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COMMENTARY

CANADA REVENUE AGENCY EXPANDS RELIEF FOR CANADIAN TAXPAYERS WITH US LLLPs AND LLPs

The following article was written by Elan Harper, MBA, Tax Advisor at Moodys Gartner Tax Law LLP, dated April 28, 2017.

During the Canada Revenue Agency (CRA) roundtable at the International Fiscal Association (IFA) conference in Toronto earlier this week, the CRA announced “administrative grandfathering” for some Canadian taxpayers with investments in US Limited Liability Limited Partnerships (LLLPs) and US Limited Liability Partnerships (LLPs). Practically, this announcement will allow some Canadians who hold investments in US LLLPs and LLPs formed prior to April 26, 2017, to continue to treat these entities as partnerships on a go-forward basis. The CRA indicates that this additional relief resulted from the submissions which have been received by the CRA and the apparent complexities of transitioning from a partnership to a corporation.

It was a year ago at the 2016 IFA conference where the CRA announced its conclusion that US LLLPs and LLPs should be treated as corporations for Canadian tax purposes, rather than as partnerships — like they are in the US. While this helped clarify the treatment of these entities, this announcement raised new issues for affected taxpayers, as discussed in our May 27, 2016, [blog](#). And, as we reported on [December 1, 2016](#), the CRA extended some relief with their announcement at the Canadian Tax Foundation

conference in November 2016, by indicating that some of these entities (on a case by case basis after applying to a special CRA working group) could simply begin to file as corporations going forward, rather than having to go back and amend prior year filings.

The CRA’s most recent announcement of administrative grandfathering is a welcome accommodation for taxpayers but comes with some conditions. Firstly, the grandfathering is for Delaware or Florida LLPs or LLLPs¹ formed prior to April 26, 2017, provided that they have not:

- had one or more members of the entity, or the entity itself, take inconsistent positions from one taxation year to another, or for the same taxation year, as between partnership or corporate treatment;
- made a significant change in the membership or the activities of the entity; or
- used the entity to facilitate abusive tax avoidance.

Where the above conditions do apply, the CRA *may* assess the taxpayer and/or the entity for one or more taxation years, on the basis that the entity is a corporation. US LLLP and LLPs, which have consistently filed as a corporation for Canadian income tax purposes, may continue to file as corporations and where a Canadian taxpayer files as if they hold an interest in a corporation then they will be required to do so both retroactively and

¹ The CRA has stated that the grandfathering will also apply to LLLPs and LLPs in other US states.

prospectively for all taxation years. Additionally, the CRA clarified that these entities will fall under paragraph IV(6) of the *Canada-US Income Tax Treaty* which provides for limited applicability of this treaty for some hybrid entities.

We applaud the CRA's ongoing efforts to treat Canadian taxpayers with the utmost fairness, but as often happens, a new announcement raises some additional questions for taxpayers. Unfortunately, announcing this relief days before the personal tax filing deadline for Canadians provides little time for answers.



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Given the CRA's initial pronouncement on May 28th, 2015, (as described in our June 1, 2015 [blog](#)) that in all likelihood they were going to classify these entities as corporations, many conservative taxpayers started filing their Canadian taxes accordingly — as if their investment in a US LLLP or LLP was, in fact, an investment in the shares of a corporation. The most obvious sign of a taxpayer who has taken this filing position would be that they reported their holdings on a T1134 form. If taxpayers have reported their US LLLP or LLP on a T1134 form, then they are likely not eligible for the administrative relief described above. In this case, we would advise taxpayers to consider approaching the CRA working group for special consideration. Clearly, these taxpayers were trying to comply with the evolution taking place in respect of these entities, and we hope that the CRA will recognize this.

Interestingly, if the tax reforms proposed by US President Trump are implemented, the US partners of these LLLPs and LLPs may no longer care what type of entity they hold. Under the Trump proposals, corporate and personal taxes on business income would be integrated to a 15% tax rate, with the result that — at least from a tax perspective — Americans would be indifferent as to whether they invested in a corporation, a partnership, or some other type of flow through entity.

Stay tuned... this issue will continue to evolve with events both north and south of the 49th Parallel having an impact.

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INCOME TAX LEGISLATION

DRAFT INCOME TAX LEGISLATION TO PROVIDE TAX RELIEF FOR FARMERS AND FISHERS SUPPLYING COOPERATIVES

On May 5, 2017, draft legislation and explanatory (technical) notes to amend the *Income Tax Act* to provide tax relief for farmers and fishers supplying cooperatives were released. Hard copies are available through Thomson Reuters as Special Release IT 17-2. For more details, please see the Department of Finance Canada news release reproduced below.

NOTICE OF WAYS AND MEANS MOTION TO AMEND THE *INCOME TAX ACT* (FORCES ON DEPLOYED INTERNATIONAL OPERATIONAL MISSIONS)

On May 18, 2017, a Notice of Ways and Means Motion and explanatory (technical) notes to amend the *Income Tax Act* were tabled addressing the deduction in the computation of taxable income for employment income earned by members of the Canadian Forces or a police force serving on a deployed operational mission. Hard copies are available through Thomson Reuters as Special Release IT 17-3.

BILL C-44 — SECOND READING

Bill C-44, *Budget Implementation Act, 2017, No. 1*, received Second Reading on May 9, 2017, and was referred to the Standing Committee on Finance.

SUPREME COURT APPEALS

The Supreme Court of Canada appeals tables on *TaxPartner* and *Taxnet Pro* have been updated through the S.C.C. *Bulletin of Proceedings* dated May 5, 2017.

The *Notices of Appeal to Federal Court of Appeal Filed* table has been updated on *TaxPartner* and *Taxnet Pro* for appeals filed through May 11, 2017.

NEWS RELEASES

GOVERNMENT PROPOSES TAX RELIEF FOR FARMERS AND FISHERS SUPPLYING COOPERATIVES

Reproduced below is a Department of Finance Canada news release dated May 5, 2017.

The Government of Canada believes that fairness is essential to ensuring Canadians have confidence in their tax system. Budget 2017 makes the tax system fairer by making existing tax relief for individuals and families more effective and accessible, by eliminating ineffective and inefficient tax measures, and by helping ensure that no taxpayer is getting an advantage at the expense of those who are paying their fair share.

The Department of Finance Canada today announced that it intends to propose amendments to the *Income Tax Act* to ensure that qualifying farmers and fishers selling to agricultural and fisheries cooperatives are eligible for the small business deduction in respect of income from those sales.

These amendments, which are being released in draft form to allow an opportunity for public comment, would ensure that recently enacted amendments to the *Income Tax Act* intended to prevent the multiplication of the small business deduction do not inappropriately deny access to the small business deduction for a farmer's or fisher's corporation selling farming products or fishing catches to an arm's length agricultural or fisheries cooperative. The amendments would apply for taxation years that begin after March 21, 2016.

Supporting draft legislation and explanatory notes on the proposed change are available via the related documents below.

Quick Fact

- The small business deduction effectively reduces the rate of corporate income tax from 15 per cent to 10.5 per cent on the first \$500,000 of active business income earned by a Canadian-controlled private corporation.

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GOVERNMENT OF CANADA OFFERS TAXPAYER RELIEF TO CANADIANS AFFECTED BY FLOODING

Reproduced below is a Canada Revenue Agency news release dated May 8, 2017.

The Government of Canada recognizes the difficulties faced by Canadians affected by recent flooding across the country, particularly in Quebec and Ontario, and is committed to help reduce their burden.

The Canada Revenue Agency (CRA) is reminding Canadians that it offers taxpayer relief when natural disasters such as the recent flooding in areas of Quebec and the National Capital Region occur.

The CRA understands that natural disasters may cause hardship for taxpayers whose primary concern during this time are their families, homes, and communities. These individuals, businesses, and first responders may find themselves unable to file or pay taxes on time. If so, the CRA encourages them to make a request for taxpayer relief. Taxpayers can make a request for taxpayer relief online, by using [Form RC4288, Request for Taxpayer Relief](#), or by calling the CRA at 1-800-959-8281 for individual enquiries, and at 1-800-959-5525 for business enquiries. The CRA will consider these requests on a case-by-case basis.

Taxpayers who are unable to physically access institutions they normally depend on are encouraged to register for the CRA's secure online services. Through [My Account](#), individuals can register for direct deposit and avoid interruptions to tax refund or benefit payments they may be expecting.

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CASE LAW UPDATE

1245989 ALBERTA LTD. v. R.

Tax Court of Canada [General Procedure]

K. Lyons J.

March 31, 2017

Citation: 2017 CarswellNat 1034, 2017 TCC 51

Tax — Income tax — Tax avoidance — General anti-avoidance rule (GAAR) — Abuse or misuse — PW, his spouse, SW, P Ltd., 124 Ltd. and 125 Ltd. were non-arm's length parties — To protect P Ltd.'s assets, PW and SW implemented corporate reorganization — Amidst that series of transactions, PW and 124 Ltd. engaged in avoidance transactions resulting in tax benefit — Avoidance transactions included transfers of PW's P Ltd class A common shares and subsequently transfers of P Ltd. assets to numbered companies in exchange for PW and then P Ltd. each receiving preferred shares of both 125 Ltd. and 124 Ltd. — PW used his capital gains exemption against capital gains from disposition of his shares — Companies used corporate deductions against deemed dividends — Minister applied General Anti-Avoidance Rule (GAAR) in s. 245 of *Income Tax Act* to deny increase in paid-up capital from tax benefit of preferred shares of 124 Ltd. — PW and 124 Ltd. Appealed — APPEALS DISMISSED — GAAR was properly applied to deny tax benefit — Avoidance transactions were abusive within meaning of s. 245(4) of Act thus defeated object, purpose, and spirit of s. 84.1 and s. 89(1) of Act — Object, spirit, or purpose of s. 89(1) of Act is designed to compute paid up capital equally of shares within class with reference to corporate law principles subject to applicable adjustments representing amount invested in company shares by its shareholders, and s. 84.1 of Act was anti-avoidance rule to prevent removal of taxable corporate surplus as tax free return of capital through use of capital gains exemptions where there is non-arm's length transfer of shares by individual resident in Canada from one corporation to another and paid up capital in excess of amount invested cannot be withdrawn tax free — Reorganization was primarily for purpose of conveying tax benefit to PW — Avoidance transactions achieved outcome that s. 84.1 of Act was intended to prevent — Reorganization was undertaken primarily to obtain tax benefits.

BIRCHCLIFF ENERGY LTD. v. R.

Federal Court of Appeal

Webb J.A. (Scott J.A. concurring, Stratas J.A. dissenting)

April 28, 2017

Citation: 2017 CarswellNat 1821, 2017 FCA 89

Tax — Income tax — Administration and enforcement — Jurisdiction of Tax Court of Canada — Practice and procedure on appeals — Miscellaneous — Taxpayer's appeal was heard by one judge of Tax Court — Nearly two years later, Chief Justice of Tax Court removed file from that judge and reassigned it to another judge of Tax Court

to render judgment, on consent of parties — Taxpayer appealed on ground that Chief Justice did not have power to remove file from judge who heard appeal and reassign it to another judge to render decision — APPEAL ALLOWED — Per Webb J.A. (Scott J.A. concurring): Even though parties did not raise this issue at trial, it was matter that must be addressed — Chief Justice did not have power to remove file from judge who heard appeal and reassign it to another judge to render judgment, for reasons set out in similar case — Conclusion and reasons in similar case were applicable to this case — Judgment rendered by second judge was nullity and matter was referred to judge who heard tax appeal to render judgment — Findings of fact were to be made by judge who heard tax appeal — Per Stratas J.A. (dissenting): For reasons given in similar case, Chief Justice had jurisdiction to reassign case to different judge — Taxpayer did not object to Chief Justice's decision at time of decision, so issue was new on appeal and it would not be considered — Failure to object to any procedural fairness deficiency at time of decision constituted waiver.

TANG, U et al. v. R.

[Official English Translation]

Federal Court of Appeal

Gauthier, Boivin, Montigny JJ.A.

November 27, 2015

Citation: 2015 CarswellNat 6406, 2015 FCA 271

Tax — Income tax — Business and property income — Income items — Miscellaneous — Administration and enforcement — Audits — Audit methodology — Penalties (administrative) — False statements — Taxpayers K and T owned corporate taxpayer — Corporate taxpayer operated currency exchange and jewellery store — Police suspected that corporate taxpayer was involved in money laundering — Following search warrant, police seized amount of \$384,145.00 from K's home — Police seized amount of \$509,406.00 from T's home — Police seized amount of \$1,663,843.00 from corporate taxpayer — Taxpayers appealed and judge reduced amounts considered undeclared — Taxpayers appealed to Federal Court of Appeal — APPEAL ALLOWED IN PART — Same money could not belong simultaneously to several taxpayers — Minister admitted impossible to determine with certainty who owned money — Undeclared taxable income for T and K reduced by \$428,142.50 each and penalties adjusted accordingly — Money seized from store to be taken as corporate taxpayer's — Judge made no error in reversing burden of proof — Judge also correct on imposition of penalties and allocating revenues for taxation year 2007.

McCARTHY TÉTRAULT COMMENTARY UPDATE TO CANADA TAX SERVICE, RELEASE 1623

The commentary to the following provisions has been updated for the noted reasons:

- **28:** commentary updated to reflect the amendment of 28(1) by S.C. 2016, c. 12 (Bill C-29) and to reflect recent CRA publications;
- **54:** Income Tax Folio S1-F3-C2: *Principal Residence*, updated, effective March 22, 2017;
- **118.1(4); 118.1(5.4), (6); 118.1(7), (7.1); 118.1(10)–(11):** legislation updated to incorporate amendments from S.C. 2014, c. 39 (Bill C-43);
- **251.2; 261:** legislation updated to incorporate amendments from S.C. 2016, c. 12 (Bill C-29) and Reader Alerts added where appropriate;
- **253.1:** legislation updated to incorporate amendments from S.C. 2016, c. 12 (Bill C-29);
- **256:** legislation updated to incorporate amendments from S.C. 2014, c. 39 (Bill C-43) and S.C. 2016, c. 12 (Bill C-29) and Reader Alert added; and
- **256.1:** legislation and commentary updated to reflect the amendment of 256.1(1) “specified provision” by S.C. 2016, c. 12 (Bill C-29).



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