year accordingly if the taxpayer files a form T1A, T2A, or T3A on or before the due date for filing its tax return for the loss year. If a taxpayer is late in filing the form, the minister is no longer obligated to process the carryback request—a point that is important to remember, given that taxpayers with no tax payable may not be motivated to file their tax returns on time. However, if the taxpayer requests the carryback after the deadline set out in paragraph 152(6)(c), the minister may nonetheless process the request pursuant to the reassessing powers under subsection 152(4) and/or (in the case of individuals) subsection 152(4.2).

Subparagraph 152(4)(b)(i) allows the minister to reassess a taxation year for an additional three years after the expiry of the normal reassessment period to give effect to a loss carryback request,[13] even if the request is filed after the deadline set out in paragraph 152(6)(c). A reassessment made during this "extended reassessment period" must be limited to such matters as "can be reasonably be regarded as relating to" the carryback request (subparagraph 152(4.01)(b)(i)). Thus, the minister cannot use the carryback request to reopen a statute-barred year. Similarly, the taxpayer is permitted to object to or appeal such a reassessment "only to the extent that the reasons for the objection" pertain to the carryback request (subsections 165(1.1) and 169(2)). Essentially, a taxpayer cannot claim a carryback and then

12 If a taxpayer is late-filing a return and claiming carrybacks from subsequent years at the same time, those losses can be included in the original return and processed in the same manner as carryforwards.

13 This extended reassessment provision applies only to loss carrybacks; it does not apply to loss carryforwards.

reopen the entire year by disputing the reassessment implementing the carryback request.[14]

Similarly, although there is no express statement to this effect in the Act, the Federal Court of Appeal in *Agazarian* construed paragraph 152(4.01)(b)(i) as authorizing the minister to make further reassessments during the extended reassessment period to the extent that they reasonably relate to the reassessment allowing the carryback.[15] This means, essentially, that the minister can audit the losses carried back and vary or disallow them during this period.

Finally, the minister is not bound by what appears in the taxpayer's return and may thus vary or reject a carryback request (subsection 152(7)). The latter situation can cause a procedural issue for the taxpayer. If the minister rejects the carryback request without issuing a reassessment, the taxpayer may not be able to dispute the minister's decision through the usual objection and appeal process. Such a situation occurred in *Greene v. The Queen*,[16] where a taxpayer sought to carry back a large capital loss from 1988 to the years 1985, 1986, and 1987. The minister, believing the request to be unfounded, declined to process it. The taxpayer sought judicial review in the Federal Court, asking the court to order the minister to issue "a reassessment" in accordance with subsection 152(6). The Federal Court issued such an order, in response to which the minister "reassessed" the taxpayer's 1985, 1986, and 1987 taxation years in a manner identical to its previous assessments. The taxpayer sought further judicial review, arguing that such "no-change" reassessments were not consistent with subsection 152(6), but the Federal Court of Appeal disagreed. The court held that such "no-change" reassessments were appropriate and that if the taxpayer did not agree with the minister's position, he could and should pursue the matter through an objection and appeal.

THE NIL ASSESSMENT RULE

Okalta Oils: The Classic Formulation of the Nil Assessment Rule

The nil assessment rule traces its origins to the decision of the Supreme Court of Canada in *Okalta Oils v. Minister of National Revenue*.[17] *Okalta Oils* concerned an oil-producing company that received a notice of assessment for its 1946 taxation year disallowing a credit available at the time for oil drilling and exploration costs ("the oil drilling and exploration credit") pertaining to one of its wells. The taxpayer was originally assessed a nominal amount of tax and filed an objection. The

14 Subsection 165(1.1) concludes by saying that "this subsection shall not be read or construed as limiting the right of the taxpayer to object to an assessment or a determination issued or made before that time." This provision ensures that, if a taxpayer has a pending objection or appeal relating to other issues in a taxation year at the time a reassessment is issued to implement a carryback, the taxpayer can raise those former issues again on objection.

15 *Agazarian*, supra note 9.

16 95 DTC 5684 (FCA); aff'g 95 DTC 5078 (FCTD).

17 [1955] SCR 824; aff'g 55 DTC 1029 (Ex. Ct.); aff'g 53 DTC 323 (TAB).

minister allowed the objection in part and varied the assessment into a "nil assessment" that nevertheless still denied the oil drilling and exploration credit for the well at issue. Because the oil drilling and exploration credit could be carried over and applied in subsequent taxation years, the taxpayer appealed the nil assessment to the Income Tax Appeal Board, and from there to the Exchequer Court and the Supreme Court.

The Tax Appeal Board and the Exchequer Court both decided the case on its merits, holding that the taxpayer was not entitled to the oil drilling and exploration credit since, essentially, all of the relevant expenses were paid by another entity. Both lower courts expressly declined to deal with the procedural question of whether the nil assessment was subject to appeal in the first place.

The taxpayer appealed to the Supreme Court of Canada, which dismissed the appeal from the bench following the conclusion of oral argument. In very brief reasons issued subsequently, the court held that no appeal lies from an assessment that claims no tax, and thus the courts below had no jurisdiction to hear the case.

In coming to this conclusion, the court held that sections 69a and 69b of the Income War Tax Act[18] (the predecessors to sections 165 and 169 in the Act today) allowed a taxpayer to serve a notice of objection to an "assessment" and to appeal to the Tax Appeal Board only after the minister had confirmed the assessment or reassessed. The court conceded that the word "assessment" has two distinct meanings in the tax context: (1) the process of ascertaining a taxpayer's profit for the purpose of charging tax, and (2) the actual sum of tax that the taxpayer is liable to pay.[19] However, it held that the word "assessment" in sections 69a and 69b was to be understood in the latter sense.

The court's analysis in support of this conclusion was very brief and relied primarily on the fact that the predecessor provision to sections 69a and 69b—section 58 of the Income War Tax Act (repealed in 1946)—conferred a right of appeal upon "any person who objects to *the amount* at which he is assessed."[20] The court also noted that the Tax Appeal Board had previously held, in *No. 111 v. MNR*,[21] that the word "assessment" in section 69b referred only to an assessment that imposed tax.

With respect, arguably, the Supreme Court's reasoning in *Okalta Oils* was problematic for a variety of reasons, including the following:

18 RSC 1927, c. 97, as amended.

19 In this regard, the Supreme Court cited Viscount Simon's comment in *Income Tax Commissioners for City of London v. Gibbs*, [1942] AC 402 (HL), at 406: "The word 'assessment' is used in our income tax code in more than one sense. Sometimes, by 'assessment' is meant the fixing of the sum taken to represent the actual profit for the purpose of charging tax on it, but in another context the 'assessment' may mean the actual sum in tax which the taxpayer is liable to pay on his profits." See *Okalta Oils*, supra note 17 (SCC), at 825.

20 *Okalta Oils*, supra note 17 (SCC), at 826, citing the Income War Tax Act, 1917, 7-8 George V, c. 28, section 58 (emphasis added).

21 (1953), 8 Tax ABC 440.

- The court did not quote former section 58 of the Income War Tax Act in its entirety; in fact, the section conferred a right of appeal upon "[a]ny person who objects to the amount at which he is assessed, *or who considers that he is not liable to taxation under this Act* [emphasis added]."
- The fact that Parliament replaced the phrase "the amount at which he is assessed" in 1946 with the generic term "assessment" could support the inference that Parliament sought to expand the availability of the objection and appeal procedure.
- The court did not offer any discussion about whether it was just, fair, or reasonable, from a perspective of tax administration, to deny the taxpayer in *Okalta Oils* the opportunity to obtain certainty with respect to its entitlement to the oil drilling and exploration credit through the normal objection and appeal process. The Tax Appeal Board and the Exchequer Court were both perfectly able to decide the case on its merits, and there seemed to be no obvious purpose to obliging the taxpayer to repeat the entire litigation process in some future year in which there was tax payable.
- The analysis in *No. 111* about whether the Tax Appeal Board had the jurisdiction to hear an appeal of a nil assessment was largely in obiter, and in any event could hardly bind the Supreme Court.[22]

However perfunctory and questionable the reasoning may have been *Okalta Oils*, the nil assessment rule has become settled law in Canada, notwithstanding the fact that it can cause significant headaches for taxpayers, particularly those who may not have ready access to sophisticated professional assistance in planning their affairs.

The Tax Court of Canada's decision in *Joshi v. The Queen*[23] illustrates the problems that the nil assessment rule can cause for taxpayers. The case involved a dispute with the minister over moving expenses incurred in 2000 that the taxpayer carried forward to 2001. The minister denied the claim for moving expenses but, without being asked to do so, applied the taxpayer's unused tuition credits to reduce her tax payable to zero. The minister issued a nil assessment accordingly. This "solution" was unsatisfactory for the taxpayer since it reduced the amount of tuition expenses that she could claim in future years (and the moving expenses could be carried forward only one taxation year). The taxpayer thus objected and appealed. The minister made a motion to strike the appeal based on the nil assessment rule.

22 The primary issue in *No. 111*, supra note 21, was whether a bus company had to include in income, receipts for bus tickets where transportation had not yet been delivered. Three taxation years were at issue, 1946, 1947, and 1948; 1946 and 1947 were profitable, 1948 was loss-making, and the profits of 1947 were completely offset by the 1948 losses, resulting in no tax being due. The Tax Appeal Board decided the main issue on its merits, applicable to all three years. There was an additional, minor issue concerning a clerical error in the minister's determination of the taxpayer's loss for 1948. The Tax Appeal Board noted that it could deal with that issue only if and when the taxpayer attempted to apply those losses to a future taxation year.

23 2003 TCC 615.

The Tax Court dismissed the motion, reserving the question of jurisdiction for trial. The case was heard and concluded with the court's issuing an unreported order, dated May 10, 2014, allowing the appeal and referring the assessment "back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant is entitled to additional moving expenses in the amount of $9,037.43."[24] Notwithstanding this fortunate result for the taxpayer, the Federal Court of Appeal subsequently held, in *Canada v. Interior Savings Credit Union*[25] (discussed below), that the appeal in *Joshi* should never have been allowed to proceed in the first place. *Joshi* therefore remains an isolated decision that is not followed.

Interior Savings: The "Second Branch" of the Nil Assessment Rule

Okalta Oils was limited to the question of whether a taxpayer can object to or appeal an assessment that imposes no tax. However, subsequent case law developed a "second branch" of the nil assessment rule, according to which an objection or appeal of an assessment is valid only if the taxpayer is seeking an actual *reduction* of tax, as opposed to an adjustment of some other tax balance or element of the assessment.

The Federal Court of Appeal articulated this second branch in *Interior Savings Credit Union*, which concerned a certain tax balance known as the "preferred rate amount" (PRA) applicable to credit unions. Essentially, if the PRA exceeds a certain level, the credit union loses its entitlement to a particular tax credit. In this case, the minister reassessed the credit union taxpayer so as to increase its PRA balance from around $9.6 million to $64.3 million. The increase had no impact on the amount of tax due for that year. The credit union nevertheless filed a notice of objection and subsequently an appeal to the Tax Court based, not on the amount of tax assessed, but rather on the determination of the PRA balance. The minister made a motion to strike based on the second branch of the nil assessment rule, even though the assessment under appeal was not, in fact, a nil assessment; the credit union was assessed tax during the year in question.

Little J of the Tax Court dismissed the minister's motion to strike, finding that the credit union had compelling reasons for needing a definitive determination of its PRA balance (including the ability to properly comply with its regulatory obligations) and that the nil assessment rule had been attenuated by the Tax Court's decision in *Joshi* (discussed above).[26] The Federal Court of Appeal, however, reversed this decision and granted the motion to strike, holding that *Joshi* was wrongly decided and that the second branch of the nil assessment rule invalidates any objection or appeal that does not put at issue the amount of tax assessed.[27]

24 A copy of the order and minutes of the hearing was obtained from the Tax Court of Canada records.

25 2007 FCA 151; rev'g 2006 TCC 411.

26 Ibid. (TCC), at paragraphs 35-36.

27 Ibid. (FCA), at paragraphs 17-33.

The Federal Court of Appeal did not provide any indication as to what the credit union could have done to obtain certainty with respect to the amount of its PRA balance, which it needed to comply with its regulatory obligations. However, one may consider whether a reference to the Tax Court of Canada under section 173 of the Act, discussed below, might have been available. If so, it arguably would been a better use of judicial resources for the parties to convert the credit union's appeal into a section 173 reference and to obtain a binding judicial determination of its PRA while the matter was timely.

THE NEW ST JAMES PRINCIPLE

The *New St James* principle allows the minister to reassess loss years indefinitely, even after the expiry of the normal reassessment period. This result flows from a plain reading of subsection 152(4), which reads in part as follows:

> (4) The Minister may *at any time* make an assessment, reassessment or additional assessment of tax for a taxation year, interest or penalties, if any, payable under this Part by a taxpayer *or notify in writing any person by whom a return of income for a taxation year has been filed that no tax is payable for the year*, except that *an assessment, reassessment or additional assessment may be made after the taxpayer's normal reassessment period in respect of the year only if*. . . . [emphasis added].

As can be seen, the first part of subsection 152(4) authorizes the minister, "at any time," to issue assessments, reassessments, and additional assessments for tax, interest, and penalties, as well as to provide a taxpayer who has filed a return with written notification that no tax is payable for a particular year. The second part, however, limits the first part by barring the minister from issuing "an assessment, reassessment or additional assessment" after the normal reassessment period (defined in subsection 152(3.1)). Importantly, this bar does not apply to notifying taxpayers in writing that no tax is due for a particular year (that is, to nil assessments). Consequently, any so-called reassessment from the minister of a particular taxation year that simply varies the amount of a taxpayer's losses but otherwise imposes no tax can be issued at any time, even after the expiry of the normal reassessment period, and is thus not binding on the minister.

The seminal case on this principle remains *New St James v. MNR*,[28] which concerned a taxpayer that operated a hotel. The taxpayer reported losses in 1955 and was assessed accordingly, and then carried forward those losses and deducted them in its 1956, 1957, 1958, and 1959 taxation years. Four years after the original assessment for 1955, the minister disallowed most of the 1955 loss (on the basis that many of the expenses claimed were in fact capital expenditures) and reassessed the 1956 to 1959 years accordingly. The taxpayer argued that the minister was barred from revisiting the quantum of losses in 1955, since that year had become statute-barred. The Tax Appeal Board and the Exchequer Court rejected this argument, holding

28 64 DTC 121 (TAB); varied 66 DTC 5241 (Ex. Ct.).

that the taxation years at issue were 1956 to 1959 and those years were not statute-barred, even if the amount of tax due in those years was dependent on the amount of losses available for carryforward from 1955.

The leading case today on the *New St James* principle is the Federal Court of Appeal's decision in *Canada v. Papiers Cascades Cabano Inc.*,[29] in which the court endorsed the following comment by Bowman CJ of the Tax Court in *Coastal Construction and Excavating Limited v. The Queen*:

> The Minister is obliged to assess in accordance with the law. If he assesses a prior year incorrectly and that year becomes statute-barred this will prevent his reassessing tax for that year, but it does not prevent his correcting the error in a year that is not statute-barred, even though it involves adjusting carry-forward balances from previous years, whether they be loss carry-forwards or balances of investment tax credits.[30]

Taxpayers also benefit from the *New St James* principle insofar as it allows them to retrospectively modify their tax positions in past years in which no tax was payable, even after the expiry of the normal reassessment period, where doing so is relevant to their tax liability in a taxable year. In *Clibetre Exploration Ltd. v. Canada (Minister of National Revenue)*,[31] for example, a taxpayer incurred non-capital losses for 16 consecutive years (1980 to 1995) before having a profitable year in 1996. Because non-capital losses at the time could be carried forward only for seven years, the taxpayer took the position that its losses between 1980 and 1995 were not non-capital losses, but instead were Canadian exploration expenses (CEE) giving rise to a cumulative CEE balance that could be deducted in its entirety in 1996. The minister refused to accept this recharacterization and only allowed a carryforward for seven years of non-capital losses. The Tax Court accepted the minister's argument that the taxpayer could not change the characterization of its expenses because the years were statute-barred. The Federal Court of Appeal reversed this holding from the bench, remarking that "there is no statutory bar to the requested recharacterization."[32]

THE LOSS DISPUTE PROVISIONS

The Enactment of the Provisions

In the March 1977 federal budget, the government announced its intention to create a procedure whereby taxpayers with capital, non-capital, or restricted farm losses in a particular year could obtain a "determination" of those losses from the minister (that is, a NODL). This determination, once made, would be subject to

29 2006 FCA 419; rev'g 2005 TCC 396.

30 *Coastal Construction and Excavating Limited v. The Queen*, 97 DTC 26, at 31-32 (TCC), quoted in *Papiers Cascades Cabano*, supra note 29 (FCA), at paragraph 23.

31 2003 FCA 16; rev'g *Clibetre Exploration Ltd. v. Canada*, 99 DTC 3503 (TCC).

32 Ibid. (FCA), at paragraph 6.

objection and appeal (thus derogating from the nil assessment rule) and would also be binding on both the taxpayer and the minister (thus derogating from the *New St James* principle).[33]

The parliamentary records provide little indication as to what specifically prompted the government to enact the loss dispute provisions in that year. It is possible that the initiative was partly motivated by the introduction of the capital gains taxation regime in 1972, followed by the stock market crash of 1973-74, which no doubt raised the importance of capital losses in the workings of the tax system.

The government's first attempt to follow through with the announced amendments came in June 1977, when Bill C-22 enacted (among other things) the first, short-lived iteration of subsections 152(1.1) and (1.2).[34] Bill C-22 generated considerable debate between the government and the Senate Standing Committee on Banking, Trade and Commerce (hereinafter referred to as "the Senate standing committee") that reveals competing visions over the intended scope of the loss dispute provisions and ultimately ended in a compromise.

Essentially, the government's view was that the issuance of any NODL should be entirely at the minister's discretion; the original version of the loss dispute provisions enacted by Bill C-22 was consistent with that intention. The Senate standing committee, however, believed that taxpayers have a "fundamental right" to object to assessments and argued that the issuance of NODLs by the minister should be mandatory and more widely available. The standing committee set out its position in its report dated December 9, 1976, which proposed amending the Act to deem a nil assessment to be an "assessment" subject to objection or appeal, or alternatively to require the minister to issue a NODL either on request or when a taxpayer sought to carry over and apply its losses in another taxation year.[35]

Following this report, the minister of national revenue (the Honourable Monique Bégin) appeared before the standing committee. After explaining the operational challenges that prevented her officials from auditing and determining all taxpayers' losses, the minister undertook to issue a NODL in cases where her determination of taxpayer's losses differed from the amount reported by the taxpayer, and to publicize this undertaking to taxpayers. The minister of finance (the Honourable Donald S. Macdonald) also appeared before the committee and undertook to propose amendments to the loss dispute provisions to give legal effect to Minister Bégin's undertaking. The Senate passed Bill C-22 (which included a variety of other amendments to the Act) largely in reliance on these undertakings.[36]

33 Canada, Department of Finance, 1977 Budget, Supplementary Budget Papers, Budget Paper C, Notice of Ways and Means Motion To Amend the Income Tax Act, March 31, 1977, at 107.

34 An Act To Amend the Statute Law Relating to Income Tax, SC 1976-77, c. 4, section 61(1).

35 Canada, Senate, Report of the Standing Committee on Banking, Trade and Commerce Relating to the Subject Matter of Bill C-22, 30th Parl., 2d sess., December 9, 1976; reproduced in Canada, Senate, *Debates*, 1976-1977, vol. 1, at 213-16.

36 Canada, Senate, *Debates*, February 24, 1977, at 451-52 and 456 (Hayden).

The government followed through several months later: the 1977 budget legislation (Bill C-11) replaced subsections 152(1.1) and (1.2) with new subsections 152(1.1) through (1.3),[37] which provided essentially as follows:

- Where the minister ascertained the amount of a taxpayer's non-capital loss, net capital loss, or restricted farm loss for a taxation year and that amount was different from the amount reported in the taxpayer's income tax return for that year, "the Minister shall, at the request of the taxpayer," issue a NODL for that year in respect of those losses (subsection 152(1.1)).
- The provisions of the Act pertaining to, inter alia, statute-barred years, objections, and appeals were applicable, mutatis mutandis, to a NODL (subsection 152(1.2)).
- The minister could not issue a NODL unless requested to do so by the taxpayer (subsection 152(1.2)).
- A NODL, subject to being varied on objection or appeal, was binding on the minister and the taxpayer for the purpose of calculating the taxable income of the taxpayer for any other year (subsection 152(1.3)).

While the Senate standing committee ultimately recommended adoption of the 1977 budget, it remained dissatisfied with the amended loss dispute provisions and continued to believe that taxpayers should be able to obtain NODLs even in the absence of a dispute with the minister.[38] During its hearings on the 1977 budget, the standing committee raised these concerns with revenue officials, who responded that they did not have adequate resources to systematically audit all loss claims as reported on tax returns.[39] Describing the matter as "quite a bone of contention," the standing committee pursued it further with the minister (then the Honourable Joseph-Philippe Guay), who undertook to personally study the question of when a taxpayer should have the right to obtain a NODL.[40]

The 1977 budget was adopted and, although subsections 152(1.1) through (1.3) have been amended and reformulated over the years, largely as a consequence of the inclusion of other categories of losses and determinations, their core features as enacted in 1977 remain in the Act to this day as the loss dispute provisions.

37 An Act To Amend the Statute Law Relating to Income Tax and To Provide Other Authority for the Raising of Funds, SC 1977-78, c. 1, section 76.

38 Canada, Senate, Standing Committee on Banking Trade and Commerce, First Report on the Advance Study of the Budget Resolutions Respecting Income Tax and Any Bill or Other Matter Relating Thereto, December 8, 1977, at 11; reproduced in Canada, Senate, *Debates*, 1977-78, appendix A, following 226.

39 Canada, Senate, *Debates*, 30th Parl., 3d sess., December 12, 1977, at 231 (Hayden).

40 Canada, Senate, *Debates*, 30th Parl., 3d sess., December 14, 1977, at 245-46 (Hayden).

CRA Administrative Positions on the Loss Dispute Provisions

Section 11.5.10 of the *CRA Audit Manual* (as revised in January 2014)[41] sets out a number of administrative positions with respect to the loss dispute provisions that reflect the minister's current view on how the provisions are intended by Parliament to operate.

First, the minister will issue NODLs only in the context of a disagreement with the taxpayer over the quantum of losses following an audit by the CRA. The minister will not, for example, issue a NODL to a taxpayer who requests it in order to sell a loss corporation.[42] This marks an apparent change from prior understanding and practice, given that *Interpretation Bulletin* IT-512, which was in force between July 15, 1988 and September 30, 2012, identified two other situations where "it is the Department's practice to act upon a request for a determination of losses"[43]—namely, where

> (a) a corporation has been wound up under subsection 88(1) into another corporation and that corporation has made the request in respect of losses which are deemed to be its losses under subsection 88(1.1) and 88(1.2); or
>
> (b) there has been an amalgamation and the new corporation has made the request in respect of losses of the predecessor corporation referred to in subsection 87(2.1).[44]

Second, if the minister adjusts a taxpayer's loss for a particular year at the taxpayer's request, such as through an audit request or an amended return, the minister will consider the adjusted loss to be the "reported amount" for the purposes of subsection 152(1.1) and thus will not issue a NODL in such situations. The minister will issue a NODL only "where there has been a material change to a reported loss resulting from an audit by the CRA."[45]

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41 Canada Revenue Agency, *CRA Audit Manual* (Ottawa: CRA).

42 At the Tax Executives Institute round table on November 18, 2014 (CRA document no. 2014-0550351C6), the minister expressed the view that a NODL requires, as a sine qua non, a difference of opinion between the minister and the taxpayer over the amount of losses available in a particular year. Consequently, the minister cannot simply issue a NODL at the request of a taxpayer upon the filing of its return. The minister's position is that "[t]his interpretation has been confirmed by the courts," presumably in reference to *Inco*, infra note 56, and *Armstrong*, infra note 57.

43 *Interpretation Bulletin* IT-512, "Determination and Redetermination of Losses," July 15, 1988, at paragraph 3 (cancelled September 30, 2012).

44 Ibid. The wording of IT-512 is somewhat unclear in that it states that "it is the Department's practice to act" on such requests "[w]here the provisions of subsection 152(1.1) are otherwise satisfied." Of course, if the provisions of subsection 152(1.1) are satisfied, the minister is obligated to act on such requests. In context, it seems that the minister's "practice" was to issue NODLs in the two circumstances described even in the absence of a live dispute over the loss balances.

45 *CRA Audit Manual*, supra note 41, at section 11.5.10.

Third, if a taxpayer reports a profitable or "nil" year and, as a result of an audit, the minister determines that the taxpayer actually suffered a loss and reassesses accordingly, the minister will grant a NODL for that year if requested.[46]

Fourth, if a taxpayer reports a loss and, as a result of an audit, the minister disallows the loss entirely and reassesses the year as a breakeven year, the minister will issue a "nil NODL" (that is, a NODL issued where the minister determines that the taxpayer sustained no loss at all) at the taxpayer's request. Unlike a nil assessment, a nil NODL *can* be objected to and appealed. Indeed, the case of *Aallcann Wood Suppliers Inc. v. The Queen*,[47] discussed below, involved such an appeal.

Case Law on the Loss Dispute Provisions

There have been relatively few reported decisions involving the loss dispute provisions. Most of the existing case law concerns procedural issues involving their mechanics of operation and interaction with the other dispute resolution procedures in the Act. In particular, the courts have considered whether and how losses can be put at issue in a tax appeal without a NODL, what constitutes a NODL, and when the minister is obligated to issue a NODL.

Aallcann Wood: A NODL Is Not Necessary To Dispute Losses

A seminal case on the loss dispute provisions is the decision of Bowman J (as he then was) in *Aallcann Wood*. This case concerned losses incurred in 1988 that the taxpayer sought to carry over and deduct in 1985, 1986, 1987, and 1989. The minister took the position that a $250,000 capital receipt in 1988 constituted business income, and reassessed the taxpayer so as to reduce its loss in 1988 and to disallow the deduction of the 1988 losses in 1985, 1986, 1987, and 1989. The taxpayer objected and appealed the reassessments for all five years. During the proceedings, the minister took the position that

> in the appeals for 1985, 1986 and 1987 the appellant could not challenge the Minister's computation of the loss for 1988 because the appellant had not requested a NODL for 1988.[48]

The taxpayer obliged by requesting a NODL, which was issued, objected to, confirmed, and appealed, the appeal being joined to the appeal of the taxable years.

Bowman J strongly criticized the minister for obliging the taxpayer to obtain a NODL for 1988, noting that the losses incurred in that year were all validly before the court as deductions claimed in other years and that, as a result,

46 See also CRA document no. 2013-0508751I7, December 4, 2013.

47 94 DTC 1475 (TCC).

48 Ibid., at 1475.

> [t]he matter of the 1988 loss is now before the court on two bases—both as an appeal from the 1988 loss determination and as a component of the taxable income for 1985, 1986, and 1987 and, to the extent that any amount of loss remains available for carry-forward, for 1989.[49]

Bowman J observed that

> the Crown's position is so out of line with both the law and with prevailing practice and could potentially have such far-reaching effects on any number of appeals before this court that I considered it desirable that the idea be nipped in the bud.[50]

Ten years later, Bowman ACJ (as he then was) reiterated this holding in *Burleigh v. The Queen*,[51] adding that, contrary to the minister's claims, it was not necessary that a loss be previously reported on a tax return and "processed" by the minister in order to be deductible as a carryover to another taxation year.[52]

722540 Ontario: A NODL Trumps Disputing Losses in Other Years

If a taxpayer obtains a NODL in a particular taxation year but fails to object and appeal in accordance with the procedural requirements and time frames set out in section 152, subsection 152(1.3) bars the taxpayer from challenging the quantum of losses set out in the NODL in other taxation years. Such a situation occurred in *722540 Ontario Inc. v. The Queen*.[53] This case concerned (among other things) a corporate taxpayer that had declared losses in 1988, which it sought to carry over and deduct in 1990 and 1991. The minister reassessed all three years so as to deny the loss and the carryovers. The taxpayer objected to the reassessments for all three years and also sought a NODL pertaining to 1988. However, the taxpayer did not file an objection to the NODL. The reassessments of 1990 and 1991 were confirmed. The taxpayer then appealed all three years to the Tax Court. Bowie J held that in the absence of a valid objection to the NODL, the court could not hear any appeal in respect of the quantum of losses available for carryover from 1988 because subsection 152(1.3) deemed the NODL for 1988 to be valid and binding, and the taxpayer could not collaterally attack it through an appeal of the reassessments for 1990 and 1991.

In coming to this conclusion, Bowie J noted that he did not "entirely agree" with Bowman J's comment in *Aallcann Wood* that a loss could come before the court "on

49 Ibid., at 1475.

50 Ibid., at 1476.

51 2004 TCC 197, at paragraphs 8-9.

52 Ibid., at paragraph 13.

53 2001 CanLII 939 (TCC); aff'd (on other grounds) 2003 FCA 112; leave to appeal to the Supreme Court of Canada dismissed, [2003] SCCA no. 201. The appeals were pursued by another appellant and were unrelated to the NODL issue.

two bases"—namely, as an appeal from a NODL and as a component of income for a taxable year.[54] Instead, Bowie J's view was that

> once there has been a loss determination requested and made, it is only by filing a Notice of Objection to it, followed by a Notice of Appeal from it, that that determination of the loss can be brought before the Court.[55]

Bowie J's view is more likely the correct one. Bowman J did not discuss the effect of subsection 152(1.3) in *Aallcann Wood*—presumably because it was not relevant to the issues before him—and, read in context, his comment about the taxpayer's 1988 losses being before the court "on two bases" was simply a complaint about the unnecessary duplication of procedures. It does not stand for the proposition that a taxpayer can obtain a NODL for a particular year, fail to object to or appeal the NODL, and then challenge the amount of losses available in that year in the context of an appeal in respect of a year to which those losses are carried over.

Inco: The NODL Provisions Presuppose a Dispute with the Taxpayer's Filing Position

In *Inco Limited. v. The Queen*,[56] the Tax Court held that a statement of account or other document from the minister stating losses that are consistent with the taxpayer's filing position does not constitute a NODL. In a decision confirmed by the Federal Court of Appeal, the Tax Court held that the ability of a taxpayer to request a NODL was an intentional policy choice by the legislature that was consistent with the raison d'être of the loss dispute provisions—namely, to provide a vehicle for the resolution of disputes when the nil assessment rule would otherwise bar an objection or appeal.

The Federal Court of Appeal reiterated this principle in *Armstrong v. Canada (Attorney General)*,[57] where a taxpayer sought to amend its returns after filing (and, indeed, while the years were under appeal) to declare and carry back additional losses. When the minister refused to process the amended returns, the taxpayer sought a writ of mandamus ordering the minister to issue a NODL. The Court of Appeal held that in the circumstances mandamus did not lie, reiterating that the loss dispute provisions have a "relatively limited scope" and apply only when the minister disagrees with losses reported on a taxpayer's tax return.[58] Since an amended return

54 *Aallcann Wood*, supra note 47, at 1475.

55 *722540 Ontario*, supra note 53 (TCC), at paragraph 28.

56 2004 TCC 373; aff'd 2005 FCA 44; leave to appeal to the Supreme Court of Canada dismissed, [2005] SCCA no. 278.

57 2006 FCA 119. *Armstrong* involved a number of other procedural issues that go beyond the scope of this article.

58 Ibid., at paragraph 17.

does not constitute a "return," but rather a request to the CRA to reconsider a previous assessment, a refusal by the minister to allow losses claimed on an amended return cannot support the issuance of a NODL under subsection 152(1.1).

As discussed above, the minister seems to interpret *Inco* and *Armstrong* as barring the issuance of a NODL at the request of a taxpayer in the absence of a dispute over the amount of the taxpayer's losses. However, neither *Inco* nor *Armstrong* expressly articulates such a proposition, and in 2013, the Department of Finance suggested that the minister may retain discretion to issue a NODL at the request of a taxpayer based on the taxpayer's reporting position.[59]

PITFALLS

As a result of the combined effects of the nil assessment rule, the *New St James* principle, and the loss dispute provisions, taxpayers with disputes involving loss years face various obstacles and traps that can potentially result in

1. the loss of the right to object to or appeal disputed income adjustments,
2. an obligation to pay arrears interest on extinguished tax debts,
3. the revival of issues relating to statute-barred years, and
4. the duplication of proceedings.

The discussion that follows describes various scenarios that illustrate these pitfalls and suggests how they might be avoided.

Extinguishment of the Right To Object or Appeal

Scenario 1

A corporate taxpayer has $100,000 of non-capital losses in 2010 and $50,000 of net income in 2011. In its 2011 return, the taxpayer carries forward and deducts $50,000 of its 2010 losses such that its income for 2011 is reduced to nil. The minister audits the taxpayer's 2011 year and disallows $10,000 of expenses. The taxpayer disputes the disallowance of expenses but also asks the minister to carry forward an additional $10,000 of losses from 2010 to ensure that no tax for 2011 is or ever will be due. The minister obliges and issues a nil reassessment.

In the circumstances described in scenario 1, the taxpayer often does not appreciate that claiming the carryforward to offset the disputed adjustments results in a nil assessment from which there is no right of objection or appeal, giving rise to the question of whether the taxpayer can dispute the disallowance of $10,000 of expenses (and if so, then how). The NODL provisions are not available in these circumstances since the quantum of the losses in 2010 is not disputed.

The traditional solution in this situation is for the taxpayer to wait until a subsequent taxation year and then attempt to "reclaim" the $10,000 of losses that covered

59 See CRA document no. 2014-0550351C6, November 18, 2014.

the disallowed expenses. For example, if the taxpayer had $50,000 of net income in 2012, it could file a tax return claiming a carryforward of $50,000 of losses from 2010. The minister would presumably take the position that the taxpayer had only $40,000 of losses remaining from 2010 and therefore assess tax in 2012 based on $10,000 of income. The taxpayer could object to and appeal the *2012* assessment, putting at issue the expenses previously disallowed in the *2011* reassessment.

The minister might argue that because the 2011 reassessment is deemed to be "valid and binding" (subsection 152(8)), the disallowance of $10,000 of expenses in the 2011 reassessment cannot be collaterally attacked through an objection to a 2012 assessment. The case law is clear, however, that the minister would be wrong. The 2011 reassessment was a nil assessment, and it is uncontested that the taxpayer owed no tax in 2011. It is the amount of tax that is "valid and binding," not the process through which the number was reached. As the Federal Court of Appeal held in *Clibetre*, discussed above, a taxpayer is free to argue that its previous expenses and deductions from years in which no tax was due should be recharacterized, even after the normal reassessment period for those years has passed, if doing so is relevant to the determination of tax due in a taxable year.

That said, this method of disputing the $10,000 of disallowed expenses potentially keeps the issue alive for many years and can complicate greatly the calculation of the taxpayer's loss balances. For example, suppose that the taxpayer has net income of $40,000 in 2012, a subsequent loss of $30,000 in 2013, and income of $30,000 in 2014. Table 1 illustrates the availability of loss carryforwards from the taxpayer's and the minister's respective perspectives.

As the table illustrates, the taxpayer would, without controversy, offset its 2012 income entirely with remaining 2010 losses. For 2014, however, the taxpayer would attempt to offset its income by claiming $10,000 of remaining 2010 losses and $20,000 of 2013 losses. The minister would presumably disagree and disallow the 2010 carryforward, but allow the taxpayer to claim an additional $10,000 of 2013 losses, thus resulting in another nil assessment. By this point, both the taxpayer and the minister would concur that the taxpayer's 2010 losses were exhausted, but they would disagree over the amount of 2013 losses available for carryforward: the taxpayer would argue that $10,000 was available; the minister, nil. This difference would be entirely attributable to the disallowed expenses of $10,000 in 2011—an issue that would remain open and not be subject to adjudication until the taxpayer had another taxable year in the future.

An alternative way to deal with the disputed 2011 audit adjustment is for the taxpayer to not take full advantage of the carryforward but leave a nominal amount of income. For example, the taxpayer in scenario 1 may ask the minister to carry forward $9,500 of losses from 2010 to offset the $10,000 of disallowed expenses, thus leaving $500 of taxable income and a nominal amount of tax.[60] The resulting reassessment can therefore be objected to or, if confirmed, appealed.

60 If the amount of tax due is $2 or less, the amount due will be deemed to be nil, resulting in a nil assessment (subsection 161.4(1)).

TABLE 1 Comparison of Minister's and Taxpayer's Positions on Loss Continuity, Scenario 1

	Taxpayer's position				Minister's position			
	Net income/ loss	2010 losses applied	2013 losses applied	Taxable income	Net income/ loss	2010 losses applied	2013 losses applied	Taxable income
	dollars							
2010	−100,000			loss	−100,000			loss
2011	50,000	50,000		nil	60,000	60,000		nil
2012	40,000	40,000		nil	40,000	40,000		nil
2013	−30,000			loss	−30,000			loss
2014	30,000	10,000	20,000	nil	30,000		30,000	nil
Losses available for carryforward		nil	10,000			nil	nil	

While this approach may be effective in preserving a right of objection, the taxpayer's right of appeal may still be lost if the minister allows the taxpayer's objection in part. For example, if the minister on objection allows the taxpayer to deduct only $500 of the $10,000 of disputed deductions in 2011, a nil reassessment will result with, as a consequence, no right of appeal. This is very similar to what happened in the *Okalta Oils* case. Again, the orthodox solution is for the taxpayer to wait for a subsequent year to attempt to carry forward the $9,500 of losses used to offset the $9,500 of disallowed deductions. This approach results, essentially, in the $9,500 of disallowed deductions in 2011 being the subject of two separate objections: once in the context of an objection to the 2011 reassessment disallowing the deductions themselves, and a second time in the context of an objection to an assessment in a future year disallowing the losses used to offset those deductions.

A third option available for the taxpayer is to not claim any additional carryforward at the audit stage but rather let the minister reassess with no additional carryforward, and then *in the notice of objection* claim an additional carryforward sufficient to leave $500 of taxable income, should taxable income exceed $500 after the minister has disposed of the other issues under objection. However, a potential problem with this approach is that if the taxpayer is a large corporation, one-half of any amount reassessed is immediately collectible (pursuant to subparagraph 164(1.1)(d)(ii) and subsection 225.1(7)). Even if the taxpayer is not a large corporation, a significant reassessment, even one that is destined to be substantially reduced through the application of loss carryforwards, may have to be disclosed to the taxpayer's creditors or in its financial statements.

Arrears Interest on Disputed Tax Debts

Scenario 2

A corporate taxpayer has $50,000 of net income in 2010 and $100,000 of non-capital losses in 2011. In its 2011 tax return, the taxpayer carries back $50,000 of its losses to

> 2010 so as to leave no tax due in 2010. In 2015, the minister audits the taxpayer's 2010 year and disallows $25,000 of expenses. The taxpayer disputes and intends to object to this adjustment, but also asks the minister to carry back an additional $25,000 of losses from 2011 to ensure that no tax for 2010 is or ever will be due. The minister obliges and issues a reassessment with no tax due, but with interest as calculated in accordance with paragraph 161(7)(b).

Scenario 2 resembles scenario 1 but with the key difference that arrears interest will be assessed. Paragraph 161(7)(b) provides that when the minister assesses an amount of tax that is offset by a carryback, interest runs on the tax until such time as the taxpayer requests, in writing, the carryback of losses. In the case of an audit adjustment, requesting the carryback might be possible only years after the fact. In scenario 2, for example, the taxpayer could claim the carryback only in 2015, when first advised of the minister's position about the disputed expenses. If the $25,000 of increased income resulted in increased tax payable of $3,750 (prior to the carryback), the latter amount would bear interest from 2010 to 2015, and the taxpayer would be assessed such interest accordingly, even though no tax would be due. The CRA would issue an "interest-only assessment."

Paragraph 161(7)(b) is a troubling provision in that it essentially results in the assessment of interest over periods when no tax is actually due. One might see the logic in assessing interest on unpaid tax between the year in which the tax arose and the year in which the offsetting loss was incurred (that is, between 2010 and 2011 in scenario 2), since the taxpayer had use of those funds during that interval at the public's expense. However, it is difficult to see the fairness of charging the taxpayer interest over the period when tax losses have reduced the tax liability to nil (between 2012 and 2015 in scenario 2).

That said, there is conflicting case law from the Tax Court over whether a taxpayer can object to or appeal an interest-only assessment such as that seen in scenario 2. On the one hand, Pizzitelli J answered "no" in *Nottawasaga Inn Ltd. v. The Queen*.[61] Relying on the second branch of the nil assessment rule as articulated in *Interior Savings Credit Union*, he held that

> the Court has no jurisdiction to hear a challenge to the underlying taxable income calculated by the Minister on which interest is calculated in accordance with the *Act* when there is no appeal against taxes assessed or a nil assessments [sic] of tax.[62]

Pizzitelli J commented that the taxpayer essentially waived its right to dispute the minister's audit adjustment by requesting the carryback that resulted in a nil assessment.[63]

61 2013 TCC 377.

62 Ibid., at paragraph 27.

63 Ibid., at paragraph 32.

Boyle J, on the other hand, came to a different conclusion in *Shreedhar v. The Queen*, reasoning as follows:

> On its face, the reassessment of the Appellant was not a nil assessment. An amount of interest was assessed by the CRA in its reassessment of him. *Assessed interest, as opposed to post-assessment accrued interest, forms part of the assessment. As it is not a nil assessment, an appeal can proceed.*[64]

Both *Nottawasaga Inn* and *Shreedhar* were informal procedure cases and thus non-precedential,[65] and the Federal Court of Appeal has yet to adjudicate the debate between Boyle and Pizzitelli JJ. However, there are good reasons to believe that Boyle J's view is the correct one. Interest is a liability created by the Act and is assessed by the minister using the same provisions that are used to assess tax and penalties (section 152). If the minister ascertains facts that give rise to added liability for tax, interest, or penalties, sections 165 and 169 allow a taxpayer to challenge those facts through objection or appeal. There is no provision in section 165 or section 169 that states that a taxpayer can dispute an assessment of interest only if it is connected to a live dispute over the amount of tax due.

Moreover, it has long been recognized that the Tax Court can hear and decide disputes over the imposition of penalties in the absence of any dispute over underlying tax liability.[66] If *Nottawasaga Inn* was correctly decided, it implies that the Tax Court does not have any jurisdiction to hear a dispute over penalties where the underlying tax giving rise to the penalty is undisputed. That conclusion would be a major change in the long-established understanding of the jurisdiction of the court.

Further, it appears that even the minister has come to accept Boyle J's view. According to the *CRA Appeals Manual* (as revised in March 2015), the minister regards

64 2016 TCC 254, at paragraph 5 (emphasis added). This case did not involve a loss carryback, but rather unclaimed education-related deductions that extinguished the disputed tax liability but resulted in the assessment of a nominal amount of interest. The decision in *Roper v. The Queen*, 2000 CanLII 369 (TCC), also potentially supports Boyle J's view. (In *Roper*, the taxpayer appealed an assessment of interest and penalties on allegedly unremitted source deductions that were offset by GST refunds.) According to Tax Court records, the *Shreedhar* case was heard on its merits, and in the middle of the hearing, the taxpayer decided to withdraw his appeal. An unreported order dismissing the appeal without costs was issued on June 16, 2017.

65 Tax Court of Canada Act, RSC 1985, c. T-2, as amended, section 18.28. Apparently, the taxpayer in *Shreedhar* was represented by a pair of volunteer articling students from Pro-Bono Students Canada.

66 There are countless examples of reported decisions by the Tax Court in such cases, including some confirmed by the Federal Court of Appeal. See, for example, *Grier v. Canada* (April 1, 2016), docket no. 2013-1837(IT)I (TCC); aff'd 2017 FCA 129 (appeal limited to a subsection 163(2) gross negligence penalty); *Morgan v. The Queen*, 2013 TCC 232 (appeal limited to a subsection 163(1) failure to declare a penalty); *Khalil v. The Queen*, 2002 CanLII 1029 (TCC) (appeal limited to a section 162 failure to file a penalty); and *741290 Ontario Inc. v. The Queen*, 2011 TCC 91; aff'd 2011 FCA 361 (appeal limited to a subsection 227(9) failure to withhold a penalty).

objections to interest-only assessments resulting from loss carrybacks as validly filed objections and thus not subject to the nil assessment rule.[67] If such an objection is validly filed, subsection 169(1) provides for a right of appeal to the Tax Court.

Revival of Issues Relating to Statute-Barred Years

Scenario 3

A taxpayer files a timely tax return for his 2010 taxation year and is assessed on \$10,000 of net income. He is subjected to a lengthy audit concerning \$7,000 of claimed expenses. During the audit, the taxpayer also discovers that he was entitled to deduct an additional \$25,000 of unclaimed expenses and asks the auditor to adjust the assessment accordingly. Prior to the expiration of the normal reassessment period, the auditor requests, and the taxpayer provides, a waiver to the minister limited to the claimed and unclaimed expenses. At the conclusion of the audit, the minister decides not only to disallow all the expenses (both claimed and unclaimed), but also to include in income an additional \$5,000 of supposedly undeclared revenues, thus resulting a total net income of \$22,000. The taxpayer objects to these conclusions not only on their merits, but also on the basis that the year is statute-barred, and thus that subsection 152(4) barred the minister from including the supposed undeclared revenues in income. On objection, the minister agrees to allow the \$25,000 of unclaimed expenses but decides against the taxpayer on the other issues, varying the reassessment into a nil assessment with losses of \$3,000 (\$10,000 + \$7,000 + \$5,000 − \$25,000 = −\$3,000).

Buried within scenario 3 is the disturbing result that an audit adjustment that was barred by subsection 152(4), and duly objected to on that basis, was arguably "unbarred" when the year was changed to a nil year through a completely unrelated adjustment in the taxpayer's favour.

As discussed above under scenario 1, the taxpayer can still potentially dispute the \$5,000 income inclusion on its merits in the context of an appeal of a subsequent year. The taxpayer would take the position that the \$5,000 did not constitute undeclared revenues, such that he had \$8,000 of losses in 2010 (rather than \$3,000) available for carryforward. The taxpayer would then attempt to claim the loss in a future year with taxable income. The minister would presumably take the position that the taxpayer had only \$3,000 of losses in 2010 to carry forward and would assess the taxpayer accordingly. The taxpayer would be able to object to or appeal the refusal of the carryforward, putting in issue the same facts and reasons raised by the \$5,000 income inclusion. This would essentially be the taxpayer's second objection on exactly the same issue.

However, while the taxpayer would be able to dispute the \$5,000 inclusion on its merits, he might no longer be able to argue that it was statute-barred. Although there seems to be no case law on this precise issue, this result seems to flow from the

67 Canada Revenue Agency, *CRA Appeals Manual* (Ottawa: CRA), at section 3.10.3.1: "In the following situations, the objector is considered to have filed a valid objection even though no federal tax is payable: . . . Assessment of interest only (e.g., interest due to assessing adjustments that are eliminated by loss and tax credit carry-backs from subsequent years)."

wording of subsection 152(4) read in conjunction with the nil assessment rule and the *New St James* principle. Subsection 152(4) bars the minister from reassessing *years*, not *issues*. During the normal reassessment period for a particular year, the minister may reassess more or less as he or she sees fit. After the normal reassessment period, however, the minister is barred from reassessing tax for that year unless any of the various exceptions set out in subsection 152(4) or elsewhere apply. One such exception allows the minister to reassess a statute-barred year if the taxpayer has provided a valid waiver for that year (subparagraph 152(4)(a)(ii)), subject to the limitation that any such reassessment can pertain only to the matters specified in the waiver (subparagraph 152(4.01)(a)(ii)). In other words, the minister may reassess a statute-barred *year* in respect of *issues* for which valid waivers have been provided. The starting point, however, is always the *year being assessed*, not the *issue* or the year in which the issue arose.

Because the taxpayer in scenario 3 is in a dispute with the minister over the quantum of losses in 2010, he could request a NODL for that year and then dispute the $5,000 inclusion through objection and appeal. However, it is unclear whether he could continue to rely on the fact that the $5,000 audit adjustment was first made after the normal reassessment period. As discussed above, the issuance of a NODL triggers the start of the normal redetermination period, during which the minister can "redetermine" the taxpayer's losses more or less as he or she sees fit. It arguably follows that the issuance of an initial NODL restarts the statute-barred period and thus reopens any issue in a year that may have been statute-barred, including issues that may even have been under objection on the very ground that the year was statute-barred.

This result is inconsistent with the underlying policy justification for the nil assessment rule, which allows the minister to forgo auditing a taxpayer's loss claims (however large) until such time as those losses actually make a difference in the amount of tax that the taxpayer has to pay. The minister benefits by being able to focus the CRA's limited resources on audits that have the greatest potential to reveal unpaid taxes, and taxpayers with money-losing businesses also generally benefit from not having a tax audit to add to their business woes. However, where a taxpayer has filed a return showing tax payable and has been assessed accordingly, the minister has been effectively put on notice that if he or she wishes to challenge the taxpayer's returns, he or she must take action in a timely manner. If the minister does so, audits the taxpayer, and ultimately makes adjustments in the taxpayer's favour that convert the year into a loss year, there seems to be no principled reason why the statute-barred period should completely restart and any issues relating to a statute-barred year should suddenly be revived.

Certainly, the reverse is not true: the conversion of a loss year to a profitable year does not restart the normal reassessment period. Under subsection 152(3.1), the issuance of a notification that no tax is due (which includes a notice of assessment for a loss year) starts the normal reassessment period. After the expiry of that period, the minister remains free to "reassess" so as to vary the amount of the losses, but the minister cannot assess tax unless one of the exceptions set out in subsection 152(4) or elsewhere in the Act applies.

Ultimately, the problem is that there is a gap in section 152 insofar as it does not contemplate situations in which a taxation year is originally reported and assessed as taxable but then reassessed as a nil year or a loss year through taxpayer requests or audit adjustments. Although the minister partly fills this gap by issuing NODLs in situations where the taxpayer disputes the quantum of the loss,[68] this administrative concession does not address the problem of the revival of issues relating to statute-barred years.

It is possible that the courts may decide—in a manner similar to what was done in *Agazarian*—to construe subsections 152(1.2) and (4) in a purposive manner so as to fill this gap, and to hold that if a taxpayer obtains a NODL for a taxation year that was originally reported and assessed as a profitable year, the taxpayer can challenge any of the minister's adjustments made after the normal reassessment period as being statute-barred. Such an interpretation could conceivably find justification in subsection 152(1.2), which provides that subsection 152(4) applies to any NODL "with any modifications that the circumstances require."

Otherwise, there seems to be little that the taxpayer in scenario 3 can do to avoid losing his ground of objection that the minister was statute-barred from including the $5,000 of alleged undeclared income in 2010. One possibility might be to pre-empt the issuance of the nil assessment by proceeding directly to the Tax Court before the minister concedes the $25,000 of additional expenses at the conclusion of the objection. In the context of an appeal, the Tax Court would hear and decide all the relevant issues—including the application of subsection 152(4) to the $5,000 of alleged undeclared revenue—and its findings would bind the minister through the doctrine of res judicata. This approach, of course, would come with the added costs, complexity, and publicity of a trial. It would also run the risk that the minister might not concede the $25,000 of additional expenses but instead litigate them as well. The minister could also conceivably seek to put a premature end to the appeal by simply reassessing the taxpayer to apply the undisputed expenses, and then move to strike the taxpayer's appeal on the ground of the nil assessment rule, thus pushing the issue of the $5,000 undeclared income to another day in a non-statute-barred year.

Duplication of Remedies and the Large Corporation Rules

The three scenarios described below are similar. They illustrate situations where a large corporation taxpayer with a dispute concerning losses (whether the quantum of losses in a particular year or the use of carryovers to offset disputed amounts in taxable years) files multiple objections in different taxation years covering the same disputed adjustment.

68 See the discussion above under the heading "CRA Administrative Positions on the Loss Dispute Provisions." It is unclear from the *CRA Audit Manual*, supra note 41, whether the minister will issue a nil NODL if the minister's position is that a profitable year has been converted to a break-even year and the taxpayer claims that it should be converted to a loss year.

Scenario 4a

A large corporation taxpayer has $100,000 of non-capital losses in 2010 and $50,000 of net income in 2011. In its 2011 return, the taxpayer carries forward and deducts $50,000 of its 2010 losses, such that its income for 2011 is reduced to nil. The minister audits the taxpayer's 2011 year and disallows $10,000 of expenses. The taxpayer claims an additional $9,500 of its 2010 losses to offset the inclusion, thus leaving net income of $500, which results in a reassessment for nominal tax. The taxpayer objects to the reassessment, setting out facts and reasons against the disallowance of the $10,000 of expenses. The minister allows an additional $500 of expenses but otherwise disallows the objection, issuing a nil reassessment, which is not subject to appeal. Thus, the dispute over the $9,500 expenses, and the necessity of the carryforward, is deferred to another year (as discussed in scenario 1).

In 2012, the taxpayer has ample net income, against which it seeks to carry forward and deduct $50,000 of losses from 2010. The minister's position is that the taxpayer has only $40,500 of available losses to carry forward and reassesses accordingly. The taxpayer objects, offering the same facts and reasons as in its objection to the 2011 reassessment, as well as several new ones.

Scenario 4b

A large corporation taxpayer declares $40,000 of non-capital losses in 2010 and $100,000 of net income in 2011. On its 2011 tax return, the taxpayer carries forward and deducts all of its losses from 2010. The minister audits the taxpayer and adds $10,000 of undeclared revenues to 2010, thus reducing the non-capital loss and the available carryforward. The minister reassesses both 2010 and 2011 accordingly—2010 as a nil assessment and 2011 with tax due. The taxpayer objects to the 2011 reassessment, presenting facts and reasons against the inclusion of the additional revenue in 2010. The taxpayer then obtains a NODL for 2010 and objects to it, offering the same facts and reasons as in its objection to the 2011 reassessment, as well as several new ones.

Scenario 4c

A large corporation taxpayer declares $100,000 of non-capital losses in 2010 and $50,000 of net income in 2011. On its 2011 tax return, the taxpayer carries forward and deducts $50,000 of its 2010 losses, such that its income for 2011 is nil. The minister audits the taxpayer, disallows $50,000 of the non-capital losses claimed in 2010, and reassesses accordingly. There is no change to the 2011 taxation year. The taxpayer obtains a NODL for 2010 and objects. While the objection is under review, the taxpayer files its 2012 tax return and seeks to carry forward and deduct the disallowed $50,000 of losses from 2010. The minister disallows the loss claim and assesses the taxpayer's 2012 year accordingly. The taxpayer objects to the 2012 assessment, offering the same facts and reasons as in its objection to the 2010 NODL, as well as several new ones.

The procedural issue presented by scenarios 4a, 4b, and 4c is whether a large corporation taxpayer can adduce new facts and reasons in its various objections. Pursuant to subsection 165(1.11), a large corporation (as defined in subsection 225.1(8)) is required, in a notice of objection, to describe the issues to be decided, to provide facts and reasons in support of its position, and to specify in respect of each issue the relief sought, expressed as a change in a "balance" (as defined in subsection 152(4.4)). If and when the minister reassesses a large corporation taxpayer following the filing of a notice of objection and the taxpayer objects, the taxpayer may only raise issues that it properly described, substantiated, and quantified in its previous objection (subsection 165(1.13)). Similarly, a large corporation taxpayer may appeal to the Tax Court only with respect to issues that it has described, substantiated, and quantified in its objection (subsection 169(2.1)).

A full review of the case law interpreting subsection 165(1.11) and its related provisions (collectively, "the large corporation rules") falls beyond the scope of this article. However, there do not seem to be any reported cases that discuss whether a large corporation taxpayer that essentially files objections in different taxation years pertaining to the same underlying adjustment, as a result of the application of the nil assessment rule and/or the loss dispute provisions, can raise new facts and reasons in subsequent objections.

The answer, however, might be found in the precise wording of subsections 165(1.13) and (1.14) and 169(2.1), which set out the consequences for non-compliance with the large corporation rules. As can be seen in these provisions, the large corporation rules produce effects only when (1) the minister varies an assessment under objection (subsection 165(1.13)) or (2) the taxpayer seeks to appeal an assessment to the Tax Court (subsection 169(2.1)). In the former case, subsection 165(1.13) limits the ability of a taxpayer to object to a "particular assessment" for a given taxation year issued in response to an objection. On its plain reading, the provision has no application to reassessments issued for *other* taxation years. Similarly, in the latter case, subsection 169(2.1) applies to situations where a taxpayer seeks to appeal an assessment "for the year" in respect of which the taxpayer has served a notice of objection. Once again, on its plain reading, subsection 169(2.1) starts with an assessment in a given taxation year. It has no application for other assessments issued in other taxation years.

It seems to follow, therefore, that a large corporation taxpayer placed in a position to dispute exactly the same adjustment in multiple years because of the mechanics of the nil assessment rule—as seen in scenarios 1, 3, or 4a, for example—is not bound by its facts, reasons, and quantum as set out in the taxpayer's first objection. Rather, the taxpayer is free to add new facts and reasons, or revise its quantum, in new objections filed in other taxation years.

A similar result seems to follow for objections to NODLs, such that the taxpayer in scenario 4b should be able to adduce new facts, reasons, and quantum in its objection to the NODL over and above those presented in its objection to the reassessment of the year to which the losses were carried forward.

That said, the converse is not necessarily true, given Bowie J's analysis in *722540 Ontario*[69] to the effect that obtaining a NODL for a particular year essentially preempts any objections in other taxation years that concern the quantum of losses in

69 See the discussion above at note 53 and following.

that year. Consequently, in scenario 4c, while the large corporation rules would not necessarily preclude the taxpayer from making new arguments in its 2012 objection to the disallowance of the $50,000 of losses, such arguments would essentially be moot since the question of the amount of losses in 2010 available for carryforward would be resolved definitively in accordance with the 2010 objection.[70]

CONCLUSION: REFLECTIONS AND OPTIONS FOR REFORM

There are sound policy reasons for treating loss years differently than profitable years for the purposes of applying the Act's statute-barring rules or dispute resolution provisions. The minister's resources are no doubt better spent auditing profitable businesses with tax to pay, rather than money-losing businesses where the primary (if only) source of contention is the quantum of losses that might be carried over to future years. The nil assessment rule and the *New St James* principle ensure that disputes over losses can be pursued only when the losses have an actual impact on the amount of tax due.

The loss dispute provisions provide that if the minister does decide to examine a taxpayer's loss claim in a particular year, and then disputes it, the taxpayer can seek a binding resolution of the dispute. However, the loss dispute provisions have limited application, leaving gaps that can result in the duplication, prolongation, or complication of proceedings when loss years are involved, as well as, in some cases, the loss of the right of objection or appeal, either de jure or de facto.

Section 173 offers a potentially simple and flexible vehicle to address some of these situations without Parliament's involvement. Subsection 173(1) allows the minister and a taxpayer, if they agree, to state a question of law, fact, or mixed law and fact to the Tax Court for resolution "in respect of any assessment, proposed assessment, determination or proposed determination." While the potential scope of application of section 173 is very broad, the provision is rarely used owing to the minister's longstanding position that it is to be used sparingly.[71] However, with a change in attitude on the part of the minister, section 173 could be used to confer jurisdiction on the Tax Court to hear and decide disputes in relation to assessments or determinations other than the precise quantum of tax liability.

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70 However, in *Devon Canada Corporation v. Canada*, 2015 FCA 214, at paragraphs 30 and 33, the Federal Court of Appeal held that if a large corporation taxpayer submits additional facts and reasons to the minister while an objection is under review, and the minister considers them, then those facts and reasons are considered to have been part of the objection and can be raised on further objection and appeal. Consequently, in the case of the taxpayer in scenario 4c, if (1) the taxpayer presented its 2012 objection while its 2010 objection was under review, (2) the two objections were assigned to the same officer and processed together, and (3) the officer considered the additional grounds raised in the 2012 objection, then those grounds might be considered to be incorporated into the 2010 objection.

71 See Colin Campbell, *Administration of Income Tax*, 2017 ed. (Toronto: Thomson Reuters, 2017), at section 14.1.1; and *CRA Appeals Manual*, supra note 67, at section 7.9.4.1.

Indeed, if a taxpayer initiates an appeal that is contrary to the nil assessment rule but is otherwise grounded in a live, bona fide dispute with the minister that would benefit from prompt resolution—such as the taxpayer in *Okalta Oils* (which sought certainty with respect to its entitlement to the oil drilling and exploration credit), the taxpayer in *Joshi* (who faced an issue over her education-related credit balances), the taxpayer in *Interior Savings Credit Union* (which sought certainty regarding its PRA), or the taxpayer in *Nottawasaga Inn* (which offset disputed income with loss carryovers)—perhaps the default reaction from the minister should not be a motion to quash but rather an invitation to the taxpayer to convert the appeal into a section 173 reference on the disputed issues.[72] The Tax Court would then have jurisdiction to hear and decide the reference on its merits while the matter was fresh, and the taxpayer would not be obliged to conserve all of its records with a view to relitigating the issue years later when its tax liability would be affected.[73]

Alternative reforms would likely require amendments to sections 152, 165, and 169. One possible reform—first suggested in 1977 by the Senate Standing Committee on Banking, Trade and Commerce—would allow taxpayers to seek a NODL for any loss year once a carryover of those losses was claimed.[74] This approach would enable taxpayers to obtain greater certainty with respect to the use of their losses, while also ensuring that the minister would be potentially bound by a taxpayer's reported losses only when those losses started to have an actual effect on the taxpayer's tax liability in another year. However, although potentially useful, this reform would not address the pitfalls and legislative gaps discussed in the previous section, such as those caused when losses are carried over to offset disputed income inclusions or when profitable years are changed into loss years.

An arguably more useful reform—one that would directly address the problems set out in scenarios 1 and 2 above—would allow taxpayers to object to and appeal from nil assessments that arise simply as a result of the application of loss carryovers. This could potentially be accomplished through the enactment of provisions that would

- deem such a nil assessment to be an "assessment" for the purposes of sections 165 and 169,
- provide that loss carryovers would be essentially disregarded for the purposes of disposing of the issues under objection or appeal, and
- provide that the outcome of the objection and appeal would be valid and binding notwithstanding the *New St James* principle.

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72 As stated in the *CRA Appeals Manual*, supra note 67, at section 3.10.1, "[a]lthough an objection to a notification that no tax is payable is invalid, the CRA follows the practice of reconsidering the issues at the time the objection is filed with a view to resolving them when they are current in the minds of the objector and the CRA auditor."

73 If the minister unreasonably refused to consent to the conversion of an appeal of a nil assessment to a section 173 reference, the taxpayer could seek judicial review of the refusal in the Federal Court.

74 See the discussion of the Senate report, supra note 35 and the accompanying text.

A similar result might also be achieved by enacting provisions analogous to the loss dispute provisions that would permit taxpayers to seek a "notice of determination of taxable income prior to application of loss carryovers" (a NOTIPALC) in years where the minister disputes the taxpayer's reported calculation of taxable income in a particular year but nevertheless issues a nil assessment owing to loss carryovers. A NOTIPALC would essentially be the counterpart to a NODL, but applicable to years where losses are carried over instead of years where losses are realized.

Another potentially useful reform, which would largely address the issue set out in scenario 3, would involve clarifying how section 152 applies in situations where a profitable year becomes a loss year owing to audit adjustments, and in particular the apparently incongruous result, discussed above, that the statute-barred period essentially restarts if the taxpayer requests a NODL, thus reviving issues that the minister would otherwise be barred from adjusting.

To the extent that all of these possible reforms would reduce the need to file duplicative objections in multiple taxation years relating to the same disputed amounts, the issues and uncertainties set out in scenario 4 would also be largely ameliorated.

Relatively simple steps such as those suggested above have the potential to greatly simplify the resolution of disputes involving loss years and to help taxpayers to navigate a procedural minefield that many—especially average business people—no doubt find impassable.

ADDENDUM

While this article was in production, the Federal Court of Appeal issued its decision in *Bakorp Management Ltd. v. Canada*,[75] which illustrates another procedural pitfall in claiming losses. In that case, the taxpayer was apparently denied the ability to make full use of its losses even after it had successfully litigated to establish their existence.

Bakorp concerned a taxpayer in a longstanding dispute over the amount of non-capital losses experienced in its 1987 taxation year. The taxpayer carried over and deducted some of the disputed losses in its 1989 taxation year. The minister disputed the carryover, leading to an appeal in the Tax Court in respect of the 1989 taxation year, which was settled partly in the taxpayer's favour in 2010.

Following the settlement, the taxpayer devised a plan to make the best use of its belatedly established losses. As a result of an amalgamation, the taxpayer had two year-ends in 1992: one in January and one in March. The taxpayer asked the minister, pursuant to subsection 152(4.3), to reassess its taxation year ending in January 1992 so as to reduce the amount of losses carried forward by $439,581, and to offset any additional tax due in that taxation year with additional investment tax credits.[76] It then sought, in its return for the taxation year ending in March 1992

75 2019 FCA 195; aff'g the unreported decision of the Tax Court of Canada.

76 Neither the Federal Court of Appeal's decision nor the decision of the Tax Court in *Bakorp*, discussed below, explains where these investment tax credits came from, or why losses had

(which was not filed until 2011), to carry forward and deduct this additional $439,581. The minister refused the subsection 152(4.3) request and reassessed the taxation year ending in March 1992 so as to refuse the additional $439,581 carry-forward. The taxpayer appealed this reassessment to the Tax Court.

Subsection 152(4.3) requires the minister, following a reassessment or a decision on an appeal of a particular year, to reassess subsequent taxation years to effect changes to tax balances (including loss balances) relating to the reassessment, if the taxpayer so requests within the applicable time limit. In its appeal to the Tax Court, the taxpayer argued that it was entitled to carry forward and deduct the losses of $439,581 since the minister was required, under subsection 152(4.3), to essentially free up that amount of losses previously deducted from the taxation year ending in January 1992. At the Tax Court, in a decision rendered orally, Hogan J dismissed the appeal on the ground that the kind of change requested by the taxpayer was not within the ambit of those required by subsection 152(4.3). He also noted that the Tax Court did not have jurisdiction to decide whether the minister had wrongfully failed to process a request made under subsection 152(4.3) and that the appropriate recourse for a taxpayer seeking to dispute such a refusal by the minister was to request a judicial review by the Federal Court.

On appeal, the Federal Court of Appeal declined to deal with the merits and dismissed the appeal entirely on the question of jurisdiction, holding that the taxpayer could challenge the minister's denial of its subsection 152(4.3) request only through judicial review in the Federal Court. In coming to this conclusion, the court distinguished cases such as *Aallcann Wood*[77] and *Papiers Cascades Cabano*,[78] noting that those cases concerned alleged errors in tax treatment in statute-barred years, the correction of which could affect tax liability in subsequent years. In *Bakorp*, however, there was no error in the taxpayer's return for its taxation year ending in January 1992; the taxpayer was legally entitled to carry forward the amount of the losses claimed, to offset taxable income, and it could not change its mind about using those losses in the context of an appeal relating to a subsequent taxation year.

Essentially, *Bakorp* has clarified that the ability of taxpayers to recharacterize and restate past tax returns in statute-barred years under the *New St James* principle does not allow a taxpayer to modify previously taken positions that were factually and legally well founded.

Perhaps more important, *Bakorp* provides another example of how unclear the line often is between the jurisdiction of the Tax Court and the jurisdiction of the Federal Court over tax matters, and the unfortunate consequences to taxpayers who choose to litigate a complex dispute in the wrong forum.

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previously been carried forward to the taxation year ending in January 1992 instead of these credits being used.

77 *Aallcann Wood*, supra note 47.

78 *Papiers Cascades Cabano*, supra note 29.