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TREATMENT OF LIMITED PARTNERSHIP LOSSES IN MULTI-TIER PARTNERSHIP STRUCTURES POST-*CANADA V. GREEN*

— *Emmanuel Sala, Partner, Dentons Canada LLP, Montreal Office and Judith Lemieux, Associate, Dentons Canada LLP, Montreal Office*

Background

Prior to the decision rendered by the Federal Court of Appeal (the "FCA") in *Canada v Green*[1] ("*Green*"), the Canada Revenue Agency (the "CRA") was of the view that the "at-risk" rules provided for under the *Income Tax Act*[2] (the "ITA") applied to a limited partnership ("LP2") that was a limited partner in another limited partnership ("LP1"). Subsection 96(2.1) of the ITA deemed the losses attributed to LP2 which exceeded LP2's at-risk amount in respect of LP1 to be LP2's limited partnership losses. However, LP2 could not make use of such limited partnership losses since LP2 was not a "taxpayer"[3] for the purposes of paragraph 111(1)(*e*) of the ITA. Therefore, since LP2 could not carry forward any limited partnership losses, such excess losses were not taken into account in computing the adjusted cost base of LP2's limited partnership interest in LP1.[4]

For instance, if LP2's share of the losses of LP1 was $20,000, and LP2's at-risk amount in respect of LP1 was only $10,000.00, the $10,000.00 balance would not constitute a limited partnership loss for LP2 and would not affect the adjusted cost base of LP2's interest in LP1.

Green

In *Green*, the taxpayers were limited partners in a limited partnership ("MLP"). MLP, in turn, was also a limited partner of other limited partnerships ("PSLPs"). The PSLPs had incurred business losses, which were allocated from the PSLPs to MLP, and subsequently, from MLP to the taxpayers. Until 2008, both the at-risk amount of the taxpayers in MLP as well as the at-risk amount of MLP in the PSLPs were nil. As a result, until 2008, the taxpayers had computed the business losses that had been allocated to them by MLP as limited partnership losses. In 2009, the taxpayers' at-risk amount in MLP increased due to a capital gain that was allocated to them by MLP. Therefore, in 2009 the taxpayers claimed a portion of their limited partnership loss in their respective tax returns.

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[1] *Canada v. Green*, 2017 DTC 5068.

[2] *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.).

[3] As highlighted by the FCA, partnerships, including limited partnerships, are not legal persons and are generally not taxpayers under the ITA except as provided in subsection 102(2). *Ibid.* note 1 at para 12.

[4] See CRA Views 2004-0062801E5, Limited partnership losses — tiered partnership, for an example of the CRA's administrative position.

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Before the Tax Court of Canada,[5] the Minister argued that subsection 96(2.1) of the ITA applied to the business losses incurred by the PSLP's and therefore MLP did not have business losses, but rather had limited partnership losses. The taxpayers would therefore be precluded from having business losses from MLP and there was no provision for allocating the limited partnership losses of MLP to the taxpayers. The Tax Court of Canada disagreed with the Minister and found that the business losses of the PSLPs did not cease to be business losses and were available to be flowed out to the taxpayers who were the partners of MLP.

On appeal, the FCA ruled in favour of Green, upholding the correctness of the lower Tax Court decision. It reaffirmed that business losses flowed through from the bottom-tier limited partnership to the limited partners of the top-tier limited partnership, where the top-tier limited partnership has no at-risk amount in respect of the bottom-tier limited partnership in a given year.

In so doing, the FCA endorsed the Tax Court's medley of textual, contextual, and purposive interpretation but emphasized the latter two modes of interpretation. It underscored that it was not the legislator's intent to subject the limited partnership that is a partner of other limited partnerships to the restriction imposed by paragraph 111(1)(*e*) of the ITA and to prevent it from using this deduction in subsequent years up to the limited partnership's at-risk amount in other limited partnerships. The FCA also explained that Parliament's intent could not have been to subject partnerships that are partners of other limited partnerships to the computation of income where these limited partnerships have a net loss exceeding the respective at-risk amount of their partners in those limited partnerships. Instead, the FCA concluded that the legislator's intent must have been to either subject all partnerships who are members of other partnerships to the computation of income, or not at all for partnerships that are members of other partnerships.

The FCA concluded that, barring a scenario implicating the general anti-avoidance rule ("GAAR"),[6] the at-risk rules were not applicable to a top-tier limited partnership to which losses were allocated from a lower-tier limited partnership. The FCA concluded that the Tax Court was right in stating that business losses incurred by a lower-tier partnership which are allocated to a top-tier partnership maintain their character in the hands of the top-tier partnership. In that particular factual situation, such business losses could therefore be allocated by the top-tier partnership to its limited partners (the taxpayers) without being subject to the at-risk limitation between the lower-tier partnership and the top-tier partnership.

The FCA further reiterated the logic that the prohibition in paragraph 96(2.1)(*c*) could only apply to a limited partner that is a taxpayer and not to a limited partner that is a partnership, since only taxpayers are required to compute amounts under sections 3 and 111. In a multi-tier partnership structure, the losses of the lower tier partnership would then flow directly through partnership levels until they reach a "taxpayer" in the upper tier. Since a partnership is not a "taxpayer" for the purposes of section 3 of the ITA, the determination or computation of income does not apply to a partnership. The FCA therefore overruled the CRA's long-standing application of the at-risk rules and allowed the taxpayers to claim a portion of their limited partnership losses up to their at-risk amount in MLP.

Government Response

As a result of *Green*, the Federal Government aimed to reinstate the former interpretation and application of the at-risk rules. To that end, it proposed tax measures in the 2018 Federal Budget (the "Proposed Rules") to resolve the incongruence between the CRA's position and the FCA's conclusions in *Green*. In short, the proposals attempt to clarify that at-risk rules apply at each level of a multi-tiered partnership structure and therefore that limited partnerships who are limited partners of other limited partnerships are indeed subject to "at-risk" rules. The Federal government believes the former interpretation of the at-risk rules ought to apply to a limited partner that holds a limited partnership interest in another partnership as a matter of policy. As it stated in an annex to the tax measures proposed in the budget:

> A recent Federal Court of Appeal decision has constrained the application of the at-risk rules in the context of tiered partnership structures. The decision is inconsistent with the policy underlying the at-risk rules and could

[5] *Green v. The Queen*, 2016 DTC 1018.

[6] ITA, s. 245.

> result in limited partnership losses becoming deductible in situations where, under the long-standing understanding of the at-risk rules, they would have been restricted. Given the indefinite carry-forward of limited partnership losses, this poses a significant risk to the tax base.[7]

The Proposed Rules have the effect of limiting the losses from lower-tier partnerships (LP1) that can be allocated to top-tier partnerships (LP2) up to LP2's at-risk amount in LP1. In such situations, in a manner consistent with the previous interpretation made by the CRA, any losses allocated by LP1 to LP2 exceeding LP2's at-risk amount in LP1 could not be carried forward by LP2 as its limited partnership losses, since LP2 could not benefit from paragraph 111(1)(*e*) of the ITA.

The Proposed Rules, particularly paragraphs 96(2.1)(*e*) and (*f*), clearly reflect the foregoing:

> (**1**) Section 96 of the Act is amended by adding the following after subsection (2):
>
> (2.01) **Tiered partnerships** — For the purposes of this section, a taxpayer includes a partnership.
>
> (**2**) Subsection 96(2.1) of the Act is amended by striking out "and" at the end of paragraph (*d*) and by replacing paragraph (*e*) with the following:
>
> (*e*) if the taxpayer is not a partnership, be deemed to be the taxpayer's limited partnership loss in respect of the partnership for the year, and
>
> (*f*) if the taxpayer is a partnership, reduce the taxpayer's share of any loss of the partnership for a fiscal period of the partnership ending in the taxation year of the taxpayer from a business (other than a farming business) or from property.[8]
>
> [Emphasis added]

Therefore, in accordance with proposed paragraph 96(2.1)(*f*), in the event that LP2 has been allocated losses by LP1 which exceed LP2's at-risk amount in LP1, this excess would be applied against the loss attributed to LP2 by LP1. This ensures that LP2 cannot, as in *Green*, carry forward the excess loss as a limited partnership loss, since such excess loss is deemed to reduce losses allocated to LP2.

In all, business losses allocated by LP1 to LP2 which would exceed the at-risk amount of LP2 in LP1 would not constitute a limited partnership loss that could later be deducted when computing LP2's income.

The result is that LP2 (which is a limited partner of LP1) will be allowed to allocate losses from LP1 to its partners only up to its at-risk amount in respect of LP1.

The Proposed Rules will apply to taxation years ending on or after Budget Day, 27 February 2018. Losses from a partnership incurred prior to Budget Day will not be eligible to be carried forward to a taxation year that ends on or after Budget Day if these losses were allocated to a limited partner that is another partnership for the year in which the losses were incurred.

Conclusion

The 2018 Federal Budget augurs the prospect that the at-risk amount of a limited partner in a limited partnership (LP2) — which in turn is a limited partner in another limited partnership (LP1) — will be greater than those of LP2 in LP1. It will be important to determine the at-risk amounts in complex partnership structures as well as their attendant consequences. The risk amounts notably include the adjusted cost base of the interest in the limited partnership.[9] In accordance with subparagraph 53(1)(*e*)(iv) of the ITA, in the event of a capital injection in LP1, the adjusted cost base would increase immediately and so would the at-risk amount. Such a capital injection could enable a top-tier partnership to allocate to its partners business losses attributed to it by a lower-tier partnership.

[7] Canada. Dept. of Finance. (2018). *Budget plan 2018* (Cat. No. F1-23/3E-PDF). Tax measures: Supplementary Information — Overview, online: https://www.budget.gc.ca/2018/docs/tm-mf/si-rs-en.html.

[8] Canada. Dept. of Finance. (2018). *Budget plan 2018* (Cat. No. F1-23/3E-PDF). Tax measures: Supplementary Information - Notice of ways and means motion to amend the Income Tax Act and other related legislation, online: https://www.budget.gc.ca/2018/docs/tm-mf/nwmm-amvm-01-en.html.

[9] ITA, subsection 96(2.2).

Finally, it is worth mentioning that certain industries may also be effectively exempt. For instance, farming losses are excluded from the "at-risk" rules by virtue of subsection 96(2.1) of the ITA and may therefore be allocated by a limited partnership to its partners without being subject to the at-risk rules.

A number of tax lawyers from Dentons Canada LLP write commentary for Wolters Kluwer's Canadian Tax Reporter *and sit on its Editorial Board as well as on the Editorial Board for Wolters Kluwer's* Income Tax Act with Regulations, Annotated. *Dentons Canada lawyers also write the commentary for Wolters Kluwer's* Federal Tax Practice *reporter and the summaries for Wolters Kluwer's* Window on Canadian Tax. *Dentons Canada lawyers wrote the commentary for* Canada–U.S. Tax Treaty: A Practical Interpretation *and have authored other books published by Wolters Kluwer:* Canadian Transfer Pricing *(2nd Edition, 2011);* Federal Tax Practice*;* Charities, Non-Profits, and Philanthropy under the Income Tax Act*; and* Corporation Capital Tax in Canada. *Tony Schweitzer, a Tax Partner with the Toronto office of Dentons Canada LLP and a member of the Editorial Board of Wolters Kluwer's* Canadian Tax Reporter*, is the editor of the firm's regular monthly feature articles appearing in* Tax Topics.

CURRENT ITEMS OF INTEREST

Senate Committee Reports Finding Regarding Disability Tax Credit

Following an increase in the number of disability tax credit ("DTC") applications being rejected, the Senate Committee on Social Affairs, Science and Technology held three meetings and heard the concerns of witnesses with respect to the structure and administration of the DTC and RDSPs. The report was released on June 27, 2018. The report identifies several issues, including:

- the DTC being underutilized;
- people with certain types of disabilities have more difficulty claiming the credit;
- the DTC is administered in a way that is rigid, complicated, and costly;
- the criteria related to mental functioning are problematic;
- people with lifelong disabilities are required to periodically reapply for the DTC;
- the costs of completing the application are a significant barrier;
- more low-income/vulnerable people should be using RDSPs; and
- the DTC should not be the only gateway to the RDSP.

The report made numerous recommendations to significantly alter the rules and administration of the DTC and RDSPs. The Committee recommends that the Minister of Finance revise the tax rules as follows:

- impairments in problem solving, goal setting, and judgment need not be present together to be eligible;
- work be included as a basic activity of daily living;
- administrative guidance not clearly specified in the *Income Tax Act* be reviewed so that they better capture the realities of living with a severe disability and are not prohibitive;
- the lifelong nature of certain disabilities be recognized in such a way that taxpayers need not reapply for the credit;
- the period between when bond and grant contributions end and when an RDSP beneficiary can begin to make withdrawals (without having to repay the federal contributions) be reduced from ten years to five years;
- individuals who are not eligible for the DTC but are eligible for provincial/territorial disability support payments should be eligible for the RDSP;
- the DTC be made a refundable credit; and
- the federal government should coordinate with the provinces/territories to ensure that income from the credit is exempt for the purposes of disability support eligibility.

The Committee also recommended that the Minister of National Revenue review the appeals process in order to create a straightforward, transparent, and informed process where the applicant has access to all relevant information. Another recommendation suggested that individuals should be allowed to keep all RDSP contributions for periods in which they were eligible for the DTC. Most notably, the Committee recommended that the Minister of Finance shift the responsibility of assessing eligibility for the DTC and RDSP to Employment and Social Development Canada.

It is important to note that tax-related recommendations from a House of Commons or Senate committee are not always acted upon. The government has not yet responded to this report, and it remains to be seen whether it will make any changes to the DTC or the RDSP.

Minister of Revenue Releases Offshore Tax Gap Study

On June 28, 2018, Minister of Revenue Diane Lebouthillier announced the release of the CRA's fourth tax gap study. This particular study relates to the income tax gap for individuals earning offshore investment income. The study found that in 2014, this tax gap was between $0.8 billion and $3.0 billion, or between 0.6% and 2.2% of income tax revenue from individuals.

Comfort Letter Regarding Foreign Spin-Off

The Department of Finance provided a comfort letter dated April 30, 2018. The letter recommends to the Minister of Finance that a distribution of shares of Essity Aktiebolag by Svenska Cellulosa Aktiebolaget be a prescribed distribution for the purposes of the foreign spin-off rules under section 86.1. This distribution, which occurred on June 15, 2017, satisfies the technical requirements of the foreign spin-off rules.

RECENT CASES

Appeal from Tax Court decision that GAAR applied to corporate reorganisation allowed

The individual taxpayer, who was the sole owner of a corporation, carried out a corporate reorganization. He used his lifetime capital gains exemption when reporting the reorganization transactions, such that no tax was paid on any of those transactions. The Minister reassessed on the basis that the series of transactions constituted tax avoidance under the general anti-avoidance rule ("GAAR"). The taxpayer appealed to the Tax Court of Canada, which confirmed the Minister's assessment and the application of the GAAR. The Tax Court held that the series of transactions carried out allowed the individual taxpayer to indirectly withdraw corporate earnings on a tax-free basis by using his capital gains exemption to offset the capital gain realized on a sale to a non-arm's-length party in a share-for-share exchange. That result was achieved by triggering the paid-up capital averaging mechanism in section 89 of the *Income Tax Act* (the "Act"), resulting in the artificial inflation of the paid-up capital of the taxpayer's shares in circumstances where he made no new capital contribution. The Tax Court found that the series of transactions achieved a result that section 84.1 of the Act was intended to prevent, and defeated that provision's underlying rationale, which was to prevent the removal of taxable corporate surplus as a tax-free return of capital through the use of the capital gains exemption. The Tax Court concluded that the transactions had been undertaken in a manner that defeated the object, spirit, and purpose of sections 84.1 and 89.1 of the Act, and it followed that the transactions constituted an abuse under GAAR, which had been properly applied by the Minister. The taxpayer appealed from that decision to the Federal Court of Appeal.

The appeal was allowed. The appellate Court held that the standard of review to be applied with respect to whether there had been an abuse was that of palpable and overriding error, and that the Tax Court had erred in law and in fact with respect to the tax benefit which it perceived to have been realized. The Federal Court of Appeal held that while

there was no issue with respect to the Tax Court's characterization of the object, spirit, and purpose of section 84.1, there was no evidence before the Tax Court that there had been any distribution of retained earnings. In the appellate Court's view, while the corporate reorganization changed the tax attributes of a class of preferred shares in a way which created the potential for a tax-free distribution of retained earnings, that potential had not, to date, been realized. The appellate Court concluded therefore that because the tax-free distribution of retained earnings which section 84.1 was intended to prevent had not occurred, there was no evidence that would allow the Tax Court to conclude that, to date, section 84.1 had been misused or abused. As no misuse or abuse of section 84.1 had taken place, the Minister had erred in applying the GAAR. The Federal Court of Appeal noted, however, that its judgment on that issue was without prejudice to the entitlement of the Minister to reassess the appellants in the event that they moved to remove the taxable corporate surplus in issue as a tax-free return of capital.

¶49,976, *1245989 Alberta Ltd. et al v. AG of Canada*, 2018 DTC 5067

Tax refunds arising from disability tax credit claims for pre-bankruptcy years not treated as income of bankrupt

The bankrupt assigned herself into bankruptcy in May 2013 and was discharged in February 2014. Following her discharge, the bankrupt became aware that she could make a claim for the disability tax credit on behalf of her disabled child. She applied for and received that credit for each of the taxation years between 2005 and 2014. The resulting tax refunds, totalling $20,3339, were sent to the trustee, who applied to the Court for direction on how to deal with those amounts.

Order issued providing that only the refund for the 2013 tax year to be treated as income of bankrupt. The Registrar in Bankruptcy reviewed the wording of sections 67 and 68 of the *Bankruptcy and Insolvency Act* ("BIA"). Section 67 deals with the property of the bankrupt which is to be divided among creditors by the trustee. Section 68 defines the bankrupt's "total income" and "surplus income". He noted that the current wording of section 68 limits "total income" to "revenues . . . earned or received by the bankrupt between the date of the bankruptcy and the date of the bankrupt's discharge. The Registrar noted that had the claims for the disability tax credit for years prior to the bankruptcy been made during those years, the resulting tax refunds would have gone to the bankrupt, and the trustee would have no claim at all to the funds. The Registrar noted as well that, notwithstanding subsequent amendments to the relevant statutory provisions, Supreme Court of Canada jurisprudence indicated that income tax refunds such as the disability tax credit are to be treated as income and not as property, and therefore are governed by section 68 of the BIA. The Registrar concluded that, based on the current wording of section 68, if money was either earned or received during the bankruptcy, including tax refunds, such money forms part of the "income" for purposes of section 68. The tax refund in issue was not claimed until after the bankrupt had been discharged, and, consequently, she was required to account only for the portion that she "earned" during the bankruptcy. Accordingly, the Registrar ordered that the funds held by the trustee should be paid to the bankrupt, with the exception of the funds that were received from the Canada Revenue Agency on account of the calendar year 2013 and in respect of the bankrupt's earnings up to the date of her discharge from bankruptcy in February 2014. The amounts to be paid to the trustee were to be treated as part of the bankrupt's income.

¶49,977, *Re Chomistek*, 2018 DTC 5068

Individual taxpayer found to be in contempt of Compliance Order issued by Federal Court

In December 2016, a Compliance Order was issued by the Federal Court pursuant to section 231.1 of the *Income Tax Act*. That Compliance Order required the individual and corporate taxpayers to provide certain tax and business records within 30 days after being served with the Order. Neither taxpayer complied, and the Minister sought a further Order of the Court under Rule 466 of the *Federal Courts Rules*, requiring the respondents to show cause why they should not

be held in contempt. A contempt hearing was held in November 2017, with no one appearing on behalf of the respondents.

A contempt order was issued against the individual respondent. The Federal Court noted that the sole issue in the proceeding was whether the respondents, or either of them, should be held in contempt of Court as the result of their failure to provide the documents identified in the Compliance Order. The Court noted that the burden of proof in a contempt hearing lies upon the moving party. In order to discharge that burden of proof, it was necessary that the applicant prove beyond a reasonable doubt that the alleged contemnor had personal knowledge of the Court Order in issue, that the alleged contemnor be a primary actor, expressly or impliedly, in the conduct that was the subject of the contempt proceedings, and finally, that the alleged contemnor possessed the necessary intention to disobey the Court Order. Prior to considering the substance of the contempt application, it was first necessary to establish that the respondents had been served with notice of the hearing. The Court reviewed the evidence in that regard and concluded that, while it was satisfied that the individual respondent had been served, it could not conclude that service had been properly effected upon the corporate respondent. Consequently, the Court could not determine the allegations of contempt in relation to the corporate respondent. With respect to the substance of the allegations, the Court held that it was within the authority of the applicant to decide whether a response from a taxpayer was an adequate reply to the Compliance Order. On the evidence provided, the Court was satisfied that the individual respondent had not complied with the request made to provide specified information and documents relating to his personal income tax file which were the subject of the Compliance Order. The Court concluded that the applicant had discharged the burden of establishing the three elements of contempt with proof beyond a reasonable doubt, and had met the test for a finding that the individual respondent was in contempt of the Court's order. An order finding the individual respondent in contempt was issued, and, in accordance with the jurisprudence requiring that a person should be given the opportunity to make submissions on the appropriate penalty, the Court ordered that a hearing to address penalty and costs be held at a later date.

¶49,978, *MNR v. Gray and 619947*, 2018 DTC 5069

Application for judicial review of denial of interest and penalty relief dismissed

The taxpayers were a husband and wife who owned a small business. In 2008, the Canada Revenue Agency carried out an audit of their personal and business taxes for the 2004 through 2007 taxation years. A net worth analysis was carried out and the result of that analysis was a determination that the taxpayers had failed to report all of their income for those years. A reassessment for taxes owed was issued, together with interest charges and penalties imposed for gross negligence for 2005, 2006, and 2007. The taxpayers filed a Notice of Objection and some adjustments were made by the Objections Branch to the amounts owed. The taxpayers did not appeal the reassessments or the adjustments made, but submitted a fairness request to the Minister, seeking a waiver of the interest and penalty charges. Their request alleged delay and error on the part of the Canada Revenue Agency, as well as financial hardship and their inability to pay the interest and penalty charges. The request was denied at the First Level Review, and the taxpayers were advised that, if they believed that the reassessment contained an error, they should appeal to the Tax Court. Their arguments with respect to financial hardship were found not to be valid and it was also determined that the exceptional circumstances required for a waiver of penalties did not exist. The taxpayers sought a Second Level Review on the same grounds, as well as an inability to pay because of illness. The Second Level Review reviewed the compliance history and financial situation of the taxpayers before concluding that they did not qualify for relief on the basis of financial hardship. As well, the taxpayers were again advised that an appeal to the Tax Court should be pursued if they believed the assessment to be in error. The taxpayers then applied for judicial review of the Second Level Review decision.

The application was dismissed. The Federal Court noted at the outset that in their pleadings the applicants had identified nine issues, including the fairness of the audit and the failure of the CRA to consider all of the evidence that was submitted. The Court noted that the majority of the issues raised seemed to attack the correctness of the original

audit, and held that such question was beyond the jurisdiction of the Federal Court, which has no jurisdiction to vacate or review tax assessments. In addition, the ability to ask for relief from interest and penalties could not be used to make a collateral attack on tax assessments. Any challenge to the correctness of the tax assessments and the audit processes could only be considered before the Tax Court of Canada. The only issue which was raised by the applicants which could be addressed by the Federal Court was whether the decisions made by the CRA in denying relief were reasonable. The Court held that under the Federal Courts Act, on an application for judicial review, it could review the process by which the challenged decisions were made, but could not make an independent "new" decision. The process used to reach those decisions was to be reviewed on a standard of reasonableness, meaning that the decision was required to be justifiable, transparent, and intelligible, and to fall within a "range of possible, acceptable outcomes which are defensible in respect of the facts and the law". The Court reviewed the processes by which the impugned decisions had been made, and concluded that such processes met the reasonableness standard. In the Court's view, the decision-makers had considered and followed the factors identified in the applicable Guidelines, on the basis of the evidence provided by the taxpayers. The Court held that the conclusions reached were both transparent and justifiable on the basis of the evidence provided, and that such conclusions had been explained in a manner that met the requirement of intelligibility. The role of the Court in judicial review was to look at the decision and ask if the denial of relief against penalties imposed was reasonable, within the scope of the legal test. The Court concluded that the applicants had not shown that the decision under review was unreasonable or that any legal error was made that would justify intervention by the Court.

¶49,979, *Al-Quq et al. v. Canada (AG)*, 2018 DTC 5070

ACB of partnership interest increased only by elected amount on subsection 97(2) rollover

In a rollover done under section 97(2) of the *Income Tax Act*, the taxpayer transferred assets having a fair market value of $130 million and a cost base of $14 million and received non-share consideration of $8.5 million. When it later carried out an internal reorganization that resulted in the partnership assets being owned by an affiliated corporation, it calculated the adjusted cost base ("ACB") of the transferred assets as including both the fair market value ("FMV") of the assets and the elected amount. The taxpayer then claimed a capital loss of $122 million resulting from the transaction. The Minister reassessed on the basis that only the elected amount should have been included in arriving at the ACB, and that the transaction consequently resulted in the realization by the taxpayer of a capital gain of $140,000. The taxpayer appealed from that assessment to the Tax Court of Canada.

The appeal was dismissed. The Tax Court of Canada held that the only issue for determination was whether, on a rollover of property to a partnership under section 97(2), the transferor's ACB in its partnership interest is increased by both the FMV of the property and the elected amount. The appellant had taken the position that at the time of transfer, the rules in section 54 determined the cost of the partnership interest to be the fair market value of the transferred property, and that immediately after that time paragraph 97(2)(*b*) added an amount equal to the elected amount, less the non-share consideration. The Court held that while the specific interpretation of subsection 97(2) adopted by the appellant had not previously been considered by the Courts, there was jurisprudence on subsection 97(2) generally, and on its purpose and effect. The Court reviewed such jurisprudence, the relevant statutory provisions and the terms of the agreement transferring the property to the taxpayer. It held that there was no clear suggestion in the wording of the specific rules in subsection 97(2) that the more general rules regarding ACB found in section 54 should apply to give a cost equal to the fair market value where subsection 97(2) applied. There was, in the Court's view, no support for the taxpayer's interpretation of the text of the two provisions where those provisions were read in their context and having regard to their purpose. The Court held as well that, even in the event that the taxpayer's interpretation of the statutory provisions could be supported, it would nonetheless dismiss the appeal on the grounds that, as acknowledged by the appellant, its interpretation led to an absurd and unintended result, that the specific language used in subsection 97(2) for exactly such transactions should override the general provisions and that the Explanatory Notes for section 97 did not favour the appellant's interpretation. Finally, the Court noted that Supreme

Court of Canada jurisprudence has addressed the situation where, although the text of a provision has no patent ambiguity, there exists a latent ambiguity which can be resolved by statutory context or purpose. The Tax Court held that if the wording of the statutory provisions in question was characterized as such a latent ambiguity, applying the purpose and context analysis identified in the jurisprudence would lead it to arrive at the same result in interpreting those statutory provisions, for the same reasons. The appeal was therefore dismissed.

¶49,970, *Iberville v. The Queen*, 2018 DTC 1078

Appeal from assessment finding Canadian-source income taxable in Canada dismissed

The appellant, who was a US citizen and resident, earned income in both Canada and the US from engineering activities. In 2012, he earned $26,244 of income in Canada from the provision of engineering services. The Minister assessed on the basis that, pursuant to subparagraph 9(a) of Article V of the Canada-U.S. Tax Convention, the appellant had provided services through a permanent establishment in Canada and that pursuant to paragraph 1 of Article VII of the Convention, such income was taxable in Canada. The appellant appealed from that assessment.

The appeal was dismissed. The Tax Court held that the issue for determination was whether the appellant was deemed, under the provisions of the Canada-U.S. Income Tax Convention, to have provided services through a permanent establishment in Canada. The Court reviewed the relevant provisions of the Convention as well as the facts of the business structures through which the appellant had earned the income which was the subject of the assessment. Based on that review, it held that the appellant would be considered to have a permanent establishment in Canada if the requisite residence and income requirements set out in the Convention were met. Specifically, under paragraph 9 of Article V of the Convention, the appellant would be found to have been providing his services through a permanent establishment in Canada if the services provided by his enterprise in Canada were performed by him for a period or periods totalling 183 days or more in any twelve-month period, and if, during that time, more than 50 per cent of the gross active business revenues of his enterprise consisted of income derived from services performed by him in Canada. The Court found that the appellant did have an enterprise which performed services in Canada and that Article V therefore applied. The appellant had acknowledged that he met the residence requirements, and the Court found that he was physically resident in Canada for 188 days between August 2011 and August 2012. On the question of the income requirements, the Court held that the onus was on the appellant to prove that the revenues earned in Canada did not represent more than 50 per cent of the gross active business revenues of his enterprise, and that he had failed to do so. Consequently, the Court concluded that the amount of $26,244 earned in Canada by the appellant's enterprise was taxable in Canada under Article VII of the Convention, because it was deemed to be attributable to a Canadian permanent establishment under paragraph 9 of Article V of the Convention. The appeal was therefore dismissed.

¶49,975, *Wolf v. The Queen*, 2018 DTC 1081

Appellant's motion to strike Further Amended Reply dismissed where Reply rectifying earlier errors

The taxpayer, a non-profit organization, operated a golf course and it realized a gain of approximately $1.75 million on the sale of a parcel of land adjacent to that golf course. The sale proceeds were reported on the organization's Non-Profit Organization Information Return but not on its T3 tax return. The Minister issued a reassessment in respect of the taxpayer's failure to report the disposition and gain on the T3, and that reassessment was issued outside the normal reassessment period. The taxpayer appealed. In the course of the appeal the Minister filed a Reply which was struck by the Court, with leave to amend, on the basis that its contents did not plead facts which would have allowed the Court to conclude that the appellant had made a misrepresentation and that, in addition, it improperly pleaded mixed fact and law. The Minister then filed a Further Amended Reply seeking to correct the deficiencies in the original

Reply and to establish misrepresentation on the part of the appellant, such as would allow the Minister to reassess outside the normal reassessment period. The appellant brought a motion seeking to have that document struck on the grounds that it represented an abuse of process or failed to disclose reasonable grounds for opposing the appeal.

The motion was dismissed. The Tax Court held that the question for determination was whether the Further Amended Reply filed by the Minister resolved the deficiencies of the past Reply, which had not set out facts relevant to determining whether the taxpayer had made a misrepresentation. The Court noted that the test for striking out a pleading is difficult to meet and the threshold to strike is high. Under the Tax Court Rules, and the jurisprudence interpreting those Rules, pleadings can be struck as vexatious, and pleadings which fail to sufficiently reveal facts on which a claim is based, to make it possible to answer or for the Court to regulate the proceedings, are vexatious. Pleadings can also be struck without leave to amend for disclosing no reasonable grounds for appeal or opposing appeal. The Court reviewed the relevant jurisprudence, and noted that appellate jurisprudence has found that claiming a deduction for which a taxpayer is not entitled counts as a misrepresentation. That determination supported the respondent's view that the appellant's incorrect assumption that it was entitled to tax relief or a claim for an exemption to which it was not entitled constituted a misrepresentation under subsection 152(4) of the *Income Tax Act*. Consequently, in the Court's view, the respondent had pleaded facts to allow the Court to conclude that the appellant had made such a misrepresentation. As well, in the Court's view, the pleadings which had improperly included mixed law and fact had been rectified in the Further Amended Reply. The Tax Court concluded, therefore, that the respondent had rectified the errors which caused the initial Reply to be struck and that the Further Amended Reply should not be struck as failing to disclose reasonable grounds. The motion to strike was therefore dismissed, with costs to the respondent.

¶49,974, *Mont-Bruno v. The Queen*, 2018 DTC 1080

INTERNATIONAL NEWS

IRS Announces Plans To Simplify Personal Income Tax Return

This article originally appeared in Wolters Kluwer's Global Tax Weekly Issue 295.

The US Internal Revenue Service ("IRS") has announced plans to streamline the personal income tax return for the 2019 tax filing season, to reflect changes brought about by the Tax Cuts and Jobs Act ("TCJA").

According to the IRS, the new Form 1040 will consolidate the existing three versions of the form (forms 1040, 1040A, and 1040EZ) into one form, which will be about half the size of the current form.

The IRS said the new Form 1040 uses a "building block" approach, which can be supplemented with additional schedules if needed. Taxpayers with straightforward tax situations would need to file only this new 1040 with no additional schedules, the agency explained.

Welcoming the development, the House of Representatives Ways and Means Committee said the IRS has been able to reduce the size of Form 1040 due to simplification measures introduced under the TCJA.

"Under the old, broken tax code, 48.8m taxpayers itemized their deductions," stated a blog post on the committee's website. "According to the nonpartisan Congressional Budget Office (CBO), next year 31.1m hardworking taxpayers will no longer be burdened by the complexities of itemizing, instead choosing to take the standard deduction and filing on this simple postcard system."

The CBO has also estimated that there will be a substantial reduction in the number of taxpayers needing to calculate tax under the Alternative Minimum Tax, from 5 million in 2017 to 222,000 this year.

In addition to simplifying the form to include only the most commonly used lines, all personal information is now to be included only on the first page instead of spread throughout the form, the Committee said.

EU, UK Agree to Brexit VAT Terms

This article originally appeared in Wolters Kluwer's Global Tax Weekly Issue 295.

The EU and the UK have agreed law provisions for inclusion in a prospective Brexit transitional agreement on value-added tax administration and administrative cooperation in indirect tax matters.

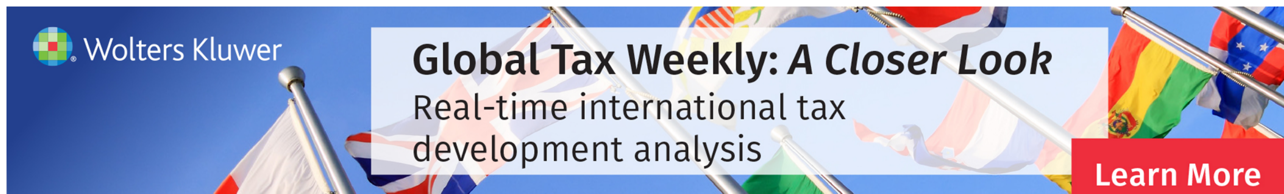
The provisions were agreed between the two parties' negotiators and published by the Commission on June 19, 2018.

The two sides have agreed that the EU VAT Directive should apply to goods dispatched or transported from the UK to an EU member state, and vice versa, provided that the dispatch or transport started before the end of the Brexit transition period and ended thereafter.

The rights and obligations of any taxable person in the EU VAT Directive involved in such will be maintained for five years after the end of the Brexit transition period. However, any application for refunds submitted on this basis must be submitted by March 31, 2021 at the latest, and any amendments to tax returns with regards to services supplied in member states of consumption before the end of the transition period must be submitted by December 31, 2021.

Further, they have tentatively agreed that Council Regulation (EU) No. 904/2010 of October 7, 2010, on administrative cooperation and combating fraud in the field of value-added tax, and the equivalent agreement covering excise duties (Council Regulation (EU) No. 389/2012 of May 2, 2012), should apply for four years after the end of any Brexit transitional period, for any supplies made prior to the end of the transitional period and those to be listed in Article 47(1) of a final agreement. For excise duty matters, the deal references as covered by the four-year term supplies instead to be listed in Article 48 of any final agreement.

Finally, the deal includes an agreement that the UK should continue to be covered by provisions concerning mutual assistance for the recovery of claims relating to taxes, duties, and other measures for five years following the end of the transition period.



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For Wolters Kluwer Canada Limited

Tara Isard, Senior Manager, Content
Tax & Accounting Canada
(416) 224-2224 ext. 6408
email: Tara.Isard@wolterskluwer.com

Natasha Menon, Senior Research Product Manager
Tax & Accounting Canada
(416) 224-2224 ext. 6360
email: Natasha.Menon@wolterskluwer.com

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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

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