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Tax Notes

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Tax Planning in a Downturn

I am tempted to pontificate on how so many financial advisors are too young to remember the "crash" of '87, let alone something really serious. I could query how it came to be that mutual funds replaced savings accounts; how people came to believe that the market goes in only one direction, or how U.S. politicians have regressed to Herbert Hoover's *laissez faire* policies.[1] But my job is just to give tax advice. So I will confine my comments to some thoughts in respect of tax planning in a downturn.

Tax-Loss Selling

Of course, given the time of year, the first thing that comes to mind is tax-loss selling. Alas, this could turn out to be of critical importance, as a tax refund from a loss carryback may be a valuable source of cash for a business, or just to meet day-to-day living expenses.

In most cases, stock market losses and the like will be capital losses.[2] Capital losses realized in 2008 must be claimed against capital gains realized in the same year. A three-year carryback is available on an elective basis; otherwise, unutilized capital gains can be carried forward indefinitely. In the past, I have said that if you do not have capital gains this year or in the previous three years, there may be no point in triggering the loss. However, with the extraordinary declines that have taken place in recent weeks, depending on the particular circumstances, consideration might be given to triggering large loss positions to be "warehoused" for future gains, i.e., on the assumption that (hopefully) we will never again see things this low. However, if an individual wants to buy back in, he or she should be aware of the superficial loss rules. These rules will be operative if the individual or an affiliated person (see below) buys an identical investment in the period within 30 days before or after the tax-loss sale, and continues to hold the investment[3] at the end of the period.

Inside

Once upon a time, the standard strategy was to wait 30 days before buying back in. But the way things are going these days, the markets could be up (or down) a thousand points in a few hours, let alone 30 days. So the better thing to do could be to have a non-affiliated person buy back in. While an affiliated person includes a spouse/common-law partner or controlled corporation, children are not affiliated with a parent, nor would a parent be affiliated with a family trust if neither of the parents are beneficiaries. For years, it used to be the case that the superficial loss rules would not apply if the individual's RRSP were to reacquire the same investment; however, the 2004 Budget put an end to this.

Rather than paying brokerage fees if you sell in the market and an unaffiliated person buys back in, it may be possible to trigger the loss by transferring the securities directly to the non-affiliated transferee. However, assuming that this is evidenced by switching the security to the transferee's brokerage account (based on its value at the time of the transfer),[4] you may have to contend with the universal market integrity rules, which restrict off-marketplace transfers of securities.[5] It is my understanding, however, that a gift is exempt from these rules, but you should consult your broker.[6] Also, if the transfer is not a gift, the transfer price should generally be at the fair market value of the particular security.[7]

To trigger a 2008 loss, the trade must settle by December 31st. On Canadian exchanges, the last day you can trigger a tax loss in 2008 is December 24th. Before realizing a capital loss in a corporation, one should review whether it has a positive capital dividend account from previous capital gains. If so, a capital dividend should be declared beforehand, as the capital loss will reduce the capital dividend account and therefore the ability to pay tax-free dividends to shareholders.

But Where Are the Gains?

Alas, the biggest question may be whether you have gains to shelter. Investors should not overlook long-standing holdings of BCE, the takeover of which is expected to close in December – if, of course, all goes well. But there are two other questions. First, do you really have a capital loss? While many investors think that they have sustained huge losses in recent weeks, it often turns out that these are paper losses only – they are giving back the accrued gains from recent years, rather than suffering an absolute loss relative to the actual tax cost of the particular investment. In determining whether a taxpayer has losses, this must be done on an investment-by-investment basis. Another thing to bear in mind is that, if there were several purchases of the same investment, the tax cost is calculated on a weighted average basis – even if the shares were held in different brokerage accounts. But the cost base averaging rule applies only to identical investments beneficially owned by the particular taxpayer.

If you are trying to shelter a gain, whose gain are you sheltering? Very often, the spouse with the gains may not be the one with the losses. If this is the case, one strategy that may come in handy is the "superficial loss shuffle", which, as the phrase implies, allows tax losses to be shuffled between spouses. The idea is that, if the loss investment is transferred to the spouse with the gains at fair market value (e.g., for cash or a promissory note bearing interest at the CRA's prescribed rate – currently 3%), the loss can likewise be transferred to the spouse, provided that the spouses elect out of the rollover in subsection 73(1) of the *Income Tax Act*. Alternatively, the spouse with the losses can simply sell the loss investment, with an identical investment bought by the spouse with the gains (with his or her own funds) within 30 days of the sale. Under these circumstances, the accrued loss at the time of the other spouse's transfer or sale will be added to the cost base of the loss investment now held by the spouse with the gains and the loss[8] on its eventual sale will be claimed by that spouse. This strategy has been affirmed by the CRA.[9] However, to trigger the superficial loss shuffle, the loss investment must be held by the spouse with the gains at the end of the 30-day period after the sale or transfer by the spouse with the losses. As I said, given the twists and turns in the market, this requirement might involve significant uncertainties.

Another possibility for tax-loss selling could be a recently acquired real estate investment. As I pointed out a year ago,[10] this could be a U.S. investment, especially since

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this market is even worse than it was last year – and still shows little sign of bottoming out. However, a gain or loss must be measured in Canadian dollars; so recent appreciation of the greenback against the Canadian dollar may reduce the loss.

For Ontario real estate at least, land transfer tax may also be a significant consideration, although in some cases tax losses could be triggered without land transfer tax applying.[11] In the real estate recession of the 90' s, properties were so far underwater that land transfer taxes were modest in relation to the income tax saving. This time around, we may not be there – not yet, anyway. So land transfer tax could blow out the income tax benefits, especially if the land is located in Toronto, where the tax can top out at 4% for residential properties (3% otherwise).

Other Tax Planning

If the bad economy continues, there will be many other tax planning areas that may be relevant.

For example, a downturn may be an opportune time to undertake an estate freeze or other estate planning. If an estate freeze has previously been done at a higher value, it is possible to "refreeze" at a lower value.

Some defensive tax planning may also be in order. In recent years, the CRA has enhanced its powers to go against taxpayers, and you can bet that the CRA will make full use of them. One of the biggest lines of attack will be based on joint and several liability for unpaid income tax, to the extent that assets have been shuffled to a non-arm's length transferee for less than full consideration.[12] This includes dividends received from a closely held company – and there is no assessment limitation period pertaining to the transferee. Careful consideration should be given to structuring distributions and transfers in a way that minimizes the risk of a successful CRA attack. Another area for CRA attack is directors' liability for unpaid source deductions and GST. Again, there is no assessment limitation period, other than a two-year limitation period that applies once a director has resigned.

Default procedures can have greatly differing tax effects to a debtor. Creative tax planning can minimize adverse tax effects (e.g., in respect of debt forgiveness, foreclosure versus power of sale, etc.). Similarly, workouts and other insolvency-type transactions can be structured to maximize preservation of losses and tax pools, perhaps allowing these to be monetized to enhance recoveries for creditors.

– *David Louis, J.D., C.A., Minden Gross, Toronto, a member of MERITAS law firms worldwide.*

Notes:

[1] Perhaps the Coolidge era of the Scopes Monkey Trial is more accurate.

[2] There may be exceptions, e.g., if trading has been very active or an individual has insider information on a particular investment. In this article, I have assumed that capital gains treatment applies to securities.

[3] Or an identical property.

[4] I suggest that there be documentation of this transfer – i.e., as a sale or gift.

[5] See, in particular, section 6.4 of the rules.

[6] Although a gift (as well as a sale) will suffice for this particular strategy, as will be seen later, another strategy, the "superficial loss shuffle", entails a sale of the security to a spouse at fair market value. It is not clear whether brokers would necessarily require specific confirmation that the transaction is a gift.

[7] Another possibility could be to leave the brokerage account as is and to document a transfer of beneficial ownership to a non-affiliated person, supplemented by a declaration of trust, whereby it is confirmed that the particular securities transferred are held in the individual's brokerage account as bare trustee for the transferee. However, this should be documented carefully, and the individual must be well organized, to ensure that post-transfer transactions are properly reported. Besides making sure the ultimate sale is reported by the transferee, dividends must also be reported in the correct manner. If the transferee is 18 or over in the year, he or she would normally report dividends; however, depending on how the transfer is structured, the attribution rules may apply to a younger transferee.

[8] Or gain.

[9] See, for example, Doc. Nos. 2003-0017075, May 27, 2003 and 2001-0100155, January 7, 2002.

[10] "Revealed – Lucrative Tax Loss Strategies", *Tax Notes*, No. 539, December 2007.

[11] If the property is inventory, it can simply be written down. However, if the property increases in value, it must be written back up again (not in excess of cost) if it remains in the same entity. If the property is capital, the building portion can qualify as a terminal loss, deductible against all sources of income. The land portion will be a capital loss which can be deducted only against capital gains.

[12] In the year in which tax is applicable or subsequent year.

Canada Pension Plan Maximum Pensionable Earnings for 2009

On November 3, 2008, the CRA announced that for 2009, the maximum pensionable earnings on which Canada Pension Plan contributions are made will be $46,300, increased from $44,900 in 2008. The basic exemption remains at $3,500 for 2009. The employee and employer contribution rates for 2009 remain at 4.95%, and the self-employed contribution rate remains at 9.9%. In 2009, the maximum employer and employee CPP contributions will be 2,118.60 (up from $2049.30 in 2008), and the maximum self-employed contribution will be $4,237.20 (up from $4,098.60 in 2008).

Estate Distributions to Non-Residents

There are numerous tax and non-tax considerations that need to be addressed before a final distribution of property is made from an estate to its beneficiaries. Executors of estates should obtain tax clearance certificates before distributing estate property and need to ensure that all taxes owing have been paid; otherwise, they risk personal liability for any unpaid taxes of the estate. Estates with non-resident beneficiaries present additional issues.

Distributions of Capital to Non-Resident Beneficiaries

Generally, a trust can distribute capital to a beneficiary in satisfaction of that beneficiary's capital interest on a tax-deferred or rollover basis. Subject to certain conditions and restrictions, subsection 107(2) of the *Income Tax Act*[1] provides a rollover on the distribution of property from a personal trust to a beneficiary in satisfaction of all or any part of the beneficiary's capital interest in the trust, except in certain situations. A "personal trust" is defined in subsection 248(1) to mean a testamentary trust or an *inter vivos* trust in which no beneficial interest in the trust was acquired for consideration payable to the trust or to any person who has made a contribution of property to the trust. Under subsection 107(5), the rollover is not available on the distribution of property (except certain property, including Canadian real property) to non-residents. Where the subsection 107(2) rollover is not available, subsection 107(2.1) will apply.

A distribution to which subsection 107(2.1) applies will not occur on a rollover basis. Instead, the trust is deemed to have disposed of the property distributed to the beneficiary for proceeds equal to its fair market value at the time of the distribution. As a result, the trust may realise a capital gain or loss at the time of distribution in respect of capital property, profits or losses in respect of inventory, and recapture or terminal losses in respect of depreciable property. The beneficiary is deemed to have acquired the trust property at a cost equal to its fair market value and the beneficiary is deemed to have disposed of all or part of his or her capital interest in the trust for proceeds equal to the fair market value of the property distributed from the trust, less certain deductions.

In cases involving non-resident beneficiaries, it may be possible to use alternative tax planning structures to defer the capital gain on the distribution. For example, it may be possible to transfer the property to a Canadian resident corporation. Such a transfer should qualify for tax-deferred treatment under subsection 107(2). Depending on the terms of the trust, it may also be possible to transfer estate property with accrued gains to Canadian beneficiaries and transfer estate property with no accrued gains to non-resident beneficiaries.

Section 116 Compliance

Tax liability under section 116 applies to non-residents who dispose of taxable Canadian property and "excluded property" within the meaning of subsection 116(6). "Taxable Canadian property" includes an interest in Canadian real property, shares in the capital stock of a private resident in Canada, and a capital interest in a trust resident in Canada. The non-resident must notify the CRA of the disposition, either in advance or within 10 days after the disposition. The purchaser is entitled to withhold 25% or 50% of the proceeds from the purchase price, depending on the type of asset being disposed of. Unless a Certificate of Compliance is obtained, the purchaser must remit the withheld amount; otherwise the purchaser will be liable for the withheld amount, interest, and penalties.

While it may not seem as though the distribution of property and cash by a Canadian resident trust to a non-resident beneficiary would be caught by these rules, the CRA takes the position[2] that payment to a non-resident beneficiary in satisfaction of part or all of a capital interest in a trust resident in Canada is a disposition to which section 116 applies. Paragraph (*h*) of the definition of "taxable Canadian property" in subsection 248(1) includes "a capital interest in a trust (other than a unit trust) resident in Canada". Furthermore, paragraph (*d*) of the definition of "disposition" in subsection 248(1) indicates that there is a disposition of a full or partial capital interest in a trust where a payment is made after 1999 to a taxpayer from a trust, that may reasonably be considered to have been made because of the taxpayer's capital interest in the trust.

The effect of these two provisions is that the non-resident beneficiary is disposing of taxable Canadian property (his or her capital interest in the trust) at the time the trust distributes the trust property to the non-resident beneficiary. The disposition or partial disposition of the non-resident beneficiary's interest in the trust will trigger the application of section 116.

If assets other than cash are distributed to the non-resident beneficiary, there may be a capital gain realized by the non-resident beneficiary. As such, the trust should withhold 25% of the trust property until a Certificate of Compliance has been issued to the non-resident beneficiary.

If there is no inherent gain in the trust property that is distributed, there should be no tax exigible under section 116. Despite this result, the CRA still takes the position that the beneficiaries are required to give notice of the disposition to the CRA, and the trustees are potentially liable for the withheld amount, interest, and penalties. In such circumstances, the Certificate of Compliance that will be issued pursuant to section 116 should provide that no tax is payable on the disposition.

If the non-resident beneficiary does not comply with the requirements of section 116 and no Certificate of Compliance has been issued, the trustees must remit the tax owing within 30 days of the end of the month in which the disposition occurred, or risk being liable for the withheld amount, penalties, and interest.

Starting in 2009, new amendments to section 116 may provide relief to trustees and non-resident beneficiaries. No withholding will be required if:

(a) the vendor and the purchaser are related;

(b) the property would be "treaty-protected property" of the non-resident vendor; and

(c) the purchaser provides notice to the CRA in respect of the acquisition within 30 days.

In most cases, a capital interest in a trust resident in Canada will be considered treaty-protected property (except where the trust derives more than 50% of its value from real property located in Canada). It is not clear at the present time how the CRA will apply these new provisions, and trustees may still wish to have the security of a Certificate of Compliance before making a distribution to a non-resident.

– Kevin Scott and S. Sebastian Elawny, Associates in the Tax Department with the Calgary Office of Fraser Milner Casgrain LLP

Notes:

[1] All statutory references herein refer to the *Income Tax Act* (Canada).

[2] See, for example, CRA Document No. 2005-0149961E5, dated March 6, 2006, and CRA Document No. 2006-0184741E5, dated July 10, 2007.

Recent Cases

Taxpayers' shareholder benefits on disposition of shares reduced

The taxpayers, husband ("H") and wife, held shares in two corporations relevant to their appeals, Profilec ("P") and Novamex ("N"). The taxpayers transferred, on a non-arm's length basis, a portion of their shares of N to P for a certain consideration per share, and as a reimbursement of the advances made by P to the taxpayers. H sold a portion of his shares of N and of a third corporation, Madcomsoft ("M"), and reported capital gains on the transactions. H also lent funds to N (for a $1 consideration) and a third party (on an interest-free basis, and without establishing repayment terms). H subsequently declared the debts non-collectable and deducted them as capital losses, after initiating collection proceedings against the third party debtor. The Minister reassessed the taxpayers for 1999 and H for 2000 on the basis that their disposition of the shares of P gave rise to shareholders' benefits under s. 15(1). The Minister also reassessed H on the basis that the proceeds from his share dispositions constituted business income. The Minister also disallowed H's capital loss deductions on his loans, on the ground that the loans were not made to earn business income within the meaning of s. 40(2)(*g*)(ii). The taxpayers appealed to the Tax Court of Canada. The appeals were heard together on common evidence.

The taxpayers' appeals were allowed in part. The taxpayers' consideration for the disposition of their shares of P was revised based on the evidence adduced, resulting in a reduction of their shareholders' benefits. The evidence also showed that the proceeds from H's disposition of his shares of P and M constituted business income. H was entitled to deduct the loan made to the third party as a capital loss. However, the Minister had properly disallowed H's capital loss deduction on his loan to N, on the basis that it was not made for the purpose of gaining or producing income from a business within the meaning of the Act. Furthermore, H had failed to adduce evidence showing that the loan was non-collectable. The assessments were referred back to the Minister for reconsideration and reassessment.

Diotte et al., 2008 DTC 4558

Taxpayer's donation of promissory notes qualified for charitable tax credits

Prior to his death in 2001, the taxpayer donated two promissory notes to a foundation (a registered charity) that he controlled, and claimed charitable donation tax credits under s. 118.1(3) in respect of the gifted securities. The foundation in turn sold the notes to a corporation ("S Inc.") controlled by the taxpayer's nephew. S Inc. carried on business activities for and with the taxpayer and in partnership with corporations owned and controlled by the taxpayer. The Minister reassessed the taxpayer's terminal year return for 2001, disallowing the deductions on the basis that the sale of the notes was not executed at arm's length, and that the notes, therefore, constituted non-qualifying securities (as defined under s. 118.1(18)(*a*)). The estate appealed the assessment to the Tax Court of Canada. Another issue raised in the appeal was whether the sale of the notes constituted an avoidance transaction that resulted in a misuse or abuse of the provisions of the Act under the general anti-avoidance rule ("GAAR") in s. 245.

The appeal was allowed. The facts revealed that the sale of the notes was executed at arm's length, in accordance with the analysis adopted by the Supreme Court of Canada in *The Queen v. McLarty* (2008 DTC 6354). Therefore, the taxpayer's donation of the notes prior to his death constituted a valid gift for purposes of the charitable tax credit provisions of the Act. In addition, while the sale of the notes did constitute an avoidance transaction under s. 245(3), it did not give rise to a misuse or abuse of the provisions of the Act within the meaning of s. 245(4). As a result, the GAAR did not apply to deny the charitable credit deductions claimed in the taxpayer's year of death.

Remai Estate, 2008 DTC 4567

Minister's decision denying taxpayer's request to amend returns and have them reassessed upheld

The taxpayer owned and operated two corporations. The taxpayer applied to the Minister on two occasions to amend his personal income tax returns and corporate returns for 1999 and 2000, and for a reassessment of those returns. The taxpayer also submitted several different amended returns for 1999 and 2000. The Minister, in turn, made several requests for information for both tax years. The Minister subsequently denied the taxpayer's requests to amend his returns in the main, and to reassess him, on the basis that he had failed to provide all the information requested, and because his documentation could not be reconciled with the information contained in his individual and corporate returns. By August 2005, the taxpayer's corporate returns were statute-barred. The taxpayer applied to the CRA for a fairness review of the Minister's decision to deny his requests, and sought a reassessment of his returns under s. 152(4.2) of the Act. The Minister rejected the taxpayer's fairness request. The taxpayer applied to the Federal Court for judicial review of the Minister's decision.

The taxpayer's application was dismissed. The Minister did not breach the rules of procedural fairness in rejecting the taxpayer's request for a readjustment and reassessment of his returns. The Minister's powers to reassess after the normal reassessment period under s. 152(4.2) does not extend to corporations, and accordingly, the Minister did not have the authority to reassess the statute-barred corporate returns. Furthermore, the taxpayer had failed to file proper documentation to enable the Minister to conduct a proper reassessment of his personal returns.

Costabile, 2008 DTC 4549

Minister entitled to reassess taxpayer after normal assessment period for failing to report income

The taxpayer, the Estate of Herman Gebhart, was reassessed by the Minister, beyond the normal period, for 1996, on the basis that it had failed to report the proceeds from the closure of an RSP account held by the deceased, Herman Gebhart, at the time of his death. The Minister contended that the taxpayer's failure to report the proceeds amounted to a misrepresentation attributable to neglect, carelessness or wilful default within the meaning of s. 152(4)(*a*) of the Act. The taxpayer appealed to the Tax Court of Canada (2007 DTC 128), which affirmed the Minister's assessment. The taxpayer appealed to the Federal Court of Appeal.

The taxpayer's appeal was dismissed. The Tax Court was correct to conclude that the taxpayer's failure to report the proceeds as income was negligent or careless, and that the Minister was therefore entitled to reassess beyond the normal period. The Tax Court decision was affirmed accordingly.

Gebhart Estate, 2008 DTC 6581

Shortfall between proceeds on issuing debentures and market price of shares issued on conversion not deductible as financing expense

The corporate taxpayers had issued convertible debentures in 1993. In 1997, the debentures were converted into shares at their market value, which was in excess of the shares' market value on the date that the debentures were issued. The taxpayers deducted the difference between the market value of the shares issued on conversion and the value they received for their debentures on the issue date (the "Amounts") as financing expenses under s. 20(1)(*f*) of the Act. All the debentures were issued at their face value. In reassessing Tembec Inc. and Cascades Inc. for 1997, and Provigo Inc. for 1998, the Minister disallowed the taxpayers' deductions, prompting their appeals to the Tax Court of Canada ("TCC"). The appeals were heard together to address the taxpayers' common legal issues. The TCC affirmed the Minister's assessments on the basis that a deduction under s. 20(1)(*f*) was limited to a portion of the difference of the principal amount of a debt paid on maturity and the debt's discounted face value on the date of issue (2008 DTC 3232). The taxpayers appealed to the Federal Court of Appeal.

The taxpayers' appeals were dismissed. The Tax Court did not err in rendering its decision. The taxpayers were not entitled to deduct the Amounts as financing expenses. The Tax Court decision was affirmed accordingly.

Tembec et al. , 2008 DTC 6601

Farm losses fully deductible

The taxpayer was a dentist operating a dental clinic. The taxpayer also operated a farming business. In computing his income under the Act for 1999 and 2000, the taxpayer claimed farm losses. In reassessing the taxpayer, the Minister reduced his claimed losses under s. 31(1) of the Act on the basis that his chief source of income was not farming or a combination of farming and some other source. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was allowed. The taxpayer's income was derived from a combination of farming and another source. Therefore, s. 31(1) did not apply to restrict his farm loss deductions. The assessments were referred back to the Minister for reconsideration and reassessment.

Loyens, 2008 DTC 4698

Legal fees incurred in divorce proceedings not deductible

The taxpayer incurred legal expenses (the "Legal Fees") during divorce proceedings, primarily to protect a rental property from foreclosure, and also to protect his credit reputation. In reassessing the taxpayer for 2003 and 2004, the Minister disallowed the deduction of the Legal Fees. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. The taxpayer failed to establish what portion, if any, of the Legal Fees was incurred to earn income, rather than as a capital or personal expense. He was therefore not entitled to the deduction claimed.

Keay, 2008 DTC 4704

Taxpayer's appeal of Minister's assessment dismissed for failure to file timely objection

The Minister brought a motion, under s. 53(*b*) of the Tax Court of Canada Rules (General Procedure), to strike out the taxpayer's notice of appeal on the basis that it was frivolous. At the hearing of the motion, the Minister also requested that the taxpayer's appeal be dismissed under s. 58(3)(*b*) of the Rules because of the taxpayer's alleged failure to file, under s. 165(1) of the Act, a timely objection to the Minister's assessment, or make a timely application, under s. 166.1(1), for an extension of time. The taxpayer did not object to the Minister's request.

The Minister's motion was granted. The taxpayer did not file a valid objection to the Minister's request under s. 165(1), and did not apply to the Minister in a timely manner for an extension of time to file the objection. The taxpayer also did not appeal the Minister's decision not to accept her late-filed objection within the time prescribed under s. 166.2(1). The Court did not, therefore, have jurisdiction to hear the appeal. However, the case did raise the issue of whether the Minister had issued a valid assessment, and, if so, when the assessment was issued. As a result, the taxpayer might be entitled to seek a remedy in respect of the assessment in a different court.

Corsi, 2008 DTC 4725

Taxpayers jointly and severally liable for outstanding tax debts of third individual following transfers to joint bank account

The taxpayers, mother ("S") and son, held a joint bank account where a series of cheques issued by S's husband ("J") were deposited. In reassessing the taxpayers for 2002 to 2004, the Minister held them jointly and severally liable for J's outstanding tax debts under the Act as a result of the fund transfers. The taxpayers appealed to the Tax Court of Canada on the basis that the cheques were issued for consideration, in part for repayment of J's alleged outstanding loan owed to S, and in part for satisfaction of J's statutory family-support obligations.

The taxpayers' appeals were dismissed. There was no evidence confirming the existence of a valid loan owed by J to S, or that the cheques were issued in respect of J's support obligations. Therefore, there was no basis to conclude that the funds were transferred for valid consideration, and the taxpayers were jointly and severally liable for J's outstanding tax debts.

Kadola et al., 2008 DTC 4727

Corporate taxpayer not entitled to tax-free rollover for property transfer

The corporate taxpayer operated a property development business. The taxpayer transferred a parcel of land (the "Property") to a related corporation following a joint election filed under s. 85(1) of the Act, and reported a capital gain on the disposition. In reassessing the taxpayer for 2002, the Minister determined that the Property was not an "eligible property" as defined in s. 85(1.1), and that the joint election was therefore invalid. The Minister also assessed an income amount as the alleged profit generated by the taxpayer on the transfer. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. The evidence showed that the Property was inventory (rather than a capital property) and was not an eligible property for purposes of the rollover provision in the Act. Therefore, the joint election filed under the Act was invalid, and the taxpayer was liable for the income assessed by the Minister on the Property transfer.

Dalron Construction Limited, 2008 DTC 4733

Amounts received by taxpayers from brokerage employer constituted employment income

The taxpayers, J and D (husband and wife), received payments from their brokerage employer ("FBN") on their retirement. They reported the amounts received as a capital gain from the disposition of property. The taxpayers contended that the amounts constituted consideration for the transfer of their clientele to two brokers, and for their agreement not to compete in the industry for a period of five years. The third taxpayer, Je, the daughter of J and D, also received payments from FBN, and reported the amount as a capital gain, arising from the disposition of her brokerage clientele. In reassessing J and D for 2002, the

Minister included the amounts in their incomes as a "retiring allowance" under s. 56(1)(*a*) of the Act, and also reduced J's deduction for her contributions under her retirement savings plan. In the alternative, the Minister contended that the amounts constituted employment income. In reassessing Je for 2002 and 2003, the Minister initially treated the amounts she received as a retiring allowance based on incorrect information in the T4 and T4A slips issued by FBN. The Minister subsequently characterized the amounts as employment income based on the information in a revised T4 slip. The taxpayers appealed to the Tax Court of Canada. The appeals were heard together on common evidence.

The taxpayers' appeals were dismissed. The amounts paid to J and D were consideration for their services to their employer, and therefore constituted employment income under ss. 5(1) and 6(3). The amounts received by Je were paid as a bonus, and were therefore taxable as employment income under s. 5(1). The assessments were referred back to the Minister for reconsideration and reassessment.

Bouchard et al., 2008 DTC 4737

Taxpayers jointly and severally liable for related corporation's tax debts

The corporate taxpayer ("Q Inc."), the individual taxpayer ("L"), and a third entity ("9039") were related for purposes of the Act. The taxpayers received dividends from 9039 at a time when the corporation had an outstanding tax debt under the Act. The Minister reassessed the taxpayers (from 1993 to 1996 in the case of L, and for 1996 in the case of Q Inc.) under s. 160(1) of the Act, holding them jointly and severally liable for 9039's tax liability plus interest and penalties. The taxpayers appealed to the Tax Court of Canada on the basis that the dividend payments did not constitute a transfer of property within the meaning of s. 160(1), or, in the alternative, if they did constitute a transfer of property, that they were effected for valid consideration. The appeals were heard together on common evidence.

The taxpayers' appeals were dismissed. The dividend payments constituted a transfer of property by 9039 to the taxpayers without consideration within the meaning of s. 160(1). The taxpayers were therefore jointly and severally liable for 9039's outstanding tax debts.

Larouche et al., 2008 DTC 4745

Funds received by taxpayer from brokerage firm in respect of investments was not income

The taxpayer received funds from a brokerage firm in respect of his electronic share trading account (allegedly operated through and on behalf of a corporation). The taxpayer had incurred trading losses. The firm in turn entered into an agreement to pay the taxpayer a sum of money reflecting the quantum of the trading losses it generated under his account. In reassessing the taxpayer for 2001 and 2002, the Minister characterized the funds as unreported income, and imposed gross negligence penalties. The taxpayer appealed to the Tax Court of Canada on the basis that the funds constituted a reimbursement of his investment in the firm.

The taxpayer's appeal was allowed. The taxpayer generated losses in his trading account. Therefore, the funds he received did not constitute investment income. The funds were paid either to reimburse him for his losses or in satisfaction of the debt owed to him. The assessments were referred back to the Minister for reconsideration and reassessment.

Hazan, 2008 DTC 4751

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