Tax Notes

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2020 TAX POLICIES OF THE MAJOR US PRESIDENTIAL CANDIDATES

— *Wolters Kluwer US*

This article describes the tax policies of the candidates of the two major parties as of September 3, 2020: President Donald Trump, the incumbent candidate for the Republican Party, and former Vice President Joe Biden, the Democratic candidate for president.

Note: *Between September 3 and the election, the positions of the candidates may change. Wolters Kluwer has based this article on what it considers accurate, nonpartisan, and unbiased information at the time of writing. All dollar figures are in USD.*

Comment: *Many of the tax proposals of President Trump when he was campaigning in the 2016 election were carried out by the passage of the US* Tax Cuts and Jobs Act *("TCJA") in 2017. As such, there are not many "new" proposals presented by his 2020 re-election campaign. For the most part, the proposals by President Trump are to make permanent many TCJA provisions that are scheduled to expire after the 2025 tax year. Joe Biden, on the other hand, has several proposals that would roll back many provisions of the TCJA. The two campaigns seem to have fundamental disagreements over the TCJA, especially as it applies to corporations and higher-income individuals.*

Individual Taxation

Income Tax Rates

Under current US law, there are seven tax brackets: 10, 12, 22, 24, 32, 35, and 37 per cent, which are applicable from 2018 through 2025 under the TCJA.

Trump

No current proposals or changes.

> **Comment**
>
> Although Trump has floated the idea of a new 10 per cent middle income tax cut, he largely supports extending the tax provisions under the TCJA beyond 2025. Additional details related to Trump's tax priorities may be released as the campaign progresses.

Biden

Biden has proposed increasing the top rate back to 39.6 per cent, where it sat prior to the TCJA.

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Capital Gains/Dividends

Under current US law, a capital gains rate of 0 per cent, 15 per cent, or 20 per cent applies to capital gains and qualified dividends received by individuals, depending upon the amount of the individual's taxable income. For 2020, the 20 per cent rate applies to joint filers with taxable incomes over $496,600 ($469,050 for heads of households, $441,450 for single filers, and $248,300 for married taxpayers filing separately).

Trump

No current proposals.

Comment

Trump stated in August that he is "seriously" considering a capital gains tax cut via executive action. Additionally, he has stated that he would propose cutting the maximum capital gains rate to 15 per cent if re-elected. His fiscal year ("FY") 2021 budget proposal would extend the applicable TCJA provisions beyond 2025. Further, Trump has floated indexing capital gains to inflation.

Biden

Biden's proposal would increase the top marginal income tax rate on long-term capital gains to 39.6 per cent for taxpayers earning more than $1 million annually and eliminate the step-up basis tax expenditure that allows decedents to pass capital gains to heirs without tax. The top rate on long-term gains would nearly double from 23.8 per cent to 43.4 per cent, according to the US Tax Foundation.

Individual Tax Incentives

Child Tax Incentives

Trump

Trump has no currently proposed expansions to child tax incentives. Trump's FY 2021 Budget proposal would extend applicable TCJA provisions beyond 2025.

Biden

Biden has proposed expanding the earned income tax credit ("EITC") and dependent care credit. Further, Biden has proposed a refundable $8,000 child care tax credit for a qualifying child or up to $16,000 for two or more children. The maximum Child Tax Credit is $2,000 through 2025 under the TCJA.

Additionally, Biden proposes a new $5,000 tax credit for caregivers of individuals with certain physical and cognitive needs.

Limitation on Itemized Deductions

Prior to the TCJA, a limitation on itemized deductions (the so-called "Pease limitation") took effect at higher income levels (in 2017, $318,700 for joint filers, $287,650 for heads of households, $261,500 for single filers, $156,900 for married taxpayers filing separately). The TCJA eliminated the limitation through the 2025 tax year.

Trump

Trump proposes a permanent repeal of the limitation.

Biden

Biden proposes restoring the Pease limitation on itemized deductions for taxable incomes above $400,000.

Carried Interest

Generally, income that flows to a partner from a private investment fund is taxed at the lower capital gains rates with a three-year holding period requirement for certain long-term capital gain and loss.

Trump

Trump proposes eliminating carried interest.

Biden

Biden proposes eliminating carried interest.

Payroll Tax

Currently, the *Federal Insurance Contributions Act* ("FICA") tax of 12.4 per cent is split between employer and employee.

Trump

No current official proposals.

Comment

Trump has consistently lobbied for payroll taxes to be cut or outright eliminated. Under a recent executive action, employers are allowed to defer the collection and payment of the employee's share of the FICA tax during the September to December 2020 period to January of 2021, with a promise to eliminate the deferred taxes if re-elected.

Biden

Biden has proposed eliminating the wage base cap on taxpayers with income above $400,000.

Business Taxation

Corporate Tax Rates

Under current law, the US corporate income tax rate is 21 per cent.

Trump

Trump has no currently proposed changes.

Biden

Biden proposes increasing the corporate tax rate to 28 per cent. Additionally, Biden proposes a minimum tax on corporations with book profits of $100 million or more.

Qualified Business Income Deduction

Under current law, the Section 199A deduction allows eligible taxpayers to deduct up to 20 per cent of their qualified business income ("QBI"), plus 20 per cent of qualified real estate investment trust ("REIT") dividends and qualified publicly traded partnership ("PTP") income. The deduction is scheduled to expire after 2025 under the TCJA.

Trump

Trump supports extending the applicable TCJA provision beyond 2025.

Biden

Biden has proposed phasing out the qualified business income deduction for incomes above $400,000.

Energy Tax Incentives

Various credits are available under current law for oil production and electric vehicles, as well as for the production of solar, wind, and other “green” energy.

Trump

Trump has no currently proposed energy tax incentives.

Biden

Biden proposes ending subsidies for fossil fuels, restoring the full electric vehicle tax credit, and various credits and deductions to incentivize both residential and commercial energy efficiency.

International Taxation

Repatriation

Under current law, US corporations can defer payment of US income tax on profits from offshore subsidiaries until they are repatriated.

Trump

Trump has no currently proposed changes.

Biden

Biden proposes ending TCJA incentives for multinationals. Additionally, according to Biden’s website, he would establish a “claw-back” provision to “force” a return of public investments and tax benefits when it closes employment locations in the US and sends jobs overseas. Additionally, Biden proposes “tightening” anti-inversion laws.

GILTI

Generally, Global Intangible Low Tax Income (“GILTI”) was enacted under the TCJA as an anti-base erosion provision. GILTI is a tax on earnings that exceed a 10 per cent notional return on a company’s invested foreign assets.

Trump

Trump has no currently proposed changes.

Biden

Biden proposes doubling the tax rate on GILTI earned by foreign subsidiaries of US firms from 10.5 per cent to 21 per cent.

Taxes and Health Care

Since passage of the *Affordable Care Act* (“ACA”), taxes and health care have become more intertwined than in previous years. The ACA created a number of new taxes and fees. However, the ACA’s individual mandate was effectively repealed by the TCJA.

Trump

Trump largely supports repealing the ACA.

Biden

Biden proposes strengthening the ACA by eliminating the 400 per cent income cap on tax credit eligibility and lowering the limit on the cost of coverage from 9.86 per cent of income to 8.5 per cent. Additionally, he would propose expanding a variety of family tax credits to increase coverage and lower premiums.

Tax Legislation on the Horizon

Before the ink was even dry on the TCJA, several GOP members of Congress, as well as President Trump, were already getting ready for "Tax Reform 2.0". Promises of further tax cuts were a rallying cry during the 2018 mid-term elections. However, the steam went out of the prospects for such a tax bill once the GOP lost the majority in the House. However, there are still many GOP members of Congress who support such a measure. Whether there is a "Tax Reform 2.0" will largely depend on the outcomes of the elections in November.

Of a much more immediate matter, a bill providing further stimulus in response to the COVID-19 pandemic ("CARES 2") seems much more likely. Both parties, and President Trump, feel that there is a need for further legislative action; however, there is a wide gulf between them all with regard to the size and scope of such a bill. The last pandemic stimulus/relief bill (the "CARES Act"), delayed many provisions of the TCJA to take effect after 2020 in order to promote business growth and survival. Whether a CARES 2 bill would further impact the provisions of the TCJA remains to be seen.

COVID-19 UPDATE

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

Federal

CRA Resuming More Audit Activities

Starting in November 2020, the CRA will resume audit activities:

- all small business audits, specifically related to income tax and GST/HST, as well as GST/HST desk audits; and
- registered plans, including employee pension plans, retirement savings plans, retirement income funds, deferred profit sharing plans, supplementary unemployment benefit plans, education savings plans, disability savings plans, tax-free savings accounts, registered investments, and pooled pension plans.

See www.canada.ca/en/revenue-agency/campaigns/covid-19-update/covid-19-business-resumption.html for additional information about the CRA's resumption of activities.

Canada Emergency Wage Subsidy Update (October 14, 2020)

On October 14, 2020, the government provided details on the parameters of the Canada Emergency Wage Subsidy ("CEWS") that are proposed to apply until December 19, 2020. In addition, other enhancements are being proposed to the program to ensure that it provides continued support to employers and responds to the health and economic situation as it evolves. These changes complement the new Canada Emergency Rent Subsidy.

The wage subsidy consists of a base subsidy for all employers whose revenues have been impacted by the pandemic, as well as a top-up subsidy for employers that are hardest hit. There is a separate rate structure for furloughed workers. It is proposed that the base subsidy rate for September 27 to October 24, 2020, continue to apply from October 25 to December 19, 2020. As such, the maximum base subsidy rate would be set at 40% for this period, and the maximum top-up subsidy rate would remain at 25%.

To make the top-up subsidy more responsive to sudden changes in revenue, the revenue-decline test for the base subsidy and the top-up subsidy would be harmonized from September 27 onward. Instead of using the current three-month revenue-decline test for the top-up subsidy, both the base and top-up would be determined by the change in an eligible employer's monthly revenues, year-over-year, for either the current or previous calendar month. This means an employer with a 70% or greater revenue loss in a period would be eligible for a 65% wage subsidy. For employers using the alternative revenue-decline test (announced on April 8, 2020), both the base subsidy and the top-up subsidy would be determined by the change in an eligible employer's monthly revenues relative to the average of its January 2020 and February 2020 revenues.

To ensure that the change in the revenue-decline test does not lead to a less generous wage subsidy, the wage subsidy program would include a "safe harbour" rule applicable from September 27 to December 19, 2020. This rule would entitle an eligible employer to a top-up subsidy rate that is no less than it would have received under the three-month revenue-decline test.

As of October 25, 2020, the wage subsidy for furloughed employees would be aligned with the benefits provided through Employment Insurance to ensure equitable support to Canadian workers and in accordance with the announcement the government made on July 17 unveiling adjustments to the wage subsidy. This means the subsidy per week in respect of an arm's length employee (or a non-arm's length employee who received pre-crisis remuneration for the relevant period) would be: the amount of eligible remuneration paid in respect of the week; or, if the employee receives remuneration of $500 or more in respect of the week, the greater of $500 and 55% of pre-crisis remuneration for the employee, up to a maximum subsidy amount of $573.

The government intends to introduce legislation to implement the extended wage subsidy.

Applications Open for New Benefits (October 12, 2020)

On October 12, 2020, the application process for the Canada Recovery Benefit ("CRB") was opened (apply at www.canada.ca/en/revenue-agency/services/benefits/recovery-benefit.html). Applications for the Canada Recovery Caregiving Benefit ("CRCB") and the Canada Recovery Sickness Benefit ("CRSB") opened on October 5, 2020; see www.canada.ca/en/revenue-agency/services/benefits/recovery-caregiving-benefit.html and www.canada.ca/en/revenue-agency/services/benefits/recovery-sickness-benefit.html, respectively, to apply.

Fish Harvester Benefit and Grant Program (October 2, 2020)

The application period for the Fish Harvester Benefit and Grant Program was extended to October 19, 2020 (6 p.m. Eastern Time).

New Support for Businesses (October 9, 2020)

On October 9, 2020, the Deputy Prime Minister and Finance Minister, Chrystia Freeland, announced that the federal government intends to introduce new support for businesses and other organizations to help them get through the second wave of COVID-19.

First, the new Canada Emergency Rent Subsidy would provide rent and mortgage support until June 2021 for qualifying organizations affected by COVID-19. The rent subsidy would be provided directly to tenants, while also providing support to property owners. The new rent subsidy would support businesses, charities, and non-profits that have suffered a revenue drop by subsidizing a percentage of their expenses, on a sliding scale, up to a maximum of 65 per cent of eligible expenses until December 19, 2020. Organizations would be able to make claims retroactively for the period that began September 27 and ends October 24, 2020. A top-up Canada Emergency Rent Subsidy of 25 per cent will be available to organizations temporarily shut down by a mandatory public health order issued by a qualifying public health authority, in addition to the 65 per cent subsidy.

Second, the government reiterated its commitment to extend the Canada Emergency Wage Subsidy ("CEWS") until June 2021. The subsidy would remain at the current subsidy rate of up to a maximum of 65 per cent of eligible wages until December 19, 2020.

And last, the Canada Emergency Business Account ("CEBA") will be expanded, which would enable businesses, and not-for-profits eligible for CEBA loans — and that continue to be seriously impacted by the pandemic — to access an interest-free loan of up to $20,000, in addition to the original CEBA loan of $40,000. Half of this additional financing

would be forgivable if repaid by December 31, 2022. Additionally, the application deadline for CEBA is being extended to December 31, 2020. Further details, including the launch date and application process will be announced in the coming days. An attestation of the impact of COVID-19 on the business will be required to access the additional financing.

One-Time Payment to Persons with Disabilities Coming Soon (October 6, 2020)

Previously, the federal government announced a non-taxable, non-reportable, one-time payment of up to $600 in recognition of the extraordinary expenses faced by persons with disabilities during the COVID-19 pandemic. The federal government has now promised that the payment will be made to eligible persons on October 30, 2020.

Regional Relief and Recovery Fund Expanded (October 2, 2020)

The Regional Relief and Recovery Fund ("RRRF") is intended to support businesses that may not be eligible for other government programs. On October 2, the federal government announced an additional $650 million in funding for the RRRF, bringing its total funding to $1.5 billion.

COVID-19 Response Measures Act Receives Royal Assent (October 2, 2020)

Bill C-4, *COVID-19 Response Measures Act*, which replaced Bill C-2, received Royal Assent on October 2, 2020. The bill will add flexibility to qualifying for EI and introduce three new COVID-19 recovery benefits that will replace the Canada Emergency Response Benefit ("CERB").

As of October 5, 2020, Canadians can apply through the CRA for the Canada Recovery Caregiving Benefit ("CRCB") and the Canada Recovery Sickness Benefit ("CRSB"). And on October 12, 2020, the CRA will open applications for the Canada Recovery Benefit ("CRB"). The CRCB and CRSB benefits are paid on a weekly basis, meaning Canadians must reapply each week they are eligible. The CRB benefit will be paid in two-week periods.

Eligible individuals can apply for recovery benefits online through the CRA's My Account portal or by phone through its automated phone line. The attestation-based application process for the new temporary benefits will have more robust verification measures upfront than the CERB. Applicants will also experience different validation checkpoints to ensure they only receive the benefits to which they are entitled. Payments will be delivered within the CRA's usual service standard of three to five business days by direct deposit and 10 to 12 business days by cheque.

Provincial

Alberta

Extended Deadlines for Claims for the Alberta SR&ED Tax Credit and Time to Serve a Notice of Objection (October 15, 2020)

Further to the federal *Time Limits and Other Periods Act (COVID-19)* and associated Ministerial Orders made by the Government of Canada, Alberta will also be extending the filing deadlines for claims for the Alberta Scientific Research and Experimental Development ("SR&ED") tax credit and the deadline to file a Notice of Objection.

Normally, a corporation is not entitled to an Alberta SR&ED tax credit unless Tax and Revenue Administration ("TRA") has received the claim on or before the day that is 15 months after the filing due date of the corporation's Alberta Corporate Income Tax Return for the year (the "SR&ED filing deadline"). However, the SR&ED filing deadlines that otherwise occurred on or after March 13, 2020, are being extended by six months or to March 31, 2021, whichever date comes first.

Accordingly, for corporations with taxation years ending from June 13, 2018, to December 31, 2018, whose SR&ED filing deadlines are otherwise from March 13, 2020, to September 30, 2020, the deadlines are extended by six months. For corporations with taxation years ending from January 1, 2019, to June 29, 2019, whose SR&ED filing deadlines are otherwise from October 1, 2020, to March 29, 2021, the deadlines are extended to March 31, 2021. If an SR&ED filing deadline falls on a weekend or a holiday, a claim for the SR&ED tax credit is considered filed on time if it is filed on the next business day on which TRA is open.

Normally, if a corporation has not served a Notice of Objection (Form AT97) within 90 days from the date of mailing of the respective Notice of Assessment, the corporation may apply for an extension of time to serve a Notice of

Objection within one year from the expiration of the 90-day period for objecting. However, the deadlines to apply to TRA for such an extension of time that otherwise occurred on or after March 13, 2020, are being extended by six months or to December 31, 2020, whichever date comes first. Moreover, if TRA has decided to refuse an application for an extension of time to file a Notice of Objection, a corporation normally may apply to the Court of Queen's Bench of Alberta to have the application granted within 90 days from the date of mailing of the decision. However, the deadlines for such applications to the Court that otherwise occurred on or after March 13, 2020, are also being extended by six months or to December 31, 2020, whichever date comes first.

British Columbia

Small and Medium-Sized Business Recovery Grant (October 9, 2020)

The Small and Medium-Sized Business Recovery Grant will invest up to $300 million in targeted financial support for some of the hardest hit businesses in BC that employ between two and 149 BC residents and have experienced declines in revenue since March 10, 2020. Grants of $10,000 to $30,000 are available. An additional $5,000 to $10,000 grant is available to eligible tourism-related businesses that have been hit especially hard by COVID-19. The program runs until March 31, 2021 or until the funds are fully allocated, whichever comes first. The grant process has five steps:

- Step 1 — Businesses apply for funding and provide information to demonstrate that they meet the eligibility criteria.
- Step 2 — A business that meets the eligibility criteria is matched with a professional services provider who will help develop a recovery plan or assess the business's current plan (a value up to $2,000 in professional services, in addition to the grant amount).
- Step 3 — Once a recovery plan is developed, submitted, and approved, funding is provided to the business to implement the actions outlined in their recovery plan.
- Step 4 — Businesses must provide regular updates that account for the spending and status of their recovery efforts supported by the grant funding.
- Step 5 — All businesses must agree to participate in a third-party audit at the end of the program.

Visit www2.gov.bc.ca/gov/content/economic-recovery/business-recovery-grant for additional information and bcbusinessrecoverygrant.com/ to apply.

Manitoba

Support for Employment and Income Assistance ("EIA") Clients (October 9, 2020)

On October 9, 2020, Manitoba announced the federal government's new Canada Recovery Benefit, Canada Recovery Sickness Benefit, and Canada Recovery Caregiving Benefit will be treated as earned income under EIA for existing clients and for anyone who may apply for benefits in the disability category. Clients will also continue to receive EIA health benefits, including prescription, dental, and optical, under the Rewarding Work Health Plan. Individuals with disabilities will receive the same enhanced earnings exemption as existing clients.

Ethnocultural Community Support Program (October 9, 2020)

The Ethnocultural Community Support Program provides support to non-profit ethnocultural organizations that are open to the public and meet the program criteria. Up to $420,000 is available and offers support in a variety of areas, but is focused on projects that:

- preserve, enhance, promote, and share Manitoba's rich and diverse cultural heritage;
- encourage the development of partnerships between ethnocultural communities to foster inter-cultural understanding, harmony, and equality;
- support the retention of heritage languages in Manitoba;
- promote anti-racism and successful inclusion; and
- support multiculturalism values and the efforts of ethnocultural youth in communities.

As a response to the COVID-19 pandemic, the province is proactively encouraging ethnocultural organizations to undertake innovative measures to augment program engagement and delivery. This may include virtual conferences,

social media gatherings, and distribution of educational materials in accordance with provincial health orders. The deadline for applications is October 31. More information on the application process can be found at www.gov.mb.ca/chc/multiculturalism/ecsp.html.

Newfoundland and Labrador

2020 Budget (September 30, 2020)

Newfoundland and Labrador Budget 2020 ("Budget 2020") was tabled September 30, 2020, by Deputy Premier and Minister of Finance Siobhan Coady. Budget 2020 projects a deficit of $1.84 billion for 2020–21, largely as a result of COVID-19 and volatility in the global oil industry. It is a six-month budget to March 2021 and does not provide multi-year fiscal forecasts due to uncertainty related to COVID-19.

Although there were no income tax measures in Budget 2020, it did announce changes to tobacco and fuel taxes. Effective October 1, 2020, the tobacco tax on:

- cigarettes will increase from 24.5¢ each to 29.5¢; and
- fine cut tobacco will increase from 40¢ per gram to 50¢ per gram.

Budget 2020 also announced a new 20% tax on vaping products, although no further details were provided.

Budget 2020 included a federally mandated increase in the provincial carbon tax to $30 per tonne, effective October 1, 2020. This will be partially offset by a two cents per litre reduction in the provincial fuel tax on gasoline. The net result is an increase of 0.21 cents per litre of gasoline and 2.68 cents per litre of diesel.

Nova Scotia

Loan Support To Help Large Tourism Operators (October 16, 2020)

The province is introducing the Tourism Sector Financing Assistance Program, which will provide large operators access to lower-cost financing through a loan backstop. The $50 million program will assist the Nova Scotia tourism sector by providing eligible operators access to debt financing, such as lines of credit or term loans issued by a chartered bank or the Business Development Bank of Canada, at more favourable terms. The amount of the debt cannot exceed $15 million per applicant. The province will guarantee up to 95% of the amount borrowed. The interest rate cannot exceed prime lending rate plus 1.5%. The program does not provide funds directly to the applicants. The program will provide a standby line of credit for the applicant to provide to their financial institution as part of the debt application.

Eligible tourism businesses include resort, tour, and scenic and sightseeing transportation operators with at least 100 full-time and/or seasonal employees and annual revenue of at least $10 million, who have experienced a revenue decline of at least 50% for the period April 1 to July 30, 2020, compared to the same period last year.

The program will be administered by the Nova Scotia COVID-19 Response Council at Dalhousie University. Further information on the program and application form can be found at novascotia.ca/coronavirus/tourism-sector-financing-assistance-program/.

Ontario

Temporary Wage Enhancement for Personal Support Workers (October 1, 2020)

The Ontario government is supporting personal support workers ("PSWs") and direct support workers in the home and community care, long-term care, public hospital, and social services sectors by investing $461 million to temporarily enhance wages. This investment will help the province attract and retain the workforce needed to care for patients, clients, and residents in response to the COVID-19 pandemic.

The province is providing a temporary wage increase effective October 1, 2020, to over 147,000 workers who deliver publicly funded personal support services:

- $3 per hour for approximately 38,000 eligible workers in home and community care;
- $3 per hour for approximately 50,000 eligible workers in long-term care;
- $2 per hour for approximately 12,300 eligible workers in public hospitals; and

- $3 per hour for approximately 47,000 eligible workers in children, community, and social services providing personal direct support services for the activities of daily living.

The temporary wage enhancement will be reviewed on a regular basis and could extend through March 31, 2021, in connection with regulations made under the *Reopening Ontario (A Flexible Response to COVID-19) Act, 2020*.

Québec

Aid for Businesses in Regions at Maximum Alert (October 1, 2020)

The government is improving the Temporary Concerted Action Program for Enterprises ("PACTE") and the Emergency Assistance for Small and Medium-Sized Enterprises ("PAUPME") program to help businesses subject to a shutdown order in the context of the second wave of COVID-19.

A new component of these programs, Aid for Businesses in Regions at Maximum Alert ("AERAM"), will allow businesses targeted by closure orders that will suffer loss of income to obtain non-refundable aid to pay their fixed costs.

The PACT and the PAUPME, set up at the start of the pandemic, continue to apply. AERAM is now added, which takes the form of loan forgiveness, according to the following criteria:

- Loan forgiveness applies to financial assistance granted through PACTE and PAUPME;
- The loan forgiveness will be equivalent to certain fixed costs disbursed for the closing period in question, namely:
  - municipal and school taxes;
  - rent (the portion not covered by another government program);
  - interest paid on mortgages;
  - costs related to public services (e.g., electricity and gas);
  - insurance;
  - telecommunications costs;
  - permits and association fees; and
- The forgiven amount may not exceed 80% of the loan amount or $15,000.

Filing Extension for Some Business Tax Credits (September 30, 2020)

Revenu Québec is postponing, to December 31, 2020, the deadline for filing requests for refundable tax credits intended for businesses, requests relating to the non-refundable tax credit for international financial centers, and the non-refundable tax for the development of e-business, as well as requests for the deduction of expenses incurred for scientific research and experimental development, when the deadline would have otherwise been after March 16, 2020, but before December 31, 2020.

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.

AgraCity Ltd. and 101072498 Saskatchewan Ltd. v. Her Majesty the Queen, 2020 DTC 1066 (Tax Court of Canada)

The *Agracity Ltd and 101072498 Saskatchewan Ltd v. Her Majesty the Queen* appeal in the Tax Court of Canada ("TCC") dealt with a transfer pricing arrangement involving the importation of ClearOut, a generic brand of herbicide, to customers in Canada.

Facts

The Farmers of North America group of companies ("FNA Group") was established to assist Canadian farmers in

improving profitability. The FNA Group undertook to act as an agent to promote the availability of ClearOut under a programme administered by Health Canada known as the Own Use Import ("OUI") program. Originally organized in 2005 using a US corporation ("NewAgco US") to act as the US wholesaler, the activities of NewAgco US were transferred to NewAgco Inc. ("NewAgco Barbados"). NewAgco Barbados acquired all of its ClearOut inventory from an arm's length supplier and determined the selling price on the basis of its costs plus a markup for profit.

NewAgco Barbados entered into a services agreement with AgraCity Ltd. ("AgraCity"), a corporation related to NewAgco Barbados, whereby AgraCity provided logistical and related activities of its sales and deliveries to the Canadian buyers. Between the FNA Group promoting the OUI program to its group members and AgraCity carrying out many of the administrative duties, the Minister of National Revenue (the "Minister") asserted that NewAgco Barbados had little activity to carry out.

Reassessments

The Minister reassessed AgraCity for its 2007 and 2008 taxation years under paragraphs 247(2)(*a*) and (*c*) of the *Income Tax Act* (the arm's length test) for an amount equal to all of the NewAgco Barbados profits from the sale of ClearOut to FNA Group members. AgraCity ultimately appealed the reassessments to the TCC and, as the hearing progressed, the Minister amended her reply to support the position that the transactions were a sham, or alternatively that the transfer pricing provisions in paragraphs 247(2)(*b*) and (*d*) applied to re-characterise the transactions; and failing that, that the transfer pricing provisions in paragraphs 247(2)(*a*) and (*c*) applied to permit a transfer pricing adjustment. Penalties under subsections 247(3) (transfer pricing penalties) and 163(2) (penalties for making a false statement or omission) were also assessed.

TCC findings

Sham

In finding that the arrangement entered into by the appellants was not a sham, the TCC noted that the evidence short of establishing that:

(1) the parties to the transaction sought to present that the legal rights and obligations of the parties were different from what they knew or understood, and

(2) any of those parties sought to deceive anyone.

Transfer Pricing Recharacterisation

The original reassessments lacked factual assumptions in the respondent's amended reply to support its position that arm's length parties would not have entered into the transactions.

The respondent's expert witness prepared a report shaped to support adjustments under paragraphs 247(2)(*a*) and (*c*) and provided little support for adjustments under paragraphs 247(2)(*b*) and (*d*).

The TCC observed that the absence of evidence supporting the position that arm's lengths parties would not have entered into the agreement was sufficient reason to dismiss this line of reasoning given the findings that NewAgco Barbados had assets and resources, and had assumed real risks. In addition, the respondent's expert witness admitted that, subject to proper pricing, the services agreement was a contract to which arm's length parties would agree to enter into with different pricing.

Transfer Pricing Adjustment

While the respondent's expert provided evidence in support of the adjustments under paragraphs 247(2)(*a*) and (*c*), he failed to consider foreign exchange, product liability, or other risks borne by NewAgco Barbados. The respondent's expert was unable to explain why an arm's length party to this kind of transaction would agree to be paid nothing when legally assuming real risk.

The appellant's expert witness provided evidence in support of the service fee comparing to arm's length examples and concluded that a margin of 5 and 15 per cent over costs is reasonable (the cost plus method is acceptable when comparable uncontrolled arm's length prices are unavailable). After adjusting for fees paid to it by the FNA Group, the return to AgraCity was approximately 12 per cent, which is at the high end of the 5 to 15 per cent range.

The TCC noted that the evidence was not without its limitations, but the appellant's evidence was the best evidence available to the TCC and was within the range of what comparable arm's length parties would earn. Accordingly, the TCC concluded that the respondent had failed to establish its submissions and found in favour of the appellant.

Penalties

The appellants were successful at defeating the argument of sham, the transfer pricing re-characterisation, and the transfer pricing adjustment. Accordingly, the penalties assessed under subsections 247(3) and 163(2) could not be supported and were also dismissed.

— Larry Nevsky CPA LLB and Mark H Woltersdorf FCPA, LLB

Barejo Holdings ULC v. Canada, 2020 DTC 5023 (Federal Court of Appeal)

Background

Saint-Lawrence Trade ("SLT"), an open-ended investment corporation incorporated in the British Virgin Islands, was a controlled foreign affiliate ("CFA") of Barejo Holdings ULC ("Barejo"), a Canadian-controlled private corporation. An open-ended investment company operates similarly to a North American mutual fund, as it pools investors' money by issuing shares, and then invests the equity into a portfolio. SLT sold ownership of its assets to a non-resident affiliate of each of The Bank of Nova Scotia ("BNS") and Toronto Dominion Bank ("TD"). Using the proceeds from the sale, SLT acquired a banknote from a non-resident subsidiary of each of BNS and TD (together, the "Notes").

The Notes were purchased for US$498 million each, representing the "Reference Assets Net Asset Value" at the time — a value that constantly fluctuates, to reflect variability within the investment portfolio. The Notes included a maturity date and a variable settlement amount based on value, and were guaranteed by BNS and TD, respectively.

Issue

Barejo was reassessed pursuant to the Foreign Accrual Property Income ("FAPI") provisions and the Offshore Investment Foreign Property ("OIFP") rules. Under the FAPI provisions, Canadian taxpayers are attributed their proportionate share of FAPI earned by a CFA. OIFP operates similarly, but imputes income on Canadian taxpayers who hold property through a non-resident entity that is not a controlled foreign affiliate. In sum, the crux of the issue that was brought before the Tax Court of Canada ("Tax Court"), and subsequently the Federal Court of Appeal ("FCA"), was whether the Notes held by SLT were an interest in an OIFP; or more specifically, whether the Notes constitute a "debt" for the purposes of paragraph 94.1(1)(*a*) of the *Income Tax Act* (the "Act").

Tax Court of Canada

The Tax Court answered this question affirmatively, holding that there are four essential characteristics of a debt for the purposes of the Act, all of which the Notes met. These are:

(1) An amount or credit is advanced by one party to another;

(2) An amount is to be paid or repaid by that other party upon demand or at some future point set out in the agreement in satisfaction of the other party's obligation in respect of the advance;

(3) The amount described above is fixed or determinable or will be ascertainable when the payment is due; and

(4) There is an implicit, stipulated, or calculable interest rate (which can include zero).

Federal Court of Appeal

On appeal, Barejo's primary argument focused on the third characteristic, insisting that not only were the amounts to be paid under the Notes unknown and would only become known when payment was due, but that it was also unknown whether the issuing banks would ultimately have any obligation to pay (i.e., in the event of a dramatic market downturn). Barejo also submitted textual and purpose-related arguments; however, neither were given any significant consideration by the FCA.

In regard to Barejo's primary argument, the FCA found that Barejo would need to produce some evidence of the "financial frailty" of the Notes to support their position, and noted that, contrary to their position, the Notes were

guaranteed by BNS and TD and enjoyed the protection of an early termination clause if recession was imminent.

The FCA's textual analysis of section 94.1 of the Act found that excluding the Notes from the ambit of a debt because their value is not contemporaneously ascertainable is directly opposed to the wording in the Act, which explicitly includes instruments that have their value derived from "portfolio investments". The same determination was reached regarding the purpose of this section, with the FCA finding that to interpret the word "debt" so as to exclude the Notes because they derive their value from assets that fluctuate whereas shares and interests qualify only because they derive their value from the same fluctuating assets "defeats that objective and provides for an absurd result".

Conclusion

In sum, the FCA concluded that a debt arises for the purposes of section 94.1 of the Act when "an amount or credit is advanced by one party to another party; an amount is to be paid or repaid by that other party at some point in the future in satisfaction of the advance and this amount is fixed or determinable or will be ascertainable when payment is due." The FCA also clarified its position, commenting that the Tax Court's fourth prescribed characteristic of a debt — that there be an interest component — is not required under civil law or common law and nothing in section 94.1 suggests that interest must be present for a debt to exist under that provision.

— *Keaton Buchberger*

Gladwin Realty Corporation v. Her Majesty the Queen, 2020 DTC 5074 (Federal Court of Appeal)

Gladwin is a recent Federal Court of Appeal decision involving the general anti-avoidance rule ("GAAR") (subsection 245(2) of the *Income Tax Act*, RSC 1985, c. 1 (5th Supp) (the "Act")). Gladwin Realty Corporation ("Gladwin") engaged in a series of transactions in 2007 and 2008, which allowed it to inflate its capital dividend account ("CDA") and pay a capital dividend to its corporate shareholder equal to the full value of the underlying capital gain. The Canada Revenue Agency ("CRA") issued a notice of determination cutting Gladwin's CDA in half, limiting the value of the capital dividend. Gladwin appealed but the matter was dismissed at the Tax Court of Canada and unanimously at the Federal Court of Appeal.

Facts

Gladwin transferred real estate assets (the "Assets") to a newly formed partnership, which disposed of the Assets and realized a capital gain of $24 million (all figures approximate). Gladwin received a distribution of $24 million from its corporate shareholder, causing the adjusted cost base ("ACB") of Gladwin's partnership interest to become negative $24 million. This caused a deemed capital gain ($12 million) that was added to CDA. The partnership allocated the capital gain from the disposition of the Assets to Gladwin, resulting in another $12 million CDA increase. Gladwin used the CDA to pay a capital dividend of $24 million to its corporate shareholder. Gladwin later elected to realize a capital loss of $24 million pursuant to subsection 40(3.12) — an amount equal to the gain it realized pursuant to subsection 40(3.1) — to offset the deemed capital gain against the allocated capital gain which decreased its CDA to negative $12 million. After the transactions, Gladwin and the partnership ceased operations, trapping the negative CDA balance.

Decision of the Tax Court of Canada

The only issue on appeal was whether the series of transactions was abusive. Hogan J found that the CDA regime was created to achieve integration of capital gains so that the tax-free portion of a capital gain would flow to the individual taxpayer. He found that the negative ACB rules were created to stop taxpayers from extracting tax-free funds in excess of their investments in partnerships. In conclusion, he decided that the result achieved by Gladwin was inconsistent with the rationale of the CDA regime and the negative ACB rules.

Decision of the Federal Court of Appeal

Noel CJ redefined the issue but remained focused on whether the series of transactions was abusive. He found that Gladwin's use of the negative ACB rules to elect a capital loss after declaring a capital dividend was not objectionable in and of itself. However, he determined that the payment of an extra $12 million in capital dividends and the permanent CDA deficit were specific steps that achieved over-integration. In making his decision Noel CJ said, "a plan

that deliberately sets out to create a permanent $12,000,000 CDA deficit in order to extract a commensurate tax-free dividend breaks the integrity of the CDA regime" (para. 85).

The CDA is a notional account used to calculate the value of tax-free capital dividends that a corporation can issue. The CDA is intended to facilitate integration by allowing the tax-free portion of capital gains to flow through a corporation to non-corporate shareholders tax-free (paras. 56 – 62).

The negative ACB rules for partnerships consist of two parts. The first is an anti-avoidance provision that levies tax when a partnership interest has a negative ACB. The second is a relieving provision that deems an offsetting loss if the ACB becomes positive. The intention is to deter abuse while mitigating the potentially harsh deemed gain with a deemed loss in circumstances where ACB may fluctuate (paras. 63 – 64).

Noel CJ also highlighted the following principles in his analysis:

- using an anti-avoidance provision to achieve a benefit is not necessarily abusive (paras 67 – 69); and
- abuse must be grounded in the frustration of the underlying rationale of a provision of the Act — not the overall effect of the series of transactions (para 70).

Due to a 2013 amendment to the Act, the planning used by Gladwin is no longer possible because taxpayers may no longer include a deemed gain/loss from the negative ACB rules when calculating CDA.

— *James Konopka*

Valovic v. The Queen, 2020 DTC 1072 (Tax Court of Canada)

Background

The decision in *Valovic v. The Queen* (2020 DTC 1072) reaffirms the principle that dividend payments can only be related to the shareholding and cannot be used as consideration for prior services provided to the corporation.

Mr. and Mrs. Valovic (the "Valovics") were equal shareholders of Ivan's Electric Limited ("Ivan's Electric"). Ivan's Electric employed both the Valovics: Mr. Valovic was an electrician and was responsible for the majority of the electrical work undertaken, while Mrs. Valovic was responsible for the administrative work and bookkeeping.

From 1995 to 1997, the Valovics received salaries from Ivan's Electric. In 1998, Ivan's Electric began paying a combination of employment income, business income, and dividend income. The Valovics received dividends from Ivan's Electric during taxation years that Ivan's Electric was liable for amounts owing under the *Income Tax Act* (the "Act").

The Minister of National Revenue (the "Minister") assessed the Valovics under section 160 of the Act for the transfer of property, the dividends, to a non-arm's length entity at less than fair market value. As a result, the Valovics were jointly and severally liable for the amounts owing by Ivan's Electric in respect of the outstanding corporate tax liability.

The Valovics argued that the dividends were consideration for the services the Valovics provided to Ivan's Electric, and that the provided services had a fair market value, at a minimum, equal to the dividends they received.

The Valovics stated the mix of payments they received was determined by their accountant, Mr. Hill, with the intent to compensate the Valovics for their services to Ivan's Electric. The Valovics were unaware of why the nature of the payments changed from salary to a combination of salary, dividends, and other payments, but were acting on the advice of Mr. Hill.

Lastly, the Valovics asserted that although the method of compensation may have changed to a combination of salary, business income, and dividends, the aggregate amounts paid were consideration for the services that they provided.

Tax Court Decision

The primary issue on appeal was whether, in accordance with section 160, the Valovics provided consideration for the dividends with a fair market value equal to or greater than the dividend amounts they received.

The Court determined that section 160 of the Act was satisfied and the assessment of the Valovics pursuant to section 160 was upheld,[1] such that the Valovics were jointly and severally liable with Ivan's Electric for the outstanding tax liability of Ivan's Electric. Concurring with the previous Supreme Court of Canada *Neuman v. MNR* (98 DTC 6297)

[1] Subject to an adjustment relating to the amount of the underlying corporate tax liability.

decision, the Tax Court and Federal Court of Appeal have consistently rejected the position, including under section 160, that dividends are valid consideration for prior services, and here Justice Monaghan concurred with those decisions.

Justice Monaghan agreed with the Minister that the services provided were not valid consideration for the dividends the Valovics received from Ivan's Electric. In the Court's view, citing *Neuman*, dividends are a gratuitous payment that can only be related to a *shareholding* and not to any other consideration the shareholder may provide. Even if the Court accepted that the dividends were paid as *de facto* compensation for their services in lieu of employment income, this was irrelevant and the appeal of the application of section 160 must fail.

Of particular interest is that Justice Monaghan expressly rejected an argument that section 160 should recognize the "economic reality" of the payment. The "economic reality" of a dividend is relevant for the tax on split income ("TOSI") rules, which provide for unfavourable tax consequences on payments of "split income" (such as dividends) where the dividend exceeds the economic contribution of the family member receiving the payment. It seems reasonable for a taxpayer to assume that, if they can only receive dividends commensurate to their contribution without offending the TOSI rules, then that same contribution should be taken into account for purposes of applying section 160.

Conclusion

In summary, the Tax Court found that the dividends paid by Ivan's Electric were not paid in exchange for consideration for purposes of section 160 of the Act and held that dividends can only be related to a shareholding. Consideration provided to the corporation is an inappropriate justification for the payment of a dividend, and payment of the dividend can lead to joint and several liability if the dividend-paying corporation has an outstanding tax liability.

— *Adam Kotlowitz*

CURRENT ITEMS OF INTEREST

Per-Kilometer Rates

When claiming travel costs for the medical expense tax credit, the moving expense deduction, and the northern residents deduction, taxpayers can use the simplified method to compute the amount of the claim by multiplying the total distance traveled by a per-kilometer rate. The rates for the 2020 tax year are as follows:

Province/Territory	Cents/km (taxes included)
Alberta	47.0
British Columbia	52.0
Manitoba	49.5
New Brunswick	50.5
Newfoundland and Labrador	54.5
Northwest Territories	59.5
Nova Scotia	51.0
Nunavut	59.0
Ontario	55.0
Prince Edward Island	49.0
Québec	52.0
Saskatchewan	49.0
Yukon	58.0

Ontario Real Estate Professionals Can Incorporate

On October 1, 2020, the Ontario government announced the first phase of regulatory changes related to the *Trust in Real Estate Services Act, 2020* ("TRESA"). Among these changes, the government is allowing real estate professionals to

incorporate and be paid through Personal Real Estate Corporations ("PRECs"). A PREC is a corporation that meets certain prescribed criteria which are provided under O. Reg. 536/20 (see https://www.ontario.ca/laws/regulation/r20536).

RECENT CASES

Unreported amounts added to taxpayer's income

The taxpayer's business involved the provision of online penny auctions via a website. On reassessment, the Minister added unreported amounts to the taxpayer's income and imposed penalties for gross negligence. On appeal to the Tax Court of Canada, the taxpayer argued, in part, that: (a) the amounts added to his income lacked the quality of income, and hence were not taxable; and (b) these amounts were paid to the taxpayer to cover his expenses, such as buying products for auction.

The taxpayer's appeal was dismissed. The taxpayer's argument that the unreported amounts in issue lacked the quality of income was untenable. Also, the gross negligence test is an objective test to be assessed by taking into account the expected conduct of a reasonable person in the same circumstances. In this case, the taxpayer's conduct showed a marked and substantial departure from the expected conduct of a reasonable businessperson in the same circumstances. The Minister's reassessment, including the penalties for gross negligence, was affirmed accordingly.

Wood v. The Queen

2020 DTC 1062

TAX NOTES

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