Tax Notes

July 2023
Number 726

The *Select Luxury Items Tax Act* 4

Current Items of Interest 6

Focus on Current Cases 8

Recent Cases 8

Wolters Kluwer

DEANS KNIGHT INCOME CORP. V. CANADA AT THE SUPREME COURT: GAAR REVISITED

— *Peter Tomlinson, Wolters Kluwer Canada*

On November 2, 2022, the Supreme Court of Canada heard arguments in *Deans Knight Income Corp. v. Canada* ("*Deans Knight*"), an appeal from 2021 DTC 5095 (FCA), which was an appeal from 2019 DTC 1059 (TCC). The Court released its long-anticipated decision on May 26, 2023 (2023 DTC 5041).

Deans Knight concerns the application of the General Anti-Avoidance Rule ("GAAR") in section 245 of the *Income Tax Act* ("Act"). Following recapitalization and restart transactions in 2008 and 2009,[1] the taxpayer deducted accumulated and unclaimed non-capital losses, scientific research and experimental development expenditures, and investment tax credits that technically avoided the acquisition of control restriction in subsection 111(5).

Facts

Paragraph 111(1)(*a*) of the Act allows a taxpayer's non-capital losses to be carried back or forward to different taxation years to offset income in those years. However, subsection 111(5) restricts non-capital loss carryovers for a corporation if control of the corporation has been acquired by a person or group of persons — *unless* it continues the same or similar business that incurred the losses. "Control" has been interpreted as referring to *de jure* control: whether the controlling party enjoys, by virtue of its shareholdings, the ability to elect the majority of the board of directors. Subsection 111(5) is an example of the principle of "continuity" in the taxation system — only the taxpayer who suffers the loss is entitled to deduct the loss.

Prior to the transactions in issue, Deans Knight Income Corp. was operating as Forbes Medi-Tech Inc. ("Forbes"). Forbes was a Canadian public corporation with shares listed on the Toronto Stock Exchange and Nasdaq. Most importantly, it had approximately $90 million of unused non-capital losses, scientific research and experimental development tax expenditures, and investment tax credits which it hoped to monetize.

Forbes was in severe financial difficulty in 2007 — it faced a potential delisting from the Nasdaq — and did not have income which its losses could offset. It entered into an investment agreement ("Investment Agreement") with a venture capital company, Matco Capital Ltd. ("Matco"), and a complex arrangement was devised to take advantage of the loss carryover deduction in paragraph 111(1)(*a*) without triggering the restriction in subsection 111(5).[2]

[1] The arrangement occurred before section 256.1 was added to the Act in 2013 to mitigate this sort of planning.

[2] Before the Investment Agreement was executed, Matco's managing director purchased 100 shares of Forbes from Newco through a holding company to ensure the agreement would not constitute a unanimous shareholder agreement.

First, in 2008 Forbes' assets and liabilities were transferred to a new parent company, 0813361 B.C. Ltd. ("Newco"). Forbes was then wholly owned by Newco. Forbes' former business was also moved to Newco, and it was then stripped down to its tax attributes.

Second, Matco purchased a $3 million debenture convertible into 35% of the voting shares and 100% of the non-voting shares Newco held in Forbes (a total of 79% of Forbes' equity). The Investment Agreement conferred additional rights on Matco. Other than when acting pursuant to the Investment Agreement, Newco and Forbes' activities were severely restricted. While not obliged to do so, Newco could sell its remaining shares in Forbes to Matco (65% of the voting shares of Forbes) for a guaranteed minimum amount of $800,000. However, practically speaking, there was little choice but to sell these shares.

Third, Matco undertook to find a new business venture for Forbes, which would be used to raise money through an initial public offering ("IPO"). The profits from the IPO could then be sheltered by the tax attributes Forbes initially could not utilize.

Matco found a mutual fund management company, Deans Knight Capital Management, that agreed to use Forbes for an IPO through which it would raise money to invest in high-yield debt instruments. Forbes' name was then changed to Deans Knight Income Corp. ("Deans Knight").

Immediately before the IPO, Matco converted its debenture into 35% of Deans Knight's voting shares and 100% of its non-voting shares. Immediately after the IPO, Matco purchased Newco's remaining 65% of the voting shares in Deans Knight.

The IPO and subsequent investment business succeeded, and Deans Knight deducted much of its non-capital losses — approximately $65 million — to reduce its tax liability from the debt-securities business.

In 2014, the Canada Revenue Agency reassessed Deans Knight's 2009, 2010, 2011, and 2012 taxation years under GAAR and denied access to the non-capital losses. Deans Knight objected to the reassessments and appealed to the Tax Court of Canada.

Justice Paris of the Tax Court found that, ". . .the object, spirit, and purpose of subsection 111(5) is to target manipulation of losses of a corporation by a new person or group of persons, through effective control over the corporation's actions."[3] While he determined these were tax avoidance transactions that resulted in a tax benefit, they were not abusive according to GAAR:

> . . . the circumstances . . . do not, in my view, indicate that Matco had effective control over the majority of the voting shares of the Appellant [Deans Knight] prior to the IPO and I find that the Avoidance Transactions do not amount to abuse of subsection 256(8) and paragraph 251(5)(*b*) of the Act.[4]

Justice Paris allowed the appeal.

The Crown appealed Justice Paris' decision to the Federal Court of Appeal, which overturned the Tax Court's judgment. The Appellate Court interpreted subsection 111(5) more expansively than Paris J., writing that:

> . . . the object, spirit and purpose of subsection 111(5) is, at least in part, to restrict the use of specified losses, including non-capital losses, if a person or group of persons has acquired actual control over the corporation's actions, whether by way of *de jure* control or otherwise.[5]

The Federal Court of Appeal concluded the Investment Agreement resulted in the handing over of actual control of Deans Knight to Matco, that the transactions were abusive, and the GAAR applied to deny the tax benefits:

> . . . the avoidance transactions circumvent subsection 111(5) of the Act in a way that frustrates the object, spirit and purpose of this provision. Accordingly, pursuant to subsection 245(2) of the Act, the tax benefit should be denied.[6]

Deans Knight appealed this decision to the Supreme Court of Canada.

Decision of the Supreme Court of Canada

Writing for the 7–1 majority,[7] Rowe J. first reviewed the steps of a GAAR analysis, which involves a structured, three-part test:

(1) Was there a tax benefit?

(2) Was the transaction giving rise to the tax benefit an avoidance transaction?

(3) Was the transaction giving rise to the tax benefit abusive?

[3] *Deans Knight Income Corporation*, 2019 DTC 1059 (TCC), para. 134.

[4] *Deans Knight Income Corporation*, 2019 DTC 1059 (TCC), para. 166.

[5] *Deans Knight Income Corporation*, 2021 DTC 5095 (FCA), para. 93.

[6] *Deans Knight Income Corporation*, 2021 DTC 5095 (FCA), para. 114.

[7] Côté J., in dissent, would have allowed the appeal and restored the Tax Court's judgment.

There is a further two-step process for determining whether a transaction is abusive:

(i) The court determines the object, spirit, and purpose of the relevant provisions of the Act, reading the Act as a whole.

(ii) Does the transaction frustrate that object, spirit, and purpose?

Steps (1) and (2) were met: there was a tax benefit and an avoidance transaction. The Supreme Court moved on to assessing the object, spirit, and purpose of subsection 111(5).

Counsel for Deans Knight argued that the object, spirit, and purpose of subsection 111(5) is to restrict loss carryovers only if there is an acquisition of *de jure* control. Parliament could have enacted a *de facto* control test to subsection 111(5) but did not do so. The *de jure* requirement brings certainty to the issue of acquisition of control the *de facto* standard lacks.

Counsel for the Department of Justice took the position that the object, spirit, and purpose of subsection 111(5) is to deny losses in situations where there is a functional equivalence to an acquisition of *de jure* control.

Rowe J. outlined the Court's approach to interpreting subsection 111(5):

> . . . The object, spirit and purpose of the provisions has been referred to as the "legislative rationale that underlies specific or interrelated provisions of the Act" . . .
>
> . . . it is critical to distinguish the *rationale* behind a provision from the *means* chosen to give that rationale effect within the provision. The drafting process reflects the task of translating government aims into legislative form in order to create intelligible, legally effective rules . . . However, the means do not necessarily provide a full answer as to *why* the provision was adopted . . . Parliament is seeking to establish a general standard that is most faithful to its objectives from the options which are available and practicable. But even the most carefully drafted provision can be abused, which is why the GAAR exists to protect the provision's underlying rationale.[8]

Consequently, per Rowe J., "The object, spirit and purpose of subsection 111(5) of the Act is to prevent corporations from being acquired by unrelated parties in order to deduct their unused losses against income from another business for the benefit of new shareholders."[9] As for the distinction between *de jure* and *de facto* control as the test for activating subsection 111(5), the Court stated that the *de jure* control test does not sufficiently capture the object, spirit, and purpose of subsection 111(5).

Deans Knight underwent a fundamental transformation that achieved the outcome Parliament sought to prevent while narrowly circumventing the text of subsection 111(5). As a result, Matco acquired the power of a majority voting shareholder and fundamentally changed Deans Knight's assets, liabilities, shareholders, and business without triggering an "acquisition of control", but using the "functional equivalent" of such an acquisition of control. The losses were then used for the benefit of an unrelated party to shelter the profits of a business that completely differed from that which generated the losses. This severed the continuity at the heart of the object, spirit, and purpose of subsection 111(5) and frustrated its rationale.

Avoidance transactions will be abusive where the outcome or result:

- is an outcome the provisions relied on seek to prevent;
- defeats the underlying rationale of the provisions relied on; or
- circumvents certain provisions in a manner that frustrates their object, spirit, and purpose.

Consequently, Deans Knight's avoidance transactions constituted abuse, and the Court applied GAAR to deny the tax benefits and dismissed Deans Knight's appeal.

Implications

In the seminal case *Commissioners of Inland Revenue v. Duke of Westminster*, Lord Tomlin averred: "Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be."[10] However, the "Duke of Westminster Principle" is not absolute, and Parliament can deviate from it, as Canada's Parliament has done through GAAR.

[8] *Deans Knight*, para. 58–59.

[9] *Deans Knight*, para. 113.

[10] *Commissioners of Inland Revenue v. Duke of Westminster*, [1936] A.C. 1 (H.L.), p. 19.

With *Deans Knight*, the Supreme Court's abuse analysis focused on the timeless legal dilemma: the spirit of the law versus the letter of the law. The Court emphasized the "rationale behind" subsection 111(5), rather than "the means chosen to give that rationale effect", by analysing the text, context, and purpose of the provision. As Rowe J. observed, ". . . specific and carefully drafted provisions are not immune from abuse. As with any other provision, the GAAR ensures that the rationale behind such provisions is not frustrated by abusive tax strategies."[11]

Rowe J. acknowledged the imperfect result of distilling complex rules into the written word, which may result in ambiguity: "Some uncertainty is unavoidable when a general rule is adopted . . . However, a reasonable degree of certainty is achieved by the balance struck within the GAAR itself."[12]

The issue of uncertainty in the law was raised by Deans Knight's counsel, and Justice Côté in her dissent addressed Justice Rowe's majority judgment directly on this point:

> . . . it requires a great leap in logic to infer that Matco "acquired" Deans Knight. Such a leap would create uncertainty as to what exactly constitutes abuse: at what point does "tak[ing] the reins" of a corporation result in the acquisition of that corporation (Rowe J.'s reasons, at para. 118)? Under my colleague's approach, the existence of abusive tax avoidance is, at best, unclear.[13]

In *Copthorne Holdings Ltd. v. Canada*, Justice Rothstein of the Supreme Court emphasizes that section 245 was enacted "as a provision of last resort".[14] He also warns that: ". . . determining the rationale of the relevant provisions of the Act should not be conflated with a value judgment of what is right or wrong nor with theories about what tax law ought to be or ought to do."[15]

Currently, section 256.1 of the Act precludes the particular transactions undertaken by Deans Knight and its associates, as well as other "loss trading" transactions, but the reasoning in the Supreme Court's judgment could potentially impact many transactions. Along with the proposed amendments in Budget 2023, the application of GAAR continues to evolve.

THE *SELECT LUXURY ITEMS TAX ACT*

— Jacques Roberge, Senior Technical Writer, Wolters Kluwer Canada

The *Select Luxury Items Tax Act*[a] (the "Act") came into force on September 1, 2022. It is a new act separate from the income tax, GST/HST, and excise taxing statutes, and so applies separately and in addition to any income tax, GST/HST, or customs duties that might apply.

Pursuant to sections 9 and 34 of the Act, "subject vehicles" and "subject aircraft" valued over a threshold amount of $100,000 will be taxed at the lesser of:

- 10% of the taxable amount of the vehicle or aircraft; and
- 20% of the amount above the price threshold.

Similarly, "subject vessels" (boats) valued over $250,000 are taxed at the lesser of:

- 10% of the taxable amount of the vessel; and
- 20% of the total price above $250,000.

"Subject vehicle" means a motor vehicle that:

- has a manufacturing date after 2018;
- is designed primarily to carry individuals on highways and streets;
- has a seating capacity of not more than 10 individuals;
- has a gross vehicle weight of 3,856 kilograms or less; and
- is designed to travel with four or more wheels in contact with the ground.

---

[11] *Deans Knight*, para. 72.

[12] *Deans Knight*, para. 48.

[13] *Deans Knight*, para. 196.

[14] *Copthorne*, para. 66.

[15] *Copthorne*, 2012 DTC 5007 (SCC), para. 70.

[a] S.C. 2022, c. 10, s. 135. All references to sections herein are to this Act except where otherwise noted.

Ambulances, hearses, vehicles equipped for police or emergency response activities, and recreational vehicles designed to provide temporary residential accommodation are excluded from the definition.

A "subject aircraft" is an airplane, glider, or helicopter manufactured after 2018 which is equipped with one or more pilot seats and up to 39 passenger seats.

An aircraft equipped for military activities or solely for carrying goods is not subject to the luxury tax.

"Subject vessel" means a boat with a manufacturing date after 2018 which is designed for leisure, recreation, or sport activities. Generally, floating homes, commercial fishing vessels, ferries, and cruise ships are not included in the definition.

The Act provides that the luxury tax applies to manufacturers, wholesalers, retailers, and importers of vehicles, aircraft, or vessels within the tax regime's scope which are priced above the relevant price thresholds. They are required to register with the Canada Revenue Agency ("CRA") as vendors. Presumably, the tax will be passed on to the purchaser of the subject vehicle, aircraft, or vessel.

Registration must be made by the day the sale is completed. In the case of an importation, registration is required by the day the subject item is accounted for under section 32 of the *Customs Act*.

If the CRA has reason to believe that a person was required to register but did not, it may notify the person in writing that it is proposing to register that person as a vendor. If the person neither applies for registration nor proves that they are not required to register, the CRA may register the person as a vendor 60 days after the notice was sent.

If a person required to be registered has not applied for registration as and when required, they may be liable to pay a penalty of $2,000 under section 109. Meanwhile, an importer required to be registered which has not applied for registration is liable to a penalty under section 114, in addition to any other penalty. The penalty will be $1,000 or 50% of the amount of the luxury tax payable, whichever is greater.

The luxury tax will also apply if a person provides the right to use a subject vehicle which has not been previously registered with a taxable amount exceeding the price threshold to another person under a lease, licence, or similar arrangement. In addition, the luxury tax will apply if a person ceases to be a registered vendor of subject vehicles and holds any tax-free inventory of subject vehicles valued above the price threshold.

The luxury tax could apply when improvements are made to subject vehicles, as set out in sections 29 to 32. According to subsection 8(1), an improvement to a subject vehicle is the provision of either:

- tangible personal property that is installed in/on or affixed to the subject vehicle; or
- a service that modifies the subject vehicle and is physically performed on the subject vehicle.

Improvements made to subject vehicles include car modifications. Examples of improvements made to a subject vehicle include stereo system installations, body kit installations, engine upgrades, vehicle wrap installations, and window tinting services.

The luxury tax on improvements will typically only apply to improvements made to subject vehicles that were already subject to the luxury tax. However, in the event that improvements are made in connection with the sale of a subject vehicle, the calculation of the luxury tax payable on the sale of the subject vehicle would take into account the cost of the improvements.

The luxury tax on improvements will apply to improvements that total at least $5,000 made during the "improvement period" of the subject item (vehicle, aircraft, or vessel) as determined under paragraphs 29(1)(*a*) (for sales) and 30(1)(*a*) (for importation). The luxury tax on improvements will be payable on the day following the improvement period.

For sales, the improvement period essentially begins on the day that an agreement for sale by the vendor is entered into, and ends on:

- if the subject item is subsequently sold to another person that deals at arm's length with the initial purchaser and the sale is completed within one year of the initial sale, the day on which the second sale is completed; and
- in any other case, one year after the initial sale.

For importation, the improvement period starts on the day tax becomes payable and doesn't exceed a year after this day.

Under subsection 8(2), the following improvements are not subject to the luxury tax:

- any repair, cleaning, or maintenance service performed on a subject item (vehicle, aircraft, or vessel);
- the provision of tangible personal property to a subject item to replace other tangible personal property that is damaged, defective, or non-functioning;
- any improvement relating to a child safety seating system or a child safety restraint system on a subject vehicle;
- any improvement to a subject vehicle relating to a trailer or camper;
- any improvement that specially equips or adapts a subject vehicle for its use by, or in transporting, an individual using a wheelchair;
- any improvement that specially equips or adapts the subject vehicle with an auxiliary driving control to facilitate the operation of the subject vehicle by an individual with a disability.

Registered vendors and persons who are required to be registered under the Act should report their luxury tax payable for each reporting period on Form B500, *Luxury Tax and Information Return for Registrants*. Registered vendors and persons who are required to be registered under the Act must file Form B500 with the CRA for every reporting period, even if they do not have luxury tax payable.

Persons who are not registered and not required to be registered under the Act should report their luxury tax payable for each reporting period on Form B501, *Luxury Tax and Information Return for Non-Registrants*. Persons who are not registered and not required to be registered are only required to file Form B501 with the CRA for each reporting period where they have luxury tax payable.

In most cases, returns may be filed by mail or electronically; however, the CRA could require certain persons to file electronically.

Every person who is required to file returns must keep all records necessary to determine their tax liabilities and obligations for a period of six years from the end of the year to which the records relate.

In general, the reporting period of a person is a calendar quarter. The return must be filed by the end of the month that follows the end of a reporting period, and any amount owing for the reporting period is also due at that time.

CURRENT ITEMS OF INTEREST

Federal Government Begins Transfer Pricing Consultation

As was initially promised in Federal Budget 2021, the Department of Finance has launched a new consultation with an aim to modernize and reform Canada's transfer pricing rules. The proposal is intended to align the application of the arm's length principle in Canada's tax transfer pricing rules with the current international standard.

The consultation paper includes draft legislative proposals that would make various amendments to section 247 of the *Income Tax Act*. The paper outlines 23 questions with respect to which the government is seeking input.

The paper also considers administrative reforms pertaining to the following:

- Exemptions for transactions below a *de minimis* threshold and small taxpayers;
- Safe harbour interest rates;
- Hard-to-value intangibles;
- Information recommended to be included in the local file; and
- Information recommended to be included in the master file.

The consultation's closing date is July 28, 2023. The consultation paper can be accessed at www.canada.ca/en/department-finance/programs/consultations/2023/transfer-pricing-consultation/consulation-on-reforming-and-modernizing-canadas-transfer-pricing-rules.html#appendix-a.

Interest Rates for the Third Calendar Quarter

The CRA announced the prescribed annual interest rates that will apply to any amounts owed to the CRA and to any amounts owed by the CRA to individuals and corporations. These rates will be in effect from July 1, 2023, to September 30, 2023. The rates are unchanged from the previous quarter, except for the rate for corporate taxpayers' pertinent loans or indebtedness. The rates for income tax purposes are:

- The interest rate charged on overdue taxes, Canada Pension Plan contributions, and employment insurance premiums will be 9%.
- The interest rate to be paid on corporate taxpayer overpayments will be 5%.
- The interest rate to be paid on non-corporate taxpayer overpayments will be 7%.
- The interest rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans will be 5%.
- The interest rate for corporate taxpayers' pertinent loans or indebtedness will be 8.44%.

Progress Of Legislation

Bill C-47, *Budget Implementation Act, 2023, No. 1*, received Royal Assent on June 22, 2023.

Bill C-241, *An Act to amend the Income Tax Act (deduction of travel expenses for tradespersons)*, is currently being considered by the Standing Senate Committee on National Finance.

Bill C-49 received First Reading on May 30. The bill is titled *An Act to amend the Canada-Newfoundland and Labrador Atlantic Accord Implementation Act and the Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act and to make consequential amendments to other Acts*. The bill would amend the *Income Tax Act* and *Excise Tax Act* to change a reference to another act.

Prince Edward Island 2023 Budget

Prince Edward Island's 2023 Budget was presented on May 25, 2023, by Finance Minister Jill Burridge. It projects revenue of $2.99 billion and spending of $3.09 billion for 2023–2024, resulting in a projected deficit of $97.6 million. Budget 2023 announced several tax changes, which are summarized below.

Personal Income Tax

Tax Brackets and Rates

Beginning in 2024, PEI's three personal income tax brackets and the surtax will be replaced with a five-bracket system, with lower tax rates in each of the first four brackets. The Budget did not provide any further details, but they were presented in Bill 14, *An Act to Amend the Income Tax Act*, which passed first reading on May 26, 2023. This is the first time since 2000 that PEI's personal income tax rates have been reduced, and the first time since 2008 that tax brackets have been indexed. The government announced its commitment to reviewing this on an annual basis.

Basic Personal Amount

PEI's basic personal amount will increase to $12,750 in 2023 and $13,500 in 2024.

Age Amount

The age amount tax credit for Islanders aged 65 and older will be increased, as shown below.

	Current	2023	2024
Age Amount	$3,764	$4,679	$5,595
Reduced by 15% of income over	$28,019	$30,879	$33,740

Children's Wellness Credit

The Children's Wellness Credit will be increased from $500 to $1,000, starting in 2024. This credit is designed to help families pay for registrations or membership fees to artistic, cultural, recreational, or physical activity programming for children.

Low Income Tax Reduction

The income threshold for the low-income tax reduction will increase from $20,000 to $20,750 in 2023 and $21,500 in 2024.

Property Tax

Assessment Rates

From 2020 to 2023, the PEI government has provided subsidies to offset property tax increases for homeowners to support Islanders during challenging economic times. Budget 2023 announced that the government will introduce legislation to reset assessment rates to levels equivalent to 2020, to prevent a sharp rise in property taxes in 2024.

FOCUS ON CURRENT CASES

This is a regular feature examining recent cases of special interest, coordinated by Ron Dueck of Dentons Canada LLP. The contributors to this feature are from Dentons Canada LLP, Montréal, Toronto, Calgary, Edmonton, and Vancouver. *Focus on Current Cases* will return next month.

RECENT CASES

CRA Efforts To Contact Taxpayer Were Not Reasonable

The Applicant applied for the Canada Recovery Benefit ("CRB") for 22 two-week periods from December 6, 2020, to October 23, 2021. A CRA agent determined that she did not meet the $5,000 minimum income threshold. The Applicant requested a second review, at which point she produced a document from Manulife Financial indicating gross pay of $117,790.96. She also provided her home and mobile phone numbers. The second reviewer was unsatisfied and, after trying to contact the Applicant at her mobile number three times in two days, denied the second request.

The Tax Court allowed the appeal. Applying *Vavilov*, the Court observed that the second reviewer was more concerned with whether the Applicant had received the income than with the Applicant's qualification for the CRB. The reviewer acted unreasonably ("it is simply incomprehensible"), since the Applicant reported the income on her 2019 return, paid taxes on it, reported it to Service Canada when applying for EI benefits, and included it on her Earnings Statement. The reviewer's decision did not exhibit the degree of justification, intelligibility, and transparency required by *Vavilov*, and the Court sent the matter back to CRA.

Mikoula v. Canada (AG)

2023 DTC 5039

CIBC's Claim Foreign Currency Loss Was an Allowable Capital Loss Rejected

In 2006, CIBC subscribed for shares of CIBC Delaware Holdings Inc. for US$1 billion (then approximately C$1.3 billion). CIBC Delaware redeemed the shares in 2007 for US$1 billion (then approximately C$1,003,600,000). CIBC reported a $63,200,000 allowable capital loss (50% of the $126,400,000 loss). The CRA denied this claim. The parties submitted the following question to the Tax Court: Does paragraph 40(3.6)(*a*) of the *Income Tax Act* (the "Act") apply to deem CIBC's loss from the disposition of Class B Shares of CIBC Delaware Holdings Inc. to be nil? The Tax Court answered this question in the affirmative (2021 DTC 1056); CIBC appealed.

The Federal Court of Appeal dismissed the appeal. The issue was whether subsection 39(2), which would allow CIBC to take the capital loss, applies before paragraph 40(3.6)(*a*), which would deem the loss to be nil. The Tax Court decided this question in the negative. Much of the argument centered around *Canada v. BMO*, which held that subsection 39(2) "applied to a disposition of shares when the loss arose by virtue of a fluctuation in the value of foreign currency." However, the stop-loss provision in *BMO* was subsection 112(3.1), which deals with losses allocated to a corporation by a partnership, so that it did not apply to block the application of subsection 39(2). The FCA first noted it was paragraph 40(3.6)(*a*) that applied here, not subsection 112(3.1). It held that the text of all relevant provisions was clear. In its contextual and purposive analysis, the FCA rejected CIBC's contention that the similar wording of subsection 112(3.1) and paragraph 40(3.6)(*a*) meant that the provisions functioned similarly, given their different contexts. It noted there was no recovery of any loss under subsection 112(3.1), whereas losses under paragraph 40(3.6)(*a*) can be recovered on a subsequent disposition of any remaining shares held by the taxpayer in the corporation whose shares were redeemed. The FCA rejected the CRA's argument that subsection 39(2) and paragraph 40(3.6)(*a*) were in different Divisions of the Act (B and C respectively), explaining the different treatment of losses, but noted that under subsection 2(2), Division B applies before Division C. The Court concluded that CIBC's losses were therefore nil, affirming the Tax Court decision.

CIBC v. The King

2023 DTC 5036

Decision Not To Issue the Required "Accredited Film or Video Production Certificates" To Qualify for the Related Income Tax Credit Overturned

The three (related) parties requested judicial review of the Minister of Canadian Heritage's decisions refusing to issue "accredited film or video production certificates" in relation to three television film productions on the basis they were excluded productions in the nature of advertising. These certificates are required to qualify for the Canadian Film or Video Production Tax Credit, which was introduced to stimulate the development of national productions.

The request was granted. The three productions are entitled "Croisière de rêve 4" (Dream Cruise 4), and "Soleil tout inclus" 8 and 9 (Sunshine Included 8 and 9). These televised productions are part of a couple of series which show the amenities and pleasures provided by cruises, or the amenities and advantages of specific hotel complexes in vacation destinations. They are presented on Canal Evasion, a French-language TV channel specializing in shows about tourism, trips, adventure, and food pleasures. It is noteworthy that previous productions of the same series had received the accreditations and therefore qualified for the income tax credit. However, the producers were subsequently told this was an error and that these productions would no longer qualify. The Government also rewrote the guidelines on the subject. The producers argued they had modified the structure of the latest production to respect the new guidelines. After reviewing all the facts and circumstances, as well as the related jurisprudence, the Court concluded that the Minister's decisions were unreasonable as they were based on an in-house criterion that a television production containing more than 15% of advertising content was considered to be advertising. The Court found this interpretation of excluded productions in the nature of advertising was not supported by the legislation and that the Minister, by incorporating the 15% criterion, added a parameter actually not found in the text of the legislation. Consequently, the Court granted the request for judicial review. The decisions were sent back to the Minister for revision.

9616934 Canada Inc. et al. v. Minister of Canadian Heritage

2023 DTC 5033

FCA Allows Canadian Corporation To Deduct Interest It Withheld on Loan to US Member of Tower Structure

Subsection 20(12) of the *Income Tax Act* allows a Canadian company to deduct non-business income tax paid by the taxpayer to the government of a country other than Canada. It contains an exception for "any such tax, or part thereof, that can reasonably be regarded as having been paid by a corporation in respect of income from a share of the capital stock of a foreign affiliate of the corporation." Emergis, a Canadian healthcare information company, set up a complex cross-border arrangement known as a tower structure — a chain of entities set up by a corporation to allow it to fund US subsidiaries in a tax-efficient manner. Emergis lent some US$267 million to USGP, a US corporation that was part of the tower structure; Emergis included in income the interest USGP paid and claimed a deduction under subsection 20(12) for the withholding taxes paid to the US government on this interest. The CRA reassessed Emergis for its 2000 and 2001 taxation years, disallowing this deduction. The Tax Court dismissed Emergis's appeal (2021 DTC 1019).

The Federal Court of Appeal allowed Emergis's appeal from the Tax Court decision. There was no dispute the withholding taxes in issue were non-business income taxes paid by Emergis to the US government; therefore subsection 20(12) applied. The only issue was whether the exception applied. The Tax Court's textual, contextual, and purposive analysis found: (a) the text applied to income from the stock of USGP; (b) the context revealed several avenues of relief with respect to foreign taxes, and Emergis was trying to take advantage of two with respect to the same income; and (c) the purposive analysis revealed only one inbound cross-border transaction, which did not involve Emergis. The FCA held that: (a) the text indicated that taxes paid by Emergis to the US government could not reasonably be regarded as taxes paid by Emergis in respect of income from the shares of one of the tower companies; (b) the context revealed no exclusion from the application of subsection 20(12), and in any event Emergis had not sought relief under two statutes for the same item of income; (c) the purpose of the statute, as indicated by the legislative history, was to provide relief to companies that had to pay interest on foreign taxes (non-deductible under paragraph 18(1)(*a*)) and could not take advantage of the tax deduction provided by subsection 126(1).

Emergis Inc. v. The King

2023 DTC 5031

Court Denies Moving Expenses in View of Definition of "Eligible Relocation"

In this case, the Appellants are appealing reassessments from the Minister, who denied their 2019 deduction for moving expenses on the grounds they did not meet the requirements of the definition of "eligible relocation". The Appellants were partners in a law firm located in Montréal since at least 2015. Once their children finished high school, they moved from l'Assomption to a house in Montréal closer to their workplace. The issue is whether the Appellants met the definition of "eligible relocation" as defined in section 248 of the *Income Tax Act*. To qualify, the moving expenses must have been incurred with respect to a "new work location". As a general rule, a taxpayer is entitled to deduct their moving expenses when they are incurred to occupy a job or position at a new work location and the taxpayer moves closer to the work location by at least 40 kilometers.

The appeals were dismissed. As the judge stated, the definition of "eligible relocation" includes references to a "new work location". After reviewing the facts, circumstances, and jurisprudence, the Court stated that the requirement for a "new work location" was clear. The Court found there was no evidence provided by the Appellants that they met the "new work location" criteria. Accordingly, the appeals were dismissed.

Del Vecchio v. The King

2023 DTC 1036

TAX NOTES

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

For Wolters Kluwer Canada Limited

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

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

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

© 2023, Wolters Kluwer Canada Limited

Wolters Kluwer