CANADIAN TAX Highlights

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CRA Considers "Reasonable Return" Exception Under TOSI

A recent technical interpretation comments that if a corporation repays a startup capital loan to an individual shareholder, that shareholder may still qualify under the "reasonable return" exception to the tax on split income (TOSI) rules (TI 2018-0771851E5, November 2, 2018). The CRA states that the shareholder may still qualify as long as the corporation, having repaid the loan, makes subsequent dividend payments to the shareholder as compensation for the risk that the shareholder initially assumed when he or she provided the loan (taking into consideration factors such as the terms and conditions of the original loan). If the reasonable return exception applies, the CRA advises that the shareholder will not be subject to TOSI on dividends received from the corporation. The CRA also confirms that undistributed retained earnings do not constitute "at-risk capital" and, accordingly, would not be considered for the reasonable return exception.

Generally, split income received by a specified individual is subject to TOSI (taxed at the top marginal personal tax rate) unless the income is an excluded amount. "Excluded amount" is defined in subsection 120.4(1). For individuals aged 18 or over, an excluded amount includes income derived directly or indirectly from an excluded business of the individual or income that is not derived directly or indirectly from a related business in respect of the individual. In addition, an excluded amount for individuals aged 25 or over also includes a reasonable return for the individual.

In the TOSI explanatory notes for subsection 120.4(1), Finance states that a "reasonable return" generally refers to a reasonable return from a business, taking into account the relative contributions made to the business by the individual and related persons. This test takes the following factors into account:

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1) work that the individual performed in support of the related business;
2) property contributed by the individual, directly or indirectly, in support of the related business;
3) risks assumed by the individual in respect of the related business;
4) the total of all amounts paid or payable by any person to the individual in respect of the business; and
5) other relevant factors.

To the extent that an amount paid to an individual represents a reasonable return, that income is not subject to TOSI.

In the TI, the CRA considers a situation of a married couple who are both over the age of 25. They incorporate a company (XCo) with nominal share capital to operate a highly speculative business. The inactive spouse owns 100 non-voting common shares of XCo and the active spouse owns 100 voting common shares of XCo. There are no other classes of shares outstanding. The inactive spouse is not involved with XCo's business operations.

The couple mortgages the family home jointly owned by the couple and loans the funds to XCo so that it can use the amount as startup capital. After several years, XCo repays the loan to the couple, who then use the amounts received to repay the mortgage.

The CRA says that the amount the inactive spouse receives from the XCo shares is likely subject to TOSI, unless he or she can show that the amount is a reasonable return relative to that spouse's contribution to XCo's business. The CRA notes that it also assumed, for the purposes of its response, that the inactive spouse is a specified individual and the active spouse is a "source individual" in respect of the inactive spouse. The CRA also assumed that XCo carries on a "related business" in respect of the inactive spouse because the active spouse owns shares of XCo with an FMV equal to at least 10 percent of the FMV of all issued and outstanding shares of the capital stock of XCo. In addition, the CRA assumed that any dividend received by the inactive spouse is derived directly or indirectly from the related business carried on by XCo. However, the CRA advises that there are not enough facts in the TI to make a clear determination for this scenario, even after these assumptions.

The CRA says that whether the inactive spouse receives a reasonable return depends on facts and circumstances that are specific to the case. For instance, the CRA says that it would have to consider the terms and conditions of the loan, among other factors, and whether the two spouses were adequately compensated under those terms and conditions, relative to the risk assumed by mortgaging the home. If the terms of the loan do not adequately compensate the inactive spouse for his or her risk, the CRA says it could consider that

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factor when determining whether the dividends he or she received, subsequent to the loan repayment, are a reasonable return.

The CRA also says that, if a taxpayer makes a good-faith judgment based on these reasonable return factors, it does not generally intend to substitute its own judgment for what constitutes a reasonable return.

The CRA reiterates that whether a specified individual has received a reasonable return is based on the relative contributions of the specified individual and each source individual in respect of the specified individual. Given that undistributed retained earnings do not represent capital contributed by either spouse, the CRA says that they would not be considered "at-risk capital" and are therefore irrelevant when assessing the reasonable return exception.

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SCC on Suing Tax Advisers

The SCC's recent decision in *Brunette* (2018 SCC 55) inspired both relief and head-scratching from tax professionals. In an 8-1 judgment, the SCC upheld lower court rulings dismissing a lawsuit filed against a group of tax advisers (lawyers and accountants) whose supposed negligence was alleged to have led to the 2010 failure of Quebec's Groupe Melior, which was in the business of building and operating retirement homes.

The SCC held that the plaintiff (Fiducie Maynard 2004, hereinafter "Fiducie") lacked standing to pursue its claims. At first glance, this result seems incongruous because Fiducie apparently had contractual adviser-client relationships with the various defendants. Legally, standing refers to whether a plaintiff has sufficient interest in a dispute to institute a claim. It is usually considered a very low bar to satisfy, and one would normally think it self-evident that a client has standing to sue its advisers for alleged breaches of their professional duties that cause injury.

The SCC decision provides very little background on the underlying tax issues that led to the collapse of Groupe Melior and how the defendants allegedly contributed to them; a review of lower court decisions in the Superior Court (2015 QCCS 3482) and Court of Appeal (2017 QCCA 391) is necessary to appreciate the reasoning behind and scope of the SCC decision. The Superior Court motions judge noted that Groupe Melior had a complex corporate structure comprising more than 60 different entities under the holding company 9143-1304 Quebec Inc. ("9143"). Generally, for each retirement home project, one entity owned the land, another entity built or renovated the retirement home, and yet another would operate it once completed. Under the self-supply rules of the federal Excise Tax Act (ETA) and the provincial Act Respecting the Québec Sales Tax (LTVQ), the entity that built or renovated the retirement home must self-assess and remit sales taxes based on the home's FMV on the date of substantial completion (but those provisions do not define how the FMV is to be calculated). Groupe Melior obtained valuations and remitted sales tax accordingly.

Revenu Québec audited Groupe Melior in 2009 and challenged its methodology for determining the properties' FMV. Essentially, Groupe Melior used a method that relied primarily on anticipated revenues, and Revenu Québec took the position that the taxpayer should have used a method based on the cost of construction. (At the same time but in a different case, Revenu Québec was challenging another taxpayer's valuations of retirement homes on the opposite basis, claiming that the taxpayer used a cost-basis methodology and not an income-based methodology: *Beaudet*, 2014 TCC 52.) Neither the ETA nor the LTVQ specifies how FMV is to be calculated; this lack of clarity has been a longstanding source of difficulty. In the 2006 case of *Lions Village of Greater Edmonton Society* (2006 TCC 670), Campbell Miller J expressed "frustration" over this issue and called for parliamentary intervention that has not materialized.

Revenu Québec issued a series of reassessments to 17 Groupe Melior entities; collections action ensued (sales tax reassessments, unlike income tax, are 100 percent collectible, even if disputed). Soon afterwards, all of the Groupe Melior entities, and Jean M. Maynard personally, filed for bankruptcy.

Fiducie owned all the shares of 9143 and estimated its total losses after the collapse of Groupe Melior to be $55 million. It sued its law firm (Legault Joly Thiffault), its accountants (Lehoux Boivin), and sales tax specialist Marcel Chaput, alleging that they had negligently participated in developing a corporate structure that did not comply with fiscal legislation and used an inappropriate valuation methodology to calculate sales tax remittances.

The defendants moved to dismiss the action on the basis that any injuries resulting from their alleged negligence were suffered by the various entities of Groupe Melior, and Fiducie suffered injury only in its capacity as shareholder of 9143. Thus, any professional negligence claim must be brought by the Groupe Melior entities—or potentially their creditors—as derivative actions in the context of the bankruptcy proceeding. The motions judge found that Fiducie lacked standing to bring its suit, and the Court of Appeal agreed.

The defendants relied on the principle set out in the classic 1843 common-law case of *Foss v. Harbottle* (67 ER 189), which held that a shareholder cannot pursue the claims of a corporation. Quebec is not a common-law jurisdiction, and although it has followed *Foss v. Harbottle*, the province's case law also recognizes that a shareholder can sue a party whose wrongful conduct results in a loss of its share value, provided that fault and direct causality are adequately demonstrated. The leading case on this matter is the SCC's 1990 *Houle* decision ([1990] 3 SCR 122), in which a bank was found liable to shareholders of a family-run corporation when the bank called in a loan to the corporation without reasonable notice, precipitously seized the corporation's assets, and sold those assets at a fire-sale price. The SCC found that under the circumstances and taking into account the relationship between the bank and the shareholders, the bank had a "distinct legal obligation to act reasonably towards [the shareholders] independently of its contractual obligation towards the company." The SCC found that the bank had breached this "distinct legal obligation" and civil liability to the shareholders arose.

Houle is a leading case on the abuse of rights in the civil law and has formed part of the standard Quebec law school curriculum for over a generation, although the decision may not be well known outside the province. Much of the SCC's analysis in *Brunette* is a reconciliation of *Houle* with the common-law principles in *Foss v. Harbottle*, and one might speculate that the SCC granted leave in this case precisely with that objective in mind.

After reviewing certain points of procedure for challenging a suit based on lack of standing (including the standard and onus of proof and the ability to adduce evidence), the SCC held that there is no inconsistency between *Foss v. Harbottle* and analogous principles in Quebec civil law, which in the end produce similar results. Under Quebec law, a corporation has a distinct legal personality and exercises its own civil rights. A cause of action that belongs to a corporation must be exercised by the corporation, not a shareholder, unless the legal requirements for a derivative action are met. As held in *Houle*, a shareholder may pursue an action against a defendant whose wrongful conduct caused damage to the corporation only if (1) the "defendant breached a distinct obligation owed to the shareholders" and (2) "the breach resulted in a direct injury suffered by the shareholders, independent from that suffered by the corporation." The SCC added that in most cases a fault committed against a corporation only indirectly affects the shareholders and thus they do not have a cause of action.

The SCC noted that although Fiducie alleged a contractual relationship with the defendants, this fact alone was not sufficient to grant standing to pursue the claims set out in its pleadings. The pleadings failed to allege with precision which duties, contractual or otherwise, to Fiducie were breached by the defendants.

The question of the sufficiency of Fiducie's pleadings (the statement of claim, then known in Quebec as the "motion to institute proceedings") was dealt with in greater detail in the lower courts. The motions judge remarked that:

> The motion to institute proceedings does not respect section 76 of the *Code of Civil Procedure*. It spans 63 pages, over 316 paragraphs, without counting the sub-paragraphs. It is sometimes incomprehensible, redundant, and stuffed with outside facts not relevant to the litigation. . . . This immense and interminable procedure gives the appearance of a complex matter, but upon examination, one is forced to conclude that it conceals a claim destined to fail. [Paragraphs 37-38, translation by author.]

The motions judge's comments confirm that Fiducie's voluminous pleadings apparently gave little, if any, indication of what the defendants supposedly did wrong in designing and implementing the Groupe Melior corporate structure. The sales tax remittance obligations were, apparently, properly identified and would likely have existed (in some form) no matter what corporate structure was chosen. The ETA and LTVQ do not prescribe a valuation method for retirement homes for the purposes of calculating sales tax, and Revenu Québec itself apparently did not have a consistent position on the subject. It is far from clear how or why Fiducie's professional advisers should be held liable for Revenu Québec's aggressive and mercurial conduct in the course and aftermath of its audit.

In its submissions before the lower courts, Fiducie argued that the defendants had a duty to warn it, as their client, of the risks attending a Revenu Québec challenge of the valuation methodology used for the retirement homes. Fiducie argued that it would not have invested so much in the business if it had been aware of this risk. Both the motions judge and the Court of Appeal seemed to accept that a shareholder of a business would potentially have had standing to bring such a claim, but that the facts alleged in the motion to institute proceedings were insufficient to support one by Fiducie. One might speculate that the outcome of *Brunette*—before both the lower courts and the SCC—may have been different if Fiducie had framed its claims more coherently and with greater focus on the defendants' relationships with and obligations to Fiducie rather than the Groupe Melior entities in general.

However, as pointed out in Justice Côté's lone dissenting opinion in *Brunette*, issues involving sufficiency of pleadings or the prima facie merits of a claim are generally not dealt with as matters of standing. In her view, the fact that Fiducie had a contractual relationship with the defendants and that it alleged—rightly or wrongly—professional negligence in the performance of their contractual duties resulting in $55 million of damages was more than sufficient to meet the very low threshold for standing. She argued that the majority's holding—that a shareholder must allege some "particular" injury distinct from that suffered by a corporation in order to have standing to pursue a claim against its own professional advisers—added novel and unnecessary complexity to the law of standing.

Even in common-law provinces, if a shareholder initiates a lawsuit that states claims contrary to the principles set out in *Foss v. Harbottle*, the remedy is not generally to seek to dismiss the suit for lack of standing, but rather to strike the claim for failure to state a cause of action. A motion to strike for failure to state a cause of action is also a recognized remedy if a plaintiff's pleadings are incoherent and contrary to the rules of procedure, which also occurred in this case. One might have thought that a motion to strike for failure to state a cause of action would have been procedurally a more appropriate course of action for the defendants in this case; as Justice Côté noted in her dissent, "it seems to me that these two exceptions to dismiss have to a large extent been confused with one another."

Brunette may be remembered primarily not for its treatment of the law of standing, but for narrowing *Houle* and bridging the longstanding gap between Quebec and the rest of Canada with regard to civil actions by shareholders. The unusual procedural aspects of this case—including the remarkable suggestion that a client lacks standing to sue its own advisers—may be attributed to incoherent pleadings rather than to the SCC's ushering in new and more restrictive principles of standing.

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Barbados and BEPS Action 5

In a November 21, 2018 statement, the Barbadian prime minister announced amendments to its preferential tax regimes as part of its response to action 5 of the OECD BEPS project. The government reaffirmed its commitment to removing any preferential tax regimes that ring-fenced the international business sector: as of January 1, 2019, international business companies (IBCs) and international societies with restricted liability (ISRLs) become regular Barbados companies (RBCs), effectively merging the tax treatment of domestic companies and international companies (resident companies that carry out all business overseas) except where grandfathering applies. Changes to the tax rate structure should significantly reduce the tax rate for domestic RBCs. Additional corporate tax changes were also announced. Unless otherwise noted, the proposals apply as of January 1, 2019.

Existing IBCs and ISRLs. Effective January 1, 2019, all IBCs and ISRLs are reclassified as RBCs: the IBC and ISRL statutes were abolished before December 31, 2018 and no new IBC or ISRL licences will be issued. Grandfathering applies. An IBC or ISRL licensed before October 17, 2017 (except an IP entity—an IBC or ISRL that holds or exploits only intellectual property) basically retains its current benefits until June 30, 2021, including a tax rate on income on a sliding scale up to 2.5 percent, but the minimum rate on taxable income over BBD 30 million increases from 0.25 percent to 1 percent. (The Ministry of International Business and Industry previously announced that an IP company with the necessary licences issued on or before June 30, 2018 retains its current benefits until June 30, 2021 for IP assets held at October 17, 2017. IP assets acquired later are grandfathered only if the company carried out the R & D that created the IP.)

An IBC or ISRL must obtain a foreign currency permit to continue exchange-control exemptions by submitting a renewal application in the normal manner.

Insurance industry. The Barbados Insurance Act will create three classes of licences: (1) class 1 (insurers of related-party risks: captive insurers) must pay an annual licence fee and a 0 percent income tax rate; (2) class 2 (other insurance companies: insurers and/or reinsurers of third-party risks) are taxed at 2 percent of taxable income; and (3) class 3 (brokers, managers, and other similar entities) are also taxed at a rate of 2 percent of taxable income.

The international insurance sector is grandfathered under the same rules as IBCs and ISRLs. The Exempt Insurance Act will be repealed; under the amended Insurance Act an exempt insurance company falls into one of the three licence classes above.

International banks licensed. The International Financial Services Act (IFSA) will be repealed; the Financial Institutions Act (FIA) will be amended to deal specifically with an institution conducting business in the sector but that generates foreign currency earnings only. These institutions—foreign currency exchange banks—will be licensed.

Companies formerly regulated under the IFSA are expected to fall within the FIA.

New corporate income tax rates. Merging international and domestic tax rates should significantly reduce tax rates for domestic RBCs. The current 30 percent tax rate on an RBC (increased from 25 percent on October 1, 2018 for the 2018 tax year, which corresponds to a company's accounting year ending in 2018) will be replaced with tax rates on a sliding scale (see the table for details), similar to those under the current IBC and ISRL regimes, effective January 1, 2019.

Taxable income (BBD)	Rate
0-1,000,000	5.5%
1,000,001-20,000,000	3.0%
20,000,001-30,000,000	2.5%
> 30,000,000	1.0%

Amendments to the Barbados Income Tax Act. A number of tax changes were announced consequential to reduced tax rates: (1) the only permissible allowances are annual capital allowances, renewable energy allowances, and R & D allowances; (2) tax losses available for offset in an income year are restricted to 50 percent of taxable income; (3) a foreign tax credit may be elected by any eligible entity if it does not reduce tax payable in Barbados to less than 1 percent of taxable income in any given year; (4) foreign currency earnings credits of up to 93 percent of tax payable (available under the previous act) are abolished from the act; and (5) a foreign currency permit can be issued to a company with 100 percent foreign currency earnings; such a company is thus allowed the same exchange-control exemptions as are currently allowed. The permit is expected to be managed by the Ministry of International Business and Industry, which previously issued licences to IBCs and ISRLs.

In light of these changes, on November 27, 2018, the International Business and Financial Services Unit of the ministry issued a practice direction concerning the procedures and fees for an IBC or ISRL under the new regime.

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Proposed US Residence-Based Taxation

US citizens living abroad are subject to very complex information reporting rules and filing requirements each year. US citizens, regardless of where they reside, are required to file a US income tax return each year and report annually any worldwide income, including any income from foreign assets. The foreign earned income exclusion and/or foreign tax credits may substantially reduce or eliminate a US citizen's tax liability; however, these filing requirements can be costly for someone who has been living outside the United States for most, if not all, of his or her life. In addition to the requirement to file an annual US income tax return reporting worldwide income, various information filings also may apply. For example, form 5471 is complex and may be required if a US citizen has an ownership interest in certain non-US corporations. In addition, a US citizen may be required to file form 3520 with respect to certain interests in non-US trusts. Failure to file a US income tax return and applicable information returns each year on time may result in significant penalties for US citizens residing in Canada. A new bill introduced in the House proposes a residence-based tax system in the United States.

This proposal puts the United States in line with many other countries around the world: the United States is one of only a few countries that tax based on citizenship. The proposed legislation, the Tax Fairness for Americans Abroad Act of 2018 (HR 7358), allows qualified non-resident citizens to exclude foreign-source income from gross income. The exclusion generally applies to income sourced outside the United States. The proposed legislation defines a non-resident citizen as a US citizen with a foreign tax home who has fully complied with the US income tax laws for the previous three years and meets one of two requirements: (1) bona fide residence in a foreign country or countries for an uninterrupted period that includes a full tax year or (2) presence in a foreign country or countries during at least 330 full days during the tax year. Of course, a qualified non-resident citizen is still liable for tax on US-source income. For instance, if a US citizen is resident in Canada and earned US-source income not otherwise exempt under the Canada-US income tax treaty, he or she must still file a US tax return and report such income under this proposed system. The organization American Citizens Abroad has been advocating for residence-based taxation for some time. American Citizens Abroad suggests that this proposal would allow more Americans to enter into the global workforce and encourage domestic job growth.

This legislation has only been proposed in the House. It must first pass in the House and the Senate and the president must then sign the law before it becomes effective. A residence-based taxation system would be welcome news to US citizens residing in Canada, but given the political climate in Washington, it seems very unlikely that this proposed law would ever pass both houses of Congress and become effective. With that in mind, Canadian-resident US citizens should be aware that their US tax-filing requirements under current law still require US citizens residing outside the United States to file a US tax return and report their worldwide income.

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British Columbia Speculation and Vacancy Tax: Part 1

Starting in 2018, British Columbia imposed an annual speculation and vacancy tax (SVT) on owners of residential property in certain urban centres of the province. After some concessions made by British Columbia's minority government to accept amendments to the draft legislation (proposed by the province's Green Party), the enacting legislation (Bill 45, Budget Measures Implementation (Speculation and Vacancy Tax) Act, 2018) received royal assent on November 27, 2018. Exemptions from payment of the SVT are available, but the registration and filing of an annual declaration are mandatory for all residential property owners subject to the SVT. The SVT makes home ownership in the taxable areas more expensive for owners who reside outside the province or hold real estate for speculative purposes. The SVT's purpose is to address the province's housing crisis by discouraging speculation and vacancies; the goal is to make home ownership more affordable for the province's residents. The tax applies in addition to British Columbia's general property transfer tax (PPT) and additional PPT. The provincial government has committed to using all revenue raised from the SVT to fund affordable housing for people who live in British Columbia.

Who is subject to the tax? The SVT is levied on owners of residential property located in the following areas:

1) municipalities within the Capital Regional District and Metro Vancouver (with some exclusions),
2) districts of Mission and Lantzville,
3) Abbotsford,
4) Chilliwack,
5) Kelowna,
6) West Kelowna, and
7) Nanaimo.

The taxable region does not include reserve and treaty lands, those of a self-governing Indigenous nation, or islands inaccessible by bridge.

The SVT is imposed on property owners at varying rates, depending on the owner's tax residence and whether the owner is a foreign owner, a member of a satellite family, a prescribed Canadian citizen, or a prescribed permanent resident (a foreign owner is an individual who is not a Canadian citizen or permanent resident of Canada). The term "satellite family" refers to an individual or spousal unit (even if each person is a Canadian citizen or permanent resident of Canada) if the majority of the family's total worldwide income for the year was not reported on a Canadian personal income tax return. The SVT is levied on those who own properties in the specified areas on December 31 of each calendar year. Despite the description of the tax, it applies regardless of whether a property was acquired with a speculative investment intention and irrespective of its occupancy status.

Calculation of the tax. The tax rate, as a percentage of the property's assessed value (on July 1), is (1) for 2018, 0.5 percent; and (2) after 2018, 2 percent for foreign investors and satellite families and 0.5 percent for British Columbians and other Canadian citizens or permanent residents who are not members of a satellite family.

Exemptions and credits. Upfront exemptions to the SVT are available for most primary residences, long-term rental properties, and certain special cases including home renovations, illness, and divorce. The list of exemptions is long—it is estimated that over 99 percent of British Columbians are exempt from the tax. A tax credit is also potentially available in varying amounts (depending on the type of owner) for owners subject to the SVT. A future article will provide more details on the available exemptions and tax credits.

Paying the tax. All residential property owners in the areas subject to the SVT must (1) make a declaration (register and claim an exemption) online by March 31 of the following year; and (2) if no exemption is available, pay any tax owing by July 2 of the following year. For 2018, the declaration must be made by March 31, 2019 and the SVT must be paid by July 2, 2019. Where a property has multiple owners, each owner, even if married or related to another owner of the property, must complete a declaration. An owner with multiple properties must complete a separate declaration for each property. Failure to file a declaration for a calendar year results in assessment at the 2 percent tax rate for the taxpayer, regardless of residence status or exemption eligibility.

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Better Late (Invoicing) than Never

Under ETA section 224, a supplier that has remitted GST/HST that is collectible from, but unpaid by, a purchaser can sue that purchaser for the unpaid tax as a debt owed to the supplier if it has complied with subsection 223(1): the supplier must provide the purchaser with written disclosure of the tax payable. Subsection 223(1) is silent as to when the tax disclosure must (or can) be provided by the supplier. The question arises whether a GST/HST invoice can be issued to a recipient years after the transactions and whether the special rules in section 224 operate to deem the GST/HST to be a debt owing to the supplier by the recipient. The recent case of *National Money Mart Company v. 24 Gold Group Ltd.* (2018 ONCA 812) considered these difficult issues. The Ontario Court of Appeal (ONCA) concluded that a supplier who issues after-the-fact invoices satisfies the tax disclosure requirements in subsection 223(1).

In *National Money Mart*, National sold approximately $12.16 million in unrefined gold to 24 Gold between July 2010 and July 2012. No GST/HST was charged or collected at the time of the transactions. In 2015, the CRA reassessed National, as the supplier, for $1.5 million in GST/HST not collected. National issued two GST/HST-only invoices to 24 Gold in May 2015, based on the CRA assessments. Each invoice identified the consideration for the gold sales and the GST/HST payable on the transactions, indicated that the "(GST/HST) at 13% was not charged in error," and also stated that "[t]he GST/HST is being billed to [24 Gold] as a result of Minister issuing an audit assessment to National Money Mart for the failure to charge and remit GST/HST on the consideration for the taxable supplies of jewellery."

After 24 Gold refused to pay the GST/HST for which it was being billed (years after the purchase), National sued in the Ontario courts and relied on ETA section 224. National successfully obtained a summary judgment against 24 Gold in the Ontario Superior Court (2017 ONSC 6373), and 24 Gold appealed to the ONCA.

On appeal, 24 Gold argued that National, as a supplier, was not allowed to bring an action under ETA section 224 because it had not complied with the preconditions in subsection 223(1) on a timely basis—effectively arguing that these rules required disclosure of the GST/HST payable at the time of the original transaction.

The ONCA concluded that while there were some conflicting lower court decisions immediately following the introduction of the GST in 1991, over the years a clear interpretation of subsections 223(1) and 224 has emerged in the case law. That interpretation, in the ONCA's view, confirmed that a supplier can invoice for GST/HST after the fact, subject only to any contractual restrictions on doing so. This conclusion was also found to be supported by CRA Policy Statement P-116 and other professional commentary, all of which confirmed that a supplier can comply with subsection 223(1) by issuing an invoice or receipt after the supply transaction.

The ONCA also chose to adopt the following comments by Bastarache JA (as he then was) in *Occo Developments Ltd. v. McCauley* ([1996] GSTC 16):

> [The ETA] imposes the tax on the recipient of the service, not on its supplier. It would therefore be an unreasonable interpretation of s. 223(1) to limit the sending of a notice of the amount of GST due to documents issued at the time the supply was received. My view on this issue is reinforced by the fact that the formulation of the obligations in s. 223(1) does not reveal any intention of Parliament to impose such a restriction.

The ONCA in *National Money Mart* has likely settled once and for all whether the disclosure obligations outlined in subsection 223(1) can be satisfied by issuing after-the-fact invoices. A purchaser may want to ensure that its purchase contracts either require a timely billing of GST/HST or perhaps are deemed to include GST/HST. This might be an acceptable self-help remedy given the ONCA's indication that a supplier's ability to invoice for GST/HST after the fact is "subject to any contractual restrictions on doing so." A commercial recipient (which acquires the initial inputs exclusively for consumption use or supply in the course of commercial activities) may want to pay the GST/HST and claim an input tax credit (ITC). Immediate legal advice is critical in such circumstances because certain requirements must be met before one can claim ITCs, and each must be met precisely—particularly if the normal time limit for claiming the ITCs has expired.

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Does TPM-17 Solve or Create Issues?

On March 2, 2016, the CRA issued *Transfer Pricing Memorandum* TPM-17 to address the longstanding question in transfer pricing of how to deal with government assistance on an intercompany charge. The focus of TPM-17 is whether tax incentives should reduce the cost base of Canadian service providers when recharging services to non-resident related parties.

A review of TPM-17 leaves taxpayers wondering whether the CRA intended to provide guidance on the proper application of the arm's-length principle or, rather, to put forward a tax policy that prevents the loss of corporate income taxes in addition to the granted tax incentives. This article explores three key questions that arise from the TPM.

Reliable evidence. The policy in TPM-17 is that the costs of the Canadian service provider should not be reduced by the government assistance unless "reliable evidence" exists that third parties would have done so under the same facts and circumstances. The first issue that arises when reading TPM-17 is the meaning of reliable evidence.

"Reliable evidence" is undefined in TPM-17 and is not a term of art in tax jurisprudence. By an unclear test, the CRA effectively denies a Canadian taxpayer the right to reasonable certainty in establishing a transfer price. A lack of clarity also goes against the raison d'être of a transfer-pricing memorandum, which is intended to clarify and not obscure the arm's-length principle. The reliable-evidence test is elusive mainly because, in practice, it is very difficult to find actual evidence, based on publicly available information, demonstrating the treatment and sharing of tax incentives between unrelated companies in the market.

Unfortunately, public financial reporting and disclosure requirements do not impose a requirement to divulge such information, which eliminates the possibility of finding reliable comparables in public sources. The absence of public data creates a void that is not easily filled; other than a fleeting mention, TPM-17 provides little useful guidance on the use of an indirect method to deal with the issue.

Interestingly, TPM-17 does not specify an overlap or equivalence between reliable evidence and arm's-length observations/evidence. Arguably, the authoritative statement of a public figure—such as a government official or a renowned tax expert—is sufficiently reliable evidence.

"Presumption-based test" and the arm's-length principle. TPM-17 concludes with another perplexing statement: "it is presumed that the Canadian taxpayer will keep the government assistance, unless it can be proven that arm's length enterprises would effectively share all or part of that assistance." The second issue is whether this implied presumption is consonant with the arm's-length principle.

The *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* state: "It is important not to lose sight of the objective to find a reasonable estimate of an arm's length outcome based on reliable information" (paragraph 1.13 of the 2010 and 2017 versions; TPM-17 is dated 2016). One must accurately delineate the transaction and do a comparability analysis to arrive at a conclusion on transfer prices (*Cameco*, 2018 TCC 195); the exercise is designed to arrive at a reasonable conclusion based on an accurately delineated transaction and the most reliable information available. In contrast, the CRA suggests that there is a predetermined conclusion that may not be reasonable, unless available and reliable evidence points to another conclusion.

If there is no reliable evidence, multiple methodologies can help with estimates that apply the arm's-length principle. The TCC in *Cameco* expands on the notion of commercial rationality in that context. In the absence of evidence, the arm's-length test suggests that one alternative is to ask if it is commercially rational to share some or all government assistance. If the answer is yes, then several analytical methodologies are available to estimate the outcome, but these are beyond this article's scope.

Tax policy: Correction of an undesired outcome? Tax policies, such as tax incentives, may have a great impact on a jurisdiction's economic activity and have been empirically proven to affect a jurisdiction's inbound investments by multinational enterprises (MNEs). An MNE will choose a jurisdiction with more advantageous tax benefits for its investment destination; to help attract the desired investment, a good tax policy ensures certainty of outcome and predictability of enforcement.

Like many transfer-pricing matters, TPM-17 is governed by the arm's-length principle, which, among many things, recognizes the "options realistically available" for an MNE investing in various jurisdictions and the inherent subjectivity in sharing tax benefits between the investor and the investee. Subjectivity in the principle's application arguably introduces uncertainty, but that may be mitigated by adequate analysis and documentation.

TPM-17 makes clear the CRA's bias against the erosion of the Canadian tax base. That bias may explain the introduction of the elusive reliable-evidence test, but it also raises the question of whether issuing a TPM is the best way to reverse the undesired outcome of an existing tax law. If Canada did not want to reduce relevant costs by tax incentives, a more prescriptive methodology might be advised, such as the thin cap rules for interest rate deductions. Making legislative changes is more complex than issuing a memorandum, but also likely provides much greater certainty. That certainty may prove better for inbound investment than adding more complexity to a highly subjective area like transfer pricing.

Corporate taxpayers must now deal with unanswered questions emanating from TPM-17. One hopes for much-needed clarity and certainty from another CRA announcement or a court decision.

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Ontario Announcement Throws a Wrench into Integration

In November 2018, Ontario announced that it would not adopt the federal government clawback (subsection 125(5.1) of the small business deduction [SBD]) when a CCPC's adjusted aggregate investment income (AAII) is more than \$50,000. The federal SBD clawback is effective for a CCPC for a taxation year beginning after 2018, at a rate of \$5 for every \$1 of AAII when the AAII was more than \$50,000 in the previous taxation year. The full \$500,000 SBD is therefore eliminated once AAII exceeds \$150,000 (that is, \$500,000 − \$5 × [\$150,000 − \$50,000]) in the prior year. The Ontario rules (Bill 57), which received royal assent on December 6, 2018, cause some unexpected integration results when corporate income is subject to the Ontario (not the federal) SBD and the after-tax amount is ultimately paid out as dividends. In 2019, a CCPC in Ontario earning ABI with access to the SBD is taxable at 12.5 percent (9 percent federal plus 3.5 percent Ontario). At general rates (not the SBD), a CCPC is taxable at 26.5 percent (15 percent federal plus 11.5 percent Ontario), and a CCPC that claws back the federal (but not Ontario) SBD is taxable at 18.5 percent (15 percent federal plus 3.5 percent Ontario). As a result, an Ontario CCPC subject to the federal SBD clawback (because its AAII is more than \$50,000) regains access to the 8 percent Ontario tax deferral, valued at up to \$40,000 in 2019 (\$500,000 × [11.5% − 3.5%]).

When after-tax corporate income is paid out to the shareholder, a CCPC with access to the SBD has total (integrated) corporate and personal taxes of 53.97 percent. A CCPC taxed at the general tax rates is subject to integrated taxes of 55.54 percent, and the CCPC (with AAII in excess of \$50,000) that claws back the federal (but not Ontario) SBD is taxable at the combined integrated tax rate of only 51.33 percent. The result is a breakdown of integration, as seen on the accompanying table.

	General rates (no SBD)	SBD rates (≤ \$50K AAII)	ON SBD only (> \$150K AAII)
Active business income	\$10,000	\$10,000	\$10,000
Corporate taxes: federal (A)	(1,500)	(900)	(1,500)
Corporate taxes: Ontario (B)	(1,150)	(350)	(350)
After-tax income available for dividends	7,350	8,750	8,150
Personal tax: federal (C)	(1,828)	(2,412)	(2,048)
Personal tax: Ontario (D)	(1,076)	(1,735)	(1,235)
Net cash to shareholder	\$ 4,446	\$ 4,603	\$ 4,867
Total integrated tax (A + B + C + D)	\$ 5,554	\$ 5,397	\$ 5,133
Integrated tax rate (%)	**55.54**	**53.97**	**51.33**

When the federal SBD is clawed back because of AAII, dividends paid by the CCPC to an individual will be eligible dividends as a result of the increase to the general-rate income pool (GRIP) account. Since each province does not have its own independent GRIP balance, there is no adjustment for the fact that Ontario tax is being paid at the lower SBD rate. (Ontario could, theoretically, create its own Ontario GRIP at the cost of additional complexity in an already overbearing tax system.)

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The result of paying eligible dividends from GRIP (defined federally in subsection 89(1)) is that a CCPC whose AAII exceeds $50,000 has a lower integrated tax rate and the federal government enjoys increased revenue at Ontario's expense.

A similar situation occurs in Saskatchewan: since January 1, 2018, a CCPC has had access to the provincial SBD on ABI up to $600,000, although the federal SBD limit is only $500,000. A Saskatchewan CCPC that earns ABI between $500,000 and $600,000 has a GRIP account addition, even though the Saskatchewan corporate tax rate paid on this income is only 2 percent. As a result, that Saskatchewan CCPC has an integrated tax rate of 42.78 percent in 2019 (in this $100,000 range); a CCPC taxable at general rates both federally and provincially (on income above $600,000) has an integrated rate of 48.75 percent.

In Quebec, a CCPC's ABI may qualify for the federal SBD but not the Quebec SBD (unless its employees worked at least 5,500 hours during the taxation year). Consequently, there is no addition to the GRIP account, and dividends from the CCPC are taxed as other-than-eligible dividends to the individual. This results in a 2019 integrated tax rate of 57.32 percent. Alternatively, if the CCPC chose to forgo the federal SBD, the 2019 integrated tax rate would drop to 56.05 percent. If the 5,500 hours test is met and the SBD is thus available both federally and in Quebec, the 2019 integrated tax rate is 54.31 percent. (See Hiren Shah and Manu Kakkar, "Coming to Grips with Quebec's Lack of GRIP" (2017) 17:2 *Tax for the Owner-Manager*.)

The policy for an Ontario corporation and its shareholders means that it will take about nine years to break even on the upfront tax cost, using a 4 percent compounded after-tax return on the 6 percent deferral inside the CCPC. (From the accompanying table, a CCPC that earns AAII under $50,000 provides a tax deferral of 6 percent [$8,750 − $8,150] that comes with a 2.64 percent tax cost [53.97% − 51.33%].)

A taxpayer and its advisers may want to reconsider investment and remuneration strategies and determine whether the tax deferral of 6 percent or the lower overall integrated rate of 51.33 percent better supports the shareholders' objectives and the corporation's business.

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