Tax Notes

March 2012
Number 590

CCH
a Wolters Kluwer business

JOINT VENTURES — OK, NOW WHAT?

— David Louis, tax partner, Minden Gross LLP, a member of MERITAS law firms worldwide

From time to time I've wondered, what if the tax laws become so complex that you can't comply with them? The issue has come up: for example, throughout the last decade, the foreign investment entity ("FIE") proposals were peppered with information requirements that simply were beyond reasonability. However, I have learned not to jump up and down, because in the end it usually doesn't come to that — at least where a lot of taxpayers are in the same boat. Cooler heads prevail (for example, the aforementioned FIE rules were scrapped in the 2010 Budget). Compromises are made. Life goes on.

But a Canada Revenue Agency ("CRA") release that recently came out relating to joint ventures has me scratching my head, especially because, for scores of taxpayers, it will be next to impossible to comply with the CRA's new policies.

A Brief History

In 1989, the CRA announced it would allow, on an administrative basis, a joint venture to establish a fiscal period that differed from the fiscal periods of the joint venture participants. (At the time, it was stated that the CRA position was intended to apply primarily where the participants have different fiscal periods, or where the participants have the same fiscal period but there are valid business reasons that justify a separate fiscal period for the joint venture — see 1989 Revenue Canada Round Table, Question 40.) As a result, it became commonplace, when filing, to include the joint venture's income in the participant taxpayer's taxation year in which the fiscal period of the joint venture ended — even though this treatment was not explicitly recognized in the *Income Tax Act* itself. This, of course, allowed for a deferral of a joint venturer's income, for example, if the joint venturer's fiscal year ended just before that of the joint venture.

In other words, the administrative policy put joint ventures on the same footing as partnerships in this regard — in fact, on an even better footing. As readers know, unlike a partnership, a joint venture allowed capital cost allowance and other discretionary deductions to be claimed at the joint venturer level, so that differing claims could be made by the respective joint venturers.

Based on this, it became common for real estate co-ventures (at least) to prefer the joint venture structure over a partnership, even though, in many cases, a joint venture might be difficult to legally distinguish from a partnership.

The New Regime

Fast forward to the 2011 federal Budget, which put an end to tax-deferred year ends for partnerships. As soon as the proposals came out, taxpayers were left to wonder, can joint ventures be far behind? In June, an announcement at the 2011 Prairie Provinces Tax Conference put an end to this speculation: the CRA confirmed that joint ventures would be put on a similar footing to partnerships, complete with transitional rules for stub period income.[1]

Further information is contained in Document No. 2011-0429581E5, released on November 29, 2011. The details of the release are contained in my January 2012 article ("What's New", *Tax Notes* No. 588). In a nutshell, the release itself indicates that, for joint venturers with taxation years ending after March 22, income from joint ventures will be required to be calculated for each participant taxpayer based on the fiscal period of the particular taxpayer; that is, deferred joint venture year ends will not be recognized. However, transitional relief similar to the partnership rules will potentially apply to the extra income that has to be reported, so that a deferral of the extra income will be offered.

As observed in my article, it would be impractical, if not impossible, for many joint venturers (e.g., for minority participants with small interest) to undertake a calculation of income based on their particular year end. In fact, this led at least one observer to question whether the joint venture vehicle itself is still manageable in light of these new policies.

In fact, as I mentioned in my article, there was one hope: perhaps, as in the partnership rules, an approximation could be permitted, based on principles similar to those in the new partnership rules (i.e., current income could be estimated based on the previous year's partnership income, subject to adjustments). The trouble is, there was no mention of this alternative in the release.

However, in Document No. 2011-0431271E5, dated January 10, 2012, the CRA announced that this approximation method is off the table. The document itself offers few clues as to the reasoning behind this decision, other than indicating that a consultation process had been undertaken, in which the formulaic approach to compiling stub period income was considered. This process took into account tax policy issues, as well as the administrative feasibility of applying an administrative policy in a similar manner as that provided with respect to partnerships. Unfortunately, however, the final paragraph of the document confirms that, for taxation years ending after March 22, 2011, actual income earned through joint ventures must be calculated for each participant based on that participant's fiscal period.

Now What?

So we are back to an earlier part of the article — no, not the part about cooler heads, but the part about the rules being unmanageable. In fact, we are in a worse position. The partnership rules recognize complexities in calculating income on the current basis by creating special rules to approximate income for partners with different year ends than the partnership. But in case taxpayers might have been tempted to try a similar approximation with joint ventures, the latest CRA missive says that this is not in keeping with CRA policy.

There does not appear to be a wide range of strategies to overcome these complexities. Some possibilities include changing corporate year ends (and/or the year end of the joint venture itself) so that the venturers' year ends coincide with that of the joint venture. Alternatively, the joint venture interest could be rolled into a new corporation with a conforming year end (in Ontario, land transfer tax can typically be deferred). Another possibility is converting the joint venture into a partnership. But this may be more easily said than done. If the co-venturers have differing cost amounts of the joint venture properties (e.g., if differing depreciation has been claimed by the respective joint venturers), an agreement may have to be reached regarding compensation for joint venturers who contribute property with an increased cost amount.

As stated above, in many cases, a joint venture may have similar attributes to a partnership.[2] It may be tempting to take the position that the joint venture is a partnership, so that the rules approximating current income (in section 34.2) may be formally used. However, careful consideration should be given to the implications of a filing position that contradicts not only a taxpayer's previous filing position, but that of the other would-be joint venturers. (For example, GST/HST compliance might be incorrect; consider also representations given to bankers, etc.)

Consideration should also be given to the impact on transitional reserves; the analysis of this issue may be hampered by the fact that the CRA appears to have offered relatively little insight into the details of the transitional rules (which in general will be applied in a manner similar to or consistent with the partnership rules[3]). Also, the joint venture agreement should be checked with respect to the feasibility of the foregoing possibilities.

But to be honest, these possibilities are not exactly panaceas. So if a client is simply facing issues of compliance with CRA policies, then what? In some cases (e.g., if a client has a major interest in a joint venture), with monthly financial statements, it may be viable to cobble together sufficient information to comply with CRA policies. But in many cases (e.g., a minor interest or long-standing joint tenancy which has been in the family for many years), contact with the person running the venture may have become limited to cheques for the rent and annual statements received in the mail. I think it is fair to say that in some cases, compliance with the new CRA policies is, at best, a time-consuming possibility.

Going forward, professionals involved in structuring co-ventures should be familiar with the new tax traps. If the approximation methodology is truly off the table, I think that the joint venture vehicle will become less commonplace, unless promoters are willing to develop sophisticated financial information mechanisms. But I'm still hoping that the CRA will change its tune.

Thanks to Joan Jung and Michael Goldberg of Minden Gross LLP.

Notes:

1 See Document No. 2011-0403081C6, June 6, 2011.

2 Alberta is considering a statutory definition of a joint venture. For details, see "Partnership Status Opt-Out Proposed for Joint Ventures", Strawson and Wong, *Tax for the Owner-Manager*, October 2011, Canadian Tax Foundation.

3 Document No. 2011-0431461E5, dated January 10, 2012, has an example of the application of the transitional rules, which assumes a joint venture with a calendar year end and two corporate co-venturers whose year ends are November 30 and January 31, respectively. It mentions that paragraphs 34.2(11)(*a*), (*b*), and (*c*) and subsections 34.2(5), 34.2(13), 34.2(18), and 34.2(15) of the Act will be applied in a "similar" manner for participant taxpayers of joint ventures. It does not specifically mention subsection 34(14), which potentially restores transitional relief for transfers of partnership interests to related or affiliated corporations. It also confirms that income for which a deduction is available under section 112 or 113 will not qualify for transitional relief.

The Technical Interpretation also confirms the extension of the filing deadline of elections to qualify for transitional relief to September 22, 2012.

RECENT CASES

Value of trip provided by taxpayer's employer included in taxpayer's employment income

Tax Court of Canada, November 29, 2011

As a reward for working for his employer for five or more years, the taxpayer's employer gave him a trip to Las Vegas for him and his wife (the "Trip"). There was no business element to the Trip. On reassessment, the Minister included $2,997 in the taxpayer's income for 2007 as an employment benefit from the Trip. On appeal to the Tax Court of Canada, the taxpayer argued that he had not been informed by his employer that the value of the Trip constituted an employment benefit to be included in his income, and it was not reported to him on a T4 form.

The taxpayer's appeal was dismissed. The value of the Trip was clearly required by s. 6(1)(*a*) to be included in the taxpayer's income. The taxpayer's arguments were irrelevant. The Minister's reassessment was affirmed accordingly.

Shanahan v. The Queen, 2012 DTC 1026

Loss on share transactions was on capital account

Tax Court of Canada, November 28, 2011

Between 1999 and 2005 inclusive, the taxpayer engaged in a modest number of purchase and sale transactions of shares of mostly well-established companies. Her level of knowledge and time spent was not greater than an average investor. The taxpayer used a line of credit to purchase the stocks, and some were held for a short time only. During part of 2005, the taxpayer was employed on contract by IBM Canada Ltd. as a training coordinator on a full-time basis, five days a week. For the years 1999 to 2004, the taxpayer reported her gains or losses from the share transactions on capital account. However, in 2005, the taxpayer deducted her losses on income account. The Minister allowed capital losses only, and the taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. The Court found that the transactions were on capital account. Overall, the evidence relating to 2005 was close to the line. However, the taxpayer filed from 1999 to 2004 on the basis that share transactions were on capital account. That was indicative of intention, and there was nothing in the evidence that would lead to the conclusion that circumstances had changed in a way that resulted in the 2005 share transactions being on income account.

Kriplani v. The Queen, 2012 DTC 1027

Registered savings funds were taxable after purchase of worthless shares

Tax Court of Canada, November 23, 2011

The three taxpayers were defrauded of their savings. One had funds in an RRSP, another had funds in a locked-in RRSP, and the third had funds in an RRIF. They were persuaded to transfer their funds to self-directed funds at another institution, and to invest in the shares of two companies. It turned out that the shares were, and had always been, worthless. The principal behind the scheme was convicted of fraud, but the taxpayers were unable to recover their funds. Assuming that the taxpayers were engaged in RRSP strips, the Minister included the difference between the amount paid for the shares and the market value of the shares (nil) in the taxpayers' incomes and imposed penalties. The taxpayers appealed to the Tax Court of Canada. By the time of the trial, the Minister acknowledged that the taxpayers were innocent victims, but argued that this made no difference in whether the amounts were taxable.

The taxpayers' appeals were dismissed, except for the deletion of the penalties. The Court found that the provisions under consideration were clear and unambiguous. The words in question were not capable of being limited to strip or avoidance situations without the addition of a qualifying word or phrase such as "knowingly" or "in a non-arm's length transaction". If Parliament had intended to limit the provisions to non-arm's length transactions, then it would not have hesitated to say so explicitly. Any event that removes value from a registered savings fund should be considered and treated as a taxable event, as there has been no prior taxation of those sheltered funds. This is true whether the event is an avoidance event or a benign one, such as a simple withdrawal. Similarly, an overpayment for an asset falls to be taxed whether it is in the nature of an attempted avoidance, through non-arm's length transactions for example, or one that is on the annuitant's part benign, as in this case, where the amounts in question are the subject of a fraud perpetrated on an innocent annuitant. They are taxed not because the annuitant has done anything wrong, but because they are tax-sheltered funds that have left the sheltered environment and so must be subject to tax.

St. Arnaud v. The Queen, 2012 DTC 1029

Taxpayer entitled to deduct child support payments under pre-May 1, 1997 court order, since subsequent separate agreement made after May 1, 1997 not registered with courts

Tax Court of Canada, December 1, 2011

The taxpayer claimed deductions of $7,487 and $7,654 as child support payments in 2008 and 2009, respectively. He paid support amounts under a court order dated June 18, 1996 (the "Order") that was enforced by the Ontario Family Responsibility Office ("FRO"). In 2006, the taxpayer entered into a separation agreement with his former spouse that provided for a support payment schedule, but this document was never filed with the courts. The taxpayer subsequently made additional support payments under a voluntary garnishment arrangement with the FRO. The Minister argued that the amounts were non-deductible, as the commencement date of payments was later than May 1, 1997.

The taxpayer's appeal was allowed. The Order governed support payments payable by the taxpayer. Since the separation agreement was not filed with the courts, it did not establish a commencement date and failed to vary, rescind, or suspend the Order. Accordingly, child support amounts were deductible as payments stemming from a pre-May 1, 1997 order.

Kerr v. The Queen, 2012 DTC 1031

Order extending time to file notice of objection not needed as Minister failed to prove notice of reassessment communicated to taxpayer

Tax Court of Canada, December 1, 2011

The taxpayer applied for an extension of time to file notices of objections to tax reassessments for 1999 and 2000. The Minister claimed the reassessments were mailed to the taxpayer on December 31, 2003 and June 11, 2004, and faxed to him in April 2005. The taxpayer testified that he first became aware of the reassessments in 2004, when he received a letter from the Canada Revenue Agency (the "CRA") that he was in arrears for income tax payments. Despite repeated attempts to receive a copy, the taxpayer only received the reassessments a few days before the hearing. A collections enforcement officer with the CRA who was responsible for the taxpayer's file from August to October 2009 testified for the respondent. The Minister also relied on reconstructed notices of reassessment and a printout of the CRA's record of the taxpayer's authorized mailing address. According to the CRA records, the taxpayer changed his home address from May 25, 2004 until April 21, 2005. The question to be determined was whether the reassessments were mailed and, if so, were they mailed to an authorized address.

The taxpayer's application was dismissed. There was no need for the order, as the Minister failed to prove that the notice of reassessment existed or had been mailed. As the taxpayer alleged that he never received the notice of reassessment, the onus was on the Minister to establish that the notice was mailed or otherwise brought to the attention of the taxpayer. The affidavit of the CRA collections enforcement officer, C, contained errors (such as that the taxpayer changed his mailing address) and was unreliable. C had no personal knowledge of the CRA mailing practices, and was not in charge of the records. His hearsay evidence regarding the mailing practices of the CRA did not meet the tests of reliability and necessity. The taxpayer provided the Court with a copy of the fax sent to him in 2005, and it did not contain the notice of reassessment as C alleged. Evidence that the CRA generated notices of reassessments did not provide evidence that they were mailed. The Minister provided no reliable evidence to show that the taxpayer ever received the notices of reassessment.

Carcone v. The Queen, 2012 DTC 1032

Taxpayer only entitled to deduction for overpayments actually paid

Tax Court of Canada, December 2, 2011

The taxpayer was released from the military in 1995, and was receiving a pension fund from the Canadian Forces ("CF") and long-term disability from the Service Income Security Insurance Plan ("SISIP"). In June 2008, his application for CPP benefits was approved retroactive to March 2007, resulting in an overpayment on his CF and SISIP plans. He claimed the overpayment amount as a deduction on his 2008 return on the basis that it was repayable, but was only allowed a deduction for the amount actually repaid. He was appealing this reduction, and also claiming a capital loss on a house he was building, arguing that it was to be used partly for business.

The taxpayer's appeal was dismissed. The *Income Tax Act* provisions allow for deductions to amounts actually paid by a taxpayer, but not to amounts that are repayable. The taxpayer received gross benefits under the SISIP of $15,127 in 2008 and repaid $1,934. The difference between those two amounts was reported as other income, and the taxpayer received a deduction for the amount repaid. Were he to be allowed to deduct the total overpayments, he would be receiving the benefit of two deductions for the same amount. The taxpayer was only entitled to a deduction for the amounts actually repaid. As for his capital loss claim, the taxpayer failed to provide any evidence that the house was not a personal-use property. Even if the taxpayer was able to show a business use, capital losses can only be deducted against taxable capital gains. As the taxpayer had no taxable capital gains for 2008, his capital loss claim was properly denied.

Lunn v. The Queen, 2012 DTC 1033

Taxpayer unable to produce charitable receipts — Deduction claim properly denied

Tax Court of Canada, December 7, 2011

The taxpayer was appealing a reassessment for 2005 that denied his deduction claim for charitable donations. The taxpayer claimed he gave cash amounts totalling $17,741 to his tax preparer to donate on his behalf to an organization called "PanAfrican". He also donated used furniture and other goods to the charity. He received a receipt for his cash and goods donations, but was unable to produce them at trial. An officer with the Canada Revenue Agency (the "CRA") confirmed that there was a charity called "PanAfrican Canadian Multicultural Centre" registered with the CRA in 2005 that had been deregistered in 2007.

The taxpayer's appeal was dismissed. The taxpayer's testimony was vague and he could not remember details such as the address of the charity. The *Income Tax Regulations* requires a taxpayer to produce an official receipt to verify the appropriateness of a claim for a charitable donation. Without a charitable receipt, it was impossible to establish the taxpayer's claim. As the taxpayer was unable to produce charitable receipts, his deduction for charitable donations was properly denied.

Clarke v. The Queen, 2012 DTC 1036

Charitable donation tax credits denied because taxpayer knowingly submitted donation receipts purchased for only 10% of face amounts

Tax Court of Canada, December 8, 2011

A business known as Payless Tax prepared the taxpayer's returns, which included a claim for charitable donation tax credits. On reassessment beyond the normal reassessment period for 2003, and on reassessment for 2004 and 2005, the Minister disallowed the donation credits claimed for those years on the ground that the taxpayer had purchased from Payless Tax the underlying charitable gift receipts for only 10% of their face value. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. The Federal Court of Appeal has held that a gift must involve a voluntary transfer of property by a donor to a donee for no consideration. In this case, the taxpayer had no donative intent, knew that his returns prepared by Payless Tax contained false information about the credits claimed, and knew that he had made no proper charitable donations. This conduct was sufficient to justify the Minister's reassessments for 2004 and 2005, and for 2003 made beyond the normal reassessment period.

Sarsonas v. The Queen, 2012 DTC 1038

TAX NOTES

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

For CCH Canadian Limited

Susan Peart, C.A., LL.M.
(416) 224-2224, ext. 6434
email: Susan.Peart@wolterskluwer.com

Natasha Menon, Content Product Manager
Tax, Accounting and Financial Planning
(416) 224-2224, ext. 6360
email: Natasha.Menon@wolterskluwer.com

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

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

CCH a Wolters Kluwer business