Symposium: Beneficial Ownership in Canadian Income Tax Law: Required Reform and Impact on Harmonization of Quebec Civil Law and Federal Legislation

Mark D. Brender*

ABSTRACT

This article examines the concept of beneficial ownership and whether it can be applied consistently under the Income Tax Act in Quebec and the common law provinces. This examination is conducted in the context of the harmonization project implemented by the minister of justice of Canada; that project seeks to ensure that the provisions of the Income Tax Act are applied consistently throughout Canada and that the legal traditions and terminology of the common law and civil law provinces are respected.

Currently, the Income Tax Act relies on subsection 248(3) to bridge the gap between the common law and the civil law in the application of the concept of beneficial ownership. The author argues that the language in subsection 248(3) may be insufficient for the purposes of achieving the goals of harmonization for three reasons. First, there is a debate in the common law provinces as to the meaning of the concept of beneficial ownership, thus making the concept difficult to apply in both the common law and the civil law provinces. Second, Quebec does not recognize the concept of beneficial ownership, and therefore its application in that province does not respect the civil law traditions. Third, subsection 248(3) may yield inconsistent results in the common law and civil law provinces.

Under the Income Tax Act, beneficial ownership in relation to Quebec entails a determination of whether the beneficiary has "a right as a beneficiary in a trust." That determination involves an analysis of the Civil Code of Quebec provisions respecting trusts. Under common law, there is no obvious meaning of the term "beneficial ownership." Some common law writers are of the view that a beneficiary will be considered the beneficial owner of property if that beneficiary has a sufficiently direct interest in the trust, which itself entails an analysis of the rights of the beneficiary. Consequently, it is possible that the threshold for beneficial ownership may not be the

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same for Quebec and the common law provinces. Therefore, it is conceivable that the same set of circumstances could result in different conclusions with respect to beneficial ownership. This, the author submits, is inappropriate from a harmonization perspective, because the Income Tax Act should not treat differently people who are similarly situated.

The author also examines the concept of "change in beneficial ownership" as it is used in the Income Tax Act and the difficulties that can arise in attempting to define the circumstances in which a change in beneficial ownership occurs when there is no clear definition of beneficial ownership itself.

The author concludes that paragraph 248(3)(f) may be deficient in achieving the objectives of harmonization. The problem with paragraph 248(3)(f) is that it is built on concepts that are not clear at common law and therefore it cannot be an effective building block. The author suggests possible solutions for achieving harmonization of the concept of beneficial ownership under the Income Tax Act as it applies to holding property directly and holding property through a trust. In the context of holding property directly, the author suggests that references to beneficial ownership can be replaced by a specific definition of the attributes of ownership and provide an exception for nominal ownership. With respect to property held through a trust, the author suggests that neutral concepts be developed that encompass the intended substantive effects of the concepts of "beneficial ownership" and "no change in beneficial ownership," without employing such terms.

KEYWORDS: BIJURALISM ■ OWNERSHIP ■ QUEBEC ■ BENEFICIARIES ■ HARMONIZATION ■ TRUSTS

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INTRODUCTION

The Income Tax Act[1] frequently uses the concept of "beneficial ownership." This concept originates from the common law and has no equivalent in civil law. As a result, the application in Quebec of certain provisions of the ITA can be somewhat problematic. The concept of beneficial ownership is used in the ITA in a variety of contexts, including, inter alia, dispositions, acquisitions, transfers of property to a trust, share-for-share exchanges, foreclosures, and guarantees. As well, the concept is used in many of Canada's tax treaties.

The term "beneficial ownership" is used in common law to distinguish the rights enjoyed by persons with a beneficial interest in property from those enjoyed by the legal titleholder to that property. Whether or not those beneficial rights constitute an actual ownership right is the subject of much debate. Under Quebec civil law, there is no such fragmentation of the right of ownership. While dismemberments of ownership exist—that is, usufruct, use, servitude, and emphyteusis—these dismemberments limit or expand rights enjoyed in property but do not convey ownership itself.[2] Furthermore, none of these dismemberments of the right of ownership can be precisely analogized to the common law concept of beneficial ownership.

Subsection 248(3), in effect, attempts to equate certain Quebec private law institutions with the common law trust. In particular, paragraphs 248(3)(a) to (d) deem certain institutions to be trusts ("deemed trusts") for purposes of the application of the ITA in relation to Quebec. Paragraph 248(3)(e) deems a person in Quebec who has a right, whether immediate or in the future and whether absolute or contingent, to receive any of the income or capital of one of these deemed trusts to be "beneficially interested" in the trust. Paragraph 248(3)(f) deems property in relation to which a person in Quebec has the right of ownership, a right as lessee of an emphyteutic lease, or a right as a beneficiary under a trust to be "beneficially owned" by the person.

Subsection 248(3) was enacted with a view to harmonizing, inter alia, the treatment of beneficial ownership in property with various institutions unique to the

1 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the ITA"). Unless otherwise stated, statutory references in this paper are to the ITA.

2 *Laliberté v. Larue*, [1931] SCR 7, at 16.

civil law of Quebec.[3] The fundamental policy objective underlying this provision is to promote equitable treatment of taxpayers and consistent application of the ITA throughout Canada, regardless of the unique features of Quebec private law. Whether or not this policy objective is achieved is questionable as a result of both the unique features of Quebec civil law and the lack of certainty as to the meaning of beneficial ownership in common law.

In addition, subsection 248(3) does not address all of the income tax issues that can arise from Canadian bijuralism. For example, in the *Construction Bérou* decision,[4] discussed below, the Federal Court of Appeal used a common law rationale to avoid giving the provisions under review in that case a narrower scope within Quebec than they would have had in the common law provinces. The same court adopted a similar approach in the *Littler* case,[5] interpreting the word "gift" narrowly in order to avoid giving the provision under review in that case a broader interpretation within Quebec than in the common law provinces. In both *Construction Bérou* and *Littler*, the court interpreted the provisions in question in a manner that led to a harmonious application of the ITA provisions concerned throughout Canada.

The harmonization project implemented by the minister of justice of Canada aims to ensure that all Canadians will have access to federal legislation that respects the legal tradition existing in the province in which they reside. With that objective in mind, the harmonization process strives to ensure that federal legislation is consistently applied throughout Canada with full respect for and recognition of both civil law and common law concepts, institutions, and terminology. From an income tax standpoint, the objective, and accordingly the challenge, of harmonization is concurrently to promote horizontal equity throughout Canada in the application of the provisions of the ITA and to preserve the tax policy objectives underlying the particular provisions of the ITA.

HARMONIZATION OF BENEFICIAL OWNERSHIP

Since the concept of beneficial ownership is not recognized, per se, in Quebec, difficulties can arise in applying provisions of the ITA that rely on the application of the concept to certain transactions having a nexus to Quebec. For example, one of the requirements to effect a tax-deferred transfer of property to a trust for the benefit of the transferor (that is, a trust that meets the requirements of subparagraphs 73(1.01)(c)(ii) and 73(1.02)(b)(ii)) is that there is no change in the beneficial ownership of the property as a consequence of the transfer. As will be illustrated below, absent harmonization measures, the tax consequences of this transaction and others like it in the Quebec context are, at best, replete with uncertainty but nonetheless

3 This objective was recognized by the Federal Court of Appeal in *Construction Bérou Inc. v. The Queen*, 99 DTC 5868, at 5870. This case is discussed later in the paper at note 73 and following.

4 Ibid.

5 *The Queen v. Littler*, 78 DTC 6179 (FCA).

yield either consistent tax results or, at worst, results that are inconsistent with the tax consequences that would arise in the common law provinces.

There are, essentially, two contexts in which the expression "beneficial ownership" or "beneficial owner" is used in the ITA. The first context relates to the identification of the person who is the "beneficial owner" of a particular property. The second context involves an assessment of whether there has been a change in the beneficial ownership of property. These two concepts will be examined in both the common law and civil law contexts, as will the application of these concepts in certain provisions of the ITA in which they are used. A comparison of the results arising from the application of those provisions in Quebec and in the common law provinces will demonstrate that the ITA, in relation to both the civil law and the common law, should be amended in order to achieve the goals of harmonization.

BENEFICIAL OWNERSHIP EXPLORED

Beneficial Ownership of Property Held in Trust

Beneficial Ownership in the Common Law Provinces

Paragraph 248(3)(f) provides that for the purposes of the application of the ITA in relation to Quebec, a property in respect of which any person has certain rights, such as the right of ownership or a right as a beneficiary in a trust, is deemed to be beneficially owned by that person. The paragraph therefore is intended to ensure that the person who has a right contemplated by that paragraph is in the same position for tax purposes in relation to the property as a person in a common law province who has a substantively similar right. This, of course, presupposes that there is a conceptual framework in the common law for the identification and determination of beneficial ownership in property. However, as will be discussed below, there is neither consensus as to the meaning of "beneficial ownership" in the common law nor a framework for analyzing the concept. There is also no clear meaning of "ownership" in the common law.

The discussion that follows will examine whether and in what circumstances a beneficiary of a trust governed by common law may be considered to be the beneficial owner of trust property. This determination is significant because it allows one to compare the status of a beneficiary of a trust governed by common law in a particular set of circumstances with that of a beneficiary of a trust governed by civil law in the same circumstances. For harmonization to be achieved, it is imperative that if a given set of circumstances results in a beneficiary of a Quebec trust being deemed to be the beneficial owner of trust property under paragraph 248(3)(f), a beneficiary of a common law trust in similar circumstances also should be regarded as the beneficial owner of the trust property. By extension, the determination of the beneficial owner of trust property is required in order to determine whether and in what circumstances a change in the beneficial ownership of property arises.

The determination of who, generally, will be considered a beneficial owner of trust property may be explored in the context of an example. Assume that the settlor of a self-benefit trust retains a general power of appointment exercisable on death

and that the trust deed provides for certain persons ("the default beneficiaries") to receive the remaining trust property in default of the exercise of the power (or if the power is not fully exercised).

The default beneficiaries have, as a matter of common law, a beneficial interest in the trust assets.[6] Consequently, they may be considered beneficiaries of the trust.[7] The question whether these default beneficiaries are beneficial owners of the trust property is contentious both at common law and for tax purposes. The controversy, though, is not limited to whether default beneficiaries are beneficial owners of property for common law and tax purposes. It is much broader in that it goes to the very nature of beneficial ownership, and the question whether such terminology reflects true ownership or whether it is a commonly used misnomer for a relationship where ownership of property, as the term is otherwise used, and most of the incidents thereof are vested in one person, and beneficial enjoyment of property is vested or is to be vested in another.

There is no obvious doctrinal meaning of the term "beneficial ownership." Waters[8] undertakes a detailed analysis of the jurisprudence that addresses the nature of beneficiary rights and demonstrates that at times it opts for the personal right of the beneficiary approach and at other times it couches decisions in terms of the proprietary rights that a beneficiary enjoys over trust property. Waters concludes that where the circumstances are such that it is not the working of the trust that is at issue before the courts but, for example, the beneficiary's liability for tax, it is more correct to engage in a proprietary rights analysis. That analysis, maintains Waters, will look to the facts of the particular case with a view to assessing whether the beneficiary has a "sufficiently direct interest" in the trust fund such that the beneficiary can be said to have more than a personal right.[9] Waters enumerates some of the factors to be examined in determining whether a beneficiary has a "sufficiently direct interest"—for example, whether the trust has been settled, whether a trustee has been appointed, and whether the beneficiary's interest has vested. However, he stops short of elucidating exactly what will constitute a "sufficiently direct interest" in the trust in order that someone may be considered a beneficial owner of trust property for income tax purposes. On the basis of this analysis, it would be reasonable to regard the sole beneficiary of a non-discretionary trust and a beneficiary of a bare trust to have a "sufficiently direct interest" in a trust.

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6 Berend Hovius and Timothy G. Youdan, *The Law of Family Property* (Scarborough, ON: Carswell, 1991), 264. See also A.H. Oosterhoff and E.E. Gillese, *Text, Commentary and Cases on Trusts*, 5th ed. (Toronto: Carswell, 1998), 127.

7 For income tax purposes, each default beneficiary would be deemed to be "beneficially interested" in the trust by virtue of paragraph 248(25)(a) and would be considered to be a "beneficiary" under the definition of "beneficiary" in subsection 108(1). However, that definition applies only for purposes of subdivision k.

8 D.W.M. Waters, "The Nature of the Trust Beneficiary's Interest" (1967) vol. 45, no. 2 *Canadian Bar Review* 219-83.

9 Ibid., at 275 and 281.

Oosterhoff and Gillese[10] seem to concur with Waters. They adopt a proprietary approach to trust property in the context of trust taxation issues and cite the decision of the Exchequer Court and the subsequent decision of the Supreme Court of Canada in *MNR v. Trans-Canada Investment Corp. Ltd.*[11] as illustrative of the application of that approach.[12] The *Trans-Canada* decision recognizes that, for certain purposes, the beneficiary of a trust could be treated as a beneficial owner of trust property. In this case, Trans-Canada Investment Corp. Ltd., the respondent, purchased common shares in selected Canadian companies and endorsed those shares over to the trustee of a unit trust. The trustee would then give the respondent certificates representing unit interests in the trust. The respondent would, in turn, sell those certificates to the public. The terms of the trust were such that the number of shares of each of the underlying companies to which holders of trust units were entitled was fixed at the time certificates were purchased and remained the same throughout. Furthermore, certificate holders could demand physical possession of the shares of the underlying companies. Finally, the trustee took meticulous care to ensure that the shares of the underlying companies represented by each trust unit were kept separate from other shares in its possession. Dividends received by the trustee on these shares were immediately placed in a segregated trust account and all distributions of these dividends were made from that same account. The respondent retained some such certificates for itself. When it received a distribution from the trust representing dividends received by the trustees from the shares that were the trust property, the respondent sought to treat that distribution as a tax-free intercorporate dividend rather than as an income distribution from the trust. The minister of national revenue challenged the respondent's categorization of the distribution and disallowed the deduction. Cameron J of the Exchequer Court concluded that, on the basis of the facts of the case (that is, the structure of the trust and, in particular, the rights of the beneficiaries just described), the holder of the trust unit was the beneficial owner of the underlying shares represented thereby. Accordingly, the income distribution could be treated as a receipt of dividends. Although the decision of the Supreme Court of Canada was a three-to-two split, the majority of the court concurred with the decision of Cameron J.[13]

Oosterhoff and Gillese then conclude that those who will take in complete or partial default of the exercise of a reserved power of appointment may be considered among the equitable owners (that is, beneficial owners) of the trust property, whereas potential appointees may not be considered as such until the appointer's discretion is exercised in their favour.[14] In other words, adopting Waters's terminology, the default beneficiaries of a trust have a sufficiently direct interest in the

10 Oosterhoff and Gillese, supra note 6.

11 55 DTC 1191 (SCC); aff'g. 53 DTC 1227 (Ex. Ct.).

12 Oosterhoff and Gillese, supra note 6, at 26 and 28.

13 The effects of this decision have been reversed by statute in subsection 108(5).

14 Oosterhoff and Gillese, supra note 6, at 127.

trust, whereas objects of a power of appointment acquire such an interest only on the exercise by the appointer of its discretion in their favour.

Similarly, the Canada Customs and Revenue Agency (CCRA) adopts the position that a power with a gift over to named heirs in default of the exercise of the power means that the settlor has not retained all of the beneficial ownership of the property, since those who will take in default are contingent beneficiaries under the trust.[15]

Not all commentators agree with these conclusions. Catherine Brown states that outside a specific finding of a court or a specific deeming rule, it is inaccurate to describe the beneficiary of a trust as having ownership of the trust property. She views the term "beneficial ownership" as merely "a short form for describing the beneficiary's right to enforce the trust against the trustee and any third party other than a bona fide purchaser for value without notice of the trust."[16]

The nature of a discretionary beneficiary's interest in trust property at common law is uncertain. The rights afforded to discretionary beneficiaries individually differ from those afforded discretionary beneficiaries as a class, and this leads to confusion when one seeks to analyze the nature of an individual discretionary beneficiary's interest in trust property. For example, the beneficiaries of a discretionary trust are not entitled to any specific part of the trust assets until the trustee exercises his or her discretion in their favour. In that respect, their position is very similar to that of an object of a power. However, if all the beneficiaries of a discretionary trust are sui juris, they may join together, terminate the trust, and obtain the trust property. And, if a trustee of a discretionary trust fails to exercise his or her discretion, the class of beneficiaries will take.[17] Therefore, at common law, an individual discretionary beneficiary, as opposed to a class of discretionary beneficiaries all of whom are sui juris, does not appear to have a sufficiently direct interest in trust property to be considered the beneficial owner thereof.

Change in Beneficial Ownership

The ITA contains various provisions that look to whether or not there has been a change in beneficial ownership. For example, one of the requirements for a tax-deferred transfer of property to a self-benefit trust[18] or a qualifying disposition to a trust[19] is that no change in beneficial ownership of the property would result from the transfer. There are two analytical approaches to the determination of whether there has been a change in the beneficial ownership of property. Both approaches are discussed below. If either analytical approach leads to a determination that there has been a change in beneficial ownership, such determination is sufficient for the conclusion that there has been such a change.

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15 CCRA document no. 9830105, February 26, 1999.

16 Catherine Brown, "Beneficial Ownership and the Income Tax Act," in this issue of the journal.

17 Oosterhoff and Gillese, supra note 6, at 127.

18 Subparagraph 73(1.02)(b)(ii).

19 Paragraphs 107.4(1) and (3).

The first analytical approach looks to whether persons who were not beneficial owners of the property before the transaction enjoy beneficial owner status after the transaction (the "beneficial owner status" approach). In analyzing whether there has been a change in beneficial ownership using this approach, one must identify and establish who are the beneficial owners of the property in question both before and after the transaction. If the beneficial owners before and after the transaction are not identical, then under this approach, there has been a change in beneficial ownership.

The second analytical approach involves a comparison of the settlor's rights over, and obligations in respect of, the property before and following the transaction (the "settlor's rights" approach). This approach examines whether, in effecting the transaction, the settlor has given up rights or has been relieved of obligations associated with beneficial ownership. If the answer is yes, then under this approach, there has been a change in the beneficial ownership of the property. For example, in the context of a principal residence, the CCRA has commented on the rights and obligations that it considers to flow from beneficial ownership. These rights are the right to possess the property, the right to collect rents therefrom, the right to call for the mortgaging of the property, and the right to transfer title of the property by sale or will. The obligations that flow from beneficial ownership in the context of a principal residence are the obligations to repair the property and to pay property taxes. The CCRA takes the position that, while a person need not be vested with all of these rights or subject to all of these obligations in order to be the beneficial owner of property, a transfer of any such rights or obligations will be indicative of a change in beneficial ownership.[20] Similarly, in the context of transactions that are sales of property, the CCRA has stated that "possession, use and risk are the primary attributes of beneficial ownership."[21] Accordingly, a change in any of these rights and obligations would suggest a change in beneficial ownership under the settlor's rights approach.

As discussed above, beneficiaries with a sufficiently direct interest in a trust may be regarded as enjoying some sort of ownership right, referred to as beneficial ownership, in trust property. In the context of the self-benefit trust example in which the settlor reserves a power of appointment and the trust provides for default beneficiaries, the settlor, as a beneficiary, and the default beneficiaries may be considered to be the beneficial owners of the trust property.[22] Given that the default beneficiaries enjoyed no such status before the constitution of the trust and that, at that time, it was the settlor who enjoyed full ownership—both legal and beneficial—of the trust property, in constituting the trust, according to the beneficial

20 *Interpretation Bulletin* IT-437R, "Ownership of Property (Principal Residence)," February 21, 1994, paragraph 4.

21 *Interpretation Bulletin* IT-170R, "Sale of Property—When Included in Income Computation," August 25, 1980, paragraph 8.

22 See the text accompanying notes 8 to 14, supra.

owner status approach, the settlor has effected a change in the beneficial ownership of the trust property.

The settlor of the trust, in naming default beneficiaries in the trust deed, has tempered his or her right to dispose of the subject property. Thus, the settlor has given up some of the rights enjoyed over the property and, according to the settlor's rights approach, has similarly effected a change in the beneficial ownership of the property. The same result would arise in the absence of default beneficiaries where the settlor reserves a specific, as opposed to a general, power of appointment exercisable on death.[23] In such circumstances, the settlor's ability to dispose of the property to whomever he or she desires is restricted; the settlor may dispose of the property only to those persons contemplated in the specific power of appointment. Consequently, a change in beneficial ownership arguably results.

In contrast, where there are no default beneficiaries and a settlor retains a general power of appointment exercisable on death, a change in beneficial ownership does not result since the settlor has not limited the class of persons to whom the property may be disposed of on his or her death.[24] The CCRA and the Department of Finance are of the same view.[25]

Where a settlor transfers property to a trust under the terms of which the settlor and other persons are discretionary beneficiaries, under both of the approaches discussed above, there will arguably be a change in the beneficial ownership of the property. In particular, under the settlor's rights approach, there would be a change in beneficial ownership because immediately before the transfer, the property was owned by the settlor; and after the transfer, the settlor, as beneficiary, is not a beneficial owner if he does not have a sufficiently direct interest in the trust. In addition, if all discretionary beneficiaries are sui juris, they may join together, terminate the trust, and obtain the trust property, which right constitutes a sufficiently direct interest in the trust. In such circumstances, the settlor, as beneficiary, is not the only "beneficial owner" of the trust property; consequently, there would be a change in the beneficial ownership of the property under the beneficial owner status approach.

Both subsections 73(1.02) and 107.4(1) prevent a tax-deferred rollover for transfers that result in a change in beneficial ownership. As a result, in a common law province, the settlor in the context of a transfer to a trust with default or discretionary beneficiaries will, as a consequence of the change in beneficial ownership, be considered to have disposed of the property for proceeds of disposition equal to fair market value.

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23 "Under a special [that is, specific] power of appointment, the choice of appointees is restricted by the donor of the power to a particular class." Oosterhoff and Gillese, supra note 6, at 117.

24 "Under a general power of appointment, the donee may appoint to anyone in the world." Ibid.

25 Canada, Department of Finance, *Explanatory Notes Relating to Income Tax* (Ottawa: Department of Finance, March 2001), clause 53; and CCRA document no. 2000-0048735, May 24, 2001.

Beneficial Ownership in Quebec

Under Quebec civil law there is, strictly speaking, no concept of beneficial ownership. The rights of a beneficiary of a trust in Quebec civil law are set out in the Civil Code of Quebec.[26] Neither the settlor, the trustee, nor the beneficiary enjoys any real rights in the trust property.[27] While the trust is in effect, the beneficiary has the right to require, according to the constituting act, either the provision of a benefit granted to him or her or the payment of both the fruits and revenues and the capital, or of only one of these.[28] The beneficiary's right is not framed in terms of the actual property of the trust but in terms of what legal actions the beneficiary can take. In contrast, at common law, the beneficial owner of property has been described as he who holds the right of enjoyment of the property.[29] The right of enjoyment is recognized in the CCQ as an aspect of the right of ownership.[30] The right of ownership, in turn, is recognized in the CCQ as a real right.[31] Given that the beneficiary of a Quebec trust does not enjoy any real rights in the trust property[32] and that the right of enjoyment is a dismemberment of the real right of ownership, it cannot be said that the beneficiary of a Quebec trust has a right of enjoyment in the trust property. Thus, the beneficiary of a Quebec trust does not meet the common law description of a beneficial owner.

It seems that, without regard to paragraph 248(3)(f), discussed below, where a settlor transfers property to a Quebec trust, there has been a change in the beneficial ownership of property even where the trust to which the property is transferred has only the settlor as a beneficiary—the settlor is the owner of the property before the transfer but not afterward. However, this conclusion is predicated on an assimilation of the rights that come with full ownership in Quebec civil law to beneficial ownership. As stated above, there is no concept of beneficial ownership in the civil law. Accordingly, there is no analytical framework to determine, from a civil law perspective, whether a transfer of property to a trust of which the settlor is the sole beneficiary results in a change in beneficial ownership.

Deemed Beneficial Ownership in Quebec

To compensate for this absence of analytical framework, and to lend meaning to the provisions of the ITA that rely on a change in beneficial ownership as a criterion for determining the tax consequences of a particular transaction, Parliament enacted paragraph 248(3)(f). Subparagraphs 248(3)(f)(i) and (ii) effectively deem property

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26 SQ 1991, c. 64 (herein referred to as "CCQ").

27 CCQ article 1261.

28 CCQ article 1284.

29 Waters, supra note 8, at 225.

30 CCQ article 947.

31 It is implicit in CCQ article 1119 that ownership itself is a real right.

32 CCQ article 1261.

in which a person has a right of ownership or a right of emphyteusis, respectively, to be beneficially owned by the person. Thus, for tax purposes, before the settlement of the trust, the settlor is considered to have beneficial ownership of the trust property. Further, subparagraph 248(3)(f)(iii) states that property in relation to which a person has at any time "a right as a beneficiary in a trust" is deemed to be beneficially owned by the person. The settlor, as beneficiary of a trust under which the settlor is the sole beneficiary and is entitled to receive all of the income and capital of a trust, is presumably within the ambit of that subparagraph. Thus, where that settlor is the sole beneficiary of a fixed-interest trust, there is no change in the beneficial ownership of the property for income tax purposes. Given that under Quebec civil law the beneficiary of a trust does not enjoy real rights in the trust property, absent the deeming rule in subparagraph 248(3)(f)(iii), it would be difficult to regard the settlor of a self-benefit trust as the beneficial owner, in the common law sense, of the property held in trust.

While the subparagraph 248(3)(f)(iii) deeming rule may seem to alleviate, albeit in a somewhat superficial manner, certain problems inherent in applying the ITA in Quebec, this, as will be described below, may not always be the case. Indeed, paragraph 248(3)(f) may, in some circumstances, cause a beneficiary in Quebec to be a beneficial owner where the common law might not consider a beneficiary in like circumstances to be a beneficial owner.

Beneficial Ownership of Property Held Directly

The preceding section examined the concept of beneficial ownership in relation to the rights of a beneficiary of a trust. The other context in which the concept of beneficial ownership is used in the ITA is in relation to the person who is entitled to the benefits from the property and to the property itself. In the latter context, the inquiry involves identifying the real or true owner of the property in question. For example, subsection 85.1(2) provides that an exchange of shares for shares of the acquiring corporation will not qualify for a rollover under subsection 85.1(1) where, immediately after the exchange, the vendor alone or together with persons with whom the vendor does not deal at arm's length beneficially owns more than 50 percent of the fair market value of all the shares of the capital stock of the acquiror. Subsection 19(5) provides that a newspaper will not qualify as a "Canadian newspaper" where, inter alia, the right to produce and publish issues of the newspaper is held by a corporation at least 75 percent of the votes and value of which are beneficially owned by Canadian citizens. Subsection 79(2) provides that "property is surrendered at any time by a person to another person where the beneficial ownership of the property is acquired or reacquired at that time from the person by the other person."

Where the arrangement is such that the person entitled to the benefits of the property is not the legal or registered titleholder, the task is to identify the beneficial owner of the property. In certain circumstances, this determination is straightforward. For example, the shares of a corporation held in "street name" would be considered to be beneficially owned by the true owner, namely, the person entitled

to the benefits from the property and to the property itself, such as the right to receive dividends on the shares, the right to receive the proceeds from the sale of such shares, and the right to exercise the voting rights attached to the shares. In this example, the titleholder holds the property only as an agent, mandatary, trustee, or other legal representative who does not have any right to enjoy the benefits from the property, and accordingly is not the beneficial owner. However, when a person holds the property otherwise than as a mere agent, mandatary, trustee, or other legal representative, the question to be determined is whether one looks through such person for purposes of determining the "beneficial owner" of the property.

For example, in the tax treaty context, discussed below, decisions of non-Canadian courts suggest that the notion of "beneficiary" or "beneficial owner" of a particular payment is an anti-treaty-shopping measure, and they have, in this respect, ignored what they regard as mere conduit or intermediary entities where such entities lacked "dominion and control" over the particular payment. This approach to the meaning of beneficial ownership is not inconsistent with the approach taken by Canadian courts in identifying persons "beneficially entitled" to property in the succession and estate duties context.

Succession Duty Cases

The Supreme Court of Canada decision in *Covert et al. v. Minister of Finance (NS)*[33] examines the meaning of the term "beneficially entitled" in the context of the Nova Scotia Succession Duty Act.[34] In this case, the testator bequeathed the property to a subsidiary of a holding corporation all the shares of which were owned by the children of the testator. The issue before the court was whether the holding corporation could be considered to be "beneficially entitled" to the property bequeathed by the testator to the subsidiary, thereby rendering the children, as shareholders of the holding corporation, liable for succession duties under section 2(5) of the Succession Duty Act.

At the relevant time, section 2(5) of the Succession Duty Act read as follows:

> Where a corporation which is not resident in the Province, other than a corporation without share capital, by reason of the death of a deceased acquires or becomes beneficially entitled to property of the deceased,
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> (a) the corporation shall be deemed not to be the successor of the property except to the extent that the value of the shares of the shareholders of the corporation is not increased in value by the corporation acquiring or becoming beneficially entitled to the property; and
>
> (b) each of the shareholders of the corporation shall be deemed to be a successor of property of the deceased to the extent of the amount by which the value of his shares

33 [1980] 2 SCR 774.

34 An Act Respecting Succession Duties, SNS 1972, c. 17 (herein referred to as "the Succession Duty Act"). See also *J.C. MacKeen Estate v. Min. of Finance*, [1978] CTC 557 (NSCA).

> in the corporation is increased by the corporation acquiring or becoming beneficially entitled to the property.

Under this section, where a corporation that is not resident in Nova Scotia "acquires or becomes beneficially entitled to property of the deceased," each of its shareholders is deemed to be a successor to the property of the deceased, to the extent that the value of his or her shares in the corporation is increased by the corporation's acquiring or becoming beneficially entitled to the property.

In a four-to-three decision, the Supreme Court held that the children were subject to the Succession Duty Act, on the grounds that the parent corporation was beneficially entitled to the property bequeathed to the subsidiary. The majority of the court was of the opinion that the words "beneficially entitled," as used in the statute, should not be given the interpretation developed by the courts in connection with trusts. In the court's view, because the parent corporation had total control over the subsidiary, it was in a legal position to compel the subsidiary to deal with its assets.

On the surface, one might conclude that the court pierced the corporate veil to conclude that the parent was beneficially entitled to property owned by the subsidiary. However, Martland J expressed the view that this was not the case because the Succession Duty Act contemplated the situation where a testator's property was bequeathed to another person for the benefit of the corporation:

> I do not think that in order to support the judgments below it is really necessary to "lift the corporate veil." Subsection 2(5) comes into operation not only when a corporation "acquires" property of the deceased but also when it "becomes beneficially entitled" thereto. This last expression, coming as it does after the word "acquires," clearly contemplates that the property has gone to another person for the benefit of the corporation. It would undoubtedly cover the case of property bequeathed to a trustee for the benefit of the corporation. It cannot be denied that in this situation the corporation would become "beneficially entitled" to the property. However the statute does not restrict the application of the provision to such a case. In my view, the corporation is no less "beneficially entitled" when the property is held by its wholly-owned subsidiary as when it is held in trust for it. Its legal entitlement is even more immediate as it does not have to call upon a third party to perform its obligation as trustee. It only has to exercise its rights as sole shareholder of its subsidiary. Nothing in the context of subs. 2(5) justifies giving a restricted meaning to the expression "beneficially entitled" which ought to be read according to the meaning of the words in ordinary language. I cannot find that it has acquired a technical meaning to which it must be restricted in this statute.
>
> In my opinion, in considering the application of subs. 2(5) to the unusual facts of this case, *this Court should not feel itself rigidly bound*, in interpreting the words "beneficially entitled," *by rules of equity evolved in the courts of chancery in connection with trusts*. This approach was manifested by this Court in *Minister of Revenue for the Province of Ontario v. McCreath et al.* [[1977] 1 SCR 2, [1976] CTC 178] [emphasis added].[35]

35 *Covert*, supra note 33, at 793-94.

In the end, it seems that the court looked through the corporations because that was the object and spirit of the law and because the transactions envisaged by the deceased were aimed at avoiding the Succession Duty Act:

> The clear intention of the testator was to divide the residue of his estate among his grandchildren. The codicil, plus the scheme of corporate arrangement with the parent company owning all the shares of the subsidiary company, accomplished the same result, but involved the residue passing through the hands of two corporations before finally reaching the intended beneficiaries. . . .
>
> This is eminently a case in which the Court should examine the realities of the situation and conclude that the subsidiary company was bound hand and foot to the parent company and had to do whatever its parent said. It was a mere conduit pipe linking the parent company to the estate.
>
> In the circumstances, it is my view that the parent company was beneficially entitled to the residue of the estate within the meaning of subsection 2(5). Although it is not a named beneficiary under the will, the corporate scheme evolved by the deceased has clothed it with total control over the named beneficiary, the subsidiary company, and has enabled it legally to compel the subsidiary company to turn the residue of the estate to it.[36]

It is interesting to note that Dickson J, writing for the minority, stated that the meaning attached to the phrase "beneficially entitled" was closely linked to the meaning of the word "beneficiary" and that such phrase was a term of art. He added that in the absence of earlier authority, a court could be inclined to accept that the expression "beneficially entitled" had a broader connotation. However, in light of the uniform jurisprudence to the contrary, he concluded that it was impossible to accept such submission:

> In sum, the legal meaning of "beneficially entitled" is firmly imbedded in the concrete of earlier adjudication. However unenamoured one may be with the conduct of the testator in this case, I do not think it is open to this court to jettison trust law and give a broad, non-technical meaning to the phrase "beneficially entitled," based upon i) the supposed intent of the legislature to catch transactions of this nature or ii) the proposition that one is beneficially entitled to property if at some time in the future he can exercise powers (not drawn from the will) by which he may ultimately acquire an interest in the property. Here the Court is not being asked to introduce words into the Act in order to cure an ambiguity, but rather to introduce a new section to provide for a situation not captured by it. To do so would be tantamount to changing the rules after the game has been played.[37]

36 Ibid., at 796.

37 Ibid., at 817-18.

Tax Treaty Cases

Many of Canada's tax treaties refer to beneficial ownership in the context of treaty shopping and anti-avoidance rules.[38] To benefit from the reduced rate provided by the treaty, the taxpayer must be the beneficial owner of the income. Because of this requirement, any amount paid to a bare trust, agent, or nominee must not be taken into account for the purposes of the treaty. A conduit vehicle that is resident in a country with which the source country has a favourable tax treaty may be disregarded. For example, paragraph 2 of article X of the Canada-United States income tax convention (1980)[39] provides that the withholding tax rate applicable to dividends paid by a company that is a resident of a contracting state to a resident of the other contracting state cannot exceed a fixed amount where a resident of the other contracting state is the beneficial owner of such dividends.

The OECD model tax convention[40] does not define the expression "beneficial ownership" and thus does not provide any guidance as to the meaning of the term. There have, however, been jurisprudential attempts by non-Canadian courts to define the concept in the tax treaty context.

First, there is the *Aiken Industries, Inc.* case,[41] a decision of a US tax court, that denied a zero withholding tax rate on interest paid by a US person to a treaty country corporation, where the interest income was immediately paid out by that corporation by way of matching interest payments to a shareholder (or affiliate thereof) that resided in a non-treaty country vis-à-vis the United States. The treaty benefit was denied on the basis that the recipient-lending corporation did not have "dominion and control" over the interest it received because of the immediate repayment by way of interest. However, a careful reading of this case indicates that the court was intent on not allowing an ultimate recipient or beneficiary of the US-source interest payment, which did not itself reside in a country that provided US treaty benefits, to utilize a stepping-stone country in a mechanical three-country arrangement. The court noted the fact that the arrangement "ostensibly conformed to the literal requirements of the withholding regulations"[42] (in this case, not requiring any treaty country party). The court also noted that, although the US Supreme Court has approved efforts by taxpayers to minimize tax burdens by tax planning, it was necessary, in a treaty arrangement, to consider the expectations of the contracting countries; and that, where an arrangement has no "valid economic or business

38 See, inter alia, Canada's tax treaties with France, Germany, the United Kingdom, Brazil, China, Japan, and the United States.

39 The Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, signed at Washington, DC on September 26, 1980, as amended by the protocols signed on June 14, 1983, March 28, 1984, March 17, 1995, and July 29, 1997.

40 Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital* (Paris: OECD) (looseleaf).

41 56 TC 925 (1971).

42 Ibid., at 931.

purpose" other than "to obtain the benefits of the exemption established by the treaty,"[43] it is appropriate to consider an inserted party as a mere "collection agent."

The elasticity of the concepts employed by the court in *Aiken Industries* and the manner in which support could be found for the decision clearly must be viewed in light of the evident bias of the court against the efficacy of an arrangement that saw a non-treaty country party accessing a treaty benefit through the formality of what was termed "a mere exchange of paper between related corporations to come within the protection of the exemption."[44] The court found that the only purpose for the creation and existence of the treaty country corporation and for the transaction was to obtain treaty benefits, and while such a tax-avoidance motive is not inherently fatal, such a motive in and of itself is not a business purpose that is sufficient to support a transaction for tax purposes.

In the *Aiken Industries* case, the court considered it appropriate, in light of the blatant treaty-shopping context, to find that the interest received by the "intermediary" was not received by it as its own, since there was an obligation to transmit that interest to a third party (that is, the originating lender). It was in that context that the recipient of the interest was considered not to have dominion and control over the interest.

Second, there is the more recent case of *Re VSA*,[45] where a Swiss company paid a dividend to a Luxembourg company, which paid the dividend out in the form of an interest payment to a shareholder who had loaned funds to the Luxembourg company, to enable it to purchase the shares of a Dutch company. Similar to the decision in *Aiken Industries*, the Swiss authorities refused the 5 percent withholding rate with respect to the dividend to the Luxembourg company on the basis that the Luxembourg company was not the beneficial owner of the dividend but merely a conduit, the dividends received having been immediately paid out in the form of an interest payment. There were sufficient indicators to allow the court to conclude that the Luxembourg company was "only a shadow company" interposed to permit a person who was not a resident of Luxembourg to benefit from the double tax convention.

As in the case of *Aiken Industries*, the context in which this decision arose must be noted. Again, the court makes it clear that it is perturbed with what is in effect paper shuffling intended to provide a party that would not otherwise enjoy benefits under the Swiss treaty to nonetheless obtain such benefits through an interposed Luxembourg company. The decision is framed and couched in terms of "abuse," as follows:

> After all, when the advantages of a double taxation convention benefit the nationals of third countries, there is an abuse of the convention, and Switzerland may adopt anti-

43 Ibid., at 934.

44 Ibid., at 933.

45 Case no. JAAC 65-86 (Federal Commission Switzerland) in *International Tax Law Reports* (London: Butterworths), 191.

> abuse measures in a unilateral fashion to assure itself that the benefits of the convention do not profit nationals or states who have no such right.[46]

With that bias in mind, it is not difficult to see how the court in *Re VSA* goes about referring to "legal form," arrangements that are "inappropriate," and the notion that arrangements of this type permit "a person who is not a resident of Luxembourg to benefit, wrongly, from a double taxation convention."[47]

In that context, the court had no problem in utilizing the notion of beneficial owner to conclude that, in the circumstances, the Luxembourg company was not the beneficial owner of the dividend: "[T]hus, a company which transferred to a third person dividends received without being able actually to dispose of them cannot be considered as the 'beneficiary.' "[48]

Interpreted out of context, the determination of the court in *Re VSA* could be seen to deny beneficial ownership status in a wide variety of arrangements.[49] However, in my view, the proper application of the decision is to restrict it to situations where it is required to support a conclusion based on context, such as treaty shopping by a non-resident to a third country.

Indeed, one commentator notes that, in a non-offensive context, the court's approach probably would not stand up to scrutiny:

> The obligation to transfer some receipts to a third party is crucial to the finding that the recipient is not the beneficial owner. A nominee, agent or a trustee is under a legal obligation to transfer a sum received to its principal or beneficiary. An intermediate holding [company] is likely to pay on sums received to its parent, however, it is not necessarily under an obligation to do so. If the intermediate holding company became insolvent before paying on the sum received, the sum would be available to its creditors and would not belong to its parent.[50]

Having regard to the tax treaty cases interpreting the meaning of "beneficial owner," and to the meaning of "beneficially entitled" under the succession duty cases, the question that arises is whether there is a basis for adopting a similar approach to interpreting or applying the concept of "beneficial ownership" in the ITA where that concept is used outside the trust context. It is arguable that such an approach is inappropriate. The scheme of the ITA is such that, absent a specific deeming provision, property held by a corporation or a trust is considered to be owned by that corporation or trust unless the corporation or trust is acting as agent

46 Ibid., at 211.

47 Ibid., at 210.

48 Ibid., at 209.

49 For example, an obligation of a landlord to use rents to pay a third-party secured mortgage could be seen as meaning that the landlord is not the beneficial owner, but that would obviously not be a normative determination.

50 Philip Baker, ed. *International Tax Law Reports* (London: Butterworths), 193.

or nominee or the trust is a bare trust.[51] Furthermore, absent sham or fraud, in income tax matters, the courts have generally been reluctant to pierce the corporate veil. Support for applying a limited role to the concept of "beneficial ownership" outside the trust context can be found in the ITA itself. For example, paragraph (e) of the definition of "Canadian newspaper" in subsection 19(5) provides that for the purposes of determining whether at least three-quarters of the votes and value of shares of a corporation are beneficially owned by Canadian citizens, where shares of a corporation are owned at any time by another corporation, each shareholder of the other corporation is deemed to own a pro rata number of shares of the corporation based on fair market value. The use of such a deeming provision demonstrates that, absent sham or fraud, the scheme of the ITA is such that intermediary entities will generally be respected from a "beneficial ownership" standpoint, notwithstanding that such entities may be subject to the control and dictates of another person.[52]

Issues Arising from the Concept of Beneficial Ownership and Change in Beneficial Ownership

The discussion that follows is not intended to be an exhaustive review of all of the possible problems that could be encountered when the provisions of the ITA in which the concept of beneficial ownership is used are applied in relation to Quebec. Rather, the analysis is intended to highlight some of the issues that can arise when certain provisions of the ITA are applied to certain transactions with the requisite nexus to Quebec.

The ITA often refers to the concept of "beneficial ownership" and to the phrase "does not result in a change in beneficial ownership" (or a variant thereof). These terms are referred to in the context of advertising expenses,[53] foreclosures,[54] the self-benefit trust,[55] share-for-share exchanges,[56] qualifying dispositions,[57] and the definition of "disposition."[58] Related concepts such as "owned"[59] and "belong to"[60] also

51 In this regard, see subsection 104(1), which specifically provides that a trust is deemed not to include an arrangement under which the trust can reasonably be considered to act as agent for all the beneficiaries under the trust with respect to all dealings with all trust property unless the trust is described in any of paragraphs (a) to (e.1) of the definition of "trust" in subsection 108(1).

52 Additional support can be found in paragraph (a) of the definition of "specified shareholder" in subsection 248(1), which deems the taxpayer to own shares of corporations that are owned by a non-arm's-length person.

53 Paragraph (e) of the definition of "Canadian newspaper" in subsection 19(5).

54 Section 79.

55 Subparagraph 73(1.02)(b)(ii).

56 Paragraphs 85.1(2)(b) and 85.1(6)(b).

57 Paragraph 107.4(1)(a).

58 Paragraphs (e), (f), and (k) of the definition of "disposition" in subsection 248(1).

59 Paragraph (e) of the definition of "Canadian newspaper" in subsection 19(5).

60 Subsection 186(2).

are used in the ITA. Some of the issues that can arise from the application of provisions using these terms in relation to Quebec are discussed below.

Trusts

The civil law and the common law treat the trust institution differently. Under common law, an analytical framework exists to justify the treatment of the beneficiary of certain trusts as a beneficial owner of the trust assets. The application of this analytical framework is contentious. Under civil law, the trust is a separate patrimony, and a beneficiary does not have any rights in the assets of the trust. The only rights afforded to a beneficiary are personal rights against the trustees.[61]

Subparagraph 248(3)(f)(iii) is necessary because there is no concept of beneficial ownership in civil law. It has been stated that in common law, beneficiary status may give rise to beneficial ownership for tax purposes, assuming a sufficiently direct interest. This line of reasoning has no basis in Quebec civil law. In this respect, paragraph 248(3)(f) is required to deem the property held by the deemed trust to be beneficially owned by the beneficiary. However, paragraph 248(3)(f) is fraught with difficulties. For example, can the usufructuary, who is deemed to be beneficially interested in the trust, be considered to have "a right as a beneficiary in a trust" and thereby be deemed to be the beneficial owner of the property subject to usufruct pursuant to subparagraph 248(3)(f)(iii)? That is to say, does the reference to "trust" in subparagraph 248(3)(f)(iii) include an institution deemed to be a trust in any of paragraphs 248(3)(a), (b), (c), and (d) and, if so, can the usufructuary who is deemed to be beneficially interested in a trust by virtue of paragraph 248(3)(e) be said to have "a right as a beneficiary in a trust"?

The answer to both questions appears to be yes. First, the trust referred to in subparagraph 248(3)(f)(iii) includes the deemed trusts referred to in paragraphs 248(3)(a) to (d). Second, the usufructuary and the naked owner, each of whom is deemed to be beneficially interested in a trust under paragraph 248(3)(e), may be treated as a "beneficiary."[62] Consequently, as a usufructuary may be regarded as a beneficiary in a trust, the usufructuary should be deemed to be the beneficial owner of the property subject to the usufruct, by virtue of subparagraph 248(3)(f)(iii).

Although the English version of the ITA suggests that there may be a technical issue[63] in arriving at this result, the French version of paragraphs 248(3)(e) and (f) makes it clear that a person deemed by paragraph 248(3)(e) to be beneficially interested in a trust is intended to be deemed by paragraph 248(3)(f) to be the beneficial owner of the trust property. The French version of paragraph 248(3)(e) deems any person with an absolute or contingent right in a deemed trust to have

61 CCQ articles 1284, 1287, and 1290.

62 See the definition of "beneficiary" in subsection 108(1).

63 The issue is whether it is correct to qualify the usufructuary as a beneficiary having regard to subsection 108(1), which defines "beneficiary," only for purposes of subdivision k, as including a person who is beneficially interested in a trust.

"un droit de bénéficiaire sur la fiducie." The French version of paragraph 248(3)(f) deems any person having "un droit de bénéficiaire dans une fiducie" to be the beneficial owner of the trust property. This also appears to be the result intended by Parliament. The May 1991 technical notes to subsection 248(3)[64] suggest that paragraph 248(3)(f) was not intended to change the meaning of the predecessor version of subsection 248(3), which stipulated that a reference to "any property that is or was beneficially owned by any person shall be read as including a reference to property in relation to which any person has or had . . . a right as a usufructuary."

A related issue that arises from the concept of beneficial ownership in relation to Quebec is the application of the concept of a change in beneficial ownership. While there is a deeming provision in connection with the concept of beneficial ownership itself, there is no equivalent for the concept of a change in beneficial ownership, and there has not been any attempt by Parliament to define, in relation to Quebec, the circumstances in which such a change has or has not occurred. Thus, although it is possible to identify the circumstances in relation to Quebec in which a person has a beneficial interest in a trust or is to be regarded as a beneficial owner of property, there is no guidance as to the determination of whether there has been a change in beneficial ownership. The concept is particularly relevant in the context of trust transfers—namely, the definition of "disposition" in subsection 248(1), which is linked to the concept of a change in beneficial ownership; and rollovers involving trusts, such as the self-benefit trust in section 73 and the qualifying disposition rollover in subsection 107.4(3).

Assume, for example, that Mr. X settles a trust by transferring to it property with an accrued gain. Mr. X is entitled to receive all the income of the trust and may require the trustees to distribute to him such part of the capital as he requests. The trust deed provides for Mr. X's children (the default beneficiaries) to receive the residual trust property on his death. Under common law, Mr. X may be regarded as the beneficial owner of the property both before and after the transfer. After the transfer, the default beneficiaries also will be regarded as beneficial owners under the common law. The transfer will therefore result in a change in beneficial ownership. Consequently, a rollover will not be available under section 73, and the transfer will not be a qualifying disposition under subsection 107.4(3).

Applying the example in relation to Quebec, by virtue of subparagraph 248(3)(f)(i), Mr. X will be deemed to be the "beneficial owner" of the property before the transfer, even though there is, strictly speaking, no such concept in Quebec civil law; and subparagraph 248(3)(f)(iii) will deem Mr. X to be a beneficial owner of the trust property immediately after the transfer. The default beneficiaries will likely be regarded as future beneficiaries under the CCQ. The default beneficiaries have future rights to receive income and capital, subject to divestment in the event that all of the income and capital is distributed to Mr. X. Under Quebec civil law, a default

64 Canada, Department of Finance, "Technical Notes to Bill C-18," in *Bill C-18*, special release (Scarborough, ON: De Boo, 1991), subclause 192(15).

beneficiary, as a future beneficiary, has the right to supervise the administration of the trust.[65] In this respect, the default beneficiary may reasonably be considered to have "a right as a beneficiary in a trust" for purposes of paragraph 248(3)(f). Consequently, the default beneficiaries will be deemed to be beneficial owners, there will be a change in beneficial ownership, and the transfer will not qualify for a rollover. This is consistent with the result that would ensue under common law.

When the foregoing analysis is applied in the context of a transfer of property to a fully discretionary trust, although the income tax consequences are consistent in Quebec and the common law provinces, in that a rollover would not be available because the transfer results in a change in the beneficial ownership of the property, the status of the beneficiaries as beneficial owners may not be the same. In particular, the discretionary beneficiary under common law may not be considered to be a beneficial owner whereas, in relation to Quebec, the discretionary beneficiary may be deemed to be a beneficial owner. Assume that Mr. X contributes property to a trust. The trust deed provides that the trustees may, in their discretion, choose among Mr. X and his children as to who will receive the income and capital of the trust, and determine their share. Under common law, Mr. X and his children may not be considered to be beneficial owners of the trust property, unless all of the beneficiaries are sui juris; beneficial ownership of the trust property is in suspension until the trustees' discretion is exercised. Mr. X would not be the beneficial owner of the trust property after the transfer and, in consequence, the transfer would result in a change in beneficial ownership.[66] It is unclear whether a discretionary beneficiary in Quebec in all circumstances has "a right as a beneficiary in a trust" because it is unclear whether a discretionary beneficiary is a "beneficiary" under the CCQ. CCQ article 1287 provides that the administration of a trust is subject to the supervision of the settlor or of his heirs, if he has died, and of the beneficiary, even a future beneficiary. CCQ article 1290 states that the settlor, the beneficiary, or any other "interested person" may take action against the trustee to compel him to perform his obligations or to perform any act that is necessary in the interest of the trust, to enjoin him to abstain from any action harmful to the trust, or to have him removed. The issue to determine is whether a discretionary beneficiary is a "beneficiary" or an "interested person." If a discretionary beneficiary is a "beneficiary" under the CCQ, he or she has "a right as a beneficiary" for purposes of paragraph 248(3)(f) and will thus be deemed to be a beneficial owner of property held in the trust. This result is inconsistent with the common law position. If, however, the discretionary beneficiary is not a "beneficiary" but is an "interested person," he or she will have a right as an "interested person," not "a right as a beneficiary in a trust" for purposes of paragraph 248(3)(f), and will therefore not be deemed to be a beneficial owner of the trust property. The position of a discretionary beneficiary is somewhat precarious in the sense that he or she has no right to require, according to the constituting act,

65 CCQ article 1287.

66 If all of the beneficiaries were sui juris, there would also be a change in beneficial ownership since Mr. X would not be the sole beneficial owner immediately after the transfer to the trust.

either the provision of a benefit granted to him or her or the payment of the income or capital of the trust[67] until such time as the trustee exercises the discretion in favour of the beneficiary. Similarly, it is questionable whether a discretionary beneficiary could be regarded as a future beneficiary for the purposes of the CCQ.

The French version of subsection 248(25) may nevertheless deem a discretionary beneficiary to have a right as a beneficiary for purposes of paragraph 248(3)(f) and therefore to be a deemed beneficial owner of trust property. According to the French version of paragraph 248(25)(b), a discretionary beneficiary is deemed to have "un droit de bénéficiaire dans une fiducie," which, translated literally, means "a right as a beneficiary in a trust," for purposes of the ITA. The French version of paragraph 248(3)(f) deems property in relation to which a person has "un droit de bénéficiaire dans une fiducie" to be the beneficial owner of the trust property. On the basis of this analysis, under the French version of paragraphs 248(25)(b) and 248(3)(f), it is clear that in relation to Quebec, a discretionary beneficiary would be regarded as a person having "a right as a beneficiary" for purposes of paragraph 248(3)(f) and would be deemed to be the beneficial owner of the trust property.

The English version of paragraph 248(25)(b) deems the discretionary beneficiary to be "beneficially interested" in the trust, as opposed to deeming the beneficiary to have "a right as a beneficiary in a trust," as in the French version. If, in relation to Quebec, it were concluded that a discretionary beneficiary enjoys the type of right encompassed by subparagraph 248(3)(f)(iii), there would clearly be a change in beneficial ownership as a result of the settlement of a discretionary trust. Conversely, if it were concluded that a discretionary beneficiary does not have "a right as a beneficiary in a trust," that beneficiary would not be deemed to be a beneficial owner of the trust property by virtue of the English version. With respect to the common law provinces, a discretionary beneficiary is generally not to be regarded as the beneficial owner of the trust property. This is inconsistent with the French version of subparagraph 248(3)(f)(iii), but not necessarily with the English version.

In either case, in relation to Quebec, the transfer of property to the discretionary trust would result in a change in the beneficial ownership of the property. This result is consistent with the result that would ensue in common law. If a discretionary beneficiary is a "beneficiary" under the CCQ and thus has "a right as a beneficiary" under paragraph 248(3)(f), all discretionary beneficiaries are deemed to be beneficial owners; and since the settlor was the only beneficial owner of the property before the transfer, there will be a change in the beneficial ownership of the property after the transfer. If the discretionary beneficiary does not have "a right as a beneficiary," the settlor will not be a deemed beneficial owner after the transfer and, consequently, there will also be a change in the beneficial ownership of the property. In this context, the provisions of the ITA could apply to classify differently, in terms of beneficial ownership, people similarly situated; but nevertheless, the provisions operate in a manner that yields consistent tax results.

67 See CCQ article 1284.

"Controlled" in Subsection 186(2)

The term "connected" is defined for the purposes of part IV in subsection 186(4). Paragraph 186(4)(a) provides that a payer corporation (of dividends) is connected with a particular corporation if the payer corporation is controlled by the particular corporation. Paragraph 186(4)(b) sets out other criteria that may render one corporation connected with another, but those criteria are not germane to this study. "Controlled," for the purposes of part IV, is defined in subsection 186(2) as follows:

> For the purposes of this Part, other than for the purpose of determining whether a corporation is a subject corporation, one corporation is controlled by another corporation if more than 50% of its issued share capital (having full voting rights under all circumstances) *belongs to* the other corporation, to persons with whom the other corporation does not deal at arm's length, or to the other corporation and persons with whom the other corporation does not deal at arm's length [emphasis added].

The dissimilar treatment in common law and in civil law of the relationship between trustees and beneficiaries on the one hand, and trust property on the other, could give rise to inconsistent results where a trust is involved.

Consider the following example involving a split-up butterfly reorganization. A, B, C, and D are brothers. A and B each own 10 common shares of Opco. There are no other Opco common shares. A testamentary trust ("the trust") created under the will of their deceased father holds 5,000 voting preferred shares. C and D are discretionary income and capital beneficiaries of the trust, and the trustee is a person dealing at arm's length with the brothers.

A and B wish to proceed with a split-up butterfly transaction. Accordingly, they transfer their common shares to holding companies, Aco and Bco, respectively. In the course of the butterfly transaction, Opco will repurchase the common shares of its capital stock from Aco and Bco for cancellation. This repurchase transaction will result in the deemed payment of dividends by Opco to each of Aco and Bco. Unless Opco is connected with Aco and Bco, the dividends deemed to have been received by Aco and Bco will be subject to part IV tax.

Given the number of voting shares held by the trust, Opco is not controlled by Aco and Bco. However, the question arises, what is meant by the words "belongs to" in subsection 186(2)? Can the voting preferred shares held by the trust be considered to "belong to" the trust?

The decision of the Tax Review Board in *Distillers Corporation—Seagrams Limited v. MNR*[68] is authority for the proposition that the words "belong to" connote ownership. The provision under examination in that case was the definition of "subsidiary controlled corporation" in paragraph 139(1)(aq) of the old Act,[69] which provided that "subsidiary controlled corporation" means a corporation more than

68 80 DTC 1649 (TRB).

69 Income Tax Act, RSC 1952, c. 148, as amended.

50 percent of the issued share capital of which, having full voting rights under all circumstances, "belongs to" the corporation of which it is a subsidiary.

If the trust is a common law trust, the voting preferred shares held by the trust would be considered to "belong to the trust."[70] In the civil law context, it is more difficult to establish to whom the property of the trust belongs, given that the trust patrimony is "ownerless."[71] It is clear under Quebec civil law that the property of the trust does not belong to the trustee or the beneficiaries since neither of them has any real rights in and to the trust property.[72] The trust patrimony is autonomous and distinct from that of the trustees and beneficiaries, and the property of the trust is thus ownerless. It may therefore, under civil law, not be possible to attribute ownership of the preferred shares to the trust. In addition, paragraph 248(3)(f) does not apply to deem the trustee to be the beneficial owner because it only deems a person having a right as a beneficiary of a trust governed by the laws of Quebec to be the beneficial owner of the trust property.

The next question to be examined is whether the discretionary beneficiaries, who do not own the trust property under Quebec civil law, are deemed to be beneficial owners of the trust property by virtue of subparagraph 248(3)(f)(iii). This analysis depends on whether C and D have "a right as a beneficiary" in the trust. As discussed above, it is not entirely clear that under Quebec civil law a discretionary beneficiary is a "beneficiary" under the CCQ; consequently, under the English version of subparagraph 248(3)(f)(iii), the discretionary beneficiaries may not be considered to have a right as a beneficiary and therefore may not be deemed to be beneficial owners under the trust. However, under the French version of subparagraph 248(3)(f)(iii), C and D will, by virtue of paragraph 248(25)(b), be deemed to have "a

70 All debate aside, the trustee of a common law trust is considered to have legal ownership and the beneficiary is considered to have beneficial ownership. If the shares held by the trust were regarded as belonging to the beneficial owners (that is, the beneficiaries), then each of Aco and Bco would be connected with Opco since C and D do not deal at arm's length with A and B.

If the shares were considered to belong to the trustee, then pursuant to paragraph 251(1)(b), the trustee (reading the term "personal trust" in paragraph 251(1)(b) as including a reference to the trustee having ownership or control over the trust property) would be deemed not to deal at arm's length with A and B because of A's and B's relationship with the beneficiaries, who are C and D. Accordingly, each of Aco and Bco would be connected with Opco. Query, though, whether reading the term "personal trust" in paragraph 251(1)(b) as including a reference to the trustee having ownership or control over the trust property is a correct reading of the term.

If the shares held by the trust were not considered to "belong to" the trustee or the beneficiaries, but instead were considered to belong to the trust arrangement itself, then the trust would be a person who does not deal at arm's length with either of Aco or Bco for the reasons described in the immediately preceding paragraph. The result would be that each of Aco and Bco would be connected with Opco. In either scenario, the voting preferred shares held by the trust would be aggregated with the shares held by Aco and Bco, thereby rendering Opco connected with Aco and Bco for the purposes of part IV.

71 Guy Fortin, "How the Province of Quebec Absorbs the Concept of the Trust" (1999) vol. 18, no. 3 *Estates Trusts & Pensions Journal* 285-316, at 292.

72 CCQ article 1261.

right as a beneficiary" and therefore will be deemed to be beneficial owners of the trust property.

If the trust property is not deemed to be beneficially owned and thus could not be said to belong to C and D for purposes of subsection 186(2), and having regard to the fact that the trustee does not have real rights in the trust property, the only other "person" to whom the shares may belong is the trust patrimony. However, since the trust patrimony is ownerless, in a technical sense it cannot be said that the shares belong to the trust.[73] Clearly, this is an unintended result. The term "belongs to" was present in subsection 186(2) and elsewhere in the ITA long before the creation of the patrimony by appropriation in the CCQ. In the context of the example under review, it would clearly be appropriate to consider the preferred shares as belonging to the trust, a result that is consistent with the common law. However, a strict application of Quebec private law to the question whether the property belongs to the trust patrimony would lead to the conclusion that the shares do not belong to the trust, and therefore, Aco and Bco would not be connected with Opco.

A court would likely not strictly apply private law principles of ownership in determining whether the property "belongs to" a Quebec civil law trust in this context. A court would likely take a liberal approach to the interpretation of the words "belongs to" in order to connect Aco and Bco with Opco, a result that is consistent or harmonious with the result that would ensue if a common law trust were involved. This bijural harmonization approach to the interpretation of words in the ITA that are susceptible of different meanings, depending on the province in which the provision is being applied, was taken in the *Construction Bérou* case, discussed below. The result in *Construction Bérou* may be desirable from a tax policy perspective; however, the approach adopted by the court may not be desirable from a bijuralism perspective in that Quebec civil law was, essentially, disregarded. Accordingly, a more appropriate resolution to the problem contemplated herein would be for the legislator to resolve the uncertainty surrounding the interpretation that ought to be given to "beneficial ownership" in Quebec.

Foreign Share-for-Share Exchanges

Subsection 85.1(6) denies a rollover on a foreign share-for-share exchange where one of five circumstances is met. The circumstance set out in paragraph 85.1(6)(b) is as follows:

> (b) immediately after the exchange the vendor, persons with whom the vendor did not deal at arm's length or the vendor together with persons with whom the vendor did not deal at arm's length,

73 Further, it is not clear whether subsections 104(1) and (2) operate to treat the trust patrimony (or trust arrangement) as having ownership of the trust property because, with respect to certain aspects of that relationship—namely, the realization of income, or disposition proceeds—that is what the ITA contemplates but seemingly might not for other aspects, as in the example discussed.

(i) controlled the foreign purchaser, or

(ii) beneficially owned shares of the capital stock of the foreign purchaser having a fair market value of more than 50% of the fair market value of all of the outstanding shares of the capital stock of the foreign purchaser.

Again, the question of what is meant by "beneficially owned" arises. Consider two corporations, Forco I and Forco II. Fifty percent of the shares of Forco I, worth $300 million, are owned by X. The remaining 50 percent of Forco I shares are held by a discretionary trust. The beneficiaries of the discretionary trust are X's children. The shares of Forco II are widely held and have a combined value of $500 million. X and the trust wish to transfer their respective shares of Forco I to Forco II. Query whether a rollover is available to X and the trust on the basis that, immediately after the exchange, the vendor together with persons with whom the vendor did not deal at arm's length beneficially owned shares of the capital stock of the foreign purchaser having a fair market value of more than 50 percent of the fair market value of all of the outstanding shares of the capital stock of the foreign purchaser.

From a common law perspective, as already submitted, it is unlikely that an individual discretionary beneficiary can be said to beneficially own the trust property, but it may be possible to consider the entire class of discretionary beneficiaries, assuming they are all sui juris, as beneficial owners of that property.[74] Query, then, who beneficially owns the Forco II shares acquired by the trust on the exchange. If the discretionary beneficiaries, as a whole, can be said to beneficially own the Forco II shares, then immediately after the transfer, X and a class of persons all of whom are not at arm's length with X beneficially own more than 50 percent of the Forco II shares; accordingly, the rollover would not be available to X or the trust. However, if it cannot be said that the discretionary beneficiaries beneficially own the trust property, who does?

If the Forco II shares are considered to be beneficially owned by the trust itself, the same result as above arises. X is not at arm's length with the trust by virtue of paragraph 251(1)(b); consequently, X and a person not dealing at arm's length with X together own shares of the capital stock of Forco II having more than 50 percent of the fair market value of all of the outstanding shares of its capital stock immediately after the exchange. If, as some maintain, beneficial ownership is in suspension—that is, no person or entity can be qualified as the beneficial owner until the trustee exercises its discretion—then the rollover will be available because immediately after the exchange, X beneficially owns shares representing less than 50 percent of the fair market value of all the Forco II shares and there are no non-arm's-length persons who own shares of Forco II.

From a civil law perspective, the discretionary beneficiaries of a Quebec trust may not be regarded as beneficial owners of the trust property, unless they are deemed to be such by virtue of subparagraph 248(3)(f)(iii). If they are within the ambit of subparagraph 248(3)(f)(iii), X's family would be deemed to beneficially own

74 See the discussion above under the heading "Change in Beneficial Ownership."

the shares of Forco II received by the trust on the foreign share-for-share exchange. The aggregate fair market value of the Forco II shares beneficially owned by X and X's children would be greater than 50 percent of the fair market value of all the Forco II shares immediately after the exchange, and thus the rollover would not be available to X or the trust.

Accordingly, under both common law and civil law, it is not clear whether a rollover would be available in the circumstances described above. Consistent treatment is a mere possibility and not, as it should be, a certainty.

Judicial Attempts at Harmonization

Construction Bérou,[75] *MNR v. Wardean Drilling Ltd.*,[76] and *Olympia & York Developments Ltd. v. The Queen*[77] illustrate the issues that may arise when private law concepts are applied in interpreting the ITA.

The *Construction Bérou* decision relied on subsection 248(3) to overcome the absence of the beneficial ownership concept in Quebec civil law. The court used the subsection as a justification for treating the rights created by the leasing contracts in question as beneficial ownership rights. In doing so, it took a broad approach to interpreting the subsection. While the result may be appropriate from a tax policy perspective, it is questionable whether the approach taken by the court is otherwise appropriate. The language of subsection 248(3) at the time of the *Construction Bérou* decision was such that certain enumerated civil law property interests were assimilated to beneficial ownership for the purposes of the ITA. With respect to leases, only emphyteutic lessees were referred to in the subsection. The absence of a reference to lessees under ordinary leases with purchase options suggests that such a property interest was not intended to be treated as beneficial ownership.[78] Thus, it is possible that the Federal Court of Appeal gave subsection 248(3) too broad a scope.

The issue in the *Construction Bérou* case was whether a transaction in the form of an equipment lease with a bargain purchase option could be recharacterized as a purchase by the lessee of such equipment for purposes of the ITA. The taxpayer corporation agreed to lease certain trucks from financial institutions that had purchased the trucks at the request of the taxpayer. Each lease had a term of 65 months. At month 60, the taxpayer had an option to purchase each truck for a purchase price equal to 10 percent of the original cost. At the inception of the lease, it was estimated that on the purchase option date the fair market value of the truck would be about 50 percent of its original cost. If the taxpayer did not exercise the purchase option at month 60, the rent payable by the taxpayer for the remaining 5 months of

75 Supra note 3.

76 69 DTC 5194 (Ex. Ct.).

77 80 DTC 6184 (FCTD).

78 Michael D. Templeton, "Financial Leases: Economic Substance Prevails," Current Cases feature (2000) vol. 48, no. 1 *Canadian Tax Journal* 148-54, at 152.

the lease slightly exceeded the purchase option price; therefore, from the outset, it was reasonable to expect that the taxpayer would exercise the purchase option.

The taxpayer, on the basis of *Interpretation Bulletin* IT-233R,[79] treated the transaction as a purchase of the trucks instead of a lease. It therefore claimed capital cost allowance and investment tax credits with respect to the cost of the trucks and deducted a portion of the rent paid under the lease as interest due on the deferred purchase price of the trucks. The minister reassessed the taxpayer on the basis that it did not acquire the trucks and therefore was permitted only a deduction for the rent paid.

The Federal Court of Appeal, in a two-to-one decision, found that, notwithstanding the fact that ownership had not been transferred as a matter of civil law, the taxpayer had acquired the trucks for the purpose of claiming capital cost allowance and investment tax credits and deducting the interest expense. All three judges agreed that in order for a taxpayer to be considered to have acquired property for the purposes of the ITA, the taxpayer must obtain beneficial ownership of the property. The majority of the court relied on the definition of "disposition," which indicated that a change of legal ownership without a change of beneficial ownership is not a disposition, and on the *Wardean Drilling* and *Olympia & York* cases. These cases stand for the proposition that in a conditional sales context, a purchaser acquires property for the purposes of the ITA when it acquires all the incidents of ownership, those being use, possession, and risk, notwithstanding that legal ownership may be reserved by the vendor to ensure full payment of the purchase price.

In the opinion of the majority of the court, the difficulty created by the absence in the CCQ of the concept of beneficial ownership was resolved by subsection 248(3). For the years under appeal, subsection 248(3) read as follows:

> In its application in relation to the Province of Quebec, a reference in this Act to any property that is or was beneficially owned by any person shall be read as including a reference to property in relation to which any person has or had the full ownership whether or not the property is or was subject to a servitude, or has or had a right as a usufructuary, a lessee in an emphyteutic lease, an institute in a substitution or a beneficiary in a trust, and a reference in this Act to the beneficial owner of any property shall be read as including a reference to a person who has or had, accordingly as the context requires, such ownership as a right in relation to that property.

The court concluded that the intent and effect of subsection 248(3) was to include, within the meaning of "beneficial ownership" for the purposes of the ITA, various property rights recognized by the CCQ:

> [S]ubsection 248(3) of the *Income Tax Act* ("the Act") evidences a valuable effort by Parliament to treat beneficial ownership in property in the same way as various forms

79 *Interpretation Bulletin* IT-233R, February 11, 1983. This interpretation bulletin has been cancelled by *Income Tax Technical News* no. 21, June 14, 2001.

> of ownership recognized in the civil law of Quebec so as to obviously offer to the taxpayers in Quebec the same benefits that this concept affords the taxpayers in the common law provinces. This was not an easy task to perform at the time because the concepts of ownership were different in the two legal systems, and the divisions of the ownership right, more limited in civil law than in common law, were not conceptually necessarily identical to those of the common law. Yet, the attempt by Parliament to harmonize the two systems with a view to providing fair and equal treatment to all Canadian taxpayers cannot be doubted. Hence, the necessity for a judicial interpretation which allows for the implementation of this legislative intent.[80]

In *Wardean Drilling* and *Olympia & York*, the courts had to analyze the word "disposition" and in both instances concluded that it should be given the widest possible meaning, at least with regard to capital cost allowance provisions of the ITA. As long as ownership or the normal incidents thereof—that is, possession, use, and risk—are transferred, there has been a disposition.

In *Olympia & York*, which was subject to the laws of Quebec, the court accepted the view that where the parties to a transaction had expressly deferred the passage of title, there was no immediate sale; however, a disposition for tax purposes could occur earlier than the sale.

In the *Wardean Drilling* case, which was subject to the laws of Alberta, the court examined whether there was an "acquisition" for income tax purposes. The issue was whether, for the purposes of claiming capital cost allowance, the taxpayer had acquired equipment in the year in question or only in a subsequent year. The contract stipulated that title would pass only upon delivery of the goods. The analysis involved a determination of whether the taxpayer became the owner of the property before year-end. In this particular case, the taxpayer did not have physical possession of the property before year-end, but the sale contract was signed before year-end. Cattanach J wrote:

> [I]t is my opinion that a purchaser has acquired assets of a class in Schedule B when title has passed, assuming that the assets exist at that time, *or* when the purchaser has all the incidents of title, such as possession, use and risk, although legal title may remain in the vendor as security for the purchase price as is the commercial practice under conditional sales agreements. In my view the foregoing is the proper test to determine the acquisition of property described in Schedule B to the Income Tax Regulations [emphasis added].[81]

The application of Quebec civil law to the facts analyzed in the *Olympia & York* and *Wardean Drilling* cases would result in a different conclusion, since the transfer of ownership occurs on the signature of the agreement (or when stipulated in the

80 *Construction Bérou*, supra note 3, at 5870.

81 *Wardean Drilling*, supra note 76, at 5198.

agreement, as in *Olympia & York*), and possession is not relevant, except with respect to the assumption of risk.[82]

Arguably, there is nothing inherently wrong with associating the transfer of the incidents of ownership in a property with the concept of beneficial ownership. However, the link between incidents of ownership and beneficial ownership merits explicit recognition in the ITA so as to avoid the necessity of relying on provincial private law, as was done by the courts in *Wardean Drilling* and *Olympia & York*. There are many instances where the ITA deems a set of circumstances to be a distinct set of circumstances for income tax purposes. In a slightly different vein, there are also instances where the ITA dissociates a private law concept from the private law and endeavours to define it for tax purposes.[83] If this were done with beneficial ownership, the results may be acceptable, subject to the discussion of this solution below. However, given that, at present, the term "beneficial ownership" is not defined in the ITA, courts have no choice but to find its meaning in the private law of the relevant province.[84] Although the term "beneficial ownership" has found its way into Quebec business parlance, and it is commonly used in Quebec contractual matters, as discussed above the concept itself is non-existent in Quebec private law. The court's error in *Construction Bérou* lay in its recourse to the private law of a common law province to determine the meaning of the term.

In light of *Construction Bérou*, the necessity of harmonization is more pressing. The court's decision, while commendable from a policy perspective, gives rise to uncertainty for Quebec taxpayers since it suggests that the determination of the tax consequences arising from a transaction governed by Quebec civil law might be based on common law principles. The conflicting objectives of applying legal principles consistently across the country and accounting for differences in the private law of the various provinces is well illustrated by the following comments made by Létourneau JA:

> I have undertaken this analysis of the leasing contract at the time because it indicates the difficult position in which Revenue Canada was placed, especially at the period in

82 CCQ articles 1387 and 1456.

83 See the definition of "disposition" in subsection 248(1). The problem with the dissociation in this definition is that, within the definition, reference is made to other private law concepts that are undefined in the ITA. In this issue of the journal, David G. Duff, in "The Federal Income Tax Act and Private Law in Canada: Complementarity, Dissociation, and Canadian Bijuralism," discusses dissociation in more detail. Dissociation, as described by Duff, means dissociating a private law concept from the civil law of Quebec, even where the issue to be resolved arises therein, and instead using the concept's common law meaning. Where a court engages in dissociation of that sort, the necessity of harmonization becomes more evident. Dissociation, as it is used in the present discussion, connotes removing a private law concept from both civil law and common law and entrenching a specific definition thereof for tax purposes in the ITA.

84 Marie-Pierre Allard, "The Retroactive Effect of Conditional Obligations in Tax Law" (2001) vol. 49, no. 6 *Canadian Tax Journal* 1726-1839, at 1728, based on *The Queen v. Lagueux & Frères Inc.*, 74 DTC 6569 (FCTD). See also CCRA document no. 2001-0066095, May 10, 2001.

> question, namely 1982. The Interpretation Bulletin issued by Revenue Canada sought, because of the legal uncertainty surrounding the idea of the leasing [sic], to introduce a salutary degree of certainty in tax matters which is necessary for the economic development resulting from these financial and commercial transactions. In operational terms, it also allowed Revenue Canada to plan and adopt a uniform and equitable approach at the national level for such transactions, whatever might be the disparities in private law produced by the special features of one legal system as compared to another.[85]

ALTERNATIVES TO "BENEFICIAL OWNERSHIP"

The preceding discussion illustrates that, in relation to Quebec, difficulties can arise in applying certain provisions of the ITA that use the concept of beneficial ownership or the word "belong." Indeed, it has been suggested that where a discretionary trust is involved, the result is peculiar, if not ironic, in that a provision—namely, paragraph 248(3)(f)—that was brought into the ITA as a measure intended to put a beneficiary of a Quebec trust on equal footing with a beneficiary of a common law trust in regard to the question of beneficial ownership of trust property, could cause a beneficiary of a Quebec trust to be a beneficial owner of trust property in circumstances where the common law might not view the beneficiary as a beneficial owner.

An effective solution to promote harmonization while preserving the integrity of the tax policy underlying the relevant provisions of the ITA may be to remove all references to beneficial ownership and specify, to the greatest extent possible, in neutral phraseology used elsewhere in the ITA, the conditions required to achieve the tax policy objective of the particular provision. Analysis of the ITA reveals that the use of the concept of beneficial ownership can be broadly grouped into two categories:

1. in relation to the rights of a beneficiary under a trust; and
2. in relation to the person who is entitled to the benefits (fruits) from the property and the property itself, and the right to dispose of or bequeath the property.

To promote uniformity of application of the provisions of the ITA, the use of concepts or terms that are unique to common law, such as the concept of "beneficial ownership," should be avoided, both in principle and where they are themselves of uncertain meaning. Rather, the underlying tax policy of provisions using the term "beneficial ownership" could be preserved by the adoption of terminology that yields the same substantive effect. Highlighted below are various examples of this approach.

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85 *Construction Bérou*, supra note 3, at 5873.

Transfers to Trusts for the Sole Benefit of the Settlor and Deemed Dispositions

Transfers to Self-Benefit Trusts

In the context of transfers of property to trusts, the ITA is primarily concerned with whether there has been a change in beneficial ownership. A good example of that concern is found in subparagraph 73(1.02)(b)(ii). Subsection 73(1) generally provides for a tax-free disposition of property by an individual to his or her spouse, a "spousal trust," an "alter ego trust," or a "joint spousal trust." Subsection 73(1.02) limits the application of section 73 by imposing certain additional conditions in order to obtain a rollover to a so-called self-benefit trust. Previously, subparagraph 73(1.02)(b)(ii) read as follows:

> No person (other than the individual) or partnership has any absolute or contingent right as a beneficiary under the trust (determined with reference to subsection 104(1.1)).

It was amended in the 2001 technical bill[86] to provide the following:

> [T]he *transfer does not result in a change in beneficial ownership of the property and there is immediately after the transfer* no absolute or contingent right of a person (other than the individual) or partnership as a beneficiary (determined with reference to subsection 104(1.1)) under the trust [emphasis added].

One of the purposes of the amendment to subparagraph 73(1.02)(b)(ii) to add the requirement that no change in beneficial ownership occur as a result of the transfer is to ensure that in the case of a self-benefit trust, the settlor does not reserve a specific power of appointment exercisable under a will. In particular, the technical notes accompanying the 2001 technical bill provide that "no change in beneficial ownership would be expected to result from a transfer of property to a trust where the power to appoint beneficiaries under the trust is reserved by the contributor and is a general power of appointment."[87] The CCRA took the same view when it commented on the then draft legislation in a technical interpretation.[88] The CCRA wrote that

> the retention of a general power of appointment by the [settlor] on the transfer of property to such a trust [that is, a self-benefit trust settled by an individual less than 65 years of age] would not be expected to result in a change in beneficial ownership of the property for the purpose of a transfer described in subparagraph 73(1.02)(b)(ii). However, if property is transferred to a trust in which the individual is the sole income and capital beneficiary during his or her lifetime and the individual retains a

86 SC 2001, c. 17, section 53 (herein referred to as "the 2001 technical bill").

87 *Explanatory Notes Relating to Income Tax*, supra note 25, at clause 53.

88 CCRA document no. 2000-0048735, May 24, 2001.

specific or hybrid power of appointment, it is our view that a change in beneficial ownership would arise as a result of the transfer.

Subsection 104(1.1) provides that for the purposes of subparagraph 73(1.02)(b)(ii), a person is deemed not to be a beneficiary under a trust where the person is beneficially interested in the trust solely because of any one, or a combination, of the following:

> (a) a right that may arise as a consequence of the terms of the will or other testamentary instrument of an individual who, at the particular time, is a beneficiary under the trust;
>
> (b) a right that may arise as a consequence of the law governing the intestacy of an individual who, at that time, is a beneficiary under the trust;
>
> (c) a right as a shareholder under the terms of the shares of the capital stock of a corporation that, at the particular time, is a beneficiary under the trust; [or]
>
> (d) a right as a member of a partnership under the terms of the partnership agreement, where, at the particular time, the partnership is a beneficiary under the trust.

Before the 2001 technical bill, the effect of subsection 104(1.1) in the context of a trust where the settlor retains a specific power to appoint in his or her will was to allow for rollover treatment under subsection 73(1) or subsection 107.4(3). In other words, the specific power of appointment retained by the settlor did not give rise to an absolute or contingent right under the trust for anyone except for the settlor. Subsequent to the 2001 technical bill, the combined effect of the no change in beneficial ownership and the no absolute or contingent right requirements of subparagraph 73(1.02)(b)(ii) (and paragraph 107.4(1)(e)), and the deeming rule in subsection 104(1.1), is to deny rollover treatment to those trusts where the settlor retains a specific power of appointment exercisable in his or her will.

Subsection 104(1.1) does not exclude the right of a potential beneficiary named in a will pursuant to a specific power of appointment. Accordingly, it is the condition in subparagraph 73(1.02)(b)(ii) and paragraph 107.4(1)(e) that there be no change in beneficial ownership that ensures that only a general power of appointment may be reserved by the settlor. Paragraph 104(1.1)(a) currently provides an exception to the no absolute or contingent right rule in subparagraph 73(1.02)(b)(ii) for persons who may be potential appointees under a power of appointment. As discussed above, subparagraph 73(1.02)(b)(ii) was amended to require that the transfer of property cannot result in a change in the beneficial ownership of the property. This change, in effect, requires that the power of appointment contemplated in paragraph 104(1.1)(a) be a general power of appointment, meaning that the appointer must have the power to appoint to whomsoever he or she chooses, including the estate of the appointer.

The CCRA considers that there is no change in the beneficial ownership of property if the settlor of a self-benefit trust reserves a general power of appointment because the settlor's ability to dictate the ultimate disposition of the trust property is unlimited. This position is consistent with the common law view of the matter. In contrast, the CCRA views the reservation of a specific power of appointment

as resulting in a change in beneficial ownership, a position that also is consistent with the common law. The addition of the no change in beneficial ownership requirement in subparagraph 73(1.02)(b)(ii) thus reflects, inter alia, a tax policy objective to prohibit the reservation of a specific power of appointment in the context of a self-benefit trust. However, this tax policy objective may be achieved without the use of the expression "does not result in a change in beneficial ownership."

Recommendations Respecting the Removal of the "No Change in Beneficial Ownership" Requirement in the Context of Self-Benefit Trusts

An alternative approach might involve the removal of the no change in beneficial ownership requirement, the preservation and perhaps enhancement of the no absolute or contingent right test, and an amendment to paragraph 104(1.1)(a) to include only the right of an appointee pursuant to a general power of appointment exercised in the last will and testament or other testamentary instrument of the settlor. This solution uses more neutral terms or concepts such as "power of appointment" and "absolute or contingent right as a beneficiary."

The terms appear to have the same meaning in both civil law and common law. According to Marc Jolin, a general power of appointment is null and void in civil law.[89] However, his view is not shared by Diane Bruneau in her paper for the Department of Justice,[90] and I agree with the view expressed by Bruneau. In particular, CCQ article 1282 provides that

> [t]he settlor may reserve for himself the power to appoint the beneficiaries or determine their shares, or confer it on the trustees or a third person. . . .
>
> In the case of a personal or private trust, the power to appoint may be exercised by the trustee or the third person only if the class of persons from which he may appoint the beneficiary is clearly determined in the constituting act.

The drafting merely suggests that a general power of appointment cannot be exercised if it is conferred on a person other than the settlor. Alternatively, if there is any doubt or inconsistency as to what constitutes a general power of appointment under common law or civil law, a specific definition of general power of appointment could be developed for this purpose. It is interesting to note that the regulations enacted under the United States Internal Revenue Code[91] define a general power of appointment as one that allows the holder of the power to appoint to "the decedent, his estate, his creditors or the creditors of his estate."

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89 Marc Jolin, "Les nouveaux types de fiducies et les possibilités de planification," in Association de planification fiscale et financière, *Les Fiducies*, colloque no. 109, May 22 and 23, 2001.

90 Diane Bruneau, "Problems in the Application of Tax Law to Civil Law Trusts," in this issue of the journal.

91 Internal Revenue Code of 1986, as amended.

In addition to the foregoing, paragraph 104(1.1)(a) could be amended as follows:

> (a) a right that may arise as a consequence of the exercise of a *general power of appointment that may be exercised only* under the terms of the will or other testamentary instrument of an individual who, at the particular time, is a beneficiary under the trust.

This proposed amendment to paragraph 104(1.1)(a) would also be applicable for purposes of paragraphs 104(4)(a.4) and 107.4(1)(e), discussed below, although those provisions would also need to be amended to remove any reference to no change in beneficial ownership, which reference also is intended to ensure, among other things, that the transferor does not retain a specific power of appointment.

Another purpose of the addition to the no change in beneficial ownership requirement in subparagraph 73(1.02)(b)(ii) is to ensure that the settlor of a self-benefit trust receives an interest in the trust equal to the full value of the property transferred to the trust.[92] An alternative measure that could be used to preserve this objective would involve adding a requirement to subparagraph 73(1.02)(b)(ii) that, as a consequence of the transfer to the trust, the fair market value of the transferor's interest in the trust immediately after the transfer be increased by an amount equal to the fair market value of the property immediately before the transfer and at all times thereafter the fair market value of the transferor's interest in the trust be equal to the net fair market value of all the property of the trust.

The no change in beneficial ownership requirement may be abandoned without permanent loss of the tax revenues that would otherwise arise on the death of an individual who is the settlor of a self-benefit trust. Under current income tax law,

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92 Before the amendment, the following scenario could have arisen. An individual, X, owns depreciable property with a low undepreciated capital cost but a high fair market value. X transfers the property to a self-benefit trust under the terms of which X is the income beneficiary, the trustee is empowered to encroach on capital in X's favour, and X retains a power of appointment exercisable in his will. X relies on subsection 73(1) to receive rollover treatment on the transfer. (X meets the necessary criteria: appointees under a will are not considered to have contingent or absolute rights since they are within subsection 104(1.1).) On X's death, there is no deemed disposition of his income interest because it is not capital property. Since X did not have a capital interest in the trust, there is no capital interest to speak of; there is no deemed disposition thereof in accordance with subsection 70(5); and neither the increase in value of the trust assets from the time they were acquired by X to the time they were rolled into the trust, nor the increase in value of the capital interest in the trust from the date of settlement to the date of X's death, is taxable.

Cindy Rajan and Catherine Brown posit that the effect of requiring that the transfer not result in a change in the beneficial ownership of property in order to take advantage of a rollover of property to a trust curtails the perceived abusive structure described above. Essentially, if X did not have a capital interest in the trust, the transfer would result in a change in the beneficial ownership of the property transferred to the trust and X would realize recapture and a capital gain at the time of the transfer. Cindy L. Rajan and Catherine A. Brown, "Personal Trusts 2000: Taxation and Planning in the New Millennium," in *Report of Proceedings of the Fifty-Second Tax Conference*, 2000 Conference Report (Toronto: Canadian Tax Foundation, 2001), 28:1-55, at 28:32ff.

when the settlor of a self-benefit trust dies, the trust is deemed to have disposed of all of the trust assets for fair market value at the end of the day on which the death of the settlor occurs and is further deemed to have reacquired those assets immediately after that day for an amount equal to their fair market value at that time.[93] Recall that the property was transferred by the settlor to the trust on a rollover basis. Accordingly, the capital gains realized by the trust on this deemed disposition will reflect accrued gains in the property from the time it was acquired by the settlor. Current income tax law also provides that the settlor's capital interest in the trust is deemed to have been disposed of for proceeds of disposition equal to its fair market value immediately before the settlor's death.[94] The capital gain realized on this deemed disposition is calculated as the difference between the fair market value of the interest and the greater of (1) its adjusted cost base (ACB) and (2) its cost amount less certain prescribed deductions.[95] Assume that the cost of the capital interest to the settlor was nil in accordance with paragraph 107(1.1)(b). The cost amount of the capital interest in the trust to the settlor is determined in accordance with the definition of "cost amount" in subsection 108(1). Paragraph (a.1) of the definition of "cost amount" sets out that, in circumstances where subsection 104(4) applies, the cost amount of the settlor's capital interest is the cost amount determined under paragraph (b) of that definition as if the taxpayer had died on the day immediately preceding the time immediately before the death of the taxpayer. Finally, paragraph (b) sets out a formula for computing the cost amount of a settlor's capital interest that takes into account the beneficiary's proportionate share of the value of the underlying capital assets less the trust's liabilities. The interaction of these provisions is illustrated with the following example.

X settles a self-benefit trust with land. The land has an ACB of $1 million. X dies 20 years later at 2:00 p.m. on Wednesday; the fair market value of the land during the week in which X dies remains constant at $2 million. Paragraph 104(4)(a.4) deems the trust to have disposed of the land for its fair market value at the end of Wednesday and deems the trust to have reacquired the land at its fair market value at the beginning of Thursday. The trust realizes and is liable for tax on a capital gain of $1 million. Subsection 70(5) deems X to have disposed of his capital interest in the trust immediately before his death—that is, at 1:59 p.m. on Wednesday. Subsection 107(1) is relevant to determine the capital gain realized on this deemed disposition. Assuming that the ACB of the capital interest was nil, X's cost amount is used to determine those capital gains. Given that X's capital interest represents 100 percent of the capital interests in the trust, the cost amount to X of his capital interest is the cost amount of the land, computed as if X had died on the day immediately preceding the subsection 70(5) deemed disposition of capital property. The subsection 70(5) deemed disposition of capital property took place at 1:59 p.m. on

93 Paragraph 104(4)(a.4).

94 Subsection 70(5).

95 Paragraph 107(1)(a).

Wednesday. Applying the definition of "cost amount" in subsection 108(1), if X were to have died on Tuesday, his capital interest would have been disposed of and reacquired on that day with the result that the cost amount of the land to X at the beginning of the day on Wednesday would be equal to $2 million. Accordingly, at the time the cost amount of X's capital interest would need to be determined for purposes of the subsection 70(5) deemed disposition—that is, at 1:59 p.m. on Wednesday—the cost amount of the underlying property would be stepped up to the fair market value at that time. The fair market value and the cost amount of the capital interest would, in consequence, be equal, and the capital gain realized on the deemed disposition would be nil.

The intended effect of the interaction between subsection 70(5), paragraph 104(4)(a.4), and the definition of "cost amount" in subsection 108(1) is to provide a step-up in the cost amount of the settlor's capital interest and to eliminate the double taxation that would otherwise arise as a result of the death of the settlor and the consequential deemed disposition of the capital interest. This intention is recognized in the March 2001 technical notes accompanying the 2001 amendments to the definition of "cost amount."[96]

If the no change in beneficial ownership requirement were removed from subsection 73(1.02)(b)(ii), or paragraphs 107.4(1)(a) and 104(4)(a.4), the intended tax consequences could be preserved by the addition to each of those provisions of the requirements that, immediately after the transfer, the fair market value of the transferor's capital interest in the trust be increased by an amount equal to the fair market value of the property transferred to the trust and that, at all times thereafter, the fair market value of the transferor's interest in the trust be equal to the net fair market value of all the property of the trust. There is precedent in subsection 107.4(4) for this valuation-based approach, admittedly in a different context, which could be adapted as the context requires.

Qualifying Dispositions and Security Trusts

Subsection 107.4(3) provides for a rollover where there has been a "qualifying disposition" of property. A qualifying disposition is defined in subsection 107.4(1) as a disposition that does not result in any change in the beneficial ownership of the property and that otherwise meets the conditions enumerated in that subsection. The same potential abuse identified above with respect to the removal of the no change in beneficial ownership requirement in the context of subparagraph 73(1.02)(b)(ii) arises in the context of a qualifying disposition under subsection 107.4(1). Absent the no change in beneficial ownership requirement, a transferor in a qualifying disposition could take back only an income interest in the settled trust. The suggested amendments with respect to subparagraph 73(1.02)(b)(ii) could also be made in the context of a qualifying disposition. The no change in beneficial ownership requirement would be removed from paragraph 107.4(1)(a) and there

96 *Explanatory Notes Relating to Income Tax*, supra note 25, at clause 83.

would be added the expansive notion of no absolute or contingent right, or possibly a requirement that after the transfer no person other than the transferor is beneficially interested in the trust, and an exception for the rights contemplated by subsection 104(1.1). In addition, there would be the requirement that the fair market value of the transferor's interest in the trust immediately after the transfer be increased by an amount equal to the fair market value of the property immediately before the transfer and that, at all times thereafter, the fair market value of the transferor's interest in the trust be equal to the net fair market value of the property of the trust.

Subsection 107.4(2) is designed to allow, in certain cases, for the division among trusts of property or a group of identical properties where the beneficial ownership of the properties is unchanged as a result of the division. In particular, where a trust disposes of a property to another trust, there is deemed to be no change in beneficial ownership of the property if the transferor trust receives no consideration for the disposition and, as a consequence of the disposition, the value of each beneficiary's beneficial ownership at the beginning of the period under the transferor trust in each particular property of the transferor trust is the same as the total value of the beneficiary's beneficial ownership at the end of the period under the transferor trust and the other trust.

The reference to the notion that there is deemed to be no resulting change in the beneficial ownership of the properties in the preamble of paragraph 107.4(2)(a) would be deleted and could be replaced with the notion that no person is deemed to have any right (whether absolute or contingent or otherwise) in the trust if the conditions of subparagraphs (i) and (ii) are satisfied. The reference to beneficial ownership in subparagraphs 107.4(2)(a)(i) and (ii) would be removed and replaced by a reference to "beneficial interest," which expression can be interpreted by reference to the definition of "beneficially interested" in subsection 248(25).

The definition of "beneficially interested" in paragraph 248(25)(a) is inclusive in that it "includes" any person or partnership having any right as a beneficiary described in that paragraph. The implication arising from this inclusive definition is that it extends, as well, to persons beneficially interested in a particular trust under common law. To achieve the goal of harmonization, "beneficially interested," for the purposes of the ITA, should be defined in an exclusive manner. That is to say, the word "means" should be substituted for the word "includes" in paragraph 248(25)(a). The ambit of subsection 248(25) is so far-reaching that the suggested amendment would not, as a practical matter, give rise to abuse.

The approach described above with respect to self-benefit trusts and qualifying dispositions could be employed in relation to paragraph (k) of the definition of "disposition" in subsection 248(1) and subsection 248(25.2), concerning security trusts. In general terms, paragraph (k) of the definition of "disposition" in subsection 248(1) provides that property transferred to a trust for the main purpose of securing an obligation will not be considered to be a disposition if there is no change in the beneficial ownership of the property as a consequence of the transfer. Subsection 248(25.2) deems the trust to deal with property as agent of the transferor

throughout the period that begins at the time of the transfer and ends at the time of the first change in the beneficial ownership of the property.

Exceptions to Dispositions

The concept of "beneficial ownership" and "change in beneficial ownership" is also intended to exclude the situation where a person holds nominal title (as agent, trustee, mandatary, administrator, or nominee) or legal ownership of property. The use of the expansive notion of the no absolute or contingent right requirement as reflected in paragraph 248(25)(a), with appropriate contextual changes, coupled with an exception for nominal ownership, may be an effective means of achieving the tax policy objective underlying paragraph (e) of the definition of "disposition" in subsection 248(1). The provision might therefore be amended to read somewhat as follows:

> "disposition" . . .
> does not include . . .
> (e) Any transfer of the property *by a person where, immediately after the transfer, no person other than the transferor has any right (whether immediate or future, whether absolute or contingent or whether conditional on or subject to the exercise of any discretion by any person or partnership) in or to the income or capital in respect of the property or property substituted therefor (excluding, for greater certainty, nominal ownership)*, except where the transfer is. . . .

Inadequate Consideration

Subparagraph 69(1)(b)(iii) stipulates that where a taxpayer disposes of property to a trust in circumstances that do not result in a change of beneficial ownership, then, unless one of the rollover provisions applies, the taxpayer will be deemed to have disposed of the property for proceeds equal to fair market value. Paragraph 69(1)(c) provides a corresponding rule that deems a person who acquires property in such circumstances to have acquired the property at its fair market value. The no change in beneficial ownership concept could be removed and the objectives of these provisions could be achieved by substituting the no change in beneficial ownership requirement with a broadly designed no absolute or contingent right concept. As suggested with respect to the definition of "disposition" in subsection 248(1), perhaps wording similar to the broad language used in paragraph 248(25)(a), which extends to any person who has "any right (whether immediate or future, whether absolute or contingent or whether conditional on or subject to the exercise of any discretion by any person or partnership)," could be an effective means of preserving the integrity of these provisions, without embracing the concept of beneficial ownership.

Deemed Dispositions

As discussed above, paragraph 104(4)(a.4) was introduced to provide the first deemed disposition day in respect of an inter vivos trust to which property was transferred

by a taxpayer who is an individual (other than a trust) in circumstances in which section 73 or subsection 107.4(3) applied. The technical notes released with the 2001 technical bill explain that

> [w]here the transfer does not result in a change in beneficial ownership of the property and no person (other than the taxpayer) has any absolute or contingent right as a beneficiary under the trust (determined with reference to subsection 104(1.1)), the first deemed disposition date of the trust property is the day on which the taxpayer dies.[97]

For reasons similar to those discussed previously with respect to the definition of "disposition" in subsection 248(1) and subparagraph 69(1)(b)(iii), the reference to "did not result in a change in beneficial ownership" in paragraph 104(4)(a.4) could be deleted, since the intended substantive effect could be achieved by utilizing the expansive notion of the no absolute or contingent right requirement in paragraph 248(25)(a). Under this approach, paragraph 104(4)(a.4) might read as follows:

> (a.4) where the trust is a trust to which property was transferred . . . in circumstances in which section 73 or subsection 107.4(3) applied and no person (other than the individual) or partnership has any right (whether immediate or future, whether absolute or contingent or whether conditional on or subject to the exercise of any discretion by any person or partnership) as a beneficiary under the trust (determined with reference to subsection (1.1)), the day on which the death of the taxpayer occurs.

Alternatively, instead of repeating the requirement established by subparagraph 73(1.02)(b)(ii) and paragraph 107.4(1)(e), paragraph 104(4)(a.4) could be amended in such a way so as to make explicit reference to those provisions (as amended in accordance with the suggestions made above) instead of the more general section references currently in the legislation. Under this approach, paragraph 104(4)(a.4) might read as follows:

> (a.4) where the trust is a trust to which property was transferred . . . in circumstances in which *the conditions set out in subparagraph 73(1.02)(b)(ii) or paragraph 107.4(1)(e) are satisfied*, the day on which the death of the taxpayer occurs.

Foreclosures

The expression "beneficial ownership" used in subsection 79(2) is arguably not required. The terms "acquired or reacquired" and "acquisition or reacquisition" have been interpreted by the courts in a manner that produces satisfactory results, in that horizontal equity was achieved although the courts failed to recognize the relevant private law. In the context of subsection 79(2), property would be surrendered by one person to another person only if the other person "acquired" the possession, use, and risk of the property, as that term has been interpreted by the

97 Ibid., at clause 78.

relevant jurisprudence (*Wardean Drilling*, *Olympia & York*, and *Construction Bérou*). The reference to "beneficial ownership" would be deleted. However, since there is a risk that a future Supreme Court of Canada decision could overturn the position taken by the courts to date as to the meaning of the term "acquired," the appropriate solution may be to adopt a specific definition of the term that reflects elements of the *Construction Bérou*, *Wardean Drilling*, and *Olympia & York* decisions, as well as the CCRA's administrative positions. A definition of "acquired" or "acquisition" could be developed that would allow all Canadian taxpayers to be on an equal footing without having to embrace the common law concept of beneficial ownership.[98]

Alternatively, subsection 79(2) could be amended to provide that property is surrendered where the property is transferred by one person to another person and, immediately after that transfer, no person other than the transferee has a right (whether immediate or future, whether absolute or contingent, or whether conditional on or subject to the exercise of any discretion of any person or partnership) in or to the property and the transfer of the property was in consequence of the person's failure to pay all or part of a debt. In addition, an exception for nominal ownership could be added. In this regard, see the previous discussion under the heading "Exceptions to Dispositions." The suggested language might achieve the same objectives without requiring a determination of beneficial ownership. These suggested amendments might also be used in the context of subsection 79.1(2).

Share-for-Share Exchanges

It is not evident what the tax policy justification is for limiting share-for-share exchanges under subsections 85.1(1) and 85.1(5) to persons who deal at arm's length with the acquiring corporation immediately before the exchange and who do not control the acquiring corporation or beneficially own shares of the acquiring corporation having a fair market value of more than 50 percent of all the shares of the acquiring corporation immediately after the exchange. In any event, the substantive effect of subparagraphs 85.1(2)(b)(ii) and 85.1(6)(b)(ii) could be achieved by deleting the reference to "beneficial" and providing an exception for nominal ownership, thereby eliminating the issues associated with the term "beneficial ownership." In addition, a deeming rule for the ownership of shares through a trust could be added to specifically deem shares held by a trust to be owned, in the case of a non-discretionary trust, in proportion to the respective interest of each beneficiary based on fair market value, and in the case of a discretionary trust, each beneficiary would be deemed to own all of the shares held by the trust. There is precedent in the ITA for such an approach to determining ownership of shares through a trust in paragraphs (b) and (e) of the definition "specified shareholder" in subsection 248(1) and, similarly, in determining associated corporation status in subparagraph 256(1.2)(f)(ii). It is recognized that the suggested approach with respect to discretionary trusts broadens the scope of transactions that might not qualify for rollover treatment

98 A similar solution appears to apply in respect of insurer foreclosures (subsection 138(11.93)).

because of the more than 50 percent beneficial ownership threshold requirement, a requirement that, it is submitted, is not necessary from a tax policy perspective in the context of share-for-share exchanges.

Subsection 186(2)

To address the issue as to whom the shares held in trust belong, a deeming rule could be added similar to the rule described above for share-for-share exchanges.

Advertising Expenses

In this context also, the approach suggested with respect to share-for-share exchanges could be used.

CONCLUSION

The primary objective and challenge of harmonization is concurrently to promote horizontal equity throughout Canada in the application of the ITA and to preserve the tax policy objectives underlying the particular provisions of the ITA. In regard to the concept of beneficial ownership, this study is intended to demonstrate that the provisions of the ITA that use the concept can be difficult to apply in Canada generally, and as a result exacerbate the difficulty relative to Quebec, and can potentially receive inconsistent application as between Quebec and the common law provinces. Apart from the uncertainty in the common law provinces, the potential inconsistency, or disharmony, is essentially due to three factors. First, there is considerable debate (and consequential uncertainty) in the common law as to the meaning of "beneficial ownership." Second, there is the unique nature of Quebec civil law, which does not recognize the concept of beneficial ownership. Third, there is the current harmonization measure in subsection 248(3). The application of this subsection could result in a person being deemed to be a beneficial owner of property under civil law in circumstances that might not give rise to beneficial ownership of property under common law. A discretionary beneficiary of a common law trust might not be considered to be a beneficial owner of the trust property. This may potentially lead to inconsistent tax treatment. Conversely, in relation to Quebec, a discretionary beneficiary may be deemed, by paragraph 248(3)(f), to be the beneficial owner of trust property. For these reasons, there is a need to adopt a more systematic approach to the treatment of ownership of property under the ITA, particularly with respect to the ownership of property through a trust. A systematic approach to defining in the ITA ownership of property held directly might involve, inter alia, specifically defining the attributes of ownership, such as possession, use, and risk, and an exception for nominal ownership. This would obviate the need for the concept of beneficial ownership outside the trust context. With respect to trusts, the approach that has been advanced is to develop neutral concepts that, in effect, encompass the intended substantive effects of the concepts of "beneficial ownership" and "no change in beneficial ownership," without actually employing those terms. The foundation of such neutral concepts could comprise the requirement, in the appropriate

contexts, that no person other than the transferor have any absolute or contingent beneficial interest in the property, save and except for any rights as a nominal owner. Under this approach, the tax policy objectives or concerns underlying the various provisions of the ITA employing the concept of beneficial ownership could be preserved while the primary objective of harmonization would be advanced—namely, ensuring that the law is interpreted and applied uniformly throughout Canada, with full respect for and recognition of both common law and civil law concepts, institutions, and terminology.