Tax Notes

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COVID-19 UPDATE

Canada

Canada Emergency Wage Subsidy Update (March 30, 2020)

On March 27, a news release from the Prime Minister's office announced that the wage subsidy for eligible businesses will increase to 75% from the originally-announced 10%. The subsidy applies retroactively from March 15 and ends after three months. Per the legislation that was enacted as a part of Bill C-13, a taxpayer can reduce its source deductions accordingly.

On March 30, the Prime Minister provided some further guidance on the wage subsidy. First, the subsidy will cover up to $847 of an employee's weekly salary. To be eligible, an employer must demonstrate that its revenue has fallen by at least 30% due to COVID-19. The Prime Minister stated that the size of the business will not affect whether it is eligible for wage assistance.

The Minister of Finance will provide further information on the wage subsidy on March 31.

Government Responds With More COVID-19 Measures (March 27, 2020)

On March 27, the federal government announced new tax measures to help taxpayers with the COVID-19 situation.

The government announced that it will defer payments of GST/HST until June 30, 2020. For monthly GST/HST filers, this applies to amounts for the February, March, and April reporting periods. For quarterly GST/HST filers, this deferral applies to tax collected in the reporting period from January 1, 2020, to March 31, 2020. For annual GST/HST filers whose return or installment is due in March, April, or May 2020, this deferral applies to amounts collected and owing for the prior fiscal year and installments owing for the current fiscal year.

Also, for import duties and sales taxes, payment deadlines for statements of accounts for March, April, and May are being deferred to June 30, 2020.

The government also announced several new loan programs for businesses.

The government is launching the Canada Emergency Business Account, which will allow banks to provide government-guaranteed loans of up to $40,000, $10,000 of which will be forgivable. The loans will be interest-free for one year. Qualifying organizations must demonstrate that they paid between $50,000 to $1 million in total payroll in 2019. Repaying the balance of the loan on or before December 31, 2022, will result in loan forgiveness of 25%.

Export Development Canada is committing $20 billion to guarantee new operating credit and cash flow term loans that financial institutions extend to small and medium businesses that are domestic or in the export sector.

The government is also launching a $20 billion co-lending program between the Development Bank of Canada and financial institutions in order to lend to small and medium businesses. Eligible businesses may obtain incremental credit amounts up to $6.25 million.

Parliament Passes COVID-19 Emergency Response Act (March 24, 2020)

Bill C-13, *COVID-19 Emergency Response Act*, was passed by the House of Commons on March 24, 2020, and on the following day was passed by the Senate and received Royal Assent. The bill enacted all of the tax measures announced on March 18, 2020, in *Canada's COVID-19 Economic Response Plan: Support for Canadians and Businesses*, or at least the ones that required legislation to come into effect.

Emergency Response Benefit

Initially, the government proposed two emergency benefit payments: the Emergency Care Benefit, and the Emergency Support Benefit. However, these two measures were instead combined into a single allowance called the Emergency Response Benefit, which was enacted under Part 2 of Bill C-13 on March 24. It is a taxable benefit of up to $2,000 per month for up to four months — the benefit is taxable but tax will not be deducted at source. Eligible individuals include people who have lost their job, are sick, quarantined, or taking care of someone who is sick with COVID-19, or working parents who must stay home without pay to care for children who are sick or at home because of school and daycare closures. Workers who remain employed but are losing income because of COVID-19 are also eligible.

With regard to how the payment amounts are calculated, the bill simply states that the amount is fixed by regulation. Hopefully, the government will soon introduce regulations that specify how much workers can expect to receive. The online portal to apply for the Emergency Care Benefit will open in early April, and the government promises the funds will be paid within 10 days of an application being made. The benefit will be paid every four weeks and be available from March 15, 2020, until October 3, 2020.

CRA Compliance Update (March 30, 2020)

Over recent days, the CRA has announced various tax relief measures such as filing and payment deferrals and suspension of compliance activities. The following is a compilation of all the tax relief steps the CRA has taken thus far.

Payments and Remittances

- The deadline to pay any balance due for an individual income tax and benefit return for 2019 has been extended from April 30, 2020, to September 1, 2020. The filing deadline, however, has only been extended to June 1, 2020.
- For self-employed individuals or those who have spouses or common-law partners that are self-employed, the deadline to pay any balance due for an individual income tax and benefit return has been extended from April 30, 2020, to September 1, 2020. The deadline for filing remains June 15, 2020.
- Administrative income tax actions required of taxpayers by the CRA that are due after March 18, 2020, can be deferred to June 1, 2020; these include filing returns, elections, designations, and information requests; payroll deductions payments and all related activities are not deferred.
- The deadline for corporations to pay any income tax amounts that become owing or due after March 18, 2020, and before September 1, 2020, has been extended to September 1, 2020.
- The deadlines for T5013 partnership and NR4 information returns are extended to May 1, 2020.
- For trusts with a year-end of December 31, 2019, the filing deadline is extended to May 1, 2020. The deadline is extended to June 1, 2020, for trusts that would otherwise have a filing due date in April or May.

- All trusts that have an upcoming income tax balance due date or an income tax instalment payment due date before September 1, 2020, will have their payment due date effectively extended to September 1, 2020.
- The following GST/HST remittances have been deferred until June 30, 2020:
  - Monthly filers have to remit amounts collected for the February, March, and April 2020 reporting periods;
  - Quarterly filers have to remit amounts collected for the January 1, 2020 through March 31, 2020 reporting period; and
  - Annual filers, whose GST/HST return or instalment are due in March, April, or May 2020 have to remit amounts collected and owing for their previous fiscal year and instalments of GST/HST in respect of the filer's current fiscal year.
- Payments of customs duty and sales tax for importers for statements of accounts for March, April, and May are being deferred to June 30, 2020.

Administration and Enforcement

- Any objections related to entitlement to benefits and credits will continue to be processed during the COVID-19 crisis; there should not be any delays associated with the processing of these objections. With respect to objections related to other tax matters filed by individuals and businesses, the CRA is currently holding these accounts in abeyance. No collection action will be taken with respect to these accounts at this time.
- For any objection request due March 18 or later, the deadline is effectively extended until June 30, 2020.
- The CRA is holding any other objections related to other tax matters filed by individuals and businesses in abeyance.
- With respect to appeals before the Tax Court of Canada ("TCC") on March 16, 2020, the TCC has ordered the extension of all timelines prescribed by the rules of that Court while it is closed for business until March 30, 2020 (this has been extended to May 1, 2020).
- Where taxpayers wish to file an appeal in relation to CPP/EI rulings decisions, they are encouraged to do so through MyAccount to avoid potential delays.
- The CPP/EI appeals program is currently only actioning appeals that are related to cases where EI benefits are pending; these cases will be treated on a priority basis and all other appeals will be actioned when normal services resume. The CPP/EI Appeals to the Minister program will exercise discretion on a case by case basis when additional time is required to respond to a request.
- The CRA is extending the filing deadline to December 31, 2020, for all charities with a Form T3010, Registered Charity Information Return, due between March 18, 2020, and December 31, 2020.
- The CRA will not initiate contact with taxpayers for audits (with certain exceptions); this includes:
  - no new audits being launched, and
  - no requests for information related to existing audits.

No audits should be finalized and no reassessments should be issued during that period.

- Collections activities on new debts will be suspended until further notice, and flexible payment arrangements will be available. Payment arrangements are also available on a case-by-case basis if you can't pay your taxes, child and family benefit overpayments, Canada Student Loans, or other government program overpayments in full.
- Banks and employers do not need to comply or remit on existing RTPs during this time.
- Taxpayers who are unable to file a return or make a payment by the tax-filing and payment deadlines because of COVID-19 can request the cancellation of penalty and interest charged to their account. Penalties and interest will not be charged if the new deadlines the government has announced for tax-filing and payments are met.

- In order to reduce the necessity for taxpayers and tax preparers to meet in person, the CRA will recognize electronic signatures as having met the signature requirements of the *Income Tax Act*, as a temporary administrative measure. This provision applies to authorization forms T183 or T183CORP.

Note that even if a taxpayer is unable to file a return or make a payment by the extended tax-filing and payment deadlines below because of COVID-19, they can send a request that the CRA cancel their penalties and interest.

COVID-19: Provincial Tax Update (March 27, 2020)

Alberta

The Alberta government is deferring the due date for corporate tax balances and instalment payments as part of the province's response to COVID-19. On March 18, 2020, the government said that it will defer the collection of corporate tax balances and instalment payments that fall due from March 18 until August 31, 2020.

British Columbia

On March 23, 2020, the British Columbia government announced the extension of tax filing and payment deadlines and delays to the implementation of planned new tax measures as part of the province's response to COVID-19.

The province will extend tax filing and payment deadlines for the provincial sales tax, municipal and regional district tax on short-term accommodation, tobacco tax, motor fuel tax, and carbon tax until September 30.

The scheduled April 1 increase to the provincial carbon tax, as well as the new PST registration requirements on e-commerce and the implementation of PST on sweetened carbonated drinks, will be delayed. Their timing will be reviewed by September 30.

Effective immediately, businesses with a payroll of over $500,000 can defer their employer health tax payments until September 30.

A new Emergency Benefit for Workers will provide a one-time, tax-free $1,000 payment to those who receive federal EI, or the new federal Emergency Response Benefit as a result of COVID-19. A one-time enhancement to the climate action tax credit will be paid in July 2020 to moderate- and low-income families.

Manitoba

Information Notice RST 20-03 announced a filing extension for RST returns. Returns for small and medium businesses with monthly RST remittances of no more than $10,000 per month that would normally be due on April 20th and May 20th will now be due on June 22, 2020. Businesses that file on a quarterly basis that have a due date of April 20, 2020, will now have the due date extended to June 22, 2020. Businesses that qualify for the filing extension that were unable to file and remit their February sales tax return by the March 20th due date will not be assessed a late filing penalty and interest will not be applied until after June 22, 2020. Interest will continue to apply on all outstanding tax debts established prior to the March remittance deadlines. Businesses will still receive paper returns in the mail or web notice reminders by email for return periods March and April.

Ontario

The Ontario government has announced a few tax measures in its March 2020 Economic and Fiscal Update, two of which relate to the COVID-19 situation.

Private-sector employers with remuneration in Ontario of less than $5 million are currently exempt from the employer health tax ("EHT") on up to $490,000 of their payroll. The government will increase this exemption to $1 million for 2020, and it will return to $490,000 beginning in 2021. This measure will provide EHT relief of up to $9,945 per eligible employer.

Beginning April 1, 2020, and ending on August 31, 2020, penalties and interest will not apply where a business fails to file a return for or remit selected types of provincially-administered taxes.

Saskatchewan

Taxpayers who are unable to remit their PST due to cashflow issues will have three-month relief from penalty and interest charges. Businesses that are unable to file their provincial tax return by the due date may submit a request for relief from penalty and interest charges on the return affected. The province has also suspended its audit program and compliance activities.

International COVID-19 Update

US Senate Passes ‘ Phase Three’ COVID-19 Aid Package

On March 25, 2020, the United States Senate overwhelmingly approved the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which represents the third package of financial aid measures to businesses and individuals affected by the coronavirus crisis and which includes numerous tax provisions to support businesses.

Notable business tax provisions in the CARES Act include employee retention tax credits, modifications to the rules surrounding the use of losses, and a temporary relaxation of the limitation on business interest expenses. These and other measures, detailed in a report produced by the Committee on Finance, are summarized below:

Employee Retention Credit for Employers Subject to Closure Due to COVID-19

The provision provides a refundable payroll tax credit for 50 per cent of wages paid by employers to employees during the COVID-19 crisis. The credit is available to employers whose operations were fully or partially suspended, due to a COVID-19-related shutdown order, or whose gross receipts declined by more than 50 per cent when compared to the same quarter in the prior year.

The credit is based on qualified wages paid to employees. For employers with more than 100 full-time employees, qualified wages are wages paid to employees when they are not providing services due to the COVID-19-related circumstances described above. For eligible employers with 100 or fewer full-time employees, all employee wages qualify for the credit, whether the employer is open for business or subject to a shut-down order. The credit is provided for the first US$10,000 of compensation, including health benefits, paid to an eligible employee. The credit is provided for wages paid or incurred from March 13, 2020, through December 31, 2020.

Delay of Payment of Employer Payroll Taxes

The provision allows employers and self-employed individuals to defer payment of the employer share of the social security tax they otherwise are responsible for paying to the federal Government with respect to their employees. Employers generally are responsible for paying a 6.2 per cent social security tax on employee wages. The provision requires that the deferred employment tax be paid over the following two years, with half of the amount required to be paid by December 31, 2021, and the other half by December 31, 2022.

Modifications for Net Operating Losses

The provision relaxes the limitations on a company’s use of losses. Net operating losses (“NOLs”) are currently subject to a taxable-income limitation, and they cannot be carried back to reduce income in a prior tax year. The provision provides that NOLs arising in a tax year beginning in 2018, 2019, or 2020 can be carried back five years. The provision also temporarily removes the taxable income limitation to allow a NOL to fully offset income (currently, taxpayers can use NOLs to offset up to 80 per cent of taxable income). These changes will allow companies to utilize losses and amend prior year returns.

Modification of Limitation on Losses for Taxpayers Other Than Corporations

The provision modifies the loss limitation applicable to pass-through businesses and sole proprietors, so they can utilize excess business losses and access critical cash flow to maintain operations and payroll for their employees.

Modification of Credit for Prior Year Minimum Tax Liability of Corporations

The corporate alternative minimum tax ("AMT") was repealed as part of the *Tax Cuts and Jobs Act*, but corporate AMT credits were made available as refundable credits over several years, ending in 2021. The provision accelerates the ability of companies to recover those AMT credits, permitting companies to claim a refund now and obtain additional cash flow during the COVID-19 emergency.

Modification of Limitation on Business Interest

The provision temporarily increases the amount of interest expense businesses are allowed to deduct on their tax returns, by increasing the 30 per cent of earnings before interest, tax, depreciation, and amortization ("EBITDA") limitation to 50 per cent of taxable income (with adjustments) for 2019 and 2020. As businesses look to weather the storm of the current crisis, this provision will allow them to increase liquidity with a reduced cost of capital, so that they are able to continue operations and keep employees on payroll.

Technical Amendment Regarding Qualified Improvement Property

The provision enables businesses, especially in the hospitality industry, to write off immediately costs associated with improving facilities instead of having to depreciate those improvements over the 39-year life of the building. The provision, which corrects an error in the Tax Cuts and Jobs Act, not only increases companies' access to cash flow by allowing them to amend a prior year return, but also incentivizes them to continue to invest in improvements as the country recovers from the COVID-19 emergency.

Temporary Exception From Excise Tax for Alcohol Used To Produce Hand Sanitizer

The provision waives the federal excise tax on any distilled spirits used for or contained in hand sanitizer that is produced and distributed in a manner consistent with guidance issued by the Food and Drug Administration and is effective for calendar year 2020.

What Happens Next?

The CARES Act now proceeds to the House of Representatives, which is expected to approve the legislation in the coming days. It is likely to be signed into law by President Trump soon after the House vote.

US IRS Announces Light-Touch Enforcement Approach

On March 25, 2020, the United States Internal Revenue Service ("IRS") announced a comprehensive package of measures to assist taxpayers facing challenges as a result of the coronavirus crisis, including easing payment guidelines and postponing compliance actions.

Highlights of the key actions in the IRS "People First Initiative" include:

Existing Installment Agreements

For taxpayers under an existing Installment Agreement, payments due between April 1 and July 15, 2020, are suspended. Taxpayers who are currently unable to comply with the terms of an Installment Payment Agreement, including a Direct Deposit Installment Agreement, may suspend payments during this period if they prefer. Furthermore, the IRS will not default any Installment Agreements during this period. By law, interest will continue to accrue on any unpaid balances.

New Installment Agreements

The IRS reminds people unable to fully pay their federal taxes that they can resolve outstanding liabilities by entering into a monthly payment agreement with the IRS.

Offers in Compromise ("OIC")

The IRS is taking several steps to assist taxpayers in various stages of the OIC process:

- Pending OIC applications — The IRS will allow taxpayers until July 15 to provide requested additional information to support a pending OIC. In addition, the IRS will not close any pending OIC request before July 15, 2020, without the taxpayer's consent.
- OIC Payments — Taxpayers have the option of suspending all payments on accepted OICs until July 15, 2020, although by law interest will continue to accrue on any unpaid balances.
- Delinquent Return Filings — The IRS will not default an OIC for those taxpayers who are delinquent in filing their tax return for tax year 2018. However, taxpayers should file any delinquent 2018 return (and their 2019 return) on or before July 15, 2020.
- New OIC Applications — The IRS reminds people facing a liability exceeding their net worth that the OIC process is designed to resolve outstanding tax liabilities by providing a "Fresh Start."

Non-Filers

The IRS reminds people who have not filed their return for tax years before 2019 that they should file their delinquent returns. More than one million households that haven't filed tax returns during the last three years are actually owed refunds and still have time to claim these refunds.

The IRS said many taxpayers should consider contacting a tax professional to consider various available options since the time to receive such refunds is limited by statute. Once delinquent returns have been filed, taxpayers with a tax liability should consider taking the opportunity to resolve any outstanding liabilities by entering into an Installment Agreement or an Offer in Compromise with the IRS to obtain a "Fresh Start."

Field Collection Activities

Liens and levies (including any seizures of a personal residence) initiated by field revenue officers will be suspended during this period. However, field revenue officers will continue to pursue high-income non-filers and perform other similar activities where warranted.

Automated Liens and Levies

New automatic, systemic liens and levies will be suspended during this period.

Passport Certifications to the State Department

The IRS will suspend new certifications to the Department of State for taxpayers who are "seriously delinquent" during this period. These taxpayers are encouraged to submit a request for an Installment Agreement or, if applicable, an OIC during this period. Certification prevents taxpayers from receiving or renewing passports.

Private Debt Collection

New delinquent accounts will not be forwarded by the IRS to private collection agencies to work during this period.

Field, Office, and Correspondence Audits

During this period, the IRS will generally not start new field, office, and correspondence examinations. The IRS will continue to work refund claims where possible, without in-person contact. However, the IRS may start new examinations where deemed necessary to protect the government's interest in preserving the applicable statute of limitations.

In-Person Meetings

In-person meetings regarding current field, office, and correspondence examinations will be suspended. Even though IRS examiners will not hold in-person meetings, they will continue their examinations remotely where possible. To facilitate the progress of open examinations, taxpayers are encouraged to respond to any requests for information they already have received — or may receive — on all examination activity during this period if they are able to do so.

Unique Situations

Particularly for some corporate and business taxpayers, the IRS understands that there may be instances where the taxpayers desire to begin an examination while people and records are available and respective staffs have capacity. In those instances when it's in the best interest of both parties and appropriate personnel are available, the IRS may initiate activities to move forward with an examination, understanding that COVID-19 developments could later reduce activities for an agreed period.

General Requests for Information

In addition to compliance activities and examinations, the IRS encourages taxpayers to respond to any other IRS correspondence requesting additional information during this time if possible.

Earned Income Tax Credit and Wage Verification Reviews

Taxpayers have until July 15, 2020, to respond to the IRS to verify that they qualify for the Earned Income Tax Credit or to verify their income. These taxpayers are encouraged to exercise their best efforts to obtain and submit all requested information, and if unable to do so, to reach out to the IRS indicating the reason such information is not available. Until July 15, 2020, the IRS will not deny these credits for a failure to provide requested information.

Independent Office of Appeals

Appeals employees will continue to work their cases. Although Appeals is not currently holding in-person conferences with taxpayers, conferences may be held over the telephone or by videoconference. Taxpayers are encouraged to promptly respond to any outstanding requests for information for all cases in the Independent Office of Appeals.

Statute of Limitations

The IRS will continue to take steps where necessary to protect all applicable statutes of limitations. In instances where statute expirations might be jeopardized during this period, taxpayers are encouraged to cooperate in extending such statutes. Otherwise, the IRS will issue Notices of Deficiency and pursue other similar actions to protect the interests of the government in preserving such statutes. Where a statutory period is not set to expire during 2020, the IRS is unlikely to pursue the foregoing actions until at least July 15, 2020.

Practitioner Priority Service

The IRS has reminded practitioners that, depending on staffing levels and allocations going forward, there may be more significant wait times for the PPS. The IRS said it will continue to monitor this as situations develop.

United States Rolls Out COVID-19 Response Tax Package

On March 20, 2020, the United States Treasury Department, the Internal Revenue Service, and the Department of Labor announced that small and medium-sized businesses ("SMEs") can begin taking advantage of two new refundable payroll tax credits under the newly enacted Families First Coronavirus Response Act (the "Act").

The new legislation, signed by President Trump on March 18, 2020, is designed to immediately and fully reimburse SMEs, dollar-for-dollar, for the cost of providing coronavirus-related leave to their employees. It applies to businesses with fewer than 500 employees.

To take immediate advantage of the paid leave credits, businesses can retain and access funds that they would otherwise pay to the IRS in payroll taxes. If those amounts are not sufficient to cover the cost of paid leave, employers can seek an expedited advance from the IRS by submitting a streamlined claim form that will be released soon.

Eligible employers will be able to claim these credits based on qualifying leave they provide between the effective date and December 31, 2020. Equivalent credits are available to self-employed individuals based on similar circumstances.

Paid Leave

The Act provides that employees of eligible employers can receive two weeks (up to 80 hours) of paid sick leave at 100 per cent of the employee's pay where the employee is unable to work because the employee is quarantined, and/or experiencing COVID-19 symptoms, and seeking a medical diagnosis. An employee who is unable to work because of a need to care for an individual subject to quarantine, a child whose school is closed or whose child care provider is unavailable for reasons related to COVID-19, and/or who is experiencing substantially similar conditions as specified by the US Department of Health and Human Services can receive two weeks (up to 80 hours) of paid sick leave at two-thirds the employee's pay.

An employee who is unable to work due to a need to care for a child whose school is closed or whose child care provider is unavailable for reasons related to COVID-19 may in some instances receive up to an additional ten weeks of expanded paid family and medical leave at two-thirds the employee's pay.

Paid Sick Leave Credit

For an employee who is unable to work because of coronavirus quarantine or self-quarantine or who has coronavirus symptoms and is seeking a medical diagnosis, eligible employers may receive a refundable sick leave credit for sick leave at the employee's regular rate of pay, up to US$511 per day and US$5,110 in the aggregate, for a total of 10 days.

For an employee who is caring for someone with coronavirus, or who is caring for a child because the child's school or child care facility is closed, or the child care provider is unavailable due to the coronavirus, eligible employers may claim a credit for two-thirds of the employee's regular rate of pay, up to US$200 per day and US$2,000 in the aggregate, for up to 10 days. Eligible employers are entitled to an additional tax credit determined based on costs to maintain health insurance coverage for the eligible employee during the leave period.

Child Care Leave Credit

In addition to the sick leave credit, for an employee who is unable to work because of a need to care for a child whose school or child care facility is closed or whose child care provider is unavailable due to the coronavirus, eligible employers may receive a refundable child care leave credit. This credit is equal to two-thirds of the employee's regular pay, capped at US$200 per day or US$10,000 in the aggregate. Up to 10 weeks of qualifying leave can be counted towards the childcare leave credit. Eligible employers are entitled to an additional tax credit determined based on costs to maintain health insurance coverage for the eligible employee during the leave period.

Payment for the Cost of Providing Leave

Normally, when employers pay their employees, they are required to withhold from their employees' paychecks federal income taxes and the employees' share of Social Security and Medicare taxes. The employers then are required to deposit these federal taxes, along with their share of Social Security and Medicare taxes, with the IRS and file quarterly payroll tax returns with the IRS.

Under guidance that will be released shortly, eligible employers who pay qualifying sick or child care leave will be able to retain an amount of the payroll taxes equal to the amount of qualifying sick and childcare leave that they paid, rather than deposit them with the IRS.

The payroll taxes that are available for retention include withheld federal income taxes, the employee share of Social Security and Medicare taxes, and the employer share of Social Security and Medicare taxes with respect to all employees.

If there are not sufficient payroll taxes to cover the cost of qualified sick and childcare leave paid, employers will be able to file a request for an accelerated payment from the IRS. The IRS expects to process these requests in two weeks or less.

Small Business Exemption

Small businesses with fewer than 50 employees will be eligible for an exemption from the leave requirements relating to school closings or childcare unavailability where the requirements would jeopardize the ability of the business to continue. The Labor Department will provide emergency guidance and rulemaking to clearly articulate this exemption shortly.

Non-Enforcement Period

The Labor Department will be issuing a temporary non-enforcement policy that provides a grace period for employers to come into compliance with the Act. Under this policy, the Labor Department will not bring an enforcement action against any employer for violations of the Act so long as the employer has acted reasonably and in good faith to comply with the Act. The Labor Department will instead focus on compliance assistance during the 30-day period.

US Taxpayers Allowed Longer To File Due To COVID-19

On March 21, 2020, the United States Treasury Department and the Internal Revenue Service announced that the federal income tax filing due date is automatically extended from April 15, 2020, to July 15, 2020, and that taxpayers can also defer federal income tax payments due on April 15, 2020, to July 15, 2020, without penalties and interest, regardless of the amount owed.

The IRS said that this deferment applies to all taxpayers, including individuals, trusts and estates, corporations, and other non-corporate tax filers, as well as those who pay self-employment tax.

Taxpayers do not need to file any additional forms or call the IRS to qualify for this automatic federal tax filing and payment relief, the IRS confirmed. However, individual taxpayers who need additional time to file, beyond the July 15 deadline, can request a filing extension by filing Form 4868. Businesses who need additional time must file Form 7004.

Most tax refunds are still being issued within 21 days, the IRS said.

Prior to this, the IRS's coronavirus relief measures extended only the tax payment deadline to July 15 for tax payments up to US$1 million for individuals and up to US$10 million for corporations.

The agency said that it will continue to monitor issues related to the COVID-19 virus, and updated information will be posted on the IRS's special coronavirus webpage.

SAFE INCOME CALCULATION MUST INCLUDE TAXES PAYABLE

— Bal Katlai, Zeifmans LLP, Toronto

In *626468 New Brunswick Inc. v. Her Majesty the Queen*, 2019 DTC 5141 (FCA), the court ruled that the taxpayer incorrectly calculated safe income on hand ("SIOH") by not considering tax liabilities prior to an intercorporate dividend payment. The Federal Court of Appeal ("FCA") applied subsection 55(2) on a portion of an intercorporate dividend and recharacterized the transaction to not be a dividend, but instead to be capital and subject to capital gain taxes. The issue in question was whether the taxes payable but not yet paid at the safe income determination time can reduce the safe income on hand that can be paid as a deductible intercorporate dividend without being re-characterized by subsection 55(2).

As case facts, Mr. Rodney Gillis wanted to sell his apartment building in New Brunswick. Prior to the sale transaction, Mr. Gillis undertook a series of reorganization steps that involved two section 85 rollovers — the first one transferred land and building in exchange for four common shares of a newly created corporation, Tri-Holdings. A second rollover transferred the four common shares of Tri-Holdings to 626468 New Brunswick Inc. ("626") and in return Mr. Gillis received four common shares of 626. Following this, Tri-Holdings sold the land and building to an arm's length buyer for $5,829,000 resulting in a capital gain in the amount of $2,639,000. Subsequently, Tri-Holdings undertook a series of paid-up capital ("PUC") increases totalling $1,879,120 — this resulted in a deemed dividend to 626 and a corresponding increase in the adjusted cost base ("ACB") of the Tri-Holdings shares held by 626. The capital dividend from the sale of the asset was elected under subsection 83(2) to account for another separate PUC increase of $1,319,500, which resulted in a separate increase in the ACB of the shares of Tri-Holdings held by 626. A final PUC increase of $569,093 was undertaken that further increased the ACB — incidentally, this increase was arranged to coincide with the sale of the shares of Tri-Holdings to an arm's length party. At issue before the FCA was if the final deemed dividend arising as a result of the increase in the PUC of the shares of Tri-Holdings was subject to subsection 55(2).

Timing-wise, the assets of Tri-Holdings were sold prior to the series of transactions that involved PUC increases. Hence, should there be an increase to the capital gain arising on a sale of Tri-Holding shares by an amount of taxes payable on account of the income realized from the sale of the asset? The court concluded that Tri-Holdings failed to reduce its ACB to account for the taxes payable and therefore applied subsection 55(2) on a portion of the inter-corporate dividends to be recharacterized as a capital gain.

The present FCA ruling focused on paragraph 55(2.1)(*c*) and whether the portion of the dividend that is recharacterized as a capital gain is the one that can be attributable to *anything* other than income that has been earned or realized after 1971 and before the safe income determination time by a corporation. The safe income represents the portion of the income earned or realized that can be attributed to the share class of a corporation held by a particular shareholder. The income here refers to a value that has inherently accrued in the share class during its holding period and contributes to the capital gain that would be realized on a disposition at fair market value of the share at that time of a sale. Hence, the income that can add a value should be after tax, since pre-tax income is not available for shareholder distribution.

The FCA ruling affirms that Tri-Holdings should have considered the available SIOH net of taxes payable — failure to do so meant that a portion of the deemed dividend realized due to the series of PUC increases resulted in an overall reduction of the FMV of the shares. The court denied a corresponding increase in the ACB of the shares that occurred due to the final PUC increase of $569,093 that would otherwise be available following paragraph 53(1)(*b*).

The FCA in its analysis examined the taxpayer's method of computing SIOH and whether this should have included any tax liability resulting from the disposal of its land and building by Tri-Holdings. In *Deuce Holdings Limited v. The Queen*, 97 DTC 921 (TCC), the court acknowledged that the wording in the *Income Tax Act* (Canada) (the "Act") does not clearly indicate that an application of subsection 55(2) must take into account any tax liability. In fact, the fair market value of a share so far as the income is considered is to be valued on an after-tax basis, and a distribution prior to tax is not wholly distributable. A similar sentiment is echoed in *Canada v. Kruco Inc.*, 2003 FCA 284, which is that SIOH is not limited to taxes paid but must include any amounts owed at a future time. In this context, the takeaway from the present ruling is that a tax liability that is not yet paid can negatively affect a share price because any arm's length purchaser who is likely buying a corporation with a latent corporate tax liability will be paying a lower price for a share sale.

Application to a Series That Is Part of a Transaction

Let us examine the consequence of the ruling to series of transactions that involve declaration of dividends — it is prudent that a SIOH be calculated before any intercorporate dividend is issued. Prior to declaring a dividend, a safe income is determined as a value at a particular time (point in time calculation) and it is determined for a share class of a corporation held by its shareholder. Per subsection 55(1), the "safe income determination time" for a transaction or event or a series of transactions or events means the time that is the earlier of

> (*a*) the time that is immediately after the earliest disposition or increase in interest described in any of subparagraphs 55(3)(*a*)(i) to (v) that resulted from the transaction, event or series, and
>
> (*b*) the time that is immediately before the earliest time that a dividend is paid as part of the transaction, event or series.

A reading of the definition of "safe income determination time" indicates an ordering rule for the safe income determination time — the ordering states that this time will be set based on the time when the first dividend is declared that is part of a transaction series. At least two questions arise:

- How does an interplay between safe income determination time and the assessment of a tax liability at the determination time affect the available SIOH attributable to a share class?
- Is there an appropriate choice of a time that can ensure maximum inclusion of after-tax amounts to SIOH?

The underlying objective is to highlight challenges that arise based on when a safe income determination time is chosen and factoring a tax payable into the SIOH at that time. A SIOH determination time is the earliest time prior to an issuance of a dividend and/or in general when declared — therefore, tax liability that is factored into the SIOH can vary based on the safe income determination time. To illustrate this, consider a hypothetical Opco-Holdco structure — Opco is directly held by Holdco and controlled by shareholder(s) — and assume a series of two transactions: an asset sale by Opco and a share sale.

Assume Opco undertakes an asset sale and transfers the shares to Holdco as part of a reorganization involving the sale. The question is on the value of the SIOH that can be attached to the shares that are transferred to Holdco. This valuation will depend on the timing of when the shares were transferred to Holdco. Based on the ordering in the definition "safe income determination time" under subsection 55(1), if Opco shares are transferred prior to the sale, the capital available following the sale will not be part of the SIOH for the shares transferred. On the other hand, if the shares were transferred after the asset sale, there is higher surplus that can be trapped as SIOH in the shares transferred, but this may also imply a higher tax liability that has to be factored into account following the taxes on the sale — this will affect the SIOH. The actual SIOH valuation will be based on the sale price and Opco's corporate tax rate.

In continuation, consider the case of an Opco share sale. Assume Opco pays a dividend to Holdco up to its SIOH prior to a share sale. As part of a series, following the sale of Opco shares, a second dividend is paid to Holdco. In this case, the portion of the income that can be attributed from the sale of the Opco shares will not be part of the SIOH for the shares transferred, even though the total amount available to be paid as dividend is the amount of SIOH in Opco prior to its share sale and the new amounts that are available after the Opco share sale.

What is the appropriate time for Opco to declare a dividend that triggers a safe income determination time? A solution can become complex and the amount of Opco's tax liability will be key. In either scenario, while the safe income determination time can limit the amount that can be paid as dividends based on the timing of when a dividend is paid, it is also necessary to factor in any tax liability at the time of determination of SIOH.

In summary, traditional SIOH calculations have relied (as a starting point) on the original Robertson rules that are now very old; there is minimal guidance from the Act and there has been significant reliance on the CRA's interpretations. The SIOH calculation when considered as point in time value should not be limited to inclusion of taxes already paid but must take into account any future tax liabilities as well. The present FCA ruling adds further prescriptive clarity to this observation. Prudent tax practitioners must factor in any tax liabilities when calculating SIOH especially if it is based on certain low-risk tax planning scenarios contemplated to minimize taxes payable. As we have seen, timing of when a dividend is issued can impact the SIOH, and in certain transactions (such as the sale transaction example here) there can be material impact on the amounts that can be safely declared as dividends after factoring tax liabilities. Our example scenario illustrates the co-mingling role of safe income determination time and the impact on the tax liability that can either work favourably or against a shareholder interest. Regardless of this observation, there are scenarios where timing is not necessarily a factor such as where a dividend is paid even if there is not a sufficient safe income from the payor end — invoking a forced subsection 55(2). Practitioners have used this as a simple mechanism to trigger a capital gain and also access the CDA balance as part of surplus stripping planning. Practitioners have to be cautious as the CRA can impose GAAR on such transaction which does not have a *bona fide* purpose.

CURRENT ITEMS OF INTEREST

Federal Budget Delayed

On March 11, Federal Finance Minister Bill Morneau announced that the 2020 Federal Budget would be tabled on March 30, 2020. However, due to the outbreak of COVID-19 the House of Commons has agreed to adjourn until April 20, 2020, so the Budget is delayed until a later date.

Saskatchewan Budget

Saskatchewan Finance Minister Donna Harpauer presented the province's 2020–2021 Budget on March 18, 2020. This included the spending estimates for the year, but not the revenue forecasts, which will be updated later in 2020 once the fiscal impact of the COVID-19 pandemic is better known. Several new tax measures were announced in the Budget, which are summarized below.

Later this year, the government will table *The Income Tax Amendment Act, 2020*, which will:

- introduce the re-indexation of Saskatchewan's Personal Income Tax system to the national rate of inflation beginning with the 2021 taxation year,
- introduce a new investment incentive for the fertilizer sector,
- extend the Manufacturing and Processing Exporter Tax Incentive for an additional three years, and
- make technical clarifications to *The Income Tax Act, 2000*.

The *Provincial Sales Tax Amendment Act, 2020* will be introduced to enact initiatives to ensure out-of-province e-commerce platforms collect and remit provincial sales tax ("PST"). This bill will also contain related amendments to *The Revenue and Financial Services Act* to maintain consistency with the PST legislative changes. The government announced a PST rebate for new home construction of up to 42% of the PST paid on a new house contract up to $350,000, excluding the land, for new homes purchased after March 31, 2020, and before April 1, 2023.

Last, the government will introduce the Oil Infrastructure Investment Program, a SaskFirst new growth tax incentive administered by the Ministry of Energy and Resources, to support new and expanded pipelines and new pipeline terminals.

Manitoba Budget

Manitoba's 2020 Budget: Moving Manitoba Forward was presented on March 19, 2020, by Finance Minister Scott Fielding. Budget 2020 was initially scheduled to be presented on March 11, 2020, before the first case of the COVID-19 virus was reported in Manitoba. To address financial uncertainty concerning the pandemic, Budget 2020 was updated to include a COVID-19 Emergency Supplement, which noted that Manitoba has nearly $1 billion of financial flexibility to address the situation, including an $872 million rainy-day fund.

The Budget announced numerous new tax measures, including:

- enhancements to the Film and Video Production Tax Credit;
- enhancements to the Child Care Centre Development Tax Credit;
- extending the Mineral Exploration Tax Credit to December 31, 2023;
- extending the Cultural Industries Printing Tax Credit to December 31, 2021;
- extending the Community Enterprise Development Tax Credit to December 31, 2021;
- requiring that the Primary Caregiver Tax Credit be renewed every three years;
- making the Manufacturing Investment Tax Credit permanent and reducing the refundable portion of the credit from 7% to 6%;
- increasing the thresholds for the Health and Post-Secondary Education Tax Levy;
- eliminating all probate fees for applications made on or after July 1, 2020;
- increasing tobacco tax rates;
- a flat $25-per-tonne Green Levy that was originally announced on March 5, 2020, to replace the federal backstop carbon tax; and
- various reductions to Retail Sales Tax rates.

2020 Quebec Budget

Quebec's Minister of Finance Eric Girard presented the province's 2020–2021 Budget, *Your Priorities, Your Budget*, on March 10, 2020. Budget 2020 projects a balanced budget in fiscal 2020–2021, after depositing $2.7 billion in the

Generations Fund. Some of the main highlights of the budget's numerous tax measures are summarized below. A full analysis of all the tax measures that were announced in the budget can be found in the Budget Dispatch.

New Refundable Caregiver Credit

A new refundable tax credit for caregivers will replace the four existing components of the tax credit for informal caregivers. The new caregiver tax credit will have two components:

(a) a universal basic tax assistance of $1,250 where the caregiver co-resides with the person and an additional $1,250 with no requirement that the caregiver co-reside with the person, and

(b) universal tax assistance of $1,250 for a caregiver who supports and co-resides with a relative aged 70 or older.

The amount from component (a) that has no co-residency requirement is reduced by 16% of the amount by which the care recipient's income exceeds $22,180, so this amount is nil once income reaches $29,993 (for 2020).

As of January 1, 2021, the refundable credit for respite expenses and refundable credit for persons providing respite to informal caregivers will be repealed.

Simplifying Payment of Credit for Solidarity to the Surviving Spouse

Following the death of a spouse, the surviving spouse will be able to continue receiving payments of the solidarity tax credit without applying to Revenu Québec, effective July 1, 2020.

Tax Credit for Investments and Innovation

A tax credit for investments and innovation is introduced for specified expenses incurred for the acquisition of a specified property after March 10, 2020, but before January 1, 2025. The tax credit may be deducted from the qualified corporation's total taxes for the taxation year, and any portion that cannot be used to reduce total taxes for the

year may be refunded, in whole or in part, or carried back to the preceding three taxation years or forward to the subsequent 20 taxation years. The non-refundable portion may not be carried back to a taxation year that ends on or before March 10, 2020.

Specified property includes manufacturing or processing equipment, computer equipment, or certain management software packages. The credit will be calculated on the portion of the expenses incurred to acquire the property in excess of $5,000 or $12,500, depending on the property. The applicable tax credit rate, in respect of a particular property, may reach up to 20% and will be determined based on the economic vitality index of the region where the acquired property will be mainly used. The expenses may not exceed a cumulative limit of $100 million.

Incentive Deduction for the Commercialization of Innovations in Quebec

Effective for taxation years beginning after December 31, 2020, there will be a new deduction for the commercialization of innovations in Quebec. This deduction will enable a corporation that commercializes a qualified intellectual property asset developed in Quebec to benefit from an effective tax rate of 2% on the qualified portion of its taxable income attributable to that qualified intellectual property asset. Currently, the corporate income tax basic rate in Quebec is 11.5%.

The amount of the credit is reduced for corporations with assets and gross income, applicable for the taxation year, over $50 million, and will be eliminated when assets and gross income for the year exceed $100 million.

The tax credit for investments and innovation will replace the tax credit for investments. A corporation may nevertheless, on certain conditions, elect to receive the tax credit for investments according to its current terms and conditions.

Introduction of the Synergy Capital Tax Credit

To support the growth of innovative businesses that, to develop their full potential, need to have access to capital and to business networks, a new tax credit will be introduced in respect of a share subscription carried out after December 31, 2020. This tax credit will foster business networking and synergy between Quebec businesses.

The synergy capital tax credit will be granted to a corporation, other than a financial institution, a real estate sector corporation, or a corporation whose activities consist mainly in granting loans or making investments, that subscribes shares of the capital stock of a qualified corporation in the life sciences, manufacturing or processing, green technologies, artificial intelligence, or information technologies sectors. It will be calculated at a rate of 30% on the amount paid by the corporation for subscription of shares. The shares subscribed must be retained by the corporation for a minimum period of five years.

The tax credit will be non-refundable and can be, for a corporation, up to $225,000 annually. This is based on a rate of 30% multiplied by the total amounts, not exceeding $750,000, each of which is an eligible investment of the investor for the year.

2020 Yukon Budget

The Premier of Yukon and Minister of Finance, the Honourable Sandy Silver, tabled the 2020–2021 Budget on March 5, 2020. For 2020–2021, total estimated spending is $1.62 billion, with a capital budget of $369.7 million and $1.25 billion for operations and maintenance. There will be a surplus of $4.1 million for Yukon in 2020–2021.

Three tax measures were announced in the Budget:

- cutting the small business tax from 2% to zero;
- modernizing the Business Investment Tax Credit; and
- amending the Yukon Basic Personal Amount under the *Income Tax Act* to align with recent changes made by the Government of Canada.

Government To Expand Zero-Emission Vehicle Incentives

According to an article by the Canadian Press, the federal government is planning to extend the 100% CCA write-off for zero-emission vehicles to off-road electric vehicles and equipment, such as electric mining or farming equipment.

CRA Cancels Transfer Pricing Information Circular

On February 26, 2020, the CRA informed stakeholders that it has cancelled IC 87-R2, *International Transfer Pricing*, because it is inconsistent with the interpretation and application of Canadian transfer pricing legislation and does not reflect updates to the OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. For reference on transfer pricing matters, taxpayers should refer to the CRA's transfer pricing memoranda and the OECD's guidelines.

Nova Scotia Budget

Nova Scotia's Finance and Treasury Board Minister, Karen Casey, presented the 2020 Budget on February 25, 2020. The Budget projects a surplus of $55 million for the upcoming fiscal year. The Budget included several new tax changes, which are listed below.

Corporate Rate Reductions

As announced earlier in February, the general corporate income tax rate will be reduced from 16% to 14%, and the small business income tax rate will be reduced from 3% to 2.5%. Both changes will take effect on April 1, 2020.

Digital Media and Digital Animation Tax Credits

Budget 2020 announced that both the Digital Media Tax Credit and the Digital Animation Tax Credit will be extended until December 31, 2025.

Nova Scotia Child Benefit

The income threshold for the Nova Scotia Child Benefit will be increased from $26,000 to $34,000, which will allow more families to qualify.

Tobacco Tax Rate Increases

The following tobacco tax rate increases take effect on February 26, 2020:

- tax on cigarettes and tobacco sticks will increase from 27.52¢ per unit to 29.52¢;
- tax on fine cut tobacco will increase from 26¢ per gram to 40¢ per gram;
- tax on cigars will increase from 60% of the retail selling price to 75%; and
- tax on other tobacco products will increase from 18.52¢ per gram to 40¢ per gram.

New Tax on Vaping Products

Nova Scotia will introduce a tax on vaping products, including those that do not contain nicotine, starting September 15, 2020. Vaping substances will be taxed at the rate of $0.50 per ml, while vaping devices and components will be taxed at a rate of 20% of their suggested retail selling price. This will not apply to cannabis vaping products, which are taxed according to the Coordinated Cannabis Tax Agreement. All retailers, wholesalers, and manufacturers of vaping products will be required to obtain a provincial permit, effective July 1, 2020.

Northwest Territories Budget

Caroline Wawzonek, Minister of Finance for the Northwest Territories, presented the 2020–2021 Budget on February 25, 2020. The Budget forecasts a $203 million operating surplus in 2020–2021, with revenue at $2.186 billion and total expenditures at $1.983 billion. The operating surplus is projected to decline to $147 million in 2021–2022, $116 million in 2022–2023, and $3 million by 2023–2024. The capital program in 2020–2021 is projected to be $399 million. The Budget did not contain any new tax measures.

Alberta Budget

Alberta Budget 2020: A Plan for Jobs and the Economy was tabled February 27, 2020, by Minister of Finance Travis Toews. The Minister announced that Alberta's total revenue for 2020–2021 is estimated at $50.0 billion. The Minister forecast total expenses will be $56.1 billion in 2020–2021. After adjustments, the government will operate at a deficit of $6.8 billion in 2020–2021. Aside from new taxes on short-term rentals and vaping products, no further tax measures were announced in the Budget.

British Columbia Budget

Budget 2020: A Balanced Plan to Keep B.C. Moving Forward was presented by British Columbia Finance Miniser Carole James on February 18, 2020. The Budget projects surpluses of $227 million in 2020–2021, $179 million in 2021–2022, and $374 million in 2022–2023. Several tax measures were announced in the Budget. The notable measures are summarized below, and all of the tax changes can be found in the WK Budget Dispatch.

New Tax Bracket

Effective January 1, 2020, a new personal tax bracket is introduced. Where a taxpayer's income exceeds $220,000, they will be subject to a new higher rate of 20.5% (up from 16.8%). Consequently, taxpayers will be eligible for a 20.5% charitable donation tax credit for donations over $200 with respect to their income that is subject to that higher rate.

Extension of Credits

The training tax credits are extended for three years to the end of 2022.

Also, the farmers' food donation tax credit is extended for three years to the end of 2023.

Changes to Film Incentives

Beginning July 30, 2020, within 60 days of incurring their first eligible expenditure, corporations must notify the government of their intention to claim the production services tax credit. Also, effective February 19, 2020, the accreditation certificate fee for the production services tax credit is increased to $10,000.

Provincal Sales Tax Changes

Beginning July 1, 2020, carbonated beverages that contain sugar or sweeteners will no longer qualify for the PST exemption for food products for human consumption.

Also beginning July 1, 2020, new registration requirements will apply to Canadian sellers of goods and foreign sellers of software and telecom services with specified BC revenues exceeding $10,000. Further, Canadian sellers of "vapour products" must register if they cause vapour products to be delivered to consumers in BC. These measures are intended to ensure that businesses involved in the digital economy are collecting sales taxes.

Effective February 19, 2020, electric aircraft are exempt from PST.

Effective February 19, 2020, there will be no restriction on the location of use with respect to the exemption for pollution control and waste management machinery and equipment.

Last, beginning February 19, 2020, real property contractors who perform value-added work to goods and then install the goods into real property outside BC can apply for refunds of the PST paid on those goods.

Alberta Court Finds Federal Carbon Tax Unconstitutional

On February 24, 2020, the Alberta Court of Appeal ruled that the federal *Greenhouse Gas Pollution Pricing Act* is unconstitutional in a 4-1 decision. This is the first provincial appeal court to side against the federal government on this matter. Both the Saskatchewan Court of Appeal and Ontario Court of Appeal ruled that the federal legislation was constitutional. The Supreme Court of Canada will hear Saskatchewan's appeal.

Final Livestock Tax Deferrals For 2019

The government has published the final list of designated regions where livestock tax deferral has been authorized for 2019 owing to extreme weather conditions.

The livestock tax deferral provision allows livestock producers in prescribed drought, flood, or excess moisture regions to defer a portion of their 2019 sale proceeds of breeding livestock until 2020, to help replenish the herd. The cost of replacing the animals in 2020 will offset the deferred income, thereby reducing the tax burden associated with the original sale.

The initial list for 2019 was published in July 2019, and included regions in British Columbia, Alberta, Saskatchewan, Manitoba, and Quebec. The federal Government has now said that ongoing analysis of drought conditions and excess moisture means the list of designated regions will be expanded. New regions have been identified for British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, and Quebec.

The criterion for identifying regions for livestock tax deferral is forage shortfalls of 50 per cent or more caused by drought or excess moisture. Eligibility for the deferral is limited to those producers located inside the designated prescribed areas. Producers in those regions can request the tax deferral when filing their 2019 income tax returns.

FOCUS ON CURRENT CASES

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

Tax Court Requires *Viva Voce* Evidence To Determine the Scope of a Waiver Provided by the Taxpayer

***632738 Alberta Ltd. v. The Queen*, 2019 DTC 1152 (Tax Court of Canada)**

This case deals with a taxpayer's unsuccessful attempt to obtain a preliminary determination from the Tax Court of Canada regarding the CRA's reassessment of the taxpayer's income for 2011. The CRA had reassessed the taxpayer, 632738 Alberta Ltd. ("632"), on the basis that an allocation of income to it through tiered partnerships, as a result of a reorganization, was unreasonable under subsection 103(1) of the *Income Tax Act* (the "Act"). In the reassessment, the CRA increased 632's income from just under $100,000 to almost $78 million. In response, 632 brought a motion under Rule 58 of the *Tax Court of Canada Rules (General Procedure)* (the "Rules") claiming that the reassessment was outside the statutory limitation period because it was issued beyond the normal reassessment period and was outside the scope of a waiver that 632 had provided. The Tax Court found that the question regarding the scope of the waiver required a trial with *viva voce* evidence (or live witness testimony), as opposed to being dealt with under the summary procedure provided in Rule 58.

Details as to the reorganization that was undertaken are not particularly germane to the Tax Court's analysis. It suffices to say that in 2011, 632 and its wholly-owned subsidiary, Thompson Contractors Inc. ("TCI"), created a general partnership, TCP. 632 owned 99.99% of the interest in TCP and TCI owned the remaining 0.01%. Several days later, 632 created a second partnership, Action, of which 632 was the general partner. Two corporations unrelated to 632 acquired limited partnership units of Action. Shortly thereafter, 632 sold its 99.99% interest in TCP to Action, following which, based upon capital contributed, 632 had only a 0.01% interest in Action.

Thereafter, another limited partnership, Thompson Bros. (Constr.) LP, which functioned as the operating entity in the construction group that included 632 and TCI, exercised an option to pre-pay $78 million to TCP (the first general partnership 632 created in 2011) in respect of future fees payable under a labour agreement. In its 2011 fiscal period, TCP included the $78 million as income and allocated it between TCI and Action, proportionate to their respective capital accounts ($7,799 to TCI and $77,992,201 to Action). In accordance with the relative capital accounts of, and partnership units held by, the partners, Action allocated $99,991 to its general partner, 632, and the remainder between the two corporations that held Action's limited partnership units. Those corporations used pre-existing losses and expenses to offset most of the income allocated by Action. The allocation to 632 is the subject of the CRA's reassessment.

In April 2015, approximately three months before the normal reassessment period for 632's 2011 taxation year was to expire, the CRA sent a letter to 632 proposing to reassess 632 under subsection 103(1) of the Act in respect of the income allocation. Subsection 103(1) allows the CRA to reassess a taxpayer to include in the taxpayer's income a reasonable allocation of income from a partnership in which the taxpayer was a partner if the principal reason for the allocation is to reduce or postpone tax payable under the Act. The CRA's proposal letter enclosed a draft waiver. 632 narrowed the waiver to contemplate only reassessments of 632's income from TCP (i.e., not from Action).

The CRA ultimately issued a reassessment after the normal reassessment period had expired. The reassessment was objected to, following which it was confirmed in May 2016. In response, 632 filed a Notice of Appeal to the Tax Court of Canada contesting the application of subsection 103(1) on the basis that the primary purpose of the allocations of income was to correspond to the partners' capital contributions rather than to reduce or postpone 632's tax liability. In its reply, the CRA described the issue as the determination of 632's income from TCP pursuant to subsection 103(1). However, the CRA subsequently filed an amended reply stating that the CRA had applied subsection 103(1) to the allocation to Action's partners. 632 filed an answer maintaining that the Action allocations fell outside the scope of the waiver and were thus statute-barred. 632, in response, brought a Rule 58 motion to determine the preliminary question of whether the waiver extended to the allocation of Action's income to 632.

A Rule 58 motion is decided in two stages. At the first stage, the Tax Court must determine whether the proposed question is appropriate for a preliminary determination. If the first stage is resolved in favour of the applicant, the Tax Court has the discretion to set the matter down for determination of the question in issue at the second stage. The applicant, in this case 632, must demonstrate in respect of the first stage that the following two conditions laid out in Rule 58 are satisfied:

(1) that the question is a question of law, fact, or mixed fact and law raised in the pleadings; and

(2) that determination of the question may be dispositive of the appeal, wholly or partially, result in a substantially shorter hearing, or substantially reduce costs that would be incurred on appeal.

The Tax Court found that the first condition was satisfied because the question of whether Action's income allocation to 632 is within the scope of the waiver is a question of mixed fact and law. However, in respect of the second condition, the Tax Court noted as follows:

> To decide if the Reassessment falls within the Waiver, the Court must consider the basis for the Reassessment, the contents of the Waiver and the parties' intentions in order to then decide if the Reassessment reasonably relates to the terms of the Waiver.

At the outset of its analysis, the Tax Court considered whether subsection 152(9) of the Act prohibited the CRA from reassessing 632 in respect of the allocation from Action rather than in respect of the allocation from TCP. In the preceding iteration of subsection 152(9), which applied in this case, the CRA was restricted from relying on new arguments and was precluded from including transactions that did not form the basis of the reassessment (*Walsh*, 2007 DTC 5441 (FCA)). However, the Tax Court relied on *Anchor Pointe Energy Ltd.* (2003 DTC 5512 (FCA)) for the principle that, pursuant to subsection 152(9), a new argument is allowed where the new transaction relied upon is related to the original transaction at issue. Therefore, if the Tax Court were to conclude on the motion that the TCP and Action transactions were related, the Tax Court was of the view that the CRA's new argument would be allowed as it would fall within the scope of the waiver.

Next, the Tax Court considered the scope of the waiver in order to determine if the parties intended to limit reassessment to the TCP transactions, in which case the transactions would not be considered to be related. Based upon the decision in *Solberg* (92 DTC 6448 (FC)), which the Tax Court described as the leading decision on the scope of waivers, the Tax Court was not prepared to look solely at the waiver, but also considered surrounding circumstances including extrinsic evidence. The Tax Court noted that there were discrepancies between the waiver, on the one hand, and the CRA's initial letter proposing to reassess 632 and the enclosed draft waiver, on the other hand, that could not be resolved on the evidence before the Tax Court. The Tax Court found that *viva voce* evidence was required, which was not permitted in a Rule 58 application.

In dealing with a Rule 58 application, the Tax Court balances the principles of summary judgment, which enable a court to determine the merits of a case on a summary basis to reduce the length and cost of adjudication, with the need for adequate evidence. In the result, the Tax Court held that it would be unfair to circumscribe the evidence the CRA may introduce, such that a full hearing was necessary to determine the relevant facts.

The decision of the Tax Court has been appealed, so it will be interesting to see whether the Federal Court of Appeal agrees with the Tax Court's approach in dealing with the waiver.

— *Emily Leduc Gagne*

Court Applies Sham Doctrine To Disallow Losses From Film Distribution Partnership

***Paletta v. The Queen*, 2019 DTC 1143 (Tax Court of Canada)**

The principal issue in these appeals was whether the taxpayers, as partners of certain film distribution partnerships, were entitled to deduct their proportionate share of the partnerships' business losses relating to promotional expenses incurred by the partnerships in respect of two feature films produced by Twentieth Century Fox ("Fox"). The films were acquired by the partnerships following production but were repurchased by Fox prior to their commercial release pursuant to call options granted by the taxpayers in favour of Fox. The Tax Court held that the business losses were not deductible pursuant to paragraph 18(1)(*a*) of the *Income Tax Act* (Canada) (the "Act"), finding that the call options were shams as Fox had pre-agreed to reacquire the films prior to their commercial release, and concluding that the partnerships' acquisition of the films had no *bona fide* income earning purpose. The taxpayers are appealing the Tax Court's decision.

The taxpayers in the appeals were a family-owned corporation (Paletta International) and Angelo Paletta, the adult son of the now-deceased family patriarch. In 2006, Paletta International engaged in a complex series of transactions in connection with its purported investment in the film entitled "Night at the Museum". In 2008, Angelo Paletta engaged in a virtually identical series of transactions in connection with his purported investment in the film entitled "The Day the Earth Stood Still". The Tax Court's written reasons largely focussed on the 2006 transactions, with instructions that such reasons should be understood to extend *mutatis mutandis* to the 2008 transactions.

Simplified, and stated very generally, the 2006 transactions involved the following steps. In late 2006, the Royal Bank of Canada made a US$212 million daylight loan to a lending trust, which on-loaned the amount to Paletta International. Paletta International used the US$212 million of borrowed money, together with US$8 million of its own funds, to finance the acquisition of a 99.999% limited partner interest in a film distribution partnership (the "Partnership"). Out of this capital investment, the Partnership paid US$128.31 million to Fox to acquire the copyright to "Night at the Museum" (the "Film"). Concurrently therewith, the Partnership purported to retain Fox to distribute the Film and paid Fox US$82 million for print and advertising expenses ("P&A Expenses") to be incurred in the lead-up to the commercial release of the Film. Paletta International and the general partner of the Partnership also purported to grant an option (the "Call Option") to Fox to acquire all of the outstanding interests in the Partnership. The Partnership and Fox then loaned US$6 million and US$206 million, respectively, to the Trust, which then repaid the daylight loan. Less than one month after the Partnership's acquisition of the Film and prior to the Film's commercial release, Fox exercised the Call Option and acquired all of the outstanding interests in the Partnership, and the Partnership was dissolved by operation of law. The exercise price payable under the Call Option was essentially the total cost to the Partnership of the Film plus 97% of the P&A Expenses.

In its tax return for the relevant year, Paletta International claimed a C$96 million business loss as its share of the Partnership's losses relating to its investment in the Film. Paletta International also reported a C$96 million capital gain in respect of the disposition of its interest in the Partnership, and claimed a C$74 million capital gains reserve.

The Minister denied Paletta International's deduction of its share of the Partnership's losses on the basis that the transactions between Paletta International and the Partnership were shams and the Partnership's acquisition of the Film was legally ineffective. The Minister also alleged that the Partnership was not a partnership in law, Paletta International's interest in the Partnership was an unregistered tax shelter, and the gain realized by Paletta International on the disposition of its interest in the Partnership was on income account. Although the Minister denied Paletta International's claim to its share of the Partnership's losses, she left intact the capital gains and certain other income reported in respect of Paletta International's disposition of its interest in the Partnership.

The Tax Court's denial of the Partnership's losses was based on its determination, not that the transactions between Paletta International and the Partnership were shams (as the Minister had submitted), but rather that the Call Option granted by the partners to Fox was a sham because the reacquisition of the Film was preordained. The Tax Court's determination was based on several factual findings, including that:

- the investment structure was created and marketed to the taxpayer by two accountants (the "Promoters") with extensive experience in the film financing industry, one of whom was a partner at one of the big four accounting firms in Canada and the other of whom had previously worked as the national sales manager for a production services tax shelter company;

- although the 2006 investment represented approximately 10% of the family's net worth, the taxpayer was not involved with negotiating the terms of the various agreements, including the purchase price for the Film, the P&A Expenses, the exercise price under the Call Option, and the distribution fees (such negotiation was left to one of the Promoters), and the taxpayer conducted minimal due diligence as to the investment;

- the investment in the Film was inconsistent with the taxpayer's ordinary business and investment practices;

- the transaction documents were drafted with a view to the unwinding of the transactions and the reacquisition of the Film by Fox, but with little regard to the consequences to the parties if the Film was not reacquired (for example, one of the security agreements allowed Fox to retain the gross receipts from the Film, net of distribution fees and release costs, in its collateral account until the expiration of the distribution agreement); and

- Fox had participated in eight similar deals in total and had reacquired the relevant film in each such deal, which suggested that its reasons for participating in these types of deals was to obtain a 3% discount on the P&A Expenses.

Interestingly, there is no analysis in the Tax Court's reasons about whether Fox had in fact a legal obligation to exercise the Call Option prior to its commercial release. As the Tax Court noted, the essence of a sham is that "the legal rights and relations set out in the documents are not the legal rights and relations the parties intended to and did create." The finding that the Call Option was a sham because its exercise was preordained would therefore seem to presuppose that the parties' true intention was to enter into some kind of long form purchase and sale agreement rather than a true option agreement. The Tax Court seems to have found that the parties understood that the Call Option would be exercised and, on that basis, to have inferred that the parties had "agreed" that the Call Option would be exercised. However, in light of the Tax Court's other findings in the case, it is doubtful that this putative "agreement" between the parties consisted of anything more than Fox's intention to exercise the Call Option from the outset and the taxpayer's awareness of such intention.

Indeed, it is respectfully submitted that the Call Option seems to be more accurately described as mere window dressing, rather than a sham. As the Supreme Court of Canada has previously noted, a "sham" is distinct from "window dressing" insofar as the former involves a deception about the legal validity of a transaction whereas the latter involves a deception about the taxpayer's intention for entering into a transaction. In *Mariano* (2015 DTC 1209), the Tax Court held that the taxpayer's option not to gift software licenses to a registered charity as part of a charitable donation scheme was mere window dressing designed to give the Minister the impression that the taxpayer had an actual choice about whether to make the gift. Similarly, in the absence of evidence that Fox had a legal obligation to reacquire the Film, the Call Option seems to be more properly described as mere window dressing designed to mislead the Minister into believing that the Partnership acquired the Film with the intention of owning it long-term. A finding that the Call Option was window dressing would have still provided ample support to the Tax Court for its denial of the Partnership's losses.

— *Kabir Jamal*

Tax Court Shows That It Has a Heart but No Discretion in Upholding TFSA Tax Assessment

***Robitaille v. The Queen*, 2019 DTC 1140 (Tax Court of Canada — Informal Procedure)**

The taxpayer in this case was an individual who over-contributed to his tax-free savings account ("TFSA") and was assessed penalty tax on his monthly excess amounts of $39,500 pursuant to section 207.2 of the *Income Tax Act* (the "Act"). The Tax Court was satisfied that the over-contribution was "a simple case of human error." However, despite the Court's sympathy for the circumstances that led to the over-contribution, the Court found that it had no discretion to vacate the assessment but urged the Minister to exercise her discretion to waive the tax pursuant to subsection 207.06(1) of the Act.

The situation that led the individual to over-contribute to his TFSA is likely not all that uncommon in that it involved an inadvertent, one-time deposit of funds to the wrong bank account that went unnoticed until almost 12 months later.

The taxpayer owned a roofing company for which his father acted as bookkeeper. The father handled all financial matters for his son and the company. The father deposited customer payments into the company's bank account. One to two times each year, the father would have the company pay a management fee to the taxpayer by issuing a $40,000 cheque to the taxpayer drawn on the company bank account, which the taxpayer would deposit in his personal bank account.

The over-contribution arose due to a mistake the taxpayer made when depositing one of the company-issued cheques. He attended an automated teller machine and inadvertently selected the TFSA button rather than the chequing account button on the on-screen display on the machine when identifying the destination account for the deposit.

For numerous reasons, the error did not come to the taxpayer's attention for almost 12 months. First, the taxpayer was not in the practice of receiving paper statements from his bank. Second, the balance of his chequing account was sufficiently high during the 12-month period following the mistaken deposit to his TFSA account such that cheques issued on the chequing account could be processed even though it was "missing" a $40,000 deposit. Third, the father did not notice anything unusual on the company side of the transaction because, once the funds were withdrawn from the company account, he did not track where they went. Fourth, although the CRA will send a letter to a taxpayer on the first instance of an over-contribution to their TFSA, the taxpayer had previously over-contributed for a prior year by $5,000 and had already received his first-time warning letter on the prior instance.

The taxpayer's father learned about the over-contribution when a CRA official mentioned the taxpayer's over-contribution as part of a conversation that the father and the CRA official were having about an HST matter for the company. The same day that the father and the taxpayer became aware of the over-contribution, the taxpayer withdrew $29,000 from his TFSA to make the TFSA compliant. However, by this point, the taxpayer's TFSA account had excess balances for the last six months in 2016 and the first six months in 2017. Under section 207.2 of the Act, excess TFSA amounts attract tax at the rate of 1% of the highest such amount in that month. In the taxpayer's case, this created a 2016 tax liability of $2,370 for the over-contribution during the last six months of that year and the same 2017 tax liability for the over-contribution during the first six months of that year. Only the 2016 assessment was before the Tax Court, as the taxpayer had failed to file a timely notice of objection for the 2017 assessment.

The Court's analysis of the taxpayer's liability for the assessed tax was limited to a mechanical application of the relevant provisions in sections 207.1 and 207.2 imposing the tax for an excess TFSA amount. Once the Court found that the taxpayer had an excess TFSA amount equal to the amount computed by the Minister, the Court considered itself bound to uphold the assessment.

Since the sanction in the Act for a taxpayer's failure to comply with his or her TFSA account limit is to impose a tax rather than a penalty, it would seem that a taxpayer is unable to argue for a judge-made due diligence defence for the assessment, which the Tax Court has applied in other penalty contexts. See *Moore* (2019 DTC 1103), *Douglas* (2012 DTC 1114), and *Home Depot* (2009 GTC 970). However, even if something akin to a due diligence defence were available here, this would likely not have been an appropriate case, since Mr. Robitaille did not take all reasonable steps to ascertain his compliance with the TFSA regime and this was not the first instance of over-contributing to his TFSA account.

Despite upholding the Minister's assessment, the Court concluded its reasons by noting that section 207.06(1) of the Act allows the Minister to cancel all of Mr. Robitaille's tax liability in respect of the excess TFSA amount. Indeed, the Court walked the parties through how the Minister's discretion might apply in the circumstances. The Court acknowledged that it had no jurisdiction to order the Minister to exercise her discretion to cancel the tax but the Court urged her to do so, implying that the Court saw genuine unfairness for the taxpayer to be subject to the excess TFSA tax in these "extraordinary", inadvertent circumstances.

— *Emily Leduc Gagne*

Some Teeth Given to Statutory Provision That Requires the Minister To Act "With All Due Dispatch"

***Stover v. The Minister of National Revenue*, 2019 DTC 5145 (Federal Court)**

This case was a judicial review application concerning the Minister's decision on a taxpayer's application for relief from arrears interest accruing on his tax debts during the period that he was disputing the underlying reassessments. As discussed below, the Federal Court allowed the taxpayer's application and set aside the Minister's decision for failing to adequately take into account the CRA Appeals Division's almost three-year delay dealing with the taxpayer's late-filed objection, which was subsequently allowed to be filed by the Tax Court of Canada.

The taxpayer in this case was an individual whose financial planning business was audited and eventually reassessed by the CRA to increase taxable income for the 2005 and 2006 taxation years by approximately $154,500 in aggregate. The relevant reassessments were issued on November 24, 2008, but the taxpayer did not file notices of objection within the 90-day period for doing so. Instead, the taxpayer filed his notices of objection with the CRA on February 2, 2010, which was within the period allowed by section 166.1 of the *Income Tax Act* (Canada) (the "Act") for him to apply to the Minister to late-file notices of objection to the reassessments issued on November 24, 2008. It is unclear from the facts reflected in the Court's decision as to the taxpayer's awareness that he was beyond the 90-day deadline for filing his notices of objection when he did so. In any event, it appears that the CRA processed the late-filed objections as if they were applications to the Minister for an extension of time to file the notices of objection pursuant to section 166.1 of the Act.

Similar to the Minister's statutory obligation under subsection 165(3) of the Act upon receipt of a valid notice of objection, subsection 166.1(5) of the Act states that, after receiving an application for an extension of time under section 166.1, "the Minister shall, with all due dispatch, consider the application and grant or refuse it, and shall thereupon notify the taxpayer in writing of the Minister's decision."

After the CRA received the taxpayer's notices of objection in February 2010, many months likely passed before the CRA advised the taxpayer of the Minister's refusal to grant an extension of time to file, since the taxpayer was forced to apply to the Tax Court of Canada in February 2012 to obtain court authorization for doing so pursuant to subsection 166.2 of the Act. The Tax Court allowed the taxpayer's application in February 2013 and the CRA assigned the taxpayer's objection file to an appeals officer in November 2013. After the taxpayer was unable to provide the CRA appeals officer with sufficient documentation to support the expenses that were disallowed under the relevant reassessments, the Minister confirmed the reassessments in March 2014. The taxpayer appealed the reassessments to the Tax Court of Canada in July 2014, requiring permission from the Tax Court to late-file his notice of appeal, but he later discontinued his appeal in December 2015.

Almost a year after the taxpayer discontinued his Tax Court appeal, the taxpayer applied to the CRA to request that the Minister exercise discretion under subsection 220(3.1) of the Act to grant relief from arrears interest that had accrued on the tax debts for the 2005 and 2006 tax years created by the reassessments issued in November 2008, citing financial hardship and illness. The Minister disposed of the application in January 2017 by granting 30 days of interest relief for the CRA's failure to internally assign the taxpayer's objection within six months of the Tax Court of Canada's authorization allowing the objections to be late-filed, but refused to provide further interest relief for the alleged financial hardship or illness. The taxpayer requested that the CRA undertake a second level review of the Minister's initial decision and he identified some additional factors to support his request for further relief from arrears interest. There was no change to the Minister's decision as a consequence of the second level review, as the CRA found that the taxpayer was unable to demonstrate either financial hardship or that any medical condition prevented him from properly complying with his obligation to file his 2005 and 2006 tax returns accurately and on time. In the second level review, the CRA also concluded that there was no action by the CRA that caused any undue delay or errors which prevented the taxpayer from addressing the balance owing. However, the CRA's report from the second level review identified the filing date for the objections as March 26, 2013 (which is presumably the date that the CRA entered the objections into their system as valid objections after the Tax Court authorization to late-file was granted in February 2013), rather than the February 2, 2010, date that the taxpayer sent his notices of objection to the CRA. Accordingly, the CRA's report did not address the CRA's conduct during the period after February 2, 2010, when the CRA was contemplating whether the Minister should exercise discretion under section 166.1 of the Act to grant an extension of time to file the notices of objection. The Minister's decision on the second level review was communicated to the taxpayer in October 2017 and the taxpayer brought this Federal Court application for review of that decision.

In a court application to review the Minister's exercise of discretion under subsection 220(3.1) of the Act, the standard for review is whether the Minister's exercise of discretion was reasonable. In this case, the Court (*per* Favel J) reviewed the factors that the Minister considered in relation to the taxpayer's alleged financial hardship, illness, and other extraordinary circumstances and found the Minister's reasons for denying interest relief on those grounds to be reasonable. However, the Court then went on to find that the Minister failed to discharge the statutory obligation under subsection 166.1(5) to consider the taxpayer's application for an extension of time to file his notices of objection and communicate a decision to the taxpayer "with all due dispatch". On this issue, the Court expressly mentioned the fact that the CRA's report prepared from the second level review neither mentioned nor provided an explanation for the almost two-year processing delay that occurred during the period immediately after the taxpayer purported to file valid notices of objection in February 2010.

Since the CRA's published guidelines clearly state that interest may be waived or cancelled if a lapse of time resulted mainly from errors in processing or undue delay on the part of the CRA, and the report reflecting the Minister's analysis underlying the decision on the second level review did not reflect a consideration of whether there were CRA processing errors or undue delay during the period that the Minister was contemplating whether to grant an extension of time for filing the notices of objection — a period that was likely between 21 and 23 months — the Minister's decision to not allow further interest relief on the basis of potential undue CRA delay during that period was inherently unreasonable simply because the Minister did not take that period into consideration. The Court thus set aside the Minister's decision and remitted the matter back for reconsideration but solely on the question of whether the taxpayer should be allowed additional relief from arrears interest for processing delays caused by the CRA.

No doubt the taxpayer was hoping for a decision from the Court that would set aside the Minister's decision in its entirety on the basis that the Minister was unreasonable in rejecting financial hardship, illness, and the other extraordinary circumstances identified by the taxpayer as reasons the Minister should grant additional relief from arrears interest. But it seems that in his submissions to the Minister and the Court, the taxpayer himself never complained about the CRA delay during the period that the Minister was contemplating whether to grant an extension of time to file the notices of objection. Accordingly, the Court's finding that there was a basis for the Minister to grant interest relief for that period could be viewed as a consolation prize for this taxpayer, even though it only covers a small portion of the 10- to 12-year period that arrears interest was accruing on the relevant tax debts.

— *John Yuan*

RECENT CASES

Notes, the value of which was in constant flux until maturity, still "debt" for purposes of paragraph 94.1(1)(*a*) of the Act

SLT, a non-resident corporation, was a controlled foreign affiliate of the corporate taxpayer. SLT acquired certain notes (the "Notes") from certain banks. After their purchase by SLT, the value of the Notes was derived from the value of certain Reference Assets, the value of which was in constant flux. As a result, the amounts to be paid out under the Notes was unknown and would remain so until their maturity or early termination. In answer to a preliminary question put before it by the taxpayer and the Crown, the Tax Court of Canada determined that the Notes were debt for purposes of paragraph 94.1(1)(*a*) of the *Income Tax Act*, even though the amounts to be paid thereunder were unknown and would remain so until the Notes would come to term. On appeal to the Federal Court of Appeal, the taxpayer argued that the Tax Court Judge erred in determining that the Notes were debt. In the taxpayer's view, the Tax Court judge failed to have regard to the well-established legal meaning of the word "debt", according to which a debt does not arise unless and until the amount to be paid is known or ascertainable.

The taxpayer's appeal was dismissed. The taxpayer's argument that a debt for purposes of paragraph 94.1(1)(*a*) does not exist unless and until the amount to be paid becomes known was untenable. Such an argument would make the word "debt" redundant; it would require that the context of paragraph 94.1(1)(*a*) be overlooked; and it would defeat the purpose for which paragraph 94.1(1)(*a*) was enacted. When regard is had to the text, context, and purpose of paragraph 94.1(1)(*a*), a debt arises for the purposes of this provision: (a) when an amount or credit is advanced by one party to another party; (b) when an amount is to be paid or repaid by that other party at some point in the future in satisfaction of the advance; and (c) when this amount is fixed or determinable or will be ascertainable when payment is due. All three of these requirements were met in the present proceedings. As a result, the Notes were debt for purposes of paragraph 94.1(1)(*a*), even though the amounts to be paid thereunder remained as yet unascertained.

Barejo Holdings ULC v. The Queen

2020 DTC 5023

Taxpayer's motion for leave to strike Minister's pleading dismissed for contravening fresh step rule

The taxpayer sought leave of the Tax Court of Canada to bring a motion striking the Minister's reply pleading. The taxpayer's motion came almost three years after the reply was filed and more than two years after all pre-trial proceedings had been completed. The motion was brought ten months after the parties had filed a joint application representing that the appeal was ready to be set down for hearing. The taxpayer had brought two interlocutory motions and one appeal to the Federal Court of Appeal. The motion for leave was dismissed on the grounds the motion to strike would contravene Rule 8 of the *Tax Court of Canada Rules (General Procedure)*, known as the "fresh step" rule: if a party pleads over to a pleading, it implies a waiver of any irregularity that might have been attacked. The judge gave four reasons for his decision: the lateness of the motion, its lack of merit, the absence of any prejudice to the taxpayer, and the prejudice to the Minister. The judge also concluded that the reply pleadings were not grossly deficient and that the facts assumed were not, as the taxpayer argued, conclusions of law. The taxpayer appealed.

The appeal was dismissed. The Tax Court's decision of whether to grant leave to bring a motion under Rule 8 is discretionary and has a large factual component. The Court of Appeal will not overturn such a decision absent a palpable and overriding error or extricable error in the assessment of the evidence of law. The taxpayer had not identified any such error in the Tax Court's decision. The facts amply justified the decision not to grant leave. The judge's discretion was exercised in a manner consistent with the objective of Rule 8, the evidence before him, and the existing jurisprudence. The thrust of the taxpayer's argument was that the Tax Court had no jurisdiction to decide the Rule 8 motion. The Court of Appeal found this argument to be devoid of merit: any deficiency in the reply pleading bears on the validity of the reassessment and has no relevance to the jurisdiction of the Tax Court. The taxpayer also contended that the reasons for the decision were inadequate. Again, the Court of Appeal found there was no merit in this argument. The reasons fully and fairly explained the basis on which the judge exercised his discretion.

Dilalla v. The Queen

2020 DTC 5024

Trustee's decision to disallow Crown's secured claim set aside

The taxpayer (the "Bankrupt") owed unremitted income tax and GST. He was also the owner of an undivided one-half interest in a certain property (the "Property"). The Minister registered judgments against the Bankrupt's interest in the Property. In proceedings in the Supreme Court of British Columbia, the Minister sought an order, in part, setting aside the Trustee's decision to disallow the secured portion of the Crown's Proof of Claim.

The Minister's application was granted. The Crown's secured claim in this case arose pursuant to subsection 223(11.1) of the *Income Tax Act*, subsection 316(10.1) of the *Excise Tax Act*, and sections 86 and 87 of the *Bankruptcy and Insolvency Act*. The Trustee's determination to disallow the security of the Crown in advance of the Bankrupt's assignment into bankruptcy was based on a statutory interpretation, which was not time-tested as the Crown's position was. The Trustee was therefore directed to allow the Crown's secured claim as submitted.

Gidda (Re)

2020 DTC 5020

Taxpayers liable for tax owing by their deceased father after receiving distributions from father's income fund after his death

B was the taxpayers' father and the annuitant of an income fund (the "Income Fund"). B designated the taxpayers as the beneficiaries of the Income Fund and later died on June 8, 2011. On July 26, 2011, each of the taxpayers received $96,640.96 in satisfaction of her beneficial interest in the Income Fund. As of July 3, 2015, B owed tax of not less than $96,640.96. Accordingly, on July 3, 2015, the Minister assessed each of the taxpayers for $96,640.96 under the transferor–transferee liability rules in subsection 160(1) of the *Income Tax Act* (the "Act"). The taxpayers appealed to the Tax Court of Canada.

The taxpayers' appeals were dismissed. The only issue was whether B and the taxpayers were dealing with each other at arm's length. In *Kiperchuk v. The Queen*, 2013 DTC 1088, the Tax Court of Canada concluded that a transfer from a person who held an interest in an RRSP or income fund to a designated beneficiary occurs on the death of the person who held the RRSP or fund. In the present proceedings, therefore, the transfer from B to the taxpayers occurred at the time of B's death. Also, the taxpayers continued to be his children after his death so that the transfer was between persons connected by a blood relationship. Such persons, moreover, are deemed under paragraphs 251(1)(*a*) and 251(2)(*a*) of the Act not to deal with each other at arm's length. As a result the transferor–transferee liability rules in subsection 160(1) applied to the taxpayers in this case. The Minister's assessments were affirmed accordingly.

Dreger v. The Queen

2020 DTC 1022

Taxpayer's husband transferred funds to their joint account without consideration while he owed tax; transferor-transferee liability rules only applied to funds removed by taxpayer from joint account

The Minister alleged that, at a time when the taxpayer's husband, W, owed GST and income tax, he transferred amounts, without consideration, from his bank account to a joint account held by him and the taxpayer (the "Joint Account") during the period from March 15, 2013 to October 30, 2015. The Minister accordingly assessed the taxpayer vicariously under the transferor–transferee tax liability provisions in section 325 of the *Excise Tax Act* and in section 160 of the *Income Tax Act* for the tax owing by W at the time of the alleged transfers. On March 26, 2014, W entered into a consumer proposal under the *Bankruptcy and Insolvency Act* (the "Proposal"). At the commencement of the hearing of the taxpayer's appeal to the Tax Court of Canada, however, counsel for the Minister informed the Court that the Minister was accepting the taxpayer's argument that any purported transfers made by W after the date of the Proposal were beyond the scope of the assessments under appeal. Counsel therefore informed the Court that the appeal under section 160 of the *Income Tax Act* should be allowed in full. Counsel also informed the Court that it should reduce the Minister's assessment under section 325 of the *Excise Tax Act* to $89,806.72, which was the amount that W allegedly transferred to the taxpayer between March 15, 2013 and March 26, 2014.

The taxpayer's appeal was allowed in part. The mere placing by W of funds in the Joint Account did not constitute a "transfer" for purposes of the transferor–transferee liability provisions of both acts (see *Fasken Estate v. Canada (MNR)*, 49 DTC 491). The "transfer" for purposes of those provisions only took place when the taxpayer actually took control of the funds by removing them from the Joint Account. The evidence provided by the Minister to the Court, although not complete, indicated that the total amount transferred for no consideration by W to the taxpayer prior to the date of the Proposal on March 26, 2014 was $34,052. The taxpayer was therefore liable for this amount under subsection 325(1) of the *Excise Tax Act*. The Minister was ordered to reassess in accordance with the foregoing analysis.

White v. The Queen

2020 DTC 1021

Application for injunction to prevent reassessment pending review of denied Voluntary Disclosure application dismissed

This is an appeal from a Federal Court decision dismissing a judicial review application of a decision rendered by an officer of the Canada Revenue Agency ("CRA") and refusing an interlocutory injunction restraining the Minister from proceeding with the reassessment of the appellant's income tax returns. The taxpayer had been informed that the CRA would issue notices of reassessments and the taxpayer had filed an application under the Voluntary Disclosure Program ("VDP"). The Minister rejected the application on the basis that the VDP application was not voluntary and indicated that another reassessment would be issued for a different period. The taxpayer argued that this was premature as he had not yet received a response to his demand of an internal review relative to his VDP application. He also asked for an interlocutory injunction preventing the CRA from issuing a reassessment for another period until the prior issue was resolved. The Federal Court rejected those demands and the taxpayer applied for a judicial review of the Federal Court's decision, the object of this case.

The application was dismissed. The Federal Court of appeal ("FCA") rejected the arguments of the taxpayer. The discretionary decision to refuse the injunction is assessed against the standard of palpable and overriding error (*Hospira Healthcare Corporation v. Kennedy Institute of Rheumatology*, 2016 FCA 215). The Notices of Reassessment having been issued, the question of whether an injunction could have been issued restraining their issuance pending determination of the second-level VDP application is moot. As a matter of law, the reassessments are valid and binding until set aside by the Tax Court, a matter within the exclusive jurisdiction of the Tax Court. In rejecting the application, among other reasons, the FCA stated that to accede to the appellant's argument would effectively nullify or override the power granted to the Minister under subsection 152(4) of the *Income Tax Act* (the "Act") to reassess "at any time". Whatever interest the appellant may have in the VDP, it is a discretionary policy issued under the authority of section 220, which grants the Minister the discretion to grant relief from interest and penalties. It remains a guideline which gives taxpayers guidance as to how the discretion might be exercised, but it cannot give rise to an estoppel. On the appellant's argument, filing of a VDP application would amount to an automatic stay of the Minister's powers under the Act. However, there is nothing in the VDP circular, nor in the statutory context within which it operates, to support the argument that the appellant had a legitimate expectation that the reassessment process would be suspended pending final consideration of the VDP application.

Prince v. Canada (MNR)

2020 DTC 5015

Corporate taxpayer permitted to deduct non-capital losses of corporation whose shares it had acquired

The corporate taxpayer was in the insurance and reinsurance business. It had no shareholders and no share capital. Its capital was provided by its members, which were 27 mutual general insurance corporations. It acquired all of the shares of ProCap. As at December 31, 2010, ProCap's accumulated non-capital losses amounted to $11,834,372. The Minister assumed that the taxpayer had acquired control of ProCap. Accordingly, in reassessing the taxpayer for 2011, the Minister disallowed the deduction of a non-capital loss of $11,834,372, relying on the rules in subsections 88(1.1) and 111(5) of the *Income Tax Act* (the "Act"), which restrict the deduction of non-capital losses. The taxpayer appealed to the Tax Court of Canada.

The taxpayers's appeal was allowed. The issues were: (a) whether the taxpayer acquired control of ProCap by acquiring all of its shares, thus preventing it from deducting ProCap's losses as it had attempted to do; and (b) whether paragraph 256(7)(*d*) of the Act applied, so that control of ProCap was deemed not to have been acquired by the taxpayer in this case. For paragraph 256(7)(*d*) to apply, the following requirements had to be met: (a) the shares of ProCap must have been disposed of in favour of another corporation (the "other corporation") in exchange for shares of the other corporation; (b) immediately after that disposition, the other corporation and ProCap must have been controlled by a person or group of persons who controlled ProCap immediately prior to the disposition; and (c) the person or persons controlling ProCap immediately prior to the disposition did not cease, during the series of events comprising the disposition, to control the other corporation. These three requirements were met in this case. As a result, paragraph 256(7) did apply in this case, so that the taxpayer was not precluded from deducting the $11,834,372 in non-capital losses which it had claimed.

Promutuel Réassurance c. La Reine

2020 DTC 1011

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