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CRA ROUNDTABLE — 2016 CANADIAN TAX FOUNDATION ANNUAL TAX CONFERENCE

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At the 2016 Canadian Tax Foundation Annual Tax Conference, held in Calgary, Alberta from November 27–29, the Canada Revenue Agency held its annual roundtable question and answer session to address issues of note affecting taxpayers and their advisors. As has been the case in recent years, a number of questions focused on the application of section 55 in various situations, the general anti-avoidance rule (the "GAAR"), and tax issues arising in cross-border situations. This article reviews several of the questions discussed at the roundtable. Unfortunately, due to time constraints, the CRA was unable to address all questions asked at the roundtable, including a time-sensitive interpretive question on the application of proposed subsection 13(38) of the *Income Tax Act* (Canada) (the "Act"), which provides a transitional rule for corporations that dispose of eligible capital property prior to 2017 in circumstances where such corporation has an off-calendar year end.

The 55(2) Questions

Questions 2, 4, and 8 each involved potential interpretive issues related to section 55. Very generally, subsection 55(2) is an anti-avoidance rule in the Act which aims to prevent so-called "capital-gains stripping", whereby the value of a share is reduced through a tax-free intercorporate dividend. Where applicable, subsection 55(2) will recharacterize the dividend as a capital gain, resulting in a taxable event. Section 55 was overhauled in 2016, with changes that had been announced in the 2015 budget becoming law with the passage of Bill C-15 on June 22, 2016. The amendments to section 55 have been discussed previously in *Tax Topics*; see, for example, No. 2257 (June 11, 2015).

At the 2016 roundtable, the CRA addressed three questions related to the application of section 55. Question 2 related to the computation and allocation of "safe income" in the context of discretionary dividend shares. Generally, the concept of safe income, which recognizes that section 55 should not apply to a dividend paid by a corporation out of its tax-paid earnings, is typically computed on a share-by-share basis. In this question, the CRA was asked to consider the following facts:

- A holding company ("Holdco A") and a trust ("Trust B") incorporated an operating company ("Opco"). Each subscribed for 50 ordinary common shares of a separate class for a nominal amount.

- One of the beneficiaries of Trust B is a separate holding corporation ("Holdco B").

- At the end of its second taxation year, the shares of Opco have a fair market value of $2 million. Opco has safe income on hand of $2 million.

- Holdco C, a corporation related to Holdco A, purchases $1 million worth of common Opco shares of a separate class from those owned by Holdco A and Trust B.

- Holdco D, an unrelated company, borrows $0.5 million from Opco and uses the money to purchase half of Trust B's shares.

- At the end of its third taxation year, Opco has earned additional safe income of $3.6 million and declares the following dividends:

  - $3 million on the class of shares owned by Holdco C; and

  - $2.6 million on the class of shares owned equally by Trust B and Holdco D.

- Trust B allocates the dividend to Holdco B. Holdco D repays the amount borrowed from Opco with a portion of the dividend received from Opco.

The CRA was asked to comment on whether the dividends paid would fall outside the safe income exemption in these circumstances. The CRA representatives noted, quite reasonably, that this seems to be a rather uncommon and very specific situation and some of the facts do not exactly add up. The CRA did note that there are circumstances in which safe income can be "shifted" among discretionary dividend shares without triggering the application of subsection 55(2), but that each case needs to be reviewed on its merits and that its earlier published comments on this matter are consistent with each other and the CRA's current position, although they should not be considered a blanket policy allowing safe income shifting.

The CRA was also asked whether its answer would change if Holdco A had frozen its interest by exchanging its common shares for redeemable, retractable preferred shares at the time Holdco C acquired its interest in Opco. The CRA did not directly answer this question.

The CRA was also asked what information it would require to support a safe income computation given the expanded scope of section 55, which will require taxpayers to rely on safe income more often than in the past. Without providing a set of guidelines, the CRA noted that it would expect taxpayers to take a reasonable approach to safe income calculations, in accordance with the established case law. Somewhat alarmingly, the CRA noted that in certain extreme cases it would consider the application of subsection 239(1) for erroneous safe income calculations. This obviously shocked the crowd in attendance, as section 239 is one of the criminal provisions of the Act. The CRA took pains to note that this would only be considered in the most extreme cases of manipulation.

Question 4 also considered the application of section 55. That question addressed a fact-specific situation involving section 55 and the tax imposed under Part IV of the Act. Generally, the question concerned a situation where a corporation that received a dividend subsequently recharacterized as a capital gain under section 55 where the payer corporation also received a dividend refund under section 129 of the Act. Because the dividend received by the corporation is deemed not to be a dividend, there can be no amount taxable to the recipient under Part IV by virtue of the payer corporation receiving a dividend refund (which would ordinarily be the case). As such, the amount added to the refundable dividend tax on hand of the recipient corporation would be less, and a smaller taxable dividend would be required to obtain a full refund.

In the view of the CRA, the above is not correct. Upon payment of the initial taxable dividend, the recipient would need to remit the full amount of Part IV tax, then refile its return on the basis that section 55 applied and request a refund only once the larger dividend had been paid. Moreover, the recipient corporation would not be able to pay a capital dividend out of the capital dividend account that arises on the deemed capital gain out of the initial dividend received; such capital dividend could only be paid out of future amounts received by the recipient.

Question 8 asked whether cash would be considered property for purposes of applying new clause 55(2.1)(*b*)(ii)(B), to which the CRA answered in the affirmative.

The GAAR Questions

Questions 1 and 7 each related to the CRA's application of the GAAR. Question 1 involved the CRA's position on the potential application of the GAAR to a specific planning situation related to the deemed disposition by a trust every 21 years pursuant to subsection 104(4) of the Act. In the situation under consideration, a trust ("Old Trust") has a corporation among its listed beneficiaries. The sole shareholder of the corporation is a newly formed trust ("New Trust"). In advance of the 21-year anniversary of Old Trust, it makes a distribution of assets with accrued gain to the corporation on a rollover basis pursuant to subsection 107(2) of the Act. As a result of this transfer, Old Trust will hold no appreciated assets on the 21st anniversary, and the trust-to-trust transfer rule in subsection 104(5.8) (which would have required New Trust to have the same 21st anniversary date as Old Trust in respect of the transferred property) does not apply as no property was transferred to New Trust.

The roundtable participants advised that the CRA would look to apply GAAR to this sort of planning, on the basis that it frustrates the scheme of the Act and the 21-year rule because Old Trust effectively transfers property to New Trust indirectly and restarts the 21 years. The CRA is concerned that gains could be deferred forever by repeating this type of transaction. The CRA advised that the GAAR committee has not taken an opinion on this yet.

The CRA noted that this planning is generally acceptable if the distribution is to a corporation and all the shareholders are residents of Canada, as the gains will eventually be taxed. If the shareholder is a non-resident, the CRA would be much more concerned.

Question 7 concerned the CRA's assessing practices as concerns the GAAR, and in particular the role that the GAAR committee plays in GAAR assessments. Of note was a remark by the CRA that the individual tax services offices no longer need to have the GAAR committee approve a GAAR assessment; that generally, only upon an objection would the GAAR committee need to be in agreement with an assessment for it to be confirmed. This appears to be a break from prior practice and does not bode well for a consistently applied national standard for the application of the GAAR, as noted by one of the roundtable moderators.

The International Questions

Several questions concerned the CRA's interpretation of various international tax issues. Question 3 concerned the CRA's interpretation of the *Agnico-Eagle Mines Ltd.* (2016 DTC 5056 (FCA)) decision, which involved the computation of gains or losses on the conversion of foreign currency denominated bonds into shares. In the CRA's view, such a loss is not a foreign exchange loss and therefore subsection 39(2) does not apply. This means that it cannot be applied against capital gains realized elsewhere.

Question 9 related to the CRA's position on BEPS (Base Erosion Profit Shifting) Action Item 13. Specifically, the CRA was asked about its expectations of the "reasonable efforts" that a taxpayer must make to determine and use arm's length transfer prices including the preparation of transfer pricing documentation that is consistent with the recommendations from the OECD in Action 13 of the BEPS initiative. The OECD Action Plan involves:

(i) a master file containing standardized information relevant for all multi-national enterprise ("MNE") group members;

(ii) a local file referring specifically to material transactions of the local taxpayer; and

(iii) a country-by-country report containing certain information relating to the global allocation of the MNE group's income and taxes paid together with certain indicators of the location of economic activity within the MNE group.

In the CRA's view, this is covered by proposed section 233.8, which is a country-by-country reporting measure under the Act and is intended to be Canada's implementation of the OECD's reporting requirements. In the view of the CRA, section 233.8 has no direct relationship with section 247 (transfer pricing rules) and thus there is no requirement to provide master or local files under Canadian law.

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CURRENT ITEMS OF INTEREST

CRA Releases New Income Tax Folio

The CRA released new income tax folio S3-F4-C1, *General Discussion of Capital Cost Allowance*, on December 9, 2016. They will be accepting suggestions related to the folio's structure and content up until March 9, 2017. The chapter discusses the numerous capital cost allowance ("CCA") rules, but does not discuss any rules with respect to the specific CCA classes.

Supreme Court of Canada Clarifies Rules of Tax Rectifications

The Supreme Court of Canada rendered two judgments on December 9: *AG (Canada) v. Fairmont Hotels Inc*. (2016 SCC 56) and *Jean Coutu Group (PJC) Inc. v. AG (Canada)* (2016 SCC 55). The taxpayer was unsuccessful in both cases. The Court established stricter criteria for a tax rectification than what has previously been required: in order for the courts to rectify an instrument, they must be satisfied that there was a prior agreement with definite and ascertainable terms in effect when the instrument was executed.

RECENT CASES

Motion to reinstate taxpayer's appeal dismissed

The Minister of National Revenue issued a reassessment disallowing commission expenses claimed by the taxpayer for the 2005 and 2006 taxation years, and the taxpayer filed a Notice of Appeal from that reassessment. The taxpayer then determined that he would seek relief under the Taxpayer Relief provisions, and his counsel, based on that understanding, filed a Notice of Discontinuance of the appeal with the Tax Court. When he became aware of the dismissal of his appeal, the taxpayer filed a motion with the Tax Court seeking to have that dismissal set aside and the appeal reinstated. He indicated that it was always his intent to pursue the appeal and that he was unaware that discontinuance of his appeal in order to seek relief under the Taxpayer Relief provisions would constitute an acceptance of his tax liability under the reassessment.

The motion was denied. The taxpayer's motion was brought under Section 172 of the *Tax Court of Canada Rules*, and, in particular, section 172(2)(*a*), which provides that a party can bring a motion to have a judgment set aside or varied on the ground of fraud or of facts arising or discovered after it was made. Specifically, the taxpayer argued that he did not appreciate that he could have applied under the taxpayer relief provisions while continuing his appeal. The Court considered the taxpayer's circumstances and concluded that there was no allegation of fraud and that the taxpayer was represented by an experienced lawyer. More important, in the Court's view, there was no new fact which had arisen or was discovered after the "deemed" judgment. The Court held that what had occurred was an error of law resulting from a misunderstanding of the process of application for relief from a tax liability under the Taxpayer Relief provisions. The Court concluded that the finality of Court decisions and the administration of justice should prevail over the sympathetic circumstances from the applicant's perspective.

¶49,534, *Stover v. The Queen*, 2016 DTC 1198

Taxpayer and divorced spouse having mutual child support obligations; taxpayer still entitled to wholly dependent person and child amount credits claimed

The taxpayer and his divorced spouse S had six children. Under the terms of a Court Order (the "April Order") as amended by a written agreement (the "September Agreement") the taxpayer was required to pay S monthly support for four children of the marriage who resided with S, and S was required to pay the taxpayer monthly support for two children of the marriage who resided with him. The minister denied the taxpayer the wholly dependent person credits and the child amount credits (collectively the "Tax Credits") which he had claimed for 2009 and 2010. In the minister's view, by virtue of subsection 118(5) of the Act, the taxpayer was not entitled to the Tax Credits claimed because he was paying child support payments to S. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was allowed. Under the September Agreement both the taxpayer and S had mutual obligations to make child support payments to each other. Under subsection 118(5.1) of the Act, however, if no individual is entitled to deduct Tax Credits of the type involved in the present proceedings because of subsection 118(5), subsection 118(5) may be ignored. By virtue of subsection 118(5.1) of the Act, therefore, the taxpayer was unaffected by the limiting provisions of subsection 118(5) in this case (see the first example set out in *Letoria v. The Queen*, 2015 DTC 1195 (TCC)). He was thus entitled to deduct the Tax Credits claimed, but only with respect to one child for both taxation years in issue, since the other child was over the age of 18 at the end of 2009.

¶49,529, *Judickas v. The Queen*, 2016 DTC 1183

Part XII.6 tax payable by company which filed invalid subsection 66(12.66) renunciations

The taxpayer was a Canadian-controlled private company engaged in mineral exploration. The company filed look-back renunciations in favour of certain of its shareholders in the 2002 through 2006 taxation years. The renunciations filed were invalid, however, as the company and the affected shareholders were not, as the legislation required, dealing with one another at arm's length. The minister denied the look-back renunciations, but nonetheless assessed the company for Part XII.6 tax payable under section 211.91 of the *Income Tax Act*. The company appealed from that assessment, arguing that no tax was payable because the renunciations filed were invalid.

The appeal was dismissed. Subsection 66(12.66) of the Act allows corporations to renounce, in favour of their shareholders, expenses which the corporation has not yet incurred. Where such renunciation is made, the corporation is then liable to pay Part XII.6 tax. The issue for determination by the Court was whether such tax was payable where the renunciations were invalid because the criteria outlined in subsection 66(12.66) were not met, and the Court held that whether Part XII.6 tax was payable in those circumstances depended on the meaning of the phrase "purported to renounce" in section 211.91 of the Act. The Court held that the interpretation of that phrase must be done with regard to its text, context and purpose, and harmoniously with the scheme and object of the Act as a whole. The Court reviewed the provision in accordance with those criteria, and concluded that the application of Part XII.6 tax in the circumstances supported the stated purpose of the provision. The appellant had made look-back renunciations to shareholders who obtained the benefit of the deductions in the year prior to their being actually incurred. In the Court's view, that resulted in a cost to the fisc which the appellant was required to pay in accordance with Part XII.6.

¶49,532, *Tusk Exploration v. The Queen*, 2016 DTC 1196

Application for extension of time to file notice of objection dismissed — one cannot object to nil assessments

The applicant was seeking an extension of time to file notices of objection for the 1997–2008 taxation years. She was seeking to object in order to determine her eligibility for the disability tax credit ("DTC"). In April 2009 the taxpayer was advised that she was entitled to the DTC for 2007 and subsequent years, making the application for 2007 and 2008 unnecessary. She received nil assessments for the 1997–2006 taxation years, meaning no taxes were payable. Although the applicant cannot use the DTC from 1997–2006, it could be used by her spouse. The minister opposed the application on the basis that the applications were filed beyond the time limit allowed to grant extensions of time to file notices of objection.

The application for an extension of time to file notices of objection for the 1997–2006 taxation years was dismissed. A nil assessment is not an assessment but rather a notice that no taxes are payable. One cannot object to or appeal from a nil assessment. Even had the applicant not received nil assessments, the application would be dismissed as it was not filed within one year of the time limit for serving a notice of objection.

¶49,530, *Mockler v. The Queen*, 2016 DTC 1194

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