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# Tax Topics®

December 17, 2009  
Number 1971-72

## 2009 Canadian Tax Foundation Conference: Wizards, Tiny Taxes and “Evil” Kirk

On Tuesday November 24, 2009, at the Annual Conference of the Canadian Tax Foundation in Toronto, presentations were made by both the Department of Finance and the Canada Revenue Agency (the “CRA”), and the CRA participated in its annual Roundtable question and answer session.

If the CRA Roundtable discussion takes on a theme from one year to the next, perhaps 2005 was the year of the income trust; 2006, the year of safe income and tax shelters; 2007 may have been the year of trusts and SIFTs; and 2008, the year of the Fifth Protocol. As the CRA continues to release guidance on the Fifth Protocol, 2009 may be the year of the unlimited liability corporation or the services permanent establishment. Or maybe it will be remembered as the year of “Evil” Captain Kirk from Star Trek. We’ll see, I guess.

### Department of Finance – Update

Louise Levonian, Assistant Deputy Minister in the Department of Finance, addressed the conference. In respect of legislation, Ms Levonian noted that most of the provisions of the 2009 Budget have been enacted. The remaining items are in Bill C-51, which received third reading in the Senate on December 10, 2009 and is just awaiting Royal Assent. The rules regarding FIEs and NRTs are being reviewed and dealt with separately from the other provisions of former Bill C-10. Finance expects to have draft FIE and NRT legislation available for comment soon, and is hopeful that the provisions will be part of the 2010 Budget. The remainder of the former Bill C-10 provisions (i.e., technical amendments, including the proposed provisions in respect of restrictive covenants) are expected to be reintroduced in the near future.

### Canada Revenue Agency – Update

Lyse Ricard, Deputy Commissioner of the CRA, addressed the conference. She announced that there will be more information forthcoming

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on new transfer pricing rules. She also announced the creation of a new Transfer Pricing Specialty Section within the International Tax Directorate, which will have the expertise and resources to handle complex transfer pricing issues.

The CRA continues to consider the issue of the CRA's access to accountants' working papers. Obviously, this issue has been raised in previous years and continues to be a "hot button" issue for tax practitioners and the CRA. The CRA is consulting on this issue, as it considers working papers necessary information on an audit. There will be more information from the CRA on this in the future.

The CRA announced a new "risk assessment" approach to the audits of large corporations. The CRA's data shows that 80% of tax raised on audits comes from 20% of taxpayers in this group. The CRA intends to identify and assess the audit risk for certain taxpayers and will develop strategies in response. The CRA intends to implement a multi-layer program for selecting returns for review, which will apparently involve the use of sophisticated algorithms to assess risk. This will result in a shift to a new system where the audit results for the previous five years will be used to determine which taxpayers will be selected for review. The CRA expects that low-risk, cooperative, compliant taxpayers will be on a less frequent audit cycle, whereas high-risk taxpayers will be subject to a frequent

audit cycle. Various offices will coordinate industry-specific teams – for example, Calgary will specialize in oil & gas, Windsor in automotive, Toronto North in financial instruments, and Laval in pharmaceuticals.

## CRA Roundtable

Following the Finance and CRA updates, the CRA participated in a Roundtable discussion on a variety of issues. The CRA was represented by Phil Jolie, Director of the International and Trusts Division in the Income Tax Rulings Directorate, and Mark Symes, Director of the Financial Sector and Exempt Entities Division of the Income Tax Rulings Directorate. The Roundtable was chaired by practitioners Andrew W. Dunn and Ron Durand.

The Roundtable discussion was carried out in a traditional question and answer format. The summary below is based on notes taken during the sessions as well as the PowerPoint presentation of the questions and answers prepared by the panellists, which has been released by the CTF. A complete summary of the Roundtable is expected to be published at a later date by the CTF and in an Income Tax Technical News published by the CRA.

## Skinny Voting Shares

The CRA was asked for its view on the valuation of skinny voting shares (a separate class of shares that have no right to dividends or proceeds on windup but which give the holder voting control). In two Vancouver cases, the CRA had assessed a premium on the value of a company's skinny voting shares (*Lacterman v. The Queen*, 2009-498(IT)G and 2009-495(IT)G and *Dustan v. The Queen*, 2009-1152(IT)G – Both cases have been discontinued). Further, at the 2009 British Columbia Tax Conference, the CRA stated its view that non-participating controlling shares have some value and may therefore command a premium. Of course, as part of a typical estate freeze, over time the freezer's freeze shares are redeemed and the freezer is left with only the skinny voting shares.

The CRA stated that, as a matter of fact, the skinny voting shares probably have some value that would generate a premium. However, the CRA stated that it will "play along" with the view that the skinny voting shares have no premium value. The CRA referred to the classic movie *The Wizard of Oz* and stated that if the taxpayer never pulls back the curtain to reveal the Wizard (i.e., a value of the skinny voting shares) then the CRA will proceed on the basis that the shares have no value. However, if the taxpayer pulls back the curtain to reveal the value of the voting shares (i.e., if the value of the shares is demonstrated

### TAX TOPICS

Published weekly by CCH Canadian Limited. For subscription information, see your CCH Account Manager or call 1-800-268-4522 or (416) 224-2248 (Toronto).

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PUBLICATIONS MAIL AGREEMENT NO. 40064546  
RETURN UNDELIVERABLE CANADIAN ADDRESSES TO  
CIRCULATION DEPT.  
330-123 MAIN ST  
TORONTO ON M5W 1A1  
email circdept@publisher.com

© 2009, CCH Canadian Limited  
90 Sheppard Ave. East, Suite 300  
Toronto, Ontario M2N 6X1

in a legal proceeding or on a sale for proceeds), then the CRA will assess on that basis.

## Key Employee Tax-Free Savings Accounts

With respect to the Tax-Free Savings Account (“TFSA”) program, the CRA stated that it seems that some people see the words “tax-free” and stop reading. The CRA’s view is that there are some strings attached to the use of these accounts, and many such strings were addressed in the Department of Finance announcement dated October 16, 2009.

The CRA has previously indicated that where common shares of a company are issued to a TFSA of a key employee as part of a freeze, it considers the shares’ FMV increase to be an advantage that is a benefit taxable to the employee.

Section 207.05 states that tax is payable where an advantage is extended to the TFSA holder. The CRA’s view is that an “advantage” under subsection 207.01(1) includes an increase in the FMV of the TFSA attributable directly or indirectly to a transaction that would not have occurred in an open market in which parties deal at arm’s length and act prudently and where one of the main purposes is to benefit from the tax-free status of the TFSA, or the payment was received in substitution for services. The CRA considers that the words “directly or indirectly” include not only increases in FMV at the time of issuance, but also future increases. In respect of timing, the amount of the advantage must be determined annually. The advantage rules could apply whether the freeze is by a private or public company.

## Life Insurance

The CRA was asked to consider a situation where A owns Parentco, which in turn owns Subco. Subco has an insurance policy on the life of A and pays its premiums. Parentco is the beneficiary of the policy. Previously, the CRA’s view has been that subsection 15(1) would not apply to include a benefit in A’s income in respect of the value of the premiums or the proceeds paid on the death of the insured (see, for example, CRA Document No. 9824645, “Capital dividend account” (December 15, 1998) and CRA Document No. 2004-0065461C6, “Corporate-owned life insurance” (May 4, 2004)). The CRA was asked whether this remains the CRA’s view.

The CRA stated that its present view is that subsection 15(1) will apply to the premiums paid by Subco to trigger a benefit to Parentco. This change will be applied prospectively. For new policies, it will apply as of January 1, 2010; for

existing policies, it will apply January 1, 2011. Further, the CRA noted that the GAAR could apply if the holding of the insurance was structured to increase the capital dividend account.

## Unlimited Liability Corporations

The CRA was asked a series of questions about the denial of treaty benefits to unlimited liability corporations (“ULCs”) under Article IV(7) of the Canada–U.S. Tax Treaty (the “Treaty”).

In the first scenario, a U.S. company owns a Canadian ULC. The ULC increases its paid-up capital and at a later time, makes a payment to distribute that capital. For Canadian tax purposes, the increase in paid-up capital would result in a deemed dividend but would have no relevance for U.S. tax purposes, whether or not the ULC was fiscally transparent. The subsequent payment on a reduction of paid-up capital would not be subject to Canadian withholding. In response, the CRA stated that, provided the deemed dividend is disregarded for U.S. tax purposes and would be similarly disregarded if the ULC were not fiscally transparent, Article IV(7) would not apply. Further, the CRA stated that it would not normally expect the GAAR to apply where the ULC is used by the U.S. parent company to carry on an active branch operation in Canada and the U.S. parent company and the ULC enter into this arrangement so as to continue to qualify for the 5% withholding tax rate on the distribution of the ULC’s after-tax earnings to the U.S. parent company.

In the second scenario, a Luxembourg société à responsabilité limitée (“Luxco”) is inserted between the U.S. parent and the ULC. Luxco is considered to be a resident of Luxembourg for Canadian tax purposes but is disregarded for U.S. tax purposes. The CRA was asked whether the 5% withholding tax rate under the Canada–Luxembourg Tax Treaty would apply to dividends paid by the ULC to Luxco. The CRA jokingly stated that it is still experiencing the five stages of grief (denial, anger, bargaining, depression and acceptance) in respect of the result in *Prévost Car Inc. v. The Queen* (2009 DTC 5053 (FCA), aff’g 2008 DTC 3080 (TCC)). (Given the CRA’s humour on the subject, it appears it is at the acceptance stage.) The CRA said that the 5% rate will normally apply if Luxco is the “beneficial owner” of the dividends. The CRA’s view on the meaning of “beneficial owner” in light of the *Prévost* decision is detailed in CRA Document No. 2009-0321451C6, “Meaning of beneficial owner in Article 10, 11 and 12 of Canada’s Tax Conventions” (May 21, 2009). The CRA said its view on the application of the GAAR was the same as in the first scenario.

In the third scenario, the ULC owes interest to its U.S. parent company. The debt is rearranged so that the interest is payable to the U.S. grandparent company (instead of the parent company). For U.S. tax purposes, the grandparent would be regarded as receiving interest from the Canadian branch of its U.S. subsidiary. For Canadian tax purposes, the interest would be treated as having been paid to the U.S. grandparent from the Canadian ULC. The CRA was asked whether it would regard the payment of interest to the U.S. grandparent company as satisfying the “same treatment” requirement in Article IV(7). The CRA stated that assuming the interest is subject to the same treatment in the United States in the hands of the U.S. grandparent as it would be if the ULC was not fiscally transparent, then Article IV(7) would not apply. The CRA’s view is that for Article IV(7), “same treatment” does not require identical treatment. The CRA has also released a recent technical interpretation on the subject (CRA Document No. 2009-031849117, “Article IV(6)/IV(7) ‘Same Treatment’” (November 13, 2009)).

The CRA added a bit of levity and drew a parallel between these hypothetical facts and an old episode of the original 1960s *Star Trek* television series in which a transporter malfunction results in an “evil” Captain Kirk threatening the safety of the crew of the U.S.S. Enterprise. The CRA’s point was that it considers that the “transporter” function of Article IV(7) works properly when what goes in is the same as what comes out on the other side – with no “Evil Kirks” showing up unexpectedly. The CRA said that, generally, this isn’t supposed to be a “gotcha” provision and the CRA intends to focus its resources on perceived abuses. Further, the CRA stated that the GAAR may apply if the ULC is part of a financing arrangement that results in, among other things, duplicated interest deductions or an internally generated interest deduction in one country without offsetting interest income in the other country.

In the fourth scenario, the CRA was asked whether Treaty benefits would be available to a U.S. limited liability corporation (“LLC”) that owns a Canadian ULC and a dividend or interest is paid by the ULC to the LLC before January 1, 2010. The CRA stated that Article IV(6) is effective for amounts paid or credited on or after February 1, 2009. Conversely, Article IV(7) has effect as of January 1, 2010. Accordingly, an amount paid or credited to a U.S. LLC by a Canadian ULC after February 1, 2009 but before January 1, 2010 would be eligible for Treaty-reduced rates to the extent that the amount is considered under Article IV(6) to be derived by a resident of the United States who is a “qualifying person” as that term is defined in Article XXIX A(2) of the Treaty. And, finally, the CRA was asked about the status of its review of certain prescribed forms for applying for treaty benefits to income paid to non-residents. The CRA stated that it is reviewing the public comments it has

received on the forms and that new forms will be released in the future. In the meantime, the CRA suggested that taxpayers should consult Information Circular IC76-12R6, “Applicable rate of Part XIII tax on amounts paid or credited to persons in countries with which Canada has a tax convention” (November 2, 2007).

## LLC with a Canadian Branch

The CRA was asked to consider a situation in which a U.S. LLC has four shareholders: a Bermuda corporation, a U.S. corporation, a U.S. tax exempt, and a U.S. resident individual. Article IV(6) of the Treaty appears to look through the LLC to the identity of the underlying shareholders to determine if Treaty relief is available. The CRA was asked how it would determine the tax consequences for the company. The CRA was also asked “do centaurs actually exist?”

The second question was a joke, but the CRA stated that, in this situation, there would be centaur-like tax treatment – the front end and the back end. The CRA stated that the LLC would be considered a corporation under Canadian domestic law, and thus Part I tax and branch tax would be determined for the LLC. Next, Article IV(6) could apply to look to the underlying shareholders for Treaty relief. In this case, Article IV(6) would apply to reduce the branch tax for the U.S. corporation shareholder to 5%, but not for the Bermuda corporation or the U.S. resident individual. Further, Article IV(6) would exempt the tranche relating to the U.S. tax exempt entity.

## Limitation on Benefits Provision (“LOB”) in Canada–U.S. Treaty

The CRA was asked under what circumstances does the Competent Authority plan to exercise the right to consider a U.S. person who is not otherwise Treaty-eligible to be a U.S. resident. The CRA representatives did not respond directly to this question during the Roundtable discussion, but instead directed the audience to conference presentation materials prepared on the subject by Karen Broadman (Senior Advisor, Tax Treaties Group, CRA) and Patricia Spice (Director, Competent Authority Services Division, CRA).

The materials state that under Article XXIX A, treaty benefits are limited to “qualifying persons” (para. 2), persons who meet the active trade or business test (para. 3), or persons who meet the derivative benefits test (para. 4). In the materials, the CRA invited taxpayers to contact the Income Tax Rulings Directorate or the audit case manager. If an advance ruling is sought and a positive ruling cannot be given, the file will be sent to the Competent Authority for consideration if the taxpayer so requests. The CRA

noted that the LOB provision is new and the Competent Authority's relief process will be refined as it gains experience on such matters.

In respect of paragraph 6, the CRA noted that a request to the Competent Authority should be made only if the taxpayer is not a "qualifying person" (para. 2) and the active trade or business test (para. 3) or the derivative benefits test (para. 4) does not apply. The CRA noted that additional information is available at the CRA's Web site (<http://www.cra-arc.gc.ca/tx/nnrstdnts/rtcl29-eng.html#p1>) and by contacting the CRA at CA-LOB@cra.gc.ca.

## Exchangeable Debentures

This has been a frequent topic in recent years after the court decisions in *Imperial Oil v. The Queen* (2006 DTC 6639 (SCC)) and *Tembec v. The Queen* (2009 DTC 5877 (FCA)) with the CRA addressing the issue in 2006, 2007 and 2008. At the 2008 Roundtable, the CRA declined to comment on *Tembec* because the time had not expired for appealing the decision of the Federal Court of Appeal to the Supreme Court of Canada, which has since denied leave to appeal.

In 2009, the CRA stated that in light of *Imperial Oil* and *Tembec*, the CRA's previous position (i.e., that paragraph 20(1)(f) applied in respect of exchangeable debentures) is no longer supportable at law. This change in position will be administered on a prospective basis to debentures issued on or after January 1, 2010. In the CRA's (new) view, on the exchange, the issuer of the debentures is not entitled to any deduction or capital loss in respect of the appreciation in principal amount over face value. The issuer has a FMV disposition on the underlying shares. The holder of the debentures has a FMV disposition of the debentures.

## CCPC Definition

The CRA was asked whether paragraph (b) of the definition of "Canadian-controlled private corporation" in subsection 125(7) refers to *de jure* control (and not *de facto* control). The CRA stated that *de jure* control is the test under paragraph (b) of the CCPC definition.

Additionally, the CRA was asked why a unanimous shareholders' agreement (a "USA") would not be considered in applying paragraph (b) of the CCPC definition. The Supreme Court of Canada has indicated (in *Duha Printers (Western) Ltd. v. The Queen*, 98 DTC 6334) that USAs are constating documents of a corporation and should be

taken into account in determining *de jure* control (see *Duha Printers*, *locus paras.* 57–73). The CRA stated that, notwithstanding the Court's conclusion in *Duha Printers*, a USA is not relevant in applying the "hypothetical shareholder" test in paragraph (b) of the CCPC definition because the hypothetical shareholder is not party to the USA.

## Exchanges of Property

The CRA was asked to confirm that all property transferred to a corporation for no consideration would have cost basis to the receiving corporation. Further, the CRA was asked whether, upon the issuance of shares by one corporation for shares of another corporation, both share issuances would be considered a transfer of property at FMV of the shares.

The CRA stated that subsection 69(1) provides a one-sided adjustment if taxpayers do not transact at FMV on a sale. Additionally, paragraph 69(1)(c) gives a two-sided adjustment if the parties misestimate the value of a gift. The CRA explained that it will apply quasi-price adjustment clauses to transfers by shareholders to a corporation for no consideration. Further, the CRA stated that it is open to discussion as to whether an issue of treasury shares will be treated as a transfer of property.

## Filings Based on Proposed Changes to Law

The CRA was previously asked about filing on the basis of proposed legislation at the 2005, 2006 and 2008 CRA Roundtable sessions. In 2009, the CRA was again asked for its view on whether it expects taxpayers to file their returns based on proposed changes to the legislation.

The CRA's answer in 2009 was substantially identical to the one it gave in 2005, namely that the CRA's longstanding practice is to ask taxpayers to file their returns based on the proposed legislation. However, where proposed legislation increases government expenditures (i.e., the Canada child tax benefit) or a significant amount of rebate or refund is at stake, the CRA's practice has been to wait until the measure is enacted. In 2009, the CRA added that a comfort letter from the Department of Finance is not considered proposed legislation and usually only reflects Finance's views on a particular issue affecting a particular taxpayer. In any event, the taxpayer may choose to file on the basis of the comfort letter, and generally the CRA will not reassess a taxpayer who filed on the basis of and in conformity with a comfort letter.

## Assessments

The CRA was asked for its view on the recourse available to a taxpayer where it feels that it has been treated unfairly by or is not receiving a proper hearing from a Taxation Services Office. Specifically, when would a taxpayer have a “right” to elevate its concern to head office?

The CRA stated that where a taxpayer and an auditor do not agree, such disagreement should be taken up with the auditor’s supervisor in the TSO. If the taxpayer is still unsatisfied with the communications with the TSO, the matter may be elevated to head office. The CRA referred to this as “throwing the challenge flag”, a phrase that will be familiar to followers of NFL football. And just as the NFL charges a timeout on an unsuccessful challenge, the CRA cautioned that this elevation should be used judiciously. Where a matter is referred to head office on a complex matter, the referral should include an agreed statement of facts and taxpayer representations. Head office will respond to the TSO. Generally, the position taken on a file is the CRA’s position, not the auditor’s position or head office’s position. Each taxpayer is entitled to deal with someone at the CRA who takes ownership of and explains the decision.

## Services by U.S. Resident to Canadian Subsidiary of U.S. Customer

The CRA was asked to consider Article V(9) of the Canada–U.S. Treaty and three situations in which a non-resident provides services in Canada.

In the first situation, a U.S. resident service provider was engaged by a U.S. multinational and a modest portion of the contract for services was provided to a Canadian resident subsidiary of the U.S. multinational. The U.S. resident service provider conducted no other business in Canada. The CRA was asked whether Article V(9) of the Treaty would apply to give rise to a deemed permanent establishment of the U.S. resident service provider. The CRA stated that Article V(9)(b) could apply to give rise to a permanent establishment for the U.S. resident service provider. However, only the profits attributable to the functions performed and the risks assumed by the provision of services in Canada would be attributable to the deemed permanent establishment. The result would be a tiny PE and tiny tax.

In the second situation, a U.S. company loaned one of its management employees to a Canadian subsidiary for eight months. The employee remained on the U.S. payroll but the Canadian subsidiary reimbursed the U.S. company for these costs. The employee was under the supervision of the Canadian subsidiary executive team. The CRA was

asked whether Article V(9) would apply to give rise to a deemed permanent establishment. The CRA stated that where a U.S. enterprise is merely reimbursed for the amount of its compensation costs in respect of an employee that has been seconded to a resident in Canada and the employee is under the supervision of the Canadian resident, the U.S. enterprise would not be seen as providing services in Canada. The employee would be seen as performing his or her employment duties as an employee of the Canadian subsidiary and Article V(9) would not apply. However, the employee’s remuneration would be taxable in Canada pursuant to Article XV (provided it exceeds \$10,000) (see Article XV – Income from Employment).

In the third situation, a U.S. resident consulting company loaned one of its employees to its Canadian subsidiary for eight months to provide services in Canada to a Canadian customer. The employee remained on the payroll but the costs are reimbursed and the employee is under the supervision of the Canadian subsidiary executive team. The CRA was asked whether Article V(9) could apply to give rise to a deemed permanent establishment. Further, the CRA was asked whether it would matter if the U.S. parent charges the subsidiary a reduced *per diem* based on the charge-out rate of the U.S. resident employee. The CRA stated that, in these circumstances, Article V(9) could apply to give rise to a permanent establishment in Canada. However, only the profits of the parent that are attributable to the functions performed and the risks assumed by the provision of the services in Canada by the parent would be attributed to the deemed permanent establishment. Further, the employee’s remuneration would be taxable in Canada pursuant to Article XV, provided it exceeds \$10,000.

## GAAP and IFRS

The CRA was again asked about the transition to International Financial Reporting Standards. In 2008, the CRA had been asked to provide guidance to taxpayers adopting the IFRS in respect of determining taxable income. At the time, the CRA stated that it would accept IFRS financial statements filed with a return because the *Income Tax Act* (the “Act”) doesn’t specify the form of financial statements required to be filed with a tax return.

In 2009, the CRA was asked what impact the switch to IFRS would have on the computation of taxable income and what is the CRA doing to accommodate and prepare for this change. The CRA stated that the financial statement income is prepared based on records of transactions. This amount is then adjusted according to the rules of the Act (notably sections 10, 12, 18, 20 and the capital gains regime). The adjusted amount would appear on the T2 return as net income for tax purposes. The CRA’s view is

that financial statement income computed on any reasonable accounting basis will produce the same adjusted income once it is passed through the filter of the Act.

### Loss Consolidations

The CRA was asked if there have been any changes in its position on and review of loss consolidation transactions. Further, does it matter if the provincial allocation changes in the course of the loss consolidation?

The CRA stated that its policy on loss consolidation remains essentially unchanged. The CRA will continue to consider the effect of provincial allocation changes. Provincial allocation questions were raised at the Roundtable in 2005, 2007 and 2008. The CRA noted that standard loss consolidations with an incidental shifting of provincial income should be acceptable. In the CRA's view, if the loss consolidation transaction was not standard (i.e., if there was a deliberate shifting of income to a lower-rate province) the CRA would address such provincial concerns.

### Conclusion

There were several questions from the audience that were handed up to the panel during the discussion, but due to time constraints such questions could not be answered during the Roundtable discussion. The CRA stated that it expects to publish its answers to all of the Roundtable questions in a future issue of *Income Tax Technical News*.

– *Timothy Fitzsimmons, associate in the Tax Department in the Toronto office of Fraser Milner Casgrain LLP.*

*A number of tax lawyers from Fraser Milner Casgrain LLP write commentary for CCH's CANADIAN TAX REPORTER and sit on its Editorial Board as well as on the Editorial Board for CCH's CANADIAN INCOME TAX ACT WITH REGULATIONS, ANNOTATED. Fraser Milner Casgrain lawyers also write the commentary for CCH's FEDERAL TAX PRACTICE reporter and the summaries for CCH's WINDOW ON CANADIAN TAX. Fraser Milner Casgrain lawyers wrote the commentary for CANADA–U.S. TAX TREATY: A PRACTICAL INTERPRETATION and have authored five other books currently available from CCH: FEDERAL TAX PRACTICE; THE ESSENTIAL GAAR MANUAL: POLICIES, PRINCIPLES AND PROCEDURES; CHARITIES, NON-PROFITS AND PHILANTHROPY UNDER THE INCOME TAX ACT; CORPORATION CAPITAL TAX IN CANADA; and CANADIAN TRANSFER PRICING. Tony Schweitzer, a Tax Partner with the Toronto Office of Fraser Milner Casgrain LLP, and a member of the Editorial Board of CCH's CANADIAN TAX REPORTER, is the editor of the firm's regular monthly feature articles appearing in TAX TOPICS.*

## Revised Guides

In this week's print report, the following revised guides have been reproduced in the "Guides" tab division in Volume 5.

- RC17, Taxpayer Bill of Rights Guide (Rev. 09)
- RC4135, Home Buyers' Plan (Rev. 09)
- T4005, Fishers and Employment Insurance (Rev. 09)

## Commentary Revisions

With this week's print report, the bibliography for subsection 84(1) has been updated and case annotations have been added for subsections 84(2) and (3).

## Recent Cases

Note that the paragraph references following the case digests below are to paragraphs in the "New Matters" division in Volume 7. The full text of each case is reproduced in the publisher's loose leaf DOMINION TAX CASES.

### Taxpayer's application for judicial review allowed

The corporate taxpayer filed income tax returns late for its 1988 to 1990 taxation years, declaring no taxable income. The Minister reassessed the taxpayer for that period for additional taxes, interest, and late-filing penalties. In December 1996, the taxpayer filed amended returns as per a settlement agreement reached with the CRA, and requested that non-capital losses incurred from 1991 to 1993 be carried back and applied to reduce its income for its 1988 to 1990 taxation years. The Minister subsequently granted the taxpayer permission to carry back the losses ("Loss Carryback"). The taxpayer applied to the Minister under s. 220(3.1) of the *Income Tax Act* for full interest and penalty relief, which was denied. The taxpayer applied to the Federal Court for judicial review of the Minister's decision, where it was held that the matter should be referred back to the Minister for redetermination and that fairness and equity would result in waiving all interest and penalties accrued after December 1996 (2008 DTC 6710). The Minister appealed to the Federal Court of Appeal.

The Minister's appeal was allowed in part. The Federal Court of Appeal concluded that: (a) the Federal Court selected the appropriate standard of review and applied it

correctly; (b) where the Minister makes an error or delay that results in a taxpayer becoming liable for interest or penalties, it is appropriate for the Minister to cancel such interest or penalties in line with s. 220(3.1); (c) the Minister made an error by failing to accept and implement the taxpayer Loss Carryback request in December 1996; and (d) the Federal Court exceeded its jurisdiction by ordering a specific result in line with s. 18.1(3) of the *Federal Courts Act*. Therefore, the application for judicial review was allowed and the matter was referred back to the Minister for redetermination in accordance with the Federal Court of Appeal's reasons.

¶46,967, *Slau Limited*, 2009 DTC 5167

### Corporate taxpayer associated with two corporations – Not entitled to SBD

P and C were the trustees of a trust settled in 1998 (the "Trust"). A numbered corporation, 9059, was the primary beneficiary of the Trust and all of its voting shares were owned by the Trust. P2, the son of P, was the secondary beneficiary of the Trust. P and his father, P3, directly or indirectly controlled Pépinière Abbotsford Inc. ("C1"), and C1 controlled Jardinage Abbotsford Inc. ("C2"). 9059 owned all of the voting shares of the corporate taxpayer. The Minister reassessed the taxpayer for 1999 to 2003 on the basis that it was not entitled to the small business deduction ("SBD") claimed, since it was associated with C1 and C2. In allowing the taxpayer's appeal, Lamarre, J. of the Tax Court of Canada concluded that: (a) during the taxation years in issue, 9059 was still in existence and had not been wound up; (b) P2's interest as the secondary beneficiary of the Trust, therefore, did not yet exist; (c) P2, accordingly,

was not a "beneficiary" of the Trust within the meaning of s. 256(1.2)(f)(ii) of the Act; and (d) the taxpayer was not associated with C1 and C2, and was thus entitled to the SBD claimed (2008 DTC 4944). The Crown appealed to the Federal Court of Appeal.

The Crown's appeal was allowed. The parties agreed that if P2 were found to be a beneficiary of the Trust, then the taxpayer would be associated with C1 and C2, and the appeal should be allowed. Under s. 256(1.2)(f)(ii) of the Act, P2 was deemed to be the owner of the shares of 9059 if his share of the accumulating income or capital from the Trust was dependent on the exercise by any person of any discretionary power. The trustees of the Trust could, at any time in their discretion, wind up 9059, which would immediately make P2 the sole beneficiary of the Trust. Lamarre, J., therefore, erred in concluding that P2's status as a beneficiary of the Trust depended on 9059 no longer being in existence. At all material times, P2 was also "a person ... beneficially interested in a particular trust" because he was a "person ... that has any right (whether immediate or future, whether absolute or contingent or whether conditional on or subject to the exercise of any discretion by any person ...) as a beneficiary under a trust to receive any of the income or capital of the particular trust ..." within the meaning of s. 248(25) of the Act. Lamarre, J. also erred in finding that s. 248(25) was inapplicable to P2's situation. Lamarre, J.'s judgment was therefore set aside and the taxpayer's appeal to the Tax Court was dismissed. The Minister's reassessments were affirmed accordingly.

¶46,970, *Propep Inc.*, 2009 DTC 5170

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**Notice:** Readers are urged to consult their professional advisors prior to acting on the basis of material in *Tax Topics*.

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