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Tax Notes

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Revealed: New Tax and Estate Planning Issues

As time goes by, it is pretty well inevitable that the *Income Tax Act* will become more and more complex; likewise for tax and estate planning structures. Much like what happens when tectonic plates collide, there can be "displacement" as these trends converge, in the form of new – and often downright offbeat – tax and estate planning issues. This article discusses a few of these issues that I have noticed in my practice.

Spouse/Alter-Ego/Joint Partner Trusts

All three of these types of trusts provide for a rollover when assets are transferred to them. However, the rollover is denied if persons other than the spouse/settlor/partner[1] can receive, or otherwise obtain, the use of any income or capital of the trust.

A recent Technical[2] raised the question of whether the rollover to a spouse trust would be available if the trustee were required to pay life insurance premiums. Not surprisingly, the CRA's answer was no: a duty to fund a life insurance policy out of trust capital or income would be one under which another person may obtain the use of the trust capital or income. Actually, this is not a new position. For example, a 2003 Technical[3] queried whether the ability of a trustee to lend funds or provide other forms of financial assistance to a person other than a spouse would taint the trust. The CRA's answer was that this would be problematic, if the trust permits funds to be loaned (or any other form of assistance to be provided) to anyone other than the spouse for inadequate consideration.

It rapidly becomes apparent that the concept of being able to "obtain the use" is potentially very broad. Even if a loan is on commercial terms, query whether the debtor is nevertheless obtaining the use of the capital. Obviously, these sorts of interpretations make no sense, and I am happy to see that this is not lost on the CRA.

Inside

Because the "no use" requirement must presumably be met under the terms of the trust, appropriate language should be inserted. One approach could be to adhere to the requirements of the CRA, including those discussed above. The problem with this is that there could be changes in CRA policy from time to time which could necessitate an amendment to the documents – if possible. Another approach is to require the trustees to adhere to the published policies of the CRA in respect of the "no use" requirement, as delineated from time to time.

Change of Trustees – More Fallout

The next thing I would like to talk about is the consequences of a fairly recent Technical Interpretation pertaining to a change of trustees.[4] I wrote about this Technical in June 2005.[5] In a nutshell, it canvasses whether control of a corporation is acquired when the trustee of a trust that controls a corporation is replaced. As I indicated in the article, the short answer is yes (with the possible exception of situations where the replacement trustee is related to the pre-existing trustees).

For many readers, this is old news, as this Technical has now received a great deal of attention.[6] However, what may be less apparent is that, besides a change of trustees itself, the Technical can be problematic in some situations where control of a corporation "passes" to a trust or estate, particularly with an "outside" trustee. As a reminder, the general rule is that where there is an acquisition of control, the usual loss restriction rules, deemed year-end, and so on, are operative unless the saving provisions in subsection 256(7) apply. However, in such situations, subsection 256(7) may not apply,[7] perhaps because it was designed for relatively simplistic situations.

While the usual impact of the change of control rules relate to the "streaming" of losses (due to the "similar business" restrictions) and a deemed year-end, I remind you that there could be other implications. For example, paragraph 111(5.1) and (5.2) are intended to crystallize losses due to declines in value in respect of depreciable and eligible capital property (this may actually be a good thing, provided that the "similar business" restrictions are met), and accrued capital losses may drop off (per subsection 111(4)).

November 9th Draft Legislation – Clauses 65 & 66: Safe Income Strips

When tax practitioners finished poring over the November 9th Notice of Ways and Means Motion (now Bill C-33) they found few changes from the previous round of technical amendments[8] emanating from the December 20, 2002 proposals other than the notoriously complex proposals relating to non-competes and other restrictive covenants, and changes to proposed section 143.3 (stemming from the *Alcatel* case[9] relating to SR&ED credits in respect of stock options). Apparently, clauses 65 and 66 are a by-product of the latter. However, soon after the proposals were announced, I received e-mails from anxious colleagues who had discovered to their consternation that the clauses may have a fundamental adverse effect on safe-income strips and other corporate transactions.

My colleague, Michael Atlas, has written about these proposals at length in a recent issue of TAX TOPICS.[10] For those involved in safe income strips, this article should be studied carefully. For now, let me give you the "Coles Notes" summary:

- Clause 65 provides that the cost base of the shares received as a stock dividend will be reduced to the extent that the amount of the dividend is deductible as an inter-corporate dividend.[11] So a stock dividend will no longer be a viable method of crystallizing safe-income.
- Clause 66 provides that the cost base of shares will not be increased by any dividend resulting from converting contributed surplus into stated capital, again, if the dividend is a tax-free inter-corporate dividend.

Other methods of safe-income crystallization, e.g., a share redemption with a paragraph 55(5)(*f*) designation, or an ordinary dividend, are not affected.

For the latter proposal, some additional explanation is in order. These provisions will typically be problematic where a safe-income strip involves an inter-corporate dividend from a Holdco with relatively low retained earnings,

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rather than a dividend from the retained earnings of Opco itself. With this situation in mind, I note that the methodology that is adversely affected is an increase in stated capital – but only if the increase reduces the corporation's contributed surplus. However, where a safe income strip in respect of a Holdco is involved, practitioners may often attempt to create contributed surplus (e.g., on a transfer of Opco to Holdco prior to the strip) because of corporate law requirements that a stated capital increase must draw down retained earnings or other surplus accounts.[12] This maneuver will now be blocked. To add insult to injury, for the purpose of calculating CDA, the acb increases blocked in clauses 65 and 66 will stand,[13] thus reducing the CDA of the vendor corporation. This could be another example of the "feel" that some proposals emanating from Ottawa seem to give off: "punishment" for that Axis of Evil – tax advisors and their well-heeled clients[14] – who have the misfortune of getting caught in this trap.

In any event, this brings me back to the convergence theme at the beginning of the article – and illustrates a point. Practitioners who work in this complex and sophisticated realm must constantly be aware that the complexities of the *Income Tax Act* can have unintended consequences – in fact, they are almost inevitable. Like colliding tectonic plates, the best we can hope for is that the result will be a mere blip on the Richter scale, rather than a tsunami.

– David Louis, B. Com., J.D., C.A., tax partner Minden Gross LLP, a member of MERITAS Law Firms Worldwide.

Notes:

[1] As may be applicable under the respective provisions.

[2] Doc. No. 2006-0185551C6, September 11, 2006, Question 2 of the 2006 STEP Round Table.

[3] Doc. No. 2003-0019235, July 17, 2003.

[4] Doc. No. 2004-0087761E5, May 24, 2005. In which, the CRA stated that:

> Where a trust has multiple trustees, the determination as to which trustee or group of trustees controls the corporation can only be made after a review of all the pertinent facts, including the terms of the trust instrument. However, in the absence of evidence to the contrary, we would consider there to be a presumption that all of the trustees would constitute a group that controls the corporation.

I also draw your attention to Doc. No. 2005-0111731E5, July 4, 2006, which seems to indicate that each trustee of a trust is considered to own shares held by the trust. If correct, this could have widespread ramifications in respect of association. I make no further comments on this issue in this article.

[5] "Change of Trustees = Tax Disaster?" TAX NOTES No. 510, July 2005.

[6] And has been brought to the attention of the Department of Finance.

[7] One example could be where "thin-voting" shares are designed to lose voting rights, e.g., on death, and by virtue of this loss, control "passes" to an estate administered by third party trustees by virtue of its pre-existing shareholdings. For example, the "estate exemption" in subparagraph 256(7)(*a*)(i) indicates that control of a particular corporation shall be deemed not to have been acquired solely because of an estate that acquired the shares because of the death of a person. Even if the thin voting shares are acquired by the estate, is control acquired because of this acquisition? The reason for acquisition of control is the drop-off of the voting rights. (Note that a bequest of the shares, rather than the drop-off of voting rights, would qualify for the estate exemption.) While subparagraph 256(7)(*a*)(ii) may potentially apply by virtue of a change in the rights or privileges of a share, the person acquiring control by virtue of the change (i.e., the estate) must be related to the corporation immediately before the time the rights change.

[8] July 18, 2005.

[9] *Alcatel Canada Inc. v. The Queen*, 2005 DTC 387, TCC.

[10] "Beware of pitfalls in November 9, 2006 Technical Amendments When Crystallizing 'Safe Income'!" TAX TOPICS No. 1820, January 25, 2007.

[11] I.e., under subsection 112(1).

[12] E.g., subsection 24(5) of the *Ontario Business Corporations Act*; subsection 26(6) of the *Canada Business Corporations Act*.

[13] Per the proposed revisions to the "capital dividend account" definition in subsection 89(1).

[14] For further comments see "Hidden Agendas – A Month in the Life", TAX NOTES, December 2006, No. 527.

2007 Automobile Rates and Limits

Department of Finance News Release No. 2006-089, dated December 27, 2006, announced that the rates and limits for automobiles would remain the same in 2007 as they were in 2006. Therefore, the maximum cost of passenger vehicles for capital cost allowance purposes will remain at $30,000 (plus federal and provincial sales taxes); the limit on deductible leasing costs will remain at $800 per month (plus federal and provincial sales taxes); and the maximum interest deduction for funds borrowed to purchase an automobile will remain at $300 per month. The maximum tax-exempt allowances paid by an employer, as set out in Regulation 7306, will remain at 50¢ per kilometre for the first 5,000 kilometres and 44¢ for each additional kilometre. The tax-exempt allowance for the Yukon, Northwest Territories, and Nunavut will remain at 54¢ and 48¢, respectively. The rates prescribed in Regulation 7305.1 to calculate the taxable benefit for personal use of an employer-provided automobile will remain at 22¢ per kilometre generally, and 19¢ per kilometre for persons employed principally in selling or leasing automobiles. These amounts are set out in a chart found at ¶513 in the CANADA INCOME TAX GUIDE.

Children's Fitness Tax Credit

On January 5, 2007, the CRA released a document that provides additional information about the proposed children's fitness tax credit, which is applicable beginning January 1, 2007 (contained in Bill C-28, which passed through the House of Commons and received first reading in the Senate before Parliament recessed in December). Excerpts from the CRA document are reproduced below.

> While the Canada Revenue Agency (CRA) will administer the credit, organizations are in the best position to determine eligibility. The CRA will work with orga-

nizations in the coming months to assist them in determining whether a particular program qualifies.

* * *

Organizations providing eligible programs of physical activity will determine the part of the fee that qualifies for the tax credit.

* * *

Calculating eligible fees

To be eligible for the children's fitness tax credit, the fees must be paid for a child who is under 16 at any time in the year. The fees must relate to the cost of registration or membership in an eligible program of physical fitness activity. If your organization provides family memberships relating to an eligible program of physical activity, you will be able to issue a tax receipt for the child's portion of the membership fees.

Registration and membership costs can include the costs of administration, instruction, and the rental of facilities. If the fees charged to parents include a part for accommodation, travel, food, or beverages (for example, room and board at a fitness camp), then this part must be deducted when calculating the part of the fees that qualify for the tax credit.

* * *

Issuing receipts

You should issue a receipt for income tax purposes for amounts **paid in 2007 only**. Amounts paid in 2006 do not qualify even if all or part of the activity takes place in 2007. A receipt should contain the following information:

- Organization's name and address
- Name of the eligible program or activity
- Total amount received, date received, and the amount that is eligible for the children's fitness tax credit
- Full name of the payer
- Name of the child and child's year of birth
- Authorized signature.

Note: An authorized signature is not required for electronically generated receipts.

A Good Tax Plan or Just a Delusion?

Demers v. The Queen, 2007 DTC 30 (T.C.C.)

The difference between tax planning that works for the taxpayer and an unacceptable sham that literally falls apart is sometimes difficult to discern. However, some tax planning falls clearly into the sham category. In the *Demers* case, in paragraph 27 of his Reasons, Dussault, J. characterized the tax planning involved as a "leurre", which roughly translates into English as a "delusion" (see *Collins Robert Concise French Dictionary*). English tax jurisprudence often uses the word "sham" in this context. A short look at the facts makes it difficult to disagree with Dussault, J.

Although the facts in the case were complex, the underlying idea was fairly simple: disguise taxable salary or bonus remuneration payable to the taxpayer as dividend income from his corporation, and then split this dividend income up between the taxpayer and his two minor daughters, while retaining total and permanent control over his daughters' dividends and their non-voting corporate shares. The first part of the plan succeeded, but the second part was totally unacceptable to Dussault, J.

The taxpayer controlled "3689735", which was a management company. He was also the sole director and general manager of "Genex". Prior to March 3, 1999, he owned 45,000 of the 55,000 Class A voting shares of Genex. He also owned one Class D non-voting share. On March 3, 1999, one Class D non-voting share of Genex was issued to each of the taxpayer's two minor daughters for a nominal consideration of $1 per share. Neither daughter paid for her Class D share, but their $2 price was deducted by Genex as an operating expense! In a separate agreement dated March 3, 1999, the taxpayer's two daughters, through the taxpayer and his wife as their legal representatives, transferred to the taxpayer all of the rights attached to their Class D shares, and offered to sell those shares to the taxpayer on December 31, 1999. In the same agreement, the taxpayer accepted this offer! On August 23, 1999 and on December 31, 1999, Genex paid a $12,000 dividend on each of its Class D shares to the taxpayer and his two daughters. The $12,000 dividend received by each of the taxpayer's daughters was deposited in the taxpayer's bank account, and each was later used by him to repay Genex for remuneration advances made by it to him. The taxpayer attempted to characterize these deposits as loans made to him by his daughters, which they allegedly consented to by the taxpayer's wife acting as their legal representative. The taxpayer also alleged that he repaid these loans by subsequently making contributions to each daughter's Registered Education Savings Plan ("RESP"), although he provided no documentation to support this allegation. On December 31, 1999, the taxpayer transferred his Class D share of Genex to 3689735, and on January 1, 2000, each of his two daughters transferred her Class D share of Genex to 3689735, as well, pursuant to their obligation to do so in

the agreement of March 3, 1999. Alleging that every transaction relating to the Class D shares issued to the taxpayer's daughters was a sham, the Minister predictably included in the taxpayer's income all of the dividend income received by his daughters on their Class D shares. Interestingly, the Minister did not attempt to re-characterize the dividends to the daughters as taxable remuneration in the taxpayer's hands, which they certainly appeared to be in substance.

How could Dussault, J. have seen all of the Class D share transactions with the taxpayer's daughters as anything but a "delusion"? In his view, the daughters' failure to pay for those shares meant that they were not validly issued under subsection 25(3) of the *Canada Corporations Act*. Even if they were validly issued, Dussault, J. said, in paragraph 28 of his Reasons, that the daughters were holding them as nothing more than the taxpayer's nominees. Dussault, J. was also critical of the non-interest-bearing promissory notes issued by the taxpayer to his daughters to evidence the fact that he had "borrowed" the dividend amounts from them. Also, his comments respecting the taxpayer's so-called "loan repayment" plan through contributions to his daughters' RESPs were scathing. In paragraph 28 of his Reasons, he said: (Translation) "That the appellant had planned to repay the sums allegedly owing to his daughters through contributions to their RESPs is, to me, totally abusive and artificial".

It would have been surprising if Dussault, J. had reached any other conclusion. However, had Demers organized things differently, his tax plan might have succeeded. Firstly, establish *bona fide* irrevocable trusts for each daughter using totally *independent arm's length* trustees. Secondly, ensure that, under the terms of the trust agreement, the trust capital goes to the daughters (at a stipulated age) with gifts over to their issue, to avoid trust capital reversions and attribution problems. Thirdly, fund these trusts properly and have them purchase, pay for, and hold the non-voting Class D shares as truly arm's length shareholders. Fourthly, consider the trusts as a means of independently funding the daughters' future needs by adding other cash and assets to them in the future. Fifthly, adopt a "let go" philosophy with the trust assets, avoid trying to over-control the daughters' affairs relating to these assets, and, above all, forget about agreements enabling the taxpayer to "buy the Class D shares back" almost as soon as they are issued. Sixthly, sever the connection between the dividends on the Class D shares and the taxpayer's own remuneration. Some would argue that all of these steps are costly and philosophically unacceptable, particularly if the taxpayer feels that the Class D dividends are important to his own cash flow. However, by adopting these steps, at least the costs of unsuccessful tax litigation could probably have been avoided, as an offset.

– Robert Jarman, B.A., LL.B.

Intergration Tables

Two new tables have been incorporated ¶8328 of the CANADA INCOME TAX GUIDE.

Table 1 shows the income tax deferral if active business income is earned and retained in a corporation as opposed to being paid out of the corporation as salary to the shareholder; and the tax saving (cost) if instead of being paid out of the corporation as salary, the after-tax corporate income is paid out as a dividend to the shareholder.

Table 2 shows the income tax deferral or prepayment if investment income is earned and retained in a corporation as opposed to being earned directly by an individual; and the tax cost if the after-tax corporate income is paid out as a dividend to the shareholder.

Progress of Legislation

The House of Commons returned from its winter recess and resumed sitting on January 29, 2007. The Senate returned on January 30, 2007.

The following items affecting income tax are currently outstanding in various stages of the legislative process. Proposed amendments to the *Income Tax Act* that have been tabled in a bill, released as draft legislation, or announced in a News Release are set out below.

- Bill C-43, the *Senate Appointment Consultations Act*, received first reading in the House of Commons on December 13, 2006. It contains consequential amendments to subsections 127(3) and 230.1(1) and (2) of the *Income Tax Act*.

- Bill C-33, *Income Tax Amendments Act, 2006*, received first reading in the House of Commons on November 22, 2006. It amends the *Income Tax Act* with respect to foreign investment entities, non-resident trusts, technical amendments, and bijuralism. This replaces the draft legislation for these amendments that was previously released on July 18, 2005, and also includes the proposals that were released on November 17, 2005, concerning the cost of property acquired in certain option and other transactions. (See CCH SPECIAL REPORT 021H.)

- Bill C-28, *Budget Implementation Act, 2006, No. 2*, received first reading in the Senate on December 11, 2006. Bill C-28 implements the income tax proposals from the 2006 Federal Budget that were not included in Bill C-13 (Royal Assent June 22, 2006), including the measures concerning dividend taxation. (See CCH SPECIAL REPORT No. 020H.)

- On December 28, 2006, the Department of Finance announced proposed changes to the taxation of finan-

cial institutions as a result of new accounting standards that took effect on October 1, 2006.

- On December 21, 2006, the Department of Finance released draft legislation amending the *Income Tax Act* to implement the distribution tax on income trusts and partnerships that was part of the Notice of Ways and Means Motion tabled on November 2, 2006. (See CCH SPECIAL REPORT No. 023H.)

- On November 2, 2006, a Notice of Ways and Mean Motion was tabled in the House of Commons to implement the following measures that were announced in Department of Finance News Release 2006-061, dated October 31, 2006:

  – introduction of a new distribution tax on publicly traded income trusts and certain limited partnerships (released as draft legislation on December 21, 2006, see above);

  – reduction of the general corporate income tax rate from 19% to 18.5% after 2010;

  – increase of the age credit amount from $4,066 to $5,066 for 2006; and

  – pension income splitting with a spouse or common-law partner for taxpayers receiving eligible pension income after 2006.

- On February 27, 2004, draft legislation was released concerning foreign affiliates and technical amendments. The technical amendments were included in Bill C-33 (see above); however, the foreign affiliate amendments have not yet been re-released. (See CCH SPECIAL REPORT No. 007H.)

- On October 31, 2003, proposed amendments to the *Income Tax Act* concerning the deductibility of interest and other expenses related to a source were released. (See CCH SPECIAL REPORT No. 006H.)

Recent Cases

For CCA purposes, mobile homes owned by corporate taxpayer were "trailers", not "buildings"

The corporate taxpayer operated 12 mobile home parks and leased out, as residential dwelling units, some 1,100 mobile homes that it owned. In its 1999 and 2000 returns, it classified the mobile homes as "trailers", falling within class 10 of Schedule II. In reassessing the taxpayer for those years, the Minister classified the mobile homes as "buildings", falling within class 1 of Schedule II. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was allowed. The taxpayer's mobile homes were, in the ordinary sense of the word, "trailers". They were clearly not "buildings", since they were built as mobile homes. The Minister was ordered to reassess accordingly.

Lansdowne Equity Ventures Ltd., 2007 DTC 3

Minister reassessed non-resident pilot's "taxable income earned in Canada" to exclude remuneration for duties performed outside Canada

In assessing the taxpayer, an Air Canada pilot, for 1996 to 1998, the Minister accepted that he was a non-resident of Canada, but added amounts to his "taxable income earned in Canada", under subsection 115(1) of the Act. In allowing the taxpayer's appeal in part (2006 DTC 2076), the Tax Court of Canada concluded that (a) a non-resident's remuneration is taxed as "taxable income earned in Canada" to the extent that the remuneration is attributable to duties performed in Canada, and (b) in this case, the computation of the taxpayer's "taxable income earned in Canada" should be redone to exclude remuneration reasonably attributable to duties performed outside Canada, such as domestic flights (the "Excluded Amounts"). The parties were asked by the Court to provide a list of the Excluded Amounts. In an addendum to the original reasons for judgment, the Tax Court listed the Excluded Amounts agreed upon by the parties.

The parties agreed that the Excluded Amounts were to be computed using percentages for each group of flights as follows: Halifax to Toronto, 22%; Toronto to Halifax, 51%; Montreal to Toronto, 0%; Toronto to Montreal, 11%; Vancouver to Toronto, 31%; and Toronto to Vancouver, 49%. The Minister was ordered to reassess accordingly.

Sutcliffe, 2007 DTC 6

Loan discharge payment made by taxpayer's employer did not constitute unreported income from employment

From 1990 to 1999, the taxpayer was employed by Dr. Reyhanian. During 2000, Dr. Reyhanian paid $15,200.83 to discharge a loan owing by the taxpayer to Canada Trust, which he had guaranteed for the taxpayer in 1997. During 2002, the taxpayer worked for Dr. Reyhanian on a voluntary basis to express her gratitude for his having repaid her loan. In reassessing the taxpayer for 2002, the Minister included in her income the $15,200.83 as unreported income from employment. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was allowed. The $15,200.83 was not income from employment for 2002, since the Minister

presented no evidence to connect the $15,200.83 loan repayment during 2002 to the so-called "voluntary" work being performed by the taxpayer for Dr. Reyhanian during 2002.

Biniaz, 2007 DTC 25

Losses sustained by taxpayer from security trading activities were non-capital losses available for carryforward

The taxpayer sustained losses from the frequent buying and selling of securities during 2000 and 2001. In assessing the taxpayer for 2003, the Minister disallowed the carryforward of non-capital losses from his 2000 and 2001 share-trading activities. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was allowed. The losses sustained by the taxpayer in trading securities during 2000 and 2001 were non-capital losses and not losses sustained on capital account. These non-capital losses were available in computing his taxable income for 2003.

Hawa, 2007 DTC 28

Shares of corporation not validly issued to taxpayer's daughters

The taxpayer controlled 3689735, which was a management company. He was also the sole director and general manager of Genex. Prior to March 3, 1999, he owned 45,000 of the 55,000 Class A voting shares of Genex, and one Class D non-voting share. On March 3, 1999, one Class D share of Genex was issued to each of the taxpayer's two minor daughters for a nominal consideration of $1 per share. Neither daughter paid for her Class D share, but their $2 price was deducted by Genex as an operating expense. In a separate agreement dated March 3, 1999, the taxpayer's two daughters, through the taxpayer and his wife as their legal representatives, transferred to the taxpayer all of their rights attached to their Class D shares, and offered to sell those shares to the taxpayer on December 31, 1999. In the same agreement, the taxpayer accepted this offer. On August 23, 1999 and on December 31, 1999, Genex paid a $12,000 dividend on each of its Class D shares to each of the taxpayer and his two daughters. The $12,000 dividend received by each of the taxpayer's daughters was deposited in the taxpayer's bank account, and each was later used by him to repay Genex for advances made by it to him. These deposits allegedly constituted loans to the taxpayer consented to by each daughter (through the taxpayer's wife as their legal representative). The taxpayer also alleged that he repaid these loans by making contributions to each daughter's Registered Education Savings Plan, although he provided no documentation to support this allegation. On December 31, 1999, the taxpayer transferred his Class D share of Genex to 3689735, and on January 1, 2000, each of his two daughters transferred her Class D share of Genex to 3689735, as well. In assessing the taxpayer for 1999, the Minister included in his income all of the dividends received by his daughters on their Class D shares of Genex. The Minister's position was, in essence, that all of the transactions relating to the Class D shares issued to the taxpayer's daughters were a sham, and that there never was any intention that his daughters would become or remain true shareholders of Genex.

The taxpayer's appeal was dismissed. Under subsection 25(3) of the *Loi canadienne sur les sociétés par actions*, the Class D shares of Genex were not validly issued to the taxpayer's two daughters, since they did not pay for them. Even if they were validly issued, the daughters were merely the taxpayer's nominees. Also, the transactions involving the alleged receipt by the daughters of dividends on their Class D shares, and their sale of those shares to the taxpayer, were a sham. The Minister's assessment was affirmed accordingly.

Demers, 2007 DTC 30

Educational tool being developed by corporate taxpayer failed to meet criteria for SR&ED and ITC considerations

The corporate taxpayer was engaged in developing a project known as the Alien Travel Guide (the "ATG"). This project involved an educational tool to assist high school students with physics and mathematics. In assessing the taxpayer for 2000 to 2002, the Minister denied the deduction of SR&ED costs and ITCs that it claimed for the ATG. The parties agreed that these costs primarily represented salaries paid to summer students involved in the ATG. The Minister's position was that the ATG did not fall within the definition of SR&ED in subsection 248(1) of the Act. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. The ATG software being developed by the taxpayer was useful, valuable, and did not exist. However, the taxpayer was unable to show that there was any technological change or uncertainty involved that could not be overcome with standard engineering. Essentially, the taxpayer was utilizing commercially available application programming tools to create a computer-aided instruction program. The ATG, therefore, failed to meet some of the SR&ED criteria set out by the Federal Court of Appeal in *C.W. Agencies Inc. v. The Queen* (2002 DTC 6740). The ATG was ineligible for the SR&ED and ITC treatment being sought by the taxpayer.

Zeuter Development Corporation, 2007 DTC 41

Value of shares received by taxpayer from U.S. corporation included in income as dividend

In reassessing the taxpayer for 2004, the Minister included in his income US$3,879.87 as a dividend from a distribution by a U.S. corporation ("FNB Corp.") of First National Bankshares.

The taxpayer's appeal was dismissed. There was no evidence that the shares of FNB Corp. were widely held and actively traded on a prescribed U.S. stock exchange, or that U.S. resident shareholders of FNB Corp.'s shares were not subject to tax under the U.S. *Internal Revenue Code* on the distribution of First National Bankshares. Also, FNB Corp. failed to provide the Minister with satisfactory information about this distribution. The distribution failed to meet the statutory criteria for an "eligible distribution" set out in subsection 86.1(2) of the Act.

Allen, 2007 DTC 48

Penalties imposed on corporate taxpayer for late source deduction remittances upheld

The Minister assessed the corporate taxpayers for penalties for late source deduction remittances for the period ending April 30, 2004 (the "Remittances"). The Tax Court of Canada dismissed the taxpayers' appeals (2005 DTC 1417). The taxpayers appealed to the Federal Court of Appeal.

The taxpayers' appeals were dismissed. The Tax Court judge correctly determined whether: (a) the taxpayers were "prescribed persons"; (b) the source deduction remittance period ended on May 3, 2004; (c) the "average monthly withholding amounts" in Regulation 108(1.2)(*b*) were miscalculated; (d) the Remittances were not received by the Minister until May 7, 2004; and (e) the taxpayers could have avoided the mistake of failing to make the Remittances to a financial institution. There was no reason to interfere with the Tax Court judge's conclusions.

N.A. Johnson Ltd. et al., 2007 DTC 5001

No ABIL deduction for loan made to acquire shares of a corporation

In reassessing the taxpayer for 2001, the Minister disallowed the ABIL deduction claimed. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. The sole issue was whether the amounts loaned by the taxpayer had been loaned to an individual, Tibor, or to one or both of two CCPCs, 892076 and Molnar. According to the documentary evidence submitted, the loans in question had not been made by the taxpayer to either 892076 or Molnar, but to Tibor, to enable him to acquire the shares of 892076. The taxpayer was therefore not entitled to the ABIL deduction claimed.

Mackay, 2006 DTC 3653

Erratum

In last month's issue of TAX NOTES, No. 528, in the table of indexed income tax parameters appearing at page 7, the years 2006 and 2007 at the top of the table were transposed. The figures in the table itself were correct.

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