

Canada

by Steve Suarez and Stephanie Wong

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It has been a busy year for Canadian tax developments, both legislative and judicial.

Legislative

Effective January 1, 2011, proposed amendments to the tax treatment of real estate investment trusts generally make it easier for REITs to qualify for exemption from the tax on specified investment flow-through entities. (For prior coverage, see *Tax Notes Int'l*, Jan. 10, 2011, p. 104, *Doc 2010-27160*, or *2010 WTD 246-5*.) Later in the year, the government released amendments to eliminate the tax advantages of stapled securities (debt and equity securities “stapled” together), which will affect arrangements previously implemented by some corporations and REITs to avoid the specified investment flow-through tax. (For prior coverage, see *Tax Notes Int'l*, Aug. 1, 2011, p. 320, *Doc 2011-15925*, or *2011 WTD 141-1*.)

On March 16 the government announced draft legislative proposals in response to three Federal Court of Appeal decisions, including *Collins v. The Queen* (regarding reducible expenses) and *Lehigh Cement Limited v. The Queen* (regarding nonresident interest withholding tax). (For prior coverage, see *Tax Notes Int'l*, Mar. 28, 2011, p. 998, *Doc 2011-5774*, or *2011 WTD 54-1*.)

The 2011 federal budget announced several important business tax measures. They included new rules to eliminate a corporation’s ability to defer the taxation of income earned through one or more partnerships with fiscal year-ends that are different from the corporation’s year-end, the scaling back of tax incentives for some Canadian oil sands expenditures, and the amendment or extension of various rules regarding flow-through shares. (For prior coverage, see *Tax Notes Int'l*, Apr. 11, 2011, p. 80, *Doc 2011-6076*, or *2011 WTD 57-2*.)

On August 19 the government released a package of outbound legislative proposals affecting Canadian taxpayers with interests in foreign affiliates. The legislation replaces some rules announced in prior draft legislation and introduces upstream loan rules and a new “hybrid surplus” regime. (For prior coverage, see *Tax Notes Int'l*, Sept. 19, 2011, p. 881, *Doc 2011-18037*, or *2011 WTD 181-15*.)

A package of technical income tax amendments was released on October 31. It included proposals to expand the application of the shareholder benefit and debt rules to address partnerships and issues arising from foreign spinoffs, and to amend rules regarding the recognition of capital losses by Canadian beneficiaries of nonresident trusts and the treatment of nonresidents with Canadian service providers.

Under the mandatory reporting regime for aggressive tax avoidance transactions, which was proposed in August 27, 2010, draft legislation, a reportable transaction entered into after 2010 (or that is part of a series of transactions that began before 2011 but is completed after 2010) must be reported by June 30 of the year after it first became a reportable transaction.

Canada’s first nine tax information exchange agreements entered into force (with the Netherlands Antilles, the Cayman Islands, Bahamas, Bermuda, St. Kitts and Nevis, St. Vincent and the Grenadines, Anguilla, San Marino, and the Turks and Caicos Islands). Canada also signed a protocol updating its 1980 income tax convention with Barbados to make it more consistent with current Canadian and international tax treaty policies.

Court Decisions

Transfer Pricing

The Federal Court of Appeal upheld the Tax Court of Canada’s decision in *The Queen v. General Electric Capital Canada Inc.* Guarantee fees the taxpayer paid to its indirect U.S. parent satisfied the arm’s-length standard in Canada’s transfer pricing rules. The Crown did

not appeal. (For prior coverage, see *Tax Notes Int'l*, Jan. 3, 2011, p. 22, *Doc 2010-26867*, or *2011 WTD 242-2*.)

In *Alberta Printed Circuits Ltd. v. The Queen*, the Tax Court substantially upheld the fees paid by the taxpayer to a non-arm's-length Barbadian corporation as representing arm's-length prices. The court expressed a preference for analysis based on comparable uncontrolled transactions, even if they aren't completely comparable. (For prior coverage, see *Tax Notes Int'l*, June 13, 2011, p. 852, *Doc 2011-11786*, or *2011 WTD 107-4*.)

On January 13, 2012, the Supreme Court of Canada (SCC) will hear the Crown's appeal (and taxpayer's cross-appeal) in *The Queen v. GlaxoSmithKline Inc.* regarding whether the taxpayer paid a reasonable price to a related nonresident for the supply of an active ingredient used in brand-name medication sold in Canada. (For prior coverage, see *Tax Notes Int'l*, Aug. 2, 2010, p. 321.)

General Antiavoidance Rule

The SCC heard the appeal of *Copthorne Holdings Ltd. v. The Queen* in January 2011. *Copthorne* concerns the appropriate calculation of a corporation's paid-up capital following a horizontal amalgamation. The SCC's decision remains pending. The SCC has also granted the taxpayer in *Garron Family Trust (Trustee of) v. The Queen* leave to appeal the lower courts' decision, which applied a central management and control test to determine that a Barbadian trust was resident in Canada for tax purposes. (For prior coverage, see *Tax Notes Int'l*, Dec. 13, 2010, p. 821.)

The Tax Court considered three artificial loss cases in which a series of transactions were implemented to generate a capital loss to offset a previously realized capital gain. The general antiavoidance rule was applied in *Triad Gestco Ltd. v. The Queen* and *1207192 Ontario Limited v. The Queen* for different reasons, while the GAAR was not applied in *Global Equity Fund Ltd. v. The Queen*. All three cases are being appealed.

Other Court Decisions

In *Imperial Tobacco Canada Ltd. v. The Queen*, the Federal Court of Appeal upheld the Tax Court's decision denying the taxpayer a deduction for employee stock option surrender payments made during its takeover, as the payments were capital outlays. (For prior coverage, see *Tax Notes Int'l*, Jan. 24, 2011, p. 270, *Doc 2011-797*, or *2011 WTD 10-4*.)

The Tax Court rejected the government's first challenge of so-called foreign tax credit generator arrangements in *4145356 Canada Limited v. The Queen*. (For prior coverage, see *Tax Notes Int'l*, June 13, 2011, p. 838, *Doc 2011-11956*, or *2011 WTD 108-4*.)

In *Sommerer v. The Queen* (under appeal), the Tax Court found that a trust relationship existed and held that gains realized by a nonresident trust were exempt from Canadian taxation under the treaty and could not be attributed to the person who sold the property to the trust. (For prior coverage, see *Tax Notes Int'l*, Aug. 15, 2011, p. 527, *Doc 2011-15238*, or *2011 WTD 157-16*.)

Commodity Tax Developments

Voters in British Columbia rejected a new provincial sales tax harmonized with the federal goods and services tax. The old provincial sales tax (which is not a VAT) will be reintroduced on April 1, 2013, or perhaps sooner. Financial institutions, including mutual funds and pension plans, were required to file a complex tax return to ensure that enough harmonized sales tax was paid to the participating provinces. Pension plans received a 33 percent rebate of both GST and HST, but employers were required to report deemed tax on supplies to pension plans. Finally, Quebec announced that the Quebec sales tax rate will increase to 9.5 percent in 2012 and will be calculated on a base that does not include GST beginning in 2013. ◆

◆ *Steve Suarez and Stephanie Wong are with Borden Ladner Gervais LLP in Toronto.*