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Tax Notes

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Bill C-50 Receives Royal Assent

Bill C-50, *Budget Implementation Act, 2008*, received Royal Assent on June 18, 2008 and is now S.C. 2008, c. 28. On June 20, the House of Commons adjourned until September 15, 2008. Bill C-10 is before the Senate Committee on Banking, Trade and Commerce, which has been holding hearings on the non-resident trust and foreign investment entity provisions as well as the film tax credit provisions. No movement is expected on Bill C-10 until the fall.

Inside

SIB Rules and Employees of Partnerships: Next Time Maybe An Announcement?

It's what I don't know that really scares me.

Just the other day I was working on a file when I came across Technical Interpretation 2007-0258011I7, "QSBC Shares – Partnership Interest" (the "2007 TI").[1] Seemed innocuous enough but, as it turns out, the 2007 TI appears to have very quietly reversed the CRA's 20-year administrative position about the application of the specified investment business ("SIB") rules to employees of partnerships, which, prior to the release of the 2007 TI, most practitioners would have considered to be employees of the partners of the partnership for all purposes (whether the partners were general or limited partners).[2] Apparently this is no longer the case in all circumstances, though it seems that the CRA has been of this view for quite some time.

The SIB Rules

For those of you who are unfamiliar with the SIB rules, subject to two exceptions (described below), a SIB is defined in subsection 125(7) of the Act as *a business carried on by a corporation*, the principal purpose of which is to derive income from passive investments.

In the past the SIB definition was primarily seen as a mechanism to restrict access to income tax benefits available to qualifying CCPCs, including the small business deduction, capital gains exemption[3] and various incentives relating to SR&ED. However, due to reductions in the general corporate tax rate and the introduction of the eligible dividend rules the ability to avoid the SIB rules has become an increasingly relevant topic.

The first exception to the SIB rules is for a corporation that "employs *in the business* [i.e., the business that would otherwise be a SIB] throughout the year more than five full-time employees".[4] The second exception to these rules applies to "a corporation that is associated with the corporation [i.e., the corporation that would otherwise earn SIB income] that provides, in the course of carrying on an active business, managerial, administrative, financial, maintenance or other similar services *to the corporation* in the year and the corporation could reasonably be expected to require more than five full-time employees if those services had not been provided".[5]

The 2007 TI, *Lerric* and Other CRA Administrative Positions

The 2007 TI only deals with paragraph (*a*) of the SIB definition. The facts of the 2007 TI involve a corporation (Aco) that owns rental properties. Aco is also a partner of a partnership involving two related individuals that provides management services solely to Aco and employs more than five employees. If Aco had employed the employees of the partnership directly, it appears that the shares of Aco would have otherwise qualified as qualified small business corporation shares. The CRA was asked whether the fact that the partnership employed the employees had any effect on the QSBC status of Aco's shares. The CRA determined that based on an extension of the reasoning in *Lerric Investments Corp. v. The Queen*, 2001 DTC 5169 (FCA), a case that dealt with the treatment of employees of joint ventures, Aco would not be considered to employ the employees of the partnership in its own passive business. As a result of not being able to claim the partnership's employees as its own employees, Aco's passive business would be a SIB and the shares of Aco would not be QSBC shares.

The issue in *Lerric* was whether Lerric Investments Corp. ("LIC"), which was a member of a number of passive joint ventures could be considered to employ all of the employees of the joint ventures it was involved in, its *pro rata* share of those employees based on its ownership in each respective joint venture or none of the employees. The FCA did not accept that each employee of a joint venture could be treated as an employee of each joint venturer since this could result in significant arbitrary double counting of employees and would not be "consistent with the words of subparagraph 125(7)(*e*)(i) in their context". [para. 13]

Regarding proportionate sharing of employees the FCA held that:

> . . . There are no words in the provision that imply that a proportional or sharing approach of the same employee by different employers is contemplated. [para. 17]
>
> * * *
>
> . . . it is the co-owners or joint venturers together, but not independently, who employ the employees. No co-owner or joint venturer can say that it individually employs the employees or portions of the employees. They can say that, in accordance with the co-ownership or joint venture agreement, they are responsible for a percentage of each employee's wages. However, this does not give rise to the allocation of fractional employees and the aggregation of these fractions to meet the "more than five full-time employees" test in subparagraph 125(7)(*e*)(i). [para. 20]

Based on the foregoing analysis, the FCA concluded that:

> The Minister says [what is now paragraph (*a*) of the SIB definition] is an arbitrary proxy for an active business and it may not accommodate every deserving situation. I am forced to agree with the Minister. It is not difficult to construct anomalies which demonstrate that either the application or non-application of subparagraph 125(7)(*e*)(i) [now paragraph (*a*) of the SIB definition] to co-ownerships or joint ventures leads to illogical results. However, applying an arbitrary rule to situations not contemplated by the rule will have that effect because it is

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> arbitrary. Be that as it may, it is the duty of the Court to take the statute as it finds it.

Consequently, LIC did not employ the required amount of employees and was a SIB as assessed.

Although the decision pointedly commented that LIC was a joint venturer not a partner,[6] the FCA did not specifically comment on how the decision in *Lerric* might impact on a similar analysis in respect of partnerships. Nonetheless, at trial,[7] Bowman, J made his opinion about the distinction known in the following *obiter* comments at paragraph 18 of the decision:

> The first approach is to consider whether the distinction drawn in paragraph 16 of IT-73R5 between a partnership and a joint venture is correct. If corporations A and B are partners and the partnership owns an apartment building and employs six full-time employees IT-73R5 says each partner employs six full-time employees. If they are joint venturers, IT-73R5 says they each employ only three full-time employees. It is somewhat difficult to rationalize this distinction. The legal rationale, rightly or wrongly, is probably that a relationship of agency exists between partners but not generally between joint venturers. This is not, however, an answer. Where two joint venturers or co-owners hire a full-time employee for a project that person is an employee of both of them regardless of the absence of agency. It is inaccurate to say that one-half of the employee is employed by one co-owner or joint venturer and one-half by the other.

Still, notwithstanding the possibility that the distinction between joint venturers and partners might be a fine one, in 2002, following the FCA decision in *Lerric*, Interpretation Bulletin IT-73R5 (the "IT") was reissued and, while it was thought that any changes to the administrative position in respect of partners merely represented a watering down of the pre-*Lerric* position, based on the 2007 TI and informal discussions with Rulings, it appears that the distinction has almost completely been eliminated (apparently since the date the IT was issued). To this end, the following comments are set out in the 2007 TI:

> Although *Lerric* concerned a joint venture, in our opinion, it is not possible to limit its application to its facts. This decision stands for the proposition that a direct relationship must exist between the corporation as employer and the employees in order for the corporation to come within the wording "the corporation employs . . . more than 5 full-time employees" [I.e., paragraph (*a*) of the SIB definition.] requirement in the SIB definition.
>
> It is our opinion that where a corporation carries on a business as a member of a partnership, employees working for the partnership are the employees of its partners collectively, but not of any of them individually. Accordingly, for the purpose of determining whether Aco's rental operations are a SIB, Aco is not considered to employ the employees of the partnership of which it is a partner, since such employees are considered to be employed by the partners collectively.

At first blush, these comments seem to be a complete repudiation of paragraph 20 of the IT, which was not referred to in the 2007 TI and reads as follows:

> 20. A business carried on by a corporation as a member of a partnership is not a "specified investment business" if the partnership employs more than five full-time employees. In other words, the corporation's share of income from the business can be included in the calculation of its "specified partnership income".

However, based on informal discussions with the CRA, it seems that the CRA is of the view that the position set out in paragraph 20 of the IT is only applicable to the determination of the tax treatment of a corporate partner's *otherwise passive partnership income earned by the partnership where the partnership itself employs the employees*. This is to be distinguished from the example in the TI where the passive income was being earned by the corporate partner not the partnership. Still it would have been nice if the CRA had at least noted the existence of paragraph 20 of the IT in the 2007 TI and specifically commented on its application or lack thereof to the 2007 TI.

It appears that the administrative position in paragraph 20 may actually represent a concession by the CRA since based on *Lerric*, presumably the corporate partners would still not be considered to employ the employees of the partnership and it appears that the provision permits each corporate partner to treat its share of the particular partnerships income as non-SIB income, in effect permitting them to "double count" the employees of the partnership.

A comparison of paragraph 20 of the IT with paragraph 16 of Interpretation Bulletin IT-73R4 (the "Old IT") appears to highlight the change in position by the CRA. In particular, paragraph 16 of the Old IT read:

> If, for example, two corporations carry on a business in partnership as equal partners with the partnership business employing more than five full-time employees, each partner would, for the purpose of paragraph (*a*) of the definition of "specified investment business" in subsection 125(7), be considered to employ more than five full-time employees.

Whereas the language of paragraph 16 of the Old IT appears to have the effect of causing the employees of the partnership to flow-through to the partners as the employees of the partners, the wording in paragraph 20 of the IT seems to merely indicate that the partnership itself will not be a SIB provided the partnership employs more than five full-time employees.

So How Does All This Affect My Clients?

The discussion below contains some practical examples that will hopefully be helpful to appreciate the impact of the CRA's change in administrative position.

In the examples that follow it will initially be assumed that the scenario involves a single wholly owned corporate real estate limited partnership involving a corporate general partner ("GP") with a nominal interest and a single corporate limited partner ("LP") whose only asset is its interest in the limited partnership. The partnership employs more than five full-time employees throughout the year and owns all of the real estate assets that give rise to income that might be considered to be SIB income.

It appears that even though based on general principles both general and limited partners are deemed to carry on the business of a partnership,[8] if the 2007 TI is applied strictly to this situation then based on its reliance on *Lerric*, the employees of the partnership would not be considered to be employees of the LP; therefore, but for the administrative concession under paragraph 20, income earned by LP and GP from the partnership would be SIB income under paragraph (*a*) of the SIB definition.[9] In the past, the administrative position in paragraph 16 of the Old IT avoided this result by deeming the partners of a partnership to be considered to employ the employees of the partnership. It also appears that the administrative position in paragraph 20 of the IT should also avoid this result by deeming the income of a partnership employing more than five full-time employees to not be SIB income in the hands of its partners.[10] Based on both the Old IT and the IT, this conclusion is unlikely to change even if the facts were modified so that there were multiple corporate LPs.

If the limited partnership did not employ any employees, but any particular partner (LP or GP[11]) directly employs more than five full-time employees whose purpose is to carry on the limited partnership's business then that particular partner's income from the limited partnership would also appear to not be SIB income under both the Old IT and the IT.[12] Of course, the income of the other partners who do not employ the requisite number of employees "in the business" of the limited partnership would not escape treatment as SIB income under paragraph (*a*) of the SIB definition.[13]

However, because paragraph (*a*) of the SIB definition requires that employees be employed throughout the year in the "business", where a corporation owns and manages its own passive investments and/or it is a partner in a number of partnerships that own passive investments,[14] it may be considered to be carrying on more than one business, in which case, establishing that the employees of the corporation are being used full-time in any particular business may be difficult.

For example, if LP employs five or less employees in a passive business, it directly carries on and the limited partnership carries on a similar business employing five or less employees, then based on the words of the SIB definition and the administrative position in the Old IT and provided the businesses could be considered to be the same business, all of the income earned by the corporation would have been non-SIB income since it was widely believed that the employees could have been aggregated. However, based on the administrative position in paragraph 20 of the IT when read in conjunction with the 2007 TI, it seems that LP would not be able to add the employees of the limited partnership nor any portion of those employees to its own employees, such that the income from the business it directly carries on would be SIB income[15] – even if both businesses were substantially the same type of business.

The (b) Plan

Notwithstanding the CRA's restrictive interpretation of paragraph (*a*) of the SIB definition, based on Technical Interpretation No. 2005-0120751E5 (the "2005 TI"), dated February 21, 2006, it appears that the CRA takes a more liberal view of the application of paragraph (*b*) of the definition.[16] The facts of the 2005 TI involved Aco, a corporation holding passive real estate that received services from a partnership employing more than five full-time employees.

Since Bco, a corporation associated with Aco, was one of the partners of the partnership, Aco's passive investment income was determined not to be SIB income. Apparently, the keys to this interpretation were that the associated corporation (i.e., Bco) was deemed to carry on the active business of the partnership based on the *Robinson* decision and that paragraph (*b*) of the SIB definition does not require the associated corporation to actually employ the employees – only that "in the year" Aco would have required five or more full-time employees to service its business in the absence of the services having been provided by the associated corporation (Bco).

This interpretation should provide some comfort to associated corporate groups where there is one central management corporation providing services to a number of passive holding corporations. Of course, the factual determination that any particular passive corporation would have needed five or more employees in the absence of services being provided by the management corporation must still be met. However, since the language of paragraph (*b*) of the SIB definition seems to require that the services must be provided "to the corporation", query whether Rulings would have come to the same conclusion had Aco been a member of a partnership that received the services rather than the services being received by Aco itself.

Wrap-Up

The effect of the "change" of the CRA's administrative position in paragraph (*a*) of the SIB definition may be to significantly affect how corporate groups that involve partnerships will be forced to operate. It will certainly cause

such groups to analyze where the employees in the group are employed to ensure that each entity (partnership or corporation) that would otherwise earn material amounts of SIB income employs more than five employees. In some situations, this may result in some entities becoming SIBs where there are insufficient employees to staff all of the entities, unless paragraph (*b*) of the SIB definition can be satisfied, which, as was discussed previously, may be problematic in the case of corporate groups that operate through a number of partnerships. Where the "(a) and (b) plans" both fail group consolidation may need to be considered – though advisors should carefully consider whether the business cost of attaining preferable tax rates is acceptable.

– Michael Goldberg, tax partner, Minden Gross, a member of MERITAS Law Firms Worldwide. Thanks to David Louis, also of Minden Gross. Any errors or omissions are strictly my own.

Notes:

[1] Dated January 23, 2008.

[2] For example, see Technical Interpretation No. 2000-0047815, dated February 21, 2001 citing Question 51 of the 1988 Canadian Tax Foundation Annual Conference Roundtable and the following recent articles: Lorne H. Beiles, "Partnerships: A Review of Tax Planning Strategies", 2006 British Columbia Tax Conference, (Vancouver: Canadian Tax Foundation, 2006), 11:17; Louis Provenzano and Sheryl Mapa, "SIB and Partnership" (2006) vol. 14, no. 4 *Canadian Tax Highlights*, 5; and Donald N. Cherniawsky, CA, LL.B., "Use of Partnerships and Joint Ventures for Owner-Manager Business", 2005 Prairie Provinces Tax Conference, (Toronto: Canadian Tax Foundation, 2005), 14:6-8.

[3] Capital gains exemption issues were the primary subject of the 2007 TI.

[4] Paragraph (*a*) of the SIB. Emphasis added. See also the recent case of *489599 B.C. Ltd. v. The Queen*, 2007 DTC 347 (T.C.C.).

[5] Paragraph (b) of the SIB definition. Emphasis added. With respect to the employment of employees under this exception it is interesting to note that the test uses the phrase "in the year" rather than "throughout the year". Whether the distinction is meaningful using a textual, contextual and purposive approach to statutory interpretation is unclear.

[6] See paragraph 3[4] of the *Lerric* decision.

[7] 99 DTC 755 (TCC).

[8] *The Queen v. Mary Robinson et al.*, 98 DTC 6065 (FCA). Generally the principals discussed throughout this article will apply equally regardless of whether the partnership is a limited or general partnership.

[9] Whether or not such partners would be able to rely on paragraph (b) of the SIB definition to escape SIB income treatment is discussed further under the heading "The (b) Plan".

[10] The lack of a reference to paragraph 20 of the IT in the 2007 TI continues to be troubling. All the more so since if the administrative position in paragraph 20 of the IT is ever revoked this conclusion would not appear to hold.

[11] As is discussed under the heading "The (b) Plan", if it is not possible to escape SIB income treatment under paragraph (*a*) of the SIB definition, in some cases paragraph (b) of the definition may be of assistance.

[12] This conclusion would appear to hold regardless of whether the CRA ever revokes its position in paragraph 20 of the IT. However, such planning would appear to cause the LP to take an active role in the business of the limited partnership, which in many jurisdictions may erode the LP's limited liability protection (Manitoba would appear to be an exception to this rule).

[13] Whether or not such partners would be able to rely on paragraph (b) of the SIB definition to escape SIB income treatment is discussed further under the heading "The (b) Plan".

[14] Often times even though there is really only one "business", corporate groups will be set up with multiple corporations or limited partnerships for asset protection and other non-tax business purposes.

[15] As was discussed above, it appears that if it can be established that enough of LP's employees were active in the limited partnership's business it may be possible for there to be a one-way aggregation of employees from the LP to a limited partnership (for purposes of calculating the particular LP's income only) with the result that it may be possible to treat the LP's share of the income of the limited partnership as non-SIB income. Similar results would appear to arise where the corporate partner is a member of a number of partnerships each of which employs less than five employees. However, unlike the one -way aggregation of employees from the LP to a limited partnership (for purposes of calculating the particular LP's income only), it does not appear to be possible for the employees of the various partnerships to be aggregated together.

[16] Informal discussions with Rulings seem to confirm that the 2005 TI continues to represent the CRA's position in respect of this provision.

Recent Cases

GAAR applied to deny taxpayers' deduction of partnership losses

The taxpayers reached an agreement with the National Bank of Canada (the "Bank") to acquire a shopping centre (the "Property"), which was the subject of foreclosure proceedings pursuant to the Bank's mortgage on the Property. The Bank, together with its newly incorporated subsidiary, formed a limited partnership (the "Partnership") and transferred its interest in the mortgage on the Property to the Partnership within the meaning of subsection 18(13) of the *Income Tax Act* (the "Act"). The taxpayers purchased units in the Partnership and the Property was subsequently transferred to the Partnership on completion of the foreclosure proceedings. The Partnership wrote down the value of the Property under subsection 10(1), generating a $6 million loss. The loss was allocated to the partners, including the taxpayers, who deducted their share of the loss in computing their income. The Minister reassessed the taxpayers for 1993, 1994, 1995, and 1998, pursuant to the general anti-avoidance rule (the "GAAR") to disallow the taxpayers' deduction of their share of the Partnership's loss and resulting loss carryovers claimed by some of the taxpayers. The taxpayers' appeals to the Tax Court of Canada (2007 DTC 425) were allowed on the basis that the series of transactions to acquire the Property, as a whole had a *bona fide* business purpose and, therefore, none of the separate transactions constituted an avoidance transaction. Accordingly, the GAAR did not apply to deny the taxpayers' loss deductions. The Minister appealed to the Federal Court of Appeal.

The Minister's appeal was allowed. The Tax Court erred in failing to consider whether one or more of the transactions that gave rise to the tax benefit at issue, within the series of transactions, constituted avoidance transactions. Although the series as a whole had a *bona fide*

business purpose, the transactions that resulted in the transfer of the accrued loss on the mortgage from the Bank to the Partnership to enable the taxpayers to deduct the loss in computing their incomes under the Act comprised an avoidance transaction within the meaning of subsection 245(3) of the Act. The avoidance transaction was in turn abusive within the meaning of subsection 245(4), in accordance with the reasoning by the Supreme Court in *Mathew v. The Queen* (2005 DTC 5538). Consequently, the Minister was correct to disallow the deduction of the transferred losses. The Tax Court of Canada decision was set aside and the Minister's assessments were affirmed accordingly.

MacKay et al., 2008 DTC 6238

Taxpayer generated capital losses on stock dispositions

The taxpayer acquired shares of his employer from its former CEO and through the exercise of employee stock options received in line with his employment contract. The taxpayer then sold the shares at a loss. The Minister reassessed the taxpayer for 2000 and 2001, treating the losses generated on the stock dispositions as capital losses. The taxpayer appealed to the Tax Court of Canada on the basis that the stock losses were on income account. The Tax Court of Canada (2007 DTC 996) confirmed the Minister's assessment, prompting the taxpayer's appeal to the Federal Court of Appeal.

The taxpayer's appeal was dismissed. The Tax Court did not err in concluding that the taxpayer did not act as a trader in exercising his stock options and disposing of his shares, but rather treated the shares as an investment. Therefore, the Tax Court was correct to hold that the losses generated on the stock dispositions were on capital account.

Ellis, 2008 DTC 6230

Taxpayer jointly and severally liable for tax debts of third party

Deposits were made in the taxpayer's bank account by a third party transferor, and by other parties, of amounts that were owed to the transferor. At the time of the bank transfers, the transferor had an outstanding tax debt under the Act. The taxpayer signed blank cheques on the account for the transferor's use and gave the transferor the bank debit card to enable the transferor to make withdrawals from the account. In reassessing the taxpayer for 2001 to 2003, the Minister held the taxpayer jointly and severally liable for the transferor's outstanding tax debts under subsection 160(1) of the Act in respect of the bank transfers. On the taxpayer's appeal to the Tax Court of Canada (2007 DTC 943), the Tax Court vacated the Minister's assessment on the basis that the non-arm's length transfer of funds was effected for valid consideration, and that the taxpayer could not be held liable for the transferor's tax debts under the Act. The Minister appealed to the Federal Court of Appeal.

The Minister's appeal was allowed. The Tax Court erred in concluding that the taxpayer had given the transferor adequate consideration for the transfers made to her bank account. There was no consideration given in exchange for the bank transfers, and the taxpayer became jointly and severally liable for the transferor's outstanding tax debts at the time that the transfers were made. The Tax Court's decision was set aside accordingly.

Livingston, 2008 DTC 6233

Taxpayer entitled to business investment loss

The taxpayer was the sole shareholder of a corporation that went bankrupt. Following the bankruptcy, the taxpayer claimed a business investment loss for his investments in the corporation. In reassessing the taxpayer for 2001, the Minister disallowed a portion of the taxpayer's business investment loss, prompting the taxpayer's appeal to the Tax Court of Canada.

The taxpayer's appeal was allowed. The taxpayer had provided sufficient evidence of his corporate investments and was entitled to his entire business investment loss claimed in filing his income tax return. The Minister's assessment was referred back to the Minister for reconsideration and reassessment.

Boily, 2008 DTC 2784

Taxpayer entitled to business losses generated on stock dispositions

The taxpayer acquired shares of his employer by exercising stock options received by virtue of his employment. Part of the taxpayer's employment duties involved promoting the sale of his employer's shares to the investment community. Following the termination of his employment, the taxpayer disposed of his shares at a loss and deducted the losses as business losses in filing an amended income tax return for 2000. In reassessing the taxpayer for 2000, the Minister treated the losses as capital losses. The taxpayer appealed to the Tax Court of Canada on the basis that he was a trader and that the losses generated on the stock dispositions were on income account.

The taxpayer's appeal was allowed. The taxpayer was a trader or dealer with respect to the sale of his shares. The taxpayer had special knowledge and expertise in his employer's operations and the market. As a result, the taxpayer generated business losses on the stock dispositions.

The Minister's assessment was referred back to the Minister for reconsideration and reassessment.

Howard, 2008 DTC 2788

Taxpayers generated capital losses on stock dispositions

The taxpayers, husband and wife, jointly sold different types of shares on three separate occasions, generating losses. The taxpayers then reported the losses as business losses in filing their income tax returns for 2003, on the basis that the stock sales constituted an adventure in the nature of trade. In reassessing the husband for 2003 and the wife for 2000 to 2003, the Minister disallowed the taxpayers' deductions, treating the losses as capital losses. The Minister also disallowed the wife's non-capital loss carrybacks to 2000, 2001, and 2002. The taxpayers appealed to the Tax Court of Canada. The appeals were heard together on common evidence.

The taxpayers' appeals were dismissed. The taxpayers had purchased their shares for investment purposes and not for the purpose of trading. Therefore, the taxpayers' losses generated on the disposition of their shares constituted capital losses. The Minister's assessments were affirmed accordingly.

Pollock et al., 2008 DTC 2797

Taxpayer entitled to deduct excess RRSP contributions

The taxpayer made excess contributions to her RRSP for 1995 to 1998 and 2001. Upon becoming aware of this, she withdrew $10,000 from her RRSP in 2005. In assessing the taxpayer for 2005, the Minister refused her a $10,000 deduction under the excess contribution provisions of subsection 146(8.2) of the Act. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was allowed. The taxpayer's undeducted (excess) contributions from 2004 and 2005 of $10,206 all related to the amount contributed to her RRSP in 2003. The $10,000 withdrawal made by her in 2005 from her RRSP was therefore made within the time limitation periods set out in paragraph 146(8.2)(*c*) of the Act. Since the Minister did not plead paragraph 60(*j.1*) of the Act and did not lead any evidence respecting this paragraph, its application to the taxpayer's appeal could not be considered. The Minister's reassessment as vacated accordingly.

Misir, 2008 DTC 3056

Taxpayers not entitled to deduct CCA on acquisition costs for computer software

In 1994, the taxpayers acquired computer software (the "Software") in what the Minister alleged to be a non-arm's length transaction. A warranty was given to them by the vendor of the Software (the "Warranty") as to the potential revenues that could be derived from the Software. In reassessing the taxpayers for 1994 to 2000, the Minister disallowed CCA claimed on the Software. The Minister's position was that: (a) the Software was not acquired to earn income; (b) the taxpayers acquired only a right to market the Software, but did not acquire full ownership of it; (c) the Software was not "available for use" (as required under subsection 13(26) of the Act); (d) the taxpayers' obligation to pay the purchase price for the Software was contingent only, so that there was no cost for CCA purposes; and (e) the software had no value, so that its cost was nil under the non-arm's length acquisition provisions of section 69 of the Act. The taxpayers appealed to the Tax Court of Canada.

The taxpayers' appeals were dismissed. It was more likely than not that the taxpayers acquired the Software for tax deduction purposes only, with no ancillary income-earning purpose. Also, the Warranty was structured so as to give the taxpayers a chance to walk away from their obligation to purchase the Software, since the revenue projections in the Warranty were unrealistic. Hence, the taxpayers never incurred an absolute obligation to purchase the Software, even if their intention was to earn income. This obligation, therefore, was only contingent, and the cost of the Software in the taxpayers' hands was nil. These conclusions made it unnecessary to consider the Minister's other arguments. The Minister's reassessments were affirmed accordingly.

Sherman et al., 2008 DTC 3069

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