

- prevent tax avoidance
- facilitate international trade and finance
- prevent double taxation

❖ Source of Law

➤ ITA

- if this does not apply, don't need to look further

➤ Tax Treaties

- apply as between contracting states
- goals
 - prevent double taxation
 - ◆ Residence/Residence - have tie breaker rules in Article 4 to assign only one residence
 - ◆ Source/Residence - Limit Source taxation and require Residence tax relief
 - Article 23 - only income taxable in a source country is sources in that country
 - ◆ Source/Source - problematic
 - prevent tax avoidance
 - Equity - equitable sharing of tax base
 - Neutrality
 - ◆ capital export neutrality (tax exported and domestic capital the same)
 - ◆ capital import neutrality (tax imported capital the same as domestic)
 - Administrative efficiency
 - ◆ Article 26 - exchange of information
 - ◆ US treaty - Article XXVI - mutual assistance in tax collection
 - Competitiveness and International Norm
 - ◆ Article 24 Non Discrimination using Nationality
 - Canada's provision is narrower to allow for branch tax and thin capitalization rule
- interpretation
 - **Income Tax Conventions Interpretation Act**
 - ◆ trumps treaties when in conflict
 - ◆ **s 3** - a term not defined, not fully defined, or defined in reference to Canadian law, has the meaning that the term has under the ITA from time to time, and not at the time the treaty was entered into
 - **Vienna Convention on the law of treaties**
 - ◆ **Article 26** - Every treaty in force is binding on the parties to it and must be performed in good faith
 - ◆ **Article 27** - A party may not invoke provisions of internal laws to justify failure to perform
 - ◆ **Article 31 - (1)** treaty shall be interpreted in **good faith**, in accordance with the **ordinary meaning** of terms, in their **context**, in light of their **object and purpose**
 - **(2)** context includes agreements made in connection with conclusion of treaties, and instruments made in connected with the conclusion and accepted by the other party
 - **(3)** take into account as context (a) subsequent agreements, (b) subsequent practice, (c) special rules of international law
 - ◆ **Article 32** - can have recourse to supplementary materials to interpret
 - **Crown Forrest** - can use OECD commentary to fill in gap, amplify existing meaning, record practice.
 - **Kubiczek** - US technical explanations same as CRA interpretation - not determinative
 - **OECD Model**
 - ◆ **3(2)** - if meaning not defined in treaty, have recourse to domestic law for meaning consistent with the context at that time, and IF NOT consistent domestic meaning give it international fiscal meaning
- Supporting Theory
 - **Economic Allegiance** - tries to divide tax liability according to a person's interest in each jurisdiction, by considering
 - ◆ where wealth is generated/originates (source)
 - ◆ where wealth is located
 - ◆ where the legal frameworks that enforce rights to wealth are
 - ◆ where the wealth is consumed (residence)
 - **Benefit** - looks at who benefits from the public services provided by the country

❖ Inbound rules - how to tax income from sources in Canada

- Part I - deals with Active Incomes
 - net basis by filing a return
- Part XIII- deals with Passive incomes
 - gross basis withheld at source

❖ outbound rules - how to tax Canadians earning foreign source income

- ITA s 2(1) and (3) Canadian residents liable to tax on worldwide income

- Active - not taxed when earned, MAY be taxed when distributed
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II) RESIDENCE

1. Tax Jurisdiction/Liability

❖ **Canadian Residents**

- 2(1) - every person **resident** in Canada **at any time** is liable to Canadian income tax on worldwide income
- 215(1) - must withhold and remit tax on payments to non-residents

❖ **Non-residents**

- 2(3) - Non-resident persons are liable to tax on income from
 - (a) Employment in Canada
 - (b) Carrying business in Canada
 - (c) Disposing of taxable Canadian Property
- 212 - non-residents are liable to pay 25% tax on every amount that a person resident in Canada pays or credits, or is deemed to pay or credit, to the non-resident person as, on account of, or in lieu of payment of , or in satisfaction of
 - (a) management or administration fees
 - (b) Interest that
 - (i) is NOT fully exempt interest, and is paid or payable to a person with whom the payer is not dealing at arm's length, or
 - (ii) is participating interest
 - (d) rents, royalties or similar payments, including

2. Individuals

❖ **ITA**

- Factual Residence determined at common law
 - residence is a matter of the degree to which a person's mind and fact settles into or maintains ore centralised his ordinary mode of living with its accessories in social relations, interests and conveniences at or in the place in question.
 - **Lee** - look at factors (long list) that establish ties with Canada vs ties other place (dwelling place, spouse, dependants, personal property, memberships, bank accounts, etc)
 - **Shujahn** - to stop being resident have to sever all ties, and retaining some because of outside influence but breaking as soon as possible won't stop form becoming non-resident at time when left Canada (wife and kids stayed behind to sell home)
- Deemed Residence
 - **250(1)** a person is deemed to be resident in Canada **throughout the year** if the person
 - (a) **sojourned** in Canada in the year for periods of more than 183 days
 - ◆ DONT qualify for 114, only relief in treaty tie breaker rules
 - ◆ IS a question of fact, and looks at making a temporary **stay** in Canada (not just a visit), that is unusual, casual or intermitted
 - ◆ any part of a day is a day, and must be physically present in Canada
 - ◆ **R & L Foods** - coming to Canada to work then going home is NOT making a temporary stay
 - ◆ **LEE** - persons immigration status is irrelevant
 - (b)-(g)
 - **250(3)** a Resident of Canada includes a person who is **ordinarily resident** in Canada
 - **Reader** - No time requirements - can be a few days a year or even absent for a number of years
 - **Thomson** - is Canada where the individual, in the settles routine of life, regularly, normally, or customarily lives? is it substantially deep rooted? (was born in Canada then left)
 - **Beament** - soldier moved overseas, married, has home - was NOT ordinarily resident. Hoping or planning to return to Canada is not determinative.
 - **Hauser** - pilot with Air Canada didn't manage to sever ties with Canada when he spent 3 months a year in Canada, kept clothing at a relatives, maintained a bank account, and pursued real estate investment in Canada
 - **250(5)** deemed NOT a resident of Canada if a treaty deems you to be a resident elsewhere
- Part-Time residence
 - **114** - taxable on worldwide income during time when resident, and Canadian source income when non-resident
- Tie Breaker rules
 - **250(5)**
 - **2501(5.1)**

- **220(4.3) individual** can post security with CRA to defer paying tax until property actually disposed
- **126(2.21)** provides credit for year of departure if a later disposition results in a tax on a gain that accrued while individual was Canadian resident, IF the country taxing has a treaty, OR the real property is located in that country
- **128.1(6) and (7)** allows to unwind deemed dispositions if a person who left Canada, later returns
- **128.1(8)** individuals can carry back loss, if a property deemed disposed is later sold for less, up to the amount of the Capital gain
- **s 114** - part time residents provision applies

❖ OECD Model

➤ Article 4 -

- (1) Is any **person** who, under the laws of that state, is liable to tax therein by reason of ... residence, place of management, or any other criterion of similar nature, **BUT DOES NOT APPLY** to any person liable to tax in respect ONLY of income from sources or capital in that state.
 - **Liable to tax** - OECD - may be liable to tax but don't pay tax, should still qualify absent a 'subject to tax' provision
 - **Crown Forest** - criterion of similar nature refers to criterion that imposes ability in country to tax worldwide income, NOT just income sources in that country
 - **Allchin** - US green card criterion of similar nature
- (2) IF a resident of BOTH contracting states then
 - (a) a resident only of the state where he has a **permanent home** available to him, AND
 - ◆ if a home in both states, only the state with the **close personal and economic ties**
 - ◆ **Hertle** - centre of vital interests - where are roots stronger
 - ◆ **Allchin** - permanent home- doesn't matter is owned or rented
 - (b) OTHERWISE a resident only of the state of his **habitual abode** if no permanent home in either state OR centre of vital interests can't be determined
 - ◆ **Allchin** - looked at number of days in each country
 - ◆ **Lingle** - not simply a numerical calculation. comparison must cover sufficient length of time to see where residence is habitual. Habitual has no frequency - can be once a week, month or year - look at attachment to state that gives a natural right to tax to that state
 - (c) OTHERWISE a resident of the state he is a national, if a habitual abode in both
 - (d) if a national of both, through mutual agreement
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3. Corporations

❖ ITA

➤ Factual Residents

- **De Beers** - resident where "it keeps house and does business" - place of central management and control
- **Unit Construction** - IF Board does not in fact exercise powers of management and control, then residence of corp is where the person who does exercise these powers is - place of ACTUAL management and control
- **Victoria Insurance** - even if there is no business reason to be in a country, if housekeeping is done there, it is resident there
- **Wood v Holden** - look at if the directors of the company are bypassed or not. IT doesn't matter is another person has influence, so long as the directors make the decision and are not bypassed.
- **BC Electric Railway** - does not matter where company is registered, but where it keeps house
- **Birchmount Holdings** - must differentiate between control of shareholder using shareholder powers, and board's power being usurped by shareholder

➤ Deemed Residence

- **250(4)** a corporation is deemed resident in Canada throughout the year if
 - (a) if incorporated in Canada after April 26, 1965
 - (c) if incorporated before 1965, was incorporated in Canada **AND** at any time in the taxation year after 1965 was resident in Canada **OR** carried out business in Canada

➤ Tie Breaker rules

- **250(5)** deemed to be NOT a resident of Canada, if under a tax treaty with another country it is resident in the other country and not resident in Canada
- **250(5.1)** if corporation continued into another jurisdiction is deemed to be resident in that jurisdiction
- **250(6)** international shipping corporations incorporated outside of Canada deemed to be non-resident even if place of central management and control is in Canada if
 - (a) its principal business is the operation of ships used primarily in transport of goods and people in international traffic
 - (b) all or substantially all of its revenue comes from this business, and
 - (c) it has not continued into Canada.

➤ Change in Residence

(1) person who by laws of the state is resident by reason of residence, place of management, or other criterion that makes it liable to worldwide taxation

- **TD Securities** - treaty is intended to benefit those whose income is comprehensively taxable in a contracting state, whether in its own hands or in the hands of the person to whom it flows
- (3) if a corporation resident in both states, deemed to be resident only in state where place of **"effective management"** is situated
 - **OECD** - where key management and commercial decisions necessary for the entity's business are made

III) ANTI AVOIDANCE

4. GARR - Applies to both domestic and international transactions.

❖ 245(2) Where a transaction is an **avoidance transaction**

- **245(3) avoidance transaction** is
 - (a) a transaction NOT for primarily for **bona fide** purposes other than to obtain a tax benefit, that results in a tax benefit, or
 - (b) a transaction that is part of a series of transactions that but for the series would result in a tax benefit, unless reasonably considered to have been undertaken primarily for a bona fide purposes
- **Canada Trust Co** - non-tax purpose test is broader than business purpose test - look at objective assessment of relative importance of all steps in the transaction
- the **tax consequences** to the person shall be determined as is reasonable in the circumstances
- in order to deny a **tax benefit** that but for this section would result directly or indirectly
 - **245(1) "tax benefit"** a reduction, avoidance, deferral of tax or other amount payable under the act, or an increase in a refund of tax or other amount, including a reduction, avoidance, deferral or tax or other amount that would be payable but for a tax treaty, or an increase in a refund of tax or other amount as a result of a treaty
 - **Canada Trust Co**- magnitude of the benefit is not relevant, and may have to determine benefit by comparing it with an alternative transaction.
 - **Univar** - alternate transaction has to be one the taxpayer would do, not one that would have resulted in the greatest amount of tax
- from a transaction or **series of transactions** that includes the transaction
 - **Craven v White** - series requires a connection that is uncontroversial - "connection is pre-ordained" planned" so that the practical likelihood that the pre-planned event would not take place in the order ordained is low
 - **245(10) - series includes** related transactions or events completed in contemplation of the series
 - the parties must have known of the event so that it could be said they took it into account when deciding to complete the transaction
 - **Canada Trust Co** - in contemplation is not knowledge, but "because of" of "in relation to" the series
 - **Copthorne** - can be forward and backward looking, BUT NOT meant to capture a related transaction that is not part of the series
- ❖ **245(4)** Subsection (2) applies ONLY if
 - its **reasonable to consider** that the transaction
 - (a) would directly or indirectly result in a **misuse of the provisions of the Act, Regulations, application rules, or a treaty**, or any other enactment that is relevant in computing tax or amount payable or refundable to any person
 - (b) would result directly or indirectly in an **abuse** regarding those provisions read as a whole
 - Determine what the purpose of the various provisions that provide the tax benefit are, AND THEN ask if the avoidance transaction **defeats or frustrates** the purpose, spirit or object of the provision in issue.
 - **Canada Trust Co** - used a literal interpretation
 - **Placer Dome** - used a contextual purposive approach, where the words of the statute give rise to more than one reasonable interpretation. An avoidance transaction is abusive if the transaction is
 - (a) is an outcome that the provisions relied out seek to prevent, (b) defeats the underlying rationale for the provision relied on, or (c) circumvents certain provisions in a manner that frustrates the object, spirit or purpose of those provisions.
 - **Leigh Cement** - can't rely on vague words to define purpose other than the textual purpose

Ask:

- ❖ what is the tax benefit arising from the transaction?
- ❖ is the transaction an avoidance transaction, ie not primarily for bona fide non-tax purpose?
- ❖ is there abusive tax avoidance such that the benefit cannot reasonably be concluded to be consistent with the object, spirit, and purpose the provision?

5. Treaty Benefits

- 4.1 - GAAR applies to any benefit provided under a convention
 - **RIMM Canadian Enterprises** - GAAR is consistent with Canadian tax treaties
 - **OECD** - commentaries believe that general anti-avoidance don't conflict with treaties
- ❖ **Treaty Shopping**
 - controversial concept
 - **Crown Forest** - the goal of the treaty is not to give its benefits to a party stranger to it, thus cede tax jurisdiction to a country it hasn't bargained with
 - **MIL Investment** - the use of a treaty to get the benefit it intends cannot be abusive. The primary purpose is the WHY, and if the reason you entered the transaction is not abusive, then the HOW can be done in a manner that is most tax efficient
- ❖ **Limitation of Benefits provisions (US CANADA)**
 - **Article XXIX A**
 - limits full treaty benefits to "**qualifying persons**" who is a resident of a contracting state who is
 - a natural person
 - a contracting state or its political subdivisions and authorities
 - a company whose principal class of shares are listed on a stock exchange or its subsidiary
 - a group of 5 or fewer people who own 50% of the votes and value of shares of a corporation, if they are qualifying persons
 - (3) if a **resident** but not a qualifying person, but you or a person related to you, **carries on an active trade or business in that state**, then
 - the benefits of the convention apply to the income from and incidental to that trade and business
 - but ONLY if the income from it is **substantial** compared to the income from the other state giving rise to the income in respect of which the benefit is sought
 - (4) a **resident** company is entitled to the benefits of the Interest, dividends, and royalties benefits
 - (a) IF the shares that represent more than 90% of the votes and value of the company are owned, directly or indirectly by a qualifying person or a person who
 - ◆ (i) is a resident of a country with which the other contracting state has a comprehensive income tax convention AND is entitled to the full benefits provided by that other state
 - ◆ (ii) would qualify for the benefits if that person were a resident of the first mentioned state, and
 - ◆ (iii) would be entitled to a rate of tax in the other contacting state that is at least as low as the rate applicable under this convention and
 - (b) the amount of expenses deductible from its gross income that are paid to not qualified persons is not more than 50%
 - (7) can deny benefits when it can reasonably be concluded that otherwise the treaty would be abused

IV) TRANSFER PRICING

6. ITA

- ❖ **s 69(1)** except as otherwise provided
 - (a) where a taxpayer **acquires** anything from a person he doesn't deal at arm's length with, for a price **exceeding FMV**, the taxpayer is deemed to have acquired it at FMV
 - (b) where a taxpayer **disposes** of anything to a non-arm's length person at **below FMV or as a inter vivos gift**, the taxpayer is deemed to receive proceeds at FMV
 - (c) where a taxpayer **acquires** a property as a **gift**, he is deemed to acquire it at a cost of FMV
- ❖ **247(2)** - applies where a taxpayer or a partnership AND a non-resident person or a partnership of which the non-resident person is a member, who DONT deal at arm's length, but participate in a transaction or a series of transactions and
 - (a) the terms or conditions are different than they would be between arm's length people, OR
 - (b) the transaction or series of transactions would not have been entered into between arm's length persons AND they could reasonably have been considered not to have been entered into primarily for bona fide purposes other than to obtain a tax benefit.
 - the amounts are adjusted to the amount that would have been determined
 - (c) where only (a) applies, if the terms and conditions were those that arm's length people would have entered into, or
 - (d) where (b) applies, the transaction or series would have been those that would have been made or entered into between arm's length parties
 - **SmithKline Beecham** - OECD guidelines should inform the interpretation and application of s. 247
 - **GE Electric** - ask what price would have been paid if parties dealing at arm's length, BUT can consider relevant inter-group factors
 - **Alberta Printed Circuits** - OECD guidelines not decisive - must apply act and treaty
- (3) provides for a penalty of 10% of the adjustment made. if adjustment exceeding lesser of 5 million or 10% of

- (1) applies to all amounts owing by a non-resident person to a Canadian resident corporation,
 - where the amount is outstanding for more than one year
 - a reasonable amount of interest has not been included in respect to the amount owing
 - (2) Extends deeming rule to indirect loans, where a non-resident owes an amount to a particular non-resident person,
 - and it is reasonable to conclude that the particular person has extended credit because a Canadian resident corporation loaned it money or transferred property, directly or indirectly
 - **on condition that ANY** person extend the loan to the non-resident
 - **THEN** the lesser of the loan is deemed owed to the Canadian resident
 - (3) does NOT apply if each non-resident person is an CFA of a Canadian resident
 - (7) allows for down-stream financial accommodation by Canadian parents of their foreign subs active business, and overrides expectation of arm's length interest and guarantees
 - (8) deems that 17(1) does NOT apply in respect to an amount owing to a corporation in Canada, by a CFA if
 - (a) the affiliate has used the money to earn income from an active business or to make a loan to another controlled foreign affiliate that used the money to earn income from active business, OR
 - (b) the amount owing arose in the course of an active business carried out by the affiliate throughout the period during which the amount was owing.
- ❖ **18(4)** deals with foreign corporations lending money to their Canadian subs
- aims to avoid excessive debt that would erode Canadian tax base b/c withholding tax on interest is only Canadian tax paid (deductible from income)
 - in computing the **income from business or property** for a corporation resident in Canada
 - doesn't apply to partnerships, trusts, branches
 - no deduction can be made in respect of that **Proportion of** any amount otherwise deductible in respect of **interest** paid or payable
 - on debts to **specified non-resident shareholders** that
 - **18(5) "specified shareholder"** is a person who alone or with persons he does not deal at arm's length owns shares that have 25% or more of the **votes OR value** of the corporation
 - ◆ include any rights to acquire shares that have not been exercised
 - Debt owed to a Canadian resident doesn't count
 - (a) The amount of debt outstanding to the shareholder - twice the equity IS OF
 - (b) the amount of debts outstanding to the shareholder
 - **amount disallowed = interest paid x (debt - 2x equity)/debt**
- ❖ **18(6)** captures back to back loans
- where ANY loan has been made
 - (a) by a specified non-resident shareholder of a corporation **OR** (b) a non-resident person with whom the specified shareholder does NOT deal at arm's length
 - Loans made to a sufficiently capitalized sub, who then loans to under-capitalized sub NOT caught
 - To another person on condition that a loan be made by ANY person to a particular Canadian resident corporation,
 - **THEN** the lesser of the first or second loan is deemed owed to the person who made the first loan
 - **Specialty Manufacturing** - thin-cap rule not in conflict with s 9 of the treaty

7. OECD

❖ **Article 9** - (1) where

- (a) where an enterprise of one contracting state participates directly or indirectly in the management, control, or capital of an enterprise of the other contracting state, or
- (b) the same person participates directly or indirectly in the management, control or capital of both enterprises,
- **and** there are conditions that are not those that would be made between independent enterprises
- **THEN** any profits which would, but for the conditions, would have accrued to one enterprise may be included in its profits

❖ **Methods**

- **Transaction based**
 - the comparable controlled price (CUP) method
 - Canadian courts prefer this
 - preferred for sales of property, where there is a comparable transaction in market, in similar circumstances
 - **GalaxoSmith Kline** - must consider all relevant circumstances as would a business person in same circumstances, including related contracts
 - the resale price method; or
 - allows taxpayer to subtract a gross markup from the price that would have been sold to unrelated parties

- ❖ The arm's length principle generally look as the price paid in the market, and assumes that the correct price is the market price that would result from hard bargains between two independent parties. There are some challenges in applying this:
 - related parties are generally not independent economically and don't bargain with each other.
 - related parties often transfer 'secret' or 'unique' properties (eg. patents) or manifestations of knowledge and business opportunity among themselves to maximize value - thus no open market transactions that resemble them
 - related parties often deal with each other constantly and in large volumes, making it hard to get information about individual transactions
- ❖ **Ennislaire Corp** - failure of parliament to use a formula in provision indicates a certain amount of flexibility for taxpayer to determine what is reasonable, so long as it reflects an arm's length price

V) NON-RESIDENTS EARNING INCOME FROM CANADA

A) OVERVIEW

- ❖ ITA deals with the taxation of non-residents in two different parts - both focused on territorial source:
 - **Part I** - taxes Canadian active income: employment income, business income, and capital gains from the disposition of Canadian property.
 - imposes tax on net income using progressive tax rates for individuals, and flat corporate taxes for corporations
 - 4(1)(b) must allocate income from source and related expenses on a reasonable basis
 - aggregated under s 115(1)
 - **Part XIII** - taxes Canadian passive income: dividends, interest, rent, royalties, other types of periodic payments
 - imposes a flat tax of 25% on gross payments - withheld at source by payor
 - reduced by treaties
 - s 129 imposes 25% tax on non-resident branches (business through a PE)
 - 216, 216.1, 217 allows for net taxation by elections on filing
- ❖ to avoid double taxation, ss 802 and 805 of the ITR provide that where an amount that is otherwise taxable under part XIII is also taxable under part I, the amount is exempt from Part XIII tax.

VI) NON-RESIDENTS EMPLOYED IN CANADA

A) SUMMARY

Income from employment is taxable in the source country ONLY if the employment is exercised in that country, AND the taxpayer is present in that country for more than 183 days during the taxation year, AND the employer is a resident of that country or deducts the remuneration in computing its profits attributable to a permanent establishment.

Director fees and similar compensation received by a person resident in one country from a company resident in another country may be taxable in the other country - the company in which the payer company is resident has jurisdiction to tax.

Income Earned by Artistes and Sportsmen are taxed in the country where the service is performed, irrespective of a permanent establishment or duration of stay.

9. ITA

- ❖ **2(3)** A person not resident in Canada at anytime in the taxation year, is subject to tax as determined under s 115,
 - IF at anytime **in the year or a previous year**, the person
 - (a) was **employed In Canada**
 - 248(1) "employment" - performing duties of office or employment
 - 248(1) "office" position entitling individual to a fixed ascertainable stipend or remuneration
 - Employee vs Independent Contractor
 - **Sgaz Industries** - is person working performing work as person in business on his own account (factors: level of control, who provides equipment, who bears risk and potential for profit)
 - **Wolf** - even long term with same employer does NOT mean employment if no job security, have financial risk, and nature of agreement
 - Employed in Canada
 - employed in Canada if the duties of employment are performed in Canada (physical presence), irrespective of where the product is exploited
 - Deemed Employed in Canada
 - **115(2)** where a **non-resident person** was
 - ◆ (a)-(b) students and teachers
 - ◆ (c) an individual who ceased to be a Canadian resident, but was paid a salary directly or indirectly

- ❖ **115(1)** - employment income of non-resident to be computed in accordance with s 5-8, as if the only income in Canada was that employment income
 - **115(1)(a) and 4(b)** - make reasonable allocation among jurisdictions
 - **Sumner** - reasonable allocation was gross revenue from concerts not days in Canada
 - **Austin** - reasonable allocation for CFL player was games played in each jurisdiction
 - **GU** - look at what the amount received by person is paid for, not what he spends it on
 - **Sutcliffe** - remuneration for pilot allocated based on flying time over Canada vs elsewhere; additional benefits related to employment allocated along other income lines
 - method employed by employer not determinative if unreasonable

10. Treaty Relief

❖ OECD

- **Article 15 - Employment Income (1)** Subject to Articles 16, 18, and 19, salaries, wages, and other similar remuneration
 - derived by a resident of a contracting state in respect of employment shall be taxable ONLY in that state
 - **UNLESS the employment is exercised in the other contracting state**, then Such remuneration as is derived therefrom may be taxed in the other state
 - employment is exercised where employee is present and doing work
 - REGARDLESS of where wages are paid OR work is exploited
 - **(2)** Notwithstanding paragraph 1, remuneration derived by a resident of a Contracting State
 - in respect of **an employment exercised in the other contracting state**
 - shall be taxable **ONLY** in the first-mentioned state [resident state] IF
 - Allows for residence taxation if all three conditions are satisfied
 - ◆ **(a)** the recipient is present in the [source state] no more than **183 days** in any 12 month period commencing and ending in the fiscal year concerned, AND
 - days include part days, days spent not working
 - days DONT include, days spent in transit through state, or days resident in that state
 - ◆ **(b)** the remuneration is paid by, or on behalf of, an **employer who is NOT a resident** of the [source state], AND
 - if payment from source company is equivalent to salary paid by residence employer, can argue that remuneration is paid on behalf of source
 - same if no profit element, or profit a percent of wages
 - ◆ **(c)** the **remuneration is NOT borne by a PE** which the employer has in the [source state].
 - whether or not deduction is made is not relevant - only matters if deductible
 - **(3)** notwithstanding the preceding, remuneration derived in respect of an **employment exercised aboard a ship or aircraft** operated in international traffic, or aboard a boat engaged in inland waterways transport, may be taxed in the contracting state in which the place of effective management of the enterprise is situated.
 - **Article 17 - Artistes and Sportsmen** - (1) income derived resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsman, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State
 - irrespective of length of stay, who bears payment, or lack of PE
 - does not include incomes of support staff
 - **Cheeke** - ask who the people pay to come see - who is the entertainment - is person is merely derivative of entertaining person, then not an entertainer - need creativity to be artiste, not just report what someone else is doing
 - **(2)** Where income **in respect of** personal services of artiste or athlete **in capacity as such** accrued to another person, that income may be taxed in the source state
 - does not apply to royalty income, but does apply to advertisement and sponsorships
 - third party need not be a resident of the same state as the entertainer
 - **CANADA** - reservation, will only apply this if payment is made to entertainer company, not other companies

❖ US-Canada Treaty

- **EMPLOYMENT** - has \$10,000 exemption for employment income earned by resident of one country in other country
 - **Prescott** - "an employment" means each individual independent employment, so can't aggregate different employment amount for purpose of this limitation
- **Artists and Athletes** -
 - exception for amounts less than \$15,000 in a year
 - anti-avoidance rule modified - if payment made to another person, to have source jurisdiction absent a PE, need artist or athlete to participate directly or indirectly in profits
 - provides exemptions for people playing on teams with regularly scheduled games in both states

- ◆ UNLESS preparatory or auxiliary as in (4)
- (6) DONT have an agency PE if it carries on business through a broker, general commission agent, or other agent of independent status, acting in the ordinary course of his own business
 - ◆ **American Income Life** - Must be legally and economically independent of non-resident
 - ◆ Absence of Insurance activities clause (collection of premiums in that state) may indicate desire to allow such cross border business
- (7) a subsidiary company is not a PE
- THEN **profits attributed** to that PE may be taxed in [the source state]
 - must be attributed for services in that state, and profits of activities in that state
 - Profits means NET income according to generally accepted accounting principles
 - **ITCIA - s. 4(1)** unless treaty provides otherwise, include all amounts requires by ITA
 - **Cudd Pressure** - can take notional expense if an arm's length person would have paid the expense to carry on that business, and other jurisdiction has it included in income
- (2) Profits of a PE are determined as if it were a separate enterprise at arm's length with other divisions of the enterprise
 - considering same and similar activities, under same or similar conditions, taking into account functions performed, risks, assumed, assets used.
- (3) where one state adjust profits, the other has to act to eliminate double taxation
- (4) where other articles deal with specific items, those articles apply
 - Article 17 - Artists and Athletes
 - Article 6 - income from immovable property
 - Article 8 - international traffic
 - Article 22 - capital gains
- ❖ **Canada-US**
 - **Article 5(9)** deems service providers to constitute a PE
 - (a) where an individual provides services and is present in the other country for more than 183 days in any 12 month period, and during that period more than 50% of the gross active business revenues of the company must consist of income derived from the services performed by the individual. OR
 - (b) a PE will be constituted is the cross-border service provider provides services for more than 183 days with respect to the same or connected projects for customers who are either residents of the other country or have a PE in the other country.
 - seems to cover where services are provided by more than one individual

VIII) NON-RESIDENTS RECEIVING PAYMENTS FROM CANADA

13. ITA

- ❖ focus is part XIII tax on non-residents receiving interest, dividend, rents, royalties and other periodic payments
- ❖ **212(1)** Every non-resident person shall pay an income tax of 25% on every amount
 - that a **person resident in Canada**
 - pays or credits, is deemed to pay or credit, as, on account or in lieu of payment of, or in satisfaction of
 - **ss. 212(1)(a) and (4)** - a management or administration fee or charge
 - **ss 212(1)(b) and 214** - interest
 - **s. 212(1)(c), (9)-(11), 214 (3)(f) and (f.1)** - estate or trust income
 - **s. 212(1)(d), (5) and (16)** - certain rents, royalties or similar payments
 - **s. 212(1)(e)** - certain timber royalties
 - **s 212(1)(f)** - alimony or other support payments
 - (2) every non-resident person shall pay an income tax of 25% on every amount that a **corporation resident in Canada** pays or credits to the non-resident, as, on account or in lieu of, or in satisfaction of
 - **s. 212(2) and 214(3)(a)** - certain dividends and deemed dividends
- ❖ **212(5.1) Non-resident actors**
 - every person who is either a non-resident actor OR a corporation related to the individual,
 - shall pay an income tax of 23% on every amount paid or credited, or provided as benefit, to or on behalf of the person,
 - payer can be by non-resident or resident Canadian
 - **for the provision in Canada of acting services of the actor in a film or video production**
 - **216.1 - net basis election**
- ❖ **214(1)** - ensures that no deductions may be claimed on s 212 amounts
 - gross basis
- ❖ **215(1)** imposes an obligation to withhold tax on each person who pays or credits an amount to a non-resident
 - **Credit** - setting aside and making available unconditionally to the non-resident an amount due to the non-resident
 - **Pechet** - ability to file under 216 on net basis does not relieve payer of obligation to withhold or remit
- (6) payer person may be liable for interest and penalties

expenses in exchange for an interest in any or all property or other thing of value that may result from the research and development

- the cost and benefits must be shared on a reasonable basis.
- while only a portion of the cost may be charged to the Canadian resident, the resident must get an interest in all the property and other things of value resulting from the arrangements.
- geographic restrictions are possible where reasonable.
- there should be no double charges, one for the cost and then for subsequent use of the property.
- as rental for the use of or right to use any property outside of Canada
- from a payer with whom the non-resident is dealing at arm's length to the extent that the amount is deductible in computing income of the payer from a business carried out in a country other than Canada

14. Interest

❖ 212(1)(b) Interest paid or credited

- "interest" generally means the return or compensation for the use or retention by one person of a sum of money belonging or owed to another, and is considered to have three characteristics:
 - it is a return or consideration received by one party for allowing another party to use its money
 - it accrues daily
 - it is computed by reference to a principal amount
- For purpose of withholding taxes, "interest" has a broader meaning:
 - Includes stand-by charges and guarantee fees - **s. 214(15)**
 - a portion of a combined income and capital payment when it is reasonable to regard part of the combined payment as being in the nature of interest - **s. 214(2)**
 - gains realized by a non-resident from the transfer of certain debt obligations to a resident in Canada - **s. 214(7)**
 - substitute payments under securities lending arrangements made by a borrower to the lender of an amount equivalent to the interest payments that the lender would have received on the security during the term of the loan - **s. 260(8)(a)**
 - fees paid by a borrower to the lender for the use of a securities lending arrangement - **s. 260(8)(b)**
 - certain dividends received by a specified financial institution on a term preferred share - **s. 258(3)**
- **By a Canadian resident**
 - focus is on source of payment being Canada usually the residence of payer
 - ◆ the location of real property that is used as security for the indebtedness - **s. 212(13)(f)**
 - ◆ the place of business that bears the interest expense, or base-erosion
 - eg. **s. 212(13.2)** - non-resident person is deemed to be a Canadian resident with respect to an interest payment IF the interest is deducted in computing Canadian source business income, unless deduction are related to treaty protected business or treaty protected property.
- **(a)** That is NOT fully exempt interest and is paid to a non-arm's length person
 - IF paid to arm's length person, is not subject to withholding tax
 - **251(1)** arms' length rules
 - **Swiss Bank** - merely interposing a third party between money does not make it non-arm's length if all funds came from the same person to related person
 - **Leigh Cement** - can split interest from principal - to get deduction interest not principal has to be paid to arm's length
 - **212(3)** "fully exempt interest" includes Canadian non-contingent government debt, real property mortgages
- **(b)** is participating debt interest
 - **212(3)**

❖ 18(4) thin capitalization rules

- Denies interest deduction equal to **(debt - 2x equity)/debt x interest paid to specified shareholder**
- if made from specified shareholder
 - **(5) "specified shareholder"** alone or with non-arm's length people owns 25% of votes OR value of company
 - Does not apply to loans from Canadians
- **(6) captures back to back loans**

❖ OECD Article 11

- paid as interest that is not fully exempt

15. Rents Royalties and similar payments

❖ 212(1)(d) does not define it exhaustively

- " is generally a fixed payment (usually periodic) for the use of property for a given time, after which the right to use the property expires, and reverts back to the owner - **St. John's Shipbuilding**
 - **Rent** - property has to revert back to originator after some time or event, but is not a lump sum for indefinite use without regard to how much used

- where a Canadian resident uses a property in connection with a foreign business, the source is deemed to be outside of Canada (ss. 212(1)(d)(ix) and (x))
- (ii) for information concerning industrial, commercial or scientific experience where the total amount payable as consideration for that information is dependent in whole or part on
 - the use to be made of, or the benefit to be derived from, that information,
 - production or sales of goods or services, or
 - profits,
 - doesn't matter where it is use, in Canada or not
 - does not necessarily capture per diem or hourly payments
- (iii) for services of an industrial, commercial, or scientific character performed by a non-resident person where the total amount payable as consideration for those services depends in whole or part on
 - the use to be made of, or the benefit to be derived from, that information,
 - production or sales of goods or services, or
 - profits,
 - but not including a payment made for services performed in connection with the sale of property or the negotiation of contract,
- (iv) made pursuant to an agreement between a person resident in Canada and a non-resident person under which the non-resident person agrees not to use or not to permit any other person to use any thing referred to in subparagraph (i) or any information referred to in subparagraph (ii),
- (v) that was dependent on the use of production from property in Canada whether or not it was an installment on the sale price of the property, but not including an instalment on the sale price of agricultural land
- ❖ **216 - can elect net basis** payment if rent or royalties form real property or timber
- ❖ **OECD Article 12**
 - defines royalties to be
 - payments for the right to use the "copyright of any literary, artistic or scientific work, including cinematographic films, any patent, trademark, design or model, plan, secret formula or process",
 - "gains from the alienation of intangible property or rights to the extent that such gains are contingent on the productivity, use or subsequent disposition of such property rights", and
 - technical service fees if the fees are periodic AND dependent on productivity or a similar measure.
 - distinguish between payment for information and for Know-how FROM payment for services which are not covered by this

16. Management and Administration fees

- ❖ 212(1)(a)
 - **Management and administration** include "the functions of planning, direction, control, co-ordination, systems or other functions at a managerial level.
 - If no identifiable service performed, then this does not apply
 - may be **15(2)** shareholder benefit or **56(2)** indirect payment
- ❖ Exemptions
 - **s 212(4)** an amount for a service performed by the non-resident in the ordinary course of carrying on a business that includes the performance of such services for a fee, provided that the non-resident and the payer were dealing at arm's length.
 - **Peter Cundill** - not dealing at arm's length factually when principal had undue influence because of his value to the company
 - **s. 212(4)** an amount relating to a specific expense incurred by the non-resident person for performance of a service that was for the payer's benefit.
 - a specific expense does NOT include depreciation, capital costs, reserves, unvouchered amounts, and does not contain a markup or profit element.
 - a non-resident persons services would not be considered beneficial if they are duplication of services already provided by the payer's personnel.

17. Dividends

- ❖ **212(2) dividends and deemed dividends**
 -
 - **248(1)** "Dividend" includes a stock dividend
 - COURTS - any pro-rate distribution to shareholders, UNLESS made in liquidation or reduction of corporate capital
 - Includes a deemed dividend on sale and shareholder benefits
 - includes a non-resident transferring shares of one Canadian corp to another Canadian Corp
- ❖ **214(3)** deems certain amounts to be dividends
 - **15(1)** shareholder benefits
 - **15(2)** income under certain shareholder loans

- (2) dividend may also be taxed in source state, BUT if the **beneficial owner** of the dividend is a resident of the other contracting state
 - **Prevost Car** - Beneficial owner is the person who has benefits and risks of ownership and use. Won't look through a corporation unless its a mere conduit.
 - ◆ A conduit company is not the beneficial owner if it has very narrow powers, performs mere fiduciary or administrative functions, and acts on account of the beneficiary - an automatic flow without discretion to do otherwise
 - **Velcro**- even with contract to pay most profits, need to look at ownership, benefit, use, and risk
 - ◆ absent automatic flow, company receiving is beneficial owner
 - **RIMM Enterprises** - BUT simply detouring money through another company doesn't change the character from being an "otherwise distribution"
 - ◆ here was only one mind involved in the transaction
- the tax shall not exceed
- (a) 5% of the gross amount if the beneficial owner holds directly at least 25% of the capital of the company
- (b) 15% in all other cases
- (4) provisions on paragraphs (1) and (2) shall not apply if the beneficial owner of the dividend carries on business in the other contracting state through a PE, and the holding in respect of which the dividend is paid is connected with the PE
- (5) the resident state may not impose a tax on the dividends on dividends paid out of income derived in that state, unless its a withholding tax on the dividend
 - **Canada - reservation to impose branch tax**

IX) NON-RESIDENTS DISPOSING OF TAXABLE CANADIAN PROPERTY

18. ITA

- ❖ **2(3)(c)** non residents are taxable in Canada if they **dispose of**
 - Dispositions include deemed dispositions
 - **Taxable Canadian Property**
 - **s 248(1) "taxable Canadian Property"**
 - Real property situated in Canada or options therein
 - ◆ **Placerfid** - an option has to be certain and relate to a right the person has to convey, not just a potential right
 - capital property used in carrying on business in Canada
 - shares of a private corporation resident in Canada
 - (d) shares of private corporations (resident and non-resident) and interest in partnership in which at least 50% of the FMV of assets consists of Canadian resource or timber properties, or income interests in Canadian resident trusts, or other "taxable Canadian properties"
 - ◆ at any time in the past 60 months for value determination
 - Units of certain unit trusts resident in Canada
 - capital interests in trusts (other than unit trusts) resident in Canada, and
 - property deemed by another provision of the act to be taxable Canadian property
 - (e) shares of a corporation listed on a designated stock exchange,
 - ◆ if at anytime within a 60 month period,
 - ◆ a non-resident shareholder or a person and those he doesn't deal at arm's length with, owned 25% of the shares of ANY class of shares, AND
 - ◆ the shares derive more than 50% of their value from real property situated in Canada, Canadian resource property, or timber resource properties.
- ❖ **115(1)(b)** - non-residents only taxable on "taxable capital gains" from dispositions of Taxable Canadian property
 - **half of capital gains**
 - **can offset allowable capital losses**
 - **Except** treat protected Property
 - **248(1)" treaty protected property"** means property, the gain or loss from which would be exempt under part I because of a tax treaty with another country
- ❖ **s 116** - with holding and remitting requirement by purchaser
 - **s. 150** vendor still obliged to file tax return

19. Treaty

- ❖ **OECD**
 - **Article 6**
 - (1) gains from alienation of immovable property taxes in state where the property is located

- smoothing of tax treatment for those moving across borders
- **article 6** preserves value of primary residence exemption
- **Article 7** - if one state deems disposition to occur, other doesn't, allows for deferral of tax

X) TAXATION OF CANADIAN RESIDENTS ON FOREIGN SOURCE INCOME

20. General

- ❖ Deals with OUTBOUND taxation
 - DIRECT - CR earns income with or w/out a PE
 - Active - full credit for foreign taxes paid up to CTOP
 - Passive - limited credit up to foreign taxes paid equal to 15%, rest deductible as expense (20(11))
 - INDIRECT - use a foreign entity to earn income
 - Active - not taxed as earned
 - dividends exempt when distributed
 - Passive - taxed as accrued
 - dividends -credit
- ❖ Relief from double taxation
 - Exemption Method - entire income exempt from tax in Canada
 - encourages investment in low tax jurisdiction
 - s. 113(1)(a) - Dividends from a FA paid from exempt surplus
 - s. 113(1)(d) - Dividends from a FA paid from Pre-acquisition surplus
 - s. 122.3 - Oversees Employment tax credit
 - Resident of Canada at any time in the Year
 - Throughout qualifying period, was employed by qualified employer doing qualifying activities
 - provides a tax reduction for up to \$100,000 income earned in a full year of employment outside Canada
 - s 110(1)(f)(i) - amounts exempt because of a treaty
 - s 110(1)(f)(iii) - income from employment with prescribed international organization
 - Reg 8900(1) - eg. UN
 - s. 100(1)(f)(iv) - income from employment with prescribed international NGO where TP
 - ◆ NOT at any time in the year a Canadian citizen
 - ◆ NOT a resident of Canada immediately before employment in Canada, and
 - ◆ became resident solely for purpose of employment
 - Reg 8900(2) - eg. world anti-doping agency
 - Case Law
 - Swantje - can consider treaty exempt income to claw back benefits delivered under ITA
 - Peter - can NOT consider treaty exempt income to reduce tax credit under ITA
 - Deduction Method - amount of tax paid deducted from income taxable in Canada
 - discourages foreign investment
 - important when foreign taxes not creditable or where TP has excess credits that cannot be carried over
 - ss 20(11) and (12)
 - Credit Method - dollar for dollar credit against Can taxes for foreign taxes paid up to CTOP
 - neutral from Canadian tax perspective
 - s. 126 (1) - credit for non-business-income-tax (NBIT) up to 15% of Foreign NBI
 - s. 126 (2) - credit for business-income-tax (BIT) up to Canadian tax otherwise payable (CTOP)
- ❖ OECD Model
 - Article 23A - Exemption method
 - Residence states exempts income taxed in Source state
 - Article 23B - Credit Method
 - Residence state allows deduction from TAX for taxes paid on income in source state
- ❖ ITA
 -

A) Framework

	Direct		Indirect (though a controlled foreign affiliate)
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21. Employment Income

A) OECD Model

❖ Article 15

B) ITA

❖ Can Choose between s. 126(1) NBIT credit or 122.3 Overseas employment tax credit

➤

❖ Overseas Employment tax Credit - **s. 122.3**

➤ **Qualification**

▪ **Qualified person**

- Individual resident in Canada in a taxation year who

▪ **Qualifying Period**

- throughout any period of more than 6 consecutive months that commenced before the end of the year **and** included any part of the year
 - ◆ **Rooke** - don't have to be outside of Canada for 6 consecutive months or even be out of Canada for 6 months

▪ **Qualified employer**

- (a) was employed by a **specified employer**
 - ◆ **s. 122.3(2)** "specified employer"
 - Person resident in Canada
 - partnership where more than 10% of FMV is owned by residents of Canada or corporations controlled by them
 - FA of a person resident in Canada
- OTHER THAN under prescribed international development assistance program of Gov of Can, AND

▪ **Qualified Activities**

- (b) performed all or substantially all of the duties of the individual's employment OUTSIDE of Canada
 - ◆ can perform some work in Canada so long as >90% outside
- (i) **in connection with a contract** under which the specified employer
 - **Rooke** - Can be 2 or more contracts
 - **Legge** - includes support activities connected to the qualifying activity, including teaching
 - whether performed by employee or subcontractor
 - ◆ **carried on business**
 - question of fact (is it a business or charity)
 - ◆ outside of Canada
 - ◆ **with respect to**
 - **Legge** - need a close connection to a qualified activity
 - (A) exploration for or of petroleum, natural gas, minerals or similar resources
 - (B) any construction, installation, agricultural, or engineering activities, or
 - (C) any prescribed activities, or
- (ii) for the purpose of obtaining, on behalf of the specified employer, a contract to do the preceding

➤ **Result**

- can deduct from the amount that would otherwise be the individual's tax payable under Part I for the year
- an amount equal to ○ that portion of the tax otherwise payable ○ that is the LESSER of (c) and (d)
 - (c) an amount equal to that portion of ○ \$80,000 that number of days
 - ◆ (i) in that portion of the qualifying period that is in the year, and
 - ◆ (ii) on which the individual is resident in Canada
 - IS of 365

AND

- (d) 80% of the individual's income from employment from that employment reasonably attributable to the duties performed during the period in (c)

IS OF

- (e) [total income for the year] the amount, if any, by which
 - ◆ (i) if the individual is resident in Canada throughout the year, the individual's income from the year, and
 - ◆ (ii) if the individual is a non-resident at any time in the year, the amount determine under 114(a)
- ◆ **EXCEEDS**
 - ◆ the total of all amounts each of which is an amount deducted under section 110.6 or paragraph 111(1)(b), or deductible under paragraph 110(1)(d.2), (d.3), (f), (g) or (j), in computing the individual's taxable income for the year.

(c) would be reasonably be regarded as an employee of the specified employer, BUT ON the existence of the Employer

22. Foreign Tax Credit

A) Computation

- ❖ The computation for the credit is on a **Country by Country** basis
 - **Can NOT** apply excess foreign tax credits from one country to reduce Canadian tax on income from another country
 - amount of credit is LIMITED by the amount of Canadian tax otherwise payable on income earned in that particular country
 - **126(6)(a)** - government of a country includes its political subdivisions and authorities
 - **126(6)(b)** - where income from more than one country, separate deductions for BIT and NBIT for each country
 - **126(6)(c)** - where income from a source in a **particular country** would be exempt income, but for the fact that at portion of that income is subject to an income or profits tax imposed **by a country** other than Canada, the portion is deemed to be income from a separate source in that **particular country**
 - may claim 20(11) deduction
- ❖ Must differentiate between **business and Non-business**
- ❖ Must convert into Canadian dollars using conversion rate at time tax paid or income converted to CAD
- ❖ Must compute on a source by source basis
 - s 4 - Employment, business, property, capital gains
 - reasonably allocation to each source
 - s 4(3) - must take deductions applicable in whole or part to each source of income in that country
 - must allocate reasonably
- ❖ **Source of Income**
 - Canadian Tax **treaties** generally provide
 - "profits, income or gains of a resident of a contracting state which may be taxes in the other contracting state in accordance with the convention shall be deemed to arise in the other state"
 - **Business Income**
 - Where business is more than one activity, each is considered separately for sourcing rules
 - need a reasonable apportionment
 - sources where operations in substance take place
 - development and sale of real property - the place where the property is situated
 - merchandise trading - place where sales are habitually completed, location of stock, place of payment, place of manufacture
 - trading in intangible property - place where purchase and sale decisions are normally made
 - money lending - the place where the loan arrangement is in substance completed
 - personal property rental - the place where property available for rent is normally located
 - real property rentals- place where property is situated
 - service - place where services are preformed
 - for **FAPI only s. 95(2)(w) - active business** is deemed to be carried out (if in more than one country)
 - ◆ **(i)** in a foreign country only to the extent it is carried out through a PE
 - ◆ **(ii)** in Canada only to the extent that income is subject to tax under part I
 - **Employment Income**
 - place where duties of employment are performed
 - **Directors' Fees**
 - where meeting takes place
 - **Commission**
 - where effort was expended to earn income
 - **Interest**
 - in nature of property income, where debtor is resident
 - **Dividends**
 - from the country in which the corporation is resident
 - **Rental of tangible property**
 - in the nature of property income, where real property is located, or where other property is used
 - **royalty**
 - where related rights are exploited
 - **Capital gains**

[from business income in that country / worldwide income] x Canadian Tax otherwise payable under Part I

- **non-business income in that country**
 - **Corporation** - doesn't include dividends received from FAs (dealt with by 113)
 - **individual** - DOES include dividends from FAs
 - must use NET amount - thus deduct all expenses and sett of gains and losses in that country
 - ◆ **Inter-provincial pipelines** - Set off cost of borrowed money
 - do NOT include **tax exempt income**, which is income from a source in a country where
 - ◆ the taxpayer is exempt because of a tax treaty from all income and profits taxes in that country, and
 - ◆ no income or profits tax to which the treaty doesn't apply is imposed in any country other than Canada
 - ◆ **Degines** - must be income according to IT - lottery winnings not income
 - ◆ **Meyer** - Must take all treaty exemptions available - Otherwise will overpay
- **World Wide Income**
 - reduced by
 - ◆ dividends deductible in computing income by virtue of s. 112 (domestic inter-corporate) or 113 (dividends from FAs)
 - ◆ net capital losses deductible under 111(1)(b)
 - Increase by
 - ◆ s 110.5 amount
- ❖ **Canadian tax otherwise payable under Part I**
- ❖ Is the federal income tax that would in theory be payable on the foreign income
 - for NBIT assumes that 10% provincial abatement DOES apply (federal rate ONLY)
- ❖ MUST take all deductions under part I
- ❖ not deductible from tax payable under other parts (eg. Part XIII)

NBIT Credit = lesser of NBIT and (NBI/worldwide income)xTOP

2) 126(2) - Business-Income Tax Credit

Provides a credit, dollar for dollar, **BUT LIMITATION** - Can deduct an amount not exceeding the **LESSER** of:

- ❖ **(a)** the amount of foreign business-income taxes paid on income from a particular country in that year **PLUS** foreign tax carry-overs from other years (previous 10 and subsequent 3 years);
 - 126(7) → “unused FTC” → amount by which BIT paid in foreign country exceeds amount otherwise deductible in 126(2)
- ❖ **(b)** Canadian tax otherwise payable on the foreign business income; and
 - [business income from country/ worldwide income] x Canadian Tax otherwise payable under part 1
 - **Business income in that country**
 - includes income deemed to be business income
 - does NOT include tax exempt income
 - must be calculated on NET basis with reference to ITA
 - ◆ deduct all reasonable direct and allocated costs
 - **Worldwide Income**
 - reduced by
 - ◆ dividends deductible in computing income by virtue of s. 112 (domestic inter-corporate) or 113 (dividends from FAs)
 - ◆ net capital losses deductible under 111(1)(b)
 - Increase by
 - ◆ s 110.5 amount
- ❖ **(c)** Canadian tax otherwise payable after deduction of any credit for foreign non-business income taxes
 - this is an ordering rule to make sure that NBIT is deducted before BIT
- ❖ **Canadian tax otherwise payable under Part I**
 - Is the federal income tax that would in theory be payable on the foreign income
 - for BNIT assumes that 10% provincial abatement does NOT apply (federal rate +10%)
 - MUST take all deductions under part I
 - not deductible from tax payable under other parts (eg. Part XIII)

BIT Credit = lesser of (a) BIT and unused tax credits OR (b) BI/WWIxTOP OR (c) TOP-NBIT credit

3) 20(11) - deduction for individuals

- ❖ **20(11)** in computing **income from ppty**
 - (other than real ppty)

- there may be deducted such amounts as the taxpayer claims
 - is voluntary as an alternative to a tax credit
 - of value when you can't use the tax credit
- not exceeding the amount of **NBIT paid** by the taxpayer for a year to a government of foreign country
 - NBIT definition NOT to include (c) or (e)
- in respect of **that** income
- **OTHER than** the portion that can reasonably be regarded as having been paid by a corporation in respect of income from a share of the capital stock of a FA of the corporation
 - does NOT apply to amounts paid as withholding tax on a dividend from a FA
- ❖ Any amount claimed here cannot be claimed under 126(1)

C) Definitions

1) s. 127(7) Business-Income Tax

- ❖ **Paid** by a taxpayer for a taxation year, in **respect of businesses carried on** by the taxpayer, in a **country** other than Canada, **means** (subject to (4.1) and (4.2))
 - The tax can be paid before, during, or after the year to which it applies
 - the portion of any **income or profits tax**
 - has to be a **TAX**
 - *a non-voluntary payment extracted pursuant to legislative authority in the exercise of taxing power, being proportional in character and payable in money imposed or levied and collected for the purpose of raising revenue to be used for public or Government purposes, and not payment for some special privilege or service rendered*
 - **Kempe** - a tax is compulsory enforceable by law imposed under authority of legislature imposed by a public body for a public purpose
 - **Nadeau** - payment tied to specific benefit is NOT a tax (not for public purpose)
 - ◆ a social security tax (CCP) would qualify
 - **Meyer** - Must take all treaty exemptions available - Otherwise will overpay and voluntary payment is NOT a tax
 - has to be **Income or Profits** that are taxed
 - **Kempe** - a surtax (tax on tax) on income tax qualifies
 - **Dagenais** - tax has to be on income as defined under ITA - windfalls and gambling winnings not income
 - **Yates** - foreign tax imposed on gross receipts may qualify IF function of gross basis is same as net basis - so long as reasonable surrogate of net income that is taxed
 - **Lai** - where tax computed by formula, will qualify IF formula produces a reasonable approximation of actual income in typical situations, AND an actual computation of net income would be significantly affected by arbitrary/estimate expense allocations
 - IF listed in Tax Convention then qualifies
 - **NOT** sales tax, consumption tax, succession duty, property tax, custom/excise tax; capital or wealth tax [capital taxes????]
 - **s. 126(5)** deems certain taxes to be income or profits taxes
 - ◆ applies to foreign oil and gas levies
 - **Paid** by the taxpayer in the year
 - has to actually be paid, unless it is a tax sparing credit (a form of foreign aid)
 - a portion that is refunded does not count
 - withholding tax paid on behalf of taxpayer qualifies
 - tax liability has to lie with taxpayer, and not someone else
 - to a government of a country **other than Canada**
 - includes taxes paid to countries other than the source country, thus all foreign countries which impose tax on the income derived from carrying on business in ONE particular country
 - that can reasonably be regarded as **tax in respect of the income** of the taxpayer
 - **from a business carried on** by the taxpayer **in the business country**
 - the source of the income must be Business for 126(2)
 - but does **NOT** include a tax, or a portion of a tax, that can reasonably be regarded as relating to an amount that
 - (a) any other person or partnership has received or is entitled to receive from that government, or
 - (b) was deductible under 110(109f)(i) in computing the taxpayer's taxable income for the year

2) Non-Business-income Tax

- ❖ **126(7) Paid** by the taxpayer for a taxation year **to the government** of a country **other than Canada**, means, subject to (4.1) and (4.2)
 - The portion of any **Income and Profits Tax**

- ▼ NOTE Capital LOSS does NOT reduce NDI, but does reduce world wide income
- THUS, employment income, capital gains, passive investment income,
 - ◆ In case of an individual
 - foreign income or profits tax in respect of foreign-source income from a property that is not real property, up to, but not exceeding, 15% of the gross amount of such income;
 - all foreign income or profits tax, not subject to the 15% limitation, in respect of foreign-source income from a property that is real property
 - ◆ in case of any other taxpayer
 - all foreign income or profits tax, not subject to the 15% limitation, in respect of foreign-source income from property.

- (b) was not **DEDUCTIBLE** under 20(11)
 - for property income by an individual, up to 15%
 - ◆ a credit up to the treaty rate
- (c) was not **DEDUCTED** under 20(12)
 - must reduce any amount deducted under 20(12)

- but does **NOT include** a tax or portion of a tax
 - (d) that would NOT have been payable if the taxpayer was NOT a citizen of that country AND that cannot reasonably be regarded as attributable to income from a source outside Canada
 - (e) may reasonably be regarded as relating to an amount that any other person has received or is entitled to receive from that government
 - may qualify for a deduction under 20(12)
 - (f) where the taxpayer has deducted an amount under 122.3(1) may be attributable to that income for which the credit was deducted
 - taxpayer can choose between the two
 - in low tax jurisdiction 122.3 better
 - in high tax jurisdiction, credit is better
 - (i) that can reasonably be regarded as relating to an amount that is deductible under s. 110(1)(f)(i)

❖ Can **NOT** be carried over to other years

D) OTHER MATTERS

1) Causes of Excess Credits

- ❖ the credit is limited to the Canadian tax otherwise payable
 - thus if the foreign tax rate exceeds the Canadian tax rate
- ❖ the difference in computation, timing, or source rules under the ITA and foreign law
 - IF the differences are permanent, the excess may be lost.
- ❖ the foreign tax is levied on a gross basis, while Canadian tax is levied on a net basis
- ❖ if the income received, while taxed in the foreign country, is not considered income from that country, making the tax otherwise payable for that country null
- ❖ losses from jurisdictions, other than the foreign jurisdiction in which the tax is paid
 - eg. if you have a loss in Canada, your TOP in Canada is zero or low, and thus despite this, the foreign tax credit is zero, or less than needed

2) Relief

- ❖ **BIT**
 - can be carried forward 10, and back 3 years
- ❖ **NBIT**
 - excess maybe deducted under 20(11) [individual] or 20(12) [corporation]
- ❖ **S. 110.5**
 - allow for creation of non-capital losses for a corporate taxpayer that is a Canadian corporation
 - Allows corporation to include in its taxable income an amount
 - thus increasing world wide income and Income tax otherwise payable
 - Allows this same amount to be added to the Non-capital losses for that year
 - under s. 111(8) - allows for 20 year carry forward and 3 year carry back
 - The formula is:
 - **Unused foreign income tax / tax rate = amount of noncapital loss for that year.**

3) Anti Avoidance

- ❖ **126(4.1)**
 - transactions where economic profit from property is not material relative to foreign tax imposed on the income

- **126(4.3) Exemptions to (4.2)**
 - **s. 126(4.3)(a)** excepts debt obligations that are capital property of the taxpayer
 - **s. 126(4.3)(b)** excepts debt obligations issued with a term of one year or less, so long as no other person holds the obligation at anytime
 - **s. 126(4.3)(d)** ensures that the application of s. 126(4.1) overrides this provision, thus allowing a deduction under s. 20(12.1) even though a credit is denied
- ❖ **126(4.4)**
 - does not consider deemed dispositions and roll-over dispositions to be dispositions for the anti-avoidance provisions
- ❖ **20(12.1)**
 - Amount of ineligible credit may be deducted in computing business income attributable to that particular property and related transitions, but NOT to create a loss

23. Dividends from Foreign Affiliates

A) General

- ❖ ONLY applies to Canadian Corporations
- ❖ Treatment depends on Source of income
 - Active business income
 - INDIRECT
 - ◆ Canada ASSUMES that foreign tax regime and rates are equivalent
 - ◆ NOT taxed when earned, and exempt when distributed from exempt surplus (113(1)(a))
 - ◆ is exempt because source country has primary taxing jurisdiction on active business income
 - ◆ promotes international competitiveness of Canadian corporations
 - Foreign Accrual Property Income
 - is taxed as it accrues, where or not it is distributed to Canada
 - ◆ the Canadian shareholder is taxed according to proportional interest in FAPI of a CFA
 - Removes tax benefits of earning foreign property income indirectly
 - FAPI is 'bad' because
 - ◆ it is highly mobile capital whose owners are only interested in competitive return
 - ◆ geographical source is not relevant, and tax jurisdiction should be residence country, but by inserting a legal entity, the Canadian taxpayer attempts to artificially not have it taxed
 - violates capital export neutrality
 - t
 - offends notion of equity and taxing Canadian residents on world wide income
 - results in erosion of Canadian tax base

B) Inclusion

1) For ANY dividend paid by a FA

- ❖ **90(1)** Canadian resident taxpayer must include in income (12(1)(k))
 - any amount **received** in the year
 - as, on account of, or in lieu of payment of, or in satisfaction of
 - **dividends** on share of the capital stock of a foreign corporation owned by the taxpayer

2) FAPI earned by CFA

- ❖ **91(1)** in computing the income of a Canadian resident taxpayer, must include as income from a share
 - in respect of **each share**
 - a share by share calculation
 - of a **CFA of the taxpayer**
 - the **percentage of FAPI** of ANY CFA of the taxpayer
 - for each taxation year of the FA ending in the taxation year of the taxpayer
 - equal to that share's **participating percentage** in respect to the FA determined at the end of such taxation year of the FA
 - **95(1) Participating percentage** of a share of a taxpayer in a CFA is
 - (a) where the FAPI of the CFA in the year is less than \$5000, NIL, and
 - (b) where the FAPI is more than \$5000
 - ◆ (i) IF there CFA has only one class of issued shares, THEN the taxpayers equity percentage
 - DO NOT look to other Canadian corporations of which the FA is a CFA

- Portion of Foreign Accrual Tax (FAT) not deductible in any previous year X RTF

- ◆ **95(1) Foreign accrual tax (FAT)** means
 - (a) the portion of any **income or profits tax paid** by
 - (i) the particular FA, or (ii) any other FA of the taxpayer in respect of a dividend received from the particular FA
 - that may be reasonably be regarded a applicable to that amount
- ◆ **95(1) Relevant tax Factor (RTF)** is
 - **individual** = 2
 - **corporation** = 1/corporate tax rate (for exam 4)
- (b) the amount by which [...]

2) From ACB of a share of a FA

- ❖ **92(1)** in calculating the ACB of a share of a FA
 - (b) must deduct in respect of the share
 - (i) any amount deducted by the taxpayer under 91(2) and 91(4)
 - (ii) any dividend received by the taxpayer to the extent deducted under 91(5)

3) From dividends paid in the year

- ❖ **91(5)** a taxpayer who received a dividend on a share of a CFA of the taxpayer
 - may deduct, in respect of such portion of the dividend paid out of taxable surplus
 - in computing the taxpayer's income for the year
 - the Lesser of
 - (a) the amount of the dividend EXCEEDING the amount deductible regarding that dividend under 113(1)(b), and
 - (b) the amount if any by which [net FAPI inclusion for those shares]
 - (i) [the amounts required to be added to the ACB of the share because of FAPI] exceeds
 - (ii) [the amounts required to be deducted from ABC of the share because of a payment of dividend that was previously included in FAPI]
- ❖ 110(1)(f)(i)
- ❖ **113(1)** where a corporation resident in Canada received a dividend on a share owned by it in a FA of the corporation
 - there may be deducted from income in the year of the corporation, and amount equal to
 - (a) an amount equal to the portion of the dividend paid out of **exempt surplus**
 - surplus accounting attached label to shareholder during period that the corporation was a FA
 - **Reg 5907(1) Exempt surplus is A-B**
 - ◆ **A** is **exempt earnings** + dividend paid by another FA of the CanTaxPayer out of its exempt surplus + Refunds of Income or profit tax relating to exempt dividend + an dividend paid by a Canadian corporation that if it had been paid to the subject Canadian taxpayer would be deductible under s 212 (would have been tax free anyways)
 - ◆ **B** is exempt loss + amount of tax paid on exempt earnings + dividends paid out of exempt surplus
 - ◆ IF **B > A** - have exempt deficit
 - **Exempt Earnings**
 - ◆ active business income earned by FA in treaty of TIEA country or Canada
 - NET of expenses and income and profits taxes paid
 - ◆ income deemed by 95(2)(a) to be income from an active business
 - ◆ gains from disposition of business property
 - ◆ tax free portion of net capital gains
 - ◆ certain other net capital gains (taxable capital gains from excluded property)
 - (b) an amount equal to the LESSER of
 - (i) The **underlying foreign tax paid** on the income out of which the taxable surplus is paid X (1-RTF) **UFTx (RTF-1)**
 - (ii) that portion of the dividend paid out of **taxable surplus**
 - **Taxable Surplus includes**
 - ◆ **Taxable earnings** = FAPI + income other than from an active business + business income from non-qualifying countries + taxable portion of net capital gains (excluded property from a non-qualifying business) + dividends received from lower tier FA out of taxable surplus
 - ◆ Subtract from this
 - taxable losses
 - dividends paid out of taxable surplus
 - (c) an amount equal to the LESSER of
 - (i) amount of NBIT paid by the corporation applicable to the dividend paid out of taxable surplus x (RTF) **WT x**

- reflects capitalized underlying value of FA reflected in shareholders capital investment
- **40(3)** amounts in excess of original investment (ACB) of shareholder is capital gain
- **93(1)** allows taxpayer to elect to reduce capital gain otherwise arising, re-characterising it to that extent as a dividend
- **Reg 5902** - sweeps through underlying chain of FAs at the time of sale all their exempt surplus (as if actually paid to shareholder) to reduce Capital gain

D) Definitions

1) Foreign Affiliate (FA)

- ❖ **95(1)** "Foreign Affiliate" at any time of a taxpayer resident in Canada means
 - a **non-resident corporation** in which, at that time
 - TO be a **corporation** look at whether the entity has
 - Limited liability AND
 - distinct personality.
 - (a) the taxpayer's **equity percentage** is NOT less than 1%, and
 - **95(4)** "equity percentage" at any time of a person in any particular corporation is the total of
 - (a) the person's **direct equity percentage** at that time in the particular corporation
 - ◆ **95(4)** "direct equity percentage" at any time in a corporation is
 - the **highest percentage** owned by that person after comparing that person's ownership if each class of shares in that corporation (relevant percentage)
 - NOT a votes and/or value test
 - Any class of shares, no matter what the value or voting power is counted
 - (b) all percentages each of which is obtained when
 - ◆ the person's equity percentage at that time
 - can be of ANY class of shares, and doesn't have to be the same class for any persons or even the same as the taxpayer
 - ◆ in any corporation
 - ◆ is multiplied by that corporation's direct equity percentage at that time in the particular corporation
 - **Can have to greater than 100% equity percentage**
 - (b) the total of the equity percentages in the corporation
 - of the taxpayer **AND**
 - each **person related** to the taxpayer (ignoring (4)(b) of the definition)
 - is NOT less than 10%
 - Except that a corporation is not a FA of a non-resident owned investment corporation

2) Controlled Foreign Affiliate (CFA)

- ❖ **95(1)** "**controlled foreign affiliate**", at any time of a taxpayer resident in Canada means
 - (a) a FA of a taxpayer that is at that time
 - **controlled** by the taxpayer, or
 - Control means **de jure** (legal) control
 - ◆ greater than 50% votes to elect the majority of the board
 - (b) a FA of the taxpayer that **WOULD** at that time be controlled by the taxpayer
 - IF the taxpayer owned:
 - (i) all shares of the FA **owned by the taxpayer**, PLUS
 - ◆ **95(2.01)** - count any shares in the FA owned by a corporation in which the taxpayer has an equity interest, in proportion to that equity interest
 - draws in shares of unrelated corporations using FMV ratios
 - (ii) all shares of the FA owned by person's **not dealing at arm's length** with the taxpayer
 - (iii) all shares of the FA owned at that time by up to ANY other 4 Canadian residents
 - ◆ whether or not related to the taxpayer
 - ◆ not including persons in (ii) AND
 - **95(2.02)** - can't double count shares
 - (iv) all shares of the FA owned by person's not dealing at arm's length with those four other Canadian residents
 - **POLICY: look to see if there is a sufficient connection of the passive income to Canada to justify taxing it**

3) Foreign Accrual Property Income (FAPI)

- ❖ **95(1)** "**Foreign Accrual Property Income**" of a FA of a taxpayer for any taxation year means the amount determined by the formula

- **UNLESS** throughout the year (need all three)
 - ◆ (a) the business is **NOT conducted with non-arm's length** people, and **IS (i)** carried on as a foreign bank or insurer regulated as such under the laws of the country it is in **OR (ii)** the business of development of real estate for sale, the lending of money, the leasing or licencing of property or the insurance or reinsurance of risk
 - ◆ (b) the affiliate or a partnership it is part of is the operator, and
 - ◆ (c) the operator employs more than 5 fulltime employees in the active conduct of the business
- **NOTE 95(1) definition of "investment Property"**
- income from an **adventure in the nature of trade**
- but does **NOT include**
 - (a) Income from a business other than an active business, or
 - (b) income for the year that pertains or incident to
 - (i) an active business of the FA
 - (ii) a non-qualifying business
- a **business other than an active business**
 - ◆ **deemed by ss 95(2)(a.1) - (b to be FAPI)**
- a **non-qualifying business**
 - ◆ **95(1) non-qualifying business** means
 - a business carried out by the FA **through a PE** in a **non-qualifying country**
 - **95(1) non-qualifying country**
 - a country with which Canada **doesn't** have a (a) tax convention or (b) a TIEA
 - (c) a country with which Canada began negotiating a treaty with 60 months ago but hasn't completed one yet
 - **OTHER THAN**
 - (a) an investment business, or
 - (b) a business deemed by 95(2) to be other than an active business
 - ◆ **95(1) income from a non-qualifying business** includes
 - income that is incident to or pertains to that non-qualifying business
 - but does NOT include
 - (a) income from property
 - (b) income deemed by 95(2) to be from a business other than an active business
- OTHER THAN**
 - (b) a dividend from another FA of the taxpayer
 - (c) a taxable dividend paid to the FA by another corporation (inter corporate dividend)
- **B is taxable capital gains** from dispositions of property accrued after 1975
- **OTHER THAN excluded property** to which 95(2)(c),(d) and (e) don't apply
 - ◆ **95(1) Excluded property** is property that is
 - (a) used or held by a FA principally for the purpose of gaining or producing income from an active business carried on by it
 - (b) shares of another FA where all or substantially all of the FMV of the property of this other FA is attributable to property that is excluded property
 - (c) property, all or substantially all of the income from which is, or would be, income from an active business, including income deemed by 95(2)(a) to be income from an active business
- **C is**, where the FA is a CFA of the taxpayer
 -
 -
- you **SUBTRACT**
 - D is losses in the year from the items included in A to make them **NET** amounts
 - E is Allowable capital losses other than from excluded property losses
 - F is
 - H is
- ❖ **95(2)(a.1)** in computing income from a **business other than an active business** include
 - **POLICY: prevents base erosion by interposing a foreign company to capture some of the profits in the sale of property**
 - income from **sale of property** (including income for services as an agent in the sale of property)
 - **WHERE**
 - (i) it is reasonable to conclude that the cost to any person of the property
 - is relevant in computing the income from business carried on by the taxpayer or a person resident in Canada with whom the taxpayer does not deal at arm's length, **AND**
 - (ii) the property was neither
 - (A) manufactures, produced, grown, extracted, or processed in the country under whose laws the person is constituted, or in which the affiliates business is carried on

- income or revenues are excluded if they arise from a "specified deposit" with a prescribed financial institution, or lease revenue and income derived indirectly or directly from arm's length persons and relates to their use of property outside Canada or is otherwise included in computing Canadian income of the FA with respect to a business conducted in Canada through a PE
- (i) of persons resident in Canada, or
- (ii) in respect of business carried on in Canada
- **UNLESS** more than 90% of gross revenues were derived from arm's length people
- **THEN** the sale of the property is deemed to be a separate business other than an active business, including any income pertaining or incident to that business
- ❖ **95(2)(b) income from services**
 - (i) is deemed to be income from a business other than an active business
 - to the extent that amounts paid and payable for those services
 - **(A)** are deductible in computing the income from an active business carried on in Canada by
 - **(I)** any taxpayer for whom the affiliate is a FA, or
 - **(II)** another taxpayer does NOT deal at arm's length with the affiliate OR any taxpayer for whom the affiliate is a FA, OR
 - **(B)** are deductible in computing FAPI of a FA of
 - **(I)** any taxpayer of whom the affiliate is a FA, or
 - **(II)** another taxpayer does NOT deal at arm's length with the affiliate OR any taxpayer for whom the affiliate is a FA
 - (ii) is deemed to be a separate business other than an active business to the extent that services are or are to be performed by
 - **(A)** any taxpayer of whom the affiliate is a FA
 - **(B)** another taxpayer who does not deal at arm's length with the affiliate, or any taxpayer of whom the affiliate is a FA
 - **95(3) Services Exempted from 95(2)(b)**
 - **(a)** transportation of persons or goods,
 - **(b)** services performed in connection with the purchase and sale of goods
 - **(c)** transmission of electronic signals or electricity through a transmission system outside of Canada
 - **(d)** services performed in connection with "toll manufacturing" outside of Canada of tangible property that is and remains owned by the Canadian taxpayer that engages the FA to perform these services
 - toll manufacturing is the service of manufacturing property, where the person who engages the toller owns the inputs and the product, and much of the risk involved in the fabrication process

Computation of FAPI

- ❖ Computation done for each year
 - positive FAPI attributed to taxpayer
 - negative FAPI NOT attributed
 - Foreign accrual Property Losses (FAPL) will reduce FAPI for other years
 - can be carried back 10, and forward 3 years
- ❖ FAPI only accrued in years where the corporation is a CFA of the taxpayer

4) Active Business

- ❖ **95(1) Active business** of a FA means
 - **ANY business** carried on by the FA
 - **OTHER THAN**
 - **(a)** an investment business
 - **(b)** a business deemed by 95(2) to be other than an active business
 - **(c)** a non-qualifying business
- ❖ **95(1) Income** from an active business
 - **INCLUDES** income **pertaining to or incident** to that business
 - need some connection between the income and the business, or
 - investment assets must be employed or risked in the business, or
 - investment assets are necessary for the business so that their removal would destabilize the business
 - but does **NOT include**
 - **(a)** income from property
 - **(b)** income deemed by 95(2) to be other than from an active business
 - **(c)** income from a non-qualifying business
- ❖ **95(2)(a)** in computing the **income or loss form an active business** of a FA

- (B) that would be included in computing earnings or loss from an active business carried in a foreign country by (I) another FA in which the taxpayer has a QI throughout the year, if the income were earned by it
- (ii) the income or loss is derived from amounts that were paid or payable directly or indirectly to the particular FA
 - (B) by (I) another FA in which the taxpayer has a QI throughout the year
 - ◆ to the extent that those amounts were **paid for expenditures**
 - ◆ that **were deductible by that other FA** in computing its income from an active business
 - (D) by another FA in which the taxpayer has a QI through the year to the extent that the amounts paid to the second FA, in respect to any particular period in the year,
 - ◆ (I) under a legal obligation to pay interest on borrowed money used to earn income, OR (II) an amount payable for property for the purpose of gaining or producing income from property **WHERE**
 - ◆ (III) the property is excluded property of the second FA that is shares of the capital stock of a Third FA, and (IV) the second and third affiliates are resident in the same country, and (V) either the third affiliate or the second affiliate as its shareholder is liable to tax in that country
- (iii) amounts derived by a particular FA to from **factoring trade accounts** acquired from another FA, in which the taxpayer has a QI throughout the year
 - to the extent that the accounts arose in the course of an active business of the other FA
 - ◆ **s 17** - ensures Canadian residents earn a suitable return on loans
- (iv) Income or loss of a particular FA from **loans or lending assets** acquired from another FA, in which the taxpayer has a QI throughout the year
 - to the extent that the loans or lending assets arose in the course of an active business carried out in a country other than Canada by another FA
- (v) income or loss from disposition of **excluded property** that is NOT capital property
 - **95(1) Excluded property** is property that is
 - ◆ (a) used or held by a FA principally for the purpose of gaining or producing income from an active business carried on by it
 - ◆ (b) shares of another FA where all or substantially all of the FMV of the property of this other FA is attributable to property that is excluded property
 - ◆ (c) property, all or substantially all of the income from which is, or would be, income from an active business, including income deemed by 95(2)(a) to be income from an active business
- (vi) income or loss related to **risk hedging** related to the active business of another FA in which the taxpayer has a QI throughout the year

E) Anti Avoidance

1) Changes to Ownership of FA

- ❖ ITA allows for adjustments to ensure integration of FAPI even after a FA ceases to be a CFA of the taxpayer
 - **Reg 5905** - takes snapshot of shareholder's interest in a FA to provide for continued entitlements
- ❖ **s. 95(2)(c)** - share for share exchanges between FAs are on a rollover basis
 - UNLESS a "relevant cost base election" at a higher amount is elected
 - increase is treated as FAPI
- ❖ **s 95(2)(d), (d.1), (e), (e.1)** - reorganizations that don't remove the FA's property from the group setting

2) 95(6)

- ❖ **95(6)** for purposes of this subdivision (except s. 90)
 - (b) where a person acquires or disposes of shares of a corporation, either directly or indirectly,
 - AND it can reasonably be considered that the **principal purpose** for the acquisition or disposition
 - **Principal purpose is determined by looking at all circumstances**
 - **Univar** - look at real transaction and determine if that is an avoidance transaction, NOT re-characterise first then see if tax is avoided
 - ◆ what is a realistic alternative transaction
 - IS to permit a **person** to avoid, reduce, or defer payment of tax or any other amount that would otherwise be payable under the ACT,
 - person who makes acquisition doesn't have to be the same as person who gets tax benefit
 - THEN that acquisition is deemed NOT to have taken place
 - **PURPOSE** is to stop the re-characterization of income
 - eg. through temporary acquisition to make property income from an active business for s. 95(2)(a)
 - eg. indirect financing through preferred shares - interest becomes dividends

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