Canada – TaxMatters@EY

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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.

Filing your 2018 personal tax returns

Alan Roth, Toronto

As the 2018 personal income tax return filing deadline quickly approaches, it's time to reflect on the year that ended and complete your tax return. That means it's also time for EY's annual list of tax filing tips and reminders that may save you time and money.

Personal tax filing tips for 2018 tax returns

No matter what, file on time: Generally, your personal income tax return has to be filed on or before 30 April. If you, or your spouse or common-law partner, are self-employed, your return deadline is 15 June (extended to 17 June in 2019, because 15 June is a Saturday), but any taxes owing must be paid by the 30 April deadline.

Failure to file a return on time can result in penalties and interest charges. Even if you are not able to pay your balance by the deadline, you should still file your return on time to avoid penalties. And even if you expect a refund, you should still file on time in case a future change or assessment results in a tax liability for the year. Remember, if you wait more than three years after the end of the year to file a return claiming a refund, your right to the refund expires and will be subject to the Canada Revenue Agency's (CRA's) discretion.

Review your 2017 return: Reviewing your 2017 return and notice of assessment is a great starting point before you complete and file your return. Determine if you have any carryforward balances that may be used as deductions or credits in your 2018 return.

Carryforward amounts could include unused registered retirement savings plan (RRSP) contributions, unused tuition, education and textbook amounts,[1] interest on student loans, capital losses or other losses of prior years, resource pool balances and investment tax credits.

Tax on split income: Recent amendments, effective for 2018 and later taxation years, have expanded the tax on split income rules to limit income splitting opportunities with certain adult family members for income derived directly or indirectly from a private corporation. Income that is subject to tax on split income is taxed at the highest marginal personal income tax rate and is calculated on Form T1206, *Tax on Split Income*. For more information on the revised rules, see the February 2018 issue of TaxMatters@EY.

Principal residence sale — reporting required, even if all gains are exempt: Capital gains realized on the sale of your residence may be exempt from tax if the residence qualifies as, and is designated as, your principal residence. No tax is owed, for example, if your residence is designated as your principal residence for each year that you owned it.

In the past, the CRA did not require you to report the sale of your principal residence if the realized gain was fully sheltered by the principal residence exemption. However, beginning with sales occurring in 2016, you are required to report the disposition of a principal residence on your income tax return, whether the gain is fully sheltered or not.

The sale of your principal residence must be reported, along with the principal residence designation, on Schedule 3, *Capital Gains (or Losses)*, of your income tax return. In addition, you must also complete Form T2091, *Designation of a property as a principal residence by an individual (other than a personal trust)*. The year of acquisition, proceeds of disposition and a description of the property must be included on the form.

If the gain is fully sheltered, you only need to complete the first page of Form T2091 and no gain needs to be reported on Schedule 3. However, the appropriate box (box 1) still needs to be ticked in the principal residence designation section on page 2 of Schedule 3. If the gain is not fully sheltered, then any capital gain remaining after applying any available principal residence exemption (as calculated on Form T2091) must be reported on Schedule 3.

There is generally a time limit for the CRA to reassess an income tax return. The normal reassessment period for an individual taxpayer generally ends three years from the date the CRA issues its initial notice of assessment. However, for 2016 and later years, if you do not report the sale of your principal residence (or any other disposition of real property) in your tax return for the year in which the sale occurred, the CRA will be able to reassess your return for the real property disposition beyond the normal reassessment period.

T1135 — remember your foreign reporting: If at any time in the year you own certain specified foreign property with a total cost of more than CDN$100,000, you are required to file Form T1135, *Foreign Income Verification Statement*. This form may be filed electronically. Failure to report foreign property on the required information return may result in a penalty. Failure to file Form T1135 on time may result in a penalty equal to $25 for each day the failure continues, for a maximum of 100 days ($2,500), or $100, whichever amount is greater. More significant penalties may apply if a person knowingly, or under circumstances amounting to gross negligence, fails to file the form. In addition, if Form T1135 is not filed on time or includes incorrect or incomplete information, the CRA can reassess your income tax return for up to three years beyond the normal reassessment period.

Taxpayers who own specified foreign property costing more than CDN$100,000 but less than CDN$250,000 throughout the year have the option of using the simplified reporting method (under Part A of Form T1135).

Reportable property generally includes amounts in foreign bank accounts and shares or debts of foreign companies, as well as other property situated outside Canada. It does not include property used in an active business, shares or debt of a foreign affiliate or personal-use property.

Capital losses: Capital losses realized in the year may only be applied against capital gains. Net capital losses may be carried back three years, and losses that cannot be carried back can be carried forward indefinitely.

Where capital losses are incurred on certain shares or debt of a small business corporation, they may qualify as business investment losses that may be claimed against any income in the year, not just capital gains.

Pension income splitting: If you received pension income in 2018 that is eligible for the pension income credit, up to half of this income can be reported on your spouse's or common-law partner's tax return. Note that recent amendments, applicable retroactively to 2015 and later years, include amounts received out of

[1] Although the education and textbook credits were eliminated for 2017 and later years, unused amounts from 2016 and earlier years may be carried forward and claimed in 2017 or later years.

a retirement income security benefit (RISB) as pension income eligible for the pension income credit and eligible for pension income-splitting purposes, in certain circumstances.

You'll reap the greatest benefits when one member of the couple earns significant pension income while the other has little or no income. In some cases, transferring income from a lower-income pension recipient to a higher-income spouse can carry a tax benefit.[2]

Climate action incentive credit: This new refundable tax credit is available for 2018 and later taxation years to eligible individuals 18 years of age or older who are resident in New Brunswick, Ontario, Manitoba or Saskatchewan on the last day of the taxation year. For more information, see the "Spotlight on personal tax deductions and credits" section of this article.

File returns for children: Although often unnecessary, in many cases there are benefits to filing tax returns for children. If your children had part-time jobs during the year or have been paid for various small jobs, such as babysitting, snow removal or lawn care, by filing a tax return they report earned income and thus establish contribution room for purposes of making RRSP contributions in the future.

Another advantage of filing a return for teenagers is the availability of refundable tax credits. Several provinces offer such credits to low- or no-income individuals. When there is no provincial tax to be reduced, the credit is paid out to the taxpayer. There is also a GST/HST credit available for low- or no-income individuals over age 18.

Claim all your deductions and credits: Remember to take advantage of the various family-related tax credits that might apply to you. See "Spotlight on personal tax deductions and credits" for details.

...or not: You may be able to increase the tax benefit of certain discretionary deductions if you defer them to a later date:

- Discretionary deductions that may be deferred include RRSP contributions and capital cost allowance.
- Similarly, consider accumulating donations over a few years and claim them all in one year to increase your benefit from the high-rate donation credit which is available for donations made within the five preceding years.
- Deferring deductions and certain credits makes sense if you are unable to use all applicable non-refundable tax credits in 2018 (and they cannot be transferred), or if you expect to earn higher income in the future.

Capital cost allowance claims: If you are a self-employed individual earning unincorporated business or professional income, you are required to report your income and deductible expenses on Form T2125, Statement of Business or Professional Activities. Likewise, if you earn income from a rental property, your rental income and deductible expenses are reported on Form T776, Statement of Real Estate Rentals. Capital cost allowance (CCA) on depreciable capital property owned may be deducted and claimed on Form T2125 or T776 if the property is available for use to earn business, professional or rental income.

Proposed amendments introduced in the federal government's 2018 fall economic statement will significantly accelerate CCA for such properties until, and including, 2027. Certain properties such as manufacturing and processing machinery and equipment will be eligible for full expensing in the year of acquisition, on a temporary basis (up to and including 2023).

The proposals apply to eligible property acquired and available for use after 20 November 2018, subject to certain restrictions. For further details, see EY's Tax Alert 2018 Issue No. 40, Federal Fall Economic Statement announces significant acceleration of CCA for most capital investments.

[2] For example, the lower-income pension recipient could then claim a greater amount of certain income-tested tax credits such as the medical expense credit or the age credit.

Get a head start on 2019 savings

Early in 2019 is a great time to think of ways to save on your 2019 taxes. Here are some ideas to help you increase your savings in April 2020:

- Contribute early to your RRSP or RESP to increase tax-deferred growth, and to your TFSA to increase tax-free growth. The 2019 TFSA contribution limit is $6,000, and the 2019 RRSP contribution limit is equal to the lesser of 18% of earned income for 2018 and a maximum amount of $26,500.
- Consider income-splitting opportunities such as prescribed-rate loans or reasonable salaries to a spouse or child for services provided to your business.[3]
- Consider tax deferral opportunities using corporations (such as revisiting your salary/dividend/remuneration needs) or other planning opportunities involving corporations. However, keep in mind that recent amendments, effective in 2018, limit income splitting opportunities with certain adult family members for income derived directly or indirectly from a private corporation. For more information, see the February 2018 issue of TaxMatters@EY. In addition, recent amendments will limit opportunities for earning certain passive income within a private corporation for taxation years beginning after 2018.[4] For more information, see the May 2018 issue of TaxMatters@EY.
- If you're planning on selling an investment or earning income from a new source in the year, consider opportunities to realize and use losses to offset that income.
- Consider converting non-deductible interest into deductible interest by using available cash (perhaps a tax refund) to pay down personal loans, and then borrowing for investment or business purposes.
- If you expect to have substantial tax deductions in 2019, consider requesting CRA authorization to decrease tax withheld from your salary.

Make time for tax planning

When your return is done, you can step back and reflect on your progress toward your financial goals in the year that just ended. It's a great primer for a meaningful conversation about tax and estate planning.

An estate plan is an arrangement of your financial affairs designed to accomplish several essential financial objectives, both during your lifetime and on your death. The plan should: provide tax-efficient income during your lifetime, provide tax-efficient dependant support after your death, provide tax-efficient transfer of your wealth and protect your assets.

Make time to review and update your will(s) and estate plan to reflect changes in your family status and financial situation as well as changes in the law. For example, recent amendments effective in 2018 may limit income splitting opportunities with certain adult family members in the context of an estate freeze.

Don't underestimate the benefits of financial spring cleaning. Tax season is a time when many focus a little more closely on their financial affairs. So this really is a good time to at least take a new look at the components of your financial and estate plan that could most impact your financial future and those who depend on you.

[3] The prescribed rate has been 2% since 1 April 2018.
[4] To the extent that passive income exceeds $50,000 in the preceding taxation year.

Spotlight on personal tax deductions and credits

A good way to save tax is by understanding the deductions and credits that are available to you. To enhance the benefit of tax deductions and credits, consider these tips and reminders while you're preparing your tax return.

Family-related and other special tax credits: Claim all credits that apply, including the adoption expense credit, tuition credit (including transfers from a child), credit for the costs of exams or accreditation as a professional, volunteer firefighting or search-and-rescue credits, Canada caregiver amount, homebuyers' amount, and the home accessibility credit.

Did you know?

- The federal climate action incentive is a new refundable tax credit available for 2018 and later years to eligible individuals who are resident in New Brunswick, Ontario, Manitoba or Saskatchewan on the last day of the relevant taxation year. The amount of the credit varies according to your province of residence, and additional amounts may be claimed for a cohabiting spouse or common-law partner and for any children under the age of 18. For 2018, the amount of the credit for a family of four (two adults and two children) will range from $256 to $609, depending on your province of residence.[5] To receive the 2018 credit, you must file a tax return for the 2018 taxation year and claim the credit on Schedule 14, *Climate action incentive*, of your income tax return.
- The Canada caregiver credit has replaced the infirm dependant, caregiver, and family caregiver tax credits for 2017 and later years. While the amounts that may be claimed under this credit are generally consistent with the former system, there are some differences. For example, the Canada caregiver credit is not available in respect of non-infirm seniors residing with their adult children.
- The federal public transit credit has been eliminated for 2018 and later years.[6]
- Senior citizens and persons with disabilities can claim a 15% non-refundable home accessibility tax credit on up to $10,000 a year of eligible home renovation or alteration expenditures that improve home accessibility or safety (maximum credit of $1,500 a year).
- The federal education and textbook credits were eliminated for 2017 and later years, but any unused amounts from previous years can still be carried forward and applied after 2016.

Charitable donations: The federal tax credit for donations is available in two stages a low-rate 15% credit on the first $200 of donations and a high-rate (33% and/or 29%) credit on the remainder. Higher-income donors can claim a 33% tax credit on the portion of donations made from income that is subject to the 33% highest marginal tax rate.[7] Otherwise, the 29% rate applies.

Did you know?

- To maximize the benefit from the high-rate credit, only one spouse or partner should claim all of the family donations.
- The first-time donor's super credit has been eliminated for 2018 and later years.
- If you donated publicly listed stocks, bonds or mutual funds to a charity, none of the related accrued capital gain is generally included in your income.
- If you donated flow-through shares, the exempt portion of the capital gain on donation is generally limited to the portion that represents the increase in value of the shares at the time they are donated over their original cost.
- A tax credit for gifts to US charities is available to the extent that the individual (or his or her spouse) making the gift has sufficient US-source income.

Child care expenses: If you paid qualifying child care expenses for an eligible child to allow you to work or attend certain educational programs, you may be able to claim a deduction. The limits are generally $8,000 for each child under 7 years of age and $5,000 for each child between 7 and 16 years of age. A higher amount may be claimed for a child who has a disability.

Did you know?

- The deduction for fees paid to an overnight school or camp is limited.
- The claim must generally be made by the lower-income spouse or common-law partner (some exceptions apply).
- You must have receipts to support your claim.

Home relocation loan deduction: The employee home relocation loan deduction has been eliminated for 2018 and later years. This deduction was equal to the amount of the taxable benefit on the first $25,000 of an employer-provided low-interest or interest-free loan that qualified as a home relocation loan.

Interest expense: If you've borrowed money for the purpose of making an income-earning investment, the interest expense incurred should be deductible.

Did you know?

- It's not necessary that you currently earn income from the investment, but it must be reasonable to expect that you will.
- Interest on the money you borrow for contributions to an RRSP, registered pension plan or TFSA, or for the purchase of personal assets such as your home or cottage, is not deductible.

Moving expenses: If you moved in 2018 to start a new job or a new business, or to attend university or college on a full-time basis, you may be able to claim expenses relating to the move.

[5] A supplement equal to 10% of the baseline credit amount may also be claimed by an eligible individual who resides in a small or rural community.

[6] In 2017, the credit was only available in respect of eligible transit use between January and the end of June 2017.

[7] For 2018, the 33% rate applies to taxable income greater than $205,842.

Did you know?

- In addition to the actual cost of moving your furniture, appliances, dishes, clothes and so on, you can claim travel costs, including meals and lodging while en route.
- Lease-cancellation costs, as well as various expenses associated with the sale of your former residence, are also deductible, including up to $5,000 in costs (such as interest, property taxes and utility costs) associated with maintaining a former residence that was not sold before the move.
- The expenses are only deductible to the extent of income from the new work or business location (or, for students, taxable scholarships or research grant income). If this income is insufficient to claim all the moving expenses in the year of the move, you can carry forward the remaining expenses and deduct them in the following year, again to the extent of income from the new work (or school) location.

Medical expenses: The claim for the medical expense tax credit is limited by an income threshold. In other words, the lower your net income, the more you can claim in eligible medical expenses. For 2018, this credit may be claimed for eligible expenses in excess of the lower of $2,302 and 3% of net income. Because one spouse or common-law partner can claim medical expenses on behalf of the entire family, it generally makes sense to claim all expenses in the lower-income spouse's return, including the expenses of dependent children under the age of 18. You might be able to claim the medical expenses paid for other dependent relatives such as elderly parents or grandparents or children 18 years of age or older, but in this case, the income threshold for 2018 is equal to eligible expenses in excess of the lower of $2,302 and 3% of the dependent's net income.

Did you know?

- Eligible medical expenses are not restricted to medical services provided in Canada, as long as they otherwise qualify.
- Transportation expenses in respect of a patient's travel to and from a location where medical services are provided may qualify if the patient travels at least 40 km to obtain the service, substantially equivalent services are not available where the patient lives, the patient takes a reasonably direct travel route and it's reasonable for the patient to travel to that place to obtain the medical services.
- Other reasonable travel expenses may also qualify if under the same circumstances the patient must travel at least 80 km to obtain the services.
- The same kind of expenses may qualify for one person who accompanies the patient, provided that a medical practitioner has certified that the patient is incapable of travelling without assistance.
- Travel expenses incurred to travel to a warmer climate, even for health reasons, are not eligible medical expenses.
- Premiums paid to a private health services plan qualify as medical expenses, so remember to claim any premiums paid through payroll deductions.
- Self-employed individuals may be allowed to deduct private health services plan premiums from business income instead of claiming a tax credit for them as medical expenses.
- An amount that may otherwise qualify may be denied if the service was provided purely for cosmetic purposes.
- You may claim expenses paid in any 12-month period that ends in the year as long as you have not claimed those expenses previously.
- For 2018 and later years, expenses related to emotional support animals specially trained to perform specific tasks for a patient with a severe mental impairment may be claimed as eligible medical expenses.
- Amounts paid for attendant care or care in a facility may be limited. Special rules also apply when claiming the disability amount and attendant care as medical expenses. For more information, refer to the September 2016 issue of TaxMatters@EY.

Learn more

Speak to your EY advisor for additional advice or assistance regarding your personal tax return.

For many more helpful tax-saving ideas and handy tips throughout the year, download your copy of our annual guide Managing Your Personal Taxes: a Canadian Perspective.

Take advantage of technology: Use software to prepare your tax return and file electronically. The CRA offers several online services to make managing your taxes faster and easier.

Registering for the CRA's My Account will allow you to view prior-year returns and assessments, check carryover amounts, view tax slips filed in your name, view account balances and statements of account, file returns, make payments and track the status of your return. It also allows you to register to receive online correspondence from the CRA within My Account, including notices of assessment, benefit notices and slips, and instalment reminders. My Account will also allow you to use the "Auto-fill my return" service, which pre-populates your return with figures from tax information slips and other information from CRA records.

The MyCRA mobile app allows you to access and view on your mobile device personalized tax information such as your notice of assessment, return status, benefits and credits, and TFSA and RRSP contribution limits. The app also lets you manage your contact and direct deposit information or make a payments from your mobile device, as well as register to receive email notifications when correspondence is available for viewing in My Account. The MyBenefits CRA mobile app allows you to view all your benefit and credit information on your mobile device, including the amount of your payments, when your benefits or credits will be paid and the status of your Canada child benefit application. It also lets you update some of your personal information that may affect benefit and credit eligibility, such as your marital status and children under your care. You can access the MyBenefits CRA mobile app through My Account.

Certain tax preparation software products offer the CRA's Express NOA service, which can provide you with your notice of assessment the day after you file your tax return electronically. You must be registered for both My Account and online correspondence with the CRA to use the Express NOA service.

The CRA's ReFILE service allows you to file adjustments to your tax return using NETFILE certified tax preparation software, provided your original tax return is also filed electronically. Adjustments can be made to your 2018, 2017 or 2016 tax return. You should receive your notice of assessment on your original return first before using ReFILE to file any adjustments.

Blockchain relevant for tax and transfer pricing

Laurette von Grambusch and Ariana Kosyan
Originally published on EY Tax Insights

Automating the processes of applying, documenting and defending transfer prices is clearly attractive, but is it feasible? The short answer is yes.

Tax professionals should be aware that blockchain technology has the potential to revolutionize the taxation of transactions as well as their record-keeping. We believe the technology even has the potential to automate many processes within the transfer pricing world.

But first, a few blockchain basics.

The signal achievement of blockchain technology is enabling the secure transfer of digital assets without a central authority, bank or any other mediator between the two parties to a transaction. A peer-to-peer network of computers equipped with cryptographic algorithms examines each new transaction, comes to a "consensus" about its validity, and either validates or rejects it. A nearly real-time record of transactions taking place through the network is visible to all participants, achieving unprecedented transparency.

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Three types of blockchain

- **Public blockchains** such as the ones that host cryptocurrencies require tremendous processing power.
- Companies wanting a smaller network create **private blockchains** to grant permissions to participants: read only, limited transactions, etc., as in a traditional corporate database. Notice that the company must re-introduce the central authority itself, but still benefits from blockchain's unique accuracy and transparency, potentially also permitting real-time auditing by regulators.
- Finally, there is the **consortium blockchain**, common in banking, which may grant reading rights to many people or even everyone, but which limits the consensus mechanism to a few trusted parties, thereby achieving faster processing.

All three blockchain types support "smart contracts," computer programs that self-execute the terms of an agreement when predefined conditions are met by transacting parties, greatly reducing or eliminating the costs of coordination, monitoring and enforcement. This is one of the features that differentiates a blockchain from a traditional database or an enterprise resource planning (ERP) system.

A multitude of blockchain applications is springing up (see Table 1), and governments are thinking that blockchains can help address some of the challenges of taxing the digital economy. Estonia, Luxembourg, Singapore and India are among the first movers, and developing countries hope blockchain technology can help them leapfrog more developed economies.

Table 1: Industrial applications of blockchain technology

Automotive	Platform for autonomous vehicle fleet management
Banking	Optimization of global internal treasury operations
Finance	Settlement of securities transactions
Food and beverages	Tracking of ingredients of groceries; authentication system for wines
Health care	Digital record-keeping
Insurance	Acceleration and simplification of captive insurance transactions
Life sciences	Product lifecycle management
Music	Digital rights management
Real estate	Decentralized global home rental platform
Various industries	Supply chain management

In other words, if you have not seen it yet, you are likely to see blockchain soon on a cloud near you.

Potential applications for transfer pricing

Given the characteristics of blockchain, it's not surprising that tax professionals are intuitively accepting the idea that value-added taxes (VATs) and other transaction taxes are candidates for management on a blockchain. How about transfer pricing?

Considering the complexity of intercompany transactions and governments' demand for transparency, automating the processes of applying, documenting and defending transfer prices is clearly attractive, but is it feasible?

The short answer is yes. There is no reason a multinational enterprise (MNE) could not reliably use blockchain to track its intercompany transactions and make payments according to pre-established, arm's-length conditions via smart contracts, when the necessary conditions are met. Intangible assets could be tokenized, with a token representing the entire intangible asset or a defined fraction of it.

This could prove especially valuable for transactions involving shared asset ownership, cost contribution arrangements and the application of profit split methods. Companies could also use blockchain technology to optimize intra-group treasury transactions, including intra-group current accounts, cash pooling, other types of lending transactions and guarantees, among others.

If a company's vendors and customers are also invited to join a private blockchain, it can track and display an entire supply chain, complete with documentation and real-time visibility of all its transactions. It's even possible that with blockchain's increasing adoption, new sources of bigger and better data will enable a more frequent application of the comparable uncontrolled price method for establishing arm's-length prices between MNEs and their subsidiaries and related groups.

Tax needs to jump in

While blockchain enthusiasm is still mostly in technology and cryptocurrency circles, the tax function needs to be an early participant to resolve questions such as:

- How can companies' ERP data be made fit for blockchain?
- How will tax compliance change with blockchain?
- How will the scope of work with accountants and auditors change?
- Will blockchain solutions, potentially also cloud based, be compatible with the bookkeeping requirements and regulations in each jurisdiction?

While the technology is deemed to be secure, or at least more secure than others, questions around the correctness of the content remain. Governments may be eager to embrace greater transparency and the potential to perform real-time tax audits. But they may also be wary about the potential downsides, wondering if the use of private or consortium blockchains will indeed provide appropriate information and how harmful leaks of stored information may be prevented to comply with traditional secrecy for tax matters.

So far, blockchain technology has received sensible praise and skepticism. We are thrilled by the challenge of understanding its promising implications for the tax world, and we urge our colleagues in the tax function to join in shaping this exciting future. ■

TCC finds reduction of tax one of the main reasons for company's existence

Jencal Holdings Ltd. v The Queen, 2019 TCC 16
Winnie Szeto, Toronto, Allison Blackler, Vancouver

In this case, the Tax Court of Canada considered whether the appellant's claims for the small business deduction (SBD) should be denied under the anti-avoidance rule in subsection 256(2.1) of the *Income Tax Act* (the Act), because one of the main reasons for the existence of the corporate taxpayer was to reduce the amount of tax that would have otherwise been payable.

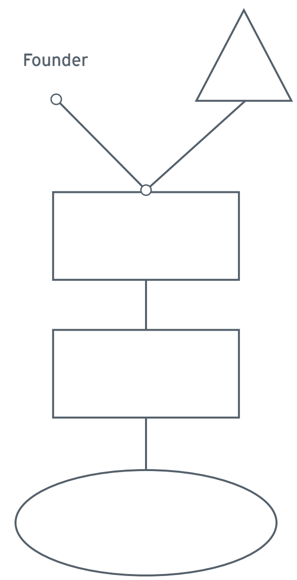
Facts

Kal Tire is a tire business with global presence. It was founded in 1953.

Corporate structure prior to 2007 reorganization

Kal Tire's business was carried on by a large number of companies and subsidiaries owned by the Kal Tire Partnership (the KT Partnership). The KT Partnership was wholly owned by Kal Tire Ltd., which in turn was wholly owned by Kal Tire Holdings Ltd. (KT Holdings). The founder controlled KT Holdings through a class of voting preferred shares. The common shares of KT Holdings were owned by the Kal Management Trust (the Management Trust). The founder was the trustee of the trust and his five children were the beneficiaries. This corporate structure came to be as a result of an estate freeze that occurred in 1987.

Pre-2007 simplified corporate structure



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The 2007 reorganization

As a part of a succession plan, the Kal Tire group underwent a reorganization in 2007 that essentially included:

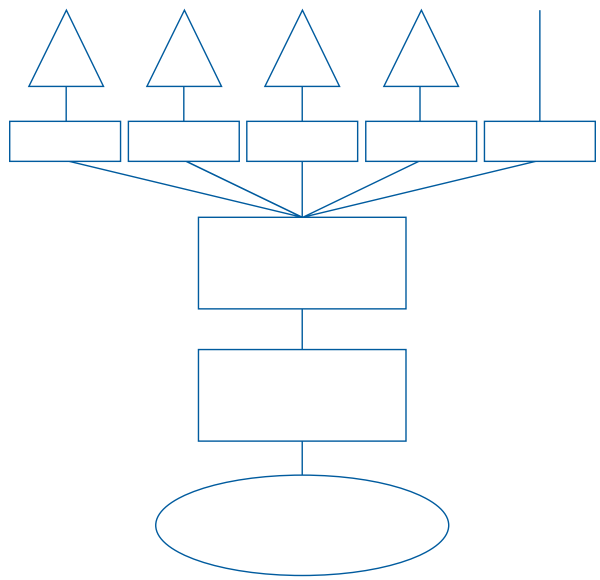
- Creation of one holding company for each of the founder's five children (the HoldCos)
- Distribution by the Management Trust of its shares of KT Holdings to the HoldCos
- Freezing of the interests of four of the founder's children in their HoldCos in favour of four new family trusts

After the reorganization, each HoldCo owned 20% of the shares of a class of voting and non-participating common shares of KT Holdings. Each HoldCo also owned 100% of one of the following classes of non-voting and participating common shares of KT Holdings: Class V Shares, Class W Shares, Class X Shares, Class Y Shares and Class Z Shares.

The appellant was the HoldCo that was created for one of the founder's daughters. This daughter owned preferred shares, and voting and non-participating common shares in the appellant. Her family trust owned voting and participating common shares in the appellant. Her children and grandchildren were the beneficiaries, and the daughter was the trustee of this trust.

The shares of the HoldCos for three of the founder's other children were held in the same manner as that of the appellant. The remaining child of owned all of the shares of his HoldCo directly; he did not have a family trust.

Post-2007 simplified corporate structure



The reduction of tax via the SBD

Under subsection 125(1) of the Act, a Canadian-controlled private corporation (CCPC) may be eligible for the SBD, which is a reduction in corporate taxes otherwise payable. The maximum amount of income that can be eligible for the SBD is currently $500,000 (the business limit).[8]

After the 2007 reorganization, each HoldCo was associated with KT Holdings.[9] Each HoldCo was also associated with the others by virtue of their association with KT Holdings.[10] If a corporation is part of an associated group, as is the case here, the business limit must generally be shared among the members of the group. However, KT Holdings made an election under subsection 256(2) not to be associated with the other companies for purposes of section 125. As a result, each HoldCo was able to maintain its own $500,000 business limit.

Following the 2007 reorganization, there was a series of dividend payments and loan transactions within the group. Kal Tire Ltd. withdrew funds from the KT Partnership, which used those funds to pay dividends to KT Holdings. KT Holdings then used those funds to pay dividends to each HoldCo. The HoldCos then used those same funds and lent them back to KT Holdings, which lent them to Kal Tire Ltd., which recontributed them to the partnership. These dividend and loan

[8] Subsection 125(2).
[9] Subsection 256(1).
[10] Subsection 256(2).

transactions occurred several times after the 2007 reorganization. The amount of dividends paid and the interest rate on the loans were selected to ensure that each HoldCo would earn $500,000 of interest income each year as a result of these transactions.

Under subsection 125(1), only active business income qualifies for the SBD. Passive interest income, such as that received by the HoldCos by virtue of the dividend and loan transactions, is normally considered to be income from property, rather than active business income. However, if a CCPC pays interest to an associated corporation, then that interest is deemed to be active business income of the associated corporation under subparagraph 129(6)(b).

KT Holdings had made an election under subsection 256(2) to not be associated with each HoldCo for the purposes of section 125. The election does not apply for other purposes of the Act. Therefore, KT Holdings and each HoldCo were deemed to be associated for the purposes of subparagraph 129(6)(b) and the interest income that the HoldCos received from KT Holdings was deemed to be active business income.

As a result of the 2007 reorganization and the elections described above, the appellant had active business income of $500,000 and a corresponding small business limit of $500,000 in each of its taxation years ending 29 February 2012, 28 February 2013 and 28 February 2014. The appellant was thus able to claim an SBD of approximately $84,000 for each of those years.

The Minister's reassessment

The Minister of National Revenue reassessed the appellant's 2012, 2013 and 2014 taxation years to deny its claim for an SBD. The Minister was of the view that the specific anti-avoidance rule in subsection 256(2.1) applied because it could reasonably be considered that one of the main reasons for the appellant's separate existence was to reduce the amount of tax otherwise payable.

[11] *Gerbro Holdings Co. v The Queen*, 2016 TCC 173, at para. 154, aff'd 2018 FCA 197 and *Groupe Honco Inc. v The Queen*, 2013 FCA 128.

Separate existence

The Court was asked to determine whether subsection 256(2.1) would apply to deny the appellant's claim for the SBD for its 2012, 2013 and 2014 taxation years.

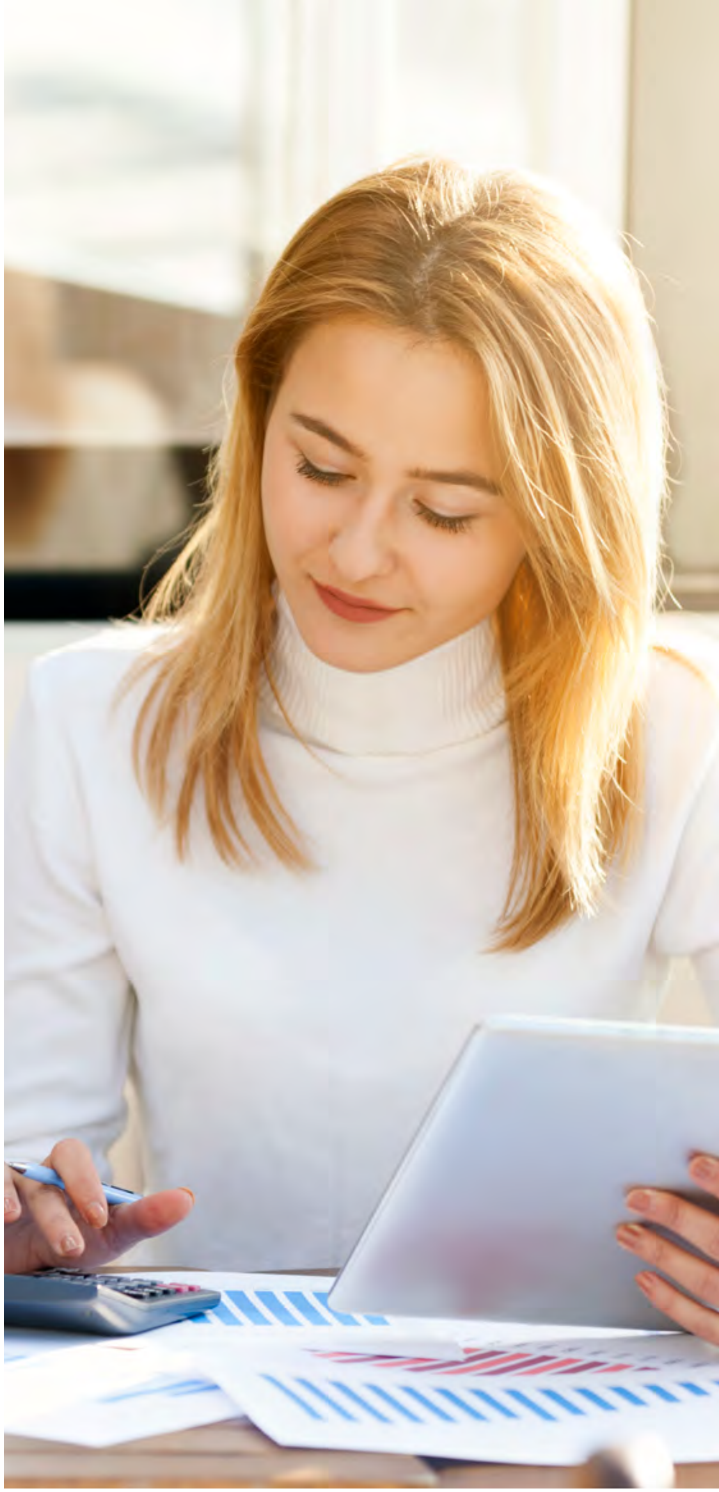
Subsection 256(2.1) deems corporations to be associated with one another if it is reasonable to consider that one of the main reasons for their separate existence is to reduce the tax that would otherwise be payable under the Act.

At the outset, the Court acknowledged that there may be more than one reason for the separate existence of a company.[11] Furthermore, it noted that the burden was on the appellant to show that reducing tax was not one of the main reasons for its separate existence. The Court found that the appellant failed its burden of proof and discussed five reasons for its conclusion.

First, the Court noted that the appellant did not provide any direct evidence of the main reasons for its separate existence. The appellant did not call either the daughter or her husband to testify even though they would have had significant insight into the main reasons for the appellant's separate existence. The appellant also failed to provide any compelling reasons for why they did not testify. In the absence of their direct testimony, the Court was of the view that there was simply insufficient evidence to prove the appellant's position.

Second, the Court noted that the appellant did not provide any direct evidence of the main reasons for the separate existence of the other HoldCos. The appellant did not call the owners of the other HoldCos to testify. If they had done so, the Court might have been able to infer that the main reasons for the appellant's separate existence were the same or similar to the reasons for the separate existence of the other HoldCos.

Third, the Court found the indirect evidence provided by the appellant's witness, its legal advisor, was unreliable. During the years leading up to and including the 2007 reorganization, the legal advisor was a partner at the law firm that advised Kal Tire, and he also advised the founder and certain members of his family. The legal advisor was able to describe to the Court the founder's intentions and motivations, and those of his children



and certain other involved parties in respect of the 2007 reorganization. While the Court found that the legal advisor was truthful in his testimony, it was not prepared to give much weight to the accuracy of the underlying statements (except for those relating to the founder). The Court was concerned that some or all of the individuals with whom the legal advisor had spoken may have been cautious in what they told him, or may even have told him things that were inaccurate.

Fourth, the Court was of the view that the documentary evidence was the best evidence it had to shed light on the main reasons for the appellant's separate existence. The documentary evidence consisted mainly of several tax planning memoranda prepared by a professional tax advisor, where tax minimization by way of SBD multiplication was highlighted as one of the tax benefits of Kal Tire's succession plan. The Court found that the daughter was made aware of the tax advantages of using a holding company at least twice in the years prior to the 2007 reorganization. While the documentary evidence showed that there may be other reasons for the use of holding companies, there was no reliable documentary evidence that suggested the daughter was aware of those reasons.

Finally, the appellant provided the following alternative reasons for its separate existence: estate planning for the founder's children, keeping ownership of Kal Tire in the family, corporate and partnership governance, and investment planning. However, the Court was not satisfied with any of those reasons.

The decision

Based on the above, the Court determined that the reduction of tax was a main reason for the HoldCos' separate existence. The documentary evidence showed that tax reduction was a main reason early in the planning process and remained important going forward. The initial structure that was proposed to achieve the tax benefits was the structure that was ultimately put into place. Therefore, the Court concluded that subsection 256(2.1) applied and the appellant was deemed to be associated with KT Holdings in the relevant years. As a result, subsection 125(5.1) also applied, and the appellant's small business limit was reduced to nil.

Lessons learned

In our view, this case highlights the importance of providing direct witness testimony in support of a tax position. The Court said that "a person's reasons for doing something are intrinsically personal" and "hearing those reasons directly from her would have been preferable."

But perhaps more important, this case drives home the importance of maintaining robust and cohesive documentary evidence that will be favourable to a taxpayer's tax position should it be challenged in the future. Companies and their tax advisors should ensure that they properly document the intentions of the parties to a transaction, should that be applicable.

Publications and articles

Tax Alerts – Canada

Tax Alert 2019 No. 1 – Northwest Territories budget 2019-20

Tax Alert 2019 No. 2 - 2019 customs compliance verification list update

The Canada Border Services Agency (CBSA) released its semi-annual list of trade compliance verification (audit) priorities in January 2019. The CBSA continues to focus on tariff classification as a priority audit area, with the introduction of two new rounds to the list of tariff classification priorities and one new round to the list of valuation verification priorities.

Tax Alert 2019 No. 3 – British Columbia budget 2019-20

Tax Alert 2019 No. 4 – Nunavut budget 2019-20

Tax Alert 2019 No. 5 - Quebec further phasing-out of ITR restrictions The restrictions

The restrictions on obtaining an input tax refund (ITR) applicable to large businesses have been gradually phased out since 1 January 2018. Accordingly, large businesses concerned must once again update their procedures as of 1 January 2019 and increase the rate of the ITRs they claim in respect of restricted expenses from 25% to 50%. As a result, with respect to taxable benefits provided to employees in 2018, registered employers that are deemed to be large businesses are required to include in the calculation of their net tax to be remitted 25% of the tax arising from taxable benefits related to expenses subject to the restrictions applicable to ITRs.

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

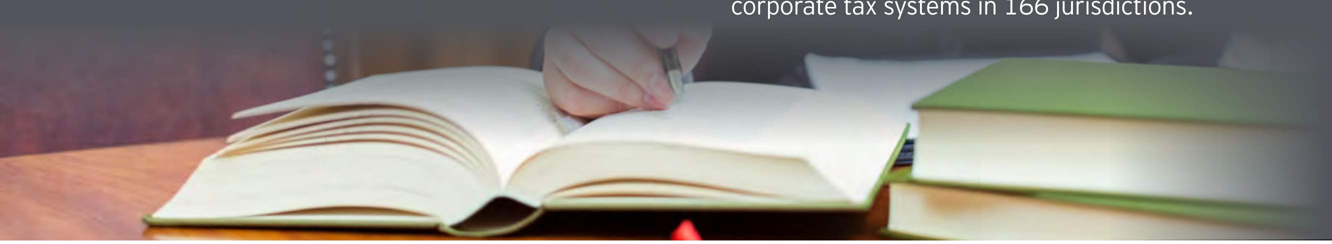
The *Worldwide Capital and Fixed Assets Guide* helps our clients navigate the rules relating to fixed assets and depreciation. It summarizes the complex rules relating to tax relief on capital expenditures in 29 jurisdictions and territories.

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 166 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

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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

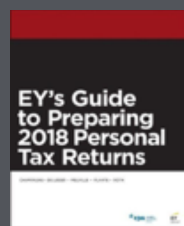
Updated monthly, our interactive map highlights where and when changes in VAT, global trade and excise duties are happening around the world. The map can be filtered by tax type, country and topic (e.g., VAT rate changes, compliance obligations and digital tax).

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

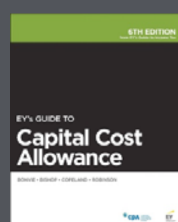
This guide is designed to help Canadian mining businesses interpret and apply the rules under the federal *Income Tax Act*, as well as under provincial and territorial legislation.



EY's Guide to 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

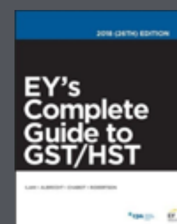
Editors: Allan Bonvie, Susan Bishop, Brett Copeland, Krista Robinson

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: SSusan 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.



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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