RECENT TAX DEVELOPMENTS 2017

Presentation to Accountants Study Group

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Topics

- Recent Legislative Amendments and Proposals.
- Update on Voluntary Disclosures in Canada and the U.S.
- Recent Cases of Interest.
- Recent Administrative Developments.
- Evolving Area of Interest – Airbnb.

Recent Legislative Amendments and Proposals

1. Taxation of WIP
2. Proposed Amendments to Taxation of Private Corporations
3. Quebec Taxation Act – Recent Amendments Affecting Transfer of Family Business

Taxation of WIP

- Professionals are required, as a general rule, to include work in progress (WIP) in calculating income.
- By exception, s. 34 ITA allowed accountants, dentists, lawyers, doctors, veterinarians and chiropractors to elect to exclude year-end WIP from taxable income.
- Federal Budget 2017 announced repeal of this election for taxation years beginning on or after March 22, 2017, and provided a 2-year transitional period to include lesser of cost and FMV of existing WIP in taxable income.
- September 8, 2017 NWMM extended transitional period over which WIP must be included in taxable income to 5 years.

Taxation of WIP

- Determination of FMV or cost of WIP may be difficult.
- CRA and Finance have previously indicated (CRA Views 5-8507, published September 19, 1989; Department of Finance Notes on Budget December 1981) that only direct overhead expenses had to be included in valuing the cost of WIP.
- This would include the cost of professional employees (i.e. non-partner lawyers, accountants and paralegals), but would exclude partner or proprietor time.
- Fixed or indirect overhead costs (e.g. rent, secretarial and general office expenses) are excluded (provided not included in WIP section of financial statements).

Proposed Amendments to Taxation of Private Corporations

- July 18, 2017, Finance Department released sweeping proposals to amend taxation of private corporations and their owners.

Proposed Tax Amendments

- Proposals target 3 broad areas of concern:
  - Income splitting (and multiplication of capital gains exemption) through private corporations;
  - Conversion of income into capital gains (surplus stripping); and
  - Investment of a private corporation's after-tax business income in passive assets.

Proposed Tax Amendments

Income Splitting

- Proposed Amendments seek to extend the application of Tax on Split Income ("TOSI").
- Current legislation imposes TOSI (kiddie tax) on dividends and other forms of passive income paid to minors.
- Proposed rules expand TOSI to broader category of persons and broader category of income.
- Expanded rules would apply to other family members, irrespective of age, unless they contribute reasonable labour or capital to the corporation's business.

Proposed Tax Amendments

Income Splitting

- Beginning 2018, a specified individual for purposes of TOSI rules will include any Canadian resident individual (not only a minor) who is related to a connected individual.
- New definition of related persons expanded to include aunts, uncles, nieces and nephews.
- Connected individual, broadly defined to apply where any of the following conditions is met:
  - Individual alone or as part of related group has direct or indirect control of corporation,
  - Individual owns 10% or more of the equity value of corporation,
  - Individual or related person owns shares of corporation carrying on a services business, and the services or business revenue are primarily attributable to the individual, or
  - Individual or related person owns shares of corporation and 10% or more of the corporation's property is derived from property acquired from the individual.

Proposed Tax Amendments

Income Splitting

- Definition of split income will be expanded to include:
  - Income on private corporation debt obligations,
  - Capital gains on private corporation shares if income therefrom would be split income,
  - Income from reinvested split income (or income subject to attribution rules) of individuals under age 25, and
  - Certain shareholder benefits.
  - Not extended to salaries

Proposed Tax Amendments

Income Splitting

- Reasonableness test – more stringent for 18 to 24 year-olds (*actively engaged on a regular, continuous and substantial basis*).
- Labour test – less stringent for those 25 or older (*must be involved in the activities of the business*).
- Burden on business owners to track hours worked, specific tasks and type of work by family members.
- Concerns as to subjectivity in determining reasonableness.

Proposed Tax Amendments

Income Splitting

Restrictions affecting Capital Gains per July 18 Proposals, BUT to be abandoned per October 16 Release

- July 18 amendments proposed to deny the lifetime capital gains exemption ("LCGE") on dispositions of shares subject to TOSI, and to make the one-half taxable portion of the capital gain subject to TOSI.
- LCGE also denied for:
  - Capital gains realized or accrued before an individual reaches 18, and
  - Capital gains accrued while shares are held in a trust.
- Where shares subject to TOSI are disposed to a non-arm's length person, amendments proposed to treat the entire capital gain as split income.

Proposed Tax Amendments

Income Splitting

LCGE – Transitional Rule

- Amendments to split income rules will apply beginning 2018.
- July 18 proposals included special election for individuals aged 18 or over (and certain trusts) to crystallize LCGE in 2018 and benefit from old rules. Presumably this will be abandoned if restrictions to LCGE are dropped as announced October 16.

Proposed Tax Amendments

Surplus Stripping

- Prior to July amendments, section 84.1 applied on transfers of private corporation shares by an individual to a NAL corporation where proceeds exceed greater of PUC and "hard" cost of transferred shares.
- ACB based on V-day value or LCGE previously claimed on shares not part of hard cost.
- Proposed amendments would have expanded section 84.1 dramatically.

Proposed Tax Amendments

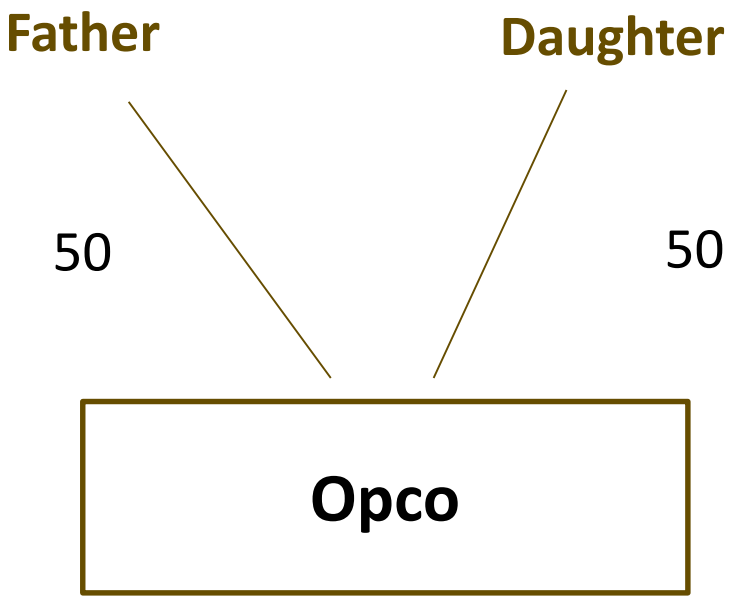
Surplus Stripping

Per July 18 proposals:

- All prior capital gains by taxpayer or NAL person on shares would become "soft" ACB.
- Amendments to s. 84.1 would apply in respect of dispositions on or after July 18, 2017.
- Would require tracking of previous transactions, including pre-July 2017.
- Would eliminate pipeline transactions, including *post-mortem*.
- Would make inter-generational transfers more difficult (no LCGE on transfer to NAL corporations) – contrary to recent Quebec amendments.

Proposed Tax Amendments

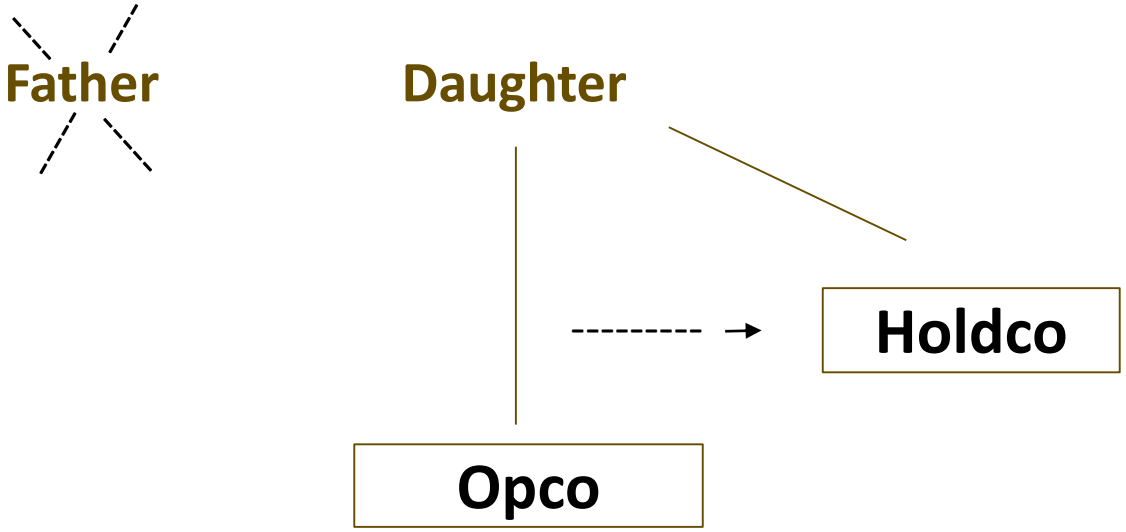
Surplus Stripping



- Father and Daughter start a new business and acquire common shares for $50 each.

Proposed Tax Amendments

Surplus Stripping



Daughter purchases shares from Father for $1M (No LCGE.)

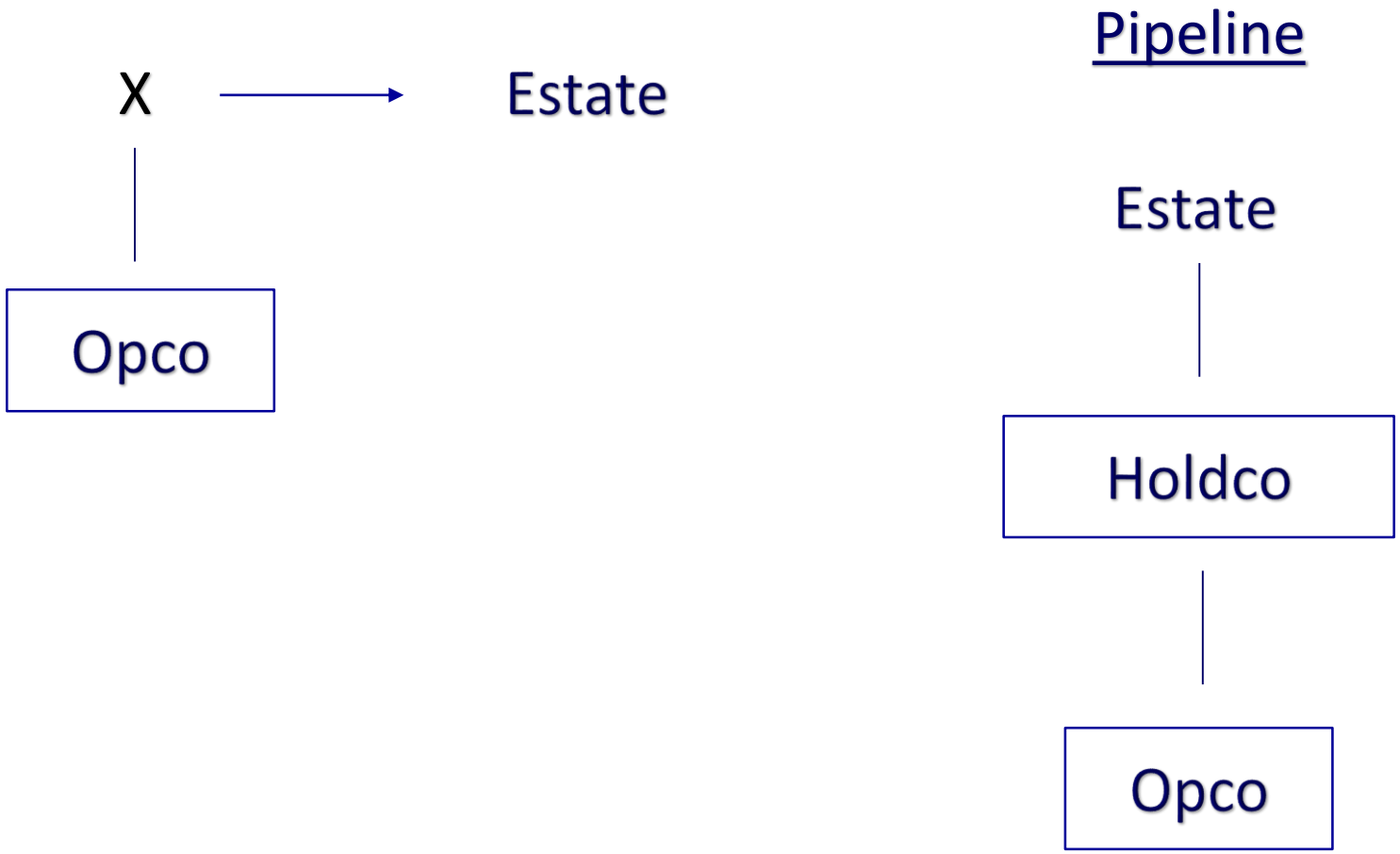
Daughter transfers Opco shares to Holdco.

Absent July amendments, Daughter may receive promissory note or high PUC shares for $1M which could then be extracted tax-free.

With July amendments, promissory note would create deemed dividend, and high PUC shares would be ground down.

Proposed Tax Amendments

Surplus Stripping



Proposed Tax Amendments

Surplus Stripping

Concerns were expressed that:

- Proposals hindered intergenerational transfers of business corporations.
- Elimination of pipeline could lead to double taxation on death (subs. 164(6) loss carry-back still in effect to avoid double tax, but subject to stringent conditions and results in effective tax at dividend rates).
- Some estates where death occurred prior to July 18, 2017 may be outside 1-year period for 164(6) election.

In response to concerns, Finance announced, on October 19, that it will not move forward with the surplus stripping amendments.

Proposed Tax Amendments

Surplus Stripping

- July amendments proposed the addition of a broad anti-avoidance rule, new section 246.1, applicable as of July 18, 2017 where

  (i) Canadian resident individual receives an amount, directly or indirectly in any manner whatever, from non-arm's length person;

  (ii) As part of a series of transactions, there is a disposition of property or an increase or reduction of PUC of a corporation's shares; and

  (iii) Reasonable to consider that one of the purposes of the series was to effect a significant reduction or disappearance of a private corporation's assets to avoid tax otherwise payable by the individual in consequence of a distribution of property by the corporation.

Proposed Tax Amendments

Surplus Stripping

- Where section 246.1 applies,
  - The amount received is deemed to be a taxable dividend received by the individual, and
  - Any capital dividend account otherwise used as part of the series is eliminated.
- Many concerns were expressed regarding this overly broad rule.
- Appears that this amendment is also being dropped.

Proposed Tax Amendments

Tax on Passive Income Resulting from Reinvestment of Active Business Profits

- No specific measures introduced, but Finance Department proposes to implement a new regime which would tax passive investment income earned in private corporations out of after-tax business income at higher rates.
- Objective to eliminate tax-assisted benefits of earning passive income in private corporations.
- Two approaches outlined in Finance paper of July 18.

Proposed Tax Amendments

Tax on Passive Income

- Possible Approaches

1. 1972 Approach
   - Refundable tax on ineligible investments (i.e. on profits not reinvested in business).
   - Not being considered due to liquidity concerns for businesses.
2. Deferred Taxation Approach (Eliminates Integration!)
   - Corporate tax at 50% on passive income, not refundable.
   - Personal tax on dividends to individuals will depend on source of income, with complicated apportionment method to track source, or elective method.
3. Other?

Proposed Tax Amendments

- At September 25, 2017 Canadian Tax Foundation policy conference, Finance officials explained objectives and provided the following comments, many of which are no longer relevant in light of the subsequent announcements:
  - They do not appear concerned about difficulties in applying reasonableness test.
  - Expect rules apply to pipelines, but double taxation on death is not the objective.
  - Consideration will be given to enhancing 164(6) (possibly extending 1-year deadline) or other solution to avoid double tax.
  - Possibility of grandfathering for deaths prior to July 18, 2017.

Proposed Tax Amendments

Finance Comments (cont'd)

- Amendments to 84.1 do not represent policy change.
- 246.1 is not intended to apply to ordinary commercial transactions.
- Addition of 246.1 closes gaps with respect to application of 84.1, but is not merely a back-stop to that provision; also intended to apply to transactions outside scope of 84.1, such as creation of NAL capital gains in corporations.
- Approach for taxation of passive investment income not yet chosen.
- Amendments will not apply to existing passive investments.
- Certain assets and some types of passive income may be excluded from high rates.

Proposed Tax Amendments

- Consultation period ended October 2, 2017.
- October 3, 2017 Department of Finance issued Release on next steps:
  - Over 21,000 written submissions received and to be reviewed.
  - Aim to avoid creating unnecessary red tape for small businesses.
  - Importance of family and intergenerational transfers of family business.

Proposed Tax Amendments

- October 16, 2017 Department of Finance Release announcing:
  - Reduction of small business tax rate to 10% effective January 1, 2018 and 9% effective January 1, 2019;
  - Intention to simplify measures relating to income sprinkling;
  - It will not move forward with proposed measures to limit access to lifetime capital gains exemption; and
  - Further steps to be announced within days.

Proposed Tax Amendments

- October 18, 2017 Department of Finance Release announcing:
  - Intention to move forward with measures to tax passive income of corporations.
  - Protection for past investments and income earned thereon.
  - $50,000 annual threshold on passive investment income.
  - Details of proposed measures to be released in Budget 2018, including description of how threshold will be applied.

Proposed Tax Amendments

- October 19, 2017 Department of Finance Release announcing:
  - Government will not move forward with measures relating to conversion of income into capital gains.
- Amendments to section 84.1 and, presumably, new section 246.1 will be dropped.

Proposed Tax Amendments

Where Are We Now?

- Changes to income sprinkling rules (TOSI) will be implemented, but on simplified basis.
- Rules on taxation of passive income of private corporations to be amended but approach not yet known. There will be grandfathering to protect past investments and earnings thereon and a $50,000 annual threshold going forward. Details expected with 2018 Budget.
- Other proposals (restricting access to LCGE and relating to conversion of income to capital gains) are being dropped.

Proposed Tax Amendments

Actions to Be Taken in 2017

- Maximize income splitting.
- Most other steps which seemed necessary post-July amendments related to LCGE and are no longer required since government announced that it is not pursuing those amendments.
- Proposed taxation of passive income may require reorganizing structures, but too soon to plan in the absence of details.
- Avoid precipitous action since much uncertainty remains, but be ready to act quickly.

Quebec Taxation Act ("QTA")

Transfer of Family Business

- To accommodate intergenerational transfers, new measures were added to the QTA effective March 2016, which allow transferor to claim Quebec LCGE on deemed dividend under s. 84.1 of the Federal Act provided certain criteria are satisfied.
- Well intentioned, but conditions are difficult to satisfy.
- Conditions are meant to ensure a true transfer of the business from former operator to new one, and to limit the financial interest that the departing shareholder can maintain in the corporation.

QTA
Transfer of Family Business

Conditions:

- Applies only to eligible primary and manufacturing shares.
- Transferor must be the individual or spouse (not a trust) who was actively engaged in the business of the corporation (or corporation in which it had a substantial interest) during 24 months prior to disposition.
- After the transfer:
  - Participation of transferor and spouse limited to transfer of knowledge for transition period, and salary limited.
  - At least one of transferee's shareholders (other than transferor or spouse) must be actively engaged in business.
  - Transferor or spouse cannot control (alone or as part of group) the corporation or corporation in which it had substantial interest.

QTA
Transfer of Family Business

Conditions: (cont'd)

- Transferor or spouse cannot hold any common shares post transfer.
- Financial interest of transferor or spouse cannot exceed 60% of FMV of all shares, and must be reduced to 30% by 10th anniversary.
- No partial sales.
- Spouses in business together must withdraw at the same time.
- Passive shareholders not eligible.

Update on Voluntary Disclosures in Canada and the U.S.

1. **Canada Revenue Agency**
    - **Significant Changes Proposed**
    - **Current Changes in Effect**
    - **Numbers**
2. **Revenu Québec**
    - **Any Changes?**
    - **Numbers**
3. **Voluntary Disclosure Programs Available to U.S. Persons**
4. **Update on OECD's Automatic Exchange of Financial Information**

Update on Voluntary Disclosure Program

Canada Revenue Agency

Significant Changes Proposed

- Proposed new Information Circular on Federal VDP IC00-IR6.
- VDP to be divided into two streams:
  - General Program – Taxpayers entitled to same protections and relief as currently available.
  - Limited Program – Taxpayers receive no interest relief and subject to $2500 minimum T1135 penalty in each year.
  - Taxpayers assigned to limited program where evidence of “major non-compliance”.

Update on Voluntary Disclosure Program

Canada Revenue Agency – Significant Changes Proposed

- Criteria evidencing major non-compliance:
  - Active efforts taken to avoid detection through use of offshore vehicles and complex structures.
  - Large amounts involved.
  - Multiple years of non compliance.
  - Sophisticated taxpayer.
  - Disclosure made after CRA announcement of intended focus of compliance or correspondence campaign.
  - Any other circumstance in which high degree of taxpayer culpability contributed to with failure to comply.

Update on Voluntary Disclosure Program

Canada Revenue Agency – Significant Changes Proposed

- Other proposed changes:
  - No more anonymous voluntary disclosures – identities provided at filing.
  - Payment of estimated tax and interest payable required at time of opening voluntary disclosure.
  - Taxpayer expected to estimate income earned in foreign account:
    - Beyond number of years for which account statements available (to opening of account?);
    - Beyond number of years for which penalty and interest relief is available under ITA.
  - Taxpayers expected to name the individuals who provided assistance in respect of setting up or administering the subject matter of the VD file.
  - No VDs for large corporations or in transfer pricing situations.

Update on Voluntary Disclosure Program

Canada Revenue Agency – Significant Changes Proposed

- Consultation Period ended August 8, 2017.
- No changes finalized yet.
- Implementation of changes delayed until September 2018 or January 2019.

Update on Voluntary Disclosure Program

Canada Revenue Agency

Current Changes in Effect

Panama Papers

- No VDs for taxpayers named in Panama Papers (if VD filed on or after CRA's first announcement April 5, 2016).
  - CRA information database much larger than what is available on website: https://offshoreleaks.icij.org/

Update on Voluntary Disclosure Program

Canada Revenue Agency – Current Changes in Effect

Costly Assessments with Limited Relief

- CRA has begun asking Taxpayers to estimate income earned and capital gains generated beyond the ten years of statements available:
  - Greater risk for taxpayers with conservative investment portfolio where income earned is easily estimated year over year.
- Minister of Revenue only authorized by *Income Tax Act* (Canada) to offer 10 years of interest and penalty relief.
- Therefore any income assessed beyond 10 years:
  - Will be subject to full compound interest rates in each year (1986 prescribed interest rates were *16%).*
  - Will be subject to non-discretionary penalties (plus interest) in each year (i.e. T1135s).

Update on Voluntary Disclosure Program

Canada Revenue Agency

Numbers

- Total unreported income from voluntary disclosures:
  - $1.3 billion from all voluntary disclosure files in 2014-2015 fiscal year, an increase of 65% over 2013-2014 fiscal year.
  - $780 million from offshore disclosure files in 2014-2015 fiscal year, a 157% increase over 2013-2014 fiscal year.
  - 19,134 voluntary disclosures received in 2014-2015 fiscal year, an increase of 21% over the prior year.
  - Administered by 72 full time equivalent employees.
  - Cost CRA $5,325,721 to administer.

Update on Voluntary Disclosure Program

Revenu Québec

Any Changes?

- RQ is following CRA's lead and will deny VDs for taxpayers named in Panama Papers.
- Introducing efforts to improve efficiency and timing of file processing:
  - Standardized agreement letters
  - Limited audit of file where simple file
  - Hiring more staff
- Otherwise business as usual at RQ.

Update on Voluntary Disclosure Program

Revenu Québec

Numbers

- At August 31, 2017, RQ had 2001 files open, of which 81% involved foreign assets.
- 1568 files voluntary disclosure files opened in 2016-2017, of which 46% related to foreign assets.
- Received 1531 voluntary disclosure applications in 2015-2016 fiscal year.
- 25% of all voluntary disclosure files opened do not meet criteria for the program.
- Administered by 23.4 full time equivalent employees.

Update on Voluntary Disclosure Program

Voluntary Disclosure Programs Available to U.S. Persons

	OVDP	Streamlined Filing Compliance Procedures	
		US Persons Living Outside US	**US Persons Living Inside US**
Taxpayers Targeted by Program	Bad Actors	US persons living outside US, unaware of filing obligations	Non-willful actors
Penalty Terms	20% of tax payable as accuracy penalty + 27.5% of highest aggregate value as miscellaneous offshore penalty (8 yrs) (misc. penalty rises to 50% of highest agg. value if bank under investigation by IRS or DOJ)	No Penalties	5% of highest year end total aggregate value of foreign accounts (6 yrs)
Covered Period	8 Years	3 Yrs income tax returns + 6 Yrs FBARs	3 Yrs income tax returns + 6 Yrs FBARs
Protection from Criminal Investigation	Yes	No	No
Closing Agreement Available	Yes	No	No

Update on OECD's Automatic Exchange of Financial Information

- First exchanges of financial information took place in September 2017 (involved European Union members and their overseas territories).
- Canada, Switzerland, Israel, and other jurisdictions to exchange financial information in September 2018.
- As of May, 2017, over 1800 activated bilateral exchange relationships under the Multilateral Competent Authority Agreement.
- To date, Canada has activated 54 such relationships including:
  - Bermuda, BVI, Cayman Islands, Gibraltar, Guernsey, Jersey, Isle of Man, Liechtenstein, Luxembourg, Malta, Monaco, San Marino, Switzerland, Turks & Caicos.

Recent Cases of Interest

1. **BP Canada Energy Co. (2017 FCA 61)**
   (access to tax accrual working papers denied)
2. **Cameco Corp. (2017 FC 763)**
   (Minister may not force oral interviews)
2. **Beima v. Canada (National Revenue) (2017 FCA 85)**
   (Minister's right to copy records)
2. **The Queen v. Green et al. (2016 FCA 107)**
   (claiming partnership losses in a multi-tier structure)
2. **Sud v. The Queen (2017 TCC 106)**
   (director resignation formalities must be followed)

Recent Cases of Interest

BP Canada Energy Co. 2017 FCA 61

- Overturning a compliance order of the Federal Court, the Federal Court of Appeal (FCA) held that the taxpayer could not be forced to give CRA its tax accrual working papers (TAWPs).
- Important because FCA established some limits on CRA's broad powers to compel disclosure of information and documents.

Recent Cases of Interest

BP Canada Energy Co.

- Case involved application by Minister to compel BP to disclose its TAWPs which identified its uncertain tax positions.
- Federal Court granted order compelling production.
- Taxpayer appealed.
- CPA Canada intervened (over CRA's objections).
- FCA granted appeal.

Recent Cases of Interest

BP Canada Energy Co.

- Wording of subsection 231.1(1) is broad enough to cover TAWPs, but must be interpreted in context and harmoniously with the object and scheme of the Act and Parliament's intention.
- Parliament must have intended that the provision be used with restraint when dealing with TAWPs.
- Taxpayer must self-assess, but not self-audit; cannot be compelled to reveal its soft spots.
- Unrestricted access to TAWPs would have a negative impact on financial reporting.
- CRA can obtain TAWPs in appropriate circumstances.

Recent Cases of Interest

Cameco Corp. (2017 FC 763)

- Imposes limits on CRA's powers under 231.1 ITA.
- ITA does not contain any provision which explicitly requires a taxpayer to submit to an oral examination.
- In the context of a transfer pricing audit, Minister sought to compel 25 Cameco employees to attend oral examinations. Cameco agreed to written questioning by the Minister, but not to oral interviews.

Recent Cases of Interest

Cameco Corp.

- One reason why Cameco refused the oral interviews was that oral interviews in past audit gave rise to dispute in Tax Court as to what was said in the interviews.
- Minister applied to Federal Court for a compliance order.
- Minister argued that the broad language of 231.1 ITA granted the powers and authority to compel oral examinations. The ability to conduct oral interviews is an inherent and integral part of the Minister's authority to inspect, audit or examine. A person under audit must answer all proper questions, and that this is not restricted to written questions.

Recent Cases of Interest

Cameco Corp.

- Federal Court disagreed with the Minister. Minister's powers are broad, but not unlimited.
- Federal Court found that 231.1(1) ITA "does not provide the Minister with an unlimited right to conduct oral interviews".

> 47 If I order the interviews to take place with a court reporter and legal counsel present as well as other procedural fairness indicia, then I have replicated what occurs at an examination for discovery in a Tax Court of Canada proceeding. However, instead of Cameco choosing their own proper officers for examination, if I were granting the application I would have allowed the Minister to pick 25 or more personnel to speak for Cameco. I cannot do it as it would disregard the *Tax Court of Canada Rules* and possibly prejudice the proceedings currently before the Tax Court of Canada, with subsequent tax years in the pipeline to be heard, by enabling the Minister to bolster evidence (if necessary) for subsequent trials regarding other audited years.

Recent Cases of Interest

Cameco Corp.

- If allowed, Minister would have right to broader form of examination for discovery than under Tax Court Rules, without any of the procedural safeguards.

> 48 The Tax Court of Canada has rules of procedure that provide for oral discovery (for example, *sections 92 to 100* of the *Tax Court of Canada Rules (General Procedure)*, SOR 90-688a [the Rules]). Some of the safeguards provided in the Rules include that the taxpayer may choose its representative to be examined (*subsection 93(2*)), there are rules to the scope of examination (*section 95*), there are consequences to refusing a question (*section 96*) and specific use can be made of the examination (*section 100*).
>
> 49 If the Minister's position is accepted, the CRA can compel oral interviews from as many persons as they see fit without any procedural limits. Oral interviews as sought on these facts at the audit stage would undermine procedural safeguards provided at the appeal stage. Furthermore, the Minister could use an isolated statement by an employee which the taxpayer would be forced to disprove at trial.

Recent Cases of Interest

Beima v. Canada (National Revenue) (2017 FCA 85)

- Scope of CRA's broad audit powers under 231.1(1) ITA. Taxpayer must provide photocopies and may not dictate how audit is conducted.
- In April 2014, CRA notified taxpayer that his tax returns re. 2006 to 2010 years, which were under objection, and his returns re. 2011 and 2012 years, which had not yet been assessed, were under review. CRA listed the specific records it required to carry out the audit.

Recent Cases of Interest

Beima v. Canada

- May 6, 2014, was the agreed upon start date for the audit.
- Two CRA auditors and their team leader arrive at the taxpayer's place of business. Taxpayer would only allow one auditor on his premises. Taxpayer also stated that he would videotape the entire audit process.
- CRA decided to not proceed with the audit in person.

Recent Cases of Interest

Beima v. Canada

- On May 28, 2014, CRA requested that certain documents be provided, by a specified date. Following taxpayer's failure to reply, Department of Justice intervened to issue same request for documents.
- Taxpayer instead replied that the CRA could come to his premises, but not copy any records.
- Department of Justice was not satisfied and successfully applied for a compliance order from Federal Court.
- Taxpayer appealed to the Federal Court of Appeal.

Recent Cases of Interest

Beima v. Canada

- Federal Court of Appeal upheld the trial court's decision to issue the compliance order. CRA did not require taxpayer consent to photocopy records and that a taxpayer could not dictate how an audit proceeds.

> We see no reviewable error in the Judge's finding that the appellant did not provide the required access, assistance or information sought by the respondent under section 231.1 of the ITA. The Judge found that, contrary to the appellant's understanding, CRA did not require the appellant's consent to copy his records: reasons at paragraphs 22-23. The Judge also found that the appellant, as a taxpayer, could not dictate how CRA conducts an audit or frustrate the respondent's ability to carry out its statutory duties by refusing entry to a second auditor or insisting on videotaping an audit process: reasons at paragraphs 21, 23. We are unable to identify any reviewable error in the Judge's findings. As such, we see no grounds upon which the compliance order under section 231.7 of the ITA should be set aside.

Recent Cases of Interest

The Queen v. Green et al. (2016 FCA 107)

- **Issue:** whether a limited partnership loss (LPL) is trapped in a lower-tier limited partnership by application of the at-risk rules.

Factual Background

- From 1996-2009, taxpayers (individuals) were limited partners in a master limited partnership (MLP).
- MLP was in turn a limited partner of other limited partnerships (PSLPs).
- The PSLPs incurred business losses, which were allocated to MLP and, in turn, from MLP to the taxpayers.

Recent Cases of Interest

The Queen v. Green et al.

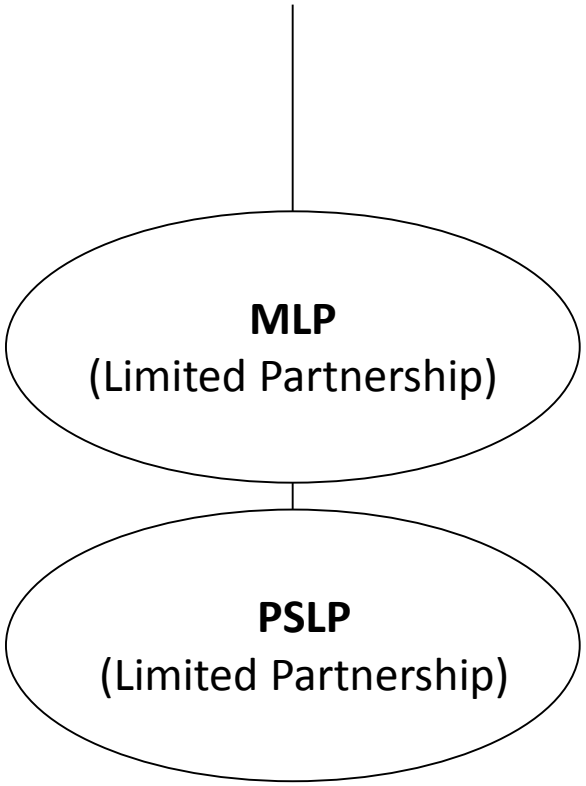
Factual Background (cont'd)

- Up until end of 2008, taxpayers' at-risk amount in MLP was nil. MLP's at-risk amount in each PSLP was also nil. Losses allocated by MLP to taxpayers over this period were added to taxpayers' LPL balance.
- In the 2009 year, taxpayers' at-risk amounts in MLP increased (capital gain was allocated by MLP to its limited partners).
- Taxpayers claimed a portion of the of the accumulated LPL.
- CRA reassessed each of the taxpayers to disallow the deduction of the LPLs.

Recent Cases of Interest

The Queen v. Green et al.

Simplified Structure



Taxpayers were members of a limited partnership, Master Limited Partnership ('MLP") which, in turn, was the 99.999% limited partner of 31 lower-tier limited partnerships (the "PSLPs").

Recent Cases of Interest

The Queen v. Green et al.

Relevant Legislative Regime

- Subsection 102(2) – deeming rule that treats a partnership as a person for purposes of sections 96 to 103.
- Section 96 – governs the computation of a partnership's income (as a separate person) for purposes of allocating to partners.
  - Under section 96 the source of income is maintained in the hands of the partners.
- Subsection 96(2.1) – at-risk rules restrict ability of members of limited partnerships to deduct losses. Losses exceeding a taxpayer's at-risk amount (under 96(2.1)(b)) are:
  - Not deductible by taxpayer in the current year (96(2.1)(c))
  - Not included in computing taxpayer's non-capital loss for the year (96(2.1)(d))
  - Deemed to be taxpayer's LPL for the year in respect of the partnership (96(2.1)(e))

Recent Cases of Interest

The Queen v. Green et al.

Relevant Legislative Regime (cont'd)

- Paragraph 111(1)(e) generally allows for an indefinite carryforward of LPLs.
  - LPLs may be deducted in future years against income from the partnership OR where taxpayer's at-risk amount in respect of the partnership has increased, against income from other sources.

Minister's Position

- Minister treated loss of the upper-tier partnership as an LPL which could not flow through to its members.
- Minister argued that the lower-tier partnership (PSLP) business losses were LPLs of the upper-tier limited partnership (MLP) – which meant that they were trapped in MLP given that s. 111 (and therefore the ability to deduct limited partnership losses under s. 111(1)(e)) was only available to a taxpayer and not to a partnership.

Recent Cases of Interest

The Queen v. Green et al.

Tax Court of Canada Decision

- TCC rejected Minister's argument. Taxpayers allowed to claim a portion of the LPL to the extent of the increase of their respective at-risk amounts in MLP.

- Applying a textual, contextual and purposive analysis of 96(2.1) supported the interpretation that business losses of lower-tier partnership (PSLP) in excess of a top-tier partnership's (MLP's) at-risk amount (in the lower tier LP) do not cease to be business losses. These losses can therefore be allocated to the partners of the top-tier partnership.

- TCC concluded that the purpose of the at-risk rules

  is not to deny absolutely the losses in excess of a limited partner's at-risk amount but, rather, to defer deduction of the excess until a time when the partnership has generated income or the partner's at-risk amount has increased.

Recent Cases of Interest

The Queen v. Green et al.

Federal Court of Appeal Decision

- Minister's appeal is rejected. FCA reiterated the view that:

  > Parliament did not intend for a partnership that is member of another partnership to compute income. Rather, parliament intended for the sources of income (or loss) to be kept separate and retain their identity as income (or loss) from a particular source as they are allocated from one partnership to another partnership and then to partners of that second partnership.

- Business losses of the PSLPs would thus be business losses in MLP, and in turn, business losses to the taxpayers once allocated to them by MLP.

- This decision overturns a longstanding CRA position (2004-0062801E5, May 14, 2004).

Recent Cases of Interest

Sud v. The Queen (2017 TCC 106)

- Director who failed to formally resign is held liable for unpaid GST going back more than a decade.
  - Taxpayer was director 1186271 Ontario Inc. ("118"). He was assessed in 2014 for unpaid GST (by 118) for the period 2003-2005. 118 ceased business activity in 2005 and had filed its last Ontario corporate tax return in 2008.
  - Taxpayer believed that 118 was automatically dissolved within 2 years following its failure to file a tax return. He, by extension, believed that he ceased to be director in or around 2010. In fact however 118 was not dissolved until 2016.
  - Taxpayer's appeal dismissed.

Recent Cases of Interest

Sud v. The Queen

- **Takeaway**
  - Subjective belief that one has resigned is not sufficient.
  - Corporate law governs director resignation requirements.
  - Even if corporation ceases operations or files for bankruptcy, this does not affect the status of an individual as a director.

Recent Administrative Developments

1. **Dividend Refund Claims**
2. **Small Business Deduction**
3. **Dedicated Telephone Service**

Recent Administrative Developments

Dividend Refund Claims
(TI 2016-0649841E5, dated May 12, 2017)

- CRA expressed opinion that private corporation is not required to claim dividend refund in taxation year when it pays taxable dividends.
- This suggests that corporation may carry forward pre-dividend RDTOH balance to next year.
- However, CRA policy (as expressed in same TI) is to automatically issue full dividend refund when it has sufficient information in T2, even if not requested (eg. by indicating 0 on line 784 of T2).
- Minister has discretionary power under paragraph 129(1)(a) ITA.

Recent Administrative Developments

Small Business Deduction (SBD) – Quebec

- Background (*Quebec Budgets 2015-2016 and 2016-2017*)
  - Qualifying for Quebec's SBD
    - Corporation is in the primary or manufacturing sector, or
    - Its employees accumulate at least 5500 hours worked during the taxation year, or
    - During the previous taxation year, the hours worked by its employees and the employees of the corporations with which it is associated total at least 5500 hours.
  - Applied in respect of taxation years commencing after December 31, 2016.
  - Taxpayers criticized these rules namely that their application would be overly complex particularly small business.
  - Modifications proposed in Quebec's 2017-2018 Budget.

Recent Administrative Developments

Small Business Deduction (SBD) – Quebec

- As part of Budget 2017-2018 Quebec announced that the "hours worked" criterion is to be replaced with an "**hours paid**" criterion.
- Maximum of 40 hours per week per employee.
- Acknowledges that shareholders may be actively involved in corporation's activities without drawing a salary (or a salary that does not correspond to full extent of hours worked by the shareholder).
    - A **shareholder who holds the majority of voting shares** is deemed to receive remuneration corresponding to a **conversion factor of 1.1 for each hour worked.**
    - The corporation is required to document the hours worked.
    - Majority shareholding (for SBD purposes) is determined based on number of votes.
    - Vacation time not included in the computation of hours worked (APFF Provincial Roundtable (Oct. 6, 2017).
- Coming into effect for taxation years commencing after December 31, 2016.

Recent Administrative Developments

Dedicated Telephone Service – Federal

Dedicated Telephone Service

- The Income Tax Rulings Directorate recently confirmed the CRA's plan to introduce a new dedicated telephone service (DTS) for income tax service providers (originally announced in Budget 2016).

- Under a three-year pilot project beginning in July, 2017, the DTS will initially be offered to certain CPAs in Ontario and Quebec. The DTS is intended to provide participants in the project with access to experienced CRA staff who can help with more complex technical issues.

Recent Administrative Developments

Dedicated Telephone Service – Federal

Dedicated Telephone Service (cont'd)

- CRA update
  - In June 2017 Rulings Officers assigned to the DTS began to accept calls from 500 registrants who were provided access under an early "soft" launch of the new service. Access to the service will be gradually expanded until 3,000 participants are registered under the pilot project.
  - Under the DTS pilot project, registration is open to small accounting practitioners in Ontario and Quebec – namely, CPAs who are in public practice as sole proprietors or in groups of up to three professional partners or shareholders.

Recent Administrative Developments

Dedicated Telephone Service – Federal

Dedicated Telephone Service (cont'd)

- DTS officers will not have access to taxpayers' accounts.
- DTS is not intended for specialized tax professionals whose services focus on complex tax planning. These tax advisors should continue to use the advance income tax rulings or technical interpretations.

Evolving Area of Interest - Airbnb

Tax Consequences of Home-Sharing (Airbnb)

- **Rental Income or Business Income?**
  - Question of Fact:
    - number and nature of services provided to guests
      - standard services included in all rentals – electricity, heat, laundry facilities, parking - likely not sufficient to constitute business;
      - cleaning, supplying of linens and washroom supplies, meals – likely business income.
    - occasional rentals vs rental operation

Evolving Area of Interest - Airbnb

Tax Consequences of Home-Sharing

- **Principal Residence**
  - If home used partly to earn income, property retains its nature as a principal residence as long as:
    - income-producing use ancillary to main use as a residence;
    - no structural change;
    - no CCA is claimed.
  - Canada Revenue Agency Folio S1-F3-C2

Evolving Area of Interest - Airbnb

Tax Consequences of Home-Sharing

- **Computation of Expenses**
  - Current Expenses:
    - Costs of supporting Airbnb activity fully deductible (i.e. cleaning before and after each guest);
    - Property costs (mortgage interest, property taxes, home insurance, utilities) – allocation based on how many days the home is rented out; if only part of home (i.e. one room) is rented – further proration required.

Evolving Area of Interest - Airbnb

Tax Consequences of Home-Sharing

- **Computation of Expenses (cont'd)**
  - Capital Expenses:
    - Major renovations to home likely would not qualify if home only occasionally rented out;
    - Claiming CCA on building affects principal residence status;
    - Possible to capitalize and depreciate furniture, etc. for rented rooms.
  - Important to keep good records

Evolving Area of Interest - Airbnb

Tax Consequences of Home-Sharing

- **GST/QST**
  - GST and QST apply on short-term rentals (less than a month), unless consideration does not exceed $20 per day of occupancy.
  - Airbnb does not collect sales taxes, hosts responsible to collect and remit GST/QST.
  - Obligation to collect and remit GST/QST, unless:
    - small supplier (total supplies of less than $30,000 for the previous four quarters, taking into account any other taxable supplies); and
    - not registered.

Evolving Area of Interest - Airbnb

Tax Consequences of Home-Sharing

- **GST/QST (cont'd)**
  - If entire house or condominium is regularly rented out and all or substantially all (generally 90%) of the rentals are for periods of less than 60 days, the home will lose its status as a "residential complex".
  - If home not "residential complex", cannot benefit from exemption for sales of previously occupied homes when selling the home.
  - Same result even if homeowner is a small supplier and not registered.

Evolving Area of Interest - Airbnb

Tax Consequences of Home-Sharing

- **GST/QST (cont'd)**
  - If homeowner lives in house and rents rooms on a short-term basis, entire property remains residential complex provided the home is used primarily (generally more than 50%) as a residence for the homeowner.

Evolving Area of Interest - Airbnb

Tax Consequences of Home-Sharing

- **Quebec Tax on Lodging**
  - On August 29, 2017 Airbnb signed an agreement with the Quebec government agreeing to collect lodging tax (*taxe sur l'hébergement*) from persons who book lodging through their platform.
  - Airbnb agreed to collect the lodging tax on stays of 31 days or less and remit it to Revenu Québec quarterly.
  - Other home-sharing platforms could also start collecting the lodging tax.

Evolving Area of Interest - Airbnb

Tax Consequences of Home-Sharing

- **Increased Audit Risk**
  - Quebec Budget 2017:

    "Revenu Québec's inspection powers will be enhanced to ensure tax compliance of taxpayers offering tourist accommodations through sharing economy platforms, such as AirBnB."

  - Revenu Québec to set up a team of 25 inspectors with the mandate to ensure that laws and regulations are complied with.