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# TAXATION OF CORPORATION

## INTRODUCTION

* **2(1)** requires income tax to be paid by “every person resident in Canada at an time in the year” and **248(1)** defines a person to include “any corporation”. Thus, resident corporations are generally subject to the same basic rules for computing taxable income in Division B and C of Part I of the ITA as apply to individuals.
* Shareholders are generally taxable on dividends received from resident corporations under **12(i)(j)** and **subdivision h**.
* Relief of double taxation can be achieved by various methods, through which, income taxation at the corporate level is “integrated” with income taxation at the personal level.
* Exemption of “inter-corporate” dividends that are paid to one corporation to another (112)
* Credit for corporate level taxes in the case of dividends received by individuals (121)
* Partial exemption of capital gains on the sale of corporate shares (38)
* Refund of corporate income tax paid on certain kinds of income by private corporations when the corporation pays a dividend to its shareholders (129)
* Also, integration may be achieved by the payment of deductible salary or interest payments.
* Corporate losses: Ts tend to utilize these losses or transfer them from one T to another—transactions which are permitted where they occur among related parties, but are otherwise generally prohibited by specific anti-avoidance rules or the GAAR.
* Rules governing corporate income tax rates and that governing corporate distributions are closely related, since tax rates for different kinds of corporate income correspond to specific methods through which the ITA mitigates the double taxation of corporate source income.

## CORPORATE INCOME TAX RATE

* If a primary purpose of the corporate income tax is to prevent the deferral of tax that shareholders could otherwise enjoy on corporate-source income that is not distributed in the form of dividends or indirectly subject to tax when shares are sold, it follows that corporate income tax rates should be set at a level designed to prevent this deferral.
* Combined federal and provincial top marginal individual tax rates.
* But it is also influenced by rates in other countries.
* Lower for qualifying come of small business and income from manufacturing activities.
* General federal corporate tax rate = 38% (**123(1)**) - Tax credit equal to 10% of the corporation’s taxable income earned in the year in a province (**124(1**)) 🡪 federal corporate tax rate for taxable income earned in a province = 28%
* **Reg400(1)**: taxable income earned in the year in a province = the total of all amounts each of which is the taxable income of the corporation earned in the taxation in a particular province[[1]](#footnote-1)
* **Small Business Deduction**
* Under **251(1)**, a Canadian-controlled private corporate (**CCPC**) may deduct from tax otherwise payable for the year a percentage (“**small business deduction rate**”) of its “**active business income[[2]](#footnote-2)**” (**ABI**) for the year, up to the “business limit” which is defined in 125(2) as $500,000 and must be shared among “associated corporations”.
* Small business deduction rate defined in 125(1.1): [16% before 2008] + [17% after 2007]
* This reduced the fed corporate income tax rate on qualifying taxable income earned in a province to 12% for the portion before 2008 and 11% after 2007.
* To this amount, province adds a further 2-4.5%, increasing the combined federal and provincial rate of tax on qualifying ABI of CCPC to 13-15.5%.
* 125(1.1) has been amended.
* **123.3** increases the rate of tax on other income of a CCPC, imposing an additional 6 2/3% tax on the lesser of the corporation’s “**aggregate investment income**” (**AII**) and taxable income that is not subject to reduced rate under 125(1).
* Purpose: the increase the rate of tax on investment income earned through a CCPC a rate that is roughly comparable to the rate for individual Ts paying tax at the top marginal rate, thereby preventing the deferral of tax that would otherwise be possible by earning investment income through a CCPC.
* In 2015, provinces add another 11-16%
* Combined rate of tax on the AII of CCPC = 28% + 6 2/3% + 11-16% = 46-51%
* **Manufacturing and processing profits deduction (125.1)**
* Corporations may deduct…the amount by which the corporation’s “Canadian manufacturing and processing profits” exceed income that is eligible for the small business deduction under 125.
* “General rate reduction percentage” is defined in 123.4(1).
* **123.4** sets out tax reductions for corporate income that is not subject to the low rates under 125 or 125.1 and not subject to the additional rate in 123.3.
* 123.4(1) defines “full-rate taxable income”.
* The effect is to reduce the general corporate tax rate…while not affecting the rates of tax on the ABI and AII of a CCPC. As a result, the rate s ultimately the same for general income and manufacturing and processing income.
* BC rate: 2.5% for qualifying ABI and 11% on all other corporate income.
* As a result, the combined rates in BC are 13.5% on the first $500,000 of qualifying ABI of a CCPC, 45.67% for AII of a CCPC, and 26% for all other kinds of income.

## CORPORATE DISTRIBUTIONS

### Dividends Received by Resident Individuals

* In the case of taxable dividends received by resident individuals, Ts are required to “**gross-up**” the cash amount of the dividend under **82(1)(b)** to reflect the underlying corporate income out of which the dividend is paid, and are allowed to deduct from tax otherwise payable a divided **tax credit** under **121** that is designed to offset the income tax paid by the corporation on the income out of which these dividends are paid.

**(i) Taxable Dividends Other than Eligible Dividends**

**82(1)(a)** requires T to **include** “the total of all amounts, **other than eligible dividends**…received…on account of, in lieu of payment of or in satisfaction of, taxable dividends.”

* **89(1)** defines a “taxable dividend” as a dividend other than a capital dividend that is exempt under 83(2).
* ITA does not define “**dividend**”. Courts have defined it as “the sum payable as the profits of a joint stock company and received by an undivided holder as his share.”
* Dividend can be paid in the form of cash, property or stock.

**82(1)(b)(i)** until 2014 requires T to **include** an **additional** 25% of the amount under 82(1)(a), in order to “gross-up” the amount of the dividend to reflect an assumed corporate tax rate of 20%, with the dividend assumed to have been paid from the remaining 80% of the corporate earnings.

**121(a)** allows individuals to **deduct** 2/3 of this additional gross up amount.

* Assuming that provinces granted an additional dividend tax credit equal to half of the amount of the federal credit (1/3 of the gross-up), the full amount of the gross up would be credited against tax otherwise payable in computing the individual’s combined federal and provincial income taxes.

The combined effect of this dividend gross-up and tax credit was to integrate corporate and shareholder income taxes for corporations subject to tax at a rate of 20%[[3]](#footnote-3).

* To prevent over-integration (credits > tax), after 2013, gross-up was reduced from 25% to 18%, and federal dividend tax credit was increased from 2/3 to 13/18. These adjustments were designed for integration at a corporate tax rate of 15%, which more closely corresponds to combined rates for qualifying ABI of a CCPC.
* To prevent under-integration (tax > credits), a separate dividend gross-up and tax credit for “eligible dividends” was created in 2005.[[4]](#footnote-4)

**(ii) Eligible Dividends and Part III.1 Tax**

The dividend gross-up and tax credit for eligible dividends are designed to integrate taxes at the corporate and individual shareholder levels for income that is neither ABI of a CCPC that is taxable at a low rate nor AII of a CCPC that qualifies for the dividend refund.

* **82(1)(a.1)** requires T to include…eligible dividends.
* “**Eligible dividend**” is defined in **89(1)** as “the portion of a taxable dividend that is received by a person resident in Canada, paid by a corporation resident in Canada and designated under 89(14) to be an eligible dividend.
* 89(14): A corporation designates a portion of a dividend…to be an eligible dividend by notifying in writing…
* As a result, an “eligible dividend” is any taxable dividend that a resident corporation designates as eligible.
* **82(1)(b)(ii)** requires T to include a **gross-up** equal to 38% (after 2011) of the amount under 82(1)(a.1).
* **121(b)** allows to **deduct** a tax credit equal to 6/11 (after 2011) of the gross up under 82(1)(b)(ii).

In order to limit the amount of “eligible dividend”, **Part III.1** imposes a special tax on “**excessive eligible dividend designations**”.[[5]](#footnote-5)

* Where a corporation would be subject to this tax, however, the corporation may subsequently elect to deem the excessive amount to be a taxable dividend other than an eligible dividend, provided that the election is made with the concurrence of the corporation and all its shareholders.
* According to **89(1)**, “excessive eligible dividend designations” generally applies to dividends that are paid out of income that was subject to tax at a low rate—either because it was paid out of ABI of a CCPC in respect of which the corporation obtained the small business deduction, because it was paid out of AII of a CCPC in respect of which the corporation was eligible for a dividend refund, or because it was paid out of non-taxable inter-corporation dividends received by the paying corporation which were themselves paid out of corporate income subject to a low corporate rate.

**For CCPCs, 89(1)(a) provides:**

**“Excessive eligible dividend designation” = (A – B) × C/A**, where

* A = eligible dividend paid in the taxation year
* B = max {o, GRIP at the end of the year}
* C = eligible dividend
* If A = C, the amount = A – B = eligible dividend – max {0, GRIP}

**89(1):**

**“General rate income pool (GRIP)” at the end of the year = C + D + E – G**, where

* C = the corporation’s GRIP at the end of the preceding year
* D = [the corporation’s “general rate factor” for the year] × [its adjusted income for the year]
* “general rate factor” = 0.72 (after 2011)
* “adjusted taxable income” = taxable income – income that is subject the low rate for ABI and AII
* E = [eligible dividends received in the year] + [dividends from foreign affiliates which are deductible under 113]
* G = [eligible dividends paid in preceding year] – [excessive eligible dividends designated in preceding year]
* Putting together, GRIP is an ongoing balance computed at the end of the corporation’s taxation year that is increased by 72% of its adjusted taxable income and eligible dividends received from other corporations, and reduced by eligible dividends paid by the corporation less any excessive eligible dividend elections.
* It reflects after-tax income subject to the general rate out of which eligible dividends may be paid.
* Since the excessive eligible dividend designation applies only if the total of eligible dividends paid exceeds GRIP at the end of the year, the corporation may pay an eligible dividend that exceeds its GRIP balance at the time without having to pay Part III.1 tax, so long as it has a sufficient balance in its GRIP at the end of the year.

**For non-CCPCs, 89(1)(b) provides:**

**“Excessive eligible dividend designation” = A × B/C**, where

* A = min {eligible dividend paid, LRIP}
* B = eligible dividend
* C = (i) under description of A
* This definition applies Part III.1 tax to any eligible dividend of a non-CCPC up to the amount of any balance at that time in LRIP.

**“Low rate income pool (LRIP)” = A + B - G – H**, where

* A = LRIP at the end of preceding year
* B = amounts deductible under 112 in respect of taxable dividends (other than a E.D.) received in the year before the particular time
* G = taxable dividends (other than a E.D.) payable in the year before the particular time
* H = excessive eligible dividend designations made in the year before the particular time
* In sum, LRIP is an ongoing balance computed at any time that is increased by taxable dividends (other than E.D.) received from other corporations and reduced by taxable dividends that are paid as well as excessive eligible dividend designations.
* It reflects after-tax income subject to a low rate of corporate tax out of which dividends may be paid.

**Anti-avoidance rule in 89(1)(c):**

* **Deems** the full amount of an eligible dividend to be an excessive eligible dividend designation of “it is **reasonable** to consider that the eligible dividend was paid…the main purpose of which was to artificially maintain or increase the GRIP, or to artificially maintain or decrease the LRIP.
* Where this provision applies, **185.1(1)(b)** imposes an additional 10% tax on the amount of the dividends, resulting in a Part III.1 tax of 30% of the excessive eligible dividend designation.
* 185.1(2) prohibits any subsequent election to deem the excessive amount of the dividend to be a taxable dividend other than an eligible dividend.
* No case on this yet.

### Inter-corporate Dividends

* Where dividends are received by resident corporations, the dividends is included in computing income under 12(1)(j) and 82(1) without any gross-up, and is generally fully deductible under 112(1). As a result, inter-corporate dividends are generally received free of tax, subject to the two exceptions: Part IV tax and other rules to discourage “after-tax financing arrangements.”
* Basically, since inter-corporate dividends are generally non-taxable while interest payments are taxable. Rules[[6]](#footnote-6) are designed to discourage so-called “**after-tax financing arrangements**” involving the conversion of what would otherwise be taxable (and deductible) interest payments on debt obligations into non-taxable (and non-deductible) dividends on shares with characteristics similar to debt.
* To prevent individual Ts to defer tax on dividend income by transferring shares to closely-held corporations, an additional tax on so-called “**portfolio dividends**” is imposed on **closely-held corporations** under Part IV of ITA.
* Part IV tax is fully refundable to the corporation under 129 when it pays a taxable dividend on its shares.

### Part IV Tax

**186(1)(a)** levies a tax on a corporation that is at any time in the year a private corporation or a subject corporation equal to “1/3 of all assessable dividends received by the particular corporation in the year from corporations **other than** payer corporations connected with it.

* “**Assessable dividend**” is defined in **186(3)** as an amount received…when it was a private/subject corporation as, on account of, in lieu of payment of or in satisfaction of, a taxable dividend from a corporation, to the extent of the amount in respect of the dividend that is deductible under 112.
* “**Private corporation**” is defined in **89(1)** as at any time a corporation that is resident in Canada, not a public corporation, and not controlled by one or more public corporations.
* “**Subject corporation**” is defined in **186(3)** as “resident in Canada and controlled…by or for the benefit of an individual or a related group of individuals.”
* “Related group of persons”—251(4)
* “Related individuals”—251(2)(a)
* Connections by “blood relationship, marriage or CL partnership or adoption”: 251(6)
* “**Connected**” is defined in **186(4)**
* **(a)** if the payer corporation is controlled by the particular corporation at that time.
* “Control” has been judicially interpreted as “***de jure* control**”, which generally involves the ownership of shares entitling the owner to elect a majority of the board of directors, but may also be exercised indirectly through a corporation that controls a second corporation.
* **186(2)** provides an **extended definition of control** for the purpose of Part IV, stipulating that “one corporation is controlled by another corporation if more than 50% of its issued share capital (having full voting rights) belongs to the other corporation, to persons with whom the other corporation does not deal at arm’s length, or to the corporation and persons with whom the other corporation does not deal at arm’s length.”
* **(b)** if the particular corporation owned at that time 10% of the voting rights of all shares and more than 10% of the FMV of all shares.
* CRA’s view: p. 247

If dividend is from a “connected corporation”, 186(1)(a) does not apply. Where a private or subject corporation receives a dividend from a connected corporation that itself receives a dividend refund on the payment of the dividend, **186(1)(b)** imposes a separate tax on the dividend equal to the proportion of the dividend refund to the payer corporation that the dividend received by the particular corporation is of all dividends paid in respect of which it obtained the dividend refund.

* This in conjunction with the tax refund mechanism, ensures that Part IV tax and refunds “cycle up” through tiers of corporations as inter-corporate dividends are paid.

Computation (p. 245)

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| --- |
| corporate income – assumed corporate tax = distributed income  + gross-up = amount included in individual’s income  × top marginal rate = tax before credit  - dividend tax credit (dividend tax rate × amount included in individual’s income) = net tax on individual  ÷ distributed income = effective rate of tax on cash amount of dividend |

### Capital Dividends

* A final set of rules applies to dividends that are paid out of the non-taxable portion of a private corporation’s taxable gains, which effectively flow-through this non-taxation to individual and corporate shareholders by allowing the corporation paying the dividend to designate it as a “capital dividend” under **83(2),** in which case it is included in computing the income of recipient shareholders.
* **83(2)** limits the exclusion to dividends paid by a “private corporation”.
* **89(1): CDA** = non-taxable portion of capital gain (after 1971) – non-deductible portion of capital losses (after 1971) + capital dividends received from another corporation + non-taxable portion of gains from disposition by the corporation of eligible capital property + net proceeds of certain life insurance policies – the total of capital dividends payable by the corporation before the time *– any amount accrued while the co is not private*
* Part III imposes a special tax on excessive elections (where capital dividend paid > CDA)

## CORPORATE LOSSES

Ts have devised various transactions to utilize losses or transfer them from one T to another—transactions which are permitted where they occur among related parties, but are otherwise generally prohibited by specific anti-avoidance rules or the GAAR.

### Loss-Utilization Strategies Involving Related Companies

1. **Transfer of a Profitable Business**

One common strategy for utilizing corporate losses involve the transfer of a profitable business carried on by a member of a corporate group to a related loss corporation, and the capitalization of a related loss corporation with funds borrowed by another member of the corporate group. (As in *Stubart Investments*)

* In ***Stubart Investments****,* SCC rejected business purpose argument and ruled for T. This case led to the introduction of the GAAR.
* But CRA suggests that the GAAR would not apply to similar loss-utilization strategy involving a transfer of property to a related loss corporation.

🡪 See p. 304, the administrative guidance applies only to transfers of property to a “related corporation”, only where “all the shares of the two corporations have been owned by the same T during the period in which the losses were incurred.”

* “If a transfer…is undertaken to avoid a specific rule, such as a rule designed to preclude the deduction of losses after the acquisition of control of a corp by an arm’s length person…would be a misuse of the provision…”

1. **Inter-Corporate Financing**

Another strategy to utilize corporate losses: Profitco borrows funds on a “daylight” basis from a bank, using these funds to subscribe for shares of Lossco, which lends these funds back to Profitco, which in turn repays the bank.

* As long as Profitco has a reasonable expectation of gross income from the shares of Lossco, the interest that it pays to Lossco is deductible under 20(1)(c)(i)[[7]](#footnote-7). (*Ludco*)
* Lossco now has interest income against which it can deduct its loss.
* Inter-corporate dividends are tax-free under 112(1).[[8]](#footnote-8)

CRA: If (1) Lossco and Profitco are related[[9]](#footnote-9); and (2) the amount of the share subscription is not in excess of the amount of monies that Lossco could reasonably be expected to be able to borrow on the basis solely of its credit from an AL lender, then the transaction would not be subject to GAAR.

### Anti-Avoidance Rules

ITA contains several specific anti-avoidance rules, which limit the availability losses and other deductions whenever a T is subject to a “loss restriction event”.

* “**Loss restriction event**” is defined in **251.2(2)(a)** as the acquisition of control of a corp by a person or group of persons.

1. **Loss Restriction Rules**

* **249(4)(a)** deems T’s taxation year to have ended immediately before the loss restriction even and a new taxation year to begin at that time.
* **111(4)(a), (b)** prohibit the carryforward and carryback of the **net capital loss**, where a T is subject to a loss restriction event.
* **111(5)(a), (b)** prohibit the carryforward and carryback of the **non-capital loss** following a loss restriction event, with however a **“loss streaming” exception** that allows T to carryover these losses to the extent that they continue to carry on the same business for profit or with a reasonable expectation of profit.

In addition, other rules prohibit access to accrued losses and other deductions following a loss restriction event by requiring Ts to realize these accrued losses or deductions immediately before the loss restriction even and adjusting the tax cost of these properties following the loss restriction event.

* **10(1):** **inventory** = min {cost, FMV at the end of taxation year}
* **10(10):** **inventory that is ACNT** = min {cost, FMV at the end of T’s year that ends immediately before the loss restriction event}
* **111(5.1):** for **depreciable capital property**—In computing income for the taxation year that is deemed to end upon the loss restriction event:
* T deduct the amount = UCC – [FMV + deducted CCA/terminal loss]
* And deems the amount deducted to have been allowed in respect of that class made under 20(1)(a)—thereby reducing the UCC of the class following the loss restriction event.
* **111(4)(c),(d):** for **non-depreciable capital property**: T is required to deduct the accrued losses in computing the ACB at and after that time and deem these losses to be capital losses from the disposition of this property for the taxation year that ended upon the loss restriction event.
* **111(4)(e):** allows T to **designate** other capital properties to have been disposed for proceeds up to their FMV and reacquired at a cost equal to this designated amount in order to trigger taxable capital gains that may be sheltered by these allowable capital losses.
* However, although any resulting net capital loss may be carried back to previous years under 111(1)(b), the carryforward to taxation years after the loss restriction event is prohibited under 111(4)(a).
* **111(5.5)**: **Anti-avoidance rule**: 111(5.1)-(5.3) and 111(4)(c)-(e) do not apply if it can reasonably be considered that the main reason that the T is subject to the loss restriction event is to cause those provisions to apply wrt the loss restriction event—thereby prohibiting transactions that are designed primarily to trigger these accrued losses or deductions.
* This rule would apply where the controlling shareholder of a corp disposes of his shares to another person and reacquires them in an attempt to have the cop’s accrued losses realized for tax purposes. (*DOF Technical Note*)
* DD: they might have forgot to make 10(10) (inventory) subject to 111(5.5).

Judicial decisions have generally considered whether a corp has continued to carry on the same business following an acquisition of control for profit or with a reasonable expectation of profit such that it qualifies for the expectation to the loss restriction rule in 111(5).

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| ***NRT Techonology 2013 FCA***  The taxpayer, which sold ATMs to the gaming industry, and specialized keyboards and price scanners to retail stores, in January 2006 acquired a corporation ("Telepanel") that had been carrying on a business of selling electronic price display modules to retail stores.   * **FCA confirms the application of REOP tests in a loss-streaming case** * C. Miller J. found that s. 111(5)(a) precluded the taxpayer from using Telepanel's losses in the taxpayer's taxation year ending on September 30, 2007, as the business was not carried on for profit or with a REOP in that year. The business was "**dormant**" in that year: the only third-party business activity identified was the receipt of a small licence fee, and explaining to a customer how to replace batteries. Furthermore, if the former Telepanel business nonetheless was still being carried on, it was not being carried on with a view to profit, having regard to the objective factors listed in *Tonn*. In particular, the business had persistent and substantial losses, and the taxpayer had no plan, and made no effort, to turn the business around, and instead used the Telepanel technology in its gaming business, which was not the same or a similar business. * Law: Requirements to deduct: (1) same biz carried on and (2) for purpose of profit or REOP 🡺 if so, deductible only against income from either (1) the same biz or (2) substantially income from similar properties * Application: (1) Biz carried on: just not enough here. Also, need to be in 2007 when they try to deduct. Need to be *carried on* **throughout** the year. * Also, wouldn’t satisfy the test of “substantial income” from “similar property”🡪 Fact finding (sometimes, court stretches this to let people deduct losses) * (2) Even if the biz been carried on, not for profit. There’s some revenue, but not profit (= revenue – cost). Also, Losing tech—no future to turn around—no REOP * Even if there’s loss, nothing to setoff against.   *DD: REOP test: Stuart shut it down, but still: if want to distinguish b/t personal v biz, REOP is still a factor to be considered.*  ***Canadian Dredge 1981 TRB***  T carried on a marine construction business in the Maritimes and incurred losses in 1968-1970. Control of T was acquired by an unrelated company in Dec 1971, after which T acquired assets that were used in a marine construction business in another place and deducted prior year’s losses in 1971-1973.   * **Doesn’t have to be the same location—same biz at different location** * Decide for T: (1) T carried on a single business in different locations. (2) T’s activities in the Maritimes represented a continuation of the marine construction business at a reduced level on the basis that it was commonplace in the industry for businesses to lease marine equipment from their competitors as part of their business.   ***Garage Montplaisir 2001 FCA***  T acquired all the shares of an auto dealership (“Pinard”) in Dec 1983, at a time when Pinard had no EEs and had sold all of its tangible assets, including the building in which it had carried on the dealership. After amalgamating with Pinard on Jan 1 1985, T sought to deduct non-capital losses which Pinard had accumulated prior to the amalgamation.   * **\*\*\*It is the business which generated the losses which must be continued**, not necessarily the corporate entity; a reduction of activities, inventory and assets is not sufficient to show that the business was terminated; a minimum of activity may suffice to lead to the conclusion that there was continuity in the business; a business may have two separate operations and it is essentially a question of fact and of weighing the evidence, as to whether the business continued or not.\*\*\* * Decide for MNR. No continuation of THE business: (1) None of the structure of the biz or its production of goods or services was maintained. (2) The Group of mechanics, salesman and clerical staff did not join T’s staff…At the time control of Pinard was taken over, the Pinard biz had ceased to exist and was not reactivated by employing is key person on Commission.   ***Wigmar Holdings 1997 FCA***:  T acquired all the shares of 860 Holdings in Oct 1985, following the failure of 860’s real estate project and the resolution of subsequent foreclosure proceedings. Following the amalgamation of the two corps in Dec 1985, T, itself in the business of developing, selling and renting property, sought to carry forward non-capital losses of 860 from its 1982 taxation year which related to its real estate development business.   * Decide for T. * TCC: …860 remained registered as a corp, litigated the foreclosure, dealt with Central Trust, negotiated with parties respecting the sale of property…860 directed its efforts to keep the company in business. The transactions prior to the end of Oct 1985 resulted in a reduction of the corp debt by a substantial sum. The **hiatus** of the short year after Oct 31 1985 is for a period of only 60 days. For a corp in the development business, this is not a long period of time for matters to be in some abeyance. * FCA distinguished *Garage Montplaisir*. Whether the business continued or ceased is a finding of fact open to TJ to decide.   ***Crystal Beach Park 2006 TCC***  T had historically operated an amusement park on a particular parcel of land. Following a change of shareholders, the T began developing the property beyond its use as an amusement park.   * Decide for T. Court adopted a brad conception of the T’s business. Court found the essence of the business (pre- and post-amalgamation) was the exploitation of a recreational site, and was satisfied that T’s business after amalgamation was essentially the same as it had been during the loss years. The business throughout was “exploiting the income-producing potential of this great old recreational site.” * *DD: court went too far.*   ***Manac 1998 FCA***  T acquired the shares of a supplier called Nortex, which manufactured FRP panels used by T to manufacture trailers. After the takeover and amalgamation, T continued to manufacture the panels through its Nortex Division, using FRP panels in three of eight types of trailers and using other panels to produce other trailers. (vertical integration—Co1 of Y biz buy Co2 X biz)   * Decide for CRA: T did not receive any income from the sale of FRP panels which were incorporated into the trailers it sold, which could not be viewed as “similar properties”. * *DD: should be within the spirit of act—not just income from that biz* |

1. **Corporate Control and Acquisition of Control**

The loss restriction rules apply only when a T is subject to a “loss restriction event” which for corporations is defined in 251.2(2)(a) as the time that “control of the corporation is acquired by a person or group of persons.”

* “Control[[10]](#footnote-10)” without modifier = de jure control = the right of control that rests in ownership of such a member of shares as carries with it the right to a majority of the votes in the election of the Board of Director. (***Buckerfield***)

A person who controls one corporation also controls any corporation that is controlled directly or indirectly by the first corporation. (*Vineland*)

* In this circumstance, **256(6.1)(a)** stipulates that a subsidiary corporation that is controlled by a parent corporation is controlled **both** by the parent and any person or group of persons by whom the parent is controlled.

Per **256(7)(a)**, the loss restriction rules permit loss trading among related persons while generally prohibiting these arrangements among unrelated persons.

**256(6)** : **deemed non-control**

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| ***Duha Printers, 1998 SCC***  A corporation ("Marr's") controlled by Mr. Marr paid $2,000 to subscribe for redeemable preferred shares representing a majority of the voting rights of a corporation ("Duha") previously controlled by the Duha family. A shareholders' agreement provided that new shares could only be issued with the unanimous consent of the existing shareholders and that the board was to comprise any three of: Mr. & Mrs. Duha, Mr. Marr; and a friend of Messrs. Duha and Marr who previously had served on the Duha board. One day later, Marr's sold the shares of a subsidiary ("Outdoor") with significant non-capital losses to Duha.   * **DD: Ordinary serious of transactions** (GAAR language) happened. * Minister disallowed the deduction on the basis that Marr’s did not control Duha No. 2 prior to its amalgamation with Outdoor, and that the transactions at issue were artificial and a sham. * USA: the shareholders obviously restricted in part the ability of the directors to manage the corporation—only the fact the restriction of issuing future shares made it USA 🡪 effect of USA: not any “serious effect on the authority of directors to govern the business of the company and generally to direct its affairs.” * Summary of principles re “control” * 111(5): de jure control * Test for de jure control = *Buckerfield* test * When consider “effective control”, consider: governing statute, share register, any specific or unique limitation on either the majority shareholder’s power to control the election of the board or the board’s power to manage the business and affairs of the company, as manifested in either the constating documents or any USA. * Other external documents are irrelevant for this purpose * Even if there is limitation, the majority shareholder may nonetheless possess de jure control, unless there remains no other way for that shareholder to exercise “effective control” over the affairs and fortunes of the corporation in a manner analogous or equivalent to the *Buckerfield’s* test. * **GAARable? (1) tax benefit (2) tax motivated (3) \*abuse?—\*what’s being abused? 256(7)(a)—engineer with the relation that’s not intended by the act—may be. But problem: did not say it that way, did it really intend it? –Can be arguable.** * Subsequent legislations made Duha not possible now. |

**S. 256.1** Contains two rules designed to counteract arrangements like those in *Duha Printers*, designed to avoid the loss restriction rules and other rules restricting the transfer of corporate tax attributes. For our purposes, we only need to concern those reverse *Duha Printers*.

* **256.1(1**) defines an “**attribute trading restriction**” to include s. 111 and 10(10), 249(4) and 256(7) and a “**specified provision**” to include 10(1) and 111(4)-(5.3).

1. 256.1(2)-(5), supplements legal acquisition of control as a requirement for application of the loss restriction rules with a deemed acquisition of control test based share ownership exceeding 75% of the FMV of all shares.

* Purpose: to prevent “transactions…where, rather than acquiring legal control of a corporation, a purchaser will acquire economic control without taking legal control.”
* Per 256.1(3)(a)(ii), you trigger deemed acquisition of control, but not to trigger other rules re control.

1. 256.1(6) deems the loss restriction rules (and other “attribute trading restrictions”) to apply to one or more corporations “as if control of each of those corporations were acquired” if…it can reasonably be concluded that one of the main reasons for the acquisition of control is so that a [loss restriction rule or another] specified provision does not apply to one or more corporations…

* Purpose: to counter tax avoidance structure based on SCC decision in Duha Printers, under which corporate tax attributes were traded by arm’s length person in circumstances where a corporation (lossco) that has undeducted tax attributes acquires control of a profitable corporation (profitco).

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| **Deemed acquisition of control**  **256(6)** If, at any time as part of a transaction or event **or series of** transactions or events, control of a particular corporation is acquired by a person or group of persons and it can **reasonably** be concluded that **one of the main reasons** for the acquisition of control is so that a **specified provision** (e.g. 111(5)) does not apply to one or more corporations, the attribute trading restrictions are **deemed to apply** to each of those corporations as if control of each of those corporations were acquired **at that time (when Marr’s control Duha: Duha deemed to acquired Outdoor). 🡪 think this rule in the context of Duha** |

## SMALL BUSINESS DEDUCTION

**S. 125: A CCPC may, in computing its Part I tax, deduct an amount = min {17% of its income from “active businesses”, its “business limit”}**

* The deduction is actually a tax credit that effectively reduces the federal rate of tax on the active business income of a CCPC to 11%.

### Canadian-controlled Private Corporation[[11]](#footnote-11)

A CCPC is a “private corporation” that is a “Canadian corporation”, other than a corporation as described in any of paragraphs (a) to (d) of the definition in **125(7)**.

* **Canadian corporation** = (a) incorporated in Canada, or (b) resident in Canada throughout the period that began on Juan 18, 1971 and ends at that time.
* **Private corporation** = as at any time a corporation that is resident in Canada, not a public corporation, and not controlled by one or more public corporations: 89(1)
* Public corporation = a resident corporation that either:

1. has a class of its shares listed on a designated stock exchange in Canada as defined in s. 262, or
2. satisfies prescribed criteria for public distribution and dispersed ownership in Reg. 4800(1), and either elected to be a public corporations or was designated as such by the Minister; or
3. was a public corporation at any time after June 18, 1971 and has neither elected not to be nor bee designated by the minister not to be a public corporation.

* CCPC **≠**

1. a corporation controlled, directly or indirectly in any manner whatever, by one or more non-resident persons, by one or more public corporations (other than a prescribed venture capital corporation), by one or more corporations described in paragraph (c), or by any combination of them,
2. a corporation that would, if each share of the capital stock of a corporation that is owned by a non-resident person, by a public corporation (other than a prescribed venture capital corporation), or by a corporation described in paragraph (c) were owned by a particular person, be controlled by the particular person,
3. a corporation a class of the shares of the capital stock of which is listed on a designated stock exchange, or
4. in applying subsection (1)…[and] the definitions ***excessive eligible dividend designation***, ***general rate income pool*** and ***low rate income pool*** in subsection 89(1) and subsections 89(4) to (6), (8) to (10) and 249(3.1), a corporation that has made an election under subsection 89(11) and that has not revoked the election under subsection 89(12);

* Note: A CCPC does not require control by persons resident in Canada, but rather requires the absence of control by one or more non-resident persons, public corporations, or listed corporations pursuant to the restriction in (a) and the absence of control by a hypothetical grouping of such persons pursuant to the restriction in (b).

Control

* **251(5)(b)** deems persons with rights to or to acquire shares or voting rights in respect of shares of a corporation or rights to cause a corporation to redeem, acquire or cancel other shares or reduce the voting rights of other shares to be in the same position in relation to control of the corporation **as if the rights had been exercised.**
* **251(5)(a)** deems a “related group” to control a corporation where it is “in a position” to control a corporation “whether or not it is part of a larger group by which the corporation is in fact controlled”—further suggesting there can be simultaneous control.
* **251(6.1)(a)** provides for simultaneous control of a subsidiary by a parent company and any person or group of persons by whom the parent is controlled.
* **251(6.1)(b)** provides for simultaneous control of a company by a “first-tier” group of persons and any group of one or more persons comprising, for each corporation that is a member of the first-tier group, either the member or a person or group of persons by whom this corporation is controlled.
* **256(6):** a corporation that would otherwise be controlled or controlled directly or indirectly in any manner whatever by a person or partnership **is deemed not to be so controlled** where the purpose for which the person or partnership controlled the corporation was to safeguard rights or interests of the controlled in respect of indebtedness owed to it by the corporation or certain share capital of the corporation owned by it and there exists an enforceable agreement or arrangement under which the corporation can reasonably expected to cease to be controlled by the controlled and to be or become controlled by an arm’s length person or group[[12]](#footnote-12).
* **256(5.1):** **“controlled, directly or indirectly in any manner whatever,” = de facto control**: the controller has any direct or indirect influence that, if exercised, would result in control in fact of the corporation.
* Although the language of 256(6) might denote only *de facto* control, **it is generally accepted that this expression encompasses both *de jure* control and *de facto* control.**

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| ***Silicon Graphics 2002 FCA (reversed by 125(7)(c)(d))***  *The taxpayer, which was a Canadian corporation with Canadian management, had effected a public offering of its common shares in the U.S. as a result of which 89% and 74% of its common shares were owned by non-residents in its 1992 and 1993 taxation years, respectively.*   * In finding that the taxpayer was not "controlled, directly or indirectly in any manner whatever, by one or more non-resident persons", Sexton J.A. found that the quoted phrase was synonymous to control by a non-resident person or *group* of non-resident persons, that "'control' necessitates that there be a **sufficient common connection** between the several persons referred to in that definition in order for there to be control by those several persons" and that "the common connection might include, *inter alia*, a voting agreement, an agreement to act in concert, or business or family arrangements". Here, there was no evidence of any common connection among the non-resident shareholders. * Respecting a submission of the Crown that a U.S. corporation ("Silicon U.S."), that had lent U.S $5 million to the taxpayer and made financial contributions for software development and marketing, whose founder was a director of the taxpayer and whose hardware was utilized by the taxpayer's software, exercised *de facto* control over the taxpayer, Sexton J.A. stated "that in order for there to be a finding of *de facto* control a person or group of persons must have the clear right and ability to effect a significant change in the board of directors or to influence in a very direct way the shareholders who would otherwise have the ability to elect the board of directors." Here, Silicon U.S. was merely protecting its interests as lender to the taxpayer, and Toronto management managed the taxpayer and annually prepared the slate of individuals to be elected to the board. |

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| ***Interpretation Bulletin IT-64R4***   * Cancelled later; but cited favourably in *Mimetix Pharmaceuticals* and *Transport M.L. Couture*. * 21. De facto control goes beyond de jure control and includes the ability to control “in fact” by any direct or indirect influence. De facto control may exist even without the ownership of any shares. It can take many forms, e.g., the ability of a person to change the board of directors or reverse its decisions, to make alternative decisions concerning the actions of the corporation in the short, medium or long term, to directly or indirectly terminate the corporation or its business, or to appropriate its profits and property. * 23. Factors to consider:  1. the percentage of ownership of voting shares in relation to the holdings of other shareholders; 2. ownership of a large debt of a corporation which may become payable on demand (unless exempted by 256(3) or (6)) or a substantial investment in retractable referred shares; 3. shareholder agreements including the holding of a casting vote; 4. commercial or contractual relationships of the corporation, e.g. economic dependence on a single supplier or customer; 5. possession of a unique expertise that is required to operate the business; and 6. the influence that a family member, who is a shareholder, creditor, supplier, etc., of a corporation, may have over another family member who is a shareholder of the corporation.  * Close family ties🡪influence (but not include siblings) |

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| ***Mimetix Pharmaceuticals 2003 FCA***  *T incorporated in Canada to carry out research and development with respect to a pharmaceutical product for which it obtained from a US company a licence.*   * Rejecting T’s argument that it was a CCPC because two of three directors were residents of Canada and 50 of 100 voting common shares were owned by Canadian residents, the court concluded that T was controlled de facto by the US co. and therefore not a CCPC that was eligible for enhanced and refundable SR&ED tax credits, for:  1. Control and supervision over the affairs and business not exercised by Canadian directors, who made no decisions, knew little about the company’s business and had never met each other, but by the non-resident director who was chair and chief executive officer of US co. 2. T was economically dependent on the US co. which not only owned the other 50 common shares (worth $1 each), but had invested over $4 million in the form of preferred shares worth $3 million and an interest-free loan of $1.1 million, had sub-licensed to the T for no consideration rights to the pharmaceutical product that it had paid $100K to acquire.   DD: Note: to be a CCPC, you don’t have to be controlled by Canadian, you just need to be not controlled by non-residents  ***Lyrtech 2015 FCA***  *Lyrtech, a public co tried to get benefits of CCPC by setting up a trust and relevant arrangements of trust.*   * Court held that the T was controlled de facto by Lyrtech on the grounds that the two inside directors exercised control over the T as trustees of FFL under a sole shareholder declaration by which FFL assumed all powers of the company’s directors, and that Lyrtech exercised significant influence over the T and…the T was economically dependent on Lyrtech. * FCA also agreed with TCC that a corporation can be simultaneously controlled by more than one persons or groups. Accordingly, even if the T was controlled de jure by a qualifying person or group, it could not constitute a CCPC because it was controlled de facto by Lyrtech.   ***Sedona Networks 2007 FCA***  *T=private Canadain corp—a number of shares owned by BMCC—a wholly owned subsidiary of BMO, a public corp—but subject to a management agreement w/ V corp, under which V had voting rights and right to acquire shares in case of termination of K.*   * Court held that the “hypothetical shareholder” in 125(7) was to be regarded as owning BMO’s shares of BMCC. * “Recognizing that control can be determined indirectly through a chain of corps, Parliament… took care to refer not only to the shares of the target corp, but to those of any relevant corporation in the chain.”   ***Ekamant 2009 TCC***  *T=private Canadian corp—75% voting shares owned by three related US residents, 25% owned by a Canadian resident who had option to buy purchase the remaining shares.*   * Rejecting T’s argument that it was a CCPC by virtue of the deeming rule in 251(5)(b)(i), which would deem the Canadian resident’s option to be exercised for the purpose of determine de jure control of T, the court held that the T was also controlled by the related US residents and therefore not a CCPC. * There can be two persons or groups of persons that are simultaneously in a position of control with respect to a corporation, namely: on the basis of reality and on the basis of legal fiction. * The fiction created by 251(5)(b) does not state that the real owners of the shares that are the subject of an option are deemed no longer to be the owners, or that they are deemed no longer to control the corp.   ***Bioartificial 2013 FCA***  *60% of T’s voting shares held by non-resident investors—USA provides for election of directors by Canadian residents; the non-residents had the right to appoint only 3 of the 7 directors.*   * Relying on *Duha* that USA must be considered when deciding de jure control, the court held that T was a CCPC notwithstanding the deeming rule in 125(7)(b) on the basis that the hypothetical shareholder contemplated by the rule could not have been controlled by the company as a result of the USA. |

### Business Limit and Associated Corporations

(a) Business Limit

**S. 125(2)(3)** limit the small business deduction to the first **$500,000** of qualifying active business income and to require this “business limit” to be shared among CCPCs that are “associated” with each other in the taxation year.

* **Purpose**: to prevent T from obtaining a reduced rate of corporate tax on more than $500K of active business income through the multiplication of closely connected or “associated” corporations.
* **125(5.1)** reduces the amount of a corporation’s business limit otherwise determined according to a formula that applies once the corp’s “taxable capital employed in Canada” exceeds $10 million and generally eliminates the business limit once it reaches $15 million.
* **125(4)** allows the Minister to allocate the business limit among associated corps.

(b) Associated Corporations

**S. 256(1): associated corps**

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| (a) Control of one corp by another | Direct Control Indirect Control |
| (b) Control of corps by the same person or group of persons | “group of persons” in 256(1.2)(a) = “any two or more persons each of whom **owns shares**” and on assumption that A and B have a **sufficient link** to enable them to exercise control or actually act together to exert control [*Silicon Graphics]*    See definition of “group” in 256(1.2)(a) and interpretive rule in 256(1.2)(b)(i), which stipulates “for greater certainty” that “a corp that is controlled by one or more members of a particular group of persons in respect of the corporation shall be considered to be controlled by that group of persons” |
| (c) Control of one corp by related persons **and** cross-ownership (>=25% shares) | “related persons”—251(2) (--251(6)) |
| (d) Control of one corp by a person related to each member of a group controlling the other corporation and cross-ownership | Note: since subsection 256(1.5) deems A to be related to himself or herself as a shareholder of Y Co., X Co. and Y Co. would still be associated even if A’s sibling or child disposed of their shares or voting rights to an unrelated person. |
| (e) Control of corp by related groups each of the members of one of which is related to all the members of the other and cross ownership by **one or more person** who were members of both related groups. | Note: since subsection 256(1.5) deems A to be related to himself or herself as a shareholder of Y Co., X Co. and Y Co. would still be associated even if one of the siblings disposed of their shares or voting rights to an unrelated person |

(i) De Jure Control

“Control” without modifier = de jure control = the right of control that rests in ownership of such a member of shares as carries with it the right to a majority of the votes in the election of the Board of Director. (*Buckerfield*)

Definitions

* “Controlled, directly or indirectly in any manner whatever”(as in 256(1)) = de facto control as well as de jure control: 256(5.1)
* “Related persons”: 251(2)
* “Related group” = a group of persons each member of which is related to every other member of the group: 251(4)

**Deeming Rules**

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| Deemed to be related | * Persons with rights to acquire shares or voting rights in shares or to cause a corp to redeem is deemed to be in the position they would be in if they exercised the rights: 251(5)(b) * Persons who own shares in two or more corps are deemed to be related to themselves: 251(5)(c) * A related group is deemed to control a corp where it is in a position to control a corp whether or not it is part of a larger group by which the corp is in fact controlled: 251(5)(a) * Two corps are deemed to be related to each other where they are related to the same corp: 251(3)   Note: the rules for related persons turn on the concept of *de jure* control, rather than *de facto* control. | | | |
| Deemed control 256(1.2)(g) |  | 256(1.2)(g) stipulates that shares are valued as if there were no voting rights to prevent majority premiums and minority discounts, and deemed control can be by a person or by a group of persons | | |
| Deemed Ownership Through a Corporation 256(1.2)(d) | (slide15 0127) | | 256(1.2)(d) deems Mr. A to own 25 per cent of Opco 2. As a result, Opco 1 and Opco 2 are associated with each other under paragraph 256(1)(c).  (If A owns 30% shares of Xco which owns Yco., A is deemed to own 30% shares of Yco.) | |
| Deemed Ownership Through a Partnership 256(1.2)(e) |  | | Assuming A, B, C and D are equal partners in ABCD Partnership, each will be deemed by 256(1.2)(e) to own 10 per cent of the shares of Corporation B. Therefore, Corporation A and Corporation B will be associated with each other under 256(1)(b) because both corporations are controlled by Mr. A. | |
| Deemed Ownership Through a Trust 256(1.2)(f) |  | | Corporation A and B are associated under 256(1)(c) since each of X’s children are deemed by subparagraph 256(1.2)(f)(ii) to own all of the shares of Corporation B that are owned by the trust. As well, since X’s uncle controls Corporation B as the sole trustee of the trust, Corporation B and Corporation C are associated under 256(1)(b). | |
| Deemed Ownership of Shares by a Parent: 256(1.3) and *431543 BC* (TCC, 2000) |  | | Since the trust was discretionary with the Barnes children as sole beneficiaries, 256(1.2)(f)(ii) deems each child to own the 100 B shares of 431453 BC. These are deemed to be owned by Janet Barnes under 256(1.3), as a result of which 431453 BC. and Edcorp are associated under paragraph 256(1)(c) [and under paragraph 256(1)(b)]. Note that the C shares of Edcorp must have been specified shares since the companies would otherwise be associated under 256(1)(c) without relying on 256(1.2)(f) and 256(1.3). | |
| Deemed Ownership of Shares & Non-Ownership of Shares | 256(1.4): options and rights deemed to be exercised  Deemed ownership rules can be taken into account when considering whether control exists—de jure control. | | | |
| Deemed Association: 256(2) | This example is based on *Holiday Luggage* (FCTD, 1987), where the court concluded that 256(2) did not apply based on a purposive interpretation of the provision, since C Co. (Stradellina) was resident in the U.S. and therefore not a CCPC. | | | A Co. and B Co. are not associated with each other but each company is associated with C Co. under 256(1)(d). As a result, they are deemed to be associated **unless** C Co. is not a CCPC or elects not to be associated with A Co. and B Co., in which case its business limit for the year is deemed to be nil.  Note: If C is not a CCPC, not deemed. Even if C is a CCPC, C can elect out of the rules. |
| Deemed Non-Association (Saving Provisions) | * 256(3): association by virtue of control where agreement to protect debt or shares and reasonable to expect control to cease * 256(4) association by reason of control by the same executor, liquidator of succession or trustee * 256(5): association where one corporation is a trustee under a trust pursuant to which the corporation is controlled | | | |

(ii) De Facto Control

See page

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| ***Transport M.L. Couture 2004 FCA***  *Case addressed the concept of de facto control in the context of associated corporation rules. Facts see ppt.*   * The taxpayer was found to be controlled within the meaning of s. 256(5.1) by another corporation ("Transport Couture") given the **economic dependence** of the taxpayer on Transport Couture and the **operational control** of Transport Couture (the taxpayer had no employees, all management and other personnel services were provided to it by Transport Couture and Transport Couture was its **only customer**) and given that Transport Couture was **owned indirectly** **by the five sons** of the sole shareholder of the taxpayer, who was in declining health and who relied on his sons. * **Take away: Factors to pay attention to in order to de facto control:** (256(1))  1. Economic dependence: generally argued when argue A depends on B. 🡨 Management, drivers, EEs, services, only contractor, same premises. 2. Family relationships. More reasonable to infer there’s control going on when in family relations. 3. Operational control: no written agreement b/t the parties—suggests an influence, statements signed by same people, all business operated by the two brothers etc.  * Argument of T (besides denying the facts): * Prices are reasonable: CRA: not the issue here. Not important. * If you got de jure control, you can’t say de facto control of another party. This argument depends on the language of 256(1.2) doesn’t include (5.1)—can’t have simultaneous control. Court: just “for greater certainty”, drafter doesn’t have to refer to it. DD: maybe they should have added (5.1), but it’s not fatal.   ***Rosario Poirier Inc 2002 TCC***  T(RPI) =CCPC—80% voting shares held by RP, remaining shares held by RP’s son LP. LP=director and EE. In late 1980s, LP acquired all the shares of Trab Co which owned a truck ($200) and a timber transport permit ($5500). T sold Trab Co its truck for $1, and Trab provided transport services to T. T’s EEs continued to drive the truck.   * Court held that T exercised de facto control over Trab such that they were associated under 256(1)(a), on the grounds that (1) T exercised operational control over Trab, and (2) Trab obtained almost all its income from T, and (3) Trab’s business was carried on by EEs of T, and (4) Trab’s place of business was that of T.   ***Société Fonciere d’Investissement 1996 TCC***  *T=CCPC—PA owns 0.2% of voting shares, and his two daughters own 49.9% each. T’s only customer is Dobersol Co, all the shares of which owned by PA.*   * Resolutions adopted by PA’s daughters in their capacity as directors of T conferred operational control of T on PA as the “General Manager” of T 🡪 T and Dobersol associated under 256(1)(b) “control by the same person”. * “During which the resolutions were in effect, he had complete authority to manage all aspects of the corporation’s commercial and financial dealings. I admit that the other shareholders had the power to divest him of this authority, but as long as he was permitted to exercise it he was in a position of unlimited control.” * The exception contained in the second part of 256(5.1) demonstrates the breadth of this provision. That exception exists when the control is derived from certain commercial agreements where the “controller” (PA) and the corporation are dealing with each other at arm’s length. There was no arm’s length dealing between PA and the corporation, not only b/c of the fact that he had very close ties with the corporation he was managing but also because of the fact that the two majority shareholders were his daughters.   ***Lenester Sales 2004 FCA***  Ts (LS and SS) and 80-90 similar corporations operated Giant Tiger stores under an arrangement whereby 499 voting shares were held by Giant Tiger Stores Limited (GTS) and 501voting shares by independent operators under a franchise agreement imposing detailed conditions on the way in which the business was conducted. Shareholders agreement: (1) 2 directors, 1 nominated by GTS and 1 by the independent operator; (2) “shotgun clause”; (3) if disagreement, either shareholder can wind up.   * The companies are not controlled by GTS, because: the franchise and shareholder agreements and banking, financial and accounting arrangements did not give GTS de facto control over the corps, and would qualify for the exception in 256(6.1) if they did. * “I think the GTS arrangement is precisely the sort of thing that the franchise exception in the second part of 256(5.1) is aimed at.” * …the franchisees and GTS were at arm’s length. They had separate interests and no single or controlling mind. Nor did they “act in concert” in a way that deprives the relationship of its arm’s length nature.   ***Brownco 2008 TCC***  *T (Brownco)=CCPC–shares held equally by 147 Co and Bost Co.*   * The taxpayer was subject to the *de facto* control of the holder of ½ of its shares ("Bost") given that under the USA between Bost and the other 50% shareholder, the board was to consist of one director nominated by each shareholder, a nominee of Bost was to be the Chairman, and in the event of a tie of votes, the Chairman was entitled to cast the deciding vote. * The franchise exception in s. 256(5.1) did not apply as the **USA was not similar to a franchise agreement** (it did not deal with providing the trade name used by Bost to the taxpayer, it did not contain any clauses dealing with the granting of a licence or a lease of property or a distribution or supply of any product, it did not specify how tasks were to be accomplished or how the business of the taxpayer was to be conducted, and instead dealt with matters between the two shareholders) and the fact that the taxpayer and Bost were **not dealing at arm's-length** was evidenced by the fact that the taxpayer provided a guarantee of Bost liabilities without receiving anything in return. * *Lenester* is distinguishable because here there is no franchise agreement. * For the purpose of determining de facto control, no difference between whether a shareholder controls the decision making of the board by virtue of being able to elect the majority of the directors, or by virtue of the fact that its nominee director is entitled to cast the majority of the votes at a meeting of directors. * Fiduciary duties not relevant—control can be held and exercised without breaching fiduciary duties.   DD: You probably can put in a franchise agreement and dress it up to fit into the exception in 256(5.1).  ***Plomberie 2007 FCA***   * Rejecting T’s argument that TJ had ignored the terms of a USA in finding that an individual RS, who held 50% of the shares of the taxpayer, had *de facto* control of the taxpayer, the Court noted that the parties did not comply with the shareholders agreement and also noted that RS had caused the corporation to engage in numerous unusual transactions without shareholder approval. And hence T and other companies by RS were associated under 256(1)(b).   ***Taber Solids Control 2009 TCC***   * The taxpayer ("Taber 1998") and its majority shareholder ("Ken") were found to have *de facto* control over a corporation that was owned by Ken's wife ("Old Taber") given that the taxpayer was the sole customer of Old Taber and Ken's wife did not have the contacts or appropriate business acumen to carry out the business of Old Taber without her husband's assistance and decision making. * Old Taber and Taber 1998 were associated because of their economically dependency relationship and because Ken exercised considerable influence over the major operational and board decision of Old Taber. (Only customer. No interest. Same premises. Ken presented daily, contact person for both companies. Treated like one co. Old Taber buy more assets so that new Taber can rent to other people, but bill paid by new Taber)   ***McGillivray Restaurant 2015 TCC***   * **Operational control, decision making and economic pressure are sufficient** * The taxpayer's business was a franchised restaurant. Boyle J found that it was required to share the small business deduction with corporations controlled *de jure* by the husband ("Robert") of its 76% shareholder on the basis that Robert had *de* facto control of it as described in s. 256(5.1): Robert as officer and director made all the important decisions; it was dependent on one of his companies for the provision of administrative services as well as for the leasing to it of the premises; and she could not have sold her controlling interest without the consent of the franchisor. * After referring to the [*Silicon Graphics*](http://taxinterpretations.com/topic/income-tax-act/section-256#node-319257) statements that, to have *de facto* control of a corporation, a person or persons must have the clear ability to effect a significant change in the board or directly influence the shareholders, Boyle J stated that more recently it had been found to be appropriate to rely on "who controlled day‑to‑day operations, who made all the decisions, who signed all the business agreements, invoices and cheques, and who was in a position to exert economic pressure in order to have its will prevail with respect to the business and… the corporation," and then stated: In applying the *de facto* control test…this Court should be attempting to determine who is, in fact, in effective control of the affairs and fortunes of the corporation. (Expanded Silicon test?)   DD: Clearly planned, but didn’t planned out of de facto control. You got to set up something that’s sufficiently real. |

(iii) Anti-Avoidance Rule

**256(2.1)** deems two or more corporations to be associated where “it may reasonably be considered that one of the main reasons for the separate existence of those corporations in a taxation year is to reduce the amount of taxes that would otherwise be payable under this Act or to increase the amount of refundable investment tax credit under s. 127.1”[[13]](#footnote-13).

* DD: arguably, If use income splitting to reduce tax, this rule can come in. (not just for small business deduction)

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| ***Hughes Homes 1997 TCC***  Hughes Homes incorporated by both Mr. and Mrs. Hughes working as a team, each owing 50% of its shares. Mr. Huges was the directing mind and Mrs. Huges performing all the office functions. Huges Homes became a management company that carried on the building business through five companies. Mrs. Huges incorporated Lopa (100% shares) to provide the design and decorating services to Huges Homes and the five companies. Later in 1990, Mrs. Huges reduced her equity in Hughes Homes from 50% to 10%.   * Issue: whether Hughes Homes and Lopa were deemed associated corporations by virtue of 256(2.1) for the 1991-92 taxation years? * T’s argument: reason to set up *Lopa*: (1) asset protection (DD: but you have five companies under Hughes Homes—it’s already insulated) (2) She wants to have a separate business. * Court: Even tax avoidance is a reason, it needs to be a “main” reason to satisfy 256(2.1). * “reasonably”—objective test * Court bought both of T’s arguments. * “while she operated a business that complemented her husband’s activities, the scope of her activities were adequately separate and distinct.” * Court also find that although Huges Homes is the only customer of Lopa’s, it is “not unreasonable to believe that such a company with so great a work load would foster its existing business relations by not seeking work with the competition. Each business was exclusively doing its own thing, with neither business encroaching on the field of the other.” * Though the share reduction accomplished tax savings for Lopa, the court didn’t find it to be one of the main reasons for Lopa’s separate existence, but only **incidental** to the above two reasons.   DD: Only customer—economic dependence—CRA could’ve used *de facto* control argument.  ***Taber, supra***: court followed *Hughes Homes* and rejected CRA’s 256(2.1) argument: there were legitimate business reasons to have separate corporations…the small business deduction was not even a reason, let alone the main reason. Tax benefit is not sufficient in and of itself to conclude it must have been a main reason for the separate existence of the corporations.  ***Brownco, supra***: After finding the corps were associated under 256(1)(a) on the basis of de facto control, the court also stated that it “would have found that one of the main reasons…was the reduction of tax” had it been necessary to address the Minister’s alternative argument (no real franchise, no real benefit for XX to have this company, evidence of tax planning etc).  ***JLP Sales Agency 2003 TCC:*** The reason for the separate existence of two corporations, one of them owned by the husband, and the other one substantially owned by his wife, was to accommodate their desire to equally split their future accrual of wealth, so that they could each leave their estates as they wished (in the context of a vehement disagreement as to whether any property should be left to their children). The two corporations were not associated.   * Court: tax benefit only incidental. (DD: emotional arguments could work.)   ***Maintenance Euréka 2011 TCC***: 2 corps, same business. Husband and wife respectively own 76% shares. Their son owns 24% shares of both corps.   * Court find tax avoidance was a main reason for the separate existence of corps and hence 256(2.1) applies. * Husband’s explanation not credible: unlikely a husband would not assist his wife in starting up a business in a field that he knows well. * 24% instead of 25% shares by son suspicious—suggests tax planning * Operated in same territory; same admin staff; consulted each other when bid * Common interest of the two corps and the family members |

### Income or loss from an Active Business

Income from an active business = the corp’s income for the year from an active business carried on by it including any income for the year pertaining to or incident to that business, *other than* income for the year from a source in Canada that is a property[[14]](#footnote-14): **125(7).**

* **Active business** = any business carried on by the corp other than a “specified investment business” or a “personal services business” and includes an adventure or concern in the nature of trade.
* **Specified investment business** = a business (other than a business carried on by a credit union or a business of leasing property other than real…property) the principal purpose of which is to derive income (including interest, dividends, rents and royalties) from property but, …*does not include* a business where

1. the corporation employs in the business throughout the year more than 5 full-time employees, or
2. any other corporation associated with the corporation 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 corp could reasonably be expected to require more than 5 full-time employees if those services had not been provided.

* Income from a source that is a property excludes income 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.

🡺 **Income from an active business** = income from any business according to its ordinary meaning other than income from a specified investment business or a personal services business, as well as income that pertains to or is incident to the business and income from an adventure or concern in the nature of trade, but excluding income from a source that is a property.

**(a) Active Business**

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| ***Canadian Marconi 1986 SCC***  Interest, which an electronic equipment manufacturer received from short term loans and certificates of deposit which it had acquired out of the proceeds of sale of a broadcasting station, was held to be "income ... from an active business carried on in Canada."   * The manufacturer has a specific "investment business" object, and there is a rebuttable presumption that income earned by a corporation in the exercise of its duly authorized objects is income from a business. * Presumption not rebutted b/c there were enough activities going on: the extensive activities of the [taxpayer's] employees in purchasing short-term investments…the day-to-day intervention of the officers and directors in the company’s business * Court: investment business here is active business and it’s a separate business from the electronic manufacturing or broadcasting business.   **Note**: this is pre-SIB. **Now would be SIB** (unless can say biz of trading capital property etc.)  **DD:** Corporate statute has changed. **The presumption is dated** and not consistent with the scheme of ITA’s—not sure can still be relied on. But the “level of activity” is important.  ***Harquail 2001 FCA***  During the relevant period T no longer carried on its business of selling lots, and its subsidiary HR had not begun to carry on a business of selling electricity. Reversing TCC’s decision, FCA held that HR had carried on an active business because “it was constantly on the look-out for a market to develop its hydroelectric potential.”   * “It was not easy to delimit the content of the concept of carrying business. One can see two outside parameters where the carrying on of business does not occur: on the one hand…has not actually commenced operation and, on the other hand, when a company has become dormant and is only holding annual meetings and filing its returns so as to avoid the forfeiture of tis charter. There are, in between, some activities, however, which are signs that a company is operating and which should fall within the spectrum of the concept of carrying on business, even though, for example, the activities are carried on for the purpose of reaching an agreement which eventually is not reached or even though they do not result in the earning of income.”   ***Ollenberger 2013 FCA***  T was established for the purpose of acquiring oil and gas properties and operating or selling these properties, but it failed to do so when it forfeited a deposit to purchase oil and gas assets, title of which turned out to be defective. Reversing TCC’s decision, FAC held that the corporation had carried on an active business on the grounds that the definition of an “active business” in 248(1) refers to “any” business carried on, and that the Crown admitted that T had actively pursued ventures involving the acquisition of oil and gas assets.   * The notion “active business” was first introduced into the Act intended to distinguish corporations that generate income from business activity from those which generate so-called “passive income…the carrying on of a business requires a minimum degree of activity. |

\*\*Important of characterizing “the business”: if it’s a separate investment business—you gotta make sure it’s not SIB.

**(b) Specified Investment Business (SIB)**

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| ***Temax Investments 1990 TCC***  T=mtg broker; business=providing mtg financing on the security of second, third and fourth mtgs. Major portion of income = interest income. T tried to rely on the presumption and level of activities. Court: statute amended; move on. Income=SIB, not income from active business.   * The legislator has used the words “principal purpose”…the purpose of defining SIB was to bring in its scope businesses such as the T’s. * Although there is, in the case of the T, sufficient activity to conclude that they are indeed deriving income from business, since the source of revenues is principally interest income, it would seem that this is what is meant by “the principal purpose of which is to derive income from property”. That is when the source of revenue, the nature of the assets held, and the purpose of the corporation are to derive income from property, such as interest income. The Ts are not generating the major portion of their income from the services that they provide but rather from the interest from mortgages.   ***Porter Land 1986 TCC:*** T derived income from contract farming, farm management and tenant farming. Concluding that the income from tenant farming operations derived not from farming but from the rental of property, the court characterized this income as income from SIB.  ***Luigi Tiengo Art & Design 1992 TCC***: T provided design and consultation services to clients (furniture manufacturers), for which T was paid a negotiated percentage of sales revenues from finished products. Rejecting the Ministers’ argument that it’s SIB the principal purpose of which was to derive royalties, the court held that the mode of remuneration should not distort the true nature of the corporation’s business, which was to derive business income from the provision of design and consulting services.  ***Hughes 1994 TCC:*** lawyer phoning in and visiting office while on business trips—not full time EE.  ***489599 BC 2008 TCC***: “more than five full-time employees” = 5 full time EEs + something else.   * If Parliament meant at least six employees, it simply would have stated it.   ***Baker 2005 FCA***: T hired 6 custodians who each worked 20 hours per week. Rejecting T’s claim that 20-hour work-weeks were standard in their industry, the court held that T was not eligible for the exception in 125(7)(a) of the definition of SIB.  **DD:** Still not clear what “full time” means. But at least we’ve settled on the “at least 5” part.  ***Casey Realty 1991 TCC***: DC and his brother held shares in three companies A B C, A owns all the shares of a subsidiary D. C carried out construction, renovation and repairs for the buildings owned by B and D. Neither employed more than five full-time EEs, but altogether they did. B’s principal purpose was to derive income from property. C carried on an active business, and C was associated with B and D.   * Issue: (1) whether the services C provided to B and D were of the type contemplated in 125(7)(b); and (2) whether B and D could reasonably be expected to require more than 5 full-time EEs if these services had not been provided. * Court: D would have required more than 5 full time EEs to renovate its properties (similar to “maintenance”). But no evidence B would have required more than 5 full time EEs. |

**(c) Income pertaining to incident to active business and income from property used or held principally for the purpose of gaining or producing income from an active business**

The cumulative effect of 129(4) and 125(7) is to expand the scope of active business income to include income from property where either the income is incident to or pertains to the active business or the property is used or held principally for the purpose of gaining or producing income from the active business.

***COURT REALLY PAYS ATTENTION TO THE NATURE OF THE BUSINESS!!***

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| ***Irving Garber Sales 1992 TCC***  The taxpayer, which was engaged in the sale of raw fur skins and of manufactured fur coats, had its holdings of certificates of deposit grow from $285,000 to $623,000 from 1978 to 1982.   * Issue: interest earned: from property or business? * Although the taxpayer's other assets (mainly accounts receivable of up to $16,000) were relatively minimal, Joyal J. found that $200,000 of the certificates of deposits constituted a reasonable reserves for the exigencies of the taxpayer's business (so that the income thereon was active business income) in light *inter alia* of the need to demonstrate financial stability in order to participate in fur auctions and the fact that it was at risk for the full amount of each individual purchase of furs which, in some cases, were substantial.   **DD**: the reserve argument is a good one; **court will look at the history, financial dependence relationship etc.**  No basis to decide what’s reasonable:  ***Atlas Industries 1986 TCC***: Deposits were not called upon to cover expenses, to provide collateral for loans, or to meet future capital requirements 🡪 interest payments = income from property.  ***McCutcheon Farms 1990 TCC***: Deposits not used for business purposes, and far larger than any reasonably foreseeable emergency would require 🡪 interest income = income from property that neither pertained to nor was incident to the T’s farming business nor from property used or held principally for the purpose of gaining or producing income from an active business.  How close the activity is to T’s active business:  ***Majestic Tools 1993 TCC***   * Court was not prepared to second-guess the T’s business judgment that the term deposits were “used to fulfill a requirement that had to be met in order to do business,…that there existed a financial relationship of substantive dependence and reliance between the …term deposits and the T’s active business, that they existed as a decided and reasonable back-up asset of liquidity as demanded in the industry, and that their fundamental purpose was to sustain the business operations during…difficult times…”. * Based on all the circumstances of T’s business, especially during the recessionary years of 1989 and 1990, “the removal of the …term deposits, whether in pat or in whole, would have had a decidedly destabilizing and significant effect on its business operations”.   ***Balmoral Investments***: T owned and operated hotels, earned interest income comprising 37% of its revenues in 1990 and 84% of its revenues in 1991 after it sold a hotel in 1989 and invested the proceeds in term deposits.   * Rejecting T’s argument that the income was active business income from capital that it intended to use to acquire other hotels, the court held that: not sufficient degree of dependence by the active business (running hotels) on the moneys. T may have needed the moneys to acquire other hotels but this…does not in itself make those moneys incident to or pertaining to the active business of the company. The company’s active business was running hotels, not the purchase and sale of hotels. The moneys were not called upon to run the business.   ***Supreme Theatres 1981 TCC***: T owned and operated theatres.   * Court: Rent from the lease of the theatre to the club and from the lease of the drive-in theatre = incidental to its active business of operating theatres; the other rental income (from basement of one theatre, vacant land it held, the rental of apartments and a portion of a theatre parking lot) was income from property. * **DD: Note court’s discretion to define the scope of T’s business.**   ***Alamar Farms*** ***1992 TCC***: T carried on farming business and derived royalty income from oil wells under the farm. On the basis that all the royalty income went into financing the farm, the court held that it was incidental…not a separate SIB.   * **DD: wrong! The language is “income pertaining to or incident to”, NOT “the use of income”.** |

## AGGREGATE INVESTMENT INCOME AND DIVIDEND REFUND

**S. 129** refunds a portion of the tax paid by a CCPC on aggregate investment income and the full amount of Part IV tax paid by a private or subject corp when the corp pays a dividend to its shareholders, in order to minimize double taxation when corporations pay dividends out of income that has been subject to tax at higher rates.

### Aggregate Investment Income

* **129(4): “Aggregate investment income”** = [“eligible portion” of the corp’s net taxable capital gains for the year – net capital losses carried over from other years] + [corp’s income for the year from property sources (other than inter-corp dividends that are deductible under 112 or 113) – corp’s losses for the year from property]
* **“Eligible portion”:** the portion that cannot reasonably be regarded as having accrued while the property, or a property for which it was substituted, was property of a corporation other than a CCPC, and the income or loss of a corporation from a source that is a property to **include** income from a SIB carried on by the corp in Canada and to **exclude** income from property that is either incident to or pertains to an active business carried on by it or that is used or held principally for the purpose of gaining or producing income from an active business carried on by it.

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| ***Marsh & McLennan 1983 FCA***[[15]](#footnote-15)  Interest earned, on the investment of funds received by an insurance broker, during the period before those funds had to be paid to the insurers, was held not to be Canadian investment income under the pre-1979 version of the definition.   * Ruled for M. Income = ABI * Per Clement, D.J.: The funds so invested may be contrasted with an investment in a long-term bond with no need to use the principal in the on-going business. Here, the funds would be required for payment to the insurers within 90 days of their investment, and the investments and the insurance broker's were interdependent. The investments thus were used in its business. * Per Le Dain, J.: The funds were employed and risked in the business, as an amount equivalent to the amount so invested was committed to the carrying-on of the business in order to meet the insurance broker's obligations to the insurers, and the invested funds were thus property used or held in the course of carrying on its business. * *DD: Act not clear whether they were talking about property or income. More agree with the majority—would make sense of the statutory scheme --> if you focus both on the income and the property, may be easier.*   ***Ensite 1986 SCC***  The taxpayer made U.S. dollar deposits with commercial banks in order to reduce its net borrowing cost under a swap arrangement respecting an investment by the taxpayer in a stamping plant in the Phillipines. The swap arrangement in turn resulted from a requirement under Phillipines law that it bring foreign currency into the Phillipines to finance the stamping plant.   * Issue: is the U.S. dollar deposits property held principally for the purpose of producing income from an active business? * Yes. The deposits complied with the test that they be property that "was used to fulfil a requirement which had to be met in order to do business. Such property is then truly employed and risked in the business." * T: everything is risked in business. Court: can’t be that broad. Risk means more than just remote risk—has to relate to the core of the business.   ***Brown Boveri Howden 1983 FCA***  Interest earned on the investment in 30-day notes of progress payments received by a manufacturer on its long-term contracts related to money that was committed to the carrying-on of the manufacturing business, and thus was not Canadian investment income.  **Cornwall Gravel 1994 TCC**  The taxpayer, which was in the aggregates business, was in many cases required to secure a performance bond from a bonding company before obtaining contracts.   * Bonner TCJ. found that the taxpayer had failed to rebut the assumption made by the Minister that term deposits, equal in amount to the lowest level of term deposits held by the taxpayer in each year, were necessary in order to receive such performance bonds. Accordingly, the related interest income pertained to or was incident to income from its active business. In addition, Bonner TCJ. found that the rebuttable presumption that income earned by a corporation was income from an active business had application even though the taxpayer's corporate objects (if any) were not entered in evidence. * Court also rejected the T’s alternative argument that it could have held the investments and borrowed funds as needed for its business operations, on the grounds that the T “did not choose to carry on business in that way.” |

### Dividend Refund

* For corporations subject to Part IV tax, integration of corporate and shareholder level tax is achieved by refunding the full amount of Part IV tax when these corporations pay a dividend out of income subject to this tax.
* **129(1) applies 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.
* If you don’t file tax return w/in 3 years, what happened to RDTOH? — It’s not reduced. (***Nanica****:* The phrase “dividend refund” in s. 129 is the refund of an amount, which is actually refunded to the T by the Minister. The intention was to prevent double taxation.)
* **129(1)(a):** the Minister may refund a **“dividend refund” = min {1/3 of taxable dividend paid when it was a private corp, RDTOH at the end of the year}**
* **129(3):** RDTOH = a + b + c – dividend refund for preceding year, where

a = min {26 2/3% of AII, 26 2/3% of [taxable income – least of 125(1)(a)-(c)]}

b = Part IV tax payable

c = RDTOH of preceding year

* 186(5) deems a subject corp to be a private corp for the purpose of s. 129.

# TAXATION OF SHAREHOLDERS

## CHAPTER 8 DISPOSITION OF SHARES

**A. CHARACTERIZATION**

Disposition of shares = Sell to someone else (individual or other corp) or back to corp

* How to treat share sales?
  + Treated as capital property, give rise to capital gain/CL (1/2 taxable)
  + 3(d) ABILs
  + 3(b) ACLs
* Exception:
  + ***Irrigation Industries***: If in the biz of dealing w/ sh’s (dealer/underwriter), then its inventory/biz income; but for most part= capital property
  + ***Fraser***: court deems shares as inventory by piercing corp veil
* S. 54.2= Certain shares deemed to be capital property
  + If got an unincorp’d AB, incorp & in exchange for that you own sh’s, even if you do this & turn around 1d later, makes it clear that it is still capital property, provided it is all or substantially all (90+%)

Tax consequences

* Context:
  + In 1972, started to tax CG & everything in symmetry; premised on assumption that corp rate @ 1/3, want dividend gross up 50% + tax credit
  + Then, it went to presumption that corp tax rate= 20%, still in symmetry
  + THEN, 1984, want to encourage entrepreneurship🡪 introduced lifetime CGE
    - 110.6(2) (farming) & (2.1) (QSBC shares) gave $500k , and 110.6(3) gave 100k generally
    - So all of a sudden, people wanted to have CG instead of dividends (***McNichol***)
  + 1994, killed 110.6(3)
  + 2000, decreased 500k to 250k
  + 2005= intro of eligible divds
  + 2006= incld fishing ppty
  + 2007= increase to 750k
  + 2014= increase to 800k + index (now $825k)
  + 2015= made farming&fishing= $1M non indexed
* Lifetime CGE & red’n in CG inclusion rate have made system out of sync since 1972
* Consider in 2016:

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| Elig | CG | Non-elig | CG (non elig) |
| Corp rate= 26%  Gross up= 38% (put you back to $102.12)  Top marginal rate= 47.75%= $48.71  Fed credit= 15.32 prov 10.21, total= 25.53  Get $23.18 of tax owing | If have $74, then ½ taxable= $37  @47.7% tax rate=  Have $17.67 | Corp rate= 13%  Gross-up= 17% ($101.79)  Tax’d @ top marginal rate= $48.55  Fed= 13/18th, prov= 2.5%= $13.35, get $35.20 of tax owing | ½ of 87= $43.50  @47.7%=  =$20.75 |

So better off earning CG in both

248(1) definition “SBC”

* Must be a CCPC
* (a) All/substantially all FMV of assets @ that time used principally in AB carried on primarily in Canada by corp or by related corp🡪 referring to qualifying assets

OR

* (b)= borrowing concept from Part IV tax🡪 qualifying share test (i.e., if have shares of another SBC & are connected & de jure controls or has more than 10% voting shares)

OR

* (c)= for purpose of S39(1)(c), get to look a year back from time share has disposed of shares or electing to deem to have disposed of shares & if you are at the time, then you are too right now even if you’re not actually (purpose= to give a better time for bankrupt corps)
* Key test is (a)

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| ***Irrigation Industries***  The only dealing in shares by the taxpayer (whose objects did not include the purchase and sale of shares) was the purchase of 4,000 treasury shares of a junior mining company and the sale of those shares between three weeks and four months later at a gain.   * In finding that the gain was a capital gain, Martland J. noted that shares "constitutes something the purchase of which is, in itself, an investment", and that the entering into of a transaction with the intention of disposing of shares at a profit as soon as there was a reasonable opportunity of doing so was not, by itself, sufficient to make that transaction an adventure in the nature of trade. |

**B. COMPUTATION**

**1. Allowable Business Investment Loss (ABIL)**

“**Allowable business investment loss**” is one-half of the T’s “business investment loss” for the year**: 38(c)**

* “Business investment loss” is generally T’s capital loss for the year from a disposition after 1977 of shares or debt of a “small business corporation” either to an arm’s length person or pursuant to subsection 50(1): **39(1)(c)**
* 50(1) allows a T to elect to dispose of a debt or share of the capital stock of a corporation for proceeds equal to nil, and to reaquire the debt or share at a cost equal to nil, at the end of a taxation year in which the debt is established by the taxpayer to have become a “bad debt” or the corporation has become bankrupt or insolvent.

Relevant definitions:

* “Small business corporation”: 248(1)
* CCPC: 125(7)
* Active business: 125(7)
* Specified investment business: 248(1)
* Personal services business: 125(7)

CRA generally interprets the phrase “**all or substantially all**” to mean at least 90%.

The **purpose** of the rules relating to the business investment loss is to encourage investment in small business corporations by giving such losses more generous tax treatment than that available for ordinary capital losses. (*Interpretation Bulletin IT-484R2*)

Unlike ordinary allowable capital losses, which are generally deductible only against T’s taxable capital gains under 3(b), ABIL may be deducted against all other kinds of income under 3(d).

In applying 39(1)(c), judicial decisions have generally considered whether the share or debt that a T has disposed of at a loss is a share or debt of a “small business corporation” within the meaning of the statutory definition.

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| ***Boulanger 2004 FCA***  A corporation's only assets since 1992 had comprised a vacant property and a sum owing for the sale of one-half of another property that originally had been intended for the operation of a business. In these circumstances, the Tax Court had not erred in concluding that the corporation did not qualify as a small business corporation when the taxpayers disposed of their shares in 1996.   * Issue: whether the corporation operated or had previously operated an active business in the 12 months before the appellants disposed of the hypothec claim they had on the Corporation in Dec 1996? * T failed to show that the commercial structure of a business had taken shape at any time: although they prepared a preliminary plan and the corporation had been created, activities were still not enough—no EEs, no office, no market or profitability study, no necessary financing, unable to conduct any major transaction wrt the type of biz it was supposed to carry on 🡪 inactive corp 🡪 not satisfy 39(1)(c) and 248(1) |

**2. Lifetime Capital Gains Deduction**

Where the share is “**qualifying small business corporation share**” (QSBC share) , an amount of the capital gain from disposing the share may be deductible in computing the T’s taxable income for the year under **110.6**.

* Introduced in 1985
* Purpose: to provide every individual residing in Canada a lifetime exemption from tax on a certain amount of net capital gains.
* In 2015, the exemption is $813,600.
* S.110.6(2.1) = only available to individuals residents to Canada throughout year
* Only for **QSBC**= definition= S110.6(1)
  + (a) Asset requirement🡪 assets have to be shares of SBC owned by individual, spouse or CL partner
  + (b) Ownership requirement🡪 shares have to NOT owned by anyone BUT individual 24 months before particular time (i.e., can incorp & do this w/in 24mo so long as don’t sell them to someone else, i.e., flip them)
  + (c) Mixed asset & ownership requirement
    - After 24 months, more than 50% of FMV was attributable to assets used principally in AB (i.e., lower threshold during the time you own shares) OR
    - Whenever you’ve acquired it & nobody else owns it
  + At determination time, w/in the 24 months before that TP owned shares of SBC, there’s 50% test for the assets, OR assets of a corp that is connected at it satisfies the 50% test
  + 110.6(14)(f)
  + Main issue: whether the assets of a corp (or a connected corp) are used principally in an active business carried on primarily in Canada. (See Skidmore)

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| ***Skidmore 2000 FCA***  F= Had Burchill Nurseries Co which produced seedlings (i.e., biz involved in growing trees); had 2 K’s w/ payment in installments; Crown was 1 customer & took on risk in case of crop failure but would had to pay back the gov’t grant they got as startup. 1988 sell biz to children to have access to CGE   * R&J Skidmore, G Skidmore, J Fox & D Birkman set up newCo, R&J sell sh’s for $645k (presumably FMV for the assets of co) but 145k paid on term deposit (think Irving Garber sales reasonable reserves) * Supposed to satisfy 90% pure test, arg reserves was part of biz in case have to pay back * But court says reserves going up each year, even though grant pay back is smaller every year (and don’t have to pay back Crown for crop failure). * PROF= Should’ve pay reserves out to HoldCo to “purify” * To be considered as asset of active biz, the assets must have been employed or risked in biz. Risk = more than remote. T failed to demonstrated the amounts which Birchill held as reserves were related to the amounts which were reaonably required as backup assets. On the whole, not established that Birchill relied on the term deposits as an integral aspect of its biz operations. 🡪 Can’t establish that all or substantially all of Birchill’s assets were used in AB. |

**Computation**: can only deduct after deduct every other loss deductible.

**Anti-Avoidance Rule**:

* **110.6(7)**: Since lifetime capital gains exemption is restricted to individuals, this provision prevents the use of other rules providing for tax-deferred transfers of property to convert what would otherwise be taxable capital gains of corporations into taxable capital gains of individuals.
* **110.6(8)**: provides that no amount in respect of a capital gains may be deducted under s. 110.6 in computing an individual’s income where the individual has capital gains for a taxation year from the disposition of a property, and it can reasonably be concluded…a significant part of the capital gain is attributable to the fact that dividends were not paid on a share (other than a prescribed share) or that dividends paid…were less than 90% of the average annual rate or return on that share…

## CHAPTER 9 PAID-UP CAPITAL, STOCK DIVIDENDS, DEEMED DIVIDENDS AND SURPLUS STRIPPING

“**Surplus stripping**”: Conversion of other wise taxable dividends into dividends, when capital gains are subject to more favourable tax treatment than dividends (e.g., if the capital gain qualifies for the lifetime capital gains deduction).

This chapter considers rules governing stock dividends, deemed dividends, and NAL share dispositions, as well as GAAR to challenge surplus stripping transactions.

### Paid-Up Capital

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| Stated Capital | In corporate law, the consideration that a corporation receives in exchange for the issuance of shares is generally added to the “stated capital”. In some circumstances, “contributed surplus” can be capitalized later. The stated capital may also be increased if the corporation capitalizes retained earnings that could otherwise be distributed as dividends. Conversely, the stated capital account of a class of shares must be reduced where the corporations purchases, acquires or redeems shares of that class. |
| Paid-Up Capital (PUC) | A measure of contributed capital and capitalized surpluses that a corporation can return to shareholders on a tax-free basis. |
| Adjust Cost Base (ACB) | Unlike PUC, ACB of a share is specific to the shareholder who has acquired the share, rather than the share itself. |

If X pay $100 to get a share. Then X sells share to Y at $250.

* Capital gain for X = $150
* ACB: $100 🡪 $250 (attribute to shareholder in respect to the share)
* PUC: $100 🡪 $100 (attribute to the corp; nothing capitalized, nothing changed)

### Stock Dividends

The payment of a stock dividend involves the capitalization of retained earnings through he issuance of new shares.

* The “amount” of a stock dividend = the amount by which PUC (of the corp that paid the dividend) is increased by reason of the payment of the dividend: 248(1)

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| Deemed Dividend |

In order to distinguish between tax-free returns of capital (from PUC) and taxable dividends, and to ensure that corporate distributions in excess of paid-up capital are subject to tax as dividends, the ITA includes various rules in s. 84 which deem corp to have paid and shareholders to have received dividends under various circumstances.

**84(1) Increase in Paid-up Capital**

**Deemed dividend =** Increase in PUC – Σ {increase in net assets + decrease in net

liabilities + reduction in PUC of shares of other classes + increase in PUC from conversion of contributed surplus}

**and** deems a dividend “to have been received at that time by each person who held any of the issued shares of the particular class immediately after that time” equal to the proportion of the deemed dividend that “the number of the shares of the particular class held by the person immediately after that time is of the number of the issued shares of that class outstanding immediately after that time.”

**Except** **by**

(a) stock dividend,

(b) a transaction by involving an increase in net assets or a decrease in net liabilities that is not less than the increase in the paid-up capital in respect of the shares,

(c) a transaction by which the PUC in respect shares of other classes is reduced by an amount not less than the increase in the PUC in respect shares of the particular class, or

(c.1), (c.2) and (c.3) the conversion of contributed surplus into PUC.

To prevent double taxation, 53(1)(b): deemed amounts under 84(1) 🡪 ACB

Increases in stated capital through the capitalization of retained earning are often undertaken by private corps in order to create a stock dividend or deemed dividend under 84(1) that can be characterized as a non-taxable capital dividend through the **election in 83(2)**. In this way, shareholders are able to obtain an increase in ACB of their shares on a tax-free basis.

* The election in 83(2) is available only where a dividend “becomes payable”.
* **84(7)**: for the purpose of subdivision h, a dividend that is deemed by s. 84 is deemed to have become payable.

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| ***Nadeau*** ***1999 TCC***  Surplus stripping through PUC averaging:   1. Holdco—A: 51sh, CN (son): 49sh. Per share: FMV=$7667, ACB=$100, PUC=$100 2. No.co—CN 100%. 3. A and CN 🡨🡪 Holdco: shares for new Class A shares[[16]](#footnote-16): ACB is bumped up to $7667. 4. 1 Class A share 🡪 100 Class A shares 🡪 new Class C and D shares: Per share: FMV=$76.67, ACB=$76.67, PUC=$1 5. No.co subscribed and paid $460,000 for one Class C share: PUC per C share is bumped up to $76.4[[17]](#footnote-17). 6. No.co financed this purchase by borrowing $460,000 from Bank. The next day, Holdco redeemed the Class C share held by No.co for $460,000 and No.co repaid the Bank.[[18]](#footnote-18) 7. Holdco redeemed A’s 6100 Class C shares over 15 year, at a price of $76.67 a share.  * The Minister: the increase in the PUC of C shares from $1 to $76.4 was an abuse. And there had been a deemed dividend of $38,498 in each of those years. * GAAR: (1) tax benefit=less deemed dividend b/c PUC bumped up; (2) tax motivated; (3) abuse/misuse: “by means of several of its provisions of the Act…abuse of the Act.”   DD: bad GAAR analysis—should’ve said which specific provisions that were abused. |

**84(2) Distribution or Appropriation of Funds or Property on Winding-up, Discontinuance or Reorganization of Business**

**84(2) generally applies** where funds or property of a corporation resident in Canada have…been distributed or otherwise appropriated **in any manner whatever** to **or for the benefit of** the shareholders of any class of shares in its capital stock, on the **winding-up, discontinuance or reorganization** of ***its* business**.

In this circumstance, the corporation shall be deemed to have paid at that time a dividend on the shares of that class equal to the amount, if any, by which

* 1. the amount or value of the funds or property distributed or appropriated,

exceeds

* 1. the amount, if any, by which the paid-up capital in respect of the shares of that class is reduced on the distribution or appropriation.

and a dividend shall be deemed to have been received at that time by each person who held any of the issued shares at that time equal to that proportion of the amount of the excess that the number of the issued shares of that class outstanding immediately before that time.

**84(2) does not apply** **if 84(1) applies**, or in respect of any purchase by a corporation of its shares **in the open market**, if the corporation acquired those shares in the manner in which shares in the manner in which shares would normally be purchased by any member of the public in the open market: **84(6)(a),(b)**

**Valuation:**

* Shares of the corporation that are distributed or appropriated to the shareholders shall be valued at an amount equal to their paid-up capital at that time: **84(5)**
* Other property value = FMV at the time (84(2)(a))
* Cost for shh = FMV (52(2))
* Proceeds for corp = FMV (69(5))

To the extent that the PUC is reduced in the circumstance where 84(2) applies, **53(2)(a)(ii)** accounts for this tax-free return of capital by **reducing the ACB** of the share.

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| ***Smythe 1969 SCC***  Classic surplus stripping case. Pre-1972.  The taxpayers were shareholders of a company (the "old company") who effectively converted its assets to cash through a series of transactions: those assets were sold to a related company owned in essentially the same manner (the "new company") in consideration for a promissory note; the note was paid-off through bank borrowings of the new company; the old company used those cash proceeds to invest in preference shares of two unrelated companies (the "dividend-stripping companies"); and the taxpayers sold the shares of the old company to the dividend-stripping companies for a cash amount based on the old company's net asset value. A portion of the cash proceeds of the sale were reinvested by the taxpayers in debentures of the new company.   * Issue: (1) whether funds or property of the corporation were distributed or appropriated to shareholders in any manner whatever; and (2) if so, whether these funds or property were distributed or appropriated on a “winding-up, discontinuance or reorganization” of the company’s business. * (1) Funds been distributed or appropriated in any manner or whatever to or for the benefit of shhs (T’s argument: money distributed came from bank, not from oldco.) (**DD: “in any manner whatever…or for the benefit” of the shhs.** But court didn’t do it in this detail)(court: look at the pic before and after, distributed through the medium) * (2) Winding up, reorganization, discontinuance. (T’s argument: not wind up or discontinued the business) (court: wind up of business for the oldco) "There was a winding-up and a discontinuance of the business of the old company, although it is apparent that there was no formal liquidation under the *Winding-Up Act* or the winding-up provisions of the Ontario *Companies Act*."   ***David 1975 TCC***  Approximately four months after the corporation of which the taxpayers (the "David group") were shareholders sold its principal business assets, the taxpayers sold their shares of the corporation to the corporation's pension plan (acting through the "Dunn group"), with the individuals associated with the pension plan then causing a distribution of the assets of the corporation.   * Walsh J. concluded that although the payments made to the taxpayers were "made to them in an indirect manner as a result of actions taken by third parties over whom the David brothers had no control, the end result was nevertheless that it was the funds of the company, including its undistributed income, which were used to pay for their shares and that the words 'otherwise appropriated in any manner whatsoever to or for the benefit of one or more of its shareholders' are wide enough to cover what took place". * Respecting the issue as to whether this appropriation occurred 'on' a winding-up, discontinuance or reorganization of a business (which after the August sale was that of an investment company), Walsh J. stated "that if any meaning is to be given to the word 'on' it must at the very least mean at the 'same time as' or possibly 'as a result of' or 'consequential to', and went on to find that even though it was "not at the time of or 'on' the discontinuance of the commercial operations of the company in August that the funds were appropriated for the benefit of the David group but only five months later", it nonetheless was "evident that the Dunn group planned to wind-up not only the commercial but all business of the company immediately after they took over, so that a winding-up was part of the plan." Accordingly, s. 81(1)(b) (now s. 84(2)) applied.   DD: 5 month not enough. In another case, T waited for 5 years—OK.  ***Kennedy 1973 FCA***  A corporation of which the taxpayer was the sole shareholder purchased a property for use as the new site for its car dealership business, paid for some renovation work and then sold the property to the taxpayer at a price that was less than its total cost including that of the renovation work, with the property then being leased back to the corporation for use in its business.   * The Minister assessed it as a shareholder benefit under 8(1) [now 15(1)]. * T argued that the benefit ought to have been assessed as a deemed dividend and therefore eligible for the dividend tax credit on the basis that property of the corporation had been appropriated to his benefit on a reorganization of it business. * Court: no reorganization, not deemed dividend. Cattanach J. stated: * "[T]he word **'reorganization'** presupposes the conclusion of the conduct of the business in one form and its continuance in a different form. * In the *Shorter Oxford Dictionary* ... the words 'reorganization' is defined as 'a fresh organization'. * Here, there was no "fresh" organization as the same corporation continued the same business in the same manner in the same form - the sale by it of a capital asset did not result in the end of its business.   ***Perrault 1978 FCA:***  Another case where T tries to argue deemed dividend under81(1) [now 84(2)] in order not to be assessed as shareholder benefit under 8(1) [now 15(1)].   * Court: A substantial dividend was not paid on the "winding-up, discontinuance or reorganization" of a company's business because, following the payment (and the sale of one of the company's two plants), the company continued to carry on business for over a year, "albeit on a reduced scale". Therefore, 81(1) [now 84(2)] does not apply.   ***Felray 1997 TCC***  T was sole owner of Editions (publishing business) and majority owner of Richelieu (photo-composition business for Editions). Richelieu purchased Savoy (printing business forms). Richelieu sold Savoy to a third party under agreement providing Savoy would reimburse Richelieu for the notes receivable through a payment directly to Richelieu’s shareholders.   * Minister: shareholder benefit. * T: deemed dividend under 84(2). * Court: The printing of business forms had never been a significant activity for Richelieu. The sale of T’s Savoy shares did not amount to a winding-up, discontinuance or reorganization of *its* business. 84(2) does not apply.   **DD: Pay attention to whose business is being wound up.**  ***Vaillantcourt-Tremblay 2010 TCC***  In order to convert their shares of a private company ("MHT") that held preferred shares of a Canadian public corporation ("Videotron") into excluded property, the taxpayers transferred their shares of MHT to a newly incorporated corporation ("8855") in exchange for shares of 8855, and then had MHT transfer its Videotron securities to 8855 on a rollover basis in consideration for convertible securities of 8855. The taxpayers then sold their shares of 8855 to Videotron in consideration for shares of Videotron and Videotron wound up 8855 on a rollover basis, with the securities that 8855 held in Videotron thereby being cancelled.   * Section 84(2) did not apply to this transaction because the property received by the taxpayers (the shares of Videotron) was never the property of 8855: "the property received by the Respondent simply never existed in the hands of 8855".   ***Maccala 1994 TCC***  T operated a company which had financed the purchase of land through a bank loan secured by a debenture on the property and guaranteed by T. When bank called on its security, T personally assumed a debt of $200K on the Company’s behalf. When T wound up the company, T received all the company’s property.   * The Minister: deemed dividend. * Court: Decided for T. The amounts owed to the T by the company exceeded the value of the property that he received on its winding-up. **The values of the property received from the company on winding-up were not appropriations of assets but were repayments of a loan**. |

**84(3) Redemption, Acquisition or Cancellation of Shares**

**84(3)** generally applies where a corporation resident in Canada has redeemed, acquired or cancelled in an manner whatever…any of the shares of any class of its capital stock” otherwise than by way of a distribution or appropriation on the winding-up, discontinuance or reorganization of a corporation’s business. In this circumstance,

1. The corporation shall be deemed to have paid at that time a dividend **on a separate class of shares** comprising the shares so redeemed, acquired or cancelled **equal to** the amount, if any, by which the amount paid by the corporation on the redemption, acquisition or cancellation, as the case may be, of those shares **exceeds** the paid-up capital in respect of those shares immediately before that time…
2. A dividend shall be deemed to have been received at that time by each person who held any of the shares of that separate class at that time equal to that portion of the amount of the excess determined under 84(3)(a) that the number of those shares held by the person immediately before that time is of the total number of the shares of that separate class that the corporation has redeemed, acquired or cancelled, at that time.

“Amount”: valued in terms of the amount of money or the value in terms of money: 248(1)

Where the amount paid by corporation incudes other shares of the corporation, the amount paid = the amount by which the PUC in respect of the class of shares to which they belong has increased by virtue of its issue [84(5)]

To prevent double taxation, paragraph (j) of s. 54 excludes deemed dividend under 84(2) and (3) from “proceeds of disposition”.

Statutory rules governing NAL transactions apply to the redemption, acquisition or cancellation of shares by a NAL company: 84(9)—“for greater certainty, where a shareholder of a corporation has disposed of a share of the capital stock of the corporation as a result of the redemption, acquisition or cancellation of the share by the corporation, the shareholder shall, for the purpose of this Act, be deemed to have disposed of the share to the corporation.”

**84(3) does not apply** **if 84(1) applies**, or in respect of any purchase by a corporation of its shares **in the open market**, if the corporation acquired those shares in the manner in which shares in the manner in which shares would normally be purchased by any member of the public in the open market: **84(6)(a),(b)**

A key consequence of 84(3) is that Ts who dispose of shares of a corporation to the corporation itself are generally subject to different ta treatment than if they were to dispose of these shares to other persons.

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| ***Katz 1999 TCC***  ACB of T’s SSCC shares = $75978, PUC = $6826; sold shares to SSCC for $91641. T thought that he was selling directly to other shareholders (would result in capital gain).   * The Minister: deemed dividend under 84(3) = $84815, Proceeds of disposition = $6826. Capital loss = proceeds – ACB = -$69152. And because T claimed capital gains deductions 1986, 1987, 1988 and 199 and therefore pursuant to 39(9) any business investment loss otherwise calculated pursuant to 39(1)(c) would be nil.[[19]](#footnote-19) * Issue: (1) Is the sale of T’s shares in SSCC a dividend or a capital gain? (2) Is the T entitled to a business investment loss (BIL)? * Court: Decided for the Minister. T’s submission is not supported by the written text of the agreement he signed and the actions of SSCC and the T.   ***Belair 1989 TCC:*** In the face of inadequate evidence, Morgan J. found that if the corporation had agreed to purchase for cancellation 1/3 of the taxpayer's common shares in each of three years, then the taxpayer realized a deemed dividend only as the shares were paid for and cancelled. "[I]f a corporation has not paid for certain of its issued shares, then the corporation has not purchased or acquired or redeemed such shares." However, if all of his common shares had been purchased in the first year followed by a loan of 2/3 of the proceeds to the corporation, then all of the deemed dividend had been realized in the first year.  ***Cabezuelo 1983 TCC:*** 84(3) deems the corporation “to have paid” a dividend and the shareholder “to have…received” a dividend at the time that the shares are redeemed, acquired or cancelled, and that 84(7) deems the dividend “to have become payable at that time”. Court rejects T’s argument that the deemed dividend should be included only when actually paid.  ***Merette 1995 TCC:*** **Open market** involves free participation by the public, the absence of any restrictions on prices, and the effect of supply and demand on prices. The court rejected T’s argument on the basis that the shares were redeemed pursuant to a private agreement between shareholders and the corporation. |

**84(4) Reduction of Paid-up Capital[[20]](#footnote-20)**

**84(4)** generally applies where a corporation resident in Canada has reduced the paid-up capital in respect of any class of shares of its capital stock **otherwise than** the circumstances to which 84(2), 84(3) or 84(4.1) applies.

1. The corporation shall be deemed to have paid at that time a dividend on shares of that class equal to the amount, if any, by which the amount paid by it on the reduction of the paid-up capital, exceeds the amount by which the paid-up capital in respect of that class of shares of the corporation has been so reduced.
2. A dividend shall be deemed to have been received at that time by each person who held any of the issued shares at that time equal to that proportion of the amount of the excess referred to in 84(4)(a) that the number of the shares of that class held by the person immediately before that time is of the number of the issued shares of that class outstanding immediately before that time.

**The purpose of 84(4)** is to tax distributions, other than dividends, paid by a particular corporation to its shareholders to the extent the distribution exceeds the amount of capital invested in that corporation by that corporation’s shareholders. (*Collins & Aikman*)

**84(4.1)** deems “any amount paid by a **public corporation** on the reduction of the paid-up capital in respect of any class of shares of its capital stock…to have been paid by the corporation and received by the person to whom it was paid, as a dividend” **unless**:[[21]](#footnote-21)

1. The amount may reasonably be considered to be derived from proceeds of disposition realized by the public corporation, or by a person or partnership in which the public corporation had a direct or indirect interest at the time that the proceeds were realized, from a transaction that occurred
2. outside the ordinary course of the business of the corporation, or of the person or partnership that realized the proceeds, and
3. within the period that commenced 24 months before the payment; and
4. No amount that may reasonably be considered to be derived rom those proceeds was paid by the public corporation on a previous reduction of the paid-up capital in respect of any class of shares of its capital stock.

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| Tax on Corporate Distributions |

**Part II.1 tax—imposed by 183.1(2)—**is designed to prevent various surplus stripping arrangements by public corporations and other resident corporations with outstanding shares that traded in the open market, particularly share buyback arrangements structured to produce proceeds of disposition as a substitute for normal course dividends. The rate is currently 45% which is intended to approximate the maximum combined federal and provincial tax that would be paid by an individual shareholder resident in Canada if corporate surplus were distributed as a dividend. The tax can be considered punitive.

**183.1(1)** states that Part II.1 potentially applies to a corporation, other than a mutual fund corporation, where at any time in the year the corporation was a public corporation or was resident in Canada and had a class of shares outstanding that were bought and sold in the manner that such shares are normally bought and sold by any member of the public in the open market.

* Part II.1 tax does not apply to most private corporations.

**183.1(2)** stipulates the nature of the transaction or series of transactions to which the tax applies:

(2) Where, as a part of a transaction or series of transactions or events;

1. A corporation, or any person with whom the corporation was not dealing at arm’s length, has, at any time paid an amount, directly or indirectly, to any person as proceeds of disposition of any property, and
2. All or any portion of the amount may reasonably be considered, having regard to all the circumstances, to have been paid as a substitute for dividends that would otherwise have been paid in the normal course by the corporation,

The corporation shall, on or before its balance-due day for its taxation year that includes that time, pay tax of 45% of that amount or portion of it, as the case may be.

* (a) captures amounts paid by the corporation itself or a NAL person and amounts paid directly or indirectly to any person. Further, a distribution may be impugned whether it is carried out as a single transaction or as part of a “serious of transactions or events”, which can include related transactions or events completed *in contemplation of* the series.
* Assuming a corporation is in a financial position where it would be capable of paying dividends[[22]](#footnote-22), in that it has corporate surplus available, the application of 183.1(2) to a particular payment will depend upon whether the payment can reasonably be seen, having regard to all the circumstances, as a substitute for normal course dividends. The factors to be considered include: (1) the corporation’s dividend policy, (2) the amount of dividends paid in the current year, and (3) objective evidence of the corporation’s intention to pay amounts in lieu of dividends[[23]](#footnote-23). Presumably, payments that are not designed to replace normal course dividends are not offensive because they do not constitute surplus stripping.

Supporting rules in 183.1(3) through (5) ensure that the main rule in 183.1(2) can apply to transactions of various forms that might be used to withdraw corporate surplus as proceeds of disposition: see page 610

**183.1(6):** **Subsection 183.1(2) does not apply** if none of the purposes of the transaction or series of transactions or events referred to therein may reasonably be considered, having regard to all the circumstances, to have been to enable shareholders of a corporation who are individuals or non-resident persons to receive an amount, directly or indirectly, as proceeds of disposition of property rather than as a dividend on a share that was of a class that was listed on a stock exchange or that was purchased and sold in the manner in which shares are normally purchased and sold by any member of the public in the open market.

* (1) Part II.1 tax only applies when the distribution is made for the benefits of individual shareholders.
* (2) The provision does not refer to “primary purpose” or “main purpose”; to rely on this exception one would have to demonstrate that none of the purposes of the transaction or series was to enable individual or non-resident shareholders to receive proceeds of disposition as a substitute for dividends that would have been paid on publicly trade shares. [*Purpose test—no case on this—but important when doing GAAR (frustrate “****scheme****”—and this is the “scheme”)*.]
* (3) The purposes must be objectively determined. Although it’s not clear in the statute, based on the Explanatory Notes, the perspective of the distributing corporation is most relevant to the determination of the purposes.
* Judicial analysis of other provisions in the ITA that refer to the purposes of transactions would be informative when considering the exception in 183.1(6).

Note: The rules above do not change the character of the distribution from proceeds of disposition to a dividend. The recipient shareholder could still claim lifetime capital gains deduction provided that other conditions are met. [[24]](#footnote-24)

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| Non-arm’s-length Disposition of Shares |

S. 84.1 was also introduced as a response to the lifetime capital gains deduction, in order to prevent yet another kind of transaction designed to convert accumulated surpluses of a corporation into capital gains in respect of which individual Ts might otherwise be able to claim this deduction. In this case, the transactions at issue involved private corporations and depended on the deduction for inter-corporate dividends in 112(1) of the ITA and the general exemption from Part IV tax for dividends received from connected corporations.

These transactions often involved the following steps:

1. A T would transfer shares (“the subject shares”) with high FMV and low PUC (“high-low” shares) of a corporation (the “subject corporation”) with corporate surplus available for distribution to another NAL corporation (the “purchaser corporation”), in exchange for shares of the purchaser corporation (“new shares”) and/or non-share consideration (“boot”) (ex promissory note).
2. FMV received – ACB = taxable capital gain. T can either offset this income inclusion by claiming the lifetime capital gains deduction or (where new shares issued to exchange) transfer the subject shares to the purchaser corp on a tax-deferred basis under 85(1).
3. PUC of new shares are bumped up.
4. Subject corp would then either pay a dividend to the purchaser corp or redeem the subject shares that had been transferred to the purchaser corporation, resulting in a deemed dividend to the purchaser corp under 84(3), which dividend or deemed dividend would be deductible under 112(1) and not subject to Part IV tax provided the two corps are related under 186(4) at the time of the (deemed) dividend.
5. Where the T received new shares with high PUC in exchange for subject shares, T would then redeem these shares in exchange for funds or property that had been distributed by the subject corporation to the purchaser corporation by way of a dividend or share redemption, resulting in no deemed dividend to the T and either no capital gain (if an accrued gain on the subject shares had been realized on their disposition to the purchaser corporation and sheltered at that time by the lifetime capital gains deduction) or a taxable capital gain that could be sheltered by the lifetime capital gains deduction.
6. Alternatively, where the T received a promissory note from the purchaser corporation in exchange for the subject shares, the T could redeem the note in exchange for cash.

**84.1(1)** imposes a reduction (“grind”) in the PUC of new shares issued by a purchaser corporation, and in certain circumstances, a deemed dividend[[25]](#footnote-25).

These rules **apply where**, after May 22 1985[[26]](#footnote-26), a T resident in Canada other than a corporation[[27]](#footnote-27) disposes of shares (“subject share”) that are capital property[[28]](#footnote-28) of the T of any class of the capital stock of a corporation resident in Canada (the “subject corporation”) to another corporation (the “purchaser corporation”) with which T does not deal with at arm’s length[[29]](#footnote-29) **and**, “immediately after the disposition, the subject corporation would be connected[[30]](#footnote-30) with the purchaser corporation.

1. **NAL b/t T and purchaser corp:**

* **251(1)(a):** **“related persons”** deal with each other at NAL
* “Related persons” is defined in **251(2):**

1. Individuals connected by blood relationship, marriage or adoption;
2. A corporation and

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

(ii) a person who is a member of a related group[[31]](#footnote-31) that controls the corp,

(iii) any person related to a person described in (i) or (ii).

* **251(1)(b):** ***De facto* NAL:** (1) common mind which directs the bargaining for both parties to the transaction (2) parties to a transaction acting in concert w/o separate interests, and (3) “de facto” control (*McNichol*, *Cote-Letourneau*)[[32]](#footnote-32)
* For this purpose of this provision, **84.1(2)(b)** provides “for greater certainty” that a T shall be *deemed* not to deal at arm’s length with a purchaser corporation if the T

1. was, immediately before the disposition, one of the group of fewer than 6 persons *(<= 5)* who controlled *(de jure control—Silicon Graphics Test)* the subject corporation, and
2. was, immediately after the disposition, one of the group of few than 6 persons that controlled the purchaser corporation, each member of which was a member of the group referred to in 84(2)(b)(i).

* **84.1(2.2)** stipulates that for this purpose,:

1. in determining whether or not a taxpayer referred to in that paragraph was a member of a group of fewer than 6 persons that controlled a corporation at any time, any shares of the capital stock of that corporation owned at that time by

**(i)** the taxpayer’s child (as defined in subsection 70(10)), who is under 18 years of age, or the taxpayer’s spouse or common law partner,

**(ii)** a trust of which the taxpayer, a person described in subparagraph 84.1(2.2)(a)(i) or a corporation described in subparagraph 84.1(2.2)(a)(iii), is a beneficiary, or

**(iii)** a corporation controlled by the taxpayer, by a person described in subparagraph 84.1(2.2)(a)(i) or 84.1(2.2)(a)(ii) or by any combination of those persons or trusts

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

1. a group of persons in respect of a corporation means any 2 or more persons (*silicon graphics: a* ***sufficient link*** *to enable them to exercise control or actually act together to exert control*) each of whom owns shares of the capital stock of the corporation;
2. a corporation that is controlled by one or more members of a particular group of persons in respect of that corporation is considered to be controlled by that group of persons; and
3. a corporation may be controlled by a person or a particular group of persons even though the corporation is also controlled or deemed to be controlled by another person or group of persons

* As a result, although these rules rely on the concept of de jure control rather than de facto control, they further extend the concept of a NAL relationship for the purpose of 84.1 by deeming T to own shares owned by a child, a spouse or CL partner, and certain trusts and corporations, by defining a group of persons in respect of a corporation as “any” two or more persons each of whom owns shares of the corporation that a group of persons corporation may be controlled by a group of persons notwithstanding that it is controlled by one or more members of the group, and by providing for the simultaneous control of a corporation by different persons and groups of persons.
* The combination of 84.1(2.2)(b) and (c) can override for the purpose of 84.1 the holding in Silicon Graphics that control by a group requires a “common link or interest” among the group.
* See ***Emory*:** Although Chen controls the purchaser corp, 84.1(2)(b) + (2.2)(b)(c)(d): Emory is a member of the group that controls. If Emory get rid of the 5 common shares, she is not a member of the group. (bad planning)

1. **“Connected” b/t subject corp and purchaser corp immediately after the disposition**

* 186(4): controlled OR >10% issued share (full voting) capital and >10% FMV of shares 🡪 **connected**
* 186(2): >50% issued share (full voting) capital = **controlled**
* 186(7)[[33]](#footnote-33): “connected” in 186(4) shall be determined by taking into account 186(2)

**Where 84.1(1) applies**, paragraph (a) provides for a reduction in the PUC of shares issued by the purchaser corporation in consideration for the subject shares, and (b) provides for a deemed dividend in certain circumstances:

1. PUC Reduction = (A-B) x C/A

A[[34]](#footnote-34) = increase in PUC of all shares of purchaser corp

B = max {[the greater of PUC / ACB of subject shares before disposition[[35]](#footnote-35) – FMV of boots after disposition], 0}

C = increase in PUC of the particular class of shares of purchaser corp

1. Deemed dividend = (A + D) – (E + F)

A = Increase in PUC of all shares of purchaser corp

D = FMV of boots after disposition

E = the greater of PUC / ACB of subject shares before disposition[[36]](#footnote-36)

F = PUC reduction in 84.1(1)(a)

If the purchaser corp has only one class of shares, then A=C, then PUC reduction = A-B**[[37]](#footnote-37)**

and if FMV of boots > PUC before, then PUC reduction = PUCnewshare – PUCsubjectshare

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Deemed dividend = (PUCnewshare + FMVboots ) – (PUCsubjectshare + PUC reduction) [[38]](#footnote-38)

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| Ex1: Subject shares (PUC=$100, FMV=$1000) in exchange for new shares (PUC=$1000, FMV=$1000), provided the two corps are connected immediately after the disposition.   * PUC reduction = PUCnewshare – PUCsubjectshare = $900 * No boots 🡪 No deemed dividend   Ex2: Subject shares (PUC=$100, FMV=$1000) in exchange for a promissory note worth $1000.   * No new share issued 🡪 no PUC reduction * Deemed dividend = FMVboots – PUCsubjectshare = $900   Ex3: Subject shares (PUC=$100, FMV=$1000) in exchange for new shares (PUC = FMV = $500) and a promissory note worth $500.   * PUC reduction = PUCnewshare – max {PUCsubjectshare - FMVboots, 0) = $500 * Deemed dividend = (PUCnewshare + FMVboots) – (PUCsubjectshare + PUC reduction) = $400 * In this case, the PUC of the new shares is reduced to zero, and the PUC of the subject shares is used to provide a tax-free return of capital in an amount of $100, with the remaining $400 of the non-share consideration treated as a deemed dividend.   Ex4: Subject shares (PUC=$100, FMV=$1000) in exchange for new shares (PUC = FMV = $925) and a promissory note worth $75.   * PUC reduction = $900 * Deemed dividend = 0 |

“**Arm’s length ACB**”: Paragraph (ii) of the description of B and E provides relief to the Ts for whom the ACB of subject shares exceed their PUC. This relief is limited, however, by 84.1(2)(a) and (a.1), which reduce the otherwise applicable ACB to T to the extent that this ACB reflect gains of T or NAL individuals that accrued prior the taxation of capital gains in 1972 or in respect of…the life time capital gains exemption claimed.

* The effect of **84.1(2)(a)(i)** is to exempt pre-1972 gains from tax.
* **84.1(2)(a.1)(ii)**[[39]](#footnote-39) **reduces the ACB** of the subject shares immediately before the disposition by the total of all capital gains realized on the subject shares or shares for which the subject shares were substituted by the T or a NAL individual, to the extent that the lifetime capital gains deduction was claimed in respect of these gains.
* A typical arrangement that is precluded by 84.1(2)(a.1)(ii) would be:

1. T sells subject shares to a purchaser corp (connected immediately afterwards) in exchange for new shares, not increasing PUC of new shares beyond the PUC of subject shares, but using lifetime capital gains deduction to shelter a capital gains realized on this sale, and
2. T then sells the new shares (“new share1”) to a second purchaser corp w/ which the first purchaser corp is connected immediately after the disposition in exchange for new shares of the second purchaser corp (“new share2”), using the increased ACB of the new share1 to increase the PUC of new share2.

* By grinding down the ACB of new share1 by the amount of the gain on the disposition of the subject shares in respect of which the T claimed the lifetime capital gains deduction, this provision prevents the use of these transactions to convert what would otherwise b taxable dividends into non-taxable capital gains.

84.1

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| ***Côté-Létourneau 2007 TCC***  The taxpayers (a husband and wife) sold their shares of Holdco to No.co ("9061") all of whose shares were held by a trust of which they and the family accountant were the trustees in exchange for a promissory note. Holdco redeemed the shares. No.co paid off the promissory note.   * Minister: 84.1 should apply—deemed dividend. * Court: The conditions for 84.1 to apply are:  |  |  | | --- | --- | | 1. T = resident in Canada 2. The shares = capital property of T | ✔  ✔ | | 1. The shares are a class of the share capital of a corp resident in Canada (“subject corp”) 2. The shares are disposed to another corp (“purchaser corp”) 3. Immediately after the disposition, the subject corp is connected w/ the purchaser corp. | ✔ T disposed of Class B shares which are shares of a corp that is also a resident of Canada, and that corp became the subject corp.  ✔Those shares were disposed of to another corp 9061, the “purchaser corp” in this situation.  ✔Immediately connected after disposition b/c 9061 owned more than 10% of the Class B common shares of subject corp. | | 1. T does not deal w/ the purchaser corp at arm’s length. | Issue in this case. |  * **S. 251: Arm’s length**: * Ts are related under 251(2)(a) of the Act b/c they are connected by marriage. And being related, they form a related group under 251(4). * Issue1: related under 251(1)(a)? 🡪 whether the related group consisting of the Ts controls 9061. If so, the group is related to 9061 and is NAL from it—251(2)(b)(ii): * Applying the test in *Duha Printers*, given that decisions of the trust were required to be made unanimously, the Ts did not have *de jure* control of the purchaser corp 9061. * Issue2: De facto NAL under 251(1)(b)? * Test from *McNichol*: (1) common mind which directs the bargaining for both parties to the transaction (2) parties to a transaction acting in concert w/o separate interests, and (3) “de facto” control. * Although major decisions of the trustees were required to be unanimous, the accountant who was paid fees by Ts would never have voted against his clients' wishes, and as a role was essentially passive. The taxpayers were not dealing at arm's length with 9061. * Held: As the sale of shares by the taxpayers 29061 was a non-arm's length transaction, s. 84.1 applied to deem them to receive a dividend on the sale.   ***Emory 2010 TCC***  T and another individual ("Chen") owned 27% and 73%, respectively of the shares (being common shares) of a corporation ("Sona"). S. 84.1(1) deemed the taxpayer to receive a dividend when she and Chen transferred their shares of Sona to a corporation ("Ontario Inc.") that was mostly owned by Chen but in which she held 5% of the common shares and for consideration that in her case was paid in cash.   * This result occurred because the T was deemed by s. 84.1(2)(b) and 84.1(2.2)(b)(c)(d) not to deal at arm's length with Ontario Inc. Woods J. stated: "the fact that the appellant owned a small number of shares in Ontario Inc. has unfortunately resulted in the application of this section."   ***Hickman 2000 TCC***  Subject corp: 42/100 shares owned by T, 48 by T’s husband. Purchaser corp was owned by a trust, of which T and T’s husband were 2/3 trustees. T sold her subject shares to purchaser corp.   * T and her husband together controlled the decisions of the trust   🡪 related group under 251(2)(a) and 251(4), and in a position to control the purchaser corp within the meaning of 251(5)(a).  🡪 T and the purchaser corp were related under 251(2)(b)(ii)  🡪 hence T and purchaser corp were NAL by virtue of 251(1)(a)  ***Lauzier 1996 TCC***  T sold subject shares to purchaser corp which is owned by T’s accountant JR. Subject corp paid $67500 to repurchase the shares from purchaser corp. Purchaser corp paid T $67500.   * Acting in concert etc. 🡪 de facto NAL (251(1)(b)) 🡪 deemed dividend under 84.1(1)(b)   ***Brouillette 2005 TCC***  The taxpayer facilitated a leveraged buy-out of him and his co-shareholder of a company ("Brouillette Automobiles") by incorporating a corporation ("9016") of which he controlled 51% of the voting shares with the balance of the shares being owned by the purchaser corporation ("9017") of which two unrelated individuals were equal shareholders, with 9016 using the proceeds of a loan to it by Brouillette Automobile to purchase for cash the shares of the co-shareholder of Brouillette Automobile, the taxpayer rolling his shares of Brouillette Automobile into 9016 for non-voting shares of 9016 (so that Brouillette Automobile was now a wholly-owned subsidiary of 9016) and then selling his shares of 9016 to 9017 for a promissory note.   * In finding that the sale by the taxpayer of the shares of 9016 to 9017 was a transaction between persons dealing with each other at arm's length, so that s. 84.1 did not apply, Lamarre Proulx J. found that the interests of the taxpayer were totally separate from those of the individual shareholders of 9017 (the two parties were each trying to get the best price), and that: "It cannot be determined that parties have acted in concert simply because they have used the same financial advisors." * DD: this is essentially surplus stripping of future profits. But there’s something real going on. And this is what lifetime capital gain deduction is about: sell your biz to someone else.   According to CRA, “Leveraged buyout” is not an abuse of the Act read as a whole: neither 84.1 nor the GAAR should apply to preclude the capital gains deduction where a T sells qualified small business shares to an arm’s length shareholder who incorporates a company to borrow funds and purchase the T’s shares. (See example on p. 632.)  ***Descarries 2014 TCC***    The six taxpayers, who were siblings, held all the shares, having an aggregate FMV, ACB and PUC of $617,466, $361,658 and $25,100 respectively, of a company (Oka). They sought through transactions to reduce the deemed dividend of $592,362, that otherwise would have arisen on the redemption of their shares, to approximately $265,505.   * CRA assessed on the basis that a deemed dividend of the larger amount had been realized, as there had been an indirect distribution from Oka described in s. 84(2). * Court: 84(2) does not apply b/c they waited for 3 and a half years before winding up the business. But GAAR applies to reduce to reduce the PUC of the 9149 shares to $92040 on the grounds that “the transactions at issue allowed the Ts to use the value accumulated before 1971 to indirectly distribute part of Oka’s surplus tax-free.” * DD doesn’t agree with this decision—reasonable tax planning. |

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| Surplus-Stripping and The GAAR |

S. 247(1) was repealed as a consequence of the introduction of s. 245, but it’s still beneficial to know it to understand the scheme of s. 245.

* S. 247(1) is directed at a transaction or series of transactions one of the purposes of which is to effect a significant reduction of, or disappearance of, assets of a corporation in order to avoid the whole or part of the tax that would have been payable on the distribution of property of a corporation.
* S. 247(1) could apply to a transaction or series of transactions that were undertaken to circumvent specific provisions that provided that a shareholder who disposes of shares to the issuing corporation account for an amount received on the disposition as a dividend rather than as proceeds of disposition. The specific rules mentioned at that time were 84.1, 212.1, 85(2.1) etc. 85.1(2.1) has been enacted to restrict the increase in PUC on a share for share exchange. Also, Part II.1 tax was imposed on corporations that pay an amount to a T as a substitute for normal dividends if they pay such amount in a manner that allows the recipient to account for the amount received as proceeds of disposition of property.

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| ***McNichol v Canada 1997 TCC***  The taxpayers sold their shares of a corporation ("Bec"), whose assets (following a sale of real estate) consisted largely of cash, to a corporate purchaser for a cash purchase price that reflected, in part, the savings that would accrue to the taxpayers from effectively receiving that cash as an exempt capital gain rather than as a liquidation dividend from Bec. Following the acquisition, the purchaser amalgamated with Bec and used the cash received on the amalgamation to pay off a bank loan that had funded the acquisition.   * Minister: (1) GAAR; (2) 84(2); (3) 84.1 * Court:  1. GAAR applies.  * Tax benefit = the difference b/t tax payable upon receipt of taxable dividends and that upon realization of capital gains from the disposition of shares. Paper trial demonstrated it. [*DD: but for tax considerations, normal way to do it would be just winding up the corp and pay dividends out.*] * Avoidance transaction: The sale of shares was selected not for bona fide reasons, which gave rise to a lifetime capital gain deduction. * Abuse/misuse: Misuse of s. 38, 110.6 and the provisions of the Act as a whole.   *[DD: s. 83 is irrelevant. SCC later says you can’t talk about the scheme as a whole. But useful to say the tension b/t the provs, and why is it wrong to use it this way.]*  (2) 84(2) does not apply: the funds paid to the Ts were CIBC loan.[DD: court didn’t pay enough attention to the words “or for the benefit of the shareholders”]  (3) 84.1 does not apply: the sale transaction was an arm’s length transaction—didn’t pass the test for de facto NAL under 251(1)(b): common mind + acting in concert + de facto control. [important: whether there’s bargaining /seeking independent interests]   * Here the interest of vendors and purchaser were divergent with regard to the purchase price, and that the individual shareholder of the corporate purchaser received his own accounting and tax advice before committing the purchaser to the transaction…transaction governed by their respective perceptions of their own self-interest and nothing else.   ***RMM 1997 TCC***  A non-resident corporation ("EC") approached a business associate who, along with two other individuals, formed a Canadian corporation ("RMM") to buy the shares of a Canadian subsidiary ("EL") of EC for a cash purchase price approximating the cash and near cash on hand of EL and a Canadian subsidiary of EL ("ECL"). Immediately following the purchase, EL was wound-up into RMM and ECL was amalgamated with RMM; and three or four days later, RMM used the cash received by it from EL and ECL to pay off a loan that had financed the acquisition.   * 84(2) applies. Court paid attention to “in any manner whatever”. “They were unquestionably received on the winding-up or discontinuance of EL’s business and it is impossible to say that the funds that found their way into EC’s hands were not on any realistic view of the matter EL’s funds, notwithstanding the brief intervention of the bank and RMM. * 212.1 applies. RMM and EC were NAL parties. …once the deal was settled…only one mind was involved. * GAAR would apply. In finding that the transaction gave rise to a benefit, Bowman TCJ. noted that the elimination of capital gains tax on the sale proceeds as a result of the application of the *Canada-U.S. Income Tax Convention* did not detract from such reduction occurring "under this Act", and also indicated that he was not prepared to say that because the envisaged U.S. tax saving was greater than the envisaged Canadian tax saving established that the primary purpose of the transaction was not the avoidance of Canadian tax.   "The *Income Tax Act*, read as a whole, envisages that a distribution of corporate surplus to shareholders is to be taxed as a payment of dividends. A form of transaction that is otherwise devoid of any commercial objective, and that has as its real purpose the extraction of corporate surplus and the avoidance of the ordinary consequences of such a distribution is an abuse of the Act as a whole." *[DD: Seems to suggest that b/c it’s tax motivated, it’s abusive—not OK analysis]*  ***Geransky*** ***2001 TCC***  The taxpayer, who owned a portion of the shares of the holding company ("GH") which, in turn, owned an operating company ("GBC") utilized the enhanced capital gains exemption in connection with the sale of a cement plant operated by GBC through the following transactions: the taxpayer and the other shareholders of GH transferred a portion of their shares of GH to a newly-incorporated company ("Newco") in consideration for shares of Newco; GBC paid a dividend-in-kind of most of the cement plant assets to GH; GH redeemed the common shares held in its capital by Newco by transferring to Newco the assets it had received from GBC; and the shareholders of Newco's sold their interests in Newco to the purchaser (“Lafarge”).   * Bowman T.C.J. found that s. 84(2) did not apply to deem the taxpayer to have received a dividend: there was no discontinuance, winding-up or reorganization of any company's business, as both GH and GBC continued to do what they had done before (Bowman TCJ having previously found that the cement construction and cement production activities of GBC were one business given the integration of personnel and operations)[*DD: seems like separate biz*]; the taxpayer was a shareholder only of GH and not of GBC, and the only "business" of GH was the holding of shares of GBC, which state of affairs was not altered by the reorganization; and under the transactions no funds or property of either GBC or GH ended up in the taxpayer's hands.   “Lafarge was no accommodation company of the type used in *Smythe* or *RMM* where the payment was made essentially by using the funds of the very company whose surplus was being stripped.”   * GAAR would not apply either. They may reasonably be considered to have been undertaken primarily for bona fide purposes other than to obtain the tax benefit. No specific provision is being misused. GAAR can not be used to fill in gaps.   ***Evans 2005 TCC***  A corporation ("117679") owned by the taxpayer issued a stock dividend of non-voting shares to the taxpayer that were redeemable and retractable for an aggregate of $487,000. The next day, the taxpayer sold these shares to a partnership of which his wife was a general partner and three of his children held a 99% limited partnership interest in consideration for a $487,000 promissory note of the partnership bearing interest at the rate prescribed for purposes of s. 74.5. The taxpayer utilized the enhanced capital gains deduction in respect of his gain on the sale. Thereafter, dividends and proceeds of redemption of the redeemable shares of 117679 were paid by way of set-off against payments of principal and interest on the promissory note.   * The Minister recharacterized under s. 245 everything that the taxpayer received from the partnership as dividends. * In reversing the s. 245 reassessment of the taxpayer, Bowman C.J. indicated that he could not find that there was "some overarching principle of Canadian tax law that requires that corporate distributions to shareholders must be taxed as dividends, and where they are not the Minister is permitted to ignore half a dozen specific sections of the Act". * *DD: must state what specific provisions are being abused. The Minister was confused about what the problem is—this case is really about income splitting, not surplus stripping--we’ll see later that there’s other tool that can be used.*   ***Desmarais 2006 TCC***  The taxpayer, who held 14.28% of the common shares of a Canadian private corporation ("Consercom") transferred a 9.76% block to a wholly-owned holding company ("6311") in consideration for preferred shares of 6311 with a high paid-up capital (thereby giving rise to a capital gain eligible for the capital gains exemption). The taxpayer also transferred shares of a Canadian private corporation ("Gestion") that he owned together with his brother to 6311 in consideration for shares of 6311. The redemption of the taxpayer's preferred shares of 6311 was financed through dividends received by 6311 from Gestion.   * Tax benefit = allowing T to distribute surplus from Gestion w/o paying tax. * Avoidance transaction = the transfer of 9.76% of the Consercom shares to 6311—primarily tax motivated—being under the 10% threshold to which s. 84.1 would apply * Abuse = the mechanism that circumvents the application of the anti-avoidance rule in 84.1 in a manner contrary to its purpose and its spirit.[[40]](#footnote-40) * It’s abusive for two reasons: (1) it is possible that Comsercom will not be able for several years to distribute substantial dividends to its shhs, primarily because it will wish to repay its long-term debt. The deferral constitutes a “tax benefit” and may in itself involve an abuse in the application of the Act, read as a whole. (2) Comsercom might become bankrupt before it can distribute dividends—in that event, the postponement of tax would become an avoidance of tax.   ***McMullen 2007 TCC***  The taxpayer and an unrelated individual ("DeBruyn") accomplished a split-up of the business of a corporation ("DEL") of which they were equal common shareholders by transactions under which (i) DeBruyn converted his (Class A) common shares into Class B common shares, (ii) the taxpayer sold his Class A common shares of DEL to a newly-incorporated holding company for DeBruyn's wife ("114") for a purchase price of $150,000, (iii) DEL issued a promissory note to 114 in satisfaction of a $150,000 dividend declared by it on the Class A shares, (iv) 114 as signed the promissory note to the taxpayer in satisfaction of the purchase price for the Class A shares, (v) the taxpayer transferred the promissory note owing to him by DEL to a holding company ("HHCI"), and HHCI purchased assets of the Kingston branch of the business of DEL in consideration for satisfaction of the promissory note.   * 84(2) does not apply: no winding-up/ discontinuance/ reorganization: “same biz in the same manner and in the same form”. No appropriation of funds of DEL. * *DD not agree: not its business anymore; once loan comes into DEL, came out as DEL’s funds. Also, “for the benefit of shh”: low PUC shares turned into debt.* * 84.1 does not apply: arm’s length parties. Once T decided to terminate his biz association w/ Mr. D, they had divergent economic interests. * GAAR does not apply. The transactions were primarily for *bona fide* business purpose, not tax-motivated. *[DD: but when applying GAAR, should look at whether each transaction is abusive separately.]* * *DD: court got it wrong. This case, unlike Geransky, should be on the other side of the line.*   ***Collins & Aikman Products 2009 TCC***  The taxpayer ("Products"), which was a corporation resident in the U.S., transferred the shares of its subsidiary ("CAHL"), which was non-resident in Canada notwithstanding that it had been incorporated in Canada in 1929, to a newly incorporated Canadian-subsidiary of Products ("Holdings") in consideration for a common share of Holdings that had a paid-up capital equal to the fair market value of CAHL. After CAHL became resident in Canada (as a result of its central management and control moving to Canada), CAHL paid dividends to Holdings, which distributed the same amounts to Products as distributions of paid-up capital.   * GAAR does not apply. (p.677) * This result was reversed by s. 212.3.   ***MacDonald 2013 FCA***    In order to make use of available capital losses before emigrating to the United States, the taxpayer sold the shares of his former professional corporation ("PC") to his brother-in-law ("JS") for a $525,000 promissory note, which was $10,000 less than the net asset value of PC (in the form of liquid assets). JS then transferred his shares of PC to a newly-incorporated holding company ("601") in consideration for a promissory note of 601 in the same amount and for the issue of common shares. The assets of PC were distributed within the following several months to 601, with $525,000 of such assets being applied to repay the two promissory notes in succession; and PC was dissolved.   * FCA: The trial judge's approach "led him to fail to give effect to the statutory phrase 'in any manner whatever,'" and "[was] not consistent with *Merritt*, *Smythe*, or *RMM*". *McNichol* was distinguishable. Near JA stated: * 84(2) leads the Court to look to:  1. who initiated the winding-up, discontinuance or reorganization of the business; 2. who received the funds or property of the corporation at the end of the winding-up, discontinuance or reorganization; and 3. the circumstances in which the purported distributions took place.  * “In this case, at the end of the winding up, all of PC's money... ended up through circuitous means in the hands of Dr. MacDonald, the original and sole shareholder of PC who was both the driving force behind, and the beneficiary of, the transactions.” * *DD: 84.1 would apply to JS.* |

## CHAPTER 10: SHAREHOLDER BENEFITS

**15(1)** requires T to include the “amount of value” of any benefit that is **conferred** by the corp on a shareholder or a **contemplated** shareholder of the corp.

* **Purpose**: to include all payments, distributions, benefits and advantages that flow from a corp to a shareholder by some route other than the dividend route and that might be expected to reach the shareholder by the more orthodox dividend route if the corp and the shareholder were dealing at arm’s length. (*Pillsbury*)

**1. Characterization as Benefit**

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| ***Pillsbury Holdings 1965 ExCt***  In 1953 two subsidiaries of the taxpayer **waived the interest** that was coming due on two loans they had made to the taxpayer a year previously, and a year later all the further interest was waived in connection with the repayment by the taxpayer of a portion of the principal in full satisfaction of the loans.   * **15(1): no "conferral" if corporation’s purpose is advancing its business and not to confer benefit. This is a bona fide transaction—no benefit.** * Cattanach allowed the taxpayer's appeal against an assessment under s. 8(1)(c) of the pre-1972 Act given that the Minister had not assumed, in making the assessment, that such waivers were an arrangement or device adopted by the corporation to confer a benefit or advantage on the taxpayer as shareholder, nor had the Minister established such an arrangement on the evidence. * "The word 'confer' means 'grant' or 'bestow'. Even where a corporation has resolved formerly to give a special privilege or status to the shareholders, it is a question of fact whether the corporation's **purpose** was to confer a benefit or advantage on the shareholders or some purpose having to do with the corporation's business such as inducing the shareholders to patronize the corporation." * *Now have new tool: rules re inter-corporate loans.*   ***Strachan 2000 TCC***  T = sole shareholder and EE of a corp which paid legal fees incurred by the T to defend himself against a **legal action**.   * Ruled for T. Court accepted T’s testimony that the corp had a vested interest in the lawsuit because it operated out of a hangar that it leased from the T which, were it seized, would jeopardize the corp’s only K with the Department of National Defence.   ***Losey 1957 ExCt***  T sold an ongoing advertising biz with fixed assets worth only $8737.52 to a solely-owned corp for shares and debt totaling $85,000, maintaining that the difference between these two amounts reflected the value of **goodwill** which had been transferred to the company.   * Although accepting the goodwill of a biz is an item of property that can be the subject of sale, the court concluded that the T had received a shareholder benefit on the grounds that the goodwill was largely personal to the T and such that its transferable value could not be otherwise than very small.   ***Morneau 1998 TCC***  T = principal shareholder of a corp to which he **sold his principal residence**, which was situated adjacent to the corp’s premises, so that the corp could increase its office space.   * M: shareholder benefit from a sale for proceeds greater than FMV. * Court: ruled for T. Corp had a pressing need for office space which could be satisfied more cheaply by purchasing T’s residence than by constructing new office space.   ***Perrault 1978 FCA***  T owned 273 of 490 issued shares of a manufacturing corp1. 193 shares of corp1 were owned by corp2 which was controlled by “Estate”. In order to assist the estate which was in financial difficulties, and as a prelude to winding-up corp1, T agreed to purchase the 193 shares held by corp2, payment of which was satisfied through a dividend of $350,000 that was paid out of the proceeds from the sale of a manufacturing plant and renounced by the T.   * Court: the dividend = corp1 discharging T’s legal obligation to pay for the share = shareholder benefit * *DD: should just redeem shares and pay inter-corporate dividend* |

**2. Conferral of Benefit**

“Bookkeep error”

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| ***Chopp 1997 FCA***  In finding that there was a shareholder benefit conferred when the taxpayer's daughter, while an inexperienced bookkeeper, used corporate funds to pay part of the purchase price for a new home.   * **Constructive knowledge test**: "I think a benefit may be conferred within the meaning of subsection 15(1) without any intent or actual knowledge on the part of the shareholder or the corporation if the circumstances are such that the shareholder or corporation ought to have known that a benefit was conferred and did nothing to reverse the benefit if it was not intended ... . If there is a genuine bookkeeping error with respect to a particular amount and that amount is truly significant ... a court may conclude that the error should have been caught ...". * “Shareholders should not be encouraged to see how close they can sail the wind under 15(1) and then plead relief on the basis of no proven intent or knowledge.” * *DD: the book keeping error re overpaying EE insurance might support T’s story*   ***Wagar 1998 TCC:*** Book keep error—ruled for T. “a little farm equipment implement business in a little farm town in rural Saskatchewan”. “ignorance and innocence are the case here”.  ***Franklin 2002 FCA***  T and wife owned shares of a private corp which purchased a condo in Florida, the funds for which were advanced out of T’s personal resources and reflected on the corp’s books as a shareholders’ loan. When T personally receviced the proceeds from a subsequent sale of an undivided half interest in the condo, however, the sale was not recorded on the corp’s books and the shareholder loan account was not acquire automobiles for the company, their cost was added to the assets of the company and their cost was added to the balance of the shareholder’s loan account.   * Ruled for T: None of the bookkeeping errors that he had caused either on purpose or inadvertently gave him any benefit that is in evidence. * DD agrees with the dissent: T received the benefit by directing the proceeds of sale fo the company’s properties into his own bank accounts or for the reduction of his personal debts, with no strings attached. Whatever occurred or did not occur thereafter is irrelevant to whether he received a benefit.   ***Poushinsky 2003 TCC***  T performed consulting services for a corp of which he was the sole shareholder, received to cheques for work performed on the company’s behalf, one of which he deposited in the corp’s account and the other to his personal account.   * T: bookkeep error. * Court: shareholder benefit.   ***Dyck 2007 TCC***  T, acting on the advice of an accountant, consolidated the investment funds of a private corp with their personal joint account in order to obtain better returns on the combined funds.   * Notwithstanding that T reversed the consolidation three years later when the accountant realized the tax implications of his earlier advice, and that the T never withdrew any funds from the joint investment account before the consolidation was reversed, the court upheld M’s assessment characterizing amounts transferred to the joint account as a shareholder benefit. |

**3. Capacity**

* When a shareholder is also an employee of a corp, T prefers to characterize benefits received as employment rather than shareholder benefits, for employment benefits are typically deductible.

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| ***Spicy Sports 2004 TCC***   * Sassy also EE of the corp. * T: received benefit as EE not as shh * Court: test=would the corp have entered into such a K with an arms-length key EE as an EE and not a shh? (no.)   ***O’Flynn*** ***2005 TCC:*** T owned a private corp that paid for dental insurance on their behalf. Court: employment benefit, because available to all EEs. The expenses were incurred for a “valid business purpose of attracting suitable EEs.”  ***Mullen 1990 TCC***  T = shareholder of corpA and EE of corpB. CorpB = subsidiary of corpA. T received benefits from corpB. Court: T is not shareholder of corpB, no shareholder benefit.   * Act amended after this case—15(1.4)(c)—NAL (+affiliated)—effectively deems shh of a holdco of the corp to be a shh of the corp |

**4. Amount or Value**

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| ***Youngman 1990 FCA***  LY loans to corp. Corp pays the house. LY pays rent to the corp: **Benefit reduced by interest-free loan made by shareholder**  *A corporation owned by the taxpayer and his family built a luxurious home in 1978 at a cost of $395,549 on land which originally had been acquired by it for a housing development which the municipal authorities had failed to approve. The taxpayer was reassessed on the basis that he had received a benefit computed by taking a 9% rate of return on the corporation's equity in the house (i.e., the cost of construction minus the amount of a third-party mortgage), adding thereto the mortgage interest and other expenses paid by the corporation, and subtracting the monthly rent of $1,100 paid by the taxpayer.*   * T’s argument: (1) FMV rent fare, (2) biz purpose, (3) interest free loan. * (1) Essence: corp use the money to provide benefit for him. Key: FMV of the investment. * (2) court didn’t accept the valid biz purpose (DD: if built a house wishing to sell, but couldn’t sell, shh moved in—shh benefit? Maybe not, bona fide purpose. Good argument but not believable on these facts) * (3) reduce the interest when computing the benefit * Pratte, J.A. accepted this computation of the benefit, with the proviso that it should be reduced by an amount of notional interest on an interest-free loan which the taxpayer had made to the corporation in order to help fund the construction, given that if the taxpayer had been dealing with a corporation of which he was not a shareholder, this interest-free loan would have been taken into account in determining the amount of the rent. Although the value of the benefit which was received, rather than the cost of the benefit to the corporation was relevant test, "in determining the value of benefit, one may take its cost into consideration". Here, the high cost of the home was attributable to the special requirements of the taxpayer, and under such circumstances a corporation of which the taxpayer was not a shareholder "would have then charged a rent sufficient to produce a decent return on its investment".   ***Fingold 1997 FCA:*** T’s corp spent $4million on a condo, which was nearby T’s mother’s condo. Although the condo was used a few times to entertain biz guests, FCA determined the condo was far larger than was needed to entertain biz guests and the location had been selected because of is proximity to T’s mother’s condo rather than for biz reasons. FCA looked a the price T would have paid to an AL corp for use of the condo which was the equity rate of return.  ***Arpeg Holdings 2008 FCA***  Cost of capital approach to the valuation of shareholder benefits received in respect of the use of a time share in Whistler and a residence on Crescent Beach.   * T: it was for biz use and not personal use. * Court: **Step1**: identify what the benefit is—what the corp did for the shareholder. **Step2**: determine what the shareholder would have had to pay to obtain that benefit if he or she were not a shareholder. * **Valuation**: The properties were no on rental market. While there were days in which the properties were used for biz functions, the properties were at the shareholder’ disposition on any other occasion, even if they chose not to make use of them. Thus the proper measure of the benefit is not the cost of renting equivalent accommodation for the period of actual personal use, but is the corporate income foregone by having the corp’s capital tied up in unproductive assets.   ***Kennedy 1973 FCA:*** Corp paid for leasehold improvements to the shareholder property.   * Court: The value of the benefit should be reduced on the basis that a portion of the leasehold improvement was found to vest in the corp rather than the shareholder: the lease was a long-term fixed arrangement, and the rent did not increase after the leasehold improvements were made. |

**Note: ordering rule: deemed dividend first—then shareholder benefit.**

Exchange of property and shareholder’s transfer of assets to a corporation for its shares:

= shareholder benefit under 15(1), except to the extent that it’s deemed dividend under 84(1).

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| T owns 1/3 common shares of an unrelated corp. T transferred land (FMV=$5K) to corp in consideration for new issued preferred shares (PUC=$1K, FMV=$1.5K) and cash of $6K.   * 84(1) deemed dividend = increase in PUC – net asset increase in corp = $1K * 15(1) shh benefit = [FMVnons-sh consideration + FMVsh] – FMVassets – 84(1) deemed dividend   = $1.5K + $6K - $5K - $1K = 1.5K |

**5. Exception**

**Stock Dividend** are generally excluded from the inclusion of shareholder benefits under **15(1)(b),** except that:

* **15(1.1):** **Notwithstanding 15(1),** if in a taxation year a corporation has paid a **stock dividend** to a person and **it may reasonably be considered that one of the purposes of that payment was to significantly alter the value of the interest** of any specified shareholder of the corporation, the fair market value of the stock dividend shall, except to the extent that it is otherwise included in computing that person’s income under any of paragraphs 82(1)(a), (a.1) and (c) to (e), be included in computing the income of that person for the year.
* **Specified shareholder:** a shareholder that owns directly or indirectly, no less than 10% of shares of any class of stock in the corp.
* **Purpose:** = specific anti-avoidance rule: to prevent the use of stock dividends to effect a change in the interests of significant shareholders in a corp and thereby shift the capital gain on a subsequent sale of shares from one person to another in order to take advantage of the lifetime capital gains exemption.

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| ***Wu 1997 FCA***  Taxpayer’s wife N a medical practitioner and taxpayer a practising C.G.A. — Taxpayer incorporating N Inc. on N’s instructions — N owning the one Class A common (voting) share and all of the Class C Preferred shares of N Inc. — Taxpayer, N, and a trust for their children each owning Class B non-voting common shares — During 1990, 1991, and 1992, N Inc. declaring stock dividends on Class B shares in the form of Class D preference shares, and N Inc. redeeming only the trust’s Class D preference shares immediately — Value of N’s Class A common share accordingly reduced by an amount equal to the redemption price of the said Class D preference shares, including the unredeemed ones still outstanding in the taxpayer’s and N’s hands — Such redemption price on taxpayer’s Class D preference shares accordingly included by Minister in taxpayer’s income as a shareholder’s benefit under subsection 15(1.1) I.T.A. — On the evidence, however, “one of the purposes” of the Class B preference share stock dividends (in the form of Class D preference shares) not necessarily to significantly alter the value of N’s Class A common share — Taxpayer accordingly not falling within the purview of subsection?15(1.1) I.T.A. — Minister thus ordered to reassess, deleting the stock dividends in issue from his incomes for 1990 to 1992.   * **Objective test under 15(1.1)**: The Tax Court Judge had erred in finding that the relevant purpose under s. 15(1.1) must be demonstrated to have been in the conscious intent of the taxpayer, i.e., a subjective test should be applied. Instead, the words "it may reasonably be considered" placed a substantial onus on the taxpayer to produce some explanation which is objectively reasonable that none of the purposes was to alter the value of a shareholder's interest". * *DD: this case is really about income splitting*   ***Wong 1999 TCC***   * Similar facts as in *Wu*. The *effect* of the manner of issuing the stock dividend in the form of Class C preferred shares redeemable at $1000 pers hare was to significantly alter the interest of Dr. Lee in the corp. * Stock dividend not subject to 15(1.1). |

## CHAPTER 11 INDIRECT BENEFITS, INCOME ATTRIBUTION AND SPLIT INCOME

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| Indirect Payments or Transfer of Property |

**56(2):** A Payment or transfer of property made pursuant to the direction of, or with the concurrence of, a T to some other person for the benefit of the T or as a benefit that the T desired to have conferred on the other person…shall be included in computing the T’s income to the extent that it would be if the payment or transfer had been made to the T.

* This provision attempts to prevent the diversion of income by a T to another person, either for the benefit of T or that other person if the T desired to confer the benefit on the other person, by including the amount paid or transferred to the other person “to the extent…”

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| ***McClurg 1990 SCC***  Mr. McClurg and Mr. Ellis each owned 400 voting and participating Class A shares and 37,500 Class C non-voting preference shares in a trucking company and Mrs. McClurg and Mrs. Ellis each owned 100 non-voting Class B shares which had a PUC of $1.00 per share and were participating where so authorized by unanimous consent of the directors (who were their husbands). Each of the three categories of shares was entitled to receive dividends exclusive of the other classes. Messrs. McClurg and Ellis declared annual dividends of $20,000 on the Class B shares, but none on the Class A's.   * S. 56(2) did not apply.  1. The discretionary dividend clause is valid in terms of the principles of corporate law. 2. The declaration of a dividend is normally beyond the scope of 56(2). 3. The facts at bar provide no evidence that the business arrangement was an attempt at tax avoidance, but rather that it was the product of a business contract made for adequate consideration. (P’s wife had taken an active part in the operation of the business and the payment was a *quid pro quo*.--> this point was denied in *Newman*) |

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| ***Newman 1998 SCC***  The taxpayer transferred his shares of a commercial real estate company to a newly-incorporated company ("Melru") in consideration for 1,285.714 Class G shares of Melru. He and his wife then paid $1 and $99 as the subscription prices for one common share and 99 Class F shares of Melru, respectively. Over a year later, his wife became the sole director and dividends of $5,000 and $14,800 were declared and paid on the Class G and Class F shares, respectively. The $14,800 then was lent by her to the taxpayer. The articles of Melru left the amount of dividends to be declared on the Class F and G shares largely in the discretion of the director, except that: dividends on the Class G shares could not exceed a return of prime + 1% on their redemption price; and after dividends of $0.01 per share were paid on the Class F share, dividends of $0.01 per share were required to be declared on the common shares before further dividends on the Class F shares could be declared.   * S. 56(2) did not apply. After noting that the only relevant distinction with the facts in *McClurg* was that, here, the wife of the taxpayer had made no contribution to the corporation (other than paying the consideration for her shares), Iacobucci C.J. stated:   "I am not aware of any principle of corporate law that requires in addition that a so-called 'legitimate contribution' be made by a shareholder to entitle him or her to dividend income and it is well accepted that tax law embraces corporate law principles unless such principles are specifically set aside by the taxing statute." |

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| Attribution Rules |

Rules designed to prevent income-splitting through the transfer or loans of property to a spouse or CL partner or related minor.

**74.1(1):** If an individual has transferred or lent property…[[41]](#footnote-41) *either directly or indirectly, by means of a trust or by any other means whatever*, to or for the benefit of a person who is the individual’s spouse or common-law partner or who has since become the individual’s spouse or common-law partner, *any income or loss*, as the case may be, of that person for a taxation year *from the property or from property substituted therefor*, that relates to the period in the year throughout which the individual s resident in Canada and that person is the individual’s spouse or CL partner, is deemed to be income or a loss, as the case may be, of the individual of the year and not of that person.

**74.1(2)** contains a similar rule that applies to property transferred or lent to or for the benefit of a person *under 18 years of age* who does not deal at arm’s length with the T or is the T’s *niece or nephew* (“related minor”), deeming any income or loss from the property or property substituted therefor to be the income or loss of the transferor and not the related minor…unless that person before the end of the taxation year, attained the age of 18. *(capital gains not subject this )*

**74.2(1)** extends the attribution rules for *spouses and CL partners* *to capital gains and losses*, deeming the net amount of the transferee’s taxable capital gains for a year from dispositions of property loaned or transferred less allowable capital losses for the year from disposition of such property to be a taxable capital gain of the transferor for the year, deeming any excess of allowable capital losses for the year from dispositions of property loaned or transferred over taxable capital gains for the year from dispositions of such property to be allowable capital losses of the transferor for the year, and deeming these amounts not to taxable capital gains or allowable capital losses of the transferee.

**74.4** contains a special attribution rule for transfers of property to corporations, attributing to an individual who transfers or loans property to a corporation of whom a “designated person” is a “specified shareholder*”(10% or more of the shares)* a deemed interest payment equal to the amount, if any, by which interest on the outstanding amount of the loan or transfer computed at the prescribed rate exceeds the total of interest received in the year on the loan or transfer (other than deemed interest under 74.4(2)), amounts included in the individual’s income as taxable dividends (other than deemed dividends under s. 84) on shares received from the corporation as consideration for the transfer or as repayment for the loan, and the amounts in respect of dividends received by a designated person who is a “specified individual” which must be included in computing the individual’s “split income” under 120.4 and is subject to tax at the highest marginal rate.

**74.5(1) and (2)** generally provide that the attributions rules do not apply to transfers for FMV consideration and loans for value, subject to an exception in 74.5(1)(c) for fair markets transfers between spouses or CL partners that the transferor must elect out of the rollover in 73(1).

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| ***Kieboom 1992 FCA***  Husband and wife are the only shareholders of the corporation. Corp issued new shares to wife at price far below its FMV. Wife then transferred a portion of interest to 3 children.   * 74(2) applies: Both “transfer of property” and “property” in this phrase is used in a very broad sense. By issuing new shares, husband’s equity value in company reduced by 40% and her equity value was increased by 40%--this constitutes “transfer of property”. |

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| Tax on Split Income |

**120.4** is designed to prevent income-splitting w/ minor children by taxing certain categories of income received by minor children at the top marginal rate.

* 120.4(2): there shall be added to a specified individual’s tax payable under this Part for a taxation year 29% of the individual’s split income for the year.
* 20(1)(ww) provides a deduction for the individual’s split income for the year in order to ensure that it is not subject to tax twice, while 56(5) and 74.5(13) ensure that amounts included in split income are excluded from the indirect benefit and income attribution rules.
* **120.4(1)** defines a “**specified individual**” in relation to a taxation year as an individual who “has not attained the age of 17 before the year”, is resident in Canada, and has a parent who is resident in Canada, and defines he “split income” of a specified individual as the total of taxable dividends and shareholder benefits received by the individual in respect of shares of the capital stock of a corporation other than shares of a class listed on a designated stock exchange, certain kinds of partnership income and trust income that is reasonably considered to be in respect of these other amounts.
* **Excluded income:**
* **120.4(4) and (5)** extend the income-splitting tax to **taxable gains** realized by specified individuals from the disposition of shares other than shares of a class listed on a designated stock exchange, where the shares are “transferred, either directly or indirectly, in any manner whatever, to a person with whom the specified individual does not deal at arm’s length”.

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| ***Gwartz 2013 TCC***    \*The facts of this case happened before the enactment of 120.4(4) and (5)\*  The Trust reported a capital gain of $74,999.50 from step **1b** for each of 2003 to 2005, which it allocated to the taxpayers for inclusion (as to the taxable capital gains portions) in their returns. The Minister reassessed the taxpayers under the general anti-avoidance rule on the basis that, by effecting the realization of capital gains and their distribution to the beneficiaries, rather than the distribution of taxable dividends, the series of transactions had abusively circumvented s. 120.4 of the *Act*.   * Hogan J. allowed the taxpayers' appeals. Although s. 120.4 was circumvented, there was no abuse. He stated: * “The fact that specific anti-avoidance provisions were enacted long before the introduction of section 120.4 leads me to infer that Parliament was well aware of the fact that taxpayers could arrange to distribute corporate surpluses in the form of taxable dividends or of capital gains subject to the application of those specific anti‑avoidance provisions. The fact that those provisions were not amended and that a specific rule was not included in section 120.4 to curtail well-known techniques leads me to infer that Parliament preferred simplicity over complexity when it enacted section 120.4.” * The present case was distinguishable from *Triad Gestco*, which involved the creation of an artificial capital loss, rather than the shifting of an already-accrued capital gain on common shares of a taxpayer to other shares (namely, the Class D shares) of the taxpayer. [*but according to DD: they created huge capital loss*] |

# TAXATION OF CORPORATE REORGANIZATIONS

## TRANSFER OF PROPERTY TO A CORPORATION

**1. Rollovers**

Where T disposes of “eligible property” to a taxable Canadian corp in exchange for consideration that includes shares of the corp, **85(1)** permits T to **jointly elect** with the corp to determine the amount at which the property is disposed.

* **85(1)(a)** deems the amount they agreed on to be the proceeds of disposition of the property to the T and the corp’s cost of the property.

1. **Eligibility**

**85(1) applies** when disposition of “eligible property” to a taxable Canadian corp in exchange for consideration that includes shares.

* **Eligible property**: most kinds of property except real property inventory: **85(1.1)**
* Shares = at least 1 share
* Note the possible avoidance of exclusion of real property inventory through sequential transfers of the property to a partnership under 97(2) and then of a partnership interest received in exchange for the property to a corp under 85(1), and the possible application of the GAAR to this back to back serious of transaction. (*Loyens*)

1. **Limits on elected amount**
2. ≤ FMV of the property transferred [**85(1)(c)**]—*no artificial income or gains*
3. ≥ FMV of boot received as consideration, **subject to 85(1)(c)** [**85(1)(b)**] —*must recognize actual gain realized*
4. ≥ min {cost to the transferor, FMV of inventory or non-depreciable capital property} [**85(1)(c.1)**] —*no artificial loss*
5. ≥ min {capital cost of the property, FMV of the property, UCC of all property of the class if depreciable property} [**85(1)(e)**] —*no artificial loss*
6. ≥ the greater of the amounts deemed by 85(1)(b) and (c.1)(d) or (e) where these rules conflict. [**85(1)(e.3)**] –*ordering rule*
7. **Consequence**

The elected amount becomes:

1. the proceeds of disposition to the T
2. the cost of the property to the corp, and
3. the basis for allocating cost to the various types of property that the T receives from the corp in exchange for the property subject to the rollover[[42]](#footnote-42)

* The determination of the cost of property received by the T:

These provisions allocate the aggregate cost of property received by the T first to non-share consideration (up to its FMV), then to preferred shares (up to FMV) and then to common shares.

1. cost of boot = min {FMV, its proportionate share of FMV of the property disposed} [**85(1)(f)**]
2. cost of preferred shares = min {FMV, their proportionate share of the amount by which the elected amount exceeds FMV of boot} [**85(1)(g)**]
3. cost of common shares = their proportionate share of the amount by which the elected amounts exceeds the FMV of boot and the cost of preferred shares received by T [**85(1)(f)**]

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| Property transferred | | Consideration | | | Consequences |
| ACB | FMV | Boot | Pref sh | Com sh |
| 40 | 100 | 60 | 0 | 0 | * Cost of boot = lesser of its FMV(60) and the FMV of the property transferred(100) = 60 * If elect 40, (1)(b) kicks in—deemed to be 60 |
| 40 | 100 | 40 | 35 | 25 | If elect 40—you got 40 of capital, the cost of the boot=40, cost of the preferred shares=0, cost of common shares =0 |
| 40 | 100 | 25 | 40 | 35 | If you elect 60, cost of boot=25, cost of preferred shares=35, cost of common shares=0 |
| 40 | 100 | 120 | 50 | 30 | * If elect 40, proceeds deemed to be 100 * Cost of boot= lesser of 120 and 100 =100 * Cost of preferred shares=lesser of 50 and 100 exceeds FMV of boot =0, * Cost of common shares=0   **These mean: you have accrued realized**   * Shareholder benefit= 120+50+30-100 = 100 * 52(1): can add amount you included to the ACB of the property * (f) doesn’t work on its own, it works together with shareholder benefit rules 15(1) and 52(1) |

**85(5)** deems the corporation to have acquired depreciable property at the transferor’s capital cost and to have deducted the difference between this capital cost and the transferor’s proceeds of disposition (the elected amount) as CCA—which makes the corp liable for recaptured depreciation up to the transferor’s capital cost. *(corp step into the shoes of T to get the recaptured depreciation / terminal loss)*

* Ex: capital cost=100, depreciated down to UCC=40, FMV=20, if you elect the less than the two amounts (100 and 20), will be deemed to be the lesser of the two amounts and the lesser of UCC of property of the class. Deemed proceeds = 20. Terminal loss = 20 – 40 = -20
* If FMV=40, UCC=20, recaptured deprecation = 40 – 20 = 20. Thus, if corp sells it at FMV, will have recaptured deprecation of 20.

1. **PUC grind**

**85(2.1)(a)**: increase in the PUC of shares received by the T as consideration ≤ [corp’s cost of the property (the elected amount) - FMV of boot received by T]

Note the possibility of a shareholder benefit on the transfer of property to a corp under s. 85. The amounts included as a benefit under 15(1) may be added to the ACB of the property received under 52(1).

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| Ex1: If property transferred ACB=40, FMV=100, on rollover basis, elect 40. You take back one common share (FMV = 40, PUC = 100):   * Cost of common share=40. * If you redeem your share at 100, deemed dividend=0 (84(3)), proceeds=100, you have capital gain=60—you can use lifetime capital gain deduction to shelter it. * PUC grind: 85(2.1): similar to 84.1. * PUC grind = increase in PUC as result of the acquisition of property – [cost of property – FMV of boot] = 100-40 = 60 * PUC =100 (PUC otherwise determined) - 60 (PUC grind) = 40 * **(the PUC is the remaining capital left)**   Ex2: If property transferred ACB=40, FMV=100, elect 40, boot=25, common shares=75.   * Cost of boot = 25; cost of common shares = 15 * 85(1)(h): ACB of the shares=15, FMV=75 (if that’s the only thing in the corp), PUC=75, * PUC grind = 75- (40-25) =60 * PUC = 15 |

**2. Stop-Loss Rules**

Various “stop-loss” rules were designed to prevent to recognition of losses from dispositions fo property in circumstances where the T or an “affiliated person” acquires the same property or an identical property within a specified period of time (30 days before and after). Loss will be allowed to realize when the property is ultimately disposed to an unaffiliated person.

* **Purpose**: to prevent the recognition of tax losses when T dispose of property without actual disposing of their economic interest—because either they or affiliated person acquires the same property or an identical property around the time of disposition.
* “**affiliated persons**”: **251.1**

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

**(b)** a corporation and

* + **(i)** a person by whom the corporation is controlled,
  + **(ii)** each member of an affiliated group of persons by which the corporation is controlled, and
  + **(iii)** a spouse or CL partner of a person described in subparagraph (i) or (ii);

**(c)** two corporations, if

* + **(i)** each corporation is controlled by a person, and the person by whom one corporation is controlled is affiliated with the person by whom the other corporation is controlled,
  + **(ii)** one corporation is controlled by a person, the other corporation is controlled by a group of persons, and each member of that group is affiliated with that person, or
  + **(iii)** each corporation is controlled by a group of persons, and each member of each group is affiliated with at least one member of the other group;
* **Group control**: *Silicon Graphics—a* ***sufficient link*** *to enable them to exercise control or actually act together to exert control*
* When you got affiliated group—*Silicon Graphics* test is easily satisfied
* **251.1(4)**: persons are affiliated w/ themselves
* **40(2)(g)(i)** disallows a “superficial loss” by deeming T’s loss from the disposition of a property by an individual to be nil.
* **Superficial loss: 54**: **(a)** during the period that begins 30 days before and ends 30 days after the disposition, the taxpayer or a person affiliated with the taxpayer acquires a property (in this definition referred to as the “substituted property”) that is, or is identical to, the particular property, and **(b)** at the end of that period, the taxpayer or a person affiliated with the taxpayer owns or had a right to acquire the substituted property,
  + 40(2)(h) carved out when the property is disposed of by a corporation, partnership, or a trust 🡪 hence it still applies to individuals
* **53(1)(f):** The superficial loss is added to ACB of the substituted property (w/in the meaning assigned by the definition superficial los in 54(a))
* **40(3.3)&(3.4)** defer the loss on certain dispositions of **non-depreciable capital property** disposed of by a corp, partnership or trust
* *Effect: loss stays in the hand of the transferor, not added to cost*
* **18(14)&(15)** defer a loss on the disposition of **inventory** held in an ANT
* **13(21.2)** defers a terminal loss on the disposition of **depreciable capital property**
* *usu UCC < capital cost, so: loss disallowed= UCC – Proceeds*

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| ***Triad Gestco 2012 FCA***    The taxpayer, which was directed and controlled by Mr. Cohen, and which had realized a capital gain of approximately $8 million, transferred $8 million of assets to a newly-incorporated subsidiary ("Rcongold") in consideration for the issuance of common shares. Rcongold declared a stock dividend of $1 on its common shares, which was payable through the issuance of 80,000 non-voting preferred shares with an aggregate redemption price of $8,000,000 and (presumably) a stated capital of $1. An unrelated individual settled, with $100, a trust of which Mr. Cohen was a beneficiary, so that under the "affiliate" definition then[[43]](#footnote-43) in effect it was an un-affiliated trust. The taxpayer then sold its common shares of Rcongold to the trust for $65 and claimed a capital loss of $7,999,935, which permitted it to offset the realized capital gain through a loss carry-back[[44]](#footnote-44).   * T’s appeal was dismissed. * T’s argument: **(1)** 40(2)(g)(h) not introduced—suggesting no intention to regulate this way / narrowly targeted /can’t argue there’s a policy (just like the argument in Gwartz) (opposing argument would be: parliament shut down the loophole—suggests how abusive it was (in Duncan)). **(2)** affiliated person is a narrow concept—if it’s BC Trust, not affiliated (affiliated doesn’t mean NAL)—you can’t read in the scope of “economic unit   FCA:   * (1) The Court found that the TJ erred in his alternative finding that s. 40(2)(g)(i) reflects a general policy against the deduction of losses "within an economic unit". * (2) After noting that after the taxpayer's disposition of its common shares it "was neither richer nor poorer," Noël J.A. stated that "the capital gain system is generally understood to apply to real gains and losses" as contrasted to "paper gains or losses", so that, under the general capital loss provisions of the Act, there was: relief as an offset against capital gain where a taxpayer has suffered an economic loss on the disposition of property... [and] offsetting a capital gain with the paper loss that was claimed [here] results in an abuse and a misuse of [these] relevant provisions... . 🡪 ***welcome back the overarching policy analysis of the GAAR!*** * (3) Finally, although there was a corresponding accrued but unrealized gain on the taxpayer's preferred shareholding, the taxpayer had not "put forth a credible scenario indicating that the preferred shares were to be sold".   *DD: Court referred to Ramsay, Carter Commission Report: “economic power” not “paper loss”, points to 38(b), 39(1)(b), and 40(1)(b) (former 55(1) confirms it)* 🡪 *but these are just mechanical rules, need to point to something behind it. Not really consistent with Canada Trustco)* |

**3. Anti-avoidance rule[[45]](#footnote-45):**

**69(11)** deems property to have been disposed of for proceeds of disposition equal to FMV (notwithstanding the rollover rule in 85(1)), where as part of a series of transactions or events a T disposes of property for proceeds less than FMV and it can reasonably be considered that one of the main purposes of the series is to obtain the benefit of various kinds of deductions available to an unaffiliated person and the subsequent disposition occurs or arrangements for it are made within 3 years.

* **Purpose**: to prevent the sheltering of income and capital gains through tax-deferred transfers of property either to unaffiliated persons with losses or other amounts (e.g. CCA) that can be deducted against income resulting from a subsequent disposition of the property or to persons who are exempt form tax on income arising from a subsequent disposition of the property.
* **Note**: 69(11) only applies to transactions between unaffiliated persons, this means that the transactions designed to obtain these deductions are allowed between affiliated persons (and thus not misuse and GAAR should not apply).
* The definition of **affiliated person** for the stop-loss rules relied on a *de facto* control whereas the definition used for he anti-avoidance rule in 69(11) is modified to **include only *de jure* control**.

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| ***Loyens 2003 TCC***    In order that the sale of a real estate property could be accomplished in a manner that utilized the losses of a loss company ("Lobro Stables") the taxpayers transferred the property to a partnership utilizing the rollover in subsection 97(2), transferred their partnership interests to Lobro Stables utilizing the rollover provision of subsection 85(1), with Lobro Stables then selling the property at a gain.   * Ruled for T.This case was decided under old rule. * (1) Would this be caught by 69(11)?   1. Part of a series of transactions? Yes   2. Less than FMV? Yes   3. Reasonbly be consideed that one of the main purposes is…? Yes   4. w/in 3 years? Yes (in one day) * (2) Fall into any exception? * Lobro Stables affiliated w/ them?—the corp is controlled by whom?—they each have 50%, not controlled by either of them. Controlled by affiliated group?—no, they are not affiliated. So under current rules, they wouldn’t be able to get the exception—69(11) would apply. * But at the time, the rule was “related” rather than “affiliated”—corp controlled by related group—and they are related group—fall into the exception. * (3) Would GAAR apply?  1. Seldom does court recognize subsequent amendment confirms the abusive nature. 2. Abused/misused 97(2), 85(1) and 85(1.1)(f)?  * T indirectly roll the real property inventory, the Harrison property, to Lobro Stables, when T could not do so directly, and were able to utilize the losses in Lobro Stables to offset the gain on the Harrison property sale. * CRA argues that 97(2) is the mechanism used by T to circumvent the definition of eligible property found in 85(1.1)(f). This results in misuse of these sections by allowing the T to avoid a gain that should otherwise have been included in their income.  1. First step: determine the policy behind the provision. The policy behind 85(1.1)(f) is to prevent a real property trader from converting income into capital gains. 2. There is no misuse: T did not violate this policy because all money related to the Harrison property were reported as income at every stage. 3. Abuse of the Act as a whole?  * In finding that these profit trading transactions did not result in an abuse or misuse for purposes of s. 245(4), Campbell T.C.J. stated that the principles in *OSFC Holdings* with respect to loss trading should not be extended to profit trading, and the transactions simply utilized the provisions of the Act for the very purpose for which they were designed. * *DD: good decision.* |

## AMALGAMATION

1. **Requirements for a statutory amalgamation in 87(1)**

* **87** **(1)** An amalgamation means a merger of two or more corporations each of which was, immediately before the merger, a taxable Canadian corporation (“predecessor corporation”) to form one corporate entity (“new corporation”) in such a manner that
  + 1. all of the property (**except** amounts receivable from any predecessor corporation or shares of the capital stock of any predecessor corporation) of the predecessor corporations immediately before the merger becomes property of the new corporation by virtue of the merger,
    2. all of the liabilities (except amounts payable to any predecessor corporation) of the predecessor corporations immediately before the merger become liabilities of the new corporation by virtue of the merger, and
    3. all of the shareholders (except any predecessor corporation), who owned shares of the capital stock of any predecessor corporation immediately before the merger, receive shares of the capital stock of the new corporation because of the merger,

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

* An amalgamation that does not qualify as a statutory amalgamation under 87(1) remains subject to corporate law principles requiring the continuation of tax attributes “without subtraction”. (*Envision*)

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| ***Envision 2013 SCC***  The taxpayer ("Envision") was formed on the amalgamation under the *Credit Union Incorporation Act* (B.C.) (the "CUIA") of two credit unions. S. 23(b) thereof provided that "the amalgamated credit union is seized of and holds and possesses all the property ... and is subject to all the debts ... of each amalgamating credit union." The taxpayer sought to avoid having this qualify as an amalgamation described in s. 87(1) of the Act (which required that all property of the predecessors, other than intercompany shares or debts, become property of the amalgamated corporation). To this end, a beneficial interest in some "surplus" real estate was conveyed to a numbered corporation subsidiary at the exact stipulated time for the amalgamation in the amalgamation agreement.   * Rothstein J found that s. 23(b) of the CIUA, which should not be overriden by the amalgamation agreement in light of the obvious intent that amalgamated corporations would be responsible for their predecessors' liabilities, caused the amalgamated corporation (Envision) to be seized of its predecessors' properties, including the surplus properties, at the moment of the amalgamation. As to the resulting effect on the sale agreement for the surplus properties: * At the moment of amalgamation, the predecessors ... no longer had separate legal personalities capable of fulfilling the terms of the sale agreements. While they were continued under the CUIA, they continued inside Envision. ... So, despite the fact that the agreements listed [them] as the vendors, at the moment of the amalgamation, the vendor was Envision. * If 87(1) doesn’t apply, what happens? * T tries to argue CL is subsumed by statute, and if statute n/a, nothing applies. * Court doesn’t agree. If statute n/a, go to CL: river of streams—w/o subtraction—same thing happens Also, even if CL n/a, they would go to GAAR. |

1. **Results at Shareholder Level: 87(4)**

* **Conditions for 87(4) to apply**: (1) qualifying amalgamation; (2) the shares of predecessor corp were capital property to the shareholder; (3) the shareholder received no consideration other than shares of the new corp.[[46]](#footnote-46)
* **Automatic rollover**: the shareholder is deemed under **87(4)(a)** to have disposed of the old shares for proceeds equal to the shareholder’s total ACB of the old shares immediately before the amalgamation, and is deemed under **87(4)(b)** to have acquired the new shares at a cost equal to the same deemed proceeds. (effect: no gain, no loss.)

1. **Results at Corporate Level**
2. **87(2)(a)** deems the amalgamated corporation to be a new corporation whose **tax year** is deemed to commence at the time of the amalgamation and deems the taxation year of each predecessor corporation to have ended immediately before the amalgamation.
3. The rollovers for property of the amalgamating corporations in:
4. **87(2)(b):** deems **inventory** of a predecessor to have been acquired by the new corp at the beginning of its first taxation year at an amount equal to its value for inventory valuation purposes of the predecessor.
5. **87(2)(d)**: deems the tax attributes of **depreciable capital property** of a predecessor to carry over to the new corp, such that the new corp inherits the predecessor’s capital cost of depreciable property and is treated as having claimed any CCA claimed by the predecessors before the amalgamation.
6. **87(2)(e)**: deems the cost **non-depreciable capital property** of a predecessor to be equal to the predecessor’s ACB of the property immediately before the amalgamation.
7. **PUC grind**

* ITA seeks to ensure that the PUC of the shares of an amalgamated corp is equal to the combined PUC of the shares of the amalgamating corps (excluding inter-corporate shareholdings).
* **87(3)(a)**: in computing the PUC of shares of the new corp, one must deduct the amount by which the PUC of the shares of the new corp (otherwise determined) exceeds the combined PUC of the shares of the predecessor corps, excluding inter-corporate holding shares. [assuming there’s only one class of shares]
* **87(3)(b)**: restore the PUC to the extent that an earlier PUC reduction under para(a) has contributed to a higher deemed dividend on that class of shares under 84(3)(4)or (4.1).

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| ***Copthorne 2011 SCC***  The ultimate controlling family members decided that a Canadian subsidiary ("Copthorne I") should be amalgamated with a wholly-owned subsidiary of Copthorne I ("VHHC Holdings"), whose shares had a nominal FMV but a PUC of approximately $67 million. In order to preserve the PUC in the shares of VHHC Holdings, the amalgamation was not accomplished as a vertical amalgamation. Instead, Copthorne I sold its shares of VHHC Holdings for a nominal amount to Copthorne I's non-resident parent company prior to a horizontal amalgamation of Copthorne I and VHHC Holdings (and some other Canadian corporations) to continue as Copthorne II. With a view to effecting a substantial distribution to its non-resident shareholder (and after Copthorne II had amalgamated with another Canadian corporation to continue as Copthorne III), Copthorne III redeemed preferred shares held by the shareholder, with no Part XIII tax being withheld in light of the high PUC of those shares.   * The Court found that this preservation of PUC gave rise to a tax benefit. As per *Trustco,* **a tax benefit can be established by comparing the taxpayer's situation with an alternative arrangement that would be reasonable but for the alleged tax benefit.** Rothstein J. stated: * Copthorne argues that an amalgamation while VHHC Holdings was owned by Copthorne I - a vertical amalgamation - "was never a live and reasonable option" and thus the Minister should not have used such a comparison. ... Copthorne says that a taxpayer would never have chosen this higher tax option, and thus that such option was unreasonable.... As the Tax Court judge pointed out, the vertical amalgamation would have been the simpler course of action. It was only the cancellation of PUC that would arise upon a vertical amalgamation that led to the sale by Copthorne I of its shares in VHHC Holdings to Big City. To use the words of Professor Duff, "but for" the difference in how PUC was treated, a vertical amalgamation was reasonable. The comparison was entirely appropriate. Copthorne has not satisfied its onus of showing that there was no tax benefit. * In finding that the taxpayer should be reassessed under s. 245, the Court found that the series of transactions pertaining to the reorganization, and the subsequent redemption, were part of the same series of transactions. Under *Canada Trustco,* a transaction is completed "in contemplation of" a series of transactions whenever it is completed "because of" or "in relation to" the series. The finding at trial that **the transactions shared a "strong nexus" thus fit the expansive meaning of "series of transactions" under s. 248(10).** * The Court also addressed the criticism of its finding in *Canada Trustco* that the words "in contemplation of" could be retrospective. * After observing that **s. 87(3)** provides for the cancellation of the paid-up capital of a subsidiary on its vertical amalgamation, Rothstein J. stated: * Having regard to the text, context and purpose of s. 87(3), I would conclude that the object, spirit and purpose of the parenthetical portion of the section is to preclude preservation of PUC of the shares of a subsidiary corporation upon amalgamation of the parent and subsidiary where such preservation would permit shareholders, on a redemption of shares by the amalgamated corporation, to be paid amounts as a return of capital without liability for tax, in excess of the amounts invested in the amalgamating corporations with tax-paid funds. (**policy of s. 87(3) is to avoid preservation of PUC on parent and sub amalgamation**)🡪 ***DD: THE PUC SCHEME IS BACK!*** * Accordingly, the GAAR assessment was appropriate: The sale of VHHC Holdings shares to [the shareholder] circumvented the parenthetical words of s. 87(3) and in the context of the series of which it was a part, achieved a result the section was intended to prevent and thus defeated its underlying rationale. The transaction was **abusive**. |

## CAPITAL GAINS STRIPPING

**1. Concept of capital gains stripping**

Understand: Why the deduction for inter-corporate dividends in 112(1) creates an incentive for capital gains stripping, as well as key transactions through which capital gains stripping could be accomplished but for the anti-avoidance rule in 55(2)

* Where a taxable Canadian corp plans to sell shares of another corp the FMV of which exceeds their ACB, the amount of this gain could be reduced through an inter-corp dividend that decreases the value of the shares prior to their sale[[47]](#footnote-47).
* Alternatively, where a taxable Canadian corp wishes to well an asset that has increased in value, it might transfer the asset to a purchaser corporation on a rollover basis under 85(1) in exchange for shares which are redeemed shortly thereafter, resulting in a deemed dividend under 84(3) which is deductible to the recipient under 112(1) rather than a taxable capital gain (or recaptured depreciation) from a disposition of the asset.[[48]](#footnote-48)

**2. Anti-avoidance rule: 55(2)**

* In order to prevent capital gains stripping, **55(2)** **re-characterizes** non-taxable inter-corporation dividends as proceeds of disposition or capital gains.
* **Conditions for 55(2) to apply**:

1. A corp resident in Canada has received a taxable dividend in respect of which it is entitled to a deduction under various provisions, e.g. 112(1). [applies only to non-taxable inter-corporate dividends]
2. The dividend was received a part of a transaction or event or a series of transactions or events, “one of the purpose of which” (or “one of the results of which” in the case of a deemed dividend under 84(3)) was to “effect a significant reduction in the portion of the capital gain that, but for the dividend, would have been realized on a disposition at FMV of any share of capital stock immediately before the dividend”; and

* **The purpose or results test** links the dividend to a significant reduction in a notional capital gain on the disposition of shares: *CPL Holdings, Meager Creek Holdings, Placer Dome*

1. The portion of the gain that is reduced by the dividend “could reasonably be considered to be attributable to anything **other than** income earned or realized by any corporation after 1971 and before the safe-income determination time for the transaction, event or series (=“**safe income**”)”.[[49]](#footnote-49)

* **Safe-income determination time** = the time that is immediately before the earliest time that a dividend is paid as part of the transaction, event or series: **55(1)**
* Computation of safe income based on the rules in 55(5)(b) or (c) and (a)
* **55(5)(c)** deems the safe income of “the income earned or realized by a corp for a period throughout which it was a private corp” to be its income for the period “otherwise determined”.
* **55(5)(b)** similarly deems the income earned or realized by a corp for a period throughout which it was resident in Canada and to a private corp to be its income for the period otherwise determined, but adds to this amount the non-taxable portion of capital gains and cumulative eligible capital—which are properly included in computing the income out of which a tax-free safe dividend may be distributed but need not be added to the income otherwise determined of private corp since private corps may distribute these amounts as tax-free capital dividends.
* **55(5)(a)** deems “the portion of a capital gain attributable to any income expected to be earned or realized by a corp after the safe-income determination time for the transaction, event or series” to be a “portion of a capital gain attributable to anything other than income”—thereby excluding from the safe income exception any expected income that has yet to be subject to tax.
* **Safe income on hand (“SIOH”)[[50]](#footnote-50)**: the portion of safe income to which a reduced capital gain on the disposition at FMV of a share immediately before the dividend is reasonably attributable.
* The attribution of a corp’s SIOH to specific shares in respect of which a dividend is received
* **55(5)(f)** allows T to designate a single taxable dividend to be more than one taxable dividend—It permits a corporation that receives a dividend a portion of which is a taxable dividend that is not entirely attributable to safe income to avoid re-characterization for part of the dividend by designating “in its return of income” under Part I of ITA “for the taxation year during which the dividend was received any portion of the taxable dividend to be a separate taxable dividend” whereupon the remaining portion is deemed to be a separate taxable dividend. (*Gestion*, *Kruco, Lamont, Nassau*)

1. **Part IV Tax Exception**

This provision does **not apply** to the extent that the dividend is subject to **Part IV tax that is not refunded** on the payment by the individual recipient of a dividend **to a corporation**. (*943963 Ontario, Canutilities Holdings*)

**Purpose or Result Test**

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| ***CPL Holdings 1995 FCTD***  The two individual shareholders of a corporation operating a machine shop ("Clem Industrial") transferred all their shares of Clem Industrial to the taxpayer (which was a newly-incorporated holding company) in consideration for high-low shares of the taxpayer. They then caused Clem Industrial to pay a large dividend (virtually equal to the FMV of its outstanding shares) to the taxpayer, which then lent the proceeds back to Clem Industrial in consideration for a demand debenture.   * The taxpayer was able to establish that the purpose of these transactions was to make the taxpayer (and therefore, indirectly, its individual shareholders) secured creditors of Clem Industrial which, at the time, was named in a law suit. Accordingly, s. 55(2) did not apply notwithstanding that after the completion of the transactions, 49% of the shares of Clem Industrial were sold by the taxpayer for a nominal amount to an arm's length individual.   DD not convinced by T’s story:   * Even if it’s a subject test, need to look to objective manifestations: If they really worry about the lawsuit, wouldn’t wait for 9 months—would’ve got out fast * Would this be caught under *Copthorne* approach? (“in contemplation of the serious”)—DD: they charged 1 dollar per share, they knew there’s not going to be a corp anymore. * This case gives T some ability to argue it’s not the purpose--“credit proving” usu used * b/c it’s a subjective test, largely depend on the credibility of witness etc. if good enough can convince court.   ***Meager Creek 1998 TCC***  Two Canadian corporations owned by the taxpayer paid significant dividends to the taxpayer shortly before the February 1990 federal Budget on the advice of their accountant who feared the introduction of a tax on inter-corporate dividends. Six months later, discussions were held with respect to a potential sale of the corporations, and a sale of one-third of the shares occurred a few months later.   * Ruled for T. * (1) None of the purposes of the dividend was to reduce a capital gain (Court accepted T’s argument that the dividend was motivated solely by the fear of a possible budget announcement). * (2) The share sale was not part of the same series of transactions as the dividend. * (3) O'Connor TCJ. stated that he could not accept the Crown's submission "that any possible or future sale can suffice to bring subsection 55(2) into play".   ***Placer Dome 1996 FCA***  After the taxpayer solicited competing bids for the sale of a significant block of shares it held in another public company ("Falconbridge") both directly and through a holding company ("McIntyre"), it accepted an offer of Falconbridge that required Falconbridge to declare and pay a significant dividend on all the outstanding shares of Falconbridge, and (following the payment of a corresponding dividend by McIntyre) to purchase the shares of Falconbridge and McIntyre held by the taxpayer.   * Ruled for T: The only purpose of the dividends was to facilitate the securities law exemption. * “One of the purposes”🡪 Once it is established that a transaction has the effect of reducing significantly a capital gain it is proper for the Minister to infer that the T had such a purpose 🡪 **To rebut this inference**, T must offer a **probable and reasonable** explanation that establishes that **none of the purposes** was to effect a significant reduction in capital gain. * Corroborative evidence helps. * Court rejected the argument that the term “purpose” must be interpreted in objective manner. |

**Safe Income Exception**

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| ***Gestion Jean-Paul Champagne 1995 TCC***  In connection with a buy-out of an individual's interest in a corporation ("Champagne") by his brother, the individual and his wife transferred their shares of Champagne to a newly-incorporated holding company, following which Champagne redeemed the transferred shares.   * Lamarre Proulx TCJ. found that considering all the retained earnings of Champagne to be attributable to the redeemed shares ran counter to the corporate law principle of the equality of shares and the purposes of s. 55(2), and found that the safe income of Champagne should be prorated among the shareholdings. * The taxpayer, which failed to report the receipt of a deemed dividend in its tax return for the relevant taxation year, was found to be entitled to benefit from a designation under s. 55(5)(f) following a reassessment by the Minister under s. 55(2).   ***Kruco 2003 FCA***  The safe income of a corporation ("Kruger") from which the taxpayer received a deemed dividend did not exclude income resulting from investment tax.   * Minister: amounts that do not constitute actual income earned ("**phantom income**") should not be considered as safe income. * Court: M’s position failed to reflect that income for tax purposes is not a logical and coherent concept that reflects reality and that the wording of s. 55(2) (and, in particular, s. 55(5)(c)) "does not permit any such orientation in the name of a perhaps desirable but non-existent realism". It is not open to the Minister to modify the amount which Parliament has deemed to be a corp’s “income earned or realized” for purposes of 55(2). * Furthermore, the approach of the Minister would result in double taxation (as a capital gain in the hands of the taxpayer) of amounts that had already been taxed to the corporation.   ***Lamont Management 1999 TCC***  In light of the specific code provided in s. 55(5), it was found that the safe income attributable to shares redeemed in the hands of the taxpayer did not include safe income earned by a U.S. corporation in which the taxpayer was indirectly invested because that corporation was not a foreign affiliate. This was so notwithstanding that "the word 'any' is all-embracing and ... in its natural meaning it excludes limitations”.  ***Nassau Walnut Investments 1997 FCA***  Although it had been planned that the portion of deemed dividends received by the taxpayer (arising on the redemption of shares held by it) that did not come out of safe income would be subject to a designation under s. 55(5)(f), all of such amounts were reported by the taxpayer in its return as deemed dividends due to an error by a subsequently-appointed accounting firm.   * Court found that the assumption of the Minister that the safe income earned by the redeeming corporation should be allocated pro rata amongst all the shares in its capital (with the result that only a pro rata portion of the safe income was applicable to the shares that were redeemed in the hands of the taxpayer) was reasonable. * A late designation under s. 55(5)(f) was available to the taxpayer, |

Part IV Tax Exception

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| ***943963 Ontario 1999 TCC***  The taxpayer (a Canadian-controlled private corporation) received $1.2 million upon the purchase for cancellation of shares, having a PUC of $732, of a connected corp (HSP), thereby realizing a deemed dividend (before any application of s. 55(2)) of $1,199,268 (which it subdivided into 10 separate deemed dividends under s. 55(5)(f), the first eight of which totaled to the estimated applicable safe income on hand of $252,265, and the ninth of which was the $566,920 amount of the dividend subject to Part IV tax).   * In calculating the portion of the deemed dividend that, in turn, was deemed to be proceeds under s. 55(2), the Minister subtracted the Part IV tax dividend amount of $566,920 from $1,200,000 to arrive at $633,080, so that the taxpayer's capital gain was $303,378 based on its adjusted cost base of $329,702. The Minister (contrary to the taxpayer's approach) did not make a further deduction for the safe income amount as this was included in the dividend subject to Part IV tax. * In rejecting a submission of the taxpayer "that a taxpayer has the right to designate which portion of a dividend that will or will not be subject to Part IV tax," and in confirming the Minister's calculation, Rip J stated that "paragraph 55(5)(*f*) is silent with respect to any allocation of the Part IV tax among the designated dividends" and: * It is readily apparent that Part IV tax is eligible on receipt of the first dollar of dividend, on the facts at bar, on amounts first totaling $566,920. **Safe income is not safe from Part IV tax.**   ***Canutilities Holdings 2004 FCA***  The two taxpayers, which were subject corporations, indirectly sold their investment in another public corporation ("ATCOR"). This was accomplished by their common shares of ATCOR being exchanged on the amalgamation of ATCOR with a newly incorporated subsidiary of a related corporation for Class A or B non-voting redeemable shares of the amalgamated corporation having a PUC approximating the respective ACB of their ATCOR common shares, with the special shares then being redeemed. The Part IV tax payable on the deemed dividends arising on this redemption was refunded because of normal-course dividends paid by the taxpayers to their shareholders that year.   * In finding that the subsequent normal course dividends were **part of the same CL series of transaction**s as the amalgamation/redemption transactions, Rothstein, J.A. stated (at para. 67):   "the fact that CU COH intended to use both the ATCOR/Forest transactions and the normal course dividends to achieve their tax avoidance objective, that they had the ability to ensure that all the transactions would occur, and that all the transactions did indeed occur as intended are sufficient to constitute them all part of a common law series for the purposes of subsection 55(2). It is of no consequence that one or more of the transactions had an independent purpose and existence." |

**3. Exception for related-party transactions: 55(3)(a)**

* **55(3)(a)**– if all involved are related persons, 55(2) doesn’t apply and inter-corp dividend will continue to be treated as dividend
  + look at whether purchaser of (increased interest in) Opco is related to person who got dividend
  + 55(3.01)(a) “unrelated person**”: brothers & sisters are deemed to be UNRELATED** for this section only: this prevents cashing out of siblings on tax-deferred basis.

1. By allocating corporate income among each of the provinces in which the relevant corporation has a “permanent establishment”—allocation rules in Part IV Reg. For our purposes, no need to examine them. [↑](#footnote-ref-1)
2. The Act defines an active business by what it is not: any business that is neither a personal services business nor a specified investment business. Active business excludes income from property and capital gains, so items like interest and rent are not active business income. However, there are exceptions. [↑](#footnote-ref-2)
3. See chart on p. 235. [↑](#footnote-ref-3)
4. In addition, as explained in Chapter 7, a degree of integration for dividends paid out of a CCPC’s AII is achieved by the combined effect of the gross-up and credit for taxable dividends and a dividend refund in 129. [↑](#footnote-ref-4)
5. Generally 20% of the excessive eligible dividend designation made by the corporation in the taxation year. [↑](#footnote-ref-5)
6. These rules operate by disallowing the deduction of inter-corporate dividends on specific types of preferred shares that are either held by or guaranteed by “specified financial institutions” and dividends on so-called “collateralized preferred shares” which resemble secured debt with a guaranteed return. We didn’t get into details in class. [↑](#footnote-ref-6)
7. It is CRA’s view that there should be a positive spread between the dividend yield on preferred shares acquired with the borrowed funds and the interest rate on that debt. [↑](#footnote-ref-7)
8. Note that there might be other tax-consequences, e.g. rules re after-tax financing arrangements. But those rules only apply to the payment of dividends on preferred shares. [↑](#footnote-ref-8)
9. The guidance assumes Lossco is a wholly-owned subsidiary of Profitco. [↑](#footnote-ref-9)
10. Per **256(5.1)**, **“controlled, directly or indirectly in any manner whatever,” = de facto control**: the controller has any direct or indirect influence that, if exercised, would result in control in fact of the corporation, except that, where the corporation and the controller are dealing with each other at arm’s length and the influence is derived from a franchise, licence, lease, distribution, supply or management agreement or other similar agreement or arrangement, the main purpose of which is to govern the relationship between the corporation and the controller regarding the manner in which a business carried on by the corporation is to be conducted, the corporation shall not be considered to be controlled, directly or indirectly in any manner whatever, by the controller by reason only of that agreement or arrangement. (DD: can make economic pressure) [↑](#footnote-ref-10)
11. Many of the cases on the characterization of a CCPC involve credits for scientific research and experimental development rather than the small business deduction. [↑](#footnote-ref-11)
12. According to CRA, this particular provision may have application when, for example, a manufacturing corporation which is a public corporation or a corporation controlled by non-residents, establishes distributorships in Canada. This is usually effected by creating a corporation in such a manner that the Canadian operator or distributor will not acquire actual control of it until certain financial obligations to the manufacturer are met. When all of the provisions of 256(6) are met, the newly created corporation will be a CCPC from the time of incorporation if the other conditions of the definition of a CCPC under 125(7) are met. (*IT-458R2*) [↑](#footnote-ref-12)
13. This provision appears to have been relied on by the Minister much less since 256(5.1) was introduced, presumably because the concept of de facto control may also be used for similar purposes. [↑](#footnote-ref-13)
14. Property within the meaning assigned by 129(4). [↑](#footnote-ref-14)
15. Before the rules for eligible dividends were introduced in 2005, the gross-up and credit mechanism for taxable dividends integrated corporate and shareholder level taxes only for a CCPC’s ABI up to the business limit or its AII after taking into account the dividend refund in s. 129. For this reason, if a CCPC’s ABI exceeded its business limit, it was generally more attractive to characterize this income as AII than income from an active business. These two cases consider this consideration issue and should be read together with cases on the characterization of ABI in Chapter 6. [↑](#footnote-ref-15)
16. Although share for share exchanges may be carried out on a tax-deferred basis under s. 85 or 86 of the ITA, Ts may generally elect to deem the proceeds realized on these exchanges at any amount between the cost of the shares and their FMV. In this case, T appears to have elected to deem the proceeds of disposition ofr her shares to be their FMV, while her son appears to have elected $400K. I both cases, these gains were presumably sheltered from tax by the lifetime capital gains deduction in 110.6(2.1). In the case of the T’s son, one may surmise that the decision to elect $400K as the proceeds of disposition was because he had already utilized some of his lifetime capital gains deduction, thereby reducing his cumulative gains limit. [↑](#footnote-ref-16)
17. Class C PUC=6100+460000=$466100; PUC of each share=466100/6101=76.4. [↑](#footnote-ref-17)
18. Classic day-night loan. No.co reported receiving a deemed dividend of $459,924—84(3) deems a corporation to have paid and shhs to have received a deemed dividend on a redemption, acquisition or cancellation of shares equal to the difference between the amount received in exchange for each share and the PUC in respect of this share. Note that this deemed dividend would be deductible in computing Part I tax under 112(1) and exempt from Prt IV tax under the extended definition of control in 186(2). [↑](#footnote-ref-18)
19. Unlike other capital losses which can only be used to offset capital gains, capital losses which fall within the definition of a BIL can be used to offset income from any source income. 39(9) provides for the reduction in a T’s BIL until the T has realized BIL equal to previous years’ capital gains which are eligible for the capital gains exemption under 110.6. [↑](#footnote-ref-19)
20. Subject to liquidity and solvency tests, corporate law statutes generally permit corporations to reduce the stated capital of a class of shares in order to distribute capital to shareholders of the class in an amount not exceeding the reduction in stated capital. [↑](#footnote-ref-20)
21. The exception in 84(4.1)(a) and (b) was introduced in 1996 and is intended to ensure that only a return of corporate capital, as opposed to a distribution of earnings may be distributed on a tax-free basis. [↑](#footnote-ref-21)
22. The term “dividend” is not defined in ITA but is merely defined to include most forms of stock dividend. For corporate law purposes, a dividend is considered to be a pro rata payment made to shareholders dividing corporate profits or other corporate surplus among them. [↑](#footnote-ref-22)
23. *Explanatory Notes* to the legislation [↑](#footnote-ref-23)
24. Also, 183.1(7) provides that the anti-avoidance rule in 110.6(8), which denies the capital gains deduction in respect of a capital gain from a disposition of shares on which insufficient dividends have been paid, does not apply to a capital gain arising from an amount that is subject to Part II.1 tax. [↑](#footnote-ref-24)
25. S. 54 prevents double taxation by excluding from the definition of proceeds of disposition “any amount that would otherwise be proceeds of disposition of property of a T to the extent that the amount is deemed by 84.1(1)… to be a dividend paid to the T.” [↑](#footnote-ref-25)
26. when lifetime capital gains deduction was introduced [↑](#footnote-ref-26)
27. which cannot claim the capital gain deduction [↑](#footnote-ref-27)
28. and therefore potentially eligible for the lifetime capital gains deduction [↑](#footnote-ref-28)
29. Otherwise, if they are AL corporations, Part IV tax would apply. [↑](#footnote-ref-29)
30. within the meaning of assigned by 186(4) if the references therein to “payer corporation” and to “particular corporation” were read as “subject corporation” and “purchaser corporation” respectively. [↑](#footnote-ref-30)
31. “**Related group” is defined in 251(4)** as a group of persons each member of which is related to every other member of the group. **Also, see 251(5)**: for the purpose of 251(2), where a related group is in a position to control a corp, it shall be *deemed to be* a related group that controls the corp whether or not it is part of a larger group by which the corp is in fact controlled… [↑](#footnote-ref-31)
32. **It is only is persons *are not related* under 251(2) that we must consider the concept of *de facto* NAL relationship contemplated in 251(1)(b). (***Cote-Letourneau***)** [↑](#footnote-ref-32)
33. 186(7) was introduced after *Olsen 2002 FCA,* the decision of which was affirmed. [↑](#footnote-ref-33)
34. A is the increase, if any, determined without reference to this section as it applies to the acquisition of the subject shares, in the PUC in respect of all shares of the capital stock of the purchaser corporation **as a result of the issue of the new shares.** [↑](#footnote-ref-34)
35. Subject to 84(2)(a) and (a.1) [↑](#footnote-ref-35)
36. Subject to 84(2)(a) and (a.1) [↑](#footnote-ref-36)
37. This means that the PUC of the subject shares can be preserved as PUC of the new shares, except to the extent that it is used to provide a tax-free return to the T in the form of non-share consideration received from the purchaser corporation. [↑](#footnote-ref-37)
38. This deemed dividend ensures that T obtains a tax-free return of capital only in an amount equal to the PUC of the subject shares. [↑](#footnote-ref-38)
39. According to 84.1(2)(a.1)(ii), where a share disposed by a T was acquired by the T after 1971 and was acquired from a person with whom the T was not dealing at arm’s length (e.g. a purchaser corp), was a share substituted for such a share, or was a share substituted for a share owned by the T at the end of 1971, the ACB to the T of the share at any time is deemed to be the amount, if any, by which its ACB otherwise determined exceeds: the total of all amounts each of which is an amount determined after 1984 under subparagraph 40(1)(a)(i) in respect of a previous disposition of the share or a share for which the share was substituted (or such lesser amount as is established by the taxpayer to be the amount in respect of which a deduction under section 110.6 was claimed) by the taxpayer or an individual with whom the taxpayer did not deal at arm’s length… [↑](#footnote-ref-39)
40. After finding that s. 84.1 was intended to prevent the stripping of surpluses of an operating company, that although Parliament had assumed that a shareholder with less than a 10% block of shares would not be able to strip the surpluses of that company, such influence could be exercised when two related shareholders held all the shares of a company (Gestion), and that there would not have been an abusive transaction if the taxpayer had transferred to 6311 only the Consercom shares, Archambault J. found that there was an abuse here where 6311 used the surpluses from Gestion to redeem the preferred shares that had been issued in consideration for the Consercom shares. The tax consequences to the taxpayer were to be determined on the basis that the sums received by him on such preferred shares in excess of their paid-up capital were a dividend to him. [↑](#footnote-ref-40)
41. otherwise by an assignment of any portion of a retirement pension under s. 65.1 of the Canada Pension Plan or a comparable provision of a provincial plan as defined in s. 3 of that Act [↑](#footnote-ref-41)
42. The aggregate cost of share and non-share consideration received by T is generally based on the deemed proceeds of disposition under 85(1)(a), and therefore represents the T’s tax-paid capital invested in such share and non-share property. [↑](#footnote-ref-42)
43. This case was before the rules re affiliated person was amended to include trust—now PC would be affiliated with PC trust under 251.1(1)(g) [↑](#footnote-ref-43)
44. “**value shifting**”: TG transferred to PS $8million for 8000 common shares; Rcongold transferred preferred shares as stock dividend to TG (PUC=ACB=1, FMV=8million)🡪shift value from common shares to presferred shares (Part IV tax would apply b/c related)—now common shares worth nothing, transferred to PC trust for $65, now TG has loss that they can use to shelter gains. [↑](#footnote-ref-44)
45. Another tool you can use besides he stop-loss rules to prevent the realization of losses when T dispose of property without actually disposing of their economic interest. [↑](#footnote-ref-45)
46. According to CRA, if shareholder receives non-share consideration the value of which exceeds $200, to the extent that the total amount or value exceeds the PUC of the fractional share that the shareholder is entitled to receive on the amalgamation, the shareholder must report a deemed dividend under 84(3) and any gain or loss from the disposition of its fractional share. [↑](#footnote-ref-46)
47. This also requires that the corp that pays the dividend is connected with the recipient corp within the meaning of 186(4) in order to ensure that the dividend is not subject to Part IV tax. [↑](#footnote-ref-47)
48. Recall that the deemed dividends under 84(3) are specifically excluded from the definition of “proceeds of disposition” in s. 54. [↑](#footnote-ref-48)
49. Thereby ensuring that the anti-avoidance rule does not apply to dividends that are paid out of income that has already been subject to tax. [↑](#footnote-ref-49)
50. to which a notional gain may be reasonably attributable —after deducting taxes and prior dividends, as well as other non-deductible exceptions. [↑](#footnote-ref-50)