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Suddenly, This Summer: Selected Tax Developments

In this article, I will summarize a number of tax-related developments occurring over the summer that I found particularly interesting.

"Vancouver Control Premium"

The issue that may garner the most attention among tax advisors as the fall goes by became high profile after a recent article in *Canadian Tax Highlights*.[1] In a Vancouver-area tax file, the CRA is apparently attempting to assert that there is significant additional death tax exposure based on a control premium, apparently retained in an estate freeze.

While estate planners were certainly aware of the issue, many felt that, with the acceptance over the years of estate freezes as a legitimate tax planning tool, the CRA would not press this point – so this is an unpleasant development.[2] Discussions with leading valuators do support the view that, even if a freezor has no other rights than to vote, a control premium might nonetheless apply – although at a much more modest percentage than the CRA appears to be asserting (a big reason being the shareholder's power to appoint directors, and the consequent ability to pay bonuses and dividends, influence the business, and so on).[3] However, the value of a control premium may be dependent upon the holder's other rights, especially in the case of so-called "exclusionary dividend" shares – that is, shares which give the holder the right to strip the company by paying dividends on the shares, to the exclusion of other classes of shares.[4] (This issue is not necessarily confined to death tax – a very large premium for such shares could result in the loss of capital gains exemptions for other shareholders on a share sale.) Conversely, a separate class of freeze shares might arguably depress the value of a control premium, especially at the inception of a freeze, because of the fact that retraction rights (which are normally included in the attributes of freeze shares) may result in the freeze shares having effective control of the corporation.

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Of course, asserting that there is a control premium undermines an estate freeze, and therefore succession planning for owner/managers and their families. Does this make sense from a policy standpoint?

I may have more to say about this issue as the fall goes on.

Third Party Information: *Redeemer Foundation*

In July, the Supreme Court released the long-awaited decision in *Redeemer Foundation*.[5] The case affirms the CRA's ability to obtain that charity's donor lists under the normal audit process[6] – i.e., in the absence of a court order pertaining to "unnamed persons".[7] In general, the case raises disturbing issues when it comes to the ability of the CRA to get its hands on third-party information. The top court held that the requirement to obtain such a court order[8] should not apply to situations in which the requested information is required pursuant to the record keeping obligations relevant to charities to verify the compliance of the taxpayer being audited,[9] even if the information allows the CRA to audit donors.[10] While some commentators have expressed uncertainty as to the extent the case extends beyond the charities sector,[11] the Court did go on to indicate that, generally, the *Income Tax Act*'s audit provisions, being broadly worded, give the CRA access to information that is or should be in the books or records of the taxpayer being audited, including access to information about third parties that is required to be kept by the taxpayer, as well as any information that may not be required to be kept but happens to be in the taxpayer's records.[12]

Ironically, other recent cases indicate that obtaining the court order in respect of "unnamed persons" – which the CRA was able to avoid in *Redeemer* – is much less problematic than was formerly the case.[13] In particular, *MNR v. Chambre Immobilière du Grand Montrèal*[14] discarded the "genuine and serious enquiry" standard; instead, a judge must merely be satisfied that the information or documents relating to one or more unnamed persons who form an ascertainable group are required to verify compliance with the Act. These cases may ultimately create a worrisome environment where taxpayers' privacy rights are subordinated to CRA audit powers.[15]

Technical Explanation to the Protocol

On July 10th, the U.S. Department of the Treasury released the Technical Explanation to the Protocol to the Canada–U.S. Treaty, which was in turn released a year ago. Although this was prepared by U.S. officials, the Canadian Department of Finance agrees with its contents.

The materials relating to the technical information are about 200 pages long and quite complicated. Fortunately, a number of leading firms issued releases which go a long way toward translating the fine print. One item that I found interesting is that the Technical Explanation clarifies that if a Canadian corporation directly holds an interest in a U.S. LLC, under the Protocol, the U.S. branch tax (which applies because, for U.S. tax purposes, the LLC is disregarded) will no longer be eligible for the favourable rate under the pre-existing Canada-U.S. Treaty. This means that the rate will jump to a prohibitive 30%, rather than 5%, as is currently the case.[16] This will likely be effective on January 1, 2010 – i.e., assuming that the United States passes the Protocol by year-end. Presumably, the remedy would be the interposition of a U.S. C corporation.

Specified Investment Businesses and Partnerships

In July, my partner, Michael Goldberg, wrote an article about a recent Technical Interpretation[17] which spells out a change in CRA policy with respect to whether employees of a partnership will count for the "more than five full-time employees" exception to specified investment income status for corporations. If the exception does not apply, the corporation's specified investment business income would be taxed at "investment rates" – close to 50% in most provinces. Formerly, the CRA's position was that, because of the *Lerric* case[18] pertaining to interests in joint ventures,[19] employees of a joint venture would not count toward the minimum employee requirement, whereas employees of a partnership would. However, the Technical Interpretation indicates that the CRA is now taking the

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position that the *Lerric* case also applies to partnerships, so that employees of partnerships (as well as joint ventures) don't count toward the minimum employee requirement. However, as an administrative exception, if a partnership itself employs more than five full-time employees, the income from the partnership will not be considered to be specified investment business income – i.e., lower corporate "business rates"[20] will apply.[21]

If employees of a partnership no longer count toward a corporate partner's number of employees, this may require a "reshuffling" of employees. However, if employees become sequestered in the corporate partner, there may be loss of limited liability, because of the legal requirement that the partner cannot take part in the control of the business of the limited partnership.[22] One countermeasure could be the establishment of a Manitoba limited partnership, since that province's limited partnership legislation does not have an anti-control provision.

While I am on the topic, I might mention the *489599 B.C. Ltd.* case.[23] There has been uncertainty as to whether the "more than five" full-time employee requirement means six or more full-time employees – see *The Queen v. Hughes*[24] – or five plus one or more part-time employees.[25] In *489599*, the court held in favour of the latter, citing, among other things, the *Lerric* case, which criticized *Hughes*. The statements in *Lerric* were not critical to the case – i.e., they were *obiter*. But they weren't just any old *obiter* – they were from none other than Marshall Rothstien, who is now on the Supreme Court of Canada. In spite of this case, I do not regard the matter as resolved.

Bill C-10 and the General Election

As I indicated in my August article, Bill C-10, which includes proposals relating to foreign investment entities, non-resident trusts and restrictive covenants, was in legislative limbo – stalled in the Senate. Furthermore, that wholesale changes in these areas is a real possibility, especially if tax advisors continue their guerilla warfare against them. With the election a month away, the status of these proposals is even more uncertain. Keep those e-mails coming (after we figure out who is Finance Minister). I am reminded of the old curse – you may get what you wish for – but just about anything would be an improvement over these misguided and horribly complex proposals.

What Didn't Happen (So Far)

One event that did not happen was the release of the Supreme Court of Canada's verdict in the *Lipson* case on GAAR and interest deductibility. At the time the appeal was heard by the Supreme Court back in April, case after case had gone in favour of the CRA, so my feeling was there was nowhere to go but up. Although there have been a couple of taxpayer victories since then,[26] this observation still applies to the uncertainty created by the ever-growing number of GAAR cases.

– David Louis, J.D., C.A., Minden Gross, Toronto, a member of MERITAS law firms worldwide. Special thanks (in alphabetical order) to Vern Blair and Richard Wise.

Notes:

[1] "Premium for Voting Control on Estate Freeze", Jack Bernstein and Elisabeth Atsaidis, *Canadian Tax Highlights*, June 2008, Canadian Tax Foundation.

[2] But perhaps not a complete surprise. For example, *Taxation of Private Corporations and Their Shareholders* (Kellough and McQuillan, Canadian Tax Foundation), suggests that the control premium issue should be resolved by *Re Mann Estate* ([1972] 5 WWR 23 (BCSC), aff'd. [1974] 2 WWR 574 (SCC)); but the publication goes on to discuss ways in which the "cautious tax planner" may minimize the issue. (See p. 3:30 *et seq.*)

[3] A maximum of 15% has been informally suggested by one leading valuator. A recent article suggests a maximum of 10%, again assuming no other rights than voting control – see "Valuation – Allocation of Value", by Vern Blair, 2007 BCC p.9:1.

[4] See, for example, *Winram Estate*, 72 DTC 6187, FCTD. Of course, a fundamental issue is the possibility of oppression remedies as affecting the value of a control premium. This will not be discussed in this article. There are indications that, in the Vancouver area, the CRA may also be taking a particularly aggressive stand in respect of an actual tax file involving exclusionary dividend shares. However, it may be too early to tell how serious the CRA is.

[5] *Redeemer Foundation v. Canada*, 2008 SCC 46.

[6] I.e., under section 231.1.

[7] I.e., under section 231.2.

[8] I.e., under subsection 231.2(2).

[9] Per paragraph 230(2)(*a*).

[10] See paragraph 22.

[11] One recent presentation stressed the Court's emphasis on the combined effect of the general audit powers under section 231.1 and the specific record keeping requirements applicable to charities under subsection 230(2) and that the CRA asserted at the hearing that it was arguing the case only in respect of charities and not in general.

[12] See paragraph 24.

[13] Especially in view of amendments from over a decade ago, repealing certain pre-requisites for an order.

[14] 2007 FCA 346. See also *eBay v. MNR*, 2007 FC 930.

[15] In *Grand Montrèal*, the Federal Court of Appeal indicated that, by the repeal of paragraphs 231.2(3)(*c*) and (*d*) (over a decade ago), "Parliament permitted a type of *fishing expedition*, [emphasis added] with the authorization of the Court . . . for the purpose of facilitating the MNR's access to information." (See paragraph 45.)

[16] See, for example, the KPMG and PWC releases on the Technical Explanation.

[17] Doc. No. 2007-025801117, January 3, 2008

[18] *Lerric Investments Corp. v. The Queen*, 2001 DTC 5169 (FCA).

[19] 2001 DTC 5169, FCA.

[20] Including the small business deduction, where applicable. However, this would be subject to the "specified partnership income" rules, which prorate the small business deduction amongst partners.

[21] See Interpretation Bulletin IT-73R6, paragraph 20. Contrast this with paragraph 16 of Interpretation Bulletin IT-73R4.

[22] See, for example, section 13 of the Ontario *Limited Partnerships Act*.

[23] Docket: 2006-1940(IT)G.

[24] The *Queen v. Hughes & Co. Holdings Limited*, 94 DTC 6511, FCTD.

[25] It does not appear that a corporation could aggregate part time employees to meet the five full-time employee requirement. See

Hughes, in which the taxpayer was unsuccessful in claiming the exemption based on four full-time employees and several part-time employees. See also *Baker*, 2005 DTC 5266, TCC and *489599 B.C. Inc.*, paragraph 16

[26] *Landrus v. The Queen*, 2008 DTC 3583 (TCC), involving terminal losses, and more recently, *Remai v. The Queen*, 2008 TCC 344, involving charitable donations.

Tax Smart Investing

Investors need to come to grips with the relatively new GRIP and dividend tax rules. This is an issue both for entrepreneurs and stock market investors, with different implications for each. Let's start with some background.

The core issue is the linkage, or "integration", between corporate and personal taxation. Corporations pay taxes on their profits and then distribute those profits to their investors as dividends. The question is how to tax the individual investor on this dividend. One school might say to give the dividend tax-free to investors, as the corporation already has paid tax. Another school says to tax the dividend the same as any other source of income that makes the investor better off. The third school says, yes, tax investors, but give them recognition (a tax credit) for the corporate tax previously paid.

The historical problem has been that, since public and private companies bear significantly different corporate tax rates, "perfect" integration with their respective investors requires different systems for each. When one system of integration is applied to both, it either favours one with over-integration, or hurts the other with under-integration. The Canadian system historically has chosen the latter, which hurts public companies.

Thanks to the *Rowell-Sirois* and *Ives Commissions* in the 1940s, all individual investors started receiving a 10% dividend tax credit in 1949, which was increased to 20% in 1953. The same 1949 Budget introduced the preferential lower tax rates for small business – which started us on the ride to the integration inequity between public and private company dividends, which landed half a century later with a resounding thump on former Finance Minister Ralph Goodale's desk in 2005.

The famous watershed Budget of December 1971 retained the small business tax preference and one dividend system for all corporations, introducing a $33^1/_3$% gross-up accompanied by the tax credit of 20%. The dividend tax system remained on the radar screen for Finance Ministers through the 1970s, including Chretien's Budget of 1977, which increased the gross-up from $33^1/_3$% to 50% and the tax credit from 20% to $33^1/_3$%, specifically targeted to bolster the then-sagging Canadian public equity markets. However, this system proved grossly rich for small business – again, the problem of one rate for two worlds – and led to the short-lived small business Part II distribution tax of $12^1/_2$% in 1981 to repair the damage. There were further tweaks to the dividend system in the Budgets of 1982, 1986 and 1987, which brought us to the system that Goodale faced in 2005: a gross-up of one-quarter and a federal tax credit of $13^1/_{13}$%, followed by provincial matching, to approximately 20% combined.

And so, it has indeed taken six decades to "get it right". Commencing in 2006, there is now a dual integration system, one for public companies and one for private. Investors in private companies engaged in entrepreneurship enjoy the "old" system on the first $400,000 of annual profits, now called "ineligible". Investors in public companies enjoy the new, richer system, called "eligible".

The accompanying chart gives some perspective on the implications of the new system. The top row shows the 2008 personal marginal tax bracket ranges. The rows following show the marginal tax rate in British Columbia for an incremental dollar of different kinds of investment income at different income levels (note that this chart would vary significantly from province to province). [The corresponding rates for all the provinces and territories are contained in the 2008 marginal rate chart reproduced in the CANADIAN TAX REPORTER at ¶254c.]

Taxable income	<$35,016	$35,017–37,885	$37,886–70,033	$70,034–75,769	$75,770–80,406	$80,407–97,636	$97,637–123,184	>$123,184
Interest	20.2%	23.0%	30.0%	32.5%	36.5%	38.3%	40.7%	43.7%
Capital gain	10.1%	11.5%	15.0%	16.2%	18.2%	19.1%	20.3%	21.8%
Ineligible Dividend	2.3%	5.7%	14.4%	17.6%	22.6%	24.8%	27.8%	31.6%
Eligible Dividend	0%*	0%*	0%*	2.2%	8.0%	10.6%	14.1%	18.4%

Implications for Stock Market Investors

A number of observations from the chart above showing marginal rates for British Columbia are worthwhile. First, the tax rate on eligible dividends is now lower than it is on capital gains, across all marginal tax brackets. Second, in comparing the two sets of tax rates for dividends, we underscore how overtaxed public company dividends have been all these years. Third, eligible dividends are totally tax-free for incomes under $70,000, and only slightly taxed between $70,000–75,000. Fourth, the top tax rate on eligible dividends is 18.4%. Fifth, the "zero" (*) tax

rate on incomes under $70,000 has a brand new additional implication – in fact, the dividend tax rate at the first three brackets is not zero, but negative: -15.56%, -11.59%, and -1.44%, respectively.

The tax credit received on dividends applies to the total tax bill resulting from total income. This means that, for incomes under $70,000, eligible dividends are not only tax-free but actually reduce the tax on other income of the taxpayer. A bigger "leakage" problem occurs when the taxpayer does not have other sources of income to soak up the excess dividend credits. For instance, someone in the lowest bracket earning only eligible dividends could leave as much as $5,600 of tax credits on the table.

A foregone tax reduction of this size may inspire tax planning initiatives that have not been previously necessary in the world of only ineligible dividends. For instance, in this circumstance, the tax law long has permitted a couple to transfer the dividend income (and the related tax credits) from the lower-income spouse to the higher-income spouse. If the transferee spouse can enjoy the tax credits and pays little or no tax on these extra dividends, the benefit for the couple would be the tax break on whatever dependent credits can now be transferred, which can be quite sizable. But this only works if there is a couple!

Another tax planning strategy to address sizable leakage is to manage taxable income in some fashion. One version of this requires proactivity during the tax year, while the other version requires some cleverness when preparing the tax returns in the following spring. Proactive steps would involve generating some taxable income to soak up the credits. This might, for instance, involve cashing out some RRSP funds! While this may seem heretical, in fact, it could make sense to use the proceeds to contribute to the new Tax-Free Savings Account, which joins our world in 2009. Alternatively, unrealized capital gains could be harvested to generate more income.

Some strategies can be executed at tax preparation time. For instance:

- Defer RRSP deductions on contributed amounts.
- Defer CCA on rental or self-employment income.
- Accelerate the taxation of a previous capital gains reserve.
- Defer some credits, like donations and medical expenses.
- Transfer eligible credits to your spouse.
- Elect pension splitting with a transferee spouse.
- Defer permissive tax shelter deductions.
- Defer loss carryforward claims.

Implications for Entrepreneurs

The dual integration system is good for entrepreneurs as well as investors. The old system only integrated well for corporate income taxed at a low corporate rate, which is what applies to many entrepreneurs. However, entrepreneurs making profits in excess of the Small Business Limit (recently raised to $400,000 annually) historically found themselves trapped into a high salary/bonus distribution tax strategy in order to avoid inadequate integration. This meant drawing a salary in excess of the entrepreneur's personal needs, and resulted in high personal tax bills. Now, with the dual system, the entrepreneur only needs to draw compensation to fund personal needs, and the excess business profits can be taxed in the company with impunity because those profits can be withdrawn in the future as eligible dividends with proper integration.

The implications of the dual system go further. An entrepreneur with low personal income needs and whose company has eligible dividends available in the GRIP pool, may find it "tax smart" to voluntarily take greater compensation than needed, in the form of eligible dividends. We can see this from the chart, which tells us that voluntary eligible dividends that raise the taxable income up to $70,000 will come tax-free.

This introduces a fundamental annual tax planning principle of "use-it-or-lose-it", akin to using up personal credits each year. When the entrepreneur has a tax-free dividend window up to $70,000 annually, it should be used, not wasted. If the entrepreneur doesn't need the extra cash, the extra funds can be retained in the business and sit in a tax (free) paid shareholder loan account in the company. However, this strategy needs to be managed in the long term if the entrepreneur intends to sell the company and qualify for the $750,000 capital gains deduction. If the company holds too much liquidity from its retained earnings, the share sale may not qualify for the tax-free capital gain.

Entrepreneurs who own passive holding companies get a new and good result, too, with eligible dividend rules. Typically, their HoldCos will only generate GRIP from the dividends in a portfolio of public stockholdings, and not from interest or rental income or capital gains. However, the HoldCo might also own shares in the entrepreneur's active company, which generates business profits in excess of the Small Business Limit. An eligible dividend paid to the entrepreneur from a HoldCo will cause that income to be tax-free as it passes through the HoldCo and taxed to the entrepreneur, according to the chart above.

Lastly, for investors or entrepreneurs with exclusively, and large, eligible dividends, the interplay of federal tax, provincial tax, and Alternative Minimum Tax ("AMT") can leave one's head spinning. Finding an optimal and tax-free strategy is pretty well impossible. This is a change, because the old ineligible dividend system never attracted the wrath of AMT. For instance, while the chart above indicates

that an incremental amount of eligible dividends is tax-free up to $70,000, if one's income is solely eligible dividends, the AMT changes that result. In fact, only $49,000 of such dividends is tax-free; above this, AMT kicks in. At $70,000, the AMT tax bill would approximate $4,100 instead of being free and, furthermore, the provincial tax credits are not fully enjoyed.

– Don Nilson, FCMA, CFP, TEP, Principal – Nilson & Company/AFT Trivest Management

Prescribed Interest Rates – Fourth Quarter of 2008

The prescribed interest rates for the fourth quarter of 2008 are noted below:

- 3% to calculate a deemed interest taxable benefit on subsidized employee and shareholder loans;
- 5% on refunds of income tax overpayments; and
- 7% on payments of overdue income taxes, insufficient income tax instalments, unremitted employee source deductions, CPP contributions or EI premiums, and unpaid penalties.

These rates will be in effect from October 1, 2008 to December 31, 2008.

Scholarships: The Enhanced Employee Incentive

Recent amendments have increased the attractiveness of a corporate scholarship plan for employees and their families. Scholarships may now be granted for elementary, secondary, and post-secondary education. If properly structured, there is no taxable benefit to the employee, and the scholarship is deductible to the employer and not taxable to the recipient of the scholarship (i.e., the student).

Paragraph 6(1)(*a*) of the *Income Tax Act* (the "Act") includes in income "the value of board, lodging and other benefits of any kind whatever received or enjoyed by the taxpayer in the year in respect of, in the course of, or by virtue of an office or employment". Although these words are sufficiently broad to include an employer-provided scholarship to dependents of employees as an employee benefit, the CRA does not assess on this basis.

Paragraph 9 of IT-75R4, "Scholarships, Fellowships, Bursaries, Prizes, Research Grants and Financial Assistance", dated June 18, 2003, states:

> (9) As a matter of good employee relations, an employer may pay tuition fees for, or give a grant or award to, one or more school-age or university-age children of employees. Such a payment is considered to be a scholarship or bursary. It is income of the child under subparagraph 56(1)(*n*)(i) if the payment is made as part of a plan to help a certain number of children who are selected on the basis of their scholastic records or other achievements or qualities. This treatment is particularly likely if the selection is made by a board or committee or by persons not connected with the employer, such as schoolteachers. In other cases, a payment to assist in the education of employees' children is normally considered to be employment income of the employee (the parent) by virtue of subsection 56(2) and paragraph 6(1)(a).

The CRA commented on the criteria it looks for in a scholarship program under paragraph 9 of IT-75R4 in *Tax Window File* 2006-0215701E5, "Employee Dependant Scholarship Program", dated September 17, 2007, in which it stated:

> "For paragraph 56(1)(*n*) to apply to such scholarships, there must be objective selection criteria that focus on the accomplishments of the dependant, for example, scholastic achievement. In this regard, it is our view that the employer's selection criteria for scholastic achievement must be higher than the minimum entrance requirements for most post-secondary institutions; otherwise, any dependant who enters a post-secondary education program would qualify for a scholarship. In addition, there must actually be a limited number of scholarships provided by the employer. Whether or not there are actually a limited number will always be a question of fact. The number of dependants chosen from those who are otherwise eligible should be low enough that most employees could not expect their dependants to be selected. Collectively, these criteria will ensure that the merit of the dependant is prevalent in the employer's selection rather than the employee's relationship with the employer."

Where an individual is otherwise required to include an amount in income under paragraph 56(1)(*n*), if the amount is received in connection with an educational program that is eligible for the education tax credit under section 118.6, of the Act a full exemption will be available for such qualifying amounts that are received in 2006 and in subsequent taxation years, pursuant to subsection 56(3). Even though a taxpayer may be eligible for a full exemption, pursuant to subsection 56(3), the payer is required, pursuant to paragraph 200(2)(*a*) of the Income Tax Regulations, to file a T4A information return and provide the student with a T4A slip.

The 2007 federal Budget proposes, for the 2007 and subsequent taxation years, that the total of all amounts received by an individual on account of scholarships and bursaries in connection with the individual's enrolment in

an elementary or secondary school will also be excluded from that individual's income.

In another *Tax Window File*, 2004-0095101E5, also with the title "Employee Dependant Scholarship Program", dated December 1, 2004, the CRA approved a scholarship for post-secondary education where the minimum average under the Scholarship Program was 70%, which is generally the minimum requirement for entrance into most post-secondary schools. It is unclear what criteria would be acceptable for elementary and secondary school.

Two recent decisions of the Tax Court dealt with employee scholarships. In *Dimaria v. The Queen*, 2008 DTC 3027, the applicant received $3,000 from Dow Chemical Canada Inc. in partial reimbursement of the Appellant's son's tuition fees. The amount was paid pursuant to Dow's Higher Education Award Program, which was established to recognize the scholarship achievement of children of eligible employees and to provide them with financial assistance for their post-secondary education. To qualify for the program, the student was required to have a minimum average of 70% in the graduating year of high school. A maximum of 100 awards are granted each year, to be selected and approved based on the highest averages of the applicants. Provided the selected students maintain good academic standing, the award can be renewed annually, for a maximum of four awards. The payment was a gratuitous payment by Dow and did not reduce the pay of the employees. The Court concluded that the amount was not taxable in the hands of the appellant. It was a benefit to the student only.

Webster's Third New International Dictionary defines scholarship as a sum of money or its equivalent offered (as by an educational institution, a public agency or a private organization or foundation) to enable a student to pursue his studies at a school, college or university (a definition that was adopted in *The Queen v. Amyot*, 76 DTC 6217 (F.C.T.D.) and *Jones v. The Queen*, 2002 DTC 3875 (T.C.C.)). The judge in *Dimaria* observed that the scholarship need not be necessarily related to academics, as there are a number of other qualities or achievements, such as age (i.e., mature students), sports, extra-curricular activities, cultural or artistic activities, and community relations or involvement, which could apply to any particular scholarship. The Court did not accept the CRA's challenge that a 70% average was not adequate. The University of Waterloo was cited as an example where 70% was the minimum average required to apply for an entrance scholarship. The scholarship was found to be properly taxable in the hands of the student.

Similarly, in *Okonski v. The Queen*, 2008 DTC 2992 (T.C.C.), the court concluded that an award from the University of Western Ontario Group Benefit Plan for tuition was properly taxable to the student, notwithstanding that it was paid to the employee. The plan also required a minimum academic average, which was unsuccessfully challenged by the CRA as being too low a threshold.

Given the high cost of tuition at private elementary and secondary schools and at universities, it is certain that many more companies will adopt scholarship plans. The inclusion of elementary and secondary schools indicates the government's intention to encourage these plans and will broaden the eligible recipients. It may be difficult to develop academic criteria for elementary school tuition. A parent in Ontario incurring $15,000 to $20,000 for a private elementary school can save 46.4% of the tuition if it is paid by the employer. The tuition must be paid by virtue of employment and not shareholding – a plan only for the benefit of the children of the owner-manager would be challenged.

– Jack Bernstein, Aird & Berlis LLP, Toronto