Tax Notes

January 2024
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Wolters Kluwer

2023 FALL ECONOMIC STATEMENT — SUMMARY OF TAX MEASURES

On November 21, 2023, Chrystia Freeland, Deputy Prime Minister and Minister of Finance, delivered the *2023 Fall Economic Statement* ("*Fall Economic Statement*"). Multiple tax-related measures were announced, details of which are discussed below.

Business Income Tax Measures

Clean Hydrogen Investment Tax Credit

The *Fall Economic Statement* proposes the details of the Clean Hydrogen Investment Tax Credit ("ITC") announced in Budget 2023.

Eligible Clean Ammonia Production Equipment

The *Fall Economic Statement* proposes that property required to convert clean hydrogen into ammonia will be eligible for the Clean Hydrogen ITC, subject to the following conditions:

- the taxpayer producing the ammonia must use their own hydrogen feedstock for ammonia production, and the hydrogen feedstock must come from clean hydrogen projects of the taxpayer that are eligible for the Clean Hydrogen ITC;
- the clean hydrogen projects have sufficient production capacity to satisfy the needs of the taxpayer's ammonia production facility; and
- the taxpayer demonstrates the feasibility of transporting the hydrogen from the hydrogen production facilities to the ammonia production facility if they are not co-located.

Power Purchase Agreements and Other Similar Instruments

The *Fall Economic Statement* proposes the following conditions in respect of the use of Power Purchase Agreements ("PPAs") and other similar instruments for the purposes of the Clean Hydrogen ITC:

- the purchased electricity is sourced from hydro-, solar-, or wind-powered generation that
  - first commenced production on or after March 28, 2023, and no more than one year before the initial project carbon intensity ("CI") assessment for the related clean hydrogen project is submitted; and
  - is located in the same province or territory as the clean hydrogen project and is connected to the electricity grid of that province or territory; and
- taxpayers would need to demonstrate that the energy being purchased under these instruments is for the operation of the clean hydrogen project.

Renewable Natural Gas

The *Fall Economic Statement* proposes that the use of renewable natural gas ("RNG") would be eligible for the purpose of calculating a project's CI, subject to the following conditions:

- the RNG would need to be produced by a supplier subject to the *Clean Fuel Regulations*;
- RNG would need to be secured from a production facility that commenced RNG production no more than one year before the initial project CI assessment for the associated clean hydrogen project is submitted; and
- producers would need to demonstrate that the RNG being purchased is for the operation of the clean hydrogen project.

Initial Project CI Assessment and Validation

Projects would undergo an initial project CI assessment based on the design of the project. The *Fall Economic Statement* proposes further clarification:

- the initial project CI assessment would need to be validated by a third party;
- taxpayers would need to submit an initial project CI assessment and third-party validation report to Natural Resources Canada; and
- once the expected CI of the project has been validated by Natural Resources Canada, the Clean Hydrogen ITC would be administered by the Canada Revenue Agency.

Compliance and Recovery

The *Fall Economic Statement* proposes that projects be subject to a one-time verification, based on a five-year compliance period.

If a project failed to achieve a CI of produced hydrogen in the same CI tier that the project was assessed at, the Clean Hydrogen ITC could be subject to a recovery equal to the difference between the Clean Hydrogen ITC amount that was claimed based on the assessed CI tier, and the Clean Hydrogen ITC amount that would apply based on the CI tier that is observed during production.

Projects with a verified CI no more than 0.25 kg of carbon dioxide equivalent ("CO_2e") per kg of hydrogen above their original validated CI would not be subject to recovery of Clean Hydrogen ITC amounts even if the verified CI exceeds the upper bound of the originally assessed CI tier.

Amounts of Clean Hydrogen ITC claimed in respect of ammonia production equipment would be subject to full recovery if the hydrogen production project supplying the hydrogen used for ammonia production has a verified CI of 4 kg or more of CO_2e per kg of hydrogen. However, there would be no recovery with respect to ammonia production equipment if the verified CI is no more than 0.25 kg of CO_2e per kg of hydrogen above the originally validated CI.

Clean Technology and Clean Electricity Investment Tax Credits — Equipment Using Waste Biomass

The *Fall Economic Statement* proposes to expand eligibility for the Clean Technology and Clean Electricity ITCs to support the generation of electricity, heat, or both electricity and heat, from waste biomass.

The expansion of the eligibility for the Clean Technology ITC would apply in respect of property that is acquired and becomes available for use on or after November 21, 2023, provided it has not been used for any purpose before its acquisition. The expansion of the eligibility for the Clean Electricity ITC would be available as of the day of the federal budget in 2024 and to projects that did not begin construction before March 28, 2023.

Waste Biomass

In the context of the proposed expansion of the Clean Technology and Clean Electricity ITCs, eligible waste biomass would include only "specified waste materials" as defined in the *Income Tax Regulations*.

Electricity Generation and Cogeneration From Waste Biomass

The *Fall Economic Statement* proposes to expand eligibility for the Clean Technology and Clean Electricity ITCs to include systems that use specified waste materials solely to generate electricity or both electricity and heat (cogeneration). Eligible systems would be those that use feedstock, all or substantially all of the energy content of which is from specified waste materials.

Heat Generation From Waste Biomass

The *Fall Economic Statement* proposes to expand eligibility for the Clean Technology ITC to include systems that use specified waste materials, other than spent pulping liquor, solely to generate heat energy. Eligible systems would be those that use feedstock, all or substantially all of the energy content of which is from specified waste materials (other than spent pulping liquor).

Canadian Journalism Labour Tax Credit

The *Fall Economic Statement* proposes to increase the cap on labour expenditures per eligible newsroom employee from $55,000 to $85,000 for the Canadian journalism labour tax credit. It further proposes that the tax credit rate be temporarily increased from 25% to 35% for a period of four years. Organizations would be able to claim up to $29,750 in eligible labour costs per eligible newsroom employee per year.

These changes would apply to qualifying labour expenditures incurred on or after January 1, 2023. The credit rate would return to 25% for expenditures incurred on or after January 1, 2027.

Dividend Received Deduction by Financial Institutions — Exception

The *Income Tax Act* permits corporations to claim a deduction in respect of dividends received on shares of other corporations resident in Canada. Budget 2023 proposed to deny the dividend received deduction in respect of dividends received by financial institutions on shares that are mark-to-market property. The *Fall Economic Statement* proposes an exception to this measure for dividends received on “taxable preferred shares”. This exception, along with the rest of the measure, would apply to dividends received on or after January 1, 2024.

Concessional Loans

Historically, non-forgivable loans from public authorities were generally not considered government assistance. This position extended to concessional loans (meaning loans that do not bear interest or that bear interest at below-market rates) from public authorities. However, in a 2021 decision, the Tax Court of Canada determined that the full principal amount of a concessional loan was government assistance. This was affirmed by the Federal Court of Appeal in 2022. The *Fall Economic Statement* proposes to amend the *Income Tax Act* to provide that *bona fide* concessional loans with reasonable repayment terms from public authorities will generally not be considered government assistance.

This amendment would come into force on November 21, 2023.

Cracking Down on Non-Compliant Short-Term Rentals

As previously announced, the *Fall Economic Statement* takes aim at property owners of “non-compliant” short-term rental property, such as Airbnb or Vrbo units, increasing their taxes in an attempt to have these units returned to the long-term housing market. In particular, the following provisions were announced:

- the denial of income tax deductions for expenses incurred to earn short-term rental income, including interest expenses, in provinces and municipalities that have prohibited short-term rentals; and
- the denial of income tax deductions when short-term rental operators are not compliant with the applicable provincial or municipal licensing, permitting, or registration requirements.

These measures would apply to deny all expenses incurred on or after January 1, 2024.

International Tax Measures

International Shipping

To ensure consistency with international tax norms, as well as greater consistency between the international shipping provisions of the *Income Tax Act* and the proposed new *Global Minimum Tax Act*, it is proposed to make the exemption for international shipping income in the *Income Tax Act* generally available to Canadian resident companies. This measure would apply to taxation years that begin on or after December 31, 2023.

Sales and Excise Tax Measures

Removing the GST/HST From Psychotherapists' and Counselling Therapists' Services

The *Fall Economic Statement* proposes that psychotherapists and counselling therapists be added to the list of health care practitioners whose professional services rendered to individuals are exempt from the GST/HST. This measure would apply on Royal Assent of the enacting legislation. This mirrors the provisions included in Bill C-323, *An Act to amend the Excise Tax Act (mental health services)*, a private member's Bill.

Proposed New Joint Venture Election Rules

A joint venture is not a person and therefore cannot register and account for tax; however, a joint venture election is available to simplify accounting procedures. Currently, the joint venture election is generally only available for real property, including related construction or development activities, as well as for mining activities. The *Fall Economic Statement* proposes the following new joint venture election rules:

- replacing the condition that the joint venture activities must be eligible activities set out in the legislation or regulations with an all or substantially all (90%) commercial activities condition (within the meaning of the GST/HST legislation);
- requiring all electing participants to be registered for GST/HST purposes; and
- replacing existing deeming measures with revised deeming measures that are more precisely focused on tax accounting.

Legislative Proposals Relating to New GST/HST Joint Venture Election Rules were issued with the *Fall Economic Statement* (fin.canada.ca/drleg-apl/2023/eta-lta-1123-l-1-eng.html). The government invites Canadians and stakeholders to share their feedback on these proposals by emailing Consultation-Legislation@fin.gc.ca by March 15, 2024.

The new proposed joint election rules are proposed to come into force on the day on which the Act enacting the new rules receives Royal Assent.

Underused Housing Tax

The existing Underused Housing Tax ("UHT") took effect on January 1, 2022. The government is now proposing to make several changes to help facilitate compliance, including:

- elimination of filing requirement for certain owners;
- expanding the definitions "excluded owner", "specified Canadian partnership", and "specified Canadian trust" to provide UHT filing and tax relief in respect of a broader range of Canadian ownership structures, applicable in respect of the 2023 and subsequent calendar years;
- reduction to minimum failure to file penalties, applicable in respect of the 2022 and subsequent calendar years;
- introducing a new UHT exemption for residential properties held as a place of residence or lodging for employees (with certain restrictions), applicable in respect of the 2023 and subsequent calendar years;
- technical changes to ensure the UHT applies in accordance with the policy intent and to ensure uniformity of tax statutes; and
- extending the filing deadline to April 30, 2024 (this deadline also applies to 2023 UHT Returns).

Draft legislation has been included with the *Fall Economic Statement* (fin.canada.ca/drleg-apl/2023/uhta-ltlsu-1123-l-1-eng.html). The federal government invites Canadians and stakeholders to share their feedback on these proposals by emailing Consultation-Legislation@fin.gc.ca by January 3, 2024.

International Tax Reform and Digitalization

The *Fall Economic Statement* reaffirmed, once again, that Canada will be moving ahead with legislation to implement the Pillar Two global minimum tax in Canada, which will ensure that large multinational corporations are subject to a minimum effective tax rate of 15% on their profits wherever they do business. However, "Forthcoming legislation would allow the government to determine the entry-into-force date of the new Digital Services Tax, as Canada continues conversations with its international partners." This is a departure from the previously announced effective date of January 1, 2024, which implies that the implementation date of the Digital Services Tax may be subject to change.

CURRENT ITEMS OF INTEREST

Government of Canada Introduces Notice of Ways and Means Motion, *Fall Economic Statement Implementation Act, 2023*

On November 28, Chrystia Freeland, Deputy Prime Minister and Minister of Finance, tabled the Notice of Ways and Means Motion[1] to introduce the *Fall Economic Statement Implementation Act, 2023*, which implements the measures announced in the Fall Economic Statement.

Explanatory Notes were also released,[2] and the legislation effecting these measures, Bill C-59, *Fall Economic Statement Implementation Act, 2023*, completed First Reading on November 30, 2023.[3]

Part 1 of Bill C-59 implements measures in respect of the *Income Tax Act* and the *Income Tax Regulations* by:

- limiting the deductibility of net interest and financing expenses by certain corporations and trusts, consistent with certain Organisation for Economic Co-operation and Development ("OECD") and the Group of Twenty ("G20") Base Erosion and Profit Shifting ("BEPS") project recommendations;
- implementing hybrid mismatch rules consistent with the OECD and the G20 BEPS project recommendations regarding cross-border tax avoidance structures that exploit differences in the income tax laws of two or more countries to produce "deduction/non-inclusion mismatches";
- allowing expenditures incurred in the exploration and development of all lithium to qualify as Canadian exploration expenses and Canadian development expenses;
- ensuring that only genuine intergenerational business transfers are excluded from the anti-surplus stripping rule in section 84.1 of the *Income Tax Act*;
- denying the dividend received deduction for dividends received by Canadian financial institutions on certain shares that are held as mark-to-market property;
- increasing the rate of the rural supplement for Climate Action Incentive payments ("CAIPs") from 10% to 20% for the 2023 and subsequent taxation years as well as referencing the 2016 census data for the purposes of the CAIP rural supplement eligibility for the 2023 and 2024 taxation years;
- providing a refundable investment tax credit to qualifying businesses for eligible carbon capture, utilization, and storage equipment;
- providing a refundable investment tax credit to qualifying businesses for eligible clean technology equipment;
- introducing, under certain circumstances, labour requirements in relation to the new refundable investment tax credits for eligible carbon capture, utilization, and storage equipment as well as eligible clean technology equipment;

[1] fin.canada.ca/drleg-apl/2023/nwmm-amvm-1123-bil.pdf

[2] fin.canada.ca/drleg-apl/2023/nwmm-amvm-1123-n-eng.pdf

[3] www.parl.ca/DocumentViewer/en/44-1/bill/C-59/first-reading

- removing the requirement that credit unions derive no more than 10% of their revenue from sources other than certain specified sources;
- permitting a qualifying family member to acquire rights as successor of a holder of a Registered Disability Savings Plan ("RDSP") following the death of that plan's last remaining holder who was also a qualifying family member;
- implementing consequential changes of a technical nature to facilitate the operation of the existing rules for First Home Savings Accounts ("FHSAs");
- introducing a tax of 2% on the net value of equity repurchases by certain Canadian corporations, trusts, and partnerships whose equity is listed on a designated stock exchange;
- exempting certain fees from the refundable tax applicable to contributions under retirement compensation arrangements;
- introducing a technical amendment to the provision that authorizes the sharing of taxpayer information for the purposes of the Canadian Dental Care Plan;
- implementing a number of amendments to the general anti-avoidance rule ("GAAR") as well as introducing a new penalty applicable to transactions subject to the GAAR and extending the normal reassessment period for the GAAR by three years in certain circumstances;
- facilitating the creation of employee ownership trusts;
- introducing specific anti-avoidance rules in relation to corporations referred to as substantive CCPCs; and
- extending the phase-out by three years, and expanding the eligible activities, in relation to the reduced tax rates for certain zero-emission technology manufacturers.

This Part also makes related and consequential amendments to the *Excise Tax Act* and the *Excise Act, 2001*.

Part 2 enacts the *Digital Services Tax Act* ("DST Act") and its regulations. The DST Act provides for the implementation of an annual tax of 3% on certain types of digital services revenue earned by businesses that meet certain revenue thresholds. It sets out rules for the purposes of establishing liability for the tax and also sets out applicable reporting and filing requirements. To promote compliance with its provisions, the DST Act includes modern administration and enforcement provisions generally aligned with those found in other taxation statutes. Finally, this Part also makes related and consequential amendments to other texts to ensure proper implementation of the tax and cohesive and efficient administration by the Canada Revenue Agency.

Part 3 implements certain Goods and Services Tax/Harmonized Sales Tax ("GST/HST") measures by:

- ensuring that an interest in a corporation that does not have its capital divided into shares is treated as a financial instrument for GST/HST purposes;
- ensuring that interest and dividend income from a closely related partnership is not included in the determination of whether a person is a *de minimis* financial institution for GST/HST purposes;
- ensuring that an election related to supplies made within a closely related group of persons that includes a financial institution may not be revoked on a retroactive basis without the permission of the Minister of National Revenue;
- making technical amendments to an election that allows electing members of a closely related group to treat certain supplies made between them as having been made for nil consideration;
- ensuring that certain supplies between the members of a closely related group are not inadvertently taxed under the imported taxable supply rules that apply to financial institutions;
- raising the income threshold for the requirement to file an information return by certain financial institutions;
- allowing up to seven years to assess the net tax adjustments owing by certain financial institutions in respect of the imported taxable supply rules;
- expanding the GST/HST exemption for services rendered to individuals by certain health care practitioners to include professional services rendered by psychotherapists and counselling therapists;
- providing relief in relation to the GST/HST treatment of payment card clearing services;

- allowing the joint venture election to be made in respect of the operation of a pipeline, rail terminal, or truck terminal that is used for the transportation of oil, natural gas, or related products;
- raising the input tax credit documentation thresholds from $30 to $100 and from $150 to $500, and allowing billing agents to be treated as intermediaries for the purposes of the input tax credit information rules; and
- extending the 100% GST rebate in respect of new purpose-built rental housing to certain cooperative housing corporations.

This Part also implements an excise tax measure by creating a joint election mechanism to specify who is eligible to claim a rebate of excise tax for goods purchased by provinces for their own use.

Part 4 implements certain excise tax measures by permitting all cannabis licensees to elect to remit excise duties on a quarterly rather than a monthly basis, starting from the quarter that began on April 1, 2023.

Government of Canada Launches Pre-Budget Consultations

On December 12, the Government of Canada launched pre-budget consultations in advance of Budget 2024 (www.canada.ca/en/department-finance/programs/consultations/2023/pre-budget-consultations-2024.html). Canadians can participate in pre-budget consultations by sharing their ideas and priorities at LetsTalkBudget24.ca until February 9, 2024.

Explanatory Notes Relating to GST/HST and Excise Levies

Following the Notice of Ways and Means Motion tabled on November 28, Explanatory Notes Relating to the Goods and Services Tax/Harmonized Sales Tax and Excise Levies were released on December 1, 2023 (fin.canada.ca/drleg-apl/2023/nwmm-amvm-1123-n-2-eng.html).

Progress of Legislation

Bill C-56, *An Act to amend the Excise Tax Act and the Competition Act*, received Royal Assent on December 15, 2023 (S.C. 2023, c. 31). Part 1 amends the *Excise Tax Act* in order to implement a temporary enhancement to the GST New Residential Rental Property Rebate in respect of new purpose-built rental housing. Part 2 amends the *Competition Act* to, among other things:

- establish a framework for an inquiry to be conducted into the state of competition in a market or industry;
- permit the Competition Tribunal to make certain orders even if none of the parties to an agreement or arrangement — a significant purpose of which is to prevent or lessen competition in any market — are competitors; and
- repeal the exceptions in sections 90.1 and 96 of the Act involving efficiency gains.

Bill C-234, *Gas Pollution Pricing Act*, passed Third Reading in the Senate on December 12, 2023. This private member's Bill would remove the carbon tax on natural gas and propane used in such activities as irrigation, grain drying, feed preparation, and heating and cooling barns and greenhouses.

New Trust Reporting Requirements for T3 Returns — Penalties

Bare trusts did not have an obligation in years prior to the 2023 tax year to file a T3 Return. The 2023 tax year will be the first time that bare trusts will have a requirement to file a T3 Return, including the new Schedule 15. Consequently, the CRA will provide relief to bare trusts by waiving the penalty payable under subsection 162(7) of the *Income Tax Act* for the 2023 tax year in situations where the T3 Return and Schedule 15 are filed after the filing deadline. For the 2023 tax year, where the tax year of the trust ends on December 31, 2023, the filing deadline of March 30, 2024, is extended to April 2, 2024, the first business day after the deadline.

This proactive relief is for bare trusts only and only for the 2023 tax year. However, if the failure to file the T3 Return and Schedule 15 for the 2023 tax year was made knowingly or due to gross negligence, a different penalty may apply.

This penalty will be equal to the greater of $2,500 and 5% of the highest amount at any time in the year of the fair market value of all the property held by the trust.

For additional details about the new filing requirements for trusts, visit: www.canada.ca/en/revenue-agency/services/tax/trust-administrators/t3-return/new-trust-reporting-requirements-t3-filed-tax-years-ending-december-2023.html.

Indexation Adjustment for Personal Income Tax and Benefit Amounts

Certain personal income tax and benefit amounts are indexed to inflation each year using the Consumer Price Index data as reported by Statistics Canada. Increases to tax bracket thresholds, amounts relating to non-refundable credits, and most other amounts take effect on January 1 of the applicable year. Increases in amounts for certain income-tested benefits like the goods and services tax credit, the Canada child benefit, and Child disability benefit, take effect on July 1 to coincide with the beginning of the program year for payments of these benefits.

The chart providing the indexed amounts for four tax years based on the announced personal income tax and benefit commitments to date is available at: www.canada.ca/en/revenue-agency/services/tax/individuals/frequently-asked-questions-individuals/adjustment-personal-income-tax-benefit-amounts.html.

Interest Rates for First Calendar Quarter

On November 24, 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 January 1, 2024, to March 31, 2024. The rates are as follows:

Income tax

- The interest rate charged on overdue taxes, Canada Pension Plan contributions, and employment insurance premiums will be 10%.
- The interest rate to be paid on corporate taxpayer overpayments will be 6%.
- The interest rate to be paid on non-corporate taxpayer overpayments will be 8%.
- The interest rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans will be 6%.
- The interest rate for corporate taxpayers' pertinent loans or indebtedness will be 9.16%.

Other taxes, duties, or charges

The interest rates on overdue and overpaid remittances will be as follows:

Tax, duty, or other charges	Overdue remittances	Overpaid remittances — Corporate taxpayers
Goods and services tax ("GST")	10%	6%
Harmonized sales tax ("HST")	10%	6%
Air travellers security charge	10%	6%
Fuel charge (under the *Greenhouse Gas Pollution Pricing Act*)	10%	6%
Excise tax (non-GST/HST)	10%	6%
Excise duty except brewer licensees (amounts due after June 30, 2003)	10%	6%
Excise duty except brewer licensees (amounts due before July 1, 2003)	8%	N/A

Tax, duty, or other charges	Overdue remittances	Overpaid remittances — Corporate taxpayers
Excise duty (brewer licensees)	8%	N/A
Softwood lumber products export charge	10%	6%

New Regulations

The following regulations were recently published:

- SOR/2023-230 P.C. 2023-1107 — *Regulations Amending Certain Regulations Made Under the Federal-Provincial Fiscal Arrangements Act*.
- SOR/2023-242 P.C. 2023-1135 — *Regulations Amending the Regulations Relieving Special Duty on Certain Tobacco Products and the Regulations Respecting Prescribed Brands of Manufactured Tobacco and Prescribed Cigarettes*.
- SI/2023-70 P.C. 2023-1105 — *Order Fixing the Days on Which Certain Provisions of the Retail Payment Activities Act and the Budget Implementation Act, 2021, No. 1 Come into Force*.
- SOR/2023-246 P.C. 2023-1161 — *Regulations Amending the Income Tax Regulations (Motor Vehicle Expenses and Benefits 2018–2023)*.

Issuing T4A and T5 Slips Electronically

Issuers of T4A and T5 slips can now distribute them by email or using an employer's or payer's secure electronic portal without obtaining written or electronic consent from the employees or recipients before distributing the slips. Previously, issuers were required to request express consent in order to provide these slips electronically; now, they do not need to, under certain conditions.

Employers and payers can also distribute T4 and T4FHSA slips by email or using their secure electronic portal without obtaining written or electronic consent from the employees or recipients before distributing the slips.

There are exceptions to this, and permission is required if:

- the employee or recipient requested that the slips be provided in a paper copy;
- the employee or recipient cannot reasonably be expected to have access to the slips in electronic format at the time the slips are issued; or
- the employer distributes T4 slips to an employee who is on extended leave or is a former employee at the time that the T4 slips are issued.

Recent Publications

The following items were recently published and/or updated by the Department of Finance:

- Information for crypto-asset users and tax professionals (www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/compliance/digital-currency/cryptocurrency-guide.html);
- Loans and employee debt (www.canada.ca/en/revenue-agency/services/tax/businesses/topics/payroll/benefits-allowances/financial/loans-interest-free-low-interest.html);
- •Employers' Guide — Payroll Deductions and Remittances (corrected version issued December 5; www.canada.ca/en/revenue-agency/services/forms-publications/publications/t4001/employers-guide-payroll-deductions-remittances.html);
- The Fiscal Monitor — September 2023 (www.canada.ca/en/department-finance/services/publications/fiscal-monitor/2023/09.html);

- Payroll Deductions Formulas — 119th Edition Effective January 1, 2024 (www.canada.ca/en/revenue-agency/services/forms-publications/payroll/t4127-payroll-deductions-formulas/t4127-jan/t4127-jan-payroll-deductions-formulas-computer-programs.html);
- Employers' Guide — Payroll Deductions and Remittances (www.canada.ca/en/revenue-agency/services/forms-publications/publications/t4001/employers-guide-payroll-deductions-remittances.html);
- RDSP Sample *pro forma* — Declaration of Trust (www.canada.ca/en/revenue-agency/services/tax/registered-plans-administrators/registered-disability-savings-plans-rdsps/sample-forma-declaration-trust.html);
- RDSP Bulletin No. 3R3 (www.canada.ca/en/revenue-agency/services/tax/registered-plans-administrators/bulletins/rdsp-bulletin-3.html);
- IC99-1R4 Registered Disability Savings Plans (www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic99-1/registered-disability-savings-plans.html);
- RC4654 Designated Educational Institutions — Filing the T2202, Tuition and Enrolment Certificate and Summary (www.canada.ca/en/revenue-agency/services/forms-publications/publications/rc4654/guide-for-designated-educational-institutions-filing-the-t2202-tuition-and-enrolment-certificate-and-summary.html); and
- Register a disability savings plan — Who can apply (www.canada.ca/en/revenue-agency/services/tax/registered-plans-administrators/registered-disability-savings-plans-rdsps/register-apply.html).

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.

Slightham et al. v. The Attorney General of Canada, 2023 DTC 5118 (Ontario Superior Court of Justice (Commercial List)) — Ontario Superior Court of Justice rectifies defective trust deeds on a retroactive basis

Background

In *Slightham*, the applicants sought an order rectifying two trust deeds on a retroactive basis. In 2010, the applicants reorganized their shareholdings of a family operating company ("Opco"). One step in the reorganization was to incorporate a new entity ("Holdco") and make it a beneficiary of the trusts.

The trust deeds were drafted in contemplation of the potential application of subsection 75(2) of the *Income Tax Act* ("ITA") (the "Attribution Rule"). To protect against the inadvertent triggering of the Attribution Rule, the trust deeds provided that Holdco would not be entitled to receive any income or capital derived from itself. However, the trust deeds inadvertently prohibited the trustees from distributing amounts received from Opco to Holdco.

Unaware of the mistake, the trustees distributed dividends received from Opco to Holdco and the trusts claimed deductions under subsection 112(1) of the ITA in respect thereof. The Canada Revenue Agency ("CRA") reassessed the trusts to deny the deductions, on the basis that the distributions were prohibited by the terms of the trust deeds. The trustees attempted to correct the error by amending the trust deeds, however the CRA took the position that it would only accept amendments to the trust deeds if they were made pursuant to a court order. The CRA did not oppose the application to the Ontario Superior Court of Justice (Commercial List).

Issue and Decision

The issue was whether the court should use its equitable jurisdiction to rectify the trust deeds, *nunc pro tunc*, to remove the prohibition on distributing amounts received from Opco to Holdco.

In *Canada (Attorney General) v. Fairmont Hotels Inc.*, 2016 DTC 5135 ("Fairmont"), the Supreme Court of Canada established the four requirements that must be satisfied for rectification:

(1) the parties had reached a prior agreement whose terms are definite and ascertainable;

(2) the agreement was still effective when the instrument was executed;

(3) the instrument failed to record accurately that prior agreement; and

(4) if rectified as proposed, the instrument would carry out the agreement.

Based on the comprehensive record, Osbourne J. concluded that the four requirements from *Fairmont* were met. There was clear, consistent evidence that a prior agreement existed and that the parties always intended that the trustees could allocate dividends from Opco to Holdco. This was evidenced by affidavits from all parties and their advisors, corroborating contemporaneous documentation (e.g., closing agenda drafts), and the subsequent conduct of the applicants and their advisors.

In concluding that rectification was appropriate in the circumstances, Osborne J. carefully considered the jurisprudence, which prohibits rectification where its purpose is to achieve retroactive tax planning. His Honour distinguished the present case from *Fairmont* and *Canada (Attorney General) v. Collins Family Trust*, 2022 DTC 5069 (SCC), on the basis that the parties were not trying to amend their agreement to avoid unintended tax consequences; rather, they sought to amend a written document that did not reflect their agreement.

Conclusion

The Supreme Court of Canada has limited the availability of rectification in the tax context. However, *Slightham* demonstrates that, provided the test set out in *Fairmont* is met, there remain situations where rectification is available, even if it may cure an unforeseen tax result.

— *Caroline Harrell*

Hall v. The King, 2023 GTC 19 (Tax Court of Canada) — Director failed to meet due diligence standard, found liable for corporation's tax debts

Background

The appellant, Michael Hall ("Mr. Hall"), was a full-time firefighter who had undertaken secondary businesses which involved managing home restorations and renovations through contracts with property loss liability insurers in Newfoundland and Labrador from 2008 to 2011. These businesses were carried on through 55668 Newfoundland & Labrador Ltd. (c.o.b. as Paul Davis Systems Newfoundland) ("556 Ltd."), a licensed user of the Paul Davis Systems (the "Licensor") trade name and other intellectual property, and Canadian Roofing Solutions Inc. ("Canadian Roofing"), a related roofing repairs company. Mr. Hall was the sole employee of Eastern Restoration Limited ("ERI") whose only role was to receive invoiced amounts from 556 Ltd. and Canadian Roofing and pay such amounts to Mr. Hall as remuneration. Mr. Hall was a director of all three companies.

By 2009, 556 Ltd. was insolvent, and in 2010 the Licensor changed the locks, hampering Mr. Hall's access to 556 Ltd.'s premises. As a result, Mr. Hall commenced intensive and protracted litigation against the Licensor. Amidst the ongoing litigation, the Minister of National Revenue (the "Minister") assessed Mr. Hall on the basis that, as a director of 556 Ltd., Canada Roofing, and ERI, he was jointly liable with the corporations under subsection 227.1(1) of the *Income Tax Act* (Canada) (the "ITA") for unremitted source deductions, and under subsection 323(1) of the *Excise Tax Act* (Canada) (the "ETA") for unpaid goods and services taxes/harmonized sales taxes ("GST/HST") of 556 Ltd., Canada Roofing, and ERI. Mr. Hall successfully objected to the Minister's assessments for the amounts owing by 556 Ltd. and Canada Roofing on the basis that he satisfied the due diligence standards under subsection 227.1(3) of the ITA and subsection 323(3) of the ETA, and that circumstances beyond his control prevented him from satisfying the relevant outstanding balances of those corporations. However, Mr. Hall filed an appeal with the Tax Court of Canada (the "Tax Court") in respect of his liability as a director of ERI.

Issues and Decision

The issues in this appeal were: (1) whether Mr. Hall took actions in a timely manner to limit ERI's failure to withhold and remit source deductions from employees' remuneration, and to pay GST/HST owing, and whether those actions were sufficient in the circumstances to rise to the objective standard of a reasonably prudent person; and (2) whether the due diligence standard under subsection 227.1(3) of the ITA and subsection 323(3) of the ETA was met.

The Tax Court held that Mr. Hall was liable for the unremitted source deductions and unpaid GST/HST of ERI. In reaching this decision, the Tax Court held that the Canada Revenue Agency's considerations for absolving Mr. Hall's liability as a director of 556 Ltd. and Canadian Roofing, including the circumstances of the lock-out and lengthy litigation involving those corporations, were not relevant to the question of whether Mr. Hall met the due diligence standard as a director of ERI. ERI was not part of the litigation that involved 556 Ltd. and Canadian Roofing. The sole purpose of ERI was to receive remuneration paid by 556 Ltd. and Canadian Roofing to Mr. Hall. Mr. Hall paid himself from amounts invoiced by ERI, but he failed to separate, retain, and remit source deductions, and to pay GST/HST owing, to the Minister when he was solely and exclusively responsible for ERI. Mr. Hall failed to act as a reasonably prudent person since he had the opportunity to pay the Crown contemporaneously with himself but decided not to. Mr. Hall was not a new business owner or a novice director and there was no evidence that he took any steps to prevent ERI's failure or, once known, correct the payment deficiency to the Crown.

Conclusion

The Tax Court found that Mr. Hall was jointly liable for the unremitted source deductions and unpaid GST/HST of ERI. The due diligence defences for director's liability under subsection 227.1(3) of the ITA and subsection 323(3) of the ETA will be applied to the particular facts of each case, and the court will analyze the steps a director has taken both in working to prevent failures in the first place, and to limit or ameliorate failures after they arise.

— *Zehan Jagosh*

Canada v. MMV Capital Partners Inc., 2023 DTC 5115 (Federal Court of Appeal) — The Federal Court of Appeal applies *Deans Knight* and finds acquiring substantial interest without *de jure* control to achieve loss monetization abusive

Background

Prior to July 2009, MMV Capital Partners Inc. ("MMV") carried on a voice-over-internet-protocol ("VOIP") business, which was never profitable. In July 2009, one of MMV's creditors put MMV into receivership and its business assets were sold to an unrelated third party. The proceeds from the sale, together with certain tax refunds, were used to settle MMV's senior secured indebtedness to MMV Financial Inc. ("MMV Financial").

By August 2009, MMV ceased carrying on business and had no assets of value. It had 78 shareholders holding preferred and common shares and unpaid indebtedness of approximately $2 million. MMV also had unused non-capital losses of approximately $27 million.

Starting in November 2010, a number of transactions involving MMV were undertaken. The millions of shares outstanding before November 2010 were reorganized and consolidated, leaving only five of the previous 78 shareholders (the original five shareholders) holding 18 common shares (carrying the right to one vote per share) as of December 21, 2010. Shortly thereafter, MMV Financial, through its wholly-owned subsidiary, subscribed for 17 common shares and, in February 2011, subscribed for 100,000 non-voting common shares. As a result, MMV Financial owned more than 99.98 per cent of MMV's outstanding common share equity while owning only 48.6 per cent of the voting shares.

MMV then used the funds it received from MMV Financial to settle all of its unsecured debt and entered into a venture lending business. In its 2011 to 2015 taxation years, MMV deducted the non-capital losses incurred in the VOIP business against its income from its venture lending business. By notices of reassessment dated June 8, 2016, the Minister reassessed MMV's 2011 to 2015 taxation years to disallow the deductions that MMV claimed in respect of the

applied non-capital losses, asserting an abuse of subsection 111(5) of the *Income Tax Act* ("ITA") so that the general anti-avoidance rule ("GAAR") in section 245 of the ITA applied.

Issues and Tax Court Decision

The issue on appeal to the Tax Court was whether a series of transactions undertaken to monetize MMV's accrued losses was subject to the GAAR. MMV conceded the existence of a tax benefit and an avoidance transaction. Accordingly, the only issue before the Tax Court was whether there was an abuse.

The Tax Court first sought to determine the object, spirit, and purpose of the provision at issue. Without the benefit of the Supreme Court of Canada's (the "SCC") decision in *Deans Knight Income Corp. v. Canada*, 2023 DTC 5041 ("*Deans Knight SCC*"), the Tax Court adopted the object, spirit, and purpose of subsection 111(5) it identified in *Deans Knight Income Corporation v. The Queen*, 2019 DTC 1059 ("*Deans Knight TCC*"). *Deans Knight TCC* was overturned by the Federal Court of Appeal (the "FCA"), and the Federal Court of Appeal's decision was upheld in *Deans Knight SCC*.

Having concluded that the object, spirit, and purpose of subsection 111(5) of the ITA is "to target the manipulation of losses of a corporation by a new person or group of persons, through effective control over the corporation's assets", the Tax Court then considered whether the facts supported a finding that MMV had acquired effective control of the respondent. It concluded they did not. As a result, the transactions in issue did not frustrate the object, spirit, and purpose of subsection 111(5) of the ITA, and GAAR did not apply.

Federal Court of Appeal Decision

In a unanimous decision, the FCA applied *Deans Knight SCC* and overturned the Tax Court's decision, finding that the transactions in issue were abusive. The FCA cited *Deans Knight SCC*, where the SCC held that the object, spirit, and purpose of subsection 111(5) of the ITA 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". It noted that the SCC had expressly criticized the Tax Court's focus on "effective control" in *Deans Knight TCC*.

MMV argued that *Deans Knight SCC* should not apply in this case for two reasons: the first is "the artificial manner in which the transactions in *Deans Knight SCC* circumvented *de jure* control, as compared with this case where MMV Financial simply acquired fewer votes than would have conferred *de jure* control"; and the second is "the complete transformation of the shareholder base in *Deans Knight SCC*, as compared with this case where the [five original shareholders] continued to hold a majority of the votes before and after the transactions". The FCA accepted the Crown's arguments that these distinctions are irrelevant because the court's task is not to compare the respondent's circumstances to those in *Deans Knight SCC*. Rather, to determine whether subsection 111(5) of the ITA was abused, the court must compare the result of the transactions to the provision's underlying rationale.

The FCA cited *Deans Knight SCC* as holding that abuse may be found "where a series of transactions 'achieved a result the section was intended to prevent' while narrowly avoiding application of the provision". The FCA found that, as in *Deans Knight SCC*, what happened here is exactly what subsection 111(5) of the ITA seeks to prevent.

The FCA noted that the five original shareholders remained with an infinitesimal equity interest, but *de jure* control does not change the fact that MMV Financial acquired MMV. This is because MMV Financial acquired well in excess of 99 per cent of MMV's equity and became MMV's only secured creditor and its only source of funding. When MMV deducted its losses against the income earned from the new business, MMV Financial was the only shareholder that benefitted from those losses.

The FCA also noted that while MMV's common shares provided the five original shareholders with *de jure* control, they had no effective way to use that control to benefit from MMV's losses. Their *de jure* control was meaningful only because it prevented MMV Financial from acquiring *de jure* control. MMV Financial acquiring *de jure* control would have been fatal to MMV Financial being able to benefit from MMV's losses.

Conclusion

In conclusion, the FCA found that the underlying series of transactions was abusive so that the GAAR applied, and as a result, the deductions were denied.

— *Ann Chen*

RECENT CASES

Appeal From Net Worth Reassessment and Penalties Allowed in Part

The Minister of National Revenue ("Minister") used the net worth method to reassess the Appellant for unreported business income, levy gross negligence penalties, and open a statute-barred year. The Appellant had reported negative income (i.e., losses) in two of three years and net income of just under $5,000 in the third year to support his family of five. The Appellant had stated that in using the net worth method, the Minister failed to take into account certain items/credits and that the gross negligence penalties were not justified. The Appellant ran his general contractor business as a sole proprietorship. In the years under appeal, he had two employees who were paid by the hour. He explained that carpentry work was weather-dependent such that every week was different, and it was very unlikely for a person to consistently work 40 hours a week in carpentry.

The appeal was allowed in part. The issues in appeal were whether the Minister properly included unreported business income in the Appellant's 2015, 2016, and 2017 taxation years, respectively; whether the Minister had properly applied gross negligence penalties against the unreported business income; and whether the Minister was justified in reassessing the Appellant's 2015 taxation year beyond the normal reassessment period. The Court observed that the Appellant had used an increasing amount of credit to cover shortfalls over the three years in question but it was unclear as to why a steady, profitable, going concern had shortfalls in those years. The value of assets such as vehicles and land was kept constant for the purposes of the net worth analysis, so they would not have contributed to a change in net worth during the period in question, hence the Court could not find that the Minister's assumptions had been rebutted with respect to the unreported business income. The Court could not find the necessary level of culpability to support a finding of gross negligence and thus penalties assessed under subsection 163(2) of the *Income Tax Act* were not justified. The Court further stated that while the Appellant did not have an accounting background nor did he have much business experience at the time, it would not have required any specialized knowledge to recognize a negative income figure. In holding so, the Court held that the Minister was justified in reassessing the Appellant's 2015 taxation year after the normal reassessment period had expired.

Lapierre v. The King

2023 DTC 1088

Appeal From Net Worth Assessments Allowed in Part

The Appellant, a certified management accountant, had appealed reassessments of her 2008 to 2013 taxation years, inclusive. There was a net worth reassessment per subsection 152(7) of the *Income Tax Act* (the "Act"), which allows for reassessments not dependent on returns or information supplied by the taxpayer. The Appellant pleaded in her Notice of Appeal that the use of a net worth method in this case was inappropriate. The Minister had raised net worth reassessments of the Appellant's income tax liabilities, resulting in a $5,540,547 total of unreported income for the 2008 to 2013 taxation years, inclusive. The issues at appeal were (i) whether unreported income amounts that the Appellant had challenged constituted income under the Act; (ii) whether the 2008 taxation year was statute-barred; and (iii) whether the assessed subsection 163(2) penalties were valid.

The appeal was partly allowed. The Court found that in the 2008 taxation year the Mineola Gardens property was not a principal residence of the Appellant. Thus, the principal residence exemption would not apply to the Appellant upon the 2008 disposition of that property. Thus, the Appellant wrongly did not report in her 2008 taxation year return any capital gain in relation to the disposition of the Mineola Gardens property. The Court further concluded that decisions regarding purchase and sale were made by the Appellant rather than by her daughter — but most particularly because the gains from selling each of the Stillmeadow Rd. and Ogden Ave. properties ended up with the Appellant and not with her daughter — that the daughter had held title to the properties as bare trustee for her mother, the Appellant. Thus the gains were taxable capital gains of the Appellant — not her daughter — as in both instances the Appellant was the beneficial owner. The Court lastly concluded that the settlement payment received by the Appellant should be included in her income as a capital benefit based on the *surrogatum* principle. The Court held it to be grossly negligent that the Appellant did not report any gain arising from her share of the settlement payment that she received.

Mann v. The King

2023 DTC 1089

Appeal From Net Worth Reassessment of Drug Dealer Dismissed

The Appellant had been found guilty of producing cannabis in his residence, possession of cannabis, trafficking cannabis, and stealing electricity from Hydro-Québec. In this context, the Minister carried out a tax audit of the Appellant. Given the illegal nature of the Appellant's activities, he did not keep any books or records. Consequently, the Minister used the net worth method during his audit, which revealed significant incompatibilities between the income declared and the lifestyle of the Appellant. The Minister issued assessments for undeclared business income and an undeclared sum the Appellant received from his union, and imposed penalties for the three tax years under examination. Three issues are in dispute, namely: whether the Appellant held $10,000 in cash before the taxation years; did the union benefits received by the Appellant constitute taxable income or a loan; and could the depressive symptoms and the personal situation of the Appellant be sufficient and taken into consideration to exclude the penalties imposed by the Minister?

The appeal was dismissed with costs. The appeal against the assessment for the 2012, 2013, and 2014 taxation years was dismissed. In regard to the sum of $10,000, the Court gave no credibility to the arguments of the Appellant, who most probably could have used this sum, if he had it, to provide for the needs of his family following his dismissal and/or to make a deposit on a new vehicle that he had purchased before the tax years concerned. The Court found that sums from the union's "Professional Defense Fund" are taxable retiring allowances within the meaning of subparagraph 56(1)(*a*)(ii) of the *Income Tax Act* since they were paid in respect of the loss of a job, and they do not constitute a loan given that the contingency, according to which the Appellant could have been obliged to reimburse the sums received by the union, is not sufficient to cause the allowance to lose its income status (*Lessard v. The Queen*, 2007 DTC 1658 (TCC)). The Court upheld the penalties, considering that the Appellant may have been in a depressed state of mind, but that he was organized enough and reasoned sufficiently logically to conduct criminal activities and derive income from them, which he deliberately failed to report due to their illegal nature.

Belval v. The King

2023 DTC 1090

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