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THE GENERAL ANTI-AVOIDANCE RULE: CRA DISCUSSIONS ON GST MATTERS

— *Brent F. Murray, Wilson & Partners LLP*

The general anti-avoidance rule (the "GAAR") provides the Canada Revenue Agency ("CRA") with the authority to determine the "tax consequences" that are associated with an "avoidance transaction", with the objective of denying any "tax benefit" that has directly or indirectly resulted from the particular transaction or a series of transactions that includes the particular transaction. In order for the GAAR to apply, there are three requirements which must be satisfied:

> (1) a tax benefit must directly or indirectly result from a particular transaction or a transaction that is part of a series of transactions;
>
> (2) the transaction must be an "avoidance transaction" in the sense that it cannot be said to have been reasonably undertaken or arranged primarily for a *bona fide* purpose other than to obtain a tax benefit; and
>
> (3) there was abusive tax avoidance in the sense that it cannot be reasonably concluded that a tax benefit would be consistent with the object, spirit, and purpose of the provisions relied upon by the taxpayer.

In contrast with the examples that are provided in Information Circular 88-2, "General Anti-Avoidance Rule — Section 245 of the *Income Tax Act*", the CRA has not provided taxpayers with any meaningful guidance in its administrative policies with respect to the application of the GAAR to deny a particular goods and services tax ("GST") or harmonized sales tax ("HST") benefit. In an effort to get a better understanding of the type of transaction to which the CRA would apply the GAAR in relation to GST/HST matters, we submitted a request (the "Access Request") under the *Access to Information Act* for all records pertaining to the CRA's interpretation of section 274 (the GAAR) of the *Excise Tax Act* (the "ETA") including any decisions made by the GAAR Committee. The Access Request was submitted to the relevant officials at the Access to Information and Privacy Directorate of the CRA in April 2012, and we received a diskette containing 1,615 pages of documents. Although the relevancy of a vast number of the documents is difficult to discern since significant portions were redacted for various reasons, including the information being "confidential information" as defined in section 295 of the ETA or subject to solicitor-client privilege, we obtained some valuable insight into the CRA's decision-making processes on the application of the GAAR. However, we did not obtain sufficient information to prepare a list of examples to illustrate the approach that the CRA will take with respect to certain transactions. The purpose of this article is to comment on the information that was provided.

Results of Access Request

Misconception that Tax Avoidance Does Not Exist for GST/HST

In an internal presentation from the Compliance Programs Branch entitled "Tax Avoidance and Special Audits — GST Tax Avoidance" that was prepared in September 2006, it was indicated that "misconceptions exist at all levels that tax avoidance does not exist in relation to the *Excise Tax Act*". Some of the reasons for the "misconception" included lack of CRA communication and jurisprudence, and it was stated that the CRA could "change the mindset" by increasing visibility and "[encouraging] referrals to Tax Avoidance". The CRA's "vision for the future" with respect to the GAAR includes the following:

(1) increased GST referrals at all levels to Tax Avoidance;

(2) a strong degree of national coordination and management of GST hot topics and avoidance issues; and

(3) an increase in the number of GST-specific special projects that have, in the past, fallen to the wayside.

The concluding comments to this presentation also suggested that abusive GST/HST planning may be happening fairly frequently, with the presenter's closing comment being "Let's all work together; let's challenge the planning and stop the abuse".

Application of GAAR can be Uncertain

In certain documents, the CRA stated that until the scope of the GAAR "is more fully addressed by the courts, there may be a substantial degree of uncertainty about the potential consequences of many transactions" and that useful guidance can be found in *Michelin Tires (Canada) Ltd. v. MNR* (2000 GTC 4070), where "significant analyses" were made.

Retroactive Legislative Amendments Preferred Option

At the March 7, 2007 GST Round Table Meeting between the GST Rulings Directorate and the Canadian Bar Association, the CRA was asked to comment on the type of situation where the GAAR would be applied. In the final response, the CRA stated, "we have not compiled examples where section 274 would apply". In an early draft response to the same question, the CRA also indicated that it would be "difficult to anticipate a situation where section 274 would be applied" and that "if it were possible to anticipate these situations, they might be addressed through changes in the legislation rather than the application of the general anti-avoidance rule".

Discussion on Misuse or Abuse

The CRA's "Facilitator's Guide" on corporate reorganizations, which was produced by the Training and Learning Directorate, provides an overview of the analytical approach that the CRA should apply in considering whether to apply the GAAR. With respect to the "misuse" and "abuse" exception to the application of the GAAR that is provided for in subsection 274(4) of the ETA, a 2012 draft of the publication states as follows:

> Subsection 274(4) contains an important limitation to the application of section 274. Even if a transaction results, directly or indirectly, in a tax benefit and has been carried out primarily for tax purposes, section 274 will not apply if it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of a specific provision of Part IX of the ETA or in an abuse of Part IX of the ETA as a whole. This measure is intended to apply where a taxpayer establishes that a transaction carried out primarily for tax purposes does not, nonetheless, constitute an abuse of Part IX of the ETA.
>
> Subsection 274(4) recognizes that the provisions of Part IX of the ETA are intended to apply to transactions with real economic substance, not to transactions intended to exploit, misuse or frustrate Part IX of the ETA to avoid tax. It also recognizes, however, that a number of provisions of Part IX of the ETA either contemplate or encourage transactions that may seem to be primarily tax-motivated. It is not intended that section 274 will apply to deny the tax benefits that result from these transactions, as long as they are carried out within the object and spirit of the provisions of Part IX of the ETA read as a whole. Nor is it intended that tax incentives expressly provided for in the legislation would be neutralized by this section.

> If a taxpayer carries out transactions primarily in order to obtain, through the application of specific provisions of Part IX of the ETA, a tax benefit that is not intended by such provisions and by Part IX of the ETA read as a whole, section 274 should apply. This would be the case even though the strict words of the relevant specific provisions may support the tax result sought by the taxpayer. Thus, where applicable, section 274 will override other provisions of Part IX of the ETA since, otherwise, its object and purpose would be defeated.

Leasing Transactions Not Abusive

Also included in the Facilitator's Guide on corporate reorganizations is an example of a transaction which produces a tax benefit but which would not be considered a misuse or abuse of the provisions in the ETA. In this respect, the CRA concluded that a financial institution that sets up a special purchase vehicle (e.g., a trust) to acquire retail banking outlets will not be engaging in an abusive transaction in situations where the trust claims input tax credits ("ITCs") and leases the retail banking outlets to the financial institution for consideration equal to the fair market value.

Claiming ITCs After Receiving Credit Notes Which Refund GST

In what appears to be a lead up to the Tax Court's decision in *Quinco Financial Inc.*[1] (which recently resulted in proposed amendments to subsection 225(3.1)), in February 2006 the CRA internally considered whether the GAAR applied in situations where a registrant does not claim ITCs until after they have received a credit note from their supplier which reduces the consideration and adjusts the amount of GST that was originally charged, pursuant to section 232 of the ETA. The conclusion that was reached by the CRA on the GAAR was redacted from the Access Request; however, given that there was no reference in the published court decision to the GAAR, based on the particular facts of the case, the CRA likely concluded that the GAAR did not apply.

Using Agency Relationships To Obtain GST Benefit

Somewhat surprisingly, in GST/HST Ruling No. 95076, dated July 26, 1995, the CRA alluded to the potential application of the GAAR when medical doctors use agency relationships to share costs including the joint employment of office staff, as follows:

> With regard to your final question as to the applicability of paragraph 274(3)(*a*) of the Act and the possibility that the transactions occurring as a result of the entering into of the agreement could be construed as avoidance transactions, it is not possible for us to definitively comment on the application of the provision given the information provided. The Act clearly contemplates that agency relationships legitimately can and will occur. Medical practitioners have been allowed to use management companies for purposes of income tax planning for some time. The actual actions of all parties to the agreement would need to be reviewed to determine that the agreement was not entered into for any other purpose other than to obtain a tax (GST) benefit. What the parties to the agreement were doing before the implementation of GST would be useful in such an assessment.

In the author's respectful opinion, it is difficult to see how using an agency relationship to share costs could be characterized as a misuse or abuse of the provisions which relieve GST/HST from being payable on employee remuneration.

Concluding Comments

Based on the volume of documents that were obtained from the Access Request (with the CRA also alluding to the GAAR in various ruling requests), it is clear that the CRA believes that the GAAR can apply in appropriate situations to deny GST/HST benefits. The CRA is also of the view that its auditors need to be more educated on the application of the GAAR to stop the abusive planning that, somewhat surprisingly, the CRA believes has been occurring. Given that the vast majority of taxpayers strive to be fully compliant with their respective tax obligations, it is unfortunate that the CRA has not updated any of its administrative policies (e.g., GST/HST Memorandum 500-6-9, dated June 7, 1991) to provide taxpayers with real guidance, in the form of examples, on the type of transaction that it considers to be an abuse or misuse of the provisions in the ETA. With respect to the application of the GAAR in section 245 of the *Income Tax Act*, the CRA has provided various examples of transactions that are viewed by the CRA as legitimate tax planning and those which the CRA believes to be abusive. Hopefully, the CRA will give this some additional thought when it updates its administrative policy and will provide similar examples to GST registrants. For example, commentary on whether any of the following examples would be considered a misuse or abuse of the provisions of the ETA would be welcome:

(1) A corporation that does not have any basis to register for GST commences a "commercial activity" for the sole purpose of allowing it to register for GST so that it can be eligible to make a section 150 election with other members of a "closely related group";

(2) A group of related corporations which are engaged in an exempt activity of renting real property set up a financing company, which is a listed financial institution, so as to allow the parties to make a section 150 election and deem services rendered between the parties to be exempt financial services;

(3) Related persons who are engaged in an exempt activity jointly employ persons who provide work that benefits both employers; and

(4) Prior to purchasing assets from a related party, a newly incorporated corporation acquires tangible personal property for use in a commercial activity so as to allow it to make a section 156 election.

— *This article first appeared in the* Canadian GST/HST Monitor*, No. 306 (March 2014).*

Notes:

[1] *Quinco Financial Inc. v. The Queen*, 2013 GTC 7.

NEW CANADIAN CITIZENSHIP RULES (BILL C-24) AND TAX

— *Kevyn Nightingale, MNP, LLP*

The rules introduced in Bill C-24 on February 6, 2014 will have a range of effects, but one of the hidden gems relates to a person's Canadian tax obligations. As Citizenship and Immigration Canada ("CIC") says:

> According to the current *Citizenship Act*, applicants must have resided in Canada for three out of four years (1,095 out of 1,460 days), yet "residence" is not defined. As a result, it has been possible for individuals who have spent little time in Canada to acquire citizenship.[1]

With these rules, it has been possible for individuals to come to Canada and become permanent residents for immigration purposes. However, some of these individuals spent a great deal of time in their original countries, while avoiding Canadian tax residency (the tax rules are different than the immigration ones). Sometimes it seemed as though they ignored Canadian tax rules. Since most of their income was earned (and left) offshore, the Canada Revenue Agency ("CRA") was not able to catch them. They then acquired citizenship without being subject to Canadian tax.

In the past, there was no tax requirement for citizenship, and CIC and the CRA did not communicate effectively. In the end, some individuals received Canadian citizenship privileges without accepting one of the more significant obligations.

The New Rules

Henceforth, an applicant will have to be physically present for four years (1,460 days) in a six-year period and for at least 183 days per year in four of the six years. He or she will be required to file Canadian income tax returns, if required under the *Income Tax Act*.

Now each applicant has an incentive to file Canadian tax returns. Without them, CIC will have to determine they were not required. As a practical matter, CIC will likely consult with the CRA to make this determination, so anyone applying for citizenship will need to have their tax affairs in order.

It is possible, but difficult, to spend the newly required amount of time in Canada without becoming a resident of Canada for tax purposes. This is because:

- most people who are in Canada for this amount of time will be "factual residents", in that Canada is their primary home;
- there is a provision in the *Income Tax Act* that deems people who "sojourn" in Canada for 183 days or more in a year to be residents;[2] not everyone who is physically present for this time is "sojourning", but the power of this provision has recently been held to be broader than was originally thought;[3] and

- of the people caught under one of the above provisions, some will still be non-residents because of a tax treaty between Canada and their home country, so this rule will not make everyone pay tax.

However, the overwhelming majority of immigrants planning to become Canadian citizens will now be required and inclined to file returns, and most of them as Canadian residents.

What This Means

Canadian residents are subject to Canadian tax on their worldwide incomes. Non-residents are subject to tax only on their Canadian-source incomes. Residents also need to disclose their foreign income-earning assets, including shares, debt, funds, companies, and trusts.[4] There are significant penalties for failure to report and pay the appropriate tax.

A larger proportion of immigrants will now be paying tax on their worldwide incomes. For high-income immigrants, proper tax planning will become even more important. We can expect greater scrutiny of these immigrants by the CRA.

And, as always, this means more work for tax lawyers and accountants. Usually, I'm thanking Finance Canada, but today I'm sending the love to Chris Alexander, Minister of Immigration.

Notes:

1 http://www.cic.gc.ca/english/department/media/backgrounders/2014/2014-02-06a.asp.

2 ITA paragraph 250(1)(*a*).

3 Bruce Elliott *et al.*, 2013 DTC 1070 (TCC).

4 Forms T1134, T1135, T1142, T1143, etc.

BRITISH COLUMBIA BUDGET

The 2014 British Columbia Budget was tabled on February 18, 2014. The Budget proposed a two-tier tax applicable to income from liquefied natural gas facilities in the province; the rates governing these tiers will be confirmed in legislation to be introduced later this year. Somewhat paralleling the federal treatment of credit unions, the Budget confirmed that the province intends, in 2016, to commence its own five-year phase-out of the preferential income tax treatment currently provided to credit unions. The Budget also proposed extension of the British Columbia scientific research and experimental development tax credit for an additional three years to September 1, 2017, and the inclusion of the Capital Regional District as an eligible "distant location" for the purposes of the distant regional location tax credit. The personal income tax bracket for taxable income in excess of $150,000, proposed in Budget 2013 for the 2014 and 2015 tax years, was implemented via the passage of S.B.C. 2013, c. 17, sections 20 and 21. The Budget documents are posted on the provincial tax News Tracker on CCH Online and, along with the CCH commentary, are also available in the *British Columbia Tax Reporter* online and on DVD.

QUEBEC BUDGET

On February 20, 2014, the Government of Quebec tabled the 2014 Budget. While the Budget contained no changes to personal tax rates or credits, it proposed harmonization with most personal tax initiatives found in the 2014 federal Budget (including the volunteer search and rescue tax credit, the rules regarding cultural property donations under tax shelter gifting arrangements, and trust-related changes in matters of split income, graduated rate taxation, and the exemption for immigrant trusts). The Budget also proposed changes regarding Capital régional et coopératif Desjardins ("CRCD") shares, including a reduction from 50% to 45% in the tax credit rate afforded to taxpayer purchases of CRCD shares acquired after February 28, 2014, and expansion of the regions for which businesses located therein may also qualify for CRCD funding.

While the Budget contained no changes to corporate tax rates, it did propose harmonization with most corporate tax initiatives found in the 2014 federal Budget (including the increased thresholds governing employer-source remittances, accelerated capital cost allowance for certain clean energy generation equipment, and changes to anti-avoidance rules pertaining to captive insurance and thin capitalization). For qualified expenditures made in corporate taxation years ending after February 20, 2014 and incurred before January 1, 2016, the Budget proposes that each dollar in excess of a one-time $50,000 threshold spent on renovation or improvement work by qualified corporations in the tourism industry will qualify for a 25% credit; this represents a change in that $50,000 was previously an annual threshold in calculating expenditures undertaken for this credit.

As well, the Budget reiterated Quebec's intention to fight corrupt and evasive tax reporting in the province, by means of extending sales recording modules to bars as well as restaurants, implementing attestation systems for employment agencies and the construction industry, and increasing the number of government agency inspections and the case management capacity of the financial penal system. The Budget documents are posted on the provincial tax News Tracker on CCH Online and, along with the CCH commentary, are also available in the *Quebec Tax Reporter* online and on DVD.

ALBERTA BUDGET

The 2014 Alberta Budget was tabled on March 6, 2014. The Budget contained limited income tax changes, including the 2014 introduction of a qualifying environmental trust ("QET") regime paralleling the federal QET system, a 3.1% upward adjustment of the dividend tax credit applicable to dividends paid out of income subject to the small business rate so as to achieve full corporate-personal tax integration, and inflation-indexed increases to the province's personal income tax credits and the Alberta family employment tax credit. The Budget documents are posted on the provincial tax News Tracker on CCH Online and, along with the CCH commentary, are also available in the *Alberta and Territories Tax Reporter* online and on DVD.

MANITOBA BUDGET

Manitoba's 2014 Budget was presented on March 6, 2014. In addition to extending the non-refundable mineral exploration tax credit to cover flow-through share agreements entered into before April 1, 2018, the Budget extended a number of previously announced fully and partly refundable tax credits to December 31, 2017, including the manufacturing investment tax credit, the book publishing tax credit, and the odour control tax credit. The Budget also announced tax measures that included:

- extending the community enterprise development tax credit to December 19, 2019, and increasing the maximum annual tax credit to $27,000; for eligible shares issued after 2014, the credit is increased to 45% and made fully refundable, the maximum eligible shares an approved company can issue is increased to $3 million, and the maximum annual shares an investor can acquire is increased to $60,000;
- amending the definition of an "eligible book" for the purposes of the cultural industries printing tax credit such that the credit is capped at $30,000 per book title and requiring that 90% of a book be new material, 65% of non-children's books be text, and the books be sold through an established distributor;
- indefinitely extending the refundable co-op education and apprenticeship tax credits, and, for employers with taxation years ending after 2014, eliminating the pre-approval process and increasing the rate for apprentices and journeypersons to 15% of wages to a maximum of $5,000; and
- introducing a seniors' school tax rebate of up to $235 for Manitoba residents 65 years of age or older who own a principle residence in the province.

The Budget also contained administrative measures to withhold and withdraw licences of income tax discounters who repeatedly file inaccurate tax credit claims and to clarify certification requirements for the rental housing construction tax credit. The Budget documents are posted on the provincial tax News Tracker on CCH Online and, along with the CCH commentary, are also available in the *Manitoba and Saskatchewan Tax Reporter* online and on DVD.

SASKATCHEWAN BUDGET

The 2014 Saskatchewan Budget was tabled on March 19, 2014. The Budget contained limited income tax changes, including adjusting the dividend tax credit on non-eligible dividends to 22.29% of the dividend gross-up (effectively making the credit 3.4% of a grossed-up dividend) and maintaining the provincial income tax reduction for credit unions (despite the phase-out of the equivalent federal tax reduction). The Budget documents are posted on the provincial tax News Tracker on CCH Online and, along with the CCH commentary, are also available in the *Manitoba and Saskatchewan Tax Reporter* online and on DVD.

PRESCRIBED INTEREST RATES — SECOND QUARTER OF 2014

The prescribed interest rates for the second quarter of 2014 were released by the Canada Revenue Agency on March 12, 2014. Except for corporate taxpayers' rates for interest on pertinent loans and indebtedness (which will be 4.89%), the rates remain unchanged from the first quarter of 2014 and are noted below.

- 1% to calculate a deemed interest taxable benefit on subsidized employee and shareholder loans;
- 1% on refunds of income tax overpayments paid to corporate taxpayers;
- 3% on refunds of income tax overpayments paid to non-corporate taxpayers; and
- 5% on payments of overdue income taxes, insufficient income tax instalments, unremitted employee source deductions, overdue CPP contributions or EI premiums, and unpaid penalties.

These rates will be in effect from April 1, 2014 to June 30, 2014.

A listing of the prescribed interest rates for each quarter, dating back to 2000, is reproduced under "Quick Links" in the *Canada Income Tax Guide* on DVD and online.

UPDATES TO INCOME TAX FOLIOS

- Effective March 11, 2014, the Canada Revenue Agency ("CRA") announced an update to Income Tax Folio S1-F2-C1, Education and Textbook Tax Credits. The update at ¶1.32 replaces the reference to cancelled Form T2202 with a reference to revised Form T2202A.
- Also effective March 11, 2014, the CRA announced updates to Income Tax Folio S1-F2-C2, Tuition Tax Credit. The Folio is updated at ¶2.37 and ¶2.44 to reflect amended subparagraph 118.5(3)(*c*)(iv) of the *Income Tax Act* with regard to ancillary fees and charges paid in respect of financial assistance. Paragraph 2.63 is also updated to replace the reference to cancelled Form T2202 with a reference to revised Form T2202A.
- Also effective March 11, 2014, the CRA announced updates to S1-F2-C3, Scholarships, Research Grants, and Other Education Assistance. The updates to the Folio include revisions to reflect recent definitional changes and legislative amendments; the changes can be found in the Folio's "Chapter History".
- Effective March 12, 2014, the CRA announced updates to S1-F3-C1, Child Care Expense Deduction. The Folio is updated to reflect recent definitional revisions and legislative amendments; the changes can be found in the Folio's "Chapter History".

SUPREME COURT OF CANADA — APPLICATION FOR LEAVE TO APPEAL

On March 20, 2014, the Supreme Court of Canada granted the application for leave to appeal in the case of *Her Majesty the Queen v. Julie Guindon*, 2013 DTC 5113 (FCA). The case concerned a taxpayer upon whom the Minister of National Revenue (the "Minister") had imposed third-party penalties under the provisions of section 163.2 of the *Income Tax Act*; at issue was whether a section 163.2 determination should be regarded as a criminal proceeding rather than a civil penalty hearing. The Tax Court of Canada ("TCC") found that, owing to the broad and far-reaching potential of section 163.2, penalties under that section were to be regarded as criminal sanctions that triggered protections and procedural rights ensured by section 11 of the *Canadian Charter of Rights and Freedoms* (the "Charter"), including the heightened burden of proof required of the Crown and the presumption of innocence afforded to the accused. The Federal Court of Appeal allowed the Minister's appeal, finding that (1) the TCC did not have jurisdiction to find that section 163.2 created an offence that could trigger section 11 Charter rights; (2) no notice of constitutional question had been served in the matter; and (3) the *Wigglesworth/Martineau* test for criminality had not been met.

FOCUS ON CURRENT CASES

This is a regular feature examining recent cases of special interest, coordinated by *John C. Yuan* and *Christopher L.T. Falk* of McCarthy Tétrault LLP. The contributors to this feature are from McCarthy Tétrault LLP, Montreal, Toronto, Calgary, and Vancouver.

Court Allows Double Counting of Safe Income

***D & D Livestock Ltd. v. The Queen*, 2013 DTC 1251 (Tax Court of Canada)**

D & D Livestock is a decision of the Tax Court of Canada (per Graham J) considering the computation of the safe income on hand of a subsidiary corporation following the payment of a dividend by its parent. The case establishes that, even though the safe income of a parent corporation includes the safe income of its subsidiaries, only the safe income on hand of the parent is reduced when the parent pays a dividend.

D & D Livestock considers whether subsection 55(2) of the *Income Tax Act* applies to a dividend received by the taxpayer corporation, D & D Livestock Ltd. By way of background, dividends received by a corporation from a taxable Canadian corporation are generally "tax-free", since the dividend is included in computing the recipient corporation's income and deducted in computing its taxable income. However, subsection 55(2) contains an anti-avoidance rule that overrides this treatment by deeming a dividend received by a Canadian corporation to be a capital gain of the corporation, or proceeds from a disposition of property by the corporation, where the dividend was received as part of a series of transactions, one of the purposes of which (or, in the case of a deemed dividend arising under subsection 84(3), one of the results of which) was to reduce the capital gain that would have been realized on a disposition of a share of any corporation. Subsection 55(2) does not apply, however, if a particular dividend is attributable to the "safe income on hand" of the dividend payer.

Although *D & D Livestock* relates to a complex series of transactions, the key facts are briefly summarized as follows. Prior to the relevant transactions, the Class A common shares of the taxpayer were owned by the Hetherington Family Trust (the "Trust") and Robert Dougall ("Dougall"). The taxpayer owned 50% of the shares of another corporation, Roberge Transport Inc. ("RTI"). The shareholders of the taxpayer undertook a series of transactions in which the Trust and Dougall sold their Class A common shares of the taxpayer to Hetherington Livestock Ltd. ("HLL"). The taxpayer then declared a dividend in the amount of $1,465,465 ("Stock Dividend 1"), which it satisfied by issuing additional shares to HLL. At the time the taxpayer declared and paid Stock Dividend 1, its safe income on hand was $1,493,364, which consisted of its own safe income ($975,876) plus its share of the safe income of RTI ($517,488). Since the taxpayer's safe income on hand exceeded the amount of Stock Dividend 1, subsection 55(2) did not apply and HLL received Stock Dividend 1 tax-free. The parties subsequently undertook a corporate reorganization in which, among other things, the taxpayer transferred its shares of RTI to a newly formed corporation ("Newco") on a tax-deferred basis under subsection 85(1). Newco then declared a dividend in the amount of $517,427 ("Stock Dividend 2"), which it satisfied by issuing additional shares to the taxpayer. The taxpayer asserted that Stock Dividend 1 did not reduce the safe income on hand of RTI and, consequently, the safe income on hand of Newco for purposes of Stock Dividend 2 was $517,488, being its share of the safe income of RTI. As a result, the taxpayer filed its tax return on the basis that subsection 55(2) did not apply to Stock Dividend 2.

The Minister reassessed the taxpayer on the basis that Stock Dividend 1 reduced the safe income on hand of RTI and, consequently, subsection 55(2) applied to Stock Dividend 2 since it reduced the capital gain that the taxpayer would realize on a disposition of its shares of Newco. The taxpayer appealed to the Tax Court of Canada. The taxpayer conceded that subsection 55(2) would apply as assessed by the Minister if Stock Dividend 1 reduced RTI's safe income on hand, but argued that subsection 55(2) does not require the safe income on hand of a subsidiary to be reduced as a result of its parent corporation paying a dividend.

The Court allowed the taxpayer's appeal and concluded that Stock Dividend 1 did not reduce RTI's safe income. In its reasons, the Court reiterated the principles governing the computation of a corporation's safe income and safe income on hand. "Safe income" generally includes a corporation's income earned or realized after 1971, as adjusted in accordance with paragraphs 55(5)(*b*), (*c*), and (*d*). By contrast, "safe income on hand" refers to the safe income of a corporation that remains available for distribution and, accordingly, is reduced by taxes and dividends paid by the corporation (*Kruco Inc.*, 2003 DTC 5506 (FCA)). Further, since subsection 55(2) does not apply to a dividend if the dividend is attributable to safe income of "any" corporation, the safe income on hand of a parent corporation includes the safe income on hand of its subsidiaries to the extent that the accrued gain on the parent's shares can reasonably be attributed to the subsidiaries' safe income on hand (*Trico Industries Ltd.*, 94 DTC 1740 (TCC)).

Applying these principles, the Court held that RTI's safe income on hand was not reduced as a result of the taxpayer paying Stock Dividend 1. Since RTI did not actually distribute any portion of its income as a consequence of Stock Dividend 1, the amount of its safe income that remained on hand and available for distribution did not change. Consequently, at the time the taxpayer received Stock Dividend 2, the accrued gain on the taxpayer's shares of Newco was attributable to RTI's safe income on hand. In reaching this conclusion, the Court rejected the Minister's argument that subsection 55(2) should be interpreted in a manner that prevents RTI's safe income from being used twice and, instead, held that subsection 55(2) clearly permits this result.

The Tax Court's decision in *D & D Livestock* appears to permit related corporations to "double up" on safe income by allowing a parent corporation to declare and pay a dividend equal to its consolidated safe income on hand without reducing the amount of safe income that remains available for subsequent distribution by a subsidiary corporation. It is interesting to note, however, that the Tax Court's decision did not consider the application of GAAR to the taxpayer's transactions. As a result, it remains uncertain whether double-counting of safe income would survive a GAAR challenge.

— *Elaine Buzzell*

RECENT CASES

No tax credit available for taxpayer receiving interest-free loan to participate in leveraged charitable donation program

The taxpayer was appealing a Tax Court decision that denied her claim for charitable donation tax credits. The taxpayer was involved in a leveraged charitable donation program through which she received a 25-year interest-free loan. The taxpayer made payments to the registered charity Ideas Canada, and through a complicated chain of transactions, the money flowed from Ideas Canada through a law firm escrow account and was used to purchase art for the MacLaren Art Centre. Twenty per cent of the money paid by the taxpayer to Ideas Canada came from the taxpayer's own funds, and 80% came from the loan proceeds. The taxpayer claimed tax credits of $64,000 from payments of $160,000 made over three years, of which only $54,000 was her own money, the balance being the proceeds of her loan. She argued that this program allowed her to make larger donations than she otherwise could and that tax savings was only a secondary consideration. The Tax Court felt bound by the *Maréchaux* decision (2010 DTC 5174) to conclude that no gift was made because the interest-free loan was a benefit (2012 DTC 1266). The taxpayer argued that the trial judge incorrectly relied on *Maréchaux*, that the judge's reasons were inadequate to allow proper review, and that materials not admitted into evidence but included in the court record could cause prejudice. Also at issue was whether section 245 (the general anti-avoidance rule) applied to restrict the taxpayer's claim.

The taxpayer's appeal was dismissed. A charitable donation tax credit can only be claimed if a gift is made. A gift is a voluntary transfer of property in return for which the donor receives no benefit. The taxpayer's donations were conditional on being approved for and receiving the interest-free loan. The loans and the charitable gifts were interconnected. The Tax Court judge held that she was bound by the *Maréchaux* decision, which held that a long-term interest-free loan is a significant benefit. The taxpayer argued that *Maréchaux* was superseded by the *McNamee* case (2011 ONCA 533), which held that the benefit must come from the donee and not a third party. That case dealt with an estate freeze and not a leveraged donation program, and does not apply to the taxpayer's situation. The findings of the Tax Court judge were comprehensive and complete and there was no need to deal with whether GAAR applied once it was determined no gift had been made. No reference was made by the trial judge to any of the documents that were in the record but not admitted into evidence. Those documents were inconsequential to the material facts in the appeal and there was no prejudice to the taxpayer.

Kossow, 2014 DTC 5017

Court upheld Minister's reassessment altering discount at which company sold receivables to parent corporation

The core business of the McKesson Group of companies, which included McKesson Canada Corporation ("McKesson Canada"), was the wholesale distribution of over-the-counter and prescription drugs. The vast majority (99.96%) of McKesson Canada's receivables were routinely collectible within 30 days; this was important because the company's profit margins were only 2%, but on very high volumes of sales. McKesson Canada entered into a receivable sales agreement (the "RSA") with its Luxembourg parent, MIH, under which MIH agreed to purchase all of McKesson Canada's receivables for the next five years at a 2.206% discount (the "Discount"). McKesson Canada deducted the Discount from its income as a financing charge, generating a loss for 2003. The predominant purpose of the RSA was to reduce McKesson Canada's Canadian tax on its profits, although the RSA also freed up the company's capital, reducing the credit risk for its customers and improving the company's balance sheet ratios. The Minister reassessed McKesson Canada for 2003 under the transfer pricing provisions of paragraphs 247(2)(*a*) and (*c*) of the *Income Tax Act* and reduced the Discount from 2.206% to 1.013%. In the Minister's view, a discount of 1.013% was more realistic and reflected the discount the parties would have reached had they been at arm's length. The Minister also imposed Part XIII withholding tax on the amount of the Discount that had been disallowed as a deduction. McKesson Canada appealed to the Tax Court of Canada.

McKesson Canada's appeal was dismissed. The components and supporting calculations used to arrive at the Discount did not reflect the high degree of collectability of McKesson Canada's receivables and were not the components and calculations that would have been used by arm's length parties in the same situation. The Discount ought to have been between 0.959% and 1.17%, and the Minister's figure of 1.013% fell within this range. In addition, the Minister's Part XIII tax reassessment was not statute-barred as McKesson Canada had contended, because it did not fall within the specific time limitation criteria set out in Article 9(3) of the *Canada-Luxembourg Tax Treaty*. The Minister's reassessments were affirmed accordingly.

McKesson Canada Corporation, 2014 DTC 1040

Taxpayer's long-term disability payments did not qualify for pension income splitting

The taxpayer suffered from chronic depression and could no longer carry on with his employment as an engineer with Hydro-Québec. As a result, he qualified for long-term disability payments under a group disability plan provided by Hydro-Québec. When he turned 65 in November 2008, these long-term disability payments were replaced by supplementary retirement annuity payments under the terms of the group policy with Hydro-Québec. During 2009, the taxpayer received $15,953.76 from Hydro-Québec's group disability plan carrier, which was reported on a T4A slip as pension income. In reassessing 2009, the Minister rejected the taxpayer's election to split this $15,953.76 with his wife under the pension income-splitting provisions of section 60.03 of the *Income Tax Act*. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. The $15,953.76 was paid to the taxpayer under a group long-term disability policy, so it did not constitute "qualified pension income" as defined in subsection 118(7), even though the payments received by the taxpayer took the form of retirement supplements after his 65th birthday. As a result, the $15,953.76 did not qualify for pension income-splitting treatment under section 60.03. The Minister's reassessment was affirmed accordingly.

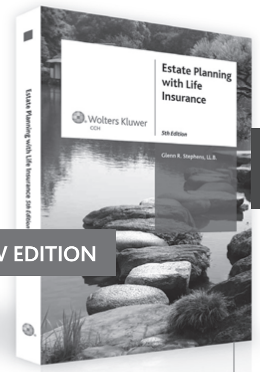
Cantin, 2014 DTC 1049

Taxpayer entitled to deduct some moving expenses disallowed by Minister

From February 2002 to January 2008, the taxpayer was employed by the Canada Revenue Agency ("CRA") as a tax officer in Ottawa and resided in an Ottawa townhouse that he owned. In January 2008, he moved to Toronto to start a new position with the CRA, but incurred travel expenses by occasionally travelling to Ottawa to work on an important appeal. He was also uncertain as to which CRA office he would report to in Toronto. He sold his Ottawa residence in March 2011. In assessing the taxpayer for 2008, the Minister disallowed the deduction, as moving expenses, of $4,975 in room rental costs and $480.69 in travelling expenses to Ottawa. In assessing the taxpayer for 2011, the Minister again disallowed, as moving expenses, $5,000 in home ownership expenses, $940.16 in travel expenses, and $560 in storage and moving expenses. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was allowed in part. The natural and ordinary meaning of the phrase "moving expenses", as used throughout section 62 of the *Income Tax Act*, refers to the ordinary out-of-pocket expenses incurred by a taxpayer in the course of physically changing his or her residence (see *Storrow v. The Queen*, 78 DTC 6551). The $4,975 in room rental costs incurred by the taxpayer during 2008 was a claim for lodging alone, and was not for "the cost . . . of meals and lodging" as that phrase appears in paragraph 62(3)(*c*). The $4,975, therefore, was fully deductible as moving expenses and was unaffected by the 15-day limitation in paragraph 62(3)(*c*). The $480.69 in travel expenses was properly disallowed as a deduction since it was incurred as an employment expense and not as a moving expense. In addition, all of the expenses claimed for 2011 as moving expense deductions were properly disallowed, since they had all been claimed by the taxpayer and allowed as rental expense deductions for 2010.

Sirivar, 2014 DTC 1052



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