IN THE SUPREME COURT OF NOVA SCOTIA
IN BANKRUPTCY AND INSOLVENCY
Citation: Fretz (Re), 2011 NSSC 467

Date: December 21, 2011
Docket: B 34356
Registry: Halifax

District of Nova Scotia
Division No. 01 - Halifax
Court No. 34356
Estate No. 51-1307118

In the Matter of the Bankruptcy of Marie Anna Fretz

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In the Matter of the Bankruptcy of Randall Arthur Fretz

D E C I S I O N

Registrar:	Richard W. Cregan, Q.C.
Heard:	October 28, 2011
Counsel:	Mark Rosen representing BDO Canada Limited
	D. Bruce Clarke, Q.C. representing the Bankrupts
	Caitlin Ward representing Canada Revenue Agency

[1] In these applications Randall Arthur Fretz and Marie Anna Fretz ask that they be discharged from bankruptcy. They are married to each other and in their mid 50's. Since 1987 they have been operating a communication consulting business, taking assignments in various places in Canada and the United States. They have a home in Barss Corner, Lunenburg County and vacant property in Cape Breton.

[2] Their Trustee, Mark Rosen of BDO Canada Limited, recommends that they now be given absolute discharges. As each has more than $200,000 of personal income tax debt representing more than 75% of total unsecured proven claims, their discharges are governed by Section 172.1 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (*BIA*). The Canada Revenue Agency (CRA) objects to their being granted absolute discharges. It asks that their discharges be subject to conditions.

[3] A brief outline of their dealings with CRA is necessary.

[4] They complied in 1997 with a request for information regarding their

Harmonized Sales Tax return. This was followed up with discussions with CRA. They thought the concerns of CRA had been resolved.

[5] On October 31, 2000, CRA executed a search and seizure warrant at their home in Barss Corner and seized their books and records. They responded in August 2001 to questions from CRA.

[6] On October 25, 2001 they each received Notices of Reassessment for taxation years 1994, 1995, 1996 and 1997.

[7] They each filed a Notice of Objection in January 2002. CRA registered liens against their real estate. In 2003 and 2004 they made payments totaling $64,119.14 on account of these reassessments.

[8] Meanwhile they and CRA had further discussions which led them to believe matters had been resolved. However, in September 2003 CRA confirmed the reassessments. CRA continued to demand payment and to take collection proceedings.

[9] On December 3, 2003, CRA makes a demand for payment in full. Two days later, Mrs. Fretz, while working in Chicago, had a severe subarachnoid hemorrhage, which required emergency surgery. Follow-up surgery was required and was done in Halifax on December 30, 2004.

[10] From 2003, there were various attempts to settle. Proceedings were commenced in the Tax Court of Canada. CRA continued with enforcement proceedings.

[11] They have been compliant in reporting and paying their taxes in 1998 and subsequent years.

[12] Mrs. Fretz has been living in Alberta where she has had work and has a modest apartment. Mr. Fretz has been living in the Barss Corner home. For reasons not entirely clear to me they think they have the responsibility of maintaining the house and the Cape Breton property by paying the taxes, the mortgage, and all the other expenses. Mr. Fretz has been living in the home. It has been listed for sale, as has the Cape Breton property. Interest is limited. With the mortgage and the security held by CRA, there is little or

no equity in these properties. They are, by continuing in possession of the home, at risk of being liable for a deficiency claim should the mortgage be foreclosed.

[13] They had operated their business as a proprietorship, under the name of Pro Serve Consultants. However, in 2009 they incorporated Pro Serve Consulting Ltd. in Alberta. Incorporation was a requirement of potential clients. They incorporated in Alberta because they had significant work in that province. Presently, they do not have any work in progress; however, they are answering requests for proposals and expect work to materialize shortly.

[14] They were equal shareholders and directors in the corporation. However, with bankruptcy, ownership vested in their trustee, and they could no longer act as directors. They appointed an unrelated person, Dawn Smith, as director. They report to her and she supervises the financial matters. Their income in recent years has been modest.

[15] As noted above, they had appealed the reassessments to the Tax Court of

Canada. The case was assigned to Mr. Justice Little. Because of the complexity of the case he advised them to consult a lawyer. They engaged Roderick Rogers, a tax practitioner in Halifax.

[16] He prepared a lengthy submission in preparation for a pre-hearing conference before a judge on July 22, 2008. A copy of this letter is before me. Counsel for CRA objected to its admission. I agreed with her that I could not take the letter as proof of the facts contained in it or as acceptance of the submissions made. However, I think it is in order for me to learn from the letter of the issues between them and CRA and of their struggles in addressing their situation.

[17] As well, I can take from the letter that there were many issues which may have had great potential for legitimate conflicting views, and that Mr. Fretz and Mrs. Fretz were making reasonable efforts to deal with them.

[18] They did not proceed with the appeal. Their lawyer told them that it would be lengthy and expensive, possibly costing $80,000. There were countless slips of paper which would have to be submitted and explained. There was

also very much a concern for what the stress of the appeal would do to Mrs. Fretz's health.

[19] Mrs. Fretz spoke of the frustration in discussions with CRA. The agents kept coming up with new claims. Somewhere in the course of it all, they were told that the file was being referred to the RCMP. This necessitated their consulting a criminal lawyer. Nothing came of this.

[20] They had spoken with Mr. Rosen in 2002. Their only solution was to come back to Mr. Rosen. This they did late in 2009. Their assignments were made on January 7, 2010.

[21] Mrs. Fretz's Section 170 report shows that $7,462.54 has been realized and estimates a further $45,860.00. Mr. Fretz's report shows $20,384.17 and $47,895.00. These total $121,601.71. Included in this amount is the surplus income required by the Trustee. Also, Mrs. Fretz's report shows unsecured debts totaling $495,024.00 of which $395,882.00 is owed to CRA and secured debt of $138,404.00, also owed to CRA. Mr. Fretz's report shows unsecured debts totaling $508,726.00 of which $423,651.00 is owed to CRA

and secured debt of $138,404.00, also owed to CRA.

[22] CRA's notice of objection is based on Paragraphs (a) and (n) of Subsection 173 of the *BIA,* namely:

> a) the assets of the bankrupt are not of a value equal to fifty cents on the dollar on the amount of the bankrupt's unsecured liabilities, unless the bankrupt satisfies the court that the fact that the assets are not of a value equal to fifty cents on the dollar on the amount of the bankrupt's unsecured liabilities has arisen from circumstances for which the bankrupt cannot justly be held responsible.
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> n) the bankrupt, if the bankrupt could have made a viable proposal, chose bankruptcy rather than a proposal to creditors as a means to resolve the indebtedness.

[23] The Trustee reports indicated that viable proposals could not be made. No evidence to the contrary was presented. Their assets are not of a value equal to fifty cents on the dollar. The question then is whether this tax indebtedness has arisen from circumstances for which they cannot justly be held responsible. I think this objection is academic. The Trustee's reports also state that they have high income tax debt pursuant to Section 172.1. The issues and consequences on this objection are subsumed under this Section.

[24] I quote the relevant portions of this Section:

> 172.1 (1) In the case of a bankrupt who has $200,000 or more of personal income tax debt and whose personal income tax debt represents 75% or more of the bankrupt's total unsecured proven claims, the hearing of an application for a discharge may not be held before the expiry of
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> (a) if the bankrupt has never before been bankrupt under the laws of Canada or of any prescribed jurisdiction;
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> (I) 9 months after the date of bankruptcy if the bankrupt has not been required to make payments under section 68 to the estate of the bankrupt at any time during those 9 months, or
>
> (ii) 21 months after the date of bankruptcy, in any other case ....
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> (2) Before proceeding to the trustee's discharge and before the first day that the hearing could be held in respect of a bankrupt referred to in subsection (1), the trustee must, on five days notice to the bankrupt, apply to the court for an appointment for a hearing of the application for the bankrupt's discharge.
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> (3) On the hearing of an application for a discharge referred to in subsection (1), the court shall, subject to subsection (4),
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> (a) refuse the discharge;
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> (b) suspend the discharge for any period that the court thinks proper; or
>
> (c) require the bankrupt, as a condition of his or her discharge, to perform any act, pay any moneys, consent to any judgments or comply with any other terms that the court may direct.
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> (4) In making a decision in respect of the application, the court must take into account

> (a) the circumstances of the bankrupt at the time the personal income tax debt was incurred;
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> (b) the efforts, if any, made by the bankrupt to pay the personal income tax debt;
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> (c) whether the bankrupt made payments in respect of other debts while failing to make reasonable efforts to pay the personal income tax debt; and
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> (d) the bankrupt's financial prospects for the future.

[25] It is conceded that their debts to CRA are "high income tax debts" as described in Section 172.1. It is thus mandatory that I follow Paragraph 172.1(3) in disposing of these applications.

[26] The evidence given by Mr. Fretz and Mrs. Fretz is that they understood they had acted responsibly in making reports of their income for the years in question.

[27] The only evidence given by CRA is in the affidavits of Jillian Fulmore, one in each application. Ms. Fulmore is the High Risk Insolvency Officer in CRA's Halifax office responsible for the collection activities of CRA respecting Mr. Fretz and Mrs. Fretz. These affidavits simply record the various procedures and financial particulars in the reassessment process.

[28] It is the submission, as I understand it, of counsel for CRA that in determining the condition of their discharge I should simply accept the Notices of Reassessment as proof that Mr. Fretz and Mrs. Fretz had acted fraudulently, or with gross negligence in reporting their income and expenses.

[29] Note should be made that these were not reassessments made within the normal three year period allowed to CRA to reassess any return. Rather CRA invoked the provisions of Subsection 152(4) of the *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.) (*ITA)* which allow the Minister of National Revenue to rule that a taxpayer has made a misrepresentation that is attributable to neglect, carelessness or wilful default or has committed fraud in filing a return or in supplying any information. This ruling extends the period for reassessment indefinitely.

[30] This ruling by the Minister is an administrative act, as is the reassessment that follows. The assessment stands and is enforceable against a tax payer without any judicial involvement. To answer the reassessment, the taxpayer must file a notice of objection. If resolution does not result, the taxpayer is

left to bring an appeal before the Tax Court of Canada. Only then is the matter dealt with judicially, with both sides being able to publicly present evidence, cross-examine the other's witnesses, make submissions and have a determination of the issues made by a superior court judge, whose decision is reviewable by higher courts.

[31] What must I make of the reassessments in the discharge proceeding now before me? The evidence given by Mr. Fretz and Mrs. Fretz is basically that they understood they did everything properly, and that no moral or legal turpitude should be found in what they did.

[32] I do not think I am bound for the purpose of determining discharge conditions to accept without qualifications evidence which was created administratively by a government office without the protections that are afforded in judicial proceedings.

[33] My problem is illustrated by this example. There are references in the reassessments to "Legal Accounting & Prof. Expenses Disallowed". An assessor presumably reviewed accounts from lawyers or accountants which

Mr. Fretz and Mrs. Fretz had claimed as expenses required in their business. I do not know what opportunity they had to give an explanation nor do I know what guided the assessor in making this determination. It could be that they were less than frank in claiming these expenses, or it could be that the assessor was over zealous. All that is clearly before me is their assertion that they understood they were reporting their income and expenses properly.

[34] Under the *ITA,* where civil penalties are assessed, as they have been in the present situation, the burden of proof, should the matter come to the Tax Court, is on the Minister, (Section 163(3) of the *ITA*). The burden of proof is also on the Minister where it is alleged that there has been misrepresentation or fraud so that there can be a reassessment after three years, as was done here. The point of this observation is that when CRA alleges fraud, etc. on the part of a taxpayer and is called to account before the Tax Court, the normal burden being on the taxpayer to refute the collector's assumptions is reversed and is shifted to the Minister. I suggest that, if the burden of proof is on the Minister in these circumstances before the Tax Court, it is not unreasonable that the same burden respecting these

matters is on the Minister when before the Bankruptcy Court.

[35] A useful discussion of the burdens of proof in this matter is found in Peter W. Hogg, Joanne E. Magee and Jinyan Li: *Principles of Canadian Income Tax Law*, 7th ed, at page 571.

[36] To put the matter another way, there is no law which says in discharge proceedings under the *BIA,* I must, apart from the amount found to be owing, accept an assessment or reassessment without question. Furthermore, the Minister has the reversed burden of proof when it is before the court charged with resolving issues of fraud under the *ITA*. When alleging fraud the burden of proof is very high. The burden on the Minister should be as high in the Bankruptcy Court as it is in the Tax Court.

[37] The practical result is that CRA cannot rely alone on the reassessments to rebut what Mr. Fretz & Mrs. Fretz have told me in court. I accept their evidence. It has not been refuted by CRA in any compelling and competent way.

[38] It might be asked; in fact counsel did ask, what does CRA have to do beyond submitting the record found in Ms. Fulmore's affidavit. I say, at least, it should have had an affidavit from an officer well familiar with the files providing in detail the bases for the reassessments and have the officer present in court to submit to cross examination on it.

[39] Counsel for CRA made a post hearing written submission. At some length she reviews the *ITA* provisions which governs the assessment process, the point of which is simply to show that an assessment, unless appealed, and once the appeal process is exhausted, is final and conclusive. Only the Tax Court of Canada has jurisdiction to deal with assessments under the *ITA* and certain other Federal taxing statutes.

[40] She cites *Norris, Re* (1989), 75 C.B.R. (N.S.) 97 (Ont. CA) which is regarded as a leading authority on the point. It concerned an attempt by a trustee to disallow an assessment under the *ITA*. Let me quote from page 99.

> A taxpayer who objects to an assessment may file a notice of objection pursuant to subsection 165(1) of the Income Tax Act and if necessary proceed to exercise rights of appeal to the Tax Court and to the Federal Court. When the trustee in bankruptcy wishes to question the validity of an assessment against a bankrupt he, like anyone else, must seek his remedy within the Income Tax Act; see *In Re Carnat Const. Co.* (1958), 37 C.B.R. 47 (Ont. S.C.) and *Re*

> *Selkirk* (1972), 17 C.B.R. (N.S.) 302 (Ont. S.C.)
>
> To hold that the trustee in bankruptcy can disallow an assessment made pursuant to the Income Tax Act would be tantamount to clothing the trustee with the powers of the Tax Court. No interpretation of the Bankruptcy Act can support such a conclusion.

[41] No such attempt is being made by the Trustee nor the Applicants. The binding effect of the assessments is accepted as conclusive of the debts in issue and that is all it settles. This is reflected in the Trustee's reports. What is not accepted is that the assessments by themselves are competent evidence in determining the conditions of discharge apart from the determination that the debts are personal income tax debts under Section 172.1. Again I am aware of no statutory law or case law that an assessment is determinative of the tax payer's morals, integrity, motives, etc., all the things which must be considered in framing the terms of discharge. It would be a travesty of justice, if in effect a determination by an assessor of fraudulent misrepresentation, gross negligence, etc. must be accepted by the Bankruptcy Court without question, when the same assessor before the Tax Court in an appeal would have the burden of proof, and a very high burden of proof at that, of proving fraud. The conclusiveness of an assessment is provided by the *ITA*, that is not questioned, but its scope is limited. What

CRA is asking goes far beyond that scope.

[42] There is a significant body of case law regarding the discharge of those who make assignments with large income tax debts. Counsel for CRA in its brief reviewed a number of cases. I have had occasion to review such cases in previous decisions, for example, *Re Rideout*, 2004 NSSC 155. It is enough for me to say that these cases emphasize the high responsibility on citizens to fulfill the obligations imposed on them by taxing statutes that each should make a fair contribution to cost of government. There is no convincing evidence that Mr. Fretz and Mrs. Fretz have not taken their responsibility seriously.

[43] I heard their evidence. They gave the court a detailed account of how they have conducted their business and of the treatment they have received from CRA. They have told me of the various encounters they had with the agents of CRA. They have been compliant to CRA's satisfaction in the subsequent years. They were compliant with CRA's demands regarding the tax years in question. They could not answer CRA's allegations by continuing with their appeal before the Tax Court. It was financially and I venture to say

physically and emotionally prohibitive. Their only solution was bankruptcy.

[44] Subsection 172.1(4) lists factors I must take into account in setting the conditions for their discharge.

[45] As to Paragraph (a), the circumstances when the debt was incurred, their evidence is that they were doing reasonably well, and properly addressing their tax responsibility as they understood it. CRA strongly suggests otherwise. I have already explained why I should not accept the results of its reassessments as against what Mr. Fretz and Mrs. Fretz said in court. I need say no more on this point.

[46] As to Paragraph (b), as I understand their evidence, they have been making significant payments on account of taxes, considering the circumstances they have been in.

[47] As to Paragraph (c), there is nothing before me to suggest that they have made significant payment on other debts to the detriment of CRA.

[48] As to Paragraph (d), they are in their mid 50's. They have no significant assets. Mrs. Fretz's health is precarious. Their employment is uncertain. They will be doing well to maintain a very modest lifestyle.

[49] CRA asks that conditions be imposed upon them. The first is that they consent to a judgment being registered against their home. This property is already subject to a mortgage as well as security already in favour of CRA. What equity there may be in the property after these encumbrances is now vested in the trustee and thus beyond their ability to further encumber.

[50] They have already paid surplus income. She $7,200, he $19,727, total $26,927. They have no work in progress. It is difficult to say whether they will have any in the immediate future. CRA has security in their properties.

[51] There is no need to address 2011 tax returns. They have been faithful in fulfilling their obligations to CRA. There is no reason to expect otherwise of them.

[52] They have been under the impression that they have had to maintain their

house until it is sold. As mentioned, this, as far as I can understand, is a mistaken assumption. They could be at risk of having to answer a deficiency claim for having continued occupancy.

[53] They need the unfettered opportunity to maintain their reputation in the community they have been serving in the working years they have before them.

[54] Subsection 172.1(3) demands that their discharges be suspended or that they perform acts, pay money, consent to judgment or comply with other terms. I think they have paid enough and suffered enough. To comply with Subsection 172.1(3), they will be discharged upon one hundred dollars being paid into each estate.

R.

Halifax, Nova Scotia
December 21, 2011