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Canada – TaxMatters@EY

July 2019

New rules for charities' political activities: are you compliant?

Yves Plante and Sharron Coombs, Toronto

When Bill C-86, *Budget Implementation Act, 2018, No. 2*, received Royal Assent on 13 December 2018, it marked the legislative culmination of the review of the rules governing the political activities of registered charities that allowed them to carry on unlimited public policy dialogue and development activities in furtherance of their stated charitable purpose(s). However, the rules preventing registered charities from devoting any part of their resources to the direct or indirect support of, or opposition to, a political party or candidate for public office remained in effect.

With the federal election looming in the coming months, registered charities must be particularly vigilant in conducting their activities, especially any political activities conducted during that period, to remain compliant with the amended *Income Tax Act* rules and thus maintain their registered charity status.

The new rules and related latest developments are summarized below.

New rules

Following the release by the Canada Revenue Agency (CRA) in May 2017 of the report prepared by the consultation panel appointed by the minister of national revenue in September 2016 on the political activities of charities (for more details, see "Welcome report on political activities of charities released and related audit activities suspended" in the [July 2017 issue of TaxMatters@EY](#)), and following further consultations after the release of the resulting draft legislation on 14 September 2018, the government made the following changes through Bill C-86:

- ▶ Removal of the quantitative limit on the resources a charitable organization or charitable foundation can devote to non-partisan political activities (they were formerly limited to generally 10% as long as these activities were ancillary and incidental to the charity's charitable purposes)¹
- ▶ Clarification that, similar to a charitable foundation, a charitable organization must be constituted and operated exclusively for charitable purposes
- ▶ Introduction of a definition for "charitable activities" to specify that charitable activities include, without limitation, public policy dialogue and development activities (PPDDAs) that further a charitable purpose, and introduction of a rule to ensure that PPDDAs carried on by a charity in support of its stated charitable purposes are considered to be in furtherance of those purposes and not in furtherance of any other purposes

These changes came into force as of 14 September 2018 and, for organizations, corporations and trusts that were registered charities as of that date, retroactively to 29 June 2012 or 1 January 2008 (depending on whether or not the provision, or portion thereof, that is amended by a particular change was enacted prior to 29 June 2012).²

As a result of these changes, charities may now pursue their stated charitable purposes by carrying on unlimited PPDDAs in furtherance of those purposes. A charity may thus devote up to 100% of its total resources to PPDDAs that further its stated charitable purposes.

PPDDAs

Although not defined in the *Income Tax Act*, the CRA's new draft guidance issued in January 2019, CG-027, *Public policy dialogue and development activities by charities*, describes PPDDAs as activities a charity carries on to participate in the public policy development process, or facilitate the public's participation in that process. Public policy refers to laws, policies or decisions of government, in Canada or from abroad. It should be noted that a charity can also transfer resources to another qualified donee to support the recipient's PPDDAs.

The CRA considers PPDDAs to include, without being limited to, the types of activities the Canadian courts have considered to be political activities, such as (similar to the list included in the Panel Report released in May 2017): providing information, research, disseminating opinions, advocacy, mobilizing others, representations, providing forums and convening discussions, and communicating on social media. See the CRA's draft guidance CG-027 for further discussion on each of these examples.

In furtherance of a stated charitable purpose

Even if an activity can be considered a PPDDA, it will not be considered to be a charitable activity if it is not carried on in furtherance of a stated charitable purpose.

To that end, the purpose must be:

- ▶ Charitable, i.e., one that falls into one of the following four standard common law categories:
 - ▶ Relief of poverty
 - ▶ Advancement of education
 - ▶ Advancement of religion
 - ▶ Other purposes beneficial to the community, such as protecting the environment, promoting health, etc. (see Annex A in the CRA's draft guidance CG-027 for a list of examples)
- ▶ Stated, i.e., appearing in the charity's governing documents
- ▶ Providing a benefit to the public

A PPDDA is considered by the CRA to be in furtherance of a charitable purpose when it satisfies the following two criteria:

- ▶ Related to the charity's stated charitable purpose
- ▶ Providing a benefit to the public, when considered together with the charity's stated charitable purpose

The stated charitable purpose cannot thus be influencing the laws, policies or decisions of a government on its own, since it is not referring to any of the four charitable categories listed above. However, advancing education by contributing to government policies in matters relating to the regulation of education should, for example, be acceptable to the CRA.

¹ Consequential changes were also made (i) to remove the rule that the making of a gift by a charity to a qualified donee to support the political activities of the qualified donee is considered to be a political activity for the donor charity; (ii) to remove the rules under which expenditures made by a charity on political activities cannot be considered in determining whether the charity has satisfied its annual disbursement quota; and (iii) to remove the rules that provide that income disbursed by way of a gift the making of which is a political activity (or any non-income amount paid as such a gift) cannot be considered in determining whether a charity is devoting its resources to charitable activities.

² Similar changes are also made in respect of registered Canadian amateur athletic associations, effective 14 September 2018 or, for existing registered associations on that date, retroactively to 1 January 2012.

Given the importance that the new changes attach to a charity's stated charitable purposes, charities should

- ▶ Ensure their stated charitable purposes are up to date
- ▶ Keep records that demonstrate that their primary consideration in carrying on PPDDAs is to further their stated charitable purpose(s) and provide a public benefit

The CRA cautions, though, that it will look at the substance of the purposes and activities of a charity; rewriting the objects in the constating documents or filing a carefully worded application for registration will thus not in itself be sufficient if not supported by the charity's actual activities.

Prohibited political activities

As mentioned at the outset, despite the new PPDDAs changes, the rules preventing registered charities from devoting any part of their resources to the direct or indirect support of, or opposition to, a political party or candidate for public office remain in effect. As a result, any of these activities are not PPDDAs, remain prohibited, and thus cannot be carried on to any degree by a charity. It should be noted, though, that this prohibition is not limited to a demonstration of bias; supporting or opposing all political parties or candidates is viewed by the CRA in the same way as supporting or opposing only one political party or candidate.

A charity may therefore publicly agree or disagree with a government's decision or position, but it must not directly or indirectly support or oppose any political party or candidate for public office (at the federal, provincial, territorial, regional, municipal or band council level). A charity must thus be vigilant in its communications so that it focuses on the policy issue under discussion rather than referring to any candidate or political party.

Having said that, the actions a political party or candidate may independently take will not deem or taint any otherwise allowed activities of a charity to become prohibited direct or indirect support of (or opposition to) that party or candidate (e.g., a charity's PPDDA does not become a prohibited support of a political party that had subsequently provided positive comments on the charity or the charity's PPDDAs).³

The CRA's draft guidance CG-027 provides examples of prohibited direct support or opposition (such as endorsing a candidate over social media) and of indirect support or opposition (i.e., where a charity's records explicitly reveal it carried on an activity (such as a public street demonstration) to support or oppose a political party or candidate, or where it transfers any of its resources to a third party to do so).

On the other hand, the CRA's draft guidance CG-027 also indicates that informing the public about the policy positions of political parties and candidates may be an allowed PPDDA, as long as it covers all political parties or all candidates (or their responses to policy questions), and it is done in a neutral fashion (so that no political party or candidate's policy position or response is singled out, favourably or unfavourably). Representatives of a charity may be involved with an election or any other political process (e.g., as a volunteer) but this has to be done on the individual's own personal time and in their private capacity, so that the charity they represent is not tainted. Similarly, none of the charity's resources may be used to support that individual's personal political involvement.

Finally, in addition to ensuring they are compliant with the new PPDDAs income tax rules, charities also have to be mindful of other legal requirements when carrying out PPDDAs, such as requirements from the *Canada Elections Act*, the *Lobbying Act*, the *First Nations Elections Act* and any applicable provincial or territorial lobbying and election legislation.



³ For the application of this prohibition, the CRA considers a candidate to be a person who meets that specific definition in the applicable election legislation (in the upcoming federal election, that would be the *Canada Elections Act*), and excludes any potential candidates.



Related latest developments

In addition to the Bill C-86 changes, the following related developments have been announced:

► **Changes to Forms T3010 and T2050** - Both Form T3010, *Registered Charity Information Return*, and Form T2050, *Application to Register a Charity under the Income Tax Act*, will be revised, but won't be made available until November 2019. In the meantime, the CRA has issued instructions on how to fill out the current forms to guide charities and applicants to take into account the PPDDA-related changes. For example, current Form T3010, *Political activities*, section C5 and Schedule 7, both of which were first introduced on the version of the form that was available to charities with fiscal periods ending on or after 1 January 2013, are simplified and replaced so that only a narrative description of the charity's PPDDAs and an explanation as to how they relate to its charitable purposes need to be provided. Incidentally, since 1 June 2019, both Forms T3010 and T2050 can be filed online as part of a new My Business Account launched on that day for charities.

► **Suspended audits and objections** - On 7 March 2019, the minister of national revenue provided her formal response to the recommendations in the Panel Report released in May 2017. As a result, the interim suspension of all of the CRA's actions in relation to the remaining audits and objections that were part of the controversial Political Activities Audit Program that was initiated in 2012 was lifted. The CRA indicated that it will contact the affected charities to discuss their outstanding audits and objections.

► **Canada Without Poverty v AG Canada** - Given the enactment of Bill C-86, the government decided, also announced as part of its formal response to the recommendations in the Panel Report released in May 2017, to discontinue its appeal of the Ontario Superior Court of Justice July 2018 decision in *Canada Without Poverty* (2018 ONSC 4147). In that decision, the court essentially found that the quantitative limit on the resources a charitable organization or charitable foundation could devote to non-partisan political activities was unconstitutional.

► **Advisory Committee on the Charitable Sector** - Also as part of her formal response to the recommendations in the Panel Report released in May 2017, the minister of national revenue announced the nomination of the two co-chairs of the new permanent Advisory Committee on the Charitable Sector, the creation of which had been announced as part of the November 2018 fall economic statement. The committee, as recommended in the Panel Report, will provide recommendations to the minister and the CRA commissioner on important and emerging issues facing the sector on an ongoing basis.

► **CRA guidance update** - The CRA recently announced that it is in the process of reviewing and updating all related guidance products to ensure they are consistent with draft guidance CG-027.

Updated online tax calculators and rates for 2019

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



We've updated our popular personal tax calculator and rate cards to reflect budget proposals and news releases up to 15 June 2019.

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 budget information, our monthly TaxMatters@EY and much more – at ey.com/ca/tax.

New regulations for short-term rentals in Québec target owners

Michael Citrome and William Jegher, Montreal



Legislation has struggled to keep up with the pace of technology, especially now in the social media age, when new apps capable of changing entire industries and economies can be deployed to millions of users almost instantly.

Online marketplaces for short-term residential accommodations that act as brokerages and have no properties of their own have been one of the most controversial exponents of the sharing economy, and efforts to regulate them have been inconsistent across Canadian jurisdictions.

New rules and greater enforcement

A recent announcement by the Québec Government of new rules set to come into force in fall 2019, and increased enforcement to match, may change the landscape considerably for operators of these short-term accommodations, particularly those who have pursued this relatively new category as a commercial enterprise.

Québec is often on the forefront of regulating emerging technologies, having fought a highly publicized battle over the regulation of ride-sharing and requiring foreign operators of online media streaming services to collect sales tax from their Québec subscribers.

Further, hosts who are registered for the federal goods and services tax and the Québec sales tax must also collect and remit tax on stays.

At a 5 June 2019 press conference, the Québec ministers of tourism and municipal affairs and housing announced new regulations concerning what was termed "l'hébergement touristique collaboratif," essentially home-sharing for tourists.

New category for principal residence hosts

One key change is that hosts who provide short-term accommodations at their principal residence are required to register with the Corporation de l'industrie touristique du Québec (CITQ), the Québec government organization that oversees touristic accommodations in the province. This is the organization that issues the "star" rating plaques ubiquitous on hotels and guest houses throughout Québec.

The draft regulations,⁴ published on 12 June 2019, provide substantially more guidance: "principal residence" is "where the operator, a natural person, habitually resides, centralizing therein the operator's family and social activities, in particular when it is not used as a tourist accommodation establishment."

This means that to fit into the category of touristic home-sharing, the host must be an individual; corporate landlords cannot fit into the category. Likewise, it has to be the host's home when not renting it out. Hosts who are tenants or condo owners must get permission from their landlords or condo association in order to be registered.

Further, the new regulations abandoned the previous rule that only accommodations available "on a regular basis in the same calendar year" are subject to registration; the new rules now apply to any accommodations "the availability of [...] which is made public by the use of any medium".

Corporate owners and multiple properties

For other short-term hosts, particularly corporations and those who have multiple properties listed online, little has changed; those properties are subject to the same set of rules that govern all touristic accommodations in Québec, namely registration with the CITQ, undergoing government inspection and the requirement to affix, in public view, a "star" plaque with a classification rating. As the minister of tourism put it, those establishments are "commercial from day one."

The analytics website *Inside Airbnb*⁵ estimates there are 19,495 hosted accommodations on the island of Montreal, of which more than 70% are "entire home/apartments" and the balance shared rooms. The CITQ website displays only approximately 250 "tourist homes" on the island.

The minister of municipal affairs and housing noted in her comments that these rules take into account concerns about maintaining housing stocks. She also stated, in a point echoed by the minister of tourism, that municipalities will be free to enact further regulation as they see fit to maintain equilibrium between housing and touristic accommodations.

Greater enforcement on the horizon

By carving out principal residence home-sharing from the rest of the categories of tourist accommodations, the Québec Government appears to be signalling that there will be greater enforcement of the rules already governing short-term accommodations. Mandatory registration will allow the taxation authorities to better monitor compliance.

In 2017, the Québec Government announced that 25 Revenu Québec inspectors would be assigned to short-term accommodation matters. On 5 June, the minister of tourism reiterated that those 25 inspectors would be enforcing the law, and referred to penalties under the current legislation of up to \$10,000 for individuals and \$25,000 for corporations, and which are "doubled for a second offence and tripled for a subsequent offence."

One of the offences under the current legislation is "operat[ing] or purport[ing] to operate a tourist accommodation establishment without a classification certificate," referring to registration with the CITQ. In short, if a host lists any accommodations online without registration, there could be serious repercussions, especially if it is not their principal residence.



⁴ Regulation to amend the Regulation respecting tourist accommodation establishments to the Act respecting tourist accommodation establishments (CQLR c. E-14.2).

⁵ insideairbnb.com

How blockchain could transform the world of indirect tax

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

By securely establishing the what, where and when of transactions, blockchain could help streamline and automate indirect tax.

If you've had a conversation recently about how taxes are developing or about the future of business, the word "blockchain" probably came up.

Until only a few years ago, blockchain remained a relatively obscure technology with seemingly few applications outside of finance. But now this distributed-ledger technology is widely seen to offer potential solutions to many problems facing governments and global businesses. In taxation, professionals are asking serious questions about blockchain, especially around indirect taxes:

- Will distributed ledgers remove the need for invoices?
- Will governments impose cryptocurrencies to collect and refund cross-border VAT?
- Will customs declarations be filed automatically not by customs brokers but by container ships?

While these potential changes are still in the future, as we have seen with other aspects of the digital economy, increasingly the future is now.

Blockchain technology has the potential to streamline and accelerate business processes, to improve cybersecurity, and to reduce or eliminate the role of trusted intermediaries (or centralized authorities) in industry after industry.

Banks, traders, exchanges and regulators are involved in many pilot projects, studying how best to harness this technology. But blockchain already has many real-world applications, including digital asset platforms, cryptocurrencies, settlement platforms for securities and commodity trades, and secure land registries.

Many more applications are likely to be adopted in the near future. And, as they prove their worth, the rate of adoption is likely to increase, with new and surprising uses for the technology being found.

The benefits of blockchain

Despite its seeming complexity, a blockchain is just another type of database for recording transactions – one that is copied to all of the computers in a participating network. Individual transactions (unique blocks) consist of:

- ▶ The header, which includes metadata, such as a unique block reference number, the time the block was created and a link back to the previous block
- ▶ The content, which is usually a validated list of digital assets and instruction statements, such as transactions made, their amounts and the addresses of the parties to those transactions

In this type of secure, shared database, participants have their own copies of the stored data. Strong cryptography ensures that transactions can be initiated only by certified parties, that changes are validated by participants collectively and that the outputs of the system are immediate, accurate and irrevocable.

Distributed ledgers are inherently harder to attack because, to be successful, a cyberattack would have to attack each copy of the data simultaneously.

A complete audit trail is maintained throughout the chain by the distributed nature of the information. Anyone with the appropriate encryption rights can access a copy of that ledger and verify past transactions without having to trust the participants in the original transaction.

A blockchain database, then, is a digital ledger that retains the complete history of all assets and instructions executed since the very first one – making its data verifiable and independently auditable.

The great trust that participants and auditors can have in a blockchain depends on this process, not on the reputation or reliability of one participant such as a bank.



Smart contracts

One application of blockchain that promises to transform business is smart contracts – computer programs that facilitate, verify or enforce the negotiation or execution of an agreement. They often replicate the logic of regular contractual clauses. Through smart contracts, many types of contractual clauses can be made partially or fully self-executing, self-enforcing or both.

Consider the example of a container-load of goods whose legal ownership is transferred while the goods are in transit. Whether value-added tax (VAT) or goods and services tax (GST) applies, which jurisdiction levies it and at what rate, and who must account for it are all questions whose answers may depend on where the goods were physically located when the transfer of ownership took place.

This could be the case even if neither party was alert to the importance of timing or the location of the transfer.

This issue commonly arises in chain transactions involving, for example, oil and other commodities, where ownership in the goods may change many times between dispatch and arrival. Smart contracts could help solve this perennial time-of-supply problem, particularly for cross-border trades.

And to take the automation process one step further, “smart” products and devices can be used. These have the ability to communicate with one another, and to report their status and position using the internet. This allows them to confirm when certain conditions in a contract have been met, so triggering payment and the creation of the next block.

Such blockchain-enabled smart contracts, concluded by “things” communicating with other “things,” will create many challenges and opportunities for businesses – and for tax and customs administrations.

Blockchain's near-term potential for indirect tax

We explore some of the likely near-term uses of blockchain that could have an impact on indirect taxes.

For tax advisors, the definition of a blockchain often brings to mind indirect taxes. These taxes include broad-based taxes on consumption such as VAT, GST and sales taxes, but also customs duties, excise taxes, energy taxes and environmental levies.

These taxes often follow chains of transactions and their tax liabilities, and obligations are often "triggered" by key events that need to be documented and recorded securely. These events include the performance of a service or the delivery of goods, the conclusion of a contract, the manufacture of a product and the act of importing or exporting goods and services.

How, where, when and what tax applies often depends on complex decisions that must be applied correctly for every transaction. Collecting the right amount of tax depends on the honest reporting of accurate information, often in "real time." Taxpayer errors, negligent accounting, lack of data and fraudulent activity can all have a significant impact.

We are starting to see tax administrations around the world considering blockchain technology. Surely it's only a matter of time before applications become a reality.

Increasingly, blockchains will find new applications where they are coupled with artificial intelligence, robotic process automation, machine learning and the Internet of Things.

So what are some of the likely near-term uses of blockchain that could have an impact on indirect taxes?

Blockchain regimes

VAT and customs administrations could create blockchains for the transmission of tax data and payments between taxpayers and government portals. These blockchains could involve taxpayers in a single jurisdiction or they could cross multiple jurisdictions, such as within the European Union or Gulf Cooperation Council.

Real-time compliance and reporting

Tax administrations around the globe are already demanding real-time information from businesses to assess and support their VAT and GST liabilities and deductions. Blockchains could greatly increase the speed, accuracy and ease of collecting this data, thereby improving the quality of VAT and GST compliance while reducing the cost of enforcement.

Tax invoices

The invoice is the most critical VAT document. In a blockchain-based regime, it is likely that for a VAT invoice to be valid, it will require a digital fingerprint, derived through the VAT blockchain consensus process.

The fingerprint would immediately confirm that the block under scrutiny is permanently linked to the previous and subsequent blocks. The entire history of the commercial chain (forward and backward from this transaction) could be followed and scrutinized by a tax official in an office, by a robot or by a customs officer at a border.

Anyone connected to an approved tax-auditing program could immediately pull up the entire commercial chain for an item from a valid invoice.

Customs documentation

Customs declarations and export controls depend on detailed, accurate information to prove the origin and destination of goods, their end use and their composition or classification, not only to ensure the correct payment of duties but also to satisfy regulations that forbid trade in illegal or dangerous substances.

The veracity and reliability of this information is vital, but certainty can be difficult to achieve as the necessary details are often provided by third parties, and they may be extracted from a range of systems in an organization. Errors can lead to penalties, lost opportunities and costly delays in transferring goods across borders.

Often it is difficult for traders and customs brokers to provide sufficient information or documentary proof to benefit from any potential reliefs or reductions (such as those available through a free trade agreement,

for example). However, if the items were traded in a blockchain and the customs authorities had access to the chain, they could verify with complete accuracy the origin and nature of the goods at every stage of the chain.

This would not only apply to finished products but also to raw materials, components and semi-finished goods. Customs authorities could, for example, collect duties automatically as goods transit across borders, cutting out third-party declarations. And as this technology would allow them to verify every aspect of a shipment with certainty, they could maintain supply chain security with fewer officers who could target their inspections more accurately.

Supporting refunds, reliefs and rebates – and combatting fraud

The use of immediately verifiable information could allow taxpayers to support claims for VAT and GST deductions and customs rebates and reliefs.

Fraudulent and incorrect claims for input tax deductions pose a severe threat to many VAT and GST systems. Currently, a VAT payer who has a valid tax invoice or customs declaration (or what appears to be a valid document) is entitled to offset the VAT shown on the document as input tax against VAT charged on sales (output tax) or to claim a refund if there is no output tax to offset.

This applies even if the supplier has not paid the tax due. A valid VAT invoice serves like a check on the tax office, and the tax administration may permanently be out of pocket if the document used to claim the input tax is false or if the supplier who has issued it acts in bad faith and does not pay the output tax shown.

The most familiar scam in the European Union is the Missing Intra-Community Trader fraud, but that is just one manifestation of the danger that dishonest traders can pose to an entire system: VAT revenue lost through fraud in the EU is estimated at €100 billion per year. Customs fraud also takes its toll as, for example, shippers mask the true origin of goods to qualify for preferential import duties or free trade agreements.

Tax and customs administrations combat fraud by demanding high levels of accuracy for accounting and reporting to support indirect tax filings and customs declarations. However, these demands can create significant compliance obligations for taxpayers and cross-border traders.

The speed, accuracy and transparency of blockchains could help to alleviate these burdens for taxpayers by decreasing the risk of fraud. Where blockchains can allow sensitive or valuable data to be passed with accuracy and trust, it is not surprising that they are becoming more commonly embedded in day-to-day business processes. Governments and regulators are already looking to them to solve some common issues created by poor recordkeeping or that require high levels of proof such as identifying land ownership rights.

We've seen how clever criminals can be, so we can't assume blockchain will eliminate fraud, but using a blockchain to collect and offset tax could greatly reduce this risk. The output tax on a transaction could be taken by the tax administration when the transaction took place, and the right to offset input tax could be verified immediately but only once the tax was paid.

Smart audits

Using blockchain regimes, indirect tax administrations could carry out independent risk analysis facilitated by artificial intelligence. Because the indirect tax blockchain regime would probably be linked to other government sources, the auditors could have immediate access to large numbers of public and private databases and large amounts of taxpayer and comparative data.

Statistical anomalies could be identified in real time, and the relevant authorities (including those in other countries) could be alerted.

Five ways to prepare for the future of blockchain

One day using blockchain technology will be common. As computing power and connectivity increase exponentially, the applications for blockchain are likely to multiply, and costs will fall. This will allow many blockchain applications to go from being a good idea for the future to becoming a practical daily reality.

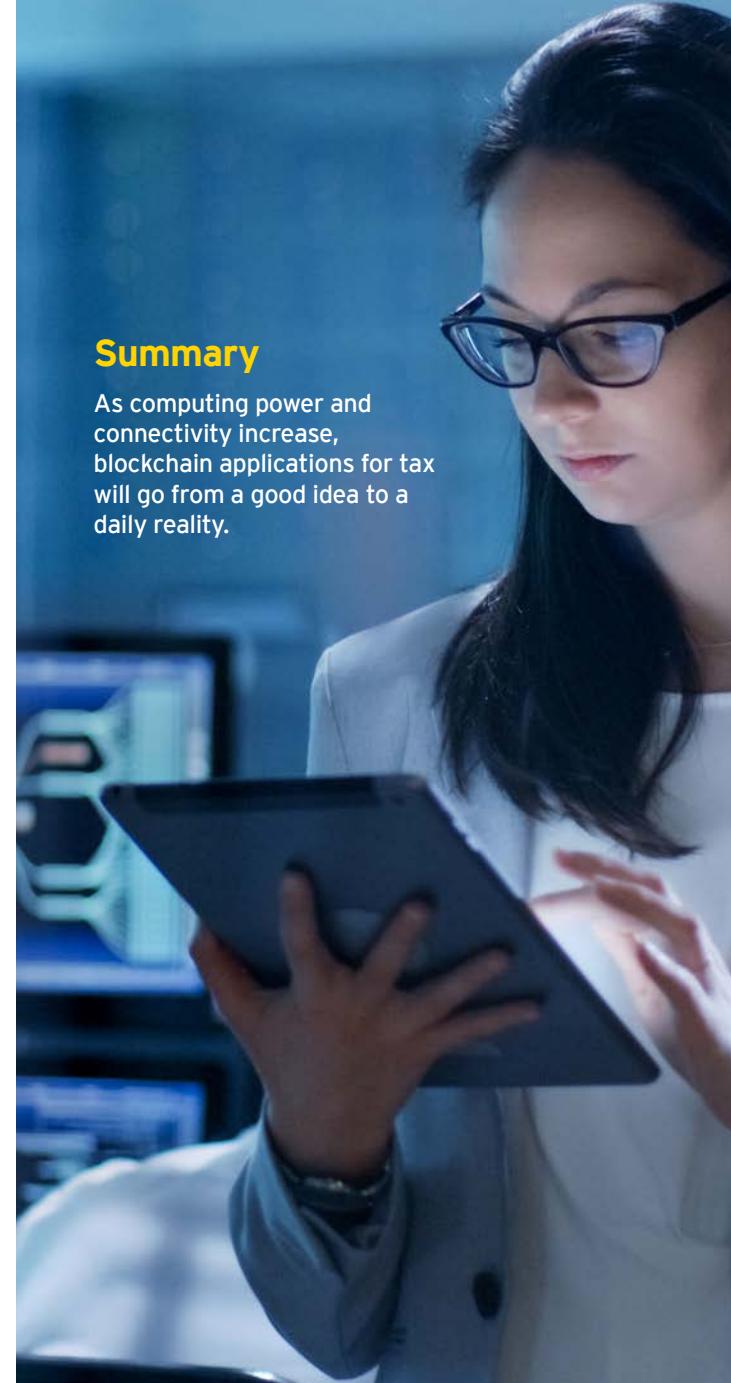
And while these applications may not yet be available in the world of indirect tax, it seems likely that one day using blockchain technology will be common – even mandatory – for accounting for and the collection of indirect taxes.

Businesses can prepare now by taking the following steps.

- 1 Assess the capability of your leadership team. Your leaders' ability to facilitate digital innovation is critical. A leadership coach skilled in digital leadership evaluation can assist you.
- 2 Add blockchain to the learning agenda. Your indirect tax professionals need to be able to talk knowledgeably about blockchain, and your tax technology and IT teams need to know the technical details. You should also quiz your tax advisors about their readiness.
- 3 Educate your board. Indirect tax compliance deadlines are becoming tighter, and this may accelerate the adoption of blockchain solutions. The C-suite needs to realize that traditional roles, structures and processes may not be sufficient for the new technological nature of indirect tax compliance.
- 4 Collaborate with thought leaders. Innovation is not always best done alone – consider working with academic institutions, professional associations, and public and private sector partnerships that employ a creative and consultative approach to delivering solutions.
- 5 Recruit "blockchainers." Often the quickest way to gain knowledge and experience is to hire it. Bitcoin entrepreneurs, steeped in the technology and its applications, may more readily see the opportunities that blockchain adoption could provide for your organization.

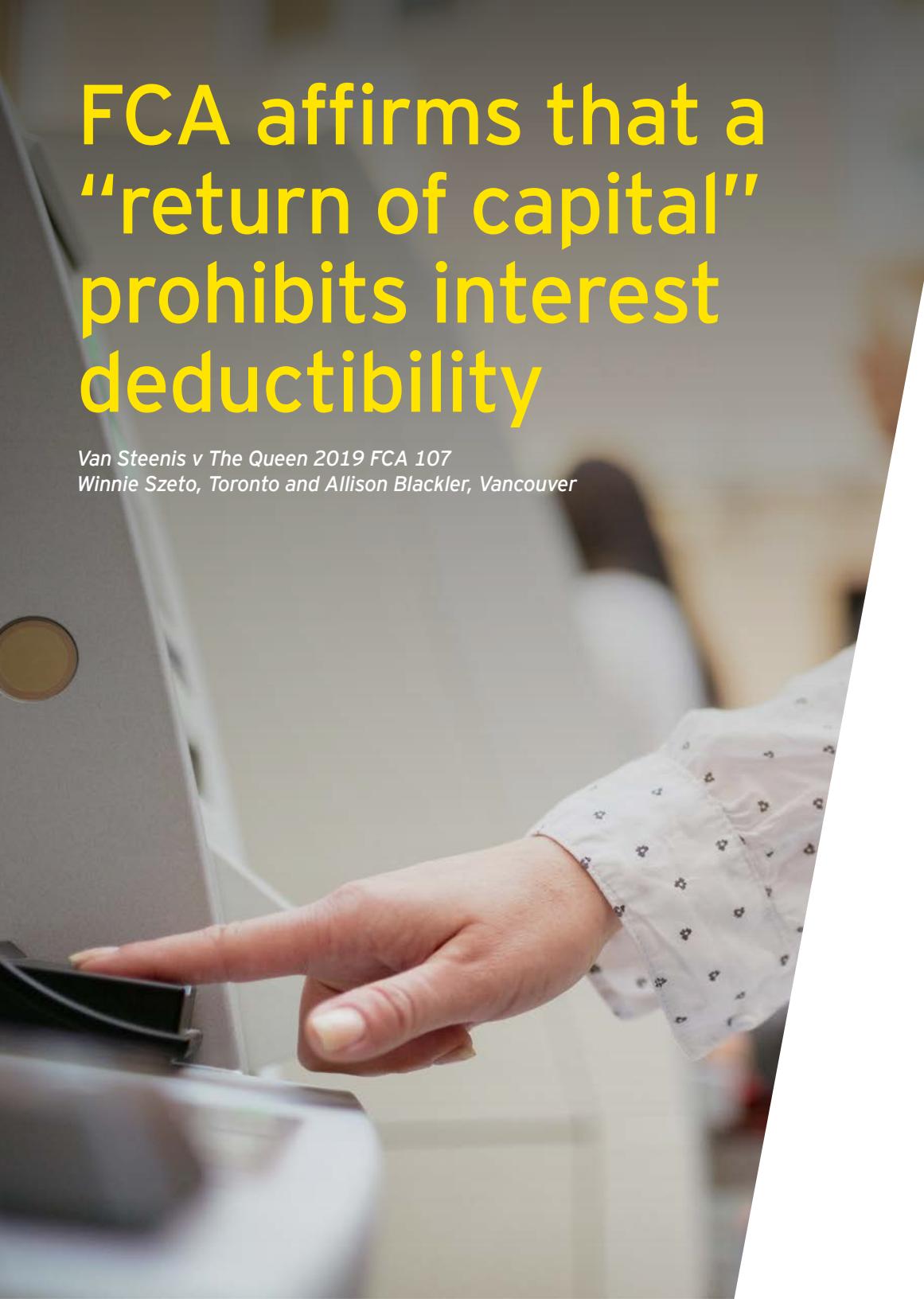
Summary

As computing power and connectivity increase, blockchain applications for tax will go from a good idea to a daily reality.



FCA affirms that a “return of capital” prohibits interest deductibility

Van Steenis v The Queen 2019 FCA 107
Winnie Szeto, Toronto and Allison Blackler, Vancouver



In this case, the Federal Court of Appeal (FCA) affirmed a decision of the Tax Court of Canada (TCC) that a “return of capital” by a mutual fund to the investor prohibits interest deductibility under subparagraph 20(1)(c)(i) of the *Income Tax Act*⁶ (the Act).

Facts

The facts are straightforward and not at issue. In 2007, the taxpayer borrowed \$300,000 to buy units of a mutual fund trust. From 2007 to 2015, the taxpayer received \$196,850 from the fund that were characterized on the T3 slip, Statement of Trust Income Allocations and Designations, as “represent[ing] distribution[s] or return[s] of capital.”

The taxpayer deducted all of the interest charged on the loan each year. In doing so, he relied on subparagraph 20(1)(c)(i) of the Act, which allows for the deduction of interest paid on borrowed money used for the purpose of earning income from a business or property.

The minister of national revenue reassessed the taxpayer’s 2013, 2014 and 2015 taxation years. The minister denied a portion of the interest deduction, because each amount distributed to the taxpayer was a “return of capital” and was used by the taxpayer for personal purposes. Therefore, the borrowed money was no longer being used for the purposes of earning income.

The taxpayer appealed to the TCC.

⁶ R.S.C. 1985, c. 1 (5th Supp.), as amended.



TCC decision

At the TCC, the taxpayer argued that he borrowed the money for the purpose of buying the units and, because he continued to own the units, his current direct use of the borrowed funds is still that same eligible use. As a result, he argued that he was entitled to deduct all of the interest payments on those funds.

The TCC judge disagreed. Although the taxpayer borrowed money to buy the units, almost two-thirds of the amount he borrowed was distributed to him as a "return of capital," and more than half of that was used for personal purposes. As a result, the TCC found that there was no longer any direct link between the borrowed funds that had been used for personal purposes and the investment in the units.

The taxpayer appealed to the FCA.

FCA decision

At the FCA, the taxpayer first argued that the TCC erred in law because it required that the borrowed money be traceable to a current eligible use (see *Shell Canada Ltd. v Canada*⁷ and *Bronfman Trust v The Queen*⁸), even when there had been no disposition, in whole or in part, of the units purchased with the borrowed money.

The FCA was not convinced that the requirement to trace borrowed money to a current eligible use applied only where there had been a disposition, in whole or in part, of the original investment. The FCA was of the view that the focus of subparagraph 20(1)(c)(i) was on the current use of the borrowed money, and not on the current ownership status of the property initially acquired with it.

The taxpayer then argued that the TCC committed a palpable and overriding error of fact in finding that the distributions from the fund constituted a return of a portion of the taxpayer's borrowed money. The taxpayer argued that there was no evidence before the TCC that supported such a finding, and that what might be characterized as a "return of capital" on the T3 slip might actually have included the fund's income. However, the FCA noted that the onus was on the taxpayer to trace the borrowed funds to an identifiable eligible use, and to disprove the minister's assumption that he had received a "return of capital" from the fund. Because the taxpayer tendered no evidence that the distributions were not a "return of capital," he did not satisfy his burden of proof.

Based on the above, the FCA dismissed the appeal.

Lessons learned

It is commonly known among investors that interest paid on borrowed money is generally deductible if the borrowed money is used for the purpose of earning income from a business or property. In our view, this case serves as a reminder that interest deductibility under subparagraph 20(1)(c)(i) is not always clear cut and, important, can change over time if circumstances change. Caution must be exercised, especially in cases that involve a "return of capital."

⁷ [1999] 3 S.C.R. 622.

⁸ [1987] 1 S.C.R. 32.

Publications and articles

Tax Alerts – Canada

Tax Alert 2019 No. 25 – Newfoundland and Labrador budget 2019-20 reintroduced

On 11 June 2019, Newfoundland and Labrador Finance Minister Tom Osborne tabled the province's pre-election fiscal 2019-20 budget as its post-election fiscal 2019-20 budget.

Tax Alert 2019 No. 26 – Proposed changes to stock option rules: update

On 17 June 2019, federal Finance Minister Bill Morneau tabled a notice of ways and means motion that contains proposed changes to the tax treatment of employee stock options that were announced in the 19 March 2019 federal budget. The proposals include a \$200,000 annual limit on employee stock option grants that can receive tax-preferred treatment under the current employee stock option rules.

In addition, stakeholders are invited to provide input on the characteristics of companies that should be considered startups, emerging and scale-up under the new rules by 16 September 2019.

Tax Alert 2019 No. 27 – CCA acceleration enacted

On 21 June 2019, Bill C-97, *Budget Implementation Act, 2019 No. 1*, which implements certain tax measures announced in the 2019 federal budget and the 21 November 2018 federal fall economic statement (as well as other previously announced measures), received Royal Assent.

As a result, the business income tax measures contained in Bill C-97 are now enacted for financial reporting purposes. Most notably, the capital cost allowance (CCA) acceleration measures that were first announced in the 21 November 2018 federal fall economic statement, including some modifications since their initial release, are now enacted.

Tax Alert 2019 No. 28 – PEI budget 2019-20

PEI Finance Minister Darlene Compton tabled the province's fiscal 2019-20 budget on 25 June 2019.



Publications and articles

Publications and articles

EY's Global Capital Confidence Barometer

The 20th edition of EY's Global Capital Confidence Barometer describes how 76% of Canadian respondents expect to pursue M&A in the next 12 months, the second-highest ever (behind April 2018) and the fifth consecutive year above the historical average of 50%.

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 2019

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 166 jurisdictions.

Worldwide VAT, GST and Sales Tax Guide 2019

This guide summarizes the value-added tax (VAT), goods and services tax (GST) and sales tax systems in 124 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.

2018-19 Worldwide Transfer Pricing Reference Guide

Transfer pricing rules and regulations around the world continue to grow in number and complexity. Practitioners need to have current 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 124 countries and territories.

Board Matters Quarterly

The June 2019 edition of *Board Matters Quarterly* highlights five ways boards can enhance their oversight of culture. It also includes a look at how long-term value is being redefined and communicated and offers five considerations as ISS looks at economic value-added metrics.

EY Trade Watch

EY Trade Watch is a quarterly communication prepared by EY's Customs & International Trade Practice. Highlights of this edition include:

Global

- ▶ What trade executives are currently thinking about global trade disruption

Americas

- ▶ Ripple effects of US Government export ban on Huawei
- ▶ The 2019 Trump trade agenda: adjusting US trade policy to the realities of the 21st century economy

Asia-Pacific and Japan

- ▶ Enhanced benefits of Australia's next generation AEO program

Europe, Middle East, India and Africa

- ▶ WTO Boeing dispute: EU issues preliminary list of US products considered for countermeasures
- ▶ Recent developments and changes to the European Union Customs Code
- ▶ Brexit update

Publications and articles

Websites

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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.

The 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 the Taxation of Mining Operations

Editors: Lee Boswell, Irene Chan, Craig Hermann, André Lortie, Jim MacLean, Michael Sabatino

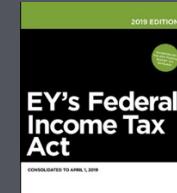
This guide is designed to help Canadian mining businesses interpret and apply the rules under the federal *Income Tax Act*, as well as under provincial and territorial legislation.



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 Federal Income Tax Act, 2019 Edition

Editors: Albert Anelli, 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 19 March 2019 federal budget, the 15 January 2019 proposed amendments to the *Income Tax Act* (salary overpayments) and 2018 legislation as passed and proposed.

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