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Review of Select Recent Technical Interpretations and Rulings

October 25, 2023

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Agenda

1. Late Filed Election
2. Limited Partnership Loans
3. Subsection 165(1)
4. Books and Records
5. Loss Consolidation Ruling
6. Cost Recovery Method

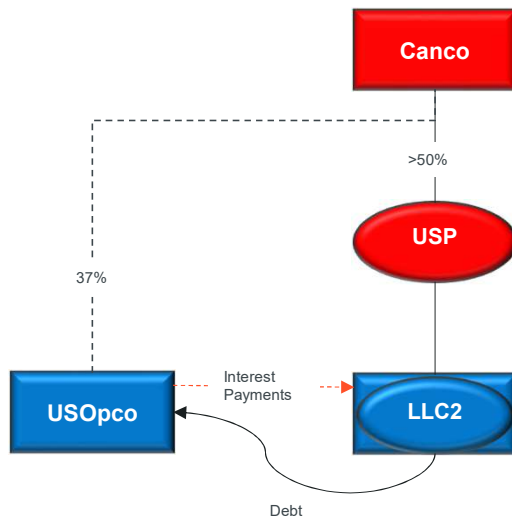


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LATE FILED ELECTIONS

Technical Interpretation 2019-080749117

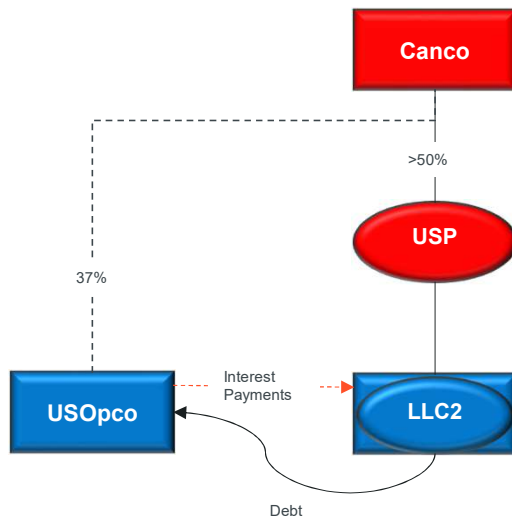
Facts (Simplified)



- Canco is a member of a partnership (“**USP**”)
- USP holds all of the shares of a limited liability company (“**LLC2**”).
- In 2011 and 2012, USOpco paid interest to LLC2 that would be considered “foreign accrual property income” (“**FAPI**”) unless clause 95(2)(a)(ii)(B) recharacterized the interest as active business income (“**ABI**”).
- Clause 95(2)(a)(i)(B) would recharacterize the interest as ABI if subsections 93.1(5) and (6) applied to USP.
- Subsections 93.1(5) and (6) apply to taxation years of foreign affiliates (“**FAs**”) of a taxpayer that end after July 12, 2013 (*i.e.*, after 2011 and 2012).

Technical Interpretation 2019-080749117

Facts (Simplified) Con't



- If a taxpayer elects in writing in respect of all of its FAs and files the election with the Minister of Natural Revenue on or before a set due date, the enacting legislation (“**CIF Provision**”) would deem subsections 93.1(5) and (6) to have come into force on January 1, 2010 (*i.e.*, before 2011 and 2012).
- The deadline for USP to file the election was December 16, 2015, and no formal written election was ever made by USP.
- Due to an equal and offsetting deduction permitted by subsection 91(5), UCP reported no net FAPI in respect of the interest paid by USOpco in either 2012 or 2013, thereby placing USP in the same position as if the interest was recharacterized as ABI.

Issues

- In these circumstances, would the election be either: (i) considered to be filed, or (ii) permitted to be filed late.

Technical Interpretation 2019-080749117

Was the Election Filed - Taxpayer's Position

- USP took the filing position that it effectively filed the election in its return because its reported FAPI was the same amount as if an election had actually been filed (*i.e.*, no net FAPI).
- However, USP did not otherwise notify CRA of the election.

Was the Election Filed - CRA's Position

- Election could not be considered effectively filed.
 - “Based on our analysis, it is our view that where a provision states that an election is available to the taxpayer, but no prescribed form is provided, the taxpayer is still required to make the election known to the CRA. Generally, in such instances, a written letter attached to the return of income is sufficient.”
 - “... Canco’s assertion that its filing position has “effectively” placed them in “the same position” as if they had filed the election is considered irrelevant.”

Jurisprudence

- Consider *Dhaliwal v R*, 2012 TCC 84

Technical Interpretation 2019-080749117

Could the election be late-filed under subsection 220(3.2)?

- **Subsection 220(3.2):** Grants the Minister the power to extend the time to make an election if election was required to be made under a prescribed provision and the extension is applied for within 10 calendar years of the end of the relevant taxation year or fiscal period.
 - Prescribed provisions listed in Regulation 600 – do not include the CIF Provision under the legislation implementing subsection 93.1(5) and (6).
 - CRA position is that it is not required nor permitted to extend subsection 220(3.2) to elections other than those listed in Regulation 600.
 - CRA believes this restriction on which elections can receive relief is likely intended to prevent taxpayers from engaging in retroactive tax planning.
- **CRA view:** Relief under subsection 220(3.2) was not available to USP.

Technical Interpretation 2019-080749117

Could the filing of the election be waived under subsection 220(2.1)?

- **Subsection 220(2.1):** Authorizes the Minister to waive a requirement under “any provision of the Act or a regulation” that “requires a person to file a prescribed form, receipt or other document” provided the document is provided at the Minister’s request.
- **CRA view:** Relief under subsection 220(2.1) was not available to USP.
 - Subsection 220(2.1) cannot override subsection 220(3.2) because 220(2.1) is a general provision and is not considered to override a more specific provision within the same section of the Act.
 - Subsection 220(2.1) does not permit the Minister to cause a taxpayer to have made an election.
 - “[A]llowing subsection 220(2.1) to waive a taxpayer's requirement to file an election not listed in Regulation 600 would negate the specific intention of Parliament in limiting late elections to only those that are prescribed in section 600 of the Regulations. It seems reasonable to conclude that the implied exclusion rule supports this view: the implication is that the exclusion of an election from the list in Regulation 600 is that Parliament does not intend for the taxpayer to have the ability to late-file that election.”

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LIMITED PARTNERSHIP LOANS

Technical Interpretation 2019-081610117

Whether paragraph 96(2.2)(c) allows a limited partnership to make loans to a limited partner?

- **Limited Partnership Losses**

- Subsection 96(2.1) limits the amount of losses that can be allocated to a limited partner of a partnership to an amount equal to the difference between the limited partner's "at-risk amount" and the sum of certain other income tax attributes allocated to the limited partner (e.g., resource expenditures).
- The limited partner's at-risk amount is determined under subsection 96(2.2).

- **Paragraph 96(2.2)(c)**

- Reduces a limited partner's at-risk amount by all amounts each of which is an amount owing at that time to the partnership, or to a person or partnership not dealing at arm's length with the partnership, by the limited partner or by a person or partnership not dealing at arm's length with the limited partner.
- Does not allow, in and by itself, a limited partnership to make loans to a limited partner.

Technical Interpretation 2019-081610117

Validity of loan from a limited partnership to a limited partner is determined as a matter of provincial law

- **Canadian common law**
 - Partnership is not a separate legal entity.
 - A partner cannot enter into a valid contract with a partnership because a partner cannot contract with itself.
- **Statutory law**
 - Varies province to province.
 - In Alberta, common law is overruled by the *Law of Property Act*.
 - What if the limited partnership is governed by Alberta law but the partner is located in a province that does not overrule the common law position?

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SUBSECTION 165(1)

Technical Interpretation 2019-079142117

Facts

- Corporation files its T2 return of income for the taxation year.
- CRA assesses the return as filed.
- At a later date within the prescribed time limit in subsection 37(11) of the Act, Corporation files a request to amend the return to include a claim for SR&ED expenses.
- CRA denies the SR&ED claim in its entirety and sends a letter advising Corporation that the claim has been denied. A Notice of Reassessment is not issued as there is no change to tax payable previously assessed.
- As a result, Corporation is not entitled to file a Notice of Objection pursuant to subsection 165(1).

Technical Interpretation 2019-079142117

If the CRA were to issue a Notice of Reassessment upon rejecting Corporation's claim for SR&ED expenses that showed no changes from the initial Notice of Assessment, would Corporation be entitled to file a Notice of Objection?

- **Subsection 165(1):** Grants a taxpayer the right to object to an "assessment".
 - Assessment is the fixing or determining tax payable and includes a "reassessment".
 - If there is no assessment or reassessment by CRA then the taxpayer has no right of objection.
 - A "Notice of Reassessment" issued by CRA which does not indicate a change of the tax payable or taxable income previously assessed is a restatement of the previous assessment and does not constitute a reassessment of the tax liability.
- **CRA's view:** Notifying a taxpayer that it has denied the taxpayer's request for adjustments to a taxation year and there are no changes to the amounts assessed, is not a reassessment (even if the notification is titled "Notice of Reassessment").

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BOOKS AND RECORDS

Technical Interpretation 2022-0954271E5*

- **Subsection 230(1):** Requires a taxpayer to keep records and books of account ("**Books and Records**") in such form and containing such information as will enable the amount of taxes payable under the Act to be ascertained.
- **Subsection 230(4):** Sets out the retention periods for Books and Records.
 - Retention periods are based on two broad categories of Books and Records:
 1. Prescribed Books and Records; and
 2. Other Books and Records.
- **Regulation 5800:** Describes various types of Books and Records and applicable prescribed retention periods.

Technical Interpretation 2022-0954271E5

Prescribed Books and Records

- Must be retained for two years after date of dissolution of the relevant corporation under paragraph 230(4)(a) and Regulation 5800(1)(a).
- Includes:
 - General Ledger and other book of final entry containing the summaries of the year-to-year transactions.
 - Where the general ledger presents only a total for several transactions otherwise presented individually in another book of final entries (e.g., a subsidiary ledger), then the other book of final entries must also be retained for two years.
 - Special contracts or agreements necessary to an understanding of the entries in the general ledger or other book of final entry.
 - Question of fact.
 - CRA views these as agreements or contracts that include “specific provisions or conditions that are not generally found in an agreement or contract of a similar nature”.

Technical Interpretation 2022-0954271E5

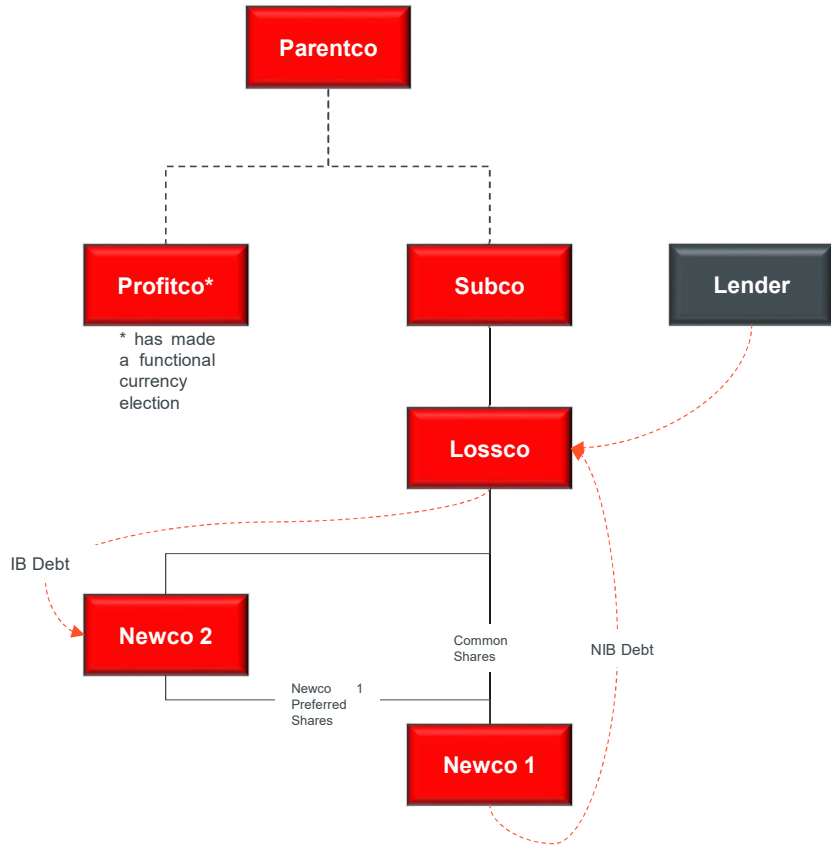
Other Books and Records

- Must be retained for six years following the end of the last taxation year to which they relate under paragraph 230(4)(b).
- Includes:
 - Vouchers and accounts necessary to verify the information contained in the general ledger or any other book of final entry;
 - CRA view notwithstanding language of subsection 230(4);
 - Generally, journal books, including subsidiary journals.

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LOSS CONSOLIDATION RULING

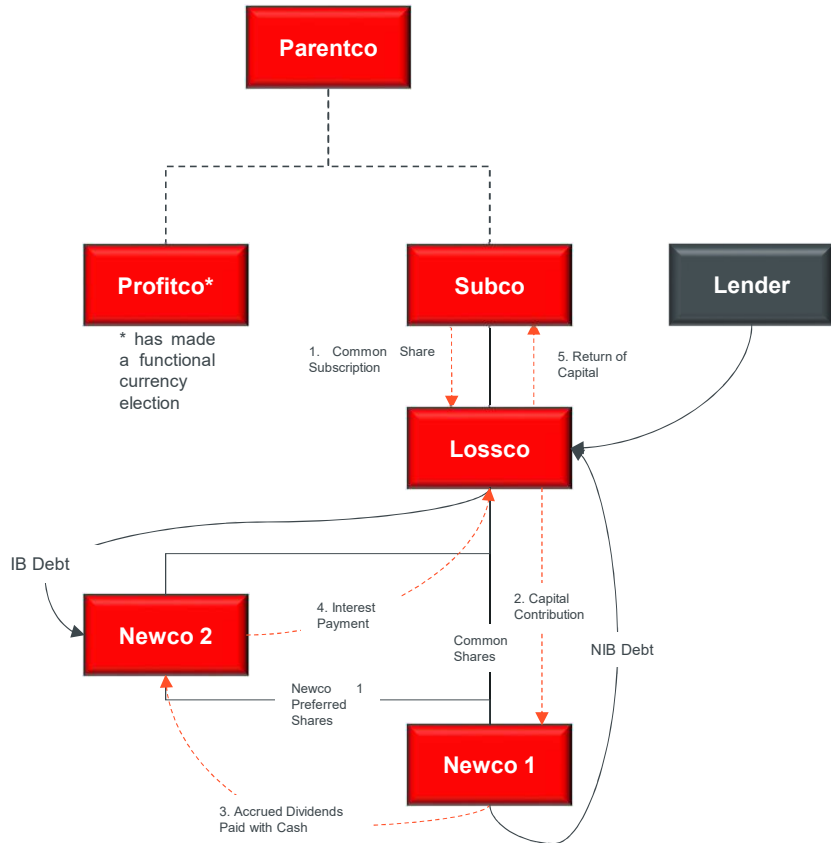
Income Tax Ruling 2022-0949841 R3



Transactions (Simplified)

- Lossco uses the proceeds of a Daylight Loan to lend money to Newco 2 via a credit facility (“**IB Debt**”) that is unsecured and has a floating interest rate.
- Parentco, Subco and Lossco will enter into the “Support Agreement” regarding the funding of dividend payments described below.
- Newco 2 uses the proceeds of the IB Debt to subscribe for cumulative, non-voting, redeemable, retractable preferred shares of Newco 1 (“**Newco 1 Preferred Shares**”) having a positive spread over the IB Debt.
- Newco 1 uses the proceeds of the Newco 1 Preferred Shares to make a non-interest bearing, payable on demand loan to Lossco (“**NIB Debt**”).
- Lossco repays the daylight loan.

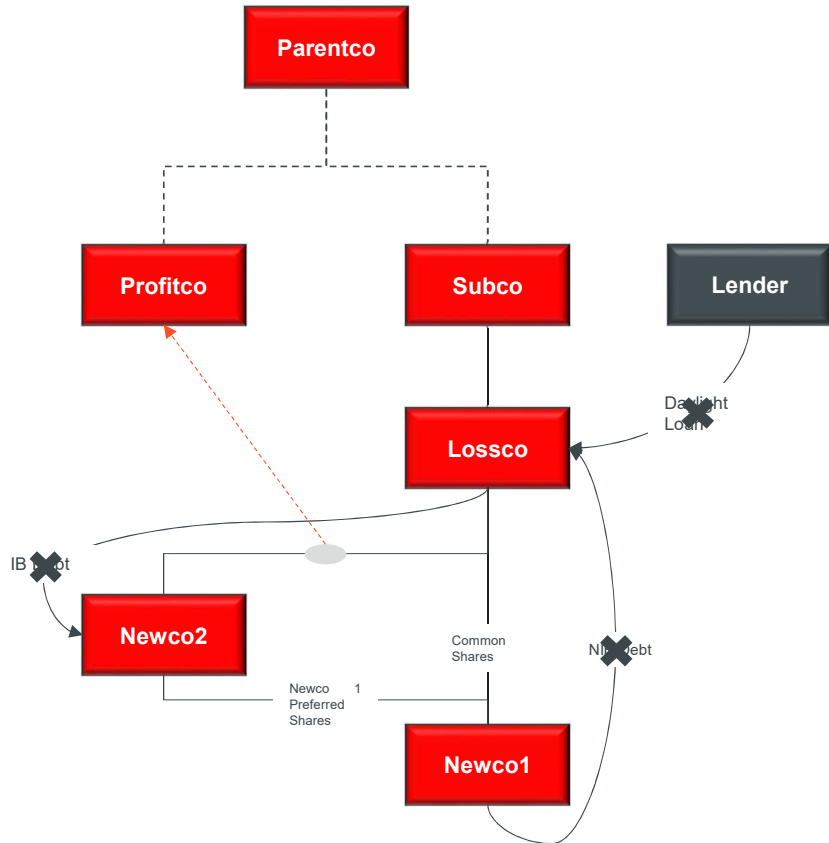
Income Tax Ruling 2022-0949841 R3



Annual Maintenance (Simplified)

- Subco subscribes for Lossco common shares in an amount equal to the dividends payable in respect of the Newco 1 Preferred Shares.
- Lossco will contribute the subscription proceeds to the capital of Newco 1. No shares will be issued, and no amount will be added to the stated capital or paid-up capital of the Newco 1 shares.
- Newco 1 will declare all accrued dividends payable on the Newco 1 Preferred Shares and pay the dividends with the contributed cash.
- Newco 2 uses the cash received from the dividends to pay the interest payable on the IB Debt.
- Lossco distributes the cash received as interest to Subco as a return of capital.

Income Tax Ruling 2022-0949841 R3



Annual Unwind (Simplified)

- Newco 1 redeems the Newco 1 Preferred Shares by transferring to Newco 2 the NIB Debt in accordance with the terms of the Newco 1 Preferred Shares.
- Newco 2 and Lossco settle the NIB Debt and IB Debt by legal set-off.
- Lossco sells all of its shares of Newco 2 to Profitco for cash consideration.
- Profitco immediately authorizes the winding-up of Newco 2 into Profitco.

The transactions are repeated using Newco 1 and additional Newcos. Once Lossco's non-capital losses and investment tax credits are fully utilized, Lossco will wind-up Newco 1.

Income Tax Ruling 2022-0949841 R3

Rulings (Simplified)

- Newco 2 will be entitled, pursuant to paragraph 20(1)(c), to deduct the lesser of (i) the interest paid or payable in respect of the year on the IB Debt, or (ii) a reasonable amount in respect thereof.
- Dividends received by Newco 2 on the Newco 1 Preferred Shares will be taxable dividends and such dividends will, pursuant to subsection 112(1), be deductible in computing the taxable income of Newco 2 for the year in which the dividends are received by Newco 2.
- Subsection 88(1.1) will apply after the windup-up of Newco 2 into Profitco.
- Subsections 15(1), 56(2) and 246(1) will not apply in and themselves.

EIFEL Representation: Proposed subsection 18.2[(2)] will not apply to limit the deductibility of the interest on the IB Debt as Lossco and Newco 2 are eligible group corporations in respect of one another and will elect to treat the interest payment under the IB Debt as excluded interest.

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COST RECOVERY METHOD

Technical Interpretation 2021-0920561E5

What is an earnout?

- Contractual provision entitling a vendor to additional compensation in the future if the target business achieves certain financial targets.
 - Used as a tool in an agreement of purchase and sale to bridge a gap between the parties as to the value of the target business.
 - Helps to eliminate uncertainty for a buyer as they pay a portion of the sale price upfront with the remainder based on future performance.
 - From the seller's perspective, allows them to receive some benefit of future growth of the business.
- Income generated by earnout payments will be categorized in one of two ways:
 1. Capital income benefiting from the capital gains exemption.
 2. Income dependent on the use or production from property taxed at the full marginal rate.

Technical Interpretation 2021-0920561E5

- **Interpretation Bulletin IT-426R *Shares Sold Subject to an Earnout Agreement***
 - CRA administrative policy that allows a taxpayer to use the cost recovery method to report a capital gain or capital loss on the sale of shares subject to an earnout agreement if certain conditions are met.
 - Results in deferred recognition of all or a portion of the capital gain or capital loss on the disposition of the shares until the point in time when the amounts that are in respect of the proceeds of disposition become determinable.

Technical Interpretation 2021-0920561E5

Does the CRA's administrative policy apply where the proceeds of disposition are paid by way of issuance of shares?

- "Proceeds of disposition" = "sale price of property that has been sold".
- Sale price, generally means the actual value of the consideration.
- Cost recovery method not precluded by proceeds of disposition being received in form of shares.

Thank you.



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