Recent Development In Tax

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Recent Development In Tax

Agenda

- 2021 Federal Budget
- Bill C-208
- CRA STEP Q&A 2021 – Questions of Interest
- Tax Compliance Changes Coming Into Effect

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2021 Federal Budget

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2021 Federal Budget

General Overview

- First budget in 2 years
- Many tax changes without accompanying draft legislations – many changes are vague
- More power given to the CRA to enforce tax collection
- Speculated changes were not implemented – higher tax rates, estate tax, capital gains tax etc

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2021 Federal Budget

Immediate Expensing of Depreciable Assets

- Immediate deduction (i.e. CCA claim) on assets purchased by a CCPC
- Only for "eligible property"
  - Capital depreciable property other than CCA class 1 – 6, 14.1, 17, 47, 49 and 51
- Limit to $1.5M per year, but shared among associated group
- Must be available for use before January 1, 2024
- No half-year rule

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2021 Federal Budget

Rate Reduction for Zero-Emission Technology Manufacturers

- Reduced corporate tax rates for zero-emission technology manufacturers
  - By 7.5% - if income is otherwise taxed at 15% general rate
  - By 4.5% - if income is otherwise taxed at 9% small business rate
- Taxpayers can choose either bracket if the eligible income is taxed at both general and small business rate
- 10% of the business gross income must at least be in manufacturing zero-emission technology
- Calculation of income must taken into account labour cost
- No detailed legislation
- Begin after 2021 and gradually phased out in 2029, fully phased out in 2031

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International Interest Deductibility Limits

- Proposed due to the BEPS Action Plan
- Interest deduction no more than a fixed ratio of "tax EBITDA"
  - Taxable income before interest expense, interest income, income tax, depreciation
- Starting in 2023, interest deduction no more than 40% of tax EBITDA in 1st year and 30% after
- Relief for small businesses and others that have no significant tax base erosion risk
- No detailed legislation.

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2021 Federal Budget

Hybrid Mismatch Arrangements

- Proposed due to the BEPS Action Plan (again)
- Two forms of arrangements being targeted:
  - *Deduction / non-inclusion mismatches* – one country allows a deduction, but the other country does not recognize income within a reasonable period of time
  - *Double deduction mismatches* – a tax deduction is available in 2+ countries for a single economic expense
- No detailed legislation but the proposed rule will be mechanical in nature and without a purpose test
- Two legislative packages to be expected – 1st to apply in 2022, and 2nd to apply no earlier than 2023

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2021 Federal Budget

Mandatory Disclosure

- In consultation stage, intended to enhance the Income Tax Act's reportable transaction rules
- Currently, a transaction must be reported if it meets 2 of the 3 hallmarks:
    - A promoter or tax advisor's fee is based on the amount of tax benefit obtained from a transaction
    - A promoter or tax advisor requires "confidential protection" on the transaction
    - The taxpayer has a "contractual protection" on the transaction, such as insurance (protects the advisor for a failure to achieve any tax benefit)
- Proposal – a transaction must be reported if it meets 1 of the 3 hallmarks
- Also to expand the reporting requirement if one of the main purpose of entering the transaction is to obtain a tax benefit

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2021 Federal Budget

Notifiable Transactions

- The CRA would have the authority to designate certain transactions as notifiable transactions, which are reportable
- Notifiable transactions would have a specific timeline for taxpayers to report
- Example used by the Department of Finance include:
  - A court decision *Paletta v. The Queen* – series of transactions referred to as straddle planning, resulted in an immediate loss realization and indefinite gain deferral
- Future Notifiable Transactions *could* include current income tax planning strategies, such as capital gains plan, 55(2) trigger, non-CCPC

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2021 Federal Budget

Uncertain Tax Treatments

- An uncertain tax treatment is generally a filing position that may or may not be accepted as being in accordance with tax law
- Current Canadian accounting standard including IFRS requires uncertain tax treatments be disclosed on financial statements
- Proposal to adopt similar standards such as IFRS to require disclosure of uncertain tax treatments to the CRA – in direct response to *BP Canada Energy*
  - Corporation with $50M+ assets
  - Audited with statements prepared with IFRS or US GAAP, and
  - Uncertain tax treatment is reflected on the audited statements

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2021 Federal Budget

Avoidance of Tax Debts

- Concern is raised where taxpayers engaged in transactions to avoid section 160 of the Income Tax Act
  - 160 deems a transferee of property received from a non-arm's length party to be jointly and severally liable for the transferor's tax debt
- In response to *Damis Properties* where it was an arm's length transfer
- Introduced anti-avoidance rules to deem certain parties as non-arm's length or certain transactions not at FMV
- No detailed legislation
- Significant penalties for promoters of tax debt avoidance scheme

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2021 Federal Budget

Foreign Non-Resident Owners of Canadian Housing

- A national, annual 1% tax on the value of Canadian housing owned by foreign non-resident owners
- Starting January 1, 2022
- A declaration on the current use of the property will need to be filed
- No specific legislation released
- May opt out houses used for tourism or resort communities

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2021 Federal Budget

<u>Non-Eligible COVID-19 Benefits Received</u>

- Currently, repayment of non-eligible COVID-19 benefits allow for a deduction to be claimed *in the year of repayment*
- The government is concerned about cash flow issues for taxpayers since the repayment may not be in the same year as the year when the benefit is received
- Proposed to allow individuals the option to claim a deduction in the year when the benefit was received rather than in the year in which the repayment was made

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Foundations

- Currently, charities are required to spend a minimum amount on their programs or gifts to qualified donees – known as the "disbursement quota"
- The disbursement quota is now at 3.5%
- Government wants to increase this disbursement quota
- Public consultation to follow

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2021 Federal Budget

New Audit Powers

- Currently, the CRA has the authority to inspect taxpayer records and property during an audit
- New proposal to expand the CRA's power on the scope and form of questions in which the taxpayer must answer
- Direct target to override *Cameco*
- This would allow the CRA to ask taxpayer questions even in the form of oral questions

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2021 Federal Budget

Digital Services Tax

- Sometimes called the "Netflix tax"
- 3% on taxpayers with a global revenue of 750M Euros, and revenues with Canadian users of more than $20M
- This will likely remain as a temporary tax because a global minimum tax, as agreed by the G7 countries will eventually replace the digital service tax
- Finance Minister Chrystia Freeland announced that Canada would continue to move forward with DST as of January 1, 2022 as an interim basis, but eventually will move forward to reflect the multilateral global minimum tax approach

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Bill C-208

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Bill C-208 – 84.1

Current legislation – before Bill C-208

- 84.1 targets specific transactions to prevent taxpayers from extracting cash from a corporation with the assistance of a non-arm's length party
- Generally 4 conditions
  - A Canadian individual transfers shares of the corporation (Target)
  - A corporation (Purchaser Co) is acquiring the shares of Target
  - Purchaser Co is dealing at non-arm's length with the individual transferor
  - Purchaser Co and Target are connected afterwards
- Consequence
  - Deemed dividend on the non-cash consideration over paid-up capital or hard ACB of Target, and
  - Reduced paid-up capital

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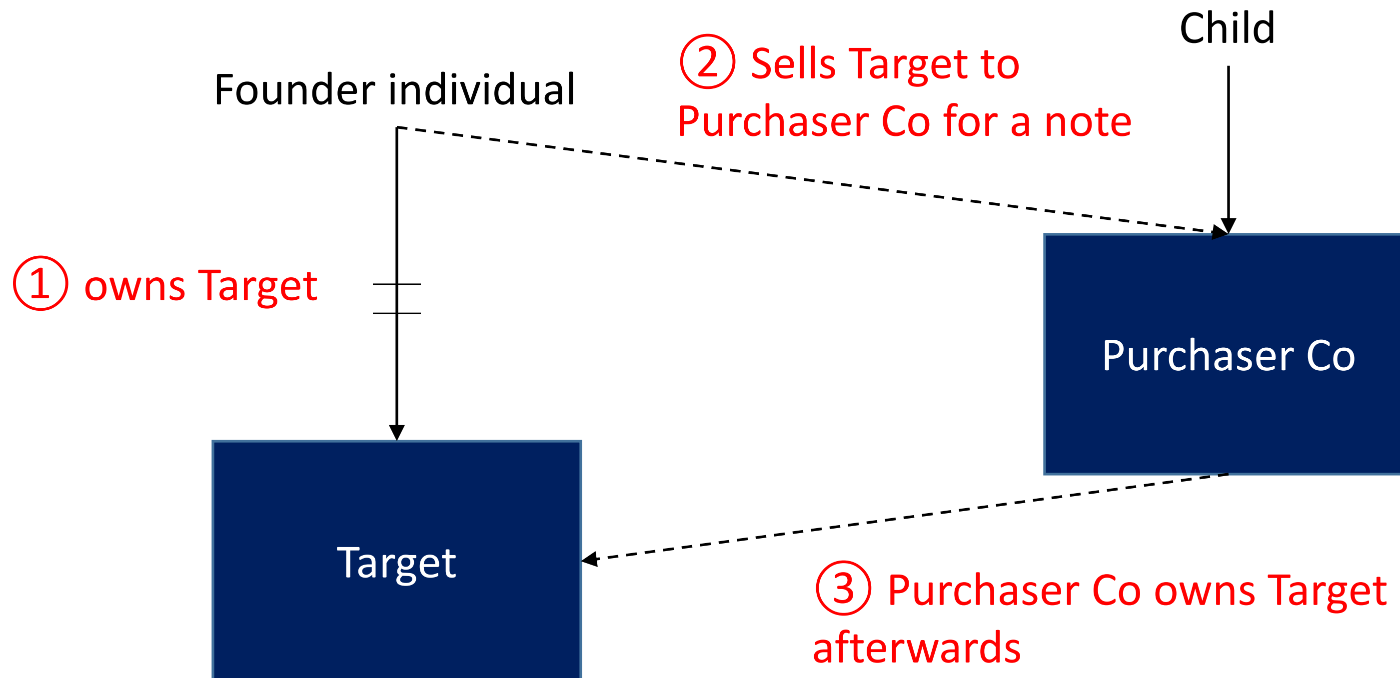
Bill C-208 – 84.1

Current legislation – before Bill C-208



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Bill C-208 – 84.1

Issue of 84.1 – Before C-208

- The current law discourages taxpayers from using non-arm's length parties to extract cash from a corporation at capital gains rate
- 84.1 forces the taxpayer to be taxed at dividend rate
- However, the policy is that it discourages taxpayers from transitioning the business to the next generation.
- From a tax perspective, the founder is better off selling the business to a 3rd party than to his/her own child
- 84.1 does not facilitate any genuine transfer of intergenerational businesses

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Bill C-208 – 84.1

Arrival of Bill C-208

- This is when Bill C-208 came
- Conservative MP Larry Maguire sponsored Bill C-208 to amend 84.1 to allow for intergenerational transfer
- A private member's bill rarely becomes law because MPs of the governing party (i.e. Liberals) usually vote against them
- However, the Liberals are in a minority position. On the 2nd reading, Liberal MPs voted against the bill but it garnered support from Conservative, NDP, Bloc Quebecois and Green Party members
- On the 3rd reading, Bill C-208 was surprisingly passed
- Bill C-208 then received Royal Assent on June 29, 2021

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Bill C-208 – 84.1

More Development of Bill C-208

- On the next day after Royal Assent (June 30, 2021), Finance announced its intention to delay the effective date of the amendment to January 1, 2022 because of the language of the bill (to be discussed later)
- This raised a legal question – how can the effectiveness of a law be delayed when it was passed?
- Then on July 19, Finance Minister Chrystia Freeland cleared up confusion by stating that Bill C-208 is now in effect (effective June 29, 2021), overriding the June 30, 2021 announcement
- However, the same announcement on July 19, 2021 indicated that legislative amendment would be coming to replace the current law, to be effective November 1, 2021

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Bill C-208 – 84.1

What is in Bill C-208?

- Bill C-208 says if the Target corporation is a qualified small business corporation shares (QSBC), then the sale of Target corporation will be considered dealing at *arm's length* if the purchaser corporation is controlled by one or more children or grandchildren who are 18+ and the shares are not disposed within 60 months
- If the shares were disposed within 60 months (other than by reason of death), then the Target corporation is deemed to be disposed to the new buyer instead
- It also reduces the vendor's ability to claim the lifetime capital gains exemption on sale of shares if taxable capital > $10M. This is to ensure relief applies only to small businesses
- An independent assessment of FMV must be provided to the CRA

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Bill C-208 – 84.1

Why Was Bill C-208 Frowned Upon by the Government?

- This private member bill was not consulted with Department of Finance and therefore the drafting was poor
- Intention was to allow for a genuine facilitation of intergenerational transfer
- However, Bill C-208 does not require the child to work, or to be the successor, or to have any beneficial interest, just “control”
- The language of “control” appears to be *de jure* control (more to discuss later)
- If there is a disposition in 60 months, consequence is that it deems the disposition to the new buyer, instead of penalizing the initial transfer to the child

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Bill C-208 – 84.1

<u>Why Was Bill C-208 Frowned Upon by the Government? (continue)</u>

- The exception to the 60 month rule is by reason of death, but not clear as whose death?
- There is also no exclusion on “disposition”. For example, an amalgamation or a redemption are considered “dispositions”. This would inadvertently trigger the rule
- The grind of the lifetime capital gains exemption is also not congruent with the language of the legislation
- The government is concerned that there is no safeguard against any unintended tax avoidance loopholes that Bill C-208 that may have created

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Bill C-208 – 84.1

<u>Can You Rely on Bill C-208 Now?</u>

- Tread with caution
- “Law is law” – Freeland. However, this type of transaction is under the CRA’s radar
- The CRA may attack an ungenuine transfer through the definition of “control”
- Currently, “control” in Bill C-208 is *de jure* control. However, a recent tax case *Dean’s Knight* may allow the term to be interpreted as *de facto* control for purposes of a GAAR analysis. This would be relevant if the CRA wants to attack the transaction via GAAR.

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Bill C-208 – 84.1

Can You Rely on Bill C-208 Now? (continue)

- If clients rely on Bill C-208, keep in mind of the following things:
  - There is a small window – reliance of the current Bill C-208 law will not be correct after November 1, 2021
  - Ensure that this is a genuine intergenerational transfer of business
  - Avoid any kinds of reorganization by the new owner within 60 months, which includes amalgamation, redemption etc.

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Bill C-208 – 84.1

What Can We Expect In the New Form Of Bill C-208?

- New amendment likely require children or grandchildren own a majority of the common shares of the purchasing corporation (not just the voting shares)
- Parents may not have the right to acquire the common shares
- Children or grandchildren will need to have the day-to-day management of the business

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Bill C-208 – Section 55

Another Change in Bill C-208 – Section 55

- Currently, subsection 55(2) re-characterizes a tax-free intercorporate dividend into a capital gain for amounts that exceed the safe income of the corporation
- Certain reorganizations, known as the butterfly transaction, are exceptions to the 55(2) re-characterization rule
- There are two forms of butterfly transaction
  - 55(3)(a) – related party transaction
  - 55(3)(b) – unrelated party transaction

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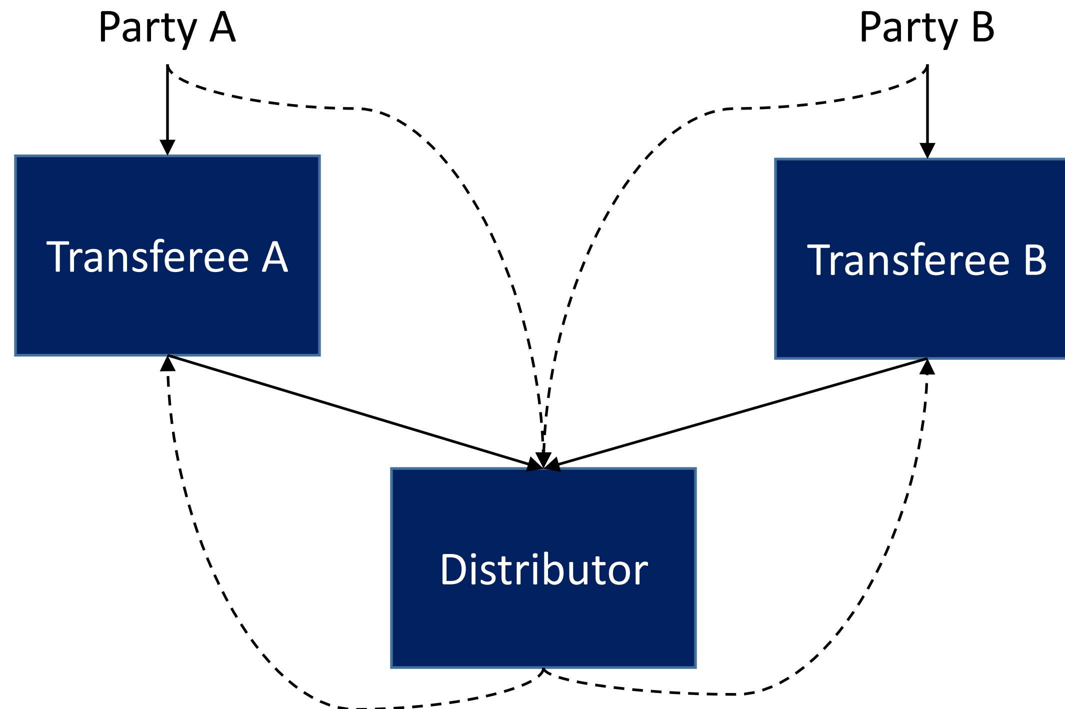
Bill C-208 – Section 55

Why is it called a butterfly?



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Bill C-208 – Section 55

Another Change in Bill C-208 – Section 55 (continue)

- 55(3)(a) related butterfly transaction is easier to implement
- 55(3)(b) unrelated butterfly transaction has more onerous rules to follow
- Before Bill C-208, siblings are considered unrelated parties. Therefore, for intergenerational transfers involving siblings, it is harder to split assets via a butterfly

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Bill C-208 – Section 55

Another Change in Bill C-208 – Section 55 (continue)

- Bill C-208 now deems that siblings are considered related for purpose of the butterfly transaction
- Additional consideration to apply – the corporation must be a qualified small business corporation, or a share of a family farm or fishing corporation

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CRA STEP Q&A 2021

(Questions of Interest)

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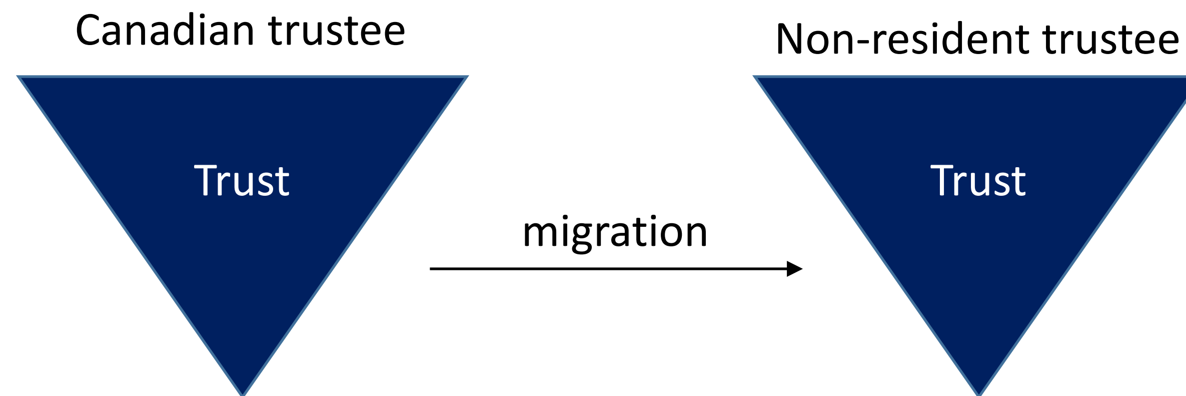
CRA STEP Q&A 2021 – Question of Interest

Question 1

- *Question* - If a Canadian resident trust becomes a non-resident (because central management has shifted outside of Canada), the trust will have departure tax. If the trust has no cash liquidity, would the furnish of security be different compared to an individual?



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CRA STEP Q&A 2021 – Question of Interest

Question 1

- Answer – No difference

- Also, the CRA prefers a letter of credit or guarantee over a line of credit. This is because a letter of credit is irrevocable and unconditionally guarantees payment, whereas a line of credit can be reduced or cancelled at the lender's discretion without advance notice

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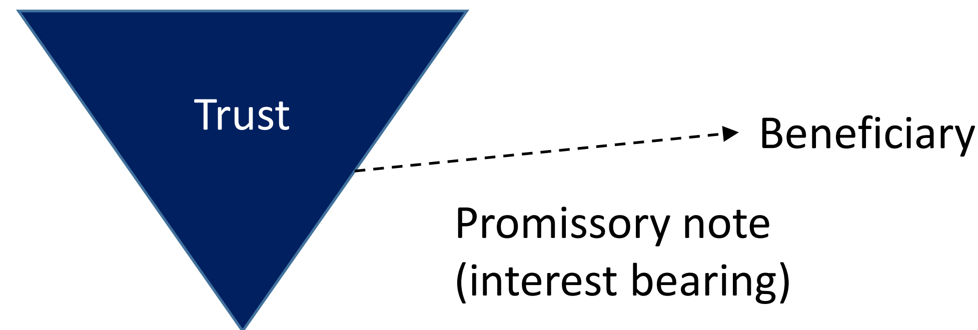
CRA STEP Q&A 2021 – Question of Interest

<u>Question 3</u>

- *Question* – A family trust distributes income to a beneficiary by making an amount payable in the year. If the note is interest bearing, will the interest income be subject to TOSI?



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CRA STEP Q&A 2021 – Question of Interest

Question 3

- Answer – By default, yes
- No real exception available for the beneficiary. Though, the beneficiary may consider the “reasonable return” exception

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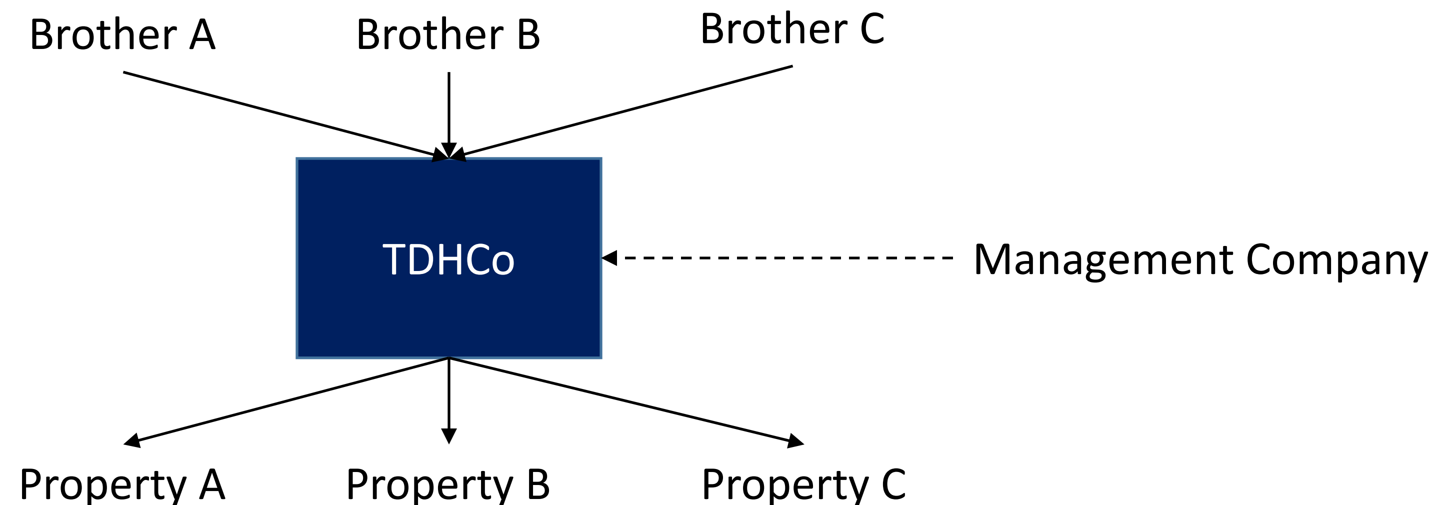
CRA STEP Q&A 2021 – Question of Interest

Question 4

- *Question* – Three brothers own TDHCo. TDHCo owns 3 properties. The brothers are not active and TDHCo uses a management company. Are dividends to the brothers subject to TOSI?



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CRA STEP Q&A 2021 – Question of Interest

Question 4

- Answer – If the shares are considered "excluded shares", then yes. But to meet the definition of "excluded shares", the income earned by TDHCo must be business income. So if there was no sufficient level of activity to constitute a business, then no excluded share -> TOSI

- Even if TDHCO were to be split-up into 3 companies, the analysis is the same.

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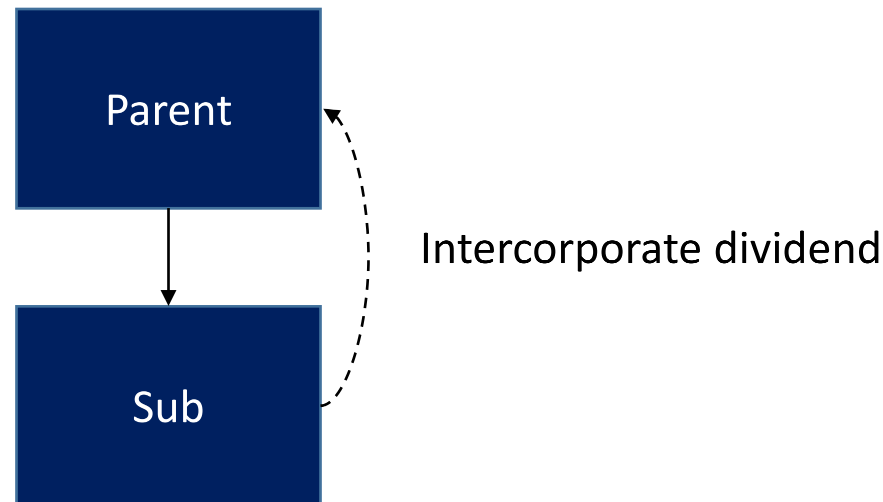
CRA STEP Q&A 2021 – Question of Interest

Question 9

- *Question* – Safe income is relevant for purpose of 55(2) re-characterization. Income Tax Technical News No. 37 states that non-deductible expenses must be deducted from safe income. What are non-deductible expenses?



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CRA STEP Q&A 2021 – Question of Interest

Question 9

- Answer – Non-deductible expenses examples include
  - Dividends paid or payable
  - Taxes (including refundable taxes)
  - Non-deductible interest and penalties
  - Charitable donations, gifts
  - Non-deductible expenditures, such as non-deductible portion of M&E

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CRA STEP Q&A 2021 – Question of Interest

<u>Question 11</u>

- *Question* – Canadian individual contributes $18,000 to TFSA in 2021 when contribution room is only $6,000. TFSA investment becomes worthless, therefore cannot withdraw excess. How can the taxpayer stop the penalty tax? And when can new TFSA contribution be made?

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CRA STEP Q&A 2021 – Question of Interest

Question 11

- Answer – The taxpayer will continue be subject to the 1% tax on the excess TFSA amount. Unfortunately, the taxpayer cannot withdraw the excess and therefore must pay the 1% tax penalty. Only new TFSA contribution room can serve to reduce the excess TFSA amount. Minister cannot waive this tax. Provided $6,000 of room continues to grow every year, the individual can make new TFSA contributions in 2024.

Year	Total room	Deficit	1% tax?
2021	Nil	$12,000	Yes
2022	$6,000	$6,000	Yes
2023	$12,000	Nil	No

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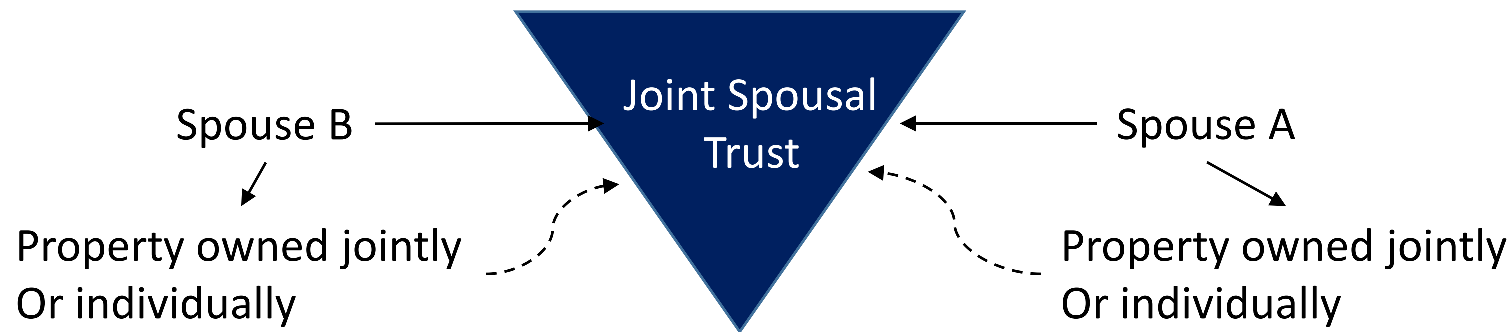
CRA STEP Q&A 2021 – Question of Interest

Question 12

- *Question* – Assume spouses both age 65 who own properties jointly and individually. Can they jointly create joint spousal or common-law partner trust with jointly-held property on a roll-over basis? Can one or both make further contributions of property on a roll-over basis?



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CRA STEP Q&A 2021 – Question of Interest

Question 12

- Answer – The joint spousal or common-law partner trust needs to be created by both spouses. This means no one else contributes property to the trust.

- Afterwards, a transfer of property by either spouse or both spouses after the trust creation would allow for a roll-over treatment. In either case, a deemed disposition of property held by the joint spousal trust only occurs on the death of the remaining surviving spouse.

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CRA STEP Q&A 2021 – Question of Interest

Question 14

- *Question* – GREs cannot last more than 36 months. If the deceased had pension entitlement, payable upon death, but the payment is received by the estate after 36 months. What is the tax treatment? If the executor cannot distribute pension income by estate year-end, is the income taxed in the estate at top rate?

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CRA STEP Q&A 2021 – Question of Interest

Question 14

- Answer – The Minister cannot extend the GRE beyond 36 months. If the income is received by the estate and the executor cannot distribution the income to any beneficiary, it will be taxed in the estate at top rate.

- If the income is distributed to the beneficiary, it will not retain the pension characterization under 104(27) because the estate is no longer a GRE. So the income will be considered regular income, and not eligible for pension split

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Tax Compliance Changes Coming Into Effect

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Tax Compliance Changes Coming Into Effect

<u>Form T1134</u>

- *Current* – A Canadian taxpayer (including partnership) is required to file Form T1134 to report any direct or indirect ownership of a foreign affiliate (foreign corporation with at least 10% ownership)
- For tax years beginning <u>prior to</u> 2020, the deadline for Form T1134 was 15 months after end of the Canadian entity's tax year

- *Now* – For tax years begin <u>in</u> 2020, the deadline for Form T1134 is now 12 months after end of Canadian entity's tax year
- For tax years begin <u>after</u> 2020, the deadline for Form T1134 is 10 months after end of Canadian entity's tax year

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Tax Compliance Changes Coming Into Effect

Form T1134 (continue)

- Example of Form T1134 due dates

Tax year end	Months after year end	Due Date of Form T1134
December 31, 2019	15 months	March 31, 2021
December 31, 2020	12 months	December 31, 2021
December 31, 2021	10 months	October 31, 2022

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Tax Compliance Changes Coming Into Effect

Form T1134 (continue)

- Many more significant changes to the form (to allow the CRA to better administer the tax system and review for any aggressive tax plans)
- Form page expanded from 6 to 12

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Tax Compliance Changes Coming Into Effect

<u>Form T1134 (continue)</u>

- New disclosure include:
  - Mailing address of entities in the organizational structure
  - Information if any reorganization such as 85, 85.1, 86.1, 87 or 88 has taken place
  - Information regarding dormant foreign affiliates (including gross receipts, cost amount, nature of assets etc.)
  - Information regarding lower-tier non-controlled foreign affiliates
  - Information on types of shares owned (such as changes in ACB) including common and preferred shares
  - Surplus account balances and information regarding upstream loan rules

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Tax Compliance Changes Coming Into Effect

<u>T3 Return - Trusts</u>

- *Current* – A trust only needs to file a tax return if it has taxes payable or makes a distribution to one or more beneficiaries.

- *Now* – For trusts taxation years ending on or after December 31, 2021, all "express trust" will now have to file a T3 return
- Express trusts are trusts that have a valid trust deed document expressing the existence of a trust – it <u>excludes</u>
  - In-trust accounts
  - Resulting trusts – implied trust that comes into existence by operation of law

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Tax Compliance Changes Coming Into Effect

<u>T3 Return – Trusts (continue)</u>

- New disclosure rules for the following people:
  - Settlor
  - Trustees
  - Beneficiaries
  - Persons with ability to exert control (e.g. protector)

- Information to be disclosed include:
  - Name, address, date of birth
  - Residency
  - Taxpayer ID (including foreign tax ID number)

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Tax Compliance Changes Coming Into Effect

T3 Return – Trusts (continue)

- Unidentified beneficiaries
- Trusts may have contingent beneficiaries or a class of beneficiaries
- The members of the class of beneficiaries may not be readily identifiable
- Law will deem requirement met if sufficient details are provided to determine whether an entity is a beneficiary.
- Explanatory Note provides an example:
  - If the trust deed says a class of beneficiaries include settlors' current children and grandchildren, and ones that the settlor may have in the future, then reporting requirement will be met for information in respect of children and grandchildren who were born

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Tax Compliance Changes Coming Into Effect

T3 Return – Trusts (continue)

- The following trusts are excepted from the new reporting requirement
  - Trusts with fewer than 3 months of existence
  - Trusts that hold less than $50,000 in certain assets throughout the year (cash, public stocks etc.)
  - Graduated Rate Estates
  - Qualified Disability Trusts
  - Trusts that are registered plans (RRSP, TFSAs)
  - Lawyer's in-trust accounts
  - Trusts that qualify as charitable organizations (Charities, NPOs)
  - Employee life and health trusts

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Tax Compliance Changes Coming Into Effect

T3 Return – Trusts (continue)

- New penalties are introduced to the new reporting requirements
- Any person knowingly amounting to gross negligence makes a false statement or omission in a return, or fails to file a return, penalty is greater of:
  - $2,500
  - 5% of the highest total fair market value of all the property held by the trust in the year

- Existing penalties still apply - $25/day with a minimum of $100, up to $2,500

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Recent Development In Tax

Questions?

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