Life is a Highway: Another Update

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The old Tom Cochrane anthem conjures up a different meaning to us tax drones - more like a highway of ceaseless new developments. This article updates some of the topics I have been discussing in recent articles.

Everyday is a Winding Road: Eligible Dividends

As is the case with my other recent articles, there have been a number of new developments on the eligible dividend front. The reason why I am making such a big deal about this is that the eligible dividend regime can be fundamental to tax planning for affluent businesses. While it used to be the case that the best strategy could be to bonus-down to the small business limit, decreasing corporate tax rates have altered the equation. As the general business rate drops, it makes more and more sense to retain income at the corporate level. Although there could be a degree of double-taxation if dividends are paid, the eligible dividend regime is meant to address this problem, allowing owner-managers to reap the benefits of the deferral afforded by lower corporate rates, without a big double tax penalty on eventual distributions. Yes, there could be drawbacks to this strategy, including loss of refundable ITCs and complications from Ontario's claw-back, but nevertheless, the decision to bonus down to the small business limit is worth revisiting, especially since the advent of eligible dividends.

Since I last commented on this topic, B.C. and Alberta announced the details of their provincial legislation, with both provinces following the feds. Effective for 2006 and subsequent years, B.C.'s tax rate on eligible dividends drops to 18.42% in the top tax bracket, while Alberta's enriched dividend tax credit phases in. By 2009, Alberta provincial tax on eligible dividends will be eliminated, leaving only a top federal tax rate of 14.55%; of course, this is noteworthy news, given the trust structures and the like that have been popular in recent years.[1]

With the majority of provinces now weighing-in, the picture that emerges is a fairly-disparate range of taxes on eligible dividends, from the Alberta low to Quebec, with a tax rate of just under 30%. (Nova Scotia is opting out of the system, so that its top tax rate on both eligible and ineligible dividends exceeds 33%.)

On October 16th, the Department of Finance released revisions to its draft legislation. A major change is an attempt to fix the "stub period" GRIP calculation[2] to take into account dividends paid within corporate groups. (GRIP is the tax account that enables Canadian-Controlled Private

Corporations to pay eligible dividends.) Although dividends paid during the stub period still reduce GRIP, there is now an add-on in respect of dividends received from a connected corporation or through a chain of connected corporations, where the dividend may reasonably be considered to be attributable to income that was subject to the general corporate rate[3]. Just a week later, the CICA-CBA Joint Committee released a submission on the original eligible dividend proposals[4] chock-full of issues, not the least of which is that the aforementioned stub period calculation omits income eligible for the M&P rate. As it turned out, the October 16th version of legislation actually included M&P income in the stub period GRIP. But this is only for 2004-2006, when the general tax 7% reduction had fully phased in so that there would no longer be a federal benefit to M&P. In the previous years - where there was a fairly modest benefit - it seems to be excluded.

Highway to Hell?

No update of mine would be complete if I didn't *kvetch* about the Ontario's commercially-challenged government. Ontario's tax rate on eligible dividends will be nearly 8 points higher than Alberta (22.38%) when the tax credit changes are finally phased-in in 2010. With the dollar continuing to batter the manufacturing sector, it seems that Ontario is getting it on all fronts including Toronto traffic being singled out as a major business problem.[5] Even Bob Rae has publicly repented his tax-and-spend ways at Ontario's helm – but the McGuinty regime just doesn't get it.

To be fair, there has been some progress made on the federal/Ontario tax collection front[6], with a Memorandum of Agreement announced early in October (available on the Department of Finance web site: www.fin.gc.ca). The MOA indicates that single corporate tax installments would commence in February 2008 (in respect of taxation years ending after December 31st, 2008), with a single corporate tax return commencing in January 2009. However, the document is vague as to when the double-audit jeopardy faced by Ontario corporations will end, and there are details of the arrangement still to be ironed out. For example, the Memorandum of Agreement does not address whether there will be a single assessment limitation period.[7]

Pit Stop: *Imperial Oil*

Another Supreme Court of Canada verdict was handed down last month. This time, the verdict did not deal with GAAR. (Or did it? See below.) *Imperial Oil*[8] dealt with whether foreign exchange losses incurred on the redemption of debt obligations could be deducted under paragraph 20(1)(f) (re obligations issued at a discount). In a 4/3 decision, the top court held that they could not and that the losses must be determined under the capital gains rules. This conclusion was reached by applying the textual/contextual/purposive ("TCP") approach that the court had championed in the *Canada Trustco/Kaulius* GAAR cases[9]. In other words, this approach applies not only in determining whether a transaction is abusive under GAAR[10], but also in ordinary cases involving

statutory interpretation[11]. But does TCP auger well in terms of certainty, or (along the lines pointed out in previous articles) is it more like beauty - in the eyes of the beholder? There's no better clue than the *Imperial Oil* case itself, with three judges decreeing that foreign exchange fluctuations can fall within paragraph 20(1)(f), and four judges decreeing they can't.

If TCP heralds a more expansive approach to statutory interpretation, one might ask where this leaves off and GAAR begins. GAAR also focuses on the element of abuse, but will this also be built into non-GAAR cases? We will find out more as we move along the post-*Canada Trustco/Kaulius* path, and whether it turns out to be a long and winding road - to uncertainty.

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[1] I have heard that Quebec has attacked a conventional Alberta trust structure.

[2] I.e., for taxation years ending after 2000 and before 2006.

[3] The broadly-drafted amendment to proposed subsection 89(7) shows that the Department of Finance is trying to keep the proposals as simple as possible.

[4] I.e., as released on June 29th, available at www.cba.org and other web sites.

[5] A streetcar project has made crossing St. Clair Avenue – a dividing line between home and office – a log jam for years to come.

[6] See also "The Budget and Ontario's Economy – Marked for Death?", by the author (*Tax Notes*, April).

[7] A government official I spoke to was not in a position to clarify this point.

[8] *Imperial Oil Ltd.* v. *Canada*; *Inco Ltd.* v. *Canada,* 2006 SCC 46.

[9] *Canada Trustco Mortgage Co.* v. *Canada*, 2005 DTC 5523; *Mathew* v. *Canada*, 2005 DTC 5538.

[10] I.e., by using TCP to devine the object, spirit and purpose of a provision.

[11] For lower court cases using this approach, see "Anniversary Waltz", in last month's edition of *Tax Notes.*