Tax Notes

August 2021
Number 703

COVID-19 Update 6

Focus on Current Cases 10

Current Items of Interest 16

Recent Cases 17

Wolters Kluwer

ACCESSING THE CAPITAL GAINS TAX EXEMPTION ON A CORPORATE SHARE SALE

— *Wolters Kluwer Canada*

Perhaps the most common way business is carried on in Canada is through a corporation. The reasons why a corporate form of doing business is often preferred are many, with two of the main ones being the limited liability a corporation provides and the preferential tax treatment afforded to capital gains realized on the sale of a qualified small business corporation's shares. As with many tax provisions, the concept is simple: provide a tax exemption for capital gains, up to a limit, that would otherwise be taxable on the sale of shares of Canadian-controlled private corporations ("CCPCs") conducting active businesses. The translation of this concept into the technical provisions, not so much. You can bet that your client will know all about the concept of the exemption, but unless he or she is a tax person as well, they will undoubtedly have no clue about the complexities involved in claiming the exemption. That is your job.

If you're just starting out in tax, the following should provide you with a good summary of the rules you will need to know in practice. If you're experienced in doing this type of planning and do it all the time, you can skip to the next item, although this may be a useful checklist for you. And if you're a highly experienced tax professional, but also highly specialized in a particular area other than this, you will find this article useful when your neighbour with a small business comes calling one evening.

So here goes.

Calculating the Deduction

Under subsection 110.6(2.1) of the *Income Tax Act* (the "Act") the permitted lifetime capital gains deduction for a year in respect of "qualified small business corporation shares" (the definition of which we'll get to in a moment) is equal to the least of four amounts:

(1) The individual's "*unused lifetime exemption for the year*" in respect of post-June 17, 1987, net taxable capital gains on qualified small business corporation shares. Unfortunately, this is calculated in the "taxable capital gain" mode, and so changes every time the capital gains inclusion rate changes to compensate for different inclusion rates in different years. For 2014 and subsequent years, the amount is indexed to inflation. For the 2021 taxation year, the regular unused exemption is the amount by which $446,109 ($892,218 of capital gains) exceeds the total of:

(a) all capital gains deductions claimed in 1985, 1986, and 1987, and after October 17, 2000; plus

(b) $^{3}/_{4}$ of all capital gains deductions claimed in 1988 and 1989 on property other than deductions on account of eligible capital property claimed in those years; plus

(c) $^{2}/_{3}$ of all capital gains deductions claimed in 1990 through 1999 inclusive, plus $^{2}/_{3}$ of amounts deducted in 1988 and 1989 in respect of eligible capital property; plus

(d) for capital gains deductions in the 2000 taxation year, the 2000 capital gains deduction times the reciprocal of the multiplier used to determine the lifetime limit for 2000; or, looked at another way, your capital gain inclusion rate for 2000 multiplied by $^{1}/_{2}$ instead of 2.

(2) The individual's "*cumulative gains limit*" at the end of the year, in excess of amounts deducted in the current year on account of the qualified farm property rules (the rules essentially provide an order of applying farm property claims, then small business share claims, then fishing property claims, in determining this limit for the year). In concept, the cumulative gains limit measures the taxable portion of net economic gain since 1985 which should be eligible for exemption. It is calculated as:

$$A - (B + C + D + E)$$

where

A is the taxpayer's cumulative net taxable capital gains since 1984, that is, the aggregate of all amounts in "A" in the definition of "annual gains limit" below for the year and all prior years ending after 1984;

B is the aggregate of all net capital loss carryovers deducted in the year (whether deducted from capital gains or other income) and in prior years after 1984 and all allowable business investment losses realized in the year and all prior years after 1984. This subtraction item is simply the aggregate of all amounts in "B" in the definition of "annual gains limit" below for the year and all prior years ending after 1984;

C is the amount deducted under paragraph 3(*e*) of the Act as allowable capital losses by the taxpayer for the 1985 taxation year;

D is the amount of capital gains exemptions claimed by the individual under section 110.6 of the Act in preceding taxation years that end after 1984; and

E is the amount of the taxpayer's "cumulative net investment loss" ("CNIL") at the end of the year. Essentially, an individual's CNIL at the end of a taxation year is the amount by which "investment expenses" claimed in the year or in a preceding taxation year ending after 1987 exceed the "investment income" earned during the same period. The account carries forward from year to year so that it is not possible for an individual to have exempt capital gains in a year to the extent of the individual's CNIL account.

(3) The individual's "*annual gains limit*" for the year, in excess of amounts deducted in the current year on account of qualified farm and fishing property. It represents the extent to which the individual's net taxable capital gains for the year might qualify for the maximum deduction permitted under subsections 110.6(2) and (2.1). The annual gains limit is determined by the following formula:

$$A - B$$

The amount determined under A of the formula is the lesser of the following two amounts:

(a) the net taxable capital gains (if any) for the year determined in accordance with paragraph 3(*b*) of the Act; this is full capital gains net of full current capital losses after all reserve calculations are accounted for, reduced to the taxable portion (if the net position for a year is a loss position, the annual gains limit is nil); and

(b) the net taxable capital gains for the year as in (a) above, recalculated as if the only properties referred to in that paragraph were properties that, at the time they were disposed of, were qualified farm properties, qualified fishing properties, qualified farm or fishing properties, and qualified small business corporation shares.

The amount determined under B of the formula is the sum of the following two amounts:

(a) the amount by which:

(i) the individual's net capital losses of other years deducted from taxable income in the year under paragraph 111(1)(*b*)

exceeds

(ii) the portion of the individual's net taxable capital gains for the year from the disposition of qualified small business corporation shares and qualified farm or fishing property;

and

(b) the individual's allowable business investment losses for the year.

(4) The individual's net taxable capital gains recognized for the year from dispositions of qualified small business corporation shares after June 17, 1987, less any amounts included under the comparable rule for qualified farm property dispositions and qualified fishing property dispositions mentioned below. In general, this amount would include taxable gains from dispositions in previous years (but after June 17, 1987) included in income under the capital gains reserve mechanism.

So much for the easy part. Now let's delve into what constitutes a "qualified small business corporation share".

Definition of "Qualifying Small Business Corporation Share"

To meet the requirements of a "qualified small business corporation share" and be eligible to claim the exemption, three tests must be met:

(1) The Small Business Corporation ("SBC") Test;

(2) The Holding Period Test; and

(3) The Basic Asset Test.

Graphically, the timing factor in each of the three tests could be depicted as follows:

		Determination Time		
(a) SBC Test				|
(b) Holding Period Test	|←	24 months	→	|
(c) Basic Asset Test	|←	24 months	→	|

The SBC Test and the Basic Asset Test are calculated similarly, but the SBC Test is determined at a particular point in

time, while the Basic Asset Test is determined over a period of 24 months. This can be crucial as it may end up with a successful corporation inadvertently losing its ability to access the exemption over time.

1. The Small Business Corporation Test

This test is under paragraph 110.6(1) “qualified small business corporation share” (*a*). At the time of disposition, the share must have been a share of the capital stock of a small business corporation and owned by the individual (or a related individual). Under subsection 248(1), a “small business corporation” is defined as a “Canadian-controlled private corporation” “all or substantially all” (which the Canada Revenue Agency (“CRA”) considers to be 90% or more) of the fair market value of the assets of which were at the particular time (subject to subsection 110.6(15) below) attributable to assets that were:

(1) used principally (considered to be 50% or more) in an “active business” carried on primarily in Canada by the particular corporation or a corporation related to the particular corporation,

(2) shares or indebtedness of other small business corporations which were connected with the particular corporation, or

(3) a combination of the assets described in (1) and (2) above.

The effect of the reference to subsection 110.6(15) in the definition of “small business corporation” deems the fair market value of certain life insurance policies, or in certain circumstances the proceeds from such policies, to be equal to the cash surrender value of the policy. As a result, life insurance policies taken out by a corporation to insure the life of a shareholder should not cause the corporation to fail the asset tests set out in the definition of “small business corporation”.

An “active business” (defined in subsection 248(1)) does not include a “personal services business” or a “specified investment business”.

The Federal Court of Appeal has held that where the term deposits maintained by a corporation were not an integral aspect of its business operations, the corporation did not meet the “all or substantially all” test, and hence was not a qualified small business corporation for the purpose of the capital gains deduction (see *Skidmore et al. v. The Queen*, 2000 DTC 6186 (FCA)).

According to the CRA, a “future income tax asset is not an asset for the purposes of the definition of SBC and of the definition of QSBC” (*Future income tax assets / Actif d’impôts futurs*, October 11, 2013, Technical Interpretation 2014-0537611C6).

2. The Holding Period Test

This test is under paragraph 110.6(1) “qualified small business corporation share” (*b*). Throughout the 24-month period immediately preceding the disposition, the share must not have been owned by anyone other than the individual or a person (including a personal trust) or partnership related to the individual.

Generally, when a corporation has issued shares after June 13, 1988, either to the individual, a partnership of which the individual is a member, or a person related to the individual, a special situation exists under paragraph 110.6(14)(*f*). This rule provides that the shares are deemed to have been owned by an unrelated person immediately before they were issued, unless one of the exceptions below is met. As a result, to meet the holding-period requirement, the shares cannot have been owned by any person other than the individual, a partnership of which the individual is a member, or a person related to the individual for a 24-month period that begins after the shares were issued and that ends when the individual sold them.

However, this rule does not apply to shares issued:

- As payment for other shares,
- For dispositions of shares after June 17, 1987, as payment of a stock dividend, or

- In connection with a property that the individual, a partnership of which the individual was a member, or a person related to the individual, disposed of to the corporation that issued the shares. The property disposed of must have consisted of either:

- all or substantially all (90% or more) of the assets used in an active business carried on either by the individual, the members of the partnership of which the individual was a member, or the person related to the individual, or

- an interest in a partnership where all or substantially all (90% or more) of the partnership's assets were used in an active business carried on by the members of the partnership.

Although the individual shareholder must have been resident in Canada throughout the year of disposition, the individual need not be resident throughout the 24-month hold period (*Qualified Small Business Corporation Share*, July 13, 2010, Technical Interpretation 2010-0359781E5).

3. The Basic Asset Test

This test is under paragraph 110.6(1) "qualified small business corporation share" (*c*). Throughout the 24-month period immediately preceding the disposition, the share must meet the following requirements:

- it was owned by the individual or a related person/partnership; and

- it was a share of the capital stock of a CCPC, of which more than 50% of the FMV of the assets were:

- used principally in an active business carried on primarily in Canada by the corporation or by a related corporation,

- shares of the capital stock or indebtedness of one or more other corporations that were connected (as defined in subsection 186(4) of the Act), where:

  - the shares or debt of the connected corporation were not held by anyone other than specified related parties throughout the relevant part (described in clause (*c*)(ii)(A) of the definition) of the 24-month period; and

  - throughout the relevant part (described in clause (*c*)(ii)(B)) of the 24-month period, the connected corporation was a CCPC that used more than 50% of the FMV of its assets in an active business as defined above, or

- a combination of the two.

However, during any time where all or substantially all (90%) of the corporation's assets were neither assets used in an active business carried on primarily in Canada by the corporation or a related corporation, nor were shares or debt of connected corporations that met the 50% active business test, the connected corporations must meet the all or substantially all test for their assets during that time (90% or more).

Qualified Farm or Fishing Property

There is also a capital gains exemption which may apply to the sale of "qualified farm or fishing property". It is similar to the exemption provided for qualifying small business corporation shares, with the notable exceptions that it applies to all qualified farm or fishing property, not just to shares of the capital stock of a family farm or fishing corporation, and that the deduction permitted is a non-indexed $500,000 ($1 million of capital gains). The technical provisions are quite similar to those set out above.

The Trap and Purification Planning

If the business is successful it will generate cash — cash that might build up in the corporation or be used by the corporation for investment purposes instead of being paid out as salary or dividends. This undoubtedly will not ring any alarm bells for your client, but the result may be that if the amount of cash and passive investments in the corporation becomes significant, the business might inadvertently lose its ability to claim the capital gains exemption based on the tests outlined above over time, as did the corporation in the *Skidmore* case noted earlier. Luckily, there is something that can be done.

Ensuring availability for the capital gains exemption may involve what is known as "purification" planning. This refers to planning where non-qualifying assets are removed from the corporation so that it can then qualify for the capital gains

exemption. In practice, this is generally done on a one-time basis when your client mentions that he or she is planning on selling the business. Alternatively, planning can be put in place whereby non-qualifying assets can be removed as a continual on-going process. The latter, which involves monitoring the level of cash and passive investments that are not necessary to the active business operations, is the preferred option to avoid nasty last-minute surprises and running into issues with the 24-month requirements noted above.

COVID-19 UPDATE

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

Federal

Tourism Relief Fund Begins Accepting Applications (July 12, 2021)

Budget 2021 proposed to establish a $500 million Tourism Relief Fund ("TRF"). The TRF will support investments by local tourism businesses in adapting their products and services to public health measures and other investments that will help them recover from the pandemic and position themselves for future growth.

Contributions to businesses will be either non-repayable (contributions up to $100,000) or repayable (contributions up to $500,000). Not-for-profit organizations and Indigenous organizations (not generating profits) will be eligible for non-repayable contributions. A minimum of $50 million of the TRF will specifically support Indigenous tourism initiatives.

Eligible organizations can now apply for funding. Interested parties should visit their regional development agency's web page: www.ic.gc.ca/eic/site/icgc.nsf/eng/h_07662.html.

Support for Indigenous Businesses in the Atlantic Region (July 12, 2021)

The government announced support for the operation, planning, and positioning for recovery of Indigenous community businesses in the Atlantic Region through the Indigenous Community Business Fund ("ICBF"). Over $13 million in non-repayable financial contributions will help Indigenous community- or collectively-owned businesses to strengthen operations, support their viability, and position them for recovery.

Further information on how to access the ICBF can be found at: www.sac-isc.gc.ca/eng/1596809415775/1596809469296.

Clearance Certificate Update (July 1, 2021)

The CRA provided an update on its processing of clearance certificates (Forms TX19 and GST352).

CRA employees have limited access to the office, which may delay receipt of submissions by mail or fax. As a result, any documentation or new clearance certificate applications sent to the CRA between March 12, 2020, and November 30, 2020, may not have been included in the inventory for processing.

If you submitted a clearance certificate request by mail between the dates identified above, it is recommended that you resubmit the request and supporting documents online through My Account, Represent a Client, or My Business Account. Requests may also be resubmitted by mail or fax, but may have a longer processing period.

Moreover, the process for sending documents by email was only temporary and has been cancelled. All documents must be submitted through the online portal, by mail, or by fax.

Bill C-30 Receives Royal Assent (June 30, 2021)

Bill C-30, *Budget Implementation Act, 2021, No. 1*, received Royal Assent on June 29, 2021. Key measures that will be enacted include:

- The extension of the Canada Emergency Wage Subsidy, the Canada Emergency Rent Subsidy, and Lockdown Support until September 25, 2021.

- The extension of income support for Canadians through the Canada Recovery Benefit and the Canada Recovery Caregiving Benefit.
- The new Canada Recovery Hiring Program, which will be available retroactive to June 6, 2021, to help businesses hire workers and increase workers' hours or wages.
- An increase to Old Age Security ("OAS") by 10% for seniors age 75 and older.
- The enhanced Canada Workers Benefit.
- The enhanced Employment Insurance sickness benefits, which will increase from 15 to 26 weeks.
- The waiver of interest on federal student and apprentice loans to March 2023.

Online Calculator for Canada Recovery Hiring Program (June 30, 2021)

The federal government has launched an online calculator to help eligible employers prepare their Canada Recovery Hiring Program ("CRHP") applications. This calculator integrates the new CRHP with the Canada Emergency Wage Subsidy ("CEWS"), automatically showing applicants which subsidy will provide them with more support, based on the information they enter. The calculator is available at www.canada.ca/en/revenue-agency/services/subsidy/recovery-hiring-program/crhp-calculate-amount.html, while the CRHP website is located at www.canada.ca/en/revenue-agency/services/subsidy/recovery-hiring-program.html.

Provincial

Alberta

Capital Cost Allowance Changes (June 24, 2021)

Alberta is adopting the capital cost allowance changes announced in the 2021 federal Budget to encourage investment and support Alberta's economic recovery. Eligible incorporated Alberta businesses are now able to fully write off the cost of qualifying capital assets in the year of acquisition, which will help encourage investment. Adopting the temporary expensing measure will allow firms to immediately expense up to $1.5 million in new capital investment. The immediate expensing measure applies for eligible property acquired on or after April 19, 2021. The property must become available for use before 2024. This change builds on previous capital cost allowance measures implemented in 2018.

Only Canadian-controlled private corporations ("CCPCs"), which tend to be small and medium-sized businesses, are eligible for the immediate expensing measure. Companies that are publicly traded and non-incorporated businesses are not eligible for this measure. Alberta is also paralleling federal Budget changes regarding the capital cost allowance treatment of clean energy equipment (classes 43.1 and 43.2).

British Columbia

Supporting a Safe 2021 Fruit Harvest (June 29, 2021)

The BC government is investing $652,000 so work camps meet COVID-19 health and safety requirements in Loose Bay (Oliver) and Summerland. These work camps have modified their operations, infrastructure, and layout to protect worker, employer, and public health, and hired an on-site co-ordinator to conduct and implement COVID-19 safety training and protocols, as well as supporting daily health checks. Funding is also being provided to support COVID-19 health and safety measures for farms and orchards that offer on-site camping for workers. A dedicated, seasonal position will be introduced in Creston to act as a COVID-19 co-ordinator and to liaise with employers and employees with on-site camping to provide support for safety, health, and well-being. The funding will help BC growers fill labour shortages by supporting safe camping and accommodation for the approximately 1,500 seasonal workers that come to BC from other Canadian provinces to work during the summer months.

Supports for Indigenous Tourism Businesses (June 24, 2021)

Indigenous tourism businesses in BC have received over $28 million for 60 projects to support recovery from the impacts of the COVID-19 pandemic. StrongerBC programs such as the Community Economic Recovery Infrastructure

Program, Tourism Dependent Communities Program, and Targeted Regional Tourism Development Initiative are part of the province's actions to support recovery of BC's tourism sector, including Indigenous tourism.

The BC Indigenous Tourism Recovery Fund was created following the recommendations of the Tourism Task Force and created to support Indigenous tourism businesses specifically. Indigenous tourism businesses include accommodation and resorts, outdoor adventure experiences, restaurants, tour companies, galleries, and gift shops owned by Indigenous people.

Province Extends Supports for BC Hydro Customers (June 22, 2021)

British Columbia announced it is extending BC Hydro's Customer Crisis Fund ("CCF") to continue providing support for people in financial crisis and help avoid disconnections of their electricity service. The Government has issued a direction to the BC Utilities Commission to enable BC Hydro to continue offering grants through the CCF. People dealing with job loss, illness, or loss of wages due to COVID-19 may qualify for the grant program for up to $600. Applications can be made online (app.bchydro.com/ccf-application) or by paper.

Manitoba

Education Property Tax Rebates (June 24, 2021)

The Manitoba government has completed mailing approximately 244,426 education property tax rebate cheques to owners of residential, farm, and commercial properties in municipalities with a June 30, 2021, property tax deadline. Rebates valued at more than $146 million were sent to property owners in Winnipeg, Brandon, and Dunnottar. In addition, an education property tax rebate calculator is now available online so property owners can calculate their 2021 rebate once they have received their 2021 property tax statement. To use the calculator or learn more about Manitoba's education property tax rebate, visit www.manitoba.ca/edupropertytax.

Newfoundland and Labrador

Tourism and Hospitality Support Program Update (July 8, 2021)

The new Tourism and Hospitality Support Program is being supported by an investment of $30 million from Budget 2021. This is in addition to the $13 million committed for tourism marketing. The program will provide financial relief to eligible tourism and hospitality operators facing substantial sales losses due to the pandemic. Applications will be available online starting July 13, 2021, and will be accepted until September 30, 2021, or earlier if all funds are exhausted. The program will be administered in partnership with the Department of Industry, Energy and Technology.

Eligible applicants are tourism and hospitality operators engaged in commercial operations that experienced a loss of sales in 2020 over 2019 and have a reasonable plan to continue operations in 2021 and/or 2022. Eligible applicants will be eligible for a minimum contribution of $2,500 or a contribution calculated at 5% of total loss of sales in 2020 over 2019, up to a maximum of $50,000, per enterprise.

Corporations and sole proprietors/partnerships that are Newfoundland and Labrador owned and operated are eligible, but municipalities are not. Applicants must have been in operation for at least one year on March 16, 2020, except for new start-ups. New start-ups that were registered in 2020 and preparing to open for the 2020 and/or 2021 season may be eligible but must provide additional information (e.g., summary of expenses) for assessment purposes. If required, applicants must be incorporated in Newfoundland and Labrador and have their primary place of operations in Newfoundland and Labrador.

Applicants are eligible to receive one non-repayable contribution per enterprise. Applications will be processed on a first-come, first-served basis until September 30, 2021.

Eligible applicants will be determined based on the following categories:

- accommodations;
- tours;
- attractions;
- food and beverage;

- outfitters;
- transportation;
- retail operations in the tourism industry; and
- events.

Nova Scotia

Deadline for Small Business Real Property Tax Rebate Program Extended (June 23, 2021)

The province announced applications for the Small Business Real Property Tax Rebate Program will be accepted for an additional two weeks — the new deadline to apply is July 9, 2021. The Small Business Real Property Tax Rebate Program provides eligible businesses with a one-time rebate of a portion of their paid property taxes. They can choose a rebate of $1,000 or 50% of the commercial real property taxes paid for the final six months of the 2020–2021 tax year.

Québec

Tax Credit for Investment and Innovation To Be Amended (June 30, 2021)

On March 25, 2021, it was announced that the rates for the tax credit for investment and innovation would be temporarily doubled to encourage Québec businesses to carry out their investment projects and to accelerate Québec's economic recovery.

To maintain the objective of allowing corporations established in territories where the economic vitality index is among the 25% lowest in Québec to benefit from the highest rate of the tax credit relating to investment and innovation, the definition of "territory with low economic vitality" will be amended. The tax legislation will therefore be amended to add the regional county municipalities ("RCMs") of Maskinongé, Domaine-du-Roy, and Papineau to the list of territories with low economic vitality for the purposes of the tax credit relating to investment and innovation. This amendment will apply in respect of specified expenses incurred after June 30, 2021, for the acquisition of a specified property after that date. However, it will not apply to a property:

- acquired in accordance with a written obligation entered into on or before June 30, 2021; and
- whose construction by the corporation or partnership, or on its behalf, was under way on June 30, 2021.

The tax legislation will also be amended to remove the RCMs of Appalaches and Côte-de-Gaspé and the Communauté maritime des Îles-de-la-Madeleine from the list of territories with low economic vitality. To provide a transitional period, this amendment will apply in respect of specified expenses incurred after March 31, 2023, for the acquisition of a specified property after that date.

Harmonization With Federal Tax Measures (June 30, 2021)

Québec tax legislation and regulation will be amended to incorporate, with adaptations on the basis of their general principles, the measures in the April 19, 2021, federal Budget concerning the tax treatment of COVID-19 benefit amounts.

Certain measures will not be incorporated because they do not correspond to the characteristics of the Québec tax system or because the latter is satisfactory or does not contain similar provisions. These measures concern:

- the extension of the Canada Emergency Wage Subsidy, the Canada Emergency Rent Subsidy, and the Lockdown Support, and the introduction of the Canada Recovery Hiring Program; and
- the extension of the prescribed time for the application of the Canadian Film or Video Production Tax Credit and the Film or Video Production Services Tax Credit.

Also, certain income tax measures in the federal Fall Economic Statement 2020 have not been incorporated because they do not correspond to the characteristics of the Québec tax system or because the latter is satisfactory or does not contain similar provisions. The measures concern:

- the Canada Child Benefit and the children's special allowance, pertaining to a quarterly enhancement for 2021 of the amounts paid under the allowances; and
- the extension of the Canada Emergency Wage Subsidy, the Canada Emergency Rent Subsidy, and the Lockdown Support.

On May 20, 2021, Canada's Minister of Finance announced a one-year extension of the proposed regulation, first published on July 2, 2020, which provides temporary relief for registered pension plans ("RPPs") and deferred salary leave plans ("DSLPs"). These temporary relief measures are intended to assist Canadian workers and their employers during the COVID-19 pandemic. Specifically, with respect to RPPs, the extension of the announced relief measures will ensure that employers and sponsors continue to have sufficient financial flexibility to administer these plans during the COVID-19 pandemic. These relief measures include the ability to make catch-up contributions to RPPs by April 30, 2022, and the temporary removal of restrictions that prohibit borrowing.

As a corollary, but in relation to DSLPs, the extension of the relief measures will result in employees who make the decision to postpone their deferred leave due to COVID-19 not suffering any adverse tax consequences for having remained at work during the pandemic. The Québec government had announced that the relief measures for RPPs and DSLPs proposed by the federal government on July 2, 2020, were retained for the application of the Québec tax system and would be applicable on the same dates as the federal measures with which they are harmonized. Given the extension of these relief measures announced on May 20, 2021, by the federal Minister of Finance, it is appropriate to subscribe once again, for the application of the Québec tax system, to the extension of these same relief measures to the RPP and DSLP rules, for the same periods as those provided for the application of the federal tax system and in accordance with the terms and conditions set out therein.

FOCUS ON CURRENT CASES

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

Canada (National Revenue) v. Boguski, 2021 DTC 5065 (Federal Court of Appeal): Federal Court of Appeal Holds that Expanded Procedural Powers under Section 174 of the *Income Tax Act* Remain "Merely Permissive and Discretionary"

Background

Under section 174 of the *Income Tax Act* (Canada) ("ITA"), the Minister of National Revenue (the "Minister") may apply to the Tax Court of Canada (the "Tax Court") for a determination of a question of law, fact, or mixed law and fact that is common to assessments or proposed assessments in respect of two or more taxpayers. Originally, section 174 only applied to questions arising out of one and the same transaction or occurrence, or series of transactions or occurrences, and accordingly typically applied to two taxpayers such as the vendor and the purchaser in the same commercial transaction. Pursuant to amendments made in 2013, section 174 may also apply to questions arising out of substantially similar transactions or occurrences, or series of transactions or occurrences.

As summarized by Justice D'Arcy in *Canada (National Revenue) v. Boguski*, 2019 DTC 1002 (TCC), ("*Boguski TCC*"), the steps of analysis required under section 174 of the ITA are as follows:

- Under subsection 174(1), the Minister must form the opinion that there is a question of law, fact, or mixed law and fact that is common to assessments or proposed assessments in respect of two or more taxpayers arising out of the same or substantially similar transactions or series of transactions;
- The Minister's application must contain the information required in subsection 174(2), including the question sought to be determined, the names of the taxpayers that the Minister seeks to bind by the question, and the facts and reasons upon which the Minister relies;

- Under subsection 174(3), the Tax Court may determine the question if it is satisfied that the question is common to assessments or proposed assessments in respect of taxpayers who have been served with a copy of the application; and
- The Tax Court must exercise this discretion in a manner that is consistent with the provisions of subsection 174(3) and does not result in an abuse of process.

The Minister's application to the Tax Court in *Boguski TCC* (the "Application") is the first time the Tax Court considered section 174 of the ITA following the amendments in 2013. The Minister's Application was for the determination of whether certain properties acquired by 81 taxpayers, being interests in certain gold mining rights in Canada, were a "tax shelter" as defined in subsection 237.1(1), in respect of which no amount was deductible pursuant to subsection 237.1(6) or (6.1). When filed, Schedule A to the Application named 67 taxpayers who had filed notices of objection with the Minister in respect of assessments or reassessments issued by the Minister (the "Assessed Taxpayers"). Schedule B to the Application named a further 14 taxpayers who had filed appeals to the Tax Court in respect of assessment or reassessments issued by the Minister, two of which (the "Lead Cases") were filed under the Tax Court's lead case rules in section 146.1 of the *Tax Court of Canada Rules (General Procedure)* (the "Rules") and the remaining 12 of which were filed under the *Tax Court of Canada Rules (Informal Procedure)* (the "Informal Appeals"). By the time the Application was heard, the Minister stated that the Application would be withdrawn in respect of the taxpayers who filed the Informal Appeals but would proceed in respect of the Lead Cases and the Assessed Taxpayers.

Decision of the Tax Court

In the Application, the Minister formed the opinion that the question that was the subject of the Application (the "Question") was common to the assessments issued against the Assessed Taxpayers and the appellants in the Lead Cases, and that the Question was of mixed law and fact arising out of the sale and issuance of interests in the gold mining rights (the "Purported Transactions"). Accordingly, Justice D'Arcy determined that the Minister was entitled, under subsection 174(1) of the ITA, to bring the Application. While it was clear from the pleadings filed by the appellants in the Lead Cases that the Question was common to their appeals, Justice D'Arcy had to determine whether the Question was also common to the Assessed Taxpayers. Since section 174 can only apply to a taxpayer in respect of an amount denied on assessments if the taxpayer has filed a valid notice of objection within the allowed statutory period in respect of the denied amount, the Minister was required to satisfy the Tax Court that each Assessed Taxpayer had filed a valid notice of objection. The Minister was only able to provide evidence that 20 of the Assessed Taxpayers had filed valid notices of objection to the denied amounts for the taxation years in question; for another 19 of the Assessed Taxpayers, the Minister only provided evidence that they had filed valid notices of objection to the denied amounts for some of the taxation years in question. For the remaining Assessed Taxpayers, Justice D'Arcy concluded that the Minister had not provided objective evidence to prove that they had each filed a valid notice of objection.

Justice D'Arcy next considered whether the Tax Court should exercise its discretion to answer the Question, and concluded that the Tax Court would not do so. Justice D'Arcy noted that there was a risk of unfairness to the parties, especially those Assessed Taxpayers who were self-represented, in directing a hearing involving 42 parties that required evidence to resolve the Question. Justice D'Arcy believed a hearing of the Application would also result in an inefficient and more expensive proceeding than would otherwise occur under the lead case rules. Among his concerns were the difficulty in sending notices relating to the Application to the 42 parties, scheduling conference calls, and conducting discoveries and a hearing with the Assessed Taxpayers who lived all over the country. On the other hand, if the Assessed Taxpayers filed appeals with the Tax Court, most of them would be heard under the Tax Court's informal procedure at locations close to their homes. Furthermore, Justice D'Arcy noted that jurisprudence on Rule 58 of the Rules (which allows a party to apply for the determination of a question of law, fact, or mixed law and fact raised in a pleading before the hearing) provides that the Tax Court will not answer fact-based questions under Rule 58 in the absence of an agreed statement of facts. Justice D'Arcy was of the view that it was not likely that the Tax Court would grant an order under Rule 58 of the Rules in respect of the Question. Accordingly, Justice D'Arcy found that the Application was an attempt by the Minister to circumvent the principle of Rule 58 and constituted an abuse of process.

Decision of the Federal Court of Appeal

In a brief set of reasons, Justice Stratas, writing unanimously for the Federal Court of Appeal (the "FCA"), upheld the decision of the Tax Court. Justice Stratas emphasized the broad discretion of the Tax Court to grant applications under

section 174 of the ITA. A finding of a common question in respect of multiple taxpayers is necessary for section 174 to operate, however such a finding merely permits the judge to exercise discretion to make an order.

The FCA recognized two reasons for the Tax Court's refusal to answer the Application. First, there was inadequate evidence produced by the Minister to demonstrate a common question. Second, even if the common question were satisfied, the Tax Court would not proceed in light of the inefficiency and procedural unfairness that would result in the subject Application. Neither of these reasons presented palpable and overriding error which required interference by the FCA. The FCA noted the relationship between the Tax Court's inherent jurisdiction to control its own practice and procedure, and the purpose of section 174 of the ITA itself. The Tax Court was entitled to find that engaging section 174 would result in procedural unfairness.

The Minister attempted to argue that anything not explicitly addressed in the Tax Court's reasons was "not considered". The FCA rejected this argument, since reasons of a first-instance court such as the Tax Court should be read holistically, making allowances for awkward expression and efforts to summarize a lot of information. Accordingly, the Tax Court did not commit a reversible error in identifying, non-exhaustively, the factors that guided its conclusion.

Conclusion

This decision is the first to address the procedural implications of the 2013 amendments to section 174 of the ITA. Justice Stratas' deference to the Tax Court's concern for procedural fairness demonstrates the importance of courts' inherent jurisdiction to organize their own proceedings. This case affirms that section 174 remains wholly permissive, subject to the holistic discretion of the Tax Court.

— *Paige Donnelly and Hannah Bourgeois*

Canadian Imperial Bank of Commerce v. Canada, 2021 DTC 5059 (Federal Court of Appeal): Federal Court of Appeal Is Divided in the Determination of the Predominant Element of Supply in CIBC and Aeroplan Arrangement

In *Canadian Imperial Bank of Commerce v. Canada* ("*CIBC*"), the Canadian Imperial Bank of Commerce ("CIBC") appealed the Tax Court of Canada's (the "Tax Court's") decision to deny CIBC's GST rebate claim under section 162 of the *Excise Tax Act* (the "ETA") for return of GST paid in error.

Facts

CIBC and Aeroplan Limited Partnership ("Aeroplan") entered into an agreement related to Aeroplan credit cards issued by CIBC (the "Agreement"). Under the Agreement, Aeroplan would provide a list of its members to CIBC and promote CIBC's credit cards. Aeroplan Miles would be issued to the holders of these cards based on amounts that such holders charged to their cards. CIBC made substantial payments to Aeroplan under the Agreement and paid GST. Since CIBC was performing a financial services business as opposed to a commercial activity, it was not entitled to claim input tax credits on the GST paid. CIBC subsequently submitted a rebate claim under section 162 of the ETA for return of the GST paid in error. The Minister denied the claim.

Decision of the Tax Court

At the Tax Court, CIBC argued that it was paying Aeroplan to issue Aeroplan Miles to its customers and that Aeroplan Miles were gift certificates. If Aeroplan Miles were gift certificates, then the issuance or sale of such Aeroplan Miles would be deemed not to be a supply pursuant to section 181.2 of the ETA and there would be no GST payable by CIBC.

The Tax Court disagreed with CIBC's position, concluding instead that "the true nature" of the Agreement between CIBC and Aeroplan was to market and promote applications for and increase the use of CIBC credit cards. In making this determination, the Tax Court relied on the express terms of the Agreement, which provided that CIBC would pay Aeroplan a fee in consideration for Aeroplan "referring or arranging for Aeroplan Members and other members of the public to make Card Applications."

Accordingly, the Tax Court determined that Aeroplan provided a taxable supply to CIBC consisting of "promotional and

marketing services". As such, CIBC was not entitled to a GST rebate. The Tax Court also concluded that Aeroplan Miles were not gift certificates for the purposes of the ETA, on the basis that Aeroplan Miles did not have attributes similar to money.

Decision of the Federal Court of Appeal

The issue before the Federal Court of Appeal ("FCA") was whether the Tax Court made a palpable and overriding error in concluding that the supply rendered by Aeroplan was promotional and marketing services and not Aeroplan Miles.

The Type of Supply or Services Made to CIBC

The FCA confirmed that the test for the determination of the predominant element of a supply was set out in *Global Cash Access (Canada) Inc. v. Canada*, 2013 GTC 1030 (FCA) ("*Global Cash*"). The question to be answered was: what did Aeroplan provide to CIBC to earn the amount payable by CIBC?

In making this determination, the majority considered the terms of the Agreement and emphasized the linkage between CIBC's payments to Aeroplan and Aeroplan's obligations to promote CIBC's card applications to Aeroplan members and the public. Particularly, the majority found that CIBC's obligation to pay was expressly linked to the promotional and marketing services to be provided by Aeroplan in both section 9 and Appendix "D" of the Agreement. In contrast, section 9 and Appendix "D" of the Agreement stated that the other obligations of Aeroplan (which would include issuing Aeroplan Miles to CIBC's customers) were merely incidental to the promotional and marketing services. The majority also referred to other sections of the Agreement that suggested that Aeroplan provided Aeroplan Miles "at its own cost."

CIBC sought to rely on the testimony of its witness Mr. Stephen Webster, a former VP of travel cards at CIBC, to demonstrate that the purchase of Aeroplan Miles was the predominant element of the supply. The FCA majority, however, found that while Mr. Webster spoke generally about the objectives of CIBC in entering into the Agreement, his testimony did not go so far as to state that CIBC was purchasing Aeroplan Miles, or that the issuance of Aeroplan Miles by Aeroplan to CIBC's customers was not incidental to having access to Aeroplan's members.

Moreover, the FCA found that insofar as Mr. Webster's testimony suggested that the issuance of Aeroplan Miles was the predominant supply, this would contradict the terms of the Agreement itself. In particular, the Agreement clearly stated that the "other obligations" of Aeroplan (which would include Aeroplan's obligation to issue Aeroplan Miles to the customers of CIBC) were incidental to its obligations to refer or arrange Aeroplan's members to make credit card applications with CIBC.

The majority also emphasized that favouring Mr. Webster's "*ex-post facto* testimony" would undermine the principles of Supreme Court cases *Symes v. Canada*, 94 DTC 6001, and *MacDonald v. Canada*, 2020 DTC 5027 ("*MacDonald*"), which highlighted the significance of "objective manifestations of purpose" relative to *ex post facto* testimony. Adopting the rule in *MacDonald*, the FCA majority found that "[a]ny statements made by Mr. Webster [. . .] cannot override the statement in the agreement that CIBC was paying Aeroplan for 'referring or arranging for Aeroplan Members and other members of the public to make Card Applications.'"

The majority reiterated that it was not the role of appellate courts to reweigh evidence weighed by the trial judge. Ultimately, the FCA majority found no basis on which to interfere with the Tax Court's decision.

The Interpretation of "Gift Certificate" Under the ETA

The FCA majority declined to address the issue of whether Aeroplan Miles are gift certificates, on the bases that neither Aeroplan nor the persons redeeming the Aeroplan Miles were party to the subject appeal, and that the redemption process for the Aeroplan Miles was unclear.

The Dissent

The Type of Supply or Services Made to CIBC

In dissent, Justice Stratas asserted that assessing the predominant element of a supply involved identifying all of the elements and asking which "in a practical or commercial sense, caused the payment of the consideration." The dissent emphasized that the Agreement alone could not be determinative, but was just one indicium of what CIBC received

from the arrangement. The dissent disapproved of the majority's exclusive reliance on the literal terms of the contractual language of the Agreement, as well as the majority's position that one need not consider the commercial efficacy of the Agreement. The dissent reasoned that the majority's approach deviated from *Global Cash* and *Great-West Life Assurance Company v. Her Majesty The Queen*, 2016 GTC 1039 (FCA), which emphasized the assessment of practical and commercial substance when determining the nature of a supply.

In this regard, the dissent found that, but for CIBC's right to allocate Aeroplan Miles, there would have been no point in the parties performing their other obligations. There would have been no point in CIBC receiving Aeroplan customer information or advertising opportunities if CIBC were not able to offer Aeroplan Miles to its customers. Accordingly, the issuance of the Aeroplan Miles must have been the predominant element of the supply.

The Interpretation of "Gift Certificate" Under the ETA

The dissent found that the ordinary meaning of gift certificate as "a device, paper or electronic, that may be used, subject to its terms, as full or partial consideration for a supply offered by a supplier" supported the conclusion that Aeroplan Miles would qualify as gift certificates.

Moreover, the dissent rejected the Tax Court's position that Aeroplan Miles cannot be gift certificates because they do not have a fixed dollar value, pointing out that this was not a required criterion under the ETA and that past jurisprudence did not require reward points to have a fixed dollar value to constitute a gift certificate. The dissent noted that Aeroplan Miles function as gift certificates in the commercial context because, like money, they are effectively used as exchange devices for property or services.

Ultimately, the dissent would have held that the Aeroplan Miles were the predominant supply and that the Aeroplan Miles qualified as gift certificates. Since gift certificates are deemed not to be a supply pursuant to section 181.2 of the ETA, CIBC would be entitled to a rebate for the GST that it had paid.

Takeaway

Although the dissenting opinion in *CIBC* makes a persuasive case that courts must consider the practical and commercial substance of a supply in determining the supply's predominant element, the dissent does not say that the Tax Court made a palpable and overriding error that warranted intervention by the FCA. Rather, the dissent found that the Tax Court's reasons were "diffuse and opaque" and essentially confusing, which, in the dissent's view, permitted the FCA to interfere with the Tax Court's decision. Meanwhile, the majority appeared to have no difficulty understanding the Tax Court's reasons. Moreover, even if the Tax Court's reasons were diffuse and opaque, it is questionable whether this rises to the level of a palpable and overriding error. As stated by the FCA in *South Yukon Forest Corp. v. R.*, 2012 FCA 16, "when arguing palpable and overriding error, it is not enough to pull at leaves and branches and leave the tree standing. The entire tree must fall."

— *Hannah Bourgeois*

Paletta Estate v. The Queen, 2021 DTC 1032 (Tax Court of Canada): Tax Court Grants Significant Costs Award to Successful Appellant

This decision is a costs order in connection with the Tax Court of Canada's decision of *Paletta Estate v. The Queen*, 2021 DTC 1011 ("*Paletta No. 1*"). The substantial success of the appellant, Mr. Pat Paletta (the "Appellant") in his appeals led to a significant costs award in his favour.

Background

Paletta No. 1 concerned the Appellant's claim of significant losses from a tax-driven method of structuring forward foreign exchange trading. In the 2000 to 2007 taxation years, the Appellant engaged in "straddle trading" whereby he closed loss positions on trades at the end of each taxation year and waited to close gain positions early in the following taxation year, so as to achieve a target net loss for each year. As a result of this scheme, the Appellant claimed losses in each of the 2000 to 2006 taxation years, and realized a modest gain in the 2007 taxation year. The Minister of National Revenue (the "Minister") disallowed all of the Appellant's claimed losses for the 2000 to 2006 taxation years primarily on the basis that there was no source of income from which to deduct the non-capital losses

and that the trading scheme was a sham. Justice Spiro rejected these arguments and found that the trading scheme was not a sham and that there was a source of income sufficient to permit the deduction of the claimed losses. While the outcome of the case was considered a substantial success for the Appellant, the Appellant was found to have made a misrepresentation attributable to neglect or carelessness in his 2002 taxation year for not having reported $8 million of gains from his trading for that year. He was also found to have knowingly, or under circumstances amounting to gross negligence, made a false statement or omission in his 2002 tax return by failing to include the $8 million trading gains for which the Minister assessed a gross negligence penalty under subsection 163(2) of the *Income Tax Act* (Canada).

The parties filed written submissions on costs for determination by the Tax Court of Canada (the "Tax Court"). The Appellant sought costs of $3,500,000, reflecting a total $996,550 in disbursements and nearly 75% of his $3,365,500 legal fees. The Crown, on the other hand, argued that since there were determinations in favour of both sides, costs should be determined in accordance with Tariff B of Schedule II to the *Tax Court of Canada Rules (General Procedure)* (the "Rules") with no disbursement costs awarded.

Issues and Tax Court Decision

Justice Spiro first considered the disbursements claimed by the Appellant and compared them against the Crown's own disbursements of $710,000. Given the onus on the Appellant to demolish the Minister's assumptions of fact in respect of sham and its arguments that the transactions were ineffective, Justice Spiro was satisfied that the Appellant's disbursements fell within a reasonable range.

Justice Spiro next considered the Appellant's claim for its legal fees against the factors set out in subsection 147(3) of the Rules. In exercising its discretionary power to determine the award of costs to parties involved in a proceeding under subsection 147(1), the Tax Court is permitted to consider, *inter alia*, the result of the proceeding, the amounts in issue, the importance of the issues, the volume of work, the complexity of the issues, whether the expense of having an expert witness was justified, and any other matter relevant to costs.

Certain costs factors weighed in the Appellant's favour. In particular, the result of the proceeding significantly favoured the Appellant. Justice Spiro did not accept the Crown's argument that the parties were equally successful in light of the fact that the Crown was only partially successful for one of the eight taxation years at issue. The amounts claimed as income losses were also significant, amounting to almost $49 million claimed by the Appellant personally. Further, the case was an important contribution to straddle trading jurisprudence, representing the first opportunity for the Tax Court to consider the Supreme Court of Canada's ("SCC's") decision on straddle trading in *Friedberg v. Canada*, 93 DTC 5507, in the context of forward foreign exchange contracts and to consider the SCC's decisions in *Stewart v. Canada*, 2002 DTC 6983, and *Walls v. Canada*, 2002 DTC 6960, in the context of straddle trading. The trial took place over a period of 15 days. During this time the Appellant had to respond to the Crown's lengthy list of complex and nuanced arguments which required careful and comprehensive explanations of the trades themselves.

Some of the costs factors, on the other hand, weighed in favour of the Crown and reduced the total amount of the Appellant's costs granted by the Tax Court. Justice Spiro found that the opinion of the expert witness called by the Appellant was flawed since the expert failed to consider the possibility that the Appellant's trading was entirely tax-driven. Justice Spiro also found that the Appellant's refusal to admit to the omission of $8 million in gains in the 2002 taxation year, and the Appellant's attempts to call an expert witness to provide evidence on English law that was "irrelevant and unnecessary", warranted reducing the award for legal fees from 55% to 50% of fees incurred. Justice Spiro further reduced the amount of fees recoverable to 45% to account for the partial costs awarded to the Crown in respect of the 2002 taxation year. Overall, the Appellant was awarded a net lump sum of $2,241,025.

Conclusion

The significant costs awarded to the Appellant under subsection 147(3) of the Rules exemplify the financial risks at stake in complex tax litigation. Procedural decisions on the selectiveness of a party's pleadings and the relative value of expert witnesses can impact final costs assessments.

— *Hannah Bourgeois*

CURRENT ITEMS OF INTEREST

Federal Government Clarifies Plans for Intergenerational Transfers of Small Business Shares

On June 29, 2021, Bill C-208, *An Act to amend the Income Tax Act (transfer of small business or family farm or fishing corporation)*, received Royal Assent. On the following day, the federal government announced that it proposed to introduce legislation to clarify that the amendments would apply effective January 1, 2022 — it also appeared that the government intended to make additional amendments.

Finally, in a news release dated July 22, Chrystia Freeland, Deputy Prime Minister and Minister of Finance, clarified the federal government's intentions. First, they affirmed that the changes in Bill C-208 now apply in law. However, to protect the integrity of the tax system, the government will propose amendments to the *Income Tax Act* to prevent any tax avoidance loopholes that Bill C-208 may have unintentionally created; these amendments will honour the original spirit of the bill.

The government appears particularly concerned about any loopholes that create the opportunity to effectively convert dividends into capital gains (which have a lower income tax rate) without a genuine transfer of ownership occurring (i.e., "surplus stripping"). The news release provided a brief list of potential issues that the government intends to address via new amendments:

- The requirement to transfer legal and factual control of the corporation carrying on the business from the parent to their child or grandchild;
- The level of ownership in the corporation carrying on the business that the parent can maintain for a reasonable time after the transfer;
- The requirements and timeline for the parent to transition their involvement in the business to the next generation; and
- The level of involvement of the child or grandchild in the business after the transfer.

The federal government plans to introduce draft legislative amendments for consultation. Following the consultation, the government will publish the final proposals which will be subsequently introduced as a bill. The proposed legislation will apply as of the later of either November 1, 2021, or the publication date of the final draft legislation.

Livestock Tax Deferral Regions Announced for 2021

The Minister of Agriculture and Agri-Food, Marie-Claude Bibeau, announced the early designation of the Livestock Tax Deferral provision for prescribed drought regions of British Columbia, Alberta, Saskatchewan, Manitoba, and Ontario. Eligible regions are identified based on weather, climate, and production data, in consultation with industry and provinces. The criteria for identifying regions for Livestock Tax Deferral is forage shortfalls of 50% or more caused by drought or excess moisture. Government officials will continue to monitor weather, climate, and production data from across Canada and will add regions to the list when they are eligible.

The Livestock Tax Deferral allows livestock producers in these regions who reduced their breeding herds by at least 15% due to drought or flooding to defer a portion of their 2021 income from sales until the 2022 tax year, when the income may be at least partially offset by the cost of reacquiring breeding animals, which may reduce their potential tax burden.

The initial list of prescribed regions can be found here: agriculture.canada.ca/en/agriculture-and-environment/drought-watch-and-agroclimate/livestock-tax-deferral-provision/2021-list-prescribed-regions.

Canada Workers Benefit Expanded

The Canada Workers Benefit ("CWB") will now be available to about one million more Canadians. The CWB is a refundable tax credit to help people and families who are working and earning a low income. Until now, the threshold of eligibility left many low-wage workers out of the program and that meant people were still living below the poverty line despite working full-time jobs. With the passage of changes contained Bill C-30, *Budget Implementation Act, 2021, No. 1*, a million more low-income workers are now eligible for a tax refund of up to almost:

- $1,400 for workers who are single and without children (a group that does not receive many benefits); and
- $2,400 for workers with families.

The government is expanding eligibility by making the CWB available to those with incomes up to:

- $32,244 as single Canadians, without children;
- $42,197 as single-earner families; and
- $56,197 as double-earner families.

This enhancement will also increase the income threshold for workers to receive the maximum benefit to $22,944 for single Canadians without families, and $26,177 for families. This expansion includes a new provision which allows secondary earners in couples, most of whom are women, to exclude up to $14,000 of their working income when calculating the benefit, allowing them to access a more generous tax refund.

Interest Rates for Third 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 (www.canada.ca/en/revenue-agency/news/newsroom/tax-tips/tax-tips-2021/interest-rates-for-the-third-calendar-quarter.html). These rates will be in effect from July 1, 2021, to September 30, 2021.

Information Circular 76-12R7 Updated

Information Circular 76-12R7 has been revised because of changes to Canada's tax conventions and the introduction of Form NR301, *Declaration of Eligibility for Benefits Under a Tax Treaty for a Non-Resident Taxpayer*, Form NR302, *Declaration of Eligibility for Benefits Under a Tax Treaty for a Partnership With Non-Resident Partners*, and Form NR303, *Declaration of Eligibility for Benefits Under a Tax Treaty for a Hybrid Entity*.

RECENT CASES

Taxpayer fined 100% of taxes evaded

Cromwell and his numbered company were convicted of willfully evading the payment of taxes by failing to declare income contrary to paragraph 239(1)(*d*) of the *Income Tax Act* (the "Act") and willfully evading the remittance of HST contrary to paragraph 327(1)(*c*) of the *Excise Tax Act*. Cromwell was also convicted of committing offences contrary to paragraph 239(1)(*d*) of the Act by willfully evading the payment of taxes in 2004 and 2005. The Crown calculated the amount of tax evaded by Cromwell and his company at $23,084.03 and requested a fine of 100% of the amount of taxes evaded. Cromwell proposed a fine of 75% of the taxes evaded and two years to pay.

The taxpayer was fined 100% of taxes evaded. The Court reviewed the jurisprudence and the purpose and principles of sentencing set out in the *Criminal Code* which apply to a sentencing for tax evasion. Proportionality is a fundamental principle of sentencing. Cromwell and the numbered company have no prior record. However, deliberately evading taxes, personal, corporate, and HST, over a two-year period constitutes a very serious offence. Cromwell's moral culpability for the tax evasion was high. The Crown sought to have Cromwell pay a fine in the amount of the taxes he evaded paying. Although Cromwell is facing a substantial civil liability as a result of his tax evasion, with onerous penalty and interest aspects, that civil assessment process is entirely separate from this criminal process. The emphasis in a case like this must be on denunciation and deterrence. These principles are not satisfied by a 75% fine. The appropriate fine is 100% of the evaded taxes, to be paid within two years.

R. v. Cromwell

2021 DTC 5064

Taxpayer denied rescission of dividend distribution that unexpectedly turned out to be taxable

The corporation made a dividend distribution to its sole shareholder from its tax-free capital dividend account, whose zero-balance meant that the distribution came from a taxable account. The taxpayer and corporation applied for rescission or rectification, reversing the dividend declaration.

The application was dismissed. Applying the criteria for rescission set forth in *Stone's Jewellery Ltd. v. Arora*, 2009 ABQB 656, the Court found that the application failed them all: there was no mistake about the underlying contract; it would not be inequitable to deny relief; other remedies short of rescission exist; the plaintiffs were asking the Court to participate in retroactive tax planning; and there would be no injury to third parties in denying relief.

RJ McLeod Investments Inc. v. McLeod

2021 DTC 5062

Denial of Request to File amended section 85 elections unreasonable

The applicants were two family trusts (the "Trusts") settled by Laurie Carlson. Laurie Carlson and the Trusts indirectly held all the outstanding shares in his family's crushed stone and sand supply business ("Mainland"). In September 2014, Mr. Carlson and the Trusts agreed to sell all the outstanding shares in Mainland to an arm's length third-party purchaser. The Trusts implemented a series of pre-closing transactions to enable their respective beneficiaries to use their capital gains exemptions ("CGEs") pursuant to subsection 110.6(2.1). The Trusts' professional advisors failed to factor into their advice the fact that a number of the beneficiaries were still minors in 2014. Following an audit of the Trusts' 2014 taxation year, the CRA concluded that subsection 120.4(5), also known as the "kiddie tax", applied to two share exchange transactions completed in the pre-sale reorganization. This subsection deemed the capital gains realized by the minors to be taxable dividends, thereby preventing those beneficiaries from using their CGEs. The Trusts attempted to file amended T2057 rollover election forms with the CRA in reliance on subsection 85(7.1) to address the error. The Minister denied those requests at the initial stage as well as a follow-up request, both on the grounds that they were retroactive tax planning. The Minister acknowledged that subsection 120.4(5) was an unintended consequence of the pre-closing transactions but did not agree it was an oversight against which the Minister's discretion should be exercised within the just and equitable ambit of subsection 85(7.1). The Trusts applied for judicial review of the Minister's decisions.

The applications were allowed. The Trusts raised two issues: (1) Were the Minister's decisions to deny the request to file the amended elections reasonable? (2) Was the Minister's decision-making process procedurally fair? The merits of the decisions were subject to review for reasonableness. A reasonable decision is one that is based on an internally coherent and rational chain of analysis and that is justified in relation to the facts and law that constrain the decision-maker. Subsection 85(7.1) permits an election made under subsection 85(1) or (2) to be amended if, in the Minister's opinion, the circumstances are such that it would be just and equitable to do so. There was no explanation in the decisions (or the memo prepared in support of the decisions) of why the error in realizing gains prematurely in the reorganization resulted in the Minister's conclusion that it was not just and equitable to extend her discretion and

permit the amended elections. This was not a case in which there was an intervening transaction which caused the Trusts to look retroactively at their tax planning and seek to recharacterize their prior actions. The requests were made in the context of a third-party sale of Mainland in which the CGEs would normally be available with some pre-planning. The Trusts were not seeking a tax advantage they had not considered at the time. If the Minister considered these circumstances sufficient to meet the test of impermissible retroactive tax planning, the Trusts were entitled to a clear explanation. The decisions lacked the rational chain of analysis and transparency of reasoning that are the hallmarks of a reasonable administrative decision. The Minister's delegate imported equitable requirements specific to rectification and rescission without acknowledging any difference in the remedies sought. The Minister overlooked the fact the Trusts proposed no amendment to the transactions or to the documents executed. They requested only the amendment of the original elections, as contemplated in subsection 85(7.1). The Court concluded the decisions must be set aside and remitted to the Minister for redetermination. The Court directed the Minister to ensure the redetermination be conducted by CRA personnel who had not been involved in an audit role of the Trusts' or Carlson family's income tax returns or other tax matters, or in the first and second reviews. While not determinative of the application, the Court dismissed the Trusts' challenge to the fairness of the Minister's process.

Carlson Family Trust v. Canada (MNR)

2021 DTC 5058

Taxpayer's conviction for failure to respond to Notices of Requirement affirmed

The taxpayer appealed conviction on four counts of failure to timely respond to Notices of Requirement, pursuant to subsection 238(1) of the *Income Tax Act* (the "Act"), to file 2014–2017 returns.

The convictions were upheld. Subsection 238(1) sets forth a strict liability offence, and the CRA proved the elements of service and failure to comply. The taxpayer's defences — including the failure of the serving official to provide a copy of their oath of loyalty to the Queen, a claim that the Notices were offers to contract with the CRA, a claim that the Act applies only to corporations, and a claim that the taxpayer was a "legal fiction" distinct from the actual person — were "organized pseudo-legal commercial arguments" uniformly rejected by the courts.

R. v. Merrill

2021 DTC 5057

TAX NOTES

Published twelve times per year by Wolters Kluwer Canada Limited. For subscription information, see your Wolters Kluwer Account Manager or contact customer service.

For Wolters Kluwer Canada Limited

Email: cservice@wolterskluwer.com *Phone: 1-800-268-4522 or (416) 224-2248 (Toronto)*

Notice: *Readers are urged to consult their professional advisers prior to acting on the basis of material in this newsletter.*

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

© 2021, Wolters Kluwer Canada Limited

Wolters Kluwer