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COMMENTARY

2019 FEDERAL BUDGET EXECUTIVE SUMMARY

By the tax professionals of Richter LLP

March 19, 2019

We have carefully reviewed the 2019 Federal Budget papers. Instead of providing a detailed summary of all tax measures, most of which impact a small minority of taxpayers, what follows is what we feel is relevant to you.

PERSONAL TAX

- No changes to personal tax rates.
- Shares acquired pursuant to a stock option agreement that otherwise would be subject to a 50% tax deduction will soon be limited to those shares having a value of $200,000 at the time the options are granted. Although there is an intention to restrict the new measure to "mature companies", few details have been provided other than that these rules are to apply prospectively, based on announcements which are expected before the summer of 2019.
- The amount that can be withdrawn from an RRSP to buy or build a first-time home is increased from $25,000 to $35,000 for withdrawals after March 19, 2019.
- Starting in 2019, eligible workers will be entitled to claim a refundable tax credit of up to $250 per year on a cumulative basis of up to $5,000 on eligible tuition and other like fees incurred.
- Introduction of a new non-refundable temporary tax credit of 15% (maximum $75 credit) will be introduced for individuals who subscribe for Canadian digital news.

CORPORATE TAX

- No changes to corporate tax rates.
- The annual expenditure limit of $3 million for qualifying SR&ED expenditures will no longer be reduced by taxable income in excess of certain thresholds. For taxation years ending on or after March 19, 2019, the only remaining criteria for reduction will be the prior year's taxable capital.
- A new CCA class will permit businesses to claim a 100% write-off for the acquisition of zero-emission vehicles after March 19, 2019, up to a maximum of $55,000, plus sales taxes.

INTERNATIONAL TAX

- For transactions occurring on or after March 19, 2019, the foreign affiliate dumping rules are expanded to apply where a corporation resident in Canada is controlled by non-resident individuals or trusts or any non-arm's length group of non-resident individuals, trusts or corporations.
- Where transfer pricing rules can apply at the same time as other income tax rules, there can be ambiguity as to which set of rules should be used to compute income. For taxation years that begin on or after March 19, 2019, priority will be given to adjustments under the transfer pricing rules.
- The definition of "transactions" for purposes of the three year extension to the normal reassessment period will be

modified to align with the transfer pricing definition of "transactions".

OTHER MEASURES

- New residential and commercial real estate audit teams will be created in Ontario and British Columbia. These teams will focus on ensuring proper reporting of principal residence exemptions, distinguishing between capital gains and income treatment and reporting of commissions and sales tax remittances.
- The *Canada Business Corporations Act* ("CBCA") was recently amended to require corporations to create and maintain a register containing certain information relating to individuals who own or control (directly or indirectly) 25% or more of votes or value in CBCA corporations. These rules are intended to make ownership and control of corporate entities more transparent and are intended to come into force on June 13, 2019. Budget 2019 proposes to make further amendments to the CBCA to make this register more readily available to tax authorities and law enforcement, but no details have been provided.

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SURPRISE! FOREIGN AFFILIATE DUMPING RULES COMING TO A PRIVATE BUSINESS NEAR YOU

By Kenneth Keung, CA, CPA (CO, USA), CFP, LLB, MTAX, TEP and Kim G C Moody, FCA, TEP at Moodys Gartner.

March 21, 2019

The Foreign Affiliate Dumping ("FAD") rules, contained in section 212.3 of the *Income Tax Act* (the "Act"), are 10 pages of the Act that many Canadian advisors of private enterprises could safely staple together and never open since its introduction in 2012. Well, as of March 19, 2019, these staples need to come off. Similar to the Government's recent legislative approach to perceived abuses of subsection 55(2), the small business deduction regime, and income splitting for family shareholders of private businesses, the Government introduced—as part of its 2019 federal Budget — a similarly heavy-handed legislative "fix" to the FAD rules that appears to go beyond addressing the perceived abuses. (For a general overview of the 2019 Federal Budget, read our budget blog). The purpose of this blog is to highlight how these proposed amendments could broaden the reach of the FAD rules to family businesses and the potential consequences of their application.

The FAD rules (both existing and proposed) are very complicated the details of which are beyond the scope of this blog. The objective of the FAD rules is to prevent foreign enterprises from using Canadian corporations as intermediaries to invest in entities outside of Canada. Canadian corporations caught within these rules are deemed to have notionally repatriated funds to their foreign parent upon such an investment, causing a reduction of paid-up capital (PUC) or triggering of Canadian Part XIII withholding tax on a deemed dividend amount. Under existing rules, the FAD rules only apply to a corporation resident in Canada ("CRIC") that (i) is controlled by a non-resident corporation and (ii) has made an investment in a foreign affiliate. Generally speaking, a foreign affiliate is a non-resident corporation in which the CRIC owns 10% or more. This type of 'sandwich' structure is typically not found within the private enterprise universe where CRICs are typically controlled by individuals and trusts. As a result, the existing FAD rules seldom have application for advisors in this space and, hence, they were safe to staple through section 212.3 of the Act.

The 2019 federal Budget documents state the Government's concern that the policy objective of the FAD rules can be circumvented when CRICs are controlled by a non-resident individual or trust. Therefore, effective for transactions or events that occur on or after March 19, 2019, the application of the FAD rules is extended to CRICs that are controlled by:

- A non-resident individual;
- A non-resident trust; or
- A group of persons that do not deal with each other at arm's length, comprising any combination of non-resident corporations, non-resident individuals and non-resident trusts

So far, these amendments appear reasonable and we can somewhat agree with the underlying policy rationale (although we think the existing version of the FAD was limited to CRICs controlled by foreign corporations for the exact reason of restricting these complicated rules to only multi-national enterprises). However, the amendments didn't end there. To pre-empt attempts to plan around the rules, a new deeming rule is proposed so that for purposes of the FAD rules, in determining whether two persons are related to each other or whether any person is controlled by any other person, it will be as if:

- Each trust is a corporation having issued a single class of voting shares;
- Each beneficiary under a trust owns a pro-rata number of these notional voting shares based on the proportionate fair market value of their beneficiary's interest; and
- Generally speaking, if the trust is a discretionary trust, each beneficiary would be deemed to own all such notional voting shares

This means, starting March 19, 2019, a CRIC that is controlled by a discretionary Canadian resident trust with one or more non-resident beneficiaries would potentially trigger the FAD rules at any time the CRIC makes an investment in a foreign affiliate. An "investment" in a foreign affiliate is very broadly defined, and it includes both equity and debt contributions amongst other types of transactions.

In other words, under the Budget amendments, FAD could apply in fairly common family enterprise situations such as:

1. A Canadian individual controls a Canadian corporation but who has since become a non-resident of Canada;
2. A Canadian trust controls a Canadian corporation and its trustee has since departed Canada, resulting in central management and control of the trust leaving Canada and thus making the trust a non-resident trust;

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3. A Canadian resident discretionary family trust that controls a Canadian corporation and has one beneficiary who is a non-resident of Canada, even if no distribution is intended for that beneficiary in the foreseeable future; and
4. A deceased left control — by automatic operation of law upon death — of a Canadian corporation to his/her Estate (note that an estate is a trust for tax purposes), and the executor of the Estate has discretion in respect of a non-resident beneficiary's share of income or capital of the Estate.

Using Canada as an intermediary jurisdiction for foreign affiliate investments is likely not the motivation behind the above situations, but for all the above situations, FAD could apply if the Canadian corporation makes any investment in a foreign affiliate. It should be noted that the FAD rules will only apply prospectively, so historical investments in foreign affiliates made prior to March 19, 2019 will not be caught.

Under the existing FAD regime, even if the FAD rules apply, cash tax outlay is often not triggered because the FAD rules provide that the deemed dividend that would otherwise arise (and attract Part XIII withholding tax) can be offset against the PUC of the shares of the CRIC. In other words, a CRIC may choose to suppress their PUC of their issued shares rather than pay a withholding tax on the amount of the investment in a foreign affiliate. With typical multi-national inbound corporate structures, sufficient PUC is often available for this purpose. In contrast, in the private business context, high PUC shares are rare because private businesses are primarily built with sweat equity and because any available PUC would likely have been withdrawn as soon as excess funds were available. This means that if the FAD rules apply, the likely result will be a 25% Part XIII tax liability (subject to potential reduction by way of an applicable tax treaty as discussed below) based on the gross amount of the investment in the foreign affiliate. The lowest tier treaty-reduced withholding rates are generally never available when the foreign controller is an individual or a trust (e.g. if FAD applies under any of the four situations described earlier, the applicable Part XIII withholding tax rate is 15% on the gross amount of the investment in a foreign affiliate; compare that to 5% if the foreign controller was a corporation).

An exception to FAD that may be available is the "more closely connected business activities" exception. The purpose of this exception is to prevent FAD from applying in circumstances where there are substantive business reasons for the CRIC to make the investment in the foreign affiliate. To meet the exception, the Act requires that the CRIC "demonstrate" that it meets all three of the following conditions:

1. The business activities carried on by the foreign affiliate are, at the investment time and are expected to remain, more closely connected to the business activities carried on in Canada by the CRIC (or by other non-arm's length Canadian corporations) than to the business activities carried on by any non-arm's length non-resident person;
2. The officers of the CRIC exercised the principal decision-making authority in respect of the investment, and a majority of those officers were resident and working principally in Canada at the investment time (or in a country of a "connected affiliate" — meaning a controlled foreign affiliate who carries on business activities that are at least as closely connected to those of the foreign affiliate in question as the business activities carried on in Canada by the CRIC are to that foreign affiliate); and
3. At the investment time, it is reasonable to expect that (i) the officers of the CRIC will exercise ongoing principal decision-making authority in respect of the investment, (ii) a majority of those officers will be resident and working principally in Canada or a country of a connected affiliate, and (iii) the performance evaluation and compensation of the officers of the CRIC will be based on the results of the operations of the foreign affiliate to a greater extent than will be the performance evaluation and compensation of any officers of a non-arm's length non-resident corporation (other than the foreign affiliate).

To put it mildly, placing the burden of "demonstrating" the fulfilment of these complex conditions to a family business is inappropriate, especially one that falls accidentally into the proposed FAD regime. Also, if the key decision maker of the business no longer resides in Canada or in a country of a connected affiliate, the exception above will likely not be met. Furthermore, meeting the tests may technically be impossible for private businesses who do not have another non-resident corporation (besides the foreign affiliate) in their organizational structure! For example, how is it possible to prove test #1 — that the business activities carried on by the foreign affiliate are more closely connected to the business activities carried on in Canada by the CRIC than to the business activities carried on by any non-arm's length non-resident person — or test #3 — that the performance evaluation and compensation of the officers of the CRIC will be based on the results of the foreign affiliate to a greater extent than the same for officers of a non-arm's length corporation non-resident corporation — , when no such non-resident corporation exists?

The "more closely connected business activities" exception is also not available where the investment in the foreign affiliate consists of shares that do not fully participate in the profits and appreciation of the foreign affiliate (unless the foreign affiliate is wholly owned by the CRIC). It is very common for third-party investors to acquire shares or units that have limited or custom participation rights in an entity. To the extent the size of the investment is sufficient to make the foreign investee a foreign affiliate (again, >10% generally), the more closely connected business activities exception won't be available, and the FAD rules may apply to trigger a Part XIII withholding tax if the CRIC falls under these proposed rules.

We are barely scratching the surface of the FAD rules in this brief blog, but we hope we impress on you that the FAD rules are now required reading even you practice solely in the private enterprise space. May the FAD be with you; and remove that staple from those 10 pages of the Act.

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SUPREME COURT APPEALS

The Supreme Court of Canada appeals tables on *TaxPartner* and *Taxnet Pro* have been updated through the S.C.C. *Bulletin of Proceedings* dated March 29, 2019.

An application for leave to appeal was dismissed on March 14, 2019 in *R. v. Gunner Industries Ltd.*, CACR2704 (SK CA) (September 21, 2018 [unreported], dismissing appeal from [2016] 2 C.T.C. 110 (SK QB)) (SCC file 38419).

Leave to appeal was granted with costs on March 21, 2019 in *MacDonald v. R.*, 2018 CarswellNat 3400, 2018 FCA 128 (FCA) (SCC file 38320).

An application for leave to appeal was dismissed with costs on March 21, 2019 in *R. v. Rio Tinto Alcan Inc.*, 2018 CarswellNat 3244, 2018 FCA 124 (FCA) (SCC file 38307).

An application for leave to appeal was dismissed with costs on March 28, 2019 in *Fiducie financière Satoma v. Canada*, [2019] 2 C.T.C. 33 (FCA) (SCC file 38146).

The *Notices of Appeal to Federal Court of Appeal Filed* table has been updated on *TaxPartner* and *Taxnet Pro* for appeals filed through April 4, 2019.

NEWS RELEASES

INTEREST RATES FOR THE SECOND CALENDAR QUARTER

Reproduced below is a Canada Revenue Agency news release dated March 28, 2019.

The Canada Revenue Agency (CRA) announced today the prescribed annual interest rates that will apply to any amounts owed to the CRA and to any amounts owed by the CRA to individuals and corporations. These rates will be in effect from **April 1, 2019 to June 30, 2019**.

Income tax

- The interest rate charged on overdue taxes, Canada Pension Plan contributions, and employment insurance premiums will be 6%.
- The interest rate to be paid on corporate taxpayer over-payments will be 2%.
- The interest rate to be paid on non-corporate taxpayer overpayments will be 4%.
- The interest rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans will be 2%.
- The interest rate for corporate taxpayers' pertinent loans or indebtedness will be 5.63%.

Other taxes, duties, or charges

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

Tax, duty, or other charges	**Overdue remittances**	**Overpaid remittances**	
		Corporate taxpayers	**Non-corporate taxpayers**
Goods and services tax (GST)	6%	2%	4%
Harmonized sales tax (HST)	6%	2%	4%
Air travellers security charge	6%	2%	4%
Fuel charge (under the *Greenhouse Gas Pollution Pricing Act*)	6%	2%	4%
Excise tax (non-GST/HST)	6%	2%	4%
Excise duty except brewer licensees (amounts due after June 30, 2003)	6%	2%	4%
Excise duty except brewer licensees (amounts due before July 1, 2003)	4%	N/A	N/A
Excise duty (brewer licensees)	4%	N/A	N/A
Softwood lumber products export charge	6%	2%	4%

The **overdue remittance rate** is the rate of interest the taxpayer must pay on amounts due to the CRA.

The **overpaid remittance rate** is the rate of interest the CRA must pay on amounts due to the taxpayer.

Quick facts

- Prescribed annual interest rates are calculated **quarterly** according to the laws that apply.
- For information on the prescribed interest rates for other calendar quarters, go to Prescribed interest rates.

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CASE LAW UPDATE

GLADWIN REALTY CORPORATION v. R.

Tax Court of Canada [General Procedure]
Hogan J.
March 21, 2019
Citation: 2019 CarswellNat 752, 2019 TCC 62

Tax — Income tax — Avoidance — General anti-avoidance rule (GAAR) — Abuse or misuse — Corporate taxpayer carried on commercial real estate business — Taxpayer's indirect shareholders were all of same member's family (individual shareholders) — During 2007 taxation year, taxpayer decided to sell commercial real estate property that it had acquired in Ottawa and held for long time — Evidence showed that taxpayer consulted its long-standing tax advisor to devise plan to minimize amount of tax payable in connection with sale of property and to maximize distribution of net proceeds of sale to individual shareholders — Tax advisor proposed plan that would enable taxpayer to distribute full amount to individual shareholders as tax free capital — Minister reassessed taxpayer pursuant to general anti-avoidance rule (GAAR) to reduce taxpayer's capital dividend by $12,155.827, equal to one half of second capital gain — Taxpayer appealed Minister's assessment — APPEAL DISMISSED — Taxpayer acknowledged that its representative had discussions with its tax advisor and legal counsel to determine best timing to generate two capital gains and offsetting capital loss for purpose of generating two increased in taxpayer's capital dividend account (CDA) — Taxpayer achieved result which led to significant over-integration and, but for application of GAAR, would have allowed taxpayer to pay capital dividend equal to entire capital gain realized from sale of property — Subsections 40(3.1) and 40(3.12) of *Income Tax Act* (Act) were not intended to allow taxpayer to achieve tax benefit that it sought to obtain through implementation of avoidance transactions.

THE QUEEN v. IZMIRLIAN, A.

[Official English Translation]
Federal Court
Martineau J.
January 16, 2019
Citation: 2019 CarswellNat 679, 2019 FC 63

Tax — Income tax — Administration and enforcement — Collection of tax — Jeopardy assessments — Taxpayer worked as mortgage broker since 2000 and had been audited by Canada Revenue Agency (CRA) for taxation years 2004 and 2005 — In September 2008, taxpayer incorporated real estate company and in 2012, CRA opened audit of taxation years 2008 to 2010 — In 2016, Minister of National Revenue issued reassessments having found that unpaid amount in taxes, penalties and interest from taxation years 2008 to 2011 would be $860,281.99 — Taxpayer filed objection, paid $150,000 to CRA and filed appeal notice before Tax Court of Canada (TCC) — *Ex parte* application for issuance of jeopardy collection order was submitted to Court — Order was issued because there were reasonable grounds to believe that granting taxpayer delay would compromise collection of Crown debt — Since issuance of order, certificate was issued under s. 223(3) of *Income Tax Act* which certified that taxpayer was indebted to Crown in amount of $801,040.71 — Certificate allowed Minister to register legal hypothec in favour of Crown on family residence — Following sale of residence, taxpayer's tax debt was reduced by $331,378.77 — Taxpayer applied to set aside jeopardy collection order — APPLICATION DISMISSED — Minister did not breach his duty of full and frank disclosure — Errors identified by taxpayer in first affidavit were not determinative — Taxpayer had been appealing reassessments to TCC since May 2018 and appeal could result in delay of more than one year — Imminent sale of family residence could have deprived Minister of amount in excess of $330,000 — Real estate company sold ten properties between 2012 and 2016, and no longer owned any real estate assets — Taxpayer had made gifts totalling $1.5 million to three children and had emptied his bank accounts of more than $550,000 since April 2014 — There were reasonable grounds to believe that granting delay in payment would compromise collection of tax debt — If order was not maintained, Minister had reasonable grounds to believe that he would lose his right to bring Paulian action — If order were set aside and taxpayer granted additional period to pay balance of tax debt, there were reasonable grounds to believe that taxpayer's remaining assets would disappear and Minister would be unable to collect balance of his claim — Confirmation of order was necessary so that Paulian action before Superior Court was not forfeited because it was not brought within one year — Delay in issuing notice of reassessment was irrelevant to question of whether, at date of application for review, any further delay would compromise Minister's collection.

MAMMONE, F. v. R.

Federal Court of Appeal
Woods J.A. (Rennie and Laskin JJ. A. concurring)
March 6, 2019
Citation: 2019 CarswellNat 744, 2019 FCA 45

Tax — General principles — Prospective or retroactive legislation — *Income Tax Act* — Deferred income plans — Registered pension plans — Transfers to other plans — Administration and enforcement — Assessments — Limitation period — Miscellaneous — Taxpayer worked as mechanic for several years and was member of municipal employee pension plan — In 2009, taxpayer established new pension plan in which he was sole member — New plan was registered as pension plan pursuant to *Income Tax Act* effective January 1, 2009 and taxpayer transferred $640,080.91 to new plan — In 2013, Minister of National Revenue sent notice of intention to revoke registration of new pension plan retroactively as of January 1, 2009 on basis that plan did not satisfy registration requirements — Twenty-eight days later Minister provided notice of revocation and also issued notice of reassessment for 2009 taxation year, which included amount transferred to new plan in taxpayer's income — Notice was sent on last day before expiry of time period that Minister was able to reassess this amount — Taxpayer pursued rights of appeal — Approximately three and one-half years later, Minister concluded that notice was ineffective because it was sent two days earlier than permitted by Act — Minister sent second revocation notice which stated that it superseded earlier one and was being issued to correct timing error, and that it was effective on retroactive basis to January 1, 2009 — Appeal by taxpayer was dismissed — Tax Court of Canada determined that factual basis

for reassessment relied on by Minister did exist at time it was issued and that there had been no change to factual basis of reassessment — Taxpayer appealed — APPEAL ALLOWED — Although notice of revocation may be issued on retroactive basis, limitation periods for reassessing also needed to be considered — It was agreed that legal basis did not change over time due to retroactive nature of revocation — Factual basis underlying reassessment did change — Revocation notice was factual element that was necessary in order to support legal basis of income inclusion — In this case, applicable revocation notice was sent in 2017, which was long after limitation period had expired — This was not factual basis on which reassessment was based when it was issued, or when limitation period expired — Tax Court's conclusion relied on new factual basis and this was error of mixed fact and law which attracted palpable and overriding error standard of review — Error made met that standard — This was clear case in which Minister's position impermissibly avoided limitation period for 2009 taxation year — Taxpayer was entitled to rely on expiry of normal reassessment period to finalize his tax payable for 2009 taxation year — In issuing second revocation notice and relying on it for purposes of reassessment, Minister was in effect seeking to do away with limitation period — Reassessment of 2009 taxation year was ordered referred back for reconsideration and reassessment to delete income inclusion relating to transfer of funds between pension plans.

McCARTHY TÉTRAULT COMMENTARY UPDATE TO *CANADA TAX SERVICE*, RELEASE 1668

The commentary to the following provisions has been updated for the noted reasons:

- **Current:** updated for the prescribed interest rates for the second calendar quarter for 2019 and also for the prescribed rates for leasing rules;
- **31:** updated to reflect recent CRA publications; and
- **113:** updated to reflect proposed Budget 2018 amendments and recent CRA Views Documents. Commentary also updated to reflect the amendment of 5907(1), (2) and (2.011) by S.C. 2018, c. 27 (Bill C-86).

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