CURRENT ISSUES – A SELECTION OF LEGISLATIVE AND ADMINISTRATIVE DEVELOPMENTS OF INTEREST TO THE OWNER-MANAGER

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CURRENT ISSUES – A SELECTION OF LEGISLATIVE AND ADMINISTRATIVE DEVELOPMENTS OF INTEREST TO THE OWNER-MANAGER

INTRODUCTION

This paper will summarize a selection of current legislative and administrative issues of interest to owner-manager businesses and their advisors. The focus is primarily on corporate and non-resident related issues.

By way of update, there are a fair number of outstanding draft amendments to the Income Tax Act (Canada)[1] including the following:

August 19, 2011 legislative amendments in respect of foreign affiliates.	This is the latest set of foreign affiliate proposals and largely replaces the outstanding portions from the February 24, 2004 foreign affiliate proposals. One item from the August 19, 2011 proposals is discussed later in this paper.
August 16, 2011 legislative proposals (now Bill C-13 which received first reading in the House of Common on October 4, 2011)	These proposals relate to the 2011 Federal Budget (March 22 and June 6). The partnership anti-deferral proposals are not discussed in this paper as they are the subject of another presentation. A recent administrative development ensuing from the foregoing is the CRA announcement at the 2011 Prairie Provinces Tax Conference of a change in its longstanding administrative practice regarding joint ventures, and specifically that taxpayers who enter into joint venture arrangements will no longer be eligible to compute income as if the joint venture had a separate year end, with transitional relief similar to that for partnerships.[2]
March 16, 2011 legislative proposals in response to certain court decisions.	These were three specific targeted responses to case law developments; two of which are discussed below.

November 5, 2010 additional technical amendments	These include proposals particular to "professional partnerships" such that current year income or loss is included in the partner's negative ACB calculation rather than included immediately after the end of the particular year. These proposals finally provide the relief contemplated in a July 11, 2003 Department of Finance comfort letter and are particularly relevant to Ontario lawyers and chartered accountants who are permitted to practice as "full shield" limited liability partnerships and as a result would be open to the negative ACB rules.
August 27, 2010 legislative proposals.	These include the proposals for reporting of tax avoidance transactions (discussed at the 2010 Ontario Tax Conference), non-resident trusts and foreign investment entities.
July 10, 2010 legislative proposals	These include technical amendments such as the restrictive covenant proposals, proposed section 143.3 limiting the amount of an expenditure where there is non-monetary consideration being the response to the *Alcatel* decision[3] and other measures that were in Parts 2-3 of Bill C-10 which ceased to exist when Parliament was dissolved on September 7, 2008.

LEGISLATIVE DEVELOPMENTS

Estate Administration Tax

The Estate Administration Tax Act[4] (the "EATA") was amended by Bill 173, Better Tomorrow for Ontario Act (Budget Measures) 2011 ("Bill 173") which received Royal Assent on May 12, 2011. Bill 173 amended a number of Ontario statutes but in particular pursuant to Schedule 14 thereof, amended the EATA. The EATA is the basis for estate administration tax, formerly known as probate fees. The present rate of estate administration tax is 1.5% of the value of the estate in excess of $50,000.[5]

Following the decision in *Granovsky Estate*[6] in 1998, typical Will planning advice in Ontario involves the preparation of the two Wills for a testator; one Will in respect of assets for which a certificate of appointment of estate trustee (formerly known as letters probate) will be sought; and one Will in respect of all other assets. Sometimes they are referred to as a primary Will and secondary Will governing the primary estate and secondary estate respectively. Sometimes the latter is referred to as the Will in respect of excluded property. Shares of private corporations are typically included in the secondary Will on the basis that a certificate of appointment of estate trustee is not required for the transfer of the shares from the name of the deceased to the estate.[7] This has also led to the practice of placing title to other assets (such as real estate) in the name of a bare trustee corporation so that upon death, beneficial ownership of such assets is addressed in the secondary Will without need to deal with title.

Some concern has been expressed that the amendments resulting from Bill 173 may affect typical multiple Will planning and lead to personal liability of the estate trustee for a subsequent assessment of estate administration tax.

Estate administration tax is payable upon issuance of an estate certificate. The application is submitted to the Ontario Superior Court of Justice at the office in the county or district where the deceased had his/her "fixed place of abode" at the date of death.[8] The material to accompany the application is set out in Rule 74 of the Rules of Civil Procedure and the form itself is prescribed.[9] Little detail of the assets is required on the prescribed application form. A total value must be provided for personal property and a total value must be provided for real property (net of

encumbrances). Under the EATA, the amount of tax payable is simply a percentage of the "value of the estate", which is a defined term. Specifically, the term "value of the estate" is defined as:

> "value of the estate" means the value which is required to be disclosed under section 32 of the Estates Act (or a predecessor thereof) of all the property that belonged to the deceased person at the time of his or her death less the actual value of any encumbrance on real property that is included in the property of the deceased person

Section 32 of the Estates Act merely requires a person applying for a grant of probate or administration to make a "true statement of the total value" verified by oath or affirmation. Such a statement would be in respect of all of the property that belonged to the deceased or in the case of an application limited to only part of the property of the deceased, the statement of the value would relate only to the property and value intended to be affected by the application. It was the latter concept which was relied upon in *Granovsky Estate*. No guidance is given as to the meaning of value for this purpose.

Pursuant to Bill 173, effective for applications for estate certificates made on or after January 1, 2013[10], if an estate representative makes an application for an estates certificate,

> "The estate representative shall give the Minister of Revenue such information about the deceased person as may be prescribed by the Minister of Finance."

Some commentators have wondered whether the above language implies that the Minister of Finance may require information about all assets of the deceased with resultant estate administration tax on all assets rather than the limited assets dealt with in a secondary Will.[11] No information has been released by either the Ontario Ministry of Revenue or the Ontario Ministry of Finance regarding the information which may be prescribed for the foregoing purpose. As an application for an estate certificate is made to the court, query whether the above implies a separate filing with the Ontario Ministry of Revenue. In any event, it seems clear that more information

will be required than present minimal requirements and such increased information may form the basis for audit and enforcement to ensure that the appropriate amount of estate administration tax is paid.

Bill 173 also amended the EATA by adding or rather, importing thereto the assessment and reassessment provisions currently found in the Retail Sales Tax Act[12]. In general terms, for a period of four years after the date on which the estate administration tax was payable, an assessment or reassessment of such tax may be made. As the estate administration tax is payable upon the issuance of the estate certificate, the four year clock then commences. The concern is that a statutorily mandated four year assessment or reassessment period may imply a stricter degree of scrutiny by the Ontario Ministry of Revenue, especially with respect to valuation. While valuation information should be available to the estate trustee where assets are subject to a deemed disposition for income tax purposes, it may not be available where assets have passed to a surviving spouse. Further, there is no certainty that the valuation used for income tax purposes will necessarily be accepted in the event of Ontario Ministry of Revenue review for estate administration tax purposes. In addition, an estate might be fully administered and distributed prior to any such review. Because of the possibility of such an assessment or reassessment and its implications for liability of the estate trustee, submissions were made to amend Bill 173 to incorporate a "clearance certificate" concept[13], similar to that provided for in subsection 159(2), ITA. But this was rejected on the basis that the EATA expressly provides in subsection 2(8) therein the tax is payable by the estate representative in his representative capacity only. This may be contrasted with subsection 159(1), ITA which states that the legal representative is jointly and severally liable with the taxpayer (estate) for amounts payable by the taxpayer (estate) to the extent

that the legal representative remains in possession or control of property that belonged to the taxpayer (estate). Notwithstanding the limitation in subsection 2(8), EATA, concern has been expressed that the estate representative may be liable at common law and potentially vulnerable if assets have been distributed and beneficiaries are outside Ontario.[14]

Draft Legislation on Contingent Amounts – Response to Collins

Draft legislation was released on March 16, 2011 in response to the Federal Court of Appeal decision in *Collins v. The Queen*[15] which proposes to reduce a taxpayer's expenditure to the extent that the taxpayer has a right to reduce the amount required to be paid in respect of same. It is helpful to recap the facts and result in *Collins* to put the draft legislation in context.

In *Collins*, the taxpayers were partners who had borrowed monies on a 15 year term from the Alberta government to construct a rental building in the early 1980's. The loan was restructured by an amending agreement in 1993 and the issue was interest deductibility in 1994, 1995 and 1996. Under the amending agreement:

- the term was extended to 20 years from August 1, 1993
- 10% simple interest to be paid each August 1 "subject to the payment provision below for the first 15 years of the term"
- Minimum annual interest payments of $20,000 for the first 15 years of the term due on or before each August 1. Any remaining unpaid interest immediately due and payable at the end of the 16th year of the term.

- Early payout option whereby borrower may, at any time in the first 15 years, pay $100,000 plus 15 minimum annual $20,000 interest payments

The terms of the early payout option were obviously financially attractive to the taxpayers. In the 1994, 1995 and 1996 taxation years, the taxpayers deducted interest based on 10% simple interest in respect of the outstanding loan (being in excess of $150,000 in each of the three years in issue), although only $20,000 was actually paid each year (being the minimum annual interest payment). The Federal Court of Appeal held that interest was payable in respect of the year notwithstanding that it was not due until a future year. The Court held that the taxpayers did not have a contingent obligation; it was not the taxpayer's obligation to pay interest that was contingent but rather, the taxpayer's right to exercise the settlement (early payout) option.

Proposed subsection 143.4(2) will limit the amount of a taxpayer's expenditure[16] and specifically, will reduce it by the "contingent amount" in respect of the expenditure. A "contingent amount" is defined as an amount that the taxpayer (or non-arm's length person) has a "right to reduce". A "right to reduce" includes a right that is contingent upon the occurrence of an event, if it is reasonable to conclude, having regard to all the circumstances, that the right will "become exercisable". As the limitation on the amount of the expenditure is made in the year in which the expenditure occurs and as the test measures whether the right will "become exercisable" (as opposed to whether the right will be exercised), it seems that it is the likelihood of the contingency which is considered, absent other prerequisites. It should also be noted that the definition of the term "right to reduce" is not limited to a right to reduce that is contingent upon the occurrence of an event, but also has the puzzling words "or in any other way", i.e., a right to reduce that is contingent upon the occurrence of an event or in any other way. With reference to *Collins*, the

effect of the foregoing would appear to be a limitation of the expenditure to the minimum annual interest actually paid. The right to reduce the amount of interest in any particular year was, as noted by the Federal Court of Appeal, an option that could be exercised by the borrower at any time in the first 15 years. Therefore the right to reduce was contingent upon the occurrence of an event, being the decision of the borrowers.

Under proposed subsection 143.4(3), If the contingent amount is paid in a subsequent year, then the portion paid is deemed to: (a) have been incurred by the taxpayer in such subsequent year; (b) have been incurred for the same purpose and to have the same character[17] as the expenditure which was reduced; and (c) have become payable by the taxpayer in such subsequent year.

If the right to reduce arises in a subsequent year in respect of a prior year's expenditure, proposed subsection 143.4(4) may trigger paragraph 12(1)(x) consequences to the taxpayer.

It is noteworthy that the "normal reassessment period" will not apply to these provisions. Indeed, proposed subsection 143.4(7) provides that none of the statutory limitations in subsections 152(4) – (5) shall apply.

The above amendments are proposed to apply in respect of taxation years ending on or after March 16, 2011.

Draft Legislation on Non-resident withholding tax in respect of interest – Response to Lehigh

Draft legislation was released on March 16, 2011 in response to the Federal Court of Appeal decision in *Lehigh Cement Limited v. The Queen*[18] which proposes to extend the circumstances in which non-resident withholding tax under Part XIII shall apply. Pursuant to paragraph 212(1)(b), non-resident withholding tax applies to: (i) interest that is not “fully exempt interest” (largely government debt obligations) paid to non-arm’s length persons; and (ii) participating debt interest. In *Lehigh*, the Canadian corporation was part of a multinational group and initially had a loan outstanding to a non-arm’s length member of its international foreign group. Non-resident withholding tax applied to the interest on such loan. In 1997, the loan was effectively bifurcated when the right to receive the interest payments was sold by the non-resident holder to an arm’s length person. Thus, the Canadian corporation paid interest to an arm’s length person yet the principal amount of the debt was held by a non-arm’s length person. The taxation years in issue in *Lehigh* predated the 2007 amendments which reduced the scope of Part XIII as described above. The Minister reassessed to apply the General Anti-Avoidance Rule to impose Part XIII tax, on the basis that there was a misuse or abuse of former subparagraph 212(1)(b)(vii). The Federal Court of Appeal held in favour of the taxpayer.

Subparagraph 212(1)(b)(i) is proposed to be amended to impose Part XIII withholding tax on interest that is not “fully exempt interest” which is paid or payable to:

- A non-arm’s length non-resident
- Any non-resident (whether arm’s length or non-arm’s length) if the interest is paid on a debt obligation owed by the payer to a non-arm’s length non-resident.

The amendment is proposed to apply to interest paid or payable after March 16, 2011 unless it is interest on an obligation incurred by the payer before March 16, 2011 and the recipient acquired the entitlement to the interest before March 16, 2011.

<u>August 19, 2011 – Legislative Proposals in respect of Foreign Affiliates</u>

The Department of Finance released a long anticipated package of draft legislation in respect of foreign affiliates on August 19, 2011 (the "2011 FA Proposals"). The 2011 FA Proposals will undoubtedly be the subject of much commentary in the international tax planning context. However, in the owner-manager environment, the proposals relating to the "upstream loan" are noteworthy. These are described in the Explanatory Notes to such legislative proposals as anti-avoidance rules designed to prevent "synthetic dividend distributions". The proposals are apparently modeled after subsection 15(2) in the domestic context (but modified).

Pursuant to subsection 90(4) as proposed to be amended by the 2011 FA Proposals, where a person or partnership that is at any time a "specified debtor" in respect of a taxpayer resident in Canada receives a loan or becomes indebted to a creditor that is a foreign affiliate of the taxpayer, the "specified amount"[19] in respect of the amount of the loan or indebtedness is included in the taxpayer's income for such taxation year. The foregoing shall not apply where:

- the loan or indebtedness is repaid (other than as part of a series of loans or other transactions and repayments) within two years of the day the loan was made or the indebtedness arose [proposed paragraph 90(5)(a)].

- the indebtedness arose in the ordinary course of business of the creditor or the loan was made in the ordinary course of the creditor's business of lending money and *bona fide* arrangements were made for the repayment within a reasonable time at the time the indebtedness arose or the loan was made [proposed paragraph 90(5)(b)].

The two year repayment exception in proposed paragraph 90(5)(a) is similar to that provided for in subsection 15(2.6) in the domestic context. The difference is that the former exception in the 2011 FA Proposals requires repayment by the second anniversary date of the making of the loan whereas the domestic exception in subsection 15(2.6) requires repayment within one year after the end of the taxation year of the lender/creditor in which the loan was made or indebtedness arose. Practitioners may recall that years ago, CRA unsuccessfully challenged a running loan account of an owner-manager on the basis that there was a series of loans or other transactions and repayments. However, following the decisions in *Attis v. MNR*[20] and *Nigel T. Hill and Uphill Holdings Ltd. v. MNR*[21], both of which were decided in favour of the taxpayer, CRA changed its administrative position to that which is now reflected in paragraph 29 of *Interpretation Bulletin* IT-119R4[22]:

> *"Persons affected by subsection 15(2) may have loan accounts, drawings accounts, or other similarly named accounts that contain several charges for loans, payments made to third parties on behalf of the shareholder, advances against future salaries, rents or anticipated dividends or other charges, and one or more repayments. If a shareholder has an account with a number of these features (a running loan account), all of the relevant factors will be considered to determine whether a series of loans or other transactions and repayments exists. Bona fide repayments of shareholder loans that result from, for example, the payment of dividends, salaries, or bonuses, are not part of a series of loans or other transactions and repayments."*

Presumably CRA will apply a similar position where a foreign affiliate makes its funds available by loan to its Canadian parent with the intention of periodically rationalizing same by way of dividend and in fact declares and pays such dividends.

While the upstream loan proposals may clearly apply to a loan from a wholly owned foreign subsidiary to its Canadian parent corporation, the scope of the proposals is broader because of the definitions of “foreign affiliate” and “specified debtor”. The proposals apply to a loan or indebtedness from a foreign affiliate of a taxpayer to a specified debtor. Both relationships are measured by reference to a Canadian resident taxpayer. The definition of foreign affiliate[23] requires a Canadian resident taxpayer whose equity percentage of such non-resident corporation is at least 1% and an equity percentage of at least 10% when combined with that of persons related to the taxpayer. Thus the concept of a foreign affiliate of a taxpayer is clearly not limited to a non-resident corporation which is wholly owned by a Canadian parent corporation. Further, proposed subsection 90(4) contemplates a loan to or indebtedness incurred by a “specified debtor” of the taxpayer which is defined to mean a person non-arm’s length with the taxpayer.[24] As a result, the borrower/creditor need not be a shareholder (direct/indirect) of the foreign affiliate or indeed, Canadian resident. However, the adverse consequence of income inclusion falls to the Canadian resident taxpayer of which the non-resident corporation is a foreign affiliate.

Careful attention to documentation must be exercised where a dividend is used to effectively repay an upstream loan. Evidencing same in the tax compliance and/or financial statements alone may not be sufficient. If the specified debtor is a shareholder of the foreign affiliate and therefore a recipient of a dividend declared by the foreign affiliate, then the set off of the loan payable against the dividend should be clearly expressed in the relevant documentation as set off is not necessarily an automatic legal consequence but rather depends on the intention of the parties. If the specified debtor is not the direct recipient of a dividend declared by the foreign affiliate, the assignment of

the dividend receivable by the shareholder to the specified debtor who seeks to set off same against the upstream loan must be diligently documented. This may require a tri-partite agreement. In the context of the domestic shareholder loan provisions in subsection 15(2), CRA has previously challenged the validity of repayment where effected by means of journal entry or where more than one party is involved.[25]

If an amount is included in income pursuant to the proposed upstream loan provision, an offsetting deduction is available in the year of repayment pursuant to proposed 90(9) to the extent that the repayment was not part of a series of loans or other transactions and repayments. This is similar to the offsetting deduction permitted in paragraph 20(1)(j) in the domestic context.

The 2011 FA Proposals also provide an elective reserve mechanism to offset the income inclusion from the upstream loan, absent actual repayment. The theory appears to be that if a fully deductible dividend could have been paid by the foreign affiliate rather than making the funds available to the debtor by means of an upstream loan, a deduction pursuant to a proposed 90(6) may be available to offset the income inclusion in the year. Specifically, pursuant to proposed subsection 90(6), the taxpayer may deduct an amount in respect of a particular loan or indebtedness included in income in the year if:

(a) the taxpayer demonstrates that if the particular portion of the loan or indebtedness had been distributed directly or indirectly as one or more dividends, it reasonably could be considered to give rise to a deduction under any of paragraphs 113(1)(a)-(b);

(b) during the portion of the year in which the loan or indebtedness was outstanding, no dividends are paid to the taxpayer or another person resident in Canada by any of the foreign affiliates relevant to the determination made above; and

(c) no other loan or indebtedness was made or incurred during the year that relies upon the same surplus balance of the foreign affiliate.

The amount deducted pursuant to the above is added back to income in the following year and a new deduction may be made pursuant to the above, if the conditions continue to be met. Thus the above may provide an annual inclusion and deduction mechanism while the loan or indebtedness is outstanding.

The upstream loan proposals in the 2011 FA Proposals are proposed to apply after August 19, 2011. Where a loan or indebtedness was outstanding on August 19, 2011 that would otherwise fit within the parameters of the proposals, there is a deemed "re-birth", i.e., it is deemed to be a separate loan or indebtedness received or incurred on August 19, 2011. The result is that the two year repayment period commenced for pre-existing loans on that date.

ADMINISTRATIVE DEVELOPMENTS

Non-Resident Withholding Tax Developments

CRA released the final versions of Forms NR301; NR302 and NR303 (the "New NR Forms") in April 2011. These forms had previously been released in draft form for public consultation. At the same time, CRA announced pending updates ("Pending Updates Announcement") to

Information Circular IC 76-12[26] and also provided further information on the use of the new forms[27].

The New NR Forms may signal CRA's expectation of greater due diligence on the part of payers to determine the appropriate rate of Part XIII tax to withhold on payments to non-residents and in particular, eligibility for treaty benefits. Each form relates to a different type/character of non-resident payee as is evident from its name:

NR301	Declaration of Eligibility for Benefits under a Tax Treaty for a Non-Resident Taxpayer
NR302	Declaration of Eligibility for Benefits under a Tax Treaty for a Partnership with Non-Resident Partners
NR303	Declaration of Eligibility for Benefits under a Tax Treaty for a Hybrid Entity

Prior to the release of the New NR Forms, CRA administratively accepted the use of name and address of payee as that of the beneficial owner[28] as *Information Circular* IC76-12 bluntly stated that the payer can accept the name and address of the payee as being that of the beneficial owner unless there was reasonable cause to suspect otherwise. Thus the address was the accepted manner of determining the appropriate rate of withholding tax. In the Pending Updates Announcement, CRA states that a payer "must have recent and sufficient" information to establish the identity of the beneficial owner for the purpose of determining whether treaty benefits apply; whether the person is resident in a treaty country and whether the person is eligible for treaty benefits. The onus is clearly shifted to the payer.

Use of the New NR Forms is not mandatory. They are not prescribed forms and there is no statutory basis for their use. According to the Pending Updates Announcement, "equivalent

information" can be accepted, but it is clear that a payer is expected to have evidence (other than a simple address) of beneficial ownership, residence and eligibility for treaty benefits to establish the appropriate rate of Part XIII withholding tax. Although they are not prescribed forms, their use may well become the standard. According to the Pending Updates Announcement, there is a transition period to December 31, 2011 to allow payers to gather any additional information. After that date, simple reliance on the payee's name and address to establish eligibility for treaty benefits will no longer be in keeping with CRA's administrative practice.

Each particular New NR Form generally provides a certification by the non-resident as to its state of residence; that it is the beneficial owner of the income to which the form relates and that it is entitled to the benefits of the treaty between Canada and the country recorded on the form.[29] Further, the non-resident undertakes to notify the payee of any changes to information on the form. Each New NR Form explicitly sets out an expiry date: "For Part XIII tax withholding purposes, this declaration expires when there is a change in the taxpayer's eligibility for treaty benefits or three years from the end of the calendar year in which this form is signed and dated, whichever is earlier." As it may be questionable whether the undertaking on the form is enforceable as between payer and payee, it seems prudent to incorporate the undertaking and the obligation to provide the New NR Form in the license, loan agreement or other contract that forms the legal basis for the payment subject to Part XIII.

Neither in the New NR Forms nor in published CRA statements to date, has there been any suggestion that a payer who relies *bona fide* on a signed New NR Form will be relieved from adverse assessment if CRA takes the position that a different (higher) rate of Part XIII tax should

have been withheld. It is noteworthy that the statute does not provide a due diligence defense for the payer, but rather only a right to recover the amount from the non-resident person.[30] At the 2011 International Fiscal Association (Canada branch) seminar[31], a CRA official declined to provide any such comfort and merely noted that a taxpayer may, in appropriate circumstances, apply for interest and penalty relief. This may be of little solace to the payer who continues to bear the risk. The payer may be assessed for the tax which should have been withheld[32], a penalty based on 10% or 20% (where the failure to deduct was made knowingly or under circumstances amounting to gross negligence)[33] and interest[34]. It should also be noted that such an assessment can be made "at any time"[35] (meaning that the "normal reassessment period" concept does not apply) and directors of a corporate payer may be held jointly and severally liable together with the corporation to pay such amount and any interest and penalties relating to same[36]. The standard of a reasonably prudent director may now include establishing procedures for the gathering of the New NR Forms where the corporation pays or credits amounts to non-residents.

Form NR302 "Declaration of Eligibility for Benefits under a Tax Treaty for a Partnership with Non-Resident Members" can be contrasted with subsection 212(13.1). Pursuant to subsection 212(13.1) where a person resident in Canada pays or credits an amount to a partnership (other than a "Canadian partnership"), such partnership is deemed to be a non-resident person. By definition, any partnership with even a single non-resident partner is not a "Canadian partnership"[37]. As a result, a payment to such a partnership would be subject to Part XIII withholding tax. Historically, CRA took the position that 25% Part XIII withholding tax should apply in such circumstances[38], but more recently CRA has adopted a look through position[39]. This seems to be formalized in Form NR302. The worksheets included in Form NR302 (which would presumably be completed

by the partnership and submitted to the Canadian payer) calculate an effective rate of Part XIII withholding tax based on the percentage allocation to each partner.[40]

The New NR Forms also indicate in their instructions that they are to be submitted in support of an application for waiver/reduction of Regulation 105 withholding (Form R105) and a certificate of compliance under section 116 (Form T2062 or T2062A).

Section 216 returns and capitalized interest

Non-resident withholding tax under Part XIII applies to rent or a payment for the use of property in Canada.[41] Where an amount is paid to a non-resident in lieu of payment of or in satisfaction of rent on real property in Canada, the non-resident may, within two years after the end of the year, file a separate return pursuant to subsection 216(1) with the result that the non-resident is liable to pay tax under Part I in lieu of paying tax under Part XIII.[42] At the CRA Roundtable of the 2010 Annual Tax Conference of the Canadian Tax Foundation, a question was asked regarding the capitalization of interest in circumstances where a section 216 election was made by the non-resident. The question assumed that a non-resident taxpayer had capitalized interest under section 21 for a number of years and in a subsequent year disposed of the property for proceeds of disposition in excess of original cost. The response from CRA was: "Section 216 facilitates the reduction or elimination of the non-resident's Part XIII tax liability. It is not intended to allow reduction of the capital gain that would otherwise be realized by the taxpayer under Part I of the Act if no section 216 return had been filed." CRA stated that this assessing position would be adopted only in respect of capitalized expenses incurred after 2010. However, it was also stated

that CRA will apply this assessing position before 2011 in respect of interest payable to a non-arm's length person in circumstances where the arrangement in question does not reflect "normal commercial dealings". It appears that CRA accepts that a non-resident may elect under section 21 in a section 216 return to add an amount to the cost of depreciable property, but the amount so added may be relevant only in computing the income from property on the section 216 return. In other words, it seems that the capitalized amount is an addition to the capital cost of the property but only for the purpose of computing capital cost allowance on the section 216 return and not to reduce the gain on a subsequent disposition. The words in subsection 216(1) which arguably support same are "without affecting the liability of the non-resident person for tax otherwise payable under Part I" such that where the non-resident elects to capitalize interest in the section 216 return, that is "without affecting" its liability for tax otherwise payable under Part I.

The above question and answer came some time after the archiving of *Interpretation Bulletin* IT-121R3, "Election to Capitalize Costs on Borrowed Money" in 2004. Paragraph 16 of IT-121R3 expressly contemplated the capitalization of interest in circumstances where a section 216 election was made.

> "Amounts elected under section 21 are, however, included in
>
> …
>
> (f) the capital cost of property, including property in respect of which a non-resident taxpayer has elected to file a return of income pursuant to section 216"

While the above did not expressly provide that the capitalized amount was limited to consequences of the section 216 return, there was also no express statement that the capitalized amount was not applicable on a computation of gain on a later disposition.

There has been some CRA review in connection with the above. Specifically information and/or documentation has been requested to establish the arm's length and/or commercial nature of the loan and prior years interest paid by a non-resident. This issue may arise where a Form T2062A is filed in respect of the disposition of depreciable taxable Canadian property. Form T2062A specifically requests documentation to support a subsection 21(1) election regarding interest capitalization.[43]

Partnership Information Return Filing Requirements

On September 17, 2010, CRA announced changes to the requirements for filing partnership information returns effective for fiscal periods ending on or after January 1, 2011.[44]

Pursuant to paragraph 221(1)(d), Regulation 229 requires every member of a partnership that carries on business in Canada, or a SIFT partnership, or that is a Canadian partnership, at any time in the fiscal period of the partnership to make an information return containing prescribed information. Regulation 229(2) provides that a return made by one partner is deemed to be made by all partners of the partnership. By administrative practice however, CRA has indicated that the filing requirement was waived for partnership with five or fewer members throughout the fiscal period where no member was another partnership.[45] Notwithstanding same, advice was typically given to file the information return as there would otherwise be no statute-barring of the determination of income or loss, any deduction or any other amount of the partnership. This derived from subsection 152(1.4)[46] which has been the subject of some commentary.[47]

The new CRA filing criteria replaced threshold of the number of partners with a financial threshold. Specifically, effective January 1, 2011, a partnership that carries on business in Canada or a Canadian partnership with Canadian or foreign operations or investments must file Form T5013 for each fiscal period of the partnership if:

- at the end of the fiscal period, the partnership has an absolute value of revenues plus an absolute value of expenses of more than $2M, or had more than $5M in assets
- at any time in the fiscal period,
  - the partnership is a tiered partnership (i.e., has another partnership as a partner or is itself a partner in another partnership)
  - a corporation or a trust is a partner
  - the partnership has invested in flow-through shares of a principal business corporation that incurred Canadian resource expenses and renounced those expenses to the partnership
  - CRA requests the filing.

For the above purposes, "absolute value" is based on financial statement information, without reference to its positive or negative sign. In other words, total expenses should simply be added to total revenues to determine if the above threshold is met, rather than netting expenses against revenues. Further, "revenues" refers to revenues that have not been netted and the determination of whether a partnership has more that $5M in assets should be based on cost of assets without taking depreciation into account.

A penalty can be assessed under subsection 162(7) for failure to file an information return as and when required by the ITA or regulations. Also, there is a specific penalty under subsection

162(7.1) for failure to make a partnership information return. CRA document no. 2011-0397361I7[48] points out that the limitation period for assessing a partnership under either of the foregoing penalty provisions begins at the earlier of the time that there is a determination in respect of the partnership under subsection 152(1.4) and the time of assessment of an initial penalty. Effectively, this means that the period is virtually open-ended.

Recent CRA Administrative Statements of Interest

CRA document no. 2011-0401241I7 – Taxpayer requested adjustment

CRA document no. 2011-0401241I7 dated September 7, 2011 dealt with a taxpayer requested adjustment outside the normal reassessment period in respect of an unpaid non-arm's length management fee. The taxpayer in question was a non-resident corporation carrying on business in Canada through a permanent establishment with a US parent corporation. For a number of taxation years, the taxpayer accrued and deducted management fees to its parent corporation but such accrued management fees were not paid. The taxpayer and its parent corporation did not file an agreement in prescribed form as contemplated in paragraph 78(1)(b). Part XIII withholding tax was not remitted on the basis that such fees would otherwise have been exempt by virtue of paragraph 212(4)(b) as reimbursement of specific expenses. The taxpayer requested adjustments to its income for its 1995-2007 taxation years to apply paragraph 78(1)(a) so as to include the unpaid management fees in computing its income in the third taxation year following the taxation year in which such fees were incurred. For some of these taxation years, the taxpayer apparently had non-capital losses available and requested such non-capital losses be deducted to offset the

income inclusion. For all of the years in question, the CRA had issued notifications that no tax was payable (i.e., a so-called NIL assessment).

This CRA document serves as a reminder of a number of longstanding positions. CRA confirmed its administrative position as set out in *Interpretation Bulletin* IT-109R2 that subsection 78(1) will not generally be applied to debtors and creditors who account for income on an accrual basis except where the unpaid amount appears to be part of a "tax avoidance scheme". Further the CRA document points out that if an unpaid amount is included in income pursuant to subsection 78(1), there is no statutory provision permitting a deduction in the event of a subsequent payment.

The CRA document stated that the taxpayer requested adjustments may be accepted notwithstanding that the years in respect of which the adjustments were requested were beyond the "normal reassessment period". The term "normal reassessment period" is defined in subsection 152(3.1) as three or four years (as the case may be) after the earlier of the day of sending of a notice of original assessment and the day of sending of an original notification that no tax is payable for the year. In the particular fact situation, the normal reassessment period for the years in question commenced running from the dates of notification of no taxes payable. The CRA document noted that while subsection 152(4) provides that the Minister "may at any time" notify in writing a person by whom a return has been filed that no tax is payable for the year, the ability to make an assessment, reassessment or additional assessment of tax beyond the normal reassessment period is limited to the circumstances enumerated in such subsection. Accordingly, as long as the taxpayer requested adjustment to the year beyond the normal reassessment period did not result in any additional assessment of tax, same could be processed.

The particular taxpayer also requested a determination of losses for the years in question (i.e., subsequent to the adjustment to apply section 78). The CRA document serves as a reminder that a notice of determination of loss is not automatically issued but rather there are prerequisites to same in subsection 152(1.1). Among other things, "the Minister [must] ascertain the amount of a taxpayer's capital loss" to be different from that reported in the taxpayer's return. In the particular fact situation, the change in loss balance would result from a taxpayer requested adjustment and it was accordingly considered that there was no amount "ascertained" by the Minister. As a result, the requirements for a notice of determination of loss in subsection 152(1.1) were not met.

CRA document no. 2011-0405701I7 – Dividend refund may be denied

CRA document no. 2011-0405701I7 dated May 23, 2011 addressed the three year limitation period in subsection 129(1) in respect of a dividend refund. Subsection 129(1) provides that where a corporation's return under Part I is made "within three years after the end of the year", the Minister may (pursuant to paragraph (a) therein) refund without application the corporation's "dividend refund as calculated therein when sending the notice of assessment for the year, and must (pursuant to paragraph (b) therein) make the dividend refund after sending the notice of assessment upon application by the corporation within the "normal reassessment period" for such year. The CRA document noted that there is Ministerial discretion to extend the time for making a return under the ITA pursuant to subsection 220(3). It was stated however that this does not affect the requirement in subsection 129(1) that the corporation file its return within three years after the taxation year in question.

The effect of the foregoing CRA document is that failure to file a corporation's tax return within three years after the end of the year effectively foregoes the corporation's dividend refund. The provision for mandatory making of the refund in paragraph 129(1)(b) will be of no assistance since it nonetheless is subject to the preamble which requires that the return have been filed within three years after the end of the particular year.

A recent comment in *"Tax for the Owner-Manager"*[49] discussed the above problem and apparent inequity. In a typical holding company structure where a holding company has received a dividend from a subsidiary, the failure to file a corporate tax return of the holding company within the three year time period contemplated in subsection 129(1) may lead to the holding company being subject to Part IV tax yet the otherwise offsetting dividend refund may be denied by CRA for failure to file the tax return within the delineated time.

The recent Tax Court of Canada decision in *Tawa Developments Inc. v. The Queen*[50] illustrates the above. Tawa was a CCPC which received dividends from a connected corporation in 2004. Tawa had a December 31 taxation year end. Tawa did not file its 2004 tax return until January 15, 2008. In its 2004 tax return, Tawa reported Part IV tax liability arising from the dividends received. It also reported the payment of taxable dividends to non-connected shareholders and claimed a dividend refund. The dividend refund was denied on the basis of Tawa's late filing of its 2004 tax return. Further, in respect of Tawa's 2005 taxation year, CRA reduced Tawa's RDTOH balance by the amount of the dividend refund claimed in its late filed 2004 tax return.

The Tax Court of Canada denied Tawa's appeal with respect to the dividend refund in respect of its 2004 taxation year based upon a strict interpretation of the preamble to subsection 129(1). However, with respect to the issue of whether the denied 2004 dividend refund should reduce Tawa's RDTOH account in its 2005 taxation year, the Court held in favour of the taxpayer. In this regard, it is instructive to consider the actual wording of subsection 129(1) which is reproduced below:

> 129. (1) Where a return of a corporation's income under this Part for a taxation year is made within 3 years after the end of the year, the Minister
>
> (*a*) may, on sending the notice of assessment for the year, refund without application an amount (in this Act referred to as its "dividend refund" for the year) equal to the lesser of
>
> (i) 1/3 of all taxable dividends paid by the corporation on shares of its capital stock in the year and at a time when it was a private corporation, and
>
> (ii) its refundable dividend tax on hand at the end of the year; and
>
> (*b*) shall, with all due dispatch, make the dividend refund after sending the notice of assessment if an application for it has been made in writing by the corporation within the period within which the Minister would be allowed under subsection 152(4) to assess tax payable under this Part by the corporation for the year if that subsection were read without reference to paragraph 152(4)(*a*).

Arguably, based on a strict textual reading of the above, the term "dividend refund" acts only as defined term for the amount which may be refunded. The Crown argued that based on the above provision, a "dividend refund" was merely a notional amount computed as above. The Court applied a textual, contextual and purposive analysis with respect to the term "dividend refund". The Court found that an ordinary interpretation of the term favoured the taxpayer as it suggested a return or repayment of a sum. On a contextual basis, the Court also found that section 129 is expected to work to the advantage of the taxpayer and if the term "dividend refund" was

considered to be an amount that was not in fact refunded but which still reduced the corporation's RDTOH balance, then such term will become equivalent to a penalty, contrary to the general nature of refunds. The Court also reviewed the history of tax reform leading to the integration of corporate and shareholder taxation in its purposive analysis. The statutory interpretation exercise led the Court to reject the CRA's argument that an actually un-refunded "dividend refund" should reduce the corporation's RDTOH account.

The above CRA document also stated that subsections 221.2(1) and (2) would not apply in the circumstances. These provisions permit a taxpayer to request an amount that has been "appropriated to a debt" be appropriated to another amount that is or may become payable under the ITA. Effectively, these provisions permit the taxpayer to request the Minister to apply amounts owing to other tax balances. The CRA document indicated that a dividend refund which is statute barred as a result of the lapse of the three year filing period referred to in the preamble in subsection 129(1) cannot be considered an amount that was appropriated to a debt.[51]

<u>CRA document no. 2010-0373231C6 – Timing of share issuance for subsections 85(1) and 51(1)</u>

CRA document no. 2010-0373231C6 dated October 8, 2010[52] commented on the distinction between subsections 85(1) and 51(1) in connection with the issuance of shares. The particular question was the time at which shares must be issued to satisfy the statutory prerequisites.

Subsection 85(1) states:

> "Where a taxpayer has, in a taxation year, disposed of any of the taxpayer's property that was eligible property to a taxable Canadian corporation for consideration that includes shares of the capital stock of the corporation …"

In contrast, subsection 51(1) states:

> "Where a share of the capital stock of the corporation is acquired by a taxpayer from the corporation in exchange for …."

The CRA document referred to the decision in *Dale v. The Queen*[53] where the Tax Court of Canada ruled that the term "consideration that includes shares" (as reproduced above) does not mean that the shares must be issued simultaneously with the transfer of property as consideration (in the legal context) may be either executed consideration or executory.

The CRA document confirmed that paragraph 35 of *Interpretation Bulletin* IT-291R3 continues to remain CRA's administrative position[54]. Thus, if the shares to be issued in consideration for the transferred property are not legally authorized in the Articles of Incorporation or other constating documents of the transferee corporation as at the date of transfer, CRA has stated it will accept an election under subsection 85(1) if:

(a) there is an agreement between the transferor and transferee requiring that the transferee issue the shares in question;

(b) the transferee immediately takes the necessary steps to authorize the issuance of shares including the filing of Articles of Amendment if required; and

(c) once the foregoing has occurred, the shares are issued by the transferee corporation without delay.

CRA also stated that the above position applies even if the necessary authorized share capital is not created until after the due date for the filing of the election (Form T2057) as set out in subsection 85(6). This is not specifically mentioned in *Interpretation Bulletin* IT-291R3.

CRA noted however that subsection 51(1) might not apply in these circumstances. The reasoning was based on the different wording which CRA considered to require the simultaneous exchange of property by the taxpayer and issuance of shares by the corporation.

A closer examination of the language in subsection 85(1) reveals use of the term “right to receive” shares and “shares of the capital stock of the corporation receivable”. Neither was mentioned in the above CRA document. The term “right to receive” appears in paragraph 85(1)(b) which sets a limit on the elected amount (i.e., not less than the fair market value of non-share consideration or boot). Paragraph 85(1)(b) refers to consideration “other than any shares of the capital stock of the corporation or a right to receive any such shares”. The concept of shares “receivable” appears in paragraph 85(1)(g) which describes the cost to the transferor taxpayer of preferred shares. Paragraph 85(1)(g) refers to “the cost to the taxpayer of any preferred shares of any class of the capital stock of the corporation receivable by the taxpayer as consideration for the disposition….” There is similar wording in paragraph 85(1)(h) with respect to common shares “receivable”.[55] Such terms suggest shares may be “received” by the transferor taxpayer after the time of disposition. An earlier Technical Interpretation[56] (which was not referred to in the above CRA document) raised the question of whether the right to receive shares necessarily has the same fair market value as issued shares, noting that until shares are in fact issued, the taxpayer merely has a right to receive shares but none of the other rights of a shareholder including the right to receive dividends or the right to receive assets upon the liquidation of the corporation. The earlier Technical Interpretation seemed to contemplate issued shares and a right to receive shares of the same class as consideration for the same disposition and commented that this might lead to issues in the determination of cost.[57] Subsection 85(1) does not specifically address the consequences

when the "right to receive shares" becomes issued shares. If a taxpayer disposes of eligible property for a promise of the corporation to issue shares (i.e., executory consideration) which in the hands of the taxpayer is a right to receive shares, arguably there is a later disposition of such right in exchange for the shares themselves.[58]

CRA document no. 2010-0373301C6 – Classes of shares with identical characteristics

CRA document no. 2010-0373301C6 dated October 8, 2010[59] asked if two identical classes of shares under the Quebec Business Corporations Act have separate paid-up capital and whether the adjusted cost base averaging rules in section 47 apply. Under the "new" Quebec Business Corporations Act which entered into force February 14, 2011, the shares of two or more classes or two or more series of the same class may carry the same rights and restrictions.[60] In Ontario, the Business Corporations Act was amended effective January 1, 2007 to provide for the foregoing. This was discussed at the 2007 Ontario Tax Conference.[61]

The CRA document states that the two identical classes of shares will each have their own paid-up capital. The rationale was that paid-up capital is defined in subsection 89(1) by reference to a class of shares. As a "class of shares" is not a defined term, applicable corporate law must be considered and the CRA document noted that under the Quebec Business Corporations Act, the paid-up capital of each class of shares is computed separately. Under the Ontario Business Corporations Act[62] ("OBCA"), stated capital is a class concept[63]. The paid-up capital in respect of a class of shares is "computed without reference" to the provisions of the ITA[64] and is generally considered to be the "stated capital" determined under corporate law. Thus, it seems clear that an

OBCA corporation with two classes of shares with identical attributes will have separate stated capital and paid-up capital in respect of each class.

With respect to adjusted cost base, the CRA document indicates that different classes of shares having the same rights and restrictions are considered identical properties such that averaging rule in section 47 applies.

<u>CRA document no. 2011-0399191I7 – Assessing a dissolved company</u>

CRA document no. 2011-0399191I7 dated August 10, 2011 considered whether a parent corporation can be assessed for taxes owing by its subsidiary where the subsidiary has been wound up into the parent and dissolved. The CRA document stated that the parent corporation can be considered the "legal representative" of the subsidiary. Reference was made to the 1998 amendments to subsection 159(1) to provide that the "legal representative" of a taxpayer is jointly and severally liable with the taxpayer to pay any amount that is payable by the taxpayer and to perform any obligation or duty imposed on the taxpayer under the ITA. Reference was made to the Technical Notes to such amendments, the relevant portions of which read as follows: [65]

> "… actions and proceedings under this Act taken by the representative (in that capacity) or taken by the Minister against the representative, would be binding on the taxpayer. For example, the issuance of a notice of assessment against a legal representative of the taxpayer (say a parent corporation that wound up its subsidiary and acquired its assets) will have the same effect as if it had been issued against the dissolved taxpayer at that time, assuming it had been in existence at the time."

The definition of the term "legal representative" in subsection 248(1) was amended at the same time as the above amendments to section 159 and currently reads as follows:

> *"legal representative"* of a taxpayer means a trustee in bankruptcy, an assignee, a liquidator, a curator, a receiver of any kind, a trustee, an heir, an administrator, an

> executor, a liquidator of a succession, a committee, or any other like person, administering, winding up, controlling or otherwise dealing in a representative or fiduciary capacity with the property that belongs or belonged to, or that is or was held for the benefit of, the taxpayer or the taxpayer's estate"

A parent corporation acts as a shareholder in dissolving its subsidiary corporation. In the case of a voluntary dissolution under the OBCA, the corporation may be dissolved upon the authorization of a special resolution passed at a meeting of the shareholders of the corporation duly called for such purpose or by the consent in writing of all shareholders entitled to vote.[66] It is not necessary that a liquidator be appointed. Rather, the typical corporate steps involve satisfying the interests of known creditors or otherwise obtaining their consent and entering into a winding up conveyance whereby all the assets of the subsidiary are distributed to the parent (in its capacity as shareholder). Thereafter, subject to obtaining the consent of the Ontario Ministry of Revenue,[67] Articles of Dissolution in prescribed form are filed and the corporation is thereby dissolved. A similar process is followed under the Canada Business Corporations Act[68] ("CBCA") except that consent of the Ontario Ministry of Revenue is not required.[69]

It is not clear that a parent corporation in its capacity as shareholder is necessarily a "legal representative" as defined in subsection 248(1). Prior to the dissolution, the parent corporation and subsidiary are distinct legal entities. It is difficult to accept that the parent corporation (as shareholder) can be said to be acting in a representative or fiduciary capacity with respect to the property of the subsidiary. At the time at which the voluntary dissolution is authorized and the assets of the subsidiary are conveyed to the parent corporation as shareholder, the subsidiary continues to exist and its directors and officers continue in office. It should be noted that cancelled versions of a circular and interpretation bulletin (predating the 1998 amendments to section 159

and the definition of "legal representative") suggested that a voluntary dissolution might fall within the scope of section 159.[70]

Under the OBCA, a "civil, criminal or administrative action" may be brought against the corporation as if the corporation had not been dissolved and any property that would have been available to satisfy any judgment if the corporation had not been dissolved remains available for such purpose.[71] A notice of assessment or reassessment has been held to be an "administrative action".[72] Therefore, the subsidiary may be reassessed notwithstanding its dissolution. Some corporate statutes limit the period of time within which such a claim may be made. For example, under the CBCA, such an "administrative action" must be brought within two years after the dissolution.[73] Corporate statutes permit limit recovery from the shareholder in these circumstances. In the case of the OBCA, subsection 243(1) limits the liability of a shareholder to whom any property of the dissolved corporation has been distributed "to the extent of the amount received by that shareholder upon the distribution"[74] and states that an action may be brought to enforce such liability. The CBCA has a similar limitation but in addition, the action to enforce such liability must be brought within two years of dissolution.[75]

In the event that CRA determines the subsidiary to have a tax liability subsequent to its dissolution, CRA could (pursuant to the provisions in the OBCA and CBCA or similar provisions in the relevant corporate statute) assess the dissolved subsidiary as the assessment or reassessment is considered an "administrative action" which may be brought against the corporation as if it had not been dissolved. In contrast, CRA document no. 2011-0399191I7 states that the parent corporation may be assessed pursuant to subsection 159(3) as a "legal representative" in respect of the

dissolved subsidiary. In either case, recovery is limited to the value of the assets distributed. The difference seems to be one of timing as subsection 159(3) permits assessment of the legal representative "at any time" whereas proceedings under the relevant corporate statute are subject to the time limits expressed therein and recovery subject to applicable limitations legislation.

An alternative to the above may be an assessment of the parent corporation pursuant to section 160.[76] Such an assessment can be made "at any time" and without the need to find the parent corporation to act as "legal representative" in respect of the subsidiary. However, query whether there is a transfer of property by the subsidiary for less than fair market value consideration as arguably, the parent corporation effectively surrenders its shares of the subsidiary on the dissolution.

<u>CRA document no. 2010-038060 - Ontario Apprenticeship Training Tax Credit</u>

The apprenticeship training tax credit ("ATTC") is a refundable Ontario tax credit provided under the Taxation Act (Ontario)[77] ("Ontario TA") and is available to employers who train apprentices in certain trades. The maximum credit per qualifying apprenticeship is $10,000 per year to a maximum of $40,000 in the first 48 months of apprenticeship. The credit is based on a specified percentage (35% - 45%) of "eligible expenditures" in respect of a qualifying apprenticeship[78], largely being salary and wages.

While the partners of a partnership may claim the ATTC, the general rule in subsection 89(16), Ontario TA is that each partner may claim the amount reasonably considered to be its share, at first blush, one might assume that this might be based on income allocation. The foregoing is subject

subsection 89(17) which seems to permit an override and disproportionate allocation. In addition, it should be noted that subsection 89(18), Ontario TA expressly provides that a limited partner of a limited partnership cannot claim the ATTC. There is a similar prohibition for the refundable Ontario co-operative education tax credit.[79] The relevant provisions of the ATTC read as follows:

> (16) The following rules apply if a corporation or individual (in this section referred to as the "partner") is a member of a partnership and the partnership would qualify for a fiscal period ending in a taxation year of the partner for an apprenticeship training tax credit if the partnership were a corporation or an individual, as the case may be, and the fiscal period were its taxation year:
>
> 1. Subject to paragraph 2, the portion of that apprenticeship training tax credit that may reasonably be considered to be the partner's share of the tax credit may be included in determining the amount of the partner's apprenticeship training tax credit for the partner's taxation year.
> 2. If the partner or any other member of the partnership bases a claim in respect of the partnership for the taxation year under subsection (17), no amount in respect of the partnership may be included in determining the amount of the partner's apprenticeship training tax credit for the partner's taxation year otherwise than pursuant to subsection (17).
>
> (17) If it is acceptable to the Ontario Minister, a partner's share of a partnership's apprenticeship training tax credit determined under subsection (16) for a fiscal period shall be equal to such amount as the partner claims not exceeding the amount, if any, by which the amount of that credit exceeds the total of all amounts each of which is claimed under this section, section 43.13 of the *Corporations Tax Act* or subsection 8 (16.1) of the *Income Tax Act* in respect of the amount of that credit by any other partner.

CRA document no. 2010-0380601R3 dated XXXX 2011 is an advance income tax ruling involving a limited partnership structure with a single corporate general partner and a single limited partner (initially an income fund which converted to a corporation). The limited partnership agreement was amended to specify that tax credits which cannot be claimed by limited partners would be allocated to the general partner(s) based on each general partner's pro rata share of the aggregate general partner income or loss allocation. As there was only one general partner,

100% of the ATTC of the limited partnership would effectively be allocated to the sole corporate general partner. A ruling was issued to the effect that the limited partnership may allocate 100% of the ATTC to the sole general partner as long as all partners based their claim to the ATTC on the basis of subsection 89(17), Ontario TA and agree to the disproportionate allocation. Given that no limited partner may claim any portion of the ATTC, such an allocation to the general partner (which presumably has an insignificant income allocation from the partnership) permitted full access to the refundable tax credit.

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[1] R.S.C. 1985, c.1 (5th Supp.) as amended (herein referred to as "ITA"). Unless otherwise stated, statutory references herein are to the ITA.

[2] See CRA document no. 2011-0403081C6, June 6, 2011.

[3] *Alcatel Canada Inc. v. The Queen*, 2005 DTC 387. See Paul Stepak, "An Axe instead of a Scapel: Finance Canada's Response to the Alcatel Decision" in *Tax Topics* No. 1792 (Toronto: CCH Canadian Limited, July 13, 2006); Albert Baker and Joyce Lee, "Section 143.3 Comfort Letter", (2010) vol. 18, no. 3 *Canadian Tax Highlights*; Marc Ton-That, "Unintended Section 143.3 Application" (2009) vol. 17, no. 5 *Canadian Tax Highlights*.

[4] S.O. 1998, Chapter 34.

[5] See subsection 2(6), EATA. Technically, there is a lesser rate of 0.5% of the first $50,000 of the value of the estate; with the rate of 1.5% of the value of the estate in excess of $50,000. The rate was last changed in 1992, representing a threefold increase over the prior rate.

[6] *Granovsky Estate v. Ontario* (1998), 21 E.T.R. (2d) 25 (Ont. Gen. Div.) In the *Granovsky Estate* case, the deceased had executed two wills, referred to as the "Primary Will" and the "Secondary Will". The Primary Will was probated and probate fees were paid on the value of the assets governed by the Primary Will. The Secondary Will was not probated. The Secondary Will governed the deceased's shares of specified corporations, receivables owing to him from such corporations and any property held in trust for him by such corporations. The Primary Will governed all other assets of the deceased. The issue was whether the Secondary Will must also be probated. The estate trustee argued that although s. 53 of the Estates Act, R.S.O. 1990, c. E.21 (as it then read), required that fees to be paid on the "whole estate" of the testator, section 32 allowed for a limited grant of probate. Section 53 then read as follows:

> (1) Fees to be on value of whole estate. - The fees payable upon the value of the estate of the deceased shall be calculated upon the value of the whole estate, including the real estate as well as the personal estate.
>
> (2) Deductions. - In calculating the value of the real property, there shall be deducted the actual value of any encumbrance thereon.

The relevant portion of section 32 read as follows:

(3) Evaluation of limited grant. - Where the application or grant is limited to part only of the property of the deceased, it is sufficient to set forth in the statement of value only the property and value thereof intended to be affected by such application or grant.

Freer J. agreed, and in holding that that there was no legal obligation to obtain probate, stated [at paragraph 23]: "If the directors of the private companies in which the deceased owns shares or has an interest at death do not require the formal grant from the Court to deal with the transmission of the assets and are prepared to deal with the estate trustees named in the Secondary Will, why then should the estate have to pay probate fees on those assets?" Section 53 of the Estates Act has since been repealed [S.O. 1998, c.34, s.63] while subsection 32(3) above remains in force.

[7] Subsection 67(8), Business Corporations Act (Ontario), R.S.O. 1990, c. B.16, as amended provides that if the laws of the jurisdiction governing the transmission of a security of the deceased do not require a grant of probate in respect of the transmission (and it is not so required in Ontario), then the legal representative is entitled to become the registered holder upon depositing the following with the corporation: share certificate owned by the deceased; and reasonable proof of the governing laws, the deceased's interest and the right of the legal representative to become registered holder.

[8] See subsection 7(2), Estates Act. If the testator had no fixed place of abode in Ontario, the certificate may be issued by the court in the country or district in which he/she had property.

[9] See Rule 74.04(1), Rules of Civil Procedure, Courts of Justice Act R.R.O. 1990, Reg. 194. Form 74.4.1 is the Application for a Certificate of Appointment of Estate Trustee with a Will limited to assets referred to in a Will, available electronically at www.ontariocourtforms.on.ca .

[10] See subsection 4.1(1), EATA which also contemplates that a later date may be prescribed.

[11] See Paul Trudelle, "A better tomorrow? Not necessarily so for estates: amendments to the Estates Administration Act" in *The Probaters*, 2011 vol. 16 (a newsletter of Hull & Hull LLP). See also Clare Sullivan, "Ontario to change the way it collects estate administration tax" in *STEP Inside*, (2011) vol. 10, p.6 (Toronto: Society of Trust and Estate Practitioners (Canada)).

[12] R.S.O. 1990, c. R.30 ("RSTA"). This includes the assessment provisions in subsections 18(4)-(9), RSTA, the objection and appeal provisions in section 24-30, RSTA and the audit and inspection powers n subsections 31(1)-(2.2), RSTA. It should be noted that because of the adoption of subsection 18(9), RSTA, an assessment or reassessment of estate administration tax shall be payable notwithstanding an outstanding objection or appeal.

[13] Submissions were made following second reading of Bill 173 to the Standing Committee on Finance and Economic Affairs (see May 5, 2011 minutes available on the website of the Legislative Assembly of Ontario for the 39:2 session ended June 1, 2011, http://www.ontla.on.ca)

[14] See Barry S. Corbin, "Estate Administration Tax – The Nightmare Begins" in *Deadbeat*, Volume 29, No. 4 (Toronto: Ontario Bar Association, May 2011).

[15] 2010 FCA 12 reversing 2009 TCC 56. *Collins* has been the subject of considerable comment. See, e.g., Daniel Sandler, "A Matter of Interest" in Current Cases, (2010) vol. 58, no. 2 *Canadian Tax Journal*, and Barbara Worndl, "*Current Tax Cases, Part I*" in 2010 Ontario Tax Conference (Toronto: Canadian Tax Foundation, 2010).

[16] The term "expenditure" is defined in proposed subsection 143.4(1) broadly to include not only income outlays but also the cost or capital cost of property. This is the same definition as in proposed subsection 143.3(1) being the response to the *Alcatel* decision, *supra* footnote 3.

[17] The concept of an amount having the "same character" also appears in the proposed partnership anti-deferral rules and in particular, proposed subsection 34.2(5) in Bill C-13 relating to the amount included in income as adjusted stub period accrual, and proposed subsection 260(8) (as proposed in the July 10, 2010 legislative proposals) relating to a securities lending arrangement compensation payment. Presumably "same character" is different than same source; arguably the latter seems more appropriate in respect of an income inclusion item such as adjusted stub period accrual whereas the former is more appropriate in respect of a payment.

[18] 2010 FCA 124. See Worndl, *supra* footnote 15, for a discussion of this case.

[19] "Specified amount" is defined in proposed subsection 90(8) to mean the amount of the loan/indebtedness multiplied by the Canadian taxpayer's "equity interest" in the lending foreign affiliate. "Equity interest" for this purpose is measured by reference to the taxpayer's "surplus entitlement percentage" in the foreign affiliate. In the simple wholly owned foreign affiliate situation, the specified amount of the loan/indebtedness would be the full amount of same.

[20] 1992 CarswellNat 260 (TCC).

[21] 1992 CarswellNat 458 (TCC).

[22] August 7, 1998.

[23] Subsection 95(1).

[24] The definition in proposed subsection 90(10) has particular provisions for partnerships, but specifically excludes a controlled foreign affiliate (using for this purpose the broader definition of same in subsection 17(15)).

[25] See CRA Audit Manual, chapter 24.12.6, "Offsetting accounts receivable and payable".

[26] See "Pending updates to IC76-12, Applicable rate of Part XIII tax on amounts paid or credited to person in countries with which Canada has a tax convention" related to forms NR301, NR302 and NR303 available at http://www.cra-arc.gc.ca/formspubs/frms/ic76-12r6-eng.html)

[27] See "More information on Forms NR301, NR 302 and NR303", available at www.cra-arc.gc.ca/formspubs/frms/nr301-2-3-eng.html.

[28] *Information Circular* IC-76-12R6, "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 at paragraph 4.

[29] In the Canada – United States context, this effectively means that the non-resident is certifying that the requirements of the limitation on benefits provision in Article XXIXA of the Canada – United States Tax Treaty are satisfied. A discussion of the limitation on benefits provision is beyond the scope of this paper. See Kara Ann Selby, "Navigating the New Bilateral Limitation-on-Benefits Rule", (2009), vol. 57, no. 1 *Canadian Tax Journal*, 86-118.

[30] Subsection 215(6).

[31] CRA Roundtable, International Fiscal Association (Canadian Branch), 2011 International Tax Seminar.

[32] Subsection 227(10).

[33] Subsection 227(8).

[34] Subsection 228(8.3).

[35] Subsection 227(10).

[36] Subsection 227.1(1).

[37] Subsection 102(1).

[38] Paragraph 7 of *Interpretation Bulletin* IT-81R, "Partnerships – Income of Non-Resident Partners", May 6, 1976 states: "Where tax is to be withheld under Part XIII because a partnership is deemed by paragraph 212(13.1)(b) to be a non-resident person, the withholding applies to the full amount of the payment even though some members of the partnership are residents of Canada. The portion of such tax withheld that is attributable to a resident member of the partnership may be claimed by him as a credit against the tax otherwise payable under Part I of the Act."

See also CRA document no. 9716735, October 30, 1997.

[39] See CRA document no. 2004-0074241E5, July 19, 2005.

[40] An abbreviated version of the example in Form NR302 is as follows:

ABC Partnership is a non-resident partnership with the following members and allocations of income:

W is a resident of Bahamas for treaty purposes, 15% allocation

X is a resident of Spain for treaty purposes, 15% allocation

Y is a resident of Taiwan for treaty purposes, 55% allocation

Z is a resident of Canada, 15% allocation

ABC Partnership expects to receive dividends from a Canadian corporation. To receive a reduced treaty rate of withholding, ABC Partnership completes Form NR302 and provides it to the Canadian corporation.

The effective rate of Part XIII withholding on dividend payments to ABC Partnership is 19.75% determined as follows:

W: no treaty benefits [15% *25% = 3.75%]

X: Article X of the Canada-Spain Treaty should apply. X should complete Form NR301 and provide same to ABC Partnership. [15% * 15% = 2.25%]

Y: no treaty benefits [55% * 25% = 13.75%]

Z: Canadian resident; withholding not applicable

The effective Part XIII withholding tax rate is the sum of the above.

[41] Subparagraph 212(1)(d)(i).

[42] Pursuant to subsection 216(4), where a non-resident person files an undertaking within 6 months of the end of the year to file the separate return as permitted by subsection 216(1), the non-resident's Canadian agent may be permitted to withhold and remit 25% of an amount which is less than the gross rental. Otherwise, section 216 does not expressly relieve the Canadian payer from withholding less than 25% of the gross payment. See Maureen Y. Berry, "Section 216 Shortfall" in Tax Topics No. 1904 (Toronto: CCH Canadian Limited, September 4, 2008) for a

discussion of the effect of making a subsection 216(4) election and the administrative policy of the CRA to not assess a tenant for failure to withhold in circumstances where a subsection 216(4) election has been made.

[43] It is also possible that CRA may be monitoring compliance with subsections 212(13) as certain payments by a non-resident may nonetheless be subject to Part XIII withholding tax.

If the non-resident is not carrying on business principally in Canada and is merely earning rent in respect of Canadian real estate, interest paid to another non-resident may fall within the ambit of paragraph 212(13)(f). Paragraph 212(13)(f) provides that where a non-resident pays or credits an amount as, on account or in lieu of payment of or in satisfaction of interest on any mortgage or other indebtedness secured by Canadian real estate, to the extent that the amount paid or credited is deductible in computing the non resident's taxable income earned in Canada or the amount on which the non-resident is liable to pay tax under Part I, the non-resident is deemed in respect of that payment to be a person resident in Canada. As a result, Part XIII withholding tax may apply in respect of such interest payment. Where a section 216 election is made, the non-resident is liable to pay tax under Part I in lieu of paying tax under Part XIII. It appears that in these circumstances, if the indebtedness was secured by Canadian real estate, Part XIII withholding tax may be exigible in respect of a non-resident to non-resident interest payment, regardless of capitalization of the interest under section 21. Subject to the terms of any applicable bilateral tax treaty, Part XIII now applies only to interest that is not fully exempt interest paid to a non-arm's length person, or participating debt interest, as defined. Therefore the scope of the above is necessarily limited.

[44] Details are available on the CRA website http://www.cra-arc.gc.ca/whtsnw/tms/prtnrshp-eng.html

[45] The administrative exemption was originally found in paragraph 11 of *Information Circular* IC 89-5R, "Partnership Information Return", June 21, 1991 (cancelled) and later in T4068, Guide for the T5013 Partnership Information Return.

[46] Subsection 152(1.4) is rather broadly worded. It provides that the Minister may "… determine any income or loss of the partnership for the fiscal period and any deduction or other amount, or any other matter, in respect of the partnership that is relevant in computing the income, taxable income or taxable income earned in Canada of, tax or other amount payable by, or any amount refundable to or deemed to have been paid or to have been an overpayment by, any member of the partnership for any taxation year …" under Part I. While the income or loss of a partnership allocated to any particular partner clearly fits within the above, the words "any other matter in respect of the partnership that is relevant in computing the income … of … any member of the partnership" imply great scope. It is trite to point out that the phrase "in respect of" contains words of the widest possible scope in conveying some connection between two related subject matters. [*Nowegijick v. The Queen*, 83 DTC 5041 (SCC)]. It is interesting to note that paragraph 197(6)(b) relating to SIFT partnerships cross references a determination by the Minister under subsection 152(1.4) and in this regard, expressly states "including the assessment or reassessment of Part I tax payable in respect of the disposition of an interest in a SIFT partnership by a member of the partnership". Query whether the specific reference to a disposition of a partnership interest means that a subsection 152(1.4) determination would not otherwise extend to a gain on disposition of a partnership interest.

[47] See Joel Nitikman, "Should you file a Partnership Information Return?" in *Tax Topics* No. 1831 (Toronto: CCH Canadian Limited, April 12, 2007) and Anthony V. Strawson, "Should Partnership Information Returns Be Filed as a Matter of Course?" (2009) vol. 9, no. 4 *Tax for the Owner-Manager* (Toronto: Canadian Tax Foundation).

[48] May 24, 2011.

[49] Brian J. Wilson, "The problem with dividend refunds", (2011) vol. 11, no. 3 *Tax for the Owner-Manager* (Toronto: Canadian Tax Foundation).

[50] 2011 TCC 440.

[51] See CRA document no. 2011-0410961I7, January 13, 2011 for discussion of the re-appropriation provisions in section 221.2. This CRA document states that section 221.2 does not permit a refund of an overpayment of tax where such refund is statute barred by virtue of subsection 164(1). However, it is stated that in such circumstance, section 221.2 may permit CRA to re-appropriate the amount and therefore to transfer same to another account of the taxpayer where there is indebtedness owing by the taxpayer. See also Paul Hickey, "Access to Statute-barred Refund", *Canadian Tax Highlights*, vol. 19, no. 9 September 2011 (Toronto: Canadian Tax Foundation).

[52] This is question 22, APFF-Congrès 2010.

[53] 94 DTC 1100 (TCC) affirmed 97 DTC 5252 (FCA). Although *Dale* is often discussed in connection with rectification and in particular, whether a provincial court order of rectification is binding on CRA, the case basically involved a purported subsection 85(1) transfer of property to a corporation in consideration of preference shares which were not authorized capital of the corporation at the time of transfer. Three years later, the corporation was continued to another province and on *ex parte* application to the court, the court ordered that the share capital of the corporation was amended to include the preference shares in question and that the preference shares were issued to the individual taxpayers, all retroactive to the date of transfer. The portion of the Tax Court of Canada judgment referred to in CRA document no. 2010-0373231C6 was as follows [at paragraph 51]:

> "The expression "consideration that includes shares" does not, as counsel suggests, imply that the share must necessarily be issued simultaneously with the transfer of property to the company or indeed within the same taxation year. What is essential is that there be either an actual issuance of shares or a binding obligation to do so at the time of transfer and that the shares be issued within a period of time that, in all the circumstances, is reasonable. There is no basis, in my view, for confining the word "consideration" to executed consideration. Consideration is of two kinds -- executed and executory -- and it would be an unwarranted restriction on that term to limit it to only one of the two types."

The majority in the Federal Court of Appeal did not specifically address the above issue, but rather confirmed the lower court decision on the basis that the provincial court order rectifying the share capital retroactive to the date of transfer was binding on CRA. Pratte, J.A. dissented and held that "consideration that includes shares" cannot refer to consideration that consists of "a simple promise to issue shares" [at paragraph 54]. Pratte, J.A. noted the reference to a right to receive shares in paragraph 85(1)(b) and held that the draftsperson therefore was conscious of the difference between shares and a right to receive shares.

[54] Earlier versions of this Interpretation Bulletin did not contain the equivalent to current paragraph 35. The current version of *Interpretation Bulletin* IT-291R3 is dated January 12, 2004 and reflects the discussion of *Dale*, *supra* footnote 53 in Income Tax Technical News No. 3, January 30, 1995.

[55] It seems curious that paragraph 85(1)(f) addresses the "cost to the taxpayer of any particular property (other than shares or a right to receive shares) received by the taxpayer as consideration for the disposition …" whereas paragraphs 85(1)(g) and (h) address the "cost to the taxpayer of … shares … of the capital stock of the corporation receivable by the taxpayer as consideration for the disposition …". Typically, one would look to paragraphs 85(1)(g) or (h) as the case may be to determine the cost of shares even where such shares are received at the time of disposition. IT-291R3, paragraph 21 makes no distinction between shares receivable and shares received.

[56] CRA document no. RCT 5-4379, September 23, 1982. This earlier technical interpretation takes a contrary position to paragraph 35 of IT-291R3 and states that while the language of subsection 85(1) does not prevent the use of a right to receive shares as consideration, the preamble of subsection 85(1) requires that some shares must be received at the time of the disposition.

[57] *Ibid*.

> "You have indicated that in your opinion the references in 85(1) to "a right to receive shares" and to "shares receivable" accommodate this type of transaction. Our concerns in this area lie with the valuation problems which might arise in connection with shares to be issued in the future. This right to receive shares or shares receivable must be valued for purposes of 85(1)(e.2) and also for purposes of 85(1)(g) and (h). 85(1)(h) for instance allocates the elected amount to the common shares receivable on the basis of the relative fair market values of each class of common shares. Each share of the same class of shares ends up with the same cost. It appears that the legislation assumes that each common share of a particular class has the same value. If some shares are received but some are only receivable and by agreement won't be issued until some specified date in the future, it is not likely that the latter shares have the same value as the issued shares. The right to receive shares is not likely entitled to any distribution of assets on the dissolution of the corporation nor would it be entitled to dividends."

[58] Perhaps the preferred shares receivable and common shares receivable in paragraphs 85(1)(g) and (h) respectively are the same as a right to receive shares. If so, then the cost of the right to receive shares is determined accordingly. But if the right to receive shares is disposed of when the shares are issued to the taxpayer, should there be a subsequent election?

[59] French only. This is question 23, APFF-Congrès 2010. For an abbreviated English summary, see CRA Views in Focus (Carswell).

[60] Business Corporations Act, (Quebec), R.S.Q., c. S31.1, section 49.

[61] See subsection 22(7), OBCA. See Joan E. Jung, "Recent Ontario Business Law Changes and Related Tax Considerations", 2007 Ontario Tax Conference (Toronto: Canadian Tax Foundation).

[62] R.S.O. 1990, C.B. 16 as amended.

[63] Subsection 24(1), OBCA: "A corporation shall maintain a separate stated capital account for each class and series of shares it issues."

[64] See definition of "paid-up capital" in subsection 89(1) and *Interpretation Bulletin* IT-463R2, "Paid-up Capital", September 8, 1995, paragraph 2.

[65] See Technical Notes to Bill C-28; S. C. 1998, c. 19, s.185.

[66] See section 237, OBCA.

[67] See section 5, O. Reg. 289/00 under the OBCA.

[68] R.S.C. 1985, c. C-44 as amended.

[69] See subsection 210(3), CBCA.

[70] See paragraph 2, *Interpretation Bulletin* IT-368,May 28, 1977, "Corporate Distributions – Clearance Certificates" (cancelled):

> "The term "and other like person" includes any person acting in the capacity of liquidator, whether or not a formal appointment was made. In a voluntary dissolution, there may be no formally appointed liquidator and the responsibility

> may have been assumed by an auditor, director, officer, or other person. Whether or not a person falls within the scope of subsection 159(2) will be determined in accordance with the facts of the particular case."

See also paragraph 3, *Information Circular* IC 82-6R, February 28, 1977 (Cancelled).

A voluntary dissolution under the OBCA may be contrasted with a voluntary winding up under the OBCA, section 193-205. In the case of a voluntary winding up, a liquidator is appointed. Section 198, OBCA provides that a corporation being wound up shall cease to carry on its undertaking except in so far as may be required as beneficial for the winding up. Further, section 199 provides that no actions or other proceedings may be brought against a corporation after the commencement of a voluntary winding up except with leave of the court.

[71] See subsection 242(1), OBCA.

[72] See also *460354 Ontario Inc*. 92 DTC 6534 (FCTD) and *Hadi Saraf in his capacity a s director of 495187 Ontario Limited at the time of its dissolution* 94 DTC 6229 (TCC).

[73] See paragraph 226(1)(b), CBCA. By way of example, see also paragraph 227(2)(b), Business Corporations Act (Alberta), R.S.A. 2000, C. B-9; section 348, Business Corporations Act (British Columbia), S.B.C. 2002, c.57. There is no express time limitation in section 242, OBCA.

[74] Subsection 243(1), OBCA reads:

> "Despite the dissolution of a corporation, each shareholder to whom any of its property has been distributed is liable to any person claiming under section 242 to the extent of the amount received by that shareholder upon the distribution, and an action to enforce such liability may be brought."

[75] See subsection 226(4), CBCA. Although there is no equivalent time limitation in section 243, OBCA, the Limitations Act, 2002 S.O. 2002 c.24 must be considered.

[76] See CRA document no. 9414347, July 4, 1994 where this is mentioned as a possibility.

[77] S.O. 2007, c.11

[78] The criteria for a qualifying apprenticeship are set out in subsection 89(7), Ontario TA and generally require registration of a training agreement or contract of apprenticeship under applicable legislation or that the apprenticeship be in a "qualifying skill or trade", as determined by the Minister of Training. Colleges and Universities (Ontario).

[79] See subsection 88(2), Ontario TA.