Tax Notes

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DEANS KNIGHT INTERSECTS BILL C-208: THE MEANING OF CONTROL AND IMPLICATIONS FOR INTERGENERATIONAL TRANSFERS

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Deans Knight and the Question of Control

In the recent case of *Canada v. Deans Knight Income Corporation*, 2021 DTC 5095, the Federal Court of Appeal addressed the object, spirit, and purpose of subsection 111(5) of the *Income Tax Act* in the context of determining whether there had been abuse for the purposes of the GAAR.

The wording of subsection 111(5) itself refers to a *de jure* control test. It is one of the provisions known as the stop-loss rules which restrict a corporation's ability to deduct losses when there has been an acquisition of control. There have been a number of amendments to the stop-loss rules over the years; however, none of them sanction the replacement of a *de jure* control test with a *de facto* control test. Prior jurisprudence had indicated that using *de jure* control was a deliberate choice by Parliament to provide certainty. Whatever certainty the wording of the subsection itself provided now appears to be lost due to the risk of GAAR assessments.

Prior jurisprudence such as *Duha Printers (Western) Ltd. v. Canada*, 98 DTC 6334 (SCC), and the Tax Court decision in *Deans Knight*[1] indicated that Parliament had specifically chosen to use *de jure* control for the purpose of subsection 111(5) and that a change should be left to Parliament. Despite this, the FCA adopted an expanded concept of control as part of the object, spirit, and purpose of subsection 111(5). The FCA discussed *Duha Printers* and took the view that the GAAR, which was not in force at the time relevant to that case, was a form of response allowing the courts to look beyond the concept of *de jure* control in the provision. The FCA's definition of the object, spirit, and purpose uses the term "actual control" "whether by way of *de jure* control or otherwise".

The FCA's test does not refer to *de facto* control and indeed the decision suggests that "actual control" "includes forms of *de jure* control and *de facto* control". It is possible that "actual control" could be interpreted as a new form of control. In that case, there is now a high degree of uncertainty about the type of control that could trigger a GAAR assessment with relation to the misuse or abuse of subsection 111(5) and similar provisions. Further jurisprudence will likely be necessary to confirm what "actual control" means, whether it should be taken as a new form of control, and if so, how it differs from *de facto* control as currently understood.

As a practical matter, it seems probable that the factors which would be relevant to the analysis of "actual control" for this purpose will be similar to factors which would be relevant to a *de facto* control analysis as previously understood. The examples which the

[1] 2019 DTC 1059.

FCA referred to in concluding that the transaction was abusive are points that would also be relevant for *de facto* control and largely focused on the provisions of the investment agreement between the parties.

The investment agreement was between Deans Knight, its shareholder, and the corporation providing the framework for the monetization, Matco Capital Ltd. ("Matco"). The investment agreement provided for payments based on the value of the tax attributes, i.e., losses. This included an initial payment of $3,000,000 and a potential further payment of $800,000 representing 21% of the total. The further payment could be withheld due to lack of compliance with obligations under the agreement or a rejection of a monetization opportunity identified by Matco. The court found the obligations backed by a contingency on 21% of the total funds sufficient to give Matco "actual control". This is specific to the facts and does not provide overall guidance on the combination of obligations and financial consequences which will trigger "actual control".

The FCA decision is certainly relevant to situations involving stop-loss rules. It may also have broader implications for the application of the GAAR for other provisions which involve concepts of control. Subsection 111(5) has a history around the specific use of *de jure* control. If the object, spirit, and purpose of a provision with that history contains a broader idea of control, it is possible that other provisions which directly refer to *de jure* control will also have a broader concept as part of their object, spirit, and purpose. This should be taken into account when assessing GAAR risk.

Possible Implications for Bill C-208 Provisions

One relevant example of another situation where the CRA may seek to apply similar reasoning relates to the recent changes to the *Income Tax Act* made by Bill C-208. After initially indicating that it would not allow the changes to take effect, the Department of Finance ("Finance") relented and acknowledged that Bill C-208 is in force. However, Finance indicated that further amendments will be forthcoming. In the meantime, the approach the FCA took in *Deans Knight* may provide the CRA with an opportunity to challenge certain types of transactions relying on the provisions of Bill C-208 which Finance may find abusive.

Bill C-208 was intended to facilitate intergenerational transfers of a business. Among other things, it amended section 84.1 (the "Amendment"). When section 84.1 is triggered, it causes a capital gain to be treated as a deemed dividend. Bill C-208 provided a carve-out (the "Carve-Out") that deems a transfer by an individual (the "Transferor") to a corporation controlled by a child or grandchild of the Transferor who is at least 18 years of age to be at arm's length when certain conditions are met. When the Carve-Out is applicable, section 84.1 would not be triggered because it only applies to a transfer by an individual to a corporation that does not deal at arm's length with the individual.

The Amendment does not refer to control "directly or indirectly in any manner whatever" and a *de facto* control test. Based on the text of the Amendment itself, a situation involving a corporation where the child has the majority of the votes and therefore *de jure* control could qualify for the Carve-Out. This would be the case even where the child's votes do not represent a significant amount of the value of the corporation and the child is not otherwise involved in the business.

While such a transfer would fall within the wording of the Amendment currently enacted, it does not seem to fit within the goal of promoting the transfer of businesses within families. It could also lead to forms of surplus stripping which does not appear to be what legislators intended when they voted to enact the provision.

Prior to *Deans Knight*, it was not clear whether the CRA could have successfully challenged an arrangement which used the Amendment to effect a surplus strip where a child obtained *de jure* control of the corporation and the parent retained *de facto* control. *Deans Knight* assists the CRA with an argument that such a transaction would be outside of the object, spirit, and purpose of the provision and that the GAAR applies to preclude the application of the Carve-Out to section 84.1. In particular, they could argue that the Carve-Out does not apply because the object, spirit, and purpose of the provision requires that the child has "actual control" and not merely *de jure* control.

Given the decision in *Deans Knight* and the reaction of the Department of Finance to Bill C-208, it is likely any transactions relying on the Amendment as it currently exists will be subject to close scrutiny. Anyone intending to rely on Bill C-208 should exercise extreme caution.

COVID-19 UPDATE

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

Federal

Canada Digital Adoption Program

On August 5, 2021, the federal government announced a call for applications for youth employment providers for the Canada Digital Adoption Program ("CDAP") second stream, Boost Your Business Technology. As part of Boost Your Business Technology, up to $139.3 million in funding will be provided to not-for-profit organizations to employ up to 16,800 students and young Canadians to support businesses looking to adopt digital tools and technologies.

Prospective applicant organizations will need to demonstrate they are well established, have a strong track record of delivering youth placement services, and can place students and recent graduates with small and medium-sized enterprises ("SMEs") across the country. Students and recent graduates will then support the digital transformation efforts of companies that are eligible for funding under the Boost Your Business Technology stream.

The Boost Your Business Technology stream consists of several components to help businesses take the necessary steps to deepen their digital transformation journey. Under this stream, eligible SMEs will also benefit from financial support in the form of a grant to offset the costs of retaining an advisor to create a digital adoption plan. The grant may cover up to 90% of the cost associated with developing the plan to a maximum value of $15,000. SMEs will have access to a roster of experienced, vendor-neutral digital advisory service providers across Canada to develop curated and comprehensive digital adoption plans. A call for applications will be announced for interested digital advisory service providers in the coming weeks.

In addition, SMEs will be able to access a zero-interest loan (up to $100,000) through the Business Development Bank of Canada ("BDC") to finance the implementation of their digital adoption plan. They will also be able to apply for a wage subsidy of up to $7,300 to pay for work placements of students and recent graduates to support their digital transformation efforts.

Announced in Budget 2021, CDAP is an investment of $4 billion and is composed of two streams. The call for applications for the first stream, Grow Your Business Online, was launched July 8. Funding under that stream will be awarded to not-for-profit organizations to support small businesses as they adopt digital technologies, such as digital storefronts and e-commerce platforms, and expand their digital presence. The call for applications for the second stream closes on September 8, 2021, at 2:59 p.m. (Eastern Daylight Time). For additional information on the program, see the application guide: www.ic.gc.ca/eic/site/152.nsf/eng/00003.html.

Canada Recovery Benefit Requirements

In most cases, applicants for the Canada Recovery Benefit must have filed a 2019 or 2020 tax return; however, an exception to this requirement was recently highlighted in changes to the webpage "Who Can Apply" at www.canada.ca/en/revenue-agency/services/benefits/recovery-benefit/crb-who-apply.html. A 2019 or 2020 tax return is not necessary if the applicant:

- applied for less than 21 periods since September 27, 2020; and
- applied for period 21 (July 4 to 17, 2021) or an earlier period.

Atlantic Canada Opportunities Agency

With $48.5 million in funding for the Atlantic region tourism sector, the Atlantic Canada Opportunities Agency ("ACOA") will provide direct support to tourism businesses and organizations to help them create or enhance tourism experiences and products to attract more local and domestic visitors. These investments will also help the sector safely welcome international visitors by providing the best tourism experiences Atlantic Canada can offer. Tourism businesses and organizations can visit the Tourism Relief Fund page on ACOA's website (www.canada.ca/en/atlantic-canada-opportunities.html) to see if they are eligible and submit an application.

CEWS and CERS To Be Extended

The federal government is proposing to extend the Canada Emergency Wage Subsidy ("CEWS") and Canada Emergency Rent Subsidy ("CERS") until October 23, 2021. It also plans to increase the wage and rent subsidy rates for the period between August 29 and September 25, 2021. The government is also proposing technical changes and clarifications to increase flexibility and certainty for organizations using these programs and the Canada Recovery Hiring Program ("CRHP").

Bill C-30 extended the CEWS and CERS to September 25, 2021, but the government announced that these programs will be extended to October 23, 2021. During this additional period (from September 26 to October 23), the maximum rates for the CEWS and CERS will be 20%.

For Period 20 (August 29 to September 25), the maximum rates for the CEWS and CERS will be increased to 40% — the rates were to decrease to 20%, per amendments from Bill C-30. For the CEWS, the 40% represents the combined base (25%) and top-up (15%) subsidies. For the CERS, the 40% only represents the base subsidy; the lockdown support will remain at 25%.

The government also proposes to allow an eligible organization to elect to use the alternative approach to calculate its revenue decline for Periods 14 to 17 (March 14 to July 3, 2021) if it was not carrying on a business or otherwise carrying on ordinary activities on March 1, 2019. These changes would align the rules for Periods 14 to 17 (March 14 to July 3, 2021) with those for Periods 1 to 4 (March 15 to July 4, 2020) for organizations that began operating between March 1, 2019, and the onset of the pandemic, making them eligible for continued support under these programs.

Last, the CEWS for furloughed employees will no longer be available after August 28, 2021, including the subsidy for the employer's portion of contributions under the CPP, EI, the QPP, and the QPIP in respect of furloughed employees.

Pandemic Support Programs To Be Extended

The federal government announced it plans to extend the Canada Recovery Benefit ("CRB"), the Canada Recovery Caregiving Benefit ("CRCB"), and the Canada Recovery Sickness Benefit ("CRSB") until October 23, 2021.

The government also plans to increase the maximum number of weeks available for the CRB, by an additional four weeks, to a total of 54 weeks, at a rate of $300 per week, and ensure it is available to those who have exhausted their employment insurance ("EI") benefits.

Provincial

Alberta

Deadline for Critical Worker Benefit Extended

The Critical Worker Benefit provides a one-time payment of $1,200 to eligible workers. However, their employers must apply for the benefit. To ensure these businesses can focus on reopening while ensuring their employees can get the Critical Worker Benefit, the deadline for private sector employers to submit applications was extended to August 31.

Ontario

Second Career

While the Second Career program is open to all laid-off workers and job seekers, priority is given to applications for people who were laid off because of COVID-19 and want to retrain for jobs in sectors that have good potential for future employment. Effective July 13, 2021, the Ontario government made changes to the program to better help laid-off workers pay for tuition and living expenses if they retrain for new careers.

Applications that meet all the following criteria will go through a faster approval process:

- The applicant was laid off on or after March 1, 2020;
- The applicant has high school education or less, or was laid off from an occupation requiring no more than a high school education and job specific training, such as food and beverage servers, flight attendants, and retail salespersons;
- The applicant was laid off from an industry hit hard by the pandemic, such as hospitality and food services, transportation and warehousing, or wholesale and retail trade; and
- The applicant wants to train for a career in demand in local communities or provincial priority areas.

To learn more about the Second Career program, visit www.ontario.ca/page/second-career and contact the closest employment service provider.

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.

Magren Holdings Ltd. Et Al. v. the Queen, 2021 DTC 1034 (Tax Court of Canada) — Tax Court of Canada holds that series of transactions to create capital gains was a sham

Background

The taxpayers entered into a complex series of transactions that occurred on the same day. The taxpayers reported capital gains of $226,258,087 and capital losses of $224,762,077 under Part I of the *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.) (the "ITA"). The taxpayers then declared a series of dividends of $109,720,500 and elected, pursuant to subsection 83(2) of the ITA, that they be deemed to be capital dividends payable from their respective capital dividend accounts.

The Minister reassessed the taxpayers under Part I of the ITA to reduce the capital gains and capital losses described above to nil (the "Part I Reassessments") and issued notices of assessment on the basis that the dividends were subject to Part III tax on excess capital dividends (which assessments were later reassessed to amend the tax rate from a legislative change) (the "Part III Reassessments").

The Minister took the position that a series of transactions was undertaken in order to artificially create the capital gains and offsetting losses leading to the alleged additions to the capital dividend accounts of the taxpayers. The Minister argued that the steps undertaken by the taxpayers were legally ineffective or were a sham and a misrepresentation. In the alternative, the Minister relied on the general anti-avoidance rule ("GAAR") as set out in section 245 of the ITA.

The taxpayers did not object to the Part I Reassessments; however, the taxpayer did appeal the Part III Reassessments on the excess capital dividends, which were the subject matter of the appeals.

Issues and Tax Court Decision

The following issues were considered by the Tax Court of Canada (the "TCC"):

(a) Whether the Part III Reassessments were statute-barred and therefore invalid and without legal force, on the basis that the Part I Reassessments were statute-barred.

The TCC held that it is well established that a taxpayer cannot appeal a nil assessment because no tax is payable. The TCC further held, that while the Part I Reassessments, which were nil assessments, were statute-barred, nothing prevented the TCC from reviewing the validity of the alleged transactions that triggered the capital gains and capital losses which created the capital dividend accounts that are the subject of the Part III Reassessments. The TCC further held that, if it were wrong, the taxpayers made a misrepresentation attributable to neglect, carelessness, willful default, or fraud such that there is no limitation period for assessing.

(b) Whether the Part III Reassessments were void *ab initio*, invalid, and without legal force, on the basis that the Minister failed to issue only "one" assessment for each election filed and failed to proceed "with all due dispatch", as required by subsection 185(1) of Part III of the ITA.

The TCC held that the language of subsection 185(1) of the ITA does not preclude or exclude the possibility that the Minister may review more than one election or issue only one assessment dealing with multiple elections, particularly when those elections relate to dividends that have been declared and paid by a corporation in the same taxation year. With respect to the issue of "with all due dispatch", the TCC held that it was bound by the decision of the Federal Court of Appeal in *Carter*[1] and *Ginsberg*[2], and that even if the TCC was of the view that the assessment process involved an "inordinate" amount of time, there is no power in the court to vacate an assessment on the grounds that the Minister did not act with due dispatch.

(c) Whether the series of transactions that are alleged to have given rise to the subject capital gains and capital losses were legally effective or were a sham and a misrepresentation, along with whether there were additions to the taxpayers' respective capital dividend accounts and whether or not the taxpayers could rely on the excess elections if the capital dividends were excess capital dividends.

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[1] *Carter v. The Queen*, 2001 FCA 275.

[2] *Ginsberg v. Canada*, [1996] 3 FC 334.

The TCC held that there was no actual disposition on the transfer of the property in question that supposedly triggered the capital gains and capital losses as there was no actual change in the beneficial ownership of the property. As the transactions did not result in capital gains, there could be no addition to the capital dividend accounts. Further, the TCC held that the transactions were undertaken to create an illusion. It held that the transactions that purported to trigger the subject capital gains and offsetting capital losses were undertaken "with an element of deceit so as to create an illusion" and that those transactions were a sham and a misrepresentation and should be disregarded.

In addition to the TCC holding that there was no actual disposition of the property in question such that there were no capital gains triggered, it noted that, in any event, the dividends declared could not be characterized as capital dividends as the purported capital gains and capital losses were triggered on the same day, which capital losses would have reduced the capital dividend account such that the capital dividend account was nil when the purported capital dividends were declared.

As a result of the conclusion above and the TCC's finding that the additions to the capital dividend accounts were a sham and a misrepresentation, it followed that the taxpayers were are not entitled to rely on the elections filed pursuant to subsection 184(3) of the ITA to treat the excess dividends as ordinary taxable dividends. The TCC stated that the election is intended to allow corporations to correct their mistakes and avoid Part III tax, but it is not intended that it will apply where the initial capital dividend account is a sham. The taxpayers were subject to 60% Part III tax on the excess capital dividends.

(d) Whether the series of transactions was subject to GAAR.

The TCC agreed with the Minister's alternative argument that GAAR would apply as the transactions were intended to defeat the "underlying rationale" of the capital dividend provisions and otherwise met the requirements of section 245 of the ITA.

Conclusion

The taxpayers lost on all issues and the Part III Reassessments were confirmed.

— *Keith Hennel*

Canada v. Canada North Group Inc., 2021 DTC 5080 (Supreme Court of Canada) — CCAA priming charges have priority to Minister's deemed trust under subsection 227(4.1)

Background

Canada North Group and six related corporations ("Debtors") sought to restructure under the *Companies' Creditors Arrangement Act* ("CCAA"). They requested the creation of three super-priority charges ("Priming Charges"). First, they requested an administration charge of up to $1,000,000 in favour of counsel, a monitor, and a chief restructuring officer for the fees they incurred. Second, they requested a $1,000,000 financing charge in favour of an interim lender. Third, they sought a $150,000 directors' charge protecting their directors and officers against liabilities incurred after the commencement of the proceedings. The Debtors attested that there was a $1,140,000 debt to Her Majesty the Queen for source deductions and GST.

Initial Order

The Court of Queen's Bench of Alberta granted the application on the terms requested, other than a reduction to the administration charge by $500,000. The initial order stated that the Priming Charges would "rank in priority to all other security interests, trusts, liens, charges and encumbrances, claims of secured creditors, statutory or otherwise . . . in favour of any Person." The order also stated that the Priming Charges "shall not otherwise be limited or impaired in any way by . . . the provisions of any federal or provincial statutes".

Motion To Vary Initial Order

The Crown sought a variance of the order on the grounds that subsection 227(4.1) of the *Income Tax Act* (the "ITA") created a proprietary interest that took priority over the court-ordered Priming Charges. Justice Topolniksi of the Court of Queen's Bench of Alberta dismissed the motion. She found that although the CCAA preserved the operation of the deemed trust, it authorized the reorganization of priorities by court order. Since the Priming Charges were critical to the restructuring process, they were required by the CCAA regime.

Court of Appeal of Alberta

On appeal, the Court of Appeal of Alberta was divided on whether the Priming Charges had priority over Her Majesty's claim. Justice Rowbotham, writing for the majority, found that subsection 227(4.1) of the ITA creates a security interest that is "like a floating charge over all of the assets of the tax debtor in the amount in default".[1] She went on to find that "a deemed trust that could not be subordinated to super-priority charges would undermine both" the ITA's and CCAA's "objectives because fewer restructurings could succeed and thus less tax revenue could be collected".[2]

Supreme Court of Canada

The Crown appealed the Court of Appeal's decision to the Supreme Court of Canada ("SCC"). Justices Wagner, Côté, and Kasirer's reasons for judgment were written by Justice Côté. She noted that section 11 of the CCAA and some of the provisions following that section "include the power to order a super-priority security or charge on all or part of a company's assets in favour of interim financiers (s. 11.2), critical suppliers (s. 11.4), the monitor and financial, legal or other experts (s. 11.52), or indemnification of directors or officers (s. 11.51)" (paragraph 23). She went on to note that "[e]ach of these provisions empowers the court to 'order that the security or charge rank in priority over the claim of any secured creditor of the company' (ss. 11.2(2), 11.4(4), 11.51(2) and 11.52(2))" (paragraph 23).

Justice Côté found that the Priming Charges

> in favour of the monitor, financiers and other professionals are required to derive the most value for the stakeholders. They are beneficial to all creditors, including those whose claims are protected by a deemed trust . . . For a monitor and financiers to put themselves at risk to restructure and develop assets, only to later discover that a deemed trust supersedes all claims, smacks of unfairness. [para. 30]

Justice Côté found that subsection 224(4.1) of the ITA "does not create a beneficial interest that can be considered a proprietary interest" as the deemed trust does not attach to any specific property of the debtor (para. 57), and that a court-ordered super-priority charge under the CCAA is not a security interest within the meaning of subsection 224(1.3) of the ITA and as such it prevails over a deemed trust under subsection 224(4.1) (para. 68). However, Justice Côté qualified her conclusion with an admonition that courts should only grant a Priming Charge over a deemed trust under the ITA where doing so is necessary to achieve the objectives of the CCAA.

Justices Karakatsanis and Martin found that the appeal should be dismissed on different grounds. Justice Karakatsanis found that the scheme of the CCAA permits a court to create Priming Charges ahead of the Crown's deemed trust "[s]o long as the Crown is paid in full under a plan of compromise" (para. 173), rendering the issue of whether the Priming Charge is a security interest under subsection 224(4.1) of the ITA irrelevant. He went on to note that this scheme enables a court to further the remedial objectives of the CCAA:

> If there is evidence that interim lending cannot be obtained without ranking the interim loan ahead of the Crown's deemed trust, such an order could, again depending on the circumstances, further the remedial objectives of the CCAA. [para. 174]

Conclusion

As a result of this decision, courts have the flexibility to grant Priming Charges under the CCAA that have priority to the Crown's deemed trust under the ITA.

— *Gergely Hegedus*

4431472 Canada Inc. v. Canada (AG), 2021 DTC 5093 (Federal Court) — Ambiguous decision of CRA to not assess amended tax returns set aside

In this judicial review, Justice Pamel of the Federal Court set aside a decision (the "Decision") by the Canada Revenue Agency (the "CRA") with respect to amendments filed by 4431472 Canada Inc. ("443 Inc.") for its 2008 to 2011 taxation years (the "Amended Returns"). The amendments concerned the taxability of payments from a discretionary Alberta trust, the Thames Trust, to 443 Inc. Subsequently, the CRA also assessed Irving Ludmer, the sole shareholder of 443 Inc., for the same period with respect to the same funds under subsection 56(2) of the *Income Tax Act*, Canada (the "ITA"). Mr. Ludmer appealed his reassessments.

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[1] *Canada v. Canada North Group Inc.*, 2019 DTC 5111 (ABCA), para. 13.

[2] *Ibid.*, paragraph 14.

Background

From 2008 to 2011, 443 Inc. received discretionary distributions from the Thames Trust (of which 443 Inc. was a discretionary beneficiary), which trust had received the underlying funds from a Bermuda company, GAM Ltd. 443 Inc. initially reported the payments it received from the trust as taxable income, which returns were assessed by the CRA. 443 Inc. did not object to the assessments. 443 Inc. later filed the Amended Returns recharacterizing the payments as non-taxable and requesting a refund of taxes previously paid on the payments. The CRA did not reassess the Amended Returns.

443 Inc. took the position that similar payments in subsequent taxation years were also non-taxable. The CRA disagreed and reassessed 443 Inc. to recharacterize those payments as taxable income. Mr. Ludmer was also reassessed for failing to include payments in his income that originated from GAM Ltd. between 1995 and 2005 under subsection 56(2) of the ITA. The payments to 443 Inc. and Mr. Ludmer involved the same funds originating from GAM Ltd. Mr. Ludmer objected to the reassessments, and filed appeals with the Tax Court ("Mr. Ludmer's Appeal").

The controversy arose because 443 Inc. had already paid tax in respect of the payments while the CRA also took steps to collect tax on the same money from Mr. Ludmer (contrary to its administrative position against collecting tax on the same income twice, as detailed in Interpretation Bulletin IT-335R2). In doing so, the CRA put forward conflicting alternative assessing positions: either 443 Inc. was liable for tax on the payments under subsection 9(1) of the ITA, or Mr. Ludmer was liable for tax on the payments under subsection 56(2) of the ITA.

443 Inc. was of the opinion that if the CRA would not reassess its 2008 to 2011 taxation years, then the CRA should abandon its reassessment of Mr. Ludmer for his 2008 to 2011 taxation years. The CRA took the position that it would not decide whether to process the Amended Returns until the question of whether the payments should be included in Mr. Ludmer's income was finally determined. The CRA asserted it was justified in relying on alternative assessing positions to protect its claim.

The CRA's position frustrated 443 Inc. because 443 Inc. wanted to receive a judicial decision regarding the Amended Returns and it could not do so unless the CRA proceeded with a reassessment from which 443 Inc. could appeal. Thus, 443 Inc. filed an application seeking an order of *mandamus* to compel the CRA to make a determination under section 164 of the ITA regarding the Amended Returns. In response, the CRA issued a letter to 443 Inc. stating that the CRA was not bound to process the Amended Returns and had decided not to accept or process the Amended Returns (the "Decision").

Federal Court Decision

The application for the *mandamus* order was not before the court. The issue before the Federal Court was whether the Decision should be set aside and sent back for redetermination. The parties agreed that the applicable standard of review of the Decision was its reasonableness.

443 Inc. argued that the Decision was unreasonable on the basis that, although the Decision suggested that the CRA's decision not to process the Amended Returns and reassess 443 Inc. was final, it was not in fact actually final, and that the CRA intended to eventually process the Amended Returns on the basis of the Tax Court's determination of Mr. Ludmer's Appeal. 443 Inc. further argued that if the Decision was in fact final, it deviated from the CRA's established practice of not assessing the same income twice.

The Court found that the text of the Decision could be read to support the conclusion that the Decision not to process the Amended Returns and reassess 443 Inc. was, in fact, a final decision. However, the Court found that an earlier motion of the Minister to stay the present application, together with testimony given by the CRA, suggested that the Minister had, in fact, decided to postpone its decision as to whether to process the Amended Returns and reassess 443 Inc. until the resolution of Mr. Ludmer's Appeal.

In the balance, Justice Pamel set aside the Decision on the basis that it was unreasonable on account of its being "unclear and open to two diametrically opposed interpretations as regards the core issue between the parties". However, rather than sending the matter back to the CRA for redetermination, Justice Pamel left the matter to the parties. He said that if the CRA were to make a final determination not to reassess based on the Amended Returns, then the CRA should clearly address its alternative assessing positions and explain why Interpretation Bulletin IT-335R2 was not being followed. Additionally, he stated that the CRA should take a consistent position in respect of Mr. Ludmer's appeal of his reassessments as regards the 2008 to 2011 taxation years.

443 Inc. indicated to the Court that if the parties are unable to resolve the matter, it would proceed with its *mandamus* application.

— *James Konopka*

CURRENT ITEMS OF INTEREST

Federal Government Launches Consultations on Proposed Luxury Tax

On August 10, the federal government launched a consultation on its proposed luxury tax on select luxury goods, which was announced in Budget 2021. The tax would apply on the sale of new luxury cars and aircraft with a retail sale price over $100,000 and new boats over $250,000. The tax would be equal to the lesser of 20% of the price in excess of the dollar threshold, or 10% of the full value. The proposed tax would come into force on January 1, 2022.

The consultation includes a backgrounder document that explains the proposed rules in detail. Until September 30, comments can be sent to fin.luxury-luxe.fin@fin.gc.ca with "Luxury Tax" as the subject line. The backgrounder document can be accessed at: www.canada.ca/en/department-finance/programs/consultations/2021/consultation-proposed-luxury-tax/select-luxury-goods-tax.html.

New CRA SR&ED Policy Document

The CRA published *Guidelines on the Eligibility of Work for Scientific Research and Experimental Development (SR&ED) Tax Incentives* on August 13. These new guidelines replace the *Eligibility of Work for SR&ED Investment Tax Credits Policy*, which has been archived. The new guidelines feature simplified explanations of program requirements, clear breakdowns of what constitutes eligible work, and links to further guidance on what you can claim and how to support your claim. The new guidelines can be accessed at: www.canada.ca/en/revenue-agency/services/scientific-research-experimental-development-tax-incentive-program/policies-procedures-guidelines/guidelines-eligibility-work-sred-tax-incentives.html.

Consultation: Tax on Unproductive Use of Housing

Budget 2021 announced the government's intention to implement a national, annual 1% tax on the value of non-resident, non-Canadian-owned residential real estate that is considered to be vacant or underused, effective January 1, 2022. This will ensure that foreign, non-resident owners, who simply use Canada to passively store their wealth in housing, pay their fair share. The Department of Finance is seeking feedback on the design of the proposed Underused Housing Tax ("UHT"). The consultation is open until September 17, 2021.

Design aspects under consideration include:

- the definition of "residential property";
- the definitions of "owner" of residential property and "interest" in residential property;
- the value on which the tax would apply;
- "excluded owners" in respect of which the tax would not apply;
- exemptions from the tax;
- the annual declaration requirement and the consequences of failing to file the declaration; and
- whether special rules should be established in respect of residential properties located in smaller, resort and tourism communities, and if so, what those rules should be.

The department is seeking the views of tax practitioners and legal experts, as well as the real estate and tourism sectors. Interested members of the public are also invited to provide feedback.

For additional information on the consultation process, visit www.canada.ca/en/department-finance/programs/consultations/2021/tax-unproductive-use-housing-non-resident-non-canadian-owners.html.

Additional Prescribed Drought Regions for Livestock Tax Deferral

The Minister of Agriculture and Agri-Food announced the designation for Livestock Tax Deferral of additional prescribed drought regions in British Columbia, Alberta, Saskatchewan, and Ontario. This adds to the list of prescribed drought regions across Canada announced on July 22, 2021.

The Livestock Tax Deferral provision allows livestock producers in prescribed 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.

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. Agriculture and Agri-Food Canada officials continue to monitor weather, climate, and production data from across Canada and will add regions if they meet the eligibility criteria.

Consultation: Boosting Charitable Spending

Every year, charities are required to spend a minimum amount on their charitable programs or on gifts to qualified donees. This is known as the "disbursement quota" and it ensures that charitable donations are being invested into communities. Budget 2021 announced the government's intention to potentially increase the disbursement quota, which could boost support for the charitable sector, benefitting those that rely on its services.

The Department of Finance is seeking feedback on potentially increasing the disbursement quota and updating the tools at the Canada Revenue Agency's disposal in order to enforce the disbursement quota rules, beginning in 2022. Specifically, feedback is being sought on the following:

- Should the disbursement quota be raised to produce additional funding for charities, and to what extent?
- Would it be desirable to increase the disbursement quota to a level that causes foundations to gradually encroach on investment capital, and would it be sustainable in the long-term for the sector?
- What additional tools (e.g., monetary penalties or other intermediate sanctions) should be available to the CRA to enforce the disbursement quota rules?
- Do the relieving and accumulation of property provisions continue to be useful for charities?
- Do the existing carry-forward provisions strike the appropriate balance between ensuring the timely disbursement of funds and allowing foundations to make large gifts on a more infrequent basis?
- Are there any temporary changes to the disbursement quota that should be considered in the context of the COVID-19 recovery?

The department is seeking the views of stakeholders in the charitable sector. Tax practitioners, legal experts, researchers and academics, and interested members of the public are also invited to provide input. For additional information on the consultation process, visit www.canada.ca/en/department-finance/programs/consultations/2021/boosting-charitable-spending-communities.html.

RECENT CASES

Credits disallowed because taxpayer controlled by public corporation

In 2004, CO2 Solution Inc., a high-tech carbon dioxide capture and management business, became a public corporation ("Public CO2"). In 2005, as part of a reorganization involving several subsidiaries and a trust ("Fiducie"), Public CO2 transferred its SR&ED activities to CO2 Solution Technologies Inc. (the "appellant"). During this reorganization, Fiducie became the appellant's sole shareholder and solely empowered to choose its directors. According to the deed creating Fiducie, its trustees had to be sitting directors of Public CO2 and accept the office of trustee in writing. In its 2009 tax return, the appellant claimed the refundable tax credit and the associated enhancement related to SR&ED expenses it incurred. The Minister disallowed the credits claimed on the ground the appellant did not qualify as a Canadian-controlled private corporation ("CCPC") for the taxation year in issue, as it was directly or indirectly controlled by Public CO2, a public corporation. The appellant appealed to the TCC, which upheld the assessment (2020 DTC 1002). It then appealed to the FCA.

The appeal was dismissed. The issue was whether the TCC judge could conclude that Public CO2 exercised *de jure* or *de facto* control over the appellant in 2009 such that it was not a CCPC pursuant to subsection 125(7). The *de jure* and *de facto* control tests aim to determine who controls the composition of a corporation's board of directors and therefore the corporation itself. The exercise of either of these types of control by Public CO2 disqualifies the appellant from CCPC status. *De jure* control lies with those who have the power to appoint the board of directors. Generally, these are the majority shareholders. However, certain documents can modify or restrict their power. Thus, *de jure*

control analysis deals with any internal restriction — in the corporation's articles of incorporation or a unanimous shareholder agreement — on shareholders' power to elect the board or limit the ability of the board to manage the affairs of the corporation. *De facto* control is a more recent concept introduced in the *Income Tax Act* in 1988 by subsection 256(5.1). It's determined on the same basis as *de jure* control but allows for factors external to the corporation to be taken into account. The influence required for a finding of *de facto* control must come from legally binding or enforceable arrangements. This approach was enlarged in 2017 by subsection 256(5.11), but the facts in this case occurred before it took effect and the more stringent approach propounded in *McGillivray Restaurant v. The Queen*, 2016 DTC 5048 (FCA), applies. Fiducie's deed of trust gave Public CO2 *de facto* control of the appellant. The trustees' freedom to decide was subject to the will of CO2 Public. The TCC judge properly concluded Public CO2 controlled the appellant during the year in issue, and the appeal was dismissed.

CO2 Solution Technologies Inc. v. The Queen

2021 DTC 5073

Application for waiver of interest under subsection 220(3.1) dismissed: assessing ability to repay when tax debt was incurred rather than period for which waiver was sought

The CRA twice denied the taxpayer's application for waiver or cancellation of interest accrued from 2008 to 2018, on tax debt incurred between 2002 and 2007, under subsection 220(3.1) of the *Income Tax Act*. The taxpayer appealed, arguing that the CRA improperly considered his ability to pay from 2002 to 2007 rather than 2008 to 2018. Because he sought relief for the latter period, the CRA should only have considered his circumstances for that period.

The application was dismissed. Under subsection 220(3.1), the CRA can waive or cancel interest accrued during the 10 calendar years before the application. However, the statute does not prohibit the CRA from considering any of the evidence before it that reflects the taxpayer's ability to pay. This includes events that occurred before the 2008 to 2018 period. The 2002 to 2007 period, when the tax debt was incurred, was relevant. The CRA considered both periods, and found that the taxpayer had sufficient assets to pay the tax debt when it was incurred. The court also rejected the taxpayer's argument that the proportion of accrued interest to underlying tax debt was "inordinate and disproportionate".

Da Silva v. Canada (MNR)

2021 DTC 5069

Efforts to block water flow in a large underground box culvert not considered SR&ED qualifying expenses

The issue in this appeal was whether the appellant engaged in scientific research and experimental development ("SR&ED") with respect to its activities/efforts to block water flow in a large underground box culvert in 2015. The appellant claimed two SR&ED projects that year: one entitled "improved sealing between submerged, rough cast surfaces" and the other "pressure activated removable plugs for large box culverts." The Minister disallowed the allegedly qualifying SR&ED expenditures. The taxpayer appealed the reassessment to the Tax Court.

The appeal was dismissed. After reviewing all the facts, the judge agreed with the respondent that the taxpayer's activities did not meet the definition of SR&ED. The judge stated that it is clear there was uncertainty as to how the appellant might resolve the problem before it. However, that uncertainty did not reach the level of a technological risk or uncertainty which could not be removed by routine engineering or standard procedures. The appellant tried existing dewatering procedures in terms of the inflatable bladder dam and a rigid cap. The appellant ultimately used the concrete cap, inserted physical objects to block any remaining gaps, and controlled ongoing seepage by using pumps. The judge considered the use of physical objects and pumps in this manner to be within the scope of their standard usages. The judge concluded that the appellant successfully solved a problem within the time and monetary constraints before it and showed itself to be resourceful and committed. However, there was no advancement in the field of civil engineering for the purposes of the SR&ED provisions. Accordingly, the appeal was dismissed without costs.

WRD Borger Construction v. The Queen

2021 DTC 1031

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