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Price Adjustment Clauses

Included among the first Folios released by CRA was Folio S4-F3-C1[i] dealing with the price adjustment clause (a "PAC"). This cancelled and replaced the 40 year old Interpretation Bulletin IT-169[ii].

Folio S4-F3-C1 states that if the four requirements set out in paragraph 1.5 are met, then property will be considered to be transferred for fair market value consideration and there will be no inclusion in income pursuant to a number of listed provisions: subsections 15(1); 51(2); 69(1); 74.1(1) and (2); sections 74.2 and 74.3; subsections 74.4(2) and 75(2); paragraph 85(1)(e.2) and subsection 86(2). The four requirements are similar to those in Interpretation Bulletin IT-169 and are summarized below:

1. The agreement reflects a bona fide intention to transfer property at fair market value. Interpretation Bulletin IT-169 contained a similar requirement. However, Folio S4-F3-C1 goes on to state that where there is a significant difference between the value determined by the parties and the "real" fair market value, this may indicate that the parties did not make a "real effort".
2. A fair and reasonable method must be used. There was a similar statement in Interpretation Bulletin IT-169. However, Folio S4-F3-C1 also states that a taxpayer's reliance on a different valuation method than that relied upon by CRA and the "relative inaccuracy of a FMV determination performed in good faith" will not necessarily cause the PAC to be inoperative. It is not necessary that the valuation be completed by a valuation expert. But simply relying on a generally accepted valuation method is not enough; rather it must be "properly applied having regard to all the circumstances".
3. The parties must agree to use the value determined by CRA or the courts, if the FMV so determined differs from the one used by the parties. This was also found in Interpretation Bulletin IT-169.

4. Any excess or shortfall in price is actually paid or refunded or a legal liability is adjusted. This was found in Interpretation Bulletin IT-169 too.

The requirements do not include notification to CRA, unlike Interpretation Bulletin IT-169. But CRA had long ago indicated that failure to adhere to the notification requirement set out in the Interpretation Bulletin would not, in and of itself, render the PAC invalid.[iii]

Generally, a PAC is utilized to ensure fair market value consideration and avoid triggering benefit provisions. For example, in a typical estate freeze, the freezor will exchange or transfer his/her common shares of a corporation for redeemable/retractable preferred shares with an aggregate redemption/retraction amount equal to the fair market value of such common shares. The freeze could be implemented pursuant to section 85, 86 or 51. If the fair market value of the preferred shares received by the freezor in consideration of his/her pre-existing common shares do not have equivalent fair market value, then the freezor may recognize a gain pursuant to paragraph 85(1)(e.2); or subsections 86(2) or 51(2). Further, as an estate freeze will typically involve "new" common shares being issued for nominal consideration to a family trust or next generation family member, a subsection 15(1) benefit could arise if the preferred share consideration received by the freezor was deficient in value as the "new" common shares should then have greater than nominal value. Paragraph 1.2 of the Folio specifically lists the foregoing statutory provisions as consequences avoided by a valid PAC.

It should be noted that the deficiency of consideration provisions above, i.e., paragraph 85(1)(e.2), and subsections 86(2) and 51(2), contemplate taxpayer intention to confer a benefit on a related person:

> " … it is reasonable to regard any part of the excess [i.e., excess of the fair market value of the property transferred over the fair market value of consideration received] as a benefit that the taxpayer desired to have conferred on a person related to the taxpayer …"

It is submitted that a PAC by its very nature (whether or not complying with CRA policy) is a contra-indication of desire to confer a benefit.

Paragraph 1.2 of the Folio also lists a number of attribution rules whose consequences are avoided by a valid PAC – subsections 74.1(1) and (2); sections 74.2 and 74.3; subsections 74.4(2) and 75(2). Reference might be made to *The Queen v. Kieboom*[iv] for the concept that an undervaluation of shares may lead to the transfer of an "economic interest" in the corporation. In *Kieboom*, a husband and wife were the holders of common shares in a 90%:10% proportion. A second class of non-voting common shares was created and the wife subscribed for such shares at a nominal subscription price resulting in a dilution of the husband's equity position. The Federal Court of Appeal held that the husband had disposed of an "economic interest" in the corporation and had transferred a portion of his "ownership equity" to the wife. The court recognized the wide interpretation given to the terms 'transfer" and "property" and held that there was a transfer of property such that paragraph 69(1)(b) and the attribution rule in former subsection 74(1) applied. By analogy, in an estate freeze, if the preferred share consideration received by the freezor does not equal the fair market value of his/her pre-existing common shares, then arguably the freezor might be considered to have disposed of an "economic interest" and to have transferred of a portion of "ownership equity" to the "new" common shareholder. However, if a PAC operates to increase the redemption/retraction amount of the preferred shares, then the foregoing should not be true.[v] This seems to be recognized by CRA since paragraph 1.2 of the Folio recognizes that a valid PAC will avoid the consequences of 74.1(1) and (2); sections 74.2 and 74.3; and subsection 74.4(2 and 75(2). Older CRA

Documents had raised the possible *Kieboom* concern as a transfer of property to a trust for purposes of subsection 75(2).[vi] A more recent CRA Document[vii] has confirmed that CRA would take a price adjustment clause into consideration when considering whether the conditions to subsection 75(2) are met. In other words, if a PAC is effective, then surely there could be no deficiency of consideration and therefore no property in the form of "economic interest" transferred to a trust in circumstances which might trigger subsection 75(2).

Similar to Interpretation Bulletin IT-169, Folio S4-F3-C1 is couched in terms of a transfer of property. Both refer to the case "where property is transferred in a non-arm's length transaction".[viii] Folio S4-F3-C1 also uses terms such as the "transaction price" and "acquisition price"[ix]. These references serve to limit the CRA's perspective on the operation of a PAC.

Folio S4-F3-C1 expressly recognizes that the PAC may be in a covering agreement for the transfer of property or in the terms of the share consideration. Interpretation Bulletin IT-169 had been worded only with reference to the former. Although the reference to the PAC being included in the terms of the shares might seem to broaden the ambit of a PAC, the Folio specifically refers to shares issued as consideration for the transferred property. This is the limiting assumption of transfer of property. Nonetheless, acceptance of a PAC in the terms of share consideration is a welcome reference. Previously, some practitioners had expressed concern about implementing a section 86 share capital reorganization simply by Articles of Amendment whereby shares are changed into shares of another class[x], rather than by share exchange agreement out of an abundance of caution given the requirement in Interpretation Bulletin IT-169 for a transfer agreement.

Because the Folio is couched in terms of a PAC in connection with a "transfer" of property, it is unclear whether there has been any change to CRA's position that a price adjustment clause does not apply in the case of a stock dividend freeze.[xi] In a stock dividend freeze, there is no "transaction price", or consideration for transferred property. In a stock dividend freeze, there is no "price" to adjust. But the goal is the same as the reason for a classic PAC in a section 85 or section 86 estate freeze. The goal is to ensure a matching valuation and the avoidance of benefit conferral. In a stock dividend freeze, a PAC (which is probably a misnomer as the clause is a redemption amount adjustment rather than a price adjustment) is naturally included in the terms of the shares as there would be no other logical placement. The operation of such a PAC is therefore dependent on corporate law[xii] and could be triggered in the same circumstances as a PAC in respect of shares issued in consideration of a subsection 85(1) transaction. If the preferred shares issued in payment of the stock dividend are drafted so that their aggregate redemption amount refers to fair market value (rather than specifying a dollar amount as the redemption price per share)[xiii], this should be considered some evidence of intention to transact at fair market value and conversely, to not confer a benefit. There does not seem to be a compelling reason to differentiate the use of a clause in the terms of shares which adjusts their redemption amount in a stock dividend freeze from the use of a clause in the terms of shares which adjusts their redemption amount in a subsection 85(1) freeze.

Interestingly, the list of provisions in paragraph 1.2 of Folio S4-F3-C1 for which an effective PAC will avoid the adverse consequences does not include subsection 87(4) which deals with share exchange upon amalgamation. Because subsection 87(4) invites a comparison of the FMV of the "old shares" (before amalgamation) and the FMV of the "new shares" (following amalgamation), the terms and conditions of shares issued upon amalgamation can sometimes include an adjustment to the redemption and retraction amount to ensure that the share exchange occurs on a fair market value basis. But the adverse consequences of subsection 87(4) require not only deficiency of value upon the amalgamation share exchange, but also taxpayer intention to confer a benefit upon a related person. In this regard, the language in subsection 87(4) is similar to that in paragraph 85(1)(e.2) and subsections 86(2) and 51(2). Therefore, a clause which adjusts the redemption and retraction amount of shares received on the amalgamation share exchange is important as it rebuts the intention to confer a benefit (whether or not such a clause constitutes a PAC within the parameters of the Folio). It may be a misnomer to refer to such a clause as a price adjustment clause (since there is no price to adjust).

Folio S4-F3-C1 indicates that a PAC can have effect many years after the transaction in which the particular share consideration was issued. Under the heading, "Estate Freeze", the Folio states that where the holder of shares issued in circumstances in which a PAC applied still owns the shares at death, the PAC might affect the determination of the fair market value for purposes of the deemed disposition pursuant to subsection 70(5). This was the situation contemplated in CRA Document Number 2011-0429991E5[xiv] which addressed questions relating to the death of a taxpayer who had implemented an estate freeze sixteen years prior to the year of death. In connection with the estate freeze, the taxpayer had received shares whose rights and conditions included a PAC. There was also a PAC in the particular purchase and sale agreement pursuant to which the taxpayer's "old" common shares had been exchanged for preferred shares. CRA's position was that if the PAC was valid, then it had retroactive effect to the time of the transaction and therefore, upon the taxpayer's death, the proceeds of disposition in respect of the deemed disposition of the "freeze" preferred shares would be the value on the freeze, as adjusted by the PAC. The fact that the year of the estate freeze was statute barred was not considered relevant, since the tax event (i.e., deemed disposition) was in the current taxation year.[xv]

The potential long life of a PAC can raise drafting issues. In the example in the Folio and CRA Document Number 2011-0428881E5, the taxpayer remained the owner of the original "freeze" preferred shares at the time of death. In practice, other reorganization transactions may occur in the intervening years. The taxpayer may transfer the original "freeze" preferred shares to another corporation in consideration of shares. Corporations may amalgamate. These subsequent reorganization steps may occur after the "normal reassessment period" for the taxation year in which the estate freeze was implemented. For example, if the original "freeze" preferred shares are being transferred to a holding corporation in consideration of preferred shares pursuant to subsection 85(1); should the new preferred share consideration also include a price adjustment clause? It may be prudent to do so.

Discretionary Dividend Shares

Discretionary dividend shares present an opportunity for income splitting and dividend streaming[xvi] and have been the subject of CRA technical interpretations from time to time. The issue raised is typically the risk that a benefit may be conferred on a shareholder pursuant to subsection 15(1) at the time the shares are issued for nominal consideration. There could also be the opposite issue at time of exit, whether deemed disposition or other transfer.[xvii]

Discretionary dividend shares are designed with attributes to support lack of value. In general terms, their attributes are usually the following: (a) non-voting; (b) non-participating on liquidation or dissolution of the corporation with a specifically limited entitlement (e.g., limited to nominal $1 per share); (c) redeemable by the corporation at a redemption price per share equal to the liquidation entitlement; (d) discretionary dividends as and when and in such amount as declared by the directors of the corporation with no preference or priority. To rebut the corporate law presumption of equality amongst shares and therefore to permit dividend sprinkling, the Articles of Incorporation (or amendment, as the case may be) should expressly provide that dividends may be declared and paid on the discretionary dividend shares as a class without first declaring and paying a dividend on the other classes of shares.[xviii]

In CRA Document Number 2012-0454181C5[xix], a fact situation was outlined involving the proposed issuance of discretionary dividend shares in what was presented as a creditor proofing exercise as follows:

- X is the sole shareholder of a corporation, Opco whose retained earnings generally increase by $500,000 each year. X holds Class A common shares with nominal paid-up capital and adjusted cost base. The fair market value of X's Class A common shares is estimated at $5 million.
- X shall incorporate a new corporation, Holdco, and shall subscribe for 100 common shares of Holdco for $100. X shall be the sole shareholder of Holdco.
- By means of a subsection 51(1) reorganization, X's Class A common shares shall be converted into 5,000,000 preferred shares with a value of $5 million. X shall thereafter subscribe for 100 new Class A common shares for a subscription price of $1 per share.
- Holdco shall subscribe for 100 discretionary dividend shares of Opco for a subscription price of $1 per share.
- In the future, Opco shall declare dividends on its discretionary dividend shares held by Holdco, but not to adversely affect the $5 million redemption value of the 5,000,000 freeze preferred shares.

CRA's response indicated that subsection 15(1), paragraph 110.6(7) and the general anti-avoidance rule in section 245 could apply in appropriate circumstances. The first two statutory provisions suggest a possible valuation attack – were the discretionary dividend shares issued for fair market value consideration? In the fact situation, the subscription price for the discretionary dividend shares was nominal. It should also be noted that such shares were proposed to be issued immediately following a freeze type reorganization in that the existing common shares were converted into redeemable retractable preferred shares. New common shares were to be issued at that time too, also for nominal consideration albeit to the person who was previously the sole shareholder.

The distinguishing feature of the above technical interpretation is that the discretionary dividend shares were issued immediately following a freeze type reorganization thereby facilitating the issuance of new shares (whether common or discretionary dividend) for nominal consideration. Previous technical interpretations[xx] did not involve such a share capital reorganization and the possible application of paragraph 69(1)(b) was raised, based on *Kieboom*. A share exchange or share capital reorganization with a valid price adjustment clause should address both the subsection 15(1) benefit and paragraph 69(1)(b) concern upon issuance.[xxi]

It is also important that all corporate steps be properly implemented. Deficient implementation may cause other avenues of risk. For example, the share subscription price for the discretionary dividend shares (albeit nominal) should be paid in full as required under the applicable corporate statute and dividends (if paid on the discretionary dividend shares) should be paid to the registered holder of the shares rather than directed elsewhere. *Patrice Demers v. The Queen*[xxii] was a case involving discretionary dividend shares issued to minors where the father was reassessed on the basis of subsection 56(2). The shares were not fully paid for and the dividend was paid and deposited to father's account rather than the registered shareholders' account. Where discretionary dividend shares are issued following a freeze type reorganization converting original common shares into redeemable retractable preferred shares, there will most likely be a non-impairment clause in the terms and conditions of the shares (or otherwise in the applicable Articles of Amendment) prohibiting the payment of dividends on any class of shares if that would result in the corporation having insufficient net assets to pay the redemption amount in respect of the issued and outstanding "freeze" preferred shares.[xxiii] Such a clause must also be respected.

A discretionary dividend share most likely constitutes a "taxable preferred share" as defined in subsection 248(1) because the share is non-participating upon the dissolution of the corporation, i.e., the amount which the holder is entitled to receive in respect of the share upon dissolution or liquidation of the corporation is fixed. This can raise the potential application of Part VI.1 tax. Subject to certain exceptions and an annual dividend allowance of $500,000, Part VI.1 imposes a 25% tax on the dividend payer. Such tax is deductible in computing taxable income at the rate of 3.5 times the Part VI.I tax.[xxiv] Typically one would expect to see discretionary dividend shares used in closely held situations such that Part VI.I tax may not be a concern, largely because of the "substantial interest" exemption in paragraph 191(2). Provided that the holder of the discretionary dividend shares is related to the corporation, such shareholder has a "substantial interest" in the corporation pursuant to paragraph 191(2)(a) and accordingly, dividends paid on the discretionary dividend shares would be "excluded dividends" and thus, not subject to Part VI.1 tax.[xxv] In the CRA Document discussed above, Holdco (being the holder of the proposed discretionary dividend shares) was controlled by X who controlled Opco and was therefore related to the corporation paying the dividends. Assuming that discretionary dividend shares are used in the family owned environment, it seems likely that the holder of the discretionary dividend shares may be related to the dividend payer corporation such that the substantial interest exemption will apply. There may be issues however where the holder of the discretionary dividend shares is a trust as it is more difficult to fit within this exemption. The substantial interest exemption in paragraph 191(2)(a) requires the particular shareholder to be related to the corporation but there is no specific provision in section 251 dealing with a trust as a related person although an argument can be made. Assuming that the dividend payer corporation is controlled by one person, if all of the trustees of the trust are related to such one person, then the trust (holding the discretionary dividend shares) and the corporation are arguably related pursuant to subparagraph 251(2)(b)(iii)[xxvi]. In addition, reference should be made to paragraph 191(3)(d) which deems a trust not to have a substantial interest in a corporation unless each person beneficially interested in the trust is related to each other person beneficially interested in the trust, other than a registered charity.[xxvii] Therefore it is also necessary to consider the identity of all persons beneficially interested in the trust.

Corporate Attribution Rule – Transfer to Corporation

A technical interpretation (CRA Document Number 2012-0449871E5[xxviii]) addressed the corporate attribution rule in s.74.4 and illustrated the calculation of the imputed interest benefit.

The fact situation in the technical interpretation involved a typical estate freeze followed by a roll to a holding company.

- The individual taxpayer, X, exchanged his common shares of Opco for redeemable retractable preferred shares of Opco pursuant to either s.51 or s.85(1).
- A trust whose beneficiaries included "designated persons" subscribed for common shares of Opco for nominal consideration.
- X transferred his redeemable retractable preferred shares of Opco to Newco in consideration of common shares, pursuant to s.85(1).
- Newco will have income from other sources, i.e., other than the preferred shares of Opco. It is anticipated that the common shares of Newco will increase in value.
- Opco shall gradually redeem its preferred shares held by Newco.

The “outstanding amount” is the basis for calculation of the imputed interest benefit. The technical interpretation indicated that the “outstanding amount” for purposes of subsection 74.4(2) was set at the time that X transferred the Opco common shares to Opco and was equal to the fair market value of the transferred property (i.e., Opco common shares) at that time. As the Opco common shares were exchanged for Opco preferred shares pursuant to section 51 or subsection 85(1), this was also the aggregate redemption and retraction value of the Opco preferred shares. The interpretation indicated that the redemption of the Opco preferred shares held by Newco would not reduce the “outstanding amount”.

The calculation of “outstanding amount” is found in paragraph 74.4(3)(a) and starts with the fair market value of the property transferred to the corporation at the time of transfer. Subparagraphs (i) and (ii) provide for amounts which reduce the “outstanding amount” as follows:

(i) The fair market value at the time of transfer, of consideration other than excluded consideration received by the transferor for the property; and

(ii) The fair market value at the time of receipt, of consideration other than excluded consideration received by the transferor from the corporation or a person non-arm’s length with the corporation in exchange for excluded consideration previously received by the transferor as consideration for the (transferred) property or for excluded consideration substituted for such consideration.

Therefore, the “outstanding amount” was equal to fair market value of the Opco common shares which were transferred to Opco which in turn was the same amount as the aggregate redemption and retraction amount of the Opco preferred shares, subject to reduction based on subparagraphs (i) or (ii). The redemption of the Opco preferred shares held by Newco did not result in consideration received by the transferor, X as required by subparagraph (ii). Accordingly, subparagraph 74.4(3)(a)(ii) was not engaged and there was no reduction of the “outstanding amount”.

Although not addressed in the technical interpretation, if Newco common shares held by X had been purchased for cancellation so that X received consideration, it seems that subparagraph 74.4(3)(a)(ii) could have been engaged to reduce the “outstanding amount”. Newco was non-arm’s length with Opco. The requirements of subparagraph (ii) appear to be met because the Newco common shares would have been excluded consideration (i.e., a share of the capital stock of a corporation) which were substituted for the Newco preferred shares which X originally received in consideration of the freeze. Because only consideration other than excluded consideration applies to reduce the outstanding amount, the redemption price or purchase for cancellation price received by X would have to be paid in cash and not by promissory note.[xxix]

With respect to the computation of the imputed interest pursuant to subsection 74.4(2), the technical interpretation indicated that dividends paid by Newco on its common shares held by X would be subtracted in such calculation pursuant to paragraph 74.4(2)(f). Paragraph (f) provides for a reduction in the imputed interest calculation based on taxable dividends received (other than section 84 deemed dividends) by the individual in the year on shares received from the corporation as consideration for the transfer of the property or shares substituted therefor. Dividends paid by Opco on its preferred shares would not be subtracted because paragraph (f) requires the dividends to be received by the individual who transferred property and the Opco preferred shares were held by Newco. Dividends paid on the Newco common shares satisfied the requirements of paragraph (f) because such shares were substituted property for the shares received by X for the transfer of property and X was the holder of such shares.

An alternative means of achieving the same structure could be a subsection 85(1) transfer to the holding company to facilitate a downstream freeze.

Step 1: X could transfer his Opco common shares to Newco in consideration of Newco common shares pursuant to subsection 85(1).

Step 2: Newco as the holder of Opco common shares could exchange such shares for preferred shares pursuant to subsection 86(1).

Step 3: As in the above technical interpretation, the trust would become a common shareholder of Opco.

At first blush, this alternative methodology would appear to not attract the operation of subsection 74.4(4) given that the transfer of property for the benefit of the trust (designated persons) is made by a corporation rather than an individual. However, pursuant to the bask-to-back transfer rule in subsection 74.5(6), the property transferred by X to Newco (being the Opco common shares) in Step 1 which was then transferred by Newco to Opco in Step 2, is deemed to have been transferred by X to or for the benefit of the trust (designated persons).[xxx] Thus, subsection 74.4 could apply, subject to the "small business corporation" exception[xxxi]. If so, and the Newco common shares held by X are purchased for cancellation, it is not clear that the "outstanding amount" is reduced. Although subsection 74.5(6) deems X to have transferred the Opco common shares to the corporation (Opco), there is no deeming rule with respect to consideration received by X.[xxxii] For the same reason, it is not clear that dividends paid by Newco on the common shares held by X would reduce the imputed interest.

Dividend Designation from a Trust

The deceptively simple question: "When will a taxable dividend designated in respect of a beneficiary of a trust pursuant to subsection 104(19) be considered to have been received by the beneficiary?" was addressed in CRA Document Number 2012-0465131E5[xxxiii]. The answer given was that the dividend is considered to have been received at the time that is the end of the taxation year of the trust in which the dividend was received by the trust. This technical interpretation was dated prior to the June 26, 2013 Royal Assent date to Bill C-48 and made no mention of the then proposed (and now enacted) amendment to subsection 104(19).

Little explanation was given other than paraphrasing subsection 104(19) (as it was prior to the enactment of Bill C-48). As amended, the preamble to subsection 104(19) now expressly provides for some degree of timing. The designated amount is deemed to be a taxable dividend received by the taxpayer (beneficiary) in its taxation year in which the particular taxation year of the trust ends. However, as the amended language only addresses the taxation year of receipt, it seems that the technical interpretation is still relevant.

Subsection 104(19) does not expressly state the time in the particular year when the dividend is deemed to be received. The explanation for CRA's position likely lies in what was previously the opening words of subsection 104(19): "received by a trust in a taxation year throughout which it was resident in Canada" and the timing of designation. As amended by Bill C-48, subsection 104(19) continues to have the same "throughout the year" residency requirement in paragraph (b) therein. An analogy may be made to subsection 104(20) which deals with capital dividends received by trust, CRA's administrative position is that the capital dividend is added to the corporate beneficiary's capital dividend account at the end of the trust's taxation year. The reasoning is that as subsection 104(20) requires the trust to be resident in Canada throughout the year, such condition cannot be met until the end of the trust's taxation year and accordingly, the earliest time at which the designation can be made is at the taxation year end of the trust.[xxxiv] Similarly, the earliest time at which a designation can be made under subsection 104(19) would be at the end of the taxation year of the trust and until such designation is made, the taxable dividend character cannot flow through to a beneficiary.

In the case of a corporate beneficiary ("Benco") of a trust, the timing of receipt could have Part IV tax significance. For purposes of this discussion, assume that a trust is the common shareholder of a corporation ("Payer Co") and Benco is a beneficiary of such trust. Payer Co declares a dividend on its common shares held by the trust. The trustees take the necessary action to cause an amount to become payable to Benco and make a designation under subsection 104(19) at the end of the taxation year of the trust. Benco could be subject to Part IV tax in respect of such dividend, depending on whether Payer Co is connected with Benco. Based on the above technical interpretation, as Benco is considered to receive the taxable dividend at the end of the taxation year of the trust, it seems that "connectedness" is tested at the end of the taxation year of the trust. Subsection 186(1) does not specify a time when the payer corporation must be connected with the corporation receiving the dividend. Typically, one would expect the time of declaration and payment by the payer corporation to be the same as the time of receipt by the corporation receiving the dividend so that this would be moot.[xxxv] Based on the above technical interpretation:

If Payer Co is not connected with Benco at the end of the taxation year of the trust, Benco would pay Part IV tax equal to 1/3 of the dividend. Depending on the taxation year end of Benco relative to Payer Co, deferral of the Part IV tax liability may be available. For example, if Payer Co has a November year end; the trust has a December year end and Benco has a November year end, then it appears that a dividend declared and paid by Payer Co. on November 30, 2013 would be considered received by Benco at December 31 2013 and therefore subject to Part IV tax in Benco's taxation year ended November 30, 2014.

If Payer Co is connected with Benco at the end of the taxation year of the trust (December 31 2013), Benco would pay Part IV tax in its November 30 2014 taxation year proportionate to Payer Co's dividend refund for its November 30 2013 year in which it paid the dividend.

Payer Co could be connected with Benco at the time the dividend is paid (to the trust as shareholder), but not be connected at the taxation year end of the trust. For example, dividends might be paid as part of pre-sale tax planning for Payer Co at a time when it is connected with Benco. However, the share sale may close prior to the taxation year end of the trust so that Payer Co and Benco would not be connected at the relevant time.

Capital Dividend received by a trust and CDA

A recent technical interpretation (CRA Document Number 2012-0469591E5[xxxvi])makes it clear that a capital dividend received by a trust in a particular year must be distributed and designated pursuant to subsection 104(20) in the same year in order to be added to the capital dividend account of a corporate beneficiary.

In the particular interpretation, a trust received a capital dividend from a corporation in Year 1, but that amount was not made payable to any beneficiary in the year and no designation was made pursuant to subsection 104(20). The beneficiaries of the trust were individuals, all of whom were "designated persons" as defined in subsection 74.4(5) in respect of "X" such that the amount could not be made payable to the individual beneficiaries. The beneficiaries also included a corporation controlled by "X", but there was apparently no such corporation in existence in Year 1. Such a corporation was incorporated in Year 2. However, CRA held that no amount could be designated by the trust in Year 2 pursuant to subsection 104(20). This means that after the year of receipt of the capital dividend, the ability to pass on the CDA was effectively lost.

The wording of subsection 104(20) refers only to one taxation year:

> "… the amount of a dividend (other than a taxable dividend) paid on a share of the capital stock of a corporation resident in Canada to a trust during a taxation year of the trust that can reasonably be considered … to be part of an amount that became payable in the year to a particular beneficiary …. shall be designated by the trust in respect of the particular beneficiary in the return of the trust's income for the year …"

The taxation year of the trust in which the capital dividend was paid by the corporation must be the same year in which the amount became payable to a particular beneficiary and the subsection 104(20) designation is made in the trust's return for that year.

The technical interpretation provided no explanation for the corporation paying the capital dividend to trust in Year 1, rather than waiting until Year 2 when a corporate beneficiary was in place. If this had been the case, i.e., capital dividend paid to the trust in Year 2, then the subsection 104(20) designation could have been made in Year 2.

Presumably the capital dividend (received in Year 1) would have become trust capital to the trust following the end of Year 1. Thus, the amount could have been distributed as a distribution of capital in Year 2 to capital beneficiaries tax-free. However, a corporate beneficiary who received a distribution of capital without a valid subsection 104(20) designation would not thereby have any addition to its capital dividend account.[xxxvii]

Change of Trustee and Control

Since 2005, CRA's position as set out in CRA Document Number 2004-0087761E5[xxxviii] has been that where a majority of the voting shares of a corporation are held by the trustees of an inter vivos trust, there is a presumption that all of the trustees constitute a group. As a result, a change in any of the trustees results in a new group controlling the corporation and therefore an acquisition of control with all the attendant consequences of same. Based on the foregoing, it would seem that a change of a single trustee in the above situation could result in two deemed year ends pursuant to subsection 249(4) – one upon the resignation or death of a single trustee (as the group will then consist of the remaining trustees) and another upon the appointment of the replacement trustee (as there will be a new group consisting of the replacement trustee plus the remaining trustees).

It has been suggested[xxxix] that the acquisition of control consequence can be managed by making use of the so-called saving provision in subsection 256(7) which deems control not to have been acquired, in enumerated circumstances, for purposes of listed statutory provisions including subsection 249(4) (which would otherwise trigger a year end) and subsection 111(4) (loss streaming). If the trustees of an inter vivos trust have voting control of a corporation and one trustee is replaced by a related person, the issue is whether clause 256(7)(a)(i)(A) might apply to prevent an acquisition of control. In 1993 however, CRA had stated that paragraph 256(7)(a) did not apply in these circumstances.[xl] This clause is reproduced below for ease of reference.

> (a) control of a particular corporation shall be deemed not to have been acquired solely because of
>
> (i) the acquisition at any time of shares of any corporation by
>
> (A) a particular person who acquired the shares from a person to whom the particular person was related (otherwise than because of a right referred to in paragraph 251(5)(b)) immediately before that time.

A recent ruling[xli] involved a fact situation with a change of individual trustees to related corporate trustees. A positive ruling was given with respect to the application of paragraph 256(7)(a). The facts of this ruling were:

- All of the voting shares of a private corporation ("Opco") were held by an inter vivos trust which had apparently controlled Opco since incorporation. Other issued share capital (non-voting common shares) was held by Mr.A and his son, B.
- None of the trustees of the trust were related to one another.
- B was one of the trustees of the trust.
- Under the terms of the trust, a named Protector had the authority to name a replacement trustee in the event of resignation or death of an existing trustee.

The proposed transactions were as follows:

- Each trustee would incorporate a new corporation and become the sole shareholder of the new corporation. Trustee #1 would incorporate Newco #1 and be the sole shareholder of Newco #1. Trustee #2 would incorporate Newco #2 and be the sole shareholder of Newco #2. Trustee #3 would incorporate Newco #3 and be the sole shareholder of Newco #3.
- The change of trustees would happen sequentially.
- Trustee #1 would tender resignation contingent on the appointment of Newco #1 as replacement trustee.
- Then, Trustee #2 would tender resignation contingent on the appointment of Newco #2 as replacement trustee.
- Then, Trustee #3 would tender resignation contingent on the appointment of Newco #3 as replacement trustee.
- Each of Trustee #1, Trustee #2 and Trustee #3 will provide in their respective Wills that their respective shares of Newco #1, Newco #2 or Newco #3 as the case may be, will be bequeathed to a related person.

CRA ruled that pursuant to clause 256(7)(a)(i)(A), control of Opco will be deemed not to have been acquired upon the change of trustee from the individual trustees to Newco #1, Newco #2 and Newco #3 .

Because of the sequential resignations and appointments set out in the proposed transactions, it may be seen that in each change, the replacement trustee was related to the resigning trustee. For example, Trustee #1 resigned and was replaced by Newco #1. Trustee #1 was the sole shareholder of Newco #1 and therefore Newco #1 was related to Trustee #1. Thus, immediately before the resignation, the group of trustees was Trustee #1, Trustee #2 and Trustee #3 whereas immediately following the first resignation and apparently simultaneous appointment, the group of trustees was Newco #1, Trustee #2 and Trustee #3.

Clause 256(7)(a)(i)(A) requires the acquisition of shares of any corporation by a particular person who acquired the shares from a person to whom the particular person was related immediately before that time. Therefore, this saving provision requires Newco #1 to <u>acquire shares</u> of Opco <u>from</u> Trustee #1. While the result of the above ruling is helpful, it is not entirely clear from a strict legal perspective that the new trustee acquires shares from the resigning trustee where there are multiple trustees of the trust. For purposes of associated corporation analysis, CRA has taken the position that where an inter vivos trust holds shares of a corporation, the trustees own the shares. [This is distinct from the operation of the deeming rules in paragraph 256(1.2)(f) which may apply to deem a beneficiary of the trust to own shares held by the trust.] While CRA's position regarding the nature of ownership amongst multiple trustees (proportionate or otherwise) has not been consistent[xlii], the acceptance of ownership by the trustees seems to be in keeping with subsection 104(1) which provides that a reference to a trust or estate shall be read to include a reference to the trustee or executor. .

For trust law purposes, trustees are considered to hold property as joint tenants and are vested with title to the property.[xliii] Joint tenancy has been explained as follows:

> "A joint tenancy is a form of co-ownership giving the joint tenants simultaneous rights to the ownership and possession of the same piece of property. This form of co-ownership has two important characteristics. The first is that where property is held jointly, there is only one title to the underlying realty in which the joint tenants participate concurrently. They do not hold undivided shares. The second is the *jus accrescendi*, or right of survivorship. Immediately on the death of one joint tenant, his interest in the land is extinguished and, by virtue of property law principles, the interest of the surviving tenants in the whole continues regardless of any provision made in the deceased tenant's will."[xliv]

In the case of trustees holding shares of a corporation, the thought that a replacement trustee will have acquired shares from the resigning trustee seems to imply that each trustee has a separate and divisible interest, which is probably contrary to the property law concept of joint tenancy as opposed to co-tenancy. This is however analogous to the manner in which CRA has often treated joint tenants.[xlv] Arguably, each trustee has an interest in the shares (i.e., an undivided interest in the whole) rather ownership of shares or a fraction thereof so that it is an interest in shares (rather than "shares" as specified in paragraph 256(7))(a)) which the replacement trustee acquires from the resigning trustee.

The ruling is also interesting in its proposed use of corporations as trustees. While beyond the scope of this paper, use of a private corporation as a trustee of an inter vivos trust has been the subject of commentary[xlvi] and may assist in avoiding the replacement trustee/acquisition of control issue as the corporate trustee(s) can continue. Instead, ownership of the shares of such a corporate trustee will have to be addressed.

Part IV Tax/Denied Dividend Refund

CRA Document Number 2012-0436181E5[xlvii] was released subsequent to the Tax Court of Canada decision in *Tawa Developments Inc. v. The Queen* [xlviii]. CRA has maintained its administrative position that there is a reduction to the payer corporation's RDTOH where dividends are paid in a taxation year, notwithstanding that the payer corporation does not receive an actual refund because it failed to file its return within three years of the end of such taxation year as required by subsection 129(1).

Tawa was the subject of commentary in the 2011 Ontario Tax Conference.[xlix] In *Tawa*, the appellant was a CCPC which received taxable dividends from a connected corporation in the amount of $321,414 in its 2004 taxation year. The appellant also paid dividends to its shareholders (who were not corporations) in the amount of $321,414. In its 2004 tax return, the appellant reported Part IV tax of $107,138 and claimed a dividend refund in the same amount. The appellant's taxation year end was December 31 and its 2004 tax return was filed on or about January 15, 2008 – more than three years following the end of its 2004 taxation year end. The Minister denied the dividend refund.[l]

The Tax Court of Canada upheld the Minister's reassessment finding that subsection 129(1) which governs the Minister's jurisdiction to issue a refund, contains a condition that a tax return for the taxation year be filed within three years after the end of that year. In *Tawa*, the appellant missed the three year deadline.

A large portion of the Tax Court judgement addressed the issue of whether the appellant's RDTOH account should be reduced by the amount of the dividend refund which it failed to receive. The Tax Court held that there should be no such reduction. In CRA Document Number 2012-0436181E5, this portion of the judgement in *Tawa* was distinguished as being obiter.[li] This seems technically correct. RDTOH is computed at the end of the taxation year of the particular corporation and is reduced by the corporation's dividend refund for the preceding year.[lii] In *Tawa*, it was the appellant's 2004 taxation year which was reassessed. The dividend refund (if any) for its 2004 taxation year would be deducted in computing RDTOH at the end of Tawa's 2005 taxation year but would not be relevant to the computation of RDTOH in Tawa's 2004 taxation year being the year under appeal.

Based on the above technical interpretation, CRA's current administrative position is that where a CCPC does not meet the condition in subsection 129(1), i.e., does not file its return within three years from the end of its taxation year, the corporation will not receive a refund and notwithstanding same, the denied refund amount will not be added back to the corporation's RDTOH.[liii]

The crux of CRA's position is that the term "dividend refund" is a notional amount and notwithstanding the inclusion of the word "refund" within the term, it does not connote or require an actual refund. Rather, "dividend refund" is essentially a defined term equal to the lesser of the two amounts listed in subparagraphs (i) and (ii) of paragraph 129(1)(a):

(i) 1/3 of all taxable dividends paid by the corporation of shares of its capital stock in the year at a time when it was a private corporation; and
(ii) its refundable dividend tax on hand at the end of the year.

If the denied amount was simply added back to the corporation's RDTOH, then the corporation could declare and pay the appropriate taxable dividend in a subsequent year, file its corporate tax return within three years of the end of such subsequent year and receive a refund of the amount. In other words, the three year condition in subsection 129(1) would not seem to have any meaning.

The particular technical interpretation also addressed the question of whether a dividend recipient corporation must pay Part IV tax on a dividend from a connected payer corporation if a dividend refund is not paid to the payer corporation which failed to meet the three year condition in subsection 129(1). CRA's answer was "yes". Paragraph 186(1)(b) charges Part IV tax on dividends received from connected corporations "equal to that proportion of the payer's corporation's dividend refund (within the meaning assigned by paragraph 129(1)(a)) for its taxation year in which it paid the dividend". CRA's position was that the term "dividend refund" is simply the lesser of the two amounts listed in subparagraphs (i) and (ii) of paragraph 129(1)(a) and not based on actual receipt of a refund amount. If paragraph 186(1)(b) is read in this manner, it can be seen that the charge to Part IV tax depends on the payer corporation's dividend refund as a notional amount rather than the payer corporation's receipt of an actual refund.

Amendment to prior year's capital cost allowance

Recent technical interpretations addressed the vexing issue of amendments to returns for statute-barred taxation years with little resulting clarity.

It has been said that the Minister of National Revenue cannot be compelled to accept an amended return or to act upon it if he chooses not to.[liv] Further, an amended return for a taxation year for which a notice of assessment has been issued does not trigger the obligation in subsection 152(1) to assess with all due dispatch. An amended return has been described as "simply a request that the Minister reassess for that year".[lv]

But the Minister can make changes to balances arising in statute-barred years. This is the so-called *New St. James* principle from the case of the same name.[lvi] Although the "normal reassessment period" prevents the Minister from reassessing the tax in respect of a statute-barred taxation year, carry forward balances can be recomputed even where the balance derives from a statute barred year. In *New St. James*, the taxpayer's 1955 taxation year was statute barred, but the Minister considered that certain amounts should have been capitalized rather than currently deducted and adjusted the loss carry forward balance which the taxpayer sought to apply in subsequent open taxation years.

The result in *New St. James* suggests that adjustments may be made to statute barred years, provided that the adjustments do not affect the assessment of tax of such years.

In *Clibetre Exploration Ltd. v. The Queen*[lvii], the taxpayer had losses for each of its 1980-1995 taxation years. In 1996, it had income. The carry forward of the maximum permissible seven years of non-capital losses did not fully shelter the income The taxpayer requested that the expenses which had given rise to the non-capital losses for its 1980-1995 taxation years be recharacterized as Canadian exploration expenses. This would have resulted in a cumulative Canadian exploration expense balance at the end of its 1995 taxation year and its 1996 income could then be fully sheltered. The Tax Court held that because certain years were statute barred, the Minister could not recharacterize the expenses as requested. The Federal Court of Appeal found that there was no statutory bar to the requested recharacterization, because the taxable income and tax payable would be nil whether the expenses were treated as deductions from income resulting in a non-capital loss or as Canadian exploration expenses.

In a recent technical interpretation (CRA Document Number 2013-0474111I7[lviii]), the taxpayer proposed to amend its returns to make use of the rule in subsection 111(5.1). The taxpayer had been subject to an acquisition of control. It had non-capital losses which had expired and sought to "refresh" such losses in the following manner. The taxpayer proposed to amend prior years' returns to "un-claim" capital cost allowance thereby increasing its undepreciated capital cost allowance balances. While the "un-claiming" would have decreased the non-capital losses for the particular years being amended, the increased undepreciated capital cost balance would be subject to subsection 111(5.1) upon the acquisition of control. As a result, the "unclaimed" CCA would effectively be converted into non-capital losses of the year ended immediately before the acquisition of control. While *New St. James* and *Clibetre* might appear to support the proposed amendment as there would have been no change in the assessment of tax for the statute barred years, the technical interpretation distinguished *Clibetre* as a case where the taxpayer had made an error (deducting the amounts as current expenses rather than as CEE) for which correction was subsequently requested. In the case at hand, CRA's view was that the taxpayer had made no error but rather had chosen to take a permissive deduction, i.e., CCA. The proposed amendment was refused.[lix]

This may be contrasted with the taxpayer positive result in CRA Document Number 2012-0459341I7[lx]. The taxpayer had deducted non-capital losses from prior years to reduce taxable income to nil in its 2003-08 taxation years. These years were statute barred. The taxpayer proposed to claim business expenses which had not previously deducted in those statute barred years and substitute same for non-capital losses previously claimed. While this would not change taxable income or tax payable in the statute barred years, the non-capital loss carryforward available in the current year would increase. The *Clibetre* case was cited as support for the proposition that CRA "substitute" the business expenses for non-capital losses. The proposed amendment was found acceptable.

Clearly, CRA applies *Clibetre* on a restricted basis; an error is required rather than a choice. CRA's published policies with respect to revision of capital cost allowance claims and other permissive deductions as set out in Information Circular 84-1[lxi] and the CRA Audit Manual[lxii] do not seem as restrictive.

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[i] March 27, 2013.

[ii] August 6, 1974.

[iii] See "Revenue Canada Round Table," in Report of Proceedings of the Forty-Second Tax Conference, 1990 Conference Report (Toronto: Canadian Tax Foundation, 1991), 50:1-68, question 58 and CRA Document Number 2013-0480291C6, 2013 STEP Roundtable Q.7.

[iv] 92 DTC 6382 (FCA).

[v] See CRA Document Number 9225295, December 9, 1992, "Attribution rules" which stated that if the trust paid fair market value for the new common shares, then there was no transfer of an economic interest based on *Kieboom*. There was no mention of a PAC. See also Joan E. Jung, "Price Adjustment Clauses Under Attack?" (2011) vol. 11, no. 2 *Tax for the Owner Manager*, 1-3.

[vi] See CRA Document Numbers 2010-0366301I7, November 2, 2013, "Attribution of trust income and gain" and 9832385, October 13, 1999, "Attribution to contributor to trust".

[vii] CRA Document Number 2012-0453891C6 (French only), October 5, 2012, "Price adjustment clause".

[viii] See paragraph 1 of Interpretation Bulletin IT-169 and paragraph 1.1 of Folio S4-F3-C1.

[ix] See Summary of Folio S4-F3-C1.

[x] Paragraph 168(1)(h) of the Business Corporations Act (Ontario), R.S.O. 1990, c.B.16 as amended ("OBCA") provides that a corporation may amend its articles to change the shares of any class into the same or different number of shares of other classes. Thus, the necessary class of preferred shares could be created and the change of shares from one class to another could be implemented by Articles of Amendment without the need for a separate share exchange agreement. Prior to amendments to the OBCA in 2007, it may have been preferable to effect the change (from one class of share to another class) by way of Articles of Amendment rather than a separate share exchange agreement, as the statute expressly provided for the stated capital reduction of the one class to be added to the stated capital of the other class (see subsection 35(4)). However, a share exchange agreement would typically result in a new share issuance with the addition to stated capital being limited only in the circumstances set out in the statute. Prior to the 2007 amendments, generally only non-arm's length share issuances could result in a limited addition to stated capital (i.e., less than fair market value) which was typically desirable to match stated capital and paid-up capital. However, subparagraph 24(3)(a)(iii) of the OBCA now permits a limited addition to stated capital upon the issuance of shares in arm's length circumstances, subject to a consent requirement. Accordingly, there seems to be no compelling reason to favour a section 86 share capital reorganization with or without a share exchange agreement.

[xi] See CRA Document Number 2003-0004125 (French only), April 1, 2003, "Freeze by paying a stock dividend".

[xii] See Jack Bernstein, "Valuation and Related Tax Issues, Part 1" Report of Proceedings of the Sixty-Third Tax Conference, 2011 Tax Conference (Toronto: Canadian Tax Foundation, 2012), p.17:25/26/27.

[xiii] For example, if the freezor holds all of the common shares of the corporation, Articles of Amendment could be filed to create 10,000 Class A shares (being the preferred shares to be used to pay the stock dividend). The authorized capital of the Class A shares should be capped so that such shares shall be single purpose and all issued in one issuance. The aggregate redemption and retraction amount of the 10,000 Class A shares could be defined to be equal to the fair market value of the issued and outstanding common shares immediately prior to the first issuance of Class A shares. In this manner, by definition, such 10,000 Class A shares should have an aggregate redemption and retraction value equal to the freeze value. Then, such 10,000 Class A shares could be paid as a high-low stock dividend as permitted by subsection 38(2) of the OBCA with a nominal amount added to the stated capital account in respect of the Class A shares.

[xiv] May 24, 2012, "Price adjustment clause". See discussion of this technical interpretation by P. Robert Arkin, "Price Adjustment Clauses — Selected Issues," 2012 Atlantic Provinces Tax Conference, (Toronto: Canadian Tax Foundation, 2012), 3: 1-15.

[xv] CRA Document Number 2011-0429991E5 also stated that if the price adjustment clause was not valid, then subparagraph 152(4)(a)(ii) could be considered with respect to the taxation year in which the estate freeze was implemented. The undervaluation in connection with the estate freeze could be a misrepresentation attributable to neglect, carelessness or willful default such that the earlier taxation year would not be statute barred. See *Petric v. The Queen*, 2006 TCC 306 (TCC) where a similar argument was made, albeit not in the context of an estate freeze.

[xvi] See Jeffrey R. Blucher, “Safe Income Strips”, *Tax Hyperion* Vol. 8, No. 10, October 2011 for discussion of use of discretionary dividend shares to stream safe income in pre-sale planning.

[xvii] Although outside the scope of this paper, the issue is one of valuation once there is a history of dividend payments on the discretionary dividend shares. Reference might be made by analogy to *Boulet v. The Queen* 2010 DTC 1015 (TCC) as discussed in Joshua L. Harnett, “Fair Market Value in a Restricted Market”, Vol. 22, No.1 (November 2011) of the OBA Taxation Law Section Newsletter.

[xviii] See Charles P. Marquette, "Share Capital Attributes: Corporate and Tax Issues" in "Personal Tax Planning," (2009), vol. 57, no. 3 *Canadian Tax Journal*, 607-631 at p.617.

[xix] October 5, 2012, APFF Question 12.

[xx] See CRA Document Numbers 2010-0364131E5, May 19, 2010, “Issuance – discretionary shares” and 2002-0179095, March 11, 2003, “Issuance – discretionary shares non consideration”.

[xxi] See prior discussion of price adjustment clauses. Although the use of a section 51 or 86 reorganization should assist in addressing the valuation issue and related subsection 15(1) benefit concern, one must be mindful of subsection 74.4(4) depending on whether the holder of the discretionary dividend shares is a “designated person” in respect of the freezor.

[xxii] 2008 DTC 3807 (TCC). The taxpayer lost on the basis of subsection 56(2). Father was the CEO and controlling shareholder of a private corporation. Father had an employment agreement with the corporation which set out the terms of his compensation for the year, including the payment of $36,000 dividends on the Class D shares of the corporation. Father held one (1) Class D share. Father caused one (1) Class D share to be issued to each minor daughter. The agreed upon $36,000 dividend was paid to the three Class D shareholders – being father and the two minor daughters, except that the dividend amount payable to the daughters was deposited in father’s account.

[xxiii] See Question 13 of “Revenue Canada Round Table,” in *Report of Proceedings of the Thirty-Second Tax Conference*, 1980 Conference Report (Toronto: Canadian Tax Foundation, 1981), 591-628, at p. 602. But also see discussion in *Taxation of Private Corporations*, 4th edition (Canadian Tax Foundation) p.3-29.

[xxiv] See paragraph 110(1)(k). The deduction of 3.5 times the Part VI.I tax should provide a full offset where the corporate tax rate is at least 28.5%. In Ontario, as the general combined federal/Ontario rate is 26.5%, Part VI.1 tax imposes a cost.

[xxv] See definition of the term “excluded dividend” in subsection 191(1) and the charging provision for Part VI.I tax in subsection 191.1(1) which excludes an “excluded dividend”.

[xxvi] Subparagraph 251(2)(b)(iii) does not specifically contemplate a group of persons but rather deems any person related to the person who controls the corporation, to be related to the corporation.

[xxvii] Note that paragraph 191(3)(d) contains extended deeming provisions so that a person is deemed related to a niece or nephew.

[xxviii] July 31, 2012, “Attribution rules – transfer to corporation” (French only). See summary in CRA Views in Focus (August 29, 2012) and Tax Topics no. 2122 (Toronto: CCH Canadian, November 8, 2012).

[xxix] See also CRA Document Number 2001-0063305, March 19, 2002, “Outstanding Amount”.

[xxx] The so-called "back to back" rule has been the subject of some commentary. See Paul Festeryga, "Corporate Attribution – The Anti-Freeze Rule", (2010) *Canadian Tax Journal* vol.3, p. 675.

[xxxi] See discussion in Festerya, *ibid*, p.682-3.

[xxxii] Paragraph 74.5(6)(d) deems the consideration received by the third party (Newco in this case) for the transfer of property to have been received by the individual (X in this case). But this is expressly stated to be for the purposes of subsection 74.5(1), rather than for all purposes or indeed for purposes of section 74.4.

[xxxiii] January 14, 2013, "Dividend designation from a trust".

[xxxiv] See CRA Document Numbers. 2010-0363191C6, June 8, 2010, "Capital dividend account – beneficiary of a trust" and 2010-0358471E5 (French only), May 3, 2010, "Capital dividend account – beneficiary of a trust".

[xxxv] In the case of the redemption of shares resulting in a deemed dividend under subsection 84(3), CRA's administrative policy as set out in Interpretation Bulletin IT-269R4, "Part IV Tax on Taxable Dividends Received by a Private Corporation or a Subject Corporation", April 24, 2006, paragraph 17 is to look to "connectedness" immediately before the redemption.

[xxxvi] May 14, 2013, "Capital dividend received by a trust and capital dividend account". See also Georgina Tollstam, "CDA Trapped in Trust", (2013) vol. 21, no. 8 *Canadian Tax Highlights*.

[xxxvii] See paragraph (g) of the definition of "capital dividend account" in subsection 89(1). Such an amount could be considered to be a "distribution made by a trust to the corporation in the period <u>in respect of</u> a dividend (other than a taxable dividend) paid on a share of the capital stock of another corporation" so as to fit in the opening words of paragraph (g). This is based on the broad interpretation accorded to the phrase "in respect of". However, the addition is limited to the lesser of (i) the amount of the distribution; and (ii) the amount designated under subsection 104(20) by the trust in respect of the corporation in respect of the dividend. In this scenario, the latter would be the lesser amount as no subsection 104(20) designation could be made.

[xxxviii] May 24, 2005, "Acquisition of control – replacement of trustees". The technical interpretation acknowledged that a determination of which trustee or group controls the corporation can only be made after consideration of all relevant facts. It could be said that the above was CRA's position since 1993 but there were two contradictory 1993 technical interpretations (see CRA Document Numbers 9307165, July 28, 1993 and 9319425, August 6, 1993). See also Income Tax Technical News No. 34, April 27, 2006 where CRA clarified that the position in Interpretation Bulletin IT-302R3, paragraph 10 only applies to the case of an estate and not an inter vivos trust and in any event, indicated that consideration would be given to withdrawing the position in the next revision of the bulletin in light of certain legislative changes subsequent to the date of the bulletin. The above was confirmed at the CRA Round Table at the 2007 STEP Conference, Question 12 (CRA Document Number 2007-0240431C6, June 8, 2007) and Income Tax Technical News No. 38, September 22, 2008.

[xxxix] See R. Daren Baxter, "Current Issues in Trust and Estate Planning," Report of Proceedings of Sixtieth Tax Conference, 2008 Tax Conference (Toronto: Canadian Tax Foundation, 2009), 34:1-33 at p. 34:12-13 and Mary Anne Bueschkens, "Trusts: Practical Issues, Uses, and Pitfalls," Report of Proceedings of Fifty-Eighth Tax Conference, 2006 Tax Conference (Toronto: Canadian Tax Foundation, 2007), 34:1-29 at p.34:12.

[xl] CRA Document Number 93194525, August 6, 1993, "Acquisition of Control" stated in part as follows: "Paragraph 256(7)(a) of the Act envisages an acquisition, redemption or cancellation of the shares of a corporation. In a situation such as the one described in your letter, where a trust owns the shares of a corporation and where there is merely a change in the trustees of the trust, it is our view that the paragraph has no direct application."

[xli] CRA Document Number 2010-0360921R3.

[xlii] In the associated corporation context, CRA's positions have been 100% ownership by each trustee (CRA Document Number 2005-0111731E5, July 4, 2006, "Ownership of shares held in a trust"); pro rata ownership by each trustee (CRA Document Number 2008-0285021C6, October 10, 2008, "Associated corporations and trustees"); and ownership as a group (CRA Document Number 2009-0330271C6, December 9, 2009, "Associated corporations and trust").

[xliii] See Waters' Law of Trusts in Canada, 4th Ed., at 15.VI.A While section 9 of the Trustee Act (Ontario), R.S.O. 1990, c.T.23 provides for a statutory vesting of title to property upon the appointment of a new trustee, this expressly does not apply to the shares of a corporation. As a result, the procedures and requirements for registration are dependent on the relevant corporate statute.

[xliv] See Catherine Brown, "The Taxation of Jointly Owned Property", (1984) vol. 32, no.5 *Canadian Tax Journal*, 870-885, at o.871.

[xlv] See Maureen De Lisser, "Update on the Taxation of Jointly Owned Property" in "Personal Tax Planning," (2008), vol. 56, no. 2 *Canadian Tax Journal*, 511-533 at p.520.

[xlvi] See Sheila M. Crummey, "Using a Private Company as Trustee in Ontario", a presentation at the 2013 National Conference of the Society of Trust and Estate Practitioners (Canada).

[xlvii] October 18, 2012, "Part IV tax/denied dividend refund".

[xlviii] 2011 TCC 440.

[xlix] See Paul Bleiwas, Jesse Brodlieb and Alexandra Brown, "2011 Case Law Update" in 2011 Ontario Tax Conference. See also Ryan Adkin, "Denied Refund Reduces RDTOH?" (2011) vol. 19, no. 11 *Canadian Tax Highlights.*

[l] See *Nacom v. The Queen* 2013 TCC 90 for an example of the application of the three year deadline.

[li] See *Ottawa Ritz Hotel Company v. The Queen* 2012 DTC 1172 (TCC), paragraph 5 in which this obiter statement was applied although the taxpayer's RDTOH balance was not in issue. In this case, like *Tawa*, the taxpayer failed to meet the three year condition in subsection 129(1). The taxpayer paid a dividend in its March 31, 2007 taxation year but did not file its 2007 tax return until Jun 5, 2010. The matters under appeal were the denied refund and a subsection 162(2) penalty.

[lii] See paragraph (d) of the definition of refundable dividend tax on hand in subsection 129(3).

[liii] See also CRA Document Numbers 2002-0132427 (French only), June 28, 2002, "Refundable dividend tax on hand" and 2004-0098611E5, December 1, 2004, "Subparagraphs 129(1)(a)(i) and (ii)".

[liv] *Imperial Oil Ltd. v. The Queen* 2003 DTC 179, paragraph 38.

[lv] *Armstrong v. The Queen*, 2006 DTC 6310 (FCA), paragraph 8.

[lvi] *New St. James Ltd. v. MNR*, [1966] Ex. CR 977 (Exchq. Ct.).

[lvii] 2003 FCA 16.

[lviii] March 25, 2013, “Amendment to prior years’ capital cost”.

[lix] CRA Document Number 2010-0352901I7, July 7, 2010 “Re-characterising expenses of statute-barred years” is similar with the same emphasis on “permissive deductions”.

[lx] December 11, 2012, “Adjustments Beyond Normal Reassessment Period”.

[lxi] July 9, 1984, “Revision of capital cost allowance claims and other permissive deductions”, paragraphs 9-10.

> 9. If a taxpayer requests a revision of capital cost allowance claimed in a year that was assessable to tax, such requests will be acceded to only if the time has not expired for filing a notice of objection in respect of that year (i.e. 90 days from the day of mailing of the notice of assessment or reassessment for that year) unless the comments in 8 above apply. If, however, circumstances are such that the request for revision of capital cost allowance claimed in a year accompanies a request for an offsetting change in some other “permissive” deduction, the result of which is that no change occurs in the assessed tax for that year (or any other year for which the 90 day time-limit has expired), such requests will ordinarily be acceded to.
>
> 10. Where a taxpayer requests a revision of capital cost allowance claimed in a taxation year for which a notification that no tax is payable had been issued (e.g. because of a non-capital loss in that year, the application of a non-capital loss of another year, or the fact that income was exempt from tax in that year), such request will be allowed provided there is no change in the tax payable for the year or any other year filed, including one that is statute barred, for which the time has expired for filing a notice of objection. Such request will not be allowed, however, where after February 24, 1977 the Minister has issued a notice of determination pursuant to subsection 152(1.1). A taxpayer who wishes to revise the capital cost allowance in a year for which a notice of determination has been issued should do so within 90 days from the day of mailing the notice of determination for that year.

[lxii] See Section 12.1.2, “Specific Audit Guidelines and Checklists”, Taxpayer Requests.