In this issue

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Canada – TaxMatters@EY

February 2019

Ontario opts out of passive investment income rules impacting the small business limit

Alan Roth, Toronto

On 15 November 2018, the Ontario Government announced that it would not parallel recently enacted federal legislation that reduces a Canadian-controlled private corporation's (CCPC's) access to the small business deduction where passive investment income[1] earned by a CCPC exceeds a specific threshold. This may lead to anomalous results, with a CCPC having one small business limit in a year for federal purposes and another for Ontario purposes.

[1] Examples include dividend income on a stock portfolio, interest income on the holding of debt instruments and taxable capital gains realized on the disposition of assets that are not used by the corporation to earn active business income in Canada.

TaxMatters@EY is a monthly Canadian bulletin that summarizes recent tax news, case developments, publications and more. For more information, please contact your EY advisor.

In June 2018, amendments to the *Income Tax Act* (Canada) were enacted that include new rules that reduce the federal $500,000 small business limit for CCPCs (and associated corporations) earning passive investment income in excess of $50,000, effective for taxation years beginning after 2018 (subject to transitional rules). This reduction results in reduced access by a CCPC to the federal small business corporate income tax rate (9% in 2019, compared with the 15% general corporate tax rate). These amendments were announced in the 2018 federal budget with the objective of limiting the deferral advantage of private companies earning passive investment income.

Under the new rules, a CCPC's small business limit for a taxation year will be reduced by $5 for every $1 by which the CCPC's passive investment income and that of its associated companies in total exceeds $50,000 in the preceding year. A CCPC's small business limit will be reduced by the greater of the reduction determined by the taxable capital grind[2] and the reduction determined by the passive investment income grind. The entire small business deduction will be unavailable to a CCPC in a taxation year if income from passive investments of the associated group exceeds $150,000 in the preceding year, or if the total taxable capital of the associated group exceeds $15 million in the preceding year. See "Federal budget simplifies passive investment income proposals" in the May 2018 edition of TaxMatters@EY and EY Tax Alert 2018-07 for further details on these new rules and some background on a CCPC's access to the small business corporate income tax rate.

Each of the provinces and territories has its own small business limit[3] and small business income tax rate. The provinces and territories have legislation that generally parallels the federal legislation for the determination of income that is eligible for their small business deduction.

Ontario and Quebec have their own formulas for calculating the taxable capital grind, with each producing the same result as the federal formula. Since the announcement of the new federal passive investment income rules, only Quebec and Ontario have commented on whether they intend to parallel the federal legislation.

In its fall economic update released on 15 November 2018, Ontario announced that it would not parallel the federal rules. Quebec, on the other hand, announced on 3 December 2018 in its own economic update that it would follow the federal lead.

For now, the other provinces and territories are expected, at least in the short term, to follow the new rules, as their respective legislation already parallels the federal small business deduction rules. However, the story does not end there. One or more of these provinces or territories could potentially still announce, perhaps in their next budget, their intention not to adopt the federal rules.

Ontario small business limit

Ontario recently enacted legislation that includes an amendment to ensure that it will not parallel the new federal rules noted above.[4] Section 31 of the *Ontario Taxation Act, 2007*, contains provisions that outline the calculation of a CCPC's small business limit and deduction for Ontario purposes.

Generally speaking, if a CCPC meets the criteria to claim the federal small business deduction, then it is eligible to claim the Ontario small business deduction. For 2019, the Ontario small business limit is also $500,000 and the Ontario small business tax rate is 3.5%. (The Ontario general corporate income tax rate is 11.5%).

The Ontario legislation also includes a provision for a taxable capital grind, calculated in the same manner as the federal taxable capital grind.[5] Because the new Ontario rules remove the impact of federal subsection 125(5.1) (i.e., the federal passive income grind) there will continue to be only one grind for Ontario purposes for taxation years beginning after 2018. And, since the federal legislation stipulates that a CCPC's small business limit is reduced by the greater of the two grinds noted above, it will be possible for a CCPC's Ontario small business limit to be different from the small business limit calculated for federal purposes in certain situations for taxation years beginning after 2018, as shown in the example below.

In some cases, the resulting difference in a CCPC's income tax liability could be significant where the small business limit is different for federal and Ontario purposes. For example, if a CCPC is eligible for the full $500,000 small business deduction for Ontario purposes in 2019, but is not eligible at all for the federal small business deduction because it (and/or any associated corporations) had passive investment income exceeding $150,000 in the preceding year, the combined federal and Ontario tax rate on the first $500,000 of active business income for tax purposes would be 18.5% (15% federal general tax rate plus 3.5% Ontario small business rate). Had Ontario paralleled the new federal rules, the tax rate would have been 26.5% (15% federal plus 11.5% Ontario general tax rate), resulting in an increased income tax liability of $40,000 ($500,000 x (11.5% - 3.5%)).

[2] Existing legislation already reduces the income available for the small business deduction to the extent that an associated group of companies has taxable capital in excess of $10 million. The small business limit is reduced on a straight-line basis for CCPCs (together with any associated companies) that have taxable capital employed in Canada of between $10 million and $15 million in the preceding year. The small business deduction is eliminated completely when taxable capital exceeds $15 million. In very general terms, a corporation's taxable capital is the aggregate of the amount by which its shareholders' equity, loans and advances to the corporation, its future income tax liability and certain amounts not currently deductible for income tax purposes exceed certain types of investments in other corporations.

[3] For 2019, all of the provinces and territories also have a $500,000 small business limit except for Saskatchewan, which has a $600,000 small business limit.

[4] See new paragraph 31(1)(b) of the *Ontario Taxation Act, 2007*, enacted in December 2018.

[5] See s. 31(5.5) of the *Ontario Taxation Act, 2007*.

The following example, originally included in the May 2018 TaxMatters@EY article to illustrate the determination of a CCPC's small business limit for the 2019 taxation year, has been modified slightly to compare the CCPC's business limit for federal purposes vs. its business limit for Ontario purposes:

Example – Small business limit, federal vs. Ontario purposes

Scott is a Canadian resident and is the CEO and sole shareholder of Parts-for-cars Inc., a wholesale distributor of auto parts located near Windsor, Ontario. Parts-for-cars Inc. has a 31 December year end and is not associated with any other corporations for taxation purposes in either 2018 or 2019. Ontario is the only province in which the company has a permanent establishment for taxation purposes and, therefore, Parts-for-cars Inc. is only subject to income tax federally and in the province of Ontario.

Since Parts-for-cars Inc. is a CCPC earning active business income, it could potentially qualify for the small business deduction. Not all of Parts-for-cars Inc.'s after-tax income is required by the company or by Scott each year and, therefore, a portion of the company's retained earnings is invested each year in a portfolio of blue chip stocks.

Upon retirement, Scott intends to sell the portfolio, withdraw the proceeds from the company and purchase a home in Florida. For the 2018 taxation year, Parts-for-cars Inc.'s taxable capital employed in Canada was $12 million and the stock portfolio earned $95,000 in dividend income.

Federal small business limit calculation

As Parts-for-cars Inc.'s 2018 taxable capital employed in Canada was between $10 million and $15 million, and because its passive investment income was between $50,000 and $150,000 that year, the company's federal $500,000 small business limit for 2019 will be reduced by the greater of the taxable capital grind and the grind applicable to the passive investment income earned in the company in 2018.

[6] See paragraph. 125(5.1)(a) of the Act.

[7] See new paragraph 125(5.1)(b) of the Act.

[8] See subsection 31(5.5) of the *Ontario Taxation Act*, 2007.

The reduction to the 2019 small business limit attributable to the company's taxable capital is calculated under the Act as follows[6]*:*

$$\$500{,}000 \times \frac{0.225\% \times (\$12{,}000{,}000 \text{ of taxable capital} - \$10{,}000{,}000)}{\$11{,}250}$$

$$= 500{,}000 \times \frac{4{,}500}{11{,}250}$$

= **$200,000**

The passive investment income grind under the new legislation[7] *is calculated as follows:*

$500,000 Parts-for-cars Inc.'s small-business limit x 5 x ($95,000 of dividend income -$50,000)/$500,000

= **$225,000**

The greater of the two small business limit grinds is the passive investment income one and, therefore, Parts-for-cars Inc.'s federal small business limit in 2019 will be ***$275,000*** *($500,000 - $225,000).*

Ontario small business limit calculation

As Parts-for-cars Inc.'s 2018 taxable capital employed in Canada was between $10 million and $15 million, the company's Ontario $500,000 small business limit for 2019 will be reduced by the Ontario taxable capital grind. There is no passive investment income grind for Ontario purposes.

The reduction to the 2019 Ontario small business limit attributable to the company's taxable capital is calculated in the same manner under the applicable Ontario legislation[8] as the federal taxable capital grind and is, therefore, **$200,000** in this example. Since there is no other small business limit grind that is applicable for Ontario purposes, Parts-for-car Inc.'s Ontario small business limit in 2019 will be **$300,000** ($500,000 - $200,000).

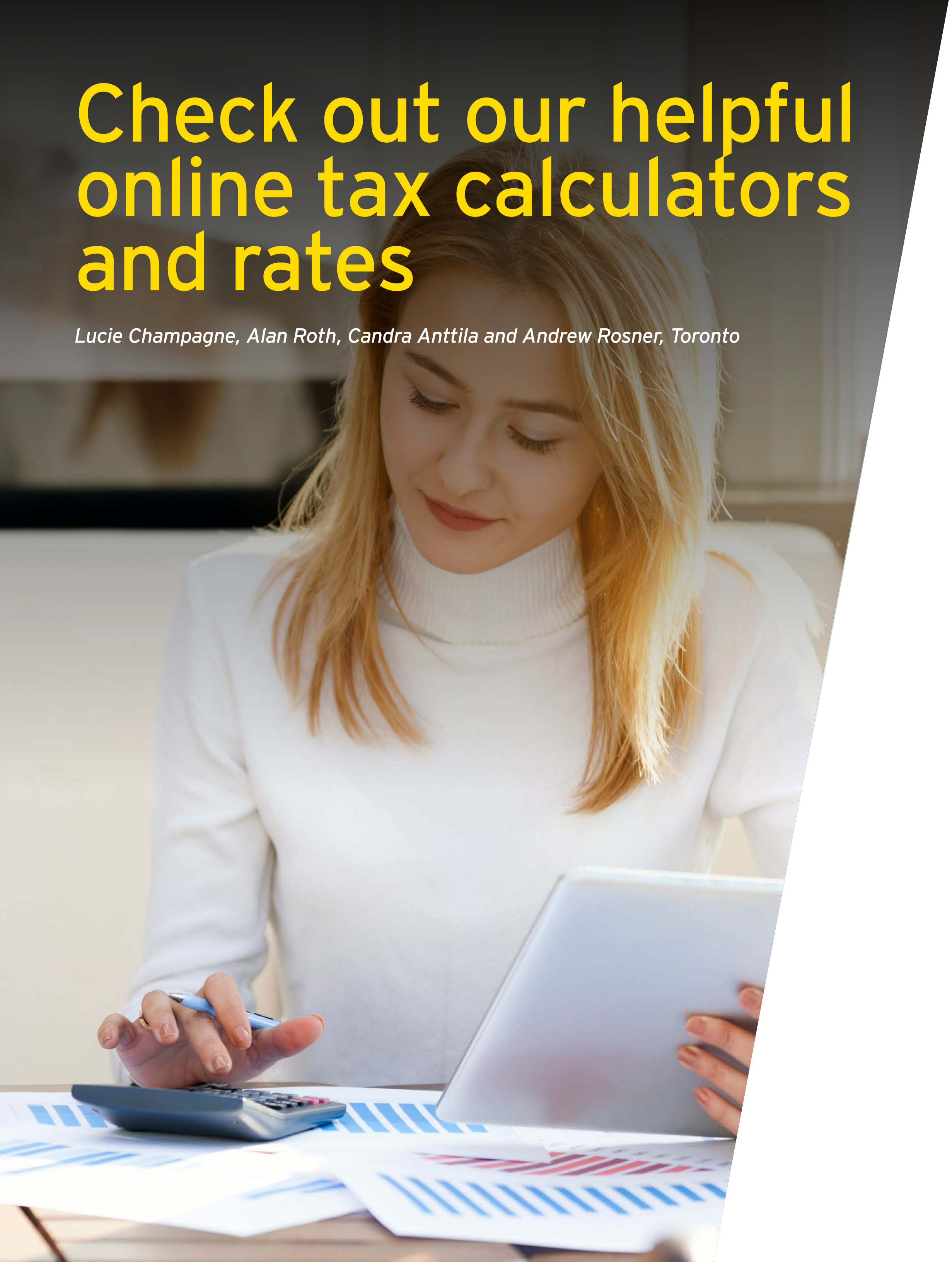
Conclusion

If your corporation has income that is subject to tax in Ontario and has a passive investment income portfolio that may be affected by the new federal rules, your corporation's small business limit for federal purposes calculated under these rules may potentially be different from its small business limit for Ontario purposes. The impact on your corporation's income tax liability may be significant, depending on the extent of that difference.

Accordingly, you may wish to re-evaluate your overall remuneration and investment strategy. As the full tax cost of earning passive investment income through your corporation may now be greater than holding it personally, take a step back and consider implementing a full integration analysis to determine an appropriate strategy in your particular circumstances.

Consult with your EY Advisor for further details.

Back to contents



Check out our helpful online tax calculators and rates

Lucie Champagne, Alan Roth, Candra Anttila and Andrew Rosner, Toronto

Frequently referred to by financial planning columnists, our mobile-friendly 2019 personal tax calculator is found at ey.com/ca/taxcalculator.

This tool lets you compare the combined federal and provincial 2019 personal income tax bill in each province and territory. A second calculator allows you to compare the 2018 combined federal and provincial personal income tax bill.

You'll also find our helpful 2019 and comparative 2018 personal income tax planning tools:

- An RRSP savings calculator showing the tax saving from your contribution
- Personal tax rates and credits, by province and territory, for all income levels

In addition, our site offers you valuable 2019 and comparative 2018 corporate income tax planning tools:

- Combined federal-provincial corporate income tax rates for small business rate income, manufacturing and processing income, and general rate income
- Provincial corporate income tax rates for small business rate income, manufacturing and processing income, and general rate income
- Corporate income tax rates for investment income earned by Canadian-controlled private corporations and other corporations

You'll find these useful resources and several others – including our latest perspectives, thought leadership, Tax Alerts, up-to-date 2019 information, our monthly TaxMatters@EY and much more – at ey.com/ca/tax.

Back to contents

How "NAFTA 2.0" brings some clarity about trade in the Americas

Gijsbert Bulk, EY Global Director of Indirect Tax
Originally published on ey.com

As USMCA trades places with NAFTA, it brings the promise of greater clarity for business in terms of supply chains and tax planning.

US President Donald Trump repeatedly called the North American Free Trade Agreement (NAFTA) the "worst trade deal ever made." However, on 30 September, after more than a year of negotiations, he, Canadian Prime Minister Justin Trudeau and Mexican President Enrique Peña Nieto unveiled NAFTA 2.0 or, as the US prefers to call it, the United States-Mexico-Canada Agreement (USMCA).

The deal, which still needs to be signed and passed through the US Congress before it enters into force, likely in 2020, is something of a relief **in the midst of America and China's increasingly serious trade dispute.**

Back to contents

While it's true that imports of steel, aluminum, solar panels and washing machines still attract tariffs — even those from Canada and Mexico — USMCA does a least give companies some clarity about the future.

Michael Leightman, EY Global Trade Practice's Trade Reform Initiative Leader, says: "At least there is now some certainty in terms of trade planning and alternatives to consider — whether that is shifting production into the US or from other countries into Mexico and then on to the US market under the qualifications of the new trade agreement."

Dalton Albrecht, EY Global Trade Leader in Canada, says: "USMCA will help stabilize things, but nobody really knows where these tariffs are going and to what extent you can make plans. There are certain general things we look at, though, such as can you get remissions of duty (refunds or advance duties relief) and what about alternative-sourcing planning? Can you change supply chains for different destinations for the goods?"

Leightman and Albrecht also advise that companies carefully consider the tariff classification and declaration of origin. Under USMCA there are rules of origin that stipulate what percentage of inputs imported from elsewhere are permitted for goods. For example, 75% of the key components in cars will have to come from the country of origin (i.e., US, Canada or Mexico) under the deal.

Armando F. Beteta, leader of the EY Global Trade services at the Latin American Business Center, says: "The new rules included under the USMCA for the automotive industry are particularly important for Mexico. While the rules of origin for this industry are clearly more strict and new requirements have been added (e.g., 70% of aluminum and steel should be from North America and a high-wage labor value content), there are also interesting incentives linked to the agreement via side letters that, for example, will waive for a high number of Mexican autos/autoparts any potential punitive tariffs, if these are imposed by the US under Section 232 in the near future."

Leightman says: "We are seeing an increase in jurisdictional enforcement, where customs are looking more closely in each country at the qualifications, the documentation, the information submitted to ensure that companies are complying with the rules. In a broader context, across the globe we are also seeing an increase in inspections and requests for data and information on declarations, so we recommend that regulatory and compliance divisions are involved proactively and not reactively."

He adds: "Companies need to ensure they are using the lowest duty values legally permissible from a customs declaration perspective and that they are looking to see if they can reduce the value of intangibles included in the duty value.

"There are a number of strategies that companies might use in the duty deferral area, such as bonded warehouses or free trade zones. Then there is the drawback potential where you can reclaim some of the costs of duty and trade flow costs. So, there are a variety of different options to at least reduce impact if you are not able to find alternative sourcing for certain products," says Leightman.

In an EY poll of 600 tax executives, almost a quarter of companies, 24%, were looking at duty drawbacks and/or the use of free trade zones to mitigate the effects of tariffs.

EY survey of tax executives, October 2018

Twenty-four percent of respondents' companies were looking at duty drawbacks and/or the use of free trade zones to mitigate the effect of tariffs.

The US did design provisions to allow companies in certain industries that are affected by the duties to request exclusions or exemptions where specific circumstances are warranted such as unavailability of a particular item in the US. However, as these provisions have stringent requirements, they are not easily achieved. For the steel tariffs, as an example, to date there has been an approximate 50% to 55% approval rate for requests for exclusion, granted for a year, after which companies have to reapply.

However, while the US has also provided exclusion provisions for the tariffs imposed on China-origin goods, it is anticipated that only 10% to 15% of exemptions for Chinese products will be approved. "The tariff on Chinese products was designed to try to demonstrate the need for companies to locate other sources, so tariff exemptions or exclusions are only being granted where the tariff will be more harmful than helpful in the administration's view," says Leightman.

Mike Heldebrand, EY Global Trade Leader for US West Region, says that boards are well placed to understand the implications of USMCA. "From a C-suite perspective, what is interesting is that the US introduced something, about a year ago, called the border-adjustment tax (destination-based cash flow tax) so you had a very high level of executives involved in that, inputting values that they had never had insight of previously. The introduction recently of additional tariffs has elevated trade practitioners from technical advisors to strategy advisors. This shift has brought them higher visibility in business planning."

Tax specialists deserve their place at the top table, according to Ute Benzel, EY EMEIA Tax Leader, who says: "My advice to board members would be to go into the discussion early and be part of it. If you are head of tax, sit in the driving seat. Make sure that you follow what's going on that is relevant to your business in trade and tariffs. Try to make sure you have the right supply chains and the right delivery models to fit the new rules."

Panel: key differences between NAFTA and USMCA

Critics have dubbed USMCA "NAFTA 2.0," saying that little has changed since the original agreement but there are fundamental additions.

Automotive industry

The agreement states that 30% of vehicle production must be done by workers in factories where the average wage is at least $16 an hour. In 2023, this rises to 40% of workers. Auto workers also have the right to labor union representation.

Also, 70% of the steel and aluminium used in vehicles will have to come from the US, Canada or Mexico.

Manufacturers qualify for zero tariffs if 75% of their vehicles' components are manufactured in the US, Canada or Mexico – it was 62.5% under NAFTA. If the US imposes section 232 national security interests tariffs on autos, Mexico and Canada will be able to export up to 2.6 million vehicles to the US each year tariff free.

Not qualifying for the new terms is arguably not the end of the world, especially those involving US sales, because US tariff rates are a low 2.5%, says James Mackie, Co-Director of the EY Quantitative Economic and Statistics (QUEST) group. "In some cases, it could cost more to comply with NAFTA – for example, because of the complexity of meeting wage requirements for autos – than it's worth," says Mackie.

Dairy farming

US farmers will be able to export about $560 million of dairy products to Canada for the first time.

Metal tariffs

US national security interest safeguard tariffs of 25% on steel and 10% on aluminum from Canada and Mexico remain.

Intellectual property

For first time, law enforcement officials can stop suspected counterfeit or pirated goods in any of the three countries, with harsher punishments for pirated movies online.

Evergreen clause

If the deal starts, as expected, in 2020 it may last at least 16 years, with a review every six years and an option to extend it to 2042.

Summary

The United States-Mexico-Canada Agreement (USMCA) offers organizations much-needed clarity on the future. The agreement replaces NAFTA, a document US President Donald Trump called the "worst trade deal ever made." One of the main changes is an increase in jurisdictional enforcement to ensure companies comply with the rules, which means that regulatory and compliance divisions need to be involved proactively rather than reactively.

TFSAs – what's the advantage?

Louie v The Queen, 2018 TCC 225
Winnie Szeto, Toronto, and Allison Blackler, Vancouver

Tax-free savings accounts (TFSAs) were introduced by legislation enacted in January 2009 (the TFSA rules). By October of the same year, legislative amendments were introduced to prohibit share exchange transactions (swaps) between TFSAs and other registered or non-registered accounts held by the same taxpayer or by the taxpayer and a non-arm's-length individual.

These amendments were a response to reports of shrewd investors who had already grown the value of their TFSAs from the initial $5,000 investment to more than hundreds of thousands of dollars by swapping shares back and forth between their various accounts. This exceptional growth was partly due to the investors' swapping choices and partly due to market conditions at the time; these swap transactions occurred shortly after the financial crisis of 2008, during the recovery period that began in March 2009. It is against this backdrop that this case came before the Tax Court of Canada.

Back to contents

Facts

The appellant was a sophisticated investor. In 2008, she had two accounts with her brokerage firm: a Canadian direct trading account (CDTA) and a self-directed registered retirement savings plan (RRSP). She opened a third account with the broker, a TFSA, in January 2009 when the TFSA rules were first enacted.

From 15 May to 17 October 2009, the appellant made 71 swap transactions, whereby she transferred publicly listed shares between her TFSA and her CDTA and RRSP. Using the broker's guidelines for transfers between accounts, the appellant selected the highest trading price of the day for shares swapped out of her TFSA, and the lowest trading price of the day for shares swapped into her TFSA. She also intentionally chose shares with a high degree of share-price volatility, which gave her the potential for the greatest spread between the prices at which her shares were swapped into or out of her TFSA. In this time period, the total fair market value (FMV) of the appellant's TFSA increased from $5,000 at the beginning of 2009 to more than $205,000 by the end of 2009, which represented an increase of more than 4,000%.

The legislative amendments prohibiting swap transactions became effective on 17 October 2009. As a result, the appellant made no swaps after this date and made the decision to leave the shares in her TFSA. However, due to market forces, the FMV of the TFSA continued to increase in 2010 and 2012, but decreased in 2011.

The Minister of National Revenue reviewed the appellant's TFSA as part of a national TFSA audit project and assessed her on the basis that the FMV of her TFSA had increased in 2009, which tainted the subsequent FMV increments in 2010 and 2012, and as a result, she was extended an "advantage" under subsection 207.01(1) of the *Income Tax Act* (the Act) and, therefore, was liable to pay the special advantage tax that applies under section 207.05.

The amount of tax at issue was significant and was equal to the amount of the increase in value in the TFSA in each year, over and above the annual permitted contributions. The appellant did not dispute that the total FMV of her TFSA had increased in 2009, 2010 and 2012. However, she argued that such increase was not an advantage under the Act and, even if it was, any resulting tax should be payable by the broker under subsection 207.05(3).

Although many other taxpayers have been similarly assessed as part of the Minister's TFSA audit project, this is the first time that the Minister's position was considered on its merits by the Tax Court of Canada.

The Tax Court of Canada decision

During the period when the appellant made the swaps between her accounts, an advantage under subsection 207.01(1)[9] generally meant:

- A benefit that is an increase in the total FMV of the property held in the TFSA if it is reasonable to consider that the increase is attributable, directly or indirectly, to:
  - A transaction or event or a series of transactions or events that:
    - Would not have occurred in an open market in which parties deal with each other at arm's length and act prudently, knowledgeably and willingly, and
    - Had as one of its main purposes to enable a person to benefit from the exemption from Part I tax.

Because the appellant did not dispute that there had been an increase in her TFSA's FMV, the Court's analysis focused on the remaining elements of that meaning. In doing so, the Court separately considered whether the swapping transactions in 2009 extended an advantage to the appellant under the Act, and then whether any subsequent increases in FMV in 2010 and 2012, after the swapping stopped, also extended an advantage to her under the Act.

[9] The definition of advantage was amended on 17 October 2009 to include swap transactions. However, since all of the swaps in this appeal occurred prior to that date, it was necessary for the Court to consider whether the swaps constituted an advantage under subsection 207.01(1) as it read before 17 October 2009.

The swapping transactions in 2009

The Court first considered whether the swaps should be considered a "series of transactions," and observed that for purposes of the TFSA rules, this phrase reflected the common law meaning as expanded by subsection 248(10) of the Act, which deems any related transaction which is completed in contemplation of a series to be part of that series. As a result, the Court concluded that it was not necessary for the appellant to know in advance which shares she would eventually swap, so long as she planned on doing swap transactions with the purpose of achieving the objectives of the series. With that in mind, the Court concluded that the swap transactions were completed in contemplation of the series.

The Court then considered whether the swap transactions would have occurred in an open market, and concluded that they would not. When the appellant chose which shares to swap, she had the ability to pick and choose any price between the high and low of the day to swap those shares. In the long run, this enabled her to artificially transfer more shares from her RRSP and CDTA to her TFSA. According to the Court, this was not realistic trading at FMV in an open market.

On this element, the appellant argued that she and the broker, acting as trustee of the RRSP, and separately acting as trustee of the TFSA, were all unrelated parties and therefore whether the swaps were between her TFSA and her RRSP or her TFSA and her CDTA, the parties were all acting at arm's length. However, the Court was of the view that the appellant was the single mind directing all the swap transactions because she alone determined which shares would be swapped, at what price, in what quantity and at what time. While she gave instructions to the broker, the broker always complied with her requests. Furthermore, the Court found that the parties in control of the accounts acted in concert without separate interests, as the swap transactions always favoured the TFSA to the detriment of the RRSP and CDTA. As such, the Court concluded that the series of swap transactions would not have occurred if the parties had been dealing at arm's length and were acting prudently, knowledgeably and willingly.

Finally, the Court found that one of the appellant's main purposes of the series of swap transactions was to benefit from the exemption from tax under Part I found in the TFSA rules. The Court was of the view that the incurrence of relatively significant transaction costs to complete the swap transactions, and the appellant's strategy of identifying the upward and downward price momentum of the shares swapped, created a strong inference that she entered into those transactions to benefit from the Part I tax exemption on the subsequent sale of the shares held in the TFSA.

Based on the above, the Court concluded that the appellant received an advantage under subsection 207.01(1) in relation to her TFSA in 2009.

The subsequent increases in 2010 and 2012

The Court next considered whether the increase in FMV of the TFSA in 2010 and 2012 was directly or indirectly attributable to the swap transactions in 2009 so as to constitute an advantage under subsection 207.01(1). Here, the Court was mainly concerned with how far into the future an advantage (i.e., an increase in the FMV of the TFSA) will be considered as attributable to an impugned transaction.

Applying a textual, contextual and purposive analysis, the Court stated:

> [78] Although the purpose of paragraph (b) of the definition of "advantage" is an anti-avoidance one, the text and context do not support extending the definition such that it would apply to the 2010 and 2012 taxation years. The broader scope of "directly or indirectly" is limited by the reasonableness requirement also present in paragraph (b). In this case, the circumstances that it is reasonable to consider in deciding whether the 2010 and 2012 increases are attributable to the 2009 swaps include the fact that, unlike in 2009, in the 2010 and 2012 taxation years the Appellant was no longer engaging in swap transactions and the account was subject purely to market forces.

The Court continued:

> [81] ...How far into the future do the swaps continue to affect the funds? How much of the gain is attributable to the Appellant's contribution of $5,000 in 2009? What about her contributions of $5,000 in 2010, 2011 and 2012? What about the Appellant's loss in 2011? A transfer of property has a defined end point, although a circuitous route may be taken to get there. Here, there is no easily defined or delineated end point for the purpose of the analysis regarding the length of time during which an increase may still be attributable to an impugned transaction.
>
> [82] A more restrictive interpretation of paragraph (b) of the definition avoids these difficulties while still fulfilling the anti-avoidance purpose of the provision. The 2009 swap transactions had an avoidance purpose and would not have occurred in an open market in which parties deal with each other at arm's length and act prudently, knowledgeably and willingly. Those transactions increased the value of the Appellant's TFSA in 2009 by 4,032%. The transactions can be clearly delineated and the resulting value is fully caught by the provision. The same cannot be said with respect to the increased value in 2010 and 2012.

Although the Court acknowledged that the phrase "directly or indirectly" is generally interpreted quite broadly, it concluded that the phrase is limited in this context by virtue of the requirement that it be reasonable in the circumstances. In the Court's view, the increase in FMV of the TFSA in 2010 and 2012 was reasonably attributable to market forces, and not directly or indirectly to the swap transactions. Consequently, the subsequent increases in value were not an advantage for purposes of the TFSA rules.

Liability to pay tax under s. 207.05

The final issue the Court considered was whether the broker, and not the appellant, was liable for the advantage tax by virtue of subsection 207.05(3) of the Act, which imposes liability on an issuer if that issuer extends the advantage. The appellant had argued that because she had engaged in the swaps in a manner consistent with the broker's guidelines, and because the broker was the trustee of the TFSA, any advantage must have been extended by them. However, the Court was not convinced, particularly in light of the scant evidence produced at trial on this issue, that the broker should be held liable in the circumstances.

Result

Based on the above, the appeal for the 2009 taxation year was dismissed and the appellant was liable to pay Part XI.01 tax.

The appeals for the 2010 and 2012 years were allowed and no advantage tax was payable under Part XI.01.

Lessons learned

This was the first time that the Tax Court of Canada considered the application of the TFSA rules and, in particular, the definition of advantage under subsection 207.01(1), as that provision read prior to the October 2009 amendments.

In our view, this decision is particularly noteworthy because of the Court's recognition of the difference between increases in value due to an investor's swapping choices and those due to true market forces. Interestingly, the Court made no mention of any such distinction in respect of the increases that arose while the investments were being actively swapped, even though at least some of the gains in that period may have had just as much, if not more, to do with the rebounding market than anything else.

The appellant has appealed, and the respondent has cross-appealed, against the decision of the Tax Court. Therefore, the matter has yet to be settled. Perhaps the Federal Court of Appeal will be able to shed some light on whether those market gains should be reasonably excluded from the advantage as well.

Publications and articles

Tax Alerts – Canada

Tax Alert 2018 No. 39 – "Foreign specified suppliers": less than two months to register

Non-Quebec resident suppliers that are located outside Canada and not registered for the purposes of the goods and services tax (GST) meet the definition of "foreign specified suppliers" and have until 1 January 2019 to comply with the new provisions of the *Act Respecting the Québec Sales Tax*.

Tax Alert 2018 No. 40 – FES announces significant acceleration of CCA

On 21 November 2018, federal Finance Minister Bill Morneau presented the Fall Economic Statement in the House of Commons. On the same day, the Minister tabled a notice of ways and means motion to amend the *Income Tax Act* and the Income Tax Regulations, which was accompanied by explanatory notes relating to these measures.

The statement introduced three key capital cost allowance (CCA) acceleration measures:

- Full expensing for M&P machinery and equipment
- Full expensing for clean energy equipment
- An accelerated investment incentive.

Publications and articles

EY's Global Capital Confidence Barometer

The 19th edition of EY's Global *Capital Confidence Barometer* describes how Canada's executives are optimistic about the strength of the Canadian and global economies but are dialing back their merger and acquisition intentions.

EY's Worldwide Personal Tax and Immigration Guide 2018-19

This guide summarizes personal tax systems and immigration rules in more than 160 jurisdictions, including Australia, Brazil, Canada, France, Germany, Mexico, the Netherlands, the Russian Federation, the UK and the US.

EY's Worldwide Capital and Fixed Assets Guide 2018

The *Worldwide Capital and Fixed Assets Guide* helps our clients navigate the rules relating to fixed assets and depreciation. It summarizes the complex rules relating to tax relief on capital expenditures in 29 jurisdictions and territories.

EY's Worldwide Estate and Inheritance Tax Guide 2018

EY's Worldwide Estate and Inheritance Tax Guide summarizes the estate tax planning systems and describes wealth transfer planning considerations in 39 jurisdictions around the world, including Australia, Canada, China, France, Germany, Italy, the Netherlands, the UK and the US.

Worldwide Corporate Tax Guide 2018

Governments worldwide continue to reform their tax codes at a historically rapid rate. Chapter by chapter, from Afghanistan to Zimbabwe, this EY guide summarizes corporate tax systems in 165 jurisdictions.

Worldwide VAT, GST and Sales Tax Guide 2018

This guide summarizes the value-added tax (VAT), goods and services tax (GST) and sales tax systems in 122 jurisdictions, including the European Union.

Worldwide R&D Incentives Reference Guide 2018

The pace at which countries are reforming their R&D incentives regimes is unprecedented. This EY guide summarizes key R&D incentives in 44 countries, and provides an overview of the European Union's Horizon 2020 program.

2017-18 Worldwide Transfer Pricing Reference Guide

The proliferation of transfer pricing rules and regulations around the world, and the huge increase in focus on the subject by the world's tax authorities, require practitioners to have knowledge of a complex web of country tax laws, regulations, rulings, methods and requirements. This guide summarizes the transfer pricing rules and regulations adopted by 119 countries and territories.

Board Matters Quarterly

The January 2019 issue of Board Matters Quarterly includes four articles from the EY Center for Board Matters. Topics include: the board's role in confronting crisis, cybersecurity disclosure benchmarking, improving board performance through effective evaluation, and today's independent board leadership landscape.

EY Trade Watch

The December edition throws a spotlight on trade deals that have been reached in principle, looking at the United States-Mexico-Canada Agreement (USMCA) set to replace the North America Free Trade Agreement (NAFTA). The publication also covers Brexit, looking at the progress of the draft Withdrawal Agreement. In addition, the publication looks at the Comprehensive and Progressive Agreement for the Trans-Pacific Partnership that came into effect on 30 December 2018.

Publications and articles

Websites

EY Law LLP

Our national team of highly qualified lawyers and professionals offers comprehensive tax law services, business immigration services and business law services. Serving you across borders, our sector-focused, multidisciplinary approach means we offer integrated and comprehensive advice you can trust. Visit **eylaw.ca**.

Focus on private business

Because we believe in the power of private mid-market companies, we invest in people, knowledge and services to help you address the unique challenges and opportunities you face in the private mid-market space. See our comprehensive Private Client Services **webcast series**.

Online tax calculators and rates

Frequently referred to by financial planning columnists, our mobile-friendly calculators on ey.com/ca let you compare the combined federal and provincial 2018 and 2019 personal tax bills in each province and territory. The site also includes an RRSP savings calculator and personal tax rates and credits for all income levels. Our corporate tax-planning tools include federal and provincial tax rates for small-business rate income, manufacturing and processing rate income, general rate income and investment income.

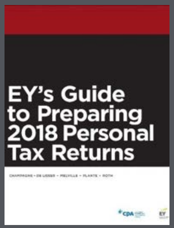
Tax Insights for business leaders

Tax Insights provides deep insights on the most pressing tax and business issues. You can read it online and find additional content, multimedia features, tax publications and other EY tax news from around the world.

Worldwide Indirect Tax Developments Map

Updated monthly, our interactive map highlights where and when changes in VAT, Global trade and excise duties are happening around the world. The map can be filtered by tax type, country and topic (e.g., VAT rate changes, compliance obligations and digital tax).

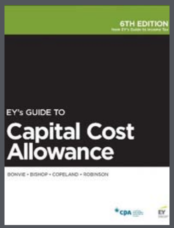
CPA Canada Store



EY's Guide to Preparing 2018 Personal Tax Returns

Editors: Lucie Champagne, Maureen De Lisser, Gael Melville, Yves Plante, Alan Roth

This is the line-by-line guide busy tax professionals rely on throughout the tax season. The guide includes a summary of what's new for the 2018 taxation year as well as tips, suggestions and reminders to consider when preparing 2018 personal tax returns. Available as an easy-to-use and searchable internet collection (includes access to four years of previous internet editions).



EY's Guide to Capital Cost Allowance, 6th Edition

Editors: Allan Bonvie, Susan Bishop, Brett Copeland, Krista Robinson

Takes you through the capital cost allowance and eligible capital expenditure rules in Canada with commentary and illustrative examples. Unique CCA lookup tables (by class and by item) are included.

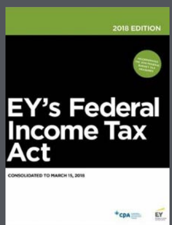
EY's Guide to Scientific Research and Experimental Development, 3rd Edition

Editors: Susan Bishop, Kevin Eck, Elizabeth Pringle, Krista Robinson

This guide has been prepared to assist Canadian tax professionals in understanding the scientific research and experimental development (SR&ED) rules in Canada.

Publications and articles

CPA Canada Store



[EY's Federal Income Tax Act , 2018 Edition](#)

Editors: Alycia Calvert, Warren Pashkowich and Murray Pearson

Complete coverage of Canada's *Income Tax Act* and Regulations. Included with this edition: interactive online features and purpose notes for selected provisions. Purchase of a print book includes access to an online updated and searchable copy of the federal *Income Tax Act* as well as the PDF eBook. This edition contains amendments and proposals from the 27 February 2018 federal budget tax measures, Bill C-63 (SC 2017, c. 33), *Budget Implementation Act*, 2017, No. 2, the 13 December 2017 amendments to the *Income Tax Act* and Regulations (income sprinkling), and the 24 October 2017 notice of ways and means motion.

[EY's Complete Guide to GST/HST, 2018 (26th) Edition](#)

Editors: Dalton Albrecht, Jean-Hugues Chabot, Sania Ilahi, David Douglas Robertson

Canada's leading guide on GST/HST, including GST/HST commentary and legislation, as well as a GST-QST comparison. Written in plain language by a team of EY indirect tax professionals, the guide is consolidated to 15 July 2018 and updated to reflect the latest changes to legislation and CRA policy.

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