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## THE CONDUCT OF JUDGES: OPTICS AND REALITY

By David W. Chodikoff, Editor-in-chief of Taxes & Wealth Management, National Tax Litigation Leader, Miller Thomson LLP

Almost a year has passed since the Canadian Judicial Council ("CJC") completed its review of the alleged misconduct by three judges. The complaints were dismissed. As one noted tax lawyer observed in a recent piece in Canadian Tax Focus, "common sense has finally prevailed."[1]

The background to this story begins with a couple of media investigative programs. The CBC's Fifth Estate and Radio Canada's Enquête raised questions regarding the possible conflict of interest for judges attending events and conferences funded by private sector interests. The core allegation was that some of the private sector sponsors were involved in ongoing litigation matters before the courts.

The specific allegations were as follows: in the case of Justice Pelletier of the Federal Court of Appeal, it was argued by the complainant that his attendance at an international tax event sponsored by a large management firm was inappropriate. Similarly, the complainant raised the question of whether it was appropriate for Justice Randall Bobcock of the Tax Court of Canada to attend a cocktail party hosted by a law firm that was representing a client on a case in which he was the case management judge. The complainant also raised the question of whether it was appropriate for the Chief Justice of the Tax Court of Canada, Eugene Rossiter, to defend judges who attend social events funded by the private sector with some well-placed humour.

The procedure for dealing with such complaints is well established.[2] The complaint is made to the CJC. The CJC was created by Parliament in 1971 and it was given the authority under the *Judges*

[1] Brian Carr, "*Ethical Principles of TTC and FCA Judges Revisited*," Canadian Tax Focus, Vol. 8, No. 2, May 2018.

[2] See: Canadian Judicial Council, The Conduct of Judges, and the role of the Canadian Judicial Council.


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## IN THIS ISSUE


The Conduct of Judges: Optics and Reality ...................... 1

A UK Corporate Criminal Offence With a Global Reach — Failure to Prevent the Facilitation of Tax Evasion ............ 2

Taxation of Cryptocurrencies & Tokens: Simple, Yet Not So Simple, Taxation (Part 1) ............................................ 6

Trump Tax Changes to the "Controlled Foreign Corporation" Definition and the Impact on Canadian Tax Planning ....... 8

Personal Pension Plans — a Powerful Solution for Highly Taxed Business Owners and Incorporated Professionals .... 9

*De Facto* Control Reviewed in *Aeronautic Development Corporation v. Canada* ................................................ 11

A Question of Interpretation — *Canada v. Cheema*, 2018 FCA 45.................................................................. 13

*Le v. Queen*: Incorporator Not Director......................... 20



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*Act* to investigate and rule on complaints about the conduct of federally appointed judges.

It is the responsibility of the Council's Judicial Conduct Committee to review conduct in a manner that is fair, efficient and objective.

The process of filing a complaint is straightforward. Although a complaint can come from a provincial Attorney General or the Minister of Justice, the majority of complaints come from the general public. A person does not need to hire a lawyer to file a complaint. All that is required is that a person file a complaint in writing to the Canadian Judicial Council. The content of the complaint is simple too. It contains the complainant's name, address, the name of the judge, the court, the background facts and description of the conduct in question. Thereafter, a member of the Council's Judicial Conduct Committee examines the complaint and decides whether the judge in question should be contacted. If the matter is very serious, or if the complaint comes from the Minister of Justice or a provincial Attorney General, an Inquiry Committee may be appointed in order to hold a public hearing. Following the inquiry, the matter would go to the full Council for discussion. It is possible that after considering the report of an Inquiry Committee, the Council may recommend to Parliament that the judge be removed from office. In some instances, the Council may choose to express its concern about a judge's conduct where the matter is not serious enough to recommend judge's removal from the court. Once the complaint has been considered and determined, the Council will provide the complainant with its decision in writing.

The mechanics of the procedure for filing a complaint and its disposition by the Judicial Conduct Committee aside, what strikes me as important are the lessons that can be learned from this entire episode. First, it is relatively easy for the media to create an impression that the conduct of these judges was somehow inappropriate when in fact, it was not. There is absolutely nothing wrong with judges intermingling in professional settings with lawyers, accountants, academics and government employees. We want our judges to be attuned to the real world as opposed to living sheltered and disconnected professional lives. The connection to the various professionals that occupy their courts helps ensure that decisions reflect the norms of our society. To be clear, no single voice or point of view dominates at any conference I have ever attended, and my experience covers 28 years. At the same time, it is obvious that the reporting of such events can take a dark, suggestive and sinister tone. However, such a conclusion is ridiculous. Specifically, does anyone really believe that judges can be swayed by a cocktail and socialization? Really, do we have such a low societal regard for the moral character and ethical standards of our judges? Even so, the media, perhaps inadvertently, can sow doubt in the minds of some people. Second, knowing that optics may affect the public's perception, judges have a duty to consider their actions and words carefully. In the words of the Canadian Judicial Council's Ethical Principles for Judges,

> [A] judge must be and be seen to be free to decide honestly and impartially on the basis of the law and the evidence, without external pressure or influence and without fear of interference from anyone.[3]

[3] See: Canadian Judicial Council, Ethical Principles For Judges, ISBN 0-622-38118-1, page 4; see also the Remarks of the Right Honourable Beverly McLachlin, P.C. Chief Justice of Canada, Sixth Templeton Lecture on Democracy, University of Manitoba, June 3, 2004.

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Surely, judges attending industry conferences that are open to all or judges making humorous remarks to an industry group should not be taken out of context.

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## A UK CORPORATE CRIMINAL OFFENCE WITH A GLOBAL REACH – FAILURE TO PREVENT THE FACILITATION OF TAX EVASION

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On 30 September 2017, Part 3 of the Criminal Finances Act 2017 ("the CFA") came into force in the UK. The CFA created two new corporate criminal offences which apply to all businesses located anywhere in the world, including Canada. Under the new legislation, a corporate body or partnership (a "relevant body") may be criminally liable where it fails to prevent its employees or associated persons from criminally facilitating tax evasion. There is no requirement that the tax evaded is UK tax. An offence is capable of being committed under the CFA even if the tax evaded is Canadian tax.

Both offences are strict liability offences. This means that a relevant body will be guilty if any of their associated persons criminally facilitate the evasion of tax. The only defence available is for a


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relevant body to demonstrate that it had "reasonable preventative procedures" in place.

Some organisations may be familiar with this approach based on their response to the failure to prevent bribery offence provided for by section 7 of the UK Bribery Act 2010. However, tax evasion risks are different in their presentation and require a completely new, bespoke approach.

The offences are radical, not only in terms of their territorial scope but also in terms of their role in helping to reshape English law on corporate criminal liability. This article gives a brief overview of the structure of the offences and outlines the steps that organisations, including those based solely in Canada, need to take to demonstrate that they have procedures in place to prevent the facilitation of tax evasion and avoid corporate criminal liability.

## THE OFFENCES

There are two offences, a UK offence and a foreign offence, but their extra-territorial nature means that both offences could potentially affect Canadian businesses, as well as any other businesses, regardless of where they are based.

### The UK Offence (section 45, CFA)

The UK tax evasion facilitation offence applies to all relevant bodies, regardless of where they were incorporated or formed and is committed when the following elements are present:

- Stage 1: A natural person or legal entity commits a "UK tax evasion offence", i.e., an offence of cheating the public revenue or an offence under the law of any part of the UK consisting of being knowingly concerned in, or taking steps with a view to, the fraudulent evasion of a tax. Each element of the offence must be present, i.e., the objective and mental elements, but this does not need to have been proved before a relevant body can be prosecuted.
- Stage 2: An associated person of the relevant body criminally facilitates the UK tax evasion offence at Stage 1, i.e., that associated person: is knowingly concerned in, or takes steps with a view to, the fraudulent evasion of tax by another; aids, abets, counsels or procures the commission of a UK tax evasion offence, or is involved in the commission of an offence consisting of being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of a tax.

### The Foreign Offence (section 46, CFA)

The foreign tax evasion facilitation offence requires some nexus with the UK (see further below).

Otherwise, the offence consists of the following elements:

- Stage 1: A natural person or legal entity commits a "foreign tax evasion offence", i.e., conduct which amounts to an offence under the law of a foreign country, which relates to a breach of duty relating to a tax imposed under the law of that country and which would be regarded by the courts of any part of the UK as amounting to being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of that tax. In other words, dual criminality is required, but the offence does not need to have been proved before a relevant body can be prosecuted.
- Stage 2: An associated person criminally facilitates the foreign tax evasion offence at Stage 1, that is, conduct amounting to an offence under the law of a foreign country, which relates to the commission by another person of a foreign tax evasion offence under that law and which, if the foreign tax evasion offence were a UK tax evasion offence, would amount to a UK tax facilitation offence.

### Extra-territoriality

The offences are intended to have wide extra-territorial reach, which has significant implications for branch structures.

Where UK tax is involved, a relevant body may be liable **wherever** it was established or formed and **wherever** the relevant conduct takes place. By way of example, if a Canadian company assisted a sales representative based in the UK to evade UK income tax, the Canadian company would be criminally liable under the UK offence.

Where the evasion of foreign tax is concerned, a relevant body will be liable if:

- it was incorporated or formed under UK law;
- it carries on a business or part of a business in the UK (which will include a representative office, for example); or
- any conduct constituting part of the criminal facilitation of tax evasion takes place in the UK.

By way of example, if an employee of a Canadian company met with an employee of a French company in London, and they conspired to evade French corporation tax. The Canadian and French companies would be liable under the foreign offence as the conduct constituting part of the criminal facilitation of tax evasion took place in the UK.[1]

### Associated Persons

In determining whether somebody is an associated person of a business, a court will have regard to all of the relevant circumstances and not merely to the nature of the relationship between the relevant body and the alleged associated person. The CFA defines an associated person of a business as:

- an employee, acting in the course of their work;
- an agent, acting in their capacity as an agent, or
- any person who performs services for or on behalf of a company in their capacity of performing a service.

It is important to note that, in order for the offences to be made out, the associated person must be acting in the relevant capacity when carrying out the criminal facilitation. Thus, an employee acting outside the scope of their employment duties when committing the facilitation would not be committing it in their capacity as an associated person. The same principle applies to every class of associated person.

[1] The example assumes that the act of facilitation is recognised by France as a criminal offence under its domestic laws, even if it is committed outside of its borders.

### Comparison to Canadian Legal Principles

We understand that, in 2004, the Parliament of Canada adopted *Bill C-45, An Act to Amend the Criminal Code* (*Criminal Liability of Organizations*), which significantly altered the legal landscape of Canadian corporate criminal liability by holding corporations liable for the actions of their "senior officers" which included employees, agents or contractors with "an important role in the establishment of an organisation's policies or who manage an important aspect of the organisation's activities".

The offences under the CFA have a much broader and more radical effect. There is no requirement to establish that the employee, agent or associated person who committed the tax evasion had an important role in the organisation. A business will be liable so long as an associated person, at whatever level in the organisation, was acting in the relevant capacity when carrying out the criminal facilitation.

## THE DEFENCE

The only defence to the offences will be that the relevant body had reasonable procedures in place to prevent the facilitation of the tax evasion by its associated person, or that it was not reasonable in all the circumstances to expect it to have any preventative procedures in place (sections 45(2) and 46(3), CFA).

Whilst there may be other ways of challenging a prosecution, such as arguing that the associated person in question was not acting for or on behalf of the relevant body when they committed the facilitation, these defences depend heavily on the facts, and their merits can only be assessed after the event. The only pre-emptive defence available is for an organisation to develop reasonable preventative procedures to sit alongside its existing risk and compliance frameworks.

It is important to note that being based in Canada or in any other jurisdiction outside of the UK will not be considered to be a mitigating factor if a business does not have preventative procedures in place.

### What are reasonable preventative procedures?

What is considered "reasonable" for a relevant body in any given case will depend on a variety of factors, such as the size of the business, the jurisdictions in which it operates and the industries in which it provides its services. Her Majesty's Revenue & Customs ("HMRC") have published guidance[2] on the content of the procedures relevant bodies are expected to have in place. The Guidance does not differentiate between what is considered to be reasonable for a Canadian business or UK business. Therefore, Canadian businesses must ensure that they assess what is "reasonable" from an objective viewpoint.

As the offences are modelled on the offence contained within section 7 of the UK Bribery Act 2010 (the offence of failure to prevent bribery by commercial organisations), the statutory defence has a familiar feel to that of the equivalent defence of adequate procedures to prevent bribery. The guidance published by HMRC sets out six principles which businesses should take into account in formulating procedures to prevent themselves from falling foul of the new offence. These are:

1. **Risk assessment:** Businesses should identify the nature and extent of the risk that their associated persons are criminally facilitating tax evasion. The risk assessment should be documented and kept under review.
2. **Proportionality**: The preventative procedures will need to be proportionate to the risk the business faces, which will depend on the nature, scale and complexity of its activities. Businesses are not required to have to undertake excessive due diligence, but they will have to show that they have paid more than just "mere lip service" to preventing the facilitation of tax evasion.
3. **Top-level commitment:** Businesses must be able to demonstrate that top-level management is committed to preventing persons associated with the business from engaging in criminal facilitation of tax evasion.
4. **Due diligence**: Businesses should apply a risk-based approach to due diligence on their associated persons in order to mitigate the identified risks.
5. **Communication**: Businesses should seek to ensure that their preventative policies and procedures are embedded and understood throughout the organisation, through internal and external communication, including training.
6. **Monitor and review:** Businesses should monitor and review their preventative procedures and make improvements where necessary.

## SANCTIONS

Following a recent raft of new regulations, tax authorities now have access to unprecedented levels of taxpayer data. Their capability to analyse that data means that the detection of tax evasion has become far more likely than was historically the case.

A number of serious consequences may arise should a business fail to develop "reasonable preventative procedures" and an instance of criminal facilitation occurs which is detected by the aurthorities. As well as facing an unlimited fine, the business found guilty of one of the offences could find itself subject to ancillary orders such as confiscation orders and serious crime prevention orders.

In addition, a public conviction would carry obvious reputational implications, and may require disclosure to professional regulators both in Canada and overseas. For Canadian companies who bid for public contracts in the UK, they will likely find themselves barred from future bidding and this could be fatal to the business. Canadian companies may be familiar with this approach as we understand that under the government-wide Public Services and Procurement Canada Integrity Regime, companies may be barred from conducting business with the Canadian government for up to 10 years if they have been convicted or discharged for integrity-related offences.

## WHAT BUSINESSES NEED TO DO

The six principles contained within HMRC's guidance give organisations a high-level steer in terms of what they are expected to do in order to have reasonable preventative procedures. However, the principles are not prescriptive and do not provide any real help as to

[2] *Tackling tax evasion: Government guidance for the corporate offences of failure to prevent the criminal facilitation of tax evasion (1 September 2017), online .*


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the programme of work or the methodologies that Canadian businesses might employ to build their preventative procedures.

Although the detailed design and implementation of an anti-tax evasion facilitation programme is outside the scope of this article, because it must necessarily be based on a bespoke risk assessment, what follows is an outline of a typical work plan, and what it means in practical terms, to take a relevant body from having no procedures in place to having procedures in place that a court would consider reasonable.

### Project Scoping and Impact Analysis

Particularly for larger and more complex businesses, project scoping is essential in order to ensure that sufficient organisational "buy in" is obtained so that that the entire work programme can be completed in a timely manner. Spending the time to scope out the project accurately also enables the organisation to demonstrate its "top-level commitment".

Once the work programme has been effectively scoped, the next stage will be to undertake the impact analysis. An impact analysis is an identification of the contact points between the offences and the business in question. It also allows organisations to understand the impact of the offences by identifying their associated persons, what they provide "for or on behalf of" the organisation and what types of risk that creates.

### Undertake the Risk Assessment

The purpose of the risk assessment is twofold:

- to identify and characterise the set of risks potentially arising as a result of the conclusions of the impact analysis; and
- to evaluate the potential significance of those risks and to gain an indication of the relative importance of each risk within the business.

The initial risk assessment should be an assessment of inherent risk, that is, a risk which exists before the mitigating effects of any existing controls are taken into account. Residual risks, on the other hand, are the risks that remain after these mitigating factors have been taken into account. It is important to avoid the temptation to focus on existing controls when undertaking the initial inherent risk assessment, as this can lead to the inadvertent failure to spot certain risks.

Organisational buy-in is key to ensuring consistency of approach, and to ensuring that the full range of perspectives within the organisation is taken into account. A steering committee should be assembled whose membership comprises a representative cross-section of the relevant body.

Once the inherent risk assessment has been agreed, the organisation's existing control framework will need to be mapped onto the identified inherent risks. This will result in the organisation's residual risks being identified. The extent to which the organisation's existing controls do not address the residual risks represents the gaps in the control framework that will need to be plugged through enhancements to it.

### Undertake the Enhancement Programme

Once the required enhancements have been identified, they can then be incorporated into a programme of remediation which mitigates the risk in a proportionate manner. Key phases of any remediation programme would typically include:

- Design: building on the gap analysis to identify resource and designing procedures based on the nature of the gap identified.
- Build: drafting the new procedures, training materials etc.
- Roll-out: launching the new procedures and ensuring that this is effectively communicated through the relevant body.
- Implementation: using the new procedures in the day-to-day running of the business.

### Ensure Compliance Standards are Reviewed and Maintained

The final element of any work programme to implement reasonable preventative procedures is the design of a programme to review and maintain the new enhanced standards. This is consistent with the sixth principle in the guidance (ongoing monitoring and review). Businesses should build audit programmes and implement technology tools to identify risks, report breaches and deal with investigations and prosecutions. Regular reviews of existing policies and procedures should be scheduled.

## CONCLUSION

Her Majesty's Revenue & Customs have indicated that the preventative procedures that are considered reasonable will change as time passes. What was considered reasonable on the first day of implementation of the offences will not be the same as that which is considered reasonable after a number of years. Though there may be other ways of challenging any prosecution, such as arguing that the associated person in question was not acting in the capacity of that type of associated person when they committed the facilitation, the only comprehensive insurance policy will be to develop the reasonable preventative procedures to sit alongside a business's existing risk and compliance frameworks.

As a minimum, HMRC expect all businesses, even those based in Canada, already to have performed the following steps:

- demonstrated top-level commitment;
- conducted an inherent risk assessment; and
- developed an implementation period plan.

If they have not already done so, Canadian businesses should act immediately to ensure that they have in place a programme of work to develop their reasonable preventative procedures and mitigate their risk of being found criminally liable for the facilitation of tax evasion.

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# TAXATION OF CRYPTOCURRENCIES & TOKENS: SIMPLE, YET NOT SO SIMPLE, TAXATION (PART 1)

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## INTRODUCTION

The first quarter of 2018 has been marked by considerable debate about the future of cryptocurrencies, such as Bitcoin.[1] Detractors continue to admonish against their fraudulent use and propound their demise. Yet the amount of capital raised by way of initial coin or token offerings (each, an "Offering")[2] in the first quarter of 2018 stands at a staggering USD$6.3 billion; well in excess of the total proceeds derived from 41% more Offerings in 2017.[3] These figures suggest that Offerings have gained considerable traction as a viable financing alternative for blockchain businesses despite regulatory and market uncertainty. The apparent success of Offerings is certainly partly attributable to the fact that, while generally acknowledged as a risky endeavor, the potential for substantial returns in connection with coins and tokens remains alluring to investors *qua* speculators, token holders and platform/network participants.[4]

The following is the first of a series of four articles,[5] each considering the tax treatment of particular transactions involving coins or tokens under the *Income Tax Act* (Canada),[6] the regulations thereunder and, where relevant, the *Excise Tax Act* (Canada)[7] and the published administrative positions of the Canada Revenue Agency (the "CRA") in connection with the acquisition, holding and disposition of virtual currencies. In particular, this first article addresses the Canadian tax considerations relevant to a Canadian-resident person (the "Investor") throughout each step of a generic non-registered[8] Cryptocurrency or token trade life cycle (the "Trade Life Cycle").

Generally, the Trade Life Cycle is comprised of the following steps:

1. registering with a Canadian-resident Cryptocurrency exchange (an "Exchange") and transferring Canadian dollars from the Investor's bank account to a digital wallet administered by the Exchange (an "Exchange Wallet");
2. acquiring one of the Exchange's onboarding Cryptocurrency of choice (an "Exchange Cryptocurrency");
3. acquiring Cryptocurrencies as speculative investment;
4. converting such investments back into the Exchange Cryptocurrency and (immediately thereafter) Canadian dollars; and
5. withdrawing Canadian dollars from the Exchange Wallet and transferring Canadian dollars to the Investor's bank account.

## TRADE LIFE CYCLE ON AN EXCHANGE

### (1) Registration & Deposit

An Investor's choice of Exchange may be dictated by the particular coin or token being purchased as part of an Offering. At that time, the particular coin or token is not available for purchase on all Exchanges; rather, the particular coin or token is initially available only on a single Cryptocurrency exchange. Onboarding is not a taxable event to the Investor.

Those interested in investing in either coins or tokens must first transfer Canadian dollars from their bank account(s) to a wallet administered by an Exchange. Exchanges will generally charge investors a "deposit fee" on every deposit made to a wallet. Typically, the deposit fee will range from 1.5% to 10% of the amount being transferred. The transfer of funds can currently be accomplished through a number of payment methods, including the following: credit card, Interac Online, email transfer, money order, bank draft, wire transfer, redeemable vouchers, etc. Transfers are generally capped to a maximum (daily) amount, which will vary depending on the particular payment method being used by the purchaser (*e.g.,* a person can transfer up to CAD$10,000$/day by wire transfer). Where an investor wishes to deposit a significant sum, generally, or with a view to capitalizing on a time-sensitive trade, then the foregoing restrictions can prove to be quite cumbersome, especially given the current volatility of the Cryptocurrency-market.

As mentioned above, depending on the coin or token that is being purchased, an investor may have little choice with respect to the Cryptocurrency exchange through which to execute the purchase. It may only be possible to make such a purchase on an exchange situated outside of Canada (a Foreign Exchange). Such an Investor

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[1] Reference herein to the term "Cryptocurrency" includes a "token" and a "coin", unless otherwise specified. A "coin" means a virtual currency generated and distributed through a process generally referred to as "mining" and which can generally be bought and sold on a specialized Cryptocurrency exchange and used by a holder thereof as a form of payment in lieu of fiat currency; In addition, there are essentially two types of tokens, namely: (i) security tokens, and (ii) utility tokens. A security token (a "tokenized security") is an investment contract the main purpose of which is to earn future profits in the form of dividends, revenue share or price appreciation (see *Pacific Coast Coin Exchange v. Ontario Securities Commission*, [1978] 2 S.C.R. 112). A utility token provides its holder with access to a digital platform and also constitutes a payment mechanism to the holder for the use of a software service operated by distributed ledger technology.

[2] Generally, an initial offering of coins or tokens consists in raising funds through a sale of coins or tokens generated by a protocol (e.g., the Bitcoin or Ethereum protocols) and issued *via* a crowdsale platform in consideration for monetizable cryptocurrencies (e.g., Bitcoin or Ether) or fiat currency.

[3] David Floyd, "$6.3 Billion: 2018 ICO Funding Has Passed 2017's Total," *Coindesk* (April 19, 2018) https://www.coindesk.com/6-3-billion-2018-ico-funding-already-outpaced-2017/.

[4] In addition, a number of jurisdictions, including Canada and the United States, have sought to protect the investing public from fraudulent Offerings and brought such issuances within the purview of their respective securities legislative and regulatory regimes. See CSA Staff Notice 46-307 Cryptocurrency Offerings (August 24, 2017). A further consideration of Canadian securities legal and regulatory

[5] Future articles will treat, in succession, the following topics: (i) the tax treatment of 'forks' and 'airdrops'; (ii) the tax considerations in structuring an initial coin or token offering; and (iii) the tax treatment of Losses arising from the theft or embezzlement of coins or tokens & certain other off-market transactions.

[6] R.S.C. 1985, c.1 (5th Supp.), as amended from time to time (the "Act").

[7] R.S.C. 1985, c. E-15, as amended from time to time. This article does not address potential sales tax implications, if any, associated with the transactions relevant to a Trade Life Cycle.

[8] While "currency" and certain types of commodities are eligible investments for purposes of deferred investment plans under the Act (e.g., a registered retirement savings plan and a tax-free savings account, each a "Registered Plan"), coins (and, presumably, tokens — based on the CRA's current published administrative positions) cannot be held directly by a Registered Plan or a deferred profit sharing plan (a "DPSP"). A Registered Plan or a DPSP could, however, hold such assets indirectly through a registered mutual fund trust, the units of which are already eligible investments for such plans.


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would then generally be required to convert Canadian dollars into the relevant foreign fiat currency,[9] purchase the Foreign Exchange's onboarding Cryptocurrency and (almost immediately thereafter) purchase the desired Cryptocurrency. Provided that all of these steps occur at, or substantially at, the same time, this series of transactions should not give rise to a significant tax liability to the Investor.[10] Going forward, however, such Investors may find themselves subject to Canada's onerous foreign property reporting requirements.[11]

### (2) Conversion of Canadian Dollars to the Exchange Cryptocurrency

In order to invest more broadly in coins or tokens, an Investor must first acquire the Exchange Cryptocurrency — usually Bitcoin or Ether, which are considered to be liquid cryptocurrencies. The Investor will execute a buy trade for the Exchange Cryptocurrency using either a limit order or the Investor will then quote for the Cryptocurrency. The Exchange will charge the Investor a "trading fee" ranging from 0.1% to 0.5% of the transaction value. The acquisition of the Exchange Cryptocurrency should not constitute a taxable event to the purchaser.

### (3) Cryptocurrency for Cryptocurrency

Investors will then use the Exchange Cryptocurrency to purchase coins and tokens on the Exchange. The coins and tokens listed on an Exchange are only available for purchase in consideration for a liquid Cryptocurrency. It should be noted that Investors are not resigned to trade only on the onboarding Exchange. The coins or tokens, as well as any balance of either cash or Exchange Cryptocurrency, can be transferred to a wallet on another exchange. That said, Investors would be remiss to ignore the cost associated with "exchange-hopping". While a trading fee is generally applicable to transactions within an Exchange, a transfer to another Exchange would be subject to a "transfer fee", "gas"[12] and potentially a "deposit fee" levied by the other exchange. Exchange-hopping would, however, not be a taxable event. That being said, each Cryptocurrency trade on an Exchange would constitute a taxable event to a Canadian-resident seller for Canadian income tax purposes and give rise to taxable income (or losses).[13]

Briefly, the CRA's current administrative position is that a virtual currency (which includes a coin and presumably a token) is not an actual "currency" for purposes of the Act. Instead, a Cryptocurrency is to be treated as a "commodity" for purposes of the Act, similar to precious metals such as gold or silver. As described in more detail below, such a characterization entails a number of tax implications. In particular, that any transaction involving coins or tokens as the medium of exchange will constitute a barter transaction for purposes of the Act.[14] Indeed, the CRA generally treats Cryptocurrency trades as a barter transaction, resulting in the recipient of the Cryptocurrency obtaining a tax cost in the Cryptocurrency received on the exchange equal to the fair market value of the goods/services/rights that were given up in exchange for the Cryptocurrency.

Generally, the buying and selling of a commodity can be regarded as being on capital account unless it is either carried out in the course of a business of buying and selling such commodities or such buying and selling amounts to an "adventure or concern in the nature of trade". Such a determination is to be accomplished on a factual, case-by-case basis, requiring a detailed review of the nature of an Investor's dealings with the particular Cryptocurrency.[15]

### (4) Conversion of Cryptocurrency to Canadian Dollars

In order to "cash out" of an investment, Investors will generally need to enter into a series of dispositions in connection with, first, a conversion of the Cryptocurrency into the Exchange Cryptocurrency and, second, the conversion of the Exchange Cryptocurrency into Canadian dollars. Each disposition will constitute a taxable event to the party disposing of the Cryptocurrency for purposes of the Act, thereby giving rise to taxable income (or losses) in the year of disposition as described above.

### (5) Withdrawal of Canadian Dollars

An Investor's withdrawal of Canadian dollars from an Exchange Wallet and the transfer of such funds to a bank account would not constitute a disposition for purposes of the Act. Notwithstanding the existence of a plethora of fees, Exchanges nevertheless levy a "withdrawal fee" (substantively similar to a "deposit fee" as described in step (1) above) with respect to transfers of fiat currency from an Exchange Wallet to a bank account.

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9 Foreign Exchanges may apply a currency conversion fee where the deposit is made directly in Canadian dollars. This fee may apply in addition to those already levied by financial institutions with respect to fund transfers.

10 If there is a significant increase in the value of the Exchange Cryptocurrency over the course of a hold period prior to the acquisition of the desired Cryptocurrency, then the seller thereof will realize a taxable capital gain. The tax implications of such a trade between commodities is considered in detail below.

11 Taxpayers that own "specified foreign property" with an aggregate cost of more than CAD$100,000 are required to file Form T1135 with the CRA on an annual basis. The CRA takes the view that a Cryptocurrency constitutes "funds or intangible property" for purposes of the Act. To the extent that a Cryptocurrency is situated, deposited or held outside of Canada and not used or held exclusively in the course of carrying on an active business, then it will be considered by the CRA to be "specified foreign property" for purposes of the Act. The CRA's characterization of Cryptocurrency as "funds or intangible property" appears to be completely at odds with its prior published administrative positions, which treat such property as a commodity for purposes of the Act. In addition, a determination of whether a Cryptocurrency is situated, deposited or held outside of Canada is a question of fact that is complicated by the digital nature of the property and which, depending on the circumstances, may likely depend on where the Foreign Exchange servers are located and whether control in exerted thereon by the Foreign Exchange.

12 Broadly speaking, "gas" refers to a reward of Cryptocurrency to a successful "miner" of a transaction occurring on the protocol, the validity of which is recorded on a decentralized, immutable distributed ledger.

13 It should be noted that taxpayers must report their income in Canadian dollars, which may lead toInvestors owing tax without having received a corresponding amount of cash to satisfy their liability (*i.e.*, dry income). A non-resident seller disposing of Cryptocurrency on an Exchange should not be taxable in Canada in respect of any income unless the non-resident is, *inter alia*, carrying on business in Canada for purposes of the Act. Whether a non-resident is carrying on business in Canada for the purposes of the Act is a mixed question of fact and law. Both a common law test and a statutory deeming rule (section 253 of the Act) are applicable in determining whether a non-resident's activities in Canada exceed the threshold for carrying on business in Canada, which is generally quite low.

14 CRA Document no. 2013-11-05 — What You Should Know About Digital Currency (November 5, 2013); CRA Document no. 2014-0525191E5 — Virtual currencies (Bitcoins) (March 28, 2014); and Marc Richardson Arnould, "Tax Consequences of Mining and Transacting in Bitcoin," Bloomberg BNA: Tax Management International Journal (TMIJ), Vol. 43, No. 10, (October 10, 2014).

15 The deductibility of the various exchange-related fees identified herein will largely depend on the treatment of the income (or losses) for purposes of the Act.

## CRYPTOCURRENCY EXCHANGE EXPENSES

As discussed above, the fees levied on Investors participating in Cryptocurrency transactions in connection with an Exchange are clearly significant, while their deductibility remains uncertain. Indeed, the deductibility of transaction expenses will depend on a number of factors, including the treatment of income (or losses) for purposes of the Act. The tax treatment of gains, losses and expenses from Cryptocurrency or token transactions must be assessed factually on a case-by-case basis.

Generally, trading fees, transaction fees, conversion fees, commissions and "gas" should apply to reduce taxes in respect of capital gains since such fees are to be added to the adjusted cost base ("ACB") of the purchased Cryptocurrency. If the Investor is required to convert Canadian dollars into a foreign currency in the process of purchasing the Cryptocurrency, an adjustment to the ACB would also include conversion fees and any foreign exchange gains or losses. Alternatively, if the investment has a reasonable expectation of generating income in the future, then fees incurred from managing or administering the investment (other than commissions) and carrying charges may be eligible as a deduction. The concept of a carrying charge includes deposits, withdrawals, and transfer fees in addition to any legal fees in connection with the preparation of the investment income section of a tax return, as well as foreign exchange conversion fees incurred in respect of the transaction, where applicable. Given the substantial fees paid in connection with Cryptocurrency transactions, especially when compared to those fees levied in a traditional investor-registered broker relationship, their deductibility warrants consideration.

Finally, the deductibility of the cost of purchasing a piece of hardware in which Investors store their Cryptocurrency "off chain" (commonly referred to as a "cold wallet") has not yet been addressed by the CRA. Given the risks associated with Cryptocurrency wallets being hacked, many investors have purchased these cold wallets, which can be relatively expensive. In the 2013 Federal Budget, the Department of Finance disallowed safety deposit box fees used to store investment certificates as a deductible investment expense for all taxpayers.[16] Arguably, this amendment to the Act may be a result of a perceived decline in the use of safety deposit boxes for traditional purposes based on a recognition of the digitization of securities and their potential use for purposes other than the protection of investments (e.g., the storage of personal information and property). Yet, based on the justification for the deductibility of such fees in the past, it would not be unreasonable to take the position that the cost of a cold wallet, the sole purpose of which is to protect an investment in Cryptocurrency, should be deductible where such fees are incurred for purposes of earning income from a business or property.

## CONCLUSION

The foregoing certainly speaks plenty about the brave new world tax practitioners now face in identifying, considering and applying fundamental principles in addressing novel issues. Indeed, the challenges which Cryptocurrencies present often reveal themselves most readily where there exists a manifest tension between tradition and modernity. There is no simple remedy. Our current legislative and regulatory framework cannot provide a comprehensive approach to the treatment of Cryptocurrencies.

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[16] Federal Budget 2013: https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/federal-government-budgets/budget-2013/budget-2013-deduction-safety-deposit-boxes.html

## TRUMP TAX CHANGES TO THE "CONTROLLED FOREIGN CORPORATION" DEFINITION AND THE IMPACT ON CANADIAN TAX PLANNING

By Hayley Ossip, Ossip Professional Corporation

On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act ("TCJA"), amending the Internal Revenue Code of 1986 and overhauling the American taxation system. While the name of the Act emphasizes lower tax rates, Canadians doing business with the United States — and Canadians who are United States citizens — may come across the opposite situation, since the Act significantly expands the definition of a "Controlled Foreign Corporation" ("CFC"). These provisions may expose American shareholders of Canadian corporations to additional income inclusions on their American annual returns, as well as a new tax on their shareholdings in such companies. Corporate and family tax plans which involve United States entities must be reviewed in light of these changes.

The TCJA expands the definition of a CFC by encompassing more shareholders in the definition of "U.S. shareholder" and by changing rules regarding constructive ownership. The changes apply for the tax year which began prior to January 1, 2018. These changes lead to a significantly higher number of Canadian corporations and U.S. taxpayers that will be exposed to American taxes and extensive reporting obligations.

Prior to the enactment of the TCJA, Section 957 of the Internal Revenue Code described a CFC as a foreign corporation that is more than 50% owned — by voting power or stock value — directly, indirectly, or constructively under Section 958(b) by U.S. persons who are U.S. shareholders. The definition of a "U.S. shareholder" was defined in Section 951(b) as a U.S. person who owns 10% of the *voting* stock of a CFC. Shareholders who fell into the definition of a U.S. shareholder were required to provide extensive reporting on their American tax returns for foreign corporations which they and other U.S. persons controlled. In many cases, they were subject to taxes on undistributed earnings of such corporations.

Now, Section 14214 of the TCJA expands the definition of a U.S. shareholder to mean any U.S. person who owns 10% of the stock of a CFC — by vote or by value. Therefore, it does not matter whether a shareholder is in a controlling position of a corporation — if 10% of stocks are owned, such a shareholder falls within the expanded definition and the corresponding obligations.

Section 14213 of the TCJA also amends the constructive ownership rules to allow for downward attribution of the CFC designation by repealing section 958(4) of the Internal Revenue Code. Historically, to determine whether the U.S. shareholders owned more than 50% of a CFC, the shareholders had to be direct or indirect shareholders of the foreign corporation. Under the new regime, a foreign subsidiary that is more than 50% owned by a foreign parent corporation is treated as a CFC if the foreign parent also owns more than 50% of the value of the stock of an American subsidiary. The at-


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tribution also applies if a foreign co-investor in a foreign parent corporation has a U.S. affiliate. In this case, the foreign parent becomes a CFC as well. In order to limit the breadth of this provision, however, the Internal Revenue Service has issued guidance that explains that regulations will be instated which will relieve the U.S. subsidiary from CFC reporting obligations in situations where there is no U.S. shareholder in the direct or indirect ownership chain of the CFC.[1] Given this change — and the expanded definition of "U.S. shareholder"— many more persons are subject to greater reporting requirements and taxes.

In addition to the expanded definition of U.S. shareholder, the TCJA adds Section 951A to the tax code which requires a U.S. shareholder of a CFC to include in its income, as a deemed dividend, the return its pro rata share of the CFC's global intangible low-taxed income ("GILTI"). For the purposes of this rule, the GILTI is defined as the excess of the U.S. shareholder's share of the CFC's aggregate net income, reduced by 10% of the CFC's adjusted tax basis in depreciable tangible personal property.[2] In effect, this rule ensures that U.S. shareholders cannot as successfully defer income tax on income earned in a foreign jurisdiction. Commentators have argued that the intended goal was narrower — to target US companies holding intellectual property in foreign low-tax jurisdictions.[3] Unlike the expanded definition of a U.S. shareholder which applied to tax years beginning *before* January 1, 2018, the GILTI provisions apply to tax years starting *after* December 31, 2017.

Certain relief provisions apply to a corporate shareholder paying the GILTI tax, but not to a non-corporate U.S. shareholder. For example, a corporate U.S. shareholder is entitled to a credit for 80% of its pro rata share of foreign income taxes paid attributable to the income of the CFC in calculating its net CFC tested income. Furthermore, a U.S. corporate shareholder is entitled to reduce its GILTI by 50% (during 2018-2025), thus reducing the U.S. federal corporate tax rate under the TCJA from 21% to 10.5%.[4] These relief provisions are not available to a non-corporate U.S. shareholder.

Overall, these changes to the CFC regime impact tax planning as it relates to both corporate and family tax planning. For example, previously-implemented structures designed to avoid the 10% voting shares threshold no longer limit tax liability if 10% of the equitable interest is owned by a U.S. shareholder. Similarly, close attention must be paid to whether related entities cause an otherwise non-U.S. entity to become a CFC given the status of unrelated investors. When complex structures are at issue, such an exercise can be quite cumbersome.

With respect to family tax planning, the expanded definition of a "U.S. shareholder" means that a U.S. beneficiary of a Canadian trust may be a U.S. shareholder of a corporation owned by the trust, even if he or she does not have any control over the trust. Similarly, a common estate freeze plan — in which a Canadian founder owns all the voting shares, a Canadian trust holds 90% of the value, and a US S-Corp holds 10% of the value of a Canadian Holding Company, which in turn has US and Canadian subsidiaries — now causes the US S-Corp to declare its share of income from the Canadian holding company and the Canadian operating company.[5]

Given the proclivity for the structures above, the impact of the CFC changes on U.S. shareholders can be significant. Tax plans for corporations and families alike must be reassessed given the updated provisions. It is unclear, however, whether the consequences were intentional. Some have surmised that the answer to that question is in the negative. There is currently an effort being undertaken to have the Treasury provide guidance or to have Congress work to lessen the impact of the new rules.[6] For now, the rules remain in place and must be followed. Canadians — and other foreigners — must pay close attention when implementing tax structures involving American persons.

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[1] Internal Revenue Service Notice 2018-13, "Additional Guidance Under Section 965 and Guidance Under Sections 863 and 6038 in Connection with the Repeal of Section 958(b)(4)" (Section 5.02).

[2] 26 US Code 951A.

[3] Grant Thornton Tax Alert, "US tax reform and the impact on cross-border individuals" Grant Thornton (January 2018), online: < https://www.grantthornton.ca/globalassets/1.-member-firms/canada/insights/pdfs/us-personal-tax-alert_us-tax-reform-and-the-impact-on-cross-border-indiv....pdf>.

[4] Serangian, Paul et al., "The brave new (tax) world: what Canadians should know about U.S. tax reform" Osler, Hoskin, and Harcourt LLP (January 2018), online: < https://www.osler.com/en/resources/cross-border/2018/the-brave-new-tax-world-what-canadians-should-knew>.

[5] KPMG, "More Canadian Companies May Now be Considered U.S. CFCs", *Global Tax Adviser* (April 10, 2018), online: < https://assets.kpmg.com/content/dam/kpmg/ca/pdf/tnf/2018/ca-more-canadian-companies-may-now-be-considered-us-cfcs.pdf>.

[6] Drier, David and Weeks, Grayson, "New Tax Law May Result in Additional Taxes for Certain US Persons who Directly or Indirectly Own Equity in a Foreign Corporation", White and Case Client Alert (March 2018), online: < https://www.whitecase.com/publications/alert/new-tax-law-may-result-additional-taxes-certain-us-persons-who-directly-or>

## PERSONAL PENSION PLANS – A POWERFUL SOLUTION FOR HIGHLY TAXED BUSINESS OWNERS AND INCORPORATED PROFESSIONALS

By Tina Tehranchian, MA, CFP©, CLU©, CHFC©, Branch Manager and Senior Wealth Advisor, Assante Capital Management Ltd.

Many business owners and professionals have used their corporations as vehicles for saving for their retirement. However, the new tax measures proposed by the Minister of Finance in July 2017 and revised in December 2017 that target income sprinkling, holding a passive corporate investment portfolio and converting a private corporation's regular income into capital gains, boil down to higher taxes for business owners and incorporated professionals and their families and less money for retirement savings.

### THE BEST KEPT SECRET IN TAX AND RETIREMENT PLANNING

One extremely tax-effective solution that is still available to business owners and incorporated professionals is the Personal Pension Plan or PPP. The PPP is a "three-accounts-in-one combination registered pension plan governed by the same rules as other tax-assisted retirement plans and has been available since 2012 but is extremely underutilized. It was developed by pension lawyer, Jean-Pierre Laporte of Integris Pension Management Corp. According to Laporte, "The PPP is the most tax effective retirement savings

program in Canada and is superior to IPPs and RRSPs."[1] By combining elements of Defined-Contribution (DC) and Defined-Benefit (DB) rules, the PPP gives business owners and incorporated professionals more flexibility, allowing them to take a break from contributing to the plan when cash is tight, and it has higher limits than RRSPs that are capped at 18% of income to a maximum of $26,230 for 2018. Depending on the age of the pension plan member, annual contributions to a PPP can be as high as $43,500 per year.

According to Integris,

> The key advantage of the PPP design is that it provides flexibility with respect to the amount of contributions made each year. In good years, a business owner might utilize the DB component of the PPP to tax-deduct as much as possible. In lean years, the same business owner may elect to save under the DC component and reduce contributions to a mere 1% of salary. When business subsequently picks up again, the member could look back to the years where contributions were small and retroactively effect a 'buy back of past service', thus creating additional contribution room.[2]

The "additional voluntary contribution" (AVC) subaccount forms the third component of the PPP plan design. This AVC account allows for the tax-deferred transfer of RRSP assets and is not permanently 'locked-in' by pension legislation, making the funds in it accessible at any time to the business owner. If and when the member chooses to use the DC account in a particular year instead of the DB account, contributions can be made on a voluntary basis to the AVC account as well during the year, triggering a personal tax deduction for the plan member of up to 17% of their T-4 income in that year.

The PPP includes the following additional tax deductions and advantages that are not available to business owners and incorporated professionals who save through their corporation or via RRSPs:

1. **Past service purchases**. The ability to buy back past service allows you to earn a pension for the years where you had T4 income from the corporation before the plan was set up. Typical amount of deduction can vary between $30,000 and over $500,000.

2. **Special payments**. These can be made if the return on the assets in the DB component of the PPP are less than the prescribed 7.5 per cent per year rate of return expectation or if there is a deficit/liability in the plan due to poor performance of the portfolio.

3. **Terminal funding**. If early retirement is elected, terminal funding can enable the purchase of an enhanced pension that is indexed to inflation. Typical amount of this tax deduction can range between $55,000 to over $1,000,000.

4. **RRSP double dips**. In the year the plan is set up, the member can claim a personal tax deduction by contributing to his or her RRSP, in addition to the annual pension plan deduction claimed by the corporation for its contribution.

5. **Investment management fee deductions**. Under the *Income Tax Act* the investment fees for managing the pension money are tax deductible whereas the management fees for managing RRSP and other registered assets are not.

6. **Interest deductions**. If the corporation borrows money to contribute to the PPP the interest on the borrowed funds will be tax deductible, whereas interest on money borrowed to contribute to an RRSP is not tax deductible.

7. **Higher annual contribution limits compared to RRSPs**. Contribution limit to a PPP can be $270 to $17,300 more than the allowable maximum RRSP contribution.

8. **GST/HST Pension Entity Rebate**. This rebate applies to PPPs that use the trust platform and gives the corporation a rebate of 33% of all HST paid in connection with the PPP. On the insurance platform the PPP is HST-free to the company.

9. **Lifetime Capital Gains Exemption**. Terminal Funding and Buy Back of Past Service can be used to "purify" the corporation of non-active business income assets, so it can qualify for the Lifetime Capital Gains Exemption of $848,252 in 2018. This type of purification needs to be done when a corporation is sold through a share transaction.

10. **Inter-generational Tax-Deferred Wealth Transfer**. In a family business where several family members participate in a single family PPP, upon the death of retired family members, PPP assets earmarked to fund the stream of pension benefits become surplus. The plan provisions can stipulate that any surplus in the pension plan belongs to the surviving plan members to fund their own pension benefits. This will eliminate the problem of "deemed disposition" of RRSPs on death and will allow for the transfer of wealth from one generation to another without triggering any immediate taxation. Taxes of course will eventually be payable when pension income is taxed in the hands of retiring plan members.

11. **Commuted Value Transfers**. When an individual who is a member of a Defined Benefit (DB) pension leaves their employer, a portion of the commuted value of the DB pension is subjected to an excess amount calculation under ITR 8517, and is taxed in the hands of the member in the year of the transfer. If the individual joins their family business or sets up a new corporation, all of the DB assets can flow on a tax-deferred basis into the DB component of a PPP without triggering any taxation.

12. **Superior Creditor Protection Features**. Whereas RRSPs at banks and financial institutions are only creditor protected in the event of bankruptcy, the PPP is provided with the highest level of creditor protection in Canada that applies to all formal registered pension plans. The assets of the pension plan cannot be seized by creditors of the plan member (except spousal creditors under Family Law legislation) nor of the corporation that sponsors the pension plan. Moreover, pursuant to recent changes that were made in 2008 to the federal *Bankruptcy and Insolvency Act*, the annual contributions required of the company to the pension plan receive 'super priority' in the event of the insolvency of the corporate sponsor and rank above the claims of the secured creditors such as major commercial lenders.

Considering all the above advantages, a business owner, or incorporated doctor, dentist, lawyer or accountant, can tax-shelter hundreds of thousands of extra dollars in a PPP due to the more generous tax treatment of registered pension plans by the *Income Tax Act* (Canada).

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[1] Online: <www.integris-mgt.com/>.

[2] *Ibid*.


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The only legal stipulation for a business owner or incorporated professional to be able to benefit from a PPP is that he/she and any family members who receive a salary from the corporation for work done, is receiving T4 income from the corporation since dividend income does not qualify as "pensionable".

Membership in the PPP can be restricted to the business owner and one or more key employees (who can be family members).

For example, a 45-year-old business owner who incorporated in 2008 and had a T4 eligible income of $100,000 per year (opting to take the rest of his income in dividends) would be able to claim the following corporate deductions — assuming a 5% per year growth rate for invested assets:

a) Past service of $56,227.

b) Special Payments of $72,434 (assuming assets 5% annually v. 7.5%).

c) Terminal funding (age 57) of $625,344 (further discussed below).

d) Deduction for payment of fees (assuming 1% fee per year on assets) of approx. $4,000 in 2018 assuming $400,000 in the plan. Each year as the assets grow this annual deduction will be higher, e.g. in 2028 when there is over $1,000,000 in the plan the deduction will be approximately $10,000.

e) Extra contributions in excess of RRSP limits over 20 years: $360,651 .

Therefore, this business owner can significantly exceed the tax savings that RRSPs offer. For example, at age 57, the company will have accumulated an extra $ 926,673 in registered dollars over and above what the RRSP can provide (including Terminal Funding).

If the business owner decides to retire early, a tax-deductible terminal funding amount can be paid by the corporation to pay for an unreduced early retirement pension. Assuming the business owner in the above example elects to retire at age 57 (which he could do by simply shifting his compensation from salary to dividends and continuing to work as before), he could receive a $96,323 a year pension and trigger a supplemental corporate tax deduction of $625,344 in the form of terminal funding. Higher pensions would be payable in proportion to the salary received by the business owner from the corporation.

It is important to note that the $96,323 pension in this example is also eligible for "pension income splitting" with a spouse as early as age 55, whereas RRIF income can only be income split starting at age 65. The business owner and his wife can each claim a $2000 per person pension income credit. Therefore, the taxable pension income of the business owner in this case would be only $48,161.

While the intention of the Department of Finance is to restrict the ability of business owners and incorporated professionals to treat their corporations as a retirement savings vehicle, the PPP can help them absorb the effects of the new tax hikes and create a substantially larger retirement nest egg at the same time.

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*Assante Capital Management Ltd. is a member of the Canadian Investor Protection Fund and is registered with the Investment Industry Regulatory Organization of Canada.*

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## *DE FACTO* CONTROL REVIEWED IN *AERONAUTIC DEVELOPMENT CORPORATION V. CANADA*

By Jane Loyer, Associate Miller Thomson LLP Toronto

On April 4, 2018, Gleason J.A. of the Federal Court of Appeal upheld the Tax Court of Canada Decision of Hogan J. in *Aeronautic Development Corporation v. Canada.*[1] At issue was whether Aeronautic Development Corporation ("ADC") was a Canadian controlled private corporation ("CCPC"), within the meaning of subsection 125(7) of the *Income Tax Act*[2] (the "Act"), such that it was entitled to claim refundable scientific research and experimental development investment tax credits (the "SRED RITCs") at the rate of 35%.

While Gleason J.A. agreed with the Tax Court in determining that ADC was not a CCPC, he held that the Tax Court erred in its interpretation of *de facto control* within the meaning of subsection 256(5.1) of the Act.

### FACTS

A Canadian company attempted to develop a small aircraft known as the Seawind to be sold in kit format (the "Seawind"). However, this company was largely unsuccessful. As a result, an investor named Mr. Silva acquired all of its intellectual property rights. Mr. Silva is a United States citizen and resident who is an experienced engineer and architect in the field of aeronautics.

In order for the Seawind to be eligible for certification and commercially viable, Investissement Quebec and Industry Canada informed Mr. Silva that he would have to abandon the original kit format. Both agencies informed Mr. Silva that Seawind could be eligible to claim SRED RITCs for the production of the Seawind if the work was executed by a Canadian CCPC.

Following his acquisition of the intellectual property rights, Mr. Silva completed the production of the Seawind through a new Canadian Corporation, Flight Dynamics Corporation ("FDC"). Once completed, Mr. Silva created a new corporate structure to assist in having the Seawind designated as a "type" certified aircraft. FDC went bankrupt following a crash during a test flight shortly thereafter.

Mr. Silva then incorporated ADC in 2009 as a Nova Scotia unlimited liability corporation and acquired all the assets of FDC. Its sole shareholder was Seawind Corp. ("Seawind Corp"), an American corporation controlled by Mr. Silva. ADC and Seawind Corp. entered into a Development Agreement to provide prototyping and certification services. Pursuant to the Development Agreement, any prototyping and certification expenses would be reimbursed by Seawind Corp. As a result, ADC had to remit any SRED RITCs received to Seawind. Seawind Corp. funded the Appellant's ma-

1 *Aeronautic Development Corporation v. Canada*, 2018 FCA 67 (F.C.A.).
2 *Income Tax Act,* RSC 1985, c 1 (5th Supp) (Canada).

terial, equipment and tools, and remained its only client during its 2009, 2010 and 2011 taxation years in issue.

On August 17, 2009, ADC issued additional common shares to several Canadian residents. As a result, the majority of its common shares were held directly or indirectly by persons resident in Canada. Therefore, Seawind Corp. held 46% of ADC's common shares and voting rates, while two Canadian corporations and one Canadian resident individual held the remaining 54% of the outstanding common shares and voting rights.

The Minister of National Revenue (the "Minister") took the position that ADC was not a CCPC during its 2009, 2010 and 2011 taxation years, from August 2009 onwards, since ADC was ultimately controlled by Mr. Silva, a United States citizen and resident. Therefore, it was not entitled to the SRED RITCs.

## THE TAX COURT DECISION

The Tax Court held that ADC was not a CCPC during its 2009, 2010 and 2011 taxation years and therefore was not entitled to claim SRED RITCs at the rate of 35% on the basis that Mr. Silva had direct or indirect influence of ADC pursuant to subsection 256(5.1) and as a result ADC was not a CCPC pursuant to paragraph 125(7)(a).[3]

In considering the decision in *McGillivray Restaurant Ltd. v. R.*,[4] Justice Hogan held that commercial agreements and arrangements could be considered in establishing *de facto* control:

> [T]he evidence must show that the controller has the ability to affect the economic interest of the voting shareholders in a manner that allows the controller to impose his or her will on them, should he or she decide to do so (para 46).

Therefore, unless the commercial agreements between the corporation and its controller are the product of an arm's length relationship, they must be considered in determining *de facto* control.

After establishing the test for operation control, the Tax Court found that Mr. Silva had exercised *de facto* control over ADC for the taxation years in issue. Factors that the Tax Court considered included that ADC was dependent on funding from Seawind Corp., ADC did not own the intellectual property rights, and if the Seawind aircraft were to become certified, it would be controlled by Mr. Silva's other company. Overall, Justice Hogan found that ADC was economically dependent on Seawind Corp.

The Tax Court then considered whether ADC fell within the exception in subsection 256(5.1) of the Act. First, ADC and Seawind Corp. were not dealing at arm's length when they entered into the agreement since they were considered to be related persons pursuant to subparagraph 251(2)(b)(ii) of the Act. Second, ADC, Seawind Corp. and Mr. Silva dealt at non-arm's length with one another. Finally, Justice Hogan found that ADC was economically dependent on Seawind Corp. and therefore Mr. Silva:

> [. . .] I suspect Mr. Silva did not require the Appellant to enter into a formal lease because the Appellant was economically dependent on Seawind Corp., a corporation wholly owned by Mr. Silva. Seawind Corp. would have had to fund the lease payments under the terms and conditions of the Development Agreement. This would have been tantamount to Mr. Silva paying rent to himself.
>
> The absence of a lease, however, suggests that the parties envisaged that the Appellant would not operate independently of Seawind Corp. and Mr. Silva. If the Appellant had expected to do so, I believe it would have insisted on a lease to avoid being evicted from its place of business when it secured other business. I suspect that Mr. Silva would also have insisted on a lease based on normal commercial terms. Otherwise, the Canadian Resident Shareholders would have benefited from the rent free arrangement if the Appellant secured new clients. The absence of a lease suggests that the parties were not dealing at arm's length (at paras 68-69).

Thus, ADC was not a CCPC during that time and could not claim SRED RITCs at the 35% rate.

## THE FEDERAL COURT OF APPEAL DECISION

The Federal Court of Appeal upheld the Tax Court decision finding that ADC was not a CCPC and therefore was not entitled to the SRED RITCs at the 35% rate. However, it found that the Tax Court erred in its interpretation of *de facto control* within the meaning of subsection 256(5.1) of the Act.

Gleason J.A. found that certain factors considered by Justice Hogan to find *de facto* control were not the product of a legally enforceable agreement. These include ADC's financial position, the other shareholders' dependence on the viability of ADC and representations made by Mr. Silva in newsletters regarding the integration of ADC with his other companies. Therefore, the Tax Court erred in relying on factors considered irrelevant in *McGillivray* to constitute *de facto* control.

Secondly, the Tax Court also erred in relying on the fact that ADC and Seawind Corp. were related corporations prior to the Development Agreement in August 2009 to determine whether or not ADC and Seawind Corp. were operating at arm's length within the meaning of subsection 256(5.1) of the Act.

However, since the Development Agreement constituted a legally-enforceable agreement, and therefore was a supply agreement within the meaning of subsection 256(5.1) of the Act, Seawind Corp. exercised *de facto* control over ADC. Further, Gleason J.A. found that it was open to the Tax Court to consider whether ADC and Seawind Corp. were operating at arm's length from one another, noting:

> Under paragraph 251(1)(c) of the ITA, the requisite inquiry is entirely factual, and the ability to set the terms of the supply agreement must accordingly be considered in context. In the context of the instant case and in light of ADC's near-total economic dependence on Seawind Corp., the fact that the owner of the latter company dictated (and was able to dictate) the terms of the relationship between the two companies is a very relevant factor in determining whether the three were dealing at arm's length. Even more telling was Mr. Silva's ability to make the two companies disregard the terms of the development agreement — as he decided to do when he unilaterally decided that the 5% mark-up would not be paid to ADC (at para 58).

## ANALYSIS

A corporation who qualifies for CCPC status is eligible for several benefits within the Act. Apart from being eligible to claim the SRED RITCs at the rate of 35%, a CCPC is also entitled to a lower tax rate,

[3] *Aeronautic Development Corp. v. R.*, 2017 TCC 39 (T.C.C. [General Procedure]).

[4] *McGillivray Restaurant Ltd. v. R.*, 2016 FCA 99 (F.C.A.).


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the lifetime capital gains exemption for shareholders, access to allowable business investment losses, special treatment for employee stock options and more time to pay taxes.

Whether or not a corporation qualifies for CCPC status depends on its residence and the control of the corporation. Pursuant to subsection 248(1) of the Act, the definition of a CCPC is set out in subsection 125(7), which states that a CCPC is (1) a private corporation that is (2) a Canadian corporation (3) that is not:

(a) a corporation controlled, directly or indirectly in any manner whatever, by one or more non-resident persons, by one or more public corporations (other than a prescribed venture capital corporation), by one or more corporations described in paragraph (c), or by any combination of them,

(b) a corporation that would, if each share of the capital stock of a corporation that is owned by a non-resident person, by a public corporation (other than a prescribed venture capital corporation), or by a corporation described in paragraph (c) were owned by a particular person, be controlled by the particular person,

(c) a corporation a class of the shares of the capital stock of which is listed on a designated stock exchange, or

(d) in applying subsection (1), paragraphs 87(2)(vv) and (ww) (including, for greater certainty, in applying those paragraphs as provided under paragraph 88(1)(e.2)), the definitions excessive eligible dividend designation, general rate income pool and low rate income pool in subsection 89(1) and subsections 89(4) to (6), (8) to (10) and 249(3.1), a corporation that has made an election under subsection 89(11) and that has not revoked the election under subsection 89(12); (société privée sous contrôle canadien)

The language "controlled, directly or indirectly in any manner whatever" in paragraph (a) denotes *de facto* control. This expression is defined in subsection 256(5.1) of the Act:

> For the purposes of the Act, where the expression "controlled directly or indirectly in any manner whatever," is used, a corporation shall be considered to be so controlled by another corporation, person or group of persons (in this subsection referred to as the "controller") at any time where, at that time, the controller has any direct or indirect influence that, if exercised, would result in control in fact of the corporation, except that, where the corporation and the controller are dealing with each other at arm's length and the influence is derived from a franchise, licence, lease, distribution, supply or management agreement or other similar agreement or arrangement, the main purpose of which is to govern the relationship between the corporation and the controller regarding the manner in which a business carried on by the corporation is to be conducted, the corporation shall not be considered to be controlled, directly or indirectly in any manner whatever, by the controller by reason only of that agreement or arrangement.

In order to have *de facto* control, share ownership is not required. Rather, the "clear right and ability to effect a significant change in the board of directors or powers of the board of directors or to influence in a very direct way the shareholders who would otherwise have the ability to elect" qualifies for *de facto* control.[5] Other factors that will be considered in determining *de facto* control include family influence, financial influence and contractual influence over the corporation.[6] An exception is where the corporation and its controller are dealing at arm's length pursuant to subsection 251(1) of the Act.

The Federal Court of Appeal recently reviewed the meaning of *de facto* control in *McGillivray*. In that case, the court held that a legally binding agreement is required to establish *de facto* control within the meaning of subsection 256(5.1) of the Act:

> A factor that does not include a legally enforceable right and ability to effect a change to the board of directors or its powers, or to exercise influence over the shareholder or shareholders who have that right and ability, ought not to be considered as having the potential to establish de facto control.
>
> An interpretation of subsection 256(5.1) that encompasses "operational" control would import a degree of subjectivity into the de facto analysis that, in my view, would lead to unpredictability, rather than predictability, as mandated by the Canada Trustco interpretative approach. (paras. 48 and 50)

Following this decision, parliament enacted subsection 256(11) to overrule *McGillivray*. Paragraph (b) of this subsection provides that the determination of whether a taxpayer has any direct or indirect influence over a corporation is not limited to "whether the taxpayer has a legally enforceable right or ability to effect a change in the board of directors of the corporation, or its powers, or to exercise influence over the shareholder or shareholders who have that right or ability."

The decision of the Federal Court of Appeal in the present cases provides for greater consistency with *McGillivray* and clarity for taxpayers following the Tax Court of Canada on the role of operational control for determining *de facto* control.

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5 *Silicon Graphics Ltd. v. R.*, 2002 FCA 260 (Fed. C.A.).

6 *Lyrtech RD inc. c. R.*, 2014 FCA 267 (F.C.A.).

## A QUESTION OF INTERPRETATION – *CANADA V. CHEEMA*, 2018 FCA 45

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### INTRODUCTION

On February 27, 2018, the Federal Court of Appeal ("FCA") in *Canada v. Cheema*[1] ("*Cheema*") provided concrete guidelines with respect to the new housing rebate ("NHR") provisions[2] in section 254 of the *Excise Tax Act*[3] ("ETA"). The case is interesting not only for its clarification of the NHR rules. More importantly, *Cheema* warrants discussion because of its thought-provoking debate on the role of statutory interpretation, particularly within the context of analyzing Canada's tax statutes.

1 *Canada v. Cheema*, 2018 FCA 45 (F.C.A.) [*Cheema*].

2 The new housing rebate provisions are provided for at sections 254 to 256.77 of the *Excise Tax Act*, RSC 1985, c E-15. For the purposes of this article, the defined term NHR refers only to the rebate provided for under section 254.

3 *Excise Tax Act*, RSC 1985, c E-15 [ETA].

In order to fully appreciate the analysis in *Cheema*, it is essential to have a fundamental understanding of the NHR. Found in section 254 of the ETA, the NHR regime allows individuals to recover a portion of the GST/HST paid when purchasing a newly constructed or substantially renovated single unit residential complex or residential condominium unit ("residential unit"), provided that certain conditions are met. Subsection 254(2) sets out the conditions to qualify for the federal NHR, as well as the amount of NHR that can be claimed. In simplified terms, subsection 254(2) provides for a rebate where:

1. A residential unit property is "supplied by way of sale" to a "particular individual" (paragraph 254(2)(a));
2. At the time the particular individual assumes liability pursuant to a purchase and sale agreement ("PSA") for the property, the particular individual intends to use the property as the primary residence for him or herself or for a relative (paragraph 254(2)(b));
3. The particular individual has paid all required taxes in respect to the supply (paragraph 254(2)(d));
4. Ownership of the property is transferred to the particular individual after the construction or substantial renovation of the property is substantially completed (paragraph 254(2)(e));
5. The property was not previously occupied and the particular individual or his or her relative is the first person to occupy the property after it is completed (paragraphs 254(2)(f) and (g)); and
6. The purchase price of the property is less than $450,000 (paragraph 254(2)(c)).

For participating provinces, the provincial NHR is payable under section 256.21 of the ETA. In Ontario, the NHR is provided for in section 41 of the *New Harmonized Value-added Tax System Regulations, No. 2*[4] (the "*Regulations*"), which makes available to the individual an additional Ontario NHR if the individual would be entitled to a federal NHR, if subsection 254(2) were read without reference to the purchase price limitation of $450,000. Essentially, the Ontario NHR provides a minimum rebate amount of $24,000 regardless of the purchase price.

## THE PRE-*CHEEMA* DECISIONS

Since the availability of the Ontario NHR is based on whether the individual qualifies for a federal NHR, the interpretation of subsection 254(2) of the ETA has been the subject of numerous tax reassessment appeals. Much of the debate centers on the meaning of the term "particular individual", which is not a defined term. Further complicating matters is the application of subsection 262(3) of the ETA, which provides that where the supply is made to two or more individuals, the term "particular individual" in subsection 254(2) refers to all of those individuals as a group and each of those individuals must satisfy the rebate conditions, but only one of those individuals may apply for NHR (the equivalent provision with respect to the Ontario NHR is found at section 40 of the *Regulations*).

The application of subsection 262(3) creates significant confusion in a situation where a third-party individual (the "third-party") has signed a purchase contract for a residential unit solely for the purpose of assisting another individual (the "true purchaser") to obtain the mortgage necessary to acquire the property. In such cases, is the third party considered a "particular individual" that must also satisfy the requirements of subsection 254(2) in order for the true purchaser to qualify for NHR, even if the third-party never intended to acquire a beneficial interest in the property?

There are a number cases prior to *Cheema* which offer insight with respect to the general judicial attitude on this issue.[5] With few exceptions, the Tax Court of Canada ("TCC") has consistently been of the view that the NHR must be denied where a third party who co-signs a PSA does not meet the rebate conditions. However, there certainly appears to be an underlying sentiment of sympathy. While the taxpayers were unsuccessful in the majority of these prior cases, the courts have indicated a willingness to consider whether some sort of trust, agency or financing arrangement could somehow remove the third party from being categorized as a "particular individual".

In *Rochefort,*[6] a wife and husband signed a PSA but were unable to get a mortgage due to the wife's poor credit rating. Ultimately, title to the property was registered in the name of the husband and a third-party to secure financing. The wife was not on title and it was questioned whether, as a "particular individual", she met the transfer ownership condition under paragraph 254(2)(e). Miller J. found the third party to be a trustee holding the property for the wife and therefore the wife beneficially owned the property in satisfaction of the rebate conditions.

In *Javaid,*[7] Mr. Javaid was in need of a guarantor in order to obtain a mortgage to finance the construction of a new home. The guarantee arrangement required the guarantor to sign the PSA and be on title as co-owner. Mr. Zia, one of the proposed guarantors who was added as a purchaser to the PSA, backed out before the closing and was replaced by someone else. However, the PSA was not amended to reflect the change so that at the time of closing, Mr. Zia remained as a named purchaser under the PSA. The Minister took the position that Mr. Zia was a particular individual and the fact that he backed out of the deal before closing was irrelevant. The TCC, noting that the existence of a trust and agency arrangement between Mr. Javaid and Mr. Zia was clearly evidenced by a written declaration, concluded that Mr. Zia was a mere agent and therefore not a "particular individual".[8] The NHR was available as Mr. Zia did not need to satisfy the rebate conditions. In her closing comments, Woods J. noted the difficulty she had in accepting the notion that an individual who backed out of the arrangement prior to closing was still required to comply with rebate conditions.

While *Javaid* was a significant victory in favour of taxpayers who need assistance in financing the purchase of a new home, the decision in *Malik,*[9] which came out just two days prior to *Javaid*, found

4 *New Harmonized Value-added Tax System Regulations, No. 2*, SOR/2010-151 [*Regulations*].

5 See *Goyer c. R.*, 2010 TCC 511 (T.C.C. [Informal Procedure]); *Sharp v. R.*, 2014 TCC 323 (T.C.C. [Informal Procedure]); *Al-Hossain v. R.*, 2014 TCC 379 (T.C.C. [General Procedure]); *Henao v. R.*, 2015 TCC 81 (T.C.C. [Informal Procedure]) [*Henao*]; *Malik v. R.*, 2015 TCC 83 (T.C.C. [Informal Procedure]) [*Malik*]; *Rochefort v. R.*, 2014 TCC 34 (T.C.C. [Informal Procedure]) [*Rochefort*]; *Javaid v. R.*, 2015 TCC 94 (T.C.C. [Informal Procedure]) [*Javaid*]. It should be noted that these cases were decided under the Informal Procedure at the Tax Court of Canada ("TCC") and may be considered by some to be of limited precedential value.

6 *Rochefort, supra* note 5.

7 *Javaid, supra* note 5.

8 *Ibid.*, at paras 23-25.

9 *Malik, supra* note 5.


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that the taxpayer's uncle who signed the PSA solely to assist the taxpayer in obtaining financing was still considered a "particular individual". It is not clear, post *Javaid* and *Malik*, whether the agency and trust doctrines are to be factored into the NHR rules. Must an agency and trust arrangement be evidenced by writing, as a verbal agreement or understanding was insufficient? To what extent do the sympathies of the particular decision-maker factor into the outcome of the case? There was a clear need for a more consistent approach. And that is where *Cheema* comes in.

## *CHEEMA* — THE OPPOSING VIEWS

In *Cheema*, the taxpayer Mr. Cheema and his friend, Dr. Akbari, both signed a PSA for the construction of a new home. The purchase price for the home was $800,000, so only the Ontario NHR was at issue. The home was intended for Mr. Cheema and his family. It was accepted that Dr. Akbari only signed the PSA to help Mr. Cheema obtain mortgage financing. Dr. Akbari did not pay any part of the purchase price, did not pay for the ongoing expenses and never intended to occupy the house as his primary residence. On closing, Dr. Akbari acquired a 1% interest in the property and signed a trust declaration acknowledging that he was holding this 1% interest in trust for Mr. Cheema and his spouse.

The Minister denied Mr. Cheema the Ontario NHR on the basis that Dr. Akbari did not meet the subsection 254(2) conditions. The TCC allowed Mr. Cheema's appeal. Although the language of subsection 254(2) does not specifically exclude a trust, agency or financial arrangement in the meaning of "particular individual", the Court took note of the well established law that bare trustees should be disregarded for tax purposes. The TCC found Dr. Akbari to be a bare trustee, and as such, Dr. Akbari was not considered a "particular individual" and did not have to meet the rebate conditions for Mr. Cheema to claim NHR.

The Minister appealed the decision of the TCC to the Federal Court of Appeal ("FCA"), which rendered a split decision (2-1). Stratas J.A., writing for the majority, allowed the appeal and ruled that the Ontario NHR was not available.

### The Webb Dissent

The unusual aspect of the *Cheema* decision is the lengthy and forceful dissenting reasons of Webb J.A. and his approach to the interpretation of subsection 254(2). After carefully scrutinizing various provisions of the ETA, Webb J.A. concluded that Dr. Akbari was not considered a "particular individual" under subsection 254(2).

First, Webb J.A. considered the term "recipient". Pursuant to the definition in section 123 of the ETA, "recipient" refers to anyone to whom a supply is made and who is liable to pay consideration for the supply under an agreement for the supply. If the term "recipient" was applicable to paragraph 254(2)(a), then anyone who was liable for the purchase price by signing a PSA would be considered a "particular individual" regardless of whether ownership is transferred to that person.

Webb J.A. found that because paragraph 254(2)(a) requires that a supply be made "by way of sale", the term "recipient" has no application. The word "sale" includes a transfer of ownership or possession of the property.[10] As the language "by way of sale" was specifically used in paragraph 254(2)(a), Webb J.A. concluded that Parliament must have intended that only those who obtain actual ownership or possession of a residential complex can be considered a "particular individual". This interpretation would be consistent with the rebate's objective of benefiting new home buyers.[11]

The analysis then turned to section 133, which deems a supply of property to be made at the time the agreement to provide the property is entered into. The application of section 133 to paragraph 254(2)(a) means that the supply of the residential complex is deemed to occur when the PSA is signed, and therefore whether a person is a particular individual is also determined at that time. Webb J.A. found that section 133 was also not applicable to the NHR provisions for several reasons:

1. Section 133 cannot be reconciled with the other requirements of subsection 254, in particular paragraph 254(2)(e). This paragraph requires ownership of the property to be transferred *after* construction or substantial renovation of the residential complex is substantially completed. However, it is often the case that no building exists yet when the PSA is signed. If a supply is deemed to have occurred when the PSA is entered into, then ownership of property would be transferred *before* the residential complex was substantially completed, not after.[12]
2. If section 133 were applicable, it would deem the builder to have supplied the same residential complex to a new purchaser every time an additional person is added to the PSA. However, there is no provision which removes a person from being considered a "particular individual" if they are removed as a purchaser under the PSA.[13]
3. The determination of entitlement to the NHR is only made once, and entitlement can only arise if ownership is transferred to the particular individual *after* the residential complex is substantially constructed or renovated. If section 133 applies, the determination of who constitutes a "particular individual" would occur when the PSA is signed, at a time when there can be no entitlement to the NHR.[14]

Webb J.A. concurred with the TCC that Dr. Akbari was a bare trustee, and that "there is no apparent reason to depart from the general principle that bare trusts will be ignored for the purposes of the ETA".[15] Justice Webb suggests that a supply should refer only to a transfer of beneficial ownership, as the purpose of the NHR is presumably to benefit the beneficial purchasers of new houses.[16]

Based on the above analysis, Justice Webb concluded that a person who signs a PSA but does not acquire a beneficial interest in the residential complex will not be considered a "particular individual". In this present case, this meant that Dr. Akbari was not a particular individual and the NHR would be available to Mr. Cheema.

### The Stratas Response

With respect to the phrase "supply by way of sale", Stratas J.A. was of the view that the words "by way of sale" were used only to

[10] ETA, *supra* note 3, s 123.

[11] *Cheema, supra* note 1 at paras 32-38.
[12] *Ibid.,* at para 48.
[13] *Ibid.,* at para 53.
[14] *Ibid.,* at para 54.
[15] *Ibid.,* at para 61.
[16] *Ibid.*

distinguish and exclude other forms of supply such as rentals and leases — it did not import the requirement of a transfer of ownership or possession into the initial determination of whether a person was a particular individual.[17] Further, he rejected the proposition that a "supply" in paragraph 254(2)(a) referred to a transfer of beneficial ownership. Such an interpretation would extend the availability of the NHR to non-relatives, a result which is "clearly not intended by the rebate scheme".[18]

Justice Stratas concluded that section 133 was applicable and was not displaced by the word "sale" in paragraph 254(2)(a). Given the frequency with which the phrase "supply by way of sale" was used in the ETA, Parliament would have introduced specific language had it intended for the phrase "supply by way of sale" to be immune from the deeming effects of section 133.[19] Neither was section 133 irreconcilable with paragraph 254(2)(e): section 133 is a deeming provision creating a fictional supply, whereas paragraph 254(2)(e) refers to an actual supply of property.[20] There is no ambiguity in the language in paragraph 254(2)(a) as to when a supply occurs for the purpose of identifying "particular individuals". It is deemed by section 133 to occur at the time the PSA is entered into.

Based on the above analysis, Dr. Akbari became a particular individual to whom a supply was made when he signed the PSA. He had to meet the NHR conditions in order for Mr. Cheema to be eligible for the NHR. Dr. Akbari failed to meet the condition in paragraph 254(2)(b) as he had no intention to occupy the property as his primary residence, therefore, the NHR was unavailable.

Stratas J.A. concluded that the doctrine of bare trustee was irrelevant in the analysis of subsection 254(2). In addition to the fact that the provisions of subsection 254(2) provide no exceptions for agents and trustees, paragraph 254(2)(b) is clear that a purchaser's intended use of the property is assessed at the time he or she assumes liability under a PSA. Thus, the paragraph considers the relationship of the purchaser to the builder; it does not take into account the relationship between co-purchasers. Any trust or agency arrangement between co-purchasers is extraneous to the analysis.[21]

## THE RULES OF STATUTORY INTERPRETATION

### General Guiding Principles of Statutory Interpretation

It would appear that the contrasting conclusions of Justice Webb and Justice Stratas are shaped by their different approaches to the statutory interpretation of subsection 254(2). The starting point for Justice Webb was the legislative intent behind the NHR provisions. As he noted, denying the NHR to individuals such as Mr. Cheema would be contrary to Parliament's stated purpose of ensuring that GST did not pose a barrier to affordable housing. This consideration informed the remainder of Justice Webb's analysis.

Stratas J.A., on the other hand, considered the rules of statutory interpretation at length. He noted that the correct approach is to objectively examine the text, context and purpose of the provision, as distinguished from a result-oriented approach aimed at reaching a sensible, practical and common sense outcome. The latter approach inappropriately permits judges to interpret legislation in a way that accords with their own particular subjective views. While judges may support the purpose behind the NHR, they cannot stretch the meaning of the language beyond the authentic meaning of the relevant sections as can be derived from a textual, contextual and purposive analysis.[22] Further, taxation statutes invite a largely textual interpretation. Where the language is clear and precise, the interpretation of those provisions should not be result-oriented and should accord with the ordinary meaning of the words and must be constrained by the specific language used.[23] Applying these principles, Stratas J.A. took a predominantly textual approach to the interpretation of subsection 254(2).

It is well established today that the proper approach is the modern purposive approach formulated by Elmer A. Dredger — that,

> [T]he words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.[24]

This holistic approach ousted the traditional "plain meaning rule" of statutory interpretation, which propounded a strictly textual approach.

The plain meaning rule held that where the words of the statute are clear, they must be given their plain, ordinary and literal meaning, even if legislative intention or practical considerations suggested otherwise. Courts could only consider extrinsic interpretive aids such as the purpose, consequences, and contextual background of the provision if the text was ambiguous and there was something to suggest that the meaning of the words differed from its plain meaning. Theoretically, the appeal of the plain meaning rule was that it created certainty in the meaning of the law, such that people can rely on the text of the statute and take comfort in knowing that the law means exactly what it says. Further, it provided for judicial neutrality, so that the application of the law would not be coloured by the decision-maker's personal partialities.

Despite its promise of clarity, neutrality and certainty, the plain meaning rule was heavily criticized not only in Canada, but also in England and the US. The principle failing of the plain meaning rule, as discussed by Gonthier J. in *2747-3174 Québec Inc. c. Québec (Régie des permis d'alcool),*[25] was the fallacious assumption that words have a plain, ordinary meaning apart from its context. This assumption failed to account for the ambiguities naturally inherent in language. Furthermore, the determination of whether the text of a statute is clear and unambiguous at the outset of this approach already involves "an implicit process of legal interpretation" on the basis of a concealed underlying premise: the understanding of the plain meaning of simple texts is influenced by the interpreter's own context, such as his or her upbringing, social status, and generational biases. Thus, rather than enhancing certainty in the law, the plain meaning rule was criticized as being irresponsible, allowing decisions to be based on an arbitrarily preferred meaning rather than a thoughtful analysis of reason and principle.[26]

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[17] *Ibid.,* at para 101.
[18] *Ibid.,* at paras 103-104.
[19] *Ibid.,* at para 101
[20] *Ibid*.
[21] *Ibid.,* at para 94.
[22] *Ibid.,* at paras 74, 77-80.
[23] *Ibid.,* at paras 81-83.
[24] Elmer A. Driedger, *Construction of Statutes*, 2d ed (Toronto: Butterworths, 1983) at p 87.
[25] *2747-3174 Québec Inc. c. Québec (Régie des permis d'alcool)*, [1996] 3 S.C.R. 919 (S.C.C.).
[26] *Ibid.,* at paras 153-158.


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In *Rizzo & Rizzo Shoes Ltd., Re* [27] (as well as numerous other decisions in varying contexts) the Supreme Court of Canada ("SCC") endorsed Dreidger's modern purposive approach as the preferred approach to statutory interpretation in numerous decisions. The importance of context was further emphasized in the SCC decision *Bell ExpressVu Ltd. Partnership v. Rex*.[28] Since *Rizzo* and *Bell ExpressVu,* the following guiding principles have emerged:

1. In every case, the court must first undertake the modern purposive approach set out by Dreidger to determine the intent and purpose of the legislation.
2. Determine whether the words are genuinely ambiguous, in the sense that the provision must be reasonably capable of more than one plausible, meaning, and each alternative interpretation must be equally in accordance with the intentions of the statute.
3. Other principles of interpretation, such as the strict construction of penal statutes, may only be applied if it is determined that there is a genuine ambiguity in the meaning of the provision.

As noted in *Rizzo*, it remains a well-established principle of statutory interpretation that the legislature does not intend to produce absurd results.[29] A result may be considered absurd if it is extremely unreasonable or inequitable, illogical or incoherent, leads to ridiculous or frivolous consequences, or is incompatible with other provisions or with the object of the legislative enactment.[30]

### The Special Considerations in Interpreting Tax Statutes

The rules regarding the interpretation of Canadian tax legislation shifted in a similar way. For many years, the text of tax legislation was to be strictly construed. An ambiguity in a taxing provision was resolved in the taxpayer's favor, whereas an ambiguity in an exempting provision was resolved in favor of the Crown. In 1984, the SCC in *Stubart Investments Ltd. v. R.*[31] held that the strict approach to interpreting tax legislation was no longer the appropriate test, and that Driedger's purposive approach should be applied. The *Stubart* decision predated *Rizzo* by over a decade.

The SCC has made it clear that the general guiding principles of statutory interpretation is applicable to all statutes, including the ETA and the *Income Tax Act*[32] ("ITA"). Nevertheless, courts have adopted the purposive approach with some reservation in tax cases. In *Ottawa Air Cargo Centre Ltd. v. R.,*[33] Justice Lamarre (as she then was) cautioned that the judiciary must not usurp the role of Parliament and step into the shoes of the legislature.[34] In *Shell Canada Ltd. v. R.,*[35] McLachlin J. reiterated that "[f]inding unexpressed legislative intentions under the guise of purposive interpretation runs the risk of upsetting the balance Parliament has attempted to strike in the Act."[36]

Particular considerations must be taken into account in the interpretation of tax statutes, given their distinctive nature. These considerations were discussed in *Canada Trustco Mortgage Co. v. R.,*[37] which addressed the application of the general anti-avoidance rules ("GAAR") in the ITA. The SCC noted that the ITA was a complicated instrument dominated by specific, detailed and explicit provisions intended to result in specific consequences.[38] The goal of achieving consistency, predictability and fairness in the application of the ITA is especially important so that taxpayers may intelligently engage in tax planning.[39] The SCC cited P. W. Hogg and J. E. Magee: "It would introduce intolerable uncertainty into the Income Tax Act if clear language in a detailed provision of the Act were to be qualified by unexpressed exceptions derived from a court's view of the object and purpose of the provision."[40]

The degree of precision and detail contained within tax statutes have led courts to place a greater emphasis on a textual interpretation of its provisions. As summarized in *Canada Trustco*: "When the words of a provision are precise and unequivocal, the ordinary meaning of the words play a dominant role in the interpretive process."[41]

Interestingly, the comments and concerns discussed above seem to mirror the same considerations and theoretical advantages that favored the plain meaning rule. Is the SCC's emphasis on the dominant role of textual analysis suggesting a reversion away from the purposive approach and back to the strict construction or plain meaning approach to statutory interpretation? It's unlikely, given that the problems with a purely textual interpretation based on the ordinary meaning of words in a statute have already been thoroughly canvassed and debated. After having definitively endorsed the application of the purposive approach to all statutes of Canada, the SCC could not have intended to displace its application to tax statutes. Hence, the above comments should be understood as simply informing the manner with which the purposive approach should be applied in the interpretation of tax statutes.

So how can the two sets of interpretive guidelines be reconciled? First, while a precise and clearly worded provision may invite a predominantly textual interpretation, this is but one factor in the analysis. The first step will still require the court to consider the textual, contextual and purposive approach in order to determine the intent and purpose of the legislation. As stated in *Canada Trustco*, the context and purpose of a statute may reveal latent ambiguities even if the provision does not appear to be ambiguous at first glance.[42] Thus, whether the language of a provision is clear, specific and precise speaks merely to the weight that should be accorded to its textual interpretation.

As above, the second step is to determine whether there is a genuine ambiguity in the language of the provision.

Third, where the provision is found to be ambiguous, its textual interpretation plays a lesser role.[43] However, the court may con-

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27 *Rizzo & Rizzo Shoes Ltd., Re*, [1998] 1 S.C.R. 27 (S.C.C.) [*Rizzo*].
28 *Bell ExpressVu Ltd. Partnership v. Rex*, 2002 SCC 42 (S.C.C.) [*Bell ExpressVu*].
29 *Rizzo, supra* note 27 at para 27.
30 *Ibid*.
31 *Stubart Investments Ltd. v. R.*, [1984] 1 S.C.R. 536 (S.C.C.).
32 *Income Tax Act,* RSC, 1985 c 1 (5th Supp) [ITA].
33 *Ottawa Air Cargo Centre Ltd. v. R.*, 2007 TCC 193 (T.C.C. [General Procedure]).
34 *Ibid.,* at para 14.
35 *Shell Canada Ltd. v. R.*, [1999] 3 S.C.R. 622 (S.C.C.).
36 *Ibid.,* at para 43.
37 *Canada Trustco Mortgage Co. v. R.*, 2005 SCC 54 (S.C.C.) [*Canada Trustco*].
38 *Ibid.,* at para 13.
39 *Ibid.,* at para 12.
40 *Ibid.,* citing Peter W. Hogg and Joanne E. Magee, *Principles of Canadian Income Tax Law* (Scarborough, Ontario: Carswell, 1997), pp. 475-76.
41 *Canada Trustco, supra* note 37 at para 10; see also *Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*, 2006 SCC 20 (S.C.C.) at para 32 [*Placer*].
42 *Ibid.,* at para 47.
43 *Placer, supra* note 41 at para 22.

sider the other articulated considerations at this stage such as whether the interpretation encourages consistency, predictability and fairness, introduces intolerable uncertainty into the tax statute, leads to absurd results, and whether (as suggested by Stratas J.A.) the interpretation favors administrative efficiency.[44]

### Application to *Cheema*

While Justices Webb and Stratas do refer to a number of cases with regard to the rules of statutory interpretation, their analysis are in slight deviation from the general guidelines outlined in *Rizzo* and *Bell ExpressVu*. Justice Webb focuses on the purpose and intent of the NHR provisions, without comparison to the meaning of the provision as supported by a textual analysis. In contrast, Justice Stratas formulates his analysis on the basis that the wording of subsection 254(2) is clear and precise. Therefore, he engages a predominantly textual interpretation.

In a case such as this where Parliament has expressly identified its intention and purpose in enacting the NHR provisions, it seems incongruous to accord the textual meaning with greater weight than the contextual and purposive interpretations. It is clear from the *Explanatory Notes*[45] that the NHR provisions are intended to provide tax relief to purchasers of new or substantially renovated residential units who intend to use the unit as their own, or their relatives', primary place of residence. The NHR is not intended to benefit those who acquire residential units as investment or recreational properties.[46]

The motivation behind providing this tax relief is to ensure that tax does not pose a barrier to affordable housing.[47] As noted by Parliament, while new homes are not taxed directly, a substantial amount of sales tax is hidden in housing prices. This is a result of the sales tax applied on the inputs to the construction or renovation of a new home, for which suppliers may claim an input tax credit and pass the tax burden down the chain to the final consumer.[48] Thus, the NHR provides tax relief to those who bear the sales tax burden buried within the purchase price of the new home.

From the writer's perspective, the *Cheema* case actually raises two distinct questions of interpretation: (i) whether the term "particular individual" should be interpreted to exclude those who sign the PSA as a mere agent or bare trustee for a co-purchaser, or whether it broadly and generally includes anyone that signs a PSA; and (ii) whether the appropriate time to determine if a person is a "particular individual" should be at the time the PSA is signed, or at the time of closing.

#### *i. Should agents and bare trustees be excluded from being a "particular individual"?*

With respect to the first question, the legislature's comments in the *Explanatory Notes* reveal that the NHR in section 254 was targeted towards specific persons who bear a specific tax burden. However, in enacting paragraph 254(2)(a), Parliament's focus was on the type of transaction that is covered by the NHR.[49] The *Explanatory Notes* do not indicate how to determine who is a "particular individual", nor how Parliament intends to treat third-parties who sign a PSA merely to assist the true purchaser in obtaining financing for the purchase.

While the language used in subsection 254(2) is clear and precise, it is not apparent that the text reveals any intention that is contrary or in addition to Parliament's expressed purpose and intent in enacting the provision.[50] That Parliament did not provide a specific exception for agents and bare trustees in paragraph 254(2)(a) is likely indicative that in drafting the NHR provisions, Parliament did not turn its attention to the question of whether agents and bare trustees can also be considered to be "particular individuals".

Neither Justices Webb or Stratas specifically considered the question of whether there was a genuine ambiguity as to the definition of a "particular individual". Stratas J.A. simply concluded that the text was sufficiently clear, looked to the wording in paragraph 254(2)(a), and determined that Dr. Akbari was a "particular person" as he was a purchaser of the complex. Webb J.A., on the other hand, proceeded directly to the analysis of why one interpretation should be favored over another.

In light of the legislative purpose behind the NHR provisions and the specific persons that the NHR was intended for, as discussed above, there does not appear to be a genuine ambiguity in this case. Excluding agents and bare trustees from the definition of a "particular individual" is consistent with Parliament's intention to provide tax relief to those who purchase new homes for use as a primary place of residence and who pay for the built-in sales tax on such purchase. If agents and bare trustees such as Dr. Akbari were also particular individuals, then true purchasers such as Mr. Cheema will be denied the tax relief, even though they bear the entire burden of the hidden sales tax on new homes. The NHR would be denied to those persons who are most affected by the tax barrier to affordable housing. Thus, the textual interpretation of "particular individual", which would include anyone to whom a taxable supply is made without exclusion, is inconsistent with the legislative intention. A genuine ambiguity does not exist and as a result, the interpretation that excludes agents and bare trustees from the definition of a "particular individual" should be preferred.[51]

The conclusion that agents and bare trustees are to be excluded from the definition of a "particular individual" would have been sufficient on its own to make the NHR available to Mr. Cheema. However, Webb J.A. went further to discuss the meaning of "recipient", "sale" and section 133.

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44 *Cheema, supra* note 1 at para 110.

45 Canada, Minister of Finance, *Goods and Services Tax — Explanatory Notes to Bill C-62 as passed by the House of Commons on April 10, 1990* (Department of Finance) (issued by the Honorable Michael H. Wilson) [*Explanatory Notes*].

46 *Ibid.*, p 125.

47 *Ibid.*, p 124.

48 *Ibid.*, pp 123-124.

49 *Ibid.*, pp 124-125.

50 With respect to Justice Stratas' statement that the agency or bare trustee relationship between co-purchasers is extrinsic to the determination of a particular individual's intended use of property, this statement refers to paragraph 254(2)(b) and has no relevance here. The determination of "particular individual" focuses solely on the analysis of paragraph 254(2)(a) and the preliminary question of whether a supply can be made to a bare trustee or agent at all.

51 Justice Stratas highlighted the concern that this interpretation would grant the NHR to third parties who pay the purchase price and hold the property as bare trustee for someone else without intending to reside in the property themselves. In the view of the writer, this concern can be addressed by adding a requirement to the effect of only permitting the exclusion for agents and bare trustees where the agent or bare trustee does not pay, directly or indirectly, any portion of the purchase price.


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### *ii. When is the appropriate time to determine if a person is a "particular individual"?*

The contextual and purposive background of section 254 does not provide any insight as to the intention of Parliament with respect to this specific question. Thus, the textual interpretation favored by Stratas J.A. as derived from a plain reading of the statutory language has a dominant role. In this case, the words of paragraph 254(2)(a) indicate that the intention is for the determination to be made at the time the taxable supply is made. Pursuant to section 133, this would be at the time the PSA is entered into. It is clear that section 133 is applicable — the preamble of section 133 indicates that it applies to the entirety of Part IX, under which section 254 falls.

The analysis undertaken by Webb J.A. was likely targeted at addressing an absurdity that results from this textual interpretation. If a person is determined to be a particular individual at the time of signing a PSA, then the withdrawal of that person from the purchase prior to the actual transfer of ownership at closing is irrelevant. The text of the statute does not stipulate when a person would no longer be considered a particular individual. Thus, the textual interpretation would support an absurd result where persons may only be deemed to be particular individuals, but can never cease to be one, even if they are ultimately not a purchaser of the property. The NHR would consequently be denied where the only purchaser who acquires the property at the time of closing meets all of the conditions in subsection 254(2), solely because a third party who backed out of the deal and did not meet the NHR conditions had previously signed the PSA. This would not accord with the broader intent and purpose of the NHR scheme.

This begs the question of how far one should look with respect to the relevant intent of Parliament. If the intent to be considered is the specific intent as to the appropriate time to determine who constitutes a "particular individual", this analysis does not proceed past the second step — the textual analysis clearly supports one interpretation over the other and there is therefore no genuine ambiguity. On the other hand, if the appropriate intent refers to the overarching intent of Parliament in enacting the NHR provisions as a whole, then arguably Justice Webb's interpretation accords with legislative intention while Justice Stratas' interpretation does not.

Taking into account the reservations of the SCC as discussed above, it is likely that the more specific intention is to be considered. Reference to the broader intent of Parliament arms the court with a greater ability to interpret statute in a liberal manner in order to achieve a desired result, and runs the risk of introducing unexpressed intentions of Parliament and overstepping the boundary into the legislative branch of government. Reference should be made to the SCC's comments in *Canada Trustco*:

> The courts cannot search for an overriding policy of the Act that is not based on a unified, textual, contextual and purposive interpretation of the specific provisions in issue. First, such a search is incompatible with the roles of reviewing judges... To send the courts on the search for some overarching policy and then to use such a policy to override the wording of the provisions of the Income Tax Act would inappropriately place the formulation of taxation policy in the hands of the judiciary, requiring judges to perform a task to which they are unaccustomed and for which they are not equipped.[52]

Furthermore, while the interpretation favoured by Webb J.A. is one which more closely accords with the intent and purpose of the NHR scheme as a whole, the extensive analysis by which Webb J.A. arrived at his conclusion would involve a significant alteration in the interpretation and application of certain sections and defined terms in the ETA that is not evident and, on the face of it, appears contradictory to the express language used in the Act.

## THE CONSEQUENCES OF *CHEEMA*

On the basis of the above discussion, it is possible that an analysis undertaken with stricter adherence to the general guiding principles of statutory interpretation may have yielded a different result in favour of Mr. Cheema. However, as it stands now, the decision of Stratas J.A. is the law.

The *Cheema* decision leaves definite gaps in the NHR rules. As discussed, a textual interpretation which does not provide an exclusion for agents or bare trustees leads to a denial of the NHR to the very persons for whom the NHR was intended to benefit, and may also lead to absurd consequences in practice. The *Cheema* decision effectively reverses *Javaid*. Applying the decision of Stratas J.A., the third party in *Javaid*, Mr. Zia, would be determined to be a particular individual as soon as he signed the PSA. As there is no exception for an agent or bare trustee, the NHR would not be available because Mr. Zia does not meet the rebate conditions, even though he had backed out of the deal prior to closing and was no longer a purchaser.

Further, the textual interpretation does not recognize or reflect the realities of a property purchase transaction. Often, as noted in passing by the Court in *Henao,*[53] it is the bank that requires an assisting third party to become a co-signor to the PSA. Simply guaranteeing the mortgage may not be enough to satisfy the lender.

The efforts of Webb J.A. to address these gaps are admirable and there is much merit to his dissent. However, as a final point, it is worth reiterating the closing comments of Justice Stratas: "if. . . Parliament intended the result favoured by my colleague, it can amend section 254 to make that clear."[54] This comment mirrors the views expressed in GAAR decisions — that it would be inappropriate to utilize the GAAR provisions to fill in legislative gaps left by Parliament. While the context of GAAR cases is unique, this comment has some bearing in the present case in the sense that there is a limit to how far statutory interpretation goes. Certainly, statutory interpretation is a judicial tool that may be used to address gaps in the law. However, there may be a point where the gap becomes too big — where remedying the issue would necessitate a convoluted analysis which stretches and alters the meaning of certain provisions, or introduces an unacceptable level of confusion and uncertainty into the statute — and in such cases the judiciary must step back and leave the matter for Parliament to resolve.

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[52] *Canada Trustco, supra* note 37 at para 41.
[53] *Henao, supra* note 5.
[54] *Cheema, supra* note 1 at para 112.

## *LE v. QUEEN*: INCORPORATOR NOT DIRECTOR

By Pritika Deepak, Student-at-law, Miller Thomson LLP Toronto

In *Le v. Queen*, the Tax Court of Canada (the "TCC") recently ruled in favour of a taxpayer and set aside three directors' liability assessments by the Minister of National Revenue ("MNR"). The main issue in this case is whether an individual, cited in the Articles of Incorporation as an 'incorporator' is a *de jure* or *de facto* director and therefore liable for unpaid taxes under subsection 227.1 of the *Income Tax Act* ("ITA") and subsection 323(1) of the *Excise Tax Act* ("ETA").

### FACTS

In 2006, Khanh Thi Le (the "Appellant"), the owner of several beauty salons located in North Vancouver decided to partner with one of her long-time employees, Dang Thanh Landry ("Ms. Landry") to purchase another salon in Langley (the "Langley Salon"). The Appellant was not fluent in English and permitted Ms. Landry's husband, E. Landry ("Mr. Landry"), a non-lawyer, to carry out the necessary paper work.

In early 2007, 0780221 B.C. Ltd (the "Corporation") was incorporated with the Appellant and Mr. Landry listed as the incorporator. In addition, a partnership agreement (the "Agreement") was executed by the Appellant and Mr. Landry's existing corporation, EKO Consulting And Appraisal Services Ltd. ("EKO"). Several provisions of the Agreement conflated the concepts of a partnership and a corporation. The Agreement provided that the salon is "the sole ownership of partner Khanh Le" who was entitled to 50% of the profits and losses and who would provide an initial contribution of $20,000 through beauty supplies. The Appellant signed the Agreement above a line titled "Director" with no explanation of the term or relevance of its meaning as used in the Agreement.

The Langley Salon began operating in 2007 with Mr. Landry running the business. When the Appellant visited the Langley Salon in 2009 and noticed that Mr. Landry was changing the interiors of the salon, she immediately notified him that she wanted to terminate the partnership. By May 2009, the Appellant's interest in the business was transferred to EKO.

During the course of the partnership between the Appellant and EKO, there were no director meetings and the Appellant never signed anything as a director, other than the Agreement itself.

The CRA sent a letter to the Appellant in 2013 notifying her of the Corporation's delinquent remittances of source deductions and net GST. The Appellant was advised to submit a director's resignation to the B.C. Registry Services effective May 2009, when she sold her interest in the business to EKO.

On May 23, 2014, the Appellant was assessed for unremitted net GST totalling $35,659 for the reporting periods from 2007 to 2011 under s. 323 of the ETA. She was also assessed for unremitted source deductions totalling $15,675 under s. 227.1 of the ITA for the reporting years 2007, 2008 and 2009. The Appellant appealed both assessments.

### TCC DECISION

B. Russell J. set aside the director's liability assessments, finding that the Appellant was neither a *de jure* nor *de facto* director of the Corporation for the relevant reporting periods.

### *DE JURE* DIRECTOR

Considering the relevant provisions of the *Business Corporations Act* of British Columbia ("BCA"), the TCC held that the Appellant did not meet the standards of a *de jure* director.

The BCA defines a 'first director' as an individual designated as a director of a company on the notice of articles that applies to the company when it is recognized under the BCA. Section 121 of the BCA further states that no such designation is valid unless the designated individual is either (i) an incorporator who signed the articles or (ii) an individual who consents to be a director of the company under section 123 of the BCA.

The TCC explained that a major element of the BCA that was missing was a valid incorporation agreement, which, as per subsection 10(2) requires a statement as to 'the number of shares of each class and series of shares being taken by that incorporator'. There was no evidence or references in the Agreement that any shares were taken by any of the two incorporators. The TCC states that the inadequate information demonstrates that there was no 'actual incorporation agreement', which statutorily leads to the conclusion that the Appellant was not an 'incorporator' as defined in the BCA.

Section 123 of the BCA requires an individual to provide consent to be a director of a company either in writing or by performing functions of, or realizing benefits exclusively available to, a director of the company. The TCC found that no form of consent was established.

Having the Appellant sign her name over the designation of 'Director' was insufficient to establish consent as no context or explanation was provided for the designation. Given that the Appellant was neither an incorporator nor an individual who consented to be a director, the TCC deemed that she was not a *de jure* director of the Corporation.

### *DE FACTO* DIRECTOR

In rejecting the CRA's position that the Appellant was a *de facto* director, the TCC noted that the concept of *de facto* director should be limited to persons who hold themselves out as directors. Particularly, a person should not be considered a *de facto* director if the person did not believe he or she was a director and never thought he or she had any authority to advise, influence or control the management or direction of the company. Based on the fact that the Appellant never held herself out as a director of the Corporation, despite being registered as a director on the B.C. Registry, and never having engaged in any acts of management, the TCC found she was not a *de facto* director of the Corporation.

### CONCLUSION

In setting aside the director's liability assessments in their judgement, the TCC has confirmed the importance of substance over form when determining which individual can be held liable as a director for unremitted taxes.


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