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Canada – TaxMatters@EY

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Building a better working world means understanding your tax situation and how the ever-changing global tax landscape affects you. TaxMatters@EY is a monthly Canadian bulletin that summarizes recent tax news, case developments, publications and more.For more information, please contact your EY advisor.

TFSAs: CRA compliance initiative continues

Krista Fox and Maureen De Lisser, Toronto

Since their introduction in 2009, tax-free savings accounts (TFSAs) have proven to be a popular vehicle through which individuals can benefit from the tax-free growth of investment savings. In some cases, individuals have seen significant growth in the value of their TFSAs, far beyond the maximum allowable yearly contributions.

This significant growth in a TFSA's value has not gone unnoticed by the Canada Revenue Agency (CRA), which has been stepping up its compliance reviews of TFSAs in recent years.[1]

Background

A TFSA is an arrangement between an issuer and an account holder under which the holder makes contributions to the account, and the issuer makes distributions (or payments) from the account to the holder. To be considered a TFSA, the arrangement must meet a number of requirements.

A Canadian-resident individual aged 18 or older can open and make contributions to a TFSA, up to the individual's available TFSA contribution room limit each year. Unused contribution room can be used in a subsequent year.

1 See EY Tax Alert 2015-13, CRA targeting TFSAs for audit.

Building a better working world

Unlike contributions made to an RRSP, contributions made to a TFSA are not deductible. However, income and capital gains earned in the TFSA are not subject to tax when withdrawn. Withdrawals can be made at any time and used for any purpose. In addition, amounts withdrawn from a TFSA (including income and capital gains earned in the TFSA) are added to the individual's contribution room in the following year.

An individual may hold more than one TFSA at a time, but the total amount the individual may contribute to all TFSAs in any year is restricted to the TFSA dollar limit for that year plus various amounts, including unused contribution room from previous years.

There are very specific rules that govern contributions, re-contributions of funds withdrawn and the type of investments that can be held in a TFSA. Penalty taxes may be imposed on excess TFSA contributions, on contributions made by nonresidents, for holding non-qualified or prohibited investments in a TFSA, and on the accrual of certain benefits or advantages from a TFSA.

Excess TFSA contributions

In very general terms, the maximum TFSA contribution room available to an individual is the sum of three amounts:

1. The annual TFSA dollar limit (currently $5,500[2])
2. The cumulative unused TFSA contribution room from a previous year
3. The total amount of withdrawals made from the TFSA in the previous year

If an individual overcontributes to a TFSA in a given year by exceeding the maximum contribution room, a penalty tax of 1% per month is applied to the individual's excess TFSA amount. It is particularly important to note that if an individual has no contribution room available for a year and an amount is withdrawn from the individual's TFSA and re-contributed to a TFSA in the same year, the penalty tax will apply. Certain qualifying transfers and exempt contributions will not result in an excess TFSA amount.[3]

In CRA document 2015-0599851I7, the CRA indicated it was looking to change the assessment process associated with excess TFSA contributions, starting in 2016. The CRA has since implemented the proposed changes. Under the new assessment process, if the CRA determines that an individual has exceeded their TFSA contribution limit for the first time, the individual is sent either a warning letter or Form RC243-P, *Proposed Tax-Free Savings Account (TFSA) return*, or both.

Form RC243-P, which is not a formal assessment of tax, shows the amount of tax due according to the CRA. If an individual has removed the excess TFSA amount prior to receiving the letter, no further action is required by the individual. Otherwise, if an individual has not removed the excess, the CRA advises that they should do so immediately, and indicates that the individual has two options:

- Return Form RC243-P (signed and dated) and pay the amount of tax determined by the CRA; or
- Send a letter requesting a review, including any additional documentation or proof that the excess TFSA amount has been corrected.

The CRA will review the request and inform the individual of its decision. If the individual fails to respond, the CRA will issue an automatic assessment of tax on the excess contributions, including any applicable penalties and interest. Individuals assessed for excess TFSA contributions in prior years who failed to remove the excess amounts are also subject to an automatic assessment.

Individuals finding themselves in this situation can apply for a waiver of the TFSA excess contribution penalty tax by submitting a written request outlining why the excess contributions were made, how the excess contributions were due to a reasonable error, and what steps have been, or are being, taken to eliminate the excess contributions. Supporting documents (e.g., copies of TFSA account statements that identify the date the excess contributions were withdrawn, and any other correspondence that shows that the excess contributions arose due to a reasonable error) should be included with the letter.

Individuals exceeding their maximum TFSA contribution room limits should address the situation immediately since the penalty tax is calculated monthly, using the highest excess TFSA amount for that month. The 1% tax continues to apply for each month the excess amount remains in the account (i.e., until it is withdrawn or is eliminated through the addition of contribution room in a subsequent year).

In addition, the tax on excess TFSA contributions differs from the 1%-per-month tax on excess RRSP contributions,[4] in that there is no grace amount; the 1% tax on excess TFSA amounts applies from the first $1 of excess contributions.

2 The annual TFSA dollar limits are as follows: $5,000 in 2009, 2010, 2011 and 2012; $5,500 in 2013 and 2014; $10,000 in 2015; and $5,500 in 2016 and 2017. The cumulative total contribution limit up to 2017 is $52,000.

3 A qualifying transfer includes a direct transfer between two TFSAs held by the same individual, or a direct transfer from an individual's TFSA to a TFSA of the individual's current or former spouse or common-law partner if the transfer is made under the terms of a written separation agreement or a decree or order of a court or tribunal and they are living separate and apart at the time of the transfer. An exempt contribution is a contribution of an amount that an individual has received (as a beneficiary) from the TFSA of a deceased spouse or common-law partner, subject to a defined rollover period and the requirement for the surviving spouse or common-law partner to designate the payment as an exempt contribution.

4 Individuals can currently over-contribute up to $2,000 (cumulative lifetime limit) to an RRSP without any penalty.

Carrying on a business in a TFSA

The CRA has also stepped up its compliance initiative known as the TFSA Audit Project. One aspect of the TFSA Audit Project targets TFSA accounts that are being used to frequently trade securities, known as day trading, resulting in large gains being realized within the TFSA. The CRA takes the position that day trading in a TFSA amounts to carrying on a trading business by the TFSA, and therefore the income from that business is subject to tax.

An important distinction between RRSPs and TFSAs is the tax treatment of business income earned within the plan. The rules applicable to RRSPs specifically exempt income earned from, or on the disposition of, qualified investments held in the RRSP from being taxed as business income. This essentially means that as long as an RRSP's trading activities are restricted to buying and selling qualified investments, the RRSP can be carrying on a day trading business without attracting any tax on the resulting income.

Under the TFSA rules, if a TFSA is carrying on one or more businesses, tax must be paid on that business income. Unlike the RRSP rules, there is no exception for qualified investments bought and sold by a TFSA. This means that if the CRA is successful in arguing an individual is carrying on a business through the TFSA as a result of the level of trading activity, any income the TFSA earns resulting from this activity would be subject to regular (Part I) income tax. The tax is imposed on the TFSA trust, rather than the holder of the TFSA, and is therefore paid out of the TFSA assets.

STEP conference

During the 2017 Society of Trust and Estate Practitioners (STEP) conference, the CRA was asked for an update on the TFSA Audit Project and what the project's objectives were going forward. The CRA responded that more than $75 million in additional taxes has been reassessed as a result of the audits, and that it is "committed to maintaining a compliance presence on high-risk TFSA transactions."

There are currently no specific guidelines on what constitutes carrying on business in a TFSA. The CRA was also asked if it intended to provide information on what the acceptable limits are on securities trading in order to prevent a TFSA account from being considered to be carrying on a business. The CRA responded that it would not be providing any additional guidance specifically in relation to TFSAs because there was nothing unique about TFSAs in the context of securities trading. The CRA referred instead to Interpretation Bulletin IT-479R, Transactions in Securities, which sets out the following factors that are relevant in determining whether an individual is carrying on a business of securities trading:

- Frequency of transactions
- Period of ownership
- Knowledge of securities markets
- Security transactions forming a part of the taxpayer's ordinary business
- Time spent studying the securities markets and investigating potential purchases
- Financing of purchases on margin or by some other form of debt
- Advertising
- The speculative nature of the securities involved

Jurisprudence

To date there have been no court decisions specifically in relation to day trading within a TFSA. The 2014 case of *Prochuk v The Queen* (2014 TCC 17) does, however, provide a glimpse into the Tax Court's views on trading activity in registered plans. Specifically, the Tax Court commented that trading activity within an RRSP cannot constitute a business of the taxpayer, nor can it provide evidence of a trading business carried on outside of an RRSP.

While the Tax Court's comments acknowledge that taxpayers can and do actively trade investments in their RRSPs (and, arguably, in other tax-sheltered investment vehicles), the comment that trading activity within an RRSP cannot constitute a business was incidental to the main decision and therefore is not binding.

In CRA document 2014-0538221C6, the CRA confirmed that there had been no change in its position as a result of the Prochuk decision. In the CRA's view, the Tax Court's conclusion was limited to the fact that trading in a registered plan is not a relevant factor to determine whether an individual is carrying on a business outside of a plan. In paragraph 1.91 of Income Tax Folio S3-F10-C1, *Qualified Investments – RRSPs, RESPs, RRIFs, RDSPs and TFSAs*, the CRA states that the *Prochuk* decision "does not stand for the proposition that the trading of securities in a registered plan will not in any circumstance be considered to be carrying on a business by the plan." [5]

Conclusion

Individuals continue to embrace the flexibility and tax benefits of investing in TFSAs for saving for both long-and short term-goals and many have seen sizable growth in their TFSA's value. Since the CRA has made it clear that it intends to continue with its TFSA enforcement initiatives, individuals need to ensure they remain compliant with the TFSA rules.

Individuals withdrawing and re-contributing to their TFSA must keep careful track of their eligible TFSA contribution room to avoid finding themselves on the receiving end of a warning letter or automatic assessment for excess TFSA contributions.

The CRA's continuing compliance initiatives also means taxpayers should take steps to ensure the activities carried out within a TFSA do not attract unwanted attention. If the level of trading activity within a TFSA is frequent or the TFSA has seen significant growth in value, the CRA may consider the TFSA to be carrying on a day trading business and the TFSA may be subject to tax, interest and penalties. Whether or not a TFSA is in fact carrying on a day trading business is a question of fact that will require a full review of the particular circumstances.

Individuals finding themselves under scrutiny for non-compliance should take the appropriate steps promptly in order to avoid penalty taxes. Individuals who are subject to a TFSA audit should consult with their EY tax advisor.

[5] For further details on the Prochuk case, see the November 2014 issue of TaxMatters@EY.

The OECD's Multilateral Instrument: no time for BEPS fatigue

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Excerpted from EY's Global Tax Policy and Controversy Briefing Issue 20 August 2017

The last five years have been some of the busiest any of us will see in our tax careers. The global financial crisis gave way to increased scrutiny of taxpayers' activities by the public, charities, media and politicians, not to mention from revenue authorities; a new era of tax transparency started. And with almost a decade of austerity under their belts, governments are looking for ways to tackle perceived profit shifting by multinational companies.

Much of the change is attributable to what is known as the "BEPS" (Base Erosion and Profit Shifting) project, mandated by the G20 and driven by the Organisation for Economic Co-operation and Development (OECD).

The next stage of that BEPS journey was marked by the early June signing by 68 jurisdictions (with another 20 to 25 expected to join later during the remainder of this year) of a key OECD recommendation in Action 15, formally known as the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS.

The Multilateral Instrument (MLI) focuses on what might at surface level seem to be a relatively simple objective — to quickly and efficiently (when compared to bilateral processes) update the world's 3,400 double tax treaties, to allow them to take into account the BEPS changes. However, this also means it has the potential to deliver business a whole range of unexpected outcomes, including increased scrutiny of hitherto accepted transactions, the need to invoke different funding models, and the need to completely restructure supply chains or operations.

At this stage, it is expected that more than 1,100 tax treaties will be modified based on matching the specific provisions that the 68 jurisdictions wish to add or change. That number will likely increase rapidly in coming months.

What is the MLI trying to achieve?

Many countries have entered into tax treaties (also called double tax agreements, or DTAs) with other jurisdictions to avoid or mitigate double taxation. Such treaties may cover a range of taxes, including income taxes on dividends, royalties or licensing fees. Many business leaders may not be 100% aware of the mechanics of tax treaties, but they would notice the effects if they did not exist. Consider this, for example: if one resides in country X but has business operations in country Y, a tax treaty may reduce (or eradicate) the tax withheld from interest, dividends and royalties paid by entity X to entity Y.

The G20 and OECD feel, though, that while indeed such treaties help facilitate global business, they can also be abused. Several of the 2015 BEPS recommendations focus on techniques that are enshrined within a tax treaty, which means that these treaties needed to be updated to take account of such recommendations. But with the bilateral renegotiation of treaties taking anywhere up to a decade or more, a more efficient process was needed. This led to the birth of the MLI.

The objective of the MLI is to enable any jurisdiction to swiftly amend the entirety or part of its treaty network by just signing and ratifying one multilateral convention, instead of having to renegotiate many bilateral ones. And while many of the recommendations of the BEPS project are optional, a limited number of recommendations are minimum standards, meaning that all 100 countries that have signed up to the BEPS project agree to take these minimum standards forward into their treaties.

During a signing ceremony on 7 June 2017, 67 jurisdictions signed the MLI, covering 68 jurisdictions, as China signed for Hong Kong. Nine other jurisdictions expressed their intent to sign the MLI in the near future and, since 7 June, three others (Cameroon, Mauritius and Vietnam) have indeed done so. The MLI remains open to signature by any interested jurisdiction and, in fact, the OECD has announced that it will organize a second signing ceremony later this year. It is expected that by the end of 2017, around 90 jurisdictions will have signed the MLI. As a result, the new BEPS treaty rules will become applicable widely as of 2019, with early adoption possible for 2018.

Why business should care

The MLI means big changes to cross-border tax law. Indeed, many of the changes represent the most significant changes to tax treaties since they were first used more than 100 years ago.

Whether they introduce a BEPS minimum standard or not, the changes potentially adopted via the MLI will have significant issues for business. Consider this selection of three possible changes (one of which is mandatory for the more than 100 countries that are BEPS members) and their impacts:

Article 7 of the MLI on treaty abuse mandates that all countries signing the MLI should introduce a Principal Purpose Test (PPT), and allows them to also (optionally) apply a simplified Limitation of Benefits (LOB) provision to curb treaty abuse. Using a PPT, a country may deny treaty benefits (such as reduced taxes) where obtaining the benefit was one of the principal purposes of an arrangement, unless granting the treaty benefits would be in accordance with the object and purpose of the relevant provisions of the treaty. So, in effect, 68 countries may start scrutinizing every dividend or royalty flow in order to see if this rule is met. While no one is saying that every treaty benefit will be denied, it is likely that certain structures and transactions will meet that fate, particularly in the early days when this subjective new rule remains untested. During the signing ceremony, OECD Secretary-General José Ángel Gurria emphasized the determination with which countries have pursued this issue, which led to all BEPS members agreeing on a coordinated implementation of the new rules. That may mean a protracted period of uncertainty for business.

Article 12 of the MLI on the avoidance of permanent establishment (PE) status sets out how changes to the wording of article 5 of the OECD Model Tax Convention to address the artificial avoidance of PE status through commissionaire arrangements and similar strategies will be embedded into treaties by the MLI. A commissionaire arrangement may be loosely defined as an arrangement through which a person sells products in a jurisdiction in its own name but on behalf of a foreign enterprise that is the owner of these products. Through such an arrangement, a foreign enterprise is able to sell its products in a state without technically having a permanent establishment to which such sales may be attributed for tax purposes and without, therefore, being taxable in that state on the profits derived from such sales. Since the person that concludes the sales does not own the products that it sells, that person cannot be taxed on the profits derived from such sales and may only be taxed on the remuneration that it receives for its services (usually a commission).

The proposed changes delivered via the MLI would deem that a PE exists if a commissionaire's activities are intended to result in the conclusion of contracts that are then to be performed by the foreign principal — unless the commissionaire performs these activities in the course of their own independent business. In effect, this means that businesses currently relying on this model will need to adapt and change their delivery model in response — or risk disputes, penalties and business disruption.

Article 13 looks at the artificial avoidance of PE status through business activities that were previously seen as exempt in terms of resulting in a PE for business. In this regard, some activities previously considered to be merely "preparatory" or "auxiliary" in nature may nowadays correspond to core business activities. In order to ensure that profits derived from core activities performed in a country can be taxed in that country, the BEPS changes modify the OECD model convention on tax to ensure that each of the exceptions included therein is restricted to activities that are otherwise of a "preparatory or auxiliary" character. Again, this means that businesses currently relying on such activities to deliver their business model in a jurisdiction will need to adapt and change their delivery model in response — else risk increasing scrutiny and disruption in coming years.

These are just some examples of the many changes that will be delivered into reality via the MLI.

These are significant changes to the way in which the final tax bill is calculated, potentially driving business to restructure finance and holding companies, supply chain and operations. Little wonder, then, that OECD Secretary-General José Ángel Gurria remarked that, "We are about to make tax treaty history!" at the Paris signing ceremony, where the 68 jurisdictions not only signed the MLI but also unveiled which treaties they will be changing first, and which options they have agreed with their bilateral partners.

Given the size and nature of the potential changes ahead, one might expect tax department leaders to be picking through the country positions with a fine-toothed comb as a result. But a recent EY webcast attended by nearly 2,000 clients and other external stakeholders revealed a different picture, perhaps indicating that a "BEPS fatigue" is plaguing business.

Nearly 60% of company tax leaders watching the webcast, for example, said that the MLI will have a significant or moderate impact on their tax strategy. But less than one in ten (7%) said they fully understood how it worked or what impacts it might have on their business.

Fewer than two in ten (16%) say they are already assessing risk or have concrete plans to do so. That's concerning when 61% of the same group also say that the MLI will result in tax disputes rising "significantly" or "somewhat."

Timing

The MLI is a key part of the OECD's effort toward implementation of the recommended BEPS measures.

But countries do not need to use the MLI to adopt treaty changes; such changes may still be made bilaterally and, in some cases, countries have already pressed on and developed their own national laws that are similar to those suggested by the OECD in effect, if not form.

The MLI will enter into force after five jurisdictions have deposited their instrument of ratification, acceptance or approval of the MLI. During the ratification process, the choices made by jurisdictions may still change. With respect to a specific bilateral tax treaty, the measures will only enter into effect after both parties to the treaty have deposited their instrument of ratification, acceptance or approval of the MLI and a specified time has passed. The specified time differs for different provisions.

The first modifications to bilateral tax treaties are expected to enter into effect in early 2018. However, given the anticipated time needed for ratification, it is expected that most treaty changes will enter into effect in 2019.

What EY is recommending

While the existence of the MLI may help the OECD meet a key objective of making sure treaty changes occur as quickly as possible, the pace of the implementation of the BEPS measures by the BEPS members shows just how intricate, voluminous and fast paced those changes are likely to be. Ratification of the MLI will be a priority for many countries. Many investment location choices are based on longstanding organizational practices; one may be familiar with every aspect of investing through a particular location and using particular vehicles.

These routines may no longer be available; putting new processes in place will take time and considerable effort. Companies will therefore need to ask themselves a series of questions which in turn will permit them to formulate a robust assessment and action plan. Do we know every situation where we are relying on treaty relief? Do we have a process in place to check if the MLI may impact on our treaty analysis? And do we have the resources to deliver that process?

Things are still developing rapidly, and what we see now are very much the early days of change. The current MLI position as stated today represents a relevant starting point for an analysis, but not a reference framework that reflects the final situation. Future developments will have to be tracked in order to guarantee the latest status in relation to a specific tax treaty.

In that regard, establishing an ongoing process to monitor and track MLI implementation and then constantly assess impacts against one's current tax footprint will be an imperative. Again, these are not small changes — they are a real shift in the world of tax — history being made, so to speak.

Shareholder buyout goes awry: applying subsection 55(2) to a series of transactions undertaken to dispose of an indirect interest

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In 101139810 Saskatchewan Ltd. v The Queen (2017 TCC 3), the Tax Court of Canada (TCC) examined the applicability of former[6] subsection 55(2) of the *Income Tax Act* (the Act" or ITA) to deemed dividends received by 101139810 Saskatchewan Ltd. and 101139807 Saskatchewan Ltd. (the appellants) on share redemptions that were part of a series of transactions undertaken to allow an individual shareholder to dispose of his indirect interest in a company to other arm's-length shareholders.

The TCC upheld the Minister's assessment and re-characterized the deemed dividends received by the appellants as capital gains pursuant to subsection 55(2) of the Act. However, the TCC permitted the appellants' designation pursuant to paragraph 55(5)(f) of the Act.[7]

Factual background

Blair Case, Brian Melby and Don Rae were equal shareholders of an audio and electronic equipment company, Century Sound & Music Ltd. (CSM), through their respective holding companies. There was a disagreement between the shareholders about the future direction of the business. Therefore, Case decided to completely divest his ownership in CSM and sell his one-third interest to the other shareholders for $2.6 million.

Before the transfer, a butterfly-type series of transactions was put into place by Case's tax advisor, whereby the appellants were incorporated for the sole purpose of allowing an optimal transfer of his indirect interest in CSM. The appellants were used to replace Case's initial holdco in the holding of the CSM shares such that Case ultimately sold his shares in the appellants to Melby's and Rae's holdcos. This series of transactions included subsection 85(1) ITA transfers, subsection 86(1) ITA exchanges, redemptions of shares and promissory note issuances, as well as collateral deemed dividends from the redemption of shares, deemed dividend deductions and offsetting of notes.

Case's initial holdco reported the deemed dividends it incurred for tax purposes, following the pre-sale transactions where the appellants ultimately acquired the shares of the former holdco and further redeemed them. Following the redemption, subsection 84(3) of the Act applied and the appellants were deemed to have received dividends in the aggregate of $2.6 million. Then, upon the sale of his shares in the appellants to Melby and Rae, Case reported a capital gain of $2.6 million and paid the tax owing after claiming part of his capital gains exemption. Prior to the actual sale transaction, the appellants had also realized aggregate capital gains of $2.6 million, on which tax was levied, thus technically resulting in double tax of the same economic gain.

Subsection 55(2) applies if the result of a dividend received by a corporation effects a significant reduction in a capital gain that would, but for the deemed dividend, have been realized on a disposition of shares, unless an exception applies (such as safe income). The CRA sought to have subsection 55(2) of the Act applied to the redemption of the shares in order to recharacterize the deemed dividends as capital gains and refused the designation under paragraph 55(5)(f) of the Act. At issue was whether the result of the redemption was to reduce the hypothetical capital gain, as no exception applied.

Position of the parties

The appellants argued that subsection 55(2) of the Act should not apply. Their arguments were mostly based on principles of interpretation and fairness. They argued that there had not been a significant reduction in the portion of the capital gains. They also argued that the legislative intent is not to multiply tax liability and that subsection 55(2) of the Act is a specific anti-avoidance provision only. Additionally, the appellants argued that the Minister ignored the economic substance and commercial reality of the relevant transactions. Finally, they argued that the Minister's refusal to permit the designation pursuant to paragraph 55(5)(f) of the Act is contrary to the intent of subsection 55(2) of the Act. The appellants argued that the designation was still available for them to make should the Court maintain the undesired tax consequences.

On the other hand, the Minister argued that subsection 55(2) of the Act was correctly applied, since a corporation resident in Canada received a taxable dividend. The Minister argued that nothing in subsections 55(2), 84(3) and the definition of "disposition" in subsection 248(1) of the Act allows for tax relief based

[6] i.e., As it read prior to the 2016 federal budget modifications.

[7] Thus allowing the corporation to designate the portion of the dividend received that was attributable to safe income on hand to be a separate taxable dividend to reduce the amount that could be deemed a capital gain.

on related transactions. With regards to the designation provided by paragraph 55(5)(f) of the Act, the Minister argued that the appellant did not make such a designation. As a result, subsection 55(2) applied to the whole dividend.

Tax Court of Canada's decision

Justice Réal Favreau opined that subsection 55(2) of the Act applied to the deemed dividends the appellants received. As a result, the deemed dividends should be recharacterized as capital gains. Justice Favreau stated that the capital gains that Case realized had no relevance to the analysis, since it was clear from a plain and ordinary reading of this provision that it was meant to apply to a corporation. Justice Favreau also stated that there was no obligation to look at the transactions in their entirety when determining whether the result of the deemed dividend was a reduction in capital gains.

Moreover, Justice Favreau held that the relevant time for the analysis under subsection 55(2) of the Act is "immediately before" the deemed dividend. As such, the capital gains that Case realized after the deemed dividend are not to be taken into consideration for the purpose of subsection 55(2) of the Act.

Justice Favreau referred to the Supreme Court of Canada decision in *Shell Canada Ltd. v R*., [1999] 3 SCR 22, with respect to the appellants' argument that a purposive analysis should be undertaken and, as such, that the commercial and economic realities of the transactions should be considered. Justice Favreau held that economic realities can never supplant a court's duty to apply an unambiguous provision of the Act.

With regards to the appellants' double taxation argument, Justice Favreau held that it would offend Parliament's intent to find that subsection 55(2) should not apply. Justice Favreau stated that the appellants had the opportunity to structure the transactions, but the arrangement chosen resulted in an unfortunate result, that is, additional tax. Justice Favreau opined that the appellants and Case are not the same taxpayer for the purpose of subsection 55(2) of the Act. As a result, Justice Favreau stated that his decision does not result in double taxation, and even if it did result in double (or even triple) taxation, it should not prohibit the application of subsection 55(2) of the Act.

Finally, with respect to the designation provided by paragraph 55(5)(f) of the Act, Justice Favreau stated that it is well established that a taxpayer has the right to claim this benefit once it is assessed under subsection 55(2) of the Act.

As a result, the TCC maintained the Minister's initial assessment, as it determined that subsection 55(2) of the Act applied to the series of transactions, so that the deemed dividends the appellants received were recharacterized as capital gains. However, the TCC allowed the appellants to designate a portion of the dividends as a separate taxable dividend pursuant to paragraph 55(5)(f) of the Act.

Lessons learned

It is important to note that even if this decision was rendered under former subsection 55(2) of the Act, the reasoning of this judgment is still relevant, as it provides clarification as to the scope of this deeming provision. Subsection 55(2) of the Act applies a clear results test, targeting reductions in capital gains following a corporation's receipt of dividends, even in the context of a share redemption, where section 112 of the Act would usually have applied. As such, prudence is required in such circumstances, especially when there may not be sufficient safe income, particularly because safe income is notoriously difficult to calculate.

This decision is also interesting because it addresses the issue of not only double taxation, but triple taxation. Indeed, deemed dividends were declared for tax purposes by Case's initial holdco. For their part, the appellants declared aggregate capital gains of $2.6 million, on which tax was levied. Moreover, Case also declared a capital gain of $2.6 million, on which he paid tax and used part of his capital gains exemption. Since the appellants' argument relating to the taxation of the same amounts more than once was not considered as being relevant, tax advisors should be aware that the court did not agree with a purposive approach. Therefore, based on this case, they should assume that subsection 55(2) of the Act can apply when a corporation receives deemed dividends, notwithstanding any double or triple taxation issues relating to the other parties involved.

Finally, with regards to the designation pursuant to paragraph 55(5)(f) of the Act, the TCC confirmed the *Nassau Walnut Investments Inc. decision* (1998 1 CTC 33), which held that a designation is still available to taxpayers after there has been an assessment pursuant to subsection 55(2) of the Act.

Publications and articles

Tax Alerts – Canada

Tax Alert No. 35 – Trade compliance verification list update

On 7 July 2017, the Canada Border Services Agency (CBSA) released its semi-annual list of current trade compliance verification (audit) priorities. This mid-year update identifies that the agency remains focused on tariff classification as a priority audit area, with the introduction of three new tariff classification product categories added to the list of existing priorities.

Tax Alert No. 36 – Draft legislation for 2017 budget

On 8 September 2017, the Department of Finance released for public comment a package of draft legislative proposals and explanatory notes relating to a number of measures announced in the 2017 federal budget, as well as certain previously announced measures. Interested parties are invited to comment by 10 October 2017.

Tax Alert No. 37 – British Columbia budget update 2017-18

BC Finance Minister Carole James tabled the province's fiscal 2017-18 budget update on 11 September 2017.

Tax Alert No. 38 – Québec transparency measures in the mining oil and gas industries now effective

On 3 August 2017, the Quebec regulation respecting transparency in the mining, oil and gas industries entered into force. The legislation, which was passed on 21 October 2015, requires certain enterprises operating in these industries to declare certain payments made to certain payees. The measures are intended to discourage corruption and to foster the social acceptability of projects. The legislation provides for significant penalties for non-compliance.

Tax Alert No. 39 – Finance releases GST/HST draft legislation

On 8 September 2017, the Department of Finance released for public comment a package of draft GST/HST and excise duty legislative and regulatory proposals and explanatory notes. These proposals consist of new as well as certain previously announced measures. Interested parties are invited to comment by 10 October 2017.

Tax Alert No. 40 – Canada's Strategic Innovation Fund

On 5 July 2017, the federal government launched the Strategic Innovation Fund with a budget of $1.26 billion over five years. It is available to organizations of all sizes across all of Canada's industrial and technology sectors. In launching this funding program, the government seeks to accelerate economic growth, strengthen the role of Canadian businesses in regional and global supply chains and attract investment that creates well-paying jobs.

Tax Alert No. 41 – CETA takes effect

After several delays, Canada and the European Union (EU) formally implemented the Comprehensive Economic and Trade Agreement (CETA) on a provisional basis on 21 September 2017. The CETA is the most ambitious Canadian trade agreement to date: as of implementation, 98% of Canadian and EU tariff lines are duty free, with another 1% of tariff lines to be staged out over a number of years. Canadian and European businesses will now have increased access to a market spanning approximately 535 million people.

Tax Alert No. 42 – Quebec City FTZ point

On 30 August 2017, the Canadian federal government designated the Quebec City metropolitan area as a Foreign Trade Zone (FTZ) point. The Quebec City FTZ point is the first in the province of Quebec and the ninth in Canada. The decision is part of the federal government's drive to help Canadian businesses integrate into international markets and global value chains.

Tax Alert No. 43 – Nova Scotia post-election budget

Nova Scotia Finance Minister Karen Casey introduced the province's fiscal 2017-18 post-election budget on 26 September 2017.

Tax Alert No. 44 - First BEPS Action 14 peer review report

On 26 September 2017, the Organisation for Economic Co-operation and Development (OECD) released the first batch of peer review reports relating to the implementation of the Base Erosion and Profit Sharing (BEPS) minimum standards on Action 14 on improving tax dispute resolution mechanisms by Belgium, Canada, the Netherlands, Switzerland, the United Kingdom and the United States. In this alert, we look at the Canadian highlights.

Publications and articles

EY's Worldwide Estate and Inheritance Tax Guide 2017

EY's Worldwide Estate and Inheritance Tax Guide summarizes the estate tax planning systems and describes wealth transfer planning considerations in 37 jurisdictions around the world, including Australia, Canada, China, France, Germany, Italy, the Netherlands, the UK and the US.

Worldwide Corporate Tax Guide 2017

Governments worldwide continue to reform their tax codes at a historically rapid rate. Chapter by chapter, from Afghanistan to Zimbabwe, this EY guide summarizes corporate tax systems in 166 jurisdictions.

Worldwide R&D Incentives Reference Guide 2017

The pace at which countries are reforming their R&D incentives regimes is unprecedented. This EY guide summarizes key R&D incentives in 44 jurisdictions, and provides an overview of the European Union's Horizon 2020 program.

2016-17 Worldwide transfer pricing reference guide

The proliferation of transfer pricing rules and regulations around the world, and the huge increase in focus on the subject by the world's tax authorities, require practitioners to have knowledge of a complex web of country tax laws, regulations, rulings, methods and requirements. This guide summarizes the transfer pricing rules and regulations adopted by 118 countries and territories.

Impact of US policy reforms on Canadian companies

Canadian businesses today face unparalleled uncertainty as the public policy landscape is shifting dramatically, both at home and abroad. This thought leadership examines how these changes are creating a climate of uncertainty that may have potentially serious competitive implications for Canadian businesses.

Board Matters Quarterly

The September issue of *Board Matters Quarterly (BMQ)* includes an article about the board's role in overseeing cyber risk management amidst ongoing regulatory developments. Other articles offer a look at how Fortune 100 audit committee disclosures changed since 2012 and how the PCAOB's final standard will significantly change the auditor's report.

Operationalizing global transfer pricing

In this final installment of EY's 2016-17 Transfer Pricing Survey, we examine the work needed to respond to the seismic shifts taking place in the world of global taxation. We examine the findings of what 623 respondents in 36 jurisdictions across 17 industries have to say regarding forging a practical response to so much change – or as this report refers to such matters, operationalizing.

EY's Global Capital Confidence Barometer 16th edition June 2017

Can geopolitical uncertainty and record M&A coexist? Despite political uncertainties, companies are giving the green light to deals in the search for growth.

EY Trade Watch

This quarterly publication outlines key legislative and administrative developments for customs and trade around the world. Highlights in the September issue include:

- Agreement in Principle reached on EU-Japan EPA: potential for wide-reaching tariff reductions
- Comparing the US, Mexico and Canada key NAFTA objectives for renegotiation
- Canada-EU Comprehensive Economic and Trade Agreement update: Delay in provisional implementation to autumn 2017 due to dairy, pharmaceuticals and ISDS disputes
- UK publishes proposals for customs arrangements following Brexit

In the Americas, we hear from Argentina and the United States, in Asia-Pacific from China, and in EMEIA we report on the East African Community, the European Union, the Gulf Cooperative Council and the United Arab Emirates.

Websites

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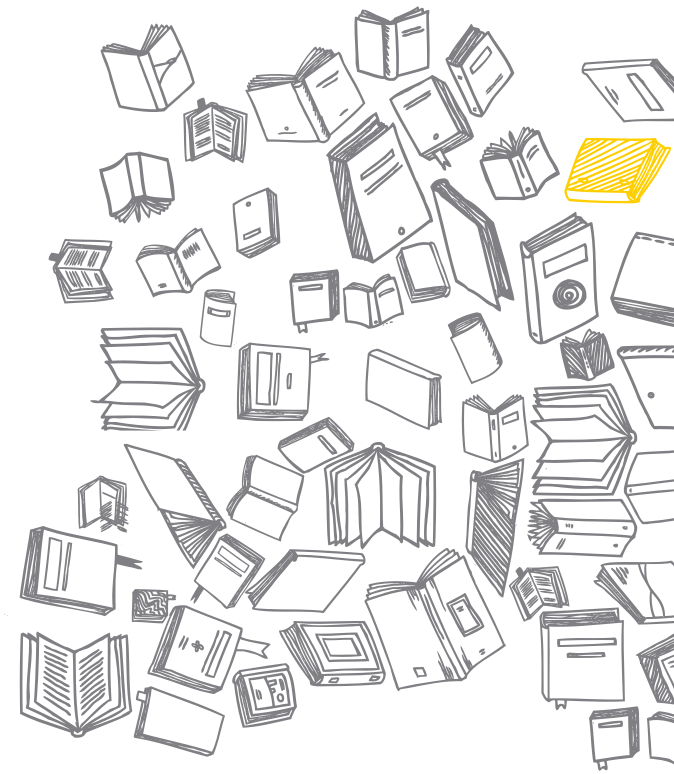
Online tax calculators and rates

Frequently referred to by financial planning columnists, our mobile-friendly calculators on ey.com/ca let you compare the combined federal and provincial 2016 and 2017 personal tax bills in each province and territory. The site also includes an RRSP savings calculator and personal tax rates and credits for all income levels. Our corporate tax-planning tools include federal and provincial tax rates for small-business rate income, manufacturing and processing rate income, general rate income and investment income.

Tax Insights for business leaders

Tax Insights provides deep insights on the most pressing tax and business issues. You can read it online and find additional content, multimedia features, tax publications and other EY tax news from around the world.



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EY's Complete Guide to GST/HST, 2017 (25th) Edition

Editors: Dalton Albrecht, Jean-Hugues Chabot, Sania Ilahi, David Douglas Robertson

Canada's leading guide on GST/HST, including GST/HST commentary and legislation, as well as a GST-QST comparison. Written in plain language by a team of EY indirect tax professionals, the guide is consolidated to 15 July 2017 and updated to reflect the latest changes to legislation and CRA policy.

EY's Federal Income Tax Act, 2017 Edition

Editors: Alycia Calvert, Fraser Gall, Murray Pearson

Complete coverage of Canada's *Income Tax Act* and Regulations. Included with this edition: interactive online features. Purchase of a print book includes access to an online updated and searchable copy of the federal *Income Tax Act*, as well as the pdf eBook. This edition contains amendments and proposals from the 22 March 2017 federal budget (special budget supplement), Bill C-29 (SC 2016, c. 12), *Budget Implementation Act, 2016, No. 2*, the 3 October 2016 notice of ways and means motion, and the 16 September 2016 legislative proposals.

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