INTRODUCTION

TWO PRIMARY REASONS FOR TAXES:

- **1. Ability to Pay –** want people to pay tax based on their ability to do
  - Since corps are artificial entities they do not have an independent ability to pay separate from the natural people behind the corporation
  - System premised on assumption that tax is bore by the shareholders
- **2. Benefits Principle** – Want to tax people on the benefits that they get from the gov't
  - Not clear that benefits are closely related to income for a corporation

REASONS FOR CORPROATE INCOME TAX:

1. Prevents Shareholder Deferral of Tax

- If don't tax income of corp at corp point, then there is a huge deferral advantage for shh

2. Taxes Non-Resident Shareholders

- Corp might be resident in Canada but shareholders are not
- Dividends paid to shh – CA imposes withholding tax on dividends paid to non-resident shhs (10%)

Double Taxation – If income is taxed at corporate AND shareholder level then issue of double taxation

Techniques to prevent double taxation → use techniques to **integrate** corporate tax and personal tax

- 1. Exempting dividends from tax or crediting corporate taxes against taxes paid by shh;
- 2. Deduction dividends paid in computing corporate income subject to tax;
- 3. Refund corporate taxes when dividends paid;
- 4. Use lower tax rates for dividend income

INTENGETRATION IN CANADA:

- 1. Exemption inter-corporate dividends (s. 112)
- 2. Credit for corp taxes for dividends received by individuals (s. 121)
- 3. Partial exemption capital gains for sale corp shares (s. 38)
- 4. Refund corporate income tax paid on certain kinds oncome by private corp when pays dividend to shh (s. 129)

Corporate Income Tax Rates

Considerations Determining Corp Tax Rate:

1. **Preventing deferral** – 40.25 – 54.75%
2. **Corp tax rate in other countries** - 12.5 – 39%
3. **Domestic policy objectives** – encouraging small enterprises and Canadian manufacturing

	Federal	Provincial	BC	Combined
General	15%	11-16%	11%	25-28%
ABI of CCPC	11%	2-4.5%	2.5%	13-15.5%
AII of CCPC	34 2/3%	11-16%	11 1/3%	50%

General Fed Corporate Rate:

- **123(1):** General Rate = 38%
- **124(1):** Provincial abatement - Reduce general rate by 10%
- **123.4(2):** Reduce rate by 13% for income not subject to low rate in 125 and not subject to additional rate in 123.3

125(1)&(1.1): Qualifying Income of CCPC – Small Biz Deduction

- Deduct from tax payable 17% of ABI up to $500K → fed rate = 10.5%
- **Policy**: Promote small biz's

123.3: AII of CCPC – Passive income taxed at top marginal rate

- 6 2/3% additional tax on the lesser of: (a) CCPC's AII & (b) Taxable income not subject reduced rate 125 (**assume AII**)
- Federal rate = 28% + 6 2/3 = 34 2/3% (combined rate = 46-51%)
- **Policy**: Prevent deferral

CORPORATE DISTRIBUTIONS

2 Categories Dividends:

1. **Taxable Dividends:** All dividends other than capital dividends **– 89(1)**
   - **To Individual**: eligible vs. non-eligible
     - **Eligible** – paid out of income that is neither ABI of CCPC taxable at low rate nor income taxed at high rate that qualifies for dividend refund
       - Dividend designated to be eligible under 89(14)
     - **Non-Eligible** – paid out of low taxed corp income – ABI taxed at low rate or ABI that is taxed high but gets refund
   - **To a Corporation**: Tax free (included but then deducted), could be subject Part IV tax

2. **Capital Dividends:**
   - Only ½ capital gain taxed – want corp to pay out tax-free capital dividends

12(1)(j): Income Inclusion – Dividends resident corp

T include in computing income from biz/property, amount of dividend required by sub h to be concluded in computing T's income

- **82(1)(a.1): Include in T's income amounts received from eligible dividends**
- **82(1)(a): Include in T's income total of amounts received from taxable dividends, other than eligible dividends**

These apply to individuals and corporations (b/c says "taxpayer")

Corporate Distributions to Individuals

GROSS-UP & CREDIT

Gov't tries integrate so earning income through corp = earning income directly:

- **Under-Integration** – paying higher tax burden if earning income through corp than if you were earning it directly

In order to integrate, individuals "gross-up" and then "credit" taxable dividends received:

- **Gross-up**: Increase cash amount of the dividend to reflect underlying corporate income out of which the dividend is paid
- **Tax Credit**: Deduct from tax payable a credit to offset tax paid by the corp on the income out of which the dividends are paid

	Eligible Subject general rate	**Non-Eligible** Subject low corporate tax rate
Income Inclusion	**82(1)(a.1)**	**82(1)(a)**
Gross-up	38% - **82(1)(b)(ii)**	17% - **82(1)(b)(i)** (was 25%)
Credit	6/11 of gross-up – **121(b)** (or 15.0198% grossed-up amount)	21/29 of gross-up – **121(a)** (was 2/3) (or 10.5217% grossed-up amount)

S. 89(1): Eligible Dividend – Dividend designated to be eligible under **89(14)**

- Paid out of income that is neither ABI of CCPC taxable at low rate nor AII of CCPC taxable at high rate that qualifies for dividend refund
- **Note**: shhs want eligible dividends b/c of higher gross-up/credit – more tax been paid at corp level so shh pays less tax

S. 89(1): Non-Eligible Dividend – All dividends that are not eligible

- Income subject to low corp tax rate

PART III.1 TAX

Taxes excessive eligible dividend designations – 20% - 185.1(1)
- Can only pay eligible dividends out of income that was taxed at the general rate (ABI > $500K)

CCPC's:
- Generally, CCPC's not taxed at general rate so cannot pay eligible dividends

GRIP = After tax income that was taxed at high rate and eligible dividends received – **CCPC pays eligible dividends out of GRIP**
- Part III.1 applies once you run out of GRIP

89(1)(a): "**Excessive Eligible Dividend Designation**" (for CCPC) → taxes the excessive amount, not the whole dividend
(A – B) x C/A
- **A** = total all amounts of eligible dividend paid by corp (= amount corp designates as eligible dividend)
- **B** = greater of nil and corp's GRIP at end of yr
  - **Note**: calculated at end of yr, so even if don't have GRIP when designate dividend as eligible as long as have some at the end of yr then okay
- **C** = amount of the eligible dividend

If only one dividend paid in the yr then C = A and formula is just A – B
- IF **GRIP > eligible dividend** THEN no excessive eligible dividend designation → Part III.1 Tax won't apply
- IF **GRIP < Eligible Dividends** THEN eligible dividend – GRIP = Excessive eligible dividend designation

S. 89(1): GRIP = C + D + E – G
- **C** = GRIP end previous year
- **D** = General rate factor (0.72) x adjusted taxable income
  - **89(1): Adjusted taxable income** = Taxable income – Amount tax under 125 (SBD) – Amount taxed under 123.3 (assume AII)
- **E** = Eligible dividends received from another corp (b/c was taxed at high rate)
- **G** = Eligible dividends paid – excessive eligible dividend designations

Non-CCPC:

LRIP = Income that was taxed at low rate – as long as corp has LRIP, then can't pay out eligible dividends

89(1)(b): "**Excessive Eligible Dividend Designation**" (for non-CCPC)
A x B/C
- **A** = lesser of:
  - **(i)** total all amounts each of which is eligible dividend paid by corp at time **and**
  - **(ii)** corps LRIP
- **B / C** = amount eligible dividend / total amounts eligible dividends paid by corp = 1 (if only one eligible dividend)

LRIP > Eligible Dividends → Excessive eligible dividends = eligible dividends
LRIP < Eligible Dividend → Excessive eligible dividends = LRIP → **As long as have LRIP, then will have Part III.1 Tax**

89(1): LRIP = A + B – G – H
- **A** = LRIP end of preceding year
- **B =** Non-eligible dividends received
- **G** = Non-eligible dividends paid
- **H** = Excessive eligible dividend designations

Anti-Avoidance Rule

89(1)(c): Formula's for excessive eligible dividend designations in (a) and (b) are **subject to anti-avoidance rule in (c)**
Excessive eligible dividend designation = amount of eligible dividend if reasonable to consider that eligible dividend was paid in transaction (or part series), one of the main purposes was artificially increase the corp's GRIP or artificially decrease corp's LRIP
- Full amount of eligible dividend deemed to be excessive
- One of the main purposes means > 50%
- No abuse test here – in GAAR need to show an abuse but this section doesn't require to show abuse
  - Could say abuse is implicit – if doing something artificially ten abusing the GRIP and LRIP sections

185.1(1)(b): Additional 10% tax on amount of dividend – **total tax = 30%**

Intercorporate Dividends

82(1)(a) & (a.1) include dividend in corp's income BUT deducted under 112(1) → tax free

112(1): Deduction taxable dividends received by corp
Where a corp receives taxable dividend from corp, an amount = to that dividend may be deducted from income of receiving corp

After-Tax Financing: Lossco wants borrow $, so lender buys shares Lossco - Lossco pays inter-corporate dividends and lender doesn't pay tax on the dividends

- SAAR's prevent this – 112(2.1) & (2.2) (financial institutions) & (2.4) & (2.5)

PART IV TAX

Problem: Ppl put shares they own in other companies into Holdco so dividends go to Holdco and aren't taxable – deferral
Solution: Tax closely held corps that receive dividends from companies closely held corp doesn't control (**portfolio dividends**)

186(1)(a): Tax on Assessable Dividends
Every corp ("particular corp") that is a private corp or a subject corp shall pay a tax under this part equal to 1/3 % of all assessable dividends received by the particular corp from a corp OTHER THAN PAYER CORPS CONNECTED with it
Tax unit = closely held corps

- **Private Corp** = Corp resident in CA that is not public or controlled by public corp – **89(1)**
  - Control = > 50% voting shares (*de jure*)
- **Subject Corp** = Not private, but is controlled for benefit of an individual or related group of individuals – **186(3)**
  - **Related Persons** – individuals connected by blood relationship, marriage, CL, adoption - **251(2)**
  - **Blood Relationship** – child or other descendant of other or one is brother or sister - **251(6)**
  - **Related Group of Persons** – Group where each persons is related – **251(4)**

Tax rate = 1/3 %
Tax Base = Assessable Dividends - Amount received by a corp at time when it is a private corp or subject corp as, on account of, in lieu of payment or in satisfaction of, a taxable dividend from a corp, to extent dividend is deductible under 112 – **186(3)**

Part IV tax goes into refundable dividend tax on hand (**RDTOH**) - **refunded when corp pays dividend** – **129(1)**

186(4): "Corps connected with particular corp" → Part IV tax doesn't apply where payer corp connected with particular corp
(a) *Payer corp is **controlled** by particular corp at that time; or*
  - If Holdco controls company paying the dividends, excluded b/c isn't portfolio dividend

(b) *Particular corp has **(i)** > 10% votes of payer corp or (ii) shares of payer corp have FMV > 10% FMV all shares*

186(2): When Corporation is Controlled
One corp controlled by another corp if > 50% votes belongs to other corp or to persons with whom corp NAL

- Aggregate the shareholdings of the corp & NAL – doesn't matter if they are acting in concert
- Relief mechanism where companies & individual that together own > 50% shares of payer corp
- **Non-Arm's length** – related persons deemed not to deal at arm's length, otherwise it is a Q of fact (**251(1)**)

186(1)(b): Allocation of Refund Among Corps
Pay Part IV tax to extent payer corp receives a dividend refund (can't just do tiers of corporations)
*Particular corp that is private/subject corp shall, pay tax = amount by which total all amounts, each of which is amount in respect of assessable dividend received by particular corp from private/subject corp that was payer corp **connected** w particular corp, = proportion payer corp's dividend refund for its tax yr in which it paid dividend*
(i) *amount dividend received by particular corp **Is of (ii)** total all dividends paid by payer corp in tax yr which paid dividend*
Exceeds 1/3%
Imposes 1/3% refundable tax on amount equivalent recipient's portion dividend refund w.r.t. assessable dividends from connected (private/subject) corps

Capital Dividends

If a corp designates a dividend to be a "capital dividend", it is not included in computing income of shhs – 83(2)

Capital Dividend: Non-taxable portion capital gain passed tax-free to shareholder

83(2): Capital Dividends – not taxable dividends

*Where at any particular time after 1971 a dividend becomes payable by a **PRIVATE CORP** to shhs of any class of shares of its capital stock and corp **ELECTS** the full amount of the dividend, the following rules apply:*

- Only private corps can pay capital dividend (not a public corp and not controlled by public corp – **89(1)**)
- Where you file form before paying the dividend and call it a capital dividend then it is one

(a) dividend deemed capital dividend to extent corp's capital dividend account immediately before particular time; &

- Can only elect capital dividends to extent of capital dividend account

(b) no part of dividend shall be included in computing income of any shh of corp.

2530-1284 Quebec Inc v The Queen (2007) TCC aff'd (2008) FCA: Do you have to satisfy (a) to get into (b)?

Facts	T generate capital gains – paying capital dividends to other corps & generate CDA's and sell corp's w CDA CRA re-characterize capital dividends as taxable dividends
TCC	Whole thing is sham – no time did corp T's have any CDA and the individual T's who received dividends from corp T knew that the corp T's never had any capital gains nor any CDA To make election under 83(2) is dishonest and contrary to the object and spirit of the provision - **Duff**: Again *Antosco* – can't rely "object & spirit" ITA, did similar interpretation - (a) & (b) operate independently
FCA	Transactions themselves were not shams – but T's argument that dividends remained capital dividends even though subs generated no capital gain must fail 83(2) provides that dividend that is made subject of election deemed come from CDA payer corp - **Duff**: that is not what 83(2) says
Holding	Dividends are not capital dividends – have to be included in income -
Ratio	***Can't rely on (b) if haven't satisfied (a) – if don't have CDA then dividend included in income***
Notes	Transactions occurred pre-GAAR → **Definitely would be caught by GAAR now** If just read the provision there is nothing linking (a) and (b) – (a) says that if don't have CDA not capital dividend, (b) says dividend not included in computing income

89(1): "Capital Dividend Account" (CDA)

Non-taxable portion taxable gains – Non-allowable portion capital losses + capital dividends received – capital dividends paid

- Ongoing balance determined immediately before when the dividend is paid
- CDA is valuable asset that can be sold – amalgamate, inherit, pay it out – if related can inherit CDA

PART III TAX

Polices corps ability pay capital dividends – if pay capital dividend but don't have capital dividend account

- **IF:** Elect amount > CDA **THEN** corp pays tax = 3/5 excess amount of dividend

184(2): Tax Excessive Elections

*If corp elected under 83(2) in respect full amount of any dividend payable by it on shares ("original dividend") and full amount of original dividend > portion of original dividend deemed by that subsection to be capital dividend, corp shall, at time of election, pay a tax under this Part **equal to 3/5 of the excess**.*

Anti-Avoidance Rules

83(2.1) – (2.4): Prevent tax-motivated transfers of CDA from private corp that cannot obtain full benefit to private corp whom ability to pay exempt dividends is more valuable

→ Deems the capital dividends to be taxable dividends

83(2.1): Anti-Avoidance Rule

Notwithstanding 83(2), where dividend that, but for this subsection, would be capital dividend is paid on share and share was acquired by its holder in transaction or part of series one of main purposes of which was receive dividend,

- *(a) dividend shall, for the purposes of this Act (other than for the purposes of Part III and computing the CDA of the corp), be deemed to be received by shh and paid by the corp as a **taxable dividend** and not as a capital dividend; and*
- *(b) 83(2)(b) does not apply in respect of the dividend.*

IF: One of the main purposes of acquiring share was to receive the capital dividend (and therefore ↑ CDA)
THEN: Dividend deemed be received by shh and paid by corp as taxable dividend and the dividend is included in the shh income

83(2.2): Exceptions to 83(2.1)

*83(2.1) does not apply for dividend where election was made under 83(2) paid to an **INDIVIDUAL** if reasonable to conclude all or substantially all (> 90%) CDA of particular corp immediately before dividend became payable consisted of amounts other than*

- Therefore 83(2.1) only applies where > 90% CDA consists of things listed – "tainted amounts"
- If have dividend paid to a corp then not in here at all – only applies when pays dividend to an individual

Tainted Amounts:

- **(a):** Acquire share, and corp that is paying the dividend acquired the share from another corp to get their CDA
- **(b):** Payer corp amalgamates to get CDA
- **(c)&(d)**: Added/accrued to CDA at time when the payer corp was controlled by 1+ non-resident persons

Group Honco v Canada (2012) TCC: "one of the main purposes"

Facts	T was corp that was part of group of companies that constructed buildings for unrelated company (Old Supervac) Old S was in financial problems so T kept building & leased it to Old S. T offers buy all inventory, lease all biz assets, acquire name, carry on biz of Old S (New S) New S became profitable and exercised option to buy all shares of Old S – amalgamation of old & new - Old S had a ton of losses but also had life insurance ($750K) - went into CDA of Old and then to new Reassessed on basis that one of the main purposes acquiring Old Super was to get capital dividend
Issue	What does it mean for "one of the main purposes" of acquiring the shares was to receive the dividend?
Analysis	Objective/subjective test – look at facts and see if really believe it is one of the main purposes or not Where $750K of life insurance going to create big CDA – assume experienced biz person knows this - T avoids bringing in witnesses who could talk about this – inference didn't want testimony in
Holding	T did not establish one of main purposes for New S acquiring Old S shares was the acquisition of CDA
Ratio	***To determine one of the main purposes, look at what is reasonable – fact based test***
Notes	Where seems like good reason why someone might have thought it was a main purpose, then better have good argument why it wasn't a main purpose

CORPORATE LOSSES

Net Capital Losses: Allowable capital loss > Taxable Capital Gains – **111(8)**

- **111(1)(b):** Carry-back 3 yrs and indefinite carry-forward

Non-Capital Loss: Losses Sources of income + ABIL > Income all other sources + Net taxable gains – **111(8)**

- **111(1)(a):** Carryback 3 yrs and carry forward 20 yr

Loss Utilization Strategies

CRA okay with related corporations consolidating losses – but doesn't like it when transfer losses to non-related corp

Transfer of Profitable Business

Stubart Investment (1984) SCC: Profitco & Lossco owned by same corp group – Profitco wants to use up losses of the Lossco

- 1. Profitco sells all of its biz assets to Lossco in exchange for debenture (low interest rate)
- 2. Lossco enters agency agreement w Profitco for Profitco to carry on biz on behalf of Lossco
- 3. Profitco pays income from biz to Lossco – so Lossco can shelter the net income with losses

CRA: These are alright as long as among **related companies** – losses have to accrued while both companies **controlled** by same T

- **251(2): Related Persons - (b)(i) corp & person** who controls corp or person who is memb of related group controls corp
  - **(c)** any **2 corps** if they are controlled by the same person or group of persons

Inter-Corporate Financing

Have a Profitco and Lossco → **suck losses out of Lossco and give them to Profitco**

1. Profitco borrows $ from bank (creates interest payments)
2. Profitco transfers $ to Lossco in exchange for shares
3. Lossco loans $ back to Profitco, who then repays the loan to the bank
4. Profitco owes $ to Lossco and has shares of Lossco – Profitco pays interest to Lossco
   - Interest is deductible if Profitco used borrowed funds for purpose earning income – used funds to repay the loan to the bank
   - 20(3) says that when use borrowed funds to repay loan, then deemed used funds for same purpose original loan
5. Lossco includes interest payments in income (sheltered by losses)
6. Lossco pays dividend to Profitco (tax-free)

CRA: Transaction is fine as long as Lossco is wholly-owned subsidiary of Profitco

- **CRA** indicated that dividends > interest so positive flow of $ to Profitco
  - Goes against what SCC said in *Ludco* – said that it is just whether borrowed funds used for purpose earning income

Loss Restriction Rules (Anti-Avoidance)

Limit on access to net capital losses and non-capital losses after a loss restriction event

251.2(2)(a): Loss Restriction Event

*T is subject to LRE, if T is a corp and at that time **control** of corp is acquired by a person/group of persons*

- **256(7):** "**Control**" – *de jure* control (50+ votes for electing board of directors)
- Control by unrelated person – if acquire control and related company then isn't LRE

249(4)(a): LRE – Year End → triggers losses at end of yr

*If T is subject to LRE then T's **tax year deemed to end** immediately before that time, a new tax year deemed to begin*

After an LRE, no carryover for **net capital losses** (**111(4)**) or **non-capital losses** (**111(5)**) before or after LRE

- BUT115 subject **loss streaming rules** – allow carryover non-capital losses as long as same biz reasonable expectation profit

LOSSES TRIGGERED

1. **Inventory – 10(1) & (10) – Valuation Inventory = lower cost and FMV at the end of T's tax year**
   - LRE triggers loss on inventory
   - Cost that the property is acquired after the LRE is the lower of cost & FMV
   - **10(1.01)** – Inventory held adventure/concern nature trade valued cost, but **10(10)** valued at lower cost & FMV before LRE

2. **Depreciable Capital Property** - **111(5.1)**
   - Prior to LRE UCC written down to FMV – T can deduct written down amount as CCA

If UCC > total of (a) FMV & (b) amount deducted as CCA THEN deduct excess and move UCC down to FMV

Ex. FMV = $10K – then acquisition control and triggers LRE – can deduct CCA

- CCA = $6,300 (30% of UCC ($21K)
- $21K > $10K + $6,300 → excess deducted under 20(1)(a) - UCC moved down to FMV and forced deduct CCA prior to LRE

3. **Non-Depreciable Capital Property – 111(4)(c) & (d)**

(c) ACB written down to FMV (ACB – FMV is subtracted from ACB going forward so that the ACB = FMV)

- No accrued loss post LRE

(d) Loss (ACB – FMV) triggered as deemed capital loss from disposition of property

Example:

- Bought property: ACB = $10K, FMV = $4K (loss = $6K) – acquisition of control and later sell property or $4K
- (c) when sell property later, ACB is not $10K, it is 10 – (10 – 4) = 4 → no loss when dispose of property later

Relief Mechanism for non-depreciable property → 111(4)(e)

If have non-depreciable property that has increased in value prior to LRE, then **allowed to notionally trigger gains** up to the FMV of the non-depreciable capital property and use losses triggered in 111(4)(c)&(d) to offset the gain

111(5.5)(b): Anti-Avoidance Rule

If engineer yourself into LRE to trigger accrued loss, then the LRE rules don't apply

*If at any time a T is subject to LRE, if it can reasonably be considered that **the main reason** T is subject to LRE is to cause **(4)(d)** to apply w respect to LRE, then that provision and (4)(e), & (ii) if that provision is (4)(d), paragraph (4)(c) do not apply w.r.t. the LRE*

- Only applies for capital property – not inventory or adventure/concern in nature of trade

LOSS STREAMING EXCEPTION TO 115

Loss Streaming Exception: (in **111(5)(a)**)

To deduct non-capital losses following LRE, corp must have been carrying on loss biz "for profit or reasonable expectation of profit throughout yr" – and losses are only deductible to extent corp's income from yr is from same/similar biz as biz carried on prior to LRE

3-Part Test:

1. **Carried on** throughout the yr
2. Expectation or **reasonable expectation of profit**
   - **Test for reasonable expectation of profit**: Profits & losses past yrs // training // intended course of action // capability capitalize // time requires make activity profitable // presence necessary ingredients profit // persistence factors causing loss // failure to adjust (***NRT***)
3. **Carrying on same biz or similar biz**

The biz that generates the losses must be continued, not necessarily the corporate entity (*Garage Montplaisir*)

- Reduction of activities, inventory, and assets not sufficient to show biz was terminated
- Min activity may suffice to find continuity of biz
- Biz may have 2 operations – Q of fact and weighing evidence, whether biz's continued or not

TAXATION OF CORPORATIONS

NRT Technology Corp v Canada (2012) TCC aff'd (2013) FCA:

Facts	**NRT** - gaming corp – casinos. **Telepanel** - had labelling system (ESL) – allows stores change prices electronically. Tele had huge loss - decided sell to NRT for $1M. Condition: (1) Telepanel no liabilities & (1) entitlement $15M loss 2 employees of Telepanel moved to NRT – NRT doesn't really do anything with the ESL, talks to Canadian tire but there is no interest and repairs some systems – suggestion NRT could start using ESL At time of sale, Tele had non-capital loss carry-forward $12.5M – NRT used $4.6M - denied by MNR under **111(5)**
Issue	1. Did NRT carry on Telepan's biz for profit or w reasonable expectation of profit throughout the yr? - NRT argued: Brought 2 employees for Telepanel and talked retailers about using ESL system - NRT argued later going to re-activate the ESL system and could succeed at some point 2. If so, was NRT's income against which it deducted the loss derived from the sale of similar properties?
Issue 1	**Biz carried on throughout the yr**: - The biz has to be carried on throughout the yr but here it was sporadic - NRT wasn't searching for new sales – was just "waiting and seeing" – was ready to commit capital, but never did - Former Telepanel employees didn't really work on ESL system – did other things for NRT **Profit / reasonable expectation of profit**: - Got a cheque for software support but not profit b/c salary expenses of employees much greater - **Factors**: profits and losses past yrs / training intended course of action // capability capitalize // time required make activity profitable // presence necessary ingredients profit o NRT never made any money, hoped to start up again but didn't do anything, dying technology **Was not carried on throughout yr with reasonable expectation of profit**
Issue 2	If found carried on w reasonable expectation profit, can **only deduct losses to extent income from that biz or similar** - Depends how you define biz - T argue NRT carrying on variety diff biz's – if say those are separate biz then sy losses similar to their other biz's - NRT has one general biz of doing these technology things
Holding	Did not qualify for loss-streaming exception – was not carrying on biz with reasonable expectation of profit
Ratio	***3 elements loss streaming exception (1) carried on throughout year; (2) reasonable expectation of profit; (3) carrying on same or similar biz***

Canadian Dredge & Dock Company v MNR (1981) TRB:
Facts: T carried on marine construction biz in Maritimes - incurred losses in 1968-70 totaling over $1M. control was acquired by unrelated company in 1971. Acquired assets used in marine construction biz in Great Lakes and deducted prior years' losses in computing taxable income. Minister disallowed deductions on ground marine construction biz in Great Lakes was diff than marine construction biz in Maritimes
Holding: Allowed T's appeal – T carried on single biz in different locations
- Activities in Maritimes represented continuation of marine construction biz at reduced level

Can carry on the same biz in different locations

Garage Montplaisir Ltee v MNR (1992) TCC aff'd (1996) FCTD, aff'd (2000) FCA:
Facts: T acquired all shares of auto dealership (Pinard) in 1983. Pinard had no employees and had sold all tangible assets. T amalgamated with Pinard and sought to deduct non-capital losses of $1.2M, which Pinard accumulated prior to amalgamation.
Holding: Pinard's biz ceased to exist before shares were acquired by T
Biz that generated the losses must be continued, not the corporate entity – reduction activity not sufficient to show biz terminate

Chrystal Beach Part v Canada (2006) TCC: **Broad interpretation of T's Biz**
Facts: T operated amusement park on parcel of land. Following change of shhs, T developed property. MNR said T abandoned previous biz and started new biz.
Holding: Rejected MNR's argument – adopted broad concept of T's biz - Essence of biz was exploitation of recreational site

Manac Inc v Canada (1998) FCA: **Vertical amalgamation**
Facts: T acquired shares to supplier (Nortex), which manufactured FRP panels used by T to manufacture trailers. After amalgamation, T continued manufacture panels and used the panels in its trailers.
Holding: T did not receive income from sale of panels which were incorporated into trailers it sold
- Dismissed argument that panels were used in development of similar property (trailers)

Don't get exception where no income for the biz b/c of a vertical amalgamation
- **Duff**: problem – rules should be re-drafted

Corporate Control

LRE only occurs when there is an acquisition of **corporate control** (**251.2(2)(a)**)

Corporate control = de jure control = Ownership such # shares as carries majority votes in election board of directors

- Look at whether the majority shareholder enjoys "effective control" over affairs of company – ownership # shares (*Duha*)
    - Look at: corp's governing statute, share registry, specific limitations on majority shh power to control election in constating docs or USA)

Direct Control:

Buckerfields (1965): De jure control = the right of control that rests in ownership of such # shares as carried with it the right to majority of votes in election of Board of directors

Dworkin Furs (1967) SCC: Look to articles to see if actually has ability to elect board of directors (had 2/3 voting shares but articles said election to board required unanimity)

Donald Applicators (SCC): Don't have to have immediate ability to elect board, if in long run have that power, then de jure control

- Shhs held B shares – no right to elect D's but had ability to remove board, and issue Class A shares that they could buy and elect new board – SCC said they had de jure control

Oakfield (1971) & Imperial General Properties (1985 – SCC): De jure control where < 50%+1 voting rights

- 2 groups shhs had equal voting rights. Common shh could cause corp to be wound up and if wound up common shh get more value. Common shh had control (even though only had 50% voting rights)

Indirect Control:

Vineland Quarries (1966): Established indirect control - Could have indirect control through another corp or tiers of corporations

Silicon Graphics: If group, there must be common link/interest b/w the group for the group to control

Southside Car Market: If individual control, then group can't control (Reversed by 251(6.1))

Parthanon Investment: Corp controlled by non-resident, non-resident controlled by resident – original corp controlled by resident

256(6.1): Simultaneous Control – Reverses Southside Car Market

(a) *Corp (sub) would be controlled by another corp (parent) if parent were not controlled by any person or group persons, sub is controlled by: parent & any person by whom parent is controlled*

(b) *Where Corp (subject corp) would be controlled by group persons (first-tier group) if no corp that is memb of first-tier group were controlled by any person of group persons, subject corp is controlled by: first-tier group, and any group 1+ persons comprised of, in respect every memb of first-tier grou either the memb, or a person or group of persons by whom memb is controlled*

- Situation where group of persons control subsidiary – have to be acting in concert

256(6): Deemed Non-Control

If have control and it is to safeguard rights/interests in respect shares/debt, but it will cease when condition satisfied and reasonable expect condition will be satisfied → deemed not to control

Acquisition of Control

256(7)(a)(i): Acquiring Control

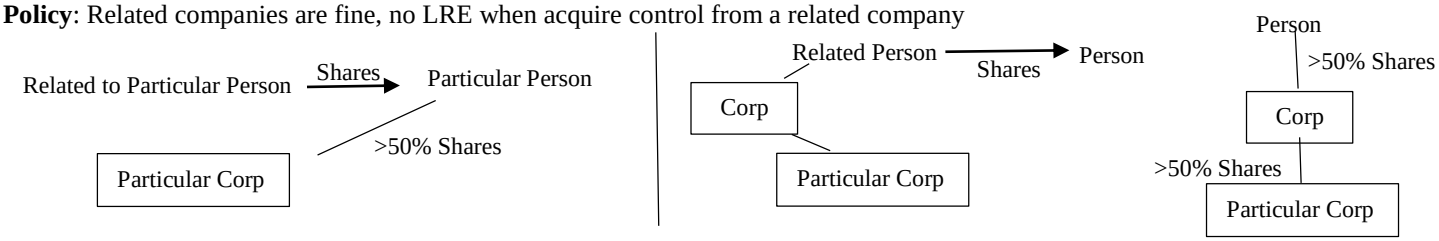
For purposes of 251.2(2)(a) (LRE rules), control of a corp shall be deemed not to have been acquired solely b/c of the acquisition at any time of shares of any corp by:

- Could still be acquired some other way

(A) A particular person acquires shares from related person, otherwise would give acquisition of control → no acquisition control

(B) Relationship not w person buy shares, but w corp acquiring control – already related some way → no acquisition control

Policy: Related companies are fine, no LRE when acquire control from a related company



TAXATION OF CORPORATIONS

Duha Printers (Western) Ltd (1998) SCC: **Determining de jure Control**

Facts	All shares Duha held by Emeric, his wife and his 3 children – speciality printing biz Outdoor sells recreation vehciles – all shares held by Marr's Leisure Holdings (held William and Nora Marr) – had non-capital losses (>$541,044). (If Duha buys Outdoor - LRE - 111(5) says losses disallowed unless Duha carried on same biz for reasonable expectation of profit – then Duha only able deduct losses from that biz) Marr's Leisure Products (sub of Marr's Leisure Holdings) was owed a lot of money from Outdoor **Transactions b/w Feb 7 – 10** → series (pre-GAAR): trying to set up arrangement where Duha related w Outoodr under 256(7)(a)(i)(A)(B) so they give Marr voting control before amalgamation 1. Duha 1 amalgamates w wholly owned sub (creates yr end per) 2. Articles Duha amended to allow issue Class C shares – 1 vote votes terminate on transfer shares or death of owner 3. Marr buys 2000 C voting shares - $1 each - Marr 55.71% – for only $2K get majority in company worth $182K 4. **SA** immediately entered into – affairs company managed by board that is elected by shh's and 3 ppl of: Emeric, wife, William Marr, & Paul Quinton (close friend of both). No shares transferred w/o consent majority D's, no shh can do anything w shares, new shares only issued with unanimous consent 5. Duha purchases all the shares of Outdoor for $1 – Duha owns loss in company 6. Duha purchase amount owed to Marr's Leisure Products ($441K) for $34,559 – receivable worthless since Outdoor is bankrupt – total Duha gave Marr was $34,560 (paying for the losses) 7. Duha & Outdoor amalgamate 8. Duha deducts the losses from outdoor in computing income 9. Election of directors of Duha – Emeric, wife, Quinton (not Marr) 10. Unwind everything – share redeemed for $2,000, Quinton resigns, losses claimed **Minister arguments**: (1) sham / (2) contrary object & spirit // (3) SA deprives Marr of control
History	**TCC allowed Duha's appeal, FCC overturned TCC's decision** **Argument 1: Sham – CRA abandons company by time get to SCC** - Sham – create legal rights and relationships that create impression to 3rd parties that aren't actually legal rights - Not a sham – actually did all of this and Marr got these rights **Argument 2: Object & Spirit** - Purpose section permit corps apply non-capital losses against income earned in subsequent yrs – amalgamated corps entitled deduct losses predecessor if amalgamated corp controlled by same person or group persons as predecessor FCA said Marr didn't control Duha b/c of SA – USA but did not need meet requirement before considered in *de jure*
Issues	Should Duha be entitled to deduct from its income non-capital losses incurred by Outdoor pursuant to 111(5)? - Should docs other than constating docs be considered in determining de jure control? Do USA's have special status? - Did Marr have de jure control over Duha?
SCC	**External Docs: General rule, should not look at external agreements to determine de jure control** - General approach to determine *de jure* control is to look at share register of corp and see which shh has ability elect majority of board – but it is proper to look beyond share register when something in constating docs alters control - *De jure* controls refers to legal sources that determine control, namely corp's governing statutes and its constitutional docs (including articles of incorporation and bylaws) **Unanimous Shareholder Agreement: Considered a constating doc for purpose determining de jure control**
Apply	Shareholder agreement did not result in loss of de jure control by Marr – **Marr had ability to elect majority of board** 111(5) does not prevent Duha from deducting the non-capital losses accumulated by Outdoor, regardless whether or not biz was carried on by Duha under loss streamlining exception
Ratio	***De jure control – party enjoys, by virtue of its shareholdings, the ability to elect the majority of the BoD*** ***While "ordinary" shh agreements and other external documents generally should not be considered in assessing de jure control, the USA is a constating doc and as such must be considered for the purposes of this analysis***
Notes	If transactions happened post-GAAR: Duff thinks GAAR would apply to this - **Tax benefit**: Get access to losses - **Tax motivated**: Part of facts is that they did this to get losses - **Abuse/misuse**: if against object and spirit then yes

Would not get this result today → reversed by 256.1

256.1(6): Deemed Acquisition of Control

If, at any time as part transaction/event/series, control particular corp is acquired by person/group and reasonably concluded one of the main reasons for acquisition control is so specified provision does not apply to 1+ corps, attribute trading restrictions deemed apply to each those corps as if control of each of those corps were acquired at that time.

- Transactions in Duha are a series, and control of Duha is acquired by Marr – reasonable to conclude one of the main reasons was so that the loss restriction rules don't apply – this section would make it so Marr acquired control of Duha

SMALL BUSINESS DEDUCTION

125(1): Small Business Deduction

*There may be deducted from tax otherwise payable under this Part for a tax yr by a corp that was, throughout the tax yr, **a CCPC** an amount = corp's small business deduction rate for the tax year multiplied by **least** of*

(a) the amount, if any, by which

*(i) total of all amounts each of which is income of corp for the year from an **active business** carried on in Canada exceeds the total of*

(iii) total of all amounts each of which is loss of the corp for the year from an active business carried on in Canada

*(c) the corporation's **business limit** for the year.*

3 Elements SBD:

- 1. Available to **CCPC's**
- 2. Only available for **active business income** (ABI) of CCPC
- 3. **Business limit** is $500K for all **associated** CCPC's

Reason for SBD:

- Low rate allows small biz to retain more earnings that can be used to reinvest and create jobs
- Compensates for disadvantages that small biz's face (regulatory, access market, capital)
- Integration of corp and shh level income taxes – reduces rate corp tax on ACBI to level which gross-up and dividend tax credit integrations corp and shh income

Canadian-Controlled Private Corporation (CCPC)

125(7): "CCPC" *means **private corp** that is Canadian corp **other than***

- **89(1): Private corp** - not a public corp and is not controlled by one or more public corps
- **89(1): Public corp** – corp resident in Canada with class of shares listed on designated stock exchange in Canada

***(a)** corp controlled, directly or indirectly in any manner whatever, by 1+ non-resident persons, by 1+ public corps, by 1+ corp described in (c), or by any combination of them,*

- "Directly or indirectly in any manner whatever" – de facto control (see **256(5.1)**)

***(b)** a corp that would, if each share of corp that is owned by non-resident person, by public corp, or by a corp described in (c) were owned by particular person, be **controlled** by the particular person,*

- Hypothetical shh test - If add up shares owned by non-resident, public, & corps on designated stock exchange and = > 50+1% (De jure control)

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

- Essentially all stock exchanges are designated (except China) – means you can list Chinese stock exchange and be a CCPC

***(d)** in applying (1), a corp that has made an election under 89(11) and that has not revoked the election under subsection 89(12);*

- Elect not to be CCPC for purposes of LRIP & GRIP rules

256(5.1): "controlled, directly and indirectly, in any manner whatever"

*A corp shall be considered to be so controlled by another corp, person or group persons ("controller") at any time where, at that time, controller has any direct or indirect influence that, if exercised, would result in **CONTROL IN FACT** of corp*

- Don't necessarily need to own shares to show influence in fact

***EXCEPT**, where corp & controller dealing with each other at arm's length and influence derived from franchise, licence, lease, distribution, supply or management agreement or other similar agreement or arrangement, main purpose is to govern relationship b/w corp & controller regarding manner in which biz carried on by corp is to be conducted, corp shall not be considered to be controlled, directly or indirectly in any manner whatever, by controller by reason only of that agreement or arrangement.*

251(5): For the purposes of definition of CCPC & Related Persons – deeming rules

***(a)** where related group is in a position to control a corp, it shall be deemed to be related group that controls the corporation whether or not it is part of larger group by which corp is in fact controlled;*

- **Allows simultaneous control** – control even if part of larger group that controls

***(b)** where at any time a person has right under a K, in equity or otherwise, either immediately or future & absolutely or contingently,*

*****(i)** to, or to acquire, shares of the capital stock of a corp or to control voting rights of such shares, person shall, except where right is not exercisable at that time b/c exercise is contingent on the death, bankruptcy or permanent disability of an individual, be deemed to have same position in relation to control of corp as if the person owned the shares at that time*

- If have right acquire majority of voting shares, deemed to have acquired them – also allows simultaneous control

***(ii)** If have right to acquire someone else's shares, then deemed to be in position as if those shares have been acquired*

Issue of what "controlled, directly or indirectly, in any manner whatever" means de facto control or also de jure control

- 256(6) contemplates them being separate – says "controlled or controlled, directly or indirectly, in any manner whatever"

Practically – **"control, directly or indirectly, in any manner whatever" = De facto & de jure**

TAXATION OF CORPORATIONS

***Silicon Graphics v Canada (2002) FCA*: Leading case characterization CCPC**

Facts	T – biz of creating and marketing advanced comp graphics software products, from 1985-1990 recognized as CCPC 1990 – Alias made public offering of common shares on US stock exchange >50% common shares held non-residents - At no time did 1 individual hold > 13% shares - No evidence the foreign shh knew each other Reassessed on basis not a CCPC b/c majority shh were non-residents (still private b/c not listed CA stock exchange)
Issue	Is a company controlled by non-resident for purpose ITA by reason solely of fact > 50% shares held non-resident persons where no evidence common connection among them?
Analysis	**De Jure Control - NO** - CRA adds up the shares and says > 50% non-residents so controlled by non-residents and not a CCPC - Court says no – need common nexus b/w no-residents to find control – link b/w them **De Facto Control - NO** - Emphasis on the board of directors still for de facto – narrow concept of de facto control (expanded later)
Holding	T was a CCPC b/c not controlled, directly or indirectly, in any manner whatever
Ratio	***For a group to control de jure, need a common link/nexus b/w the members of the group*** ***De facto control = ability influence & change board/powers board or influence shhs who have ability elect board***
Notes	Occurred when definition of CCPC only had (a), didn't have (b), (c), or (d) - If decided now under (b) – just add up shares of non-residents and the hypothetical shh would control

Mimetix Pharmaceuticals Inc v Canada (2001) TCC aff'd (2003) FCA:
Facts: T incorporated in CA in 1994 to carry out research and development of pharmaceutical product obtained from US company
Holding: Rejected T's argument that it was CCPC b/c 2/3 D's residents in CA and 50/100 voting common shares owned by CA residents – T controlled de facto by US company and therefore not a CCPC

- **Control & supervision over affairs** and biz of T was not exercised by CA Ds, who made no decisions, knew little about company's biz and never met each other, but by non-resident D who was chair and CEO of US company
- T was **economically** dependent on US company

Canada v Bioartificial Gel Technologies (Bagtech) Inc (2013) FCA:
Facts: 60% shares held by European investors, but a USA included clauses providing for election of Ds that allowed CA resident shhs to appoint most of company's D's during yrs at issue, except period which could only elect 4/8 D's
Holding: T was a CCPC notwithstanding deeming rule in 125(7)(b) of definition of CCPC – hypothetical shh contemplated by (b) could not have been controlled by company as result of USA

Business Limit

125(1): Small Business Deduction

*There may be deducted from tax otherwise payable under this Part for a tax year by a corp that was, throughout the tax year, a **CCPC**, an amount equal to corp's small business deduction rate for the tax year multiplied by least of (c) corporation's business limit*

- **125(2): Business Limit = $500K**
  - **UNLESS** corp associated in tax yr with 1+ other CCPCs, in which case, except otherwise provided, **biz limit = nil**
- **Small business deduction rate = 17% - 125(1.1)**

125(3): Associated Corporations

*Notwithstanding (2), if all CCPCs that are **associated w each other** **in a tax year** file w the Minister in prescribed form an agreement that assigns a percentage of them for year, biz limit for year of each of corps is*

(a) if total of % assigned in agreement does not exceed 100%, $500,000 multiplied by % assigned to corp in agreement; and
  - If have associated corps & assign % that don't exceed 100%, then fine – just allocate biz limit

(b) in any other case, nil.
  - If allocate % > 100% → biz limit = nil

Says "**in a tax year**" = fiscal period for a corporation (**249(1)**) – biz limit only shared if associated at the same time in the yr

- Could have corps with different tax yr ends

125(5.1): Business Limit Reduction

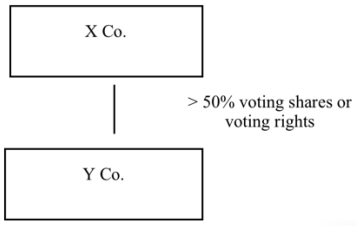
- Reduce biz limit by: **A x (B/$11,250)**
  - **A** = Amount that would be the corp's biz limit for the year
  - **B** = 0.225% x (D - $10M)
    - **D** = taxable capital in Canada
- Claw back biz limit if assets > $10M, biz limit = 0 when assets = $15M

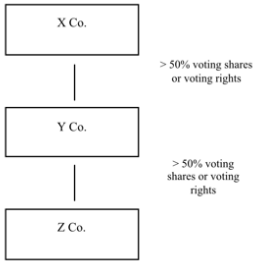
Associated Corporations

Kinds of Association – 256(1) – one corp is associated with another corp in a tax yr if, at any time in the yr,

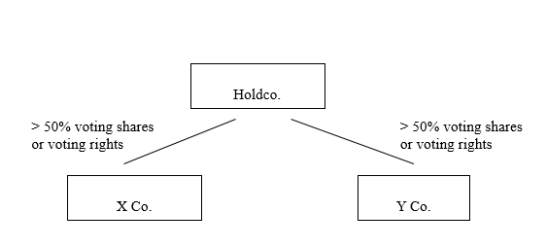
- Note: de facto and de jure control for all of these rules in 256(1)

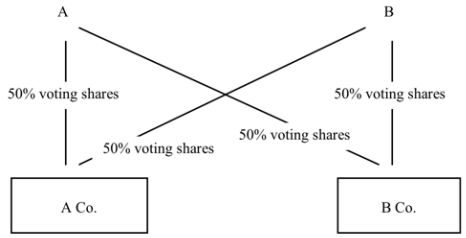
1. One of the corporations controlled, directly or indirectly, in any manner whatever, by the other





2. Both of corps controlled directly or indirectly, in any manner whatever, by the same person or group of persons



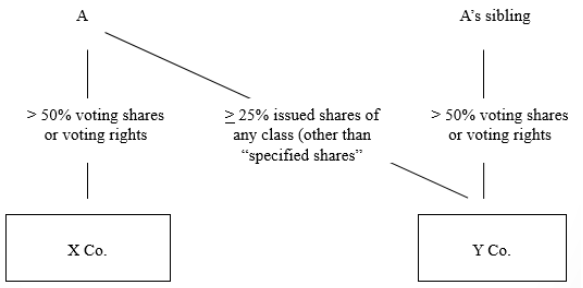


A nor B individually controls either Co – but if have sufficient look (common connect), then A Co and B Co controlled by same group

256(1.2): Group of Persons - Two or more persons each of whom owns shares of the corporation

- Group needs to be acting in concert (*Silicon Graphics*)

3. Each corps controlled, directly or indirectly in any manner whatever, by person and person who so controlled one of corps was RELATED to person who so controlled other, and either those persons owned, in respect each corp, NOT LESS 25% ISSUED SHARES of any class, other than specified class, of capital stock;



Cross-ownership shares by related people other than shares specified class

256(1.1): Specified Class – (a) Shares not convertible/exchangeable; **(b)** shares non-voting**; (c)** amount dividend paid on shares calculated at fixed amount; **(d)** Fed rate says shares can't be above – can't get shares paying dividend > prescribed rate

251(2): Related Persons

(a) ***Individuals*** *connected by blood, marriage, CL, or adoption*

(b) ***Corp*** *AND*

(i) person who controls the corp, if it is controlled by one person;

(ii) person who is member of related group that controls corp, or

- Related Group – group of persons each member of which is related to every other member of the group

(iii) any person related to person describe in (i) or (ii)

(c) any ***two corporations***

(i) if they are controlled by the same person or group of persons;

(ii) if each corps controlled by one person and person who controls one corps related person controls other corps;

- Ms. A and Mr. A each control a corp – those 2 corps are related

(iii) if one corps is controlled by one person and that person is related to any memb of related group that controls other corp

- Ms. A controls corp and sister of A and children of sister control corp – sister and her children are related and A is related to sister – 2 corps related

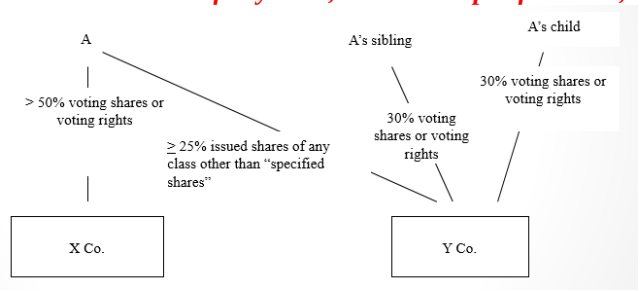
(iv) if one corps controlled by one person and that person related to each memb of unrelated group that controls other corp

251(5)(a): Can have simultaneous control – even if larger group controls, then smaller group can still control

251(5)(b): If have right to acquire option that would give control, then act like exercised that right → simultaneous control
251(5)(c): **Deeming Rule** - Deemed to be related to yourself

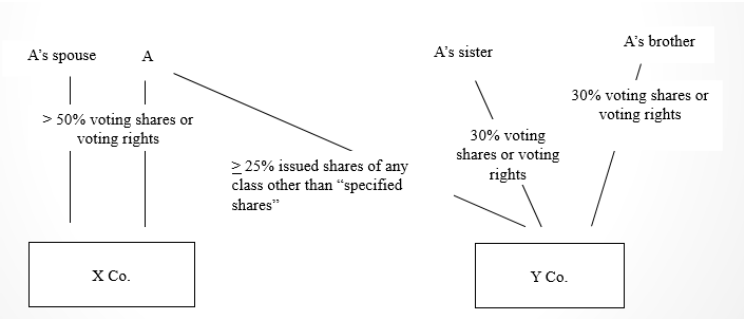
251(3): **Deeming Rule**: Where 2 corps are related to same corp, they shall, for the purposes of 251(1) & (2) be deemed to be related

4. one of corps was controlled, directly or indirectly in any manner whatever, by person and that person related to each member of a group of persons that so controlled the other corp, and that person owned, in respect of other corp, not less 25% of the issued shares of any class, other than specified class, of the capital stock or



A's sibling & A's child are not a related group – so don't fall into 3 – but A is related to both of them & A deemed to be related to self under 251(5)(c) – so long as A's share + sister share + child share > 50% then have group that controls Y

5. each of corps was controlled, directly or indirectly in any manner whatever, by related group and each of the members of one of related groups was related to all of members of the other related group, and one or more persons who were members of both related groups, either alone or together, owned, in respect of each corp, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof.



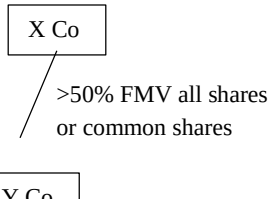
A & A spouse – related group controlling X
A's sis & A's bro – related group controlling Y
Each member of each group is related to each other
A would be related to himself (like above), so could reduce sis and bro shares

DEEMING RULES

256(1.2)(a) & (b): **Group Persons & Control**

(a) Group of persons means any 2+ persons whom own shares of the corp
(b)(i) A corp that is controlled by 1+ membs of group in respect of that corp shall be considered controlled by that group
(b)(ii) A corp may be controlled by person/group persons, even if corp also controlled/deemed controlled another person/group

256(1.2)(c): **> FMV Shares**

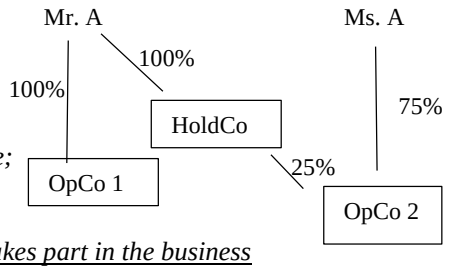


(c) a corp shall be deemed to be controlled by another corp, a person/group persons at any time where
- *(i) shares of corp having a FMV > 50% of FMV of **all issued and outstanding shares** of the corp, or*
  - Confirms *Buckerfields* test
- *(ii) **common shares** of corp having FMV > 50% of FMV of all issued and outstanding common shares*
  - Could be non-voting common
  - When value shares just look at entitlements to dividends and property on winding up

are owned at that time by other corp, the person or the group of persons, as the case may be

256(1.2)(d):

(d) where shares corp owned, or deemed by this section to be owned, at any time by another corp ("holding corp"), those shares shall be deemed to be owned at that time by any shh of the holding corp in proportion equal to proportion of all those shares that
(i) FMV of shares of holding corp owned at that time by the shh
is of
(ii) FMV of all the issued shares of the holding corporation outstanding at that time;



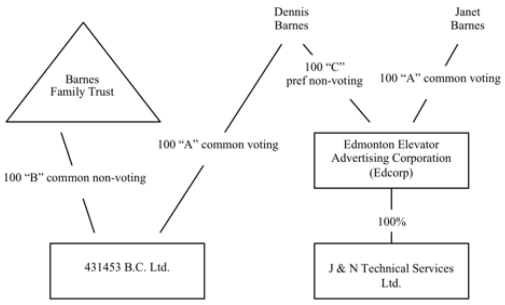
256(1.3): **Parent deemed own shares**

Parents deemed to own shares that are owned by child under age 18, unless child actively takes part in the business

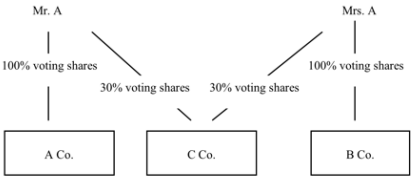
256(1.4): Options and Rights

For determining whether corp is associated w another corp, where has right at any time under K, equity, or otherwise, either immediately or in future and either absolutely or contingently, acquire shares, deemed to have the shares as if right is exercised

431543 BC LTd (2000) TCC:



Facts: Dennis & Janet related group that control Edcorp
Issue: Is # company associated with J&N Technical?
Duff: To get association need cross-ownership – D owns 100 preferred non-voting shares (100% shares class) – specified shares
Result: Discretion trust, under 251(1.2)(f), shares deemed owned each child. Children under age 18 – shares each child deemed by 256(1.3) to be owned by parent. Minister choose which parent – If choose J - J has cross-ownership > 25%



256(2): Corp's Associated Through Third Corp

Where 2 corps

(a) would, but for this section, not be associated with each other at any time, and

(b) are associated, or are deemed by this section to be associated, with same corp ("third corp") at that time, they shall be deemed to be associated with each other at that time, except that, for purposes of 125, where third corp is not a CCPC at that time or elects for its tax year that includes that time not to be associated w either of the other two corps, third corp shall be deemed not to be associated with either other two corps in that tax year and its biz limit for that tax year shall be ***deemed to be nil.***

- If C is not a CCPC, then A and B get the $500K biz limit or if C corp elects to have no biz deduction

De Facto Control

256(5.1): "controlled, directly and indirectly, in any manner whatever"

A corp shall be considered to be so controlled by another corp, person or group persons ("controller") at any time where, at that time, controller has any direct or indirect influence that, if exercised, would result in ***CONTROL IN FACT*** *of corp*

- Don't necessarily need to own shares to show influence in fact

EXCEPT*, where corp & controller dealing with each other at arm's length and influence derived from franchise, licence, lease, distribution, supply or management agreement or other similar agreement or arrangement, main purpose is to govern relationship b/w corp & controller regarding manner in which biz carried on by corp is to be conducted, corp shall not be considered to be controlled, directly or indirectly in any manner whatever, by controller by reason only of that agreement or arrangement.*

Indicia De Facto Control: 1. Operational control // 2. Economic dependence // 3. Familial Relationships

- Broader than *Silicon Graphics* that still was looking in terms of influencing the board

Transport ML Couture v Canada (2003) TCC aff'd (2004) FCA: Broader de facto than Silicon

Facts	Two corps: Transport Couture (owned by children through # company) & ML1 (owned by ML – father) – ML1 associated w Transport. ML1 small in size but TC grew considerably ML2 – owned by ML's wife (F) 90% and Claude (10%) - 1995 – TC and ML1 signed agreement: TC provide management to ML1 in exchange 10% ML1 revenue, ML1 provide trucking services to TC, TC provide drivers to ML1, ML1's trucks painted with TC's logo. 1996 – ML1 decided to sell permits to arm's length purchasers – Yvon. - Sells assets of ML1 to ML2 - Son arranged deal & ultimately signed off deal ML's behalf – ML2 continued agreement from Nov 15, ML1's behalf Reassessed on basis TC associated with ML1 and ML2 associated TC
Issue	Did TC control ML1 & ML2 directly or indirectly in any manner whatever?
Minister	Cannot rely on 256(1)(a)-(e) b/c no cross-ownership De facto control - If 1 corp de facto controls another, they are associated – 256(1)(a) - TC de facto controls ML1 & ML2 If both corps de facto controlled same person/group, associated – 256(1)(B) - Say that sons that own TC are controlling ML1 and ML2
Analysis	**Operational Control** – TC dictating terms of agreement, ML1 & ML2 simply owns trucks - TC manages all the biz – everything run through kids **Economic Dependence** – ML1 & ML2 not providing trucking services to anyone but TC – significant dependence **Familial Relationships** – Looks like kids built up dad's biz
Holding	Appeal of ML1 and ML2 dismissed – they were associated with TC
Ratio	***Indicia de facto control: operational control, economic dependence, familial relationship***

TAXATION OF CORPORATIONS

Factors Determine De Facto Control (IT-64R4):

- % ownership voting shares in relation holding's other shh – **operational** control;
- Ownership large debt corp which may become payable on demand or substantial investment in retractable preferred shares;
- Shareholder agreements;
- Commercial/contractual relationships of the corp (**economic dependence**);
- Possession unique expertise that is required to operate the biz; and
- Influence **fam member**, who is shh, creditor, supplier, etc of corp, may have over another fam member who is shh of corp

Rosario Poirier Inc v Canada (2002) TCC:
Facts: T (RPI) was CCPC operated sawmill – 80% voting shares held by company's founder Rosario, remaining shares held by his son (Luc) who was D and employee. Luc acquired all shares of company (Trab). RPI sold Trab timber transport truck for $1 and Trab provided services to RPI – but RPI's employees continued to drive the truck.
Holding: RPI exercised de facto control over Trab – associated under 256(1)(a)

- RPI exercised operational control over Trab, Trab obtained all income RPI, Trab's biz carried on by employees of RPI

Note: Could also find that Rosario de facto controlled Trab and therefore associated since Rosario controls both

Societe Foncier D'Investissement (1996) TCC:
Facts: T (SFI) CCPC - Paul 0.2% voting shares and daughters 49.9%. only customer was Dobersol, all shares owned by Paul.
Holding: SFI and Dobersol were both controlled directly or indirectly in any manner whatever by Paul – associated under 256(1)(b)

- Operational control of SFI with Paul as General Manager

Lenester Sales v Canada (2003) TCC aff'd (2004) FCA: **Exception in 256(5.1) – Franchise**
Facts: T's (Lenester & Sushi) and 80-90 similar corps operated Giant Tiger stores. 499 voting shares held by GTS and 501 held by independent operates who managed each store under franchise agreement – conditions on way biz was conducted company governed 2 D's: 1 nominated GTS and 1 independent operator.
Issue: Are the T's controlled by GTS?
Holding: GTS did not have de facto control over the corps – qualify exception in 256(5.1)

- Nothing in arrangement results in control – this is what the franchise exception is aimed at – Franchisers exercise significant control over franchisee's and Parl wanted to prevent that from being de facto control

Brownco Inc v Canada (2008) TCC:
Facts: T was CCPC, carried on biz of constructing homes "Grandview Homes – 50/50 share ownership by 147 (shares owned builder, Randy, and wife), and Bost, a company controlled by Garo which operated biz of property development and home construction.

- Under USA, each company nominate 1 D of T, and if the 2 D's couldn't agree, then chair would break tie (Bost)

Holding: Exceptions in 256(5.1) didn't apply – Bost has de facto control over T

- Most of USA was not about how biz was conducted

Plomberie JC Langlois (2004) TCC aff'd (2006) FCA: ***Reaffirmed 3 factors of de facto control: operational control, economic dependence, familial relationship***

Taber Solids control (2009) TCC: **Reconciles with Silicon Graphics**

Facts	T CCPC carried on biz of renting, repairing and rebuilding specialized equipment used in oil & gas industry – shares owned by Ken Taber and family trust. Prior 1998, biz carried on through Old Taber – shares held equally Ken & wife. Transactions where wife became sole shh of Old Taber. Biz renting, repairing, and rebuilding specialized equipment transferred to T. Old Taber & T entered agreement where Old Taber would rent equipment to Taber at 40% rate & Old Taber pay T $500/month bookkeeping services & $50.95/month health benefits.
Holding	**Old Taber and T were associated** – Old Taber was economically dependent on T - B/c Ken exercised considerable influence over major operations and Board decisions Old Taber - Economic Dependence – Old T's only source income renting to T which has arm's length customers - Operational Control – All decisions decided by Ken Quotes test for de facto control in *Silicon Graphics* - Even de facto control, goes to the board - Board decisions vs. management decisions – operational control isn't the test b/c that is management and not control of the board – board is vision and direction of the company
Ratio	***De facto control focuses on control of the board – economic dependence, family relations and operational control play role in determining who controls the board***

McGillvary Resaurants (2015) TCC: Reaffirms Silicon Graphics

Facts	T owned 24% Gordon Howard & 76% Ruth Howard. Leases premises from company and gets financing and management from another – both run by Gordon Howard
TCC	Rely on test of operational control, economic dependence, and familial relations – operational control by Gordon
FCA	No de facto control – ***Silicon Graphics*** **was never rejected – still the test** - **Duff**: Court say they want to shut down other lines of cases – and broader tests of control To have de facto control, must have right & ability change BoD in Q or influence in very direct way the shh who would otherwise have ability elect BoD - Decision-making power corp lies elsewhere than with those de jure control Rejects assertion that test for control is based on "operational control" (Duff: throws out operational control)
Ratio	***De facto controlled concerned w control over BoD and not day-to-day operations*** - ***Throw out operational control and may or may not threw out economic dependence & familial relations***

Anti-Avoidance Rule

256(2.1): Anti-Avoidance Rule

For purposes of this Act, where, in case of 2+ corps, it may reasonably be considered that ***one of the main reasons*** *for separate existence of those corps in a tax yr is to* <u>*reduce amount of taxes*</u> *that would otherwise be payable under this Act the 2+ corps shall be deemed associated with each other in the year.*

- Onus on the taxpayer to prove none of the main reasons for the separate existence of the 2 corps was to reduce taxes
- Reducing tax payable by multiplying SBD, but could also be income splitting purpose
- **Result**: Deemed to be one corporation
    - Wouldn't help income splitting – right say read in context and say purpose separate existence is to multiply SBD

Hughes Homes Inc v Canada (1997) TCC:

Facts	HH was in biz of building homes. Ms. H ran office and Mr. H constructed homes – 50/50 ownership. Eventually HH became holding company that owned 5 separate companies Ms. H incorporated Lopa – carry on biz of decorating biz – only client of Lopa was HH Companies associated at this point – 256(1)(c) – control 2 corps by 1 person and related, cross-ownership > 25% - Reduce Ms. H's ownership in HH to 10% so the 2 corps are not related
Issue	Is Lopa subject to anti-avoidance rule in 256(2.1)?
Analysis	The main reason of Lopa has to be reduction of tax in tax year – sole reason Ms. H reducing HH holding from 50 to 0 was reduction in tax but main reason separate existence of Lopa was not reduction of tax **<u>T's reasons for separate existence of Lopa</u>**: - 1. Asset Protection – concerned about lawsuits and losses in HH - Duff: HH is just a holding company that is already insulated from creditors - 2. Separate biz activity for Ms. H – Ms. H had enough work that she didn't need to go seek out clients - Duff: not really a spate biz when only client of Lopa is HH
Holding	Tax reduction was not one of the main reasons for Lopa's existence
Notes	Wouldn't have succeeded for de facto control – Mr. H isn't influencing Lopa's biz but there is economic dependence and familial relationship

For determining if it was one of the main purposes, has to do with judging the credibility of witnesses

- **<u>Example</u>**: *LIP Sales v Canada (2003) TCC*
    - **<u>Facts</u>**: T ran locksmith biz for years and ended up having biz owned by wife and he owned sales biz selling locks. Long sob story about why family split up and he doesn't want to give inheritance kids but she wants to so 2 corps
    - Court buys the whole back story and finds 256(2.1) doesn't apply

Income/Loss from Active Business

125(1): Small Business Deduction

*There may be deducted from tax otherwise payable under this Part for a tax yr by a corp that was, throughout the tax yr, a CCPC an amount = corp's small business deduction rate for the tax year multiplied by **least** of (a) the net income from an activity business*

ABI (125(7)) Low corp tax rate	AII (129(4)) Taxed at high rate

- Income from an active biz (other than SIB)
- Income pertaining/incident to an active biz
- Income from adventure/concern in the nature of trade
- SIB if:
  o Biz carried on by credit union
  o Biz leasing property (other real/immovable property)
  o Employs > 5 full-time employees
  o Corp associated, in carrying active biz, provides services to corp and corp would reasonably have required > 5 full-time employees if the services were not provided
	- Income from source that is property
	- Income from specified investment biz (SIB) – income from property (unless incident/pertain to Active biz or used principally for purpose gaining/producing income from active biz)
	- Biz of leasing real/immovable property
	- Net taxable capital gains

125(7): "Income of the corp for the year from an activity biz" means the total of

*(a) Corp's income for the year from an active biz carried on by it **including** any income for the year pertaining to or incident to that biz, **other than** income for year from a source in Canada that is a property,*

- **Includes**: Income from active business & income pertaining/incident to active business
- **Excludes**: Income from source that is property

Incident/pertaining to active biz:

- Look at whether it was risked or required for the biz (*Ensite*) – whether the property was used to fulfil a requiremernt which had to be met in order to do biz
- Must be a financial relationship of dependence of some substance b/w property and active biz (*Atlas Industries*)

125(7): "Active Biz Carried on by a Corp" means

***any business** carried on by corporation other than specified investment business or a personal services business and **includes** an adventure or concern in the nature of trade*

125(7): "Specified Investment Biz" *means*

*a biz (other than a biz carried on by a credit union or a biz of leasing property other than real/immovable property) the principal purpose of which is to **derive income** (including interest, dividends, rents and royalties) **from property** but, does not include a biz carried on by the corp in the year where*

> ***(a)** the corp employs in the business throughout the year more than 5 full-time employees, or*
> ***(b)** any other corp associated with corpor provides, in the course of carrying on an active business, managerial, administrative, financial, maintenance or other similar services to the corp in the year and the corporation could reasonably be expected to require more than 5 full-time employees if those services had not been provided*

> 5 full-time employees mean 5 full-time + at least 1 part time (*489599 (2008) TCC*)

129(4): "Income/Loss from source that is property"

***(a)** includes the income or loss from a specified investment business carried on by it in Canada other than income or loss from a source outside Canada, but*

***(b) does not include** the income or loss from any property*

> ***(i)** that is incident to or pertains to an active business carried on by it, or*
> ***(ii)** that is used or held principally for the purpose of gaining or producing income from an active business carried on by it.*

TAXATION OF CORPORATIONS

Canadian Maroconi v Canada (1986) SCC: **Leading case on characterization of active business**

Facts	CM was in biz manufacturing electronic equipment, also owned broadcasting division. CRTC said not going to re-new broadcasting license if foreign owned. CM sold its broadcasting division for $18M. Invested the $ while looking for something else to buy – earns significantly income from investments - 12 employees involved management investments, numerous purchased throughout the yr, 20% senior management's time taken up with the investments CM claimed manufacturing and processing deduction – which requires earning income from active business
Issue	Was the investment income earned by CM income earned from an active business?
Analysis	Old case law - presumption if you are a corp doing something consistent with charter, then inherently biz income - But corporate law statute changed, and corps no longer had to state an object in their charter – but the rebuttable presumption still holds **Start off assuming everything a biz does is potentially biz income** - Duff: that doesn't make sense – if income is sufficiently passive, then it is income from property
Holding	The investments were an active business – active investment biz being carried on - Turning over investments frequently – suggests biz
Ratio	***Rebuttable presumption that income that corp earns is from business***
Notes	Case was before Specified Investment Business - This would now be SIB – but may qualify under exception if more than 5 full-time employees engaged in doing this – need more facts

Threshold for active business is pretty low

Harquail v Canada (1999) TCC' rev'd (2001) FCA:

Facts: One of corp's (Arnaud) carried on biz of selling building lots, and then pursued development of hydro facility to supply electricity to lots at lower cost through the other corp (Hall).

TCC: Neither corp carried on active biz b/c Arnaud no longer carried on biz of selling lots, and Hall had not begun carrying on biz of selling electricity

FCA: Hall carried on active biz b/c it was constantly on look-out for market to develop hydro potential

- Hall spent a lot of energy and money to accomplish objects of incorporation

Spectrum for carrying on active biz – outside bounds where does not occur when company has incorporated but has not yet commenced operations, & company has become dormant and is only holding annual meetings

Ollenberger v Canada (2012) TCC, rev'd (2013) FCA:

Facts: Corp established acquiring oil & gas properties, operating and selling them. Tried to acquire property but turned out defective.

Holding: Corp was carrying on active biz – trying to acquire oil & gas properties was sufficient

Temax Investments Inc v MNR (1990) TCC: **"Specified Investment Biz"**

Facts	Mayon & Temax – Brick is president of Temax and manager of Mayon. Mayon is wholly-owned by Brick's wife - Not associated, b/c no cross-ownership Principal activity of companies was mortgage brokers – major portio income was interest income on mortgages – only full-time employees are Mr. and Ms. Brick MNR treated income as investment income, and not income from active biz – disallowed SBD T argued that activities of biz were akin to a bank
Analysis	Definition of SIB says "principal purpose is to earn income from property" – where the form of income is property (income from mortgages), then it is SIB – the amount of activity doesn't matter - Doesn't matter that there was sufficient activity to find deriving income from biz
Holding	Found to be a specified investment biz
Ratio	***Where form of income is property then it is an SIB, regardless of amount of activity***

Porter Land Ltd v MNR (1986) TCC:

Facts: T owned farm and derived income from contract farming, farm management, and tenant farming – claimed SBD

Holding: Income was from SIB – not eligible SBD

- Income from tenant farming operations derived from rental of property (and not farming) -

Luigi Tiengo Art & Design Inc v MNR (1992) TCC:

Facts: L and wife sole shareholder of T – provided design and consultation services to clients and were paid a negotiated % of sale revenues. MNR said it was SIB b/c principal purpose was to derive income from royalties

Holding: Derived business income from design and consultation services

Mode of remuneration should not distort true nature of corp's biz

TAXATION OF CORPORATIONS

Baker v Canada (2004) TCC aff'd (2005) FCA: **Exception in 125(7)(a) of SIB**
Facts: T earned rental income from commercial office building – provided cleaning services to tenants - employed 6 custodians who worked 20 hrs/week.
Holding: Not eligible for exception in 125(7)(a) of SIB
- Didn't qualify as full-time employees – 20 hr/week – T tried to argue that 20hr/week was industry standard

Determining "full-time" is not context specific

Casey Realty Ltd v MNR (1991) TCC: **Exception in 125(7)(b) of SIB**
Facts: Don and his brother held shares in 3 companies, and 1 company had wholly-owned sub. 2 companies involved in property rental, and 1 company carried out construction, renovation, and repairs for the buildings owned by the other 2 companies. Neither employed > 5 full-time employees, but together they did.
Holding: Found one of the companies would have required > 5 full-time employees (not SIB), but the other would not (SIB)

***MNR v Garber Sales Canada (1992) FCTD:* income from property included in corp's ABI**

Facts	T engaged in fur biz – Controlled by Irving Garber. Buy furs on behalf of buyers at auctions. If buyer changed mind, then vendor would make T pay – so company was at risk of buyer default Gross income of company in 1981 & 82 was largely interest income – building up cash and term deposits - CRA says this is income from property – not active biz - T argues this is income pertaining or incident to the active biz of buying/selling furs
Issue	Was the income earned by T from term deposits incident to the active biz of selling furs?
CRA	Term deposits were never at risk – not used or employed in the biz – no biz purpose of having the large deposits and if no biz purpose then not incidental to the biz
T	Needs the reserves of money in case a buyer defaults and T needs to buy the furs – went bankrupt once and doesn't want it to happen again
Analysis	Reasonable reserve of money is legitimate, but this is excessive - $20K is excessive (1/3 of total) - Was the property employed/risked in the biz - Was it required for the biz?
Ratio	***Look for a legitimate biz purpose for the investments to find incident/pertaining to active biz***

Majestic Toll & Mold v Canada (1993) TCC: **Look at Biz judgment**
Facts: T engaged tool and mold making biz – intense competition of obtain foreign customers. To enhance financial reputation, held term deposits worth b/w $150K-$260K.
Holding: $100K would be more reasonable, but not prepared to second-guess T's business judgment that term deposits were used to fulfil a requirement that had to be met in order to do biz, and there was financial relationship of substantive dependence and reliance b/w term deposits and T's active biz
- Removing the term deposits would have a destabilizing effect and effect biz operations

Deference to T's business judgment about what is necessary for their biz – T just has to make plausible argument

Colonial Realty Services v MNR (1987) TCC:
Facts: T - biz renting and managing real estate, received funds sale certain holdings and invested them in guaranteed investment certs for 5-yr term. Interest from these comprised 75% T's income – T said ABI b/c investments constituted part of its normal real estate biz
Holding: Deposits were not used principally for purpose gaining or producing income and not incidental to biz

Balmoral Investment Ltd v Canada (1996) TCC:
Facts: T owned and operated hotels, earned interest income (37% revenues 1990, 84% revenues 1991).
Holding: Not a sufficient degree dependence by active biz (running hotels) on the money – T may have needed the money to acquire other hotels, but does not make moneys incident to the active biz of the company

Supreme Theatres v Canada (1981) FCTD: **Multiple activities being carried on – depends how you define the active biz**
Facts: Primary biz was running movie theatres (income from sale tickets & concession). Also derived rental income by leasing 2 theatres and rental income from renting apts in basement of one theatre. Also had vacant parking lot that it rented.
Issue: Which of the biz's are incident to the active biz of running the movie theatre?
Holding: Rent from lease of theatres was incidental to active biz, other rental income was income from property

Alarm Farms v Canada (1992) TCC: **Wide interpretation of "incidental/pertaining to"**
Facts: Ran a farm that had oil and gas well on it. Didn't run oil and gas well – got royalties from someone else who operated it and used the royalties in the farm biz.
Holding: Royalties were incidental to farming biz
- **Duff**: if this is the test ten everything becomes incidental

AGGREGATE INVESTMENT INCOME & DIVIDEND REFUND

AII of a CCPC is taxed at high rate

Part IV Tax - applies to portfolio dividends received by private & subject corps that are otherwise tax-free on account of inter-corporate dividend deduction – **112(1)**

Refund – Portion of tax paid by CCPC on AII and full amount Part IV tax refunded when corp pays dividend to shareholders – **129**

Aggregate Investment Income

AII of a CPCC is taxed at the top marginal rate – 38 2/3% federally (additional tax from 123.3)

129(4): "Aggregate Investment Income" means the amount, if any, by which the total of all amounts, each of which is
AII = net eligible portion taxable capital gains + Net income property sources – Inter-corporate dividends subject deduction
(a) the amount, if any, by which

(i) the eligible portion of the corporation's taxable capital gains for the year

- Eligible portion capital gains = gains' that accrued while corp was eligible

exceeds the total of

(ii) the eligible portion of its allowable capital losses for the year, and

(iii) the amount, if any, deducted under paragraph 111(1)(b) in computing its taxable income for the year, or

(b) the corp's ***income for year from a source that is a property****, other than*

(i) exempt income,

(iii) the portion of any dividend that was deductible in computing the corporation's taxable income for the year*, and*

- Dividend that got the inter-corporate dividend deduction

(iv) income that, but for paragraph 108(5)(a), would not be income from a property,

exceeds the total of all amounts, each of which is the ***corporation's loss for the year from a source that is a property****.*

AII =

- Income from source that is property
- Income from specified investment biz (SIB) – income from property (unless incident/pertain to Active biz or used principally for purpose gaining/producing income from active biz)
- Biz of leasing real/immovable property
- Net taxable capital gains

129(4): "Eligible Portion"

of a corp's taxable capital gains or allowable capital losses for a tax year is the ***total of all amounts*** *each of which is portion of a taxable capital gain or an allowable capital loss, of the corp for the year from a disposition of a property that, except where the property was a designated property (within the meaning assigned by subsection 89(1)), cannot reasonably be regarded as having accrued while the property, or a property for which it was substituted, was property of a corp other than a CCPC, an investment corporation, a mortgage investment corporation or a mutual fund corporation.*

129(4): "Income/Loss" from source that is a property
(a) includes income or loss from source that is a **specified investment business** carried on by it in Canada; but
(b) **does not include** the income or loss from any property

(i) that is incident to or pertains to an active business carried on by it, and

(ii) that is used or held principally for the purpose of gaining or producing income form an active business carried on by it

Canada v Marsh & McLennan (1983) FCA:

Facts	MM – CA wholly-owned sub US company (since wholly-owned, shares not traded stock exchanged – private). Provided insurance consulting services, evaluation needs and recommendations of coverage. Commissions given to insurance brokers. Client pays premium to broker 30-days in advanced of the 60-days broker has to give it to insurer. Broker deposit premium with other receivables in chequing account – investments made occasionally and get interests.
Issue	Was the income received from short-term investments AII? - Minister arguing not income from property and T arguing AII (statute was different)
Analysis	In insurance industry, this is part of how you make money – part of the biz model – uses Ensite test and askes whether funsd employed/ or risked and found yes – committed to carrying on biz and meeting obligations to insurers
Holding	Incident/pertaining to active biz
Ratio	***Look at inter-connection, interlacing and inter-dependence b/w the two biz's***

****Canada v Ensite (1986) SCC**: **Test for incident/pertaining to active biz**

Facts	Ensite carried o biz manufacturing and selling engines – wanted invest in plant in Philippines. Philippines has law that says have to bring in foreign currency to finance plant – Ensite worried about peso devaluing **Transaction**: (1) commercial bank obtained Philippines pesos from central bank upon depositing US$ with central – pesos could be reconverted to US in future at agreed exchange rate; (2) Ensite deposited US with commercial – peso loans equivalent; (3) Esnite received certificate deposit for US$ deposits with commercial bank. Certificate enforceable against any branch commercial bank
Issue	Was the interest from the loan from active biz of manufacturing or from source that is property? (T arguing property and minister arguing active biz)
Analysis	Didn't need to invest in Philippines in this way, could have just taken risk and given money directly – biz purpose is not enough, risk means more than remote risk
Holding	Property used or held in the biz – duff thinks maybe no b/c it was not necessary to do it
Ratio	***Test is whether property was used to fulfill requirement that had to be met in order to do biz***
Duff	Biz purpose test gets you long way to satisfy the test

Sanlit v MNR (1987) TCC: **Reserves**
Facts: T was in biz collecting and processing wood shaving for agricultural use – earned interest income through term deposits – characterized as ABI b/c funds held in reserve for future expansion and offset marketing declines
Holding: Term deposits were not "pertaining to or incidental" to the active biz - Property was not risked in the biz

March Shipping v MNR (1977) TAB:
Facts: T, shipping company, earned lots of money from interest from short-term deposits received as prepayment for services.
Holding: Income was income from property
To be considered "integral" the specific function should form mnecessary part of whole operation

Canada v Brown Boveri Howden (1983) FCA: ***Income from active biz – property was "committed to carrying on the biz"***

Dividend Refund

Refund portion tax paid by CCPC on AII & full amount Part IV tax when corp pays a dividend out of that income

129(1)(a): Dividend Refund

*Where a return of a corp's income under Part I is made within 3 years after the end of the year (in respect of which the dividend is paid), the Minister may, on sending notice of assessment, refund w/o app an amount ("dividend refund") = **lesser** of*
(i) 38 1/3% all taxable dividends paid by the corp on shares in the year and at a time when it was a private corp, &
*(ii) its **refundable dividend tax on hand** (RDTOH) at the end of the year*

- Refund = RDTOH, up to 38 1/3

129(3): RDTOH =

(a) + 30 2/3% of AII
- Only a % of AII b/c want to reduce effective rate so it gets closer to gross-up & tax credit rate

(b) + Taxes paid under Part IV
(c) + RDTOH at end of previous year
(d) – Dividends refunded under 129(1) in preceding yr

129(1.2): Anti-Avoidance Rule

*Where a dividend is paid on a share of a corp and the share (or another share for which the share was substituted) was acquired by its holder in a transaction or as part of series of transactions **one of the main purposes** of which was to enable the corp to obtain a dividend refund, the dividend shall, for the purpose of 129(1), be **deemed not to be a taxable dividend**.*

- **IF:** Dividend paid on a share as part of transaction/series, one of the main purposes was to get refund
- **THEN**: Deemed not to be taxable dividend for 129(1) – no refund

INTRODUCTION

Ways Shareholders get $ from Corporation:

1. Corp pays dividends – Eligible vs. Non-Eligible
- If CCPC, assume non-eligible b/c taxed at low rate // If non-CCPC, assume eligible

2. Return of Capital - Shareholder can get money they put into corp back out tax-free

3. Disposition of Shares – Sell shares to someone else

4. Shareholder Benefits - Company pays for certain things for the shareholder and provides them with a benefit

DISPOSITION OF SHARES

Characterization

Corporate shares could be capital property or inventory (tendency is to say inherently capital property – *Irrigation Industries*)
- **Non-depreciable capital property –** Hold for investment purposes as source of dividend income
- **Inventory** - Hold for purpose of resale in a biz or adventure/concern in the nature of trade

Irrigational Industries v MNR (1962) SCC: **presumption corporate shares are capital**

Facts	T bought shares in "Brunswick" – purchased 4,000 shares for $10/share. T sold 2,400 of shares for $38,513 and remaining 1,600 for $28,000. T realized profit of $26,897 from purchase and sale of these shares. T had no dealings with securities other than purchase and sale of 4,000 shares of Brunswick. Brunswick held mining claims in NB – exploration indicated some good deposits (speculative). MNR said buying and selling shares was adventure in nature of trade
Issue	Does the profit constitute taxable income or non-taxable capital gain?
Dissent	**Factors to decide inventory**: • Short holding period – sold within 4 months, suggest adventure; • Borrowed funds to finance purchase of shares; • No immediate likelihood dividends since speculative shares, reflect possibility mineral deposits T not in business trading securities, isolated speculative purchase, no intention retaining as investment would later yield income – intention disposing shares near future at increased price
Majority	Nature of subject matter becomes deciding factor • If buy corporate shares there is **presumption of capital property** • Nature of corporate share is investment Quantity of shares purchased doesn't indicate adventure in nature of trade (4,000/500,000)
Holding	T acquired capital interest in new corp biz venture in manner has characteristics of making investment – capital property
Ratio	***Presumption with corporate shares that it is an investment – nature of subject matter***

S. 54.2: Certain Shares Deemed Capital Property

Where any person has disposed of property that consisted of all or substantially all of the assets used in an active business carried on by that person to corp for consideration that included shares of the corp, the ***shares shall be deemed to be capital property*** *of person.*
- **IF**: Dispose all/substantially all (> 90%) assets used in active biz to corp for shares of corp
- **THEN**: Shares received are capital property

When you take an unincorporated biz and incorporate it, the shares are capital property

General Computation

S. 38(a): Taxable portion gain capital property is ½ capital gain; **S. 38(b): Allowable portion loss** capital property ½ capital loss

S. 3(b): Deduct allowable capital losses from taxable capital gains
- Where **taxable capital gain < allowable capital losses → net capital losses** which can be carried back 3 years and carried forward indefinitely – **111(1)(b)**

Allowable Business Investment Loss

If allowable capital loss is allowable business investment loss (ABIL), loss deducted against all kinds income – **3(d)**

- ABIL's are carved out of 3(b) by 3(b)(ii) – more generous treatment

Still only get ½ recognition of ABIL, so still better to argue inventory, but better to argue ABIL then just capital loss

S. 39(1)(c): Business Investment Loss

*Capital loss on disposition of share of **Small Business Corporation** arm's length person or under 50(1)*

S. 50(1): Bad Debts/Share Bankrupt Corp

Allows T to elect to dispose of a debt/share of corp for PoD = nil, and to reacquire debt/shares & cost = nil at end of tax year in which the debt is established by T to have become a bad debt or corp become bankrupt or insolvent

- Didn't dispose share to arm's length person, but if show went bad then deemed to dispose PoD = nil → have ABIL

248(1): Small Business Corporation

A particular corp that is CCPC all or substantially all of FMV of assets of which at that time is attributable to assets that are

***(a)** used principally in an active business carried on primarily in Canada by particular corp or by a corp related to it,*

***(b)** shares/indebtedness of 1+ small business corporations that are at that time **connected** with particular corporation (within meaning of 186(4)), or*

- **See s. 186(4) & (2): Connected** = control or own > 10% shares/value

***(c)** assets described in paragraphs (a) and (b),*

including, for the purpose of **39(1)(c), a corp that was at any time in 12 months preceding that time a small business corporation**

39(9): Deduction Business Investment Loss

Deduct from BIL the **lesser** of: (1) BIL under 39(1)(c) & Lifetime capital gains exemption in past yrs – BILs previously disallowed

Example:

2011: $30K capital gain eligible for LCGE - $15K taxable capital gain and LCGE applies

2012: $70K capital gain – use LCGE to shelter - $35K taxable capital gain that LCGE shelters

- So far $100K of capital gains have been sheltered by the LCGE

2013: $40K Loss on disposition of shares/debt small business corp and want to claim BIL

- 39(9): Deduct from BIL lesser of amount otherwise by BIL (40) & amount sheltered (100)
- Deduction in computing BIL is 40K so no BIL in 2013

2014: $80K BIL

- 39(9): Lesser BIL otherwise determined (80) & sum lifetime capital gains sheltered (100) less amounts deducted previous yrs (40) → lesser 80 & 60 = 60 **→BIL = 80 – 60 = 20**

Boulanger v Canada (2002) TCC: aff'd (2004) FCA: "**substantially all FMV assets used principally active biz**"

Facts	1989 – T's planned to start full range auto-related services at one site. Dompierre (real estate agent) and Potvin (owns car dealership) are involved – incorporated and shares held through management company - Corp acquired 3 lots establish biz – met w engineer & architect (T paid architect directly on corp's behalf) 1990 – Dompierre ran into financial difficulty and sole to other shh his shares in management company - Construction company (Taillefer) bought 13,000 sqft (company retained sqft) - Taillefer financed construction – prepared by different architect - Leases some of building to Potvin's management company for his car dealership - Rented some space to Lada – paid $63K/month – rent guaranteed by the T's Things fall apart – shares end up being sold for a loss – T's transferred for $100 their shares in management company to arm's length person – incurred loss that they want to claim as BIL - Corp's assets were unsold portion of land, balance selling price and rental income
Issue	Was all or substantially all of the FMV of assets of the company used principally in an active biz? Or was this true within 12 months of the time that the shares were disposed of?
Analysis	Problem for T's is that the assets are land, debt, and receivable – none of those are active business assets so hard to say they are being used in an active business – there isn't even an active biz at that time - Corp was inactive
Holding	Corp did not carry on active business and therefore was not a small biz corp -
Ratio	***Test: At the time or within 12 months of the time, were >90% FMV of assets of the company used in an active biz? Biz begins operating wehn the process of making a profit making entity has commenced***
Notes	When company goes under better do this fast since have to have been active within the last 12 months from when you sell the shares to be considered a small business corporation

Lifetime Capital Gains Deduction

Shelters $400K taxable capital gains ($800K capital gains) on disposition Qualified Small Biz Corporation shares

QSBC = Qualified Small Business Corporation

248(1): Small Business Corporation

A particular corp that is CCPC all or substantially all of FMV of assets of which at that time is attributable to assets that are

(a) *used principally in an active business carried on primarily in Canada by particular corp or by a corp related to it,*

(b) *shares/indebtedness of 1+ small business corporations that are at that time* ***connected*** *with particular corporation (within meaning of 186(4)), or*

- **See s. 186(4) & (2): Connected** = control or own > 10% shares/value

(c) *assets described in paragraphs (a) and (b),*

110.6(1): QSBC Share

Elements:

(a) **Asset test** at time of disposition
(b) **Ownership test** for 2 yrs – no one unrelated to T owned the share for 2 yrs before the sale
(c) **Combined Asset & Ownership Test**

Determination time = time when share is disposed of

Asset Test: (a)

at the determination time, is a share of a small business corporation owned by individual, the individual's spouse or CL partner or a P/S related to the individual,

- Has to satisfy test for small business corporation in 248(1) – >90% assets are used principally in active biz
- Could purify the assets ahead of time – get rid of non-qualifying assets by paying big dividend

Ownership Test: (b)

throughout the 24 months immediately preceding the determination time, was not owned by anyone other than the individual or a person or partnership ***related*** *to the individual, and*

- Doesn't have to be owned by the T for 24 months before, but cannot be owned by anyone other than individual/person related

(f) *Deems shares issued to have to have owned by unrelated person,* ***unless*** *shares were*

(i) as consideration for other shares;
(ii) as part of transaction/series which person disposed of property to corp that consisted of (A) >90% assets used in active biz carried on by that person; or
(iii) as payment of a stock dividend

Issuance of new shares do not meet ownership test unless fall into (i)-(iii)

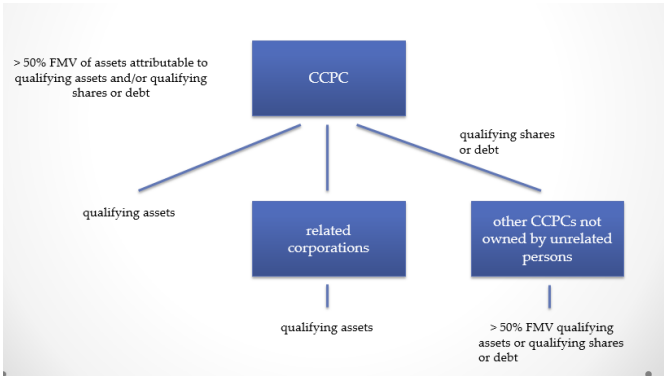
Combined Asset & Ownership Test: (c)

throughout that part of 24 months immediately preceding the determination time while it was owned by individual/person ***related*** *to individual, was share of a CCPC >* ***50% of the FMV of the assets*** *of which was attributable to*
(i) *assets used principally in active business carried on primarily in Canada by the corp or by a corp related to it,*
(ii) *shares or indebtedness of 1+ other corps that were* ***connected*** *(within meaning of 186(4))*
with the corp where

(A) *throughout that part of 24 months immediately preceding determination time that ends at the time the corp acquired such a share or indebtedness, the share or indebtedness was not owned by anyone other than the corp, a person or P/s related to the corp or a person or p/s related to such a person or p/s, and*

(B) *throughout that part of the 24 months immediately preceding the determination time while such a share or indebtedness was owned by the corp, a person or p/s related to the corp or a person or p/s related to such a person or p/s, it was a share or indebtedness of a CCPC > 50% of the FMV of assets was attributable to assets in (iii)*

Imposes additional (but lower) active biz requirement throughout ownership period in addition to active biz requirement at determination time



TAXATION OF SHAREHOLDERS

Skidmore v Canada (1997) TCC aff'd (2000) FCA: "**assets used principally in active biz**" – **cash reserves**

Facts	Burchill Nurseries incorporated to produce Balck Spruce Seedlings – got start-up grant from Ministry. Would grow seedlings in greenhouse from June-Sept and leave them outside over winter – deliver to Ministry for planting Contract with Ministry renewed for 5 yrs and then got contract with another company – payment in 3 installments - Crown – no requirement to pay first two installments if corp fails - If don't satisfy contract, have to repay part of the start-up grant Sell shares to children for $645K (term deposits form part of the assets) – and claim LCGE on the sale of the shares
Issue	At time of disposition (or 24 months before) are all or substantially all of the FMV of assets used in an active biz?
Analysis	Issue is the term deposits – T argues the term deposits are used/employed in active biz – risky biz and if crop fails then may have to pay the grant → court says no - Never had to repay the grant in the past, and the amount had to repay was decreasing each yr
Holding	Deny lifetime capital gains exemption
Ratio	***Must demonstrate risk real & amounts set aside not excessive of amount required permit biz continue operation***
Notes	Should "purify" the company prior to selling the shares – clean out the non-qualifying assets - Set up holding company, pay out dividends to get rid of the reserves

110.6(2.1): Capital Gains Deduction on Disposition QSBC Shares

In computing taxable income for a tax year of an individual who was resident in Canada throughout the year and who disposed of a share of a corp in the yr, at time of disposition, was QSBC share, ***there may be deducted amount not exceeding the least of***

(d) Gains Disposition QSBC Shares: *amount that would be determined in respect of the individual for the year under 3(b) in respect of capital gains and capital losses if the only properties referred to in 3(b) were QSBC shares of the individual.*

- 3(b) is net taxable capital gains – Losses from QSBC shares is ABIL, so 3(b) = gains QSBC shares

***(c) Annual Gains Limit**: the amount, if any, by which the individual's annual gains limit for the year*

- **110.6(1): "Annual Gains Limit" = A – B**
  - **A** = lesser (a) amount 3(b) & (b) amount 3(b) only referred QSBC shares (gain from QSBC shares)
  - **B = (a)** Net capital losses previous yrs – (amount 3(b) – A) + (b) ABIL for yr

Effect: Make all other deductions first before LCGE – deduct allowable capital losses, net loss carryovers and ABIL's

- Limit LCGE by the amount which taxable capital gain from disposition QSBC share exceeds:
  - Net allowable capital losses from disposition other kinds of property that are deducted against taxable capital gains from disposition QSBC share under 3(b)
  - Net capital losses from other years used to shelter taxable capital gains from disposition QSBC Shares
  - Individual's ABILS that are deducted under 3(d)

Example: Gain QSBC share = $40, other taxable capital gains and allowable capital losses = $100, net capital losses other yrs = $80

- A = lesser $100 & 40 = 40
- B(b) : ABIL's get taken out first, if have no ABIL = 0
- B(a): 80 – (100 – 40) = 20
- So the Annual gains limit = 20, the other 20 is being sheltered by net capital losses from other years

(a) Dollar Limit: *the amount determined by the formula in paragraph (2)(a) in respect of the individual for the year,*

- **$400,000K** taxable capital gains over course of lifetime

CORPORATE DISTRIBUTIONS

Paid-Up Capital

PUC = Measure of what the corp can pay out to a shareholder tax-free (attaches to the share)
- Consideration that the corp receives for issuance of a share – capital contributed
- Similar to ACB, except ACB is a measure of what the shh can sell the share to someone else for tax-free (attaches to the shh)

Stated Capital – consideration that the corp receives in return for the issuance of shares
- When consideration received usually added to stated capital, but doesn't have to – could be contributed surplus

Contributed Surplus – Consideration corp receives that isn't added to the PUC, but can be added later w/o tax consequences

Retained Earnings – Company earns income and keeps it – not added to capital account, but can be converted to stated capital later

89(1): "Paid-Up Capital" – Defined in terms of (1) the share; (2) the class; (3) company as a whole
(a) share of any class = PUC of class / # shares of class
(b) class shares – computed w/o reference to ITA (so get it from corporate law) → stated capital becomes basis of PUC
(c) shares of company as a whole = sum of PUC of all classes of shares

Corp can pay dividends by paying:
1. **Cash**
2. **Kind** – pay assets of corp or pays in form of shares of another corp
   - "**Amount**" = FMV of the property/shares in other corp – **248(1)**
3. **Stock** – Pays dividends in form of its own shares -Capitalization of retained earnings through issuance of new shares
   - **248(1):** "**Amount**" = **Amount which PUC increased** by payment of the dividend is taxed as a dividend under **82(1)(a)/(a.1)**
   - Pretend corp paid dividend to shh and then the shh uses the dividend to buy shares – PUC increases – added dividend
   - **52(3)** – **cost of stock dividend** = amount of the stock dividend

Stock Split vs. Stock Dividend
Stock Split – Shareholder has one share and corp splits it into 2 – nothing has been capitalized – doesn't change PUC of the class
Stock Dividend – Moving retained earnings to capital account – is becomes taxable event

Deemed Dividend Rules - 84

Increase in PUC – 84(1)

IF: PUC of class increases
- & increase was not due to:
  - (a) payment stock dividend, (already taxed as a dividend by virtue of def of "amount")
  - (b) transaction where increase value of assets or decrease corp liabilities or
  - (c) shift in PUC from one class to another

THEN Corp deemed pay dividend to shh of that class & shh of class deemed to receive a dividend
- Amount deemed dividend = increase of PUC not due to payment stock dividend or increase value assets/decrease liabilities

53(1)(b): ACB of the share - Add the amount of the deemed dividend to the ACB of the share

TAXATION OF SHAREHOLDERS

Nadeau v Canada (1999) TCC:

Facts	T & son have shares in L&C that owned sub – furniture sales – L&C is a small business corp - T - 61 shares: FMV = $467,687, ACB = $6,100, PUC = $6,100 - Son - 59 shares: FMV = $452,353, ACB = $5,900, PUC = $5,900 T wants to retire – so son incorporates # company and acquires some B shares in L&C – convert shares into common A – ACB gets bump (son ACB = 400K; T ACB = $467,687) - Both claim LCGE Exchange shares so T has 6100 C and son has 5900 D – done so T can redeem C and get money out over time Son's company borrows $460K and contributes it to L7 C in exchange for 1 C shares and redeems it for $460K - Son: 6100 C shares with PUC = 6100; # company = 1 C shares PUC = 460K (PUC of C class = $466,100) T redeems shares and pays very little tax and then redeem the 1 share for $460K → massive deemed dividend to # company but inter-corporate dividend deductible and Part IV tax doesn't apply
Issue	Was this an ineffective transaction (ie. No real contribution of $260K)? would GAAR apply?
Analysis	**Ineffective Transaction**: - Money never actually left the bank – didn't actually contribute the $460K - Not clear what court decided here – says genuine but devoid of meaning **GAAR**: - **Tax Benefit** – T gets money out of company w/o paying deemed dividend, redemption of shares w little inclusion - **Tax Motivated** – Contribute $260K for 1 C share and then redeemed – was part of a series - **Abuse/Misuse** – Shareholder cannot withdraw surpluses accumulated in company above PUC other than by means of a dividend – abuse having regard to provisions of the Act
Holding	GAAR applies
Ratio	***Where artificially increase PUC so that withdraw surpluses above what PUC should have been, GAAR will apply***
Notes	T could have sold her shares to son for FMV –son could have just given her a promissory note **Duff – Abuse/Misuse:** Abuse 84(1) – bumping PUC in way contrary to object & spirit – didn't really increase assets of the company - Scheme Act is deem dividends which says when you take income out of company should be taxable

Distribution Winding-Up, Discontinuance, Reorganization – 84(2)

Distribution > PUC Reduction

IF: Funds/property distributed or otherwise appropriated in any manner whatever to or for the benefit of shh of any class, on the winding-up, discontinuance, or reorg of its biz

- Although says "on" winding up, a distribution prior to winding-up where corp knew going to wind-up satisfied (*David*)

THEN: Corp deemed paid a dividend on shares equal = amount paid – decrease in PUC

- Amount/value of funds distributed **Exceeds** Amount by which PUC reduced on distribution/appropriation

***Smythe v MNR (1969) SCC*: Leading case (classic surplus stripping)**

Facts	Oldco – 4 shhs: Conn – 52%, Stafford – 30.8%, Clarence – 16%, Boyd – 1.2% - Assets + $728,652 undistributed income on hand – if they distributed it then it would be taxable **Transactions:** - 1. Newco incorporated & get loan from TD for $216,769 - 3. Accommodators get loan from BMO - 4. Accommodators pay $2.5M to shhs for OldCo shares - 5. Shhs have $2.5M – contribute chunk ($2.3M) to Newco in exchange for shares in Newco - 6. Newco take $2.3M and loan from TD and buy assets from Oldco - 7. Money goes to the accommodator companies - $2.6M and they repay the loan to BMO Minister relies on 84(2)
Issue	(1) Was there a winding-up, reorg or discontinuance of the biz? (2) If yes, have funds/property of the company been distributed or appropriated in any manner whatever to or for the benefit of it's shareholders?
Analysis	**Winding-up, reorg, or discontinuance of the biz**? YES - Oldco sold all of its assets to Newco – discontinuance of the business b/c Oldco no longer carrying on the biz **Funds/property Oldco distributed/appropriate in any manner whatever to or for the benefit of the shhs?** - T argue got money accommodator companies (that got money from BMO) and not from Oldco - Minister says funds of Oldco were distributed in any manner w.e. for shh benefit - Shareholders of old company were shareholders of new company – therefore they received a benefit
Holding	84(2) applies

TAXATION OF SHAREHOLDERS

Kennedy v MNR (1972) FCA: **"Reorganization"**
Facts: K was shh in a ford dealership. Dealership purchased building and renovated it – sold to K for less than FMV. K rented it back to Ford for a rental fee. Minister said that the sale for < FMV was a shh benefit – not eligible tax credit. T argued benefit should have been a deemed dividend under 84(2) and therefore eligible for credit – said property of corp appropriate for his benefit on reorg.
Holding: Rejected T's argument

- "Reorganization" is used in association with "winding-up" and "discontinuance" – therefore presupposes conclusion of the conduct of the biz in one form and its continuance in a different form

Selling assets does not constitute reorganization of the biz

Perrault v Canada (1978) FCA:
Facts: T's corp was in process slowly winding down. T agreed to buy shares from someone – company redeemed a bunch of shares.
Holding: 84(2) does not apply - although intention was to wind-up biz in near future, it continued to carry on biz

Redemption of Shares – 84(3)
Amount Paid on Redemption > PUC

IF: Corp redeems, acquires, or cancels in any manner whatever (otherwise than by 84(2)) any shares of any class

- Does not apply where corp purchases its own shares on the open market – then just a regular disposition – **84(6)**

THEN: Corp deemed to have paid dividend on shares = Amount paid by corp - PUC those shares

- Shares redeemed are treated as a separate class that the corp pays a dividend on

84(6): (2) & (3) do not apply
(a) *in respect of any transaction or event, to the extent that 84(1) is applicable in respect of that transaction or event; and*

- Ordering, first do (1), then (2), then (3)

(b) in respect of any purchase by a corp of any of its shares in the open market, if the corp acquired those shares in manner in which shares would normally be purchased by any member of public in the open market.

- **Open market** = free participation by public, absence restrictions on prices and effect supply and demand on prices (*Merette*)

54(j): "Proceeds of Disposition" - Exclude amounts deemed dividends under 84(2) and (3) from PoD

Katz v Canada (1999) TCC:

Facts	T shh of SSCC – owned 16,557 shares (ACB = $75,978, PUC = $6,826). Sold shares consideration = $91,641 - FMV Shares acquired by SCC and distributed to other shh's - T said he thought he was selling shares directly to other shh and sale would result capital gain = $15,641 - Since he sold it to the company, reassessed on basis of **deemed dividend of $84,815** (diff b/w PUC & FMV) Amount of deemed dividend taken off PoD, so PoD = $91,641 - $84,815 = $6,826, so he has a capital loss = $69,152 - Bad for T – loss only partially recognized and only deductible against capital gains
Issue	Is the sale of A's shares in SSCC a dividend or a capital gain?
Holding	T sold his shares to SSCC – 84(3) deems a dividend when SSCC purchased T's shares
Ratio	***Very important whether selling back to company or selling shareholders – difference b/w ½ taxed capital gain and fully taxable deemed dividend***

Reduction of PUC – 84(4)
Amount Paid > Reduction in PUC

IF: Corp reduced PUC otherwise than by way of (2), (3), or (4.1)

- Corp gives shareholders tax-free money but pay out more than the reduction in PUC

THEN: Corp deemed to pay dividend = Amount paid – Decrease in PUC; Shareholder deemed receive dividend

Reduction PUC of Public Corporation – 84(4.1)

IF: Public corp pays amount and reduces PUC, otherwise than by way of (2) or (3)

THEN: Amount paid by corp deemed to be dividend
Unless:
(a) Amount reasonably considered derived PoD realized by public corp (i) outside ordinary course of biz of the corp and (ii) within period that commenced 24 months before payment; and

- Ex. Sold something big, but have to pay it out within 2 yrs

(b) no amount reasonably considered derived from proceeds paid by the public corp on a previous reduction of PUC in respect of class

ACB

53(1)(b): ACB of the share - Add the amount of the deemed dividend to the ACB of the share

53(2)(a)(ii): Reduce ACB

- Reduce ACB by amount received by T on reduction of PUC, except to extent amount deemed by 84(4) or (4.1) to be a dividend received by the T

Example: T contributes $100 to corp and gets 1 share (PUC = ACB = 100)
Corporation earns $200 and pays $30 tax → $170

- FMV share = $100 + $170 = $270

Corp converted retaining earning to stated capital - increase stated capital account by $170

- **84(1):** Deemed dividend of $170
  - If didn't change ACB, and T sold to Y then ACB would still be $100 and T would pay tax on $170 – not right since already paid tax on that amount
- **53(1)(b):** Increase ACB of T's share so that the ACB & PUC = 270

Corp distributes $150 to X (pretend more than 1 class of shares)

- **84(2)**: Distributes $150 on discontinuance or winding-up – PUC reduced was $270 and then $150 paid out
  - Could also be 84(4) – reduction in PUC from $270 to $120
  - To extent amount paid does not exceed reduction in PUC, no deemed dividend – so X just gets $150
- FMV = $120 (270 – 150)

X sells to Y for $120

- If ACB not adjusted then ACB = 260 and so would have capita loss of 150 (not right)
- **53(2)(a)(ii)** – adjust ACB = 270 – 150 = 120 → no tax consequence when share is sold

Company earns another $100 (pays $15 tax) – has $85, FMV of share = $205 → T redeems share in exchange for $205

- PUC was $120, and ACB = $120
- **84(3):** Deemed dividend = $205 - $120 = $85 (So deemed dividend is not included in PoD)

NAL Disposition Shares – 84.1

Transaction 84.1 is aimed at:

1. SC (with surplus) – T (individual) owns shares in SC that have low PUC and high FMV
2. PC set up - PC is NAL with T
3. T sells SC shares to the PC for shares in PC or non-share consideration (usually promissory note)
   - T might realize gain on the sale of the shares to PC – as long as SC shares are QSBC then can shelter with LCGE
   - Under corporate law, shares of PC can be issued for PUC = FMV SC shares → so now SC shares have high PUC
4. SC pays dividend to PC or deemed dividend by redeeming PC's shares
   - Dividend is deductible as an inter-corporate dividend under 112(1)
5. Surplus has been moved from SC to PC
   - If have promissory note b/w T and PC, then PC just pays the promissory note (non-taxable event)
   - If T has shares in PC that are high PUC, then just do return of capital – non-taxable event b/c high PUC shares

84.1 does 4 things:

1. **Reduces PUC of PC shares** – prevents the bump in PUC of the PC shares
   - Grind it down to the PUC of the subject shares
2. If get non-share consideration (boot) form PC, **deem dividend** to the extent the boot received from PC > PUC SC shares
3. If get share consideration and boot – Grind down PUC and then extent amount that boot > leftover PUC
4. If ACB > PUC – get **relief "bump"** – deemed dividend is based on the greater of PUC and ACB of the SC shares

GETTING INTO 84.1

84.1(1): Applies when NAL sale of shares

*Where a **T** (other than a corp) disposes of shares ("subject shares") of any class a corp resident in Canada ("subject corporation") to another corp ("purchaser corporation") with which the T **does not deal at arm's length** and, immediately after disposition, the subject corporation would be **connected** (within the meaning assigned by 186(4) if the references to "payer corporation" and to "particular corporation" were read as "subject corporation" and "purchaser corporation) with purchaser corporation,*

Important Elements:

- T has to be an **individual** – cannot be a corporation
- T & PC **non-arm's length**
- SC and PC **connected** immediately after the disposition of shares
  - Have to be connected so that the Part IV tax doesn't apply
- SC shares are also **QSBC** b/c T claims the LCGE

Non-Arm's Length

251(1): "**Arm's Length**" – related persons deemed not to deal at arm's length, in any other case a question of fact

Factual NAL: court finds 3 categories (*Cote-Letourneau*)

- 1. **Common mind** directs activities of both sides of the transaction;
- 2. There are 2 separate minds but they are **acting in concert**;
  - The buyer and seller do not act in concert simply b/c the agreement which they seek to achieve can be expected to benefit both (*McNichol*)
- 3. **De facto control**

251(2)(b): "Related Persons" *Corp AND*

(i) person who controls the corp, if it is controlled by one person (de jure control)*;*

(ii) person who is member of related group that controls corp, or

- Related Group – group of persons each member of which is related to every other member of the group

84.1(2)(b): T Deemed NAL w PC if T:

***(i)** was, immediately before disposition, **one of a group of <6 that controlled the SC**, and*

***(ii)** was, immediately after disposition, **one of group of <6 that controlled PC**, each memb of which was a memb of the group in (i)*

- Group of less than 6 that T is part of controls the SC before and the PC after disposition

84.1.(2.2): For (2)(b)

***(a)** Determining whether T part of **group <6** who controls a corp, any share owned by*

***(i)** the T's child, who is <18 years of age, or T's spouse or CL partner,*

***(ii)** a trust of which the T, a person described in (i) or a corp described in (iii), is a beneficiary, or*

***(iii)** a corp controlled by the T, by a person described in (i) or (ii) or by any combination of those persons or trusts*

are deemed to be owned at that time by the T and not by the person who actually owned the shares at that time;

- Look through corps, trusts & shares owned by wife/child – for purposes of determining whether T is part of group who controls, T owns those shares

***(b)** a **group of persons** in respect of a corp means any +2 persons each of whom owns shares of the corp;*

***(c)** a corp that is controlled by 1+ members of a particular group of persons in respect of that corp is considered controlled by that group of persons;*

- (b) + (c) – overrides *Silicon Graphics* – can say group controls even if just 1 memb controls – tack on ppl not acting concert

(d) Multiple groups of people can control

PC & SC Connected

186(4): "Connected" - A SC will be connected with a PC immediately after a disposition of shares to PC where

(a) SC is **controlled** by the PC at that time; or

(b) the PC owned, at that time,

(i) > 10% of issued share capital (having full voting rights under all circumstances) of the SC, and

(ii) shares of the SC having a **FMV > 10%** of FMV of all of issued shares of the SC

186(2): "Control" - *One corp is controlled by another corp if > 50% of its issued share capital (having full voting rights) belongs to the other corp, to persons with whom the other corp NAL, or to the other corp and persons with whom the other corp NAL*

TAXATION OF SHAREHOLDERS

Emory v Canada (2010) TCC: **NAL**
Facts: T owned 20/75 issued shares of Sona, remaining shares owned by Chen. T sold shares for $400K to Ontario Inc, which T owned 5/100 issued shares and Chen owned remainder.
Holding: T NAL Ontario Inc b/c deeming rule 84.1(2)(b) & 84.1(2.2)

- T 's control Ontario Inc b/c only owns 5% shares
- T is member of group fewer than 6 that controls both corps – says T is part of the group

Olsen (2000) TCC; rev'd (2002) FCA: **Connected**
Facts: T had fishing company and kids had companies that were engaged in biz. For 84.1 to apply, immediately after disposition of shares, SC must be connected w PC. SC = T's company –
Issue: Is T's company connected with the kids companies?
Holding: ***186(4) incorporates the concept of control in 186(2)***

- Minister relies 186(2) – corp controlled by another corp if > 50% of issued share capital belongs to other corp (not case here) or to person whom other person deals NAL

Confirmed by **186(7):** Says that "connected" in 186(4) takes into account 186(2)

EFFECT OF 84.1

PUC Grind – 84.1(1)(a) **A - B**	**Deemed Dividend – 84.1(1)(b)** **(A + D) – (E + F)**
A = PUC PC shares = FMV SC shares B = amount, if any by which greater of: PUC SC shares & ACB SC shares > FMV boot	**A** = PUC PC shares = FMV SC shares **D** = FMV boot received by T from PC **E** = Greater of: PUC SC shares & ACB SC shares **F** = PUC Grind in (a) **Deemed Dividend = FMV boot – PUC SC** **Take the amount of the deemed dividend out of the proceeds – definition of proceeds**

84.1(1)(a): Reduction in PUC of PC shares

where shares ("PC shares") of the PC have been issued as consideration for the SC shares, in computing the PUC, in respect of any PC shares, there shall be ***deducted an amount*** *determined by the formula*

(A - B) × C/A

where
***A** = increase, if any, determined w/o reference to this section, in PUC in respect of **all shares** PC as a result of the issue of PC shares,*
***B** = is the amount, if any, by which the greater of*
***(i)** PUC, immediately before the disposition, in respect of the SC shares, &*
***(ii)** subject to 84.1(2)(a) and 84.1(2)(a.1), the ACB to the T, immediately before the disposition, of the SC shares,*
*exceeds **FMV**, immediately after disposition, of consideration (other than the PC shares) received by T from PC for SC shares, and*
C = increase, if any, determined w/o reference to this section as it applies to acquisition of SC shares, in PUC in respect of **particular class of shares** as a result of issue of PC shares; and

- Where only one class of shares then A = C

84.1(1)(b): Deemed Dividend

A dividend shall be deemed to be paid to the T by the PC and received by T from the PC at the time of disposition = to

(A + D) - (E + F)

where
***A** = increase, if any, determined w/o reference to this section, in PUC in respect of all shares of PC as result of issue of the PC shares,*
***D** = is FMV, immediately after disposition, of any consideration (other than PC shares) received by T from the PC for the SC shares,*
***E** = is the greater of*
***(i)** the PUC, immediately before the disposition, in respect of the SC shares, and*
***(ii)** subject to 84.1(2)(a) and 84.1(2)(a.1), the ACB to the T, immediately before disposition, of the SC shares, and*
***F** = is total of all amounts each of which is an amount required to be deducted by PC under 84.1(1)(a) in computing the PUC in respect of any class of shares by virtue of the acquisition of the SC shares.*
Deemed dividend = FMV non-share consideration received by T – PUC SC

Example 1: **T only receives shares from PC** (ignore ACB in B(ii) & E(ii))

- SC shares: PUC = 100, FMV = 1000

T sells SC shares to PC in exchange for PC shares – PC shares have PUC = FMV SC shares = 1000
(a) PUC Grind = PUC PC shares – PUC SC shares = 1000 – 100 = 900

- PUC PC shares = 1000 – 9000 = 100

(b) No deemed dividend b/c T receives no non-share consideration

Example 2: T only receives non-share consideration from PC (ignore ACB in B(ii) & E(ii))
T transfers shares with PUC = 100, FMV = 1000 to PC in exchange for boot with FMV = 1000
(a) Doesn't apply – no new shares issued
(b) T receives dividend = 1000 – 100 = 900

Example 3: T receives Share & boot (ignore ACB in B(ii) & E(ii))
T transfer SC shares (PUC = 100, FMV = 1000) to PC, and gets shares in PC w PUC = FMV = 500 & boot with FMV = 500
(a) **PUC Grind** = PUC of PC shares – amount, if any by which (PUC SC shares – FMV boot) = 500 (just the increase in PUC of the PC shares since PUC SC shares is < FMV boot)
- PUC PC shares = 500 – 500 = 0

(b) **Deemed Dividend** = (500 + 500) – (100 + 500) = 400

Example 4: T receives Share and boot (ignore ACB in B(ii) & E(ii))
T transfers SC shares (PUC = 100, FMV = 1000) to PC for shares w PUC = FMV = $925 and boot = $75
- (a) PUC Grind = 925 – (100 – 75) = 900
  - PUC PC shares = 925 – 900 = 25
- (b) Deemed dividend = (925 + 75) – (100 + 900) = 0 → no deemed dividend
  - 100 PUC of SC shares provide $75 tax-free return of capital for the boot

BUT have to adjust the ACB
- In B(ii) and E(ii) it says to use the greater of PUC of SC shares and the ACB

84.1(2)(a.1): ACB Grind
Decrease ACB by amount of capital gain sheltered by LCGE of T or NAL of T
- Reduce ACB SC shares immediately before disposition by the total of all capital gains realized on the SC shares (or shares substituted) to the extent the LCGE was claimed in respect of the gains

Cote-Letourneau v Canada (2007) TCC:

Facts	T and wife own 1,000 B shares (PUC = 1000, ACB = FMV = 1M) in company (Centre). - If SC owns PC then they are related – so there is trust in b/w – trust owns shares in the PC (9061) Trustees are the T, his wife, and Bertrand – everything in the trust has to be decided unanimously T & wife sell shares in Centre to 9061 in exchange for promissory note, Centre redeems shares, and trust repays note
Issue	Does T deal NAL with 9061? If yes, then the promissory note is a deemed dividend?
Analysis	**De jure control** – T do not control PC de jure – decisions have to be made unanimously so can't say T controls **De facto control** – T de facto controls 9061 – de facto control relevant for determining factual NAL - Wall was just nominally there – Wall would never vote against clients wishes – passive role **Relies on NAL test**
Holding	T and 9061 are NAL

Hickman (2000) TCC:
Facts: M, her husband & non-related person controlling fam trust. M sells bunch of shares to PC for 1 preferred share and chunk of $.
Issue: Is PC dealing NAL w M?
Holding: Trust wasn't set up to be unanimous – Mr. and Mrs. H controlled decision of trust and therefore related group who were in position to control PC

Lauzier (1996) TCC:
Facts: Low PUC and Low ACB – T's accountant has company off the shelf. SC loans money to accountant's company in exchange promissory note and company pays T for shares outright.
Issue: Is T and company NAL?
Holding: Acting in concert – factually NAL

Brouillette v Canada (2005) TCC:
Facts: SC (BAI) owned by Alain & Roland (50/50). Richard and Pierre gradually going to take over biz- want Alain out. 9017 owned by Richard and Pierre (50/50). 9016 controlled 51% Alain & 49% 9017. BAI loans $ to 9016 and 9016 buys BAI shares from Roland. Alain exchanges shares of BAI for shares of 9016. 9016 NAL w Alain b/c he controls. Sells shares to 9017 and paid $400K over 5 yrs.
Holding: Chagnon & Brunet facilitating this but not different then someone outright buying the shares and that is what LCGE is for
- Arm's length transaction – future income being used to buy shares from Alain

TAXATION OF SHAREHOLDERS

Descarries (2014) TCC:
Facts: D & 5 others have shares in Oka (PUC = $25,100, FMV = $617,466, ACB = $361,658, arm's length adjusted ACB = $92,040). Exchange shares with Oka for other shares (PUC = $25,100, FMV = $617,466, ACB = $617,466, Arm's length adjusted ACB = $347,848). Sell SC shares to 9149 and get 9149: A shares w PUC = ACB = FMV = $347,848 and B shares w PUC = 0, ACB = FMV = $269,619. Oka loans 9149 money and then 9149 redeems the A shares and B shares.
Duff: Good planning – tax consequences when realize capital gain and got rid of 2x tax that would otherwise occur
- Subject to GAAR

Surplus Stripping + GAAR

"**Surplus Stripping**" – conversion of otherwise taxable dividends into capital gains

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 avoidance transaction, 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(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
- *Copthorne* – have analyze tax benefit in the context of GAAR – what would you have done but for existence tax advantages?
- Onus is on the T to show that there was no benefit (*Copthorne*)

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** 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 series 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.*
- 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
  - Can miuse provision by using it in way not intended or by getting around provision in way not intended (*Copthorne*)
- **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

Abusive tax avoidance: (*Canada Trustco*)
- 1. Transaction achieves outcome the statutory provision was intended to prevent;
- 2. Transaction defeats the underlying rationale of the provision; or
- 3. The transaction circumvents the provision in a manner that frustrates or defeats its object, spirit or purpose

TAXATION OF SHAREHOLDERS

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

McNichol v Canada (1997) TCC: First case GAAR that went to the TCC – shopping around to find accomodator

Facts	T's members law firm in NB – incorporated Bec that constructed and owned office building where firm had its practice - Each T had 125 shares – PUC = ACB = $1 → PUC all shares = $125. Much higher FMV T moved offices – agreed someone would buy building that was in Bec for $600K Paid out a big capital dividend tax free – corp gets dividend refund (had RDTOH account) Company left with $318K and RDTOH Sells to Forestell for $300 – first sells shares to company controlled by F (Beformac), F borrowed $ from bank to buy it, then Bec pays inter-corproated dividend or Bec and Beformac amalgamate.
Issue	Does 84(2), 84.1, or GAAR apply?
84(2)	**(1) Distribution/appropriation on winding-up, discontinuance or reorg of the biz?** - Yes – sold building and the business was holding the building – no Bec anymore **(2) Distribution/appropriate to or for the benefit of the shhs in any manner whatever of funds/property?** - Money from bank that went to T's – money comes out of Bec goes to Beformac and Beformac pays bank - Funds were not distributed **to** the shareholders - Court interprets "for the benefit" in much narrower concept - "in any manner whatever" – financing the loan **84(2) does not apply** – no funds or property of corp distributed – it was bank loan given to the shh's - Is this consistent with *Smythe* where found 84(2) did apply? Court distinguishes by saying Smythe decided on legal substance and that was different than here (comfortable saying no here to 84(2) b/c knows GAAR will catch it)
84.1	**Does Beformac deal NAL with the shareholders? NO** - Buyer & seller do not act in concert simply b/c agreement they seek to achieve can be expected to benefit both - They have divergent interests – there was bargaining happening here
GAAR	**Tax Benefit**: - T says no tax benefit b/c could have left $ in company and not paid anything – this was the benchmark transaction to base the benefit off of – if this reasoning then GAAR would never apply - Doing nothing isn't the benchmark transaction – benchmark is just collapsing company and get $ out **Sale of the shares primarily tax motivated:** - This is an ordinary series – the thing that results in the benefit is the sale of the shares - T says not tax motivated – on its own wasn't motivated – just wanted to sell - Tax motivated in light of what else is going on – GAAR requires look at each transaction **Misuse/Abuse**: - T circumvented 84(2) & 84.1 - **scheme of Act is to treat distributions to shh of corporate property as income** - This is **surplus stripping** – abusive b/c had former anti-avoidance rule that was appealed when GAAR
Holding	GAAR applies

RMM (2001) TCC: International

Facts	US company (Intel) had shares to CA companies – leasing winding down- hadn't written new leases for 2 years, sole activity was collecting rent and winding down leases – assets: $3M cash, Dividend refund = $1.5M, residual leases. - Didn't want CA corps to pay dividend (b/c subject dividend withholding tax). Counsel Intel approached friend – friend + 2 others formed RMM CA – purchased shares in CA companies from Intel for amount similar to value of cash and dividend refund – resulted capital gain which Intel was exempt under tax treaty
Issue	Does 84(2) or GAAR apply to re-characterize gains as dividends?
84(2)	There was winding-up biz and "in any manner whatever" imports wide variety ways which funds end up shh's hands - Impossible to say funds that end up with US company did not originate from CA sub - Looks at realistic view - *McNichol* they said it wasn't the same funds – here they say it is → no way to reconcile
GAAR	Agrees with McNichol – **says scheme of the Act is to distribute corporate surplus to shareholders to be taxed as payment of dividends** – read ITA as a whole
Holding	GAAR and 84(2) apply
Ratio	***Form of transaction otherwise devoid any commercial objective, and that has as its real purpose and extraction of corp surplus and avoidance of ordinary consequences of such a distribution, is an abuse of act as a whole***

TAXATION OF SHAREHOLDERS

Geransky (2001) TCC:

Facts	T & his bro owned 50 common voting shares of holding company (GH) which owned all the shares of operating company (GBC) – construction and cement manufacturing. Transactions carried out to sell cement manufacturing assets to arm's length purchaser (Lafarge): - 1. T & Bro sold 40 shares of GH to 606103 for $500K (FMV) and got 100 shares of 606103 - 2. GBC distributed $1M of cement manufacturing assets to GH as dividend in kind - 3. GH redeemed 80 common shares held by 606103 in exchange for cement manufacturing assets from GBC - 4. T & Bro sold shares of 606103 to Lafarge - 5. GBC sold its land and maintenance shop to Lafarge for $200K T & bro reported gain on sale of shares of GH to 606103 – claimed LCGE
Issue	Does 84(2) or GAAR apply?
84(2)	**Distribution/appropriation on winding-up, discontinuance or reorg of the biz?** - No – treated the construction and cement manufacturing as one biz and said construction continues - Duff: Thinks you could call this 2 biz's **Distribution/appropriate to or for the benefit of the shhs in any manner whatever of funds/property?** - Assets have been distributed but ultimate thing that T gets is cash b/c arm's length sale of Lafarge - Turns on fact some assets come out of GBC
GAAR	**Tax Benefit**: Claiming LCGE is tax benefit - Could have done this by GBC selling assets outright to Lafarge - If they had 2 companies – 1 for construction and 1 for cement, could have sold cement and claimed LCGE **Sale of the shares primarily tax motivated:** No - Entire purpose was not tax avoidance – non-tax purpose was selling assets to Lafarge - **Duff**: Mistake in judgment – supposed to look at each transaction, but Bowman bundles them all – steps clearly being done to get LCGE on sale of the shares **Misuse/Abuse**: - Different than RMM and McNichol - Using provisions ITA in course commercial transaction, and applying them in accordance terms is not misuse/abuse
Holding	84(2) and GAAR doesn't apply

Canada Tructco (2005) SCC: Can't just waive hands and say surplus stripping so GAAR applies → root abuse specific provisions

Evans (2005) TCC: Post-Copthorne

Facts	T was sole shh of professional corp that derived incme from dental practice. Corp issued T a stock dividend of 487 non-voting Class B shares. T sold shares to limited P/S in which wife held 1% interest as general partner and 3 kids held 33% interest each in exchange note = $487K – interest at prescribed rate of 5%. Over next 3 yrs, corp paid dividends on and redeemed the shares – resulting in income to the P/S which was included in P's incomes. T's reported capital gain from sale of shares to limited p/s and claimed LCGE
Analysis	**Primary purpose** was to put the funds in T's hand – not to obtain a tax benefit - Duff: If look at individual steps, if just wanted to get money out then professional corp would just pay dividend to Evans – done to reduce tax **Abuse/Misuse** – is 84.1 being abused? No – Capital gains deduction was not abuse/misused – it was just used - SCC in *Copthorne* said can't waive hands around and tax dividends as income b/c surplus stripping
Holding	GAAR did not apply

Desmarais v Canada (2006) TCC:

Facts	T owns 14.3% of shares of corp, Comsercom – owned and operated senior homes, also own 50% shares in Gestion which held substantial share of p/s that carried on insurance brokerage. - Com shares had PUC = $60 and FMV = $180K, Gestion shares had PUC = $1K, FMV = $935K **Transactions**: 1. T incorporated 6311 – acquired 100 shares for $100 2. T transferred **9.76%** shares of Com to 6311 w PUC = FMV = $1/share – realized capital gain = $123K 3. T transferred all shares in Gestion to 6311 on rollover in exchange for shares with PUC = 1K 4. After receiving dividends from Gestion, 6311 redeemed shares for $123 from T – treated as tax-free return of capital
Analysis	**Tax Benefit**: Tax-free surplus distribution from Gestion - Eventually Com makes $ and pays dividend, have used up PUC so eventually subject to tax - Tax deferral is still a benefit **Sale of the shares primarily tax motivated:** Yes - Transfer of the 41 shares which is just less than 10% avoids 84.1 **Misuse/Abuse**: Yes Circumvented 84.1 together getting income from another source which means don't have pay Part IV tax – abuse
Holding	GAAR applies

TAXATION OF SHAREHOLDERS

McMullen (2007) TCC:

Facts	T & DeBruyn carried on heating and air conditioning biz through DMEL in 2 places. T acquired 50% shares for $100K. FMV increased $150K, biz operating at loss and corp owed $. T told DeBruyn he wanted server relationship. **Transactions**: (1) T and wife incorporated HHCI – acquired 50% of the shares, (2) Mrs. DeBruyn incorporated 114 – she was sole shareholder (3) DMEL was changed to DEL (4) Mr. D converted his A shares in DEL to B shares (5) T sold his class A of DEL to 114 for $150K (6) DEL declared dividend of $150K on Class A shares which held solely by 114 – got a midnight loan; (7) 114 paid amount of dividend to T; (8) DEL repaid loan T reported PoD from sale of A shares to 114 - $150K
84(2)	Winding-up, discontinuance or reorg of DMEL? Depends if think 1 biz in 2 locations or 2 separate biz's - **Duff: could say reorg** Reasonable conclude funds of property distributed to or for benefit of T? - B/c bank loan (like McNichol) hard to say funds or property distributed
84.1	Turns on whether 114 NAL with T – this is a bit of accommodating going on as part of splitting up - This is like *Geransky* – they are going separate way so arm's length
GAAR	Hard to say abuse where arm's length
Holding	84(2) doesn't apply, 84.1 doesn't apply, GAAR doesn't apply

Collins & Aikman Products (2009) TCC aff'd FCA:

Facts	T (Products) indirectly controlled 2 CA auto parts manufacturing companies worth $167M through non-resident holding (CAHL) – PUC was $475K – corp reorganization 1. New CA corp incorporated – Holdings 2. Products transferred its CAHL shares to Holdings in exchange for one common share of Holdings w FMV = $167M – added to stated capital 3. CAHL continued into Canada and amalgamated w its two subs
Analysis	**84(4)** – Distributions in excess PUC computed in accordance specific provisions deemed dividends and taxed as such - Purpose – tax distributions by corps to shareholders as income to extent those distributions are in excess of PUC - 84(4) taxes distributions, other than dividends, paid by particular corp to its shh to the extent the distribution exceeds the amount of capital invested in that crop by that corp's shh
Holding	No abuse – GAAR doesn't apply
Ratio	***Cannot use GAAP to fill in legislation – inappropriate use of the GAAR***

MacDonald (2013) FCA:

Facts	T was doc who practiced in NB through professional corp called PC. 2002 moved to US – PUC PC shares = $101. T and brother-in-law (JS): (1) JS incorporated 601 (2) T sold shares in PC to JS in exchange note for $525,068 (3) JS transferred PC shares to 601 in exchange note for $525,069 (4) PC declared dividends $525K to 601 used amounts discharge its debt to JS, who used proceeds discharge debt to T (5) PC paid additional $10K to 601 (6) PC dissolved Note: 84.1 doesn't apply b/c T sold shares in PC directly to JS – individual and not a corp T reported $525,068 as PoD of his shares of PC – sheltered by LCGE
84(2)	Winding-up, discontinuance, or reorganization of professional corp? yes Funds/property of PC distributed or appropriated in any manner whatever for MacDonald's benefit? - If we follow the money it goes PC → 601 → JS → MacDonald
Holding	84(2) applies
GAAR	Tax **Benefit** – yes – low threshold – capital gain rather than dividend **Abuse**? If 84(2) didn't apply b/c bank loan then can say abused b/c of bank loan – sort of like McNichol - McNichol & RMM are pre-Canadian Trustco – can't rely on surplus stripping is bad
Notes	JS or 601 should have borrowed money to bank to pay MacDonald and use dividend from PC to pay off bank – then would have been more similar to McNichol (but RMM would have said 84(2) would still apply) 84.1 was circumvented by selling directly to JS, rather than company and having brother put shares in company – if sold shares directly to company, it is all non-share consideration so would have been same thing

SHAREHOLDER BENEFITS

15(1): Shareholder Benefits

If, at any time, a benefit is conferred by a corp on a shh, or on a contemplated shh of the corp, then amount or value of benefit is to be included in computing income of shh, or contemplated shh, as case may be, for its tax year that includes the time,

Four Requirements: (1) **Characterized** as benefit // (2) **Conferral** of benefit by corporation // (3) Whether benefit conferred **on shh** in shh's capacity as shh (and not some other capacity) // (4) Amount or **value** of benefit

EXCEPT *to the extent amount or value of benefit is deemed by 84 to be a dividend* ***or*** *that the benefit is conferred on the shh*
(a) where the corp is resident in Canada at the time,
(i) by the reduction of the PUC of the corp,
(ii) by redemption, acquisition or cancellation by the corp of shares,
(iii) on winding-up, discontinuance or reorganization of the corporation's business, or
To extent it is a return of capital and not taxable as deemed dividend – shouldn't be taxed here
(b) by payment of a dividend or a stock dividend;
- **Stock Dividend is taxed as a dividend** so shouldn't be taxed again here

(c) by conferring, on all owners of common shares of the corp at that time, a right in respect each common share, that is identical to every other right conferred at that time in respect of each other such share, to acquire additional shares of the corp,
- If right available to all shh's to acquire other common shares for not less than FMV, then not really getting anything extra

Characterization of Benefit

MNR v Pillsbury Holdings Ltd (1965) Ex Ct:

Facts	T had 2 companies that were wholly-owned subs (Copeland & Renown) – borrowed $ from companies to buy shares President of T wrote to companies asking each company waive interest – interest was waive Yr later T writes to subs and asks them to waive interest again and said will pay back the $ - subs agree Minister says waiver of interest constitutes a benefit
Issue	Did extinguishing T's liabilities to pay interest result in benefit/advantage conferred on shh within meaning 15(1)?
Analysis	Purpose of 15(1) – payments, distributions, benefits and advantages flowing from corp to shh - Generally, payments and distributions tax as dividends – if made it so deemed dividend don't apply, benefit
Holding	Waiver of interest was not a benefit - Waivers happen all the time in biz – lender wants borrower to stay afloat so they can pay off the principle - First waiver – corp waived interest but didn't get anything (unusual) – corp finds not enough to find it is a benefit - Second waiver – bona fide – happens all the time
Ratio	***Bona fide biz transactions are not a shareholder benefit***

Strachan v Canada (2000) TCC
Facts: T was corp that carried on biz in premises leased by the shh. Shh involved in legal dispute in US that put premise at risk – the corp paid the legal fees. Minister – corp paying legal fees is a benefit. T said doing that to protect the premises
Holding: not a benefit – had bona fide business reason

Morneau v Canada (1998) TCC
Facts: T lived on property that was adjacent to property corp operated on - sold property to company for > FMV
Holding: Greater than FMV did not result in the benefit – T successfully argued there was **pressing need** for the property, and therefore corp was prepared to pay > FMV

Losey v MNR (1957) Ex Ct:
Facts: T carrying on advertising biz, then incorporated – transferred assets to corp and took back shares & debt= $85K. Value of tangible assets T contributed was only $8,700. T made argument the rest was goodwill of advertising business
Holding: T did receive a shh benefit - All the contacts were personal to T and the goodwill couldn't really be transferred to the corp
- This was not an exchange at FMV

Perrault v Canada (1978) FCA
Facts: T owned shares in Montreal Terra Cotta. And owned shares in Central Motors which was controlled by the Estate of Rocheleau. T agreed to purchase the shares held by Central – dividend of $250K paid out of PoD from sale of manufacturing plan. Central Motors transferred the shares to the T w/o further consideration.
Holding: 84(2) didn't apply, but it is a tax benefit

Conferral Benefit

Benefit must be conferred by the corporation to the shareholder

- Suggestion of **intent or constructive intent** on the part of the corp to confer the benefit

****Chopp v Canada (1995) TCC*: Corp knowledge/ought to have known**

Facts	T owned 99% issues shares in Corp. 1989 – T and wife purchased new house. While T was on vacation, T's daughter advanced sum $28,490 to T's lawyer as part of cash complete purchase – but recorded amount as debt expense account for corp legal expenses. T's shh loan account with corp had credit balance of not less than $150K MNR increased corp's income by $28,490 and increased T's income by $28,490 on basis corp conferred benefit
Holding	No benefit – corp did not know about the error and did not use the money for his own benefit
Ratio	***Benefit may be conferred within of 15(1) w/o intent or actual knowledge on the part of the shh or corp if the circumstances are such that shh or corp ought to have known benefit was conferred and did nothing to reverse it***

Franklin v Canada (2000) TCC aff'd (2002) FCA:
Facts: Corp purchased Florida condo w funds advanced by shhs. Corp sells ½ interest in the Condo – payment goes directly to T w/o any adjustment to loan account. With proceeds, T purchases cars for company – then corp increases amount of the loan account
Holding: TCC says this was just an error and FCA agrees

- T's equity position didn't change – sale wasn't recorded on companies books and loan account never went in arrears

Dissent: T knew that the proceeds weren't his, and fact he took them and put them back doesn't mean he didn't get a benefit

If closely-held corp with one shh and one director, then could say corp did have knowledge/intention, since one mind

Capacity as Shareholder

Is benefit conferred on person as employee or shareholder?

- If employment benefit, then deductible to company AND Some employee benefits are not taxable to the employee
- If shareholder benefit, then not deductible

***Spicy Sports v Canada (2004) TCC*:**

Facts	Steve was majority shh and employee. Corp paid $38,327 to cover cost operation on Steven's knee. Corp had biz renting skis. Corp purchased cost plus insurance – no evidence insurance policy available to employees other than Steve and then 4-5 months later Steve got the operation
Analysis	No one else other than T is getting benefit from this T argues that he is the key person who tests skis so he needed the surgery for his employment – bona fide biz reason Timing is suspicious – gets insurance 4 months before surgery **Would the corp have entered into such a contract with arm's length key employee as employee and not a shh?**
Holding	This was a benefit conferred on T in his capacity as shareholder
Duff	Reasonable to say that Steve built up biz and had some credibility

O'Flynn v Canada (2005) TCC:
Facts: T's owned private company that paid for dental insurance for their behalf. Minister characterized as shh benefit.
Holding: Bona fide biz purpose – employee benefit and not shh benefit

- Doesn't matter almost all employees chose not to participate

If don't deal arm's length, there is affiliated concept – if don't deal arms' length with the company then benefit conferred on shh

Amount/Value Benefit

Youngman v Canada (1990) FCA:

Facts	T & wife owned 35% shares in company, rest belonged to their 3 kids. Company acquired 16-acre parcel land for re-development – subdivision wasn't approved. Company built house for T and his family on the land – designed by T - Cost = $395,549, T paid monthly rent of $1,000/month Rent T paid was too low and did not represent real value – shareholder benefit T brought in expert and said rent was approx. $800/month
Analysis	T got right to use or occupy the house for as long as he wished and it was built specifically for him **Step 1: Determine what the benefit is** **Step 2: Determine what shh would have had to pay to obtain that benefit he they were not a shh**
Holding	Benefit

Arpeg Holding (2008) FCA
Facts: T challenge valuation of benefit for time share in whistler said - properties in issue were not specifically constructed or renovated for personal use, acquired for bona fide biz purpose
Holding: Rejected T's appeal - Properties were completely at the shareholder's use
- The property valuation is the capital being caught up in the asset
- Value at corp's income foregone by having corp's capital tied up in unproductive asset

Even if not specifically built for you, if at your disposal and not renting out, then value benefit at income to corp that is gone

Kennedy v MNR (1973) FCA:
Facts: Company paid for leasehold improvements on the shh property. Shareholder benefit but the property was leased back to the company for a long period of time
Issue: Do you value the benefit at the cost of the leasehold improvements?
Holding: Discount the leaseholder improvements until the lease ends

Note: shareholder benefit is decreased by the amount of a deemed dividend

52(1)(d): Cost Property acquired by shh
If shh buys property from corp for PoD < FMV and is assessed a shareholder benefit, add the shh benefit to the cost of property

TRANSFER OF PROPERTY - ROLLOVERS

69(1): **Inadequate Consideration**

(a) *where a T has acquired anything from a person with whom the T was NAL at an amount in* ***excess*** *of the FMV thereof at the time the T so acquired it, T shall be deemed to have acquired it at that FMV;*

- **T acquires anything from NAL person for > FMV, deemed cost = FMV**

(b)(i) *where a T has disposed of anything to a person with whom the T was NAL for* ***no proceeds*** *or for proceeds < FMV thereof at the time the T so disposed of it, the T shall be deemed to have received PoD = FMV; and*

- **If T disposes of anything to NAL person for PoD = 0 or PoD < FMV, T deemed received PoD = FMV**

PoD to T & Cost to Corp

85(1): Transfer Property to Corporation by Shareholders

Where a T has disposed of any of the T's property that was ***eligible property*** *to a taxable CA corp for consideration that includes shares of the corp, if the T and corp have* ***jointly elected*** *the following rules apply:*

Requirements to use Rollover:

1. Eligible property – Capital property, & inventory other than real/immovable property inventory - if sell it then biz income but if roll it into corp and sell shares capital gain (1/2 taxable) – **85(1.1)**

2. Joint election b/w T and the corp

3. Consideration for the property includes **share in the corp**

85(1)(a): Consequence Rollover: Elected = PoD to T & Cost Property to Corp

Amount that T and corp have agreed in their election in respect of the property shall be deemed to be the T's PoD proceeds of disposition of the property and the corp's cost of the property;

- **Elected amount = PoD to T = Cost to Corp** (subject to 85(5))
- Capital gain/income not realized is deferred to the corp until the corp disposes of the property

S. 85(1)(c): Prevent Artificial Gain (inventory, non-depreciable capital property & depreciable capital property)

Where amount T and corp have agreed on in their election in respect of the property is > than the FMV, at the time of disposition, the amount so agreed on shall, irrespective of amount actually so agreed on, be deemed to be amount equal to that FMV

IF Elect > $FMV_{Property}$ THEN Election = $FMV_{Property}$

- **Purpose**: prevent realization of artificial gain by T and creation of artificial loss to the P/S
- **Example**: Cost = 40, FMV = 100, elect 200 → election = 100
  - Electing 200 creates artificial gain and creates a cost > FMV for corp (artificial loss)

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 amount that T and corp 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 shall be deemed to be an amount = to lesser of 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(1): "Cost Amount"**
  - Non-depreciable capital property = FMV
  - Inventory = lesser cost & ACB

IF Cost < FMV → Cost ≤ Election ≤ FMV

- **Example**: cost = 60, FMV = 100, elect 45 → deemed to elect 60
  - Lower of cost and FMV is cost = 60
  - Election is less than the lesser of cost and FMV – election generates an artificial loss

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)

CORPORATE REORGANIZATION

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

IF Elect < lesser Cost, FMV & UCC THEN Election = Lesser Cost, FMV & UCC

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 corp 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

85(5): Transfer Depreciable Property – exception to 85(1)(a) that says cost to corp = elected amount

Puts corp in the shoes of T w.r.t. UCC

Where capital cost to transferor > transferor's PoD:
- *Capital cost to transferee is deemed to be the amount that was its capital cost to the transferor; and*
- *Excess deemed to have been deducted in respect of the property*

Example: Cost = 100, UCC = 40, FMV = 40 – elect 40
- PoD to T = 40
- Treat corp as acquiring cost = 100, but 60 (UCC = 40) already taken out so diff b/w cost & PoD = amount deducted by corp
- Corp deemed to have acquired property at cost = 100 and deducted 60
- So, UCC of property in the corp = 40 – now any recaptured depreciation will be in the hands of the corp

Boot = Non-Share consideration received for the property

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 corp 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***

- **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 = 40, $FMV_{property}$ =100, FMV_{boot} = 80, shares = 20 and elect =40
  - Election doesn't violate (c.1) but (b) says have boot of 80 so deemed to elect 80

IF $FMV_{property}$ < FMV_{boot} → Election = $FMV_{property}$
- **Example:** Cost = 40, $FMV_{property}$ =100, FMV_{boot} = 180, Shares = 20
  - (b) is subject to (c), so elected amount = 100
  - **Shareholder Benefit = 80**

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

Elected amount is greater of (c.1)/(e) and (b)
- **Example**: Cost = 40, FMV = 10, get back boot = 80 and shares = 20 - If elect 20
  - (c.1) says electing < lesser cost & FMV – deemed to elect 40
  - (b) says electing < FMV boot – deemed to elect 80
  - (e.3) says to elect the greater of the 2 → deemed to elect 80

Cost/ACB to T & Corp

Shareholder Benefit = (FMVboot + FMVshares received) – FMVproperty

- Unless deemed to be a dividend
- **52(1):** Shareholder benefit added to cost

85(1)(f): Cost Boot to T = Lesser FMV_{Boot} & $FMV_{Property}$

- If FMVproperty < FMVboot → election = FMVproperty, so cost boot = FMVproperty
- **Example 1**: cost = 40, FMV property = 100, Boot = 40, shares = 60, elect 40
  - Election is good – haven't elected < FMV property, have elected > FMV property, have elected < boot
  - Cost of Boot to T = lesser FMV boot & FMV property = 40
- **Example 2:** cost = 40, FMV property = 100, Boot = 180, shares = 20
  - Elect 40 → not good election b/c < FMV boot, so deemed to elect 80
  - Cost of boot = 80
- **Example 3**: cost = 40, FMV property = 100, Boot = 180, elect 40
  - Elected amount deemed to = 100
  - Cost of boot = 100
  - Shareholder benefit = 180 – 80 = 100

85(1)(g): ACB Preferred Shares = Lesser: FMV Preferred Shares & (PoD – FMV boot)

- **PoD** = Elected amount
- **Example**: Cost = 40, FMV property = 100, FMV boot = 20, FMV shares = 80 – Elect 40
  - Election of 40 is valid
  - ACB of shares = 20 (lesser of FMV shares (80) & PoD – boot (20) = 20)

85(1)(h): ACB Common Shares = PoD – FMV boot - ACB Preferred shares

- **Example**: Cost = 40, FMV = 100, boot = 20, shares = 60 (25 preferred shares, 55 common shares)
  - Elect 60 = PoD
    - Cost of Boot = 20
    - ACB of Preferred shares = lesser 25 & 40 (60-20) = 25
    - ACB of common shares = 60 – 20 – 25 = 15

PUC Grind

Able to increase PUC to FMV of property going in under corporate law - Problem b/c allows tax-free return w/o a deemed dividend

- **Example**: Cost = 40, FMV = 100, get shares back – elect 40
  - ACB = PoD = 40
  - FMV = 100 = PUC → problem

85(2.1): PUC Grind for Rollovers

Where 85(1) or 85(2) applies to a disposition of property (other than a disposition of property to which section 84.1) to a corp by a T

- If 84.1 already applies then go there – don't use this PUC grind – but 84.1 won't apply if subject shares

***(a)** in computing the PUC in respect of any particular class of shares of the corporation at the time of, and at any time after, the issue of shares of the corporation in consideration for disposition of the property, there shall be deducted:*

(A - B) × C/A

A = Increase in PUC of all shares of corp as result of corp's acquisition of the property
B = amount, if any, by which corp's cost of the property determined under 85(1) > FMV of boot

- **Example 1**: Property: Cost = 40; FMV = 100, T gets: Boot = 25, Shares = 75 → Elect 40
  - Cost of property to corp = 40
  - Cost of boot = 25
  - ACB of shares = 40 – 25 = 15
  - PUC of shares = FMV Property – FMV boot = 100 – 25 = 75
  - PUC Grind = 75 – (40 – 25) = 60
  - PUC = 70 – 60 = 1**5**

STOP-LOSS RULES

DISPOSAL AFFILIATED

IF: (1) Transferor disposes of property, (2) transferor or affiliated person acquires property 30-days before or after disposition, & (3) Transferor/affiliated person owns property at end 30-days after disposition THEN loss = nil

251.1: "Affiliated Persons"

- "Controlled" means controlled, directly or indirectly, in any manner whatever = de facto & de jure – **251.1(3)**

(a) *an* ***individual*** *and a spouse or CL partner of the individual;*

- Narrower than related

(b) a corp *&*

(i) *a* ***person by whom the corp is controlled****,*

(ii) each member of an affiliated group *of persons by which the corporation is controlled, &*

- Corp is affiliated w each memb of affiliated group
- "Affiliated Group" – Group where each member is affiliated with every other member – **251.1(3)**

(iii) *a spouse or common-law partner of a person described in (i) or (ii);*

(c) 2 corporations*, if*

(i) *each corp controlled by a person, and person controlling one corp is affiliated w person controlling the other corp*

(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*

- Group doesn't need to be affiliated with each other – but each member of the group is affiliated with the person

251.1(4): Person affiliated with themselves

Individual Disposing Non-Depreciable Capital Property

Where T controls corp that they transferor the property into, then T & corp affiliated and stop-loss rules apply

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:

- Transfer of property to a corp and loss is realized - Corp controlled de facto by the transferor – so affiliated corp.
- Whether or not rollover there is a loss b/c Cost < FMV, so election = FMV
  - ACB = 100, FMV = 40 → 60 loss
- If corp holds property for 30-days after disposition, then loss is disallowed → loss deemed = nil
- Superficial loss is added to ACB of the property, so ACB = 40 + 60 = 100
- So when corp adds property to unaffiliated person, corp will realize the loss

Corp Dispose Non-Depreciable Capital Property

S. 40(3.3): When 40(3.4) applies

(a) a corp, ("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 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 Non-Depreciable Capital Property

(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

Disposition Inventory

Generally, inventory valued at lower cost and FMV (**10(1)**) – so don't need stop-loss rule BUT for **inventory in adventure/concern in nature** of trade it is valued at cost (**10(1.01)**) 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

Stop-loss Depreciable Capital Property

Triggered if Proceeds < UCC → Terminal loss

Terminal loss stays with transferor – transferor realizes losses when:

- 1. P/S no longer uses property for income producing;
- 2. Property is disposed of to an unaffiliated person

13(21.2): Loss Transfers Depreciable Property

IF

(a) *A person ("transferor") disposes at particular time depreciable property*

(b) *the UCC of the property > PoD → Terminal loss*

(c) *on 30th day after the particular time, a person or P/S (the "subsequent owner") who is the transferor or a person affiliated w the transferor owns or has a right to acquire transferred property*

- Notice: only applies for the 30 days after (not 30-days before)
- Doesn't refer identical property b/c worried about depreciation of that property

THEN

(d) *S. 85 does not apply to the disposition,*

- Need to readjust PoD – overrides 85

(e) *for purposes applying this section*

(i) *transferor deemed have disposed of transferred property for PoD = UCC (so no terminal loss)*

(iii) *transferor deemed own a property that was acquired before beginning of tax year that includes particular time at a capital cost = excess described in 13(21.2)(b), and that is property of particular class, until the time that is immediately before the first time, after particular time,*

(A) *at which a 30-day period begins throughout which neither transferor nor a person affiliated w transferor owns or has right to acquire transferred property*

(B) *at which transferred property is not used by transferor or a person affiliated with the transferor for the purpose of earning income and is used for another purpose,*

- If corp doesn't use property for purpose earning income, then not depreciable property and deemed disposed of it – so transferor deemed to own property until it is disposed of by transferee (T or affiliated person)

EFFECT:

- Deems transferor to own property of the same class with **cost = disallowed terminal loss**, until T or affiliated person does not own property for 30 days
- Transferor continues to deduct CCA on the notional depreciable property until T or affiliated person disposes of it to unaffiliated person or starts using it for personal use

What are we trying to do with this rule?

- Where PoD < UCC (b/c FMV < UCC) and don't want to allow the terminal loss, PoD deemed = UCC (no terminal loss)
- Going to imagine transferor still owns the depreciable property
  - Cost = amount terminal loss disallowed
  - Depreciate property as long as being used by corp for purpose of earning income

Triad Gestco v Canada (2012) FCA: GAAR

Facts	Capital gain realized on arm's length sale on building - $7.8M. Triad Gestco owned by Peter (majority shh) and Ben. Peter set up trust where he was the sole B – he was affiliated w trust. - Peter affiliated with trust & Peter controls Triad Gestco – so Triad Gestco affiliated with trust Incorporates company – Rcon. Triad Gestco contributes $8M to Rcon in exchange 8,000 common shares - Triad Gestco gets stock dividend of 8,000 pref shares– amount included as dividend = amount PUC increased – PUC increased by $1 → Intercorporate dividend – but 112(1) applies - Shares redeemable for $8M = FMV Common shares now worth nothing b/c all value is in the preferred shares → value shift Sell common shares for $65 to the trust – ACB = $8M and PUC = $8M → capital loss of almost $8M triggered - If ever disposed of pref shares, then will be tax consequences but they just wont do that - Use this loss to shelter prior gain from sale of a building T reports allowable capital loss of $4M – Reassessed on basis no economic loss under GAAR
Issue	Was there a misuse/abuse of stop-loss rules? Is there abuse of scheme of Act for capital losses – losses have to be real?
Analysis	**Argument 1: Misused/Abused stop-loss rules b/c circumvented** - Used a trust b/c in 2002 the stop-loss rules didn't include trusts (now they do) - T says that stop-loss rules are used to include p/s's and corps – can't read in rule to include trusts - Could have sold to Peter's sibling and that wouldn't have been covered by rules - Rules didn't include trust at the time – can't add trusts to the stop-loss rule now - When parliament introduced "affiliated persons" it was deliberate choice not to add trusts **Argument 2: Scheme that losses have to be real – can't generate and deduct artificial losses** - Former 55(1) – deals w T artificially reducing amount of gain from disposition – Duff thinks would have applied - Paper loss claimed artificially reduce tax liability – consistent existence **overarching policy** - Duff: Aggressive judicial law making Losses have to be real – Prepared to be an overarching policy
Holding	GAAR applies
Ratio	***Overarching policy against realizing artificial losses – losses have to be real***

Anti-Avoidance Rule – 69(11)

Applies for unaffiliated

69(11): Deemed PoD

IF:

- As part of series transactions/events T disposes of property for PoD < FMV
- Reasonable considered one of main purposes is obtain the benefit of deduction in computing income, taxable income, or tax payable available to a person (**other than person affiliated** with T immediately before series, if 251.1 read w/o reference control in 251.1(3)) in respect of subsequent disposition of property
    - Defining more narrowly – so de jure control
- Disposition occurs before day that is 3 yrs after particular time (time of disposition)

THEN:

- T deemed disposed property at particular time for PoD = FMV at the particular time (time of disposition)

Series: Ordinary series + Extended in 248(10)

- Ordinary – transaction pre-ordained
- Extended – includes related transactions completed in contemplation of the series
    - Contemplation means before or after

Loyens v Canada (2003) TCC:

Facts	2 bros: William & Harry had company – Lobro Stables – was involved in horse racing and had a lot of losses - Each had 1/6th interest in parcel of land – Harrison Property (Cost = $16,666.67 FMV =$500,000) - Property was inventory and is not eligible property – so not eligible for rollover – 85(1.1) At time rules said "related persons" – 251: siblings are related so they are a related group – so both related to corp - 69(11) doesn't apply - Note rules say affiliated – would they be affiliated? Neither of them individually control the corp and they are not affiliated with one another – so under current rules 69(11) would apply Set up P/S (Varna Elevators) – transfer 1/6th interest in property to P/S in exchange for 50% interest in P/S – rollover - so P/S has 1/3 interest in property – assume mortgage (boot), so elected amount = mortgage = PoD Roll P/S interest into Lobro Stables – so now Lobro owns P/S which owns the Property - Now Harrison property in Lobro – PoD elected becomes cost of property to P/S – becomes cost property to corp and now corp sells to purchaser and has gain – gain sheltered by losses of Lobro
Analysis	**Issue 1: Is there a general policy against loss trading? NO** - OFSC – Court says scheme around loss-trading - Specified person's exception from rule and specified persons related persons and company related to bros - T say that there is very specific rule and they haven't violated it – - Rule changed in 1995 to affiliated – but facts in 1933 - now 69(11) would apply b/c not affiliated - Rejects on ground that this is profit-trading and not loss-trading (Duff: Right that they reject it, but not for this reason – better argument is that T's were within specific rule) **Issue 2: Was there an abuse of 85(1.1)(f) – eligible property? NO** - Policy is to prevent real property trader from converting income into capital - When T sells to 3rd party purchaser the Harrison property, they are still selling it as inventory – not trying to make capital gain – not trying to convert character of income
Holding	GAAR doesn't apply
Note	Today this wouldn't work b/c they would not be affiliated – 69(11) would happen if disposition happened within 3 yrs - If do this on rollover into company and then wait 3 yrs then 69(11) won't apply - GAAR wouldn't apply – outside 3 yr window and then can't use GAAR

AMALGAMATIONS

87(1): Amalgamations

Merger of 2+ corps each which was, immediately before merger, taxable CA corp ("predecessor corp") to form one corp entity ("new corp") in such a manner that

*(a) **all of property** (except amounts receivable from any predecessor corp or shares predecessor corp) of predecessor corps immediately before merger becomes property of the new corp by virtue of the merger,*

(b) all liabilities (except amounts payable to any predecessor corp) of predecessor corps immediately before merger become liabilities of new corp by virtue of merger, and

(c) all of shhs (except any predecessor corp), who owned shares of any predecessor corp immediately before merger, receive shares of the new corp b/c of the merger,

***otherwise than** as a result of acquisition of property of 1 corp by another corp, pursuant to purchase of that property by the other corp or as a result of distribution of that property to the other corp on the winding-up of the corp.*

IF: Merger 2+ corps (predecessor corps) to form one entity (new corp)

- Except than by 1 corp purchasing all the property of the other corp or distribution of all the property on wind-up

THEN:

- **All property of predecessor corps becomes property of new corp**
- **All liabilities predecessor corp become liability of new corp**
- **All shareholders of processor corps receive shares of the new corp**

EXCEPT: inter-connected amounts receivable, amounts payable or shareholders that are the predecessor corp

Rollovers

87(4): Rollover Shares Predecessor Corp to Shareholders

- **Dispose Old Shares for PoD = ACB old shares**
- **Cost to T new shares = ACB Old Shares**

87(2): Rollover Property Predecessor Corp to New Corp

(a) On amalgamation – **deemed year end for predecessor corp & new tax yr for new corp**

- Triggers things like inventory being written down to lower cost & FMV, and loss carryovers from other years

(e) Non-Depreciable Capital Property – New corp acquires @ ACB of property immediately before amalgamation

(b) Inventory – New corp acquires @ Value

- Value = lower cost & FMV (**10(1)**)

(d) Depreciable Property - New corp acquires @ cost = capital cost predecessor; UCC new corp = UCC old corp

Example: 2 depreciable properties of same class: X & Y

- X: cost = 100, UCC = 40; Y: cost = 100, UCC = 30
- New corp – acquired X for 100 and Y for 100 – add in computing UCC
- 70 is what get to depreciate going forward
- But pay attention to 100 for recaptured depreciation

Losses

87(2.1): What happens to losses of the Predecessor corps

To determine new corp's non-capital loss, net capital loss for the tax year and extent which 111(3) apply to restrict deductibility by new corp of non-capital loss, net capital loss

New corp deemed to be the same corp as, and a continuation of, each predecessor corp

EXCEPT: no effect on

- Fiscal period of new corp or predecessors
- Income of new corp or its predecessors
- **The taxable income of, or the tax payable by any predecessor corp**
  - Can't carry back losses after amalgamation predecessor corp – would affect taxable income of the predecessor corp
  - **Can carry forward losses of predecessor corp, but cannot carry back losses after amalgamation**
  - Carry forward may be subject to LRE – only able to carry forward if fit into loss streaming event

PUC Rules

Usually would say that PUC of amalgamated corp should be sum of predecessors – but this isn't the case in vertical amalgamations
- For vertical, the PUC of shares of the sub corp owned the parent corp is cancelled

87(3): PUC New Shares
Deduct from PUC of New Shares: PUC new shares otherwise determined – (sum PUCs old shares – inter-connected holdings)

PUC new = Sum PUC old – Inter-connected Holdings

***Copthorne Holdings v Canada (2011) SCC:* Most recent SCC GAAR case – PUC Scheme of the ITA**
A multinational group's CA operations were reorganized, resulting in $67M increase in PUC of shares in CA corp held by non-resident corp. Increase resulted from an amalgamation of CA parent corp w its Canadian sub, which was structured as horizontal rather than vertical amalgamation to avoid application of rules that would have eliminated sub's PUC on amalgamation. Shares of amalgamated corp subsequently redeemed for amount equal aggregate PUC of 2 predecessor corps, resulting in no Canadian tax.

Facts	Li Ka owned VHHC Investments which owned VHHC holdings – bought shares in Husky Oil & VHSUB – VHSUB at an unrealized capital loss. Li Ka also owned Big City Project which owned Copthorne Holdings which had hotel (accrued capital gains) **Transactions**: - VHHC Investments sells shares of VHHC Holdings to Copthorne – use stop-loss rules to move the losses - VHHC Holdings sells shares of VHSUB to Copthorne, who then sells to unrelated purchaser – Copthorne realizes a loss – uses loss to shelter gains from the hotel - PUC of VHHC Holdings (>$64M) is now with Copthorne (unintentional) – want to preserve that o Can't amalgamate VHHC Holdings w Copthorne b/c 87(3) will apply & PUC VHHC Holdings will disappear - Copthorne invests proceeds in company, COIL, in Singapore - Copthorne sells shares of VHHC Holdings to Big City Project for nominal consideration – this makes VHHC Holdings and Copthorne sister companies - Amalgamate Copthorne and VHHC Holdings – PUC gets summed - Sells Copthroen shares to Barbados company, LF Investment (also owned by Li Ka) (LF also owns VHHC Investments) - VHHC Investments amalgamates with Copthorne - LF redeems shares $142M - covered by PUC - nothing deemed dividend – put in $96M and getting out $142M free
Analysis	**Tax Benefit** – Yes – Vertical amalgamation would have been much simpler but would have lost PUC – benefit was getting to preserve the PUC in VHHC Holdings **Avoidance Transaction** – Yes - Redemption transaction was part of the same series as prior sale and amalgamation - Primarily tax motivated – would have been much easier to do a vertical amalgamation ****Misuse/Abuse** – Yes **89(1):** Def of PUC – paid on corporate law concept of stated capital – full amount that a corp receives for shares **84(3):** Where payment on redemption > PUC – deemed dividend **87(3):** Ensures PUC of shares of amalgamated corp do not exceed PUC of shares of amalgamating corps – - On amalgamation, any PUC of the shares of amalgamating corp are held by another amalgamating corp is not aggregated – but will be cancelled - One rationale, is that payments to shh from an amalgamated corp on share redemption should not be taxable as deemed dividends, only to extent such payments reflect investment may with tax-paid funds **Object, spirit and purpose of exclusion in 87(3) – preclude preservation of PUC of shares of sub corp upon amalgamation of the parent and sub where such preservation would permit shhs, on a redemption of shares by amalgamated corp, to be paid amounts as return w/o tax**
Holding	GAAR does apply – PUC should have been reduced and anything paid above the PUC is a deemed dividend
Note	What if some arm's length person came along and bought VHHC Holdings and that person has company and amalgamates them and gets the PUC? Is that abusive? - Starts seeming abusive if just PUC trading

CAPITAL GAINS STRIPPING

Capital Gains Stripping – Corp wants to sell shares of sub but there will be taxable capital gain, instead pay itself big dividend and sell the shares

- Stripping the capital gain out in the form of a dividend – not taxable under 112

2 Scenarios 55(2) is aimed at:

1. Sub has shares with high FMV. Sub pays big dividend to parent corp – inter-corporate and not taxable. Then sub's shares have low FMV. Corp sells the shares in sub – low capital gains
2. Corp rolls assets into purchaser corp (< FMV) and gets preferred shares in purchaser corp. Purchaser corp redeems the pref shares and there is a deemed dividend paid to the corp = FMV - PUC

55(2): Deemed Proceeds/Gain

*Where corp resident in CA received taxable dividend in respect of which entitled to a deduction under **112(1)** as part of a transaction or event or a series of transactions or events, one of the purposes of which for, (or in the case under **84(3)**, one of the results of which), was to effect a significant reduction in portion of the capital gain that, but for the dividend, would have been realized on a disposition @ FMV of any share immediately before dividend and that could reasonably be considered attributable to anything other than income earned or realize by any corp after 1971 and before **safe-income** determination time for transaction, notwithstanding any other sections of this Act, **amount of the dividend** (other than portion of it subject to **tax under Part IV** that is not refunded as a consequence of payment of dividend to a corp where the payment is part of the series)*

(a) Shall be deemed not to be a dividend received by the corps
(b) Where corp has disposed of share, shall be deemed to be PoD of share except extent otherwise included computing proceeds
(c) Where a corp has not disposed of the share, shall be deemed to be a gain of the corp for year which divided was received from the disposition of the capital property

IF:

Corp received dividend entitled to deduction under **112(1)**

- Corp receives tax-free inter-corporate dividend
- One of the purposes of the dividend was to decrease capital gains that would have been realized on disposition at FMV
  - T has to show none of the purposes was to reduce a gain (*CPL*)

OR Corp received deemed dividend under **84(3)** on redemption

- One of results of which was to effect significant reduction in portion capital gain that would have been realized disposition of share at FMV

THEN:

- Dividend deemed not to be dividend received by corp
- If corp disposed of shares, dividend deemed = PoD of share
- If corp didn't dispose of shares, deemed to be gain of corp in yr which dividend received

UNLESS:

- 1. Dividend reasonable attributable income earned or realized as safe income
  - **55(5): Safe Income** = income earned or realized – tax already paid on it (but has not yet been distributed – *Gestion*)
    - Doesn't include things like accrued gains on property
    - (a) Doesn't include future income
    - Generally, safe income can be attributed in terms of entitlement of assets on winding-up
    - Look at safe income at the point when dividend is paid – not at the end of the year – *VH Logging*
- 2. Dividend subject Part IV tax and is not refunded
- 3. Doesn't satisfy one of the situations in 55(3)

55(2) deems the entire dividend to be PoD/gain (even if some is safe income)

- **55(5)(f)** – can split the dividend so that part from safe income isn't re-characterized by 55(2)
  - Amount that is attributable to safe income stays as dividend, and rest is subject to 55(2)

CORPORATE REORGANIZATION

CPL Holdings (FCTD) 1995: "One of the main purposes"

Facts	Clem Industrial owned by Clem (99 shares) & Pauline (1 share) – biz designing specialized machines Clem was scared about lawsuit – approached lawyer and said wanted to get rid of money in company Set up holding company and Clem and Pauline transferred shares of Clem to holding company in exchange for shares in Holdco – done on rollover basis – defer gain on sale of shares (or not and use LCGE) Clem Industrial pays big dividend to Holding and then Holding loans it back – now Holding is secured creditor - Holding sells 49% shares to Larry for $1 (b/c no value in company
Issue	Does 55(2) apply? Was the purpose to reduce capital gain that would be realized if Holding sold 49% of shares to Larry immediately before the dividend?
Analysis	**"One of the purposes" – T has to argue none of the purposes was to reduce the gain** T's argument is that this was all just about creditor proofing – rule distinguishes purpose and result - If worried about lawsuit, then going to do this quickly – T waited until Jan - T says waited b/c gov't was going to remove certain tax that applied to dividend payments Court believes law suit was serious – accepting the argument – sale share to Larry was separate thing and nothing to do with it – came up later – accepts story and says just "testing the waters"
Holding	One of the main purposes was not to reduce capital gains – it was all about credit proofing
Ratio	***T has to show none of the purpose was to reduce gain → Argue only purpose was credit proofing***

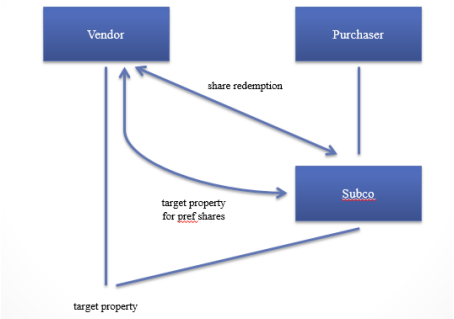
Gestion Jean-Paul Champagne Inc (1995) TCC: definition safe income

Facts	2 bros (Guy & Jean) – held 299 shares of Champagne Inc – wives each had 1 share (PUC = 30K) Jean wanted to sell to Guy. **Transaction**: - 1. Guy and wife roll shares into holding company & Jean and wife create holding company and roll shares in - 2. Company sells pig farm to Guys holding company for $100K. - 3. Company distributes $50K to each holding company – deductible under 112(1) - 4. Jean's company redeems shares for $346K
Analysis	84(3) – result of redemption is to reduce capital gain that would be realized on disposition at FMV – deemed dividend Is the result of the deemed dividend to reduce capital gain that would be realized disposition of share? - Yes – but for the deemed dividend, Jean would have capital gain Looks like 55(2) will apply UNLESS can get into safe income exception - Unreasonable to attribute all of the amount to Jean as dividend – should split equally b/w Guy and Jean - Where equal classes of shares, ten have to split the safe income equally
Holding	55(2) deems amount to be capital gain
Ratio	***Where have equal classes of share, not reasonable to attribute all the safe income to one shh***

Related Party Transactions

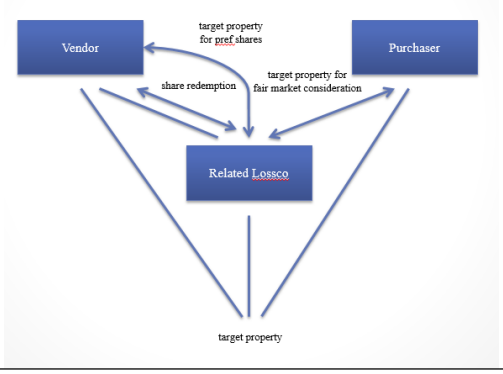
55(3): 55(2) only applies if fit into (i) – (v)
- (i) and (ii) both require sale for < FMV

(i) a disposition of property, other than
(A) $ disposed of on payment of a dividend or on a reduction of the PUC of a share, and
(B) property disposed of for proceeds that are not less than its FMV,
to a person that is unrelated immediately before the particular time



V has target property w accrued gain – wants sell to P
1. P sets up sub and V rolls target property into sub in exchange for preferred shares
2. Preferred shares redeemed → deemed dividend 84(3)

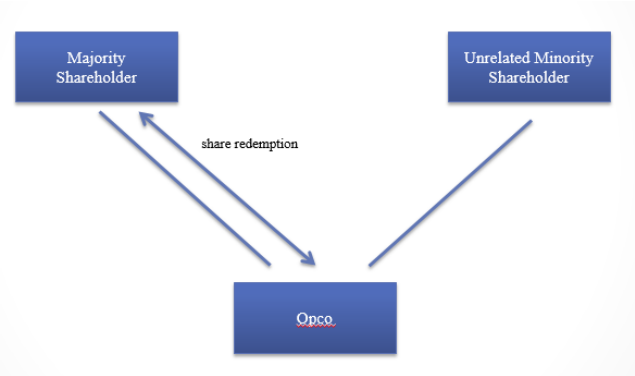
55(2) applies – deemed dividend on redemption is part of series which property disposed of to sub that is unrelated to recipient. Property disposed of < FMV (b/c Rollover)



V has target property that wants to sell to purchaser.
1. V rolls property to Lossco in exchange pref shares
2. V rolls property to Lossco in exchange for pref shares
3. Lossco sells property to purchaser for FMV – triggers gain in Lossco
4. Lossco redeems shares – deemed dividend

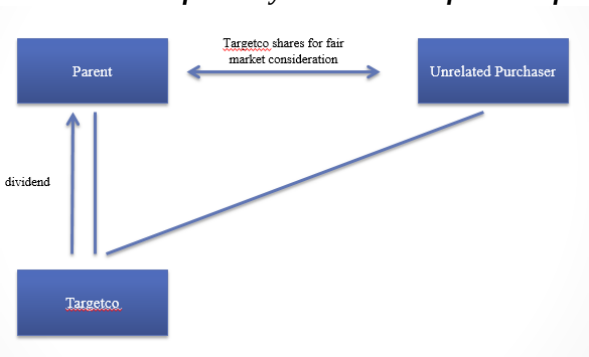
Permissible – **not caught by 55(2)** (69(11)) may apply)

(ii) a significant increase (other than as a consequence of a disposition of shares of a corp for proceeds of disposition that are not less than their FMV) in total direct interest in any corp of 1+ persons that were unrelated persons immediately before the particular time,

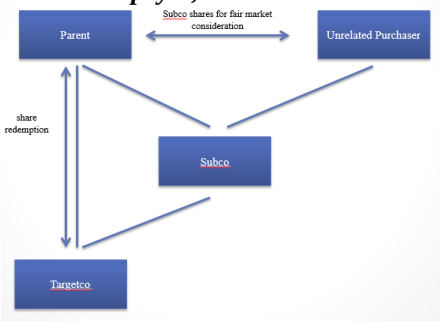


Majority shh and unrelated minority shh – majority shh wants to leave and minority will take over
Instead of majority shh selling shares (capital gain), Opco redeems all the shares of majority shh and they will be out of the picture BUT if deemed dividend doesn't reflect safe income reasonably attributable to share of majority shh, 55(2) will say to re-characterize deemed dividend as capital gain → 55(2) applies
Note: this wouldn't be subject to (i) b/c majority shh shares are disposed of to person related (since majority shh, related to the company paying the dividend) immediately before the dividend

(iii) a disposition, to a person who was an unrelated immediately before the particular time, of
(A) shares of the corp that paid the dividend ("dividend payer"), or
(B) property (other than shares of the dividend recipient) > 10% of the FMV of which was, at any time during the series, derived from any combination of shares of the capital stock and debt of the dividend payer,



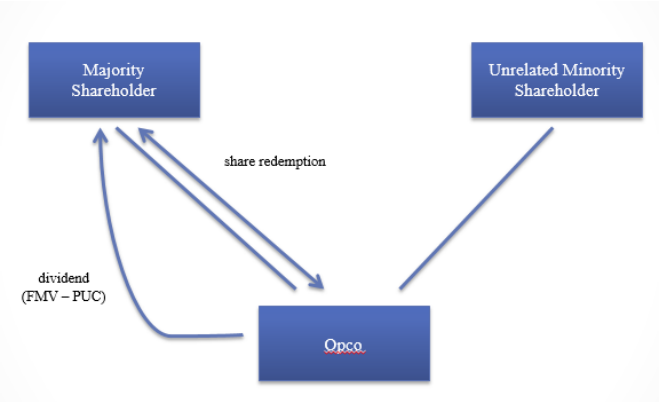
Parent wants to sell shares of target to unrelated purchaser
Target pays big dividend to parent and parent sells shares to purchaser – sale for FMV so rule in (i) & (ii) doesn't apply
→ 55(2) applies b/c of (iii)(A)



Target redeems shares of parent – reduces value of target which reduces value of sub (since sub owns target).
Parent sells shares of sub for FMV to unrelated purchaser
→ Subject to (B) if >10% FMV of subco is derived from target shares

(v) a significant increase in the total of all direct interests in the dividend payer of one or more persons or partnerships who were unrelated persons immediately before the particular time

- Like (ii) but involves redemption by minority shareholder



Have majority shh and unrelated minority of Opco
Dividend paid by Opco to majority shh and then redeems majority shh shares
And now accomplished sale to unrelated minority shh
Not caught by (ii) b/c there significant increase to unrelated person, but it says it had to be for PoD < FMV
Taken out difference b/w PUC and FMV in prior dividend
Two step way of getting around (ii)