Tax Notes

November 2016
Number 646

Wolters Kluwer

CONSIDERATIONS RELATING TO A SHORT TAXATION YEAR

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A taxation year-end may result from various transactions and events, such as an acquisition of control caused by an internal reorganization that cannot qualify within the deeming rules of subsection 256(7) of the *Income Tax Act* ("ITA"); a change of the trustees of a trust; an amalgamation that does not take place on the day following the normal taxation year-end date of the amalgamated companies; or a change in a corporation's status as a Canadian-controlled private corporation,[1] as a tax-exempt corporation,[2] or as a financial institution.[3] Furthermore, successive short taxation years could also result from an acquisition of control followed on the same day by the amalgamation of the purchaser and the target company where such amalgamation is completed in a manner that triggers two year-ends on the same day.[4]

Whether it occurs voluntarily or not, a taxation year-end of a Canadian resident corporation triggered before its normal year-end date comes with various income tax consequences that are often adverse, and that may come as a surprise to the corporation and even to its shareholders.

Income Tax Compliance Considerations

The filing of the corporate income tax returns of a Canadian resident corporation is required within six months from the end of their taxation year,[5] but, in practice, the date of this filing obligation would occur earlier than expected if the taxation year-end occurs at an earlier time, causing also interim financial statements to be prepared.

The final income tax payments that must be made on the balance due day of the corporation (normally either two or three months following the end of the taxation year)[6] can have negative implications on the cash flow management of the corporation, especially if either there has been a significant gain or income during the year not covered by the monthly instalments of the corporation, or the payment of Part IV tax could have otherwise been deferred. The instalment base for a Canadian resident corporation for a particular taxation year is determined with reference to the number of days in the preceding year, therefore a short taxation year would have an impact in that regard.[7] A Canadian resident corporation may also be required to include in its income the foreign accrual property income of its controlled foreign affiliate at a time earlier

[1] Subsection 249(3.1) ITA.

[2] Subsection 149(10) ITA.

[3] Subsection 142.6(1) ITA.

[4] Canada Revenue Agency, Income Tax Folios, S4-F7-C1 — Amalgamations of Canadian Corporations, May 8, 2015, par. 1.18 to 1.25.

[5] Paragraph 150(1)(*a*) ITA.

[6] Paragraph 157(1)(*b*) ITA and paragraph (*c*) of the definition of "balance-due day" in 248(1).

[7] See subsection 5301(3) of the *Income Tax Regulations* ("ITR") where the preceding year consists of less than 183 days.

than expected if it has a short taxation year.[8]

The corporation would be required to file certain elections, information returns, and designations at an accelerated pace. In addition, the timing for the filing of the contemporaneous documentation required under subsection 247(4) of the ITA would be modified.

Missing a filing deadline would come with interest charges in the context of late payment of income taxes on the due date for the corporation, along with penalties. In respect of compliance issues, such as the filing of certain elections and information returns, penalties could certainly be applied by the tax authorities.

The filing of Form T1134 regarding a foreign affiliate of a Canadian corporation is a good example of one of the surprises resulting from an unintended short taxation year. Form T1134 must be filed within 15 months following the end of the taxation year of the Canadian corporation. The penalties for non-compliance regarding Form T1134 could be very harsh and, in many instances, this issue could lead the corporation to proceed with a voluntary disclosure to avoid any risks of such penalties (assuming the corporation finds this issue before the audit by the tax authorities), thus adding unexpected costs to its tax compliance budget. The same results would apply with respect to the filing of forms T106 and T1135. We can imagine the difficulties facing the tax group of a Canadian multinational corporation if the filing deadline for these forms was changed suddenly because of an unexpectedly short taxation year.

Tax Attributes, Reserves, and Tax Rollovers

Prior to the change in the 2006 Budget to the carryforward period of non-capital losses and farm losses[9] from 10 years to 20 years, losing such a valuable tax attribute was a crucial issue. However, nowadays, the impact of having a short taxation year on such losses may be of a lesser concern to Canadian corporations, but other tax attributes still remain subject to relatively short carryover periods. The expiration of certain carryforward periods of the following tax attributes would be accelerated as a result of a short taxation year: investment tax credits (20 years),[10] foreign business income tax credits (10 years),[11] and charitable gifts (five years).[12]

The potential for a carryback of losses may also be impacted if the losses to be carried back are realized within a certain number of years following the taxation year during which the taxable income to be offset by the loss carryback was realized. A good example of this situation is in the context of a transaction involving a reverse earn-out exceeding three years where all or part of the losses are realized in the fourth year and where capital gain was realized in the first year.

Furthermore, where the 5-year reserve has been claimed by the Canadian corporation under subparagraph 40(1)(*a*)(iii) of the ITA, the short taxation year would reduce the duration of the deferral of income taxes payable on a capital gain realized by such corporation.

In certain circumstances, the ITA provides that an exchange of property can take place on a tax-deferred basis if one or more replacement properties are acquired within a specified time period and the proceeds received for the former property are used to acquire the replacement property.[13] However, the timing to acquire the replacement property is not subject to an extended number of taxation years following the year of the initial disposition but rather to 24 months, and thus a short taxation year would not have any negative implications for a corporation looking to benefit from such a rollover.

Another situation where a short taxation year should be considered is where a taxpayer grants an option in one taxation year and the option is not exercised until a subsequent year. In this case, the taxpayer may file an amended return (to defer proceeds from the option) in respect of the initial year. The amended return must be filed within the time for filing a return for the subsequent year provided in the ITA; the timing for filing such a return will be accelerated in the case of a short taxation year.

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[8] Subsection 91(1) ITA.

[9] Paragraphs 111(1)(*a*), (*c*), and (*d*) ITA.

[10] Subsection 127(9) ITA (20 years of carryforward).

[11] Subsection 126(2) ITA.

[12] Subsection 110.1(1) ITA.

[13] See subsections 14(6), 13(4), and 44(1) ITA.

Deductions

Numerous deductions and credits are prorated in the case of a short taxation year, including capital cost allowance for most classes of depreciable property[14] and cumulative eligible capital amount.[15]

Generally, under the half-year rule provided in subsection 1100(2) of the ITR, the maximum amount of capital cost allowance allowed in respect of depreciable assets acquired during a taxation year is limited to one-half of the normal annual deduction amount for the year. In the case of a short taxation year, this one-half amount is also subject to the requirement to prorate. The timing of the acquisition of the depreciable property should be considered to maximize the capital cost allowance of the corporation despite the half-year and proration rules.

A short taxation year may create an opportunity for a corporation which owns certain depreciable assets, such as properties falling within class 14 (patent, franchise, concession, or licence for limited period) and class 15 (wood assets), since the requirement to prorate the capital cost allowance does not apply to such assets and would thus allow the corporation to accelerate the write-off of such assets.

Paragraph 125(5)(*b*) of the ITA also provides that the annual business limit for the small business deduction must be prorated. Other proration is required for the base level deduction in respect of interest capitalization[16] and the dividend allowance in connection with dividends on taxable preferred and short-term preferred shares.[17]

Under paragraph 20(1)(*q*) and subsection 147.2(1) of the ITA, an employer can deduct its contributions to a registered pension plan within 120 days from the end of the year in which the employee's services were provided. The payment of the employer's contribution at an earlier date than usual would be required since late contributions would otherwise not be deductible.

Impact on the Shareholders

The timing of the repayment of a shareholder's loan is very important and it requires constant tracking by the shareholder or his advisors to ensure that it is repaid in cash, in kind, or through the declaration of a dividend. Subsection 15(2.6) specifically provides that, if a shareholder loan is repaid within one year from the end of the taxation year of the lender in which the loan was made and if the repayment is not part of a series of loans or other transactions and repayments, the loan is not required to be included in the borrower's income under subsection 15(2) of the ITA. Since the deadline for the shareholder's loan repayment is within one taxation year following the taxation year during which the loan was made, a short taxation year would limit the period to proceed with the repayment.

If an expense was incurred in a taxation year and remained owing and outstanding between non-arm's length parties at the end of the second taxation year following the taxation year in which the amount was so incurred, such amounts must be included in the income of the corporation having benefited from the deduction of such expense, unless a specific agreement is filed.[18] This particular situation is frequent in the cross-border context where interest is accrued and deducted by a Canadian corporation, but remains unpaid until the end of the second year following the taxation year during which such interest was deducted in order to defer the payment of the Canadian withholding tax. A short taxation year would accelerate the obligation for the Canadian corporation to pay the Canadian withholding tax to avoid the inclusion of the interest expense in the third year following the initial year during which the expense was deducted.

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[14] Subsection 1100(3) ITR.

[15] Paragraph 20(1)(*b*) ITA.

[16] Subsection 18(2.5) ITA.

[17] Subsection 191.1(6) ITA.

[18] Subsection 78(1) ITA.

Unlike the time period for repayment of a shareholder's loan in a domestic context under subsection 15(2.6) of the ITA, where a Canadian corporation is owed an amount by a non-resident person without interest at a reasonable rate, or if a foreign affiliate is owed an amount by certain Canadian resident persons, the timing to repay such loan to avoid any income inclusion is based on years rather than "taxation year". Therefore, a short taxation year would not cause the acceleration of an income inclusion for the Canadian resident corporation under subsection 17(1) of the ITA and subsection 90(6) of the ITA.

In summary, a short taxation year would not only be creating tax compliance issues but, more importantly, it can result in adverse and unexpected financial consequences for the Canadian corporation.

A number of tax lawyers from Dentons Canada LLP write commentary for Wolters Kluwer's Canadian Tax Reporter *and sit on its Editorial Board as well as on the Editorial Board for Wolters Kluwer's* Income Tax Act with Regulations, Annotated. *Dentons Canada lawyers also write the commentary for Wolters Kluwer's* Federal Tax Practice *reporter and the summaries for Wolters Kluwer's* Window on Canadian Tax. *Dentons Canada lawyers wrote the commentary for* Canada–U.S. Tax Treaty: A Practical Interpretation *and have authored other books published by Wolters Kluwer:* Canadian Transfer Pricing *(2nd Edition, 2011);* Federal Tax Practice*;* Charities, Non-Profits, and Philanthropy under the Income Tax Act*; and* Corporation Capital Tax in Canada. *Tony Schweitzer, a Tax Partner with the Toronto office of Dentons Canada LLP and a member of the Editorial Board of Wolters Kluwer's* Canadian Tax Reporter*, is the editor of the firm's regular monthly feature articles appearing in* Tax Topics.

THE CASE OF THE KVAS BROTHERS: THE APPLICATION OF SECTION 160 TO "TRANSFERS" FROM A DISSOLVED CORPORATION

— Adam Friedlan, Friedlan Law

In *Paul Kvas v. The Queen*, 2016 DTC 1169, the issue in dispute was whether section 160 of the *Income Tax Act* (Canada) (the "Act") applied to a purported "transfer of dividends" occurring "on or about" December 31, 2008, from Commercial Interior Alteration Inc. ("CIA"), which by that time had been dissolved, to Paul and Peter Kvas (the "Kvas brothers").

The Kvas brothers were both carpenters by trade and incorporated CIA in 2002 pursuant to the *Business Corporations Act* (Ontario) (the "OBCA") in order to bid on large contract jobs. CIA successfully bid on a large contract in 2005. Unfortunately, although profitable, this contract exhausted the resources of CIA and stymied efforts to secure and complete other potential work. Consequently, CIA ran losses in 2006 and 2007. As a result of the efforts of the Kvas brothers to seek out other work, and as a consequence of a lack of sufficient accounting background, CIA's tax filings went into default. On January 21, 2008, CIA was dissolved by the OBCA Director of Companies for defaulting on its obligation to file its corporate tax return.

The Kvas brothers sought to have CIA revived; however, these efforts were not successful. The Canada Revenue Agency would not consent to CIA's revival.

The accountant for CIA, upon learning of the failure of the Kvas brothers to secure the revival of the company, cancelled T-4s (totalling $17,000.00) and issued T-5s on October 29, 2009 (totalling $107,146.00). According to the accountant for CIA, these filings were intended to retroactively settle or reconcile the assets still remaining in the fall of 2009 on the financial statements of CIA as at December 31, 2007.

For some time after the 2009 T-5s were issued, the bank account of CIA and its cash simply remained in place. However, in March 2010 the funds in the former CIA account were depleted and used by the Kvas brothers.

The parties were in agreement that the only issue with respect to the section 160 assessments made against the Kvas brothers was whether there had been a transfer within the meaning of that section.

Justice Bocock held that the following are required in order for there to be a transfer within the meaning of section 160: the commission of an act or execution of a document divesting the transferor and investing the recipient with the property, the identification of some memorialized event or document which has the legal effect of conveyance, and the contemporaneous placement of that action at the time the tax debt is owed.

With respect to the purported transfer, three issues were at play. Firstly, whether subsection 84(2) dividends were deemed to have been received by the Kvas brothers (such deemed dividends constituting transfers within the meaning of section 160). Secondly, what effect the Notice of Dissolution of CIA had on the purported transfer to the Kvas brothers. Finally, apart from the legal subsistence of CIA after the dissolution date, did actions occur which constituted a transfer within the meaning of section 160?

The question of the application of subsection 84(2), which provides for a deemed dividend "where funds or property" have been distributed or appropriated to or for the benefit of shareholders on the "winding-up discontinuance or reorganization of a business", was dealt with first. Justice Bocock held that the facts did not support the application of subsection 84(2) as factually there was no winding-up or discontinuance undertaken by any relevant person at the time of the assessment. Factually, CIA had been dissolved involuntarily. Justice Bocock held that subsection 84(2) requires a more orderly and conceived transaction or series of transactions undertaken by the directors during a winding-up culminating in the final act of dissolution, reorganization, or arrangement. These requirements were not met by the involuntary dissolution of CIA.

Justice Bocock then turned to the question of the effect of the Notice of Dissolution on CIA. Justice Bocock held that the statutory requirement of a transfer could not have been met because section 160 requires a transfer by a transferor. The relevant transfers were assumed by the Minister of National Revenue (the "Minister") to have occurred on December 31, 2008, well after the dissolution of CIA. Therefore, transfers within the meaning of section 160 could not have occurred at the impugned time(s) as CIA did not exist after its dissolution. Since CIA did not exist at the relevant time(s), it also could not then have been at non-arm's length with the Kvas brothers.

Justice Bocock then considered whether other actions of CIA had constituted a transfer or transfers within the meaning of section 160. The Crown had attempted to de-emphasize the issues of dissolution and actual legal transfer and had focused instead on the unrevoked T-5s and the closing balance sheet of CIA in order to support its assumption that property held by CIA (at the time a tax debtor) had been transferred to the Kvas brothers. Counsel for the Crown had also submitted that there was no evidence that the assets owned by CIA had effectively forfeited to the provincial Crown (the legal consequence of dissolution under the OBCA).

Justice Bocock, citing *Algoa Trust v. Canada*, 93 DTC 405, maintained that a transfer occurs where "a person makes a transfer of property to another person if he does the act or executes the instrument which divests him of the property and at the same time vest it in the other person."[1]

Justice Bocock held that CIA had never transferred property by way of "transfer of dividends" on or about December 31, 2008, as alleged by the Minister. Instead the OBCA Director of Companies had dissolved CIA. Upon such dissolution, the property of CIA legally escheated to the provincial Crown. CIA took no action that the Court could understand to constitute a "transfer of property".

The Minister's assessment had referenced in excess of 25 assumed transfers after the dissolution of CIA all of which, on the basis of uncontroverted testimony, involved transfers by CIA to third parties in order to allow CIA to continue its business. The Court held that no transfers within the meaning of section 160 could have taken place after the dissolution of CIA.

Justice Bocock noted the "pink elephant in the room" was the retroactive T-5s prepared by CIA's accountant. However, the Court determined that retroactive T-5 slips and post-facto financial statements cannot create a transfer where none exists. Justice Bocock held that a transfer is an essential element of a section 160 assessment. Justice Bocock further held that such a transfer must be effected at the relevant time by a tax debtor. The transfer cannot be "constructed" through multiple third party payments and the assumed dissipation of assets over many months. Finally, Justice Bocock held that a section 160 assessment when raised must accurately describe both these "quantitative" and "timing" components.

Justice Bocock noted in passing that it was unclear why the source deductions had not been pursued in the normal manner (i.e., through subsection 227.1(1) of the Act) as presumably this would have avoided the complex issue surrounding whether a transfer within the meaning of section 160 had occurred.

For practitioners this case serves as a reminder that tax and financial reporting do not in and of themselves create legally effective transactions. Consequently, practitioners should ensure that any tax or financial reporting is reflective of the actual underlying legal relationships and transactions.

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[1] Emphasis in the original.

CURRENT ITEMS OF INTEREST

Income Tax Amendments Relating to CPP Enhancement Announced

As previously announced by the Minister of Finance, Bill C-26, *An Act to amend the Canada Pension Plan, the Canada Pension Plan Investment Board Act and the Income Tax Act*, was read for the first time in the House of Commons. The bill proposes a handful of income tax amendments that are consequential to expanding the CPP, including:

- the deduction of 1/2 of CPP contributions made by self-employed individuals is amended to allow for the deduction of 100% of the additional enhanced contributions (the other half of the regular contributions is eligible for the CPP tax credit);
- a new deduction is introduced so employees may deduct their enhanced contributions (rather than receive a tax credit);
- the tax credit for CPP contributions by employees is clarified so it does not apply to enhanced CPP contribution amounts; and
- the working income tax benefit is enhanced to offset the effects of the enhancement on low-income workers.

These changes will come into force on January 1, 2019, which is when the phase-in of the CPP enhancement will commence.

CRA Provides Update on Audit Activities in the Real Estate Sector

Recently, the CRA has been focusing its non-compliance efforts on participants in hot Canadian real estate markets. The CRA released a briefing on its activities and the corresponding results. Main areas of these non-compliance activities have been the following:

- questionable sources of funds;
- incorrectly reporting income from flipping properties;
- unreported GST/HST on sale or ineligibility for GST/HST new housing rebate;
- unreported capital gains; and
- unreported worldwide income.

These audit activities yielded strong results. From April 2015 to June 2016, 563 penalties for knowingly making a false statement were applied, which totaled $11.6 million. During the same period, $117.3 million was collected in Ontario with respect to GST/HST rebates and another $39.6 million was recovered with respect to unreported GST/HST. Audit activities related to real estate in British Columbia resulted in $25.3 million of total recoveries in the same period.

CRA Consulting Small and Medium Businesses on Potential Service Improvements

This week Minister Lebouthillier announced the *Serving You Better* consultations, which are a forum for small and medium businesses and accountants to share their perspectives of how the CRA can improve its services. Separate sessions will be provided for businesses and accountants in various cities across Canada throughout October and November. Feedback will also be accepted via online submissions.

Prescribed Interest Rates for Leasing Rules

The prescribed monthly interest rate for the purposes of the leasing rules is 2.52% for the month of November.

Bill C-2, An Act To Amend The Income Tax Act

On October 6, 2016:

- Bill C-2, *An Act to amend the Income Tax Act*, was read in the Senate for a second time and was referred to the Standing Senate Committee on National Finance.

OECD Launches Business Survey on Tax Certainty To Support G20 Tax Agenda

The Organisation for Economic Co-operation and Development ("OECD") announced on October 18, 2016, that it was launching a business survey to invite businesses and other stakeholders to contribute their views on tax certainty. It stated that it had received a "strong endorsement" from both the G20 leaders and the finance ministers to work on solutions to support certainty in the tax system with the aim of promoting investment, trade, and balanced growth.

The traditional way in which businesses can achieve tax certainty has historically been to seek tax rulings from the revenue administration authorities in the countries in which they operate, but that has lately come under question with the European Commission investigations into tax rulings in the context of whether or not they were in breach of EU state aid rules. There have been several very high profile decisions where rulings requested and granted to Apple by Ireland, Fiat by Luxembourg, and Starbucks by the Netherlands, to name three, have been overturned by administrative action of the EU, nullifying the certainty that these rulings were intended to provide.

All three of these decisions are being appealed by the countries in question. In the case of the recent Apple ruling, Irish Finance Minister Michael Noonan described both the Commission's decision and the Government's appeal as "landmark moments for Ireland's tax policy and our place in Europe", stating that the appeal is "necessary to defend the integrity of our tax system, ***to provide certainty to business***, and to challenge the encroachment of EU state aid rules into the sovereign member state competence of taxation" [emphasis added].

It is likely not a coincidence that the leaders and finance ministers of the G20 have put achieving tax certainty on the agenda of the OECD.

Businesses and other stakeholders wishing to provide input are invited to take the survey on the OECD website at http://survey.oecd.org/Survey.aspx?s=0cf6dbb32c614022a1ee37e947ab8861. The survey will be open from October 18 to December 16. It is strictly confidential and anonymous, and no individual- or organisation-specific information will be disclosed. The results of the survey will be made available in aggregated format and will be presented to the G20 in 2017.

New Bill Introduced

On October 25, 2016, Bill C-29 was introduced in the House of Commons. Bill C-29 contains many of the outstanding income and sales tax measures from Budget 2016, among others. Some of the tax measures proposed by Bill C-29 include:

- changes to eligible capital property rules;
- emissions allowances;
- multiplication of the small business deduction;
- cross-border surplus stripping;
- extension of back-to-back rules;
- country-by-country reporting;
- alternative arguments for assessments; and
- GST/HST on call centre services.

Canadian Film or Video Production Tax Credit Expanded

Until recently, a talk show was not an eligible production for the purposes of the Canadian Film or Video Production Tax Credit ("CFVPTC"). At the time this exclusion was enacted, most talk shows were produced by large broadcasters, while the credit was intended to support independent film productions. Since there exist talk shows that are created by independent production companies, the Minister of Canadian Heritage recommended that talk shows become eligible for the credit. The reference to a talk show was removed from the definition of an excluded production (as defined in subsection 1106(1) of the *Income Tax Regulations*) for the purposes of the CFVPTC. This amendment applies to productions for which the principal photography began after February 16, 2016.

Department of Finance Announces Changes Affecting Principal Residence Exemption

On Monday, October 3, 2016, Minister of Finance Bill Morneau announced new policy measures relating to the current condition of the Canadian housing market. One of these measures is a series of income tax proposals that will affect claimants of the principal residence exemption. In brief, the following four tax measures are proposed:

(1) an individual who was not resident in Canada in the year that he or she acquired a principal residence will not be allowed to claim the exemption with respect to that year by virtue of the "plus one rule" (effective for dispositions after October 2, 2016);

(2) in order for a trust to designate its property as a principal residence, the trust and its beneficiaries must meet additional criteria (effective for tax years after 2016 and subject to transitional rules);

(3) all dispositions of property for which the full principal residence exemption is claimed must be reported to the CRA (effective for tax years ending after October 3, 2016); and

(4) the CRA will be allowed to assess taxpayers beyond the normal assessment period for a tax year in which a disposition of real estate was not reported on the tax return (effective for taxation years that end on or after October 3, 2016).

These proposed amendments are available on IntelliConnect. Print copies (Special Report 095H) are available for $12.95 by calling 1-800-268-4522 or emailing cservice@wolterskluwer.com.

CBA and CPA Joint Committee's Comments on Proposed Legislation

The Joint Committee on Taxation of the Canadian Bar Association and the Chartered Professional Accountants of Canada (the "committee") has again provided comments with respect to draft legislation. Recently, the committee commented on the Budget 2016 proposals relating to life insurance policies and rules intended to prohibit multiplication of the small business deduction. The newest submission, released on September 27, 2016, comments on the amendment that allows for alternative arguments in support of assessments and the proposed measure to expand the application of the back-to-back rules. In both cases, the committee highlighted several areas where the proposals may have unintended problematic effects in their current form.

CRA Releases New Income Tax Folios

The CRA released two new income tax folios that fall under the businesses category:

- S4-F8-C1, Business Investment Losses; and
- S4-F15-C1, Manufacturing and Processing.

The positions in both folios can be relied upon as of September 27, 2016. The CRA will accept comments regarding the structure or content of the folios until December 27, 2016.

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.

Tax Court Provides Insight Into the Principles Applicable to Striking an Affidavit

***CBS Canada Holdings Co. v. The Queen*, 2016 DTC 1068 (Tax Court of Canada)**

CBS Canada is an interesting decision which sheds light on the principles applicable to (i) the inclusion of hearsay in an affidavit, and (ii) striking an affidavit filed in support of a motion brought in court.

Prior to the motion application in this matter, the taxpayer and the Crown had reached settlement of a tax appeal pursuant to which Minutes of Settlement had been executed and provided to the Court. The settlement provided for the application of non-capital losses of the taxpayer, which the Minutes stated were in the amount of $22,825,921.00.

The Court had agreed to hold the appeal in abeyance while the Minister issued assessments implementing the settlement.

However, prior to issuing assessments in accordance with the Minutes, the Minister determined that a mistake had been made: the Minister maintained that the taxpayer had no non-capital losses available, rather than the almost $23,000,000 set out in the Minutes. The Minister so advised the Court, following which the taxpayer brought a motion requesting that its appeal be allowed in accordance with the Minutes. In support of the motion, the taxpayer filed an affidavit providing exhibits and explanations as to the terms of the settlement. The affidavit was sworn to by a partner of counsel for the taxpayer.

In cross-examining the partner who had sworn the affidavit, the Minister sought to ask questions as to the basis on which the non-capital losses had been determined. The taxpayer objected to the questions on the basis that the information was privileged and, further, was not relevant. The taxpayer maintained that the Minutes of Settlement spoke for themselves as to the terms of settlement.

The Minister brought a motion to strike the affidavit filed by the taxpayer. The Minister's position was that the affidavit addressed a controversial issue, namely the existence of the non-capital losses, on which a partner of the taxpayer's counsel should not be the party swearing the affidavit. The taxpayer, on the other hand, maintained that the affidavit simply set out the terms that had been agreed upon in the Minutes, such that the affidavit did not deal with a controversial issue.

In support of its motion, the Minister maintained that:

- as the affidavit had been sworn to by a partner of the taxpayer's counsel, the affidavit should be struck or disregarded because it concerned a controversial issue and because the taxpayer's invoking of privilege and refusal to answer questions on various other bases prevented meaningful cross-examination on a controversial issue; and
- the affidavit provided excessive hearsay evidence which failed to meet the twin criteria of reliability and necessity for the inclusion of hearsay in an affidavit.

The Minister argued that if the affidavit were admitted, it would cause extreme prejudice to the Minister.

In the course of her decision, Lyons J. set out the principles applicable to striking an affidavit, as stated by the Federal Court of Appeal in *Canada (Attorney General) v. Quadrini* (2010 FCA 47):

> . . .As a general rule, the affidavit must contain relevant information which would be of assistance to the Court in determining the application. . . .[T]he purpose of an affidavit is to adduce facts relevant to the dispute without gloss or explanation. The Court may strike affidavits, or portions of them, where they are abusive or clearly irrelevant, where they contain opinion, argument or legal conclusions, or where the Court is convinced that admissibility would be better resolved at an early stage so as to allow the hearing to proceed in a timely and orderly fashion. . .

The Court cited judicial authority confirming that "motions to strike affidavits should be exceptional, especially where the question is one of relevancy, and prejudice must be demonstrated". In respect of affidavits based on hearsay, the Court quoted jurisprudence stating that:

> . . .the motion should only be brought where the hearsay goes to a controversial issue, where the hearsay can be clearly shown and where prejudice by leaving the matter for disposition at trial can be shown.

In response to the Minister's motion, the taxpayer claimed that there was no dispute about the authenticity of the affidavit exhibits, nor that these were filed, served, sent, and received. Consequently, the taxpayer asserted that the exhibits were routine documents containing uncontroversial documentary facts relevant to the taxpayer's original motion to enforce the settlement offer, and that the sole function of the affidavit was to append exhibits, as in any routine motion. As a result, the taxpayer argued that no prejudice would result to the respondent if the affidavit were admitted, but that serious prejudice would result to the taxpayer if it were struck, as critical documents would be excluded.

In conducting her analysis, Lyons J. disagreed with the taxpayer that the exhibits to the affidavit contained uncontroversial documentary facts, and that the sole function of the affidavit was merely to append exhibits similar to any routine motion. Lyons J. was of the view that the affidavit was intended not only to set out the terms of the Minutes but also to go to the truth and accuracy of the non-capital losses, matters which were in dispute.

The Court noted that the *Tax Court of Canada Rules (General Procedure)* permit affidavits that include hearsay, but only where the twin criteria of reliability and necessity are sufficiently demonstrated.

In respect of the first criterion, Lyons J. noted that "evidence in an affidavit must be capable of being tested for its reliability during cross-examination". In this case, cross-examination was precluded as a result of the affidavit having been sworn by a partner of counsel for the taxpayer.

In respect of the second criterion, it would have been possible for the affidavit to have been sworn by personnel of the taxpayer, who would have had first-hand knowledge of the facts relating to the non-capital losses and who could not assert privilege.

Further, as regards the affidavit having been sworn by a partner of the taxpayer's counsel, Lyons J. noted that "the jurisprudence has established that if there are uncontroversial documents of minimal importance and the motion is routine or straightforward, the Court has the discretion to accept a lawyer's affidavit." Here, however, Lyons J. concluded that the materials in issue "are controversial, of critical importance, and therefore, this is not a routine motion".

The Court agreed with the Minister's argument that the limitations imposed by the taxpayer on the ability to test the affidavit would result in prejudice to the Minister. Given that the affidavit was sworn in respect of a controversial issue by a partner of the taxpayer's counsel, that it contained hearsay, and that it failed to meet the twin criteria of reliability and necessity, the Court held that the affidavit could not assist in evaluating the taxpayer's motion to compel enforcement of the judgment. The affidavit was therefore struck, with leave granted to the taxpayer to file another affidavit.

The decision has been appealed by the taxpayer to the Federal Court of Appeal.

— *Krupa Kotecha, Student-at-Law*

Ancillary Tax Motive for Investing in Offshore Hedge Funds not Enough to Trigger Section 94.1

***Gerbro Holding Co. v. The Queen*, 2016 DTC 1165 (Tax Court of Canada)**

In this case, the Tax Court of Canada considered the application of the offshore investment fund property rules in section 94.1 of the *Income Tax Act* (the "Act") in the context of the taxpayer's investments in several offshore hedge funds.

The taxpayer corporation was established in 1986 as the holding company for a spousal trust created by the late Gerald Bronfman. The company was tasked with investing the trust's capital and income during the lifetime of Mr. Bronfman's wife, with the remainder going to her four children following her death.

The company's investments had to earn sufficient income to cover its operating costs and sustain Ms. Bronfman's lifestyle. However, given Ms. Bronfman's advanced age, the investments had to be liquid enough to be quickly wound up and distributed to Ms. Bronfman's four children in the event of her death. In order to meet its mandate, the company adopted extensive written investment guidelines codifying a principal investment philosophy of capital preservation. Although the taxpayer had a secondary objective of earning a return consistent with prevailing market expectations, this objective was subordinate and subject to certain volatility threshold limits.

The company did not have the in-house resources to actively manage its own portfolio and instead sought out renowned investment managers with records of proven positive returns and significant assets under management. Pursuant to advice received from a consultant, and in line with its investment guidelines, the taxpayer acquired interests in five offshore hedge funds located in the low-tax jurisdictions of the British Virgin Islands, the Cayman Islands, and the Netherland Antilles.

The Minister reassessed the taxpayer under section 94.1 for its 2005 and 2006 taxation years to include additional income of over $1.5 million on account of the investments in the five offshore hedge funds.

Section 94.1 is an anti-avoidance provision in the Act that can impute income to applicable offshore investments in excess of the income that would otherwise be recognized under the Act in respect of such investments. Section 94.1 will apply if two conditions are met. The first condition, the "value test", is met if the taxpayer acquires or holds an interest in a non-resident entity that derives its value, directly or indirectly, primarily from portfolio investments of a class of assets listed in paragraph 94.1(1)(*b*). The second condition, the "motive test", is met if one of the main reasons for the taxpayer acquiring or holding the interest was to obtain a tax benefit that allows the taxpayer to pay significantly less Part I tax than would have been payable if the taxpayer held the portfolio investments directly.

On the value test, the taxpayer argued that the definition of "portfolio investments" in section 94.1 should not include assets used in the carrying on of an active investment business. After conducting an interpretive analysis, the Tax Court rejected the taxpayer's interpretation of the meaning of "portfolio investments". Relying on a plain meaning analysis, the Tax Court instead concluded that portfolio investments were those investments over which an investor did not exercise significant control and merely held to passively benefit from an appreciation in value.

The Tax Court then went on to conclude that the word "primarily" in section 94.1 should be interpreted to mean 50% or more and applied that threshold to conclude that the taxpayer's interests in offshore investment fund property did, in fact, reasonably derive more than 50% of their value from portfolio investments made up of "listed" assets.

While the Tax Court did express some reservation about whether or not cash-settled derivatives fit under the listed assets in paragraph 94.1(1)(*b*), the Tax Court found that such cash-settled derivatives were not a primary income-generating source for the five offshore hedge funds and concluded that the holdings in the funds satisfied the value test for the purposes of section 94.1.

On the motive test, the Tax Court considered whether or not one of the main reasons for the taxpayer's acquisition and holding of its interest in the offshore hedge funds was to obtain a tax benefit that would not have been available had the portfolio investments been held directly.

The Tax Court concluded that, while tax deferral was an ancillary reason for the taxpayer to invest in the offshore hedge funds, it was not one of the main reasons for the investment.

In its reasons, the Tax Court explained that the motive test was not a purely subjective test and that the stated reasons for a taxpayer's investment must be objectively reasonable. The Tax Court further noted that a taxpayer could have both main and ancillary reasons for an investment for purposes of section 94.1.

On the basis of the taxpayer's evidence, the Tax Court concluded that, while the taxpayer did receive a significant deferral advantage by investing through the offshore hedge funds, it had invested mainly for the following four *bona fide* non-tax reasons:

- To obtain good returns that were particularly commercially attractive;
- To reduce the overall volatility of its portfolio by investing with hedge funds with non-directional strategies;
- To invest with trustworthy individuals given the risk of fraud in pooled funds; and
- To hold liquid investments in the event of Ms. Bronfman's passing.

The Tax Court reached this conclusion on the basis of strong testimony and supporting documentation which showed that the taxpayer would not have been able to replicate the investment strategy, low risk profile, and investment returns of the offshore hedge funds.

As there had previously been no meaningful case law concerning the application of the offshore investment fund property rules in the Act, this case articulates a useful framework for distinguishing between a taxpayer's main and ancillary reasons for making an offshore investment that could be subject to section 94.1. While the taxpayer was found to have made its investment in the offshore hedge funds in part because of the opportunity to defer tax, this ancillary reason took a back seat to several well-documented, non-tax reasons for making the investment.

— *Justin Shoemaker*

Absolute Means...Absolute

***Briant (Re)*, 2016 DTC 5096 (Supreme Court of British Columbia)**

Briant is a bankruptcy case in which the Minister sought to set aside the taxpayer's absolute discharge from bankruptcy. The Minister was initially successful in having a Master of the Supreme Court of British Columbia set aside the discharge. However, on appeal to a Justice of the Supreme Court of British Columbia, the Master's order revoking the discharge was overturned.

The taxpayer, Mr. Briant, had made a voluntary assignment into bankruptcy in 2005 pursuant to the *Bankruptcy and Insolvency Act* ("BIA"). The Minister was a major creditor and, at the time of assignment, was owed approximately $13,600,000 in unpaid taxes, penalties, and interest. In February 2006, an agreement was reached between the taxpayer and his creditors whereby the taxpayer was required to consent to judgement in the amount of $250,000, payable within three years. The taxpayer was also required to submit a breakdown of his income and to provide supporting documents every six months until the amount payable was paid in full; the taxpayer's trustee in bankruptcy was to act as the judgment creditor. In March 2006, the taxpayer consented to the judgement as contemplated and the Court subsequently determined that an absolute order of discharge would be issued upon the Registrar being satisfied that the bankrupt had consented to the judgement. The absolute order of discharge was issued in May 2006.

Following the taxpayer's absolute discharge, the trustee received no payment from the taxpayer despite the trustee's demands. The trustee issued a notice to creditors advising them of the taxpayer's failure to comply with the terms of the consent judgment and directing their attention to section 38 of the BIA which allows a creditor to seek leave from the court to commence a proceeding in the creditor's own name against the taxpayer. The trustee requested that any creditor interested in pursuing its rights under section 38 of the BIA provide notice of its intention to do so within ten days, but no such notices were received. The trustee was subsequently discharged in August 2011.

Despite filing income tax returns for the 2006-2009 years in the fall of 2010, the taxpayer did not make any payment of the taxes owed at the time of filing the returns and, instead, he continued to accrue income tax liability. This pattern continued until the date at which the Minister filed an application to a Master of the British Columbia Supreme Court to have the taxpayer's discharge revoked, which the Master granted.

The Master's decision was made on the basis that the taxpayer had not fulfilled his duties under paragraph 158(*o*) of the BIA, which required the bankrupt to "generally do all such acts and things in relation to his property and the distribution of the proceeds among his creditors as may be reasonably required by the trustee. . .". This finding led the Master to conclude that the Court had the authority under either subsection 176(2) or 180(1) of the BIA to revoke or annul the absolute discharge.

On appeal from the Master's decision, the Supreme Court of British Columbia (*per* Griffin J.) found that, as a matter of statutory interpretation, the Master had erred in concluding that the obligations listed under section 158 of the BIA were to continue beyond an absolute discharge. The Court reached this conclusion based on a plain reading of all the obligations listed under each paragraph of section 158, which are clearly intended to be performed by an individual after assignment into bankruptcy, but before discharge.

The Court then went on to consider whether the Master's decision could be supported on the basis of section 176 of the BIA. Subsection 176(1) imposes certain informational obligations on a bankrupt "[w]here an order is granted on terms or conditions or on the bankrupt consenting to judgement" until the terms, conditions, or judgment is satisfied. Where a bankrupt fails to comply with the obligations imposed by subsection 176(1), the Court has the authority under subsection 176(2) to revoke the order of discharge. The Court held that, notwithstanding the divided case law on the point, the Court's authority to revoke a discharge pursuant to subsection 176(2) is restricted to circumstances in which the discharge was made subject to terms and conditions and, therefore, not absolute. In reaching this conclusion, it is worth noting that the Court did not address the fact that subsection 176(1) appears to specifically contemplate that, in the case of a consent judgment, the bankrupt's obligations under this section continue until the terms of the judgment have been satisfied.

Finally, the Court considered whether the Master's decision could be supported on the basis of the Court's residual jurisdiction under section 187(5) of the BIA which allows the discharge to be annulled if the bankrupt "fails to perform [the] duties impos[ed] on him by the [BIA]". The Court concluded that, based on the jurisprudence, a finding that the taxpayer had not met the terms of the consent judgement was not on its own a sufficient basis to rescind the taxpayer's absolute discharge under subsection 187(5), given that an important factor in making a determination under this provision is the ability of the bankrupt to make the payments required by the consent judgement and a deliberate refusal to do so.

As a result, the Court granted the appeal and set aside the decision of the Master, restoring the absolute discharge of bankruptcy.

The *Briant* case provides useful guidance with respect to the factors a court will consider in making a determination as to whether to set aside an order of absolute discharge, and demonstrates jurisprudential reaction towards the concepts of certainty and finality in connection with absolute discharges from bankruptcy.

— *Krupa Kotecha, Student-at-Law*

Solicitor-Client Privilege Provides Limited Protection for Accountants' Transaction-Structuring Advice

***Redhead Equipment Ltd. v. Canada (Attorney General)*, 2016 DTC 5098 (Saskatchewan Court of Appeal)**

This case is an appeal of a decision concerning the scope of privilege over documents prepared by a corporation's accountants in connection with a reorganization transaction. The Saskatchewan Court of Appeal agreed with the application judge that privilege does not presumptively attach to documents created to structure a corporate transaction merely because a party has received legal advice on the transaction. Rather, solicitor-client privilege only protects an accountant's communications where the accountant is acting as the client's agent for the purpose of obtaining legal advice or instructing counsel.

The appellants (two corporations and an individual) operated an agricultural and industrial equipment sales and rental business. In 2009-2010, they reorganized the business's corporate structure. To that end, the appellants retained counsel to carry out the restructuring and to advise the appellants on related tax issues. In addition, the appellants asked their accountants to provide factual information to counsel to assist in the transaction, and to communicate facts, information, questions, and counsel's legal advice among the appellants, counsel, and the appellants' other relevant agents.

In August 2012, the CRA requested that the appellants provide information and documents regarding the 2009-2010 restructuring transaction in the course of an audit. In response, the appellants delivered 662 documents to the Sheriff at the Judicial Centre of Saskatoon over which they claimed privilege. The appellants asserted only solicitor-client privilege over the documents. In accordance with the procedure adopted in *Dixon* (91 DTC 5584 (Ont. Sup. Ct.)), the appellants applied to the Saskatchewan Court of Queen's Bench to resolve the issue of whether the documents were privileged. The parties made submissions on each document to an application judge, who reviewed the documents in an *in camera* proceeding. The application judge reviewed each document and made an individual determination of whether the document was privileged. The appellants appealed on the basis that the application judge's assessment of privilege was too narrow.

After determining that a standard of review of palpable and overriding error applied to the application judge's determination of whether privilege attached to each document, Ottenbreit J.A., on behalf of a unanimous panel of the Court of Appeal, turned to the legal principles governing solicitor-client privilege. The case law has established that there is no class privilege for accountants analogous to solicitor-client privilege ("accountant-client privilege") and tax accountants do not give legal advice (*Tower*, 2003 DTC 5540 (FCA)). For this reason, communications in which an accountant provides her professional opinion are not privileged.

Given the absence of a class privilege, accountants' communications must be brought within an existing category of privilege. The appellants argued that the communications of accountants working on transactions for which a lawyer has overall responsibility should be protected, akin to the transaction-based approach recognized to prevent waiver of privilege: see *Canmore Mount Villas Inc. v. Alberta (Minister of Seniors and Community Supports)*, 2009 ABQB 348, and *Trillium Motor World Ltd. v. General Motors of Canada Ltd.*, 2014 OSNC 1338 (Master), aff'd 2014 ONSC 4894.

The Court rejected the appellants' argument. Instead, Ottenbreit J.A. concluded that accountants must come within solicitor-client privilege in the same manner as any other third party without broad reliance on the presence of a legal transaction. Relying on the reasoning of Doherty J.A. in *General Accident Assurance Company v. Chursz* (1999), 45 O.R. (3d) 321 (C.A.), the Court concluded that solicitor-client privilege only extends to third-party communications in furtherance of a function essential to the existence or operation of a solicitor-client relationship. On the basis of this narrower, functional principle, in which the accountant must be acting as the client's agent for the purpose of obtaining legal advice or instructing counsel, the Court accepted almost all of the application judge's privilege assessments.

The Saskatchewan Court of Appeal's decision confirms the restrictive scope of privilege over communications from tax accountants advising on transactions established in the case law: see *Tower*. Although this case is consistent with the earlier line of authority, at first blush it seems to diverge from the more recent authorities accepting a transaction-based approach to privilege. However, those cases deal with common interest "privilege", which is not truly a form of privilege, but rather a legal principle that prevents waiver when privileged communications are shared with parties who share the same interest (*Pitney Bowes of Canada Ltd. v. The Queen*, 2003 DTC 5179 (Federal Court, Trial Division) and *Maximum Ventures Inc. v. De Graaf*, 2007 BCCA 510). Common interest does not extend privilege to documents that would not otherwise be privileged. Accordingly, the Saskatchewan Court of Appeal's decision, while disappointing for taxpayers who obtain advice from accountants on transactions, is consistent with prevailing doctrine concerning privilege.

— *Paul Davis*

RECENT CASES

Directors liable for unremitted corporate withholdings where no written resignations executed

The respondents were directors of a company owned by their spouses, and in 2001, both indicated their desire to resign as directors. Resignation documents were prepared for both respondents but those documents were never executed and contained a blank date field, with no instructions ever provided with respect to the date on which the resignations were to be effective. From 2000 to 2005 the company failed to remit its payroll tax withholdings as required and assessments for such amounts were eventually issued against the respondents in their capacity as corporate directors. They appealed from those assessments and their appeals were allowed. The Tax Court judge held that the verbal communication of an intention to resign and the preparation of draft documents to carry out that intention resulted in an effective resignation, and the assessment was vacated. The Minister appealed from that decision.

The appeal was allowed. The appellate Court held that the Tax Court judge had erred in concluding that the respondents had resigned as directors. The relevant statutory provisions provide that a resignation of a director becomes effective at the time a written resignation is received by the corporation or at the time specified in the resignation, whichever is later. The Court noted that it was self-evident that the status of directors must be capable of objective verification, as third parties rely on, and business decisions may be made based on, information with respect to the the directorship of a corporation. As well, the potential liability of former directors may, through the application of a limitation period, be determined based on a resignation date. The appellate Court concluded that there was no written resignation received by the corporation within the meaning of the relevant statutory provisions, and in the absence of a communication of a written resignation to the corporation, a resignation is not effective. The Tax Court judge had erred in concluding that the intention of the respondents to resign satisfied the necessary preconditions of an effective resignation. The appellate Court also held that the Tax Court judge had erred in concluding that the respondent Chriss had a due diligence defence based on her reasonable belief that she had resigned. The appellate Court held that while a director may be able to rely on a reasonable belief in having resigned to ground a due diligence defence, the standard must be much higher than the one applied by the Tax Court judge.

The Queen v. Chriss

2016 DTC 5101

Appeal allowed where transactions not constituting abusive tax avoidance

The taxpayer engaged in a series of transactions to package certain of its real estate holdings into a number of limited partnerships. In doing so, it used subsection 97(2) of the *Income Tax Act* to transfer the properties into three separate limited partnerships on a tax-free rollover basis. The taxpayer also elected to use paragraphs 88(1)(*c*) and (*d*) and subsection 98(3) to bump the adjusted cost base of its interests in those limited partnerships before selling those interests to tax-exempt entities. It then calculated its taxable capital gains on its disposition of those interests using the increased adjusted cost base resulting from the bumps under paragraphs 88(1)(*c*) and (*d*) and subsection 98(3). The Minister reassessed, denying the subsection 88(1) and 97(3) bumps and substantially increasing the capital gains realized by the taxpayer on the basis that such transactions were abusive and violated the general anti-avoidance rule ("GAAR"). The taxpayer appealed from that reassessment.

The appeal was allowed. The Court began by noting that, following Supreme Court of Canada jurisprudence, a three-step analysis must be carried out to determine the applicability of GAAR. To do so, it is necessary to determine whether there was a tax benefit arising from a transaction, whether the transaction was an avoidance transaction in the sense of not being arranged primarily for genuine purposes other than to obtain the tax benefit, and, finally, whether the avoidance transaction was abusive under GAAR. All three requirements must be fulfilled, and the onus is on the taxpayer to refute the first two and on the Minister to establish the third. Where the existence of abusive tax avoidance is unclear, the benefit of the doubt goes to the taxpayer. The Court then carried out an analysis of the series of transactions undertaken by the appellant using those three criteria. The appellant had conceded that tax benefits were obtained as the result of the transactions undertaken. The Court concluded that the transactions carried out by the appellant constituted, for purposes of GAAR, a series of transactions that contained one or more avoidance transactions. However, following a detailed review of the statutory provisions utilized by the appellant in carrying out its transactions, the Court held that the appellant had carried out those transactions in order to minimize its tax and that it did so in a manner that did not abuse those provisions of the *Income Tax Act*. The Court concluded that on a textual, contextual, and purposive analysis of the relevant provisions of the Act, the impugned transactions did not result in abusive tax avoidance, and that GAAR consequently did not apply.

Oxford Properties v. The Queen

2016 DTC 1172

Corporate taxpayer entitled to SRED expense and related investment tax credit deductions relating to salary paid to president of its Research Centre

The corporate taxpayer, Oldcastle, was in the business of manufacturing concrete products. It engaged C as the president of its Research Centre, and his remuneration was determined in part by a formula which took into account a percentage of the proceeds of the sale of the products developed at the Research Centre. In assessing Oldcastle for 2010 and 2011, the Minister took the position that C's remuneration did not constitute a deductible SRED expense for purposes of section 37 of the Act, for purposes of the definition of "qualified expenditure" in subsection 127(9) of the Act, or for purposes of the related investment tax credit ("ITC") provisions of subsection 127(5) of the Act. The Minister's view, in part, was that: (a) the formula used in determining C's remuneration referred to the sale of products resulting from SRED activities that had taken place in prior years; and (b) as a result this remuneration was not related to SRED activities currently being performed by C during the 2010 and 2011 taxation years under assessment. Oldcastle had also elected under clause 37(8)(*a*)(ii)(B) of the Act to use the prescribed proxy method in calculating C's remuneration for SRED deduction purposes, but the Minister initially reduced the prescribed proxy amount chosen by Oldcastle to zero. Upon receiving more information, however, the Minister reversed his position on this issue and allowed Oldcastle to benefit from the clause 37(8)(*a*)(ii)(B) election which it had originally made. Oldcastle appealed to the Tax Court of Canada on the issue concerning the deductibility of C's remuneration as an SRED expense.

Oldcastle's appeal was allowed. SRED deductions for salaries paid to employees engaged in SRED extends to bonuses paid to those employees, unless they are "specified employees", which C was not in this case. Bonuses paid to those employees, however, may not be included in their remuneration for purposes of making the related ITC calculations. It therefore became necessary to determine if C's remuneration in this case included a "bonus", which is generally considered to mean "something that is given as an extra when it was not expected". C's remuneration originally included a base salary and a variable amount which was dependent upon the sale of certain products. By the years 2010 and 2011 C's base salary had become non-existent under the formula in his contract of employment with Oldcastle, and the entire amount of his remuneration consisted of the variable amount. That said, however, this variable amount was not something that Oldcastle was free to ignore or to pay C as an extra. It was part of

Oldcastle's contractual obligation to C, and hence could not be considered as a "bonus". Oldcastle's ITC calculations, therefore, were unaffected by it. C's activities, moreover, related entirely to the management of Oldcastle's SRED activities being carried on at its Research Centre, despite the Minister's arguments to the contrary. Also, the Minister admitted at trial that 55% and 40% of C's hours during 2010 and 2011 respectively, were "directly" devoted to Oldcastle's SRED activities. Nor was there any dispute between the parties as to the fact that these activities in which C was involved did constitute SRED. In addition there was no evidence to suggest that any portion of the remuneration paid by Oldcastle to C was for anything other than his acting as the president of its Research Centre. And certainly none of that remuneration related to Oldcastle's sale of products nor to its use of assets such as patents, because these products clearly belonged to it and not to C under the terms of the latter's contract of employment. As a result of the foregoing findings, the Minister was ordered to reassess on the bases that: (a) 55% and 40% of C's remuneration for 2010 and 2011, respectively, constituted deductible SRED expense free of any "specified employee" restriction, and also qualified fully for the related ITCs; (b) Oldcastle was entitled to an amount resulting from its prescribed proxy election made under clause 37(8)(*a*)(ii)(B) of the ITA; and (c) in accordance with a concession made by the Minister during the trial, in computing its deductible SRED expense for 2011, Oldcastle was also entitled to deduct a capital expense of $22,850 which it had initially claimed for 2010.

Oldcastle v. The Queen

2016 DTC 1159

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