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# **INTRODUCTION**

## CR IS SEPARATE TAXABLE ENTITY

### SEPARATE LEGAL PERSON §2(1); DEFERRAL; SURPLUS STRIPPING; INTEGRATION; REORGANIZATION

* §2(1) CR is a separate legal person; CR taxed at ~27% flat rate tax.
* CR taxed lower than 53% marginal ind rate

**SEPARATE LEGAL**

**PERSON §2(1)**

* CR may defer taxesto leave profit in CRby (i) lowering declared revenue or
* Occurs with low corporate tax rate (ii) increasing expenses

**DEFERRAL**

* Removal of CR surplus without SH-level tax – tax avoidance/ mitigation strategy
* Get money out of CR without paying additional tax on money
* CR earnings ‘stripped’ when law differentiates btw consequences of realizing income as dividends and realizing income in other way

**SURPLUS**

**STRIPPING**

* Total amount of tax paid by CR and SH = tax SH would pay if taxed directly
* Way of overcoming double taxation issue for SH residents

**INTEGRATION**

* tax neutral; not distort business form; no change in underlying econ interest
* Rollover treatment for transfers of property to CR; some merger; acquisition

**REORGANIZATION**

## CORPORATION

### CORPORATION (IT-34R)

* ‘Entity created by law; has legal personalityand existence separate from those who created/own it; has capacityto acquire own rights and assume own liabilities’ (IT – 343R)

**CORPORATION**

## TAXATION YEAR

### FISCAL PERIOD [**§249(1)(a)** CR taxation year]

* CR taxation year is fiscal period – year CR uses for accounting/ prep docs – i.e. June 30
* Used for business/ property income (§249.1(1)) – **cannot exceed 53 weeks** (§249.1(1)(a))
* Cannot change without Minister’s consent (s.249.1(7))
* Refer to fiscal period by latter year: i.e. Jul 1 2019 – Jun 30 2020 is ‘2020 taxation year’
* All tiered partnerships have **Dec 31** fiscal period ends

**FISCAL**

**PERIOD**

***§249(1)(a)***

## CORPORATE RESIDENCE

### CR must be resident in CAN [§250(4)(a)]

* CR must be resident in Canadato be taxed. ~Easyto det; look at docs

‘any CR incorporated in Canada after Apr 26, 1965 is deemed to be resident in Canada’ (§250(4)(a)) – [occurs 99% time]

‘CR continued into jurisdiction is deemed to be incorporated in successor jurisdiction’ (§250(5.1)) – [occurs 1% time]

**CORPORATE**

**RESIDENCE**

## CORPORATE RESIDENCE JURISPRUDENCE

### ***DE BEERS*** [CR resident where CMC. Usually where directors are]. ***CROSSLEY CARPETS*** [CR can be resident in 2 nations]. ***BEDFORD OVERSEAS*** [SH have corporate control, not CMC]. ***UNIT CONSTRUCTION*** [CR resident where CMC]***. WOOD v HOLDEN*** [CMC is exercised by directors]. ***LAERSTATE*** [there is scale/continuum for CMC of directors].

* Do not confuse ‘central management’ resting with directors + ‘corporate control’ resting with SH!

***DE BEERS***  CMC

Facts: CR incorporated in S Africa. CR principally carried business in S Africa. Majority of directors residents of ENG

Some director meetings in S Africa. BUT: most important decisions **made in ENG**; ‘keeps house’ in ENG

Nutshell

* CR is resident where its ‘central management + control’ is exercised. Generally, this is with **directors**
* It is not relevant that most business operations in S Africa. Critical decisions made in ENG

Result: CR is resident in ENG. Directors are resident in ENG

***CROSSLEY CARPETS*** 2+ nations

Facts: CR incorporated in ENG. (CR subsidiary) has English resident directors

But, CR subsidiary carries on business in CAN – bank accounts and auditors in CAN

Director + SH meetings in ENG were ‘perfunctory’ – min. Directors had management meetings in CAN

Nutshell

* CR can be resident in two nations, similar to ind

Result: CR is resident in ENG and in CAN

***BEDFORD OVERSEAS*** SH have corporate control, not CMC

Facts: CAN shipping CR. Ships managed in UK. Non-res SH made major decisions in UK.

Minutes signed without question/ consultation

Nutshell

* Influence and power of SH does not give them ‘central management + control’ (CMC)
* Directors are not agents of SH/ bound to follow their instructions
* Directors responsible to CR + governed by its constitution

***UNIT CONSTRUCTION*** CMC

Facts: African CRs has UK parent CR. UK CR usurps power, makes decisions, think African CRs incompetent

Nutshell

* CR residence is est where CMC is exercised
* Boards of subsidiaries are by-passed by SHs

Result: African CRs are resident in UK. CMC exercised in UK

***WOOD v HOLDEN*** CMC exercised by directors

Facts: WOOD transferred interest in UK CR – to – Dutch CR on tax-deferred basis

WOOD held econ interest in Dutch CR through trust

There is **no UK tax** on sale from UK CR if Dutch CR is **non-resident**

Dutch CR had Dutch directors + all meetings in NETH

Law firm PWC UK gave tax advice to WOOD which were ‘recommendations’ to Dutch CR directors

WOOD’s scheme (advised by PWC UK) aim allegedly to avoid paying UK tax

Nutshell

* Distinction with *Unit Construction* in that Directors influenced by parent UK CR
* Directors must give genuine consideration for an issue
* Directors’ uninformed decision would suffice. Mindless execution wouldn’t
* **Directors made decisions themselves**

Result: WOOD is successful

***LAERSTATE*** there is scale/ continuum for CMC of directors

Facts: (BV) has interest in UK CR. (BV) has (i) director resident in NETH and (ii) resident in UK

All director meetings in NETH. But, all key decisions made in UK without board meetings/ NETH director

**Central management in NETH.** NETH director has no info, acted on SH instructions without consideration

UK director represented (BV) as principal in UK negotiations

Nutshell

* There is a **scale/ continuum of directorial actions**

Mindless execution of docs without knowing what they are

Execution without absolute min info with no consideration of axn appropriateness

Decisions made with min info, ill-informed

Decisions with **sufficient knowledge**

* In first two cases, board makes no decisions – board power usurped

Result

* Decisions made in UK when UK director physically resident in UK
* NETH director simply signed docs without reading. Director lost

## PIERCING THE CORPORATE VEIL

### PCV [**§15(1) *CBCA*, *SALOMON*,** app in ***PIONEEER LAUNDRY***]. ***ARMY & NAVY*** [CR not agent of SH].

* CR is brand new legal person with rights obligations akin to human being
* CR has legal identity separate from its SH (***SALOMON***) Applied in *PIONEER LAUNDRY*

**PCV**

***§15(1) CBCA***

***PIONEER LAUNDRY*** App of *SALOMON!*

Facts: (P Ltd) owned assets + claimed max CCA.

(P Ltd) transferred assets to (H Ltd) which transferred assets to (P1 Ltd)

SH of (P Ltd) + (P1 Ltd) are SAME

(P1 Ltd) claimed CCA on the assets (CCA was at the discretion of the Minister)

Minister did not want to allow any depreciation for (P1 Ltd). Wanted to PCV!

Issue: Can Minister disregard corporate form + look to ultimate common ownership of assets?

Nutshell

* PCV is not allowed. Strict interpretation of *Salomon*!

Result

* Minister not allowed to PCV. Why? *Salomon*!
* Decision benefitted the TP in opposition to *CANADIAN IMPORT*

***ARMY & NAVY***  CR is not agent/ trustee of SH

Issue: Are 3 CRs ‘related’? If so, are they denied lower rate of tax (similar to small business deduction)?

SH of (CR A) held shares in (CR B). Did SH indirectly own shares of (CR B)?

Nutshell

* If SH of (CR A) has no ownership in property of (CR A) + SH holds shares in (CR B), SH does not indirectly own shares of (CR B). The CRs are not related
* Corollary is that **CR is not considered the agent/ trustee of SH**. CR is the principal with respect to its property
* CR can act as agent/trustee but express/ implied legal relationship is ~needed

Result

* SH of (CR A) had no ownership in property of (CR A)
* Therefore SH cannot indirectly own shares in (CR B)!

## AGENCY

### AGENCY[CR disregarded if merely agent of another in transaction]. ***SPENCER REALTIES*** [agent has duty to person acting for].

* CR can be disregarded if it is merely agent of another person in respect of a transaction

**AGENCY**

***SPENCER REALTIES*** Agency

Facts: (S) was indebted to (SR Ltd). (S) transferred property to (SR Ltd) with value > debt owed. Great value

The basis was that sale PD in excess of debt would be repaid to (S)

Issue: Whose was the gain?

Nutshell

* (SR Ltd) was a creditor + agent of (S), only interested in repaying the debt + paying (S) the surplus as agent
* An agent acting for another person has duty to person

Result

* (SR Ltd) had right to PD up to debt but not property itself/ surplus
* Whether title passed was irrelevant. Beneficial ownership is critical for tax purposes

## MANAGEMENT OR SERVICE COMPANIES

### MANAGEMENT/SERVICE CR [CR est to do activities previously of ind]. ***KINDREE*** [Only ind, not CR, can practice medicine]. ***SAZIO*** [anyone can incorporate CR].

* CRs est to carry on activities previously carried on by an ind
* The issue is: can CR be disregarded + ind taxed directly?
* If not, can CR achieve a deferral of tax and greater deductibility of expenses
* May be attacked as an agency relationship

**MANAGEMENT/**

**SERVICE**

**COMPANIES**

***KINDREE*** Medicine is ind

Facts: (Doctor) incorporated CR. (Doctor) transferred assets of his practice to CR. ENT into employment agreement

CR purported to carry on the practice of medicine. CR billed patients in its name

(Doctor) recognized only the salary + bonus paid by CR. (Doctor) had tax mitigation scheme

Nutshell

* Medicine can only be practised by individual. Income earned by individual + assigned to CR
* However, now provinces generally permit CR to offer professional services

Result

* (Doctor) lost and had to pay full taxes

***SAZIO*** Anyone can incorporate CR

Facts: (S) is coach of Hamilton Tiger Cats. (S) incorporated (Sazio Ltd), resigns as couch

(S) becomes employee of (Sazio Ltd) + ENT into coaching contract

Minister argues *KINDREE*; alternatively, that CR is agent/ nominee/ trustee for (S)

Nutshell

* There is no prohibition on CR rendering such services
* Contracts are *bona fide* commercial transactions
* Any person can incorporate a CR to render services, provided there is no prohibition
* One can only disregard CR is arrangement is a ‘sham or a cloak’

Result

* (S) wins and is allowed to incorporate (Sazio Ltd). CR is not a sham
* The statutory response by govt was s.125 ‘personal services business’ rules which are PCV provisions

## SHAM

### SHAM **[**only successful in ***FARAGGI***]. Every other case N/A.

* Acts/docs of parties which intend to give appearance of creating legal rights/obligations different from actual legal rights/obligations parties intended to create (*SNOOK*)

**SHAM**

# **CLASSIFICATIONS**

## CONTROL

### CONTROL, *DE JURE* CONTROL [SCC embraces], *DE FACTO* CONTROL, ASSOCIATED CR, AFFILIATED PERSONS. ***BUCKERFIELDS*** [*de jure* control rests with SH]. ***VINELAND*** [control is direct/indirect; court looks to SH with voting control]. ***DONALD*** [must consider corporate Constitution]. COMMON SHARES, PREFERRED SHARES. ***DUHA*** [Embraces *de jure* control. SH agreement, voting trust not rel for *de jure* control].

* Control is (1) *de jure* or (2) *de facto*; central to classification of CRs
* Control important for det ‘related’ status in ‘AL’ and ‘related persons’ discussions
* **Different from CMC** for residency purpose

**CONTROL**

*Not CMC*

* Control flowing through **LEGAL RIGHTS** of particular persons
* i.e. right may be ownership of sufficient shares to elect majority of directors
* uses term **‘controlled’**

***DE JURE***

**CONTROL**

*SCC embraces*

* control IN FACT; requires looking at other factors
* uses term ‘controlled directly or indirectly in any manner whatever’ (§256(5.1))

*DE FACTO*

CONTROL

*SCC rejects*

* CRs associated if they are controlled by SAME person or group
* CRs may be associated because same group of persons control CRs, but members of group don’t act together and have no other connection to each other
* Prevents artificial multiplication of access to **SBD**
* Doesn’t allow group to artificially divide single income stream btw two+ CRs

**ASSOCIATED**

**CR**

* i.e. you and your spouse; you and CR controlled by you/ spouse
* i.e. partnership and majority interest partner of partnership
* i.e. a trust and its majority interest beneficiary (enjoys majority of trust income)
* Control prevents artificial access to tax losses for affiliated persons
* Control is key to det ‘affiliated’ status

**AFFILIATED**

**PERSONS**

***BUCKERFIELDS***  SH ultimate control

Facts: (BCo) and (GCo) each owned 50% of Pioneer and Federal

Would be associated if controlled by same person/ group of persons

Nutshell:

* **Directors have formal legal power to manage but ultimate control rests with SH**
* CMC looks to where CR ‘keeps house and does business’ – cannot be SH
* **Control looks to ultimate power.** Possible for no person to control
* Person with <50% of shares can still control through a USA (*CBCA* s.146)

Held:

* ***De jure* control rests in SH**
* Pioneer and Federal found to be a group – CR are associated

***VINELAND*** Direct or indirect control

Facts: SCo and TCo each hold 50% in Verben. SCo holds 50% directly; T holds 100% of BCo which holds 50% of Vineland

T holds 50% of SCo and TCo directly; SCo holds 100% of MCo which holds 50% of SCo and TCo directly

SCo and TCo are a group; are Verben, Vineland, and SCo&TCo controlled by same person or group?

Nutshell: Control can be direct or indirect. Court looks **through corporate SHs** to person who **exercises voting control**

* Control doesn’t req having any legal/ equitable interest in property of intermediate CR/ agency relationship
* S.256(6.1) provides for ‘simultaneous control’ so that both A and BCo control C Co
* **Person who controls CR also controls all CRs controlled by that CR**

Held: A controls BCo and BCo controls CCo. A will control CCo

***DONALD APPLICATORS*** Constitution

Facts: Each of 10 CRs had 500 issued shares – **498 Class B** (held by SCO) and 2 Class A

Class A shares entitled to vote on any matter; **Class B** shares on any matter other than election of directors

Class A SHs elect themselves directors; SCo makes most management decisions

Does SCo control the CR (which would then be associated?)

Nutshell: Must consider the **CR constitution** as well as share registers

Held: YES

* SCo, a holder of Class B shares, had power to amend corporate constitution (includes changing share terms, transfer decision-making powers to SH and remove directors). SCo therefore had right to control CR ‘in the long run’

|  |  |
| --- | --- |
| COMMON SHARES | PREFERRED SHARES |
| * Give voting rights to SH * Last in line when it comes to CR assets * Paid out after creditors and preferred SHs | * Gives no voting rights to SH * Paid before common SHs on winding up |

### ***DUHA\**** [SCC embraces *de jure* control. SH agreement, voting trust not rel for *de jure* control].

***DUHA*** *de jure* control

Facts: D family holds 100% of **DCo** (has income)

M family holds 100% of MCo which holds 100% of OCo (no capital losses)

DCo wants to acquire Oco for its losses – but this means acquisition of control of **OCo** which results in loss streaming

Transaction structure as follows:

* DCo issues 2000 p.s. to MCo giving MCo 55% of votes

This is acquisition of control of DCo without adverse consequences

* **DCo acquires shares of OCo**

No acquisition of control because vendor and purchaser now ‘related’ (s.251(2)(c)(i)

* **Losses accessed**; Class C p.s. redeemed
* DCo SHs agreement provides directors will be 3 – Mr. D, Mrs. D, Mr. M and Q
* Restricts ability of directors to issue new shares

CRA ARG: this is a sham – no business purpose. MCo never controlled DCo because of SH agreement

Held:

* There is no sham because no deceit; absence of business purpose irrelevant
* **Legal rather than mere contractual rules are the legal basis for control**
* **SH agreement, voting trust, or other contractual agreement is NOT relevant for *de jure* control**

Held: No sham – too bad, so sad

### GROUP CONTROL [need COMMON CONNECTION, see ***VINA RUG***]. Two persons are GROUP for associated CR (§256(1.2)(a)). RIGHTS IN RESPECT OF SHARES (§251(5)(b)). CONSTATING DOCS.

* Control can be by single person or group of persons (related and associated CRs)
* For >1 person to be part of group need **COMMON CONNECTION**
* i.e. agreement to vote together, voting trust, ‘community of interest,’ acting in concert (*VINA-RUG*)
* two+ persons **are a group** for associated CRs (§256(1.2)(a))
* can have overlapping control groups
* i.e. one control group doesn’t harm existence of larger control group encompassing first (§251(5)(a))
* If **ONE PERSON** control, he precludes control by a group (*SOUTHSIDE CAR*)

**GROUP**

**CONTROL**

* To det ‘related persons’ and CCPC status, assess ind rights:
* Acquire shares
* Cause redemption of shares
* Voting rights
* Reduction of voting rights
* i.e. option to acquire shares. Ind deemed to have SAME position as if owned shares

RIGHTS IN

RESPECT

OF SHARES

***§251(5)(b)***

Example:

MCo has 80 shares outstanding. A has complete control. X has option to account for 50 shares. If X gets 50 shares, A gets 30 shares. §251(5)(b) deems X to have control. Result is you have **two controlling SH:** A (exercises control) and X (has option to exercise control)

* Docs that must be filed with gov’t to bring CR into existence and define its characteristics
* Under *CBCA*, they consist of articles and bylaws
* SCC described USA as comparable to constating document in *DUHA*

CONSTATION

DOCS

### ***LUSITA*** [§251(5)(b) extends to all rights, including under trust]. ***HUDSON’S INVESTMENT*** [§251(5)(b) applies to voting rights].

***LUSITA*** Exception for Trust

Facts: LCo held 100% by trust of which G and X are trustees

Under trust, G can remove X but can never act as sole trustee

LCo, G and A each hold 1/3 of AGCo

Are LCo and AGCo related?

Held:

* **§251(5)(b) extends to all rights, not just under contract, including G’s rights under the trust**
* G does not have *de jure* control because can never act alone
* Is this result inconsistent with *DUHA* because trust deed is not constating document?

Reconcile on Trusts:

* *DUHA* considers *LUSITA*, but makes exception for trusts
* *Why?* Limitations on action in SH agreement are entered into by **SHs as free agents**, but terms of trust deed operate as limitation on trustees’ ability to act as free agents
* SH agreements only limit SH freedom to extent that SHs choose
* Terms of trust impose limits on powers of trustee; courts look at trust instruments to det *de jure* control

***HUDSON’S INVESTMENT*** §251(5)(b) voting rights

Facts:

* S holds 100% of SCo and 50% of HCo
* S’s nieces/ nephews hold 50% of HCo
* Shares of HCo in a voting trust; S has power to direct trustee

Held:

* S controls HCo. **§251(5)(b) applies to deem S to be able to exercise voting rights**
* Two CRs are associated; S loses and must pay tax on both

### *DE FACTO* ONTROL [SCC rejected ***DUHA***]. CANADIAN CR [incorporated/resident in CAN since 1971 §89(1)]. TAXABLE CANADIAN CR [only taxable CAN CR can have §85 election, §89(1)]. PUBLIC CR [3 req]. PRIVATE CR [§89(1)]. CCPC [§125(7)]. 50/50 foreign controlled CR is CCPC.

* Direct or indirect influence that, if exercised, would result in control in fact of CR (§256(5.1))
* **SCC has rejected *de facto* control** as a general test, as leads to ‘myriad of indicators’ apart from legal (*DUHA*)
* **SCC has embraced *de jure* control** because it is **relevant, certain, predictable** (*DUHA*)

**DE FACTO**

**CONTROL**

* CR resident in Canada; incorporated or resident in Canada continuously since 1971 (§89(1))
* CR continued ***into*** Canada is deemed to be incorporated in Canada (§250(5.1))
* CR resulting from M/A is Canadian CR only if each amalgamating CR was Canadian CR and merger took place under Canadian law
* **Only a Canadian CR can be a CCPC** or mutual fund CR

**CANADIAN**

**CR**

* Canadian CR not exempt from tax under *ITA* (§89(1))
* **Only taxable Canadian CR can access §85 election**

**TAXABLE**

**CANADIAN**

**CR**

* CR resident in Canada which satisfies one of three conditions:

1. Class of its shares is listed on ‘designated stock exchange’ in Canada
2. It has elected to be a public CR + has complied with prescribed conditions\* (many)
3. CR satisfies (2) and Minister designates it as public CR

* i.e. RBC, TD Bank, Thomson Reuters, Imperial Oil, Suncor, Rogers, Telus, Enbridge

**PUBLIC**

**CR**

* CR is resident in Canada
* Not a public CR
* Not controlled by one+ public CRs, prescribed federal Crown CRs, or combination
* i.e. Facebook, IKEA, Cargill, Mars, Coca Cola, Mandarin Restaurants

**PRIVATE**

**CR**

***§89(1)***

* Some CRs are neither public nor private
* i.e. subsidiary of public CR; subsidiary of prescribed (Reg 7100) Crown CR (deemed not pvt)
* These CRs are taxed as public CRs
* On amalgamation, if one+ predecessors is public, amalgamated CR deemed public (§87(2)(ii))

NEITHER

PUBLIC

NOR

PRIVATE

* Canadian-controlled private CR (CCPC)
* **private CR that is a Canadian CR**, other than: (defined in §125(7)):

1. CR controlled *de jure* or *de facto* by one+ non-residents, public CRs, or combinations
2. CR with shares listed on designated stock exchange (§248(1), 262(1))
3. CR making §89(11) election (relates to integration system)

* CCPC qualifies for: SBD (§125), refundable ITC (§127.1)
* Doesn’t mean Canadian-controlled so much as not foreign-controlled

(**50/50 is CCPC** absent *de facto* control)

* Limited by the ‘**hypothetical person rule’** in para (b) (**reverses** *SILICON GRAPHICS*)
* *SILICON GRAPHICS*: majority of SH are non-resident or public but not a group so no control. Still CCPC

**CCPC**

### HYPOTHETICAL PERSON RULE [ask: what would person *de jure* control?] USA. SIMULTANEOUS CONTROL [***PARTHENON*, *PERFECT FRY***].

1. Take all shares owned (or deemed) by disqualified persons and ascribe them to hypothetical person
2. **Ask: would that person control?** [Neyers and RP]

* Use only *de jure*, not *de facto* control

Example: Effect of USA on Hypothetical Person *PwC INC* –

Hypothetical person is a person

Private CR has **>60%** common shares held by non-residents. Under USA, have 7 directors: 4 named by Canadian residents. Crown ARG: hypothetical person is not bound by USA. Court: he is bound by USA.

**HYPOTHETICAL**

**PERSON RULE**

* Specific type of SH agreement that is:

1. Signed by all SH at time it is first signed
2. Binds future SH whether or not they sign
3. Removes, in whole or part, the duties/ powers from directors of CR to extent SH assume them

**UNAMINOUS**

**SH AGREEMENT**

**(USA)**

*PARTHENON*

* 2 CCPCs control USCo which control Parthenon
* Held: Parthenon is CCPC. It is ultimately controlled by CCPCs. Can only have one controller

*PERFECT FRY*

* Canadian resident individuals control >50% of Pubco. Pubco controls Perfect Fry
* Held: Perfect Fry is CCPC. Same result as *PARTHENON*

Gov’t Action

* §256(6.1) reverses this. **Deems CR to be controlled by both immediate and ultimate controllers**
* §256(6.1)(a) applies where CR (subsidiary) would be controlled by another CR (parent) if parent were not controlled by another person/ group of persons
* In that case, subsidiary is controlled both by parent **AND** person/ group that controls the parent

**SIMULTANEOUS**

**CONTROL**

# **§85 ROLLOVERS**

* TCC is taxable Canadian CR

## NATURE

### §85 ROLLOVER [transfer to TTC tax deferred. For AL/ non-AL. Elective. Aim is tax neutrality].

* Permits to transfer assets to TCC on **tax-deferred (ROLLOVER)** basis
* i.e. without gain recognition or cost step-up as result of transfer; without immediate tax
* flexible: elective, allows full/ partial tax deferral, asset by asset basis;
* **for AL and non-AL transactions**

**§85**

**ROLLOVER**

* one has a choice to get a §85 rollover or not

**ELECTIVE**

* tax system doesn’t discourage desirable transactions and forms of business organizations
* transferor continues to have indirect interest in transferred asset
* i.e. tax system doesn’t make business invest less, work less, locate in Yukon, employ less

**TAX**

**NEUTRALITY**

## ARM’S LENGTH

### §69(1) GENERAL RULE [TP acquires/ disposes property to **non-AL** person, acquires/ gets PD = FMV]. **§85 is EXCEPTION to §69(1).** §85 allows for rollover in non-AL transactions. RELATED PERSONS, ind, deemed not to act at AL (§251(1)(a)). RELATED PERSONS, CRs, relate CR’s [§251(2)(b)(c)]. ***SWISS BANK*** [investors are ‘collective directive mind’ not at AL].

* If TP acquires property from non-AL person in excess of FMV, deemed to acquire at FMV
* If TP disposes property to non-AL person for no PD/ PD less FMV, TP gets PD = FMV
* If TP acquires property via gift, deemed to acquire at FMV

§69(1) Inadequate Consideration

69(1) Except as \* otherwise provided

1. Where TP has acquired anything from person with whom TP was not dealing at AL at amount in excess of FMV \* TP shall be deemed to have acquired it at FMV;
2. Where TP has disposed of anything
3. To person with whom TP was not dealing at AL for no PD or PD less FMV
4. To any person by way of gift, or
5. To trust \*

TP shall be deemed to have received PD = FMV; and

1. Where TP acquired property by way of gift, bequest or inheritance \* TP is deemed to acquire property at FMV

* At FMV, value of price btw non-AL parties acting independently with knowledge of market
* At FMV, non-AL transactions deemed to take place on full realization basis

**§69(1)**

**GENERAL RULE**

* ‘Related’ persons are deemed not to act at AL (§251(1)(a)).
* In any other case is a question of fact (§251(1)(c)

*Who are related persons?*

* §251(2)(a) – ind related by blood relationship, marriage or CL partnership or adoption
* §251(6)(a) – blood relationship – parent, child, other ancestors or descendants, siblings
* §251(6)(b) – marriage – married to other person or to person connected by blood relationship, i.e. sister-in-law
* §251(6)(b.1) – same for CL partnership
* §251(6)(c) – adoption as child of other or of person connected by blood relationship (other than sibling)

**‘RELATED’**

**PERSONS:**

**IND’s**

**§251(1)(a)**

* §251(2)(b) – rules for relating CR and person or group of persons
* §251(2)(c) – rules for relating any two CRs
* §251(3) – two CRs related to same CR are deemed to be related
* §251(4) – related group is any group of persons each of which is related to each other

**‘RELATED’**

**PERSONS:**

**CRs**

***§251(2)(b)(c)***

***SWISS BANK*** Investors not acting at AL

Facts: Swiss investors invested in Swiss ‘fund,’ managed by Swissco; owned 80% by SB1 and SB2

Funds advanced deposited in SB1 and SB 2 (unrelated) and advanced by SB1 and SB2 to Canco

Canco is beneficially owned by investors; Canco invested in Canadian real estate

Canco paid interest to SB1 and SB2 – was it at AL?

SCC Held: NO

* Investors acting through professional managers and fiduciaries
* Interest is received by investors
* **Investors are ‘collective directing mind’** acting in concert in receiving interest and in directing Canco
* Therefore, NOT acting at AL

## 5 CONDITIONS FOR APPLICATIONS

### (1) TRANSFEROR; (2) TRANSFEREE; (3) ELIGIBLE PROPERTY TRANSFERRED [capital property and inventory]; (4) TREASURY SHARES; (5) JOINT ELECTION

|  |  |
| --- | --- |
| Req | Description |
| 1. TRANSFEROR | Must be TP |
| 1. TRANSFEREE | Must be taxable CAN CR (TCC) |
| 1. ELIGIBLE PROPERTY TRANSFERRED | Must be eligible property |
| 1. TREASURY SHARES | Consideration must include treasury shares |
| 1. JOINT ELECTION | Transferor and transferee must jointly elect for §85  Elected amount is PD (tr’or) and cost (tr’ee) |

* Transferor must be TP. Includes any person liable/ not to pay tax (§248(1))
* Individual (including a trust)
* CR (private or public)
* Partnership (s.85(2) each partner must be party to election)
* Resident or non-resident (no restriction)
* Election can be made in AL and non-AL circumstances

**1. TRANSFEROR**

* Transferee must be a TCC: a Canadian CR not exempt from tax under Part I
* **Canadian CR** is: (i) resident in CAN; (ii) incorporated/ resident in CAN since 1971

**2. TRANSFEREE**

* Only eligible property may be transferred under §85 (defined in §85(1.1))

**CAPITAL PROPERTY**

* Other than real property (or interest) owned by non-resident (§85(1.1(a))
* Includes depreciable property (§54(a))
* Includes other property gain/loss from disposition; CG/CL (§54(b))
* i.e. shares, partnership interests, land
* Capital property is **not inventory**
* **Shares are deemed to be capital property** (§54.2) [***ATLANTIC***]
* Disposition of all or most assets of active business to CR for shares
* Intended to address short hold period and eligible for LCGE (Lifetime CG Exemption)

**3. PROPERTY**

**TRANSFERRED –**

**ELEGIBLE**

**PROPERTY**

**INVENTORY**

* Other than real property (or interest in) real property (§85(1.1)(f))
* Election under §85 often made for inventory
* i.e. goods available for sale and raw materials used to produce goods
* i.e. raw materials, work-in-progress, and finished goods
* **Property that isn’t eligible:**
* Real property of non-resident
* Real property inventory
* Employee stock options (not capital property because any gain isn’t CG)
* Income interest in a trust
* Prepaid expenses
* Receivables of cash basis TP (don’t appreciate in value)
* portion of shares that CR keeps in treasury
* Shares bought back by issuing CR, reducing the number of shares outstanding on open market. Don’t pay any dividends and they don’t have any voting rights
* Consideration must include **TREASURY SHARES** of transferee CR

‘share consideration’

* Property subject to election must include shares on transfer
* Shares need not be the only consideration but must have shares
* Shares may be (i) **PREFERRED** or (ii) **COMMON**
* Share includes fractional share (§248(1)) – can be partial consideration
* Consideration for *each property* that is subject to election must include one+ shares; a fraction of a share satisfies the req
* Consideration includes ‘non-share consideration’ or **BOOT**

**BOOT:** anything other than treasury shares; cash, debt, assumption of

liabilities of transferor, property

* To max tax-deferral, boot can’t exceed ACB of property transferred
* If it does, gain/ income is realized

**4. TREASURY**

**SHARES –**

**CONSIDERATION**

*Don’t pay dividends*

*Shade consideration*

*Boot*

* Election must be jointly signed by transferor + transferee
* Must be filed on/ before earlier of tax return filing deadline (§85(6))
* May be filed late within 3 years of due date on payment of penalty (§85(8))
* May be filed after 3 years with permission of Minister (§85(7.1))

**5. JOINT**

**ELECTION**

## ELECTED AMOUNT

### Becomes transferor’s PD and transferee’s ACB. Not purchase price (FMV). Limit: can’t be nil. **FRAMEWORK**: (§85(1)(b) [not lower than boot]; §85(1)(c) [not higher than FMV]; §85(1)(c.1) [not less than lesser of (i) FMV or (ii) cost amount].

* Amount agreed upon by parties for transfer
* Becomes transferor’s PD and transferee’s ACB (cost of acquisition)
* **Consideration total value (boot + shares) = property value transferred to CR**
* NOT purchase price; purchase price is = to FMV of property transferred
* Specified in joint election. Have separate elected amount for each property

**FRAMEWORK:**

§85(1)(b) –not lower than boot FMV

§85(1)(c) – not higher than FMV of transferred property [**always overrides (b)]**

§85(1)(c.1) – not less than lesser of (i) FMV or (ii) cost amount

NOTES:

* **Can’t be nil; must elect at least $1**

**ELECTED**

**AMOUNT**

§85(1)(c.1) – INVENTORY & NON-DEPRECIABLE CAPITAL PROPERTY

* Elected amount can’t be less than lesser of (i) FMV and

(ii) cost amount of property

* prevents creation of artificial CL/ loss

**COST AMOUNT:** value for computing income for inventory + ACB for non-depreciable

capital

**§85(1)(c.1)**

DEPRECIABLE PROPERTY

### §85(1)(e) [elected amount can’t be less than least of: UCC, cost, FMV].

* Elected amount can’t be less than least of:
* **UCC of all property of class before disposition**
* **COST of property**
* **FMV of property**
* Prevents creation of artificial terminal loss
* TP can realize actual loss subject to stop-loss rules

**DEPRECIABLE**

**PROPERTY**

***§85(1)(e)***

ELECTED AMOUNT TIPS

* Limit boot to ACB/ cost amount of transferred property
* Tax attributes available after transfer should be limited to elected amount

MAX TAX

DEFERRAL

* §85(1)(e.3) – applies when elected amount under (c.1) or (e) different from that under (b) as modified by (c ) [not less than FMV boot but never more than FMV property]
* (c.1) or (e) amount is deemed to be greater of that amount and (b) amount [FMV of boot] as modified by (c))

RULES

CONFLICTS

## CCA ISSUES

### CCA, UCC, RECAPTURE, TERMINAL LOSS. §85(5) [If transferors cost > PD, transferee inherits (i) capital cost, (ii) dif deemed to be claimed as CCA. Amount RECAPTURED on next sale]. §13(7)(e)(i)

* Capital cost allowance – deduction reflecting asset’s depreciation/ deterioration in year
* Deduction for depreciation

**CCA**

* Undepreciated capital cost

Amount of asset’s cost – total amount that ind previously deducted for depreciation (CCA)

* Capital cost balance left for further depreciation
* Amount of CCA TP claims each year lowers his UCC of asset

**UCC**

* When depreciable asset is sold and sale price is greater than asset’s UCC, deductions have been taken at rate which exceeded the asset’s true decrease in value
* Excess deductions will be RECAPTURED
* Deductions that overstated the depreciation of asset will be included in TP’s income in year of disposition of asset

**RECAPTURE**

**§13**

* When sale price is less than UCC, an insufficient amount of depreciation has been claimed
* The difference, called a ‘terminal loss,’ may be deducted from income in year of disposition of asset

**TERMINAL**

**LOSS §20(16)**

* Where, on s.85 election: transferor’s cost amount > transferor’s PD

[because CCA has been claimed]

* Transferee inherits:
* capital cost of transferor
* difference deemed to have been claimed as CCA by transferee

on subsequent sale at > elected amount, will be **RECAPTURE** up to original cost

* prevents conversion of income to CG §13(7)(e)

§85(5)

CCA ISSUE

* §13(7)(e)(i) [individual] and (ii)[corporation] – applies where transfer of depreciable property **not AL** and capital cost to transferee > capital cost to transferor

capital cost to transferee = cost to transferor + ½ of difference

* prevents conversion of income to CG

§13(7)(e)(i)

CCA ISSUE

* If >1 depreciable properties disposed of at same time, TP (or Minister) must designate order of disposition (to avoid inappropriate recapture)

§85(1)(e.1)

ISSUE

## COST OF CONSIDERATION

### If elected amount = FMV boot, cost shares is nil. If elected amount > FMV boot, excess is cost of shares. If 1+ class of shares, (i) excess to *p shares*, (ii) balance to *c shares*.

* Elected amount can’t be less than FMV of boot (§85(1)(c), (e.3)
* Cost of boot to transferor is lesser of FMV of boot at time of transfer and FMV of property disposed of
* If elected amount = FMV of boot, cost of shares to transferor is nil
* If elected amount > FMV of boot, excess becomes cost of shares to transferor
* If transferor receives **more than one class of shares** (i.e. *preferred* and *common*):
* Allocate excess to *preferred* shares up to FMV of *preferred* shares (§85(1)(g))
* Allocate balance, if any, to *common* shares (§85(1)(h))
* If multiple classes, excess allocated based on relative FMV first to preferred shares up to FMV and balance, if any, to common shares

**COST OF**

**CONSIDERATION**

**MULTIPLE**

**CLASSES**

## PAID-UP CAPITAL (PUC)

### Amount of money CR gets from SH in exchange for shares of stock. LEGAL STATED CAPITAL [start at]. §85(2.1) is PUC GRIND [(A – B) x C/A]. PUC ADD BACK [§85(2.1)(b)].

* **Amount of money CR gets from SH in exchange for shares of stock**
* Therefore: (i) SH gives PUC to CR; (ii) CR gives shares of stock to SH
* Good to have because SH can take back capital with no immediate tax
* Therefore: SH gets a reduction in ACB of share (§53(2)(a)(ii))
* Tax attributes should reflect only elected amount – PUC is a tax attribute
* §85(2.1) limits addition to PUC if §85 applies and §84.1 not applicable

**PAID UP**

**CAPITAL**

**(PUC)**

* Starting point for calculating PUC. Look to the minute books
* Full amount of consideration that CR adds to stated capital accounts **upon issuing shares**
* Separate account for each class of shares. CR subtracts any amounts that are returned to SH
* PUC can never be greater than stated capital (can be less)

‘A CR shall add to the appropriate stated capital account the full amount of any consideration it receives for any shares it issues’ (CBCA, s26(2); OBCA s24(2))

* If full amount added to CR stated capital, **§85(2.1) applies to reduce PUC**
* Various provisions in ACT prevent inappropriate increase in PUC
* **Total PUC add can’t exceed amount by which elected amount exceeds FMV of boot**
* Thus, PUC reduced if total addition to stated capital exceeds permitted addition
* **Reduction is pro-rated over relevant classes** based on relative PUC increase to each class

If amount added to stated capital of shares issued > (amount by which elected amount > FMV of boot), the excess is deducted for purposes of computing PUC. The total tax attribute shouldn’t exceed elected amount.

On CR’s balance sheet, the cost of asset is the elected amount. On RS of balance sheet, that cost is reflected by FMV of boot (i.e. not or increase in liabilities) and PUC. The sum of PUC and FMV of boot must = tax cost of asset so tax balance sheet balances.

**LEGAL**

**STATED**

**CAPITAL**

***§85(2.1)***

**PUC GRIND**

* Provision that reduces or ‘grinds’ the amount of PUC
* Tax law reduces PUC depending on how much deferral there is in §85 election

**GRIND FORMULA: (A – B) x C/A**

* Det the grind, not PUC. The C/A part is only relevant when have multiple classes of shares

**A** – the amount that is added to stated capital account for corporate law purposes

**B** – difference btw elected amount and FMV of boot

**C** – amount that is added to stated capital account for corporate law purpose with respect to

particular class of shares

**GRIND**

**FORMULA**

**§85(2.1)**

* If PUC grind §85(2.1), have compensatory increase at each time afterwards under §85(2.1(b)) to avoid double tax
* Add-back is the lesser of (i) the amount by which a subsequent deemed dividend under ss.84(3), (4) or

(4.1) has been increased because of the prior grind, and

(ii) the prior PUC grind

* PUC grind applies at the time of the transaction giving rise to grind at any time after

**PUC**

**ADD**

**BACK**

## OTHER ISSUES – VALUE OF CONSIDERATION

* FMV of consideration received by transferor should = FMV of property transferred
* If FMV consideration > FMV property transferred**, §15(1)** may apply to deem transferor to get **SH BENEFIT**
* **If FMV property transferred > FMV consideration, then §85(1)(e.2) may apply**

## STOP LOSS RULES

### Prevent artificial loss. SUPERFICIAL LOSS. AFFILIATED PERSON (§251.1). §251(c) AFFILIATED RULE.

* §85 rules prevent realization of **artificial losses** (no elected amount less than lesser of FMV and cost of property) but not realization of actual losses
* Rules prevent loss realization in transactions btw closely-related persons – ‘superficial loss’

**STOP**

**LOSS RULES**

*No artificial*

*losses*

* arises where, during period 30 days before to 30 days after disposition, TP or ‘affiliated’ person acquires property or identical property (‘substituted property’) and holds it or has right to acquire it at end of period

**SUPERFICIAL**

**LOSS**

1. Individual and spouse (but not children)
2. CR and

* Person whom it is controlled (i)
* Each member of affiliated group by which it is controlled (ii)

[affiliated group – each member affiliated with each other member]

* Spouse of CL partner of (i) or (ii)

**AFFILIATED**

**PERSON**

***§251.1***

Example

F and M are spouses; G is their child

F holds 100% of FCo; F and G each hold 50% of GCo

F and M each hold 50% of FMCo

F and M are affiliated (a)

F and FCo are affiliated (b)(i)

F and M are each affiliated with FMCo (b) (ii)

M and FCo are affiliated (b)(iii)

F and GCo are not affiliated because G not a spouse

* (c) Two CR are affiliated if:
* Each is controlled by a person and controllers are affiliated (c)(i)
* One CR is controlled by person and other by a group and each member is affiliated with controller (c)(ii)
* Each CR is controlled by group and each member of each group is affiliated with at least one member of other group (c)(iii)

[ignore (d) to (h)]

**§251.1(c)**

**AFFILIATED**

**RULE**

Example (c)

K and Q are spouses

K holds 100% of KCo; Q holds 100% of QCo

K and Q each hold 50% of KQCo

QCo and KQCo each hold 50% of XCo

Result:

KCo and QCo affiliated because controllers affiliated – (c)(i)

KCo and QCo are each affiliated with KQCo – (c)(ii) [each

one is controlled by one person who is affiliated with each

member of a group that controls the other]

QCo and KQCo are affiliated – (c)(ii)

Result

XCo is affiliated with QCo and KQCo, which are an affiliated group which controls XCo – (c)(ii)

Under (c)(ii), KCo and XCo are affiliated because XCo is controlled by QCo and KQCo; KCo is controlled by K; and K and each of QCo and KQCo is affiliated

### Notes for non-depreciable capital property, depreciable property, property transfer by partnership to CR.

* § 40(2)(g) – superficial loss of an individual from disposition of a non-depreciable capital property is nil
* Loss added to cost of substituted property under s§53(1)(f) – allows unrealized losses to be transferred between affiliated persons
* §40(3.3) - where corporation, trust or partnership realizes loss effectively equivalent to superficial loss. S. 40(3.4) applies
* §40 (3.4) – loss is suspended – deemed to be nil and to be realized by the tr’or at the first time a 30 day period begins where neither the tr’or nor an affiliated person owns the property or an identical property
* §40(3.5) – identical property includes shares received on rollover
* §40(3.6) – applies where a taxpayer disposes of a share of an affiliated corporation to the corporation (e.g redemption), loss deemed to be nil and added to ACB of other shares, if any

NON-DEPRECIABLE

CAPITAL PROPERTY

* Special rules for depreciable property (§13(21.2)) delay recognition of loss until the end of a 30 day period during which neither the tr’or nor an affiliated person owns or has a right to the property

DEPRECIABLE

PROPERTY

* §85(2) allows for rollover of property by a partnership to a taxable Canadian corporation in virtually identical manner
* Main difference – partnership which is not a “Canadian partnership” (§ 102(1) – all partners must be resident in Canada) cannot transfer real property that is capital property
* §85(3) – allows for “incorporation” of a partnership
* Applies where partnership transfers property to a corporation under § 85(2), partnership is wound up within 60 days and at winding up has only money or consideration from corporation (which would include shares)
* Cost of boot to partnership is FMV
* Cost of shares rec’d by partner is ACB of partnership interest less FMV of boot, allocated first to p.s. Up to their FMV and then to c.s.
* Partner deemed to dispose of partnership interest for P.D. = cost of all property rec’d + money
* Partnership deemed to have disposed of property distributed (i.e. shares) for P.D. = cost amount

TRANSFER OF

PROPERTY BY

PARTNERSHIP TO

CR

# **CORPORATE INCOME**

### 38% GENERAL RATE (§123(1)(a)). 10% PROVINCIAL ABATEMENT (§124(1)). GENERAL RATE DEDUCTION (§123.4).

* CR computes taxable income under Div B & C (Part I) or Div D non-resident, carrying on business in Canada

To compute tax payable;

1. **Apply general rate of tax – 38% (§123(1)(a))**
2. Deduct one+ abatements or credits

**GENERAL**

**RATE**

***§123(1)(a)***

* **Federal tax rate reduced by 10%–make room for prov tax**
* Deduction is 10% of ‘taxable income earned in province’
* Many subsidiary rules

🡪 **38% - 10% = 28%**

Reg 400–413 det deduction

* **PERMANENT ESTABLISHMENT** –fixed place of business; principally carried on
* Det if permanent establishment (p/e) in province (Reg 400(2))
* If one p/e, all income earned in province
* If no p/e, no income earned in province
* If multiple p/e, weigh average (50/50) of revenues attributable to each p/e and salaries and wages paid to employees of each p/e
* [allocation formula]

**PROVINCIAL**

**ABATEMENT**

***§124(1)***

*Reg 400-13*

* **Reduces rate on active business income (ABI) from 28% to 15% (§123.4(1))**
* How? Deducts via §123.4(2) ‘full-rate taxable income’

§123.4(1) x ‘general rate reduction % (13%)’

🡪 **38% - 10% = 28%**

**28% - 13% = 15%**

* **Full-rate taxable income for non-CCPC**

Taxable income less income subject to 125.1(1) or (2) deductions – (a)(i) and (ii)

[redundant]

Gross up §125.1 deduction

M&P income $1mi. §125.1 reduction 13% or $130,000.

Deduction is $1 mi [$130,000 / 0.13]

* **Full-rate taxable income from personal services business** **(PSB) for non-CCPC or CCPC**– a(iii): deduct income from personal services business (§125(7))
* Full-rate taxable income for CCPC – (b):

Taxable income less

* Any amount deductible under (a) of def
* Income eligible for SBD under §125(1)
* ‘aggregate investment income’ under §129(4)

Result: generate rate of 15%; 28% for PSB (denial of general rate reduction)

**GENERAL RATE**

**DEDUCTION**

***§123.4***

*For business income*

*not subject to SBD,*

*deduct further 13%*

*Provides room for*

*provinces to levy*

*own tax on corporate income*

*Ontario tax 11.5%.*

*Combined federal/ Ontario*

*26.5%.*

## SMALL BUSINESS DEDUCTION (SBD)

### ABI [§126(7) net income = TCG – A CL; carried on in CAN; not SIB or PSB].

* Most income earned by CR from business activities

Net income = TCG – A CL

**ACTIVE**

**BUSINESS**

**INCOME**

***§125(7)***

* Applies low rate of tax (9% fed, 3.5% ON) to **up to $500,000** of ABI earned by CCPC; integration system equalizes tax on distribution
* Corrects ‘equity gap;’ externalities (regional dev, job creation), compensates pensions
* Reality: tax expenditure; controversial politically. Many economists hate it

Federal tax credit of CCPC eligible for SBD is reduced to 19%

[38% - 19% federal small business credit §126(1)

Where relevant income earned in province, federal rate reduced to 9%]

**SMALL**

**BUSINESS**

**DEDUCTION**

**(SBD)**

*Actually a*

*CREDIT*

***§125(7)***

* **Income from active business** carried on in Canada:
* **From any business other than a ‘specified investment business’(SIB) or a ‘personal services business’ (PSB);** includes adventure in the nature of trade
* Includes income ‘pertaining to or incident to’ the business [IT-73R6, para 5]

Income must be ‘financial relationship of dependence of some substance’

* Fact driven determination

*ATLAS INDUSTRIES –* surplus finds invested in term deposits (not needed for loan collateral

or capital expenditures) found not to be ABI (active business income).

Court: not enough factual connection

*SUPREME THEATRES –* rental from part of cinema building found to be part of normal

business activity

* ABI doesn’t include income from property source for §129(4) purposes

§129(4) defines such income to exclude income pertaining or incident to AB or income from property held to earn ABI

***ENSITE LIMITED***

Facts: surplus cash from operations used to collateralize loans to finance construction of factory.

Was income investment or business income? TP argues income investment.

Test: were funds employed or risked in business? Would withdrawal of funds have ‘decidedly

destabilizing effect’ on corporate operations?

Held: YES. Income is business income

* **ABI – business must be carried on in Canada**
* Factual Test: CRA position is that if any part of activity carried on in Canada as part

of business, business carried on in Canada (IT 73R6, para 10)

ABI REQ

*Carried on in CAN*

### SIB [§125(7) business purpose: earn income from property]. >5 FULL TIME EMPLOYEE TEST. PSB [§126(7) business providing service; has (i) specified SH and (ii) incorporated employee]. EMPLOYEE CL TESTS [control, integration, specified result, econ reality]. PSB exclusions [CR employs >5 full time employees].

* **Business the principal purpose of which is to earn income from property**

(including interest, rent, dividends and royalties)

* ‘Principal’ (purpose) is a factual determination

i.e. profits, sales, assets capital employed and employee time spent (IT-73R6 para. 5-7)

* Exclusions:
* Credit union
* Business of leasing personal property
* **Business employing >5 full-time employees throughout the year**

(or services of associated CR and would have req >5 employees absent the services)

**SPECIFIED**

**INVESTMENT**

**BUSINESS**

**(SIB)**

***§125(7)***

**SIB**

* 5 full time and some part time qualify (*489599 BC v THE QUEEN*)

i.e. 5 full time and 2 part time employees

* 5 days/ week and 4 hr/ day isn’t full time for cleaners (*BAKER*)
* If TP has co-ownership or joint venture interests, can’t aggregate fractions of shares employees (*LERRIC*)

**>5 FULL-TIME**

**EMPLOYEE**

**TEST**

* Business or providing services where:
* Ind providing services (incorporated employee) or related person is **specified SH** [holds directly/ indirectly 10%+ shares §248(1)]
* **Incorporated employee,** but for existence of CR, would be regarded as officer/ employee of recipient of services, **not independent contractor**

Example:

Employee terminates employment. Incorporates CR. CR agrees to provide employee services to client, employee agrees to provide services to CR.

**PERSONAL**

**SERVICES**

**BUSINESS (PSB)**

***§125(7)***

EMPLOYEE vs

* Four CL Tests:

1. CONTROL **–** right to control is hallmark of master-servant relationship (employee)
2. INTEGRATION – is work integral part of business or merely accessory?
3. SPECIFIED RESULT – provision of services without ref to specified result

(employee) vs have specified task/ result (contractor)?

1. ECONOMIC REALITY – is person providing services doing so as person in

business on his account? (*WIEBE DOOR*)

* Economic reality test not conclusive (*SAGAZ*)
* Other factors: whether worker provides own equipment, hires helpers, takes financial risk, has opportunity to profit. Intention of parties may be SIG (*WINNIPEG*)
* List of factors not exhaustive. **Fact dependent**

INDEPENDENT

CONTRACTOR

* Exclusion from PSB status where:
* **CR employs >5 full-time employees**
* Amount paid to CR for services is received/ receivable from associated CR [reflects provision req associated CRs to share $500,000 business limit]

PSB

EXCLUSIONS

* Not eligible for SBD
* Not eligible for general rate reduction
* Additional 5% tax – §123.5
* Deductions in computing income limited to labour cost of incorporated employee and amounts which would’ve been deductible by employee relating to sale of property or negotiation of contracts and allowed only on paid, not accrual basis

CONSEQUENCES

OF PSB STATUS

## SBD CALCULATION

### SBD §125(1) [CCPC deducts 19% least of (A) total of (i) ABI and (ii) SPI less (iii) loss from ABI and (iv) SPL; (B) taxable income for year less total of (i) 100/28 of amount deductible in §126(1); (ii) 4 and (iii) income exempt from tax; (C) $500,000 business limit.].

**CCPC deducts 19.0%** (small business deduction rate) of least of:

1. the total of
2. ABI (not as member of partnership (PS)) and
3. Specified partnership income (SPI)

Less

1. Loss from active business in Canada (not as members of PS) and
2. Specified partnership loss (SPL)
3. **Taxable income for year** less total of
4. 100/28 of amounts deductible in §126(1)
5. (Relevant rate factor) x amounts deductible in §126(2)

[relevant rate factor is 1/ (§123(1) rate – generate rate reduction, or **(1/0.25 = 4) *plug in 4***] and

1. Income exempt from tax

\*Designed to exclude exempt income and foreign-source income, the latter calculated by grossing-up foreign tax credit under §126

1. **Business limit for year of $500,000**

***§125(1)***

**SBD**

COMPUTE

*Look at para 9,*

*Handout 5*

Example (b)(ii)

$100 – foreign business income

$10 – foreign tax 10%

**$10 – TFC (§126(1))**

$25 – Canadian tax 25%

$15 – Less FTC

§125 – $10 x 4 = $40 [amount not subject to

Canadian tax]

Example (b)(i)

$100 – foreign non-business income

$20 – foreign tax 20%

**$20 – TFC (§126(1))**

$28 – Canadian tax 28%

$8 – Less FTC

§125 – 100/28 x $20 = $71.42 [amount not subject to

Canadian tax]

### SPI §125(7) [A + B]. SPL §125(7) [A+B].

**SPI:** aggregate of A + B

A = for each PS of which CCPC is a member, total of the least of:

* 1. share of PS income less expenses incurred by CCPC to earn income outside the PS, and
  2. CCPC’s proportionate share of PS income multiplied by $500,000, prorated for short years (“specified partnership business limit”)

B = lesser of:

1. loss of CCPC from an active business (not in PS) plus SPL, and
2. net income of CCPC from PSs in excess of business limit [A(a) amount less A(b) amount]

**SPECIFIED**

**PARTNERSHIP**

**INCOME**

**(SPI)**

***§125(7)***

**SPL:** aggregate of A + B

A = CCPC share of losses from PS businesses carried on in Canada

B = G – H

G = amounts deducted by CCPC in computing PS income

H = CCPC share of income of PSs for the year

**SPECIFIED**

**PARTNERSHIP**

**LOSS (SPL)**

***§125(7)***

* SPI/SPL Purpose: apply CCPC share of losses first to income not eligible for the SBD because of the business limit allocation [See Example for Corporate Partnership Rules]

## SBD – ANTI-AVOIDANCE

### MULTIPLE PS [§125(6) take income from PS with highest income]. TIERED PS [§125(6.1) one PS member of another]. BRIGHT LINE TEST [§126(6.3) person with >50% income deemed to control PS].

* Designated member of partnership
* Specified corporate income
* §129(6) anti-avoidance
* §125(9)

2016

AMENDMENTS

*Handout*

* if main reason for existence of multiple PS is to increase SBD, only income from PS with highest income (not highest share amount) is taken into account

**MULTIPLE**

**PARTNERSHIPS**

***§125(6)***

* When one partnership is a member of another
* Deems CCPC to be direct member of lower-tier PS and its share of the income of PS N deemed to be the amount to which it is directly or indirectly entitled
* CCPC has 90% interest in PS M; PS M has 60% interest in PS N; PS N has ABI of $1,000,000
* Absent (6.1), CCPC share of N’s income is 90% x 60% x $1,000,000 or $540,000 (reduced to $500,000 by the BL)
* (6.1) operates to make CCPC’s BL 90% x 60% x $500,000 or $270,000

**TIERED**

**PARTNERSHIPS**

***§125(6.1)***

*Planning*

* Prevents claiming SBD in respect of income from PS controlled directly or indirectly in any manner by non-residents or public CRs

***§125(6.2)***

PREVENTS

NON-RES/ PUB CR

***§125(6.3)***

* For these purposes one+ persons **deemed to control PS** if their share of PS income from any source >50% of total income from source

[Bright Line Test to det who controls partnership]

*BL Test*

* DESIGNATED MEMBER RULE. Applies where CCPC provides property or services to partnership of which SH (of CCPC) or person not at AL with CCPC is member
* CCPC deemed member of partnership and its ABI deemed to be partnership income (included in SPI) with BL of nil
* SPECIFIED CORPORATE INCOME.Arises where CCPC provides services or property to private CR in which CCPC, SH, or person not at AL with SH has interest in CR
* This income ineligible for SBD
* CCPC can share BL of recipient CP
* In both cases, 90%+ *de minimis* exception

POINTERS

## ELECTION NOT TO BE CCPC

### ELECT OUT [§89(11) CR can elect not to be CCPC for GRIP/ LRIP].

* **CR can elect not to be CCPC for purposes of GRP/ LRIP,** Part III.1 tax rules
* Why? Access higher GU and DTC rates for eligible dividends (at cost of losing SBD)

***§89(11)***

I AM NOT

CCPC

## REDUCTION OF SBD FOR LARGE CCPCs

### §125(5.1)(a) [A (BL) x B /$11,250 where B is 0.225% x (D – $10,000,000).

***§125(5.1)(a)***

* Limits ability of large CCPC to claim SBD
* Reduces BL by reference to capital employed in Canada (measured by reference to taxable capital employed for former Part I.3 tax), including associated CRs

**FORMULA:** Reduction is: **A (BL) x B/ $11,250**

**B is 0.225% x (D – $10,000,000)** where D is taxable capital employed in Canada

If taxable capital > $15,000,000 BL will be nil

Example:

Taxable capital is 12mi.

B is: 0.225% of 2mi = 4,500.

Reduction is 500,000 x 4,500 / 11,250 = 200,000

* CCPC doesn’t concern size. Just control. Not appropriate to give large business SBD.

§125(5.1) grinds down business limit

LARGE CCPC

## REDUCTION OF SBD FOR EXCESS INVESTMENT INCOME

### §125(5.1)(b) reduces business limit where aggregate adjusted investment income exceeds $50,000.

* **Reduces business limit where ‘aggregate adjusted investment income’ exceeds $50,000** [on 5:1 ratio]
* Thus, if that income is $150,000, excess is $100,000 and reduction is 5 x $100,000 = $500,000, so SBD is eliminated
* Intent: prevent use of low-tax income to earn investment income in CR

***§125(5.1)(b)***

SBD – ASSOCIATED CRs

### ASSOCIATED CRS [125(2-4) prevents avoiding $500,000 business limit by splitting ABI]. GROUP RULES. §256(1) [5 rules if CR is associated. *De facto* control and at least 25% shares owned is key].

* **Prevents avoidance of $500,000 Business Limit by splitting ABI among CCPCs**

which have interlocking or common ownership

* Uses concept of ‘**associated’ CRs**

§125(2) – BL of CCPC **associated** in year with one+ other CCPCs is nil

§125(3) – if associated CCPCs make and file agreement to split $500,000 BL among

them, BL for each CCPC will be that agreed

§125(4) – Minister may demand filing of agreement; failing which may allocate BL

*§256(1) to (2.1)* – association rules employ concepts of control (*de jure* and *de facto*) related

persons and extended meaning of group

**GROUP RULES**

(1.2)(a) – **GROUP** means any two+ persons who own shares

(1.2)(b) – CR controlled by one or members of group deemed to be controlled by

group and CR may be controlled by group or person notwithstanding it

is controlled by another group of person [makes *VINA RUG* statutory

law]

Example (1.2)(b): A owns 50% of Xco and 75% of Yco and B owns 50% of Xco and 10% of Yco. A and B will constitute a group which controls each of Xco and Yco notwithstanding that A alone controls Yco

(1.2)(c) – deems CR to be controlled by another CR, person or group which

holds either shares with FMV >50% of FMV of all shares or common

shares with FMV >50% of FMV of all common shares.

(1.2)(g) deems all shares non-voting for these purposes (*KRUGER*)

(1.2)(d),(e),(f) – contain look-through rules to catch shares held indirectly through

CRs, partnerships, or trusts

(1.3) – share held by minor deemed to be held by parent, unless can be reasonably

considered that child manages business without SIG parental influence

**ASSOCIATED**

**CRs**

*Group*

* **5 Rules for det if one CR is associated with another.** Each uses *de facto* control:

1. one CR controlled by the other
2. both CRs controlled by same person or group
3. each CR controlled by person who is related to other and either controller held at least 25% of shares in each CR
4. one CR is controlled by person related to each member of group that controls other and who holds at least 25% of shares of other CR
5. each CR is controlled by related group and each member of one group is related to all members of other group and one or more persons who are members of both groups own at least 25% of shares of each CR

***§256(1)***

5 RULES

*Handout 6*

### ANTI-AVOIDANCE §256(2.1) [if separate existence of two CRs is to reduce tax, CRs deemed to be associated]. §256(2), (6) [rules].

* If it may reasonably be considered that one of **main reasons for separate existence of two CRs is to reduce tax, they are deemed to be associated**

**One Test of *DORIS***

If all CRs were subject to flat 50% tax, would operations have been carried on separately?

* Bad Facts – associated:
* Common management or administration
* Steps taken to disassociate before creation of second CR
* Transfer of assets btw CRs
* Awareness of potential tax savings
* Previous co-operation in same business
* Good Facts – not associated: (recent cases *JENCAL* and *PRAIRIELAND*)
* Resolution of family or business disputes
* Limitation of liability for new business
* Different businesses carried on
* Estate planning
* Avoidance of labour/ union issues
* Asset protection
* Very fact driven. Just note types of facts.

***§256(2.1)***

**ANTI-AVOIDANCE**

* Where two CRs (A and B) aren’t associated but each is associated or deemed to be associated with third CR (C), A and B are deemed to be associated (§256(2)(a))
* For purposes of §125, if C is not a CCPC, or is a CCPC and elects to apply §256(2)(b)(ii), A and B are deemed not to be associated with each other and business limit of C (if a CCPC) is deemed to be nil

Example:

A holds 100% of Aco and 50% of Bridgeco; A’s spouse holds 100% of Bco and 50% of Bridgeco: if Bridgeco is a CCPC, and elects, Aco and Bco are not associated; BL of Bridgeco is nil

A and C; B and C remain associated

***§256(2)***

**ANTI-AVOIDANCE**

* Deals with situation where investor or lender obtains control of CR to protect its investment until, i.e. loan is repaid
* i.e. manufacturer finances its dealers and obtains control until repayment
* investor holds voting control to protect redemption right in preferred shares
* deemed not to be controlled
* relieving provision when independent third party (lender) attained control of CR

***§256(6)***

**ANTI-AVOIDANCE**

## INVESTMENT INCOME EARNED BY CCPC

### Passive investment income earned by CCPC. EDRTOH and NERDTOH [two pools of refundable tax].

* **ABI earned by CCPC** has deferral of full tax till distribution to ind SH with full integration
* **Passive investment income earned by CCPC**

[deferral prevented by using a CR but fully integrate on distribution to ind SH]

* Imposes high level of tax in the CCPC, partially refundable on payment of dividends

No 13% general rate reduction + **10 2/3% TAX UNDER §123.3**

Initial tax rate = 28% + 12% (assumed provincial rate) + 10 2/3% = 50 2/3%

* CCPC pays dividend, gets refund of 30 2/3% of 50 2/3% tax initially paid at rate of 38 1/3% of the dividend
* **RESULTING 20% CORPORATE RATE**
* If dividend paid to holding CR, recipient pays refundable tax = to dividend refund

[under Part IV, to prevent deferral]

OVERVIEW

*Combined rate*

*50.17% (Ontario)*

CCPC

$100 – income

$50.67 – corporate tax [28% + 12% + 10 2/3%]

**$30.67** –refundable tax

$80 – dividend

**$30.67** – dividend refund

$20 – net corporate tax

Individual SH

$80 – dividend

$13.60 – GU 17%

$93.60 –taxable income

$36.90 – Federal and ON combined tax of 54%

$50.50 less DTC of $13.60 = $36.90

**TOTAL TAX:** $20 + $36.90 = $56.90

Under-integration

* System amended in 2018 to **STREAM dividend refunds**
* Purpose: prevent large CCPC which earns high rate business income generating GRIP from paying eligible dividends (high GU) to recover refundable tax paid on investment income
* **Two pools of refundable tax:**

1. Eligible RDTOH (ERDTOH)
2. Non-eligible RDTOH (NERDTOH)

OVERVIEW

### NERDTOH §129(4) [calculation]. ERDTOH [calculation]. DIVIDEND REFUND (§129(1)(a)].

* ‘aggregate investment income’ is SUM of:

Eligible portion of TCG less eligible portion of ACL for year

[eligible portion is portion accruing while capital property is property of CCPC]

*+*

Income of CCPC from property (other than dividends deductible under §112(1) [ignore other exclusions] less property source losses for year

**NERDTOH**

***§129(4)***

* Includes income/ loss from SIB but not property income/ loss pertaining to active business
* Income excluded from ABI for SBD purposes is picked up in aggregate investment income

INCOME/

LOSS

FROM

PROPERTY

TOTAL of:

1. Where CR is CCPC throughout the year, the least of:
2. A – B where A is 30 2/3% of AII and B is non-business income FTC for year less 8% of foreign investment income (§129(4)).

[FII is AII computed as if no income or CG form Canadian sources, §111(1)(b) CL c/f or c/v and no income from SIB]

Item B intended to limit dividend refund relating to foreign-source income to tax notionally paid in Canada

* Assumes Canadian tax 38%
* Therefore deduct FTC [which reduces Canadian tax] but limit deduction by 8% of FII [RDTOH based on 30 2/3 % refund and 38% – 30 2/3% = 7 1/3%]

**NERDTOH**

***§129(4)***

COMPUTE

FII $100 $100

CAN tax $38. $38

Foreign tax $20. $8

FTC $20. $8

Net CAN tax $18 $30

B: (i) FTC deduction = $20 less 8% of $100, or $12; or $8 less $8 = 0

NERDTOH is $30 2/3 less $12 or $18 2/3 [$26 2/3] which ~ net CAN tax payable [or $30 2/3 less 0]

(ii):

30 2/3% of taxable income less (A) income eligible for the SBD, (B) 100/38 2/3 of s. 126(1) non-business income FTC [GU for 38 2/3% tax rate] and (C) RTF (which is 4) x s. 126 (2) business income FTC [GU for 25% tax rate]; and

(iii):

Tax payable for the year

(b) Part IV tax payable less Part IV tax included in ERDTOH, and

(c) NERDTOH at end of previous year

Less

Dividend refund from NERDTOH for previous year

* Measured at end of year

TOTAL of:

1. **Part IV tax on eligible dividends from non-connected CRs** plus Part IV tax on dividends from connected CRs giving rise to dividend refund from ERDTOH; and
2. ERDTOH at end of preceding year

Less

Dividend refunds from ERDTOH in preceding year

**ERDTOH**

***§129(4)***

Dividend Refund (§129(1)(a)):

1. Lesser of 38 1/3% of eligible dividends paid and ERDTOH
2. Total of:

* Lesser of 38 1/3% of such dividends (I) and NERDTOH (II); and
* If (I) exceeds (II), the lesser of (A) the excess and (B) the amount by which ERDTOH exceeds amount in (i). If (I) is equal to or less than (II), nil

**DIVIDEND**

**REFUND**

***§129(1)(a)***

### ASSOCIATED CR §129(6) [Investment income from associated CR].

**Investment income from associated CR (§129(6):**

* Where CR receives amount from associated CR which would otherwise be included in CAD source property income:
* Amount deductible by payer in computing ABI not included in AII of recipient nor are expenses incurred deductible in computing AII
* Amount deductible by payer deemed to be ABI of recipient for SBD and expenses incurred deemed to be for purpose of earning ABI
* Allows ABI character to be retained where amounts such as rent or interest paid to associated CR (i.e. building rented from associated CR)

***§129(6)***

ASSOCIATED

CR

* Where losses are used to reduce Part IV tax, §129 (4.1) causes §129(4.2) to apply
* Operation of §129(4.2) causes Part IV tax on eligible/eligible refund dividends to be reduced by 38 1/3% of losses claimed less Part IV tax on non-eligible/non-eligible refund dividends for the year
* Grinds NERDTOH first

**STREAMING**

**OF LOSSES**

# **CORPORATE DISTRIBUTIONS**

## DIVIDENDS

### DEBT (loans/ debt securities), EQUITY (shares). SECURITIES [not disposition – no gain or income]. DIVIDEND (248(1))

* CRs can be capitalized by **DEBT** (loans/ debt securities) and/or **EQUITY** (shares)
* Choice depends on commercial/ tax considerations
* CR can issue security (§2.1 *CBCA*), share, or debt obligation
* Creditor/ lender has no interest in CR *per se*

**SECURITY:** share(s) of any class or debt obligation of CR; includes certificate

evidencing such a share/ debt obligation (§2.1 *CBCA*)

**SHARE:** interest in CR defined by statute, constating docs, share terms

**CORPORATE**

**CAPITAL**

**STRUCTURE**

* Issuance of debt security is not disposition (§248) – no gain or income
* Issuance of equity is not disposition (§248) – no gain or income
* Costs of raising capital under §18(1)(b); but §20(1)(e) allows deduction of expenses:
* In course of issuing shares
* To borrow money to earn income from property/ business
* To incur debt in respect of property acquired to earn income
* Restructuring onside debt obligation
* 5-year amortization basis

**ISSUANCE of**

**SECURITIES**

*No disposition*

* CR may sell or grant options to acquire debt or equity - §49(1)(b). No disposition
* Investor ~acquires security as capital property with cost = amount paid
* Cost to investor of exercising option added to cost of acquired property – §49(1)(b)
* Option expires without exercise, CR deemed to have disposed of capital property:

PD = proceeds of issuance

ACB = nil

**CG result**, unless CR acts at AL with holder at time of grant §49(2)

* Interest payable by CR on debt security ~deductible under §20(1)(c) [compound interest deductible when paid under §20(1)(d)]
* Interest includable in income of resident (NR WHT (Part 13) if non-resident)
* Dividends not deductible by paying CR
* Dividends included in income of residents (account for intercorporate deduction, integration or inds) (NR WHT (Part 13) if non-resident)
* Repayment of principal by CR not deductible. If debt settled or extinguished by payment of less than principal amount, gain subject to §80 debt forgiveness rules
* For security holder, redemption/ cancellation in whole/ part is disposition
* Holder can have gain or loss on repayment or repurchase of debt security
* Expiry of option will produce loss
* Holder can have gain or loss or deemed dividend on redemption or purchase of equity security

See Handout 8

* Sum of money paid regularly (i.e. quarterly) by CR to its SH out of profits

§248(1) – includes stock dividend; stock dividend is paid in CR’s own shares

* Distribution by CR of its income or CG made *pro rate* (∞) among its SHs (IT-67R3)
* Any *pro rate* distribution of profits is dividend and taxable (*CRASSWELLER*)
* Payments are dividends if derived from capital (*NORTHERN SECURITIES*)
* TP has right to receive dividend; right taxable when received (not before) (*ROBWARAL*)

**DIVIDENDS**

***§248(1)***

## INTEGRATION SYSTEM

### INTEGRATION (full or partial) [§82(1)(a) include dividend in income; §82(1)(b) added to GU; §121 amount = GU deducted, DTC].

**INTEGRATION**: integrate treatment of personal + corporate income tax so that tax

on income earned through CR is no greater/ SAME than if earned

directly by ind

**FULL INTEGRATION:** income earned by CR allocated + taxed to SHs. Treats CR

as conduit, **ignoring it as separate taxable entity.**

Problems with liquidity, NRs, tax-exempts

**PARTIAL INTEGRATION:** tax paid in CR but credit given to SHs for corporate

tax on income distributed

Integration attempt only when dividend distributed

**INDIVIDUAL**

**SHs**

* Full integration for partnership income
* For ind SHs, form of partial integration – imputation system
* Notional amount of corporate tax imputed to dividend and claimed by SH as credit
* **No req for CR to actually pay tax in given year**

Assumption: in long run, dividends paid = after-tax income

* §82(1)(a) – ind includes full amount of dividend in income
* §82(1)(b) –% of dividend added to **gross up** dividend to amount of pre-tax income

in CR from which dividend is paid [GU reps tax notionally paid at

corporate level]

* §121 – an amount = GU is deducted in computing tax payable

This is **dividend tax credit** (DTC)

MECHANICS

1. Different types of income subject to different tax rates
2. Provinces impose PIT and CIT

\*For course, assume only federal tax

\*GU and DTC limited to residents (not non-residents) and taxable dividends

COMPLICATING

FACTORS

* To achieve integration when different types of income subject to different tax rates, need two sets of GU and DTC rates

ADVANCED

MECHANICS

## CHOICE OF GU RATE

### §82(1)(b) assigns GU rate. ELIGIBLE (**38%)** or NON-ELIGIBLE **(15%).**

* **§82(1)(b) assigns GU rate by type of dividend. ELIGIBLE (38%) or NON-ELIGIBLE (15%)**
* §12(1)(j) includes total amount in income

§89(1) – taxable dividend received by resident after 2005 paid by resident CR and

designated as such by CR under §89(14)

§89(14) – CR designates by notifying recipient in writing at time of payment

CRA – public CR can satisfy by stating all dividends to be eligible on website, AIF,

press release or regular financial reporting

Private CR must notify for each dividend by letter, cheque stub or in minutes if

all SHs are directors

* Designation solves problem for SHs
* To ensure dividends are subject to appropriate GU, penalty tax under Part III.1 for designating dividend paid out of low rate income to be eligible
* To det which type of income gave rise to dividend and thus whether dividend is excessive, concepts of **low rate income pool (LRIP)** and **general rate income pool (GRIP)** in §89(1)

**ELIGIBLE**

**DIVIDEND**

## LRIP/ GRIP

### LRIP §89(1) [calc by resident non-CCPC]. GRIP §89(1) [calc by CCPC. Formula: A – B].

* Remember: high rate CR calculates its low rate pool. Low rate CR calculates high rate pool. Counter-intuitive.

Non-CCPC

* **Non-CCPC ~have high rate income, ~designate dividends as ELIGIBLE**
* If non-CCPC designates as eligible when has LRIP balance, will have made excessive election so must exhaust LRIP first
* Thus, non-CCPC must calculate its **LRIP**

CCPC

* **CCPC will ~only have low rate income and NOT designate as eligible**
* If it designates as eligible when has no/ insufficient GRIP will have made excessive election
* Thus, CCPC must calculate its **GRIP**

GENERAL

* Only calculated by resident non-CCPC

Principal components:

A – opening balance

B – non-eligible inter-corporate dividends

D – 80% of aggregate investment income (AII) if CR would be CCPC but for §89(11)

election (electing CR is still treated as CCPC for integration system for investment

income under §129)

Less

G – non-eligible dividends paid in year before that time

**LRIP**

**[ON EXAM]**

***§89(1)***

* Only calculated by CCPC

**FORMULA: A – B**

A = C+**D+E**+F – G

C – opening balance

**D –** adjusted taxable income x general rate factor (72%). Adjusted taxable income is:

A (taxable income) – B (SBD x 100/15) – C (AII)

D is thus income not eligible for SBD or dividend refund regime

**E –** eligible dividends received in year and non-taxable dividends from foreign affiliates

B = H (I – J)

I – full-rate income for past 3 years without reference to carry-back of prior 3 years’ losses

J – full-rate income after applying losses

H – general rate factor (72%)

* B represents reduction in after tax general rate income as result of loss carry backs

**GRIP**

[Only D, E

For exam]

***§89(1)***

DIVIDEND TAX CREDIT (DTC)

### §121 sets out fraction of GU that can be deducted in computing tax payable [not on exam].

* **§121 sets out fraction of GU that can be deducted in computing tax payable**
* Only fraction because only fraction of total tax paid is federal
* Based on assumed ratio of federal to provincial tax

Example

Fraction is 6/11 (54.5%) for §82(1)(b)(ii) amount (38% GU for general rate income). Combined tax rate assumed to be 27.5% (15% federal, 12.5% prov). Federal portion is 54.5%.

\*Fractions aren’t on exam.

**DTC**

*Final part of*

*Integration is DTC –*

*deduction in tax*

INTERCORPORATE DIVIDENDS

### INTERCORPORATE DIVIDENDS [§82(1)(a), 12(1)(j) dividends received by CAN res CR 1 from CR 2 included in income, but deductible in taxable income §112(1)(a)].

* **dividends received by CAN resident CR from another included in income (§82(1)(a); §12(1)(j) but ~deductible in computing taxable income (§112(1)(a))**
* Designed to avoid multiple levels of tax
* Income taxed only in CR which earned it and on distribution to ind’s
* Applies to dividends received from taxable CAN CR and resident CR not exempt controlled by it
* Dividends from foreign CRs included in income (§90, §12(1)(k)) but limited deductions in computing taxable income

**INTERCORPORATE**

**DIVIDENDS**

### DIVIDEND STRIPPING §112(3)(b) and (3.01) [prevent use of tax-free inter-corporate dividend].

* Prevent use of tax-free inter-CR dividend to reduce value of paying CR and create loss on sale of its shares
* Applies where recipient CR may be able to influence decision to declare dividend

§112(3)(b) – loss on disposition of share which is capital property reduced by amount of

tax-free dividends and capital dividends

§112(3.01) – rule doesn’t apply where TP and non-AL persons hold <5% of shares of any

class and dividend received on share held throughout 365-day period ending

before disposition

* Similar rules for share which isn’t capital property in §112(4), (4.01)

**DIVIDEND**

**STRIPPING/**

**STOP LOSS**

**RULES**

## PART IV TAX

### To prevent tax deferrals, Part IV tax is **38 1/3%.** For private + subject CRs. Payer and recipient need to be CONNECTED (§186(4)).

* Deferral and tax saving possible by **incorporating** investment portfolio, earning passive investment income (interests, dividends, CGs) in private CR
* Test for passive status:

is investment portfolio investment with no control over the paying CR?

* **To prevent deferral, Part IV tax imposed on dividends** at rate approximating **highest marginal rate** applicable to dividends for individual and refundable on payment of taxable dividends to ind
* Pre-2016 rate: 33 1/3%. **Post-2015 rate 38 1/3%.**

DEFERRAL &

TIMING ISSUES

*Part V tax prevents*

*deferrals*

* Applies to private CRs and subject CRs

**SUBJECT CR:** (§186(3)) resident CR, not private and controlled for benefit of ind or

related group

* Applies to assessable dividends – taxable dividends deductible in computing taxable income under §112(1) or §113(1) by private or subject CR
* Portfolio status measured by whether payer and recipient are **connected**

**CONNECTED:** if (§186(4)(a) and (b) payer controlled by recipient other than by

§251(5)(b), or recipient owns **>10%** of issued voting shares of payer

with FMV>10% of FMV of all issued payer CR shares

Note: It is >10%. Not 10%

MECHANICS

### Part IV tax imposed: (1) §186(1)(a) assessable dividend received from CR not connected – 38 1/3% tax; (2) §186(1)(b) assessable dividend received from CR which is connected – tax equal to DIVIDEND REFUND.

* Part IV tax imposed in two circumstances:

1. Assessable dividend received by private/ subject CR from **CR not connected**

**Tax of 38 1/3 %** approximates tax payable at highest rate by ind on dividend.

Applies to dividends from non-connected private, public, or foreign CRs

1. Assessable dividend received from private or subject **CR which is connected**.

Tax imposed equal to dividend refund received by payer CR as result of dividend

Dividend refund is refund of tax received by payer CR as result of paying dividend

***§186(1)(a)***

***§186(1)(b)***

### DIVIDEND REFUND (§129(1)(a) [when private CR pays dividend, gets dividend refund of 38 1/3% of dividend].

**DIVIDEND REFUND:** (§129(1)(a)) when private CR pays dividend, it receives

dividend refund equal to **38 1/3% of dividend**, up to balance in its refundable dividend tax on hand accounts

* Refundable tax is aggregate of Part IV tax paid (By any private CR) and portion of Part I tax paid on investment income (by CCPC)
* Part IV is **streamed**, depending on type of dividend
* **Cascading nature** of Part IV tax

Recipient of investment income pays tax, receives refund on payment of dividend, recipient pays Part IV in amount of dividend.

Tax ultimately refunded only on payment of dividends to ind’s

* §186(1)(c) and (d) allow TP to set off portion of non-capital or farm losses against Part IV tax. Losses reduce amount of dividends subject to tax on dollar for dollar basis
* Subtract from tax payable, 38 1/3% of
* Non-capital and farm losses for year (c), and
* Non-capital losses and farm losses for 20 preceding years and 3 following years
* Inefficient use of losses because Part IV tax is refundable

**CREDIT**

**FOR LOSSES**

* Part IV tax payable on **balance-due date** for year

[for CCPC, it is 3 months after end of year]

**PAYMENT**

## CAPITAL DIVIDENDS

### *ITA* integrates taxation of corporate income + dividends. CAPITAL DIVIDENDS are tax free; flow out to SHs. CAPITAL DIVIDEND ACCOUNT (§89(1)) DIVIDENDS IN KIND [dividends not in cash/shares but other property; §52(2) PD=FMV and cost=FMV]. STOCK DIVIDEND (§248(1) dividend paid in shares of payer CR].

Integration system operates to integrate taxation of corporate income + dividends

* What happens to non-taxable income of CR – non-taxable portion of CG, or gains on sale of goodwill, mortality gains on life insurance?
* Use tax-free **capital dividends** to flow these out to SHs. Not taxable dividend
* §83(2) – private CR can elect **full amount** of dividend to be capital dividend to extent CR’s capital dividend account (CDA)
* No part of dividend included in SH’s income and doesn’t reduce ACB of share

**CAPITAL**

**DIVIDENDS**

* Measured from last time CR became private CR after 1971 to particular time (period)
* Includes:
* Non-taxable portion of CG accruing while CR was private CR less non-deductible portion of capital losses similarly realized
* Capital dividends received from other CRs
* Life insurance proceeds less premiums paid
* Less capital dividends payable by CR in period before particular time

**CAPITAL**

**DIVIDEND**

**ACCOUNT**

**(CDA)**

***§89(1)***

* Is cumulative calculation at point in time – may be prudent to pay out positive balances
* Election filed at or before time of payment
* CR electing in excess of CDA balance subject to 60% excessive election tax under Part III
* If assessed under Part III, can elect (§184(3)) to split dividend into onside and offside portions, if all SHs concur
* Can’t make election if lose private CR status

**CAPITAL**

**DIVIDENDS**

* Dividend in kind is dividend paid, **not in cash or in shares** of payer CR (stock dividend) **but in other property of CR**
* §82(1)(a) requires inclusion of all amount received as dividend
* §248 defines **amount** as right or things expressed in terms of amounts of money or value

in money

* **VALUE** is FMV
* §52(2) – CR paying dividend in kind deemed to dispose of it for PD = FMV

SH deemed to acquire at cost = FMV

* Dividend in kind economically equivalent to disposition of property by CR, followed by distribution of PD to SHs
* Dividend in kind provisions in *ITA* recognize this economic equivalence

**DIVIDENDS**

**IN KIND**

* §248(1) – **dividend paid in shares of payer CR**
* **Dividend includes stock dividend** other than stock dividend paid by non-resident CR to CR or mutual fund trust
* Designed to prevent capitalization of corporate earnings and payment to SH as tax-free return of capital
* **AMOUNT** of stock dividend is **increase in PUC** of CR as result of dividend
* Cost of share received as stock dividend (§52(3)):

1. When stock dividend is dividend, amount of dividend less §112(1) deduction [non-taxable amounts don’t increase cost]

(a.1) when stock dividend is not a dividend, nil

Include amount included in income under §15(1.1)

* §15(1.1) – exception to rule that dividend not included in SH benefit (§15(1)(e))
* Intended to prevent low-PUC stock dividends to SIG alter value of **specified** SH’s [holder of 10%+ of any class’ interest to reduce value of SH’s interest and reduce CG (*WU*)
* Stock dividends paid to NRs subject to Part XIII WHT

**STOCK**

**DIVIDENDS**

**§248(1)**

## CASE-LAW

### ***CAPANCINI and AHMAD*** [no stock dividend]

* In both cases, court agreed that there was no stock dividend because shares distributed not of same CR

*CAPANCINI*

* Held: no dividend in kind
* Shares of Electronics and Covidien never owned by Tyco [created and distributed simultaneously]

*AHMAD*

* HELD: shares of Electronics and Covidien had been held by Tyco for some time as private CR subsidiaries

Therefore: dividend in kind

## STOCK SPLITS/ CONSOLIDATIONS

* All issued shares of class converted into larger or smaller number of shares without change in stated capital (*§173(1) CBCA)*
* No dividend or disposition
* ACB and PUC of old shares allocated among new shares

***EVANS*** creative use of stock dividend

* Typical surplus stripping situation. No PUC/ cost base
* Not tax in hands of children. Succeeded

## SH BENEFITS & LOANS

### §15(1) SH BENEFITS [amounts includable in SH income other than (deemed) dividends] ***PILLSBURY*** [no SH benefit. Types of SH benefits see examples]. ***KENNEDY*** [benefit conferred when debt created, not paid]. SH LOANS [§15(2) catches loans and taxes].

* **Amounts includable (taxed) in SH income other than dividends or deemed dividends**

§15(1) – where CR confers benefit on SH/ person in contemplation of becoming SH, amount

[i.e. value] included in income for year

§15(7) – applies to resident and non-res CRs

§69(4) – CR appropriating property to SH deemed to dispose for FMV proceeds

§52(1)(a) – amount of benefit added to ACB of recipient

**SH BENEFITS**

**& LOANS**

**§15(1)**

* Distinguish btw transactions benefitting SH and *bon fide* (genuine) business transaction benefitting CR

***PILLSBURY***  No SH benefit

Facts:

* P Ltd borrowed from 2 CRs which became subsidiaries
* interest waived and debt settled for part payment

Held:

* Question of fact whether purpose to confer benefit or is in connection with CR’s business
* i.e. induce SH to patronize CR
* P Ltd in financial difficulty, no benefit to SH
* TP wins
* Can be partial benefit (*GILLIS*) – golf club membership partially includable because 60^

SH golf time spend with clients

* Applies to ‘capital benefits, indirect and unreceived benefits, consumed benefits and unsought benefits (*CHOPP*)
* **Types of benefits:**
* **Sale to CR at >FMV**
* **Sale to SH at <FMV (*GUILDER NEWS*)**
* **Forgiveness of debt owed to CR**
* **Personal use of corporate assets (*YOUNGMAN*)**
* **Payment by CR of SH expenses**
* **Improvement of property leased by CR from SH**
* Timing issues:
* Does benefit arise when improvements made or when property reverts to SH at end of lease?
* If note or share issued in overpayment for property, does benefit arise when security is issued or when redeemed?

***KENNEDY***

Facts:

* CR sold building to SH at <FMV
* SH assumed mortgage for >sale price, received note for difference
* CR made improvements to property
* SH leased property back to CR to get 9% return on his below FMV cost

Held:

* Benefit conferred when debt created, not paid, because at payment, creditor merely receives his entitlement (assuming debt well secured)
* Benefit conferred by improvements at time they were made but reduced by undervalue of leaseback
* Value of benefit is effect on reversionary value of property [benefit realized immediately] but may be no benefit it lease long enough
* Exceptions to §15(1):

1. Reduction of PUC, redemption of shares, or winding-up of business or CR to which §88 applies
2. Dividend or stock dividend
3. Grant to all holders of c.s. rights to acquire additional shares
4. Conversion of contributed surplus to capital

EXCEPTIONS

* **§15(2) designed to catch loans which are disguised distributions to SHs**
* Doesn’t apply to inter-corporate debt of CAN resident CR or debt btw non-res
* Applies to loans from non-CAN CRs and loans to partnerships [except partnerships of CAN resident CRs]
* Applies to SHs and persons **connected** with SHs (§15(2.1) as persons not at AL, except foreign affiliates to lender CR or another CR not at AL with it
* When §15(2) applies, amount of loan included in income in year it is made

Exceptions:

* §15(2.6) – loan repaid within one year after end of year loan is made

. . . others too

* Must be *bona fide* (genuine) arrangements for repayment within reasonable time (2.4(f))
* Must be reasonable to conclude loan made *qua* employee and not *qua* SH – part of reasonable compensation package (2.4(e))
* Imputed interest - §80.4(2):
* Applies to same persons as §15(1)
* Who receive loan or become indebted to CR or related CR
* Benefit equals interest computed at prescribed rate (Reg 4300) less actual interest paid

§15(9) treats as §15(1) benefit

**SH LOANS**

**§15(2)**

**Catches loans**

# **PUC: DEEMED DIVIDENDS & SURPLUS STRIPPING**

## PUC

### PUC, STATED CAPITAL, DEEMED DIVIDEND [anything distributed by CR in excess of PUC].

* Tax account analogous to corporate stated capital

**STATED CAPITAL:** FMV of consideration (cash/property) for which shares issued

* Statutes permit lower amount to be added
* Capital can be increased by capitalizing retained earnings or corporate surplus
* Requires special resolution of SHs (2/3 majority)
* Separate stated capital account for each class/ series of shares (§26(1) CBCA))
* Where shares of one class are converted to shares of another, ∞ capital of converted class is moved to new class
* Where shares of class are cancelled, ∞ stated capital of class is cancelled
* Starting point for computing PUC is stated capital
* Adjustments to stated capital may be required to det PUC
* PUC computed by class or series of shares
* PUC per share det by averaging
* PUC per share = PUC of relevant class or series / # outstanding shares of class/series
* Returns of capital to SH may come from capital contributed to CR or from retained earnings

**DEEMED DIVIDEND:** anything distributed by CR in excess of PUC

* Distributions of PUC reduce ACB or are treated as PD
* Special rules for public CR

**PUC**

Starting point

## DEEMED DIVIDENDS

### DEEMED DIVIDEND. CAPITALIZATION OF SURPLUS §84(1) [if CR increased PUC, CR deemed to pave paid dividend in that amount received by each SH *pro rata*]. EXCEPTIONS (c.3). REDEMPTION OF SHARES (§84(3)). RULE: deemed dividend trumps CG.

* Any distribution of property in excess of PUC is deemed dividend or SH benefit
* Capital can be returned by formal reduction of capital, redemption or purchase for cancellation of shares or on liquidation or winding up
* Test each transaction for distribution > capital
* CR can increase PUC – increase in PUC not ‘paid for’ gives rise to deemed dividend
* **Where CR has increased PUC of class of shares, it is deemed to have paid dividend in that amount, received by each SH of class *pro rata***
* Exceptions where increase in PUC has been ‘paid for’

**DEEMED**

**DIVIDENDS**

**CAPITALIZATION**

**OF SURPLUS**

**RULE**

**§84(1)**

Exceptions:

1. Payment of stock dividend (because taxed as ordinary dividend to extent of any PUC increase)
2. Transaction by which value of CR (assets les liabilities or liabilities less assets) has increased by amount = or > PUC increase. If not, difference is deemed dividend under §84(1)(d)
3. PUC of other classes is reduced by at least same amount so that total PUC is unchanged. If reduction insufficient, deemed dividend under §84(1)(e)

(c.1) to (c.3) capitalization of contributed surplus by insurance CR (c.1), bank (c.2), or

other CR (c.3)

(c.3) contributed surplus must arise on issuance of shares other than on [§85] rollover

**(i) acquisition of property from SH for no/non-share consideration**

**(ii) on prior reduction of PUC**

**(iii) prior conversion of PUC to contributed surplus**

* If PUC increase > amount allowed under (c.1), (c.2), or (c.3) excess is **deemed dividend** under §84(1)(f)

**EXCEPTIONS**

Deemed Dividend on Redemption of Shares – §84(3)

* CBCA (§36(1), 34(1) – CR can redeem redeemable shares for price not > redemption price and purchase (or accept donation of) other shares for cancellation
* **(a) where amount paid on redemption or purchase > PUC, dividend deemed to have been paid on separate class of shares consisting of redeemed or purchased shares and received by SH**
* §84(7) deems dividend to have ‘become payable’ at that time (can make CD election)
* §84(2) and (3) don’t apply to purchase by CR of its own shares in market in manner a member of public would purchase shares – §84(6)
* Redemption of acquisition of share by CR is disposition to CR: §84(9) [See para (b)(i) of ‘disposition’ def in §248(1)]
* PD §54 excludes deemed dividend under §84(2) or (3) [and not deemed by §55(2) or §88(2)(b)(ii) not to be dividend]
* Depending on ACB of share, can result in deemed dividend and capital loss

Example:

100 (redemption price). 20 (PUC). 30 (ACB).

Deemed dividend = 80 (100 – 20). PD = 20 (100 – 80). CL = 10 (30-20)

On REDEMPTION

OF SHARES

**§84(3)**

**Deemed div always**

**trump CGs**

* If new share issued on reorganization of business or to satisfy redemption price, valued at its PUC for §84(2) purposes and at resulting increase in PUC of class for 684(3) purposes: §84(5)
* PUC may be affected by any PUC grind
* Part IV tax purposes, SH considered to hold redeemed share at time of redemption for determining connected status [don’t lose connected status]

MacArthur:

* Where CR redeems its shares, the amount by which amount paid by CR on redemption (**redemption price)** exceeds PUC of shares will be **deemed to be dividend**
* Redemption also results in disposition of SH’s shares for PD = amount of distribution less amount of any deemed dividend – §54 (PD)
* If PD exceed (or are exceeded by) SH’s ACB of shares, SH will realize CG (or CL) = to difference

## RETURN OF CAPITAL

### PRIVATE CR [deems dividend on reduction of PUC except §84(2), (3), or (4.1)] and **PUBLIC CR** rules (§84(4) and (4.1)) [reduction of capital by PubCo deemed dividend regardless of PUC]. Authority: §84(4).

* Where CR resident in Canada (other than public CR) distributes amount to its SH on reduction of PUC, amount so distributed is ~received as **return of capital**
* If any such payment exceeds amount of reduction in PUC of shares it is **deemed to be dividen**d – §84(4)
* ACB of shares that are subject of reduction of PUC is reduced by amount = reduction in PUC – sub 53(2)(a)(ii)
* If reduction in ACB results in ACB of share becoming negative, this will trigger **deemed capital gain** = negative amount – sub 40(3)
* §84(4) deems resident CR which has reduced its PUC other than under §84(2), (3), or (4.1) **to have paid dividend** equal to amount paid less any associated PUC reduction and SHs to have received it *pro rata*
* Where amount paid includes shares, value is PUC increase resulting from issuance: §84(5)
* Amount received > deemed dividend reduces ACB of share: §53(2)(a)(ii)

**PRIVATE**

**CR**

* §84(4.1) – reduction of capital by public CR deemed to be dividend regardless of PUC, subject to 4 exceptions:
* Redemption or cancellation to which §84(3) applies
* Winding-up or reorganization of business to which §84(2) applies
* Reorganization of capital to which §86 applies
* Payment of amount ‘derived’ from PD of disposition **outside ordinary course of business**, within 24 months of disposition and paid in same reduction of capital [‘derived’ may include earn-out payments or even fees]

**PUBLIC**

**CR**

## ANTI-SURPLUS STRIPPING RULES

### §84 deemed dividend rules prevent SURPLUS STRIPPING.

* Designed to prevent TPs from converting what would otherwise be taxable dividend distribution into CG
* CGs treated at favourable rates than dividends
* Ind’s may get CG exemption (CGE); shares are of qualifying small business CR [800,000 exemption]
* Non-residents may be exempt from tax on CG
* **§84 deemed dividend rules designed to prevent ‘surplus stripping’** –

Removal of surplus from CR by tax-free return of capital; capital not ‘paid for’

* Doesn’t deal with all surplus stripping situations
* §84.1 – applies to ind’s or trusts resident in Canada
* §212.1 – applies to non-res
* Both apply on to transfers of shares of CAN CR to another CAN CR in closely connected circumstances
* Intention is to preclude extraction of corporate surplus as something other than dividend

**PURPOSE**

### §81.1 [prevent artificial realization of gain]. §212.1 [non-res transfers]. §81.1 **PUC GRIND** [A – B].

* Ind or trust transfers shares of CAN CR to another CAN CR with which transferor doesn’t deal at AL
* Following transfer, CRs are ‘connected’ under §186 (measures TP influence subject CR)
* Extended meaning of non-AL – §84.1(2)(b) and (d), 84.1(2.2)
* Extended meaning of AL:
  + §84.1(2)(d) – trust and beneficiary or related person don’t deal at AL
  + §84.1(2)(b) – TP and purchaser CR not at AL if
    - Immediately before disposition, TP was one of group [§84.1(2.2)(b) group is 2+ persons who own shares] of 6 persons controlling transferred CR
    - Same position immediately after disposition
    - Each member of control group before disposition is member of control group after disposition
    - §84.1(2.2)(c) – CR controlled by one+ members of group deemed to be controlled by group
    - §84.1(2.2)(d) – CR may be controlled by person or group even if controlled by another person or group
  + §84.1(2.2)(a) – TP deemed to own shares held by spouse, minor child, trust for them or CR controlled by TP and/or such persons

***§84.1***

Prevents

artificial

realization of

gain

* Non-res transfers shares of CAN CR to another CAN CR; transferor is non-AL
* Following transfer, CRs are ‘connected’ under §186(2)
* Extended meaning of non-AL – §212.1(3) – similar to §84.1 rules
* Consequence if §84.1 or 212.1 applies depends on nature of consideration received for shares transferred:
* If consideration includes shares of transferee, addition to PUC may be limited – PUC grind
* If consideration includes anything other than shares of transferee, deemed dividend may arise

***§212.1***

* Deemed dividend arises to extent non-share consideration exceeds greater of:
* Adjusted or AL ACB of transferred shares, and
* PUC of transferred shares
* §84.1(1)(b) – deemed dividend is (A+D) – (E+F)

A [increase in PUC], D [FMV of non-share consideration],

E [greater of PUC of transferred shares + AL ACB]

F [any PUC reduction under §84.1(1)(a)]

* Adjusted/ AL ACB (§84.1)(2)(a), (a.1):

1. Share held pre 1972 – actual cost, no increase for pre-V Day (valuation) gain

(a.1) share acquired post-1971 not at AL:

- deduct amount in (a) where TP acquired shares non-AL from pre-1972 holder, and

- deduct gain exempt under §110.6 on prior disposition

***§84.1***

* **PUC Grind = A – B**
* §84.1(1)(a) – PUC of any shares issued by transferee (item A) reduced to extent increase is more than difference (item B) btw
* **Greater of** PUC and adjusted/ AL ACB of transferred shares and

FMV of any non-share consideration

* What is added to stated capital for corporate law purposes?
* FMV of property transferred is base case
* to prevent access to CG exemption (CGE) by sale to non-AL CR
* to prevent access to V-Day value of shares by sale to non-AL CR
* adjusted/ AL ACB relevant measure because want to exclude any prior tax-free increase to ACB arising in non-AL transfer

***§84.1***

**PURPOSE**

MULTIPLCE CLASSES OF SHARES

* If transferee issues more than one class of shares, PUC reduction is apportioned based on additions to PUC of each class

ANTI-SURPLUS STRIPPING RULES

* Operates in same way as §84.1
* Difference is that ACB of transferred shares not relevant (AL or not)
* Non-share consideration and PUC increase together can’t exceed PUC transferred shares
* Deemed dividend if non-share consideration exceeds PUC of transferred shares
* Limitation on amount that can be added to PUC if share consideration delivered
* Applies to non-resident transferors only (deemed dividend subject to Part XIII tax)

***§212.1***

# **REORGANIZATION OF CAPITAL**

## FINANCING CORPORATIONS

### CRs financed with DEBT and EQUITY CAPITAL. CR may desire to REORGANIZE capital. REORGANIZATION [rollover]. Rules: §51 doesn’t apply if §85 or §85 applies [§51(4)]. §85 doesn’t apply if §85 applies [§86(3)]. §85 TRUMPS OTHER PROVISIONS.

* CRs may be financed with combination of **debt + equity capital**
* Debt may have equity-like features; i.e. be convertible to equity
* Equity may have debt-like features; i.e. be redeemable at fixed amount
* May be desirable to **reorganize capital of CR**
* Provisions in *Act* accommodate such **reorganizations on tax-deferred (ROLLOVER)** basis provided some conditions are met
* Justifications for rollover:
* Permits CR to alter capital structure to more efficient one without investors realizing gain – if investors had gain they may not agree to alteration
* Investor may not have sufficiently altered nature of investment to justify realization event
* In some cases, more than one rollover provision may apply
* *Act* specifies order of application:
* §51 doesn’t apply if §85 or 86 applies – §51(4)
* §86 doesn’t apply if §85 applies – §86(3)
* **§85 TRUMPS OTHER PROVISIONS**
* Although §85 trumps §51 and 86, §85 req **joint election** by transferor and transferee
* §51 and 86 apply automatically if conditions to their application are met
* Consider which rules most appropriate in circumstances and, where possible, ensure that rules applies and others don’t

**FINANCING**

**CRs**

REORGANIZATIONS

*At rollover*

## §51 ROLLOVER

### When (i) debt of CR converted into shares of same CR or (ii) shares of CR exchanged for shares of same CR. Applies AUTOMATICALLY [no election]. See conditions for app. CRA IT115R2 rule [may receive cash/ non-share consideration < or > $200].

* §51 provides **ROLLOVER** when:
* Debt of CR is converted into shares of same CR or
* Shares of CR are exchanged for shares of same CR

And certain other conditions are satisfied

* Issuer need not be CAN CR; investor need not be CAN resident
* If conditions met, **§51 applies automatically; no election**
* **Conditions** common to conversions of both debt and shares to shares:
* Investor must surrender debt or shares of issuer in exchange for treasury shares of issuer
* Debt or shares surrendered must be **capital property** (not securities) to investor
* Investor must receive **no consideration** in exchange for debt or shares surrendered other than treasure shares of issuer

**SHARE:** defined in §248(1) to include fraction of share

**§51 ROLLOVER**

Conditions for app

* CRA admin concession in IT-115R2:
* May receive cash or other non-share consideration in lieu of fraction of share
* If FMV cash or other property is <$200, reduce ACB of shares received by amount or report gain/loss on disposition of fraction
* If > $200 and if exceeds PUC of fraction is a deemed dividend; otherwise gain or loss

### DEBT [bond, debenture, note – not trust or PS]. SHARES [don’t need to be converted by their terms. PUC reduced §51(3)(a) A – B]. INVESTOR CONSEQUENCES [no disposition of debt/share – no gain/loss §51(1)(c)]. INDIRECT BENEFIT rules.

* Where **debt is converted:**
* Debt must be bond, debenture or note of CR – not trust or partnership
* Debt terms must confer right to exchange debt for shares on debt-holder – add conversion right to debt before converting? IT-448
* Not applicable if CR only party with right to satisfy debt with shares
* Consider §80 (debt forgiveness) – do shares have FMV at least equal to debt satisfied?

**§51 DEBT**

* **Shares do not need to be convertible by their terms**
* If addition to PUC of new shares exceeds PUC of converted (exchanged shares), PUC of new shares is reduced - §51(3)(a)
* Reduction is A – B: amount added to PUC of acquire shares less PUC of convertible shares immediately before exchange
* If more than one class received, PUC reduction allocated btw new classes in proportion to amount added to PUC of new classes
* §51(3)(b) – where there has been PUC grind, add-back as with §85

**§51 SHARES**

* **No disposition of debt/ share – no gain or loss: §51(1)(c)**
* ACB of converted security becomes cost of new shares: §51(1)(d)
* If receive more than one class of shares, ACB of converted security is allocated based on proportionate FMV of new shares
* If converted property is taxable Canadian property (TCP), new shares deemed TCP for 60 mo: §51(1)(f)

**§51 INVESTOR**

**CONSEQUENCES**

* If converted security has FMV>FMV of shares received by investor on conversion, and
* It is reasonable to consider any portion of excess as benefit investor wanted to confer on related person,
* Then **rules above re rollover** and cost of new shares not applicable §51(2)
* §51(2)(d) – investor deemed to have disposed of converted security for proceeds equal to lesser of:
* ACB of converted security plus benefit; and
* FMV of converted property
* Gain equal to value of benefit typical result but if loss (Because FMV<ACB), capital loss deemed nil (§51(2)(e))
* §51(2)(f) – cost of new shares to investor is lesser of:
* ACB of converted security; and
* FMV of new shares plus any capital loss denied by §51(2)(e)

**§51 INDIRECT**

**BENEFIT**

## §51.1 DEBT FOR DEBT EXCHANGE

* Conditions for application:
* Exchanged debt must be capital property to debt-holder
* Exchanged debt must confer right of exchange on debt-holder
* New debt must have same principal amount as exchanged debt
* Where it applies, proceeds of exchanged debt and cost of new debt = ACB of exchanged debt

**§51.1**

**DEBT FOR DEBT**

**EXCHANGE**

## §86 REORGANIZATION OF CAPITAL

### ROLLOVER when conditions met. Applies to SHARES, not debt. Trumps §51. Conditions: (i) SH must dispose of ALL shares; (ii) share exchange must occur in course of reorganization. Rules if BOOT/ NO BOOT received.

* **Provides tax-free rollover where relevant conditions are met**
* **Only applies to shares – not debt**
* Issuer need not be Canadian CR; investor need not be Canadian res
* Where conditions are met, it applies automatically: no election
* **Trumps section 51**
* SH must **dispose** of **ALL** shares it owns of exchanged class (or series) and shares must be capital property
* Test is applied SH by SH and class (series) by class (series)
* SH must receive new shares of issuer but may receive other property (**boot**)
* Share exchange must occur ‘in course of reorganization of capital of CR’
* CRA position is that ‘reorganization of capital’ req articles of amendment
* Change to authorized capital and issued capital of CR is required rather than merely exchange of issued shares for another class of authorized shares
* **If no boot received:**
* Investor is deemed to have acquired new shares at cost equal to ACB of exchanged shares
* Where investor acquires more than one class of new shares, cost is allocated to new shares in proportion to their FMV
* Investor deemed to have disposed of old shares for proceeds equal to cost of new shares (i.e. ACB of exchanged shares)
* **If boot received:**
* Investor deemed to have acquired boot at cost equal to FMV
* Investor deemed to have acquired new shares at cost equal to amount, if any, by which ACB of exchanged shares exceeds FMV of boot
* Same rule re allocating cost if more than one class of new shares as where no boot
* Proceeds of old shares deemed equal to FMV of boot plus cost of new shares – unless deemed dividend

**§86 REORGANIZATION**

**OF CAPITAL**

### §86 EFFECT ON PUC [permitted increase to PUC limited, PUC GRIND at §86(2.1)]. §86 INDIRECT BENEFIT [SH loses rollover].

* **Like other provisions, permitted increase to PUC is limited**
* §86(2.1)(a) if addition to PUC of new shares exceeds PUC of exchanged shares less FMV of any boot, **PUC of new shares reduced**
* If more than one class of shares received, PUC reduction allocated btw new classes in proportion to amount added to PUC of new classes
* §86(2.1)(b) – where there has been PUC grind, add-back similar to §51 and 85

What if FMV of boot > PUC of exchanged shares?

* PUC of new shares will be nil but also deemed dividend under §84(3) equal to excess
* §84(3) applies where CR has cancelled share
* Amount paid in excess of PUC of cancelled share is deemed dividend
* Deemed dividend not part of PD of old shares

**§86 EFFECT ON PUC**

* §86(2) very similar rule to that in §51
* Applies where FMV exchanged shares > FMV of property received in exchange (boot plus new shares) and it is reasonable to consider any portion of excess (gift portion) as benefit investor wanted to confer on related person
* **Result is SH loses rollover**
* Exchanged shares deemed disposed of for proceeds equal to lesser of:
* Their FMV, and
* Sum of FMV of any boot and gift portion
* Any loss of investor deemed nil
* No effect on cost of boot
* Cost of new shares deemed difference, if any, btw ACB of old shares and sum of FMV of any boot and gift portion

**§86 INDIRECT**

**BENEFIT**

## §85 ROLLOVER?

### §85 applies where investor transfers shares of CR back to that CR in exchange for treasury shares of CR [all §85 conditions satisfied].

* **§85 will apply where investor transfers shares of CR back to that CR in exchange for treasury shares of CR** provided all other conditions of §85 are satisfied
* §85 allows some boot but if boot exceeds PUC of transferred shares deemed dividend – same analysis as for §86
* Because §86 operates automatically, may be preferred where logistical difficulties exist for largescale §85 elections
* Under §86, cost base allocated proportionate to value, under §85, first to preferred and then to common
* §85 can be used for **non-capital property**; where disposition not in course of reorganization of capital; or where only some shares of class are being converted
* Even where no boot, **§85 may result in deemed dividend** (i.e. ACB of transferred shares > PUC of those shares and addition of PUC of new shares > PUC of transferred shares
* §85(2.1) only limits PUC addition to elected amount – assume ACB
* §84(1) deems dividend where increase in PUC without corresponding increase in assets
* Avoid by limiting addition to corporate capital to PUC of transferred shares

# **SHARE-FOR-SHARE EXCHANGES**

## SHARE FOR SHARE EXCHANGES

### Shares of one CR may be exchanged for shares of another CR. §85.1 applies AUTOMATICALLY.

* **Shares of one CR may be exchanged for shares of another CR**
  + Acquisitions
  + Corporate reorganizations
  + Divisive reorganizations
  + Business combinations
* At some times, §81.1 provides **ROLLOVER**
* **§85.1 applies automatically** if conditions are satisfied
* §85 applies only where joint election made by both parties to transferor
* §85 trumps §85.1 – if elect to have §85 apply by making election, §85.1 won’t apply

KEY

## §85.1(1)

### Basic conditions [acquiror is CAN CR; shares of TCC; shares capital property; transferor TP; **no non-share consideration**; cash $200 limit exception] AL REQ [transferor and transferee].

* Acquiror must be CAN CR
* Shares transferred to acquiror must be shares of taxable CAN CR
* Shares transferred must be capital property to transferor
* Transferor must be TP
* Acquiror must issue treasury shares of particular class in exchange for transferred shares
* **No non-share consideration may be received** in exchange for transferred shares
* BUT:
* Cash in lieu of fractional shares permitted up to $200 and reported in same manner as for §51 *ITF* S4-F5-C1, para 1.7
* If there is non-share consideration, some shares may be transferred for shares and others for non-share consideration so §85.1 applies in part
  + Language of offer important to obtain desired result
  + Same approach where acquiror issues more than one class of shares

BASIC

CONDITIONS

* Immediately before exchange, transferor and acquiror must deal with each other at AL
  + For this purpose, any §251(5)(b) rights are ignored
  + Det separately for each transferring SH
  + If particular SH is ineligible, other SHs who qualify may nonetheless rely on provision
* Immediately after share exchange, transferor (alone or together with persons with whom transferor doesn’t deal at AL) **must not:**
  + Control acquiring CR (i.e. *de jure* control) or
  + Beneficially own shares representing more than 50% of FMV of all outstanding shares of acquiring CR

AL REQ

**§85.1(a)**

**AL REQ**

§85.1 CONSEQUENCES TO TRANSFEROR

### §85.1 Deemed to dispose shares for **PD = ACB**. Deemed to acquire shares for **PD = ACB.** Applies AUTOMATICALLY.

* Except where transferor has included in income any portion of gain or loss otherwise det from disposition of transferred shares, transferor is:
* Deemed to dispose of transferred shares for **PD = ACB**
* Deemed to acquire shares of acquiror at **cost = same amount**
* If transferred shares are taxable CAN property (TCP), new shares deemed TCP for 60 mo
* **Applies automatically** if conditions are satisfied
  + Opt out by reporting gain or loss -but can’t report partial gain or loss – all or nothing gain/loss recognition
  + N/A if §85 applies by joint election of transferor and acquiror – where want to recognize part of gain only, use §85 election
* If corporate vendor opts out of §85.1 and realizes loss, stop loss rules in §40(3.3) and (3.4) will apply because exchanged shares deemed to be identical to target shares (§40(3.5)(b)(ii)) so will hold same property 30 days before and 30 days after transaction

**§85.1**

§85.1 CONSEQUENCES TO ACQUIROR

### §85.1 Cost of transferred shares lesser of (i) FMV and (ii) PUC.

* Cost of transferred shares to acquiror is lesser of
  + Their **FMV** and
  + Their **PUC**
* Acquiror’s cost not dependent on transferor’s proceeds
* Application of §85.1 to acquiror is not dependent on it applying to transferor
  + Applies automatically and independently
  + So if transferor reports gain, acquiror nonetheless subject to §85.1

**§85.1**

## §85.1 PUC CONSEQUENCES

### §85.1(2.1)(a) Addition to PUC of shares issued by acquiror limited to PUC of transferred shares

* **§85.1(2.1)(a)** – addition to PUC of shares issued by acquiror limited to PUC of transferred shares
* If acquiror issues shares of more than one class, any PUC reduction is applied proportionately to PUC additions to classes
* §85.1(2.1)(b) – similar add-back to PUC of issued shares as under §51, 85, 86

**§85.1**

## CC WITH §85

### **§85 may also be used for transfer of shares of CR to taxable CAN CR**

* Requires joint election
* Requires acquiror to issue treasury shares
* Permits boot
* May result in different allocation of ACB of old shares to new shares than §85.1 would
* Transferred shares need not be capital property
* Acquiror’s cost of shares may be > PUC
* Permits partial gain recognition

# **AMALGAMATIONS**

## AMALGAMATIONS

### Procedure; two+ CRs combine/merge to form 1 CR (§181 CBCA/§174 OBCA).

* **Statutory procedure under CR law permits two+ CRs to combine/ merge and form single CR**
* §181 *CBCA*/ §174 *OBCA* – two+ CRs may amalgamate and continue as one CR

**AMALGAMATIONS**

* Amalgamating CRs must all be governed by same corporate statute
  + If dif jurisdictions, one+ CRs may have to continue to other jurisdiction
* Amalgamation agreement req unless exception for short-form amalgamation applies
* Amalgamation agreement must be approved by SH by special resolution

(i.e. 2/3 votes cast at meeting); may req separate class votes

* Dissent rights for SHs
* Effective on issuance of certificate of amalgamation following filing articles of amalgamation

CORPORATE

REQ

* Complete acquisition of another CR
* Effect business combination
* Merge related profitable and loss CRs
* Reduce compliance, ease administration and reduce costs
* Elimination of minority SHs

REASONS FOR

AMALGAMATING

## TYPES OF AMALGAMATION

### CONVENTIONAL, SHORT-FORM HORIZONTAL, SHORT-FORM VERTICAL, TRIANGULAR AMALGAMATION

* Amalgamation of two+ CRs with dif SHs

CONVENTIONAL

AMALGAMATION

* Two+ **wholly** owned subsidiaries of single parent CR
* No SH vote or amalgamation agreement req

SHORT-FORM

HORIZONTAL

AMALGAMATION

* Amalgamation of **parent** and one+ wholly owned **subsidiaries**
* No SH vote or amalgamation agreement req

SHORT-FORM

VERTICAL

AMALGAMATION

* At least **some SHs of amalgamating CRs** receive shares of amalgamated CR’s parent instead of shares of amalgamated CR

TRIANGULAR

AMALGAMATION

## AMALGAMATION FOR TAX PURPOSES

### Must qualify as amalgamation under §87(1). See conditions. Have ROLLOVER.

* **Req’s to qualify as amalgamation under §87(1) of *Act*:**
* All amalgamating CRs must be **taxable CAN CRs (TCC)**
* All property of each predecessor (not shares/ receivables of another predecessor) **must become property of amalgamated CR**
* All liabilities of each predecessor must become **liabilities of amalgamated CR** (except if due to another predecessor)
* **All SHs must receive only shares of amalgamated CR in** exchange for their shares of predecessor
* Exception for triangular amalgamation: shares of parent deemed to be shares of amalgamated CR for this purpose: §87(9)(a)
* Exception for short-form amalgamations where shares of predecessor simply cancelled (§87(1.1))
* Cash in lieu of fractional shares permitted – S4-F7-C1
* Dissenters may receive cash for shares – S4-F7-C1

TAX

* On horizontal short-form amalgamation, shares of all but one amalgamating subsidiary are cancelled without new shares issued
* On vertical short-form amalgamation, shares of subsidiary are cancelled without shares being issued
* **§87(1.1)** deems shares of predecessor held before amalgamation and not cancelled to be received as consideration for all predecessor shares so condition in §87(1)(c) satisfied

SHORT-FORM

AMALGAMATIONS

* Not all amalgamations qualify – merger that qualifies as amalgamation for corporate law purposes may not qualify as such for purposes of §87 because conditions in §87 not met
* Consequence? *Envision Credit Union*
* §87 contains rules governing consequences of qualifying amalgamation on:
* Amalgamating CRs (each a predecessor)
* Amalgamated CR
* SHs
* Other security holders
* **General principle is ROLLOVER** for all and continuity (and in some cases aggregation) of tax accounts/ attributes of predecessors
* Rules in §87 apply automatically if merger qualifies as amalgamation as defined in §87 – no election req

TAX

## CONSEQUENCES TO AMALGAMATED CR

### Amalgamating CRs continue as ONE CR (CBCA 186(a); OBCA 179(a)). TAXATION YEAR, TAX ACCOUNTS, PUBLIC CR [if predecessor is PubCo, amalgamated CR deemed to be PubCo].

* Under corporate law amalgamated CR is continuation of all predecessors:

**‘amalgamating CRs are amalgamated and continue as one CR’ (*OBCA* s179(a))**

‘the amalgamation of amalgamating CRs and their continuance as one CR’ (*CBCA* s186(a))

TO AMALGAMATED

‘*Where there has been amalgamation \* corporate entity formed as result of amalgamation shall be deemed to be new CR the first taxation year of which shall be deemed to have commenced at time of amalgamation’* (§87(2)(a))

**TAXATION YEAR:** new CR can select taxation year that need not correspond to

taxation year of any predecessors

**TAX ACCOUNTS:** most tax accounts of predecessors are carried over into

amalgamated CR; capital cost, UCC, ACB, non-capital losses,

capital losses, reserves

*Act* takes HYBRID APPROACH:

* Amalgamated CR is new CR for some purposes
* Amalgamated CR is deemed continuation of predecessors for some purposes
* Even if not deemed continuation, often rules apply as if continuation

i.e. capital cost of depreciable property to predecessor is deemed capital cost to amalgamated CR which is deemed to have claimed CCA predecessor claimed

**Public CR Status**

* **If any predecessor is public CR, amalgamated CR will be deemed to be public CR (§87(2)(ii))**
* Can predecessor cease to be public CR prior to amalgamation?

Election may be available per Reg 4800

* Predecessors’ losses carry over into new CR
* New CR deemed same CR as and a continuation of each predecessor (§87(2.1))
* But losses realized by amalgamated CR can’t be carried back to predecessor subject to one exception for vertical amalgamation
* Amalgamated CR’s losses can be carried back but only to former parent (§87(2.11))
* Are losses subject to acquisition of control rules?

*PubCo*

## PUC IMPLICATIONS

### PUC capital of all shares (of amalgamated CR) can’t exceed aggregate PUC of shares of predecessors. If exceeds, §87(3) PUC GRIND.

* PUC capital of all shares of amalgamated CR **can’t exceed aggregate PUC** of shares of predecessors (other than PUC attributable to shares held by predecessors)
* If amalgamated CR’s PUC exceeds that amount, **it is reduced by excess and reduction applied to all classes in proportion to PUC of class – §87(3)**
* Subject to any corporate law limitations, specify in amalgamation agreement that stated capital for class will be appropriate amount so total PUC of all classes of amalgamated CR doesn’t exceed relevant PUC of amalgamating CRs

**PUC**

**IMPLICATIONS**

**PUC GRIND**

**§87(3)**

## CONSEQUENCES TO PREDECESSOR CRs

### Taxation year ends immediately before amalgamation. No gain/ loss realized on assets. §87(3) AUTOMATIC ROLLOVER [dispose old shares at ACB and acquire new shares at ACB].

* ***Act* generally silent on consequences to predecessors** but it is accepted that
* **Taxation year of each predecessor ends immediately** before amalgamation effective
  + Amalgamation is considered effective throughout day (unless certificate provides otherwise) – amalgamation on Feb 1, means predecessors’ taxation years will end Jan 31 [short taxation year]
* **No gain or loss realized on assets** notwithstanding assets become assets of new CR
* Disposition is defined in §248(1):

Disposition of any property \* includes

(b) any transaction or event by which …

(iii) where property is share, the share is converted because of amalgamation or merger

* For this purpose need not be amalgamation as defined in §87
* **If amalgamation qualifies as §87 amalgamation §87(4) provides for automatic rollover** provided:
* Shares held as capital property
* SH receives nothing other than shares of amalgamated CR in exchange for shares
* Exception for cash in lieu of fractions/ paid to dissenters
* No benefit is conferred on related person – indirect gift rule

Analogous to that in other rollover rules

* Where rollover available, disposition of **old shares at ACB and acquisition of new shares at same ACB**; where acquire more than one class of shares of amalgamated CR, ACB allocated based on relative FMV
* If hold more than one class of predecessor, can have ACB distortions because of allocation rule

TO

PREDECESSOR

**§248(1)**

**§87(4)**

### TRIANGULAR AMALGAMATION [same rules], OTHER SECURITY HOLDERS, VERTICAL AMALGAMATION **TRAP** [parent realizes gain = excess §87(11) and 88(1)(b)].

* For SHs other than parent, same rules apply
* Parent may be permitted step up in cost of shares of amalgamated CR to net tax cost of amalgamated CR’s assets (or FMV of amalgamated CRs shares if that amount is lower) where amalgamated CR is wholly-owned by parent immediately following amalgamation – §87(9)(c)

**TRIANGULAR**

**AMALGAMATIONS**

* Option holders: §87(5) rollover if capital property – doesn’t apply to employee stock options governed by §7 = not capital property
* Employee stock options: §7(2.4) rollover
* Debt holders: §87(6) rollover
* Status of shares maintained:
* Flow-through shares: §87(4.4)
* Taxable preferred shares: §87(4.2)

CONSEQUENCES

TO OTHER

SECURITY HOLDERS

* Where parent and its **wholly owned** subsidiary amalgamate and ACB of shares of subsidiary to parent is less than PUC of those shares**, parent will realize gain equal to excess: §87(11) and 88(1)(b)**

Solution

* Before amalgamation, reduce PUC of subsidiary shares to nominal amount, say $1 – consider GAAR but typically viewed as acceptable

VERTICAL

AMALGAMATION

TRAP

## ACB BUMP FOLLOWING ACQUISITION OF CONTROL

### ACB of subsidiary’s non-dep capital property may be BUMPED to amount < FMV [limited app].

* On amalgamation of wholly owned subsidiary and parent, ACB of subsidiary’s non-depreciable capital property may be ‘bumped’ to amount not exceeding FMV if certain conditions are satisfied
* Rule piggy-packs on rules applicable in winding up context
* Limited application and many ‘bump’ denial rules can result in ‘bump’ being unavailable

*THAT’S ALL FOLKS!*