# Canadian Tax Highlights

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Volume 8, Number 5, May 23, 2000


## Wills Variation Claims

On the strength of the Charter's protection from discrimination, the British Columbia Supreme Court (BCSC) in *Grigg* extended relief under the BC Wills Variation Act because a testator's will had not made adequate provision for a common law spouse.

Mrs. Grigg, now 65 years old, was divorced when she met the late Mr. Berg in 1982. In 1984 they began living together in a house owned by Mr. Berg and shared equally in making small purchases for it. The house was sold in 1992; the proceeds were deposited into Mr. Berg's bank account and used to purchase an apartment in his name. The couple moved into the apartment in 1992 and shared the cost of acquiring new furniture, appliances, and household items. Mr. Berg was hospitalized due to illness in 1995 and died in 1998.

Mrs. Grigg claimed that Mr. Berg did not make adequate provision in his will for her proper maintenance and support. Relief under the Wills Variation Act applied only to married partners, not to those who shared a relationship of permanence and interdependence analogous to marriage. The issue was whether the act violated the equality guarantee in section 15 of the Charter on the grounds of marital status. The court adopted the SCC's three- pronged approach to interpreting section 15. The estate conceded that the law imposed differential treatment and that the distinction was based on a ground of discrimination—marital status—analogous to those enumerated in section 15. On the third point, the court followed the SCC's decision in *Miron* in concluding that the effect of the offending provision was discriminatory—within the meaning of the equality guarantee—because it was based solely on marital status. Furthermore, the law was not justified under section 1 of the Charter, primarily because a proposed amendment to the act broadened eligible claimants to include persons cohabiting for at least two years in a marriage-like relationship, including same-sex couples. The appropriate relief was to adopt the proposed amendment.

*Grigg* is one example of the expanding scope of wills variation claims. An individual might consider rolling assets to an alter ego trust that provides for alternative distributions on his or her death. The trust also enjoys freedom from the disclosure required for a grant of probate. However, income from the property transferred is taxable in the individual's hands until death, and in the interim the trust's existence must be respected to forestall the transfer's being impugned as a sham. One should bear in mind the recent Ontario case of *Stone*, in which inter vivos transfers were successfully reversed to avoid depletion of family assets for spousal equalization purposes. (See "Blood and Stone," *Canadian Tax Highlights*, April 25, 2000, at 27.)

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### In This Issue




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## GIFI Your Numbers

Under its initiatives to modernize tax collection and processing systems, Revenue now requires corporations to use the General Index of Financial Information (GIFI) in federal tax returns for years ending in or after 2000.

GIFI provides numeric codes for an extensive list of about 700 predefined financial statement items: for example, cash is 1001 and accounts receivable is 1060. Corporations that do not use tax preparation software and have both gross revenue and assets under $3 million may file a paper version of the GIFI, the "GIFI-Short," based on 100 commonly used balance sheet and income statement items. Each balance sheet and income statement item must be entered and identified with the most appropriate GIFI code, an exercise that requires a time investment in 2000, the year of implementation. In addition to the required fields, Revenue will expect to receive the same level of information provided in paper-filed financials, including notes; most corporations will probably report 30 to 50 GIFI line items.

The GIFI format should facilitate Revenue's conduct of audit screening and Statistics Canada's collection of national statistics. GIFI also paves the way for the electronic filing of federal corporate tax returns expected to be introduced later this year. Corporations may thus also benefit from GIFI's streamlined compliance requirements, because EFILE may open up concurrent filing of federal, Ontario, and Alberta tax returns. (Most provinces—except Alberta, which does not require financial statements—still require the filing of traditional paper financials with income or capital tax returns.) EFILE will trigger electronic acknowledgments that returns were received and processed, and Revenue claims that it will shorten processing time and expedite the issuing of tax refund cheques.

GIFI also requires completion of a notes checklist concerning the preparation of the financials and the type of information in the notes to the financials. A short series of questions determines who prepared the financial statements and the extent of their involvement, ranging from an independent auditor who issued a report without reservations, to a company employee, associate, or executive who prepared the financials without the services of an independent accountant. The new system changes only the reporting format, not the financial reporting standard: for example, corporations subject to the federal large corporations tax must still report balance sheet amounts prepared in accordance with GAAP.

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## Negligence Penalty Onus

The recent TCC decision in *897366 Ontario* (*Carlile*) dealt with the so-called 25 percent GST negligence penalty imposed if "an omission or false statement in a return [is] made knowingly or in circumstances amounting to gross negligence" (section 285 of the Excise Tax Act). Unlike its income tax counterpart, section 285 does not specifically place the onus on the Crown to prove the prerequisite elements. In *Carlile*, Mr. Justice Bowman read in a reverse onus—"[it would be] a remarkable result if the onus of proof lay on the Crown in one case and on the taxpayers in another"—and disapproved, to the extent that stare decisis allowed, of a contrary conclusion by the Exchequer Court in 1961 in *Pashovitz*.

Although *Pashovitz* characterized the penalty as civil in nature, the TCC said that "where a government imposes a penalty upon a subject for conduct in which a necessary ingredient is mens rea or intent or recklessness, it is incumbent upon the government to justify its action." The court also referred to obiter in a recent FCA decision, *Consolidated Canadian Contractors*, to the effect that section 285 placed "a duty on the Minister to establish that a registrant's conduct falls within those provisions." Because the Crown led no evidence to substantiate the penalty, the court declined to impose it. The court noted:

> It seems that the GST assessors have gotten a little carried away with penalties. Until the [FCA] set them straight in *Consolidated* . . . they were blithely and routinely imposing no fault penalties every time their calculations differed from those of the taxpayers. It seems they have now transferred that attitude to section 285 penalties. . . . The fact that not a shred of evidence supporting the . . . penalties was adduced leads me to conclude that the Crown had none, either at trial or on assessing. The imposition of penalties under section 285 requires a serious and deliberate consideration by the taxing authority of the taxpayer's conduct to determine whether it demonstrates a degree of wilfulness or gross negligence justifying the penalty. Section 285 is not there to permit assessors to punish taxpayers for being frustrating or annoying. It cannot be overemphasized that penalties may only be imposed under section 285 in the clearest of cases, and after an assiduous scrutiny of the evidence.

The court's decision may be relevant to other negligence penalties silent on onus, such as the 25 percent penalty under the Ontario Retail Sales Tax Act for conduct "attributable to neglect, carelessness, wilful default or fraud."

On another matter, the TCC noted that too frequently in GST appeals the court sees the taxpayer arrive with boxes of invoices; both parties aver that the other was uncooperative and failed to consider the evidence; and Revenue usually intones that the taxpayer failed to keep adequate books and records. The court's function, the TCC said, is not to perform an audit. In the absence of a resolution, the evidence should be offered through "the testimony of a competent witness who has perused the entire mass and will state summarily the net result."

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## Health and Social Transfers

The federal and provincial governments were in crisis a quarter-century ago: medical care costs were no longer under control. The system that was then adopted to add spending discipline was successful for a number of years but is now showing strain.

In the early 1970s, the federal government automatically covered 50 percent of all approved provincial spending on hospital insurance and medical care. Partly on the basis of national average per capita costs, some provinces received more than 50 percent and others less. Because the provinces' cost was only about 50 cents for each additional dollar of spending, they found it difficult to refuse requests for additional funding, and bills to the federal government grew at annual rates exceeding 20 percent. Ottawa was losing control over a major part of its budget.

The solution arrived at in 1977, now known as the Canada Health and Social Transfer (CHST), combined additional tax room and a cash payment unrelated to actual provincial spending, giving the federal government a predictable spending program with a lower rate of growth. The provinces were freed from detailed accounting, a rigid formula for reimbursement, and restrictions on allowable expenditures. But health care spending continued to grow, albeit at a slower rate than 30 years ago, and the growth falls squarely on the provinces—the federal cash transfer grows independently and more slowly than health care spending. The original arrangement was premised on faster growth in the tax points more closely matching the spending responsibility. The provinces, however, no longer see the link between the federal commitment and the tax points; the transfer of tax room that was then incorporated into provincial tax systems is no longer considered part of the compensation. Ottawa steadfastly maintains that its contributions to the three main programs under the CHST in 2000-1 total $30.8 billion, the sum of cash and tax room, but the provinces count only the $15.5 billion cash as the federal contribution. The issue is further complicated by the fact that the original agreement included federal contributions not only for health care but also for post-secondary education, and was expanded to social assistance—the Canada Assistance Plan. The cash transfers were cut under federal austerity measures in the early 1990s, and recent federal budgets increased them.

**Federal CHST Allocations, 2000-1**

| | Actual amounts ($ millions) | | Per capita amounts | |
|---|---|---|---|---|
| | Cash | Tax room | Cash | Tax room |
| Nfld. | 297 | 250 | 549 | 462 |
| PEI | 74 | 64 | 536 | 464 |
| NS | 507 | 437 | 539 | 465 |
| NB | 404 | 350 | 535 | 464 |
| Que. | 4,123 | 3,434 | 561 | 468 |
| Ont. | 5,243 | 6,328 | 455 | 550 |
| Man. | 613 | 533 | 536 | 466 |
| Sask. | 544 | 478 | 529 | 465 |
| Alta. | 1,320 | 1,648 | 445 | 556 |
| BC | 2,313 | 1,736 | 575 | 432 |
| Total/ average* | 15,499 | 15,300 | 508 | 502 |

* The totals (actual amounts) and the averages (per capita amounts) include the figures for the territories (not shown).

Debate has centred recently on the size of the federal cash transfers and on the per capita levels in each province. The total entitlement—cash and tax points—for each province is roughly equal, but the per capita value of the tax points varies, as shown in the table. This makes the per capita cash transfer smaller in wealthier provinces, which charge that the apportionment of the CHST cash element discriminates against them.

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## FTCs: Treaty Versus Act

Once again Revenue has gone to court on a position seemingly contrary to its own administrative practice, and won. In *Dagenais*, a Canadian resident had capital gains from the disposition of US securities and US lottery winnings: the former were not subject to US tax, and the latter attracted US federal and state income tax. Arguing that the gains were US-source and that the taxes were non-business-income taxes, Mr. Dagenais claimed a foreign tax credit (FTC) against his 1995 Canadian tax on the gains. The TCC said that the tax was not a tax on income because the lottery winnings were not income under the Act.

Several aspects of *Dagenais* are troubling. The court did not consider the Act's definition of non-business-income taxes. And a longstanding administrative position in respect of part-year residents suggests that an item taxed abroad need not be income in Canada for the tax to be an income tax. Revenue has also taken the position for some time that taxes that are the subject of an income tax treaty are automatically income taxes. Lottery winnings are taxed under the Code, and the Canada-US treaty contemplates that any such tax is eligible for treaty benefits. Thus Mr. Dagenais should have been able to claim a credit for those taxes.

Although ignored in *Dagenais*, the treaty has supremacy over Canadian domestic law and should have been the first step in the analysis; however, it seems that ultimately no FTC could have been claimed under the treaty. Article XXIV(2) is "subject to the provisions of the law of Canada," wording generally accepted as referring to the Act's mechanical rules such as carryforwards and separate country limitations. It seems that the Act's mechanics allow for the pairing of taxes on the lottery winnings with the gains, and that the treaty considers such taxes eligible as income taxes. However, under the treaty the gain on the US securities is likely Canadian-source, resulting in a disallowance of the FTC claim (article XXIV(3)). (Today the Act yields the same result.) But the treaty is expressly relieving in nature, leaving Mr. Dagenais still entitled to claim an FTC under the Act as it then read (article XXIX(1)).

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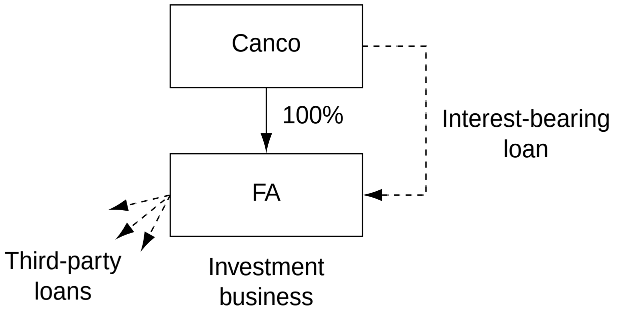
## FOREIGN DEBT

Interest income is imputed to a Canadian-resident corporation (Canco) on indebtedness owing by non-residents that remains outstanding for more than one year. Effective after 1999, these provisions extend to "indirect debt" between non-residents. (See "Foreign Debt, Take Three," *Canadian Tax Highlights*, April 20, 1999, at 27.) Revenue interpretations confirm that anomalies involving the indirect debt rules continue to surface.




Canco owns a foreign affiliate (FA). Canco lends at interest to FA, which uses the proceeds to make third-party loans. FA does not have more than five full-time employees, and any net income is FAPI. Under the indirect debt rules, the third parties are deemed to be indebted to Canco, and Canco is taxed on deemed interest as well as on the actual interest it receives from FA. Although the deemed interest inclusion is reduced by amounts included in Canco's income as FAPI, this reduction offers little relief if FA's FAPI is reduced or eliminated as a result of its interest expense to Canco. The resulting double taxation may be avoided if Canco converts its loan to FA into share capital. Deemed interest may also arise if a Canco pays a dividend or returns capital to its foreign parent, which uses the proceeds to make loans to non-residents of Canada. Finance apparently recognizes this latter anomaly and will recommend retroactive alleviating amendments, applicable after 1999.

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## FILM TAX SHELTERS

The statutory repeal of "cheap" art flips and Revenue's attack on software tax shelters have left film production services partnerships and flowthrough shares as the remaining tax shelters. Revenue has been issuing advance tax rulings on the film deals.

Investment in a master film-financing limited partnership (FFLP) is an opportunity to participate in revenues from the commercial exploitation of feature films and television productions and to benefit from deductions. In at least one film deal on the market, Grosvenor Services 2000, the FFLP in turn invests in class A units of various production services limited partnerships (PSLPs), which provide certain production services to foreign film studio and film and television companies ("the studios") for a fee including a percentage of any net production revenues. A private financial institution has agreed to lend almost 85 percent of the $162,500 payable at the time of subscription—including $8,800 for loan arrangement fees and interest expense—on a full recourse basis, repayable in 2010, with interest payable annually.

A foreign producer provides the production's non-Canadian labour expenditures (NCLE) for a fee from the studio equal to 80.01 percent of the NCLE incurred by it and a percentage of the net production revenue. That producer contracts for the provision of NCLE services with a PSLP, to be remunerated in an analogous manner. To finance the NCLE, the PSLP uses indirect loans from the studio, limited recourse amounts under the at-risk rules. The foreign producer has a 10-year option to acquire at FMV class B units in the PSLP and pays interest on any unpaid balance of the exercise price. A priority distribution of partnership profits is made to class A unit holders to retire the subscription price loan; then to class B unit holders; then they both share ratably.

Opinions and rulings given deal with several issues. The PSLP's NCLE are deductible; the exception to the matchable expenditures rules applies. (The amount exceeding 80 percent of the NCLE is included in the PSLP's income for the year.) Losses allocated to the FFLP investors and class A and class B unit holders in the PSLP are deductible up to the at-risk amount—the subscription price of the class A and the FFLP investors. Interest paid or payable on the full recourse loan and on the unpaid purchase price of class B units is deductible. And the studio's production company is entitled to production tax credits for the Canadian labour expenditures.

The reduction in capital gains rates has increased the differential between the tax savings on deductions (about 47.87 percent) and the tax rates on future capital gains (about 32 percent). An individual who receives a lump sum, including a large bonus or severance, may defer the tax for 10 years and effectively convert an income deduction into a capital gain to offset, for example, capital losses incurred in the stock market. Payment of mortgage debt can be accelerated and non-deductible interest converted into deductible interest related to a loan for the film investment; the tax savings may reduce the mortgage. An owner-manager can minimize the tax on a bonus and free the tax savings to reinvest in the business or to repay a shareholder loan or discharge tax on a delinquent shareholder loan.

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## Filing US Returns Abroad

Historically, the IRS has accepted US tax returns mailed by taxpayers in foreign countries as being timely filed if they are postmarked on or before midnight of the last date prescribed for filing, including extensions (or the next business day if the last date is a Saturday or Sunday). There was some concern that this policy was unsettled by the decision in *Pekar* that a foreign postmark was not proof of timely filing. Now the IRS has announced that it will continue its "timely mailed/timely filed" rule for foreign taxpayers, acknowledging that its position in *Pekar* was "mistaken."

The recent announcement applies only to US tax returns: claims, statements, and other documents filed with the IRS must generally be received by the IRS or bear a US postal service postmark by midnight of the prescribed deadline. Also acceptable is a postmark of certain "designated delivery services" set out in a list as revised from time to time by the IRS: (1) Airborne Express's Overnight Air Express Service, Next Afternoon Service, and Second Day Service; (2) DHL Worldwide Express's Same Day Service and USA Overnight; (3) Federal Express's FedEx Priority Overnight, Standard Overnight, and FedEx Second Day; and (4) United Parcel Service's UPS Next Day Air, UPS Next Day Air Saver, UPS Second Day Air, and UPS Second Day Air A.M.

In general, US corporate tax returns of foreign corporations (form 1120F) are due on or before the 15th day of the third month after the corporation's tax year-end (including Canadian corporations' returns claiming treaty exemption for lack of a US permanent establishment). A non-resident alien individual who is obliged to file a personal US tax return (form 1040NR) must file it by the 15th day of the sixth month after his or her tax year-end, but by the 15th day of the fourth month after year-end if he or she received US-taxable wages subject to withholding at source. US citizens living abroad generally have a two-month filing extension to the 15th day of the sixth month if on the return's regular due date they live outside the United States and their main place of business or post of duty is also outside the United States; interest is charged on any tax unpaid by the regular due date.

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## Making Your Bed

The FCA recently rejected the taxpayer's attempt in *Molinaro* to use the substance-over-form doctrine to recharacterize a receipt of $1.5 million from salary to capital gain, emphasizing the importance of legal arrangements in determining tax consequences.

Mr. Molinaro sold through his holdco all his shares in a manufacturing company, Pizza Crust. A letter of intent provided that Catelli was to buy Pizza Crust for $10 million and retain Mr. Molinaro for at least three years after closing at an approximate salary of $1.8 million, $1.5 million of which was payable even if Mr. Molinaro died or was dismissed for "good reason." To earn the remaining $100,000 annually, Mr. Molinaro had to actually be employed by Catelli; his benefits package was calculated as if his salary were only $100,000 per annum. In fact, Mr. Molinaro worked less than the three years for Catelli and received $1.6 million. He argued that the $1.5 million represented proceeds of disposition of his capital interest in Pizza Crust; the holdco included the sum in its proceeds from the Pizza Crust shares. The taxpayer urged the TCC to follow *Farm Business Consultants*, in which the FCA said that "[t]he essential nature of a transaction cannot be altered for income tax purposes by calling it by a different name." Mr. Justice Bowman in the TCC said that the taxpayer was bound by the ancient principle that "if one makes one's bed in a particular way one should—particularly if one has had help from professional accountants

## SHOE *by Jeff MacNelly*

and lawyers in making the bed—be prepared to lie in it." The court agreed with the reasoning in *Pallin*, which said that by making such a claim "not only are the [taxpayers] impugning their own conduct, but also that of the professional advisers who obviously played a significant role in what was said and done. They are alleging that what was done to realize a final settlement . . . was morally blameworthy in that in large part it was a sham."

The FCA said that mere subjective intention was insufficient to recharacterize a transaction; evidence of intention occasionally clarifies transactions but is rarely determinative. The court noted that Mr. Molinaro did not himself own any shares of Pizza Crust. The employment agreement was finalized after lengthy and serious negotiations in which both lawyers and accountants represented the taxpayer. The court said that form is of utmost importance in tax matters: the taxpayer was entitled to arrange his affairs to minimize tax but could not disavow a written agreement that he entered into merely because a different arrangement would have been more advantageous.

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## SR & ED: Cost of Materials

A new Revenue application paper dealing with the cost of materials for SR & ED purposes, "SR & ED 2001-01," illustrates how complex the program administration has become.

As a result of the February 23, 1998 recapture legislation, there are two methods of calculating the cost of SR & ED materials; they produce drastically different results. Taxpayers using the proxy method of calculating overheads may only claim the cost of materials consumed in the prosecution of SR & ED; the traditional method allows claims for the cost of materials so consumed or transformed. Materials consumed are defined as "material that was destroyed or rendered virtually valueless as a result of the SR & ED." Materials transformed include those changed in the process, such as experimental product that is sold. (The sale triggers the new recapture rules.) Examples in the application paper illustrate the difference. A textile manufacturer modifies equipment; tests of the new equipment produce yarn of poor quality that is sold at a significant discount. The proxy method does not allow a claim related to the cost of the yarn because the yarn is not consumed.

The proxy method was intended to simplify accounting for overheads. However, given these new rules and the restrictive "directly engaged in" rule that determines eligible employee activities under the proxy method, more and more taxpayers will revert to the traditional method. Because the election to use the proxy method is not revocable, it is imperative that taxpayers consider the option carefully before filing claims.

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## US E-Commerce Proposals

In October 1998, the US Internet Freedom Act was enacted, establishing a three-year moratorium on the imposition of new federal, state, and local taxes on Internet access and e-commerce. An advisory commission created under the aegis of that act was mandated to develop recommendations regarding the state taxation of e-commerce and to report back to Congress within 18 months. The commission's report was just released amid much controversy and has already drawn criticism from the Clinton administration and state and local governments.

Much was expected from the commission; arguably, not much was delivered. The commission narrowly approved three main proposals: a permanent prohibition on taxing Internet access fees; elimination of the 3 percent federal excise tax on telecommunication services; and extension to 2006 of the prohibition against creating new and discriminatory Internet taxes. The commission also proposed a list of e-commerce activities that by themselves should not trigger state sales and use taxes: for example, the solicitation of orders, the presence of intangible assets such as Web sites, the use of an ISP, and the use of the Internet to create a Web site. In contrast, the recent budget in British Columbia proposed the imposition of registration and tax collection requirements on persons located outside the province who solicit orders by advertising or other means, or who cause goods to be delivered into the province. This move seems directed in part at sales solicitation over the Internet and British Columbia's perceived need to protect its revenue base and the integrity of the existing sales tax system. Clearly the debate surrounding e-commerce continues on both sides of the border.

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## Estates and Stop-Loss Rules

An estate's shares may be redeemed to trigger loss carrybacks for the deceased's terminal return under subsection 164(6). But stop-loss rules apply if the estate is affiliated with the corporation immediately thereafter, and the loss disappears if the estate owns no other shares of the corporation.

**Two hats.** In two recent technical interpretations, Revenue confirms that an estate with more than one trustee is not normally affiliated with a corporation if no trustee is affiliated with another trustee and the estate does not have de facto control over the corporation, even if the corporation is controlled by a related group consisting of the estate trustees or by a second trust with those same trustees. In one situation the estate originally controlled the corporation through freeze shares; after their redemption the deceased's children, who were also the estate executors, controlled via the common shares. In the second situation the estate retained common shares equal in value to the corporation's capital dividend account and transferred the balance of the common shares to a second testamentary trust under the deceased's will. The deceased's spouse and sister and an unrelated individual were both the estate executors and the trustees. The estate's common shares were purchased for cancellation. But those fact patterns do not reflect the more typical situation of one person wearing both hats. In a third technical interpretation, a single individual—not a non-affiliated group—controlled the corporation and wore two hats; Revenue concluded that subsection 40(3.6) applied. Mr. A owned all of A Co's voting shares; the pref shares were owned by a trust, with Mr. A as sole trustee, making him the legal owner of the preferred shares. He was deemed affiliated with himself as controller of A Co (paragraph 251.1(4)(a)), and thus the trust and A Co were affiliated.

**De facto control.** Previous technical interpretations suggest that the holder of a promissory note could thereby have de facto or indirect control of a corporation, a concern for an estate that receives a promissory note in consideration of the redemption or repurchase of its shares. Revenue now says that de facto control is by definition fact-dependent, but is not normally the result of merely holding non-demand debt.

**GAAR.** In the second situation described above, Revenue said that a GAAR determination was fact-dependent, but generally GAAR does not apply if "the potential application of a [rule] . . . such as subsection 40(3.6) is based on whether a particular person has de facto control over a corporation and the facts . . . do not indicate that such de facto control is present." Revenue holds a similar view if, in lieu of the corporation's issuing a promissory note to redeem the estate's shares, the beneficiaries obtain daylight loans and lend the funds to the corporation, which redeems the estate's shares, and the estate then distributes cash to the beneficiaries to repay their loans.

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## ACB Increase on Winding Up

Post mortem planning may avoid the double taxation resulting from a deceased's owning shares of a private company, particularly an investment holdco more likely to be liquidated than sold. Due to the recently reduced capital gains inclusion rate, a bump plan may produce less tax than a windup and loss carryback plan if most or all of the corporate assets are eligible for the bump.

Under a bump plan, the investment holdco shares are transferred to a newco before holdco's windup; if all technical requirements are met, the adjusted cost bases (ACBs) of the newco's non-depreciable capital assets may be bumped to FMV. The requirement that control of the holdco must be acquired is facilitated by a special rule: if control of a corporation is last acquired by an acquiror because of a share acquisition as a consequence of an individual's death, the acquiror is deemed to have last acquired control from an arm's-length person immediately after the death.

Finance has indicated that this special rule does not allow a spousal trust to bump the ACB of the corporation's assets on the basis of their FMV at the surviving spouse's death. (See question 10 at the 1999 APFF Conference.) Even though the shares are deemed disposed of and reacquired by the trust on the survivor's death, there does not appear to be an acquisition of control at that time. In the case of a testamentary spousal trust, only a bump based on the assets' FMV at the first spouse's death may be available. If this interpretation is correct, a similar issue arises when the beneficiary's death triggers a deemed disposition in a joint spousal trust or an alter ego trust holding the shares, but no bump is possible because the trust acquired control from a living individual. Finance also indicated that it will not recommend changes to an already complicated section of the Act unless a situation arises in which the bump is not available. We understand that Revenue was recently asked for a technical interpretation on the application of this special deeming rule to spousal trusts. Until this issue is dealt with, estate planners will be reluctant to advise their clients to transfer private company shares to a spousal trust, a joint spousal trust, or an alter ego trust if the bump plan is preferred post mortem.

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## Hindsight in Valuation

A taxpayer is deemed to receive the FMV of an inter vivos gift when it is made. The discretion inherent in timing a non-testamentary gift allows the donor to gift at market lows so that growth enures to the donee. The Canadian tax standard of FMV assumes a willing buyer armed with then existing information. A recent US federal gift tax case, *Hartmann*, affirmed an IRS valuation of a gift of shares that used information that would not have been available to a notional buyer and seller at the valuation date—the

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Published monthly

Price: $13.33 per copy
Subscription rate: $160 per year
Canadian Tax Foundation

595 Bay Street, Suite 1200
Toronto, Canada M5G 2N5
Telephone: (416) 599-0283
Facsimile: (416) 599-9283
Internet: http://www.ctf.ca

ISSN 1192-2672

company's financial statement for the fiscal year ending four months later. If the value of the gift is not reasonably known until several months later, the control implicit in discretionary timing may be somewhat illusory.

The US District Court noted earlier cases that distinguished between the non-admissibility of unforeseeable subsequent events—such as discovering oil on a property—and the general relevance and admissibility of evidence of actual sale prices subsequently received for the property, assuming that the sale occurred within a reasonable time and intervening events did not drastically change the property's value. The court said that the financials were more analogous to subsequent sale prices, because one would not expect the "financial figures available in December 1988 to vary significantly from [the year-end statements] available four months later," which was after the winter, the traditionally slow period in the company's construction business.

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# Foreign Tax News

## OECD

By June 2000, the OECD will publish a blacklist of 47 tax havens—categorized as cooperative, less cooperative, or non-cooperative—and will delay for one year its call for sanctions by member states in order to pursue alternatives based on the responsiveness of the listed jurisdictions.

The Fiscal Affairs Committee released a unanimously approved report proposing measures to improve tax administrations' access to bank information. The primary intent is to limit tax avoidance in a borderless global environment—not to end bank secrecy—by providing information to tax administrators on specific cases, not fishing expeditions.

The guidelines for multinational enterprises are under review and drafts are available from the OECD Web site (http://www.oecd.org/daf/investment/guidelines/newtext.htm). A further report is planned for June 26, 2000.

## Russia

Amendments to last year's transfer-pricing rules clarify the arm's-length determination and expand reviewable transactions. Tax authorities have greater control over determining prices and may examine any transaction with a 20 percent deviation from prices previously charged. Interdependency between parties is defined at length, but does not include, for example, two subs of a common parent and joint stock companies and their shareholders.

## Korea

A recent tax ruling under thin cap rules allows the exclusion of foreign currency loans by a foreign bank's home office to a Korean branch from its loan-to-equity ratio (even if it is unclear whether the funds were used for certain purposes), if the branch has a reasonable method of segregating the borrowings. Under new regs, all non-residents without a PE must report all Korean-source income quarterly, effective January 1, 2001. Tax exemptions and reductions for direct investments by foreign companies in which Korean entities have an equity interest are now disallowed.

## Ireland

The 2000 Finance Act includes the reform of life insurance and mutual fund taxation; a new tax base for gift and inheritance taxes; exemptions from and compliance rules for the 1999 withholding tax on Irish resident companies' dividends; new anti-avoidance measures; improvements to the securitization regime; the extension of capital gains tax to all land; tax depreciation for capital expenditures on transmission capacity rights; and deferral of tax on stock options. The Irish Revenue are in Australia to study transfer-pricing techniques; legislation is expected within the next few years.

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## UPCOMING CONFERENCES

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