Tax Notes

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Wolters Kluwer

# FEDERAL BUDGET 2023 HIGHLIGHTS

— *Wolters Kluwer Canada*

Federal Budget 2023: *A Made-in-Canada Plan: Strong Middle Class, Affordable Economy, Healthy Future* ("Budget 2023") finally arrived, and with it many newly announced tax measures. Notable announcements in Budget 2023 include: amendments in response to Bill C-208, modifying the alternative minimum tax, and many measures for incentives pertaining to clean energy.

You can access in-depth technical commentary from the experts at Dentons Canada LLP in the 2023 Federal Budget Special Report. AnswerConnect subscribers can access the Special Report and the Federal Budget documents on the main page of AnswerConnect, and links to these documents in the nightly "Tax News Headlines" email.

## Personal Income Tax Measures

**Strengthening the Intergenerational Business Transfer Framework:** Budget 2023 proposes to amend the rules introduced by Bill C-208 to ensure they apply only where a genuine intergenerational business transfer takes place. To provide flexibility, it is proposed that taxpayers who wish to undertake a genuine intergenerational share transfer may choose to rely on one of two transfer options:

- an immediate intergenerational business transfer (three-year test) based on arm's length sale terms; or
- a gradual intergenerational business transfer (five-to-ten-year test) based on traditional estate freeze characteristics (an estate freeze typically involves a parent crystalizing the value of their economic interest in a corporation to allow future growth to accrue to their children while the parent's fixed economic interest is then gradually diminished by the corporation repurchasing the parent's interest).

Budget 2023 also proposes to provide a ten-year capital gains reserve for genuine intergenerational share transfers that satisfy the above proposed conditions.

These measures would apply to transactions that occur on or after January 1, 2024.

**Alternative Minimum Tax for High-Income Individuals:** The federal government proposes to:

- Increase the Alternative Minimum Tax ("AMT") capital gains inclusion rate from 80% to 100%. Capital loss carryforwards and allowable business investment losses would apply at a 50% rate;
- Include 100% of the benefit associated with employee stock options in the AMT base;

- Include 30% of capital gains on donations of publicly-listed securities in the AMT base, mirroring the AMT treatment of capital gains eligible for the lifetime capital gains exemption. The 30% inclusion would also apply to the full benefit associated with employee stock options to the extent that a deduction is available because the underlying securities are publicly-listed securities that have been donated;
- Disallow 50% of certain personal deductions;
- Allow only 50% of non-refundable tax credits to reduce the AMT, although the Special Foreign Tax Credit would continue to be allowed in full and would be based on the new AMT tax rate. The proposed AMT would continue to use the cash (i.e., not grossed-up) value of dividends and fully disallow the Dividend Tax Credit, and some non-refundable credits that are currently disallowed would continue to be disallowed in full;
- Increase the exemption from $40,000 to the start of the fourth federal tax bracket. Based on expected indexation for the 2024 taxation year, this would be approximately $173,000. The exemption amount would be indexed annually to inflation; and
- Increase the AMT rate from 15% to 20.5%, corresponding to the rates applicable to the first and second federal income tax brackets, respectively.

The proposed changes would come into force for taxation years that begin after 2023.

**Grocery Rebate:** Budget 2023 proposes to introduce an increase to the maximum GST/HST tax credit ("GSTC") amount for January 2023 that would be known as the Grocery Rebate. Eligible individuals would receive an additional GSTC amount equivalent to twice the amount received for January. The Grocery Rebate would be paid as soon as possible following the passage of legislation, through the GSTC system. The maximum amount under the Grocery Rebate would be:

- $153 per adult;
- $81 per child; and
- $81 for the single supplement.

To implement this change, the maximum GSTC amount for January 2023 would be replaced with an amount that is triple the maximum for that month under the current rules. For the January 2023 replacement payment only, the phase-in and phase-out rates would be tripled to 6% from 2% and to 15% from 5%, respectively. This ensures that the Grocery Rebate would be fully phased in and phased out at the same income levels as under the current GSTC rules for the 2022–23 benefit year.

**Automatic Tax Filing:** The CRA's automatic tax filing service called "File My Return", which reached some 53,000 Canadians in 2022, will be expanded to reach more than 2 million Canadians by 2025. The government will report on the progress of this initiative in 2024. The government also announced that, starting in 2024, there will be a new automatic filing service to help vulnerable Canadians who currently do not receive certain tax benefits because they do not file their tax returns. The CRA will also consult with certain community organizations and present a plan in 2024 to expand this service even further.

**Employee Ownership Trusts:** Budget 2023 proposes new rules to facilitate the use of Employee Ownership Trusts ("EOTs") to acquire and hold shares of a business. These changes would extend the capital gains reserve to ten years for qualifying sales to an EOT, create an exception to the current shareholder loan rule, and exempt EOTs from the 21-year deemed disposition rule that applies to certain trusts. These amendments would apply as of January 1, 2024.

**Deduction for Tradespeople's Tool Expenses:** Budget 2023 proposes to double the maximum employment deduction for tradespeople's and apprentice mechanics' tools from $500 to $1,000, effective for 2023 and subsequent taxation years.

**Registered Education Savings Plans:** Budget 2023 proposes to increase limits on certain RESP withdrawals from $5,000 to $8,000 for full-time students, and from $2,500 to $4,000 for part-time students. Budget 2023 also proposes to allow divorced or separated parents to open a joint RESP for their children. These changes would come into force on March 28, 2023.

**Retirement Compensation Arrangements:** Budget 2023 proposes that, effective for fees or premiums paid on or after March 28, 2023, fees or premiums paid for the purposes of securing or renewing a letter of credit (or a surety bond) for a Retirement Compensation Arrangement ("RCA") that is supplemental to a registered pension plan will not be subject to the 50% refundable tax. Employers would be able to request a refund of previously-remitted refundable taxes in respect of fees or premiums paid for letters of credit (or surety bonds) by RCA trusts, based on the retirement benefits that are paid out of the employer's corporate revenues to employees that had RCA benefits secured by letters of credit (or surety bonds). Employers would be eligible for a refund of 50% of the retirement benefits paid, up to the amount of refundable tax previously paid. This change would apply to retirement benefits paid after 2023.

**Registered Disability Savings Plans:** Budget 2023 proposes to extend the qualifying family member measure (which allows a family member to open an RDSP for an adult relative) by three years, to December 31, 2026. Siblings will also be qualified family members, as of Royal Assent.

## Business Income Tax Measures

**Investment Tax Credit for Clean Hydrogen:** Budget 2023 proposes to introduce the refundable Clean Hydrogen Investment Tax Credit ("CH Tax Credit"). The following credit rates would apply, based on assessed carbon intensity ("CI") of the hydrogen that is produced (i.e., kilogram (kg) of carbon dioxide equivalent ("CO2 e") per kg of hydrogen), to eligible property that becomes available for use before 2034:

- 40% for a CI of less than 0.75 kg;
- 25% for a CI greater than or equal to 0.75 kg, but less than 2 kg; and
- 15% for a CI greater than or equal to 2 kg, but less than 4 kg.

The CH Tax Credit would be fully phased out for property that becomes available for use after 2034 and would apply to property that is acquired and that becomes available for use on or after March 28, 2023.

**Clean Technology Investment Tax Credit — Geothermal Energy:** Budget 2023 proposes to expand eligibility of the credit to include geothermal energy systems that are eligible for Class 43.1 of Schedule II of the *Income Tax Regulations*. The expansion of the credit would apply in respect of property that is acquired and becomes available for use on or after March 28, 2023, where it has not been used for any purpose before its acquisition.

Budget 2023 also proposes to modify the phase-out schedule of the Clean Technology Investment Tax Credit announced in the 2022 Fall Economic Statement. Rather than starting the phase-out in 2032, the credit rate would remain at 30% for property that becomes available for use in 2032 and 2033 and would be reduced to 15% in 2034. The credit would be unavailable after 2034.

**Labour Requirements Related to Certain Investment Tax Credits:** The 2022 Fall Economic Statement announced the government's intention to attach prevailing wage and apprenticeship requirements to the proposed Clean Technology and Clean Hydrogen Investment Tax Credits. The government also proposes to have these requirements apply to the proposed Clean Electricity Investment Tax Credit. The government also intends to apply labour requirements to the Investment Tax Credit for Carbon Capture, Utilization, and Storage. The requirements would apply to work that is performed on or after October 1, 2023.

**Investment Tax Credit for Clean Technology Manufacturing:** Budget 2023 proposes to introduce a refundable investment tax credit for clean technology manufacturing and processing, and critical mineral extraction and processing, equal to 30% of the capital cost of eligible property associated with eligible activities. The credit would apply to property that is acquired and becomes available for use on or after January 1, 2024, would be gradually phased out starting with property that becomes available for use in 2032, and would no longer be in effect for property that becomes available for use after 2034.

**Reduced Rate for Zero-Emission Technology Manufacturers:** Budget 2023 proposes that income from certain nuclear manufacturing and processing activities would qualify for the reduced tax rates for zero-emission technology manufacturers, effective for taxation years beginning after 2023. Budget 2023 also proposes to extend the availability of these reduced rates by three years, such that the planned phase-out would start in taxation years that begin in 2032. The measure would be fully phased out for taxation years that begin after 2034.

**Investment Tax Credit for Carbon Capture, Utilization, and Storage:** Budget 2023 proposes that dual-use equipment that produces heat and/or power or uses water, that is used for carbon capture, utilization, and storage as well as another process, be eligible for the CCUS Tax Credit. It is also proposed that British Columbia be added to the list of eligible jurisdictions for dedicated geological storage, applicable to expenses incurred on or after January 1, 2022.

Budget 2023 proposes that, rather than obtaining approval from Environment and Climate Change Canada for the process for using and storing $CO_2$ in concrete, taxpayers would need to have their technology validated by a qualified third party, which would confirm that the process meets the minimum 60% mineralization requirement.

Budget 2023 proposes that CCUS Tax Credits related to eligible refurbishment costs incurred once the project is operating would be calculated based on the average of the expected eligible use ratio for the five-year period in which they are incurred, and each subsequent period (i.e., the periods over which they contribute to the useful life of the project). These periods would be the same as those used to calculate the CCUS Tax Credit during construction.

These measures would apply to eligible expenses incurred after 2021 and before 2041.

**Flow-Through Shares and Critical Mineral Exploration:** Budget 2023 proposes to add lithium from brines as a mineral resource for the purposes of the Critical Mineral Exploration Tax Credit ("CMETC"). Eligible expenses related to lithium from brines made after March 28, 2023, would qualify as Canadian exploration expenses and Canadian development expenses. The expansion of the eligibility for the CMETC to lithium from brines would apply to flow-through share agreements entered into after March 28, 2023, and before April 2027.

**Tax on Repurchases of Equity:** The 2022 Fall Economic Statement announced the government's intention to introduce a 2% tax on the net value of all types of share repurchases by public corporations in Canada. Budget 2023 provides the design and implementation details of the proposed measure. The tax would apply in respect of repurchases and issuances of equity that occur on or after January 1, 2024.

**General Anti-Avoidance Rule ("GAAR"):** Budget 2023 proposes to amend the GAAR by:

- introducing a preamble;
- changing the avoidance transaction standard;
- introducing an economic substance rule;
- introducing a penalty; and
- extending the reassessment period in certain circumstances.

**Dividend Received Deduction by Financial Institutions:** To align the treatment of dividends and gains on portfolio shares under the mark-to-market rules, Budget 2023 proposes to deny the dividend received deduction in respect of dividends received by financial institutions on shares that are mark-to-market property. This measure would apply to dividends received after 2023.

## International Tax Reform

Budget 2023 provided a brief update on Canada's participation in the Organisation for Economic Co-operation and Development ("OECD") /G20 Inclusive Framework on Base Erosion and Profit Shifting ("BEPS") two-pillar plan for international tax reform which was agreed October 8, 2021.

For Pillar One — Reallocation of Taxing Rights, the federal government continues to work with international partners to develop and implement a multilateral framework.

Budget 2023 announced the government's intention to introduce legislation implementing the Income Inclusion Rule ("IIR") and a domestic minimum top-up tax applicable to Canadian entities of multi-national enterprises ("MNEs") that are within the scope of Pillar Two — Global Minimum Tax, with effect for fiscal years of MNEs that begin on or after December 31, 2023. The government also intends to implement the Untaxed Profits Rule ("UTPR") with effect for fiscal years of MNEs that begin on or after December 31, 2024. The government intends to release draft legislative proposals for the IIR and domestic minimum top-up tax for public consultation in the coming months, with draft legislative proposals for the UTPR to follow at a later time.

## Sales Tax Measures

**GST/HST Treatment of Payment Card Clearing Services:** In response to a recent court decision that held that the GST/HST does not apply to supplies of these services, Budget 2023 proposes to amend the GST/HST definition of "financial service" to clarify that payment card clearing services rendered by a payment card network operator are excluded from the definition to ensure that such services generally continue to be subject to the GST/HST.

**Alcohol Excise Duty:** Budget 2023 proposes to temporarily cap the inflation adjustment for excise duties on beer, spirits, and wine at two per cent, for one year only, as of April 1, 2023.

# CURRENT ITEMS OF INTEREST

## PSAC ON STRIKE

The collective agreement for Public Service Alliance of Canada ("PSAC") workers expired in 2021. Since no deal was reached, PSAC authorized a general strike involving 159,000 members (120,000 Treasury Board of Canada and 39,000 Canada Revenue Agency), which began at 12:01 am EST on Wednesday April 19, 2023.

## T1 Filing Deadline Will Not Be Extended

According to Global News, the CRA announced it does not plan to extend the deadline to file taxes if its workers strike:

> There are no plans to extend the T1 tax filing deadlines, as a potential strike in no way impedes the ability of Canadians to file their taxes electronically or on paper.
>
> Canadians should take steps to ensure their return is filed by May 1, 2023, along with payment for any balance owing.

## Labour Disruptions Impact at the Canada Revenue Agency

*The following is a reproduction of the CRA's webpage that discusses the implications of a labour disruption. The CRA will continue to update the page as the situation develops. The page can be accessed at: www.canada.ca/en/revenue-agency/corporate/about-canada-revenue-agency-cra/collective-bargaining/labour-disruptions-impact.html.*

### Overview

The Government of Canada is committed to negotiating collective agreements that are fair for employees and reasonable for taxpayers.

However, bargaining groups representing approximately 159,000 public servants may be in a legal strike position as early as mid-April. These employees provide a range of services for the public.

In the event of a labour disruption, certain services may be affected.

Benefit payments would be prioritized. The Canada child benefit (CCB) [www.canada.ca/en/revenue-agency/services/child-family-benefits/canada-child-benefit-overview.html] would continue during any labour disruption.

### Services maintained

We encourage Canadians to file their taxes [www.canada.ca/en/services/taxes/income-tax/personal-income-tax/get-ready-taxes.html] as soon as possible, not only this year but every year. Registering for CRA My Account [www.canada.ca/en/revenue-agency/services/e-services/e-services-individuals/account-individuals.html] access will enable you to use digital services such as Auto-fill my return and Express NOA in certified tax-filing software. There are a variety of NETFILE-certified software products to meet your needs, some of which are free.

Canadians are encouraged to use CRA's online services to manage their tax affairs. There are many tasks that taxpayers can complete by logging into My Account such as:

- register for direct deposit
- change your personal information, such as your address, phone number, and marital status
- make a payment
- track the status of your return
- apply for child benefits
- receive mail and email notifications
- view uncashed cheques

Businesses, representatives, tax preparers and charitable organizations are encouraged to use MyBusiness Account or Represent a Client [www.canada.ca/en/revenue-agency/services/e-services/cra-login-services.html] to manage their tax affairs or the tax affairs of their client/organization.

### Services partially or fully disrupted

In the event of a labour disruption, certain CRA services may be delayed or unavailable. More specifically, we anticipate there may be delays in processing some income tax and benefit returns, particularly those filed by paper, and increased wait times in our contact centres.

The CRA is committed to being transparent with Canadians about impacts to services, should they happen, and can consult the Contact Us [www.canada.ca/en/revenue-agency/corporate/contact-information.html] page for current wait times.

As we learn more about a possible labour disruption, we will continue to update this page to tell you how services may be impacted.

## CRA EFILE News and Program Updates

### T1 Adjustment Requests — Enhancements to Change my return and ReFILE

The Canada Revenue Agency's ("CRA's") Change my return and ReFILE services allow Canadians to request changes to their returns online.

**Change my return** is a secure My Account (www.canada.ca/en/revenue-agency/services/e-services/e-services-individuals/account-individuals.html) service that lets individuals make online adjustment requests for the 10 previous calendar years. Representatives can access the Change my return service in the Represent a Client portal at www.canada.ca/en/revenue-agency/services/e-services/represent-a-client.html.

**ReFILE** is an online service that lets individuals and EFILE service providers send online adjustment requests for the 2022, 2021, 2020, and 2019 returns with certified NETFILE software and EFILE software.

**New features and options in Change my return and ReFILE**

- You can now request carry back amounts such as capital or non-capital losses.
- You can now split pension income:
  - Both the transferring spouse or common-law partner and the receiving spouse or common-law partner must ask for an adjustment, if the elected split-pension amount was not previously claimed, before a request can be allowed. For more information, see How to split your pension income (www.canada.ca/en/revenue-agency/services/tax/individuals/topics/pension-income-splitting/you-split-your-pension-income.html).
- Other enhancements include messages when additional information is needed, errors are detected, or supporting documentation is needed to finalize your request. Resolving these situations soon will streamline the processing of your adjustment request.

**Additional new features and options in Change my return**

- You can now make changes to carry forward amounts such as farming or fishing losses or restricted farm losses.
- New features guide you through common adjustments such as adjustments to add tax information slips or to claim the disability tax credit.
- You can now request changes to certain non-resident returns. For more information, go to Non-residents of Canada (www.canada.ca/en/revenue-agency/services/tax/international-non-residents/individuals-leaving-entering-canada-non-residents/non-residents-canada.html#flngrtrn).

For more information on changing your client's return, go to After you file your tax return — Personal income tax (www.canada.ca/en/services/taxes/income-tax/personal-income-tax/after-you-file.html).

### EFILE Helpdesk Hours of Service

The CRA has extended the service hours of its EFILE Helpdesks in advance of the T1 filing deadline.

Go to the EFILE Helpdesk support page at www.canada.ca/en/revenue-agency/services/e-services/e-services-businesses/efile-electronic-filers/efile-helpdesk-support-t1-returns.html for more information. You can also find copies of all previously issued messages on the EFILE News and Program Updates page at www.canada.ca/en/revenue-agency/services/e-services/e-services-businesses/efile-electronic-filers/efile-news-program-updates.html.

## CRA Announces Waiver of Penalties and Interest for Underused Housing Tax

On March 27, the CRA announced that:

> The application of penalties and interest under the UHTA for the 2022 calendar year will be waived for any late-filed underused housing tax (UHT) return and for any late-paid UHT payable, provided the return is filed or the UHT is paid by October 31, 2023.

For practical purposes, this postpones the filing deadline until October 31, 2023, for most UHT returns. However, the CRA has only announced that no penalties will be applied prior to October 31, rather than actually extending the filing deadline. Therefore, an election with respect to the UHT (i.e., the election for multiple residential properties in Part 3 of the UHT-2900 or the fair market value election in Part 7) would need to be made by the May 1 filing deadline to be a valid election, unless the CRA indicates that it will accept a late-filed election (which it has not yet indicated).

The full news release is available at www.canada.ca/en/revenue-agency/news/newsroom/tax-tips/tax-tips-2023/underused-housing-tax-penalties-and-interest-waived.html.

Also, as mentioned in the news release, the CRA has started to publish a series of Questions and Answers about the Underused Housing Tax, which is available at www.canada.ca/en/revenue-agency/services/forms-publications/publications/uhtn15/questions-answers-underused-housing-tax.html. The first set was published on March 27, 2023, and the CRA has indicated there are more to come.

## Interest Rates for the Second Calendar Quarter

The CRA has announced the prescribed annual interest rates that will apply to any amounts owed to the CRA and to any amounts owed by the CRA to individuals and corporations. These rates will be in effect from April 1, 2023, to June 30, 2023. The rates for income tax purposes are as follows:

- The interest rate charged on overdue taxes, Canada Pension Plan contributions, and employment insurance premiums will be 9% (up from 8% in Q1).
- The interest rate to be paid on corporate taxpayer overpayments will be 5% (up from 4% in Q1).
- The interest rate to be paid on non-corporate taxpayer overpayments will be 7% (up from 6% in Q1).

- The interest rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans will be 5% (up from 4% in Q1).
- The interest rate for corporate taxpayers' pertinent loans or indebtedness will be 8.40% (up from 8% in Q1).

## House of Commons Passes Bill That Would Enact Travel Deduction for Tradespersons

On March 22, 2023, private members' Bill C-241, *An Act to amend the Income Tax Act (deduction of travel expenses for tradespersons)*, received Third Reading in the House of Commons and First Reading in the Senate. The bill would amend the *Income Tax Act* to allow tradespersons and indentured apprentices to deduct from their income amounts expended for travelling where they were employed in a construction activity at a job site that is located at least 120 km away from their ordinary place of residence. The deduction would be provided by new paragraph 8(1)(*q*.1), which would apply to 2022 and subsequent years.

## New Legislation Would Implement Grocery Rebate Announced in Budget 2023

On April 19, 2023, Bill C-46, *An Act to amend the Federal-Provincial Fiscal Arrangements Act and the Income Tax Act*, received Third Reading in the House of Commons and First Reading in the Senate. The bill would amend the *Income Tax Act* to provide an additional payment of the Goods and Services Tax/Harmonized Sales Tax (GST/HST) credit equal to double the amount of the regular January 2023 payment. This would implement the grocery rebate enhancement to the GST/HST credit that was announced in the federal budget on March 28.

## New Comfort Letter

A new comfort letter from the Department of Finance has been made available. The letter discloses that the Department of Finance would advise the federal government to amend the election under subsection 207.5(2), which generally allows a retirement compensation arrangement ("RCA") to elect to reduce its refundable tax in certain cases if the property held consists solely of cash, debt obligations, and listed shares. The letter recommends adding units of an exchange-traded fund to the types of eligible property. If implemented, the amendment would apply retroactively to 2020 and subsequent years.

## Bill Proposes To Amend *Canada Business Corporations Act*

Bill C-42 received First Reading in the House of Commons on March 22, 2023. The bill would amend the *Canada Business Corporations Act* to, among other things,

(a) require the Director appointed under that Act to make available to the public certain information on individuals with significant control over a corporation;

(b) protect the information and identity of certain individuals;

(c) add, or broaden the application of, offences and provide the Director with additional enforcement and compliance powers; and

(d) add regulatory authority to prescribe further requirements in certain provisions.

It also makes consequential and related amendments to other Acts, including the *Income Tax Act*.

# FOCUS ON CURRENT CASES

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

## *1048547 Ontario Inc. v. R.*, 2023 DTC 1024 (Tax Court of Canada)

### Background

1048547 Ontario Inc. operates a dairy business named Skotidakis Goat Farm ("SGF"). John Skotidakis, Antigoni Skotidakis, Kostantina Skotidakis, and Kostantinos Skotidakis (the "Family Members") travelled extensively during 2014 and 2015 with SGF paying their travel expenses. In some instances the Family Members were accompanied by their spouses and other family members who were not shareholders or employees of SGF.

The Canada Revenue Agency ("CRA") disallowed various travel expenses claimed by SGF in 2015 and reassessed the Family Members in 2014 and 2015 to include travel expenses as benefits under paragraph 6(1)(*a*) and/or subsection 15(1) of the *Income Tax Act* ("ITA"). The CRA also disallowed licence fees expensed by SGF in 2015.

SGF and the Family Members appealed the reassessments in five appeals that were heard together by the Tax Court of Canada on common evidence.

### Issues and Decision

The issues before the Court were:

(1) For the taxation year ended December 31, 2015, was SGF entitled to claim additional deductions composed of travel expenses and licence fees in the computation of its business income?

(2) For the 2014 and 2015 taxation years, should amounts in respect of shareholder or employee benefits be included in the income of each of the four Family Members?

The Court dismissed all of the appeals.

In the result, John and Antigoni were found to have received shareholder benefits under subsection 15(1) of the ITA, Kostantina and Kostantinos were found to have received employment benefits under paragraph 6(1)(*a*) of the ITA, and SGF's expenses were not deductible.

The Court found that the Appellant's evidence was not credible and insufficient to show that the travel expenses were incurred for the purpose of gaining or producing business income. Similarly, the Appellant did not show that SGF paid the licence fees. There were no supporting documents for the travel expenses or the licence fees other than credit card statements showing some of the travel expenses. The Court found that John's testimony and the testimony of SGF's financial controller were not credible. The other Family Members did not give evidence and therefore the Court inferred that their testimony would have shown that the travel expenses were personal in nature.

### Conclusion

In this case the Appellant did not have sufficient evidence to show that all of the claimed travel expenses were for business purposes despite the fact that SGF appears to have legitimately required extensive business travel.

This illustrates the importance of calling key witnesses to testify in court and providing fulsome supporting evidence when appealing a factual dispute to the Tax Court of Canada. Here, the Court did not have the evidence necessary to find in favour of the Appellant and, under the circumstances, made negative inferences about what would have been contained in the evidence that was not provided.

— *James Konopka*

## *Ahamed v. The King*, 2023 DTC 1020 (Tax Court of Canada)

This case dealt with the question of whether a tax-free savings account ("TFSA") trust remains exempt from tax if it carries on a business of trading qualified investments.

### Background

The Appellant was Canadian Western Trust Company as Trustee of Fareed Ahamed. Mr. Ahamed is a professional investor and an investment advisor. In 2009, Mr. Ahamed opened a self-directed TFSA trust and he was the beneficiary and holder of the trust. All securities purchased and sold by the TFSA trust were "qualified investments" pursuant to subsection 207.01(1) of the *Income Tax Act* (the "ITA"). Most of the stocks were non-dividend-paying penny stocks that were only owned for a short period.

Mr. Ahamed made annual contributions of $5,000 to the TFSA trust in 2009, 2010, and 2011. The value of the TFSA trust grew to $564,482.90 at the end of 2012. In 2013, the TFSA trust sold its securities and transferred the proceeds of $547,788.83 to Mr. Ahamed.

The Minister of National Revenue (the "Minister") reassessed the Appellant for each of the 2009, 2010, 2011, and 2012 taxation years on the basis that the Appellant was carrying on a business of trading qualified investments, and therefore the income was subject to Part I tax under subsection 146.2(6) of the ITA.

The Appellant attempted to rely on paragraph 146(4)(*b*) of the ITA, pursuant to which any income earned by an RRSP that is carrying on a business of trading qualified investments is exempt from tax.

### Issues and Decision

The issue before the Court was whether the income earned by the Appellant's TFSA trust was exempt from tax under paragraph 146(4)(*b*) of the ITA or if it was taxable pursuant to subsection 146.2(6) of the ITA

The Tax Court justice stated that the "RRSP regime set out in section 146 is a statutory scheme separate from the TFSA trust regime set out in section 146.2." He enumerated the following ten differences between the two schemes:

> (1) there is no minimum age to contribute to an RRSP while you must be 18 or older to contribute to a TFSA;
>
> (2) there is a maximum age to contribute to an RRSP, but not a TFSA;
>
> (3) contributions to an RRSP are fixed in accordance with an individual's "earned income" from the previous year, up to a maximum, while contributions to a TFSA are fixed at the same inflation-adjusted dollar amount for everyone;
>
> (4) there is a deadline to contribute to an RRSP, while there is no deadline to contribute to a TFSA;
>
> (5) contributions to an RRSP are deductible while contributions to a TFSA are not;
>
> (6) a spouse may benefit by contributing to their spouse's RRSP but a spouse cannot contribute to their spouse's TFSA;
>
> (7) income earned in an RRSP is tax-deferred whereas income earned in a TFSA is tax-free;
>
> (8) RRSP withdrawals cannot be recontributed while TFSA withdrawals can;
>
> (9) RRSP withdrawals are taxable in the year of withdrawal while TFSA withdrawals are not taxable; and
>
> (10) RRSP withdrawals may affect the holder's entitlement to federal income-tested benefits and credits while TFSA withdrawals do not.

Justice Spiro found that "Parliament's primary purpose for creating the TFSA was to encourage savings. Its secondary purposes were to achieve that objective within certain limits, including a limit on the type of income that could accumulate tax-free within a TFSA." He wrote that "[h]ad one of Parliament's purposes been to extend the scope of the tax exemption to TFSA trusts carrying on a business of trading qualified investments, Parliament would have said so." Parliament already created such an exception with the RRSP legislation and it deliberately chose not to do so for TFSAs.

The Court concluded that the Appellant carried on a business of trading qualified investments and therefore was subject to tax pursuant to subsection 146.2(6) of the ITA. This was based on the fact that the Appellant traded frequently at the behest of Mr. Ahamed. Mr. Ahamed had extensive knowledge and experience in the securities market as a professional advisor and he spent considerable time researching the securities market. The Appellant had a history of buying and selling shares that were mostly speculative in nature, and owned shares for short periods, which was indicative that the Appellant was carrying on a business of trading.

### Conclusion

This case makes it clear that a taxpayer who carries on a business of trading qualified investments in a TFSA will not be entitled to the exemption provided to RRSPs under paragraph 146(4)(*b*) of the ITA, and will be subject to tax under subsection 146.2(6) of the ITA. Taxpayers should monitor the nature and frequency of trades that they execute in their TFSAs to avoid being considered to be carrying on a business of trading qualified investments.

— *Gergely Hegedus, Dentons Canada LLP*

## *K&D Logging Ltd. v. His Majesty the King*, 2023 DTC 1022 (Tax Court of Canada)

A loan to a foreign corporation that bears no interest and has remained in place for more than a year will generate imputed income under subsection 17(1) of the *Income Tax Act* ("ITA") and the disposition of such loan is not deductible under subsection 20(21).

### Background

The Minister of National Revenue (the "Minister") assessed K&D Logging Ltd.'s ("K&D") 2005 and 2006 taxation years and denied deductions in the amounts of $495,083 (2005 taxation year) and $6,970 (2006 taxation year) claimed by K&D under subsection 20(21) of the ITA.

K&D was a resident of Canada and was in the logging business. K&D owned 44% of Interan S.A. ("Interan"), a non-resident corporation incorporated under the laws of Uruguay that was in the business of tree farming, cattle ranching, and agriculture.

In 1996, K&D entered into a loan agreement (the "Loan Agreement") with Interan, and K&D advanced funds to Interan accordingly (the "Loan"). Under the Loan Agreement, any payment by Interan insufficient to cover an amount due would be applied in the following order: (1) fees and expenses; (2) overdue payments and interest thereon; (3) interest; and (4) principal.

Importantly, the rate of interest in the Loan Agreement was left blank. There was no other agreement or correspondence between K&D and Interan that addressed when interest was payable, or the amount of interest that was to be charged, in connection with the Loan Agreement.

Although the Loan Agreement was silent in relation to the amount of interest that was to be charged in connection with the Loan, K&D annually reported income on the Loan from 1997–2007 at the prescribed rate, booking the interest as "interest receivable", and reported the annual amounts on Schedule 1 of its T2 income tax returns as "Net income (loss) after taxes and extraordinary items per financial statements".

In 2005, K&D determined that the total amount booked as interest receivable, being $495,083, would not be received and wrote off such amounts as a bed debt accordingly. Further, in 2006, K&D determined that $6,970 that was booked as interest receivable would not be received and wrote off such amounts as a bad debt.

As of December 31, 2005, the total amount of principal outstanding on the Loan was $1,628,173. On or around February 23, 2006, K&D received a payment of $1,350,651 from Interan in repayment of the outstanding balance of the Loan.

At the hearing, K&D's witnesses testified that K&D reported that the Loan bore interest at the prescribed rates; however, there was no evidence that K&D at any time obtained or sought Interan's agreement that the Loan would bear interest at any rate.

In addition, K&D argued that the sought deductions should be allowed per subsection 20(21) of the ITA as the Loan was disposed of when K&D included interest amounts on the Loan as income.

## Issues and Decision

The issue before the Court was whether the claimed deduction amounts were deductible or whether such amounts constituted imputed income per subsection 17(1) of the ITA. Specifically, the question was whether the claimed deductions were deductible given that the Loan was interest-free.

The Court summarized that subsection 17(1) applies where an amount owed by a non-resident person, Interan, to a Canadian resident corporation, K&D, bears no or unreasonably low interest, and such amount has been outstanding for more than a year. The general purpose of the version of subsection 17(1) in force for the taxation year in question was to prevent a corporation that is resident in Canada from using its capital abroad through non-interest-bearing loans to prevent Canadian income tax on profits derived from such loans.

Here, as the Loan bore no interest, the Court concluded that there could not have been any "receivable interest" present that K&D had annually booked and reported as income. Therefore, per subsection 17(1), there was no "interest in respect of the amount owing". As a result, K&D would have imputed income equal to the amount owed on the Loan multiplied by the pertinent prescribed rate, minus 0, the actual interest on the amount owing on the Loan.

The Court disagreed with K&D's submissions that the annual amounts booked as receivable interest should be recognized as such for the purposes of subsection 17(1). Justice Russell opined that doing so,

> . . . would fly in the face of the above-noted purpose of subsection 17(1), being to impute income in respect of Canadian corporations that have made interest free or unreasonably low interest loans to non-residents that remained [in] place for more than a year. Here, the Loan was interest-free, made to a non-resident person by a Canadian corporation. The imputed income cannot be nil if subsection 17(1) is to mean anything.
>
> Parliament undoubtedly intended that an amount reported as being "receivable interest" actually be receivable interest. Fictional amounts cannot be condoned. This is particularly so in light of the transfer-pricing purpose that subsection 17(1) served.

Although K&D reported the correct amount in relation to the Loan by booking interest on the Loan at the respective prescribed rate, it was done on the wrong basis by being booked as receivable interest, rather than imputed income as required by subsection 17(1).

As a result, the true legal nature of each of the two amounts in issue, being $495,083 (2005) and $6,970 (2006), is that such amounts are properly calculated as imputed income per subsection 17(1) for the years 1997 through 2005.

Lastly, the Court held that subsection 20(21) had no application to the disposition of the Loan. Subsection 20(21) cannot apply when subsection 17(1) is applicable. Here, the interest amounts were *imputed* income under subsection 17(1) and allowing a deduction for such income "on the basis of fictional receivable interest would completely nullify the intended purpose and effect of subsection 17(1). It would leave the appellant in a better place than if the true situation of the Loan being non-interest bearing had governed from the start."

## Conclusion

Subsection 17(1) applies to a loan that bears no interest between a Canadian resident and a non-resident and has remained in place for more than a year, even if such loan is reported as having receivable interest. The loan will result in the inclusion of imputed income in accordance with subsection 17(1) with no deduction available under subsection 20(21) after the disposition of such loan.

— *Adam Kotlowitz*

# RECENT CASES

## Judicial Review Overturns Decision Rendered on TFSA Overcontributions

The Applicant attained Canadian citizenship in 2013 which made him eligible to contribute to a Tax Free Savings Account ("TFSA"). He inadvertently over-contributed to his TFSA based on mistaken information provided by the Canada Revenue Agency ("CRA") about the TFSA contribution room for the period between 2009 and 2012, when he was not a citizen of Canada. The CRA corrected their error and reduced the Applicant's TFSA contribution room without notice to him. The Applicant learned of the over-contribution on his own and subsequently transferred an amount out of his TFSA. The Applicant received TFSA notices of assessment on the over-contribution for the years 2020 and 2021 and he withdrew the excess amount within 30 days. The Applicant registered an objection with the Appeals Division regarding the notices requesting a waiver/cancellation of the tax on the excess. His requests were denied by the CRA on the ground that he did not withdraw the excess in a reasonable time. The Applicant requested a second review of the CRA's decision where the relief was denied to the Applicant. The decision of the CRA was brought before the Federal Court for a judicial review.

The application was granted. The Court stated that subsection 207.06(1) of the *Income Tax Act* provided for a tax waiver/cancellation of over-contribution upon establishment and satisfaction of the Minister on the fact that: (a) the excess taxable amount arose as a consequence of reasonable error; and (b) steps were taken to remove the excess without delay (within 30 days from the date of notice). The Court found the CRA's issue was with the time taken by the Applicant to remove the over-contributions, thus accepting that the excess arose as a result of a reasonable error. After a thorough inquiry into the matter, the Court held that the decision given by the CRA regarding both the 2020 and 2021 taxation years was unintelligible and lacked justification and transparency. The decision of the CRA was set aside and the matter was remitted back to the CRA for re-determination by a different CRA officer.

*Ossai v. AG of Canada*

2023 DTC 5023

## Application for Late-Filed Election Not Contemplated by Reg. 600 Dismissed by Federal Court

During an audit of its 2017 T2, the Applicant asked the CRA to accept amended returns so that it could attach letters electing to treat certain depreciable capital properties as separate classes of eligible non-residential buildings under subsection 1101(5*b*.1) of the *Income Tax Regulations*, which would allow it to deduct a 6% capital cost allowance rather than 4%. The CRA rejected this attempt, regarding it as a request to accept a late-filed election. The Applicant argued the list of regulations contemplating late-filed elections in Reg. 600 established a rebuttable presumption allowing late filing, even though Reg. 1101(5*b*.1) is not on the list. The Applicant further argued that it was entitled to this rebuttable presumption because it made an honest mistake, rather than engaging in retroactive tax planning.

The Federal Court dismissed the appeal. The Court agreed with the CRA's characterization of the appeal as an attempt to late-file an election and noted, as the Applicant acknowledged, that Reg. 1101(5*b*.1) is not one of the regulations listed at Reg. 600. The jurisprudence makes clear that late-filed elections are only available for Reg. 600-listed regulations. Even if the Applicant was correct, it was engaged in rebutting the wrong presumption: that late-filed elections are attempts to engage in retroactive tax planning. It focused on its actions and intentions rather than the legislative provision at issue. The Applicant's reliance on the *Nassau Walnut* case was misplaced, as that case dealt with late-filed designations and explicitly distinguished late-filed elections.

*Banff Caribou Properties Ltd. v. Canada (AG)*

2023 DTC 5022

## Amounts Distributed Were Deemed Dividends per 84(2)

The Appellants were shareholders of a company incorporated in Canada (the "Company") that was involved in the business of exploitation of automated performance grapher ("APG") software along with providing other IT-related services. A competing entity incorporated in the US and having a subsidiary in Canada offered to acquire the Company for $50,000,000. The Company and its holding company amalgamated with the Canada-based subsidiary to form a new entity through a hybrid sale. The Appellants, upon selling their shares, reported capital gains and claimed deductions to fully offset the gain in their tax returns for the year 2012. The Minister had issued reassessments and treated the amount received by the Appellants against the sale of their respective shares as deemed dividends as per subsection 84(2) of the *Income Tax Act*. The Appellants appealed these reassessments before the Tax Court on the basis that the conditions for the application of subsection 84(2) were not met, which was dismissed. The Appellants had argued that the Tax Court did not consider the balance note "excess cash" that was distributed and thus erred in holding that the Company distributed more funds than it had.

The appeals were dismissed. The Federal Court of Appeal ("FCA") held that the Tax Court considered the balance note as a cash equivalent and found it to be in fact excess cash, thus rejecting the Appellants' argument. Based on the Company's accountant's testimony that the balance note was never meant to be paid, the FCA affirmed the Tax Court's conclusion that the debt in the form of the balance note was indirectly distributed by the Company to the Appellants, which in return impoverished it. The FCA affirmed the Tax Court's holding that the Company's business was reorganised for the purpose of subsection 84(2) on the ground that the Company's business was split between two entities (US and Canada-based) upon the acquisition. This reorganization resulted in the end of the conduct of the Company's business in one form which was continued in another form by the two entities for the purpose of subsection 84(2). The holding company's only function was to hold the Company's share on behalf of one of the Appellants. After the hybrid sale, the holding company's function was entirely discontinued for the purpose of section 84(2).

*Foix et al. v. The King*

2023 DTC 5013

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