INTRO PARTNERSHIPS

S. 12(1)(l): Partnership Income

Include in computing income of T for tax year as income from B/P any amount that is, by virtue of sub j, income of T for year from B/P

- **Subdivision j (ss. 96 – 103)** – rules computing T's income from p/s

96(1): General Rules

Compute income as if p/s were separate person and inclusion of income & deduction losses by each P by their share in the p/s

Partnership is a "flow-through entity" – compute income at the p/s level and then tax the P's on their share

LEGAL CHARACTER OF PARTNERSHIP

Partnership is relationship among two or more persons carrying on business in common w view profit

- Owning piece of property, that doesn't produce any income, fails threshold carrying on biz

General rules from Partnership Act

(a) Joint tenancy/tenancy common, joint property/common property/part ownership doesn't create p/s

- Jointly owning property doesn't create a p/s
- Joint Venture – one off activity

(b) Sharing of gross returns doesn't itself create a p/s

- If arrangement where someone entitled first cut of income/profit from property, then presumption is person is a creditor

(c) Receipt by person share of profits of a biz is proof, in absence of evidence to contrary, that they are a P in biz, but receipt of share or payment, contingent on or varying w profits of biz, doesn't itself make them a P in biz

- Receipt of share of profits (absent evidence to contrary) → presumption partnership

Every partner is an **agent** of the firm and the other partners

- Every P who does any act carrying on in the usual way of biz of kind carried on by the firm, binds the firm and the other P's

Each P jointly liable for debts and obligation of the firm while the person is a P

Limited Liability Partnership – P's are not liable for liabilities of the p/s or any other P arising from negligent acts or omissions that another P commits in the course of the p/s biz

***MNR v Braat (1969) Ex Ct*: Family Farm**

Facts	Jacobus had 8 children, owned a farm. 1957 – J bought another farm (Houlton) with his 3 eldest sons (John, Marinus, & Peter). Joint bank account opened – "Jacob Braat & Sons". All of the kids worked on the farm – given promissory notes. For tax purposes J deducts promissory notes to the kids when computing income (and children include them as income). Re-assessed on basis that should compute income on cash basis (only deduct amounts when payed them)
Issue	Was there a partnership? - If yes – J is manager and income of p/s being allocated to the members of p/s (regardless of whether it is received by the kids) – promissory notes indication of kids share of p/s and taxable in their hands
Analysis	Clear there was a p/s that included the oldest 3 sons (bank account in all their names and could take money in and out) Real issue is **whether the younger kids were part of the p/s** - Other kids never got signing authority on the bank account - Intention is evidence by the behaviour of the parties (don't need document) – conduct created a p/s - Common element – all the kids got something and got relatively similar shares - No one thought the younger kids would be treated differently than the older kids Mere mutual arrangement by members of a family to assist in support operation farm doesn't constitute a p/s
Holding	P/S included the younger kids
Ratio	***Don't need express agreement to create a p/s – p/s can be created by implied agreement to carry on biz together – look at the real intention of parties to determine whether P/S***
Duff	Court bending over to help these guys – helps that p/s did exist b/w father and older brothers, so it was easier to just find that the young kids were part of an existing p/s - Nothing malicious here – J wasn't trying to avoid taxes

***MNR v Shields (1962) Ex Ct*: Father & Son Construction – No P/S**

Facts	T was a builder in TO. During tax years (1951 – 53) received income from multiple sources, including Shields Construction. Shield stated to be p/s which T and son (V) entitled to profits. V was 17 and in high school. **P/S Agreement**: (1) share profits equally, (2) net profits belong P in equal shares; (3) divide expenses equally; (4) T purchases land & V perform work he is reasonably capable of doing. Weird provisions: T signs cheques, property registered T's name (not P/S), son cannot do biz that is the same kind as p/s w/o T's permission. T included in his personal returns ½ profits of firm and firm paid the tax on V's amount. T actually takes most of the profit (don't divide equally) Minister said T was a sole proprietor and therefore had to include all of Shield's profits.
Issue	Are the father and son in a partnership?
Evidence	**Supporting P/S:** (1) P/S agreement; (2) V worked and put effort in; (3) some profits paid to V; (4) Amount paid to V varies (unlike salary); (5) bought some property together **Not P/S**: (1) T told bank this was a p/s for tax purposes only (bank thinks T is sole proprietor); (2) Period of time V only paid hourly salary and applied employee insurance; (3) T registered as sole proprietor, not p/s
Analysis	**"Simulate Agreement"** – sham agreement so not a real partnership - Purpose for T entering p/s with minor son was to share profits and reduce own tax burden - T never considered the p/s agreement binding on him
Holding	No p/s
Ratio	***Presence of a P/S agreement is not sufficient to establish a P/S – need intention to create a P/S***
Duff	If arose today, CRA might not argue sham and instead argue 103(1.1) – reallocate income so most goes to the father 103(1) would have been satisfied in Shields if P/S was found

***Conforth v Canada (1982) FCTD*: Husband & Wife - Physiotherapists**

Facts: T & wife both physiotherapists, operated practice out of their home. Sought to divide income from practice. Wife was actively involved in the biz.

Holding: No P/S

- Didn't show intention to enter a p/s – also didn't divide net profits of the biz
- Although wife contributed substantially, found that the explanation for contribution was not a p/s, but of husband and wife

Court is reluctant to consider a spousal arrangement as a real P/S

- Attitudes started to shift – but maybe still valid?

***Continental Bank Leasing Corp v Canada (1998) SCC*: Bank & Leasing Corps**

LOWERS THRESHOLD FOR P/S

Biz Carried on: Business includes every trade, occupation and profession

- Don't need to be signing new biz to find biz being carried on (*Hickman Motors*)

Biz carried on in common

- **Sharing Profits**: Look whether P/S distributes profits in proportion P's interest – indicates doing biz in common
- **Contractual liability** of all partners indicates in common

View to Profit – profit doesn't need to be main purpose, can be ancillary purpose less important than primary purpose

- Just b/c parties had overriding intention creating P/S for purpose doesn't negate fact profit-making was ancillary purpose

Duration of P's membership in the P/S is not relevant

***Backman v Canada (2001) SCC*: Dallas Apartments – American P/S**

Biz Carried on - (1) Occupation of time, attention & labour // (2) Incurring liabilities another person // (3) Purpose livelihood/profit

- P/S may be formed for single transaction
- Suggests "carrying on a biz" means more than just simply holding property

In Common – Contribution skill // Knowledge to common undertaking // Joint property interest // Sharing profit/losses // Filling income tax returns as P/S // Financial statements and joint bank accounts

View to Profit – Intentions of parties entering into the "P/S" – T just needs to show ancillary profit-making purpose

- Where P/S formed w predominant motive to acquire tax losses, not necessary show intention to profit by amount necessary to recoup acquired losses or produce net gain

Can't become pattern by simply buying or acquiring an interest – have to reaffirm the 3-part test

***Spire Freezers Ltd v Canada (2001) SCC:* Tremont Apts – American P/S**

- View to profit doesn't require recouping initial loss
- Example where it was found that they were a P/S – kept apt that was making rent (see below)

COMPUTATION P/S INCOME

96(1): General Rules

Where T is a member of a P/S, the T's income shall be computed as if

(a) the P/S was a separate person

- P/S is not separate legal person, but the notional computation of income as if p/s was separate person

(b) the tax year of the P/S were its fiscal year

(c) each P/S activity (including ownership property) were carried on by the P/S as a separate person and computation made of the amount of (i) each taxable capital gain and allowable capital loss and (ii) each income or loss from the partnership from each other source

- Assuming all activities being carried on as separate person

(f) income of P/S for tax year from any source were income of the T from that source for the tax year of the T in which a P/S tax year ends to the extent of the T's share, and

- **Income retains its character when it flows-through to the P**

(g) loss of P/S for a tax year from any source were loss of T from that source for tax year of T in which P/S tax year ends

- End of fiscal year of partnership goes into the partners' tax year

Reg 1102(1a): CCA calculated at P/S level and then net flows through – Partner cannot include CCA in class of depreciable property that they own

Share income flow-through to P – Doesn't matter if p/s actually pays amount to P, the share of P/S is allocated to the P

Madsen v Canada (2000) FCA: **Ownership of Property – Sewage Waste into Oil (Duff: wrong approach)**

Facts	Note: Transactions are in 1982 → **Pre-GAAR** Deduct form income losses for purchase of units in capital of ITOLP 1979 – IRRI incorporated (Gill sole shh and president); 1981 – ITML incorporated (Gill sole shh and director) Limited P/S entered b/w ITML (GP) and Gill → ITOLP – purpose was fund purchase and operation of machinery to use process sewage waste into oil. IRRI sells equipment to ITOLP for $6.85M (equipment is depreciable property) – P/S deducted large CCA - FMV equipment is $422K, so generate additional deductions by claiming cost is $6.85M MNR found sale equipment not made at arm's length – reassessed CCA deductions – decrease dramatically - Two T's gained undivided ownership of equipment due to status as P's
Issue	What is the extent to which 96(1) affects the characterization of transactions involving p/s at private law?
Analysis	Partners acquired the property and not the P/S – pierce the partnership veil - P/S as entity separate from P is temporary – does not extend to colour true legal nature of transaction at time they are entered into by a p/s Gill & ITML are T's and deal at NAL w vendor (IRRI) since Gill controls IRRI and ITML → easy that 69(1) applies **Ownership equipment couldn't & didn't vest in ITOLP** – acquisition took place b/w IRRI & ITML on behalf ITOLP
Holding	Minister's assessment of equipment's FMV of $422K stands and CCA deducted accordingly
Ratio	***Partners own the property on behalf of the P/S***
Duff	Private law says P/S property becomes property of the P/S, rather than the partners Thinks Madsen is wrong – shouldn't have pierced the P/S veil

Deptuck v Canada (2003) FCA: **Duff: Right approach**

Facts	Essentially identical facts as Madsen. Deptuck was someone who bought shares in ITOLP, then says that he does deal at arm's length so rules don't apply
Analysis	Doesn't piece partnership veil – look at P/S and say that under 96(1) it is being treated as if it is a separate person B/c P/S regarded as if a person, then by treating P/S as a person, does the "person" deal no at arm's length with the corporation – clearly not arm's length here All turns on "as if" in 96(1) – allows you to say that the p/s is a person 96(1) – single computation of income at the P/S level, meaning p/s property held at uniform cost
Ratio	***Deeming notion in 96(1) allows P/S to be viewed as person for computational rules***

Former Anti-Avoidance Rule

FORMER ATTRIBUTION RULE

Where husband & wife are Ps in any biz the total income from the biz may in the discretion of the Minister be treated as income of the husband or wife and taxed accordingly

- Minister has broad discretion to reallocate income of p/s carried on b/w husband and wife

***Klamzuski v MNR (1952):* Wife with Cows**

Facts	T was miner in Drumheller. Wife worked and saved up $500 before getting married. T purchased farm property an started farming. Wife assisted him but also used her own money to buy a cow. T gave up the farm but 2 years later the wife bought back farm and bought other properties. T and wife live and operated the farm together – taxes paid by wife (since she purchased the property). Minister reassessed – all income from farming taxed in hands of T
Issue	Were the T and his wife *bona fide* carrying on a p/s in farm operations?
Analysis	Provision gives Minister the discretion to reallocate – doesn't make sense but nothing the court can do about it
Holding	Minister's allocation of income to T stands

2 Anti-Avoidance Rules (103(1) and (1.1) limits tax avoidance through allocation P/S income or losses

Anti-Avoidance Rule – S. 103(1)

S. 103(1): Agreement share income to reduce/postpone tax payable

Where membs of a P/S agreed to share, in a specified proportion, any income or loss of P/S from any source or any other amount in respect of any activity of P/S that is relevant to computation of income or taxable income of any of memb thereof, and ***principal reason for the agreement may reasonably considered to be the reduction/postponement of the tax*** *that might otherwise have been or become payable under this Act, the share of each member of the P/S in income or loss, as case may be, or in that other amount, is amount that is* ***reasonable having regard to all the circumstances*** *including proportions in which memb have agreed to share profits and losses of P/S from other sources*

- Where P's of P/S agreed to allocation of amount, the principal reason for allocation reasonably considered to be the reduction or postponement of tax that might otherwise have been payable then deem allocation to be that which is reasonable having regard to all the circumstances including proportions which members agreed to share profits
- **Principal reason test** – Reasonable conclude principal reason for allocation was to postpone/reduce tax
    - Objective purpose test

What if Minister used 103(1) in *Shields*?

- Assuming Shields was a P/S – look at circumstances to conclude whether reasonable allocate profits 50/50
    - Son spent a lot less time working on business and all of the capital was coming from the father

***XCO Investments Ltd v Canada (2005) TCC aff'd (2007) FCA:* Topaz & Westhill Apts**

Facts	P/S 2 apts: Topaz & Westhill – planned selling Westhill (Value - $10.8M, debt - $3.5M – net = $7.3M). Sale going trigger substantial capital gain. XCO - 1% in P/S & West Topaz Ltd - 99% interest. Woods willing sell losses offset gain – Woods enter p/s for Westhill - Woods get income when Westhill sold. Woods participate 80% net cash flow Westhill. **Transaction**: (1) Additional $5M mortgage so Woods doesn't have to contribute as much to buy into the P/S. (2) P/S Agreement amended: (1) Wood participation limited Westhill; (2) Wood – 80%, West Topaz – 19.8%, XCO – 0.2%; (3) P/S share in distribution of net proceeds in proportion interest; (4) Wood can withdraw any time with 6 months notice, but if Westhill sold then can't withdraw before end of the fiscal year. (3) P/S sold Westhill for $10.85M to arm's length purchaser → 80% paid to Woods & Woods gets small amount rental income that came in before end fiscal year ($9K). (4) Woods withdraws from p/s after the end of the fiscal year Two tax years relevant: 1992: Woods joined p/s for 6 weeks so got 80% of rent & 1993: Woods gets 80% of sale - Woods paid $1.26M and gets $1.808M so they made $548K Minister reassessed T's, allocating to each of them according to their interest in the p/s the income that the p/s had allocated to Woodward – 3 arguments: (1) No Partnership; (2) Unreasonable allocation (103(1)); (3) GAAR - 245
Issue	Was the Minister right to allocate to the T a substantial portion of income earned by a P/S which they were members?
Analysis	**Was there a Partnership?** Abandoned this argument by time of trial P/S is business carried on in common with a view to profit - Woodsward is not trying to profit – it is selling losses - Not carrying on thing in common – Woods gets in and 6 weeks later only asset is sold By time got to trial, CRA decided weren't going to win this argument **Was there an unreasonable allocation under 103(1)?** Was **principal reason for agreement the reduction or postponement of tax**?

	- Hard to say principal reason other than reduction tax – bringing Woods into the p/s was tax-motivated - Reduces tax to P/S b/c $5.8M allocated to Woods and Woods has losses - Test focuses on the agreement – agreement limited to one property, nothing says can't have p/s where only participating in part of it but indicative of what is happening in this case o P/S free to create unorthodox means of dividing the profits and assets of the P/S What is a **reasonable allocation**? - Duff: What would be reasonable? o Woods comes in for $1.2M to get 80% net value Westhill o Unreasonable allocate $118K (income entire year) to Woods who only joined w 6 weeks left in yr –share income for 6 weeks and allocate that to Woods, anything beyond that is unreasonable o Argue unreasonable allocate any gain on sale Westhill to Woods – Woods didn't really contribute anything Court does something diff – allocate gain Woods would get b/c actually saw income – court looks at **cash distribution** - Unreasonable for Woods to be allocated 80% of income from Westhill – **arrangement falls within 103(1)** - But Minister went too far with the allocation – minister reallocated everything to the T's
Holding	Arrangement falls within 103(1), but Minister's allocation went too far – not all of the income was allocated to the T's
Ratio	***"Reasonable" is relative and depends on circumstances but determination is not discretionary act of the Minister***

Flicke v MNR (1980) TRB: Husband & Wife carpentry biz
Facts: Husband & wife carried on carpentry business – he is the carpenter and wife runs the office. Divided profits 50/50. Revenue authority saying not reasonably allocating income
Holding: Court says 50/50 allocation not reasonable, so does 65/35
- Pretty random result – unclear how the court landed at this allocation

Pelletier v MNR (1982) TRB: Husband & Wife restaurant biz
Facts: T & wife had p/s agreement for restaurant biz which they operated jointly for 15 years
Holding: 103(1) does not apply
- **Principal reason for agreement was not reduction or postponement of tax otherwise payable**

Note: Both Flicke and Pelletier would be decided under 103(1.1) today b/c no principal purpose test

Anti-Avoidance Rule – S. 103(1.1)

S. 103(1.1): Agreement share income in unreasonable proportions

Where 2 or more memb of a P/S who are not dealing with each other at arm's length agree share any income or loss of P/S or any other amount in respect of any activity of the P/S that is relevant to computation of income or taxable income of those membs and share of any such member of that income, loss or other amount is not reasonable in the circumstances having regard to the capital invested in or work performed for the P/S by the members thereof or such other factors as may be relevant, that share shall, notwithstanding any agreement, be deemed to be the amount that is reasonable in the circumstances.

- **Doesn't require a tax avoidance purpose**
  - **Might be a business purpose test (*Archbold*) or a non-tax purpose test (*Paajanen*)**
- Only applies where 2 or more members of P/S do not deal at arm's length – where agree to share amount, and share not reasonable then deems share to be amount that is reasonable
- **S. 251: Non-Arm's length** – related persons deemed not to deal at arm's length, otherwise it is a question of fact
- **S. 251(2): Related Persons** – individuals connected by blood relationship, marriage, common law, adoption
- **S. 251(6): Blood Relationship** – child or other descendant of other or one is brother or sister

Facts to consider reasonable allocation:
- Capital invested
- Work performed
- Other relevant factors
- Cash actually drawn from the p/s (*Paajanen*)

***Archbold v Canada (1995) TCC:* "Creative Skate & Dance Wear" - Salary from P/S**

Facts	Husband and wife carried on p/s "Creative Skate & Dance Wear". Husband works on p/s after work and she worked on it M-F – she is providing more labour and he is providing more capital. 1985 – Amend P/S Agreement to say that 10% gross sales off the top goes to Wife + 30% residual profits. 70% residual profits after the 10% and all losses go to husband. Minister reassesses – disallowed computation of income claimed as salary to wife and re-determined allocation of p/s profit and losses based on 50/50 share.
Issue	Can a partnership pay a salary to a partner? How do we determine what is a reasonable allocation?
Analysis	**Can a P/S pay a salary to a Partner?** P/S statute says "no partner is entitled to remuneration for acting in the p/s business" - But this is subject to an agreement b/w the partners – so if P/S agreement says P can get salary then they can **How is a reasonable allocation determined?** - Court reads in a business purpose test to determine what is "reasonable" - Would a reasonable biz person acting at arm's length do this?
Holding	Allocation of income and losses on ratio of 50/50 was reasonable within meaning of 103(1.1) - Salaries of P may be included in calculation of income of P/S and losses but be shares on 50/50 ratio
Ratio	***"Reasonable" - what is reasonable in a business sense – would a reasonable biz person acting at arm's length do this?*** ***No impediment to a partner drawing salary from a P/S***
Note	CRA – can't pay P a salary b/c can't be a P and an employee – you would be contracting with yourself - Salaries paid to partners are not deductible in computing p/s income for tax purposes - Considered to be a method of distributing p/s income among members – not a business expense CRA pulled this Interpretation Bulletin but never replaced it – not clear position
Duff	If a partner is able to be the landlord of a partnership, then doesn't understand why you can't also be an employee - Duff thinks that a p/s can pay a salary to a partner

Crestglen Investments Ltd v MNR (1993) TCC: Management Fees
Facts: T received management fees from 2 P/S's of which its shareholders were also members. MNR characterized these fees as income from personal service biz (ineligible small biz deduction).
Holding: The shh who performed services on T's behalf could not, but for the existence of the T, be regarded as an employee of the P/S on the grounds that*:* **a P cannot be both the employee and the employed in the same P/S biz**
P cannot be an employee of a P/S that is capable of entering into a K of employment with the P/S

Mazurkewish v Canada (2007) TCC: **Unclear whether P can get salary**
Facts: T carried on p/s with Jeff and their wives. All members of p/s (other than T) allocated notional "wages", resulting in net losses which were divided equally among the P's.
Issue: Can a P/S deduct salary or wages paid to a P?
Analysis: Judge just says that ***there is support in either direction that P could get wage/salary***

CRA's most recent statement on tax treatment to partner
- CRA says there are some circumstances where a p/s would be able to deduct amounts paid to a P in computing income of the p/s – ex. fees paid to a P for services provided to the p/s that are not part of the business
- CRA says people should incorporate themselves to provide services and that will make it clearer

Adams v Canada (1998) FCA: Medical P/S – Rental Inducement
Facts: 18 membs. medical P/S enter lease of premises where the landlord was a corp acting as bare trustee for the P/S. Corp (as landlord) paid rental inducement of $1.2M to P/S (as tenant) – P's sought to deduct.
Holding: 18 membs. of P/S were both tenants and landlords of the lease agreement - $1.2M payment was of no legal consequences

To determine what is reasonable, other cases pay attention to **capital invested**
Zalesky v Canada (2000) TCC: allocation husband & wife
Facts: Husband & wife carry on business in p/s selling personal and household products – losses were $14K in 1995 and $13K in 1996 – losses were allocated entirely to husband who had a full-time job
Holding: 100% allocation to husband is unreasonable – allocated 75% losses to husband on basis he had, throughout the entire period funded the losses out of his salary - Rejected Minister's argument that losses should be allocated 50/50
- ***A requirement to bear losses can support an increased allocation***

Spencer v Canada (2003) TCC: allocation husband & wife
Facts: T spouses carried on embroidery business in p/s. most of financing supplied by husband, most of labour supplied by wife. Profits and losses allocated equally 1988-1990. 1991 – 85% in favour husband, 1991-1995 – 90% to husband when p/s incurred net losses. 1993-1995 – husband earned employment income. When biz became profitable, wife took over as sole proprietor.
Holding: Allocation during years 1993 - 1995 unreasonable - allocation of 75% in favour husband was reasonable in circumstances

Fillion v Canada (2002) TCC, aff'd (2004) FCA: reasonableness requires, at a min, that allocations reflect reality

Facts: T purported carry on p/s w spouse and two sons – biz selling financial products. T was only memb of fam who had insurance broker's license. Cheques were made out and cashed by the T and actual work performed by the other fam memb was unclear.

Holding: Allocation was not reasonable within meaning of 103(1.1) and not warranted

- Income generated by T's professional work was not divided in an objective, rational and plausible manner in accordance with the work performed or capital contributed, and the real objective was tax saving

Duff: Would have been better to argue that no P/S existed

Krauss v Canada (2010) TCC aff'd FCA: Capital Invested

Facts: T entered P/S with her son – each transferred 50% interest in real property (worth approx. $2.5M) in exchange for 1,252,000 Class A units in the P/S redeemable for $1 each. Later contributed more property worth over $600K in exchange for Class B units

- 1993 – family trust contributed $100 and got 100 Class C units of p/s
- 1994 – P/S made profit of $343,431 – P/S allocated $216,710 to Class A, $126,721 to Class C

Holding: The amount allocated to the Class C units was not reasonable having regard to the capital invested and work performed

- No reality in allocating $126,721 to the Trust after a $100 investment

Paajanen v Canada (2011) TCC: Allocation b/w non-arm's length parties

Facts: T commenced retail biz in p/s with her sister after sister's husband died and she was left with children and debts. income from P/S was allocated to T was 6.5% in 2004 and 15% in 2005.

- Minister allocated 50% of p/s income to the T on basis sister's contribution to p/s were relatively equal

Holding: Allowed taxpayer's appeal

- Wrong to state general principle - allocations b/w non-arm's length Ps must always be based solely on biz related criteria
- 103(1.1) is anti-avoidance– agreement b/w sisters to share income unequally was not all motivated by tax considerations

Reasonable for P's to agree to share income based on actual distributions of each partner

- Modifies test in Archbold to **non-tax purpose test**, as opposed to business test

Examples from CRA Interpretation Bulletin:

- A & B contribute property to a p/s – B contributes $100 and A contributes property with cost of $1 and FMV of $100
  - Partners are 50/50 b/c they contributed the same value
- P/S sells A's property for FMV of $100 and has a $99 gain – how should this gain be allocated?
  - CRA says reasonable to allocate the entire gain to A

THE PARTNERSHIP INTEREST

Generally, partnership interest constitutes a form of capital property that, like shares of a corporation, may be bought or sold

- Where a p/s interest is capital property, it is **non-depreciable capital property**

***MNR v Strauss (1960) Ex Ct*: P/S Interest vs. P/S Property**

Facts	P/S formed to acquire right to purchase a property – land was inventory; purpose was to sell it at a profit. T had a 1/3 interest in the property – paid $11,666.66 for his P/S interest. T sold ½ of his 1/3 interest for $15,000 ($9,166.67 profit). Minister added to T's income the $9,166.67 as biz income on assumption that this amount represented profit made by T on sale of part of his interest in the land acquired by the p/s for the purpose of disposition at a profit. T - capital gain (non-taxable) – land is inventory to p/s, but he sold his interest in the p/s not his interest in the property - He is not in the business of buying and selling p/s interests – so argues his interest in the p/s is capital property
Issue	Was $9,166.67 received by T from sale of 1/2 of his 1/3 interest in P/S a capital gain or profit from an adventure in nature of trade?
Analysis	Purchase of land was made for biz purpose by the p/s, not the parties acting personally – acting as a group - Each P's right was, not a right to dispose of land, but right to participate in division of profits realized by the p/s - Property could not have been disposed of w/o consent of each and every P T didn't sell the land, personally he did not have the power to, he sold his right to the profits of the sale which would eventually be made by the p/s - T disposed of part of his source of income → capital asset – doesn't constitute adventure/concern in nature of trade
Holding	T sold interest in capital property – not taxable
Ratio	***Each P's right is not a right to dispose of P/S property, but it is a right to participate in the division of the profits realized by the biz operations of the P/S***

***Walchuk v Canada (2004) TCC*: Difficult for P/S interest to not be treated as capital property (as inventory)**

Facts: T, stockbroker, invested as P in restaurant in Greece. Lost $413K when p/s ceased. T characterized losses as biz loss.

Holding: Loss = capital loss from disposition T's interest in p/s

To overcome status of P/S unit as capital property is more onerous than for shares b/c of the nature of structure

- P is owner of: capital property, p/s interest, & underlying assets, the biz
- To claim 2 biz's must be compelling & convincing evidence dealing w one, p/s unit, is distinct & separate from dealing w other

Adjusted Cost Base of P/S Interest

S. 40: "Gain" & "Loss"
- Gain = PoD > ACB + Expense Disposition
- Loss = ACB + Expense > PoD

S. 54: "Proceeds of Disposition" - Sale price that the property has been sold

S. 54: Adjusted Cost Base - Cost to the T of the property adjusted, as of that time, in accordance with s. 53
- **Purpose of ACB is to give tax-free return of capital** – the cost of the capital property the T gets back tax-free

If PoD > ACB → Capital Gain
If PoD < ACB → Capital Loss

↑ACB (↓ Capital Gains)	↓ACB (↑ Capital Gains / ↓ Loss)
S. 53(1)(e)(i): + T's share of income of P/S - Calc at the end fiscal period	**S. 53(2)(c)(i):** - T's share of loss of the P/S - Calc at the end fiscal period
S. 53(1)(e)(iv): + capital T contributed to P/S - Calc anytime	**S. 53(2)(c)(v):** - Amount T received of P/S profits/capital - Calc anytime

S. 53(2)(d): ACB Decrease for Partial Disposition
Subtract from ACB, where property is such that T has, disposed of a part of it while retaining another part of it, the amount determined under section 43 to be the adjusted cost base to the taxpayer of the part so disposed of;
- Where part of property disposed of and part of it is retained, subtract part disposed of from ACB of the remaining portion

ADDITIONS TO ACB

S. 53(1)(e)(i): Share Income
The cost of T's interest in a P/S is increased by all amounts each of which is T's share of the income from any source for each fiscal period of the P/S ending after 1971 and before that time
- Income received by P/S, it is attributed to the P's and taxed in their hands, even if they didn't get it
- Don't want to tax this amount twice b/c it is already taxed when it is "allocated" to the P's
- Adding share of income which is share of capital gain (not the taxable capital gain)

S. 53(1)(e)(iv): Capital Contributed
The amount of any capital that a T contributes to a P/S shall be added in computing the cost to T of the T's interest in the P/S, except to extent the contribution can reasonably be regarded as benefit conferred on any other member of the P/S who was related to the T
- For arm's length transaction, add amount of capital contributed to the ACB
- Assumption of P/S liability = capital contributed and is added to ACB

Purpose: Permit tax-free return of capital on disposition of p/s interest, EXCEPT if reasonably regarded as benefit conferred on related person, then amount of benefit subject to tax at time P/S interest disposed

SUBTRACTION TO ACB

S. 53(2)(c)(i): Share Loss
Cost to the T of P/S interest is reduced by total of amounts each of which is the T's share of any loss of the P/S from any source
- If losses of P/S, losses will get flowed out to the P's – losses can be used to shelter other sources income
- Prevent double deduction that would occur if T disposed of p/s interest for proceeds that were reduced by amount of loss which T already obtained recognition for tax purposes

S. 53(2)(c)(v): Amount Received
Cost to T of P/S interest is reduced by amount received by T of distribution of the T's share of the P/S profits or P/S capital
- ACB T's P/S interest reduced to ensure T does not obtain additional tax-free return of capital on disposition P/S interest
- Reduces value of what is in the P/S
- Doesn't matter if distribution of profit or capital b/c it is just w.e. distribution coming out of the P/S

NEGATIVE ACB

Negative ACB → Subtractions 53(2) > Cost to T + Additions 53(1)

40(3): Negative ACB = Deemed Gain

Where ACB negative when dispose interest, negative ACB deemed to be gain for T for year from the disposition

- **53(1)(a):** the amount of the deemed gain is added to the ACB of the property (so that the ACB = 0)
- **BUT partnerships are excluded** from 40(3) b/c 40(3) excluded subtractions to ACB under 53(2)(c)

S. 54(d): "ACB"

In no case shall the ACB to the taxpayer of any property at any time be less than nil

- This means that this "negative ACB" is notional

In a partnership, when have a notional negative ACB, the deemed gain is triggered in **3 ways***:*

1. **100(2): Gain from disposition interest in P/S**

When computing T's gain from disposition of interest in P/S, include notional negative ACB

- Add the negative ACB, not at the time it is negative, but at the time the T disposes of the P/S interest
- Gains disposition P/S interest = PoD + negative ACB

2. **98(1)(c): Disposition P/S Property – on Windup of P/S**

At the end of the fiscal period of the P/S, the ACB of P/S interest is negative, deem negative amount to be gain of the T for the T's tax year that includes that time from a disposition at that time of that interest

- Negative ACB deemed to be gain to T in the tax year – end of fiscal period that P/S ceases to exist

3. **98.1(1)(c): Residual Interest in P/S – on Withdrawal/Retirement of P/S**

Where at end of a fiscal period of a P/S, in respect residual interest in P/S, negative ACB deemed be a gain of T for T's tax year

- Deemed gain from negative ACB triggered at end of fiscal period of P/S that the P withdraws

***Stursberg v MNR (1993) FCA*: "Distribution" in s. 53(2)(c)(v)**

Facts	T was P in GP (Kanvan Group). Had a 40% interest, other P, WGB, had a 10% interest. Clause in P/S Agreement allowed a P to reduce his interest in whole or in part provided they found someone else to acquire the interest. Feb 7, 1983 – interest of T reduced from 40% to 15% and interest WGB increased from 10% to 35% & WGB paid $162,500 into the P/S and the P/S paid $162,500 to T. Aggregate capital contributions of all P's = $400K; Accumulated losses of /S = $1,079,248. FMV P/S assets > $250K
History	**TCC** – dismissed T's appeal - T sold 25% interest in P/S to WGB – substance of transaction was just a sale from T to WGB - P/S was simply used as a conduit in the transaction - Duff: as a matter of Canadian case-law, you can't look at what "really" happened – substance doesn't trump form **FCTD** – dismissed T's appeal - 53(2)(c)(v) not applicable to payment of funds by P/S to plaintiff b/c distribution of p/s capital didn't occur - Distinction b/w *Distribution* of p/s profits or capital and *disposition* by P of part of his p/s interest - No change in overall capital account of p/s; no contribution of capital made to the p/s
Issue	Was the money given to T a distribution of p/s capital or a payment for the disposition of T's p/s interest?
Analysis	Distribution does not require a proportionate division among the recipients – distribution can be to only one beneficiary Unchanged nature of the capital structure of the p/s before and after the transaction - For there to be a distribution of profits or capital then something must have changed
Holding	Not a distribution of capital of the p/s – p/s capital was not reduced by $162,500 or at all
Ratio	***For distribution of capital to have occurred, there must be a change in the capital structure of the P/S***
Duff	CRA should have argued that since T started with 40% interest and then afterwards he only had 15%, then he must have disposed of it – only thing that could have happened - Reason for this being better is that, what if P/S borrowed the $162K and paid it to T and then a week later WGB contributed the money to the P/S then under the court's view the capital structure would have changed - Shouldn't focus on whether the capital structure has changed, should focus on fact the P/S interest has decreased
Note	If had tons of partners in P/S and people are constantly joining and leaving so everyone else's interest changed by 0.1% then CRA said that there is no disposition of p/s interests every time

LIMITED PARTNERSHIPS

Limited Partnerships – P/S with a GP and LP's, limited P's liability is limited to their investment in the P/S
- LP is not liable as a GP, unless in exercising their rights as LP they take part in control of the biz

Flow through + exclusion deemed disposition under 40(3) facilitate P/S to obtain losses that can be used to shelter other sources of income - Tax shelters often structured through a Limited P/S – investors get losses and limited liability

At-Risk Principle

Minister tried to argue that deduction of P/S losses should be limited to T's contributed capital that was "at risk"
- Court said no (*Signum*)

***Signum Communications Inc (1988) FCTD aff'd (1991) FCA*: At-Risk Principle**

Facts	Signum was looking to invest to reduce income – invested $2500 Limited P/S Tertius Film, Signum became LP. Tertius was set up by Quadrant Ltd. Signum paid Quadrant $47,500 as deposit, and Quadrant loaned this to Tertius. Tertius acquired 3 films (total capital cost over $2M), Tertius claimed CCA of $804,214 (1974) & $45,037 (1975) – losses of $816,650 (1974) and $45,037 (1975). Signum claimed proportionate share of p/s losses - $111,870 (1974) & $6,296 (1975) – deducted these amounts Minister disallowed all but $2,500 of losses claimed – Signum says contributed $2,500 and $47,500, so if should be limited, then should be limited to $50K
Issue	Can Signum only claim deductions against its taxable income in the amount proportionate it its share in the p/s losses?
Analysis	**Argument 1: At-Risk Principle** - The $47,500 given to Quadrant was not contributed capital to the P/S – doesn't matter that it may have been "at risk" - The CRA cannot invent a principle that says its not a real loss b/c only contributed certain amount - Case was after enactment of "at-risk" provisions before facts were before them – so no provision in ITA at relevant times – no reason why it should be limited to "at-risk amount" **Argument 2: Former Section 245 (Repealed when GAAR came in)** - Prohibited deductions w.r.t. artificial transactions – this is an incentive set up by gov't so nothing artificial going on **Argument 3: 103(1)** - Nothing unreasonable about losses allocated to Signum – proportionate to capital contributed
Holding	Signum can deduct the losses
Ratio	***No at risk principle – access to losses are not limited to the amount that the limited partner has at-risk***
Note	Would this transaction be GAAR now? - Tax benefit – yes – access to losses - Primarily tax motivated – yes – Signum investing to get access to the losses - Abuse/Misuse – gov't set this up, so just using what the gov't gave

At-Risk Rules

Amount loss > At-risk Amount → Not deductible, but carry-forward to other years

S. 96(2.1): Limited Partnership Losses

Limits amount of losses LP can deduct up to the "at-risk" amount

Notwithstanding, general rule that says flow-through losses, where T is, at any time in a tax yr, a LP of P/S, amount, if any, by which

(a) total of all amounts each of which is T's share of the amount of any loss of the P/S, determined in accordance with subsection 96(1), for a fiscal period of the P/S ending in the taxation year from a business or from property

exceeds

(b) T's at-risk amount of the p/s at the end of the fiscal period

shall

(c) not be deducted in computing the taxpayer's income for the year

S. 111(1)(e): Carry-forward Limited P Losses

Carry the amount loss > at-risk amount forward to other years
- Unlimited carry-forward
- Deduct Limited P/S loss to the extent have at-risk amount
- Carry-forward losses in hope get at-risk amount in the future (by contributing capital or having share in income)

S. 96(2.2): "At-Risk Amount" = (a + b) – (c + d)

(a) → ACB T's P interest of P/S at that time
- **S. 96(2.7)** – if T contributes capital and P/S loans it back/repays it to T → deem no contribution

(b) → Limited P's share income at end of the fiscal year

(c) → Amounts owing by Limited P (or NAL person) to the P/S
- **S. 96(2.6)** – Where pay amount owing to P/S to increase at-risk amount and access losses → deemed not have paid

(d) → Amount/Benefit T is entitled to for the purpose of reducing impact of loss T may sustain
- If LP has agreement/K/benefit going to get that reduces risk of loss, then that reduces at-risk amount

S. 96(2.4): "Limited Partner"

A T who is a memb of a P/S at a particular time is limited P if within 3 years after that time

(a) by operation by law governing the P/S arrangement, the liability of the member is limited
- **Limited partner by law**

(b) member (or NAL person) entitled, either immediately or in the future and either absolutely or contingently, to receive an amount or obtain a benefit described in (2.2)(d)
- **Entitled to benefit that guarantees against loss**

(c) one of the reasons for existence of member who owns the interest

(i) reasonable considered to be to limit the liability of any person w.r.t. that interest; and

(ii) cannot reasonably be considered to be to permit any person who has an interest in the member to carry on that person's biz in most effective manner; or
- **If have another reason for a corp as a P, then that is okay, but if reason is to limited liability then the corporation is a limited P**

(d) there is an agreement/ arrangement for disposition of an interest in P/S and one of main reasons for the agreement/arrangement can reasonably be considered to be attempt to avoid the app of this subsection to the member.

96(2.3)(b): ACB P/S Interest Transferee

Limits ACB of P/S interest acquired from another LP is greater of: ACB of transferor's P/S interest; & Nil
- Only for purposes of computing the transferee's at-risk amount

S. 53(2)(c)(i.1): ACB Limited P/S Interest

Subtract from ACB amount in respect each fiscal period of P/S ending before that time that the T's limited P/S loss in respect of the P/S for the tax year in which that fiscal period ends to extent such loss was deducted by the T in computing the T's taxable income for any tax year that commenced before that time

➔ Subtract "at-risk" amount (or amount they actually deduct) from ACB of limited P interest b/c this is loss deducted by limited P
- Share in losses deferred until P is actually able to claim it

S. 53(2)(c)(i) – Not getting access to Limited P/S losses, so don't subtract the losses in computing the ACB of the P/S interest

➔ Don't subtract under s. 53(2)(c)(i) for limited P P/S interest

Signum Example:
- $110K losses & $2,500 allowed under 96(2.1) then remainder ($107,500) is limited P/S loss which can be carried-forward
- ACB P/S interest reduced by $2,500 – paid $2,500 for P/S interest minus $2,500 → ACB = 0

Say, next year get $10,000 of income – now use $10,000 from carry-forward, so losses can access go down to $97,500 in subsequent years when have at-risk amount

Prevention Artificial Transactions

S. 96(2.6): Artificial Transactions

For purposes of 96(2.2)(c) (↓ at-risk by amounts owing by LP to P/S), where at any time an amount owing by a T (or NAL) is repaid and it is established, by subsequent events or otherwise, that repayment was made as part of a series of loans or other transactions and repayments, the amount owing shall be deemed not to have been repaid.
- Where pay amount so can get access to losses, then amount owing deemed to not have been paid

S. 96(2.7): Artificial Transactions

For purposes of 96(2.2)(a) (↑ at-risk amount by ACB), where at any time a T makes a contribution of capital to a P/S and the P/S or (person/P/S NAL to P/S) makes a loan to the T or (person T NAL) or repays the contribution of capital, and it is established, by subsequent events or otherwise, that loan or repayment, as the case may be, was made as part of a series of loans or other transactions and repayments, contribution of capital shall be deemed not to have been made to the extent of the loan or repayment, as the case may be.
- T contributes capital to P/S, and the P/S loans it back and do this as part of series, then cannot bump-up at-risk amount

***Brown v Canada (2003) FCA*: 96(2.4) & 96(2.2)(d)**

Facts	CEG P/S established to raise capital to acquired software programs for video games from ASC. Dec 31, 1993 – 28 P's (including T), T acquired 80 units for $10K/unit - $4K/unit cash & $6K/unit debt CEG bought software ASC for $8.25M, buys with loan and investors assume debt– CEG has very high CCA 1995 - Amendment P/S agreement 2 rs later that says can redeem units $8K cash + shares of ASC T deducted from income biz losses, including CCA, based on acquisition cost of software programs and expenses incurred by the P/S – Minister re-assessed T, disallowing deductions - CRA says this is a guarantee (amount or benefit) - $8K back and shares worth about $2,000
Issue	Losses happened in 1993 and 1994, but agreement in 1995, so does the agreement effect ability to deduct losses?
Analysis	**Is T a limited partner? Yes** - CEG is general partnership, so T not LP by operation law - 96(2.4) - "within 3 years after that time", so in 1993 & '94 the agreement not in place, but it is in place within 3 years - If T becomes entitled to obtain benefit within 3 years after T seeks to deduct P/S losses, the T will be deemed limited P, regardless whether benefit itself is obtained immediately or at any time in the future - Within 3 years, T is entitled to, either immediately or eventually, entitled to a benefit under (2.2)(d) o Guarantee to buy for $8K + shares count as an amount/benefit T is a limited partner, in 1993 and 1994 b/c within 3 years had a benefit **T's ability to claim losses in 1993 & 1994:** - Within 3 years, T is entitled to, either immediately or eventually, entitled to a benefit under (2.2)(d) - ACB = $800K (based on the capital contributed) - At-risk amount = $800K - $480 = $320K o 800 = ACB; 480 = if ASC deals NAL with CEG, then subtract $6K (per unit) for the assumed debt - In 1993 & 1994 T doesn't have the benefit (agreement comes in 1995) – he is an LP but 96(2.2)(d) doesn't say "within 3 years" so doesn't have the benefit - Court assumes that 3-year thing for definition LP also applies for "at-risk" amount o Duff: this part isn't well analysed **How to Compute benefit in 96(2.2)(d)?$2K/unit** - Guarantee is only for $8K/unit – shares haven't been listed yet and never actually are listed - Though the shares were likely intended to cover this amount, share benefit is too vague to ascribe a value to it o Duff: Court is right here – can't say they are worth only $2K
Holding	A's amount at risk was $2K/unit
Ratio	***"Within 3 years" also applies retroactively to receiving a benefit for computing at-risk amount under 96(2.2)(d)***

Deemed Gains

People were getting around rules by:

- 1. Losses flowed out // 2. Distribute capital of P/S // 3. Have at-risk amount that would make ACB = zero // 4. Distribute capital and have negative ACB – reduce at-risk amount but not claiming losses anymore

S. 40(3): Negative ACB deemed gain from disposition property

- Add negative amount in computing ACB of property – 53(1)(a)

S. 40(3.19): 40(3) does not apply where 40(3.1) applies

****S. 40(3.1) & (3.11): Deemed Gain Certain Partners**

If T is a limited P or specified member of P/S – deem negative ACB of T's P/S interest to be a gain at end of fiscal year

- Negative ACB = Capital gain at end of fiscal year
- If T disposes of P/S interest, then **100(2)** applies instead of these rules
- Add this deemed gain in computing ACB to restore it zero – **s. 53(1)(e)(vi)**
- If reasonable to consider one of the main reasons that P is not a specified P is to avoid 40(3.1), then deem P to be specified memb. – **40(3.131)**

S. 40(3.14): "Limited Partner" Same definition as 96(2.4)

S. 248(1): Specified Member

- Extends deeming rules to passive members of P/S who haven't been involved in the biz

S. 40(3.12): Elect Loss

If T has subsequent ACB, can elect to realize loss equal to lesser of the subsequent ACB and the gain that was deemed under 40(3.1) less any amount previously recognized under 40(3.12) and then carry-back to offset the deemed gain from when you had - ACB

- Allows you to offset ACB deemed gain when ACB later becomes positive

If trigger a deemed loss, subtract that loss from the ACB of T's P/S interest – **s. 53(2)(c)(i.2)**

TRANSFER PROPERTY TO P/S

S. 97(1): Basic Rule for Transfer Property to P/S
Where at any time after 1971 a P/S has acquired property from a T who was, immediately after that time, a member of the P/S, the P/S shall be deemed to have acquired the property at an amount = FMV at that time and the T shall be deemed to have disposed of the property for PoD = FMV.

- Applies even where transferor does not deal at arm's length with the P/S

2 sets of rules govern transfers of property to a P/S:
Rollover Rules – facilitate reorganization of the biz as a P/S by allowing transferors to defer tax on the transfer of property to a P/S of which they are a member
Stop-Loss Rules – prevent artificial realization of losses through transfers to a P/S with which the transferor is "affiliated"

ROLLOVEROVER RULES

Allow the T (jointly with all the other members) to elect the amount at which the property is transferred to the P/S

- Elected amount deemed to be the PoD to the partner and the cost of the property to the P/S

➔ Partnership inherits the tax costs

S. 97(2): Rollover Rules – imports rules from 85(1)(a) – (f)
*Notwithstanding any other provision, where T at any time disposes of any property that is a capital property or inventory of T to a P/S that immediately after that time is a Canadian P/S of which **T is a member**, if T and all the other members of the P/S **jointly so elect***

- **S. 102(1): "Canadian Partnership:"** P/S where all the members are resident in Canada
- Joint election of all the members of P/S

Elected Amount

Rules tell what elected amount is – effect of elected amount is that it is deemed to be PoD to T and cost property to P/S

S. 85(1)(a): Election amount = PoD to T & Cost property to P/S
the amount that the T and the other members of the P/S have agreed on in their election in respect of the property shall be deemed to be the T's proceeds of disposition of the property and the P/S's cost of the property;

- Elected amount deemed to = PoD to T = Cost Property to P/S
- Capital gain/income not realized is deferred to the P/S until the P/S disposes of the property – once P/S disposes of the property, income/capital gains flows to the P's (96(1))

S. 85(1)(c): Prevent Artificial Gain (inventory, non-depreciable capital property & depreciable capital property)
*Where amount that the T and all other members of the P/S have agreed on in their election in respect of property is greater than the FMV, at the time of the disposition, of the property so disposed of, the amount so agreed on shall, irrespective of the amount actually so agreed on, be **deemed to be an amount equal to the fmv***

- **If election > FMV property → election deemed = FMV**
- **Purpose**: prevent realization of artificial gain by T and creation of artificial loss to the P/S

Example: Inventory cost = 60, FMV = 100, elect 150

- Electing 150 creates artificial income inclusion and creates a cost > FMV for the p/s (artificial loss)
- Deemed to elect 100 – could elect less than 100

S. 85(1)(c.1): Prevent Artificial Loss - Inventory & Non-Depreciable Property
Where the property was inventory or capital property (other than depreciable property) … and the amount that the T and all the other membs of the P/S have agreed on in their election in respect of the property is the less of the lesser of

(i) The FMV of the property at the time of the disposition, and
(ii) The cost amount to the T of the property at the time of the disposition

The amount so agreed on shall, irrespective of the amount actually so agreed on by them, be deemed to be an amount equal to the lesser of the amounts in (i) and (ii)

- **If elect less than the lesser of cost & FMV → deemed elect lesser cost & FMV**
- T can use election to recognize real losses but not to create artificial losses by electing amount less than FMV or the cost
- **S. 248: "Cost Amount"**
  - Non-depreciable capital property = FMV
  - Inventory = lesser cost & ACB

Effect of combination of (c) and (c.1): for inventory and non-depreciable property

IF cost < FMV → Cost ≤ Election ≤ FMV

- **Example**: cost = 60, FMV = 100, elect 45 → Inventory has a gain
- Lower of cost and FMV is cost = 60
    - Election is less than the lesser of cost and FMV – election generates an artificial loss
        - Deemed to have elected 60

IF FMV < Cost → Election = FMV

- **Example**: cost = 100, FMV = 60 → Inventory has decreased in value
    - Elect 60 – this is okay
    - Elect 45 – real loss of 45 but trying to claim loss of 55 – not allowed, artificial loss
        - Deemed to have elected 60 (lesser of FMV and cost)

S. 85(1)(e): Prevent Artificial Loss - Depreciable Property

Where the property was depreciable property of a prescribed class of the T and the amount that, but for this paragraph, would be the proceeds of disposition thereof is less than the least of

(i) The UCC to the T of all the property of that class immediately before the disposition;

(ii) The cost to the T of the property, and

(iii) The FMV of the property at the time of the disposition

The amount agreed on by the T and the P/S in their election in respect of the property shall, irrespective of the amount actually so agreed on by them, be deemed to be the least of the amount described in (i) to (iii)

- **Floor for elected amount is least of: UCC, Cost & FMV**

Example 1: Capital Cost = 100, UCC = 50, FMV = 20, elect 10

- UCC < FMV – hard on the property, so depreciated faster than expected
- If elect 10 then trying to create artificial terminal loss, real terminal loss is 50 – 20 = 30
- Deemed to have elected 20

Example 2: Capital cost = 100, UCC = 20, FMV = 50, elect 10

- If elect 10, creating terminal loss that is not real b/c the FMV is 50
- Don't have to elect 50 b/c that would create recaptured depreciation
- Deemed to elect 20

Boot

S. 85(1)(b): BOOT - If the elected amount < FMV_{boot} → deemed election =FMV_{boot}

*Subject to 85(1)(c), where amount that the T and the P/S have agreed on in their election in respect of the property is less than FMV, at the time of the disposition, of the consideration therefor received by the T, the amount so agreed on shall, irrespective of the amount actually so agreed on by them, be **deemed to be amount equal to FMV of the consideration***

- (c) says can't elect more than FMV property transferred in
- **Effect**: requires transferor to realize income/capital gain when the FMV_{boot} received as consideration for property transferred to the P/S exceeds the cost of the property transferred in

IF $FMV_{property}$ > FMV_{boot} → FMV_{boot} ≤ Election ≤ $FMV_{property}$

- **Example**: Cost = 60, $FMV_{property}$ =100, FMV_{boot} = 80 and elect =60
    - Realized 80 so rule kicks in and says elected amount = 80
    - Have to realize gain of 20

IF $FMV_{property}$ < FMV_{boot} → Election = $FMV_{property}$ & FMV_{boot} - $FMV_{property}$ = Withdrawal (↓ ACB)

- **Example:** Cost = 60, $FMV_{property}$ =100, FMV_{boot} = 120
    - P/S distributed 20 of value to P
    - Elected amount = 100 - Don't realize gain
    - Treat 20 as withdrawal of capital – reduce ACB P/S interest by 20

85(1)(e.3): (b) & (c.1)/(e) applies

Elected amount is greater of (c.1)/(e) and (b)

- **Example**: Cost = 60; $FMV_{property}$ = 100; FMV_{boot} = 40. Elected 20
    - Election violates (b) and (c.1) - (b) says elected would be 40, (c.1) says 60
    - (e.3) says elect 60 and both rules are satisfied
- **Example**: Cost = 60; $FMV_{property}$ = 100; FMV_{boot} = 75. Elected 20
    - FMV_{boot} > Cost, so election deemed to be 75

85(1)(e.2): BENEFIT RULE

where the $FMV_{property}$ immediately before the disposition exceeds the greater of

(i) *the FMV_{boot}, immediately after the disposition, and*

(ii) *the elected amount,*

*and reasonable to regard any part of the excess as a benefit that the T desired to have conferred on a person related to the T (other than a corp that was a wholly owned corp of the T immediately after the disposition), the amount that the T and the corp agreed on in their election in respect of the property shall, regardless of the amount actually so agreed on by them, be **deemed** to be an amount equal to the total of the amount referred to in subparagraph 85(1)(e.2)(ii) and that part of the excess*

- Where $FMV_{property}$ > of Elected amount & FMV_{boot}
  - If excess reasonable regard benefit to related person → **elected amount = elect + benefit**
- **Effect**: T has to realize up to the amount of the benefit where T's attempt to use rollover provisions to confer economic benefit on related persons

Example: Cost = 60; $FMV_{property}$ = 100; FMV_{boot} = 80. Elected 60

- Diff b/w amount received (80) and amount given (100) reasonable regard benefit on someone else
- (e.2) deems elected amount to be the elected + benefit = 60 + 20 = 80 - Forces T realize at least the gain of the benefit

85(1)(f): Cost Boot to P = Lesser of FMV_{boot} & $FMV_{property}$

- Cost of the boot that the P receives in exchange for property that they transfer into the P/S

Example: Cost = 60; $FMV_{property}$ = 100; FMV_{boot} = 80.

- If elect < 60, the deemed to elect 60 (c.1)
- If elect less than 80 then deemed to elect 80 (b)
- (e.3) says greater of those amounts, so elect 80
- But cost to the partner = 80

Example: $FMV_{property}$ < FMV_{boot}

- Cost boot deemed $FMV_{property}$ so going to realize a gain
- Punitive – distribution of income/capital P/S

Unless $FMV_{property}$ < FMV_{boot}; **cost of boot = FMV_{boot}**

ACB P/S Interest

97(2)(b): Adjust ACB

in computing, at any time after the disposition, the ACB to the T of the T's P/S interest immediately after the disposition,

*(i) there shall be **added** the amount, if any, by which the T's PoD of the property exceed the* FMV_{boot} *received by the T for the property, and*

IF PoD > FMV_{boot} → ↑ ACB (adding tax paid value)

*(ii) there shall be **deducted** the amount, if any, by which the* FMV_{boot} *received by the T for the property so disposed of by the taxpayer exceeds the* $FMV_{property}$ *at the time of the disposition*

IF FMV_{boot} > PoD → ↓ ACB (distribution profits/capital)

97(4): Depreciable Property – P/S inherits capital cost and UCC

Where 97(2) has been applicable in respect of the acquisition of any depreciable property by a P/S from a T who was, immediately after the T disposed of the property, a member of the P/S and the capital cost to the T of the property exceeds T's PoD

(a) *the capital cost to the P/S of the property shall be deemed to be the amount that was the capital cost thereof to the T; and*

(b) *the excess shall be deemed to have been allowed to the P/S in respect of the property under regulations made under paragraph 20(1)(a) in computing income for taxation years before the acquisition by the partnership of the property.*

P/S steps into shoes P w.r.t. original capital cost – **P/S inherits capital cost Property & UCC**

- Inheriting UCC that exists after the transfer, and inheriting capital cost

Example: Cost = 100; FMV = 20; UCC = 50

- P/S deemed acquired property 100
- Difference b/w capital cost and proceeds deemed to have been allocated to P/S as CCA
- Deemed to have deducted 80 as capital cost in past and UCC = 20

Two kinds of cases:

1. Where T transfers property on tax deferral basis to P/S and then **within period of time get money**, is that boot?
   - If boot, can't elect less than amount of boot – 85(1)(b)
   - If not boot, and is distribution profits/capital of P/S, not taxable event – reduce ACB and if not limited partner, not triggered
2. **Characterization issue**
   - Property that if disposed of it directly to someone would give rise to recaptured depreciation or biz income (fully taxable)
   - Transfer it into P/S on rollover basis and take P/S interest and then sell P/S interest – capital property
   - Converted taxable income into partly taxable capital gain

Haro Pacific Enterprises v Canada (1990) TD: CHARACTERIZATION PAYMENT AS "BOOT"

Facts	π claims certain property was transferred to P/S is governed by rollover and no capital gains tax payable by π for transfer Feb 7, 1982 – π transferred properties worth $1.9M to P/S - Election filed in 97(2) – agreed property being transferred in return for P/S interest Feb 7, 1982 - # Corp (other memb/ P/S) contributed $950K Feb 12, 1982 - P/S paid π $950K
Issue	Is the $950K given to the π boot? If boot, have to elect no less than $950K and gain of $650K
Analysis	The $950K is boot – consideration other than interest in the P/S - Substance of the matter – regarded as boot (Duff: not supposed to engage in economic substance argument) Could say looked at agreement that says when properties transferred in $950K transferred out- makes it look like boot - P/S Agreement says that after transfer of title to lands, π should be entitled to demand and received out of property of p/s capital repayment equal amount contributed # corp Consideration for transfer of property was both P/S interest and the $950K cash 85(1)(b) – amount received by T on transfer property to P/S greater amount agreed upon by π and P/S in 97(2) election
Holding	Minister correct in deeming π's PoD of property – this is boot
Ratio	***Even if money isn't given at the time of transfer, it can still be characterized as boot***
Note	Issue is that π wanted this in the P/S agreement – need to trust it will happen and then it will look like a distribution If someone did this transaction and it turned out not to be boot, then GAAR apply

MDS Health Group v Canada (1995) TCC aff'd (1996) FCA:

Facts: T received $1.5M when it transferred to P/S technology - other memb of that P/S elected nominal amount under 97(2)
- T argued payment should not be characterized as consideration subject to deeming rule in 85(1)(b) – bound by P/S agreement to contribute the amount withdrawn back into the P/S over 3-year period

Holding: Court dismissed T's appeal – money that T received was boot
- Characterization of payment as PoD "better reflected the true nature of the transaction"

Manji v Canada (1999) TCC:

Facts: T entered into agreement to sell property (worth $1,175,000) to P/S in exchange for $500K promissory note and 4 P/S units the capital account of each was credited $168,750
- T received $1,175,000 from P/S a week after sale closed
- T and other members of P/S elected $500K as the T's PoD

Holding: Payment is boot - Amount paid in consideration for transfer of the property

Pinot Holdings Ltd v Canada (1999) FCA:

Facts: T owned real property – 3 mortgages (totalled $13.5M) – T was in default
- T formed equal P/S with arm's length company – transferred properties and company loaned $5M interest-free
- P/S obtained new mortgage ($10M) – that + $3.5M from company was used to outstanding the mortgages
- T & company jointly elected to transfer properties to P/S for proceeds = tax cost (defer capital gains & CCA)
- Minister reassessed – included $977,435 & recaptured depreciation of $3,716,895 on basis T received $13.5M in form p/s repayment of mortgages

Holding: Affirmed Minister's assessment – 96(1) regards p/s as separate person for purposes computing income
- Legal character of amounts paid by a p/s to a P is function of obligation discharged irrespective of how payment is funded

Ceco Operations v Canada (2006) TCC: GAAR APPLIES

Facts	T wholly-owned sub of Ceco Properties which wholly-owned sub of Cypress – shares owned Holdco's - owned by 6 key employees. 1 employee wanted retire and dispose of interest in biz – sought purchaser. Equipment wanted to sell was in "Properties" – transferred assets to Operations on rollover (85(1)) Group buying assets made P/S (SML) – Operations transferred assets P/S on rollover basis and got cash, notes, assumption of debt and "F" units (F units – entitled Operations dividends from investment income into Holdco's) - Don't treat these F notes as boot Sell assets and take out $18.7M upward of chain – cash coming out and never pay dividends
Issue	Is the $18.7M boot?
Analysis	$18.7M not boot - Consideration goes to corp (other than Operation), so have to pierce corporate veil GAAR – sophisticated set of transactions to get money out in exchange for property w/o being subject boot rule - When GAAR came in, gov't said would apply GAAR to transactions to get around *Haro* - **Tax benefit** – deferral of tax made possible by rollover in 97(2) - **Primary purpose transaction** – transaction formed series & undertaken exclusively to defer tax of portion sale price - **Misuse/abuse** – use of avoidance transactions to secure rollover and permit tax deferred proceeds to reach the Holdcos results in patent abuse of 97(2)
Holding	Dismiss taxpayer's appeal
Ratio	***GAAR will apply to transactions like Haro if found not to be characterized as boot***

***Continental Bank Leasing Corp v Canada (1998) SCC*: VALIDITY TRANSACTION**

Facts	Leasing Co was sub to Bank and in leasing biz (owns assets and leases them out) – assets had recaptured depreciation. Bank collapses and is in the process of liquidating assets. Loyd's agreed purchase assets – but didn't want Leasing assets. **Dec 24, 1986 - P/S created** – Leasing transferred biz to P/S in return 99% interest – leasing biz worth $130M – rollover - Two subs of Central transfer $656,929 for 0.5% P/S interest each - The 1st fiscal period of P/S ended Dec 27, 1986 – 3-day P/S **Dec 27** – Leasing wound-up into Bank, so Bank has 99% P/S interest **Dec 29** - Subs of Central acquire P/S interest from Bank **Effect**: Property rolled into P/S, sub amalgamated w parent and parent sells P/S interest to P in P/S - P/S interest is capital property and sale is capital gain on sale P/S interest Leasing's filed return on basis that pursuant to 97(2), it transferred all its assets to P/S in return for interest in P and that interest was transferred to Bank – MNR reassessed on basis P/S transaction invalid and true nature was disposition by Leasing of its leasing assets to Central – 97(2) election invalid
Issue	(1) Was there a partnership? If no P/S and deny rollover then Leasing has to pay recaptured depreciation on all the assets (2) Is the P/S invalid b/c the Bank Act says it is illegal for a bank to carry on biz in P/S?
***Issue 1**	**Biz Carried on** – Yes – Business includes every trade, occupation and profession o Don't need to be signing new biz to find biz being carried on (*Hickman Motors*) o Biz carried on before and after the 3 days and biz was not suspended during those 3 days **Biz carried on in common – Yes** o P/S distributes some of the profits – indicates doing this in common (distribute profits in accordance P's interest) o Some contractual liability – leasing liable for those 3 days o Contractual arrangement is test for whether have something carried on in common and sharing profits **View to Profit** – profit doesn't need to be main purpose, can be ancillary purpose less important than primary purpose o Leasing received cheque for $130,736 was described as 99% share of P/S income o Bank & Leasing main intention was to get rid of its leasing assets o Just b/c parties had overriding intention creating P/S for 1 purpose doesn't negate fact profit-making and profit-sharing was ancillary purpose **Duration of P's membership in the P/S is not relevant**
Issue 2	*Bank Act* - unlawful for Bank to hold interest in P/S // *P/S Act* - P/S dissolved where unlawful for biz to be carried on - Leasing is the partner and not Bank – not unlawful for Leasing to be a member of the P/S - Once Leasing rolled into Bank, Bank is memb P/S but by that time properties already put into the P/S - P/S was not void
Holding	Valid partnership within meaning s. 2 partnership Act - Election under 97(2) was valid
Ratio	***Radically lowered the threshold for satisfying the test for establishing a P/S***

ACQUISITION P/S LOSSES

Two Kinds of Losses:

1. Non-Capital Losses – Computation under s. 3 is negative (usually loss from biz or property) - Losses from Biz/Property > income
- 3 years carry-back and 20 years carry-forward – s. 111(1)(a)

2. Net Capital Losses – Allowable Capital Losses > Taxable Capital Gains
- Carry back 3 years & Carry-forward indefinitely – s. 111(1)(b)

For a P/S, losses flow out to the P's at the end of the fiscal year
- **Issue**: P sells P/S interest (w right losses) before end of fiscal year to someone who can make use of the losses

***Backman v Canada (2001) SCC*:**

Facts	American P/S established – had Dallas Apt Complex 1988 – FMV of apt complex declined → **FMV < Cost** - T and bunch CA's tried get access losses – buy accrued losses August 29, 1988 – series of transactions in 1 day (note: GAAR only applies to transactions after Sept 19, 1988) - CA's buy P/S interest from US P's for $180K so now CA's own P/S which owns Apt - Apt immediately sold back to US P's which triggers loss on value of Apt - CA P's decide to do something else with P/S so they spend $5K for 1% interest in oil and gas property – never produces profit and don't seem to monitor it carefully – eventually buy Montana Condo At end of fiscal year of P/S, losses get flowed out to CA P's – MNR disallowed P/S losses claimed by T
Analysis	**Carrying on Biz**: First thing P/S does is sell Dallas Apt (same day) – biz is not being "carried on" - Even though acquired oil & gas interest no real activity –passively holding property – "window dressing" **In Common**: No business being carried on so not carried on in common **View to Profit**: View to profit at Tremont Apts and it makes profit eventually so okay – doesn't matter huge loss initially
Holding	No Partnership
Ratio	***Have to have real business being carried on after and have to demonstrate P/S can profit (but don't need to profit)***

Spire Freezers Ltd v Canada (2001) SCC:

Facts	P/S developed luxury condos in California – had to develop low cost apts – Tremont Apt - 2 corp's held interest in P/S: BCE and Peninsula Cove End 1986 – development cost Hamilton Grove Condos > FMV = accrued loss = $10M Nov 30, 1987 – T (and other Canadian's) buy losses for 20 cents on the dollar - Loan given by BCE to P/S – uses to buy Tremont Apt from corp so now Tremont Apt owned by P/S - P/S has 2 assets – one asset has accrued losses - T acquires ½ BCE P/S interest and all Peninsula P/S interest (Canadian group acquires rest of BCE interest) - P/S sells Hamilton Grove Villas to BCE – trigger $10M loss - Losses flow through at end of fiscal year to T - P/S holds on to Tremont Street apt and eventually turns a profit Result: T (and rest of Canadians) paid $1.2M to acquire Tremont and the losses of $10.4M CRA reassesses T – not true P's and therefore could not claim biz loss
Analysis	**Carrying on Biz**: - Tremont Apts owned by P/S before and continues to be owned by P/S after – continue carrying on biz - Business is being carried on **In Common**: found the biz is being carried on in common **View to Profit**: valid and existing P/S formed with view to profit - Despite fact loss incurred by subsequent sale of condo, fact CA P's were aware of potential for Tremont and fact Tremont consistently turned profit established biz was carried on w view to profit
Holding	Had a valid P/S

Witkin v Canada (2002) FCA:
Facts: T (& other CA T's) acquired 99% interest in US P/S – had tax loss of $45M resulting - write down of real property inventory.
Holding: Disallowed loss b/c T had not become a P to whom losses could be allocated under 96(1) and did not carry on biz in common with view to profit

- T's sole purpose acquiring interest was acquire tax losses – no ancillary intention carrying on biz in common w view to profit

Geddes Contracting Co v Canada (2005) TCC aff'd (2006) FCA:
Facts: T (& other CA purchaser's) acquired interest in US P/S which held land inventory with accrued loss. Following withdrawal of US P's, land sold to new US P/S. CA P's continued to hold an "option" w.r.t. the original P/S property.
Holding: No P/S – option was not a real option – no right to participate in decisions w.r.t. project, and "option" just quietly expired

96(8): Foreign P/S

Where at particular time person resident in CA becomes memb of P/S, or a person who is a memb of a P/S becomes resident in CA, and immediately before particular time no member of the P/S is resident in CA, following rules apply for purpose computing P/S income for fiscal periods ending after the particular time:
(a) *where, at or before the particular time, the P/S held depreciable property of a prescribed class,*
(ii) where property is P/S's property at particular time, property shall be deemed to have been acquired, immediately after particular time, by the P/S at capital cost equal to the lesser of its FMV and its capital cost to the P/S otherwise determined;

- If have one item depreciable property, terminal loss is when FMV < UCC
- Generally, (ii) will be the FMV (b/c capital cost is < FMV) only when multiple property in a class
- **Where Canadian becomes member foreign P/S, P/S property deemed acquired by P/S at cost = FMV**

(b) *in case of P/S property that is inventory (other inventory of a biz carried on in CA) or non-depreciable capital property (other than taxable CA property) of P/S at particular time, its cost to P/S shall be deemed to be, immediately after particular time, equal to lesser of FMV and its cost to P/S otherwise determined;*

- **Write down cost property to lower cost & FMV** – if FMV < cost - cost deemed FMV – gets rid accrued loss

*****(c)*** *any loss in respect of the disposition of a property (other than inventory of a business carried on in Canada or taxable Canadian property) by the P/S before the particular time shall be deemed to be nil*

- Inventory and taxable property carved out b/c already susceptive Canadian tax
- **Loss deemed to be nil** – limits access to losses in fiscal period

How would 96(8) work in ***Backman*** & ***Spire Freezers***? Both cases T would not access the loss b/c cost written to FMV at time T acquired the property so when property sold no loss (Spire – inventory (b), Backman – Depreciable capital – (a))

Unclear if in Canadian P/S could rely on 103(1) and (1.1) to reallocate:

- Unreasonable allocate loss to P who was not a P when loss accrued but was P when loss was realized
- If someone joints P/S at end of the fiscal year to get access to the loss, then could say unreasonable allocation
- 103(1) – have to argue principal reason was to reduce tax (not clear could make that argument)

103(1.1) –argue unreasonable to allocate to someone who joined P/S at end of fiscal period but wasn't there when loss accrued

***Stow v Canada (2010) TCC*: Cannot use 103(1) and (1.1) to allocate to former P**
Facts: T acquired 80% interest in P/S with unrealized losses > $7.5M - $6M allocated to T at end fiscal year
Holding: Rejected use of 103(1) & (1.1)

- **103(1)** – Principal reason allocation income and losses in P/S agreement was not reduction/postponement of tax
- **103(1.1)** – Not unreasonable to allocate 80% losses to T taking into account capital invested in P/S

Minister argued loss should be allocated to former partner

- Court said that ***nothing in 103(1) and (1.1) permits the allocation to P/S to former P***

S. 96(1.01)(a): Income Allocation Former Member
If T ceases to be memb of P/S, then for purposes of 96(1) and 103, the T is deemed to be a memb of the P/S at the end of the fiscal yr

- So when someone has left a P/S, can allocate loss to them if deemed to be memb of P/S at end of fiscal period

***Duncan v Canada (2002) FCA*: GAAR (before 96(8))**

Facts	US P's owned P/S that held IBM mainframe comp (cost = $3.7M, FMV = $7K). US P's sell P/S to CA investors - UCC was $3.7M b/c no subtraction under Canadian law Accrued unrealized loss depreciable property – sells computer and claim terminal loss of $3.65M - flows to CA investors
Issue	Does GAAR apply?
Analysis	**Tax benefit** – yes – huge terminal loss that flowed-through to CA P's **Primary Purpose obtain tax benefit** – yes – Duff: Court so overwhelmed by magnitude of tax benefit **Misuse/Abuse –** yes – abuse/misuse CCA regime - 96(8)(a) would have prevented this - T argued that ITA was amended so before amendment this was okay - Duff: Court thinks this is so egregious, can't let this go – getting to deduct UCC twice
Holding	GAAR applied

Could GAAR apply to loss trading to transaction in domestic context? Prob not

- If CA acquires from CA P their P/S interest to get losses – try applying GAAR
- ITA considers it for domestic corps and trusts and foreign P/S so hard to say abusive for domestic P/S

STOP-LOSS RULES

Stop loss rules prevent recognition artificial losses from disposition of property in circumstances where T or "affiliated person" acquires the same property or identical substitute within specified period of time

Capital Property	Inventory	Depreciable Property
Gain = Pod – ACB Loss = cost + transaction cost – PoD S. 40(1)	Gain = PoD – Cost/FMV (lesser) s. 9(1)	PoD – UCC - Positive: terminal loss – s. 21(16) - Negative: recaptured depreciation 13(1)

T may want to realize loss (to offset gain) but don't actually want to lose the property – so sell property and realize loss and then buy it again (or sell it to closely affiliated person, so retain economic interest)

➔ ITA doesn't like this – so stop-loss rules introduced

Where dispose of property to "affiliated person" or dispose property and reacquire it, then stop the loss

- Gain = nil & Loss = nil → eliminate terminal loss

251.1(1): "Affiliated Persons" – narrower concept than related
*(a) an **individual** and a spouse or common-law partner of the individual;*
*(b) a **corp** and*
(i) a person by whom the corporation is controlled,
- Control – directly or indirectly in any manner whatever (de facto)

(ii) each member of an affiliated group of persons by which the corporation is controlled, and
- Corp affiliated with each memb of affiliated group – if spouses hold corp then each affiliated w corp

(iii) a spouse or common-law partner of a person described in subparagraph (i) or (ii);
- Could be affiliated with company even if don't own shares – spouse owns company

*(c) **two corps**, if*
(i) each corps is controlled by a person, and person by whom one corp is controlled is affiliated with the person by whom the other corp is controlled,
- X & Y control a corp – if X & Y spouses then the 2 corps affiliated

(ii) one corp is controlled by a person, the other corp is controlled by a group of persons, and each member of that group is affiliated with that person, or
- X has 50% X co and X has Holdco that has other 50% X Co. Y has 100% Y Co → if X and Y are spouses then X Co and Y Co affiliated

(d) *a* ***corp and a P/S****, if corp is controlled by a particular group of persons each member of which is affiliated with at least one member of a majority-interest group of partners of the P/S, and each member of that majority-interest group is affiliated with at least one member of the particular group;*

- Each memb. Of group that controls corp is affiliated w at least one-member majority interest group
- Each memb. Majority interest group is affiliated with at least 1 memb of group that controls corp

(e) *a* ***partnership and a MIP*** *of the partnership; (*MIP could be P/S itself)

(f) ***two partnerships****, if (i) the same person is a majority-interest partner of both partnerships,*

248(1): "Majority-Interest Partner"
T and those affiliated with T entitled > 50% P/S income or > 50% P/S property on dissolution

S. 251.1(3): "Majority-Interest Group" - If 1 person held interest of group, then that person would be a MIP

S. 251.1(4): Persons are affiliated w themselves

- If have yourself and spouse controlling corp and MIP, then affiliated with each memb. Of group b/c affiliated w yourself

Individual Disposing Non-Depreciable Capital Property

S. 40(2)(g)(i): T's loss from disposition of property to extent it is a superficial loss is nil

S. 54: "Superficial Loss" *means T's loss from disposition of a particular property where*
(a) *during period begins 30 days before and ends 30 days after disposition, the T or a person affiliated with the T acquires a property ("sub property") that is, or is* ***identical to****, the particular property, and*

- T or an affiliated person within 60-day window, acquires property that is the particular property or identical property

(b) *at end of that period, the T or a person affiliated with the T owns or had a right to acquire the substituted property,*

- Acquire property within 60-days but dispose before 30 days after then really have disposed of it - stop-loss rule won't apply

T disposes of property and then in 60-day window from that disposition T or affiliated person reacquires or acquires identical property and holds it past 30-days → stop loss rules will apply

Except if ***(h)*** *disposition where* ***40(3.4)*** *applies*

S. 53(1)(f): ACB Substituted Property
Amount of superficial loss is added in computing the ACB of the sub property

- **Result**: recognition loss not disallowed – deferred until sub property disposed of

Example: Individual disposes non-depreciable capital property to P/S. Individual is MIP.P/S acquires property and holds it 30 days after disposition. Loss to the P. (ACB = 100, FMV = 40)

- Loss deemed to be nil
- ACB PS property is 40 + superficial loss (60) = 100
- 97(2) – deems proceeds to be 40 (even on rollover basis) – can't have amount less than lesser of cost and FMV (40)

Corp, P/S or Trust Dispose Non-Depreciable Capital Property

S. 40(3.3): When 40(3.4) applies
(a) a corp, trust or P/S ("transferor") disposes of particular capital property (other than depreciable)
(b) during period that begins 30 days before and ends 30 days after disposition, transferor or a person affiliated w transferor acquires a property ("substituted property") that is, or is identical to, the particular property; and
(c) at the end of the period, the transferor or a person affiliated with the transferor owns the substituted property.

- Same as definition of superficial loss above

Corp, Trust, or P/S dispose of property, within 30 days before or 30 days after disposed of property, reacquires same property or identical property, and holds it past 30 days after disposition → stop-loss rules apply

S. 40(3.4): Loss Certain Properties
(a) *deems transferor's loss, if any, from disposition to be* ***nil***
(b) *deems amount transferor's loss, if any from disposition to be a loss of transferor from disposition of the particular property at time that is immediately before the first time, after the disposition*

(i) *at which a 30-day period begins throughout which neither transferor nor a person affiliated with the transferor owns*
(A) *substituted property, or*
(B) *a property identical to the sub property and that was acquired after day that is 31 days before the period begins,*

Defers loss to be recognized as a loss of transferor until a 30-day period where property has not been reacquired or acquired by T or person affiliated with T – transferor claims loss immediately before first disposition

- Loss stays w the transferor (unlike above where loss is given to the transferee and claimed when they dispose of the property)

S. 40(3.5): right to acquire property is deemed to be property that is identical

Inventory

Generally, inventory valued at lower cost and FMV – so don't need stop-loss rule BUT for inventory in adventure/concern in nature of trade it is valued at cost so need stop-loss rule

S. 18(14): When (15) applies (note: see 18(13) for same provision with money lending biz)
(a) *a person ("transferor") disposes of a particular property;*
(b) *particular property is described in an inventory of a business that is an adventure or concern in the nature of trade;*
(d) *during period that begins 30 days before and ends 30 days after the disposition, transferor or a person affiliated with transferor acquires property ("substituted property") that is, or is identical to, the particular property; and*
(e) *at end of the period, the transferor or a person affiliated with transferor owns the substituted property.*

S. 18(15): Adventures in nature of trade

- Effectively same as 40(3.4) – loss disallowed and remains w transferor until property disposed of to unaffiliated person and 60-day period expires

Events:

- Transferor disposes of property
- Transferor or affiliated person acquires sub property during period 30-days before or 30-days after disposition
- Transferor/affiliated person owns the property at the end of the 30-days after the disposition

Consequences:

- Transferor's loss from disposition = nil
- Transferor gets loss at end 30-day period after disposition, neither transferor nor person affiliated w transferor owns property

18(16): Right to acquire property is deemed to be property that is identical

GAAR + Stop-Loss

3 Elements to the GAAR:
1. **Tax Benefit** results directly or indirectly from series of transactions
2. **Transaction primarily tax motivated**
   1 + 2 = avoidance transactions – **245(3)**
3. **Abuse/Misuse** – **245(4)**

245(2): Charging Provision GAAR
Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.

S. 245(5): Determine Tax Consequences

- (a) Can go after deductions, exemptions, exclusions
- (b) Can relocate deductions or exclusions income, ect
- (c) Can say that isn't interest, that is gain of capital - Make something, something else
- (d) Can ignore stuff

"tax consequences" – means basically anything can be re-done to re-characterize the amounts

S. 245(1): Tax Benefit (very broadly defined)
Reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act, and includes a reduction, avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of a tax treaty

S. 245(3): Avoidance Transaction – tax benefit could result from single transaction or series
(a) Transaction *that, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit; or*

- Transaction itself results in benefit

(b) Transaction *that is part of a series of transactions, which series, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit.*

Note:

- Onus is on T to establish reasonable argument as to why transaction was not primarily tax motivated
- "Avoidance Transaction" is singular – transaction alone could result in benefit or transaction as part of a series
- Could have series where each step motivated by bona fide reasons, but series itself if tax motivated and GAAR won't apply
  - Test is on "the" transaction when looking at the purpose

S. 245(4): Abuse/Misuse Test

Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction

(a) would, if this Act read w/o reference this section, result directly/indirectly in misuse of provisions of any one or more of (i) this Act, // (ii) Income Tax Regulations, // (iii) the Income Tax Application Rules, // (iv) a tax treaty, or // (v) any other enactment that is relevant in computing tax or

(b) would result directly or indirectly in abuse having regard to those provisions, other than this section, read as a whole.

- Says "misuse provision" or "abuse having regard provisions read as whole" – clearly saying these are different
  - Court has said that they are the same though – *Canada Trustco (2005) SCC*
- GAAR won't apply if reasonable conclude transaction doesn't result in misuse or abuse – means now looks like onus is on CRA to come up with argument that transaction results in misuse/abuse – so 2 reasonable arguments then CRA wins
  - Court still goes with **as long as reasonable argument transaction is not misuse/abuse then GAAR will not apply**
- **Misuse** – look at specific provisions relied on by T to get tax benefit and determine if been misused
- **Abuse** – having regard to provisions of Act read as a whole – broader scheme of ITA

Avoidance transaction also needs to be the abusive transaction - Should analyze primary purpose of all relevant transaction

248(10): Series of Transactions

Series shall be deemed to include any related transactions or events completed in contemplation of the series.

- **Series** = Ordinary series (pre-ordinated) + related transaction in contemplation
  - Related transaction don't need to be pre-ordained (*QSFC*)
- **Step-Transaction Doctrine** – pre-ordained in order to produce given result
- **Contemplation =** later transaction that contemplates earlier one or earlier transaction that contemplates later one

QFSC Holdings v Canada (2001) FCA: GAAR Applied

Facts	Standard - biz lending $ security mortgages of real property. Standard went under – E&Y liquidator – wanted make available the losses that Standard had (STIL II portfolio) to investors – didn't want to sell to arm's length purchaser b/c losses realized by Standard. FMV mortgages was $33M and cost was $85M → accrued loss = $52M - 1. Oct 16, 1992 – subsid incorporated (wholly owned Standard) - 2. Oct 21, 1992 – formation STIL II P/S - transfer losses (portfolio) to P/S – Standard 99% interest and sub 1% interest o Under 97(1) or 97(2) the PoD = FMV = $33M (if don't elect then 97(1) applies and PoD = FMV, if do elect then 97(2) applies and deem election = FMV) o Stop-loss rule kicks in b/c deals NAL so since Standard has 99% ownership in P/S then affiliated o Wanted it to be subject to stop-loss so PoD = $33M but what happens to $52M loss? o 18(13) – disallowed loss added computing cost sub property → cost = $33M + $52M = $85M - 3. Oct 23, 1992 – E&Y started intensive marketing Standard's 99% interest - 4. Jan 1993 – Negotiations with OFSC - 5. May 31, 1993 – OFSC purchased Standard's 99% P/S interest - 6. New P/S (SRMP) with P's OFSC & others (Mathew) – OFSC transferred 99% interest in STIL II to SRMP Losses flow out to through SRMP to OFSC and other partner's – OFSC gets 24% losses **Summary transactions:** 1. **Standard Transactions**: (1) incorporate sub // (2) loan sub $ // (3) P/S formed // (4) transfer mortgaged to P/S 2. **Additional transactions**: (5) Acquisition P/S by OFSC // (6) SRMP and acquisition // (7) losses flow
Issue	Does the GAAR apply to this to disallow OFSC accessing the losses?
Analysis	**TAX BENEFIT** – access to the losses - Results from losses flowing out – results from ownership of P/S interest and everything that happened before **Series = Standard transactions + Acquisition Transaction** - Standard Transactions are part of "ordinary series" → packing the losses - T's acquisition of STIL II P/S interest connected to series of Standard transactions – knew Standard series and took that into account when deciding to complete acquisition transaction **Duff**: Generally, think "contemplation" means do something before thing you contemplated – but court finds that the packaging of the losses (Standard transactions) completed in contemplation subsequent acquisition transaction - Stupid result – if investor didn't know about prior series, then GAAR wouldn't apply to them **REASONABLE CONCLUDE TRANSACTION PRIMARILY BONA FIDE PURPOSE** - Each of Standard transactions undertaken primarily to obtain a tax benefit – each was avoidance transaction - T *bona fide* biz purpose acquiring STIL II P/S interest from Standard but tax benefit was also purpose of acquisition - Disparity b/w potential benefit to T and expected returns suggests T acquisition 99% interest was not undertaken for bona fide purpose other than to obtain tax benefit **Duff**: look each Standard transaction and see if reasonable conclude primary purpose was to get tax benefit - Each Standard– primary purpose was not to get tax benefit but on facts the purpose was to get rid of the losses - TCC found all 4 were primarily tax motivated and GAAR operates – determination primary purpose is Q of fact **Acquisition P/S interest** – Looks other transactions (QFSC acquiring P/S) – T argues not primarily tax motivated b/c: - **1. QFSC is in biz acquiring, arranging and improving distressed properties**

	○ **Court**: QFSC has a bona fide biz reason for acquiring P/S BUT primary purpose tax motivated ○ Part of biz is packaging and selling loses so investors – screams tax motive ○ Combo relative amounts of $ real biz and $ losses and how they deal with interest → primarily tax motivated - **2. Tax benefit contingent- would have purchased anyway but at different price** ○ Court not convinced by this argument b/c if they accepted this GAAR would be useless **MISUSE/ABUSE**: **Has to be clear and unambiguous establishment misuse/abuse** - **Misuse** – 18(13) (stop-loss rules) and to get result needs 96(1)(g) which flows-through losses at end fiscal year - **Abuse** – 111(5) (loss restriction rules), 96(8) (foreign P/S) 103 (prevent loss trading) **Misuse**: **rules 18(13) was not misused - Policy 18(13)** – prevent tax recognition losses where haven't disposed economic interest in property (primary purpose) & takes disallowed loss and adds it in computing ACB sub property ○ 18(13) amended to prevent this – loss stays with transferor until sub property disposed of to unaffiliated person - **Duff**: Rothstein too narrow – could have gone further and said policy was disallow loss & preserve be realized later **Abuse**: broader scheme of the Act - **111(5)** – where subject to loss restriction event, acquisition of control by unrelated person, then no amount non-capital loss deductible after that time – scheme for corp losses to prevent loss trading - Losses start in corp (Standard) and end up in corp (OFSC) – against scheme of the Act - T argues was in biz turning around distressed property – court said T has carry on biz and QFSC didn't

Mathew (2005) SCC: **right on 18(13), wrong on 96(1)(g)**

Facts: Mathew investor in SRMP – not corps so basis that OFSC decided won't work

Analysis: link b/w tax motivated transaction and abuse – look at all of the transactions unless you know which transaction going to say is abusive – then just look at that one here it was transferring the mortgages to STIL II

96: Predicated requirement that P's in P/S pursue common interest in biz activities of P/S, in non-arm's length relationship

- Although, on its face 96(1) does not impose restriction on flow of losses except for foreign P/S (96(8)), implicit that the rules are applied when Ps in P/S carry on biz in common, in non-arm's length relationship
- **Purpose treatment loss trading** b/w P's – promote org structure allows P's to carry on biz in common in, NAL relationship
- Policy that losses should only flow out to P if they were a P when that loss was realized

18(13): Prevent T who is in biz of lending $ from claiming loss upon superficial disposition mortgage/similar non-capital property

- Confine loss that would ordinarily be claimed by transferor to NAL transferee

Holding: MNR properly denied T's the losses under GAAR

- To use provisions to preserve and sell an unrealized loss to an arm's length party results in abusive tax avoidance – transaction do not fall within spirit and purpose of 18(13) & 96, properly construed

Combined misuse and abuse to one analysis – read down abuse and read up misuse

WITHDRAWAL & RETIREMENT FROM P/S

2 Ways a P Can Leave a P/S:

- **1. Sell P/S Interest** – disposition capital property, negative ACB will be deemed to be gain under 100(2)
- **2. Withdraw P/S** – need to know what P is getting out of P/S
  - May get out: Income of P/S, Capital or more

Characterization of Payments

MNR v Wahn (1969) SCC:

Facts	T withdraws from P/S: (1) undrawn profits, (2) portion profits of yr of withdrawal; (3) profits accruing/accrued from work in progress or in contemplation (guarantee min) – T gets amount spread over 4 yrs and gets $10K/yr
Issue	What is the character of the payments for the profits accruing for work in progress or contemplation? - T argues payment was capital (b/c don't have to pay tax) – tax consequence will be to the other P's
Analysis	When T joined the P/S, he didn't put capital in – makes it look more like income #3 looks like future income being allocated to T – income In agreement, income anticipated – say if paid estate of person, a sum equal income tax payable by estate w.r.t. profits
Holding	Payment was income – appeal allowed
Ratio	***To determine characterization of payments, consider P/S agreement and intention of the P's***

Boorman v Canada (1977) FCTD:

Facts: T one of several P's in medical P/S who sought to characterize payments of 2 retired Ps as distributions of P/S income rather than capital. P/S agreement stipulated remaining Ps shall purchase interest of deceased or retiring P.

Holding: Payments were distributions of P/S income

- P/S had no capital asset other than accounts receivable reflecting fees payable for services rendered to patients

Delesalle v Canada; Canada v Cohos (1986) FCTD:
Facts: Membs architectural firm - D withdrew pursuant agreement - paid "for capital contributed by him and interest, his share p/s profits for fiscal year, and various other amounts. D included his share in P/S profits in computing income but characterized payment for capital contributed as proceeds for disposition goodwill. Remaining P's characterized all payments to D as distributions P/S profit.
Issue: Is the payment to T income or capital?
Holding: Payment was capital in nature

- When D leaves, the firm initially gets to keep his name – suggests selling his goodwill (capital in nature)
- Turns out he had to pay capital in the past, so the payment is capital

MNR v Sedgwick (1963) SCC:
Facts: T was 1 of 5 passive membs. P/S – advanced funds to the active membs. of P/S to enable him to purchase seat on TO stock exchange and to provide working capital stock brokerage biz. TO exchange ruled membs. of P/S not actively engaged in stock brokerage biz could not share in profits – passive P's gave up their interest in stock exchange seat and the physical assets in the biz and their right to share of profits of the biz in exchange for $550K ($300K represented share of Creditors in net profits of biz)
Holding: Payment characterized as distribution P/S profits on which T was liable to pay tax

- Agreement for winding-up of p/s was necessitated by the TO stock exchange board
- Lenders withdrawing from biz the capital value of which they had provided to it in form of capital assets and were paid out the profits which they acquired out of the operation of the biz

Allocation to Retiring P

96(1.1): Allocation Share Income Retiring P ➔ Allows P/S income to be allocated to a retiring Partner
(a) Where principal activity of P/S is carrying on a biz in CA and its membs. have entered into an agreement to allocate a share of income or loss of P/S from any source or from sources in a particular place, as the case may be, to any T who at any time ceased to be a member of

(i) the P/S, or
(ii) a P/S that at any time has ceased to exist or would, but for subsection 98(1), have ceased to exist, and either
(A) the members of that P/S, or
(B) the members of another P/S in which, immediately after that time, any of the members referred to in clause 96(1.1)(a)(ii)(A) became members

- Situation where P/S ceases to exist, but some else effectively continuing
- Contemplating circumstances where someone withdraws and P/S ceases to exist b/c of withdrawal
- If members of P/S were members of another P/S then works

have agreed to make such an allocation
or to T's spouse, or CL partner, estate or heirs or to any person referred to in subsection 96(1.3), the T, spouse, or CL partner, estate, heirs or person, as the case may be, shall be deemed to be a member of the partnership; and
(b) all amounts each of which is an amount equal to the share of income or loss referred to in this subsection allocated to a T from a P/S in respect of a particular fiscal period of the P/S shall, notwithstanding any other provision of this Act, be included in computing the T's income for the tax year in which that fiscal period of the P/S ends.

- If this rule is invoked, then former P can still get a share of the P/S income
- P/S allocate retirement income to someone who leaves P/S – not taxed in the hands of remaining P's – it is allocated to a former P who withdrew

Delesalle v Canada; Canada v Cohos (1986) FCTD:
Cohos argued - remaining P's could agree among themselves to allocate share of P/S income to former P under 96(1.1)
Court rejected this – principle that person not bound by terms of agreement which they are not party to

- **96(1.1)** – applies to situation where membs. P/S allocate share income/loss of P/S to T who ceased to be memb. of P/S but who is nevertheless deemed to be a continuing member solely for purpose of allocation of income/loss
  - Not intended permit continuing P's change original agreement allocation of share of income/loss of P/S to retiring P

96(1.1) says that retiring P has to be party to the agreement

Valo v MNR (1988) TCC:
Court - rejected argument that the recipient of share allocated under 96(1.1) need not be party to the agreement
Agreements within purview of 96(1.1) must be entered into among the withdrawing P and all the other membs of the P/S

96(1.4): Right deemed not to be capital property

- **Retiring partner has a right to income/loss** ➔ income right (not capital property)

For purposes of this Act, a right to a share of income or loss of a P/S under an agreement referred to in subsection 96(1.1) shall be deemed not to be capital property.

96(1.2): Disposal Right to Share Income

Where in tax year a T who has a right to a share of the income or loss of a P/S under an agreement referred to in subsection 96(1.1) disposes of that right,

(a) there shall be included in computing the taxpayer's income for the year the PoD

Full amount that the T gets is included in computing income – no cost attached generally and fully taxable as income

96(1.3): Deductions – buy income interest - Amount paid can be deducted – full deduction against income included

Where, by virtue of 96(1.1) or 96(1.2), an amount has been included in computing a T's income for a tax year, there may be deducted in computing the T's income for the yr the lesser of

***(a)** the amount so included in computing the T's income for the year, and*

***(b)** the amount, if any, by which the cost to the T of the right to a share of the income or loss of a P/S under an agreement referred to in 96(1.1) exceeds the total of all amounts in respect of that right that were deductible by virtue of this subsection in computing the taxpayer's income for previous tax years.*

If someone buys income interest from a P, then they will get income under 96(1) – don't pay tax until recover cost of purchase

- Deduct up to amount included

Example: Buy income interest $10

- Yr 1 get $150 – 96(1.3) says deduct $100 of that, so include $50

Or

- Yr 1 get 40, yr 2 get 80 – so yr 1 deduct 40 and cost is taken out first and year 2 deduct 60 and pay tax on 20

98.1(1): Residual Interest in P/S

Where T has ceased to be a memb. of a P/S of which the T was a memb. immediately before that time, the following rules apply:

***(a)** until such time as all the T's rights (other than a right to a share of the income/loss of the P/S under an agreement in 96(1.1)) to receive any property of or from the P/S in satisfaction of the T's interest in P/S immediately before the time at which the T ceased to be member of the P/S are satisfied in full, that interest ("residual interest") is deemed not to have been disposed of by the T and to continue to be an interest in the P/S;*

- **Until retiring P's rights are satisfied in full, they are deemed not to have disposed of their P/S interest → have a residual interest**

***(b)** where all of the T's rights described in (a) are satisfied in full before end of the fiscal period of the P/S in which the T ceased to be a member thereof, the T shall, notwithstanding (a), be deemed not to have disposed of the T's residual interest until the end of that fiscal period;*

- **Deemed not to have disposed of residual interest until end of fiscal period with which T's rights satisfied**
- Then compute whether capital gain/loss on disposition of P/S interest

***(c)** notwithstanding 40(3), where at end of a fiscal period of the P/S, in respect of a residual interest in the P/S,*

***(i)** total of all amounts required by 53(2) to be deducted computing ACB to T of the residual interest at that time exceeds*

***(ii)** total of cost to the T of the residual interest determined for purpose of computing the ACB to the T of that interest at that time and all amounts required by 53(1) to be added to cost to the T of residual interest in computing the ACB to the T of that interest at that time*

the amount of excess shall be deemed to be a gain of the T, for the T's tax year that includes that time, from a disposition at that time of that residual interest

- **Negative ACB for residual interest realized as gain at end of fiscal year where P leaves** (even if rights aren't satisfied until the subsequent fiscal period)

DISSOLUTION OF P/S

P/S may dissolve from:

- Expiration term (if entered for a fixed term);
- Termination of adventure/undertaking (if entered for single adventure/undertaking);
- Death/insolvency of a P;
- Happening of event that makes it unlawful for biz of firm to be carried on or membs. carry on biz in P/S;
- Court order

Inside basis = cost property to P/S

- Determines rollover for P/S – deems P/S disposed its property for PoD = inside basis

Outside basis = ACB P/S interest

- If outside basis > inside basis – take excess outside basis and bump up cost of property that P gets out

S. 99(1): Fiscal Period of Terminate P/S

Subject (2), if, at any particular time in a fiscal period of a P/S, the P/S would, if this Act were read w/o reference to 98(1), have ceased to exist, the fiscal period is deemed to have ended immediately before the time that is immediately before that particular time.

- **Fiscal period deemed to ended** immediately before the P/S ceases to exist

S. 98(1): Disposition P/S Property – *where P/S, but for this section, would be regarded as having ceased to exist, then:*
(a) *Until such time as all P/S property and any property sub therefor has been distributed to persons entitled by law to receive it, P/S shall be deemed not to have ceased to exist, and each person who was a P deemed not to have ceased to be a P,*

- **Until all of the P/S property is distributed to the P's, the P/S deemed not to have ceased to exist**

(b) *The right of each such person to share in that property shall be deemed to be an interest in the P/S, and*

- **P/S interest = P's share in P/S property**

(c) *notwithstanding 40(3), where at end of a fiscal period of the P/S, in respect of an interest in the P/S,*
(i) *&* ***(ii)*** *ACB is negative*
excess shall be deemed to be a gain of the T for the T's tax year that includes that time from a disposition at that time of that interest.

- **Negative ACB at end of fiscal period deemed to be a gain at the end of T's tax year**

S. 98(2): Deemed Proceeds when P/S disposes property to P
Subject 98(3), 98(5) & 85(3), where P/S disposed of property to a T who was, immediately before that time, a memb of the P/S, the P/S shall be deemed have disposed of the property PoD = FMV at that time and T deemed acquired property at amount equal to FMV.

- **General rule - P/S disposes property @ FMV and T acquires property @ FMV**

98(6): Continuation predecessor P/S by new P/S
Where Canadian P/S ("predecessor P/S") ceased to exist at any particular time and, at or before that time, all of the property of the predecessor P/S has been transferred to another Canadian P/S ("new partnership") the only members of which were members of the predecessor P/S, new P/S deemed to be a continuation of the predecessor P/S and any member's P/S interest in the new P/S shall be deemed to be a continuation of the member's P/S interest in the predecessor P/S.

- Applies where:
  - All the property old P/S transferred to new P/S
  - All membs. of new P/S were membs. of old P/S
- Like a rollover, but not explicit – for tax purposes, just going to say the **new P/S is the same as the old P/S**

98(3) & 98(5) Rollovers

Rules	98(3) – Joint Ownership P/S Property	98(5) – Sole proprietorship
Applies when…. (preamble)	All P's prior to dissolution of P/S jointly elect to convert all P/S property into jointly owned property – former P's % interest is same in all property	Within 3 months of dissolution of P/S, 1 P is carrying on the biz of the P/S as a sole proprietor and using **any** P/S property – mandatory (not elective) Note: 98(5) trumps 98(3)
Consequences from disposition P/S (f)	P/S deemed disposed of each such property for PoD = cost amount to P/S of the property - Applies to all P/S property	P/S deemed disposed each such property for PoD = cost amount to P/S of property immediately before particular time – applies to P/S used in sole proprietorship
Disposition former P's P/S interest (a)	PoD = greater of: - OB: ACB P/S interest - IB: $ received + P's share P/S property	PoD = greater of: - OB: ACB Proprietor's P/S interest + ACB P/S interests acquired by proprietor via (g) - IB: cost amount P/S property received by proprietor + other PoD for proprietor's interest proprietor receives
Cost to P's of P/S non-depreciable property (b) & (c)	P's cost % cost amount to P/S of property + (c) - If OB > IB then excess Only bump to extent of % FMV of property and excess basis	Same as for 98(3)
Cost to P's for depreciable property	Former P is in same position as P/S was w.r.t. to CCA and recapture depreciation	Same as 98(3)

Rules in 98(3) and (5) are essential the same – 2 differences

- 1. 98(3) applies to all P/S property, 98(5) only applies to P/S property used to carry on sole proprietorship
- 2. 98(5) has notional P/S in 98(5)(g) where only P is sole proprietor and sole proprietor acquires interest from the other P's

WHEN DOES 98(3)/(5) APPLY?

(3) conversion P/S property into jointly owned property

If at any particular time P/S has ceased to exist and all the P/S property has been distributed to persons who were members of the P/S immediately before that time so that immediately after that time each such person has, in each such property, an undivided interest, that, when expressed as a percentage of all ***undivided interests or rights in the property, is equal to the person's undivided interest or right, when so expressed, in each other such property,*** *if each such person has jointly so elected in respect of the property*

- Joint election of all P's prior to dissolution
- Only applies where **all** p/s property converted into jointly owned property
- % interest is same in all the property – ex. 2 partners, X - 60%, Y - 40% and 2 pieces of property (A & B) – so X has 60% interest in A and 60% interest in B

(5) P/S property used to carry on biz in sole proprietorship

At any particular time a p/s has ceased to exist and within 3 months after the particular time 1, but not more than 1, of the persons who were, immediately before the particular time, members of p/s (the "proprietor", whether an individual, a trust or a corp) carries on alone the biz that was the biz of the P/S and continues to use, in the course of the biz, ***any*** *property that was, immediately before the particular time, p/s property and that was received by the proprietor as PoD of the proprietor's interest in the P/S*

- Mandatory provision that applies to any P/S property that is used in the course of biz that was biz of the P/S
- Carried on by sole proprietorship by former member of P/S within 3 months after dissolution of P/S
    - Has to be something enduring – can't just carry on biz for a day

TAX CONSEUQENCES FOROM DISPOSITION P/S PROPERTY

98(3)&(5)(f): P/S deemed to dispose of property = cost amount of P/S property

- **98(3)**: Applies all P/S property
- **98(5)**: Applies P/S property used in the sole proprietorship

Result: No tax consequences– rolled-out

S. 248(1): "Cost Amount"

- Non-Depreciable Capital Property = ACB
- Inventory = lower cost or FMV
- Depreciable Capital Property = UCC

DISPOSITION FORMER P's INTEREST IN P/S:

S. 98(3)(a):

Each such person's PoD of person's interest in the P/S shall be deemed to be an amount equal to the greater of

(i) the ACB to the person, immediately before the particular time, of the person's interest in the P/S, &

- **Outside Basis** – Pure rollover, will be no gain/loss if PoD from disposition P/S interest = ACB

(ii) amount of any $ received by the person on cessation of the P/S's existence + person's % of the total of amounts each of which is cost amount to the P/S of each such property immediately before its distribution;

- **Inside Basis –** Not pure rollover, paying tax on realized amount

If OB > IB → PoD = OB = ACB → no gain/loss

If IB > OB → PoD = IB & Gain = IB – OB

S. 98(5)(g):

Where, at the particular time, all other persons who were membs. of P/S immediately before that time have disposed of their interests in P/S to the proprietor, the proprietor shall be deemed at that time to have acquired P/S interests from those other persons and not to have acquired any property that was property of the P/S

- For a moment proprietor acquires interest from the other P's but does not acquire the P/S property – notional P/S exists with just one P (the proprietor)

S. 98(5)(a):

The proprietor's PoD of the proprietor's interest in the P/S shall be deemed to be an amount equal to the greater of

(i) total of the ACB to the proprietor, immediately before the particular time, of the proprietor's interest in the P/S, and the ACB to the proprietor of each other interest in the P/S deemed by paragraph 98(5)(g) to have been acquired by the proprietor at the particular time, and

- **Outside Basis – ACB of propietor's interest + ACB**

(ii) the total of

(A) cost amount to P/S, immediately before particular time, of each such property so received by proprietor, +
(B) the amount of any other PoD of proprietor's interest in the P/S received by the proprietor;

- Inside Basis

Doesn't apply to other membs. Of P/S who dispose of interest to proprietor, but does apply even if proprietor does not acquire other interest in P/S but continues to carry on biz of P/S using property that was P/S property

COST TO P's OF P/S PROPERTY

98(3)(b): Non-Depreciable

Cost to each such person of that person's undivided interest or right in each such property is deemed to equal to the total of

(i) *P's % of cost amount to P/S of the property immediately before its distribution,*

(ii) *where (a)(i) > (a)(ii), amount determined in (c) in respect of the P's undivided interest or right in the property;*

- Outside basis > inside basis – excess outside basis, this is added to cost

98(3)(c): Non-Depreciable

Amount determined under this paragraph in respect of each such person's undivided interest or right in each such property that was a capital property (other than depreciable property) of the P/S is such portion of the excess, if any, described in subparagraph (b)(ii) as is designated by the person in respect of the property, except that

- **Only applies where non-depreciable capital property – allowed to bump up cost of property to P**

(i) *in no case shall amount so designated in respect of the person's undivided interest or right in any such property exceed the amount, if any, by which the person's percentage of the FMV of the property immediately after its distribution exceeds the person's percentage of the cost amount to the partnership of the property immediately before its distribution, and*

- **Bump up only to % FMV of the property - % cost amount of P/S property**

(ii) *in no case shall total of amounts so designated in respect of the person's undivided interest or right in all such capital properties (other than depreciable property) exceed the excess, if any, described in subparagraph (b)(ii);*

- **Max bump is amount excess b/w (a)(i) & (a)(ii) – bump individual properties up to FMV of those properties**

"Bump" cost of property getting out - preserves cost base that would otherwise be lost on the disposition former P's P/S interest in exchange property w tax cost less than former P's ACB in P/S interest

98(3)(e): Depreciable property

If property so distributed by the P/S was depreciable property of the P/S of a prescribed class and any such person's % of amount that was capital cost to the P/S of that property exceeds amount determined under paragraph (b) to be cost to the person of the person's undivided interest or right in property, for the purposes of sections 13 and 20 and any regulations made under paragraph 20(1)(a)

(i) capital cost to the person of the person's undivided interest or right in the property is deemed to be the person's % of the amount that was the capital cost to the P/S of the property, and

(ii) excess is deemed to have been allowed to the person in respect of the property under regulations made under paragraph 20(1)(a) in computing income for taxation years before the acquisition by the person of the undivided interest or right;

If what comes out is depreciable property, then want former P to step into shoes of P/S

- Former P getting the property deemed to taken CCA that P/S took
- **Former P is in same position as P/S was for recaptured depreciation**

Note: same rule for sole proprietor under 98(5)(b), (c) & (e)

98(5)(b):

The cost to the proprietor of each such property shall be deemed to be an amount equal to the total of

(i) *cost amount to the P/S of the property immediately before that time,*

(ii) *where the amount determined under 98(5)(a)(i) exceeds amount determined under 98(5)(a)(ii), the amount determined under (c) in respect of the property;*

98(5)(c):

Amount determined under this paragraph in respect of each such property so received by the proprietor that is a capital property (other than depreciable property) of proprietor is such portion of the excess, if any, described in 98(5)(b)(ii) as is designated by the proprietor in respect of the property, except that

(i) in no case shall amount so designated in respect of any such property exceed the amount, if any, by which the FMV of the property immediately after the particular time exceeds cost amount to the P/S of property immediately before that time, and

(ii) in no case shall the total of amounts so designated in respect of all such capital properties (other than depreciable property) exceed the excess, if any, described in subparagraph 98(5)(b)(ii);

Mihelakos v Canada (1997) TCC:

Facts	2 guys: M & D – P's in P/S – P/S owned 2 buildings – ran biz out of one and rented out the other 1988 – the 2 P's had a falling out and had a complete communication breakdown D offered purchase M's interest for $300K – out of which M obliged discharge mortgage for $43K - Lawyers prepare 2 agreements: (1) sell ½ interest real property - $175K; (2) sell ½ interest in rest biz – 125K Docs purport to make M & D vendors to P/S consisting of D and his two sons - Looks like M & D selling P/S – suggestion old P/S dissolved and sold assets to new P/S
Issue	How did the situation go from M &D being P's to situation where D & sons are P's? - M argued selling P/S interest to D - MNR said P/S realized taxable capital gain of $80K on disposition – ½ included A's income
Duff	**<u>3 ways that things could have gone from M&D P's to D & son P's:</u>** **1. P/S dissolves and assets are sold to the new P/S** - Own property jointly and then sell the property to new P/S - If elected under 98(3) - property comes out on tax-deferred basis and assets rolled into new P/S – ▪ D got assets on rolled-over basis & M sells undivided interest in assets to new P/S and realized gain - If did not elect under 98(3) - default rule is in 98(2) and property transferred @ FMV – triggers tax consequences for both M & D – doesn't matter for M b/c he is cashing out anyway **2. P/S sells asses to new P/S and then dissolves** - Realize gain on sale of assets (may be recaptured depreciation on sale building) – tax consequence flow to P's - Only M gets consideration, so doesn't make a lot of sense to say they are both selling to new P/S - New P/S will get bump in all assets up to FMV **3. M sells his P/S interest to D & sons –** most advantageous arrangement for M - M sells capital property and PoD are what he got - $300K - No bump to cost of property for new P/S - Can't rely on 98(6) – only could if they first admitted sons to P/S and then did this
Holding	M disposed of his capital interest in the P/S – clear intention nto treat assets as P/S property and P/S did not dispose of its assets – 98(2) doesn't apply (M transferred interest in P/S) & 98(3) doesn't apply – P/S did not cease to exist
Duff	Most plausible is that P/S ceased to exist once M & D stopped talking to each other – no longer carrying on in common - Tax consequences that P/S disposed of property to M and D and then sold to new P/S

<u>Example of s. 98(3</u>):
Two P's: A has 60% of P/S (ACB = 20), B has 40% interest (ACB = 100)
P/S owns 2 pieces of property: X: ACB = 100; FMV = 180; Y: ACB = 50; FMV = 70 (Total FMV = 180 + 70 = 250)
Sum inside basis = $ACB_X + ACB_Y$ =100 + 50 = 150
- IB_A = 60% ACB_X + 60% ACB_Y = (0.6 x 100) + (0.6 x 50) = 90
- IB_B = 40% ACB_X + 40% ACB_Y = (0.4 x 100) + (0.4 x 50) = 60

Outside basis: OB_A = ACB A's interest = 20 & OB_B = ACB B's interest = 100
98(3)(f): P/S deemed disposed property = cost
- Cost = ACB_X and ACB_Y → no tax consequences to P/S

98(3)(a): PoD to former P's
- A: PoD is greater of OB (20) & IB (90) = 90
  - A realized gain of 70
- B: PoD is greater of OB (100) & IB (60) = 100
  - No recognition gain/loss

98(3)(b): Cost of property to P
- A: Total cost to A of interest in property = 90
  - X = 60% x ACB_X = 0.6 x 100 = 60
  - Y = 60% x ACB_Y = 0.6 x 50 = 30
  - Since OB < IB, then don't have to worry about (c)
- B: 60 + bump in (c)
  - X = 0.4 x 100 = 40
  - Y = 0.4 x 50 = 20
  - BUT OB > IB – so need to go to (c)

98(3)(c): Bump in cost
- OB – IB = 100 – 60 = 40 → excess outside basis
- X: 40% of FMV_X – 40% of ACBx = (0.4 x 180) – (0.4 x 100) = 72 – 40 = 32
- Y: 40% of FMVY – 40% of ACB_Y = (0.4 x 70) – (0.4 x 50) = 28 – 20 = 8
- So for X you can add up to 32 and Y add up to 8

Cost to B of X: 40 + 32 = 72 & Cost to B of Y = 20 + 8 = 28

INTRO TRUSTS

Main Issues:

1. Legal character of a trust - Determined by private law
2. Taxing Income - Tax income that a trust receives **&** Flow out income to beneficiaries but losses are stuck in the trust (*Fraser*)
3. Trust interests - Income interest vs. capital interest
4. Transfer of property to/from a trust
- Trust deemed to dispose of capital property ever 21 years, to prevent accrual of gains/losses – **104(4)**

LEGAL CHARACTER OF TRUSTS

Trust = Relationship among**:** Settlor (contributor property) **//** Trustee (legal control/ownership property) **//** Beneficiary (benefits from the property – use/enjoyment)

3 Certainties:

1. Intention: Intention that the trustee is under obligation to hold property for benefit of another – more than moral obligation
2. Subject matter: What the trust assets are that will best in the trustee and be used for the benefit of the B
3. Object: Who the beneficiaries are needs to be certain

Characteristics of a Trust: (Waters)

1. **Fiduciary relationship** where 1 party holds title to property and manages it for the benefit of another;
2. **Dual ownership of property** by the trustee and beneficiary
3. **Trust property is not available to creditor** of bankrupt trustee

Can also divide trusts into personal trusts and commercial

S. 248(1): Personal Trusts – trust that is: (a) GRE or (b) trust which no beneficial interest was acquired for consideration payable directly or indirectly to (i) the trust or (ii) any person or P/S that made contribution to the trust
- **Commercial trust** – B provided consideration to get their trust interest

108(1): "Trust"

Includes inter vivos trust and testamentary trust
- Distinction used to be very important b/c testamentary got progressive rates, but now it only GRE gets progressive rates for 3 years so distinction isn't as important

Testamentary Trust – A trust that arose on and as a consequence of the death of an individual – **108(1)**
Inter Vivos Trust – A trust other than a testamentary trust - **108(1)**

248(1): Graduated Rate Estate – get progressive rates for 3 yrs (exception to 122(1) that says trusts taxed top marginal rates)
means the estate that arose on and as a consequence of the individual's death if
(a) that time is no more than 36 months after death, // (b) the estate is at that time a testamentary trust, // (d) estate designates itself as GRE of individual in its return of income under Part I for its 1st tax yr that ends after 2015, & // (e) no other estate designates itself as the graduated rate estate of the individual in a return of income under Part I for a taxation year that ends after 2015 → only get 1

104(1): Reference to Trust/Estate

*A reference to a trust or estate ("trust") shall, unless context otherwise requires, be read to include a reference to trustee or other legal rep having ownership or control of the trust property, **but** a trust is deemed not to include an arrangement under which the trust can reasonably be considered to act as agent for all the B's under the trust with respect to all dealings with all of the trust's property*
- Draws distinction b/w trustee and agent (*Fraser*) - Trust is a relationship among people, agent is a contractual relationship

104(2): Trust Taxed as Individual

A trust shall, for this Act, & w/o affecting liability of trustee for own income, deemed to be in respect of trust property as an individual
- Trust is separate taxable person – means that all the rules that apply to individuals are subject individual tax rates
- Solves practical problems of tax administration (*Garron*)

Trust is subject same rule as individuals – **except**: **122(1)** – Trusts subject tax at top marginal rate // **122(1.1)** – Trusts may not deduct personal tax credit // **104(4)** – Deems trust dispose capital property for PoD = FMV and reacquired capital property cost = FMV every 21 yrs // **104(6)** – Trusts can deduct amounts payable to B's and amounts taxed in hands of B's

122(1)(a): Tax payable by trust

Trusts are taxable at the top marginal rate – prevents incentive to set up multiple trusts
- So to extent can attribute income to B's, then get benefit of B's progressive rates
- Pre-2016: Testamentary trusts and pre-1972 *inter vivos* pay tax at progressive rates, now just GRE get progressive rates

Fraser v MNR (1991) FCA: TRUST VS. AGENCY

Facts	Mr. L heavily involved in development – active investment advisor – he would collect $ and invest in certain projects. 70's set-up "pooling" arrangement – investors contribute funds; L buy mortgages on properties and holds them to maturity and instead of giving back money, keep buying mortgages. Investors redeem units of fund and get $ back out but don't get to choose whether to invest each mortgage - L ran this through 2 companies 80's – real estate market crashed – investors want to access the losses
Issue	Was there a trust b/w the investors and Mr. L or was it just co-ownership of property? - T argued not trust so that he could access losses – say it is just an agency - Note if found to be a trust, then losses are losses of the trust and do not flow out to T's
Analysis	**Agency vs. Trust** - Agency is contractual, and trust is about ownership of property - Agent is someone who takes instructions about what the principal wants them to do – not happening here, here L has discretion to buy and sell mortgages – investors are managing what the investments are T argues no **certain of intention** – L knows what trusts are and he didn't intend to set this up - Court doesn't give much weight to what L says his intention was – after the fact and self-serving - Not the intention of L that matters, it is the intention of the transferor of the property (the investors) - Look at context and surrounding circumstances to determine intention – determine intention by looking at context and surrounding circumstance sand what was reasonable to expect
Holding	There was a trust - Investors had the intention to create a trust – just gave their $ to L to manage it
Ratio	***Determine intention create a trust by looking at intention of transferor of the property – context, surrounding circumstances and what is reasonable to expect*** ***Trust can't flow-through losses***

Capital property step-up strategy: (***Antle***)

- Shifting capital property (w accumulated gain) from husband to Barbados spousal trust
- Trust sell property to beneficiary wife
- Wife sells property to 3rd party purchaser using proceeds to pay off the trust
- Trust distributes funds to wife as beneficiary and Trust dissolves

Result → no tax (no capital gain taxable in Canada)

Antle v Queen (2010): Existence Trust

Facts	A (and another guy) owned shares SCC company (owned through PM Holdings) 1998 – PM acquired SCC shares from Stratos and Stratos received preferred shares, debt, and right 50% profits in event future sale by new owner. 1999 – A entered discussion for possible sale of PM (and SSC) to MI. Planned a capital property set up strategy: - 1. A established spousal trust in Barbados (low tax) w his wife as the beneficiary – transferred PM shares into trust o B/c spousal trust, can transfer shares in on a tax-deferred basis - 2. Trust sells shares to wife for promissory note - 3. Wife sells shares of PM to MI (arm's length purchaser) - 4. Spouse pays off promissory note to the trust - 5. Trust collapses – proceeds held by spouse is gifted to A Stratos learned about this – agreed settle for $797K for preferred shares and debt was $2.2M – Stratos learns about sale and says PM is same as SSC and therefore owe 50% gain (wants another $1.3M) – A agreed and Stratos signed off on the sale, later A sues Stratos and says he only agreed under duress
Issue	Was there really a trust?In dispute was certainty of intention and subject matter
Analysis	**Certainty intention** – trustee did not have discretion, A did not truly intend to settle the shares - A did not truly intend to settle shares in the trust – never intended to lose control of shares or $ from sale **Certainty subject matter** – A sues Stratos – indicates that he retains some sort of interest - Element of ownership in PM did not pass – creates lack of certainty of subject matter **Constitution of trust** - have to give up ownership/control of property, and he doesn't really do that - A never transferred all of his right and interest in the shares to the Trust - Title never effectively transferred the trustee
Holding	Trust was never properly constituted – no trust
Ratio	***Ownership/control of property has to be in the trustee in order for a trust to be properly constituted***
FCA	Don't just look at the trust deed – look at the **surrounding circumstances** TCC in obiter found that trust was not the sham – FCA finds sham - Required intent or state of mind is not equivalent to mens rea and don't need to give rise to tort of deceit

***Garron Family Trust v Queen (2012) SCC*: RESIDENCE OF TRUST**

Facts	Myron and Berna Garron made a lot of $ in PMPL Holdings, brought in Andrew Dunin to help run it - Garron's held shares in PMPL through holding company (Garron Holding) and Dunin held the shares directly Gain in PMPL, but don't know exactly what going to be – freeze value shares and create new class that will increase in value when shares come through – set up two trusts: - Garron Trust and Dunin Trusts – managed by trust companies in Barbados - Common shares issued to 2 companies: new Garron and new Dunin, which are owned by trusts – issued $80 - Purchaser buys out shares of New Garron and New Dunin – buys shares in them from trust for $217M & $240M Sale happens as if trusts were residence in Barbados – challenged on basis that trust residence in Canada - Note: could have also challenged on basis that there wasn't a real trust constituted
Issue	Is the trust residence in Canada or Barbados? - Should you use the residence of trustee or where the central management and control is taking place?
Analysis	Determine residence of a corp by looking at "central management and control" – where the BoD makes decisions 104(2) - trust deemed to be individual with reference trust property; (1) trust reference includes reference to trustee **Two arguments of T**: (1) T argues trust is not a person, so management & control test doesn't apply & (2) if look at 104(2) and (1) then when talking about rusts then talking about trustee and trustee is in Barbados **Argument 1**: Could use management and control test – 104(2) deems trust to be individual **Argument 2**: 104(1) and (2) don't say anything about residence of a trust - 104(1) says that the trustee is the person you go after to pay the tax – can't read residence into that Trust are kind of like corporations – central management and control test is useful way determine residence of trust
Holding	Trust is resident in Canada
Ratio	***Trust residency determined by central management and control test – trust resides where its real biz is carried on***

Residence of trust can be significant for tax planning – happens domestically in Canada
- For a while Alberta had 10% rate and other provinces were much higher, so people would set up trusts in Alberta

Discovery Trust v MNR (2015) Newfoundland SC:
Facts: Ppl in Newfoundland set up trust in Alberta – wanted to sell shares of company so they moved the shares to Alberta and had trust sell off shares
Holding: Trustee did enough for trust that the trust was resident in Alberta – applied management and control test
Boettger, trustee of Nancy Smith, Spousal Trust v ARC (2015) QBSC:
Facts: Settlor and beneficiary didn't know the trustee. Trustee was Alberta lawyer in contact with Montreal law firm that held establish trust. Settlor was able to remove trust at any time.
Holding: Trust was resident in Quebec

Where one off transaction can argue: (1) No trust & (2) Trust remains residence in CA – look at degree of control trustee has - Where ongoing thing, where trustee continues to manage assets, then more likely residence will be where trustee is

FLOW-THROUGH TRUST INCOME

Trust is taxable as an individual, so it is taxed on income – but rules allow trust to deduct certain amounts that are included in computing the income of the B of the trust
- **Note**: Income can be flowed out but losses cannot (*Fraser*)

Inclusions Computing Income of Beneficiaries

104(13)(a): Income of Beneficiary

*There shall be included in computing income for particular tax yr of a B under a trust: (a) in case of a trust such part of amount that, but for (6), would be the trust's income for trust's tax year that ended in particular year as became **payable to the B** in trust's year;*
- Not just any amount included, it is amounts that would be income of the trust
- Inclusion happens at the end of the trusts tax year in the B's tax year

104(24): Amounts Payable

Amount deemed not become payable to B in a tax year unless it was paid in yr to B or B entitled in year to enforce payment of it
- Amount payable when T has absolute right income and is under no restriction as to its disposition, use, or enjoyment (*Hall*)
- Often trusts has power to force a trustee to pay amount – until power exercised then B is not entitled to amounts
- If right to demand depends on approval of 3rd party, then until 3rd party agrees, no entitlement (IT-286R)
- If power to amend trust deed to make income payable, until power is exercised, B is not entitled to amount

If amounts are made for the benefit of the B, but not to the B then it is not an amount payable (*Howard Lang Family Trust*)

Non-Discretionary Trust – income of trust goes to person named, B is entitled to amount in yr b/c that is what trust says

- For non-discretionary trust, as soon as income is received by the trust, it is deemed payable to B (*Ginsburg (1992) TCC*)

Discretionary Trust – more difficult determine when amount is paid or payable b/c depends on exercise of discretion of trustee
Criteria to determine when amount payable: (1) **Exercise discretion** // (2) Exercise discretion **irrevocable** // (3) **Allocation** to Bs (if multiple Bs been determined (4) B have been **advised** of allocation (not technically a requirement but makes sense B needs to know to determined taxes)

104(18): Trust for a Minor

Allows trust accommodate minor B's – allocate income - have it taxed in hands of kids but don't actually give kids the income
Where any part amount that, but for 104(6), would be income of trust for a tax year throughout which was resident in CA

(a) has not become payable in the year,
(b) was held in trust for an individual who did not attain 21 years of age before the end of the year,
(c) the right to which vested at or before the end of the year otherwise than because of the exercise by any person of, or the failure of any person to exercise, any discretionary power, and

- **Entitlement to income but not immediate – income held for someone who is not 21 but once they turn 21 they will have the income (doesn't depend on discretionary power)**

(d) right to which is not subject any future condition (other than condition that individual survive to age not > 40 years), notwithstanding 104(24), that part of the amount is, for the purposes of 104(6) and 104(13), deemed to have become payable to the individual in the year.

- If deemed payable then rely on **104(13)(a)** and include it in B's income, and the trust can deduct it

Note: Situation where income splitting is contemplated by the rules

105(2): Upkeep & Maintenance

Such part of amount paid by trust out of income of trust for upkeep, maintenance or taxes of or in respect of property that, under terms of trust arrangement, is required to be maintained for use of a tenant for life or a B as is reasonable in circumstances shall be included in computing income of the tenant for life or other B from the trust for the tax year for which it was paid.

- Include in B's income reasonable amounts paid by trust out of the trust income for upkeep, maintenance or taxes of or in respect of property required to be maintained for use of life tenant or beneficiary under terms trust arrangement

Blackstein v The Queen (1998) TCC: Inclusion under 105(2) – "under terms of a trust arrangement"

Facts	Trust = estate of Max Blackstein. Max married Sarah in 1982 – entered marriage K that said their property would be kept separate but when one dies the other gets to live in the house until they die. 1990 – Max died, owned condo in TO that wife is not entitled to live in until she dies but estate had legal ownership - Estate owes condo fees of $4000/yr, executor of estate are children of Max and they don't want to pay the tax Children argue that the benefit is conferred on wife and therefore should be included in her income under 105(2) and deducted by estate under 105(6)(b)
Issue	Are the condo fees a benefit conferred on wife under 105(2)?
Holding	105(2) doesn't apply - Sara isn't required to pay – her right to live there is by virtue of marriage K, and not a Will - 105(2) says "under the terms of the trust arrangement" – this isn't the terms of a trust arrangement - Kids are paying condo fees b/c they own it, and she gets to live there by virtue of a marriage K
Ratio	***In order to rely on 105(2), has to be by virtue of a trust arrangement that the upkeep or maintenance arises – a marriage contract can't be relied on to use this provision***

105(1): Benefits under Trust - NO POSSIBILITY OF A DEDUCTION UNDER 105(1) – DELIBERATELY PUNITIVE

The value of all benefits to a T during a tax year from or under a trust, irrespective of when created, shall, subject to 105(2), be included in computing the T's income for year except to the extent that the value

- **If included under 105(2) then can be deducted by trust, if included under 105(1) then trust can't deduct it**

(a) is otherwise required to be included in computing the T's income for a tax year; or

- **If already included in income of B, then won't be included here**

(b) has been deducted under 53(2)(h) in computing the ACB of the T's interest in trust or would be so deducted if that para
(i) applied in respect of the taxpayer's interest in the trust, and
(ii) were read w/o reference to clause 53(2)(h)(i.1)(B).

- Where benefit conferred in way which Act says that in this circumstance going reduce ACB, then Act deals with benefit and it wouldn't be right to tax it too

Inclusion in computing income of any T (not just B's) of the value of all benefits to the T during a tax year from or under a trust, except to extent the value is otherwise required to be included in computing T's income for the tax year or has been deducted in computing the ACB of T's interest in the trust

***Cooper v MNR (1989) FCTD*: Interest free loan**

Facts	T and mother co-executor of father's estate. Mother is life tenant - getting income (paid/payable to her and could be included in her income). Residual B are son and daughter (once mom dies, they get property) - Son is of age and daughter is a minor Son wants to buy house, so trust loans son (interest free) $400K
Issue	Does 105(1) apply to the interest-free loan? If yes, will be included in son's income and not deductible to the trust
Holding	105(1) does not apply - 105(1) is kind of like 6(1)(a) and 15(1) – specific rules that deal with interest free loans - 80.4 is computation rule to determine taxable benefit for employment and shareholder context – but leaves trusts out Secondary reason: if the dad was alive, he prob wouldn't have charged his son interest on the money
Ratio	***Interest-free loan not a benefit that is included under 105(1)***

Deductions Computing Income of Trusts

104(6)(b): Deduction computing income of trust

There may be deducted in computing the income of a trust for a tax year the amount that the trust claims not exceed the part of its income for the year that became payable in the year to, or that was included under 105(2) in computing the income of, a B

- 104(13)(a) and 105(2) supports this deduction
  - If amount paid or payable then can deduct at trust level – 104(13)(a)
  - If amount included for upkeep, then deduct at trust level – 105(2)
- No deduction for amounts included under 105(1) → punitive

***Brown v The Queen (1979) FCTD:* "May" (104(6)) vs. "Shall" (104(13)(a))**

Facts	Trust = Ethel Brown, Beneficiary & Trustee = Grant Brown (son of Ethel). Terms of trust direct trustee to invest and keep invested money and receive income and pay income to son and if he dies to daughter in law (not discretionary) Testamentary trust, pre-2016, so gets advanatage of progressive rates Son doesn't include it in his income and trust doesn't deduct it – MNR says all of it is included
Issue	Is the beneficiary required to include amounts payable in their income even if it is not deducted by the trust?
Holding	Yes – 104(13)(a) says "shall" so it must be included - Doesn't matter whether or not the trusts deducts it - The trust "may" deduct it, but is not required to
Ratio	***Amount that's become payable to B must be included in B's income under 104(13)(a), whether or not the trust deducts it***
Note	This would have a better result for the taxpayer if it was a discretionary trsut – since he is trustee, he could pay out amount as he sees fit and keep money in the trust

***Howard Langer Family Trust (1992) TCC*: "to the beneficiary"**

Facts	Trust set up by husband and wife – own shares in private company. - Trustees = Howard (husband) and Janice (wife); Beneficiaries = their kids Trust receives income from dividends and interest from the company. For yrs at issue, trust deducts amounts and kids include amounts - most of the funds are actually going to Howard T argues this was for benefit of kids (ex. Tennis lessons, clothes, etc), but the payment wasn't actually made to the kids
Holding	Amount has to be paid to the beneficiary – doesn't matter if it is used for the benefit of the B - 104(13)(a) - include amounts that became payable "to the B", - 104(24) says amount deemed not to be payable unless it is paid to the B
Ratio	***In order to use 104(13)(a) or 104(24) to include amounts in B's income, the amount actually has to go to the B, it can't just be for the B's "benefit"***

Character of Income to Beneficiaries

Income retains its characters when flowed-through to the beneficiaries

S. 108(5)(a): Amount included = income from property

An amount included in computing income for a tax year of a B of a trust under 104(13), (14) or 105 shall be deemed to be income of the B for the year from a property that is an interest in the trust and not from any other source, and

S. 12(1)(m): Income Inclusion

Included in computing income of T for tax year as income from B/P (m) any amount required by subdivision K to be included in computing the T's income for the year, except (i) any amount deemed by that subdivision to be taxable capital gain for T

- Subdivision K: 105 & 104(13)

104(19) & (21): Designation Taxable Dividend/Net Taxable Capital Gain

Permit trust designate amounts in respect of taxable dividends received by the trust (19) and net taxable capital gains (21) realized by the trust in a particular tax year of the trust to be taxable dividends/taxable capital gains of the B, to the extent that the amounts may reasonably be considered (having regard to all the circumstances, including terms & conditions of the trust) to be of the amount that was included in computing the B's income for that tax yr b/c of 104(13)(a) or 105.

104(21): Designations Taxable Capital Gains

Capital character flows-through to B and overrides general rule that income from trust is income from property

*For purposes ss. 3 & 111, an amount in respect of a trust's **net taxable capital gains** for a particular tax year of the trust is deemed to be a taxable capital gain, for tax year of a T in which particular tax year ends, from disposition by T of capital property if*

- Refers to net taxable capital gain – so it is not each capital gain that designation applies, it is the net for the year – treated as single taxable capital gain in the hands of the B

104(21.3): Net Taxable Capital Gains = A+ B – C – D (amount that can be designated)

- (+) A = Taxable capital gains from disposition capital property of trust
- (+) B = Trust is B of another trust and gets amount designated to be capital gain
- (-) C = Allowable capital losses (other than ABIL)
- (-) D = Amount deducted under 111(1)(b) – net capital loss carry overs from other years

Requirements for character to flow through:

(a) the amount

(i) is designated by the trust, in respect of T, in trust's return of income under this Part for the particular taxation year, and

- Trust designates the net taxable capital gain in the year that it has the net capital gain

(ii) may reasonably be considered (having regard to all circumstances including terms and conditions of trust) to be part of amount that, because of (13)(a), (14) or s. 105, was included in computing income for that tax year of the T;

- Needs be reasonable to consider net capital taxable gains are funding amount under 104(13)(a), (14) or 105
- Look at terms of trust – if discretionary then designate to person who can take advantage of gain and designate net taxable capital gain is paid out to that B

*(d) total of all amounts each of which is an amount designated, under this subsection, by trust in respect of a B under the trust in the trust's return of income under this Part for the particular taxation year is **not greater than trust's net taxable capital gains for the particular taxation year**.*

104(19): Designation Taxable Dividends

If have Canadian corp that pays taxable dividend to trust, trust can designate dividends be received by B's as income from share in Canadian corp (and not income from trust) – Act as if trust didn't exist

Portion taxable dividend received by a trust, in a particular tax year of trust, on a share of capital stock of a taxable Canadian corp is, for purposes of this Act, deemed to be a taxable dividend on the share received by a T, in the T's tax year in which particular tax year ends, and is, for the purposes of 82(1)(b) & 112, deemed not have been received by trust, if

- **82(1)(b) – gross-up individual who receive taxable dividends // 112 – inter-corporate dividend deduction (not taxable)**

Requirements for 104(19) to apply:

(a) an amount equal to that portion

(i) is designated by trust, in respect of T, in the trust's return of income under this Part for particular tax year, and

(ii) may reasonably be considered (having regard all circumstances including terms & conditions of trust) to be part of amount that, b/c of 104(13)(a), (14) or 105, was included in computing income for that tax year of the T;

(b) T is in the particular tax year a B under the trust;

(c) trust is, throughout particular tax year, resident in Canada; and

(d) total all amounts each of which is amount designated, under this subsection, by trust in respect of a B under the trust in trust's return of income under this Part for particular tax year is not greater than the total of all amounts each of which is amount of a taxable dividend, received by the trust in the particular tax year, on a share of capital stock of a taxable Canadian corp.

Capital Dividend = dividend received out of non-taxable portion of the capital gain – so doesn't get included in income of trust

- But we care about this designation to adjust ACB of B's trust interest in case sell trust interest
  - See the designation in 104(20)
- Since not paying tax on capital dividend, then should not reduce ACB – so important to designate to not reduce the ACB
  - No reduction in ACB – 53(2)(h)

104(20): Designation Non-Taxable Dividends (Capital Dividend)

Portion total of all amounts, each of which is amount of a dividend (other than taxable dividend) paid on a share of capital stock of a corp resident in Canada to a trust during a tax year of trust throughout which trust was resident in Canada, that can reasonably be considered (having regard to all the circumstances including terms & conditions of trust arrangement) to be part of an amount that became payable in year to particular B under trust shall be designated by trust in respect of particular B in return of trust's income for year for purposes of 53(2)(h)(i.1)(B)(II)

- **Capital dividend – flow-through the character**
- **53(2)(h)(i.1)(B)(II)** – non-taxable amount like capital dividend doesn't reduce the ACB

Deem Amount Not Paid/Payable

Trust to deem amount not to be paid to payable and therefore no inclusion or deduction for B – taxed in trust

Advantages:

1. If testamentary trust, could pay out to B but have some taxed in hands of trust and some taxed in hands of B
   - Take advantage of trusts and B's progressive rates – income splitting
2. If trust is in low tax jurisdiction, pay amount to B but tax in hands of trust
3. If income taxed hands of trust and not B, then might be able to avoid attribution rules
   - Attribution rules depend on income being paid/payable, so if nothing is paid/payable then attribution rule may not apply

****4. Use up losses in the trust** - If losses in trust, they are trapped (*Fraser*) – so by taxing in hands of trust, can deduct the losses

- This is the only use permitted today

104(13.1): Income – Amounts deemed not paid

Where trust, in its return of income under this Part for tax year throughout which was resident in Canada and not exempt from tax under Part I by reason of 149(1), designates amount in respect of B under trust, not exceeding amount determined formula, then amount so designated shall be deemed, for purposes of 104(13) & 105(2), not to have been paid or become payable in year to or for benefit of the B or out of income of the trust.

- Designated amounts not including in B's income under 104(13) & 105(2), but if don't designate then included in B's income
  - Can mix and match

Can't designate amount that exceeds:

$$A/B \times (C - D - E)$$

- **A** = B's share of income of trust for year computed w/o reference to this Act;
- **B** = total of all amounts each of which is B's share of income of trust for year computed w/o reference to this Act
  - If only one beneficiary, then A/B = 1

A/B attributes amount based on beneficiaries share of the trust

- **C** = Total of all amounts each of which is an amount that, but for this section or 104(13.2), would be included in computing income of B by reason of 104(13) or 105(2)
  - Amounts that would be included in B's income if it wasn't for this section
- **D** = Amount deducted under 104(6) in computing income of trust for year (if don't deduct anything, D = 0)
  - Have to choose b/w deducting amount paid/payable and designating
- **E** = Amount determined by trust for yr and used as value of C for purposes of formula in 104(13.2), or if no amount determined, nil
  - Integrates this rule with 104(13.2) – capital gains

If no capital gains and no deduction, then amount otherwise included in B's income under 104(13) and 105(2)

104(13.2): Taxable Capital Gains

Where trust, in its return of income under this Part for tax year throughout which it was resident in CA designates an amount in respect of a beneficiary under trust, not exceeding amount determined by formula

A/B × C

Where

A =Amount designated by trust for the year in respect of the B under subsection 104(21),

- 104(21) – designation capital gains - flow-through character to B

B = total of all amounts each of which designated for year in respect of a B of the trust under subsection 104(21), and

A/B = 1 if only one B

C = Amount determined by trust and used in computing all amounts each of which is designated by trust for year under this subsection, not exceeding amount by which

(i) total of all amounts each of which is amount that, but for this subsection or 104(13.1), would be included in computing income of a beneficiary under the trust by reason of 104(13) or 105(2) for year

- Max amount designated is capital gains included under 104(13) and 105(2)

exceeds

(ii) amount deducted under subsection 104(6) in computing the income of the trust for the year,

Consequence → amount designated shall

(a) for purposes 104(13) and 105(2) (except in application of (13) for purposes of (21)), be deemed not to have been paid or to have become payable in year to or for the benefit of the beneficiary or out of income of the trust

Can mix-and-match, **if deduct then can't designate and if don't deduct then can**

104(13.3): Invalid Designation – applies tax years 2016 and after

If trust has positive taxable income, then can't designate

*Any designation made under (13.1) or (13.2) by a trust in its return of income under this Part for a tax year is invalid if trust's taxable income for the year, determined w/o reference to this subsection, is greater than **nil**.*

- If trust has losses, then want to designate so losses can be used up – designate to have income taxed in hands of trust

Can only designate to use up losses in trust – use to shelter income of trust

If amount designated and trust pays tax on it, then under 53(2)(h), the ACB on B's trust interest is reduce – entitlement but no tax paid since paid at trust level

Lussier v The Queen (2000) TCC:

Facts	Estate of Simon Lussier – set up company. Beneficiary = Spouse. Trustees = Children 1992 & 93 – trust paid $86,786 & $60,015 to B – spouse included in computing her income and trust deducted amounts Changed accountants, new accountant said since testamentary trust should have been paying out amounts but designate under 104(13.1) – get progressive rates in the trust 1994 – write letter to CRA for 1992 & 1993 saying they want to do it – CRA says no b/c 104(13.1) says you have designate amount in return of income – and estate didn't do it when filed return
Holding	**Allows change of tax return to get designation** - 104(13.1) doesn't put time limit on designation – just says "designation in return of income" - As long as not statute barred, no reason why T can't go back and amend return - If parliament intended to require designation be filed within prescribed time, it would have said so explicitly – unreasonable impose condition on T that is not clearly stated This is not retroactive tax planning – but doesn't say if it was then couldn't make designation later This is case of **using trust for income splitting** – get 2 sets of progressive rates (trust and B - Income splitting fine here – unless specific rule, can't say general scheme of Act prevents income splitting
Ratio	***There is no prescribed time limit to make the designation in 104(13.1)*** ***Income splitting found to be fine here – no general scheme of Act preventing income spliting***
Note	104(13.3) – can't use rule for income-splitting purpose anymore – can only use rule for losses

ANTI-AVOIDANCE RULES

3 Sets Rules:
1. **Consolidating trusts** – 104(2)
2. **Attribute** income to 1 person that would otherwise be taxable in hands of someone else
3. **Tax in income split -** tax at top marginal rate – "kiddie" tax

Consolidating Trusts

104(2): Consolidate Trusts

Where have a bunch of trusts and just 1 Beneficiary class and all comes from same settlor – treat as one trust so don't get progressive rates (for 3 years of GRE)

Where there is more than one trust and

(a) substantially all of the property of the various trusts has been received from one person, and
- "substantially all" > 90%

(b) various trusts are conditioned so that income thereof accrues or will ultimately accrue to same beneficiary, or group or class of beneficiaries,

such of the trustees as the Minister may designate shall, for the purposes of this Act, be deemed to be in respect of all the trusts an individual whose property is the property of all the trusts and whose income is the income of all the trusts.

- Minister gets to designate as many of the trustees as Minister feels appropriate to be deemed to be one trust

***Mitchell v MNR (1956) TAB*: "Group or Class of Beneficiaries" – just put 1 B**

Facts	Set up 1 trust each kid (4 kids) – contributed $150 to each trust and each trust invested in Seaborne. $600 in Seaborne. Seaborne acquired 63 common shares in Stevedoring company (T's company) in exchange preferred shares in Seaborne - CA Stevedoring paid $31K in dividends to Seaborne CRA challenged on 2 grounds – attributed dividend income given to Seaborne to T - 1. Personal corporation (rule no longer exists) – personal corp deemed distributed income and tax shareholders - 2. Consolidate the trusts under 104(2)
Analysis	**104(2)(a):** Has substantially all of the property of the trust received from one person? - Yes - $150 came in from T and trust bought shares with it - Really the property is being substituted for property – doesn't say that is ok in section but court says it is fine **104(2)(b**): Is income accruing being receive by one group or class of B's? - MNR says they are the same group/class – all T's kids
Holding	4 separate trusts and each one is distinct from the 3 others
Ratio	***So long each trust has 1 B - no class/group – for group/class to be satisfied, need groups/classes in same trust***
Note	MNR also argued 74.1(2) – attribute income from property to parent - There was transferred property to person under 19 by means of trust – transferred $150 - Problem is that attribution rule attributes income to the transferor – but the property of the trust is $150 and they buy sharers so as long as income stays in Seaborne, nothing to attribute

Attribution Rules

Key Provisions:

56(2) – indirect payments
56(4) – transfer of rights to income
56(4.1) –(4.3) – interest-free or low interest loans
74.1(1) & (2) – attribution of income from property transferred or loaned to spouse or common law partner and related minor
74.2(1) – attribution taxable capital gains & allowable capital losses from property transferred/loaned to spouse or CL partner
74.3 & 74.5(9) – special rules for transfers or loans to trust
74.5(1) & (2) – transfers for FMV consideration and loans for value
74.5(6)-(8) – back to back loans and transfers and guarantees
75(2) – attribution of income and capital gains of trust to settlor

74.5(9): Transfers or Loans to a Trust – Deeming Rule

Where a T has lent/transferred property, either directly or indirectly, by means of a trust or by any other means whatever, to a trust in which another T is beneficially interested, the T shall, for the purposes of this section and sections 74.1 to 74.4, be deemed to have lent/transferred the property, as the case may be, to or for the benefit of the other T.

- Where lend/transfer property to trust, then deemed to have lent/transferred property for benefit of B of trust

74.1(1): Transfers/Loan to Spouse/CL Partner

If individual transferred/lent property, either directly or indirectly, by means of trust or by any other means whatever, to or for the benefit of a person who is individual's spouse/CL partner or who since become individual's spouse or CL partner, any income or loss, as the case may be, of that person for a tax year from property or from property substituted therefor, that relates to period in the year throughout which individual is resident in CA and that person is individual's spouse or CL partner, is deemed to be income or a loss of individual for the year and not that person.

Applies when:

- Transferor transfers property via trust (or any other means whatever)
- Transfers property for benefit of transferor's spouse or CL partner

Then: Any income/loss from the property (or sub property) deemed be income/loss of transferor and not transferee

74.1(2): Transfer/Loan to Related Minor

If individual transferred/lent property, either directly or indirectly, by means of trust or by any other means whatever, to or for benefit of a person who was under 18 years of age and who

(a) does not deal with the individual at arm's length, or (b) is the niece or nephew of the individual,

*any income or loss, as the case may be, of that person for a tax year from the property or from property sub for that property, that relates to period in the tax year throughout which individual is resident in Canada, is deemed to be income or a loss of the individual and not of that person **unless** that person has, before the end of the taxation year, attained the age of 18 years.*

Applies when:

- Transferor transfers property via trust (or any other means whatever)
- For benefit of someone under 18 and NAL or is niece or nephew of individual and that person doesn't turn 18 within the year

Then: Any income/loss from the property (or sub property) deemed be income/loss of transferor and not transferee

74.2(1): Capital Gain or Loss Deemed that of Transferor

Where individual lent/transferred property, either directly or indirectly, by means of trust or by any other means whatever, to or for benefit of person ("recipient") who is individual's spouse or CL partner or who has since become individual's spouse or CL partner, then for purposes of computing income of individual and recipient for tax year:

(a) net taxable capital gains from lent/transferred property

(b) net taxable capital losses from lent/transferred property

shall be deemed to be taxable capital gain of individual for year from disposition of property other than listed personal property;

Applies when:

- Transferor transfers/lends property via trust (or any other means whatever)
- For benefit of T's spouse or CL partner (recipient)

Then: Aggregate capital gains from loaned/transferred property & capital losses from loaned/transferred property – if net > 0 then gain attributed to transferor, if net < 0 then loss attributed to transferor and not the transferee - (e)

74.3(1): Transfer/Loan Property to Trust

Where an individual lent/transferred property, either directly or indirectly, by means of a trust or by any other means whatever, to a trust in which another individual who is at any time a designated person in respect of individual is beneficially interested at any time

- **74.5(9)** – transfer to trust is for benefit of B of the trust
- If individual is designated person w.r.t. to trust, then rules apply
- **74.5(5): Designated Person** – person subject to attribution rules
  - Spouse or CL partner of individual; or is under 18 and is NAL w individual or is niece/nephew of individual

(a) ***74.1*** → *income of designated person for tax yr from lent/transferred property shall be deemed be amount equal **lesser of***

- **Lesser of amount B's get from trust or share of income that comes from lent/transferred property**
  - If > B, then ratio of amount that 1 B gets of amount that all the B's are getting from trust

(i) *amount in respect of trust that was included by virtue of 12(1)(m) in computing income for yr of the designated person, and*

- 12(1)(m) – amount required subdivision K be included computing T's income (except amount deemed taxable capital gain)

(ii) *proportion of amount that would be income of trust for year from lent/transferred property or from property sub if no deduction were made under 104(6) or (12) that*

(A) amount determined under 74.3(1)(a)(i) in respect of the designated person for year

is of

(B) total of all amounts each of which is amount determined under 74.3(1)(a)(i) for year in respect of designated person or any other person who is throughout the year a designated person in respect of the individual

- **Note**: if there is only one beneficiary then (A)/(B) = 1 – so focus on income from trust for lent/transferred property w/o deductions under 104(6) and (12)

Capped at amount of income that is from lent/transferred property, but if have amount from lent/transferred property but nothing paid to B, then no attribution

- If income stays in trust, then no attribution rule – trust already taxed at top marginal rate

(b) ***74.2*** → *amount equal to the* ***lesser*** *of:*

- **Lesser of designated amounts to B (could be from all capital gains and allowable capital losses) and the actual capital gains of the trust from the lent/transferred property**

(i) the amount designated under ***104(21)*** *in respect of the designated person in trust's return of income for the year, and*

(ii) amount, if any, by which

(A) total of all amounts each of which is taxable capital gain for year from disposition by trust of lent/transferred property or property sub therefor

exceeds

(B) total of all amounts each of which is allowable capital loss for year from disposition by trust of lent/transferred property or property sub therefor,

shall be deemed to be a taxable capital gain of the designated person for year from disposition of property (other than listed personal property) that is lent/transferred property.

- If nothing actually paid out by trust, then nothing attributed to transferor
- If something paid out/designated, amount attributed back is lesser amount paid out and income from lent/transferred property

74.5(1): Transfers for FMV

If transferred/lent property at FMV then 74.1 and 74.2 don't apply to income, gain or loss

- FMV transferred property not > FMV property received as consideration
- FMV debt = debt owing by trust to person where interest = payable at prescribed or arm's length rate

74.1(1), (2) & s 74.2 do not apply to any income/gain/loss derived in particular tax yr from transferred property or property sub if

(a) at time of transfer FMV of transferred property did not exceed FMV of property received by transferor as consideration for transferred property;

(b) where consideration received by transferor included indebtedness,

(i) interest was charged on the indebtedness at a rate ≥ than the lesser of (A) prescribed rate, and (B) rate would have been agreed b/w parties dealing at arm's length

74.5(2): Loans for Value - 74.1 and 74.2 doesn't apply to property lent at value/prescribed rate

74.5(6): Back to Back Loans & Transfers

Look through multiple transfers – where transfer property to 3rd party, property deemed/lent or transferred original person

- Specified person = designated person

Where individual lent/transferred property

(a) to another person and that property, or property sub, is lent/transferred by any person ("3rd party") directly or indirectly to or for benefit of specified person w.r.t individual, or

(b) to another person on condition property be lent/transferred by any person ("3rd party") directly or indirectly to or for benefit of a specified person w.r.t. individual,

then:

(c) for 74.1, 74.2, 74.3 & 74.4, property lent/transferred by 3rd party shall be deemed to have been lent/transferred, as case may be, by individual to or for benefit of specified person, and

(d) for 74.5(1), consideration received by 3rd party for transfer property shall be deemed have been received by individual.

74.5(11): Artificial Transactions

74.1 to 74.4 do not apply to a transfer or loan of property where it may reasonably be concluded that one of main reasons for transfer/loan was reduce amount of tax that would, but for this subsection, be payable under this Part on income and gains derived from the property or from property substituted therefor.

- If use attribution rule, one of the main reasons was to reduce tax, then attribution rule won't apply

Romkey (2000) FCA:

Facts	Private company. 1987 – set up trust for kids (Brian Romkey Trust and Barrie Romkey trust). Brian has 2 shares in Brimar and Margaret has 1 share. Brian Romkey trust gets 166 B shares and Barrie Romkey gets 250B shares – whole bunch of other shares issued (Brian gets 100 A and 167 B, Margaret gets 167 B, etc) Company pays $33K dividend to each child trust – dividend designated to kids Reassessed – transfer of property to or for benefit of kid by means of trust
Issue	Has there been a transfer of property when give up a share and bunch of other shares issued for little consideration?
Holding	Transfer of property – giving up entitlement to share of dividends to trust
Note	Now would be caught by 120.4 and taxed at top marginal rate

Murphy v The Queen (1980) FCTD: **Attribution Rules**

Facts	Testamentary trust. Widow get $20K/yr out of income or dip into capital. 3 children (George, Edythe & Nora) get 1/3 remaining revenue (min $4K – come out of income/capital). Trustees: 2 of children (George & Edythe) - If George dies – share goes to his wife (Ester) - If Nora dies - share goes to George and Edythe (equal split) - If Edythe dies – share goes to husband and if husband dead then goes to her kids - If mom dies – 1/3 to George, 1/3 Nora, 1/3 Edythe 1967 – Nora dies – so now George and Edythe get min $6K Term of trust gets varied: on death of George or Edythe, then their share goes to spouse – got rid of $4K each, and just say discretionary – B's are George, Edythe, spouses, and Edythe's 2 kids 1974– the mom dies Reassessed for 1974 – 1976 – amounts paid out by George's wife, wife gets ¼ of income and George gets ¼ - George splitting his ½ of income b/w himself and his wife - Wife includes the amounts and then deducts it
74.1(1)	When T gives up right to $6K/yr does he transfer property, directly or indirectly, by means of trust or any other means whatever, for the benefit of his spouse? **Yes – transfer took place - indirect benefit of wife** **Transfer of right to income is a transfer of property in any manner whatever for the purposes of 74.1(1)**
Holding	Under 74.1(1) – attribute amount from wife to George
74.5(9)	If happened today – would be much clearer → 74.5(9) – where T transfers property to trust in which another T is beneficially interested, then the person is deemed to have transferred property to or for the benefit of the other T - Court finds there was indirect property right transfer - So if use 74.5(9) – George has given up right, and wife is beneficially interest in trust, so this provision deems George to have transferred property to wife and therefore definition use 74.1(1)
74.3	All of the income of the trust would be split equally b/w George and sister – they both gave up their share so they both transferred property to the trust
Ratio	***Broad interpretation of what it means for an individual to have transferred property, including surrender of vested rights in a trust***

Sachs (1980) FCA:

Facts	Set up family trust. Trustee: wife, Beneficiaries = children T owned real estate development company – sold shares to trust in exchange for promissory note w/o interest - 74.5(2) would apply if interest charged at prescribed rate – but here no interest was charged Company pays dividends to trust – trust elects income taxable in hands of kids under preferred B election – 104(14)
Issue	Do the attribution rules apply?
Analysis	T says that rule shouldn't apply b/c no vested right in kids – just being allocated amounts under preferred B election Even discretionary B gets right – when transfer property to trust transferring property to discretionary B (74.5(9) Income from property? Yes Transfer of property happens when property transferred – discretionary B's have property right that they didn't have before and income from property and it is income allocated under preferred B election
Holding	**Attribution rule kicks in – tax it**
Note	Today, election in **104(14)** only applies disabled kids or spouses – so if you wanted to get dividend paid to trust to be taxed in hands of kid B's: Pay amount to kids and have them include under 104(13) and deduct under 104(6) and then designate under 104(19) for these to be taxable dividends and use kids tax credits - 120.4 would nail it if kids under age 17; or **104(18)** – trust for minors – as long as make trust so kids have vested rights (non-discretionary), can leave income in trust but deemed to be payable to kids

75(2): Attribution Trust Income to Settlor

Attribute income to settlor if they retain certain control over property and decisions of the trust

If trust, that is resident in Canada and that was created in any manner whatever since 1934, holds property on condition

(a) that it or property sub therefor may

(i) revert to person from whom the property or sub property was directly or indirectly received ("the person"), ***or***

- Implicitly it has to revert **by operation of the trust** and not some other means/circumstances

(ii) pass to persons to be determined by the person at a time subsequent to creation of the trust, ***or***

- Settlor controls designation of the property – if settlor is also trustee and it is discretionary trust then tainted
- If there is a class of B's and the settlor (who is also trustee) has ability to decide how much ppl get, then not tainted – settlor just determines amount, trust determines who the B's are
  - If exercise in way so some ppl get nothing - tainted – settlor determine which person get property

(b) during existence of person, property shall not be disposed of except w person's consent or accordance person's direction,

- Gatekeeping – doesn't mean settlor doesn't determine who property goes to, trust can't dispose of property unless settlor's consents → if settlor is sole trustee, trustee has power to decide whether to dispose of property – taints trust

any income/loss from the property or from property sub for property, and any taxable capital gain/allowable capital loss from disposition of property or of property sub for the property, shall, during existence of person while the person is resident in Canada, be deemed to be income/loss or a taxable capital gain/allowable capital loss of the person

- Note: Rule doesn't say it is not attributed to trust - double taxation, courts generally don't tax in hands both trust and settlor

Applies when:

- Settlor gives up property by retains control over it (i) **get property back**; (ii) **deciding who the property goes to**; or (b) has to **consent on the purchase and sale of the property in the trust**
  - CRA – even if small part of property may revert, all of the income from the property attributed back to settlor
  - Trustee may have discretionary ability to cause property to revert back to settlor

Then: Income/loss from property deemed to be income/loss of settlor

Exception:

- **Secondary Gift** - Trust where settlor contributes property, there is a capital distribution to a B and then the B gives it to the settlor – secondary gift and reverted back to settlor but not by means of the trust – so not caught by rule
- **B gets property and on B's death it goes to settlor** – operates outside of trust to rule doesn't apply

Howson:

Facts: Couple set up offshore trust that was allowed to be tax-free 5 yrs. Loan transferred into trust and at end of 5 yrs a bunch of $ went to wife. CRA - property reverted to person who contributed so for those years don't get tax-free b/c income attributed to wife

Holding: CRA using "reversion" wrong

- Reversion in 75(2) = reversion of capital and not reversion arising from a creditor/debtor relationship

Queen v Sommerer (2012) FCA:

Facts	T had 25% shares Vienna Systems & owned Cambrian Systems – potential purchasers - Nokia & Northern Telecom 90's – Austria set up private foundation - bring investment into Austria (like a corp/trust) - Taxable low rate in Austria Oct 3 – T's father sets up Austria foundation and contributes 1M shillings – T and his wife and kids are B's Oct 4 – Trust purchases shares in Vienna System (66.5 cents) and Cambrian ($1.75) Dec – foundation sells some Vienna shares for $4.50 - 2 yrs later – remainder of Vienna shares sold for $9/share Cambrian shares sold for $14.97/share Minister argues: 75(2) – this is trust for Canadian tax purposes and it acquired property from T (shares) and since T is a beneficiary, the property could revert back to him
Issue	Is this Austrian foundation a trust? Does 75(2) apply to revert the property back to T?
Analysis	**Issue 1: Is this a trust? Doesn't Decide** - TCC accepted it was a trust but FCA says don't need to decide b/c sides with T on second issue, but doubts whether this is a trust - Nothing in constating docs support conclusion that right of foundation to deal with property is constrained by legal or equitable obligations analogous to those of trustee **Issue 2: Does 75(2) apply? No** Foundation received $ from T's father which was used to pay for the shares - Property received by T and property could revert back to him through Foundation - Would be attributed to apply to the father and not T, since property was received by T's father
Ratio	***75(2) doesn't apply to FMV acquisitions***

Tax on Split Income

Gov't shut down income splitting with minor children (but not with spouses)

120.4(2): Tax on Split Income – "Kiddie" Tax

There shall be added to a specified individual's tax payable under this Part for a tax year, the highest individual percentage for the year multiple by the individual's split income for the year

120.4(1): "Specified Individual" means an individual who (i) is under 18 for the entire year, (ii) at no time in year was non-resident; and (iii) has a parent resident in Canada (note: only needs to be 1)

120.4(1)(c): "Split Income" *of a specified individual for a tax year, means the total of all amounts each of which is*

- Some activity by related person that is giving rise to income that is being split with specified individual

portion of amount included b/c of 104(13) or 105(2) in respect of trust in computing individual's income for year, to extent portion
(i) is not included in an amount in (a)
(ii) can reasonably be considered

*(A) to be in respect of taxable dividends received in respect of shares of capital stock of a **private corp**,*

- If publicly listed, not going to be shares subject to the rule – rule targets shares of private corp

(B) to arise b/c of s. 15 in respect of ownership by any person of shares of the capital stock of a corp (other than shares of a class listed on a designated stock exchange), (Includes shareholder benefits)

(C) be income derived from provision of property/services by a P/S or trust to, or in support of, a biz carried on by

(I) a person who is related to the individual at any time in the year,
(II) a corp of which a person who is related to the individual is specified shh at any time in the year, or
*(III) a professional corp of which a person related to individual is a shh at any time in the year, **or***

- Income derived from biz of P/S or trust carried on by related person/corp

(D) to be income derived from a biz of, or rental of property by, a particular P/S or trust, if a person who is related to individual at any time in the year is actively engaged on regular basis in the activities of particular P/S or trust related to earning income from a biz or rental of property.

Doesn't apply to lots kinds of income - If trust has publicly traded shares and it pays out money to kids then that won't be caught here

S. 20(1)(ww): Split Income

In computing T's income for tax year from biz/property, there may be deducted Where the T is a specified individual in relation to the year, the individual's split income for the year

- Got income from trust - either designated under 104(19) as taxable dividends or reasonable consider attributable as dividend and included under 104(13) and deducted under 104(6), then under 120.4 it is taxable and would be subject to regular tax rate but carve out split income – only taxable at top marginal rate

120.4(4): Gains Disposition of Shares = Deemed Dividend

*If a specified individual would have for a tax year, if this Act were read w/o reference to this section, a taxable capital gain (other than an excluded amount) from a disposition of **private company shares** that are transferred, either directly or indirectly, in any manner whatever, to a person with whom the specified individual **DOES NOT DEAL AT ARM'S LENGTH**, the amount of that taxable capital gain is deemed not to be a taxable capital gain and 2x the amount is deemed to be received by the specified individual in the year as a taxable dividend that is not an eligible dividend.*

120.4(5): Taxable Capital Gain of Trust = Deemed Dividend

*If specified individual would be, if Act read w/o reference to this section, required under 104(13)(a) or 105(2) to include amount in computing specified individual's income for tax year, then to extent amount can reasonably be considered to be attributable to taxable capital gain (other than **excluded amount**) of a trust from disposition of shares (other than publicly traded shares) that are transferred, either directly or indirectly, in any manner whatever, **to a person with whom specified individual DOES NOT DEAL AT ARM'S LENGTH**, 104(13)(a) & 105(2) do not apply in respect of amount and 2x amount is deemed to be received by the specified individual in the year as a taxable dividend that is not an eligible dividend.*

- Re-characterize capital gain as taxable dividend – so 2x taxable capital gain is dividend deemed to be included

120.4(1): "Excluded Amounts" *in respect of an individual for a tax year, means an amount that is the income from, or taxable capital gain from disposition of, a property acquired by or for the benefit of the individual as a consequence of the death of*

(a) a parent of the individual; or
(b) any person, if the individual is
(i) enrolled as full-time student during year at a post-secondary educational institution (as defined in 146.1(1)), or
(ii) individual in respect whom an amount may be deducted under 118.3 in computing T's tax payable under this Part for year

If parent dies then not going to do this, and if someone else dies and get money while at university, then allow the split income

Note: Attribution rules in 74.1(1) & (2), 74.3(1) and 75(2) do not apply to an amount included in computing an individual's split income for the year – 74.5(13)

TRUST INTERESTS

Two kinds of interests: (1) Income Interest & (2) Capital Interest

- **Commercial trust** – capital interest
- **Personal trust** then:
  - **Income Interest** – B entitled to income of trust during their lifetime
  - **Capital Interest** – residual B – person who accesses capital at end of income B's lifetime

108(1): "Income Interest" = under personal trust **– right to income or to enforce payment of income**
Means a right (immediate, future, absolute or contingent) of the T as a B under a personal trust to, or to receive, all or any part of the income of the trust and includes a right to enforce payment of an amount by the trust that arises as consequence of such right

108(1): "Capital Interest" – everything that isn't an income interest, is capital interest
Means all rights of the T as a B under the trust and includes a right to enforce payment of an amount by the trust that arises as a consequence of any such right, but does not include an income interest in the trust

Taxation of Income Interests

COST OF INCOME INTEREST

Key Provisions:
106(1.1): Cost of income interest generally = nil
- **Unless** T acquires any part of the income interest from someone who was a B immediately before the acquisition

69(1)(c): Where income interest acquired from person who was B by way of gift, bequest or inheritance, cost deemed to be FMV
69(1)(a): Where income interest acquired from NAL person who was B at an amount greater than FMV, cost deemed to be FMV
Otherwise, where income interest acquired from person who was B, cost is amount paid by T for income interest
106(1): Cost income interest may be deducted against amounts included w.r.t. income interest - 104(13) (payable) / 106(2) (PoD)

106(1.1): Cost to T of Income Interest in a Trust
= **nil** UNLESS
(a) any part of interest was acquired by T from a person who was B in respect of interest immediately before that acquisition; or
- **Cost is nil unless T acquires income interest from a B, then cost = amount T paid for income interest**

69(1): Inadequate Consideration
(a) T acquires interest from NAL person who was B for **greater than FMV**, T deemed acquired it = FMV
(c) T acquires property by way gift/bequest/inheritance or b/c disposition that does not result in change beneficial ownership of property, T deemed to acquired property = FMV
- **If income acquired from person who was a B by way of gift, cost = FMV**

106(1): Income Interest in Trust – offset cost against income get w.r.t. income interest
- T acquired interest of trust from B, now have income to include – sell to Z so have cost = what T paid or FMV - 106(1) allows T to deduct in computing income until exhausted cost

Where amount in respect of T's income interest in a trust has been included in computing T's income for tax year by reason 106(2) or 104(13), there may be deducted in computing T's income for year the lesser of
(a) amount included in computing the T's income for year, and
(b) amount, if any, by which cost to T of income interest > total all amounts in respect of the interest that were deductible under this subsection in computing T's income for previous tax years.

Example: **Buy income interest for $200K**
Yr 1: Get $100K from trust as income included under 104(13)
- Deduct lesser of amount included ($100K) & amount by which cost > amounts previously deducted ($200k) – deduct $100K

Yr 2: Get $150K included in income under 104(13)
- Deduct lesser amount included ($150K) & amount cost ($200K) > amount deducted previously ($100K) – deduct $100K & include $50K

DISPOSITION OF INCOME INTEREST

Huge difference b/w disposing income interest to trust (not taxable) vs. 3rd party (fully taxable)

Key Provisions:
106(2)(b): If T disposes income interest any taxable capital gain or allowable capital loss = nil
106(2)(a)(c), 106(3): If property trust distributed to T who was B in satisfaction of all or part T's income interest, no amount included computing T's income, trust deemed disposed property PoD = FMV, cost property received by T = FMV at time deemed disposition
106(2)(a) & (c): If T disposes income interest otherwise than exchange property of trust, amount PoD > amount already included w.r.t. right enforce payment under 104(13) included computing T's income, cost of property received by T = FMV at time disposition
69(1)(b): If T disposes income interest by way gift or to NAL person for PoD = 0 or PoD < FMV, T deemed received PoD = FMV

2 Scenarios:
1. Dispose of income interest to a 3rd party – **106(2)(a)**
   - Include in T's income: PoD – Amounts included in T's income but T didn't receive
2. Dispose of income interest in exchange for property of trust – **106(3)**
   - No tax consequences to T, but trust dispose of property for PoD = FMV

106(2)(b) & (c): Applies in both scenarios
(b) any taxable capital gain/allowable capital loss from disposition = nil
   - **All on income account, not capital**

(c) cost to T of each property received by T as consideration for disposition = FMV of property at time disposition

106(2): Disposition by T of Income Interest – Dispose interest to 3rd party
Where T disposes of income interest in a trust
(a) except where (3) applies, **include in computing T's income** in year amount, if any, by which
(i) PoD > (ii) where interest includes right to enforce payment, amount in respect of that right that has been included in computing T's income for a tax yr b/c of 104(13)
   - PoD – Amounts included in T's income but didn't receive (already paid tax)

106(3): PoD Income Interest – dispose interest for property of trust
Where at any time any property of trust distributed by the trust to a T who was a B under trust in satisfaction of all or any part of T's income interest, trust shall deemed to dispose property for PoD = $FMV_{property}$
- When trust formed and T became B (cost = nil), settlor could have given T property directly and T would not have paid tax b/c it is gift - T pay tax on income from property going forward (just like they would if settlor gave them property directly)
- (2) doesn't apply if (3) applies – so where dispose of interest to trust then **no inclusion of PoD in T's income**

69(1)(b): If T has income interest and give it to someone for free → T **deemed disposed PoD = FMV**

McKenzie (2011) TCC:

Facts	Estate of Rolf Zimmerman. Trustees = Barbara (daughter) and his lawyer. RZ set up corp (Swiss Herbal) - 20% shares Swiss gifted to – daughter - 80% put in trust for wife, another daughter, lawyer & T - T worked for Swiss and was senior exec - All income B's for life, and for T it was for life or when she leaves the company - RZ made T a B to make sure she would remain in company and earn income going forward - Barbara is capital B – entitlement all shares once all income B's die or T leaves company All income B's but T die - Barbara has 80% interest and fires T so T's income interest is gone **104(4)** – every 21 yrs there is deemed disposition capital property of trust- happens in 1999 and dispute over who will pay tax (usually would be capital B) – tax of $1.4M becomes $1.7M with interest Barbara and T come to agreement where T will give up rights in exchange for $1.7M - Barbara sets up # company which acquires shares of Swiss from trust in exchange for note for $1.7M and note is distributed to T - # company pays T in exchange for the note
Issue	Did T receive property from trust in satisfaction income interest or did T dispose of income interest to # company/Barb? - Cost T's income interest = nil (personal trust & got interest as gift from Settlor) - If disposed to trust – no income inclusion (106(3)); if disposed to # company – full inclusion (106(2)(a))
Holding	T disposed of income interest to trust – gets $1.7M tax free - Note distributed to T by the trust – trust disposed of shares to # company, but disposed of note to T

COST OF CAPITAL INTEREST

107(1.1): Cost capital interest in personal trust = nil, **unless** any part of capital interest acquired by T from person who was B in respect interest immediately before acquisition
69(1)(c): Where capital interest acquired from person who was B by way gift, bequest, or inheritance, cost = FMV
69(1)(a): Where capital interest acquired from NAL person who was B at amount > FMV, cost = FMV
53(2)(h)(i.1): Tax-free return of capital – reduce ACB capital interest

- Deduction computing ACB capital interest all amounts payable to T (otherwise than PoD) **except extent** (A) amounts included T's income - 104(13), or (B) amounts designated taxable capital gains - 104(21) or non-taxable dividends - 104(20)

Capital interest is generally capital property, but may be inventory

**107(1.1)(b): Cost Capital Interest

Cost to a T of a capital interest of the T in a personal trust is **deemed to be nil**, unless (i) any part of interest was acquired by T from a person who was B in respect of the interest immediately before acquisition

53(2)(h)(i.1): Deduct ACB Capital Interest

Where property is capital interest of T in a trust (other than interest in personal trust that has never been acquired for consideration)

- **If it is capital interest in personal trust that has never been acquired for consideration, cost = nil (rule doesn't apply)**

(i.1) *any amount become payable to T by trust in respect of interest (otherwise than by PoD interest),* ***except to extent*** *portion thereof*

(A) that was included in the T's income by reason of 104(13)

- If amount included in computing income - don't reduce ACB of capital interest

(B) where the trust was resident in CA throughout its tax year in which the amount became payable

(I) that is equal to the amount designated by the trust under subsection 104(21) in respect of the taxpayer,

- **104(21)** – designate taxable capital gains – want the non-taxable portion capital gain to come out tax free
- Non-taxable portion capital gain = taxable portion, can just say not to reduce ACB by taxable capital gain

(II) that was designated by the trust under subsection 104(20) in respect of the taxpayer, or

- **104(20)** – non-taxable capital dividends – not included under 104(13) but are amount payable
- Doesn't reduce ACB b/c want it to come out tax-free

Reduce ACB for all amounts payable to the T, except extent amounts included in T's income per 104(13), (20), (21)

107(1)(e): Capital Interest = Inventory

Where T disposed of all or part of T's capital interest in a trust if capital interest is inventory of T, notwithstanding def "cost amount" in 108(1), its **cost amount is deemed** to be amount, if any, by which

(i) amount that would, if this Act were read w/o reference to this para and def in 108(1), be its cost amount

Exceeds

(ii) total all amounts, each of which is an amount in respect of the capital interest that has become payable to the T before the disposition and that would be described in 53(2)(h)(i.1) if that subparagraph were read w/o reference to its sublcause (B)(I)

- All amounts that would be return of capital will reduce cost but w/o reference (B)(I)
- (B)(I) – rule for taxable capital gains – designation taxable capital gains are not allowed as tax-free return

If get tax-free portion of capital gain and holding capital interest as inventory, cost of inventory is reduced

248(1): "**Cost amount**" = value under **s. 10** – inventory valued lower cost and FMV

107(1.2): Deemed FMV non-capital property – deals with fact inventory can be written down, even if not disposed of

For purposes of s. 10, FMV of capital interest deemed to be total of:

(a) Amount that would be its FMV at that time;

(b) total of all amounts, each of which is an amount that would be described, in respect of the capital interest, 53(2)(h)(i.1) if that subparagraph were read w/o reference to (B)(I), that has become payable to the T before that time

- Add back to FMV the tax-free returns of capital

Add amounts that grind down cost of inventory capital interest for determining FMV - can't claim deduction = lower cost & FMV

DISPOSITION OF CAPITAL INTEREST

Rules differentiate b/w disposition capital interest to trust and disposition to 3rd party

- If dispose capital interest to 3rd party, PoD determined by what you sell for it, or rules in 69(1) applies

107(1)(a): Disposition by T of Capital Interest

To determine capital gain from disposition all or part of capital interest in personal trust, T's ACB of interest immediately before disposition deemed = greater ACB otherwise determined (OB) & "cost amount" to T as defined 108(1) (IB)

Where T disposed all or part of T's capital interest in personal trust, for purpose computing T's capital gain, if any, from disposition, ACB to T of interest or part of interest, immediately before disposition is, unless any part of interest has ever been acquired for consideration and, at time of disposition, trust is non-resident, deemed to be the greater of

*(i) its **ACB**, otherwise determined, to the T immediately before the disposition, (***Outside Basis)*** and*

- If personal trust and T acquired capital interest from settlor, then ACB = nil (107(1.1)), otherwise it will be the amount T paid to acquire the capital interest from another B

*(ii) the cost amount to the T immediately before the disposition (**Inside Basis)***

If OB > IB – T acquired capital interest from past B and it increased in value → ACB = OB

If B acquired capital interest from settlor, OB = nil (b/c 107(1.1)), and ACB = IB

108(1)(a): "Cost Amount" – disposing interest to trust and trust giving property

Cost amount to a T at any time of capital interest or part of it, as case may be, in a trust, means

(a) where any $ or other property of trust has been distributed by trust to T in satisfaction of all or part of T's capital interest, total of

(i) the $ so distributed; &

(ii) all amounts each of which is cost amount to trust, immediately before the distribution, of each such other property

Dispose Capital Interest to Trust in exchange for property:

107(1)(a), def "cost amount" in 108(1), & 107(2) – property disposed of by trust for PoD = cost

- If ACB < Cost amount (OB < IB) then gain realized (OB < IB) – no tax to trust and T acquires property for cost = cost amount (rollover to trust but not full rollover to B)

108(1)(b): "Cost Amount" – disposing interest to 3rd party

Cost amount to a T at any time of capital interest or part of it, as case may be, in a trust, means, in any other case than (a), the amount determined by the formula: **(A – B) x C/D**

A = total of **(i)** all $ of the trust on hand immediately before that time; + **(ii)** all amounts each of which is cost amount to trust, immediately before that time, of each other property of trust

B = total all amounts each of which is amount of any debt owing by trust, or of any other obligation of trust to pay any amount, that was outstanding immediately before that time

C = FMV at time of capital interest in the trust / **D** = FMV of all capital interests in the trust = B's proportion of the IB

107(2): Distribution by Personal Trust – T disposes capital interest in exchange property of trust – (a)

Subject (2.001), (2.002), & (4)-(5), if at any time property of personal trust is distributed by trust to T who was a B under the trust and there is resulting disposition of all or any part of T's capital interest in the trust

- (2.001), (2.002), and (4)-(5) allow B to elect out of rollover

(a) trust deemed disposed of property PoD = cost amount to trust immediately before that time

- "Cost amount" defined in 108

(b) subject (2.2), T deemed acquired property at cost = total cost amount to trust immediately before that time and specified percentage of amount, if any, by which

- T deemed acquired property = cost + bump
- Bump when OB > IB (personal trust where B acquires interest from someone else at higher amount than IB) – Act giving relief for fact that OB > IB – only do % b/c if added full then would give excess benefit

(i) ACB to T of capital interest or part of it, as case may be, immediately before that time (w/o reference to (1)(a))

- 107(1)(a) – ACB = greater of OB and IB, but this is the ACB, otherwise determined so it is just OB

Exceeds

(ii) cost amount to the T of the capital interest or part of it, as the case may be, immediately before that time

- Inside basis

Cost amount to T of property received from the trust = cost amount of property to the trust

- If OB > IB, also add specified percentage x (OB – IB)

(b.1) Specified Percentage - (*i) where property is capital property (other than depreciable) = 100% // (ii) any other case = 50%*

(c): PoD - *T's PoD of capital interest in trust disposed of by T on the distribution are deemed to be equal to amount, if any, by which*

- *(i) cost at which the T would be deemed by (b) to have acquired the property if specified percentage = 100%*

Exceeds

- *(ii) debts*

(d): Depreciable Property: If acquiring depreciable property, B deemed acquire at capital cost that trust acquired & deducted CCA

Example 1: OB > IB

Property trust is real property inventory (held in adventure/concern in nature of trade) → Cost = 100 to trust, FMV = 500

- T acquired capital interest from another B for 400 → OB = 400

107(2)(a): Trust deemed to dispose property, PoD = cost = 100

(b): Cost of property – T deemed acquired property at cost =

- Total cost amount to trust (100) +
- Specified percentage of amount which (i) ACB to T of capital interest (400) > (ii) cost amount to T of capital interest (100)
  - Specified percentage of 300 = 50% of 300 (since this is not capital property) = 150
- Cost of property to T = 100 + 150 = 250

(c): PoD

- No debts - (ii) doesn't apply
- Cost which T deemed acquired property if specified percentage was 100% = 100 + (400 – 100) = 400
- PoD = 400

Example 2: IB > OB

Non-depreciable capital property: ACB = 100, FMV = 500

- T acquires capital interest in trust from the settlor – ACB = nil (107(1.1))

107(1)(a): ACB = greater nil and cost (100)

(2)(a): Trust deemed disposed of property PoD = cost = 100

(2)(b): T deemed acquire property at cost amount = 100

(2)(c): PoD of capital interest = amount by which cost at which deemed acquire the property = 100

R v Chan (2000) FCA:

Facts	Trust set up for T (and his siblings) benefit, but T didn't hear about it until later. Trust has 3500 shares of a company. Trustees = T's parents. Company had building and it was about to dispose of it – about to be big distribution to trust T sues parents – settled trustees will give him an amount and he will give up interest in trust property – receives $1.8M
Issue	What happened in the settlement? Did T have a distribution of trust property or did he sell his interest to his parents? - T arguing distribution of trust property and CRA arguing he is selling interest to parents
Holding	No distribution of trust property – transaction was just a sale outside of the trust - Not property of trust that was distributed – It was not action of trustee under their obligation under trust - "Distribute" in 107(2) refers to allotment of trust property to B in accordance with his proportionate share

Taxpayer disposes capital interest to trust and gets property in return:

107(1)(a): ACB Capital Interest of T = Greater of:

- OB = ACB, otherwise determined
- IB = cost amount = $ received by T + Cost amount property received by T

107(2)(a): PoD to trust from disposition property = cost amount property

107(2)(b): Cost to T of property received = cost amount to trust of property + (OB – IB) x specified percentage

107(2)(c): PoD to T for capital interest = cost amount property to trust + (OB – IB)

T disposed Capital interest to 3rd party:

No rollover – T realize taxable capital gain if receive PoD > ACB (as determined by 107(1)(a))

TRANSFER PROPERTY

If transfer property into trust on rollover basis then it doesn't come out on rollover basis, if transfer property into trust not on rollover, then can get property out on a rollover

Spousal, Alter Ego, Joint	Other
Rollover when transfer property into trust	No rollover – pay tax on disposition of property
No subject 21 year deemed disposition	Subject to 21 year deemed disposition
No rollover when transferring property out	Rollover when transfer property out

248(1)(c): "Disposition"
Includes transfers of property to a trust and from a trust to a beneficiary

Transfer Property to a Trust

Deemed dispose & reacquire at FMV – generally disposition subject tax, unless qualify under rollover rules

Key Provisions:
70(5): Deemed disposition and acquisition of all capital property immediately before dead for PoD = FMV
69(1)(b) & (c): deemed disposition and acquisition at FMV of all property disposed by way of gift and disposition that do not result in change beneficial ownership of property
70(6): Rollover on transfer capital property as consequence death of spouse or spousal trust
73(1): Rollover inter vivos transfer capital property to spousal trust, alter ego trust, or joint-spousal trust

251(1)(b): T and Trust NAL
Deems a T and a personal trust not to deal at arm's length if the T or person not dealing at arm's length with the T is beneficially interested in the trust

69(1): Inter Vivos Transfer
(b) *Where T disposed:*
(i) to person whom T NAL for PoD = 0 or PoD < FMV
(ii) any person by way of gift, or
(iii) to a trust b/c of disposition of property that does not result in a change in beneficial ownership of the property
→ T deemed received PoD = FMV
Where transfer to trust by way of gift, transferor deemed receive PoD = FMV, trust deemed acquire property at FMV

70(5): Capital Property Deceased T
Transfer property into trust upon death, deem dispose & trust acquire capital property immediately before death for = FMV
Where in tax year a T dies
(a) T deemed, immediately before death, disposed of each capital property of T and received ***PoD = FMV property*** *immediately before the death*
(b) any person who as a consequence of T's death acquires any property that is deemed by (a) to have been disposed of by T shall be ***deemed acquired it at time of death at cost = FMV*** *immediately before the death*
70(5.2) – Similar deemed disposition for land included in inventory of a biz

70(6): Transfer/Distribute to Spouse – **applies capital property transferring to spouse on death**
Where property of T that is property which (5) would otherwise apply is, as a consequence of death, transferred or distributed to
IF:
****(b):** *a trust, created by T's will, immediately after the time the property vested indefeasibly in trust and under which*
(i) *T's spouse is entitled to receive all of the income of the trust that arises before spouse's death, and*
(ii) *no person except the spouse may, before spouse's death, receive/otherwise obtain use of any income/capital of the trust*
if it can be shown, within period ending 36 months after death of T that property has become vested indefeasibly in spouse/trust
- Clear that trust has complete legal ownership of the property

THEN*:*
(c): *70(5)(a) and 70(5)(b) do not apply w.r.t. the property*
- Don't have disposition and acquisition at FMV

(d): *Subject to (d.1), T deemed to have, immediately before T's death, disposed of property and received PoD =*
(i) *where property depreciable property: lesser capital cost and cost amount to T of property immediately before death*
(ii) *any other case, ACB to the T immediately before death*
and spouse or trust deemed acquired property at time of death at cost = proceeds

73(1.01): When 73(1) applies

Subject to (1.02), property transferred by individual in circumstances to which subsection applies where it is transferred to (c) trust created by the individual under which

(i) Spousal Trust*: individual's spouse entitled receive all income of the trust that arises before spouse's death & no person except spouse may, before spouse's death, receive/otherwise obtain use any income/capital of the trust*

(ii) Alter Ego Trust: *individual entitled receive all of income of the trust that arises before individual's death and no person except individual may, before individual's death, receive or otherwise obtain use of any of income/capital of the trust,* ***or***

- **Note**: under **104(4)(a)(ii.1)** for alter ego trust could elect out of rollover into the trust – then have deemed disposition every 21 years, but can rollout tax free under **107(2)**

(iii) Joint-Spousal Trust: *individual/individual's spouse is, in combo w the other, entitled receive all income of trust that arises before later of the death of individual and death of the spouse and no other person may, before later of those deaths, receive or otherwise obtain the use of any of the income or capital of the trust*

73(1.02): Additional Requirement - alter ego or joint-spousal

73(1.01) applies to transfer property by an individual to trust the terms of which satisfy conditions in (1.01)(c)(ii) & (iii) only where

(a) trust was created after 1999;

(b)(i) individual attained 65 years of age at time trust was created

- Don't want people to set these up when they are < 65 so avoid the 21 yr disposition

73(1): Inter Vivos Transfer by Individuals

For purposes this Part, where at any time any particular capital property of an individual transferred circumstances (1.01) applies, and both individual and transferee are resident in CA at that time, unless individual elects in individual's return of income under this Part for tax year which property was transferred that the provisions of this subsection not apply, particular property deemed

- Note: T can elect out of rollover

(a) have been disposed of at that time by the individual for PoD =

(i) Where particular property is depreciable property – UCC, and

- Note: 73(2) has boiler plate CCA – step into shoes of transferor w.r.t. Capital cost and CCA

(ii) in any other case, the ACB to the individual of the particular property immediately before that time

(b) have been acquired at that time by the transferee for amount = proceeds

73(2): Depreciable property – trust steps into shoes of transferor w.r.t. UCC and CCA

Peardon v The Queen (1986) TCC: "Entitled receive all income of trust & no other person may receive income/capital"

Facts	Estate of Wilbert Peardon. Had wife Sadie. Trust had farm which had building and granaries on it. - Term estate: use any part of my estate, as may be required for property and sufficient maintenance of my wife during her lifetime, amount to be such as absolute discretion of executors (discretionary distribution of income/capital) - Son given one granary and grandson uses farmhouse for renting farm land and both use granary's
Issue	Does this estate qualify for 70(6) rollover? - Is spouse entitled to receive all of the income of trust that arises before death and is no other person except spouse able to receive/obtain use of income/capital of the trust?
Analysis	**Farmhouse** – renting land so wife is getting consideration - "no person except spouse may obtain use of income/capital of trust" doesn't include use for *bona fide* exchange **Granaries** – no rent - Might have thought since court found farmhouse was fine, then granaries are fine b/c using it for efficient use of land – might have thought same principal but court says no **Income to wife** - Issue is that this trust is discretionary – she might not get all of the income of the trust and therefore she is not entitled to all of it – no guarantee that she gets income
Holding	Does not satisfy 70(6) – cannot do rollover – trust does not ensure she is the only one who gets income

Evoy Estate (2016) TCC:

Facts: Set up 3 trusts. Wife was entitled to all of the net income and no one else was before her death. On her death, the income distributed at discretion of trustees to the children. Trust could be terminated at discretion of trustees. CRA wanted to consolidate trusts b/c same class of B's benefiting from trust (the wife)

Issue: Does this qualify as a spousal trust? Yes

Holding: Can't aggregate all the class into one

Deemed Disposition while Trust has Property

104(4): Deemed Disposition by Trust – every 21 years

Every trust, at end of following days, is deemed to dispose of each property of trust that was non-depreciable capital property or land included in inventory of biz of trust for PoD = FMV at end of day and reacquired property immediately after day for amount = FMV

- If transfer property on rollover basis, then out of deemed disposition ever 21 years
- Every 21 years triggers gains/losses

If not spousal, alter ego or joint trust:

(b) *day that is 21 years after the latest of (i) Jan 1, 1972 and (ii) day which trust was created*

(c) *day that is 21 yrs after any day that is b/c of this subsection, a day which trust is deemed to have disposed of each such property*

- Every 21 years after that

If spousal, alter ego or joint trust:

(a) *Roll property into trust and 21-year disposition rule doesn't apply* – applies once

  - For spousal trust - death of spouse
  - For alter ego trust - death of settlor
  - For joint trust – death of later of the two

- If spouse dies and trust continues to exist, then there will be 21 year deemed disposition after that

Transfer Property out of Trust

Key Provisions:

107(2): Rollover on distribution of trust property in satisfaction capital interest

107(4): (2.1) applies ((2) does not apply) where property distributed to B by trust in 104(4)(a) (spousal, alter ego or joint) where B is not eligible B under 104(4)(a) and distribution occurs before earlier of reacquisition trust property on deemed disposition on death B or cessation of trust

107(5): (2.1) applies ((2) doesn't) where property distributed to B where 75(2) applied in respect of property and recipient of property is neither person from whom trust received property nor person in respect of whom rollover in 73(1) would apply to transfer of capital property by the settlor

107(2.1): Trust deemed disposed property PoD = FMV, B deemed acquired property at cost = FMV, and B's proceeds of former capital interest deemed to be amount by which proceeds to trsut > FMV property – sum of cost amount of property to trsut and any eligible offsets

107(4): Trust in favor spouse, CL partner or self – no rollover

Sub (2.1) applies (and (2) does not apply) at any time to property distributed to a B by a trust described in 104(4)(a) where

(a) the B is not

(i) in the case of a post-1971 spousal trust, the spouse referred to in paragraph 104(4)(a),

(ii) in case of an alter ego trust, the T referred to in paragraph 104(4)(a), and

(iii) in the case of joint spousal trust, the T or spouse referred to in paragraph 104(4)(a)

107(4.1): Where 75(2) Applicable

107(2) does not apply in respect of a distribution of any property to a T who was a B where 75(2) applies

- Can't roll out if subject to 75(2), unless rolling out to settlor – if transferring to anyone else then PoD = FMV (107(2.1))

107(2): Trust transfers property to T (who is a B) in return for B's capital interest – see above

- **Rollover when distribution trust property in satisfaction capital interest**

107(2.1): No Rollover – where (2) doesn't apply (is not a personal trust) or 75(2) applies, use this rule

(a) Trust is deemed to have disposed of the property for PoD = FMV at that time;

(b) B is deemed to have acquired property at a cost = PoD = FMV determined under paragraph (a);

(c) ***B's PoD*** *of portion of the former interest disposed of by the B on the distribution are deemed to be = the amount, if any, by which*

- PoD = PoD of trust – Gains realized by trust

(i) the proceeds determined under paragraph (a)

exceed total of

(ii) where property is not a Canadian resource property or foreign resource property, the amount, if any, by which

(A) FMV of property at that time > (B) cost amount to trust of the property immediately before that time

A – B is gain to the trust

Green v The Queen (2012) TCC:

Facts	Estate set up when T's grandmother dies in 1967 – has a building. T's mother has life interest in property – on her death (2007) T and his siblings get building and trust cease to exist (each get ¼ interest) 2007 – sold building and got money ($395K) Trust was set up pre-1971 – FMV in 1971 = $100K – CRA says that there is $295K gain and so taxed each sibling ¼ of the gain, but T says that trust should have paid tax on accrued gain in 1999
Holding	Ignores rules – don't get hit with interest penalties
Note	**What ought to have happened?** - Trust should have had deemed disposition in 1999 b/c property didn't come into trust on rollover basis (mother/daughter is not exception) – accrued gains in 1999 should been taxed – deemed disposition & reacquisition - Most of gain happened b/w 1971 and 1999 – so that would have been significant tax (pretend FMV 1999 = $300K) - B/c none exception trusts, we are in 107(2) – property comes out on rollover basis & each B acquires ¼ interest o Each beneficiary has a small gain

Kanji v Canada (2013) ONSC:

Facts	T set up family trust in March 1992 – T had companies (including Suter Hill). Transfers $5K to the trust and trust buys shares in Suter Hill). Trust also bought some other real estate. Beneficiaries are T, his spouse and his children (doesn't qualify rollover treatment on putting property in b/c kids are B's) Property going in is subject to deemed disposition, but property going in is just $5K cash. 21 yar deemed disposition gong to kick in 2013 – value of real estate is over $60M - No eligible for 107(2) rollout – property can revert back to T since he is B - Only get rollout if rolling out to self – 107(4) but he wants to roll out to his kids Applies to court and says that the whole thing wasn't what he wanted – tries to make it so trust is not reversionary trust where 75(2) applies – taken off as beneficiary so he can roll it out to his kids
Holding	Go hit with deemed disposition in 2013