CCH
a Wolters Kluwer business

Tax Notes

May 2007
Number 532

Aging Boomers Up the Estate Planning Ante – Part II

This continues our discussion of estate planning for baby boomers we began in the March issue of TAX NOTES (The federal Budget, particularly its far-reaching proposals relating to the financing of foreign affiliates, interrupted our discussion.) As I said in March, the confluence of the greatest wealth transfer in history and increasingly complex tax laws has altered the landscape for estate planners. A good example – discussed in Part I of this article – is the impact of the FIE and non-resident trust proposals on beneficiaries of foreign trusts and estates, which have forced many estate planners to become familiar with these super-complex rules. Also, increased mobility will raise international tax issues, especially for those who relocate to the US with interests in investment-type corporations.

Wealthy Owner-Managers – A Holistic Approach?

Apart from this, it has long been my contention that, in the owner-manager context at least, good estate planning advice requires a holistic approach which includes both personal and corporate tax knowledge – specifically to "drill down" to the underlying corporate structure in order to determine the effect that corporate-level assets and transactions might have on an estate plan, notably, post-mortem procedures. In this respect I believe that relatively recent tax changes have upped the ante considerably.

There is no better example than the eligible dividend regime. The ability to pay eligible dividends may be important to post-mortem planning. For example, a subsection 164(6) "carryback" against terminal period gains may be more efficient if the taxable dividend generated in the estate is an eligible dividend. Where there is non-grandfathered corporate-owned life insurance, death taxes can be minimized by the so-called "50% solution", which involves the repurchase of the decedent's corporation's shares held by the estate for a 50% capital dividend/50% taxable dividend.[1]

Inside

Prior to the eligible dividend rules, the "50% solution" was, in reality, more like a "33 1/3 solution", because of the relatively high tax rate attaching to non-eligible dividends. However, the tax rate on taxable dividends will be reduced to the extent that eligible dividends can be paid.

The maximization of eligible dividends may involve, for example, the determination of whether a subsection 89(11) election is advisable (whereby the corporation will fall under the "eligible dividends by default" regime). Also, the decision of whether or not to bonus to the small business limit will become more relevant in the estate planning context.

More generally, the significance of eligible dividends is that we now have a comprehensive system of integration of major types of Canadian-source income earned by private corporations, including high rate business income. This heightens the importance of corporate-level transactions in the estate planning context, since these can be accomplished on a more tax-efficient basis.

Some "Housekeeping Tips" for the Wealthy

Where particularly wealthy individuals are involved, there is a tendency to overlook a number of "housekeeping" matters when it comes to estate planning. Consider the following:

TAX NOTES

Published monthly by CCH Canadian Limited. For subscription information, see your CCH Account Manager or call 1-800-268-4522 or (416) 224-2248 (Toronto).

For CCH Canadian Limited

ROBERT SPENCELEY, Editor
(416) 224-2224, ext. 6279
e-mail: Robert.Spenceley@wolterskluwer.com

ROBIN MACKIE, Director of Editorial
Tax, Accounting and Financial Planning
(416) 228-6135
e-mail: Robin.Mackie@wolterskluwer.com

TR ISLAM, Marketing Manager
(416) 228-6166
e-mail: TR Islam@wolterskluwer.com

PUBLICATIONS MAIL AGREEMENT NO. 40064546
RETURN UNDELIVERABLE CANADIAN ADDRESSES TO
CIRCULATION DEPT.
330–123 MAIN ST
TORONTO ON M5W 1A1
email circdept@publisher.com

Personally Held Assets

Sometimes there will be little attention paid to personally held assets, as opposed to those at the corporate level. Once upon a time, there was a provision in the *Income Tax Act* which limited death tax exposure to 50% of recapture. However, that provision was removed years ago, so that the full amount of recapture is potentially taxable. It may be advantageous to transfer buildings and other assets exposed to recapture into a corporation,[2] so that the exposure on the deemed disposition would be treated as a capital gain, rather than be fully taxable.[3]

Pre-Mortem Redemptions

If a corporation is generating refundable tax and/or capital dividend account, it may be beneficial to systematically redeem freeze shares – i.e., because the personal tax resulting from deemed dividends on redemption would largely be tax-paid. This will reduce the exposure from the deemed disposition on death and could also reduce the need for cumbersome and expensive post-mortem reorganizations. In a freeze situation, it may make sense to inject investment assets into the corporate system in order to maximize this effect.

Don't Forget About the Freeze Itself!

Time after time, I have seen clients who provide elaborate instructions in their wills, with no thought given to the value accumulated in their family trusts. I recently dealt with a file involving a wealthy client who did a will with an elaborate scheme of distribution to his kids. Trouble is, he lost sight of the fact that he had done an estate freeze some years ago – and the fact that his personally owned assets now accounted for only a minority of the value of his family's business and investments. There was no guidance as to whether the scheme of distribution should be replicated by the trustees (or for that matter how the common shares held by his family trust should be distributed), without which the trustees could rapidly face fiduciary issues. The moral of the story: don't forget to take the estate freeze into account when it comes to estate planning.

Family Law Considerations

The family law impact of estate planning is hardly a new topic. However, much of the discussion has focused on considerations relating to the freezor, as opposed to the beneficiaries.

One of the reasons for this is that, when estate freezes are carried out, the beneficiaries may be fairly young and family law complications seem remote. However, the typical 21-year life span of a family trust is not a long period of time. During that period children and grandchildren can get married or remarried, often with adverse family law consequences. I will use Ontario as an example. If a freeze was effected prior to marriage, it is not at all clear that a distribution from a trust after marriage will be totally protected from a family law claim; an argument can be made that the value of an interest in a discretionary family trust at the time of marriage is low, leaving the post-marriage appreciation up for grabs.[4] If, on the other hand, the assets are simply left in a will, there should be no family law issues if the actual bequest takes place after marriage.

Conclusion

As can be seen, estate planning for wealthy baby boomers now brings into play some very complex rules in the tax area and otherwise. Advisors who are unaware of them act at their peril.

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

Notes:

[1] The stop-loss rules in subsection 112(3.2) may force taxable dividends of magnitude equal to capital dividends; otherwise part or all of the loss will be denied.

[2] Or partnership.

[3] Even at the expense of land transfer tax.

[4] See *Black v. Black* (1988) 18 R.F.L. (3d) 303 (Ont. H.C.). However, in *Sagl v. Sagl*, (1997), 31 R.F.L. (4th) 405, additional reasons (1997), 35 R.F.L. (4th) 107) (Ont. C.J. (Gen. Div.)), the value of the discretionary interest in a family trust was determined (both at the date of marriage and the valuation date) by dividing the value of the corpus of the trust by the number of discretionary beneficiaries at the two dates.

It seems to me that the same sort of issue can arise with the use of an alter-ego (or joint partner) trust, rather than a will. If assets are transferred prior to marriage/remarriage, at least in some circumstances, I can see an argument being made that the distribution from these trusts would not be completely protected from family law claims. If the trust is revocable or capital distributions can be made from the alter ego or joint partner trust, it could be argued that the value of the interest in the trust may be low, in comparison with the amount of the actual distribution received after marriage.

CRA's Action Task Force on Small Business Issues

Reproduced below is a CRA Fact Sheet, released on April 11, 2007 with the Report of the Canada Revenue Agency's Action Task Force on Small Business Issues. The Report, News Release, and Fact Sheet have been posted on CCH Tax PROTOS® and the News Tracker.

The Canada Revenue Agency's (CRA) Action Task Force on Small Business Issues was created at the request of the Honourable Carol Skelton, Minister of National Revenue. Its mandate was to identify which of the CRA's administrative practices imposed the greatest burden on small businesses, develop solutions to reduce the burden, and introduce a systemic approach to burden reduction across the CRA.

The Action Task Force was an innovative joint public/private sector task force composed of senior CRA officials, small business owners, representatives from Industry Canada, and representatives from a number of key organizations, such as:

- the Canadian Federation of Independent Business
- the Canadian Payroll Association
- the Canadian Chamber of Commerce
- the Joint Committee on Taxation of The Canadian Bar Association and The Canadian Institute of Chartered Accountants
- CCH Canadian Limited
- the Certified General Accountants Association of Canada
- l'Association de planification fiscale et financière, and
- the Richard Ivey School of Business at the University of Western Ontario.

The Action Task Force members identified the main sources of compliance burden from a variety of sources including survey results, and presentations from both private sector and public sector officials. The members received presentations from key CRA program managers, inter-government stakeholders such as the Department of Finance, Service Canada, Industry Canada and the Advisory Committee on Paperwork Burden Reduction and from private sector small business representatives.

The Action Task Force's report, *Helping Small Businesses by Reducing the Compliance Burden*, identifies concrete actions to be undertaken by the CRA to tangibly reduce the compliance burden on small businesses and support the achievement of the federal government's burden reduction targets. These initiatives will focus on three specific areas.

The CRA will:

1. Simplify, improve, and, where appropriate, reduce the frequency of small business interactions with the CRA.
2. Improve how and when we communicate with small businesses.
3. Make burden reduction systemic within the CRA.

Specific measures to reduce the compliance burden on small businesses include:

- reducing the number of tax filings and remittances for more than 350,000 small businesses across Canada.
- reducing the paperwork burden by as much as 70%.
- enhancing our electronic services so that businesses can do more on their schedule, not ours. Forms will be made electronic, so that busy business owners will not have to close up their shops to go to the post office.

- reviewing our forms to simplify them and streamline the information requested.
- analyzing the most common errors made by small business and take proactive measures to reduce them. For example, Small Business Information Seminars are already underway.
- continuing with our targeted advertising program for businesses.
- approaching the provinces to include trade schools in our outreach activities. We hope to have something in place within a year.
- simplifying forms for the Scientific Research and Experimental Development program and also reducing the processing time.

The CRA is committed to implementing all of the action items identified in this report and sustaining the focus on burden reduction in the years to come in a manner consistent with its overall accountability for tax compliance, revenue collection and taxation data collection.

List of Registered Investments

The CRA published the list of registered investments, as at December 31, 2006, in the *Canada Gazette* Part I, dated April 14, 2007. This list is published annually, pursuant to section 204.5 of the *Income Tax Act*. It has been incorporated in place with this report.

Should You File a Partnership Information Return?

All "taxpayers" must file tax returns. While a partnership may be deemed in some cases to be a "person", it is not for these purposes a "taxpayer"[1] and hence is not required to file tax returns.

Paragraph 221(1)(*d*) of the *Income Tax Act* (the "Act") empowers the Governor in Council to make regulations requiring any class of persons to file information returns. Under Regulation 229(1), every partner of a partnership that is either a Canadian partnership or carrying on business in Canada[2] must file an information return containing prescribed information. By Regulation 229(2), if any one partner files the return, all the partners are deemed to have filed a return. It is therefore common for the partners to designate one partner to file the return.

Subsection 220(2.1) of the Act permits the Minister to exempt certain partnerships from the requirement to file information returns:

> **220(2.1) Waiver of filing of documents**
>
> Where any provision of this Act or a regulation requires a person to file a prescribed form, receipt or other document, or to provide prescribed information, the Minister may waive the requirement, but the person shall provide the document or information at the Minister's request.

On March 27, 2007, the CRA announced that where there are five partners or fewer, and at anytime during the fiscal period of the partnership, any of the partners was a corporation or trust, the partners would not have to file an information return (see TAX NOTES No. 531). On March 30, 2007, the CRA announced that this policy was **not** yet in effect and was simply being considered by the CRA.

Accordingly, at the present time, the only "official" exemptions from Regulation 229 are those announced by the CRA in paragraph 11 of Information Circular 89-5R, dated June 21, 1991, as amended by Special Release dated December 1, 1994:

> 11. Subsection 220(2.1) of the *Income Tax Act*, applicable to the 1992 and subsequent taxation years, gives the Minister the discretionary power to exempt the members of any partnership or any class of partnerships from filing the Partnership Information Return. The Minister has exercised this authority to exempt the following classes of partnerships:
>
> (a) Partnerships with five or fewer members throughout the whole fiscal period where no member is another partnership. This exemption formerly read "Partnerships with five or less members". The revised exemption is effective for the first fiscal period of a partnership ending after December 31, 1990.
>
> (b) Limited partnerships whose only activity is restricted to investment in flow-through shares, and the renunciation of exploration expenses and the allocation of incentive grants related to those shares during the fiscal period. These limited partnerships may also receive interest, dividends, capital gains, etc., related to those particular flow-through shares.
>
> The limited partnership must file Forms T102 Summary and T102 Supplementaries (Resource Expenses Attributable to Partners) and attach a copy of the financial statements of the limited partnership for the fiscal period to the T102 Summary.
>
> The limited partnership must file a Partnership Information Return if, in a fiscal period, it does not have any exploration expenses renounced to it or does not have any incentive grants allocated to it.
>
> (c) Partnerships where none of the income allocated from the partnership to its partners is included in computing the income of any partner in the partnership because of exempting provisions in paragraph 81(1)(*a*) of the *Income Tax Act* and Section 87 of the *Indian Act*.
>
> All of the income of the partnership must be earned through a permanent establishment of the partnership operated on a reserve. All of the members of the partnership must be status Indians.

While it is obviously "nice" not to have to file a return under Regulation 229, one must be very careful about deciding to take advantage of the CRA's largess. This is because partners who do not file information returns are never statute-barred in connection with their income from the partnership.

This somewhat counterintuitive conclusion is based on subsection 152(1.4), which provides that the Minister may assess[3] a partnership for three years after the later of two times, one of which is the date on which the return under Regulation 229 is filed:

152(1.4) Determination in respect of a partnership

The Minister may, within 3 years after the day that is the later of

(a) the day on or before which a member of a partnership is, or but for subsection 220(2.1) would be, required under section 229 of the Income Tax Regulations to make an information return for a fiscal period of the partnership, and

(b) the day the return is filed,

determine any income or loss of the partnership for the fiscal period and any deduction or other amount, or any other matter, in respect of the partnership for the fiscal period that is relevant in determining the income, taxable income or taxable income earned in Canada of, tax or other amount payable by, or any amount refundable to or deemed to have been paid or to have been an overpayment by, any member of the partnership for any taxation year under this Part.

It is clear from the words "or but for subsection 220(2.1) would be" in paragraph 152(1.4)(*a*) that a partnership cannot rely on the fact that it was exempt by subsection 220(2.1) from filing the return in contesting a determination under subsection 152(1.4). Therefore, a partnership which takes advantage of its exemption will, under paragraph 152(1.4)(*b*), never have its three-year determination period expire. Under subsection 152(1.7), the partnership determination will be binding on each partner of the partnership:

152(1.7) Binding effect of determination

Where the Minister makes a determination under subsection (1.4) or a redetermination in respect of a partnership,

(a) subject to the rights of objection and appeal of the member of the partnership referred to in subsection 165(1.15) in respect of the determination or redetermination, the determination or redetermination is binding on the Minister **and each member of the partnership** for the purposes of calculating the income, taxable income or taxable income earned in Canada of, tax or other amount payable by, or any amount refundable to or deemed to have been paid or to have been an overpayment by, the members for any taxation year under this Part; and

(b) notwithstanding subsections (4), (4.01), (4.1) and (5), the Minister may, before the end of the day that is one year after the day on which all rights of objection and appeal expire or are determined in respect of the determination or redetermination, assess the tax, interest, penalties or other amounts payable and determine an amount deemed to have been paid or to have been an overpayment under this Part in respect of **any member of the partnership** and any other taxpayer for any taxation year as may be necessary to give effect to the determination or redetermination or a decision of the Tax Court of Canada, the Federal Court of Appeal or the Supreme Court of Canada.

Therefore, before deciding whether to file information returns, partnerships should consider the downside of not filing, namely, permitting the Minister unlimited time to assess the partners.[4]

– Joel Nitikman, tax partner with Fraser Milner Casgrain LLP, Vancouver.

Notes:

[1] The Court in *Deptuck v. Her Majesty the Queen*, 2003 DTC 5272 (F.C.A.), at paragraph 11 held that a partnership was a "taxpayer" for purposes of section 69, based on the definition of "taxpayer" in subsection 248(1), which refers to a person "whether or not liable to pay tax". This finding was an error, which the Court would have realized had it been referred to its own decision in *Oceanspan Carriers Limited v. Her Majesty the Queen*, 87 DTC 5102 (F.C.A.), where it said:

"The definition of "taxpayer", properly understood in its context in the whole of the scheme of the Act, shows, indisputably in my view, that it refers to resident individuals or corporations who may be liable to pay tax **at some time** whether or not they are, at any given time, liable therefor."

As a partnership will never be liable to pay tax, it cannot be a taxpayer, even though it may in some cases be a person.

[2] That is, it does not apply to a partnership that is not a Canadian partnership and its only income earned in Canada is property income earned from a rental property in Canada. Hence, subsection 152(1.4) cannot apply to such a partnership. See Technical Interpretation "Determination of Partnership Information", December 10, 2004, Document No. 2004-0103741E5.

Effective October 31, 2006, Regulation 229 will also apply to SIFT partnerships, pursuant to clause 30 of Bill C-52, *Budget Implementation Act, 2007* (Notice of Ways and Means Motion to Implement Certain Provisions of the Budget (CCH Special Report 026H), dated March 19, 2007).

[3] Subsection 152(1.4) refers to a "determination", rather than an "assessment", but for these purposes the two appear to be interchangeable. See *Perfect Fry Company Ltd. v. Her Majesty the Queen*, 2007 TCC 133.

[4] See TEI Conference, December 4, 2001, Question 10, "Partnership Information Returns", Document No. 2001-0110905.

Bill C-52, *Budget Implementation Act, 2007*, Receives First Reading

Bill C-52, *Budget Implementation Act, 2007*, received first reading in the House of Commons on March 29, 2007. Bill C-52 includes the tax measures contained in the Notice of Ways and Means Motion tabled on March 27, 2007, as well as other non-tax-related Budget proposals. Subscribers to the Canada Income Tax Guide (print, CD-ROM, or Internet) will have received CCH Special Report No. 026H, which contains the proposed legislation and the News

Release from March 27, 2007. Additional copies of the Special Report may be ordered by calling the CCH Customer Satisfaction Hotline at (416) 224-2248. Outside the Greater Toronto Area, call toll free at 1-800-268-4522. Explanatory notes for the tax measures were not released with the legislation, but according to Department of Finance News Release No. 2007-028, the notes will be released "in the near future". The tax measures contained in Bill C-52 include the income trust measures released as draft legislation on December 21, 2006 (CCH SPECIAL REPORT 023H), as well as the pension income splitting measures, change in the age amount, and future reduction of the corporate tax rate, which were tabled in a Notice of Ways and Means Motion in November 2006. It also includes Budget proposals for the child tax credit, increased spousal and other amounts, the increase in the age limit for RPPs and RRSPs, and changes relating to RESPs and qualified investments for RRSPs. Legislation for other tax proposals that were in the 2007 federal Budget will be tabled at a later time.

Recent Cases

Losses from taxpayer's book writing and publishing activities not deductible

In reassessing the taxpayer for 2001 to 2003, the Minister disallowed the deduction of business losses incurred in writing, publishing, and promoting a book. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. Applying the principles set out by the Supreme Court of Canada in *Stewart v. The Queen* (2002 DTC 6969), the Court concluded that (a) there was a personal element involved, and (b) in light of the sales record and losses for the book, the taxpayer was unable to show that any commercial activity was being carried out by him using objective standards of business-like behaviour.

Harrison, 2007 DTC 377

Minister's refusal to reassess taxpayer to recognize business losses upheld

The Minister refused the taxpayer's request to reassess his 1996 to 1999 taxation years, under subsection 152(4.2) of the Act, to recognize certain business losses. The taxpayer applied to the Federal Court for judicial review of the Minister's decision.

The taxpayer's application was dismissed. The applicable standard of review was reasonableness (see *Lanno v. CCRA*, 2005 DTC 5245 (F.C.A.)). Only the taxpayer's 1996 taxation year was statute-barred. It was therefore the only year to which the reassessment provisions of subsection 152(4.2) could apply. The Minister's assessments for 1997 to 1999 were not yet statute-barred, and could not be dealt with in these judicial review proceedings. The Minister's decision-maker had acted reasonably in this case, since the taxpayer failed to provide the documentation requested that would have assisted in determining which of the taxpayer's expenses were personal, as opposed to employment or business related.

Gagné, 2007 DTC 5087

Taxpayer still owned shares of corporation at time of redemption – Criteria for subsection 85(1) rollover were not met

Following the taxpayer's divorce, she and her former spouse agreed that her 45 Class A shares of 2743-0156 Québec Inc. ("2743") should be redeemed for $150,000. The parties also agreed that the shares (with a paid-up capital of $45) should first be rolled over, under subsection 85(1) of the Act, to a newly incorporated holding corporation, 9084-3772 Québec Inc. ("9084"). 2743 subsequently redeemed the 45 Class A shares for $150,000. In assessing the taxpayer for 2000, the Minister included in her income a deemed dividend of $149,955 ($150,000 less $45) under subsection 84(3) of the Act. The Minister's position was that the subsection 85(1) rollover never actually took place, and that the taxpayer did not file the related T2057 election form in a timely fashion. On her appeal to the Tax Court of Canada, the taxpayer argued that (a) substance should prevail over form, (b) by refusing to accept the late-filed T2057 form, which the Minister could have done under subsection 85(7.1) of the Act, he was perpetrating a serious injustice, and (c) her Class A shares of 2743 were in fact transferred to 9084, so she should not have to include the $149,955 in her income as a deemed dividend, since she was no longer the owner of those shares.

The taxpayer's appeal was dismissed. There was no documentary evidence to show that the taxpayer's Class A shares of 2743 were actually transferred by her to 9084, or that 9084 ever issued shares to her. Therefore, the essential criteria for the proposed subsection 85(1) rollover were never met. Also, the Tax Court did not have jurisdiction to hear a judicial review application after the Minister refused to make a discretionary decision under subsection 85(7.1) of the Act. The taxpayer still owned the 45 Class A shares of 2743 at the time of their redemption, so the subsection 84(3) deemed dividend was properly included in her income for 2000. The Minister's assessment was affirmed accordingly.

Vachon, 2007 DTC 321

Taxpayer not entitled to tax credit for charitable donation for which he received "kickback"

The Association for the Betterment of Literacy and Education ("A.B.L.E.") was a registered charity being promoted as a tax shelter by Henry N. Thill. In assessing the taxpayer for 1996, the Minister disallowed a charitable donation tax credit claimed for donations made to A.B.L.E. totalling $125,000. The Minister's position was that, in making this donation, the taxpayer realized that he would receive 75% of the $125,000 back as an "educational gift", which was really a "kickback". On his appeal to the Tax Court of Canada, the taxpayer argued that he neither expected nor received an "educational gift" of 75% of his payments to A.B.L.E.

The taxpayer's appeal was dismissed. On a balance of probabilities, the taxpayer both expected to receive and received a kickback equal to 75% of his donations to A.B.L.E. For a transaction to qualify as a gift, there must be an element of impoverishment, which was lacking in this case. A number of tax schemes had been before the courts involving tax shelter promotions by Henry N. Thill. Although the taxpayer alleged that he had been duly diligent in trying to ensure that A.B.L.E. was a legitimate charity, he should have tried to acquire background information on Henry N. Thill's past promotions. The Minister's assessment was affirmed accordingly.

McPherson, 2007 DTC 326

Investment by taxpayer's RRSP in shell corporation not a "qualified investment"

In assessing the taxpayer for 1999, the Minister included in his income, under paragraph 146(10)(*a*) of the Act, $29,000 invested by his RRSP in a shell corporation, Jovalguy Inc. ("Jovalguy"), on the ground that this amount was not a "qualified investment", as defined in subsection 146(1) of the Act. In allowing the taxpayer's appeal (2006 DTC 2102), the Tax Court of Canada concluded that (a) the shares of Jovalguy were not a "qualified investment", but (b) Jovalguy was involved in a sham, so the taxpayer's RRSP never actually acquired a non-qualified investment in Jovalguy, and the income inclusion was not justified. The Tax Court judge developed the sham analysis on her own account, since neither party raised this issue in their pleadings. The Crown appealed to the Federal Court of Appeal.

The Crown's appeal was allowed. The Tax Court judge was correct in concluding that the shares of Jovalguy were not a "qualified investment". However, those shares were acquired by the taxpayer's RRSP, which meant that their cost was required to be included in the taxpayer's income. The fact that they were worthless did not, in itself, constitute a sham. Were it not for an investigation by the Quebec Securities Commission, the taxpayer would have received the proceeds of a loan as part of the overall investment scheme involving the acquisition of the Jovalguy shares. The Tax Court judge simply erred in concluding that a sham existed. Also, having concluded that the acquisition of the Jovalguy shares constituted a non-qualified investment, it was not open to the Tax Court judge to engage in a sham analysis since that issue was not raised by the parties. The Tax Court judgment was accordingly set aside in part, and the matter was referred back for a determination of the fair market value of the Jovalguy shares.

Nunn, 2007 DTC 5111

Shareholder's loss incurred from guarantee of corporation's debt was capital in nature

The taxpayer held 25% of the shares of A & L DeCicco Ltd. (the "Corporation"). The Corporation held an interest in a strip mall on which Manulife held a mortgage (the "Mortgage") that had been granted in connection with a refinancing program. The taxpayer was one of the guarantors of the Mortgage when it went into default. After the litigation settlement by Manulife against the guarantors of the Mortgage, the taxpayer paid $87,500, which he sought to deduct in computing his income for 2000. The Minister disallowed the deduction as an expense, but treated it as a capital loss. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. A loss sustained by a shareholder for a guarantee of corporate debt is usually capital in nature, unless the shareholder has provided the guarantee in the ordinary course of business, or holds the corporation's shares as a trading asset (see *Easton v. the Queen* (97 DTC 5464) (F.C.A.)). The taxpayer alleged that he had guaranteed the Mortgage to Manulife in return for a guarantee fee, and was thus involved in an adventure in the nature of trade. In his view, he fell within the first exception to the general rule set out in the *Easton* case. However, his testimony lacked credibility, and the evidence that he provided did not justify a conclusion that he had agreed at the outset to bear the risk of the Corporation's loss, or that his principal motivation in guaranteeing the Corporation's liability under the Mortgage was to earn a fee. Hence, he was not entitled to deduct the $87,500 payment on his guarantee as an expense.

DeCicco, 2007 DTC 388

CCH
a Wolters Kluwer business

CCH Canadian Limited
300-90 Sheppard Avenue East
Toronto ON M2N 6X1
416 224 2248 • 1 800 268 4522 tel
416 224 2243 • 1 800 461 4131 fax
www.cch.ca