Tax Notes

Report No.: 705

Date: October, 2021

RESIDENCY FOR INDIVIDUALS

- –Wolters Kluwer Canada

SIGNIFICANCE OF CANADIAN RESIDENCE

Determining an individual's residency status is a question of fact and is often difficult to resolve with certainty. The usual dispute over residence has been between individuals who wanted to claim non-resident status to avoid tax on worldwide income while living abroad, and the CRA, who wanted to continue taxing the individual on world income. The impact of departure tax—a deemed disposition of assets at fair market value upon becoming non-resident—shifts the nature of the argument in some cases, with the CRA being happy to impose immediate tax on the assets of the departing Canadian individual (especially the departing Canadian who has substantial assets to tax), and the Canadian individual resisting classification as a non-resident. In other cases, the argument will be resolved or shifted to new ground by the deemed non-resident rules, which will force the application of treaty rules if the person moves to a country with which Canada has a tax treaty. Even the most casually departing Canadian should ascertain the consequences of their departure in advance.

If they are a factual resident of Canada, they will be a resident of a province or territory and will file returns for the province in which they resided (under these rules) on December 31. Québec is the only province that makes an independent determination of residence, and in theory Québec is more restrictive in acknowledging that an individual has given up Québec residence upon emigrating.

RESIDENCE IN FACT (COMMON-LAW RESIDENCE)

The CRA distinguishes between a "factual resident" and a "deemed resident". A person will be a "factual resident" if they are resident in Canada under the legal tests (common-law rules) and are not deemed to be a non-resident. If they do not meet the tests for residence, they may nevertheless be a deemed resident. However, the common-law rules take precedence over the deemed resident rules; that is, if they are a factual resident under the common-law rules, they cannot be a deemed resident at the same time, although they may be a deemed resident at some other time in the same year. Thus, they can be a deemed resident only if they are not otherwise a factual resident.

Factual residence is a question of fact, the legal framework of which is based on Canadian case law. The law does not define a factual resident under a bright-line test, but provides only general guidelines. In general, a person is a resident in Canada if they live primarily or have major residential ties in Canada. Since the determination of factual residence is based on judge-made or common law rather than bright-line statutory rules, a factual resident is sometimes referred to as a "common-law resident".

A person may be also considered a factual Canadian resident if they reside for most of the year in another country but maintain a home or family in Canada (subject to the deemed non-resident rules). If they had Canadian residence at one time but have since moved to another country, they may be considered to have retained Canadian residence if they still have sufficient residential ties here. The CRA distinguishes between "significant residential ties" and "secondary residential ties". While acknowledging, as case law requires, that the residence status of an individual can only be determined on a case-by-case basis after taking into consideration all of the relevant facts, the CRA nevertheless sets out as a general policy that unless an individual severs all significant residential ties with Canada upon leaving Canada, the individual will continue to be a factual resident of Canada and subject to Canadian tax on their worldwide income (again, subject to the deemed non-resident rules).

"SIGNIFICANT RESIDENTIAL TIES"

The residential ties of an individual that will almost always be significant residential ties for the purpose of determining residence status are the individual's:

(1) dwelling place (or places);
(2) spouse or common-law partner; and
(3) dependants.

Where an individual who leaves Canada keeps a dwelling place in Canada (whether owned or leased) available for their occupation, that dwelling place is a significant residential tie with Canada during the individual's stay abroad. However, if an individual leases a dwelling place located in Canada to a third party on arm's length terms and conditions, the CRA will take into account all of the circumstances of the situation (including the relationship between the individual and the third party, the real estate market at the time of the individual's departure from Canada, and the purpose of the stay abroad) and may not consider the dwelling place to be a significant residential tie with Canada except when taken together with other residential ties.

If an individual who is married or cohabiting with a common-law partner leaves Canada but their spouse or common-law partner remains in Canada, then that spouse or common-law partner will usually be a significant residential tie with Canada during the individual's absence. Similarly, if an individual with dependants leaves Canada but their dependants remain behind, then those dependants will usually be considered a significant residential tie with Canada while the individual is abroad. Where an individual was living separate and apart from their spouse or common-law partner prior to leaving Canada by reason of a breakdown of their marriage or common-law partnership, that spouse or common-law partner will not be a significant tie with Canada.

"SECONDARY RESIDENTIAL TIES"

Where residence cannot be determined solely by reference to significant residential ties, the CRA examines secondary residential ties. Unlike significant ties, where any one test may be determinative, the CRA concedes that secondary residential ties must be looked at collectively to evaluate the significance of any one such tie. Therefore, it would be unusual for a single secondary residential tie with Canada to be sufficient in and of itself to lead to a determination that an individual is factually resident in Canada while abroad.

Secondary residential ties the CRA will examine in determining the residence status of an individual while outside Canada are:

(1) personal property in Canada (such as furniture, clothing, automobiles, and recreational vehicles);
(2) social ties with Canada (such as memberships in Canadian recreational and religious organizations);
(3) economic ties with Canada (such as employment with a Canadian employer, active involvement in a Canadian business, and Canadian bank accounts, retirement savings plans, credit cards, and securities accounts);
(4) landed immigrant status or appropriate work permits in Canada;
(5) hospitalization and medical insurance coverage from a province or territory of Canada;
(6) a driver's license from a province or territory of Canada;
(7) a vehicle registered in a province or territory of Canada;
(8) a seasonal dwelling place in Canada or dwelling place the individual has leased to a third party;
(9) a Canadian passport; and
(10) memberships in Canadian unions or professional organizations.

The courts have identified other residential ties that may be relevant in determining the residence status of an individual while outside Canada. These include the retention of a Canadian mailing address, post office box, or safety deposit box; personal stationery (including business cards) showing a Canadian address, telephone listings in Canada; and local (Canadian) newspaper and magazine subscriptions. These residential ties are generally of limited importance except when taken together with other residential ties or with other factors.

"ORDINARILY RESIDENT"

Where an individual has not severed all their residential ties with Canada but is physically absent from Canada for a considerable period of time (that is, for a period of time extending over several months or years), the courts have at times focused on the term "ordinarily resident" in determining the individual's residence status while abroad. The *Income Tax Act* provides that a person resident in Canada includes a person who is at the relevant time ordinarily resident in Canada. In general, a temporary absence from Canada, even on an extended basis, is insufficient to avoid Canadian residence for tax purposes if the individual maintains sufficient residential ties with Canada. Accordingly, where an individual maintains residential ties with Canada while abroad, the following factors will be taken into account in evaluating the significance of those ties:

- evidence of intention to permanently sever residential ties with Canada;
- regularity and length of visits to Canada; and
- residential ties outside Canada.

It would appear that no one element in this list is determinative by itself. In any event, the CRA stated that it does not consider that an intention to return to Canada, in and of itself and in the absence of any residential ties, is a factor whose presence is sufficient to lead to a determination that an individual is resident in Canada while abroad.

DEEMED RESIDENTS

Certain persons are deemed to be residents of Canada and therefore must pay Canadian tax on their world income, although they are not factual residents or common-law residents. However, if such a deemed resident is otherwise determined to be resident in another country under a tax treaty with that country, the latter rule prevails such that the individual will be considered a non-resident under the Canadian *Income Tax Act*.

SOJOURNERS IN CANADA

The most common deemed residents of Canada are sojourners. If they sojourn in Canada (i.e., visit Canada temporarily) for periods totalling 183 days or more in a year, they are deemed to be resident in Canada for the whole year, unless they are deemed to be a non-resident. This rule applies only if they are not otherwise a factual resident of Canada, and this status may change from year to year without any substantial change in their way of life.

Example

A resident of New York state might visit Canada for 200 days in Year 1 and 150 days in Year 2 in connection with his employment as an engineer. While in Canada, he lives in various hotels. For Year 1, he will be considered a Canadian resident and be taxable in Canada on his income from all sources. For Year 2, he is considered a non-resident of Canada and is taxable in Canada only on his income from Canadian sources. This type of individual must be distinguished from one who actually takes up factual residence in Canada during the year whether or not he is present for more than 183 days in that year. An individual who actually takes up residence in Canada (or leaves Canada) during the year will be taxed as a "part-time" resident. They could also be a deemed resident for the year, however, if they contrived to sojourn in Canada for 183 days or more before taking up or after giving up factual residence.

The CRA indicates that the 183 days sojourning in Canada include the days they attended a Canadian university or college, the days they worked in Canada, and the days they spent on vacation in Canada including on weekend trips. If they lived in the United States and commuted to work in Canada, they do not include commuting days in the calculation.

Caution: Foreign Students

Foreign students in Canada are often sojourners under this rule, and are therefore subject to Canadian tax. Foreign students who are deemed resident could in the first instance be taxable in Canada on grants or other formal assistance (but not on support from parents or guardians) from their home country as well as Canadian-source assistance; however, such formal assistance may be protected by the tax treaty between Canada and the country from which the student has come. (s. 250(1))

Although a sojourner is deemed a resident of Canada under the 183-day rule, Québec is the only province with a special rule that deems a non-resident of Canada sojourning in the province for 183 days to be a resident of the province. The result is that a non-resident who has been in Canada but not in Québec for 183 days is treated as a resident of Canada but not a province, and accordingly files the T1 General for Non-Residents and Deemed Residents. They will file no provincial forms with the T1 return but will pay a federal surtax in lieu of provincial tax. Such deemed residents are, in general, not eligible for provincial tax credits.

To avoid double taxation (surtax for non-residents and deemed residents of Canada plus Québec provincial income tax), sojourners who are deemed resident in both Canada and Québec should attach a note to their federal return that specifies that they are subject to Québec provincial income tax, they are filing a Québec provincial return, and that they are asking for relief from the non-resident and deemed resident of Canada surtax.

CANADIANS EMPLOYED ABROAD IN OFFICIAL OR QUASI-OFFICIAL CAPACITY

A person is deemed to be a resident of Canada throughout a taxation year if any of the following apply:

(1) They are, at any time in the year, a member of the Canadian Armed Forces.

(2) They are, at any time in the year, an ambassador, minister, high commissioner, officer, or servant of Canada, or an agent-general, officer, or servant of a province, who was resident in Canada or deemed to be resident in Canada immediately prior to appointment or employment or received representation allowances in respect of the year. The terms "officer or servant of Canada" and "officer or servant of a province" have been interpreted by the CRA as including any officer or employee of a federal or provincial Crown corporation or agency if, in the statute under which it is organized or established, its officers and employees are given the status of servants to Her Majesty or are designated as being part of the public service of Canada or the province. If the corporation or agency is designated as an agent of Her Majesty without specific mention being made as to the status of its officers and employees, they will be assumed to be officers or servants of Canada or a province. An officer or employee of a Crown corporation or agency who is required to perform the duties of his office or employment outside Canada for an extended period should ask their employer whether they are an officer or servant of Canada or of a province, and whether they will be taxed as a deemed resident of Canada.

(3) They performed services at any time in the year in a foreign country under an international development assistance program of the Canadian International Development Agency (“CIDA”) that is financed out of external affairs appropriations, if they were resident in Canada at any time in the three-month period preceding the day services commenced. If they fall into the classification of employment

under such a prescribed international development assistance program, CIDA will usually inform them of this.

(4) They are, at any time in the year, a member of the overseas Canadian Armed Forces school staff and have filed an income tax return for the year on the basis they were resident in Canada throughout the period that they are a member.

(5) They are, at any time in the year, a dependent child of a person described in (1), (2), (3), or (4), and their income does not exceed the basic personal amount for individuals. Where the deeming rule does not operate because income is exceeded, residence will be either a question of fact or of the deeming rules for non-residents. Dependent means dependent for support at any time in the year on the parent who is a deemed resident, which is a question of fact in each case.

(6) They are, at any time in the year, entitled to an exemption from tax in a country other than Canada by virtue of a provision of a treaty between Canada and that country or an international agreement (such as the *Visiting Forces Act*) because they are related to or a member of the family of an individual resident in Canada (usually but not necessarily a deemed resident). However, this deeming rule does not apply if the treaty or agreement in question does not exempt them from tax on all or substantially all of their income for the year from all sources. The CRA usually takes "all or substantially all" to mean 90%, while admitting that this is a rule of thumb and not a rule of law.

A special overriding rule provides that, if at any time in a taxation year they cease to be a person described in items (1) through (4) above, they are deemed to be resident in Canada throughout the part of the taxation year preceding that time (i.e., they are not deemed to be resident throughout the entire taxation year as per the regular deeming rules). Similarly, if their spouse or child would otherwise be deemed resident under item (5) or (6) above, they are deemed to be resident in Canada throughout the part of the taxation year preceding that time.

IMPACT OF TAX TREATIES ON RESIDENCE STATUS

By applying Canada's domestic law, it is possible for an individual to be considered resident of more than one country; this situation has parallels in many other countries. In such a situation an individual could be subject to double taxation. The various income tax conventions that Canada has signed with other countries provide relief from this situation. These conventions for the most part will provide a determinacy of residency between the two countries that will override domestic law.

COVID-19 UPDATE

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

FEDERAL

CEWS/CERS Regulations Amended (September 1, 2021)

The *Income Tax Regulations* were amended to implement changes to the Canada Emergency Wage Subsidy ("CEWS") and Canada Emergency Rent Subsidy ("CERS") that were first announced on July 30. These amendments extend the CEWS and CERS to October 23, and add flexibility to the revenue decline calculation.

PROVINCIAL

British Columbia

FAIRS, FESTIVALS, AND EVENTS RECOVERY FUND (AUGUST 27, 2021)

The province began accepting applications to support BC-based events through the new Fairs, Festivals and Events Recovery Fund. The government of BC is providing up to $12.9 million in one-time grants to eligible event organizers to support their efforts to resume safely. Grant amounts for each event will be up to 20% of the total event budget, to a maximum of $250,000 per application. Eligible events include sport, arts and culture events, community celebrations, agricultural fairs, rodeos, and exhibitions. Applications submitted by organizations will be required to demonstrate local or regional support and show the economic and social benefits for the community.

Applications are being accepted until October 1, 2021, for eligible events that take place between July 1, 2021, and September 30, 2022. Organizations are encouraged to submit their applications as soon as possible. Eligible expenses include operational costs, health and safety measures, venue rental, marketing, wages, and promotion. To see the Fairs, Festivals and Events Recovery Fund criteria and application, visit: gov.bc.ca/fairs-festivals-events-recovery.

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.

FOIX V. THE QUEEN, 2021 DTC 1044 (TAX COURT OF CANADA)—AMOUNTS RECEIVED BY SHAREHOLDERS ON A SALE OF SHARES AS PART OF A HYBRID TRANSACTION DEEMED TO BE DIVIDENDS PURSUANT TO S. 84(2)

Background

Watch4Net Solutions Inc. ("W4N") was a Canadian corporation primarily in the business of operating its proprietary Automated Performance Grapher software ("APG Software") for its business customers, as well as providing ancillary advisory, maintenance, and installation services in respect of the APG Software.

In 2012, W4N was sold to EMC Corporation of Canada ("EMC Canada") and EMC Canada's US public company parent, EMC Corporation ("EMC"), pursuant to a share and asset purchase agreement (the "Hybrid Transaction"). Early in the discussions or negotiations regarding the Hybrid Transaction, EMC either agreed to or proposed that W4N shareholders "withdraw excess cash" from W4N prior to closing.

The asset purchase side of the Hybrid Transaction consisted of EMC acquiring a package of W4N's assets and property (the "Purchased Assets") that included the APG Software (W4N's most valuable asset) and most of W4N's other assets (including those related to intellectual property). The Purchased Assets became part of EMC's business which EMC went on to operate directly.

The share purchase side of the Hybrid Transaction consisted of EMC Canada subsequently acquiring all of the shares of W4N, which resulted in the taxpayers—Michel Foix, Nicolas Souty, and Sonia Lebel—all receiving payments for the sale of shares. Specifically, EMC Canada purchased shares of W4N directly from Souty and the 2007 Souty Family Trust (of which Lebel was one of multiple beneficiaries) and indirectly by acquiring all of the shares of Foix's holding company, Virtuose Informatique Inc., which merely held shares of W4N.

Subsequent to the Hybrid Transaction, EMC Canada, Virtuose Informatique Inc., and W4N were amalgamated under the name EMC Canada. What remained of W4N's business, and that was amalgamated into the new EMC Canada, was the offering of advisory, maintenance, and installation services. The newly amalgamated EMC Canada could not operate the APG Software worldwide, although it may have been authorized by EMC to sell APG Software licenses to its Canadian customers.

Although EMC was primarily interested in the APG Software, the share and asset purchase agreement made it clear that W4N disposed of its entire business.

Issues and Decision

The issue considered by the Court was whether the sums received by Foix, Souty, and the Souty Trust (of which Lebel was a beneficiary) for the sale of shares to EMC Canada (an unrelated party) were deemed to be dividends received by Foix, Souty, and the Souty Trust pursuant to subsection 84(2) of the *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.) (the "ITA") or, in the alternative, under section 84.1 of the ITA.

The Court decided that subsection 84(2) applied to deem the sums received by Foix, Souty, and the Souty Trust to be dividends. In reaching its decision, the Court considered whether:

(1) funds or property of W4N (i.e., W4N's excess cash) was distributed or otherwise appropriated in any manner whatever (i.e., indirectly distributed in the form of a sale of shares) to or for the benefit of W4N's shareholders (i.e., to the taxpayers); and

(2) such distribution or appropriation of the funds or property of W4N took place on the winding-up, discontinuance, or reorganization of W4N's business.

Regarding the first issue, the Court cited *The Queen v. MacDonald* (2013 DTC 5091 (FCA)) for the proposition that the words "distributed or otherwise appropriated in any manner whatever" in subsection 84(2) "are words of the widest import, and cover a large variety of ways in which corporate funds can end up in a shareholder's hands". This wide interpretation for purposes of subsection 84(2), along with the fact that early in the transaction EMC either agreed to or proposed that W4N shareholders "withdraw excess cash" from W4N prior to closing, helped the Court find that the sale of shares as part of the Hybrid Transaction was effectively a "roundabout" way of distributing W4N's excess cash to the taxpayers.

Regarding the second issue, the Court found that the distribution of W4N's excess cash to the taxpayers took place on a "reorganization" of W4N's business because the transactions under the share and asset purchase agreement, including a pre-closing reorganization, were a series of transactions carried out in anticipation of each other and amounted to a process through which W4N reorganized its business and financial structure. In support of this, the Court noted that after the Hybrid Transaction, the former business of W4N was carried on by the amalgamated EMC Canada in a very different manner than W4N did before the Hybrid Transaction. The Court also found that it was unable to conclude as to whether EMC continued to operate W4N's business in the same way and in the same form as W4N did before the Hybrid Transaction, but even if EMC did, this would not be relevant because subsection 84(2) relates to only a single company, which in this case was W4N (which became the amalgamated EMC Canada).

Since the Court found that subsection 84(2) applied, it was unnecessary for the Court to rule on the application of section 84.1.

Conclusion

In this case, subsection 84(2) of the ITA applied to deem certain amounts received by the taxpayers on the sale of shares as part of the Hybrid Transaction to be dividends instead of capital gains. The case highlights the importance of the intention of the parties in determining whether a sale of shares is a "roundabout" way of distributing excess cash to taxpayers. The case also suggests that where a purchaser bifurcates a vendor's business between two members of a corporate group, this bifurcation may be sufficient to constitute a "reorganization" for purposes of subsection 84(2) of the ITA.

—*Francis Chang*

KALLIS V. THE QUEEN, 2021 DTC 1046 (TAX COURT OF CANADA)—LENDING ACTIVITIES HELD NOT A BUSINESS

Background

The taxpayer, Mr. Kallis, founded a successful company in the oil and gas industry. He used some of his income from the company to make interest-bearing loans to third parties, including Assistive Financial Corporation ("AFC") and First Capital Management ("FCM").

During the 2010 to 2014 taxation years, the taxpayer subscribed for 16 debentures from AFC, which were "generally for renewable one-year terms, usually at a rate of 16%, and the amounts ranged from $500,000 to $5.66M." The debentures were unsecured. In 2014, the debenture holders applied for a bankruptcy order against AFC because AFC had failed to make interest payments to the debenture holders since September 2013. AFC owed the taxpayer $10,025,000 in principal plus unpaid interest.

The taxpayer made four loans to FCM between 2006 and 2007, each with a five-year term with a monthly interest rate of 22.5%. In 2010, FCM became insolvent and Mr. Kallis lost the loan principal of $3.5 million.

Issue and Decision

The main issue in this case was whether the losses the taxpayer incurred with respect to the loans made to AFC and FCM were on account of income or capital, which turned on whether the taxpayer was in the business of lending money or if he was an investor in the taxation years at issue.

A determination as to whether the taxpayer's income is from a business is made by looking "at their whole course of conduct in light of the surrounding circumstances" and, in particular, examining "the number of transactions, their volume, their frequency, investment turnover, and the nature of the investments themselves" (see *Canadian Marconi Company v. The Queen*, 86 DTC 6526 (SCC), at para. 12). In other words, what was the taxpayer's overall level of activity? Further, "were the taxpayer's activities conducted in an orderly, businesslike manner consistent with the way in which a business person would normally be expected to do?" (see *Kaye v. The Queen*, 98 DTC 1659 (TCC), at para. 5).

The Court set out certain factors to consider which may support that there was a business, such as the source of the funds that were lent, whether the taxpayer took security on the loans, and the overall number and complexity of the loans. On the other hand, the Court set out certain factors to consider which may indicate the lack of a business, such as a lack of advertising and promotion and the lack of screening of new borrowers. The Court relied on prior cases for these factors (namely, *Meilleur v. The Queen*, 2017 DTC 1002 (TCC), and *Langhammer v. The Queen*, 2001 DTC 45 (TCC)).

The positive factors in this case were either absent or minimally present:

- the taxpayer used his own funds for the loans;
- the AFC debentures were unsecured;
- the taxpayer had a limited portfolio of borrowers;
- no evidence was introduced as support that the number of loans the taxpayer made was significant in the circumstances or that the arrangements were complex; and
- it seemed that the taxpayer did not negotiate the terms with AFC.

With respect to advertising and promotion, the taxpayer relied on word of mouth and screened potential borrowers when they were taken to various social activities.

The taxpayer did not produce records to show that the taxpayer had other actual or potential borrowers. From this, the Court drew an adverse inference that he did not keep business records for his lending activities, which was more consistent with record-keeping for investment activities. The Court referenced the taxpayer's proven business acumen in respect of his company and ultimately concluded that the taxpayer did not carry on his lending activities in an orderly, business-like manner, as a business person would normally be expected to do.

Conclusion

The Court dismissed the taxpayer's appeal. The losses the taxpayer incurred with respect to AFC and FCM were on account of capital.

—*Darren Chung*

CANADA (NATIONAL REVENUE) V. MILLER, 2021 DTC 5104 (FEDERAL COURT)—CAMECO DOES NOT LIMIT MINISTER'S AUTHORITY TO REQUIRE INFORMATION UNDER S. 231.1(1) OF THE ITA REGARDING ORAL CONTRACTS AND ITEMS THAT SHOULD BE IN TAXPAYER'S BOOKS AND RECORDS

Background

The taxpayer (Mr. Miller) provided consulting services to foreign companies seeking to access Canadian public markets. He received at least some of his fees through a Luxembourg bank account and Canadian lawyers' trust accounts. The CRA commenced an audit of Mr. Miller's 2007–2015 taxation years beginning in December 2016, which audit was soon extended to include the taxpayer's 2016 taxation year. After a period of approximately two and a half years, the taxpayer failed to produce much of the documents and information requested by the auditor. In December 2019 the CRA issued a demand letter under subsection 231.1(1) of the *Income Tax Act* (Canada) (the "ITA") requesting 22 items (the "Demand Letter"). Following receipt of one of the requested items, the CRA issued a follow-up letter to its Demand Letter in May 2019 advising that it intended to seek a compliance order under subsection 231.7(1) of the ITA. The Department of Justice ("DOJ") then issued a letter in February 2020 further advising of its intent to seek such an order, following which the taxpayer's accountants advised the Minister that the taxpayer did not have the requested items in his possession or control. The DOJ refined its demand to copies of and information in respect of a particular requested contract, certain invoices in respect of payments made under that contract, and a schedule outlining the location at which the services were performed and the compensation received, and certain other related information (the "Demanded Items"). The taxpayer's accountant advised the DOJ in July 2020 that the requested contracts and invoices had been agreed to orally between the taxpayer and his client and had never been reduced to writing, and that the balance of the Demanded Items were not in the taxpayer's possession or control.

The CRA filed a Notice of Summary Application nine days later requesting a court compliance order under subsection 231.7(1) of the ITA, alleging that the taxpayer failed to provide the Demanded Items under subsection 231.1(1).

Issues and Decision

The Court noted that the taxpayer had been given a reasonable period of time to produce the Demanded Items and that no claim of solicitor-client privilege had been made by the taxpayer. Accordingly, the issues before the Court were (1) whether the Demanded Items were within the scope of the Minister of National Revenue's (the "Minister's") authority to request pursuant to subsection 231.1(1) of the ITA, and (2) if so, whether the taxpayer had complied with the Minister's requests by providing the Demanded Items.

The taxpayer took the position that the Federal Court of Appeal's decision in *Cameco Corporation v. the Queen* (2019 DTC 5042 (FCA), "*Cameco*"), wherein the Federal Court of Appeal held that the Minister's authority under subsection 231.1(1) did not extend to compelling oral interviews of either a taxpayer or their employees, meant that the Minister's authority in the present circumstances did not extend to requiring a taxpayer to produce documents and information which had only ever existed orally or were not otherwise in the taxpayer's possession and control.

The Court disagreed, finding that subsection 231.1(1) "protects the Minister's ability to conduct an audit by ensuring her access to both (1) a taxpayer's books and records; and (2) information that ought to be documented in the taxpayer's books and records" (para. 31), and that the decision in *Cameco* does not limit the Minister's entitlement to information that "should be" in the taxpayer's books and records irrespective of whether the information had never been reduced to writing.

Accordingly, the Court ordered the taxpayer to provide the Minister with information regarding the terms and conditions of his oral contract, the invoices, and the balance of the requested information, and indicated that it would then be up to the Minister to determine whether she is satisfied that the taxpayer made reasonable efforts to comply with the request.

The Court further found that *Cameco* did not exempt the taxpayer from being required to provide the Minister with foreign bank account records which should be in the taxpayer's books and records but which the taxpayer did not have in its possession or control, nor information regarding the purpose of various payments made into his lawyer's trust accounts.

Conclusion

The CRA's inspection powers under subsection 231.1(1) of the ITA remain broad and provide the CRA with the authority to compel production of written descriptions of oral agreements or arrangements and records not in the taxpayer's possession or control.

—Ron Dueck

TELLZA INC. V. CANADA (NATIONAL REVENUE), 2021 GTC 1022 (FEDERAL COURT) —CAMECO DOES NOT LIMIT MINISTER'S AUTHORITY UNDER S. 188(1) OF ETA TO REQUIRE TAXPAYER TO PROVIDE 15 MONTHS OF ELECTRONIC ACCOUNTING DATA

Background

Tellza was a Canadian corporation carrying on a telecommunications business. The CRA commenced an audit of Tellza's goods and services tax/harmonized sales tax returns for its reporting period November 1, 2016, to January 31, 2018. In connection with its audit, the CRA issued a letter to Tellza under subsection 288(1) of the *Excise Tax Act*, RSC 1985, c E-15 (the "ETA") purporting to require Tellza to provide the CRA with all of its electronic accounting data for the period (the "Requirement Letter").

Issues and Decision

Tellza brought an application for judicial review to have the Requirement Letter quashed or set aside on the grounds that the authority of the Minister to "inspect, audit or examine the documents, property or processes" of a taxpayer under subsection 288(1) is limited to requests, and that requirements to produce documents must be made under subsection 289(1) of the ETA—thereby making the decision of the Minister to issue the Requirement Letter under subsection 288(1) unreasonable. In making this argument, the taxpayer relied in part on the Federal Court of Appeal's determination in *Cameco* (2019 DTC 5042 (FCA)) that the words "inspect, audit or examine" in subsection 231.1(1) of the *Income Tax Act* (Canada), being largely identical to those found in subsection 188(1) of the ETA, "mean 'self-directed inquiry' but do not include 'a power to compel a person to answer questions'" (para. 19).

The Court agreed that the scope of "inspection powers" under subsection 288(1) is more limited than the scope afforded to the Minister under subsection 289(1), but disagreed that the Minister is not authorized to require a taxpayer to produce documentation under subsection 288(1). The Court reasoned that as the power of the Minister to "inspect" a taxpayer's documents at their premises under subsection 288(1) is merely permissive, then the provision must afford the Minister the authority to inspect a taxpayer's documents elsewhere which must then necessarily impute to the Minister the authority to require a taxpayer to provide the Minister with the documents she wished to inspect. The Court further reasoned that as the definition of "document" in subsection 123(1) of the ETA includes anything containing information in any form, the Minister could not inspect unwritten or electronic records absent the authority to compel the taxpayer to provide these records to her.

The Court also rejected the taxpayer's argument that *Cameco* restricted the Minister's authority in the circumstances. The Court found that *Cameco*, while relevant to the ETA's sister provision in subsection 188(1), was distinguishable as the power of the Minister to conduct a "self-directed inquiry" of electronic data requires the Minister to have the authority to require its production in order for the self-directed inquiry to even take place.

As to the scope of the Minister's Requirement Letter, the Court noted that the Supreme Court of Canada had confirmed that the Minister enjoys broad powers to inspect all records of a taxpayer which might be relevant to an audit of their tax returns (*R. v. McKinlay Transport Ltd.*, 90 DTC 6243).

The Court held that the Requirement Letter was not unreasonable, its scope was permissible, and that the taxpayer had engaged in "an unacceptable line-by-line treasure hunt for errors" (para. 28).

Conclusion

The CRA's inspection powers under subsection 188(1) of the ETA remain broad and provide the CRA with authority to compel production of full electronic accounting data.

—*Ron Dueck*

CURRENT ITEMS OF INTEREST

KILOMETRIC RATES FOR 2021

When claiming travel costs for the medical expense tax credit, the moving expense deduction, and the northern residents deduction, taxpayers can use a simplified method to compute the amount of the claim by multiplying the total distance traveled by a per-kilometre rate. The rates for the 2021 taxation year are now available and are as follows:

Province/Territory	**Cents/km (taxes included)**
Alberta	51.0
British Columbia	56.0
Manitoba	52.0
New Brunswick	54.5
Newfoundland and Labrador	58.0
Northwest Territories	64.5
Nova Scotia	55.0
Nunavut	60.5
Ontario	57.5
Prince Edward Island	53.0
Quebec	55.0
Saskatchewan	51.5
Yukon	63.0

INTEREST RATES FOR FOURTH CALENDAR QUARTER

The CRA announced the prescribed annual interest rates applicable to amounts owed to the CRA and to amounts owed by the CRA to individuals and corporations. The rates are effective from October 1, 2021, to December 31, 2021. The only change from the previous quarter is the rate for pertinent loans or indebtedness. For income tax purposes, the rates are as follows:

- The interest rate charged on overdue taxes, Canada Pension Plan contributions, and employment insurance premiums will be 5%.
- The interest rate to be paid on corporate taxpayer overpayments will be 1%.
- The interest rate to be paid on non-corporate taxpayer overpayments will be 3%.
- The interest rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans will be 1%.
- The interest rate for corporate taxpayers' pertinent loans or indebtedness will be 4.17% (up from 4.10% in the third quarter).

COMFORT LETTER

The Department of Finance issued a comfort letter that is of interest to Canadian taxpayers who directly hold shares in Novartis AG of Switzerland. Essentially, the Department of Finance would recommend to the Minister of Finance that a spin-off distribution of Alcon shares to common shareholders of Novartis be a prescribed distribution for the purposes of the foreign spin-off rules under section 86.1 of the *Income Tax Act*. The letter was dated February 14, 2020.

2022 EMPLOYMENT INSURANCE PREMIUM RATES

On September 14, 2021, the Canada Employment Insurance Commission ("CEIC") announced that the 2022 Employment Insurance ("EI") premium rate will be $1.58 per $100 of insurable earnings for employees and $2.21 for employers. This rate is unchanged because last year the federal government froze these EI premium rates for 2021 and 2022 at the 2020 rate.

The premium rate in 2022 for Québec employees will be $1.20 per $100 of insurable earnings for employees, and $1.68 per $100 of insurable earnings for employers. In 2021 these rates were $1.18 and $1.65 respectively.

The CEIC also announced that the Maximum Insurable Earnings ("MIE") for 2022 will increase to $60,300 from $56,300 in 2021. Accordingly, the maximum annual EI contribution for a worker will increase by $63.20 to $952.74 (up $88.48 for employers to $1,333.84 per employee). The maximum annual contribution for a worker in Québec will increase by $59.26 to $723.60 (up $82.96 for employers to $1,013.04 per employee).

RECENT CASES

TAX LOSS MONETIZATION ARRANGEMENT INVOLVING IPO TO AVOID AN ACQUISITION OF CONTROL STRUCK DOWN AS OFFENDING GAAR

This appeal from the decision of the Tax Court of Canada (2019 DTC 1059) concerns the application of the general anti-avoidance rule ("GAAR") to a tax loss monetization arrangement. Prior to the transactions which were the subject of the appeal, the respondent was a Canadian public corporation, Forbes Medi-Tech Inc., that had approximately $90 million of unused non-capital losses and other deductions "tax attributes". It sought to realize the value of these tax attributes and entered into an agreement with Matco Capital Ltd. ("Matco"), which was a venture capital company that had previously arranged transactions of the kind contemplated and which provided a framework for the tax attribute monetization arrangement (the "Investment Agreement"). In an involved series of transactions, Matco arranged with Deans Knight Capital Management Ltd. ("DK Capital Management") to take over the respondent by way of an IPO, as part of which the respondent changed its name to Deans Knight Income Corporation. An IPO was chosen to avoid an acquisition of control from occurring. The respondent raised $100 million in the IPO, which was managed by DK Capital Management and invested in corporate debt securities. From 2009 to 2012, the respondent deducted a majority of its tax attributes to reduce its tax liability from the debt securities business. Following the issuance of reassessments to deny the deductions, the respondent successfully appealed to the Tax Court of Canada. The Crown appealed from that decision on the basis that GAAR is applicable to the monetization arrangement because it results in an abuse of the provisions of the *Income Tax Act* that restrict the use of tax attributes following an acquisition of control.

The appeal was allowed (unanimous decision). The Tax Court concluded that Matco had not acquired effective control of the respondent as part of the series of transactions undertaken that resulted in the use of the tax attributes, and that the respondent freely participated, such that an acquisition of control did not occur. However, this conclusion was not supported by the evidence. The standard of review in cases such as this is whether a palpable and overriding error has been made by the lower court. In this case, the error was palpable because it was “plain to see” that the Tax Court’s conclusion was not consistent with the terms of the Investment Agreement and it was overriding because it affected the result.

The Queen v. Deans Knight

2021 DTC 5095

CROWN'S CLAIM FOR SECURED INTEREST IN PROPERTY UPHELD

The “Bankrupt” was indebted to the Crown for unremitted income tax and GST of $1,107,248.85 as of the date of his bankruptcy. At all material times, the Bankrupt was the owner of an undivided one-half interest in the “Property” with his brother, who was the owner of the other undivided one-half interest. The Federal Court certified the Bankrupt’s tax debts and the Minister registered the Crown’s judgments in the land title office against the Bankrupt’s interest in the Property. The Bankrupt later made a voluntary assignment into bankruptcy. Several judgments were registered against the title of the Property prior to the Crown’s judgments. The Crown maintained that the bankruptcy triggered section 87 of the *Bankruptcy and Insolvency Act* which, combined with the *Income Tax Act* subsection 223(11.1) and *Excise Tax Act* subsection 316(10.1), resulted in the Crown’s judgments being deemed secured claims in the bankruptcy. The Crown filed a proof of claim as a secured creditor for the amounts owing under the Crown’s judgments, and as unsecured for the balance. The trustee disallowed its Proof of Claim. The Crown appealed. The Master set aside the trustee’s decision, directed the trustee to allow the applicant’s proof of claim as submitted at the value set out in the proof of claim for all purposes, and ordered the trustee to pay to the Crown the proceeds of sale of the Property, secured by the memorials, including all accrued interest. The trustee was also ordered to pay costs of the appeal personally. The trustee appealed to the BC Supreme Court, arguing that where other judgments are registered against title to the property prior to the Crown’s registration, the Crown’s claims would be subordinate to those other judgments.

The appeal was dismissed. Because this appeal involved a question of law, the standard of review was correctness. The Master’s interpretation of the legislation was correct and he made no reviewable error. Under the circumstances, the secured tax debts owed to the Crown ranked as a secured claim in priority over the previously registered judgments. The trustee’s appeal of the decision on the merits was dismissed. The trustee’s appeal of the determination that costs were payable by him personally was allowed and costs ordered payable by the Bankrupt’s estate.

Gidda (Re)

2021 DTC 5097

CRA LETTER DECISION REGARDING TREATMENT OF TRUST DISTRIBUTIONS QUASHED BY TAX COURT

The applicant was a Canadian corporation that was one of the beneficiaries of distributions received from a Bermuda-based corporation through a trust. Until 2007 the trust was Bermudan; in that year it was replaced by a Canadian trust. The applicant and its principal allegedly discovered in 2010 that distributions from 2008 onward should have been treated as non-taxable voluntary payments and amended its T2 returns to reflect that claim. (Only the 2008–2011 distributions were at issue in this case.) Meanwhile, the principal, who had been reassessed for not having reported the trust income, appealed the reassessments in the Québec courts; that appeal had not yet been resolved. In a proposal letter of July 2017 the CRA expressed its intention to treat the distributions as taxable and stated it would not process the applicant's and the others' amended returns "until a final and unappealable determination had been made" on this issue, presumably referring to the Tax Court proceeding. By letter of May 7, 2019, the CRA issued a "final" decision declining to process the amended returns for 2008–2011, and the applicant sought relief. (At the same time, the CRA reassessed the applicant's principal for not having reported the trust income; his appeal to the Tax Court remained unresolved.) The

CRA's position as stated in the letter was that it would not process the amended returns before a "final and unappealable determination" (presumably of the Tax Court appeal), that it would pursue both of the "alternate" positions provided by the *Income Tax Act*, subsections 9(1) and 56(2), and that if it made the wrong decision now limitations would prevent it from going back to reassess.

The decision was quashed. Applying the reasonableness standard, the Court examined the CRA's prior statements and the decision. It held that (1) the CRA statements belied its claim that its decision was "final", since it had stated it would process the amended returns when a final disposition was reached; (2) those statements were incompatible with its "limitations" claim. Most importantly, the Court observed that the CRA was proceeding under two incompatible theories—the "Applicant Theory" for the applicant, and the "Principal Theory" against the applicant's principal. Since the CRA decision could be read in these two incompatible ways, it was "neither transparent nor intelligible", and therefore unreasonable.

4431472 Canada Inc. v. Canada (AG)

2021 DTC 5093

CRA PROPERLY EXERCISED ITS DISCRETION IN DECLINING TO REOPEN AN AUDIT/REASSESSMENT

In 2019, the applicant sought review of the CRA's discretionary refusal to reopen its reassessment of the applicant's 2012 taxation year, which resulted in an increase of over $3 million in tax payable. The applicant maintained that employee mismanagement caused it to be unaware that the limitation period for objecting to the reassessment (issued in 2017) had expired. The applicant asked the CRA to extend its time to object, as it had done for the 2013 and 2014 tax years, and the CRA refused. This application to the Tax Court followed.

The application was dismissed. The *Income Tax Act* (the "Act"), paragraph 152(4)(c), authorized the CRA to reassess a taxation year conditioned on the taxpayer's filing a timely waiver, which the Court found the applicant had done. Section 231.1 of the Act is the provision that empowers the CRA to conduct an audit. The parties disagreed over which provision justified the CRA's refusal to reopen the reassessment, but the Court held that both applied. Under the reasonableness standard, the Court found that (a) the CRA did not "fetter" its discretion by rebuking the applicant for not having taken timely measures; (b) it did not abuse its discretion with respect to additional information provided by the applicant, especially given the applicant's failure to respond to numerous contacts over the years; (c) the applicant's case and regulatory authorities were distinguishable; and (d) the CRA reasonably relied on the jurisprudence it cited.

Amdocs v. Canada (MNR)

2021 DTC 5090

AGREEMENT DATED TO BE EFFECTIVE AFTER DEATH OF TRUST BENEFICIARY DID NOT TAKE EFFECT ON EARLIER DATE OF EXECUTION

The applicants were a corporation and an alter ego trust for one of its directors. The trust held Class A shares of the corporation. When the director was diagnosed with a terminal illness, as part of his estate planning, the corporation would redeem the trust's Class A preferred shares and elect to have the resulting deemed dividend treated as a tax-free capital dividend. The instrument was executed on April 26, 2011, to take effect on May 2; however, the director died on May 1. The applicants claimed that the May 1 date was a "mistake" and sought rectification of the effective date to April 26, the day the instrument was executed.

The application was dismissed. The applicants cited the Supreme Court in *Canada (AG) v. Fairmont Hotels Inc.* (2016 DTC 5135) for the proposition that rectification is an equitable remedy available to "give effect to the parties' true intentions, rather than to an erroneous transcription of those true intentions." The Court noted that according to the same case, "[r]ectification is limited to cases where the agreement between the parties was not correctly recorded in the instrument that became the final expression of their agreement". The applicants presented no evidence that the instrument here incorrectly recorded their intentions. According to their own submissions, they chose May 2 as the effective date in order to allow time for the instrument to be registered. The Court concluded that the mistake was not a drafting error but the assumption that the trustee would be alive on the intended effective date. Thus, rectification was unavailable here.

Glenmac Corporation Ltd. v. Canada (AG)

2021 DTC 5087

ATHLETIC ASSOCIATION SATISFIED STATUTORY CRITERIA FOR A REGISTERED CANADIAN AMATEUR ATHLETIC ASSOCIATION

In 2014, the appellant applied for registration as a Canadian amateur athletic association ("RCAAA") in accordance with subsection 149.1(1) and the definition of "registered Canadian amateur athletic association" under subsection 248(1) of the *Income Tax Act* (the "ITA"). The CRA rejected the application and, after receiving no response to its Notice of Objection, the appellant appealed in 2019. The CRA rejected the application because the appellant proposed to provide direct funding to amateur athletes, which was not a purpose enumerated in subsection 149.1(1), and did not show it had a nationwide basis, a requirement of subsection 149.1(1).

The appeal was allowed and remanded to the CRA for redetermination. The Court noted that the alleged purpose and function requirements the CRA cited were not in the ITA, but appeared to derive from CRA guidance that expired in 2011. The real question was not the source of the requirements but whether the appellant's purposes and functions satisfied the requirements of the ITA; the CRA had no discretion to refuse an RCAAA application except under enumerated factors, and direct funding of amateur athletes was not one such. Further, The CRA's objection that the appellant lacked a physical presence throughout Canada was misguided. The ITA requires that a charitable organization have a "nationwide presence"; the Court held that this phrase does not mean, as the CRA argued, that the organization must have a physical presence throughout Canada to qualify for registration. The ITA only requires that an RCAAA promote amateur athletics nationwide, and there is no reason it cannot do so from a single physical location.

Athletes 4 Athletes Foundation v. Canada (MNR)

2021 DTC 5084