Tax Topics

January 3, 2019
Number 2443

A SURVEY OF GLOBAL DIGITAL TAX DEVELOPMENTS

— Stuart Gray, Senior Editor, Global Tax Weekly

This article originally appeared in Wolters Kluwer's Global Tax Weekly Issue 313.

With events moving fast in the area of digital taxation, the debate about how best to tackle the tax challenges associated with the digital economy appears to have reached a critical juncture. Indeed, it is arguable that the international coalition for a multilaterally-agreed solution to this problem, overseen by the OECD, has fatally split. This article explores measures proposed or being considered at jurisdictional level to ensure more appropriate taxation of the digital economy.

BEPS Action 1

The problem, as the OECD observed in the final report for Action 1 of the BEPS project (Addressing the Tax Challenges of the Digital Economy),[1] is that many of the key features of the digital economy, particularly those related to mobility, generate BEPS concerns in relation to both direct and indirect taxes.

The OECD has argued since the commencement of the BEPS project in 2013 that, as the digital economy is increasingly becoming the economy itself, this challenge should be tackled by changes to existing tax rules, rather than the introduction of special "digital taxes". This viewpoint was reemphasized by the Paris-based body when it issued its interim report on the topic in March 2018.[2] The BEPS Inclusive Framework instead chose to review two key concepts of the international tax system: "nexus" and "profit allocation" rules. A final report from the OECD, possibly including new recommendations, is expected in 2020.

Multilateralism Versus Unilateralism

Governments largely agree with the OECD's measured approach to the taxation of the digital economy and recognize that a coordinated multilateral response to the problem is preferable. Yet, on the other hand, governments, motivated by public pressure to tackle tax avoidance and keen to raise new revenue, have grown impatient with the slow pace of the multilateral process. As we have seen in recent months, some are now considering new national tax measures. These are intended to ensure that companies deriving income from the sale of digital services and with little or no physical presence make a tax contribution commensurate with the amount of revenue they make from monetizing the user data of taxpayers in a jurisdiction.

[1] https://www.oecd-ilibrary.org/docserver/9789264241046-en.pdf

[2] https://www.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-interim-report_9789264293083-en

Wolters Kluwer

Some jurisdictions are attempting to achieve this by introducing new taxes on the revenues of companies selling digital services to other companies. Others are looking to solve the problem by updating existing corporate tax rules with the introduction of virtual permanent establishment rules. These are designed to ensure companies triggering certain thresholds of economic activity pay tax in a given jurisdiction even when they have little or no physical presence.

The main jurisdictional developments are summarized below.

European Union

In March 2018, shortly after the publication of the OECD's interim report, the EU put forward its own two-part proposal.[3]

First, the Commission proposed that a digital platform would be deemed to have a taxable "digital presence" or a virtual permanent establishment in a member state if it fulfills one of the following criteria:

- It exceeds a threshold of €7 million (US$8 million) in annual revenues in a member state;
- It has more than 100,000 users in a member state in a taxable year; or
- Over 3,000 business contracts for digital services are created between the company and business users in a taxable year.

The Commission said the measure could eventually be integrated into the scope of the Common Consolidated Corporate Tax Base ("CCCTB") — the already proposed initiative for allocating profits of large multinational groups in a way which better reflects where the value is created.

The second, temporary, and highly controversial solution is intended to ensure there is at least a harmonized EU approach to digital taxation, in the absence of a global agreement, to deter member states from introducing unilateral measures. This would entail the introduction of an indirect tax, at a three per cent rate, which would apply to revenues created from certain digital activities that escape the current tax framework entirely.

According to the Commission, the tax will apply to revenues created from activities where users play a major role in value creation and those that are the hardest to capture with current tax rules, such as those revenues:

- Created from selling online advertising space;
- Created from digital intermediary activities, which allow users to interact with other users and which can facilitate the sale of goods and services between them;
- Created from the sale of data generated from user-provided information.

Tax revenues would be collected by the member states where the users are located, and will apply only to companies with total annual worldwide revenues of at least €750 million and EU revenues of €50 million.

While the EU has stressed that it continues to support the OECD's work and advocates a multilateral agreement, it appears determined to proceed with the plan, and in September 2018, the Committee on Economic and Monetary Affairs submitted its proposal on the text of a new EU Directive that would introduce digital permanent establishment rules. The EU is hoping for an agreement on the interim measure by the end of the year. However, with that deadline now looming large, and with certain member states opposed to a unilateral EU digital tax, this goal is looking increasingly ambitious.

United Kingdom

As announced at Budget 2018 on October 30,[4] from April 2020, the government will introduce a new three per cent tax on the revenues of certain digital businesses which derive value from their UK users. The tax will:

- Apply to revenues generated from the provision of the following business activities: search engines, social media platforms, and online marketplaces;
- Apply to revenues from those activities that are linked to the participation of UK users, subject to a £25 million per annum allowance;

[3] https://ec.europa.eu/taxation_customs/business/company-tax/fair-taxation-digital-economy_en

[4] https://www.gov.uk/government/speeches/budget-2018-philip-hammonds-speech

- Only apply to groups that generate global revenues from in-scope business activities in excess of £500 million per annum; and
- Include a safe harbor provision that exempts loss-makers and reduces the effective rate of tax on businesses with very low profit margins.

The government intends to consult on the detailed design of the Digital Services Tax and legislate in Finance Bill 2019–20.

Spain

The Spanish Government is proceeding with a proposal to introduce a digital services tax along similar lines to the European Commission's proposed interim digital tax.[5] Under the proposal, a three per cent tax will be imposed on certain digital services provided by companies with global sales exceeding €750 million and sales of more than €3 million within Spain. Revenue from the selling of online advertising, digital intermediary and brokerage services, and personal data would be included in the scope of the law.

The proposal has been included in the budget agreement negotiated by the minority socialist Government and the Podemos party.

Italy

On May 16, 2018, the Italian Ministry of Finance launched a consultation[6] seeking stakeholders' feedback on whether to support the EU's digital tax plans, and in particular its proposal for an "interim tax" on otherwise untaxed turnover earned by certain digital economy firms. The Ministry requested that comments be specific about the proposals released and documents released by the Commission. The consultation concluded on June 22, 2018.

India

In July 2018, India's Central Board of Direct Taxes issued a consultation[7] on the design of the country's new digital permanent establishment rules, which are proposed to be introduced from April 1, 2019.

The digital PE rules would expand the definition of business connection to India to include a non-resident entity with a "significant economic presence (SEP)" in the country. Initially it was proposed that such an SEP would be satisfied through:

> . . . transaction[s] in respect of any goods, services, or property carried out by a non-resident in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or (b) systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means.

The new consultation concerns the as-yet-undetermined thresholds mentioned above for a company to have established a digital PE, or SEP.

When unveiling the digital PE proposals, the Government confirmed that the terms of tax treaties held by India with other countries in relation to permanent establishment rules will continue to be observed.

The Indian Government announced on July 13, 2018, that it would add to the aforementioned wording, to provide that "transactions or activities shall constitute SEP in India whether or not the agreement for such transactions or activities is entered into in India or the non-resident has a residence or place of business in India or renders services in India."

Further, the Government announced, "it is also provided that only so much of income as is attributable to the transactions or activities referred above shall be deemed to accrue or arise in India."

---

[5] https://www.elmundo.es/economia/2018/10/04/5bb5f898e2704e48a68b4610.html (In Spanish)

[6] http://www1.finanze.gov.it/finanze2/servizi/n_consult_newDF/consulta.php?id=1301 (In Italian)

[7] https://www.incometaxindia.gov.in/Lists/Latest%20News/Attachments/262/sep-rules-calling-stakeholder-comments-13-07-2018.pdf

As well as clarifying the scope of the digital PE rules, the Indian Government has launched a consultation on what thresholds, in terms of sales volumes or number of users, should be used for a business to have established an SEP.

Specifically, it is seeking input on thresholds in respect of the value of supplies of physical goods or services by a non-resident to India required to establish a digital PE; the value of supplies of digital goods or services to establish a digital PE; and the number of Indian users with whom a non-resident engages with on a systematic and continuous basis as part of their business activities.

The consultation closed on August 10, 2018.

Australia

On October 2, 2018, the Australian Government released a discussion paper[8] seeking views on how it could move toward "a fairer and more sustainable tax system for the digitalized economy." The discussion paper seeks feedback on the following:

- Is user participation appropriately recognized by the current international corporate tax system and, if not, how should value created by users be quantified and taxed?
- Is the value of intangible assets appropriately recognized under the current system and if not how should it be quantified and taxed?
- Are the current profit attribution rules fit for purpose?
- How should taxing rights over residual profits associated with user contribution to "user" countries or "marketing intangibles" to market countries be allocated?
- Should existing nexus rules for determining which countries have a right to tax foreign resident companies be changed?
- From a tax perspective, is the digitalized economy distinguishable from the traditional economy?
- Can and should any changes to the international and profit attribution rules be ring-fenced to apply only to highly digitalized businesses?
- Are there changes other than to nexus and profit attribution rules that should be made to the existing international corporate tax framework and/or Australia's tax mix to address the challenges presented by globalization and digitalization?
- What does the experience of other countries that have introduced interim measures or that are contemplating them mean for Australia?
- Should Australia pursue interim options ahead of an OECD-led, consensus-based solution?
- Would an interim measure applied to digital advertising and/or intermediation services accurately target that value and how should these services be defined?

The closing date for submissions on the discussion paper has been set for November 30, and the development of draft legislation in this area cannot be ruled out.

United States

As things stand, the US Government is strongly opposed to any measures which deviate from the OECD's work in this area. This position was summarized by Treasury Secretary Steven Mnuchin in a short statement issued on October 24,[9] in which he expressed "strong concern" with tax proposals that he said appear targeted at large US tech companies and which abandon the long-held principle that governments should tax profits, not revenues.

"Treasury is working very closely with the OECD and our counterparts there to address issues of base erosion and fair taxation," he stated. "We believe the issues are not unique to technology companies but also relate to other companies, particularly those with valuable intangibles."

---

[8] https://static.treasury.gov.au/uploads/sites/1/2018/10/c2018-t306182-discussion-paper-1.pdf

[9] https://home.treasury.gov/news/press-releases/sm534

Mnuchin added:

> I have instructed our team to continue their efforts in the OECD so that we can make progress on these issues quickly. I highlight again our strong concern with countries' consideration of a unilateral and unfair gross sales tax that targets our technology and internet companies. A tax should be based on income, not sales, and should not single out a specific industry for taxation under a different standard. We urge our partners to finish the OECD process with us rather than taking unilateral action in this area.

Members of Congress are similarly concerned by the willingness of governments in the EU and elsewhere to preempt the work of the OECD on digital taxation. In October 2018, members of the US Senate Committee on Finance wrote to European Commission President Jean-Claude Juncker and Council President Donald Tusk expressing their "significant and growing concern" at the proposals, which they argued have been "designed to discriminate against US companies and undermine the international tax treaty system."[10]

The senators identified multiple problems with the proposal. They warned that it would violate "the long-held principle that taxes on multinationals should be profit-based, not revenue-based." They also stated that the EU already has a revenue tax based on the location of customer in the shape of VAT, meaning that the digital services tax would lead to the double taxation of multinational companies.

The letter further alleged that the envisioned turnover threshold for the new tax is discriminatory and would put companies at a competitive disadvantage.

Finally, the senators pointed out that although the tax is billed by the EU as an interim measure, no end date has been announced and it could theoretically be in force indefinitely. Should the proposal be approved as an interim measure, "taxpayers and taxing authorities would be required to develop new, complex, and costly tax collection and compliance systems, which would be discarded once international consensus is reached."

The senators said the EU should refocus its efforts on reaching an international consensus within the OECD on new digital taxation models. "This will allow for the development of a policy that will guarantee fairness, avoid discrimination, and prevent double taxation," they concluded.

Based on these comments, any attempts to legislate for a US digital tax are highly unlikely to be approved. However, it remains to be seen how the US responds to new digital taxes introduced elsewhere, as well to the OECD's final recommendations when they emerge. But irrespective of any new tax measures that the US may introduce, US multinationals will still have to grapple with new digital tax measures introduced elsewhere.

Observations

While only a small group of jurisdictions so far are considering or attempting to legislate for new tax measures targeting non-resident companies making substantial levels of income from the sale of digital services, they nevertheless represent some of the world's major economies, and there is a strong possibility that these ideas will encourage other governments to act unilaterally.

In the EU, it is encouraging at least that Italy and Spain are seeking to shadow the proposals issued by the European Commission in March 2018. However, we are already seeing examples of different approaches to the issue at jurisdictional level: notably, the UK Government has decided to set different rates and thresholds to the Commission's proposed interim digital services tax. The danger here is that an inconsistent digital taxation landscape will emerge.

Another issue is the longevity of digital tax measures intended to be legislated for on a temporary basis until the OECD delivers its recommendations in this area. As the US Senate Finance Committee observed in its letter to the EU, there is no guarantee that the interim tax, if introduced, will actually be removed. The risk is that governments will be tempted to leave such measures in place, especially if they are generating large amounts of revenue.

It may be the case that, eventually, jurisdictions will implement any new recommendations from the OECD in this area. However, as can be seen, there is already plenty of evidence that governments are finding their own solutions, and such an inconsistent approach to the challenge of finding appropriate solutions to the taxation of the digital economy could pose major compliance challenges for multinational companies.

---

[10] https://www.finance.senate.gov/imo/media/doc/2018-10-18%20OGH%20RW%20to%20Juncker%20Tusk.pdf

Update

Since the above article was published there have been further developments of note which tend to support the view that the world is moving towards country-based digital taxation, rather than a coordinated approach. At the meeting of the EU Finance Ministers on December 4, 2018, no agreement was reached on the temporary solution proposed, despite prior work by Austria and a last-minute compromise proposal being tabled by France and Germany to limit taxation to online advertising. All that was achieved was an agreement to keep talking.

At its meeting on December 13, 2018, the European Parliament noted that the OECD's work to date had not resulted in significant progress and directed the EU Council to be "ambitious" in introducing a broader tax on digital services. It proposed adding the supply of digital content (video, audio, games, or text) to the list of taxable activities, which would sweep companies such as Netflix, which sell digital content, into the tax net, as well as lowering the minimum threshold above which a company's revenues will be subject to tax to €40 million. It suggested a target date of April 2019 for implementation of the necessary directives.

However, shortly after the meeting of EU Finance Ministers, French Finance Minister Bruno Le Maire announced that France would continue to work on an EU digital tax until March 2019, but, failing agreement, would move to unilaterally introduce a tax on digital companies at that time. That announcement was superceded by an announcement on December 17 that France was moving the agenda forward and would be imposing a digital tax starting on January 1, 2019. Le Maire indicated that while the exact scope of the tax had yet to be determined, it was estimated that it would bring in an additional €500 million in 2019.

Given that much of the impetus at the EU was led by France and Germany, and with France now following the UK and Spain in acting unilaterally and imposing a national digital tax, can Germany be far behind? And what are the ramifications of that for an EU solution?

CURRENT ITEMS OF INTEREST

Government Announces 2019 Automobile Deduction Amounts

The federal government has announced the various automobile deduction limits and expense benefit rates for 2019. There are two changes that apply as of 2019.

First, the per-kilometre deduction limit for tax-exempt allowances paid to an employee for using their personal vehicle for business purposes is increased by three cents. Therefore, for 2019, the allowance amount is 58 cents/km on the first 5,000 km and 52 cents/km thereafter. For Northwest Territories, Nunavut, and Yukon, these amounts increased to 62 cents/km on the first 5,000 km and 56 cents/km thereafter.

Second, the prescribed rate used to compute the taxable operating expense costs reimbursed to an employee is increased by two cents to 28 cents/km. For taxpayers employed principally in selling or leasing automobiles, the rate is increased by one cent to 25 cents/km.

The following amounts will remain the same in 2019:

- the $30,000 (plus sales taxes) capital cost limit for passenger vehicles;
- the $300 per month interest deduction limit with respect to amounts borrowed to purchase an automobile; and
- the $800 (plus sales taxes) deduction limit of leasing costs with respect to a leased automobile.

RECENT CASES

ETA s. 222 decision of the Federal Court of Appeal overturned by Supreme Court of Canada

The question of law at issue was formulated as follows and assumed the existence of a pre-bankruptcy liability under s. 222 of the *Excise Tax Act* (the "ETA"). Does the bankruptcy of a tax debtor and subsection 222(1.1) of the ETA render the deemed trust under section 222 of the ETA ineffective as against a secured creditor who received, prior to the bankruptcy, proceeds from the assets of the tax debtor that were deemed to be held in trust for the Plaintiff?

The Appeal is allowed for the reasons of the dissenting judge in the Federal Court of Appeal, and the Supreme Court reinstates the order of Justice McVeigh of the Federal Court that answered in the affirmative the question of law submitted by the parties. The Federal Court had answered the question in the affirmative but the Federal Court of Appeal reached the opposite conclusion. The FCA reached its conclusion based on the application of the governing principle of statutory interpretation where the intention of Parliament is to be gleaned from the text, read in its context and in light of its purpose. Both the textual and contextual analysis supported the FCA's conclusion that the question should be answered in the negative. With respect to purpose, the FCA found that Callidus' interpretation effectively defeats the purpose of the addition of subsection 222(3) and would create perverse incentives on the part of the secured creditors to not abide by the deemed trust. Justice Pelletier dissented with the majority decision for the following reasons: (1) Subsection 222(1) creates a trust with respect to amounts collected as tax but not remitted. Subsection 222(3), on the other hand, creates a trust with respect to the property of the "person" i.e., the tax debtor. (2) The subsection (1) trust arises when an amount is collected as or on account of tax and ends when the amount is remitted to the Receiver General. The result is that the amount subject to the subsection (1) trust varies as amounts are collected and remittances are made to the Receiver General. (3) The event which gives rise to the deemed trust pursuant to subsection 222(3) is not the failure to remit the amounts collected as tax to the Receiver General, as is the case in subsection 222(1). It is the failure to remit the amount deemed by subsection 222(1) to be held in trust for Her Majesty "...if at any time an amount deemed by subsection 222(1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General . . . property of the person . . . is deemed . . . to be held, from the time the amount was collected by the person, in trust for Her Majesty..." As a result, if amounts are deemed to be held in trust pursuant to subsection 222(1) and not remitted to the Receiver General, then the property of the person is deemed to be held in trust from the time the amount was collected. It follows from this that if no amounts are deemed to be held in trust, no subsection 222(3) trust arises. (4) While the subsection 222(3) trust attaches to property of the person, it does not capture the whole of the person's interest in their property. The property subject to the subsection 222(3) trust is defined as "... property of the person . . . equal in value to the amount so deemed to be held in trust [pursuant to subsection 222(1)] is deemed . . . to be held . . . in trust for Her Majesty..." In finality, the dissenting judge saw no difference in principle between the reduction of the subsection 222(1) trust to nil by payment or by operation of law. In either case, the subsection 222(3) trust whose operation depends upon the existence of an amount deemed to be held in trust pursuant to subsection 222(1) is at an end. Had Parliament meant to make the subsection (3) trust a function of the continued existence of unremitted amounts, it could have said so easily enough. The Supreme Court sided with the dissenting judge, allowed the Appeal, and reinstated the original Federal Court decision.

¶50,100, *Callidus v. The Queen*, 2018 DTC 5128

New hearing ordered where language rights violated

At the hearing in the Tax Court of Canada ("TCC") (2016 UDTC 13), several witnesses and counsel for the intervenor indicated a preference to testify or address the court in French. The judge informed counsel for the intervenor that if his witness testified in French, the hearing would have to be adjourned. Further to a suggestion by counsel, the witness testified in English, using a few words in French where necessary. During the rest of the hearing, some of the other witnesses, as well as counsel for the intervenor, indicated they wanted to speak in French, but the judge asked them to speak in English and steered the testimony and presentation of counsel's arguments back to English. The judge decided the appeal in the taxpayer's favour, and the intervenor appealed the TCC's decision on the ground that the language rights of its witnesses and counsel had been violated. The Federal Court of Appeal allowed the appeal (2017 DTC 5046) and ordered a new hearing before a different judge of the TCC. The taxpayer appealed to the Supreme Court of Canada.

The appeal was dismissed. All persons who appear in federal courts must be able to freely exercise their fundamental and substantive right to speak in the official language of their choice. The federal courts must provide the resources and procedures needed, even where a hearing is conducted in accordance with an informal or simplified procedure. Language rights must be interpreted purposively, in a manner consistent with the preservation and development of official language communities in Canada. Judges are required to participate actively in protecting language rights. They are primarily responsible for upholding language rights; a lawyer's failure to intervene does not release a judge from his or her duties. If a judge asks a person to speak in an official language other than the language of the person's choice, this constitutes a violation of section 14 of the *Official Languages Act*, section 19 of the *Canadian Charter of Rights and Freedoms*, and section 133 of the *Constitution Act, 1867*. The language rights of several individuals who participated in this case were infringed at the hearing in the TCC. The violations were numerous and had an impact on the witnesses and parties, on the conduct of the hearing, and the outcome. Counsel for the intervenor took appropriate steps to assert his own rights as well as the rights of his client and witnesses. His choice to defer to the judge's instructions resulted from the judge's insistence and was not a tactical move. The witnesses did not waive their right to testify in French. Where the language rights of a party or of his or her counsel are not upheld, the appropriate remedy will generally be to order a new hearing, as was done by the Federal Court of Appeal. The Supreme Court agreed, dismissing the taxpayer's appeal and ordering a new hearing before a different judge of the TCC.

¶50,099, *Mazraani v. Industrielle Alliance*, 2018 DTC 5126

Minister's application to compel production of due diligence report allowed

In the course of an audit of the corporate taxpayer, the Minister issued a Requirement for Information ("RFI") under section 231.7, requiring the taxpayer to provide a due diligence report which had been prepared by its accountants in connection with a transaction it had undertaken. The taxpayer refused to provide the report, arguing that the Minister had not established its relevance and that the report was, in addition, protected by solicitor-client privilege. The taxpayer also took the position that the report was not compellable under the *Income Tax Act* (the "Act"), because compelling its production would impose on the taxpayer an obligation to self-audit. The Minister brought an application before the Federal Court seeking an order requiring the taxpayer's compliance with the RFI.

The application was allowed. The Federal Court noted that, as acknowledged by both parties, the Minister did not have to demonstrate that the requested documentation was relevant, only that it may be relevant. In the Court's view, it was undisputed that the report requested had been prepared for purposes of the transaction that was under audit, and it was not necessary that the Minister demonstrate that it was relevant to a particular issue under audit. The Court concluded that the Minister's purpose in seeking the report related to the administration or enforcement of the Act and that the information in the report may be relevant to an amount payable by a taxpayer under the Act. The Minister had, therefore, met the low threshold for relevance with respect to an application under section 231.7. On the question of solicitor-client privilege, the Court noted that there are circumstances in which such privilege can apply to documents which had been prepared by a third party, in particular by an accountant. The Court reviewed the circumstances in which the report was prepared before concluding that the dominant or principal purpose when the report was commissioned and generated was to inform the decision of whether to proceed with the transaction and at what price. As such, that purpose was a business purpose and such finding was determinative of the Court's conclusion that the report was not protected by solicitor-client privilege. Finally, the Court considered the taxpayer's argument with respect to a requirement to self-audit. In making that argument, the taxpayer had relied on a decision of the Federal Court of Appeal, but the Federal Court held that compelling the taxpayer to provide the report would not offend the principle outlined in that decision that a taxpayer is not required to self-audit. It also held that the taxpayer had identified no additional basis that would, in the Court's view, warrant the exercise of its discretion to decline to order provision of the report. An order was therefore issued requiring the taxpayer to provide the due diligence report to the Minister within 45 days of the date of judgment.

¶50,098, *Canada (MNR). v. Atlas Tube Canada*, 2018 DTC 5124

Appeal from denial of business deduction for file-storage expenses allowed

After practicing law for 27 years, the taxpayer ceased to provide legal services in 2013 and became a retired member of the Nova Scotia Barristers Society. As required by the terms of her professional liability insurance, she retained client files and incurred costs to store such files. She deducted the costs of that storage in her return for the 2015 tax year, but such deduction was denied by the Minister, on the basis that the taxpayer had not, as required, incurred those expenses for the purpose of gaining income from business during 2015, and had operated no business during that taxation year. The taxpayer appealed.

The appeal was allowed. The Tax Court of Canada held that the issue for determination was whether the appellant, as a retired member of the Barristers Society with no current business income, was entitled to deduct file storage fees as an expense in relation to client files created during previous tax years when she had such business income and pursued a profit from business. The Court held that during the years in which she provided legal services, the appellant was accruing annually "run-off" responsibilities concerning file retention, accessibility, and, ultimately, future storage obligations and, consequently, she incurred the requirement to expend future sums on storage to earn then current income. In the Court's view, the past accrual of future record keeping services, the file storage, and the need to protect (in the present) her insurance coverage for past legal services all represented the enduring and current provision of legal services beyond the temporal period in which the income from such services was received. The Court concluded that the continuing services provided by the appellant in 2015 were referable and connected to the income earned in previous years and, as such, were properly deductible by her. The respondent Minister had not raised any issue with respect to the reasonableness of the amount of the expenses deducted, and the Tax Court therefore concluded that the taxpayer was entitled to the deduction in the amount claimed.

¶50,104, *Tournier v. The Queen*, 2018 DTC 1164

Minister's GAAR reassessment disallowing capital loss deduction affirmed on appeal

M. Jobin was the sole shareholder of: (a) the corporate taxpayer; (b) Groupe AST which operated a consulting business; and (c) a numbered company, 9144. M. Jobin's son Maxime Jobin was the sole shareholder of another numbered company, 9149. On January 4, 2005, by way of a subsection 85(1) rollover, M. Jobin transferred to the taxpayer his common shares of Groupe AST for a consideration equal to their ACB of $341,413 at a time when their fair market value was $11,143,607. At the same time 10,802,195 Class E preferred shares, with a redemption value of $1 per share, were issued to M. Jobin in exchange for his shares of Groupe AST. Neither of the foregoing two transactions involved any immediate tax consequences for M. Jobin since the amount at which the shares in issue were transferred in both cases was their ACB. On January 6, 2005, Groupe AST added to the paid up capital of its common shares held by the taxpayer the sum of $2.6 million. As a result, the taxpayer was deemed under subsection 55(2) of the Act to have realized a capital gain of $2.6 million. On January 14, 2005, the taxpayer transferred to 9144 all of its shares of Groupe AST for a consideration equal to their fair market value of $12,847,200, which resulted in the taxpayer realizing a capital gain of $9,875,137. When this capital gain was added to the previously mentioned $2.6 million capital gain, the taxpayer's total capital gain for 2005 amounted to $12,475,137. On January 17, 2005, an arm's-length third party corporation acquired from 9144 its shares of Groupe AST for $12,847,200. Since this amount corresponded to the ACB of those Groupe AST shares, no capital gain was realized by 9144 from this transaction. Later in 2005, 9144 declared an in-kind dividend on its class A shares held by the taxpayer by issuing 13,000 redeemable Class B shares for $13 million. Since the redemption value of these Class B shares exceeded the value of the share capital of 9144, and because this class of shares took precedence over all other classes of shares, the dividend in Class B shares brought about a transfer of the value of the Class A shares to the Class B shares. And since the ACB of both the Class A and Class B shares remained unchanged, the Class A shares from that point on embodied an unrealized loss of $12,847,299 and the Class B shares embodied an unrealized gain of the same amount. This unrealized loss associated with the Class A shares was realized by the taxpayer the following day upon their sale to 9149 at their fair market value of $1 per share. And since 9144 and 9149 were not "affiliated persons" within the meaning of section 251.1 of the Act, the minimization of loss rules in subparagraph 40(2)(*g*)(ii) and subsection 40(3.4) of the Act did not apply, leaving the unrealized loss of $12,847,299 intact. On reassessment, the Minister disallowed the taxpayer's attempt to deduct this $12,847,299 in computing its income for 2005. The Minister's position under the GAAR was, in essence, that, while the taxpayer's $12,847,299 loss claim was in conformity with the provisions of the Act being relied upon by the taxpayer, it was not in accordance with the purpose of those provisions. In dismissing the taxpayer's appeal, the Tax Court of Canada concluded, in essence, that: (a) the tax advantage to the taxpayer in this case resulted from a series of transactions, one of which had no true purpose; (b) this tax advantage was contrary to the spirit and purpose of paragraphs 38(*b*), 39(1)(*b*), and 40(1)(*b*) of the Act; and (c) the taxpayer's argument based on the allegation that the Minister's reassessment was unreasonable and resulted in double taxation was without merit. The taxpayer appealed to the Federal Court of Appeal.

The taxpayer's appeal was dismissed. The Tax Court judge committed no error in concluding that the taxpayer had received a tax benefit in this case in the form of the deductible loss that it was claiming. Also, if the taxpayer's objective was to freeze the value of the Class A shares held by it to enable Maxime Jobin to profit from the future growth in 9144, the taxpayer could simply have relied on subsections 85(1) and 86(1) of the Act to transfer its class A shares in favour of 9144 at an amount equal to their ACB, in exchange for preferred shares with a redemption value equal to the market value of the Class A shares. Overall the taxpayer failed to demonstrate that any of the transactions forming part of the series of transactions in this case had any real purpose. In addition, in support of its double taxation argument, the taxpayer alleged that the Tax Court judge ought to have taken into account the deemed capital gain which M. Jobin would realize at the time of his death on the Class E shares of the taxpayer which he still held. This argument was untenable. In conclusion, therefore, the Tax Court judge made no errors which required appellate intervention.

¶50,101, *2763478 Canada Inc. v. The Queen*, 2018 DTC 5130

Appeal from decision finding taxpayer resident of British Columbia dismissed

The taxpayer filed his 2009–2012 tax returns on the basis of Alberta residency. The CRA reassessed the taxpayer on the basis of BC residency and the taxpayer appealed. There were two issues: (1) whether the taxpayer was a resident of both Alberta and BC on the last day of the relevant year; and (2) if he was, then in which province was his principal residence? The taxpayer was the CEO of an oil company headquartered in Calgary, where he rented a 600 square foot apartment while his wife held sole title to a 10,000 square foot waterfront home in Surrey, BC. The taxpayer spent an average of 42.84% of his days in BC and 27.86% in Calgary. Government-issued documents and a bank account indicated he was resident in Alberta, and he owned a yacht registered in Edmonton but moored in Surrey.

The taxpayer's appeal was dismissed. A person is resident where he, in the settled routine of life, regularly, normally, or customarily lives. The taxpayer met this test for both provinces. His business was in Alberta and his family and social ties were in BC. The test for a taxpayer's principal residence is qualitative rather than quantitative. The fact that the taxpayer was employed in Alberta was not sufficient to make the province his principal residence, nor was the fact that he spent the plurality of his days in BC sufficient to make BC his principal residence. The judge concluded, on a fulsome examination of the taxpayer's social and economic links to each province, that while the taxpayer worked in Alberta, he lived in BC.

¶50,108, *Sampson v. British Columbia*, 2018 DTC 5134

Appeal from denial of charitable donations tax credit dismissed where no valid in-kind gift made

Two taxpayers participated in a pharmaceutical donations program which involved an in-kind donation of pharmaceuticals. One of those taxpayers also participated in a similar program through which he purchased pharmaceuticals which were then to be donated to a registered charity. Both taxpayers claimed charitable donation tax credits as the result of their participation in the program(s). On assessment, the Minister denied, in part, the credits claimed in relation to the pharmaceutical purchase program on the basis that the valuations on which the amount of such credits were based were invalid. The credits claimed for an in-kind charitable donation of pharmaceuticals were denied. Both taxpayers appealed from the Minister's assessments and their appeals were heard on common evidence.

The appeals were allowed in part. The Tax Court of Canada noted that under common law, in order for there to be a gift, there must be an intention on the part of the donor to make such gift, without consideration or expectation of remuneration, that there must be acceptance of the gift by the donee, and there must be a sufficient act of delivery or transfer of the property to complete the transaction. The Court then considered the transactions undertaken by the appellants in light of those requirements. It first considered the program through which a charitable donations tax credit had been claimed in relation to donations of purchased pharmaceuticals. The Court reviewed the evidence put forward by the appellant before concluding that he had provided no reliable evidence of the fair market value of those purchased pharmaceuticals at the time of donation. Consequently, the appellant had failed to demolish the assumptions contained in the Minister's assessment with respect to the value of the gift. With respect to the program involving in-kind donations, the Court held that the common-law requirement that there be a delivery or transfer of property to complete the gift had not been met. It concluded that the certificates received by the appellants were not reliable evidence of the purported acquisition and distribution of pharmaceuticals. Consequently, in the Court's view, neither of the appellants had made a valid in-kind gift of pharmaceuticals during the taxation years at issue. The appeal with respect to the donation of purchased pharmaceuticals was allowed in part, to the extent of the Minister's determination of the value of those purchased pharmaceuticals. The appeal with respect to the purported in-kind donation of pharmaceuticals was dismissed.

¶50,096, *Morrison et al. v. The Queen*, 2018 DTC 1155

INTERNATIONAL NEWS

IRS Issues Notice on Previously Taxed Earnings

This article originally appeared in Wolters Kluwer's Global Tax Weekly Issue 319.

The US Treasury Department and the Internal Revenue Service have announced that they intend to issue regulations addressing certain issues arising from the enactment of the Tax Cuts and Jobs Act of 2017 with respect to foreign corporations with previously taxed earnings and profits ("PTEP").

The term PTEP refers to earnings and profits ("E&P") of a foreign corporation attributable to amounts which are, or have been, included in the gross income of a United States shareholder under Section 951(a) or under Section 1248(a). Distributions of PTEP are excluded from the US shareholder's gross income, or the gross income of any other US person who acquires the US shareholder's interest (or a portion thereof) in the foreign corporation. PTEP is further excluded from a US shareholder's gross income if such E&P would be included in the gross income of the US shareholder or successor in interest as an amount determined under Section 956. Distributions of PTEP to a US shareholder or successor in interest generally are not treated as dividends except that such distributions immediately reduce the E&P of the foreign corporation.

Notice 2019-01 describes regulations that the Treasury Department intends to issue, including:

- Rules relating to the maintenance of PTEP in annual accounts and within certain groups;
- Rules relating to the ordering of PTEP upon distribution and reclassification; and
- Rules relating to the adjustment required when an income inclusion exceeds the earnings and profits of a foreign corporation.

It is anticipated that the regulations announced in the notice will apply to taxable years of US shareholders ending after the date of release of the notice and to taxable years of foreign corporations ending with or within such taxable years.

The Treasury Department and the IRS are welcoming comments on the proposed regulations, which should be submitted by February 12, 2019.

IRS Issues Proposed Regulations on BEAT

This article originally appeared in Wolters Kluwer's Global Tax Weekly Issue 319.

On December 13, 2018, the United States Internal Revenue Service issued proposed regulations on the operation of the base erosion and anti-abuse tax ("BEAT"), contained in Section 59A of the Internal Revenue Code.

Added to the tax code by the Tax Cuts and Jobs Act of 2017, Section 59A is a minimum tax provision, designed to penalize those companies that make deductible payments to foreign affiliates to substantially reduce their exposure to US taxation. The BEAT is calculated by adding back certain deductible payments made to foreign affiliates and applying a minimum tax to a percentage of the difference between the taxpayer's modified taxable income and their regular tax liability, at a rate of five per cent for 2018. This rate will rise to 10 per cent in 2019 and to 12.5 per cent from 2025.

The provision primarily affects corporate taxpayers with gross receipts averaging more than US$500 million over a three-year period who make deductible payments to foreign related parties.

The proposed regulations provide detailed guidance regarding which taxpayers will be subject to Section 59A, the determination of what is a base erosion payment, the method for calculating the base erosion minimum tax amount, and the required base erosion and anti-abuse tax resulting from that calculation.

The IRS is welcoming comments on the proposed regulations. These must be submitted within 60 days of their publication in the Federal Register.

France To Levy Digital Tax Starting January 2019

This article originally appeared in Wolters Kluwer's Global Tax Weekly Issue 319.

The French Government has decided to bring forward the introduction of a national tax on digital companies following the failure of European Union member states to agree on an EU-wide digital services tax.

Finance Minister Bruno Le Maire informed a press conference on December 17 that a French digital tax would be introduced on January 1, 2019, and would raise an estimated €500 million (US$567 million) next year. However, the exact scope of the tax has yet to be determined.

After EU finance ministers failed to reach an agreement on a proposed digital services tax earlier in December, Le Maire indicated that France would continue to push for an EU solution early in 2019, but would seek to legislate for a national digital tax if no agreement could be reached by next March.

However, it is thought that the French Government has decided to accelerate the introduction of a national digital tax to offset proposed new tax cuts for individuals in the wake of street protests against its tax policies.

CORRECTION

In Tax Topics no. 2439, *Accelerated CCA and Other Measures from the 2018 Fall Economic Statement*, it was incorrectly stated that the half-year rule applies to Class 13 leasehold interests that are acquired after 2023. In fact, the half-year rule continues to be suspended after 2023 for property that is accelerated investment incentive property. We apologize for any confusion this may have caused.

TAX TOPICS

Published weekly by Wolters Kluwer Canada Limited. For subscription information, see your Wolters Kluwer Account Manager or call 1-800-268-4522.

For Wolters Kluwer Canada Limited

Tara Isard, Senior Manager, Content
Tax & Accounting Canada
(416) 224-2224 ext. 6408
email: Tara.Isard@wolterskluwer.com

Natasha Menon, Senior Research Product Manager
Tax & Accounting Canada
(416) 224-2224 ext. 6360
email: Natasha.Menon@wolterskluwer.com

Wolters Kluwer Canada Limited
300-90 Sheppard Avenue East
Toronto ON M2N 6X1
1 800 268 4522 tel
1 800 461 4131 fax
www.wolterskluwer.ca

Wolters Kluwer