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USING LOSSES IN A CORPORATE GROUP: AN OVERVIEW OF LOSS CONSOLIDATION

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Corporate taxation in Canada is not consolidated at the group level. This means that planning is required to address situations where one corporation in a group has losses and another has profits, since the losses will not automatically offset the profits of the other corporation in the group for tax purposes.

There are a number of planning techniques that can be used for this purpose. One basic structure involves an interest-bearing loan from the loss corporation ("LossCo") to the profitable corporation ("ProfitCo"). ProfitCo then uses the loaned funds to purchase preferred shares of LossCo. The income from the interest ProfitCo pays to LossCo can be offset by LossCo's losses. From Profitco's perspective, the interest paid on the loan and inter-corporate dividends on the preferred shares can generate deductions.

As a recent ruling discussed further below demonstrates, loss consolidations can vary in their structure and complexity. Depending on the structure, the relevant considerations may vary somewhat. However, there are factors which are relevant in most loss consolidation scenarios. Key, though non-exhaustive, examples of those considerations include ensuring that:

- the interest on the loan will be deductible under paragraph 20(1)(*c*) of the *Income Tax Act* ("ITA");
- the dividends will be deductible under subsection 112(1) of the ITA and that Part IV tax will not apply; and
- the general anti-avoidance rule ("GAAR") will not apply.

Like other transactions which are intended to have particular tax implications, loss consolidation transactions should represent genuine, legally effective transactions.

There are also specific considerations regarding the relationships between the corporations which can undertake loss consolidations. Remember that the purpose of loss consolidation transactions is to avoid one member of a corporate group paying tax while another member of the corporate group has a loss. As such, the corporations do need to be part of the same corporate group. In particular, the corporations involved should generally be related, affiliated, or both (see paragraph 1.71 of Income Tax Folio S3-F6-C1 — Interest Deductibility).

Once it is clear that the corporations in question are part of a corporate group, the transaction needs to be structured in a way that will meet the requirements of the provisions necessary to achieve the intended results. As noted, interest deductibility is usually an important part of loss consolidation arrangements. It is therefore important that the requirements in paragraph 20(1)(*c*) for the deduction of interest are met. One of those requirements is that the borrowed money is "used for the purpose of earning income from a business or property". In order to meet that requirement, the preferred shares which are usually part of loss consolidations would have a dividend entitlement which serves as a source of income. However, that is not the only consideration to keep in mind in loss consolidations. It is the CRA's view that the dividend yield should be greater than the interest due on the loan (paragraph 1.73 of Income Tax Folio S3-F6-C1 — Interest Deductibility). In that case, the income is greater than the amount spent to generate it which is consistent with an income-generating purpose. The other requirement, that the amount be paid or payable in the year pursuant to a legal obligation to pay interest, must also be met.

The requirements for the relevant provisions with respect to dividends must be met as well. For instance, in order for the dividends to be deductible, the requirements of subsection 112(1) must be met. Most often, that will mean ensuring that the corporation paying the dividend (usually LossCo) is a taxable Canadian corporation. Corporate groups contemplating a loss consolidation will often want to take steps to prevent the application of Part IV tax on the dividends as well. Doing so will remove the need to monitor and ensure refundable tax is indeed refunded. Preventing the application of Part IV will typically mean ensuring that the corporation paying, and the corporation receiving, the dividends are connected due to either control or meeting the 10% votes and value test.

The considerations mentioned above are common factors that will be relevant in most loss consolidations. Other examples of provisions which may need to be considered include subsection 55(2) and section 69. Depending on the particular transaction undertaken, other provisions of the ITA may be relevant as well; this list is not exhaustive.

A recently released CRA ruling, 2020-0847681R3, provides an example of a more complex loss consolidation arrangement where other provisions of the ITA were also relevant. At a high level, the proposed transactions addressed in the ruling involved multiple loss and profit corporations, as well as a limited partnership with the profit-generating corporations as limited partners. The loans from the corporations with losses were made to the limited partnership, rather than the profitable corporations directly. The limited partnership then subscribed for preferred shares of new corporations established for the purpose. The new corporations then used the subscription funds to loan money to the original loss corporations. This enabled the loss corporations to use the new loans to pay off the original third-party funding they used to make the loans to the limited partnership. The loss corporations also committed to funding the new corporations such that they could meet their dividend obligations. The limited partnership could then use the dividends to pay interest to the loss corporations. Other provisions that became relevant in this scenario included subsections 103(1) and (1.1), which address agreements to allocate income among partners.

As the example from the ruling shows, loss consolidation arrangements may be useful where a corporation or corporations in a corporate group has a loss, and another has profits. There are different structures ranging from the simple to the relatively complex, and the optimal structure will depend on the specific circumstances. Interest deductibility and dividends will generally be factors. However, this article is a high-level overview of loss consolidation. It is not an exhaustive list of the issues which should be considered.

COVID-19 UPDATE

Given the rapidly changing information related to COVID-19 we are providing continuously updated information at blog.intelliconnect.ca/.

Provincial

British Columbia

Arts Impact Grant

Arts and culture groups throughout BC can now apply for the Arts Impact Grant, for which the province provided $3.5 million and is available through the BC Arts Council. It provides greater flexibility for organizations as they prioritize how to use the funding. All non-profit organizations with an arts and culture mandate, and Indigenous governments and community organizations offering dedicated arts and culture programming, are eligible to apply. The application deadline is January 20, 2022. Through intake of the Arts Impact Grant, eligible arts and cultural organizations can receive as much as $30,000. BC Arts Council funding applications are adjudicated through peer assessment. Applications will be assessed based on the effect and outcomes of the proposed activities. For additional information, see www.bcartscouncil.ca.

Support for Agri-Food Sector

The Government of Canada is providing up to $4,150,000 in funding for the Government of British Columbia's Ministry of Agriculture, Food and Fisheries for an employer-based farm worker isolation program and to support an emergency response to an outbreak in the agri-food sector. The funding can support up to an estimated 1,350 agricultural workers living and working across British Columbia to safely isolate and will be used on an as needed basis. This program provides funding to agriculture employers who have farm workers residing on-farm who required self-isolation for COVID-19 reasons and did not have an appropriate space on the farm to do so. Eligible employers may apply for reimbursement for expenses incurred from April 1, 2021, onwards for safely isolating worker(s) at a hotel/motel and providing daily needs.

Manitoba

Support for Bus and Air Charter Transportation Companies

The Manitoba government is launching a new, $1.92 million program to support bus and air charter transportation companies that have been affected by the COVID-19 pandemic and public health restrictions. Each charter/tour bus and charter air-service operator will be able to apply for funding to address costs related to maintaining, restarting, or ramping up operations that temporarily ceased or were significantly reduced because of COVID-19-related travel restrictions. Only costs not covered by other relief programs can be claimed under this program. Charter bus operators provide urban and rural services, as well as school and employee transportation under contract. Air charter operators serve remote communities, tourism, and business travel. Applications will be accepted starting in late December, 2021.

FOCUS ON CURRENT CASES

This is a regular monthly feature examining recent cases of special interest, coordinated by Tony Schweitzer of Dentons Canada LLP. The contributors to this feature are from Dentons Canada LLP, Montreal, Toronto, Calgary, and Vancouver.

The Queen v. Alta Energy Luxembourg S.A.R.L., 2021 DTC 5125 (Supreme Court of Canada) — The SCC rules on tax treaty shopping

On November 26, 2021, the Supreme Court of Canada ("SCC") released its long-anticipated decision in *The Queen v. Alta Energy Luxembourg S.A.R.L.* ("*Alta Energy*"). The majority of the Court dismissed the Crown's appeal and confirmed that, where Canada has agreed in a double-tax treaty to cede taxing rights to another country, it cannot use the general anti-avoidance rule ("GAAR")[1] to renege on its agreement. In other words, a deal is a deal.

Background

The case involved the 2013 sale (the "Sale") by Alta Energy Luxembourg S.A.R.L. ("Alta Lux") of shares (the "Shares") of Alta Energy Partners Canada Ltd. ("Alta Canada") to Chevron. Alta Canada was a corporation resident in Canada that operated a business of acquiring and developing oil and natural gas properties in Alberta. Alta Lux had been created and acquired the Shares solely for the purpose of entering into the Sale and claiming a treaty exemption on the resulting gain. On the Sale, Alta Lux realized a gain in excess of $380 million. There was no question that the Shares constituted "taxable Canadian property"; absent an exemption under an applicable tax treaty, Alta Lux would have been subject to tax under the ITA on the taxable portion of its gain.[2]

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[1] *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supplement), as amended (the "ITA"), subsection 245(2).

[2] Pursuant to subsections 2(3) and 115(1) of the ITA.

The Treaty

Articles 13(4) and 13(5) of the *Canada — Luxembourg 1999 Income and Capital Tax Convention*[3] (the "Treaty") exempt from Canadian taxation gains realized on the disposition of shares the value of which is derived principally from immovable property situated in Canada and in which the business of the company was carried on (the "Business Property Exemption"). The sole question before the SCC was whether, taking GAAR into account, Alta Lux's gain was sheltered by the Business Property Exemption, given the company's lack of economic substance in Luxembourg.[4]

The CRA's Concern

While the Canada Revenue Agency (the "CRA") conceded that Alta Lux was a "resident" of Luxembourg taking into account only the literal wording of Article 4(1) of the Treaty, it argued that Alta Lux was not a "real" resident of Luxembourg and that, therefore, it was not entitled to the Business Property Exemption. In making that argument, the CRA attempted to invoke GAAR to override Articles 13(4) and 13(5). The CRA's concern arose from two facts:

(i) one year prior to the sale, Alta Energy Partners, LLC ("Alta LLC") transferred the Shares to Alta Lux; and

(ii) Alta Lux did not have a substantial economic connection to Luxembourg (no large office, no employees, no active bank account, etc.).

Alta LLC's transfer of the Shares to Alta Lux did not qualify for a treaty exemption and so was a taxable transaction for purposes of the ITA. However, because it was at a much lower price than the proceeds received a year later by Alta Lux on the Sale, a large portion of the overall gain realized from the time Alta Canada was created would be exempt from Canadian tax.

GAAR

In undertaking any GAAR analysis, there is a three-part test:[5]

(i) whether there was a "tax benefit"[6] arising from a transaction,

(ii) whether the transaction constituted an "avoidance transaction",[7] and

(iii) whether the avoidance transaction was abusive.

Before the SCC, Alta Lux conceded that Alta LLC's transfer of the Shares to Alta Lux not only created a tax benefit for Alta Lux but was carried out primarily to confer that benefit, hence making it an "avoidance transaction". Therefore, the sole issue before the SCC was whether the transfer constituted abusive tax avoidance.

The CRA argued that, as Alta Lux was merely a holding company with no employees, it was abusing both the Treaty's residency rules and the Business Property Exemption. Accordingly, the CRA's position was that Canada was not required to let Luxembourg have sole taxing rights in respect of Alta Lux's gain on the sale of the Shares.

The Majority's Decision

In a 6–3 decision, the majority of the SCC did not accept the CRA's argument. Citing interpretive principles set out in the *Vienna Convention on the Law of Treaties*,[8] the majority confirmed that parties to a treaty must keep their sides of the bargain and perform their obligations in good faith (or as the old Latin expression goes, *pacta sunt servanda*: "every treaty in force is binding upon the parties to it and must be performed by them in good faith"). In the majority's view, Canada entered into a binding agreement with Luxembourg knowing that the Grand Duchy did not tax capital gains, yet did not insist on language that would have resulted in the gain from the sale of the Shares being taxable in Canada.

In undertaking the abuse analysis, the majority referred to some guiding principles. It distinguished between what is "immoral" on the one hand and "abusive" on the other and confirmed its previous ruling in *Canada Trustco* that courts

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[3] *Convention between the Government of Canada and the Government of the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital*.

[4] In the lower courts, the CRA also argued that the nature of the business carried on by Alta Canada did not meet the technical requirements for the Business Property Exemption to apply. The CRA did not raise this argument before the SCC.

[5] See *Canada Trustco Mortgage Co. v. Canada*, 2005 DTC 5523 (SCC) ("*Canada Trustco*") and *Copthorne Holdings Ltd. v. Canada*, 2012 DTC 5007 (SCC).

[6] Within the meaning of subsection 245(1) of the ITA.

[7] Within the meaning of subsection 245(3) of the ITA.

[8] *Vienna Convention on the Law of Treaties*, Can. T.S. 1980 No. 37, arts. 26, 31.

should not infuse the abuse analysis with "a value judgment of what is right or wrong nor with theories about what tax law ought to be or ought to do". Furthermore, the majority reiterated that the abuse analysis is not meant to be a "search for an overriding policy of the [ITA] that is not based on a unified, textual, contextual and purposive interpretation of the specific provisions in issue" but rather the interpretation of the object, spirit, and purpose of the specific provisions of the ITA or of a particular tax treaty. The majority noted that GAAR cannot be used to replace or change clear wording in a tax or treaty provision based merely on the underlying purpose of that wording.

The majority then embarked on an analysis of the object, spirit, and purpose of the residency requirements in Articles 1 and 4(1) of the Treaty. It concluded that the underlying rationale of Article 4(1) is to allow all persons who are residents under the laws of one or both of the contracting states to claim benefits under the Treaty, so long as their residency status could expose them to full tax liability (regardless of whether there is actual taxation). The majority noted that there is no reference to "sufficient substantive economic connection" in Articles 1 and 4 and that "the inclusion of an unexpressed condition must be approached with circumspection".

Next, the majority analyzed the object, spirit, and purpose of the Business Property Exemption and concluded that it was intended to foster international investment in business assets embodied in immovable property, such as hotels and mines. By agreeing to the Business Property Exemption, Canada sought to increase employment and economic investment in Canada by providing an incentive to foreign investors. Had the drafters wished to put limits on this objective, there were safeguards that could have been included in the Treaty. For example, Canada could have insisted that the Business Property Exemption be applicable only if the relevant gain were taxable in Luxembourg (or only if the treaty resident had carried on the business for a minimum period of time, etc.).

Ultimately, the majority concluded that the provisions of the Treaty operated in the way the contracting states intended them to operate and, thus, the transfer of the Shares to Alta Lux and the subsequent Sale did not abuse those provisions.

Crucially, the majority held that, in a treaty context, the intentions of *both* countries must be taken into account in any GAAR analysis. Luxembourg had negotiated for the Business Property Exemption to benefit its residents. Using GAAR to override that exemption would be to displace unilaterally Luxembourg's agreement and intentions.

The Dissenting Opinion

In contrast to the majority, the three dissenting justices focused on the fact that many countries had seen their tax base erode as a result of multinational corporations profiting from gaps and mismatches in international tax rules. Consequently, they viewed Alta Lux's tax benefit under the Treaty as being the result of abusive avoidance transactions that frustrated the rationale underlying the Treaty's relevant provisions. They did not believe that either the Tax Court of Canada or the Federal Court of Appeal (or the majority of the SCC) identified properly those provisions' rationale.

Furthermore, they held that Parliament's intention in enacting GAAR was to allow the courts the unusual duty to look beyond the words of a given provision and ascertain why it was adopted. Without such power, GAAR would be meaningless.

In the dissent's view, the object, spirit, and purpose of Articles 1, 4, and 13 of the Treaty were akin to the theory of economic allegiance. This theory assigns allocation of taxation powers to the state that has the closest taxation connection to the relevant income.

The dissent agreed that Article 13(4) allocates solely to Luxembourg the right to tax its residents' indirect gains from immovable property situated in Canada that is used in a business, but noted that Alta Lux had no or few genuine economic connections with Luxembourg. The dissent held that this resulted in a breach of that Article's rationale. The dissent concluded that, where taxing rights in a tax treaty are allocated on the basis of economic allegiance and conduit entities claim tax benefits despite the absence of any genuine economic connection with the state of residence, treaty shopping is abusive.

Impact of Decision Going Forward

The majority's holding that GAAR cannot be used to replace the words of a provision is critical to our understanding of GAAR. For example, in a recent decision the Federal Court of Appeal applied GAAR to read the word "control" in subsection 111(5) as meaning "actual control".[9] The taxpayer in that case has applied for leave to appeal. The decision in *Alta Energy* should give it a much stronger basis for its leave application.

On the other hand, the transactions at issue before the SCC predated the coming into force in Canada of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the "MLI") and the principal purpose test contained therein. Accordingly, a future court may have to determine the impact of the MLI on any later transaction.

— *Mark Jadd, Marc Lesage, and Joel Nitikman, Q.C.*

Lauria v. The Queen, 2021 DTC 1059 (Tax Court of Canada) — Misrepresenting the fair market value of shares subject to an impending liquidity event

Background

Mr. Freedman and Ms. Lauria (collectively, the "Taxpayers") were both officers and directors of wealth management company Gluskin Sheff+Associates Inc. ("GS+A"). In 2001, the Taxpayers entered into option agreements with GS+A, whereby each of them had the opportunity to purchase common shares in the capital stock of GS+A at a price determined by a particular valuation formula. The common shares were subject to multiple restrictions and did not carry voting rights, and the valuation formula took this into account by applying a significant marketability discount. Between 2001 and 2004, Mr. Freedman purchased 100,000 common shares and Ms. Lauria purchased 25,000 common shares pursuant to the option agreements.

In February of 2006, the Taxpayers became aware that GS+A intended to pursue a public offering ("IPO"). Shortly thereafter, in March of 2006, the Taxpayers consulted with an estate planning lawyer and arranged for the formation of family trusts for each of them. Mr. Freedman then transferred 3,000 common shares to his family trust and Ms. Lauria transferred 1,000 common shares to her family trust, both at a price of $25.78 per share (which was recorded as the fair market value of the common shares in each of the share purchase agreements). This price was consistent with the same valuation formula the Taxpayers used to purchase the common shares, and the Taxpayers reported the resulting capital gains on their respective personal tax returns.

In April of 2006, GS+A filed a preliminary Prospectus, and in contemplation of the IPO, GS+A filed articles of amendment in May of 2006 that converted each common share held by the family trusts and the Taxpayers into 28.8 "Subordinate Voting Shares", a class of shares in the capital stock of GS+A that were required to be sold pursuant to the IPO. The following day, the IPO was completed and the family trusts and the Taxpayers sold their Subordinate Voting Shares at a price of $18.50 per share (the equivalent of $532.80 per common share).

In 2017 (beyond the normal reassessment period), the CRA reassessed the Taxpayers, substantially increasing the amount of the taxable capital gains reported as a result of their respective dispositions of the common shares to the family trusts in 2006. The reassessment was on the basis that the common shares had significantly higher value than the $25.78 reported. The CRA supported this reassessment with a comparative valuation analysis, comparing GS+A against similar public companies. A second valuation report was then prepared by an expert witness who testified at the trial, relying on an income approach to valuing GS+A with a 40% marketability discount (in respect of uncertainty that the IPO may not be completed), ultimately valuing the common shares at $307.20 per share.

Issues and Decision

The CRA conceded to the expert witness' valuation at trial. The Tax Court of Canada was also fairly complimentary of the expert valuation report (particularly in comparison to the valuation formula used by the Taxpayers). The Court found that although the valuation formula may have been an appropriate measure of the fair market value of the common shares in isolation, the parties were required to consider the impending liquidity event (the IPO) in determining the fair market value of the common shares in 2006 when they were sold to the family trusts. Ultimately adopting the valuation prepared by the expert witness, the Court concluded that the common shares were sold to a

[9] *The Queen v. Deans Knight Income Corporation*, 2021 DTC 5095 (FCA). For comment, see Mark Jadd and Joel Nitikman, Q.C., "The GAAR Analysis in *Deans Knight*: Apparently a Cigar is not Always just a Cigar" (2021), Tax Litigation (Federated Press), Volume XXIV, No. 2.

non-arm's length party (the family trusts) by the Taxpayers at less than fair market value, and that subparagraph 69(1)(*b*)(i) of the *Income Tax Act* (the "ITA") deemed the Taxpayers to have received proceeds equal to fair market value ($307.20 per share).

The second issue before the Court was whether a misrepresentation attributable to carelessness or neglect was made by the Taxpayers with respect to the reported proceeds of disposition of the common shares they disposed of in 2006, such that subsection 152(4) of the ITA would apply to allow the CRA to reassess the Taxpayers beyond the normal reassessment period. To that end, the Court found that the Taxpayers knew that the impending IPO would impact the value of their common shares, and that they could not ignore this impact for the purposes of their personal tax returns, especially when they had engaged in estate planning for that same purpose. The Taxpayers also did not seek to obtain any independent valuation of the common shares outside of the valuation formula. As a result of the forgoing, the Court found that the Taxpayers were negligent and careless in making the misrepresentation of the fair market value of the common shares and allowed the reassessment of the under-reported taxable capital gains.

— *Keaton Buchburger*

Wang v. The Queen, 2021 DTC 1062 (Tax Court of Canada) — Purchase and sale of townhouse not in the course of business nor an undertaking in the nature of trade

When examining if sufficient indicia of a business or an adventure or concern in the nature of trade are present, legal ownership and equitable ownership are considered equal. Further, a change of circumstances may act as a determinative factor in finding that an adventure or concern in the nature of trade is absent.

Background

To constitute a "builder" under subsection 123(1) of the *Excise Tax Act* (the "ETA"), sufficient indicia of a business or an adventure or concern in the nature of trade must be present. The decision in *Wang v. The Queen* reaffirms the factors considered in *Happy Valley Farms Ltd. v. Minister of National Revenue*, 86 DTC 6421 (FCTD) ("*Happy Valley Farms*"), when determining whether property has been acquired and then sold in the course of business or an undertaking in the nature of trade. In doing so courts will consider:

(i) the nature of property sold,

(ii) the length of period of ownership,

(iii) the frequency or number of similar transactions,

(iv) work expended on or in connection with the property,

(v) the circumstance giving rise to the sale, and

(vi) motive.

In the decision, the Appellant, Ms. Wang, purchased a townhouse on November 13, 2007, located in Markham, Ontario (the "Property") and took possession of the Property on May 19, 2011, with registered title being conveyed on December 22, 2011.

In December 2010, Ms. Wang began a relationship with her current husband, an American citizen, and shortly thereafter, in early 2012, when the relationship grew and became permanent, Ms. Wang listed the Property for sale. Subsequently, the Property sold in June 2012 and Ms. Wang permanently moved to the United States.

The Minister of National Revenue (the "Minister") assessed HST on the sale of the Property, deeming Ms. Wang to be a "builder" under subsection 123(1) of the ETA on account that she acquired and then sold the Property in the course of business or an undertaking in the nature of trade.

The Minister focused on the *Happy Valley Farms* factors and submitted that:

(1) The Property was owned for less than a year as legal title wasn't received until December 2011 and the Property was sold in June 2012;

(2) The nature of the Property was a single-unit condominium which is easily sold for profit in business or trade;

(3) No improvements were made to the Property;

(4) Ms. Wang lived in the Property for a short duration; and

(5) Ms. Wang's motive at the outset was to acquire the Property and sell it for a profit.

Issues and Tax Court Decision

The primary issue on appeal was whether Ms. Wang was a "builder" in accordance with subsection 123(1) of the ETA as she acquired and then sold the Property in the course of business or an undertaking in the nature of trade.

The Court applied the *Happy Valley Farms* factors and allowed the appeal, holding that the acquisition and sale of the Property was not in the course of business nor an undertaking in the nature of trade.

Justice Bocock agreed with the Appellant that as Ms. Wang held equitable title in the spring of 2007, although legal title was not received until December 2011, the argument that Ms. Wang owned the Property for only a short period of time was nullified. Given the transitory nature of urban living, the five years that Ms. Wang owned the Property was not an inconsiderable or short time.

The Minister failed to establish that Ms. Wang engaged in a number of similar transactions, and as the Property was a condominium unit it may be both a long-term investment and/or residence or a short-term asset in inventory. Furthermore, although no work was performed on the Property, as it was a new condominium, this was not a determinative factor.

In relation to the motive of Ms. Wang, there was no evidence of a plausible and rational plan to sell the Property for profit. There was little evidence, if any, that Ms. Wang's intention when purchasing the Property was to carry on a business or venture; rather, life-changing events arose after Ms. Wang's purchase of the Property. Moreover, there was no evidence to suggest that this sequence of events was anticipated or fell within the usual alternative business plans manifested in a practical "Plan B". No apparent business plan, commercial approach, or organized effort to sell the Property in a business-like fashion was present.

Lastly, *in obiter*, the Court commented that Ms. Wang may have had an exemption from "self-supply" under subsection 191(5) of the ETA. However as the argument was not advanced, and the appeal was allowed, this issue was not further elaborated.

Conclusion

In summary, the Tax Court found that, on a balance of probabilities, Ms. Wang conducted herself during the acquisition of the Property in a manner that indicated that it was an investment and/or residence of an owner-occupier pursuant to the *Happy Valley Farms* factors. Ms. Wang held the Property for five years, had a credible and logical reason for acquiring the property to live in, and there was no apparent business plan nor commercial approach to the acquisition of the Property.

Ultimately, the fact that Ms. Wang had a change in circumstances through marrying a US citizen was allocated determinative weight that Ms. Wang did not acquire the Property in the course of business nor an undertaking in the nature of trade.

— *Adam Kotlowitz*

***Dias v. The Queen*, 2021 DTC 1061 (Tax Court of Canada) — Insufficient evidence to support ABIL claim**

This case dealt with the denial of a claim for an allowable business investment loss ("ABIL") of $846,480, for loans issued by taxpayers to a corporation that was not a small business corporation and then further loaned to a corporation that was a small business corporation.

Background

The taxpayers were Mr. and Mrs. Dias. Mrs. Dias wanted to start a retail fashion and furniture business with her brother, Mr. Anselm. They consulted an accountant who advised them to incorporate two companies for the business: Dandy Holdings Inc. ("Dandy") and Indiva Retail Inc. ("Indiva"). Ms. Dias owned 45% of each corporation and Mr. Anselm owned the remaining 55% of each corporation.

Mr. and Mrs. Dias were also 50/50 shareholders of a corporation named 201475 Ontario Inc. ("201"), which was not a small business corporation.

Both Dandy and Indiva required financing, so between November 2006 and October 2007, the taxpayers made a series of large deposits into the bank account of 201. 201 then transferred these funds to Dandy. By July 31, 2007, $825,000 had moved from the taxpayers through 201 to Dandy.

In their tax returns for the 2014 tax year, the taxpayers claimed an allowable business investment loss in respect of their loans to 201. In their 2015 tax returns, they claimed non-capital loss carryforwards relating to the unused portion of those allowable business investment losses. These claims were denied by the Minister of National Revenue (the "Minister").

Issues and Decision

The issue before the Tax Court of Canada was whether the taxpayers were eligible to claim ABILs in respect of the loans for the 2014 tax year and non-capital loss carryforwards for the 2015 tax year.

The Respondent argued that the taxpayers were not eligible to claim ABILs since the taxpayers issued the loans to 201 and 201 was not a small business corporation.

The taxpayers agreed that 201 was not a small business corporation. However, they argued that 201 was merely a conduit for their money and the loans were actually made to Dandy and/or Indiva. They argued that since Dandy and Indiva were both small business corporations, their claims for ABILs and loss carryforwards should be allowed.

Justice Graham of the Tax Court found that the taxpayers were not eligible to claim ABILs and denied the loss carryforwards. He found that the taxpayers lent money to 201 and 201 then lent similar amounts of money to Dandy. This finding was based on the documentary evidence and the testimony of Mr. Dias.

On 201's Schedule 100, which was filed with its T2 return for the taxation year ending July 31, 2007, 201 reported that it had loans receivable of $790,080 and outstanding shareholder loans of $781,338. Justice Graham found that this demonstrated that the accountant who had designed the structure for the new business and prepared the tax returns took the position that the taxpayers had lent the money to 201 and that 201, in turn, lent the money to Dandy. Justice Graham also found that this indicated that Mr. Dias agreed with this position as he signed the return. Since the loans receivable and the shareholder loans were less than the $825,000, Justice Graham found that this indicated that some repayments had been made, which was contrary to Mr. Dias' testimony. Also, the fact that the loans receivable and shareholder loans payable were not equal to one another indicated that different adjustments were made to those balances, which was inconsistent with the idea of a conduit.

On 201's Schedule 100, which was filed with its T2 return for the taxation year ending July 31, 2014, 201 reported that it had liabilities of $830,514 and assets of $846,380. Justice Graham questioned why the amount of the assets did not amount to $850,000, which was the amount that was shown to have been advanced in bank statements.

Justice Graham also noted that the taxpayers claimed business investment losses totaling $846,480 in respect of loans the taxpayers made to 201, not Dandy or Indiva. It was only once their claims for ABILs were denied that they raised the idea that they actually lent money to Dandy and Indiva. Justice Graham noted that all of the documentary evidence indicated that the money flowed from 201 to Dandy, not Dandy and Indiva. He questioned why the money flowed through 201 and then to Dandy. He found that this was likely because the taxpayers loaned money to 201 and 201 then lent the money to Dandy for the purpose of earning investment income.

Justice Graham also questioned why the taxpayers claimed an ABIL of $846,480 when they claimed to have lent $850,000.

Mr. Dias testified that Mr. Anselm was the one who was responsible for the finances of the business and he dealt with the accountant. Justice Graham drew an adverse inference from the fact that the taxpayers did not call Mr. Anselm as a witness, even though he owned 55% of Dandy and Indiva and he would have been in a better position to answer many of the financial questions. Furthermore, he would have had a say in whether Dandy and Indiva borrowed money from 201 as a majority shareholder.

Justice Graham distinguished the taxpayers' case from Chief Justice Bowman's decision in *Borys v. The Queen*,[1] where the Court allowed a claim for an ABIL for an amount that the taxpayer had loaned to a company. In that case, the funds flowed from the taxpayer to a shareholder, then from the shareholder to the company. Justice Bowman found that the shareholder was a mere conduit as the documentary evidence matched the taxpayer's intention throughout that the funds would be lent to the company. The company had signed a promissory note reflecting the fact that it had borrowed funds from the taxpayer, and not from the shareholder. Meanwhile, Mr. and Mrs. Dias only recently asserted that they intended for the loans to be to Dandy and Indiva, and not to 201.

Conclusion

This case demonstrates the importance of taxpayers properly documenting their intentions when they enter into transactions. If the taxpayers had properly documented their intention to loan funds to Dandy and Indiva, and not to 201, then there may have been a different outcome to the case, as there had been in the *Borys* decision noted above. It is also a reminder that loans to corporations that are not small business corporations are not eligible for an ABIL.

— *Gergely Hegedus*

CURRENT ITEMS OF INTEREST

Progress of Legislation

The Standing Committee on Finance completed its review of Bill C-2, *An Act to provide further support in response to COVID-19*, on December 14, 2021. Two amendments to the bill will effectively restrict access to the CEWS where the entity is publicly traded and pays a taxable dividend. On December 16, 2021, the bill received Third Reading in the House and quickly passed through the Senate. It received Royal Assent on December 17, 2021.

Bill C-8, *Economic and Fiscal Update Implementation Act, 2021*, received First Reading in the House of Commons on December 15, 2021. This bill includes the following tax measures from the Economic and Fiscal Update:

- enhancing the Northern Residents Deduction;
- enhancing the Eligible Educator School Supply Tax Credit;
- introducing the new Small Businesses Air Quality Improvement Tax Credit;
- introducing the new Farmers Fuel Charge Refundable Tax Credit; and
- introducing the new Underused Housing Tax.

Taxpayer Relief Deadline Approaching

The CRA is reminding taxpayers and registrants that they have until December 31, 2021, to request relief of interest and penalties related to the 2011 taxation year or reporting period. The deadline applies to relief requests for:

- the 2011 tax year,
- any reporting period that ended during the 2011 calendar year, and
- any interest and penalties that accrued during the 2011 calendar year for any tax year or reporting period.

If a taxpayer is involved in a tax process (e.g., audit, objection, or appeal) with the CRA for the 2011 tax year or a reporting period that ended in 2011, they should make a relief request by the deadline.

[1] 2005 DTC 1069 (TCC).

Federal Economic and Fiscal Update

The Honourable Chrystia Freeland, Deputy Prime Minister and Minister of Finance, presented the Economic and Fiscal Update 2021 (the "Update") on December 14, 2021. Two Notice of Ways and Means Motions were also tabled, one of which became Bill C-8.

The Update reports a deficit of $327.7 billion for the last fiscal year and $144.5 billion for this fiscal year, down from Budget 2021's forecasts of $354.2 billion and $154.7 billion, respectively. The Update included announcements of several new tax measures which are briefly summarized below.

Income Tax Measures

Extending the Home Office Deduction

In 2020, the government introduced a temporary flat rate method to calculate a deduction for home office expenses for Canadians who were required to work from home during the pandemic. The government announced that they will extend the simplified rules for deducting home office expenses and increase the temporary flat rate to $500 annually for the 2021 and 2022 tax years.

Expanding the Eligible Educator School Supply Tax Credit

Under current rules, teachers and early childhood educators may claim a 15% refundable tax credit based on an amount of up to $1,000 in expenditures made in a taxation year for eligible supplies. The Update proposes to increase the rate of the refundable tax credit to 25%.

Additionally, this measure would clarify and broaden the rules regarding the locations where teaching supplies are permitted to be used by removing the requirement that teaching supplies must be used in a school or regulated child care facility to be eligible. This measure also expands the list of eligible durable goods to include certain electronic devices.

The following items would be added to the list of prescribed durable goods:

- calculators (including graphing calculators);
- external data storage devices;
- web cams, microphones, and headphones;
- wireless pointer devices;
- electronic educational toys;
- digital timers;
- speakers;
- video streaming devices;
- multimedia projectors;
- printers; and
- laptop, desktop, and tablet computers, provided that none of these items are made available to the eligible educator by their employer for use outside of the classroom.

These measures apply to the 2021 and subsequent taxation years. Proposed legislation that would implement these changes is included in Bill C-8.

New Small Businesses Air Quality Improvement Tax Credit

The federal government is proposing a new temporary refundable Small Businesses Air Quality Improvement Tax Credit. Proposed legislation that would implement this credit is included in a Notice of Ways and Means Motion released on December 14, 2021. To access the credit, a taxpayer must be an eligible entity and incur qualifying expenditures attributable to air quality improvements in qualifying locations. The costs must be incurred between September 1, 2021, and December 31, 2022.

Eligible Entity

An eligible entity includes an individual (other than a trust), a partnership, or a qualifying corporation. A qualifying corporation means a Canadian-controlled private corporation ("CCPC") with taxable capital employed in Canada of less than $15 million in the prior tax year.

Qualifying Expenditures

Qualifying expenditures would be prescribed by regulation. They would include outlays and expenses that are directly attributable to the purchase, installation, conversion, or upgrade of a new or retrofitted HVAC system placed in service at a qualifying location. They would also include outlays and expenses that are directly attributable to the purchase of a device that is placed in service at a qualifying location and designed to filter air using a HEPA filter. The expenses are prescribed only to the extent that they are reasonable and intended primarily to increase outdoor air intake or to improve air cleaning.

However, qualifying expenditures do not include an expense:

- made or incurred under the terms of an agreement entered into before September 1, 2021;
- related to recurring or routine repair and maintenance;
- for financing costs in respect of a qualifying expenditure;
- that is paid to a party with which the eligible entity does not deal at arm's length;
- that is salary or wages paid to an employee of the eligible entity; or
- that can reasonably be expected to be paid or returned to the eligible entity, or to a person or partnership either not dealing at arm's length with the eligible entity or at the direction of the eligible entity.

Qualifying Location

A qualifying location is real or immovable property in Canada used by the eligible entity primarily in the course of its ordinary commercial activities, which includes rental activities. However, it excludes a "self-contained domestic establishment" (i.e., a personal residence).

Calculating the Tax Credit

The refundable credit is equal to 25% of the qualifying expenditures. Total qualifying expenditures will be limited to $10,000 per qualifying location and $50,000 across all locations — these limits are shared among affiliated businesses.

Qualifying expenditures incurred before January 1, 2022, would be claimed by an eligible entity for its first taxation year that ends on or after January 1, 2022. Qualifying expenditures incurred on or after January 1, 2022, would be claimed by an eligible entity for the taxation year in which the expenditure was incurred.

Government Assistance

The amount of a claimable qualifying expenditure is reduced by the amount of any government assistance received in respect of that expense.

Also, the amount of the tax credit would be included in the taxable income of the business in the year the credit is claimed.

New Farmers Fuel Charge Refundable Tax Credit

Under the federal carbon pollution pricing system, the government applies a price on pollution in jurisdictions that do not have their own system. All direct fuel charge proceeds are returned to the province or territory of origin. In non-participating ("backstop") jurisdictions, 90% of direct proceeds are returned to residents of those provinces through Climate Action Incentive payments (the other 10% is used to support small businesses, Indigenous groups, and other organizations).

Recognizing that many farmers use natural gas and propane in their operations, the government proposes to return fuel charge proceeds directly to farming businesses in backstop jurisdictions via a refundable tax credit starting for the 2021–2022 fuel charge year. This would be available to corporations, individuals, and trusts that are actively engaged in either the management or day-to-day activities of earning income from farming and incur total farming expenses of

$25,000 or more, all or a portion of which is attributable to backstop jurisdictions. This would include where they carry on business through a partnership.

The credit amount would be equal to the eligible farming expenses attributable to backstop jurisdictions in the calendar year when the fuel charge year starts, multiplied by a payment rate specified by the Minister of Finance for the fuel charge year. The Minister has specified payment rates for eligible farming expenses of $1.47 per $1,000 in eligible farming expenses for 2021, and $1.73 per $1,000 in eligible farming expenses for 2022. Businesses can claim these refundable tax credits through their tax returns that include the 2021 and 2022 calendar years.

Where an eligible farming business is carried on through a partnership, the credit would be claimed by a corporation, individual, or trust that is a partner in the partnership at the end of the partnership's fiscal period. The partnership would calculate the total amount of eligible farming expenses and each partner would then calculate their credit entitlement based on their proportionate interest in the partnership. Special rules would apply to calculate a partner's credit entitlement where a partnership interest is held indirectly through one or more partnerships.

Eligible farming expenses are amounts deducted in computing income from farming for tax purposes, excluding any deductions arising from mandatory and optional inventory adjustments and transactions with non-arm's length parties. Where taxation years do not align with the calendar year, eligible farming expenses would be allocated to each calendar year based on the number of days in each calendar year over the total days in the taxation year, and then subjected to the applicable payment rate for the calendar year. Expenses must also be attributable to one or more backstop jurisdictions. For businesses operating in multiple jurisdictions, eligible farming expenses would be apportioned by jurisdiction

Northern Residents Deduction

Bill C-8 proposes to implement changes to the Northern Residents Deduction that were initially proposed by Budget 2021. These amendments expand access to the travel component of the deduction. Accordingly, a taxpayer can claim, in respect of each of the taxpayer and each eligible family member, up to:

- the amount of employer-provided travel benefits the taxpayer received in respect of travel by that individual; or
- a $1,200 standard amount that may be allocated across eligible trips taken by that individual.

A maximum of two trips would be eligible for the deduction for non-medical personal travel; there is no trip limit for medical purposes.

Digital Services Tax

The December 14, 2021, Economic and Fiscal Update notably includes a Notice of Ways and Means Motion ("NWMM") presenting the anticipated draft legislation for the Digital Services Tax ("DST") which may or may not be implemented in January 2024 with retroactive application to January 2022.

The proposed Act (the "Act") would implement the DST announced in the 2020 Fall Economic Statement (the "Statement"), further details of which were presented in Budget 2021. The DST was discussed extensively in the December 2021 edition of the GST/HST Reporter.

The DST was proposed from the outset as an interim measure, to apply until an acceptable multilateral approach comes into effect. In international negotiations, 137 members of the OECD/G20 Inclusive Framework agreed to an October 8, 2021, Statement on a two-pillar plan for international tax reform. The Statement was subsequently endorsed by G20 Leaders and Finance Ministers. Canada is working with international partners to bring the multilateral agreement into effect.

In the interim, to protect the interests of Canadians, the government is moving forward with legislation for the DST. Consistent with the Statement, the DST would not be imposed earlier than January 1, 2024, and only if the treaty implementing the Pillar One tax regime under the multilateral approach has not come into force. In that event, the DST would be payable as of the year that it comes into force in respect of revenues earned as of January 1, 2022. The government hopes that the timely implementation of the new international system will make this unnecessary.

As a reminder, here is a summary of the main features of the DST:

Rate

The DST would apply at a rate of 3% on certain revenue earned by large businesses from certain digital services reliant on the engagement, data, and content contributions of Canadian users, as well as on certain sales or licensing of Canadian user data.

Thresholds

The DST would apply to large businesses, both foreign and domestic, that meet both of two revenue thresholds. If a taxpayer is a member of a consolidated group, these thresholds would be calculated on a group basis.

- Total Revenue Threshold — If a taxpayer or, if applicable, its consolidated group, earns total revenue from all sources of €750,000,000 or more in a fiscal year of the taxpayer or group that ends in a particular calendar year, the taxpayer or group would meet this threshold for the subsequent calendar year. Additionally, if a taxpayer joins a group that meets the €750,000,000 threshold, the taxpayer would meet this threshold as of the date of joining the group.
- Canadian In-Scope Revenue Threshold — A taxpayer would meet this threshold for a calendar year if the taxpayer (or the taxpayer's consolidated group, if applicable) earns more than $20,000,000 of Canadian in-scope revenue in the calendar year.

In-Scope Revenue

Four categories of in-scope revenue are proposed:

(1) Online marketplace services revenue;

(2) Online advertising services revenue;

(3) Social media services revenue; and,

(4) User data revenue.

Sourcing to Canada

The DST would only apply to in-scope revenue associated with users in Canada. Revenue sourcing principles would vary according to the nature of the revenue.

Online marketplace services revenue would be sourced using one of three methods, depending on how the revenue is earned.

(1) **If revenue is earned from facilitating the supply of a service delivered in physical form**, such as the provision of transportation or accommodations, and the service is performed in Canada, the revenue from facilitating that specific transaction would be entirely sourced to Canada.

(2) **If revenue is associated with facilitating a particular transaction between users**, other than a service delivered in physical form, sourcing to Canada would depend on where those users are located. If both users are located in Canada, all the revenue associated with facilitating that transaction would be sourced to Canada. If only one user is located in Canada, 50% of the revenue associated with facilitating that transaction would be sourced to Canada.

(3) **If online marketplace services revenue cannot be traced to a specific transaction**, the revenue would be sourced to Canada based on a formulaic approach that calculates the percentage of the marketplace's transaction participants that are located in Canada.

Online advertising services revenue would be sourced based on one of two methods, depending on how the revenue is earned.

(1) **If revenue can be traced to the display of an advertisement to a specific user**, and that user is located in Canada, the revenue would be entirely sourced to Canada.

(2) **If revenue cannot be traced to specific users**, the revenue would be sourced to Canada based on a formulaic approach that calculates the percentage of users to which the advertisement was displayed that are located in Canada.

Social media services revenue would be sourced using only one method: **a formulaic approach** that calculates the percentage of the platform's users that are located in Canada.

User data revenue would be sourced based on one of two methods.

(1) **If revenue can be traced to the user data of a single user**, and that user is located in Canada, the revenue would be entirely sourced to Canada.

(2) **If revenue relates to a set of data that was collected from multiple users**, revenue would be sourced to Canada based on the percentage of those users that are located in Canada.

User Location

Whether a user is located in Canada or outside Canada would be determined based on a taxpayer's available data with respect to the user. This could include the billing, delivery, or shipping address, or phone number area code, most recently provided by the user, global satellite positioning data, or Internet Protocol address data. If, based on this data, it is reasonable to conclude that the user is located in Canada, that user would be considered to be located in Canada.

The method of determining a user's location is dependent on the kind of revenue for which the determination is made. In most cases, user location is where the user is normally located (i.e., their usual or ordinary location).

$20,000,000 Deduction

The DST would apply to in-scope revenue sourced to Canada only to the extent that it exceeds a $20,000,000 deduction. This deduction would be shared amongst members of a consolidated group based on a formula.

Group Administration

Given the group-level threshold calculations and group-wide sharing of the $20,000,000 deduction, certain administrative rules would be included in the Act to simplify compliance and enforcement.

Members of consolidated groups would be allowed to designate an entity in the group to fulfill their filing obligations, pay the DST liability, and otherwise comply with the administrative requirements of the Act.

The Act would include a joint liability provision whereby each entity in a consolidated group would be jointly and severally liable for DST payable by any other group member.

General Administration

The Act would require registration by certain taxpayers that meet two thresholds. To assist enforcement, the Canadian in-scope revenue threshold for registration would be $10,000,000 rather than $20,000,000 (the threshold for tax liability), although the €750,000,000 total revenue threshold would be the same.

Feedback

Interested parties are invited to provide comments on the proposed Act. Please send your comments to DST-TSN@fin.gc.ca by February 22, 2022.

Other Measures

Help for Guaranteed Income Supplement Recipients and Students Affected by CERB Payments

To compensate low-income individuals who have seen a decline in their Guaranteed Income Supplement ("GIS") or Allowance payments in 2021 as a result of having received Canada Emergency Response Benefits ("CERB") or Canada Recovery Benefits ("CRB") in 2020, the government is proposing to pay a one-time payment to compensate them for their loss of all or a portion of their benefit.

The government is also proposing to provide debt relief to some students who received CERB payments in error and are now required to repay that amount, by allowing their CERB-related debt to be applied to their entitlement under the Canada Emergency Student Benefit ("CESB") for the same benefit period.

New Underused Housing Tax

In Budget 2021, the Government announced its intention to implement a national, annual 1% tax on the value of non-resident, non-Canadian-owned residential real estate in Canada that is considered to be vacant or underused (the "Underused Housing Tax"). A consultation was held, through the Department of Finance, from August 6 to September 17, 2021, and, where appropriate, feedback received from stakeholders has been taken into consideration as part of the final design of the proposed taxation framework. The final legislation is proposed by Bill C-8.

It is proposed that the Underused Housing Tax be effective for the 2022 calendar year. The initial Underused Housing Tax returns, for the 2022 calendar year, would be required to be filed with the Canada Revenue Agency on or before April 30, 2023, and any tax payable would be required to be remitted on or before that date.

The Economic and Fiscal Update underlined that in addition to exemptions described in the consultation paper, it is proposed that an owner's interest in a residential property would be exempt from the Underused Housing Tax for a calendar year if a residence that is part of the residential property is, in respect of the calendar year, the primary place of residence of:

(1) the owner;

(2) the owner's spouse or common-law partner; or

(3) an individual that is the child of the owner or of the owner's spouse or common-law partner, but only if the child is in Canada for the purposes of authorized study and the occupancy relates to that purpose.

Furthermore, the government plans to bring forward an exemption for vacation/recreational properties, which would apply to an owner's interest in a residential property for a calendar year if the property:

(1) is located in an area of Canada that is not an urban area within either a census metropolitan area or a census agglomeration having 30,000 or more residents; and

(2) is personally used by the owner (or the owner's spouse or common-law partner) for at least four weeks in the calendar year.

An owner eligible for either of the above exemptions would claim the exemption in the annual return that they would be required to file with the Canada Revenue Agency in respect of the residential property.

Luxury Tax Update

Budget 2021 proposed to implement a tax on the sale of luxury cars and aircraft over $100,000 and boats over $250,000, if acquired for personal use. The Economic and Fiscal Update provided a brief update on the status of this proposed tax. The Department of Finance is currently integrating feedback results from the recent stakeholder consultation into the proposed framework. Draft legislation, including the effective date, will be released in early 2022.

Update on Investment Tax Credit for Carbon Capture, Utilization, and Storage

Budget 2021 proposed an investment tax credit for capital invested in carbon capture, utilization, and storage ("CCUS") projects. The government has consulted with various stakeholders regarding the design of the incentive. The final design of the proposed credit will be provided in Budget 2022.

Relief for Taxpayers Affected by Flooding

In a recent news release, the CRA affirmed its commitment to provide relief options to taxpayers affected by flooding in British Columbia and Eastern Canada. Recognizing that many individuals, businesses, and first responders may be unable to meet their tax obligations due to the situation, the CRA is putting measures in place to ensure that Canadians facing such extraordinary circumstances will be treated fairly. Also, per existing taxpayer relief measures, the CRA can cancel or waive penalties and interest due to circumstances beyond a taxpayer's control.

Climate Action Incentive To Be Paid Quarterly

The Department of Finance published legislative proposals on December 3, 2021. This legislation would change how the refundable Climate Action Incentive ("CAI") tax credit is paid to taxpayers. To deliver the CAI to Canadians on a more regular basis, it would be issued quarterly, with the first payment occurring as a "double-up" payment in July 2022.

As a result, the CAI will not be claimable when filing a personal tax return for 2021. However, individuals must still file a return to be eligible for the credit. They must also indicate on the return whether they are eligible for the supplement for rural residents.

RECENT CASES

BC Court grants injunction against federal *Disability Tax Credit Promoters Restrictions Act*

In 2014, Parliament enacted the *Disability Tax Credit Promoters Restrictions Act* (the "Act") to restrict the fees charged by disability tax credit ("DTC") promoters who make DTC requests under the *Income Tax Act* on behalf of a claimant. (The Act is to become operative when its accompanying regulations come into force, which was on November 15, 2021.) The applicant sought a pretrial injunction, arguing that in pith and substance, the Act regulates a profession, a matter properly left to provincial law, and that it discriminates against disabled persons.

The application was granted, suspending the operation of the Act and regulations once they come into force. The applicant's affidavit evidence presented a credible picture of the challenges presented to applicants for the DTC. The applicant raised a serious issue concerning the division of powers between the provinces and the federal government. The applicant argued that the Act and regulations regulated the provision of professional services, a matter for the provinces; the respondents argued that the Act is intended to ensure "fair and ethical" treatment of DTC applicants. The applicant's evidence revealed a valid concern about irreparable harm (i.e., its lost and irrecoverable fees). Finally, the public interest concerned, that of aiding DTC applicants, tipped the balance in the applicant's favour.

True North Disability Services v. Canada (MNR)

2021 DTC 5123

Supreme Court approves FAPI exception

The *Income Tax Act* requires Canadian taxpayers to report income earned by their controlled foreign affiliates ("CFAs") if it qualifies as foreign accrual property income ("FAPI"), subject to an exception for financial institutions. Appellant Loblaw Financial Holdings ("Loblaw") established a subsidiary ("Glenhuron") in Barbados; for the taxation years 2000 to 2005, 2008, and 2010, it did not report income from Glenhuron as FAPI. The CRA reassessed the income as FAPI. The Tax Court agreed with the CRA (2018 DTC 1128). Analyzing Glenhuron's receipt of funds indiscriminately, it found that Glenhuron conducted mostly business with non-arm's length parties. Regarding Glenhuron's use of funds, the Tax Court regarded Glenhuron as an investment manager for Loblaw, which exercised close oversight and control. The Federal Court of Appeal disagreed (2020 DTC 5040). It held that Glenhuron dealt basically with arm's length persons and that only its income-earning activities should be considered. Because Loblaw's direction, support, and oversight were not income-earning activities, the FCA referred the reassessments back to CRA.

The FCA ruling was affirmed. There are four requirements for the exception to FAPI; the only one at issue here was that the subsidiary's business must be conducted principally with persons with whom it deals at arm's length. On the one hand, Loblaw's capitalization and oversight of Glenhuron did not amount to doing business with a foreign affiliate. The CRA invoked Barbadian law, which construes a banking business as the generalized receipt and use of funds. The Court rejected this application of Barbadian law, repeating its frequent affirmation that capitalization and the conduct of a business are distinct; thus, Loblaw's funding of Glenhuron was not "doing business." The Court also rejected the

Barbadian concept on the receipt side. There, Glenhuron's activities had to be considered business by business, not in the aggregate. At least 86% of Glenhuron's activities consisted of dealing in short-term debt securities and cross-currency and interest swaps, both arm's length activities. Thus, Loblaw's income from Glenhuron qualified for the FAPI exception.

The Queen v. Loblaw Financial

2021 DTC 5131

Tax Court rejects CIBC's claim of foreign currency exchange losses

In 2006, CIBC subscribed for 1,000 shares of a US subsidiary for US$1 billion ($1.13 billion at the spot exchange rate). In 2007, it redeemed those shares for US$1 billion ($1.0036 billion). It realized a foreign exchange loss of $126,400,000 and reported a capital loss of $63,200,000 for the 2007 taxation year. The parties asked for a Rule 58 hearing on the question whether paragraph 40(3.6)(*a*) of the *Income Tax Act* applied to the transaction, in which case the foreign exchange loss would be marked down to nil.

The Tax Court answered the question in the affirmative. The case hinged on the interplay of subsections 39(1), 39(2), and 40(1) and paragraph 40(3.6)(*a*). The appellant took the position that under the leading case, *BMO v. The Queen* (2020 DTC 5043), subsection 39(2), which concerns recognition of foreign exchange gains and losses, operates to allow the losses as claimed. The respondent took the position that under *BMO*, gain or loss for the purposes of recognition must first be calculated under subsection 40(1), which in turn, in the present circumstances, requires the application of paragraph 40(3.6)(*a*). Thus, the loss would have been set to nil before subsection 39(2) ever applied. After a comprehensive review of the legislative and judicial history, the Court read *BMO* as holding that subsection 40(1) applies to determine gain or loss on a property; subsection 39(2) only deals with the reason for the gain or loss. However, subsection 40(1) applies "[e]xcept as otherwise provided expressly in this Part," which means that paragraph 40(3.6)(*a*) applies, deeming the loss to be nil, and preventing subsection 39(2) from even applying.

CIBC v. The Queen

2021 DTC 1056

Federal Court of Appeal upholds indemnification clause in contract between Scandinavian mining companies

The applicants ("Boliden" and "Kevitsa") were Swedish and Finnish mining companies, respectively. Boliden entered into a share purchase agreement for Kevitsa with the respondents; the respondents' holding company ("FQM") contracted to indemnify the applicants for losses resulting from inaccuracies or breach of warranty, and a freestanding tax-specific indemnity. The agreement closed in 2016. Kevitsa's losses by 2016 totalled €81 million. The applicants tried to carry over these losses to their 2017 and 2018 taxation years. Finnish tax authorities disallowed the losses in a reassessment that generated a still-ongoing proceeding, resulting in tax losses to the applicants of some €14 million, over €8 million of which they had paid without indemnification by the respondents. The applicants sought declarations that the respondents had breached their indemnities and were liable for all taxes arising from the Finnish reassessment.

The application was granted in part and dismissed in part. The Court isolated six issues raised by the applicants. First, the respondents argued that their indemnities were conditional, and they could not have reasonably foreseen that the Finnish tax authorities would reassess Kevitsa; the Court held to the contrary on both questions. Second, the respondents argued that the applicants had no right to indemnification under the stand-alone clause in the contract, because it included only losses "with respect to" the pre-closing period, and the 2017–18 losses were not "with respect to" a pre-closing period. The Court rejected this argument, holding that though the 2017–18 losses were not incurred during the pre-closing period, they were "with respect to" pre-closing losses because the appellants' payments to the Finnish tax authorities were for such losses. Third, the respondents argued that Boliden's recognition of its post-closing losses in its public disclosures constituted a change in accounting methods, which was expressly disallowed under the indemnity agreement. Pointing out that an accounting method comprises accounting rules that conform to GAAP or IFRS, the Court held that there was no change in accounting method. Fourth, the respondents argued that the appellants' indemnity claim for 2017–18 was an abuse of process, because its previous statements that the 2016 transaction was not tax motivated conflicted with its current position that the losses acquired from Kevitsa had value. The Court simply noted that these positions are not inconsistent. Fifth, the respondents argued that the contract required the appellants to prorate amounts pertaining to the 2016 taxation year. The Court noted that its earlier rulings made it unnecessary to consider this issue. Finally, the Court required the respondents to reimburse the applicants for the €8 million they had already paid.

Boliden Mineral v. FQM Kevitsa

2021 DTC 5122

Request of judicial review of rejected demand for tax remission pursuant to the *Financial Administration Act* dismissed

This case concerns a request for judicial review of a decision rendered against the appellant in her role as executor of her deceased husband's estate. The decision rejected her demand for a tax remission pursuant to subsection 23(2) of the *Financial Administration Act*. The tax remission request followed an income tax reassessment raised by the Canada Revenue Agency ("CRA") against the deceased. The appellant, after having produced the tax return of her deceased husband for 2016, received a notice of assessment stating she had unused net capital losses of $48,191. She was told that if she applied this amount to previous years she may need to recalculate her unused balance and was referred to guide T4037, *Capital Gains*, for more information. She had some problems in obtaining access to her husband's previous tax returns. Having learned in 2018 that his RRSP matured after his death with a FMV of $124,124, she then produced her husband's final tax return for taxation year 2017 claiming a deduction of $72,288 relative to unused capital losses of previous years. The CRA rejected the deduction stating that her husband was not entitled to it because he had claimed a capital gains exemption of $96,467 in the 1990 taxation year. The appellant objected to the assessment, which was ultimately confirmed. This led to the tax remission request under the *Tax Administration Act* on the basis that the appellant had no way of knowing a capital gains exemption had been claimed in 1990, and that the CRA did not inform her of this fact before rejecting the deduction. If she had been aware, different tax planning would have been completed. Therefore she argued having been treated unfairly and denied procedural equity.

The request was dismissed. Such tax remissions are exceptional measures that should only be granted if the Governor in Council considers that the collection of tax is unreasonable, unjust, or that, generally speaking, the remission is in the Public's interest. After reviewing all the facts, the Federal Court judge dismissed the request for judicial review of the decision ruling that the appellant did not convince the Court that the decision was unreasonable or violated the principles of natural justice or procedural equity.

Hébert (Estate) v. Canada (AG)

2021 DTC 5121

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