Tax Notes

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COVID-19 UPDATE

Given the rapidly changing information related to COVID-19, we are providing continuously updated information at https://wolterskluwer.ca/learning/covid-19/.

Federal

Wage Subsidy Application Portal To Open April 27 (April 21, 2020)

The application portal for the Canada Emergency Wage Subsidy ("CEWS") opened on Monday April 27, 2020. 90% of applications are expected to be processed by May 4, with payments coming later that same week. The CRA website has been updated with additional details about the application process, including a helpful calculator to determine how much subsidy a business can receive. A business can apply via any of the following methods:

- using My Business Account;
- through a representative using Represent a Client; or
- using a separate online application form.

The CEWS will be processed at the payroll program ("RP") account level, and separate applications must be filed for each RP account.

If a business is expecting a payment of $25 million or more, they will have to receive the payment through the large value transfer system ("LVTS"). This requires being enrolled in direct deposit for the payroll account and being registered for the LVTS.

Support for Students and Recent Graduates (April 22, 2020)

The Government of Canada announced $9 billion worth of support for students and new graduates affected by COVID-19.

To assist students who are ineligible for the Canada Emergency Response Benefit, the government is proposing the Canada Emergency Student Benefit. This benefit would provide $1,250 per month for eligible students or $1,750 per month for eligible students with dependents or disabilities. The benefit would be available from May to August 2020.

The government is also proposing the new Canada Student Service Grant, which will help students gain valuable work experience and skills while they help their communities during the COVID-19 pandemic. For students who choose to do national service and serve their communities, the new Canada Student Service Grant will provide up to $5,000 for their education in the fall.

The federal government will expand existing federal employment, skills development, and

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youth programming to create up to 116,000 jobs, placements, and other training opportunities to help students find employment and develop valuable skills this summer and over the coming months. In addition, to help students continue their studies in the fall, the government will:

- Double the Canada Student Grants for all eligible full-time students to up to $6,000 and up to $3,600 for part-time students in 2020-21. The Canada Student Grants for Students with Permanent Disabilities and Students with Dependents would also be doubled.

- Broaden eligibility for student financial assistance by removing the expected student's and spouse's contributions in 2020-21, in recognition that many students and families will struggle to save for school this year.

- Enhance the Canada Student Loans Program by raising the maximum weekly amount that can be provided to a student in 2020-21 from $210 to $350.

- Remove the restriction that allows international students to work a maximum of 20 hours per week while classes are in session, provided they are working in an essential service or function, such as health care, critical infrastructure, or the supply of food or other critical goods.

- Increase existing distinctions-based support for First Nations, Inuit, and Métis Nation students pursuing post-secondary education by providing an additional $75.2 million in 2020-21.

- Extend expiring federal graduate research scholarships and postdoctoral fellowships, and supplement existing federal research grants, to support students and post-doctoral fellows by providing $291.6 million to the federal granting councils. In addition, the government intends to enhance work opportunities for graduate students and post-doctoral fellows through the National Research Council of Canada.

This list of new spending is not exhaustive. Additional new support for students and new graduates can be found at: https://www.canada.ca/en/department-finance/news/2020/04/support-for-students-and-recent-graduates-impacted-by-covid-19.html.

Federal Rent Assistance for Small Businesses (April 24, 2020)

The federal government has reached an agreement in principle with all provinces and territories to implement the Canada Emergency Commercial Rent Assistance ("CECRA") for small businesses. The provinces and territories have agreed to share up to 25% of the costs, subject to the terms of agreements with the federal government.

The CECRA will provide forgivable loans to qualifying commercial property owners to cover 50% of three monthly rent payments that are payable by eligible small business tenants who are experiencing financial hardship during April, May, and June. The loans will be forgiven if the mortgaged property owner agrees to reduce the eligible small business tenants' rent by at least 75% for the three corresponding months under a rent forgiveness agreement, which will include a term not to evict the tenant while the agreement is in place.

Thus, the CECRA will lower rent by 75% for small businesses that have been affected by COVID-19. The small business tenant would cover the remainder, which would be no more than 25% of the rent. The federal government and the provinces/territories will effectively subsidize 50% of the rent, so the property owner would lose 25% of the total rent.

Impacted small business tenants are businesses paying less than $50,000 per month in rent and who have temporarily ceased operations or have experienced at least a 70% drop in pre-COVID-19 revenues. This support will also be available to non-profit and charitable organizations.

Further details on the CECRA will be shared in the near future once final terms and conditions are available. The government expects the CECRA to be operational by mid-May, with commercial property owners lowering the rents of their small business tenants payable for the months of April and May, retroactively, and for June. The forgivable loans would be disbursed directly to the mortgage lender.

Filing Extension for Part XVIII and Part XIX Returns

The filing dates for 2019 information returns under Part XVIII and Part XIX of the *Income Tax Act* (i.e., FATCA and the Common Reporting Standard) are extended to September 1, 2020. Usually, the Part XVIII Information Return (slips and summary) and the Part XIX Information Return (slips and summary) must be filed by May 1 following the calendar year to which the information return applies.

Provincial

British Columbia

Business COVID-19 Support Service (April 16, 2020)

The B.C. Business COVID-19 Support Service will be operated by Small Business BC ("SBBC"), a non-profit organization that will act as a one-stop resource to answer questions about supports available to businesses from the provincial and federal governments, industry, and community partners. Starting April 16, 2020, advisors are available Monday to Friday, from 8 a.m. to 6 p.m. (Pacific time) and Saturday from 10 a.m. to 4 p.m. at 1-833-254-4357. Inquiries can also be emailed to covid@smallbusinessbc.ca, or raised on the live-chat feature available on SBBC's dedicated website: https://covid.smallbusinessbc.ca.

The website will include announcements from industry and community partners, as well as a variety of resources, including webinars and practical tools. In addition, SBBC will continue to provide its usual services, like access to expert business advisors, educational services, and free resources in the context of COVID-19.

Manitoba

Support for Small and Medium Enterprises ("SMEs") (April 22, 2020)

The Manitoba government announced up to $120 million of funding for Manitoba SMEs affected by the COVID-19 crisis. The Manitoba Gap Protection Program will provide a non-interest-bearing, forgivable loan of $6,000 to any Manitoba SME which has been impacted by COVID-19, but has not qualified for any federal government grants.

International

New OECD Report Advises G-20 States on COVID-19 Responses

The OECD has recommended that G20 states target COVID-19 tax and fiscal policy responses at individuals adversely affected by containment measures and businesses seeking to maintain their workforce and recover.

The OECD has prepared a report titled "Tax and Fiscal Policy in Response to the Coronavirus Crisis", which was prepared at the request of the Saudi G20 Presidency and presented to G20 finance ministers and central bank governors during a virtual meeting held on April 14.

The report takes stock of the emergency tax and fiscal policy measures introduced by countries worldwide. It discusses how tax and fiscal policy can cushion the impact of continued containment and mitigation policies and subsequently support economic recovery. It also outlines the major policy reforms that will be needed to prepare for restoration of public finances.

While the report acknowledges that many governments have taken rapid, extensive, and often unprecedented action, many countries could do more to support the most vulnerable households and firms. It underlines that developing countries will need specific support — notably significant financial support — for helping health and fiscal systems withstand the current shocks.

"Tax policy responses have been strong and rightly focused to date on providing liquidity," said OECD Secretary-General Angel Gurria. "This has helped maintain confidence through an unprecedented shock. These efforts will need to continue as containment is relaxed gradually, to ensure a strong recovery. We should meanwhile map out the trajectory to a tax system that can help restore public finances while sharing the burden evenly."

Maintaining business cash-flow has been a core goal of the fiscal policy measures, the report highlights, noting that measures have included extending deadlines for tax filing, deferral of tax payments, faster tax refunds, more generous loss offset provisions, and some tax exemptions. Governments have also helped businesses retain their workers through short-time work schemes or wage subsidies, the report continues, and some governments have extended income support to households, eased access to and expanded eligibility for sick-leave benefits, and sometimes broadened the coverage of unemployment benefits to self-employed workers.

The report points out that as containment is gradually relaxed, expansionary fiscal policy may be needed for a sustained period to stimulate broader household consumption and business investment where recovery is anaemic.

Tax policy can contribute to covering the costs of the crisis, according to the report. The unprecedented nature of the crisis should prompt debate on how wide-ranging tax reforms, including solidarity levies, carbon taxes, and supporting greater progressivity across the tax system, can help governments better restore public finances, the report suggests. Low-income countries could benefit from new international efforts to address the challenges they face in taxing cross-border activity and offshore assets, it adds.

The report concludes that addressing the tax challenges posed by digitalization of the economy, and ensuring that multinational enterprises pay a minimum level of tax, will become more prominent issues after the crisis. "The increased use of digital services and the need to collect more revenues could provide new impetus to efforts to reach agreement internationally," the OECD said.

US IRS Issues Cross-Border COVID-19 Tax Guidance

On April 21, 2020, the United States Treasury Department and the Internal Revenue Service issued guidance that provides tax relief to individuals and businesses affected by travel disruptions arising from the COVID-19 emergency.

The guidance includes the following:

- Revenue Procedure 2020-20, which provides that, under certain circumstances, up to 60 consecutive calendar days of US presence that are presumed to arise from travel disruptions caused by the COVID-19 emergency will not be counted for purposes of determining US tax residency and for purposes of determining whether an individual qualifies for tax treaty benefits for income from personal services performed in the United States;
- Revenue Procedure 2020-27, which provides that qualification for exclusions from gross income under section 911 of the Internal Revenue Code will not be impacted as a result of days spent away from a foreign country due to the COVID-19 emergency based on certain departure dates; and
- An FAQ, which provides that certain US business activities conducted by a non-resident alien or foreign corporation will not be counted for up to 60 consecutive calendar days in determining whether the individual or entity is engaged in a US trade or business or has a US permanent establishment, but only if those activities would not have been conducted in the United States but for travel disruptions arising from the COVID-19 emergency.

The Treasury Department and the IRS said that they are continuing to monitor these and other issues related to the COVID-19 emergency, and updated information about relief will continue to be posted on Coronavirus Tax Relief on IRS.gov.

CURRENT ITEMS OF INTEREST

Federal Government Clarifies Support for Canadian Journalism Measures

On April 17, 2020, the federal government released draft legislative proposals that would make adjustments to the journalism tax measures from Budget 2019. These changes would apply retroactively to the coming into force dates of each of the Budget 2019 measures. According to the government news release, these changes would:

- Allow news publishers and media organizations that receive support through the "Aid to Publishers" grant of the Canada Periodical Fund to qualify for the Canadian journalism labour tax credit.
- Remove the requirement that qualified Canadian journalism organizations be "primarily" engaged in the production of original news content and not be significantly engaged in the production of content to promote goods or services. Newsroom employees eligible for the labour tax credit would need to spend at least 75 per cent of their time engaged in the production of original written news content.
- Introduce an explicit mechanism for the CRA to revoke a qualified Canadian journalism organization's designation where it no longer meets the eligibility requirements. The CRA would be required to consider any advice provided by the Advisory Board before revoking an organization's designation.
- Clarify that only organizations that carry on "licensed" broadcasting undertakings are ineligible for the Canadian journalism labour tax credit.
- Enable the Canadian journalism labour tax credit to be allocated to active members of a qualifying journalism organization that is a partnership.

- Provide that the Canadian labour tax credit be prorated based on the proportion of an organization's taxation year during which it qualifies as a qualifying journalism organization.
- Enhance transparency by clarifying the CRA's authority to publish both the names of organizations whose digital news subscriptions are eligible for the subscription tax credit, as well as the qualifying subscriptions they offer, and require organizations to inform subscribers if their subscriptions cease to qualify for the credit.

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.

Federal Court of Appeal Confirms That Safe Income Must Reflect Accrued Tax Liability Associated With Income on Hand

***626468 New Brunswick Inc v. Canada*, 2019 DTC 5141 (Federal Court of Appeal)**

This case is an appeal from a decision of the Tax Court of Canada which held that, when a corporation pays a dividend, the safe income of the payor corporation that is available to be distributed to shareholders is to be reduced by the amount of income tax payable in respect of transactions that the corporation undertook prior to the safe-income determination time. The payor corporation realized a gain on the disposition of real property assets and took steps to crystallize its safe income by making a series of successive paid-up capital increases to allow the amounts to be reflected in the adjusted cost base of the shares of its sole shareholder.

In 2006, an individual who owned an apartment building sought the advice of an accountant with respect to how a potential sale transaction should be structured. Following the structuring advice of the accountant, the following transactions were undertaken:

(1) the individual transferred the real property assets to newly-formed Tri-Holdings Limited on a tax-deferred basis under section 85 of the *Income Tax Act* (the "Act"), taking back common shares of Tri-Holdings Limited;

(2) the individual then transferred the common shares of Tri-Holdings Limited to the taxpayer corporation;

(3) Tri-Holdings Limited then sold the land and building to an arm's length purchaser, realizing a capital gain and recaptured capital cost allowance on the disposition;

(4) Tri-Holdings Limited then undertook a series of successive increases to the paid-up capital of its common shares, which resulted in dividends being deemed to have been paid by Tri-Holdings Limited to the taxpayer corporation;

(5) The taxpayer corporation then sold its common shares of Tri-Holdings Limited to an arm's length purchaser (after Tri-Holdings Limited had issued voting preferred shares to an arm's length party, presumably to avoid triggering an acquisition of control and deemed tax year-end of Tri-Holdings on the sale of the common shares); and

(6) Tri-Holdings Limited was then continued to British Columbia and acquired certain software that allowed it to claim deductions that resulted in its income for the year being reduced to nil.

The issue before the Tax Court of Canada concerned the deemed dividend that arose as a result of the final increase to the paid-up capital of the common shares of Tri-Holdings Limited and, in particular, whether Tri-Holdings Limited had sufficient safe income on hand at the time to allow the entire dividend to be paid out of safe income and thereby avoid having subsection 55(2) apply to cause the paid-up capital increase to not be a dividend and prevent the taxpayer from receiving the step-up in the cost of its Tri-Holdings Limited common shares that was connected to the final paid-up capital increase.

The Tax Court of Canada concluded that the safe income of Tri-Holdings Limited was reduced by its income tax liability related to the disposition of the real property assets, which occurred prior to the increases in paid-up capital. Accordingly, since the aggregate amount of the paid-up capital increases did not reflect a reduction to the corporation's safe income on account of the tax liability, subsection 55(2) applied to the deemed dividend that arose on the last paid-up capital increase to deem the last paid-up capital increase to not be a dividend (and, therefore, no corresponding increase to the adjusted cost base for the taxpayer's Tri-Holdings Limited common shares).

In the Federal Court of Appeal, the taxpayer corporation conceded that the deemed dividend in issue resulted in a significant reduction in the capital gain that would have been realized on a disposition at fair market value of the shares of Tri-Holdings Limited, which is one of the conditions that the Minister needed to satisfy to have subsection

55(2) apply to the dividend. The taxpayer also conceded that the purpose of this deemed dividend was to reduce the capital gain that would be realized on the sale of the Appellant's shares to the arm's length purchaser, which is another required element for subsection 55(2) to apply to a dividend. The taxpayer relied solely on the fact that it had sufficient safe income on hand to shelter the deemed dividend pursuant to subsection 55(2.1)(*c*) of the Act. The Crown argued that the safe income of Tri-Holdings Limited was reduced by its tax liability related to the disposition of its real property assets and therefore the amount of safe income was inadequate to be excluded from the application of subsection 55(2).

The Court (*per* Webb JA, for the unanimous court) conducted a textual, contextual, and purposive analysis of subsection 55(2).

The Court's analysis involved the following steps:

(1) a determination of the fair market value of the shares of Tri-Holdings Limited immediately before the final deemed dividend was paid;

(2) a determination of the adjusted cost base of the shares of Tri-Holdings Limited held by the Appellant immediately before this final deemed dividend was paid;

(3) a determination of the capital gain that would be realized on a disposition of the shares of Tri-Holdings Limited held by the Appellant immediately before the final deemed dividend was paid;

(4) a determination of the safe income of Tri-Holdings Limited as of the safe-income determination time, and in particular, whether the safe income was reduced by the taxes payable by Tri-Holdings Limited as the result of its disposition of its assets; and

(5) a determination of the safe income on hand as of the time immediately before the final deemed dividend was paid.

The fair market value of the shares of Tri-Holdings Limited was held to be equal to the amount paid by the third-party purchaser. The adjusted cost base of the shares of Tri-Holdings Limited was increased by the amount of the deemed dividends on the successive increases in paid-up capital. Therefore, the capital gain that would be realized on a disposition of the shares of Tri-Holdings Limited held by the Appellant immediately before this final deemed dividend was equal to $508,545. The safe-income determination time was held to be immediately before the first dividend was deemed to be paid as part of the series of transactions, which was immediately before the first paid-up capital increase. At such time, Tri-Holdings Limited had realized income arising from the sale of the real property assets, but the taxes associated with the sale were not yet payable. The Court, following the reasoning of the Tax Court of Canada in *Deuce Holdings Limited* (97 DTC 921), held that:

> . . . any arm's length third party purchaser of shares would take into account any existing tax liability of the corporation, even though such liability may not be payable until a later date. In this case, the tax liability arose as a result of the disposition by Tri-Holdings [Limited] of its real property. Any tax liability of Tri-Holdings [Limited] would remain with Tri-Holdings [Limited] following a sale of its shares.

Accordingly, the safe income of Tri-Holdings Limited as of the safe-income determination time was held to reflect the income tax liability that, although not payable immediately, would eventually have to be paid. The final deemed dividend significantly reduced the capital gain that would have been realized by the Appellant on a fair market value sale of its shares and such reduction was not attributable to income earned or realized. Therefore, subsection 55(2) of the Act was applicable.

The Court also held that the context and purpose of subsection 55(2) was to allow a person to reduce a capital gain by an amount that reflects any income that has been earned or realized under the Act. The capital gain is divided into two categories — the portion attributable to safe income and the portion attributable to something else. The portion of the capital gain attributable to safe income being decreased on account of income taxes that would ultimately be payable on the gain on the sale of the real property assets was held to be within the context and purpose of subsection 55(2) of the Act.

In light of the foregoing analysis, the Federal Court of Appeal dismissed the taxpayer's appeal, finding that the safe income of Tri-Holdings Limited was reduced by the amount of income tax that one would expect to be payable by it in respect of the sale of the real property assets, notwithstanding the fact that, at the time of the deemed dividend, no income taxes had been paid and that the payor corporation undertook a subsequent transaction before the end of the same taxation year to reduce its income tax liability for the year to nil. Subsection 55(2) applied and the amount in issue was deemed not to be a dividend and there was no corresponding addition to the adjusted cost base of the shares with respect to the final increase in paid-up capital that preceded its sale to the third party. As a result, the taxpayer realized an increased capital gain on the sale.

— *Steve Marshall*

Meaning of "Debt" Under Rules for Offshore Investment Fund Property Informed by Context and Purpose

***Barejo Holdings ULC v. The Queen*, 2020 DTC 5023 (Federal Court of Appeal)**

In this case, the issue was whether two "notes" whose value tracked certain reference assets but had debt-like characteristics were "debt" for the purposes of the rules governing offshore investment property in section 94.1 of the *Income Tax Act* (the "Act"). The Federal Court of Appeal held that the notes were debt for purposes of that section and, in so doing, essentially ruled that as the Act is "a statute known for its specificity" it is important to examine the provision in issue to determine the meaning of a particular word. The Court also provided a helpful discussion on the various meanings of debt found in different areas of law.

The taxpayer was a Canadian-controlled private corporation who held shares of a non-resident corporation, St. Lawrence Trading Inc. ("SLT"), that was an open-ended investment company organized under the laws of the British Virgin Islands. At all relevant times, SLT was a controlled foreign affiliate of the taxpayer.

Prior to a reorganization in 2001, SLT had both Canadian-resident and non-resident shareholders but, in anticipation of some changes to Canadian tax laws that would adversely affect the Canadian shareholders under the investment structure then in place, the parties reorganized the shareholdings and investments of SLT. The non-resident shareholders exchanged their SLT shares for shares of another non-resident corporation to which SLT had transferred assets that were notionally attributable to the exchanging non-resident shareholders. The remaining SLT assets, which were notionally attributable to the Canadian SLT shareholders, were sold to non-resident affiliates of two Canadian banks for US$998 million in aggregate. SLT then used the sale proceeds to purchase from the bank affiliates the two notes that were the subject of the appeal.

The aggregate purchase price for the notes represented the amount by which the value of the reference assets that SLT had previously sold to the bank affiliates exceeded certain liabilities chargeable against those assets. The amounts payable in settlement of the notes upon maturity (or early termination) was to be the net value of the reference assets at such time. The reference assets were comprised of interests in a group of investments managed by a hedge fund manager. As such, the composition of the reference assets was expected to be in constant flux.

The foreign accrual property income ("FAPI") regime attributes to Canadian taxpayers their proportionate share of FAPI earned by a controlled foreign affiliate. The computation of FAPI can include income from property owned by the controlled foreign affiliate that would be offshore investment fund property under section 94.1 if it were owned by the Canadian person to whom the non-resident corporation is a foreign affiliate. And, in the context of this case, the notes held by SLT would only be offshore investment fund property if held by a Canadian-resident person if those obligations were "debt" within the meaning of paragraph 94.1(1)(*a*).

The Tax Court held that the notes were debts for purposes of paragraph 94.1(1)(*a*) because the relevant jurisprudence identified three elements for the creation of a debt — (1) an amount is advanced by one party to another, (2) an amount is to be paid or repaid by that other party at some point in the future in satisfaction of the advance, and (3) this amount is fixed or determinable or will be ascertainable when payment is due — and all three elements were present in the case of the notes. The Tax Court came to this conclusion notwithstanding the taxpayer's submission that the third element required the amount payable at maturity to be ascertainable at any time that the obligation is outstanding and this was not possible with the notes in this case because the value of the reference assets to which the payment obligation was tied was constantly fluctuating in value. The Tax Court arrived at its decision based on a meaning of debt that the Tax Court considered to apply to the entirety of the Act and without the benefit of a textual, contextual, and purposive analysis of the meaning of the expression "debt" as it is used in section 94.1 of the Act.

The Federal Court of Appeal began its analysis by observing that the phase "debt" is not defined in the Act. Thus, its legal meaning is derived from commercial law. In this case, the taxpayer and the Crown each relied on different decisions to suit their position. The Court found this situation to be a ripe example of the importance of context when analyzing a provision of the Act. In other words, the Court noted that the presumption of consistent expression is not absolute, particularly with respect to the Act. The Court held:

> That the same word can have a different meaning depending on the context in which it is used is particularly so when dealing with the Act, a statute known for its specificity . . . This case illustrates the importance of examining the particular provision in issue when dealing with the Act.

Accordingly, the only way of arriving at a meaning of debt that "best reflects Parliament's intent" is by undertaking a textual, contextual, and purposive analysis of paragraph 94.1(1)(*a*).

The Court began its examination of the text by observing that, to the extent that section 94.1 applies to debts, a "simple reading" of the provision suggests that it covers a debt that "may derive its value from portfolio investments that fluctuate over time." The Court noted that excluding a debt from the scope of section 94.1 simply because the amount that will ultimately be payable at maturity will be unknown until that time would seem to frustrate Parliament's intent. The payment obligation would presumably always track the changing value of other investments.

In its textual analysis, the Court also took note of the various meanings of debt that have been used by various courts in different jurisdictions and with respect to different areas of law:

- The Alberta Court of Appeal noted that:

  "The term 'liability'. . . has been interpreted as 'the condition of being actually or potentially subject to an obligation, or, in a more special sense, as denoting inchoate, future, unascertained, or imperfect obligations as opposed to debts — the essence of which is that they are generally ascertained and certain."

- The Alberta Court of Queen's Bench held that: "'liability' is a broad term and 'debt' a narrower one, which means a specific kind of obligation for a liquidated or certain sum."

- Under civil law, "a debt ('créance') may exist even if the future value of the prestation [a civil law term for the performance to be tendered] is uncertain prior to maturity, provided that it is precisely and objectively determinable based on the terms of the Contract."

- The Saskatchewan Court of Appeal has held that: "an action for debt can result from a contract 'that by its terms, furnishes the means of ascertaining the amount due.'"

- In commercial law and insolvency law, there are various forms of debt: "a contingent debt is not presently fixed but may become fixed in the future with the occurrence of some event; an exigible debt is liquidated; a liquidated debt is an amount determined by agreement of the parties or by operation of law; a liquid debt is due immediately and unconditionally; and an unliquidated debt is one that has not been reduced to a specific amount, about which there may be a dispute."

The Court's contextual analysis focused on the FAPI regime, the rules for offshore investment property embodied in section 94.1, and how the two regimes interact with one another. As part of that analysis, the Court noted that the inclusion of the expression "debt" in paragraph 94.1(1)(*a*) was meant to capture transactions that would otherwise escape Canadian tax or the FAPI regime. Essentially, section 94.1 "operates as an anti-avoidance measure". FAPI is a regime to determine whether foreign income should be treated as income if it would otherwise exist outside the Canadian tax system. Accordingly, the Court found that it was clear from the context that a "debt" in paragraph 94.1(1)(*a*) should include "a right to claim an amount that derives its value from portfolio investments that fluctuate."

The Court then moved on to address the purpose of section 94.1, considering the collective purpose of the offshore investment fund property rules and the FAPI regime. It held that the "fundamental objective . . . is export neutrality, i.e. taxing capital appreciation in a similar way whether it results from Canadian or foreign investments". Accordingly, an interpretation of "debt" that would include the notes in this case aligned with the purpose of those two sets of rules.

Ultimately, the Court said that the Tax Court had correctly identified the three essential core characteristics of debt for the purpose of paragraph 94.1(1)(*a*) and properly applied them to the facts:

(1) SLT made a US$498 million advance to each of the issuing banks;

(2) the issuing banks were to repay an amount equal to the net value of the reference assets on the date of maturity (or early termination); and

(3) this amount was ascertainable at the due date.

The Court also acknowledged the Tax Court's conclusion that debt generally requires a fourth characteristic to be present — that there must be an implicit or stipulated interest rate — but indicated that, unlike the other three criteria, this fourth characteristic is not a required element for purposes of identifying a "debt" for the purposes of paragraph 94.1(1)(*a*).

In the end, the Federal Court of Appeal agreed with the Tax Court's disposition of the appeal, even though the appeal court felt the need to embark on a different analysis than the Tax Court used to reach its decision. If nothing else, this case highlights the importance that the Federal Court of Appeal places on interpreting the meaning of an undefined term with the benefit of knowing the context in which the term appears and the purpose underlying the regime of which the relevant provision is part.

— *Hilary Smith*

It's All in the Timing

***Landbouwbedrijf Backx B.V. v. The Queen*, 2019 DTC 5143 (Federal Court of Appeal)**

This case is an appeal of a Tax Court of Canada decision which held that the taxpayer corporation, a company incorporated under Dutch law, was liable for Canadian income tax under Part I of the *Income Tax Act* (the "Act") on the gain from the disposition of an interest in a partnership that operated an Ontario dairy farm. They were assessed on the basis that the corporation was a resident of Canada at the time of the disposition. As discussed below, the Federal Court of Appeal held that the Tax Court correctly decided that the taxpayer was a Canadian resident at the time of disposition in 2009, but erred in that it did not properly consider subsection 128.1(1) of the Act, which could potentially reduce the amount of the gain that the taxpayer realized for Canadian tax purposes in 2009. The Federal Court of Appeal also held that the Tax Court was wrong to have stated that the provisions of the *Canada-Netherlands Tax Convention* had no bearing on the appeal.

The taxpayer was an entity that was incorporated in 1997 by Mr. and Mrs. Backx while they were residents of the Netherlands. Mr. and Mrs. Backx were the sole shareholders and the directors of the taxpayer, and remained the sole shareholders of the taxpayer at all relevant times. In May 1998, the Backx couple emigrated to Canada to pursue Canadian farming opportunities. They decided to make Mrs. Backx's sister, a resident of the Netherlands, the sole director of the taxpayer when they moved, but they remained the sole shareholders. That June, a partnership was formed to operate a dairy farm in Ontario. The taxpayer held a 49% interest in the partnership and Mr. and Mrs. Backx jointly held the remaining majority partnership interest of 51%.

In 2009, it was decided that a Canadian corporation should be inserted in the ownership structure. Consequently, Backx Limited was incorporated under Canadian law with Mr. and Mrs. Backx as its sole directors and shareholders. The Ontario dairy partnership interests of both Mr. and Mrs. Backx and the taxpayer were acquired by the newly organized company, with the taxpayer realizing a gain on the disposition of its minority partnership interest. The Minister assessed the taxpayer on the basis that it was a Canadian resident during 2009 and taxed the gain of the disposition under Part I of the Act.

The decision of the Tax Court of Canada, which dismissed the taxpayer's appeal, focused on the residency of the taxpayer in 2009. The Tax Court found that, even though the taxpayer's sole director in 2009 was a Netherlands resident, management and control of the taxpayer was located in Canada because, on the facts, Mr. and Mrs. Backx were in charge of making the decisions for the taxpayer's operation. The Tax Court thus held that the corporation was a resident of Canada for 2009 by virtue of its management and control being exercised by persons in Canada at that time. It is not clear how forcefully the taxpayer argued in the Tax Court for the application of subsection 128.1(1) — which would have treated the taxpayer as having disposed of and reacquired capital property when it became a resident of Canada — in a year preceding 2009, as the taxpayer's main position was that it was not a resident of Canada in 2009. Nonetheless, the Tax Court concluded that subsection 128.1(1) could not apply to the taxpayer until it ceased to be a resident of the Netherlands, and there was no evidence to support that it ceased to be a resident of the Netherlands at any time, despite being found by the Tax Court to be a resident of Canada in 2009. The Tax Court canvassed certain portions of the *Canada-Netherlands Tax Convention* but, as noted above, concluded that the provisions of that tax treaty had no bearing on the appeal.

On appeal, the Federal Court of Appeal (*per* Rivoalen JA) found that there was no palpable and overriding error by the Tax Court in its determination that the taxpayer was a resident of Canada in 2009. On this point, the taxpayer had argued that the Minister should be estopped from reassessing the taxpayer as a resident of Canada in 2009, having accepted the taxpayer's Canadian tax filings in prior years which reported that the taxpayer was a non-resident of Canada in the years before 2009. The Federal Court of Appeal rejected this argument on the basis that the Minister, as an exercise of its statutory duty, can make a different assessment in a later year even if the relevant facts in the later year are the same as those that existed in the earlier period.

However, the Federal Court of Appeal found that the Tax Court erred in not applying subsection 128.1(1) of the Act, which deems a taxpayer who becomes a resident of Canada in a year to have made a fair market value disposition and reacquisition of most types of property that it held at the time it became a Canadian resident. As noted earlier, it seems that the Tax Court had concluded that section 128.1 of the Act would only apply to the taxpayer if it ceased to be a resident of the Netherlands, but the Federal Court of Appeal found no basis for the Tax Court to read that condition into section 128.1 of the Act. On this issue, the Federal Court of Appeal referred the matter back to the Tax Court of Canada to provide an analysis of how subsection 128.1(1) applied to the taxpayer in the circumstances.

Curiously, in the course of the Federal Court of Appeal's discussion of the Tax Court's error on this point, it did not make any mention of the fact that the Tax Court also made a finding that "it is more likely that the Appellant became a resident of Canada for tax purposes as early as 1998 (when the Backxes moved to Canada) and consequently, that the adjusted cost base of the Farm Partnership interest was correctly calculated from that date." If one accepts this as the Tax Court's determination of the timing of the taxpayer's acquisition of Canadian residency, the subsection 128.1 implications for the taxpayer in relation to its Canadian tax cost for its interest in the Ontario dairy partnership should be clear: the partnership was formed after the Backxes moved to Canada and, since the taxpayer became a resident of Canada upon the Backxes permanent move to Canada, there would be no deemed disposition of the partnership interest by virtue of subsection 128.1 at that time because the partnership had not even been formed yet. Accordingly, it is possible that when the matter returns to the Tax Court as directed by the Federal Court of Appeal, the Tax Court will simply elaborate on how section 128.1 would not have any impact on the taxpayer's cost of its partnership interest in light of a conclusion that the taxpayer became a resident when the Backxes moved to Canada.

The Federal Court of Appeal also found fault with how the Tax Court dealt with the taxpayer's arguments based on the *Canada-Netherlands Tax Convention*. The Federal Court of Appeal did not identify any specific errors that the Tax Court made when it reviewed the tax treaty provisions in its reasons for decision. Rather, the Federal Court of Appeal seemed to simply seize on the Tax Court's conclusion that "[s]ince I have already concluded that the Appellant was a resident of Canada for tax purposes, I also conclude that the Tax Treaty does not have a direct bearing on this appeal."

When one reviews the provisions of the *Canada-Netherlands Tax Convention* that the Tax Court of Canada canvassed in its reasons for decision, one can see how the Tax Court came to a view that the provisions of that treaty could not assist the taxpayer in this case. As with all of Canada's bilateral tax treaties, only a person who is a resident of the country that is the treaty counter-party can obtain relief from Canadian taxation on types of income covered by the particular treaty. Accordingly, in this case, the taxpayer would only be entitled to relief from Canadian taxation on any of its income if it could demonstrate that it was a resident of the Netherlands for purposes of the *Canada-Netherlands Tax Convention*. The Tax Court examined Article 4 of the *Canada-Netherlands Tax Convention* and noted that, where the tax authorities in both countries regard that person to be a resident of its own country for tax purposes, the treaty requires the competent authorities of each country to come to an agreement as to in which of the two countries the person is resident and, in the absence of an agreement between the competent authority for Canada and the competent authority for the Netherlands on this question, the person is deemed to be neither a resident of Canada nor a resident of the Netherlands. The result of the foregoing is that, in the absence of an agreement between both countries' competent authorities that the taxpayer should be regarded as a resident of the Netherlands for 2009 for purposes of the *Canada-Netherlands Tax Convention*, the provisions of that treaty could not apply to relieve the taxpayer in this case from Canadian taxation on any of its income. Thus, it seems that the Tax Court only stated that the *Canada-Netherlands Tax Convention* had no bearing on the appeal because the taxpayer was unable to demonstrate that it was a resident of the Netherlands for purposes of that treaty, which is a pre-condition to obtaining relief from Canadian taxation. Despite the Tax Court's review of the relevant treaty provisions to lead to this conclusion, the Federal Court of Appeal seemed to have misread the Tax Court as suggesting that the treaty was to be ignored.

The Federal Court of Appeal's misunderstanding of how the *Canada-Netherlands Tax Convention* would apply to this case is perhaps best illustrated by the fact that it outlined the taxpayer's position on how that treaty should apply without noting the obvious flaws in the taxpayer's reasoning. In its submissions to the Federal Court of Appeal, the taxpayer pointed to the same tax treaty provision that the Tax Court identified to deal with persons whom both Canada and the Netherlands consider to be resident for tax purposes. As noted above, a proper reading of this provision in the full context of the *Canada-Netherlands Tax Convention* makes it clear that the provision establishes a mechanism whereby persons that are dual tax residents do not get access to treaty benefits unless and until the competent authorities of the two countries can agree that the person should be treated as a resident of the country that is not the one that is seeking to impose the tax. This is in contrast with the taxpayer's submission that the provision operates as a condition precedent to the Canadian tax authorities treating the taxpayer as a resident of Canada for purposes of the Act. The provisions of the *Canada-Netherlands Tax Convention* simply do not interact with the provisions of the Act and the Minister's ability to treat a person as a resident of Canada in the manner asserted by the taxpayer. While it is true that subsection 250(5) of the Act deems a person who is resident of another country pursuant to a tax treaty between Canada and the other country to be a non-resident of Canada, subsection 250(5) would not apply to the taxpayer in this case because, in the absence of an agreement between the competent authorities of Canada and the Netherlands with respect to the taxpayer's tax residency in 2009, this taxpayer is considered to be neither a resident of Canada nor a resident of the Netherlands under the *Canada-Netherlands Tax Convention*.

It will be interesting to see how the Tax Court addresses the errors that the Federal Court of Appeal identified to allow the taxpayer's appeal. However, despite being successful in the Federal Court of Appeal, the taxpayer should perhaps prepare itself for the possibility that the Tax Court will deal with those errors by simply providing a more detailed explanation of the analysis that led to the conclusions in the original reasons for decision, and perhaps confirming that it meant to say in its original reasons for decision that, even if subsection 128.1(1) of the Act applied to the taxpayer, it would have applied at a time that preceded its acquisition of its interest in the Ontario dairy partnership.

— *Sarah Ferguson*

Cash Is Not Always King

***Markou v. The Queen*, 2019 DTC 5140 (Federal Court of Appeal)**

Markou is an appeal in the Federal Court of Appeal by four individual taxpayers who participated in a charitable donation scheme that was previously considered by the same court almost a decade earlier in *Maréchaux* (2010 DTC 5174). Back then, the Federal Court of Appeal upheld the Tax Court of Canada's decision to disallow the taxpayer's claim for a charitable donation tax credit on the basis that the taxpayer lacked the requisite donative intent to make the purported gift.

The issue raised in the *Markou* case was whether or not the *Maréchaux* decision really stood for the proposition that the taxpayer should be denied the charitable donation tax credit for the entire amount of the alleged gift and not just the portion that did not correspond to an actual cash outlay the taxpayer made as part of the series of transactions, since this particular issue was not fully argued when the *Maréchaux* case was heard by the Tax Court. As discussed below, in this case, the Federal Court of Appeal left no doubt that, where there is a lack of a donative intent, the disallowance of the charitable donation tax credit extends to the entire amount of the alleged gift. However, it should be noted that the transactions covered by this appeal took place on or before December 20, 2002, and the split-gifting rules in subsection 248(30) of the *Income Tax Act* (the "Act"), which apply to transactions occurring after December 20, 2002, could at least theoretically allow for a different answer to the question for a transaction undertaken under similar circumstances after that time.

As in *Maréchaux*, the charitable donation program in *Markou* was created and promoted by Trinity Capital Corporation and was known as the "Donation Program for Medical Science and Technology". Participants pledged to make a donation to a specific charitable foundation, with approximately 30% funded by cash and the balance by way of a non-interest bearing loan that was arranged for the participants as part of the program. The participants also paid additional cash amounts into the program equal to approximately 10% to 17% of the pledged amount to cover (i) a security deposit that was to be invested and available to repay the loan, (ii) an insurance policy covering the risk that the value of the security deposit would not grow to at least 10 times its then-current value within 20 years, and (iii) certain fees. The promotional materials circulated to individuals who were interested in participating in the charitable donation program represented that they would receive a tax credit that was equal to approximately 155% of their cash contribution.

The vast majority of the cash and borrowed amounts the participants contributed to the charitable foundation were used by the foundation to make donations to a registered charity and a US university that was a qualified donee for purposes of the charitable donation rules under the Act. Although daylight loans from an arm's length financial institution were used under the program structure to provide the money that initially funded indirect loans to the individual participants, there was circularity in the cash flows such that the daylight loans were repaid almost immediately after the proceeds were advanced using funding that came from a British Virgin Islands' corporation from which the two designated charities had pre-arranged to purchase certain medical equipment or rights to exploit medical intellectual property using money that would be coming to the two charities as donations under the program.

A key feature of this charitable donation program was that the participants had the right to fully discharge their loan obligations to the program lender by assigning the participant's right to the security deposit and the insurance policy in respect of the accretion of value of the deposit in 20 years' time. Each of the taxpayers in this case exercised their rights in respect of their obligations under the loan in the first month after the end of the year in which they purported to make their donations.

In the Tax Court, the appeals of the four individual taxpayers were dismissed. Although the Tax Court discussed the *Maréchaux* case at length, it was unclear from the Tax Court's reasons for decision whether the Court was simply applying the *Maréchaux* decision to the case at bar in light of the fact that the tax consequences at issue in both cases arose from the exact same transaction undertaken by similarly situated taxpayers. In any event, the Tax Court made the finding that the taxpayers lacked the requisite donative intent because, under the program arrangements, they received the benefit of the right to receive a significant loan together with the right to discharge the loan obligations by assigning the security deposit and the rights to the insurance policy to the lender. The Tax Court then undertook a separate analysis of whether the taxpayers should be entitled to claim tax credits for the cash portion of their contributions under the program and reached the same conclusion that both the Federal Court of Appeal and the Tax Court did in *Maréchaux*, namely that the donation program transactions were all part of "just one interconnected arrangement" and it was not possible to regard any part of the taxpayers' cash contributions as a separate transaction which could be found to have its own donative intent.

The Federal Court of Appeal confirmed that the *Maréchaux* decision was dispositive of both aspects of the appeal — the lack of donative intent and there being no basis for finding a separate transaction for the cash component — since the earlier Federal Court of Appeal decision was a binding precedent that the Tax Court judge was required to follow on both issues and there was no factual basis for distinguishing the two cases based on the evidence. Accordingly, the only conclusion the Tax Court was allowed to reach in the face of the *Maréchaux* decision was that the taxpayers in *Markou* did not have the requisite donative intent and that the cash portion of the transaction could not be separated from the rest of the transactions that were part of the interconnected arrangement that formed the donation scheme in which they participated.

As part of its case, the taxpayers asked the Federal Court of Appeal to overrule the *Maréchaux* decision, alleging that there were statutory provisions or other binding precedents that needed to be taken into account to produce a different result. However, the Federal Court of Appeal found that there was nothing in the taxpayers' submissions to the Court to cause it to question the correctness of its decision in *Maréchaux*.

Interestingly, it seems that in the course of the taxpayers making their submissions to the Federal Court of Appeal in *Markou* on the issue of donative intent, there was some discussion concerning whether it is possible for an individual to have a donative intent where there would be a "profit" due to the favourable tax consequences from making the gift, with the taxpayers directing the Court to some prior jurisprudence which seemed to suggest this was possible. The Court was able to reconcile the situations in the cited cases with the notion that there generally cannot be a donative intent where the person anticipates receiving tax benefits that exceed the value of the alleged gift and that impoverishment is an "essential element of a gift under both the civil law and the common law."

The irony is that, had either the Tax Court or the Federal Court of Appeal been able to find its way to allowing the taxpayer to receive charitable donation treatment for the cash portion of their alleged gifts, it seems that they would have been impoverished because the tax benefits associated with the cash component of their contribution to the donation program would have been less than their cash outlay. And, in the days before *Maréchaux*, the Minister was likely open to the possibility of resolving disputes involving dubious charitable donation schemes on the basis of allowing the participants to receive charitable donation treatment for their cash outlay.

— *John Yuan*

RECENT CASES

Whether Minister justified in imposing on taxpayer penalties for gross negligence after accepting his VDP application

The taxpayer was the Chief Financial Officer and an indirect shareholder of Solaris Pharmaceuticals Inc. ("Solaris"). The Minister accepted the taxpayer's application under the Voluntary Disclosure Program (the "VDP"). Accordingly, in reassessments for 2006 to 2012 and in an assessment for 2013 (the "Initial Reassessments"), the Minister included in his income certain loan amounts relating to a number of loans made between Panamanian corporations in which he held shares. No penalties were included in the Initial Reassessments. Following a subsequent audit of both the taxpayer and Solaris, the Minister reassessed the taxpayer for 2006 to 2013, adding certain additional amounts to his income which had not been disclosed in his VDP application, and imposing penalties for gross negligence (the "Penalty Reassessments"). The taxpayer applied to the Federal Court for judicial review of the Minister's decision to issue the Penalty Reassessments. His arguments were: (a) that he had legitimate expectations that he would not be assessed with penalties after his application to the VDP was accepted; (b) that the Information Circular relating to the VDP is a public communication to taxpayers that, where an application to the VDP is accepted, the taxpayer will not be assessed with penalties; (c) that the doctrine of *functus officio* prevented the Minister, a public authority, from revisiting a past decision, and for the Minister to do so was a breach of the duty of procedural fairness; and (d) that the Minister was estopped from rendering the Penalty Reassessments, given the public promises and representations regarding the VDP in the Information Circular.

The taxpayer's application was dismissed. The taxpayer's arguments were untenable. The Minister is not barred from undertaking audit procedures even after the acceptance of the VDP, which was the situation in this case, and this fact was communicated to the taxpayer in the VDP Decision Letter. The doctrine of *functus officio*, moreover, was inapplicable in this case. In addition, to establish promissory estoppel one must show: (a) a promise that the promisor will conduct itself in a certain way in given circumstances; (b) reliance on that promise by the promisee; and (c) action on the promise to the promissee's detriment and/or the promisor's benefit. As the Minister contended, however, none of these three conditions was established by the taxpayer in this case. In conclusion, therefore, the Minister, in this case, did not breach the rules of procedural fairness in issuing the Penalty Reassessments, was not estopped from doing so, and did not act unreasonably.

Grewal v. Canada (MNR)

2020 DTC 5030

Taxpayer's broker not liable in negligence for omitting cost of taxpayer's shares from T-5008 forms prepared for taxpayer

The defendant, TD Waterhouse, provided the taxpayer with brokerage trading accounts and with margin trading privileges. It reported to the CRA the proceeds of disposition on each sale of shares made by the taxpayer in a separate T-5008 form. However, in each T-5008 form, it did not report the cost to the taxpayer of the shares sold by him, leaving that box on the form blank. The CRA subsequently assessed the taxpayer for 2010 including in his income the full proceeds of disposition of the shares shown in the T-5008 forms without taking into account the cost of those shares, as if the taxpayer had paid nothing for them. The taxpayer had initially failed to file a tax return showing the cost of the shares that he had sold, but later did so, with the result that the CRA's erroneous assessment was ultimately corrected. The taxpayer later sued TD Waterhouse in the Ontario Superior Court of Justice for negligence in failing to report the cost of his shares sold in the appropriate box in the T-5008 forms. He alleged, in part, that he had lost his job because of the CRA's erroneous assessment, and that this assessment had caused him anxiety and distress. He also made other non-tax-related allegations to the effect that TD Waterhouse was liable in negligence for taking steps that did not protect him from foreign exchange loss. TD Waterhouse moved for summary judgment dismissing the taxpayer's action.

TD Waterhouse's motion was granted. TD Waterhouse provided the taxpayer with all applicable cost information in its T4 Summary so that he could file his tax returns as required by law. Accordingly, even if TD Waterhouse owed a duty of care in filing T-5008 forms, the evidence was uncontested that it met the prevailing industry standard at the time. Nor was there any evidence that any such duty included filing cost information on each T-5008 form, rather than providing cost information to each customer in the T-5008 Summary forms approved by the CRA.

Chen v. TD Waterhouse

2020 DTC 5029

In determining net revenues earned from certain mining properties, defendants improperly deducted corporate capital tax

A number of parties entered into a net profit interest agreement (the "NPI Agreement") requiring a corporation, Triton, to drill on certain properties (the "Rocanville Properties") at its own expense, and to share any resulting net profits with various parties to the NPI Agreement. In proceedings subsequently instituted in the Court of Queen's Bench of Alberta, the plaintiffs alleged that the various parties to the NPI Agreement did not properly account for the net profits earned on the Rocanville Properties between 1999 and 2015. One of the plaintiffs' claims was that the defendants breached the NPI Agreement by wrongfully deducting taxes paid pursuant to sections 3(1.1) and 13 of the *Corporation Capital Tax Act* (the "CCTA") from the production revenues earned from the Rocanville Properties. The plaintiffs also questioned certain other deductions made by the defendants from those revenues.

The plaintiffs' action was allowed in part. In determining the "net profits" required to be paid to the plaintiffs under the

NPI Agreement, Clause III.B.1 of that Agreement specifically permitted the deduction from the proceeds of oil and gas production received by Triton "all taxes thereon other than income taxes". However, the CCTA tax was not a tax on production per se, but a corporate tax determined by reference to production. As a result the defendants did breach the terms of the NPI Agreement by deducting the CCTA tax from the production revenues earned from the Rocanville Properties; however, a portion of the CCTA tax claim was statute-barred. The defendants, however, did not act negligently or in breach of any fiduciary obligations to the plaintiffs. To implement the foregoing findings, the NPI Agreement was required to be adjusted to correct for all of the improper deductions (including the CCTA tax deductions) made from the production revenues in issue between 2008 and 2015.

Hudson King v. Lightstream Resources Ltd

2020 DTC 5026

Non-resident taxpayer required to provide security for costs in his appeal to Tax Court

The taxpayer, who was self-represented, appealed to the Tax Court of Canada from the Minister's assessment disallowing donation tax credits relating to gifts allegedly made by him to a program known as the Global Learning Gifting Initiative ("GLGI"). There were thousands of taxpayers who had claimed donation tax credits relating to alleged donations to GLGI, and, in a test case (*Mariano v. The Queen*, 2015 DTC 1209 (TCC)), the Minister was successful in disallowing donation tax credits relating to the GLGI program on the ground that the donors to that program lacked donative intent. The taxpayer chose not to be bound by the *Mariano* case and launched his own appeal to the Tax Court. In the course of that appeal, the Minister moved for an order requiring the taxpayer to pay $19,375 into Court as security for costs within 30 days of the date of the order.

The Minister's motion was granted in part. The taxpayer was a non-resident of Canada and the Minister had filed a Reply (these were two prerequisites for the making of an order for security for costs under section 160 of the *Tax Court of Canada Rules (General Procedure)*). However, several appeals had been heard since the *Mariano* case and the Minister was successful in each of them. Also, the Minister had a high likelihood of success in the taxpayer's appeal in this case. Nor did the taxpayer provide evidence to show that the Minister could collect costs without difficulty in this case. Conversely, the taxpayer did not have to provide the entire amount of the security for costs within 30 days as the Minister had requested. He was, therefore, ordered to pay: (a) $3,000 on or before April 15, 2020; (b) $4,000 30 days prior to the deadline for completing his examination for discovery; and (c) $12,375 upon filing a joint request for a hearing date.

Sweetman v. The Queen

2020 DTC 1030

Parts 1 and 2 of *Greenhouse Gas Pollution Pricing Act* unconstitutional in their entirety

The *Greenhouse Gas Pollution Pricing Act*, S.C. 2018, c. 12 (the "Act"), mandates minimum national standards for pricing of commodities and activities that produce greenhouse gas ("GHG") emissions. On a constitutional reference to the Alberta Court of Appeal, Canada defended the constitutionality of the Act on the sole basis that it falls within the national concern doctrine of Parliament's peace, order, and good government power in subsection 91 of the *Constitution Act, 1867* (the "1867 Act").

Canada's argument was untenable. The regulation of GHG emissions does not fall under any head of power assigned to Parliament by the 1867 Act. Rather such regulation falls within heads of powers assigned to the provinces under sections 92A, 92(2), 92(10), 92(13), and 109 of the *Constitution Act, 1982*. The Act therefore was a constitutional Trojan horse, inasmuch as it contemplated a wholesale takeover of a collection of clear provincial jurisdictions and rights. To hold otherwise would be to subject almost every aspect of the provinces' development and management of their natural resources to federal regulation to reduce GHG emissions. Parts 1 and 2 of the Act, therefore, were found to be unconstitutional.

Greenhouse Gas Pollution Pricing Act (Re)

2020 DTC 5025

Payments made by taxpayer under forward hedging contract capital in nature, and thus not deductible on income account

When his brokerage firm was acquired in 1988 by the Bank of Nova Scotia (the "BNS"), the taxpayer M became the owner of 183,333 common shares of the BNS. After he left the BNS, M was offered a credit facility by the Toronto-Dominion Bank (the "TD Bank") but was required by the TD Bank to pledge 165,000 BNS shares as partial security for that credit facility (the "Reference Assets"). In addition, the credit available to him under the credit facility was not to exceed 95% of the value of the Reference Assets. As a result, M was required to enter into a "forward contract" with TD Securities Inc., which was to be cash settled through payments known as "Cash Settlement Payments". These had the effect of correspondingly reducing the number of shares included under the forward contract. In computing his income for 2004, 2005, and 2006, M took the position that he had been using the forward contract for speculation, not hedging. As a result he deducted, as income losses deductible against income from other sources, the Cash Settlement Payments made by him under the forward contract. On reassessment, the Minister characterized the Cash Settlement Payments as capital losses that were not deductible on income account, but only against capital gains, on the ground that the forward contract was a hedge of the BNS shares that M was holding on account of capital. In allowing M's appeal (2018 DTC 1044), the Tax Court of Canada concluded, in essence, that the forward contract was a speculative instrument, so that the Cash Settlement Payments were properly characterized as losses on account of income. In allowing the Crown's appeal (2018 DTC 5077), the Federal Court of Appeal concluded unanimously that the forward contract was a hedge of M's BNS shares, so that the Cash Settlement Payments gave rise to capital losses. M appealed to the Supreme Court of Canada.

M's appeal was dismissed. A forward contract is an agreement for the purchase/sale of an asset at an agreed future date. More technically, it is a type of derivative contract that creates an obligation for one party to sell and another party to buy an underlying asset (the "Reference Asset") at a pre-determined future date and at a pre-determined price (see *Ontario (Minister of Finance v. Placer Dome Canada Ltd)*, 2006 DTC 6532 (SCC)). The income tax treatment of gains and losses arising from derivative contracts depends on whether the derivative contract is characterized as a hedge or a speculation. In addition, gains and losses arising from hedging derivative contracts take on the character of the underlying asset, liability, or transaction being hedged (see *Shell Canada Ltd. v. Canada*, 99 DTC 5669 (SCC)). A long line of jurisprudence supports the conclusion that the characterization of a derivative contract as a hedge turns on the contract's purpose, and purpose is ascertained objectively (see *Ludco Enterprises Ltd. v. Canada*, 2001 DTC 5505 (SCC)). While subjective manifestations of purpose may sometimes be relevant, the taxpayer's stated intention, as Noel CJ of the Federal Court of Appeal pointed out, is not determinative in this context. In addition, the case law demonstrates that the characterization of a derivative contract as a hedge turns on its purpose. Furthermore, the primary source for ascertaining a derivative contract's purpose is the extent of the linkage between the derivative contract and an underlying asset. In this case the substantial linkage between the forward contract and M's BNS shares fully supported Noel, CJ's conclusion that this contract was a hedge. It had the effect, moreover, of nearly perfectly neutralizing fluctuations in the price of the BNS shares being held by M, pointing to a close linkage. The foregoing analysis led to the conclusion that the purpose of M's forward contract was to hedge against market price fluctuations in his BNS shares. As a result the Cash Settlement Payments under the forward contract gave rise to capital losses as the Minister had contended.

MacDonald v. The Queen

2020 DTC 5027

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