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Tax Perspectives

Review of 2024 and 2025 Outlook

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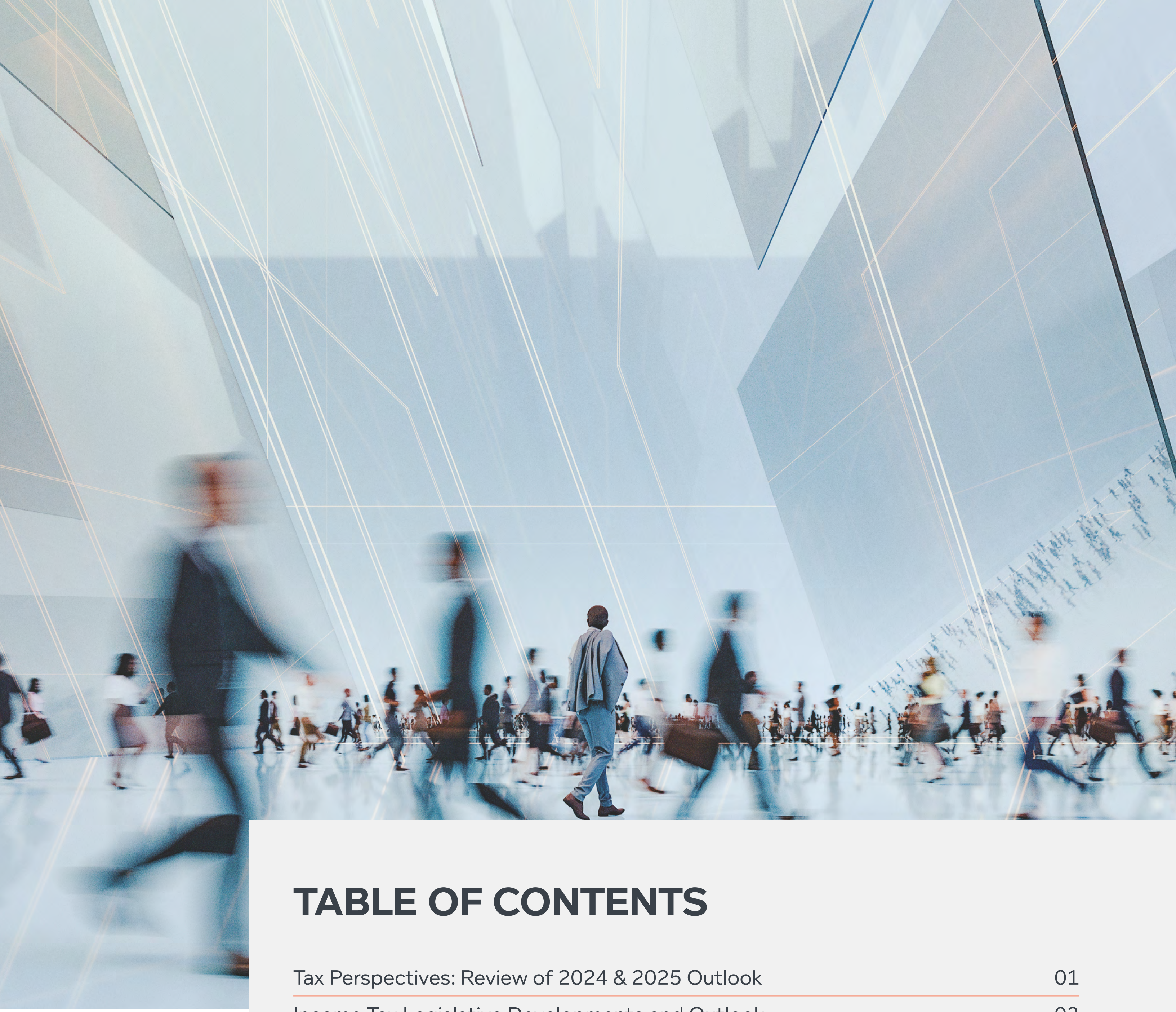
Authors:
Matt Kraemer, Adam Unick, Sara Baxter, Dominic Bédard-Lapointe, Hubert Cadotte, Robert Celac, Giorgina Chum, Stephanie Dewey, Mike Dolson, Simon Douville, Daniel Downie, Kassandra Grenier, Erica Hennessey, Jeremy Ho, Micky Hoskin, Kabir Jamal, Almut MacDonald, Emma Murin, Al-Nawaz Nanji, Fred Purkey, Erich Schultze, Randy Schwartz, Suhaylah Sequeira and Jesse Waslowski



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Tax Perspectives: Review of 2024 & 2025 Outlook

Over the past few years the Government of Canada ("Government") has been active in its commitment to further tax reform by introducing legislative proposals, draft legislation and technical amendments to Canadian tax law addressing a wide range of tax measures. Although 2024 saw a slower pace of legislative proposals announced by the Government than 2023, we continued to see a steady stream of draft legislation released by the Department of Finance ("Finance"), consultation with Canadians on draft legislation, and, in some cases, revised draft legislation implementing prior proposals. As we move into 2025, the activity of 2024 has already been overshadowed by the prorogation of Parliament announced on January 6, 2025.

2024 saw the enactment of two significant packages of legislation that were tabled in Parliament in late 2023, bringing into effect many of the tax measures announced by the Government over the past few years. Although this legislation finally came into force, the Canadian tax community continued to spend much of 2024 engaging with the recent legislative changes to advise clients of the impact of dramatically different rules than only a few years ago.

On January 6, 2025, Prime Minister Justin Trudeau announced that he will resign as Prime Minister and leader of the Liberal Party of Canada and that the Governor General, Mary Simon, had granted his request to prorogue Parliament until March 24, 2025. Subject to certain exceptions, the prorogation of Parliament means the termination of all Parliamentary business. This means that any Bill that was tabled in Parliament and that had not received royal assent before prorogation is terminated and must be reintroduced in the next session of Parliament as if it had never been tabled (unless the House of Commons unanimously consents otherwise). Prorogation also creates significant uncertainty for any government proposals that were announced or for which draft legislation had been released before Parliament was prorogued.

The prorogation of Parliament creates significant uncertainty regarding whether the Budget 2024 proposal to increase the capital gains inclusion rate from 1/2 to 2/3 for capital gains realized on or after June 25, 2024 (and related proposals) will ever be tabled again and passed into law. The proposed introduction of the clean electricity investment tax credit and electric vehicle supply chain investment tax credit are also in significant jeopardy of never being passed into law. Further, it is questionable whether proposals to expand the property eligible for the clean technology investment tax credit, clean technology manufacturing investment tax credit and the clean hydrogen investment tax credit will be advanced. At this time it is unclear whether such proposals will go ahead in the next session of Parliament or ever become law. This uncertainty is further compounded by the fact that 2025 is a federal election year in Canada and the possibility that a different party from that which was governing at the time these proposals were introduced may form the next government. We have included discussion of these proposals below.

This article provides an overview of the important Canadian legislative and judicial tax developments of 2024, and looks ahead to potential significant Canadian tax changes in 2025. This article does not attempt to be comprehensive but highlights those developments we consider to be most impactful to a broad audience of our clients. This article describes proposed tax changes that may be affected by prorogation of Parliament and a potential change in government (including those noted above). As mentioned above, there is currently significant uncertainty as to whether such proposed tax measures will ever become law and Canadian taxpayers will be tasked with navigating that uncertainty in 2025. It will therefore be important to watch the development of these proposed measures carefully as the year progresses and the situation in Parliament becomes clearer.

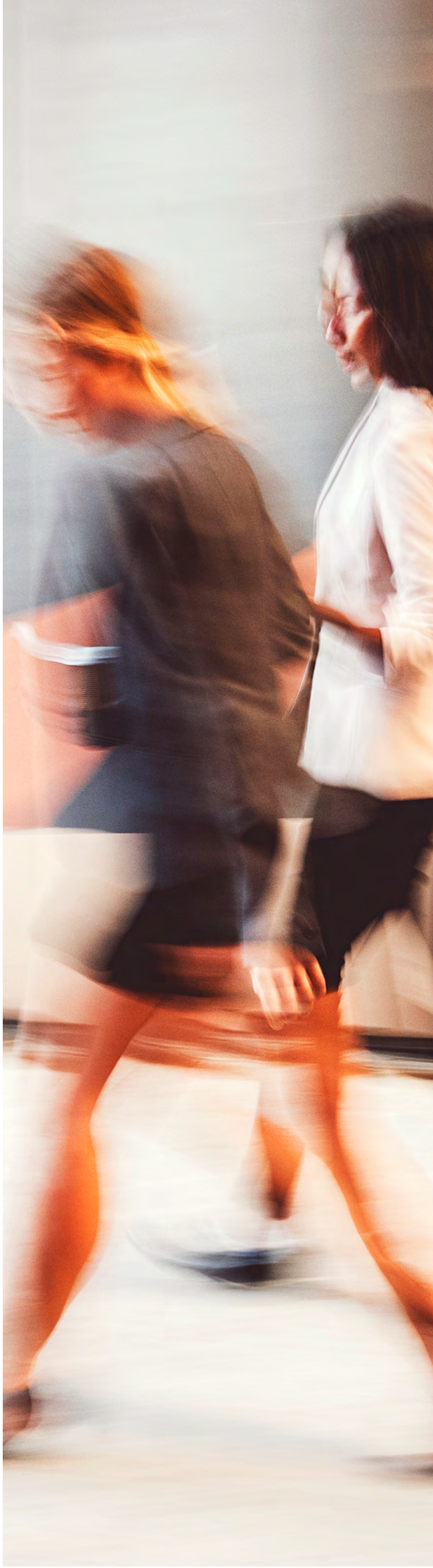
Our commentary regarding the proposed changes to the capital gains regime reflects the changes as proposed in the Notice of Ways and Means Motion tabled on September 23, 2024. The Government's announcement on January 31, 2025, to, among other things, defer the implementation of the increase to the capital gains inclusion rate until January 1, 2026 would modify such proposals.

Our commentary is divided into sections as follows:

— Income Tax Legislative Developments and Outlook

— Commodity Tax Developments and Outlook

— Tax Disputes and Litigation Developments and Outlook



Income Tax Legislative Developments and Outlook

The significant volume of new proposals and draft legislation and tabled legislation implementing previously announced proposals included the following.[1]

— On January 31, 2024, Finance released consultation papers regarding **cost-neutral ways to modernize and improve the scientific research and experimental development program** and the **suitability of creating a patent box regime in Canada**. The consultations ran from January 31, 2024, to April 15, 2024.

— On February 19, 2024, the Organisation for Economic Co-operation and Development ("OECD") and G20 inclusive framework on base erosion and profit shifting ("Inclusive Framework") released a **report** on Pillar One Amount B which provides for a simplified and streamlined approach to the application of the arm's length principle. The report was incorporated into the OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.

— On February 22, 2024, the CRA published revised administrative **guidance** regarding advance pricing arrangements ("APAs").

— On March 28, 2024, the CRA issued a news release announcing that bare trusts would not be required to file T3 returns, including Schedule 15 (*Beneficial Ownership Information of a Trust*), for the 2023 taxation year unless directly requested by the CRA. The first filing deadline for which the new trust reporting rules were to apply to bare trusts would have been April 2, 2024.

— On April 16, 2024, the Government released the **2024 federal budget** ("Budget 2024") which included a proposal to increase the capital gains inclusion rate for all taxpayers (and related proposals), particulars regarding the clean electricity investment tax credit ("CE ITC") and a new electric vehicle supply chain investment tax credit ("EV ITC"), the introduction of new and enhanced powers to assist the CRA in obtaining information during audits, further amendments to the alternative minimum tax, and a number of measures intended to make housing more affordable. The **McCarthy Tétrault LLP overview of Budget 2024** provides a more detailed review.

— On April 25, 2024, the OECD released updated and consolidated **commentary** to model Global Anti-Base Erosion model rules ("Model Rules").

— On April 30, 2024, the Government introduced Bill C-69, the *Budget Implementation Act, 2024, No. 1*, in the House of Commons. Bill C-69 introduced a number of previously announced tax measures including, among other measures, the *Global Minimum Tax Act* ("GMTA"), amendments to the alternative minimum tax, the Indigenous loan guarantee program, an amendment to the "government assistance" definition to address *CAE Inc. v. Canada* (2022 FCA 178 aff'g 2021 TCC 57), the clean technology manufacturing investment tax credit ("CTM ITC"), and the clean hydrogen investment tax credit ("CH ITC").

1 All statutory references herein are to the *Income Tax Act* (Canada) (the "Act") unless specifically otherwise noted.

— On May 24, 2024, Finance released **explanatory notes** regarding the legislative proposals relating to the GMTA.

— On June 10, 2024, the Deputy Prime Minister and Minister of Finance tabled a **Notice of Ways and Means Motion** in the House of Commons including amendments to the Act to effect the capital gains inclusion rate increase.

— On June 17, 2024, the OECD released its fourth set of **guidance** regarding the model GloBE rules ("June Guidance"). This guidance should be incorporated into the commentary to the model GloBE rules which was last consolidate by the OECD on April 30, 2024 (see above).

— On June 20, 2024, Bill C-59 and Bill C-69 received royal assent and brought into force many significant tax measures including, *inter alia*, the expanded general anti-avoidance rule ("GAAR"), the EIFEL Rules, the employee ownership trust rules, the clean technology investment tax credit ("CT ITC"), the investment tax credit for carbon capture, utilization and storage ("CCUS ITC"), the CTM ITC, the CH ITC, the prevailing wage and apprenticeship requirements ("Labour Requirements") applicable to the CT ITC, CCUS ITC, CH ITC and CE ITC, the tax on repurchases of equity by Canadian publicly traded entities, the intergenerational business transfer framework, the dividend received deduction for financial institutions, the substantive CCPC rules, the anti-hybrid mismatch rules ("Hybrid Mismatch Rules") and the *Digital Services Tax Act* ("DSTA").

— On June 25, 2024, the capital gains inclusion rate increase and related proposals took effect.

— On June 28, 2024, the DSTA entered into force.

— On August 12, 2024, Finance released proposed draft legislation for a number of previously announced proposals ("August 12 Proposals") including draft legislation relating to the **capital gains inclusion rate**, proposed amendments to the **GMTA**, proposed amendments to the Act and the Regulations relating to **Budget 2024 and other proposals** including the CE ITC, expanded audit powers, amendments to the alternative minimum tax, the employee ownership trust rules and additions to section 160, and other **technical amendments** including clarifications to the bare trust reporting rules.

— On August 15, 2024, the CRA released an update to its **guidance** on the mandatory disclosures rules. The CRA guidance is expected to continue to evolve.

— On September 23, 2024, the Deputy Prime Minister and Minister of Finance tabled a **Notice of Way and Means Motion** in the House of Commons including revised draft legislation to effect the capital gains inclusion rate increase.

— On November 21, 2024, the Government released a **Backgrounder** announcing two months of relief from Goods and Services Tax/Harmonized Sales Tax ("GST/HST") on certain groceries, restaurant meals and holiday essentials ("GST/HST Holiday Relief").

— On December 16, 2024, the Government presented the **2024 Fall Economic Statement** ("Fall Economic Statement") in the House of Commons. The tax measures introduced in the Fall Economic Statement included relaxing the requirements for the tax deferral in respect of dispositions of eligible small business corporation shares ("ESBC shares"), enhancing tax incentives for scientific research and experimental development ("SR&ED"), notable updates to the design and delivery of certain of the Clean Economy Tax Credits, and extending the accelerated investment incentive and immediate expensing measures.

CAPITAL GAINS INCLUSION RATE INCREASE AND LIFETIME CAPITAL GAINS DEDUCTION INCREASE

In Budget 2024, the Government announced a proposal to increase the capital gains inclusion rate from 1/2 to 2/3 for capital gains realized on or after June 25, 2024. These proposals were tabled in the House of Commons as a Notice of Ways and Means Motion on September 23, 2024 (the "Capital Gains Proposals"). This summary provides an overview of the proposed changes to the capital gains regime.

Inclusion Rate

The increased inclusion rate is proposed to apply to capital gains realized by corporations or trusts and to capital gains realized by individuals (either directly or indirectly through a trust or a partnership). For individuals, the lower inclusion rate of 1/2 will continue to apply on the first $250,000 of capital gains realized in a taxation year. Net capital losses that are carried forward or back will generally be subject to the inclusion rate applicable in the taxation year in which the losses are deducted. This means that capital losses realized prior to June 25, 2024, may generally fully offset equivalent capital gains if carried forward and deducted in a taxation year ending after June 25, 2024. The Capital Gains Proposals also include transitional rules that apply to determine the inclusion rate applicable to capital gains and capital losses realized in a taxation year that straddles June 25, 2024.

The Capital Gains Proposals include consequential changes to other provisions of the Act, including provisions addressing the employee stock option deduction, capital dividend account, lifetime capital gains exemption, and hybrid surplus calculation, some of which are discussed in greater detail below. The Government also announced limited tax incentives for certain taxpayers, such as the Canadian Entrepreneur Incentive (discussed below), which are designed to provide tax relief to entrepreneurs.

Lifetime Capital Gains Exemption

The Capital Gains Proposals increase the lifetime capital gains exemption from $1,016,836 to $1,250,000 with respect to dispositions that occur on or after June 25, 2024. The indexation of the lifetime capital gains exemption is proposed to resume in 2026. This change, coupled with the increased inclusion rate, would increase an individual's maximum lifetime capital gains deduction from $508,418 (1/2 x $1,016,836) to $833,333 (2/3 x $1,250,000). If an individual claims the lifetime capital gains exemption in respect of a capital gain realized on or after June 25, 2024; that was effectively included in income at the one half inclusion rate (for example, by way of the transitional rules), the amount of the deduction would effectively be reduced to reflect the lower inclusion rate.

Hybrid Surplus

The Capital Gains Proposals introduce two new hybrid surplus pools to the foreign affiliate regime: "legacy hybrid surplus" and "successor hybrid surplus". These new surplus pools are intended to reflect capital gains realized within a foreign affiliate system that have been subject to the 1/2 inclusion rate and 2/3 inclusion rate, respectively. "Legacy hybrid surplus" generally takes into account capital gains and losses realized by foreign affiliates from dispositions of shares of other foreign affiliates and partnership interests that are excluded property occurring before June 25, 2024, dividends received from other foreign affiliates that are paid out of the hybrid surplus of such other foreign affiliates before June 25, 2024, and dividends received from other foreign affiliates that are paid out of the legacy hybrid surplus of such other foreign affiliates. "Successor hybrid surplus" generally takes into account capital gains and losses realized by foreign affiliates from dispositions of shares of other foreign affiliates and partnership interests that are excluded property occurring after June 24, 2024, and dividends received from other foreign affiliates that are paid out of the successor hybrid surplus of such other foreign affiliates. Dividends received by Canadian-resident corporations from foreign affiliates that are paid out of legacy hybrid surplus are generally deductible at a 1/2 rate, whereas dividends that are paid out of successor hybrid surplus are generally deductible at a 1/3 rate.

Canadian Entrepreneur Incentive

The Canadian Entrepreneur Incentive reduces the capital gains inclusion rate from 2/3 to 1/3 on dispositions by an eligible individual of shares of a "qualified small business corporation" (other than an "excluded business"), up to a lifetime maximum of $2 million of applicable capital gains. The $2 million capital gains limit would be phased in over 5 years, starting at $400,000 beginning on January 1, 2025, and ending at $2 million on January 1, 2029. In order to take advantage of this incentive, the individual must have owned at least 5% of the issued and outstanding shares (having full voting rights under all circumstances) for the 24 months preceding the disposition, and the individual must have been actively engaged on a regular, continuous and substantial basis in the activities of the business for a total period of at least three years prior to the disposition.

PILLAR 2 – GMTA AND OECD GLOBE GUIDANCE UPDATES

The members of the OECD and the Inclusive Framework confirmed their intention to move forward with a Two-Pillar solution to address the digitalization of the economy in October 2021. Pillar One proposes to reallocate a portion of the profits of large multinational enterprises ("MNEs") to market jurisdictions; while Pillar Two imposes a 15% global minimum tax on MNEs with consolidated financial accounting income of €750 million or more.

Enactment of the GMTA

On June 20, 2024, the GMTA received royal assent as part of Bill C-69, marking a critical milestone in Canada's implementation of Pillar Two. As enacted, the GMTA is substantially similar to the draft legislation originally released by Finance on August 4, 2023, with certain amendments including to reflect subsequent OECD guidance. Explanatory Notes for the GMTA were released in May 2024.

The GMTA currently includes two of the three GloBE taxing measures contained in the Model Rules: a domestic minimum top-up tax ("DMTT") (intended to be a qualified domestic minimum top-up tax for purposes of the Model Rules) and an income inclusion rule ("IIR"). Both measures apply to taxation years beginning on or after December 31, 2023.

— The DMTT is a domestic minimum top-up tax on low-taxed income of Canadian entities and branches of MNEs to ensure such income is subject to the global minimum tax rate of 15%. The DMTT is intended to provide Canada with the first right to tax this income.

— The IIR requires a relevant parent entity located in Canada to pay a top-up tax on its allocable share of the under-taxed income of its foreign subsidiary entities in order to bring the global effective tax rate on such income up to 15%.

The GMTA includes an interpretive rule substantially the same as that proposed in the August 4, 2023, draft legislation, which provides that, unless the context otherwise requires, the GMTA is to be interpreted consistently with the Model Rules, the OECD Commentary to the Model Rules, and other administrative guidance approved by the Inclusive Framework and published by the OECD, as amended from time to time. The Explanatory Notes provide some further details regarding how this rule is intended to be applied, and suggest that substantial weight is to be given to the intended outcomes and policy of the Pillar Two rules.

Also as proposed in the August 4, 2023, draft legislation, the GMTA incorporates the GAAR in the Act "with any modifications that the circumstances require." The Explanatory Notes do not provide any additional insight on how the GAAR is intended to be applied, or potential double taxation is to be avoided, in light of the GMTA being a part of a global system of rules.

For further details regarding these measures, see the **McCarthy Tétrault Review of 2023 and 2024 Outlook** publication.

OECD Developments

The OECD has released four sets of administrative guidance since it published the Model Rules in 2021, the most recent of which were released in December 2023 and June 2024:

— The December 2023 administrative guidance, among other things, includes further guidance on the application of the transitional country-by-country reporting safe harbour and a simplified calculation safe harbour for non-material entities.

— The June Guidance includes amendments to the determination of the financial accounting income of flow-through entities and to the treatment of deferred tax assets, and also permits participating jurisdictions to choose to exclude certain securitization entities from taxation under a qualifying domestic minimum top-up tax or the UTPR.

In April 2024, the OECD published a consolidated version of the OECD Commentary which incorporates the administrative guidance released up to December 2023.

August 2024 Amendments

On August 12, 2024, Finance released draft legislative proposals to amend the GMTA ("GMTA Proposals"). Explanatory notes to the proposed amendments followed shortly thereafter. The GMTA Proposals contain amendments to incorporate an undertaxed profits rule ("UTPR") – the third GloBE taxing measure under the Model Rules – into the GMTA, as well as to align the GMTA with the June Guidance.

The UTPR

The UTPR is a backstop to the IIR and ensures that MNE groups are subject to top-up tax on the profits of low-tax constituent entities that do not have a relevant parent entity in a participating jurisdiction. The UTPR allows other adopting jurisdictions (i.e., Canada) in which the MNE group is located to impose top-up tax on the under-taxed income. The UTPR will apply to financial years beginning on or after December 31, 2024.

Consistent with the approach set out in the Model Rules, the allocation of Canada's share of the MNE group's total UTPR top-up amount is to be determined by reference to the number of employees and the net book value of tangible assets in Canada, relative to the number of employees and the net book value of tangible assets in all applicable UTPR jurisdictions.

The Model Rules do not specify how the top-up tax imposed under a UTPR is to be allocated among the MNE group's constituent entities located in an implementing jurisdiction. The GMTA Proposals allocate Canada's share of the UTPR top-up amount among Canadian entities proportionately, again by reference to employees and tangible assets in Canada.

Consistent with the Model Rules, the GMTA Proposals include an exception from tax under the UTPR for MNE groups that are in the initial phase of international activity, as well as a transitional UTPR safe harbour. The transitional UTPR safe harbour is available on an elective basis for fiscal years beginning before January 1, 2026, and ending before December 31, 2026, and requires that the ultimate parent entity of the MNE group be located in a jurisdiction with a corporate income tax rate of at least 20%.

Other Amendments

The GMTA Proposals include amendments to the GMTA to reflect the June Guidance including the adoption of an exception to exclude certain securitization entities from taxation under the DMTT or UTPR.

The GMTA Proposals also propose to amend section 4.4 of the *Income Tax Conventions Interpretation Act*, effective January 1, 2024, to clarify that Canada's tax treaties do not prevent taxation under the GMTA nor require Canada to provide relief for taxes levied by other countries under their Pillar Two rules.

Subject to Tax Rule

In September 2023, the Inclusive Framework completed negotiations on the *Multilateral Convention to Facilitate the Implementation of the Pillar Two Subject to Tax Rule* ("STTR MLI"). The subject to tax rule ("STTR") would generally allow a source jurisdiction to impose a tax on certain intragroup payments (including interest, royalties and service fees) to which treaty relief is provided where the income is taxed at a corporate income tax rate of less than 9% in the jurisdiction of residence. On September 19, 2024, nine countries signed the STTR MLI. While we understand Canada intends to proceed with a STTR, Canada has not yet signed the STTR MLI, and the GMTA Proposals notably do not include amendments to implement a STTR.

CLEAN ECONOMY TAX CREDITS

Over the past few years, the Government has introduced the Clean Economy Tax Credits to promote investment in clean energy technology in Canada.

2024 marked a significant milestone for the Clean Economy Tax Credits as Bill C-59 and Bill C-69 received royal assent. Budget 2024 also introduced the new EV ITC, additional implementation and design particulars for the CE ITC, and provided further enhancements to the now-enacted Clean Economy Tax Credits. The August 12 Proposals included long-awaited proposed draft legislation for the CE ITC.

Bill C-59 and Bill C-69

On June 20, 2024, Bill C-59 and Bill C-69 received royal assent and enacted the legislation implementing the CCUS ITC, the CT ITC, the CH ITC, the CTM ITC, and the prevailing wage and apprenticeship requirements that a taxpayer must elect to satisfy in order to maximize the applicable rate for a CCUS ITC, CT ITC, CH ITC or CE ITC.

Electric Vehicle Supply Chain Investment Tax Credit

To support investments in Canada's electric vehicle industry, Budget 2024 announced the EV ITC as a 10% investment tax credit in respect of the cost of buildings used in the three qualifying segments of the Canadian electric vehicle supply chain: (1) electric vehicle assembly; (2) electric vehicle battery production; and (3) cathode active material production.

The EV ITC would be available in respect of property that is acquired and becomes available for use on or after January 1, 2024. The Fall Economic Statement confirms that the EV ITC would be phased out with a reduced rate of 5% for property that becomes available for use in 2033 or 2034, and no credit available for property that becomes available for use after 2034.

The Fall Economic Statement included additional design and implementation details for the EV ITC and indicated that other design elements would generally be based on those of the CTM ITC under section 127.49.

Eligible Property

Property eligible for the EV ITC would include buildings and structures, including their component parts, described in paragraph (q) of capital cost allowance Class 1 in Schedule II to the Income Tax Regulations. Eligible property must be used in one of the three qualifying segments which the Fall Economic Statement defines as follows:

— electric vehicle assembly which comprises the final assembly of a fully electric vehicle or a plug-in hybrid vehicle with a battery capacity of at least 7kWh;

— electric vehicle battery production which comprises the manufacturing of battery cells or battery modules used in the powertrain of a fully electric vehicle or plug-in hybrid vehicle; and

- cathode active material production which includes the production of cathode active material used as an input to manufacture battery cells used in the powertrain of a fully electric or plug-in hybrid vehicle other than preliminary processing activities such as activities that could generally allow property to qualify for the CTM ITC.

Investment Requirement

As initially described in Budget 2024, to be eligible for the EV ITC, a corporation must have invested in, and claimed the CTM ITC in respect of, each of the three qualifying segments. The Fall Economic Statement provides that, in order to satisfy this requirement, a corporation or a related group of which the corporation is a part, must:

- acquire property eligible for the CTM ITC at a cost of at least $100 million and that has become available for use in each of the three segments; or
- acquire property eligible for the CTM ITC at a cost of at least $100 million and that has become available for use in two of the three segments and hold shares of an unrelated corporation, representing at least 10% of the voting rights and 10% of the value of the shares of that corporation, that acquires property eligible for the CTM ITC at a cost of at least $100 million in the other qualifying segment.

Recapture

EV ITC is proposed to be subject to repayment obligations similar to the existing recapture rules for the CTM ITC.

Clean Electricity Investment Tax Credit

Announced in Budget 2023, the CE ITC is a 15% refundable investment tax credit applicable to investments in "clean electricity property" (as defined in subsection 127.491(1)). The stated purpose of the CE ITC is "to encourage the investment of capital in the deployment of clean electricity property in Canada." The August 12 Proposals include draft legislation to implement the CE ITC. Budget 2024 indicated that the Government intended to table legislation enacting the CE ITC in the House of Commons in fall 2024. With that deadline now passed, the Fall Economic Statement provides that legislation enacting the CE ITC is expected to be introduced in the House of Commons "soon".

The CE ITC is available as of Budget Day 2024 in respect of projects that commenced construction on or after Budget Day 2023 and before January 1, 2034.

There is significant (although not perfect) overlap between the types of property that qualify for the CE ITC and the CT ITC. Notably, eligible for the CE ITC but not the CT ITC is "nuclear energy equipment," "qualified natural gas energy equipment," "qualified interprovincial transmission equipment" and hydroelectric property that exceeds the 50 megawatt-rated capacity limit in subparagraph (d)(ii) of Class 43.1.

The most significant difference between the CE ITC and the CT ITC is that the CE ITC is available to both taxable Canadian corporations and certain tax exempt entities. More specifically, the CE ITC is available to be claimed by

designated provincial Crown corporations, corporations described in paragraph 149(1)(d.5) of which not less than 90% of the shares or capital are owned by one or more municipalities in Canada or an "Aboriginal government" (as defined in subsection 241(10)) or similar Indigenous governing bodies described in paragraph
149(1)(c), corporations described in paragraph 149(1)(d.6) of which 100% of the shares (other than directors' qualifying shares) are owned by one or more municipalities in Canada or an "Aboriginal government" (as defined in subsection 241(10)) or similar Indigenous governing bodies described in paragraph 149(1)(c), a corporation of which all of which 100% of the shares (except directors' qualifying shares) or capital of which is owned by any combination of the above entities.

Also eligible for the CE ITC is a pension investment corporation to which paragraph 149(1)(o.2) applies or a trust that, at all relevant times, each beneficiary of which is a pension investment corporation described in paragraph 149(1)(o.2), that is a limited partner of a partnership and the sole undertaking of which is the holding of its interest in the partnership.

The August 12 Proposals include draft legislation clarifying that, where a partnership acquires property eligible for both the CE ITC and the CT ITC, a partner will be able to claim its reasonable share of either credit for which the partner is otherwise eligible (but not both credits in respect of the same property). For example, if a partnership with a 50% tax-exempt corporation partner and a 50% taxable Canadian corporation partner incurs expenditures to acquire property that is eligible for both the CE ITC and the CT ITC (and the Labour Requirements are met), the tax-exempt corporation partner should be entitled to claim a credit equal to its reasonable share of the 15% CE ITC to which the partnership would be entitled if it were an eligible entity for purposes of the CE ITC and the taxable Canadian corporation should be entitled to claim a credit equal to its reasonable share of the 30% CT ITC to which the partnership would be entitled if it were a qualifying taxpayer for purposes of the CT ITC.

If a qualifying entity does not elect to satisfy the Labour Requirements, the amount of the CE ITC is reduced by 10%. Our detailed review of the Labour Requirements can be found **here**. The more detailed review includes a description of the penalties and consequences of a claimant electing to satisfy the Labour Requirements but failing to do so. Please refer to the detailed review for a summary of these consequences.

CE ITC for Provincial and Territorial Governments

Budget 2023 included the following statement regarding the requirements that would need to be satisfied to access the credit:

> "In order to access the tax credit in each province and territory, other requirements will include a commitment by a competent authority that the federal funding will be used to lower electricity bills, and a commitment to achieve a net zero electricity sector by 2035."

This statement introduced significant uncertainty as it was not, at that time, apparent that these conditions would only apply to provincial and territorial Crown corporations or what specifically would be required to satisfy the conditions.

Budget 2024 indicated that provincial and territorial Crown corporations would be eligible to claim the CE ITC only in respect of investments made in eligible property situated in designated jurisdictions. In the Fall Economic Statement, the Government details the proposed conditions that must be satisfied by provincial and territorial governments in order for the jurisdiction to be designated for purposes of Crown corporations claiming the CE ITC and reporting requirements for provincial and territorial Crown corporations claiming the CE ITC. For additional details regarding such proposed conditions and reporting requirements please refer to our **detailed review** of the Clean Economy Tax Credit measures announced in the Fall Economic Statement.

Expanded Eligibility of the CE ITC for the Canada Infrastructure Bank

The Fall Economic Statement proposes to expand eligibility for the CE ITC by including the Canada Infrastructure Bank as an eligible entity for purposes of the CE ITC.

Under the August 12 Proposals, for purposes of the CE ITC, the capital cost of a clean electricity property to a qualifying entity is reduced by the amount of any government assistance or non-government assistance received by the qualifying entity in, or before, the taxation year in which the property is acquired. The Fall Economic Statement proposes to introduce an exception so that financing provided by the Canada Infrastructure Bank would not reduce the capital cost of a clean electricity property to a qualifying entity for purposes of the CE ITC.

The Fall Economic Statement proposes that the measures with respect to the Canada Infrastructure Bank and the CE ITC would apply to clean electricity property that is acquired and becomes available for use on or after December 16, 2024.

Select Proposed Amendments to Clean Economy Tax Credits

Polymetallic Projects

Budget 2024 proposed to modify the CTM ITC to expand eligibility for the credit to businesses engaged in polymetallic projects. The August 12 Proposals include draft legislation effecting that proposal by modifying the "CTM use" definition in subsection 127.49(1) by replacing the "producing all or substantially all qualifying materials" requirement (generally regarded as 90% or more) with an "expected to produce primarily qualifying materials" test which will be measured in terms of the fair market value of all commercial outputs relevant to the taxpayer's CTM ITC. Budget 2024 indicated that the "primarily" test is generally regarded as 50% or more; however, the explanatory notes accompanying the August 12 Proposals do not comment on the meaning of the term "primarily."

To support a claim for the CTM ITC in respect of a polymetallic project, a taxpayer must submit to the CRA an attestation from an arm's length qualified engineer or geoscientist for each relevant mine or well site. If a taxpayer does not submit such attestation then its CTM ITC in respect of a polymetallic project is deemed to be nil.

Eligibility for Waste Biomass

The August 12 Proposals also include draft legislation reflecting the 2023 Fall Economic Statement proposals to expand the property eligible for the CT ITC to support the generation of electricity, heat, or both electricity and heat from waste biomass comprising "specified waste materials" as defined in subsection 1104(13) of the Regulations. Eligible systems under this expanded eligibility for the CT ITC must:

— use feedstock which derives all or substantially all of its energy content (expressed as the higher heating value of the feedstock) from specified waste materials, as determined on an annual basis;

— not use fuel that is not produced as an integrated part of the system (even if produced from specified waste material); and

— not exceed a heat rate threshold of 11,000 British thermal units per kilowatt-hour.

The August 12 Proposals also include the 2023 Fall Economic Statement proposal to amend subsection 1104(17) of the Regulations to clarify that properties that would otherwise be eligible for inclusion in Class 43.1 or 43.2 will only be deemed not to be eligible if there is substantial non-compliance by the taxpayer with environmental laws, bylaws and regulations at the time the property first becomes available for use.

Preliminary Work Activity

The August 12 Proposals introduce a new reduction to the capital cost of clean technology property for any amount that is in respect of an expenditure incurred for a preliminary work activity ("Preliminary Work Activity Reduction"). An equivalent adjustment to the capital cost of clean electricity property for the purpose of the

definition of "clean electricity investment tax credit" in subsection 127.491(1) is also proposed.

The proposed preliminary work activity definition defines a preliminary work activity to mean any activity that is preliminary to the acquisition, construction, fabrication or installation by or on behalf of a taxpayer of property including, but not limited to, a preliminary activity that is any of the following:

— obtaining a right of access to a project site or obtaining permits or regulatory approvals (including conducting environmental assessments);

— performing front-end design or engineering work, including front-end engineering design studies, or process engineering work for the project, including (i) collecting and analyzing of site data, (ii) calculating energy, mass, water or air balances, (iii) simulating and analyzing the performance and cost of process design options, (iv) selecting the optimum process design, and (v) conducting feasibility studies or pre-feasibility studies;

— clearing or excavating land;

— constructing a temporary access road to the project site; or

— drilling of a well.

Although an analog of the Preliminary Work Activity Reduction was proposed to apply to the CCUS ITC and the CH ITC since the original draft legislation for those credits was released by Finance, such a reduction to the capital cost of property eligible for the CT ITC and CE ITC was not proposed until the August 12 Proposals. Despite this, the Preliminary Work Activity Reduction definition is proposed to apply retroactively to the original effective date for both the CT ITC and the CE ITC. It should therefore be considered in determining the capital cost of clean technology property for any project in respect of which a CT ITC or CE ITC will be claimed regardless of the timing of the claim.

Expanded Eligibility of CH ITC for Methane Pyrolysis Projects

The CH ITC is currently available in respect of hydrogen produced from electrolysis of water or from the reforming or partial oxidation of natural gas or other eligible hydrocarbons (where emissions are abated using a carbon capture, utilization and storage process).

The Fall Economic Statement proposes to expand the eligibility for the CH ITC to include projects that produce hydrogen from the pyrolysis of natural gas and other eligible hydrocarbons. The existing legislation regarding the CH ITC would generally apply in respect of such projects subject to certain modifications. The Fall Economic Statement indicates that the Government will continue to review eligibility for other low-carbon hydrogen production pathways.

For additional details regarding the proposed expansion of the CH ITC please refer to our **detailed review** of the Clean Economy Tax Credit measures announced in the Fall Economic Statement.

TRUST REPORTING RULES AND PROPOSED AUGUST AMENDMENTS RE: BARE TRUSTS

First announced in Budget 2018, enhanced trust reporting rules were enacted by Bill C-32 and came into force on December 15, 2022 ("Bill C-32 Rules").

Under the Bill C-32 Rules, most trusts were required to file a T3 "Trust Income Tax and Information Return" ("T3 Return") and new Schedule 15, "Beneficial ownership information of a trust" (Schedule 15) annually for taxation years ending on or after December 31, 2023, and onwards. Schedule 15 required the provision of information regarding reportable entities, including the trust's trustees, beneficiaries and settlors and controlling persons (e.g., a protector), subject to limited exceptions. A key change under the Bill C-32 Rules was that most bare trusts were subject to these enhanced reporting requirements.

In the lead up to the first T3 Return, including Schedule 15, filing deadline under the Bill C-32 Rules of March 30, 2024, there were numerous CRA administrative statements and substantial media coverage as taxpayers and the tax community found the requirements and penalties for bare trusts to be onerous and unclear. On March 12, 2024, the CRA announced it would waive the late-filing penalty under subsection 162(7) for the 2023 taxation year in respect of late-filed T3 Returns, including Schedule 15, barring gross negligence. Then, on March 28, 2024, only a few days before the filing deadline, the CRA announced that it would not require bare trusts to file a T3 Return, including Schedule 15, for the 2023 taxation year, unless directly requested by the CRA.

The August 12 Proposals include proposed amendments to the trust reporting rules ("August 2024 Revised Trust Reporting Rules"). The August 2024 Revised Trust Reporting Rules include changes that attempt to more clearly define the beneficial ownership arrangements that are subject to the reporting rules, add or broaden exceptions to the enhanced reporting requirement and clarify the Schedule 15 additional reporting requirements, each as more particularly described below.

First, the August 2024 Revised Trust Reporting Rules propose to repeal existing subsection 150(1.3), applicable to taxation years that end after December 30, 2024, such that bare trusts would not be required to file T3 Returns, including Schedule 15, for the 2024 taxation year. On October 29, 2024, the CRA confirmed that it will not require bare trusts to file T3 Returns, including Schedule 15, for the 2024 taxation year unless the CRA makes a direct request for these filings.

For taxation years that end after December 30, 2025, bare trusts would only be subject to the trust reporting requirements if they are deemed to be express trusts under proposed subsection 150(1.3).

Proposed subsection 150(1.3) provides that an express trust is deemed to include any arrangement under which:

- one or more persons (referred to as the "legal owner") have legal ownership of property that is held for the use of, or benefit of, one or more persons or partnerships, and
- the legal owner can reasonably be considered to act as agent for the persons or partnerships who have the use of, or benefit of, the property.

In this arrangement, each person that is a legal owner is deemed to be a trustee of the trust, and each person or partnership that has the use or benefit of property under the arrangement is deemed to be a beneficiary of the trust.

The deemed express trust rule in proposed subsection 150(1.3) is subject to a number of exceptions set out in proposed paragraphs 150(1.31)(a) to (g). Exceptions include arrangements where:

— each legal owner of the property is also a deemed beneficiary;

— a partner (other than a limited partner) of a partnership holds property throughout the year solely for the use or benefit of the partnership and the partners thereof are required to file a T5013 "Statement of Partnership Income";

— the property under the arrangement is "Canadian resource property" that is held for the benefit of publicly-listed corporations or their subsidiaries; or

— under the arrangement, property is held exclusively for the use or benefit of a tax exempt person under subsection 149(1), each legal owner is a person described under subsection 149(1) and the property consists solely of funds received from the Crown.

Second, a trust that is specifically listed in subsection 150(1.2) is not required to file Schedule 15. The August 12 Proposals broaden the exceptions in subsection 150(1.2) for certain "small trusts" and regulated trust accounts and introduces new "related party" and statutory trust exceptions, applicable to taxation years that end after December 30, 2024. Simplified:

— Paragraph 150(1.2)(b) provides an exception for a trust that holds assets with a total fair market value that does not exceed $50,000 throughout the year, where the only assets held by the trust are certain prescribed assets. The prescribed assets requirement is proposed to be removed.

— Paragraph 150(1.2)(c) provides an exception for a trust that is required by rules of professional conduct or the laws of Canada or a province to hold funds for a regulated activity, except where the trust is maintained as a separate trust for a particular client or clients. This paragraph is proposed to be amended to extend to separate trusts where the only assets held by it throughout the year are money with a value that does not exceed $250,000.

— Proposed paragraph 150(1.2)(b.1) introduces an exception where each beneficiary and trustee of the trust is an individual and each beneficiary is related to each trustee of the trust. The total fair market value of the property of the trust cannot exceed $250,000 throughout the year and the trust may only hold certain prescribed assets.

— Proposed paragraph 150(1.2)(q) introduces an exception for a trust that is established for the purpose of complying with a statute of Canada or a province that requires the trustee to hold property in trust for a specified purpose, such as bankruptcy trustees or provincial guardians.

Finally, the August 12 Proposals propose to clarify the additional reporting requirements in Schedule 15, applicable to taxation years that end after December 30, 2024. In particular, Regulation 204.2(1) is proposed to be amended to include a partnership that is a trustee, beneficiary, or settlor of the trust in the scope of reportable entities, and new Regulation 204.2(3) is introduced to define "settlor" for the purposes of Regulation 204.2(1).

Following the release of the August 2024 Revised Trust Reporting Rules, Finance held a consultation process and asked for comments from stakeholders on the new rules by September 11, 2024. The Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada's submission in respect of these rules described a number of concerns and provided suggested revisions. It remains to be seen as to whether the Government will release further revised trust reporting rules.

ALTERNATIVE MINIMUM TAX

Budget 2024 proposed further changes to the AMT to revise the tax treatment of charitable donations from individuals, provide more credits and deductions under the AMT, and provide exemptions for certain trusts for the benefit of Indigenous groups. The August 12 Proposals supplement the amendments proposed in Budget 2023, some of which were enacted by Bill C-69. The coming-into-force provisions in Bill C-69 clarify that these amendments apply retroactively, such that the new AMT rules are in effect as of January 1, 2024.

Individuals and certain trusts are subject to AMT if their federal income tax payable as otherwise determined for a particular taxation year is less than their "minimum amount" for that year. In general, the minimum amount is computed pursuant to section 127.51 by (i) applying the flat rate of 20.5% against the amount by which the taxpayer's "adjusted taxable income" for the year exceeds the taxpayer's basic exemption, and (ii) deducting the taxpayer's basic minimum tax credit for the year determined under section 127.531.

Among other things, amendments enacted by Bill C-69:

- increase the AMT rate to 20.5% from 15%;
- increase the basic exemption amount for individuals and graduated rate estates to approximately $173,205 (i.e., the start of the fourth federal tax bracket), subject to indexation; and
- broaden the AMT tax base by, among other things:
  - increasing the AMT capital gains inclusion rate from 80% to 100% (with capital loss carryforwards and allowable business investment losses applying at a 50% rate);
  - including 100% of employee stock option benefits;
  - including 30% of capital gains on donations of publicly listed securities (mirroring the current treatment of capital gains in respect of which the capital gains deduction is claimed);
  - disallowing 50% of various deductions, most importantly for interest expenses and investment counsel fees;
- exempting certain unit trusts from AMT; and
- applying the basic exemption to a qualified disability trust.

Proposed amendments from Budget 2024 which are not yet in force include an exemption from AMT for trusts for the benefit of Indigenous groups. These trusts include (i) trusts established by statute in respect of constitutional rights of Indigenous persons, or under a treaty or settlement agreement with an Indigenous community, and (ii) trusts with beneficiaries who hold rights under, or perform certain functions for the benefit of those who hold rights recognized and affirmed by, section 35 of the *Constitution Act, 1982*.

As part of the August 12 Proposals, Finance announced further changes to the AMT that are intended to avoid the AMT disincentivizing investments in flow-through shares. Specifically, paragraph 127.52(1)(d.1) will be repealed retroactive to January 1, 2024, and replaced by new paragraphs 127.52(1)(d.1) and (d.2), which will require an add-back in computing adjusted taxable income in respect of flow-through shares donated to charity limited to 30% of the "true" economic gain on the donated shares. Paragraph 127.52(1)(e.1) will also be repealed retroactive to January 1, 2024, with the effect that taxpayers will no longer be required to add back deductions for Canadian exploration expenses, Canadian development expenses, or Canadian oil and gas property expenses deducted in respect of a flow-through share in computing adjusted taxable income.

EMPLOYEE OWNERSHIP TRUSTS

Employee Ownership Trusts ("EOT") were first introduced in Budget 2023 to facilitate the purchase of businesses by employees. The EOT rules proposed in Budget 2023 are now in force following Bill C-59 receiving royal assent on June 20, 2024. The EOT rules retroactively apply to transactions that occur on or after January 1, 2024.

The 2023 Fall Economic Statement proposed a capital gains exemption for the first $10 million of capital gains realized on the sale of business to an EOT. Budget 2024 proposed further exemptions and qualifying conditions for this exemption, the enabling legislation for which was included in Bill C-69 and is now in force. The EOT capital gains exemption in subsection 110.61(2) will be available for transactions that occur between January 1, 2024, and December 31, 2026.

Finance also proposed an equivalent exemption where shares of a corporation are disposed of to another corporation that is a worker cooperative. The amount of the exemption in proposed section 110.62, and the period in respect of which the exemption will be available, are the same as the exemption of and availability period for the EOT capital gains exemption. The building blocks for the exemption in proposed subsection 110.62(2) are the proposed definitions of "qualifying cooperative conversion" and "worker cooperative" in subsection 248(1). Along with the conditions in proposed subsection 110.62(1), these definitions are intended to replicate the economics of a qualified business transfer to an EOT.

In the enacted subsection 110.61(1), relevant conditions for the capital gains exemption include:

- the claimant for the exemption must be an individual (other than a trust);
- the disposition of shares to the EOT must be a "qualifying business transfer," as defined in subsection 248(1);
- the disposition must occur between 2024 and 2026;
- no individual has previously sought to claim an exemption in respect of a disposition of shares to an EOT where the shares derived their value from an active business relevant to the determination of whether the particular disposition was a qualifying business transfer;
- throughout the 24 months preceding the disposition, the shares were not owned by any person other than the individual or a related person, and over 50% of the fair market value of the shares was derived from assets used principally in an active business;
- immediately before the disposition, neither the subject corporation nor any affiliated corporation in which the subject corporation owns shares is a professional corporation, and the EOT does not control a corporation whose employees are beneficiaries of the EOT;
- at the disposition time:
  - the individual is at least 18 years of age;
  - the individual, or the individual's spouse or common-law partner, was actively and continuously engaged in a relevant business for at least 24 months before the sale; and
  - at least 75% of the beneficiaries of the EOT are resident in Canada; and
- the individual, the EOT, and any purchaser corporation controlled by the EOT, jointly elect to claim the exemption for up to a maximum of $10 million and, where there is more than one individual vendor in respect of a qualifying business transfer, the vendors agree to the percentage of the $10 million exemption to which each vendor will be entitled.

Even if all of these conditions are satisfied, the exemption may be denied if a "disqualifying event" occurs within 24 months of the qualifying business transfer, or the EOT may be deemed to have disposed of the shares at fair market value if a disqualifying event occurs more than 24 months after the qualifying business transfer. For these purposes, a disqualifying event will occur if the trust ceases to be an EOT or if less than 50% of the fair market value of the shares of the qualifying business is attributable to assets used principally in an active business. The exemption is also subject to an anti-avoidance rule in subsection 110.61(5), which may apply if the EOT is used as a conduit for an acquisition of shares by another person, or if transactions are undertaken to permit an exemption to be claimed more than once in respect of a particular business.

Capital gains in respect of which the $10 million exemption for sales to EOTs is claimed are effectively excluded from adjusted taxable income for AMT purposes under subparagraph 127.52(1)(h)(vi). This should prevent the value of the $10 million exemption from being eroded through the imposition of AMT on individual vendors who may not otherwise have sufficient tax payable to avoid AMT liabilities.

The $10 million capital gains exemption for qualifying business transfers to an EOT will make the prospect of a sale to an EOT more appealing to many owner-managers; it was unlikely that many businesses would have been sold to EOTs absent this exemption. However, given the multitude of requirements that must be satisfied, the requirement to split the $10 million exemption between all individual vendors, and the credit risk associated with selling to an EOT, it is unclear how many business owners will be enticed to sell to an EOT if there are other bidders. Furthermore, there are now only 24 months remaining before the exemption expires, and it is possible that the exemption may expire before taxpayers and advisors are fully comfortable with the EOT structure.

NON-RESIDENT SERVICE PROVIDER WITHHOLDING

Budget 2024 proposed new subsection 153(8) which would provide the CRA with broader statutory authority to waive the requirement to withhold under Regulation 105. The August 12 Proposals included proposed subsection 153(8). The language of proposed subsection 158(3) in the August 12 Proposals is identical to the language proposed in Budget 2024. See **our Firm's commentary** on Budget 2024 for background information on this proposed measure.

Paragraph 153(1)(g) and Regulation 105 impose a 15% withholding tax on payments made to non-resident persons for services performed in Canada. Regulation 105 withholding tax is not a final tax, but is on account of the non-resident person's potential liability for Canadian income tax. Where the non-resident person is ultimately not liable for Canadian income tax (e.g., because a treaty exemption applies or because the service is international shipping or operating an aircraft in international traffic), the non-resident person is required to file a Canadian income tax return in order to seek a refund.

The CRA currently provides waivers of withholding in certain circumstances on an administrative basis. However, these waivers must generally be applied for on a transaction-by-transaction basis.

Proposed subsection 153(8) will allow the CRA to waive Regulation 105 withholding tax from payments to a non-resident service provider (during a period of time specified by the CRA) if the CRA is satisfied that:

- the payments are one the following:
  - the payments are income of a "treaty-protected business" (as defined in subsection 248(1)) of the non-resident (i.e., the income from the business carried on by the non-resident is exempt from tax under Part I because of a tax treaty); or
  - the payments would not be included in computing the income of the non-resident because of paragraph 81(1)(c) (i.e., it is income from providing services related to international shipping or the operation of an aircraft in international traffic); and
- the conditions established by the CRA are met (these conditions were not released as part of the August 12 Proposals).

Proposed subsection 153(8) is a blanket waiver for the stated purpose of improving efficiency. It applies over a period of time specified by the CRA, allowing the withholding requirement to be waived on multiple transactions with a single waiver.

If the CRA is no longer satisfied that the conditions (described above) are met, the CRA may revoke the waiver.

Subsection 153(8) is proposed to come into force on royal assent.

PURPOSE BUILT RENTAL HOUSING AMENDMENTS FOR CCA AND EIFEL

New rules for purpose-built residential rentals were first announced in Budget 2024, and the draft rules were included in the August 12 Proposals. A purpose-built residential rental is defined as a building (or part of a building) located in Canada with at least four private apartments or ten private rooms or suites, with at least 90% of the residential units used for long-term rental (not shorter than 28 consecutive days).

The changes contained in the August Proposals include increasing the capital cost allowance from 4% to 10% for new purpose-built residential rentals. To qualify as a new purpose-built residential rental, construction on a new or substantially renovated building must begin after April 15, 2024, and before 2031, with the building being made available for use before 2036.

Additionally, the draft legislation proposes to create a new excessive interest and financing expenses limitation exemption for arm's length financing used to build, convert, or acquire a purpose-built residential rental. This new exemption would apply on or after October 1, 2023.

Given that the Government has made affordable housing a key policy and has emphasized the need to address the housing crisis, we anticipate more comprehensive legislation and policy updates in the coming year to further support affordable housing initiatives.

OTHER FALL ECONOMIC STATEMENT PROPOSALS

Scientific Research and Experimental Development Tax Incentive Program

The Fall Economic Statement announced significant reforms to Canada's SR&ED program. The changes proposed in the Fall Economic Statement went beyond the commitments made in Budget 2024 to encourage Canadian businesses to invest more in innovation. The reforms are designed to address a decade-long decline in research and development ("R&D") expenditures in Canada, which lags behind international peers, and to bolster the country's competitive position in the global innovation landscape.

The federal SR&ED tax incentive program has been a cornerstone of Canada's economic development strategies since 1987. It is the largest single tax incentive program, providing support to more than 20,000 businesses annually.

The program is based on the concept of qualified SR&ED expenditures, which generally include labor costs, contract payments to third-party companies performing qualified work in Canada, the cost of materials consumed or transformed during the SR&ED process, as well as third-party payments to research institutions, universities, or labs conducting SR&ED.

The current SR&ED program represents about $4 billion in annual tax incentives. The proposed changes would increase this by almost $1.9 billion over the next six years, by incorporating the following updates to the program:

— Return of Eligible Capital Expenditures: Starting next fiscal year, capital expenditures will once again qualify for deductions and investment tax credits, reversing changes made in 2014. These rules will apply to capital property acquired after December 16, 2024, and to lease payments becoming payable after the same date.

— Increased 35% Rate Cap: The expenditure limit for the enhanced 35% rate will rise from the first $3 million to the first $4.5 million of qualified expenditures.

— Higher Phase-Out Thresholds: The taxable capital employed in Canada thresholds for enhanced credit eligibility will increase from $10 million–$50 million to $15 million–$75 million.

— Extended Enhanced Credits: Canadian public corporations will qualify for the enhanced 35% refundable credit. Currently, the enhanced 35% refundable credit is only available to Canadian-controlled private corporations.

The proposed updates to the SR&ED program follow extensive public consultations led by Finance. These consultations explored new eligibility conditions, adjustments to the tax credit rate structure, and the potential adoption of a patent box regime to incentivize the creation, commercialization, and retention of intellectual property in Canada. In the Fall Economic Statement, the Government announced its intention to implement a patent box regime and that it will announce additional details in the 2025 federal budget. Introducing such a regime in Canada could encourage companies to develop, commercialize, and retain intellectual property in Canada by taxing income earned from qualifying intellectual property at a lower rate than standard corporate income.

The Government indicated that the proposed changes would be the first of further reforms to the SR&ED

program, with coming updates on program administration and qualified expenses to be announced in the 2025 federal budget.

The SR&ED program has long been a cornerstone of Canada's efforts to foster innovation. However, businesses advancing beyond early-stage R&D or with sustained, long-term R&D needs have often struggled to fully leverage its benefits. The expansion of SR&ED to include scale-up activities and to move into the public company space will create a more supportive environment for Canadian business. The Government's proposed reforms aim to strengthen incentives for businesses to invest in R&D, ultimately driving economic growth.

Extension of the Accelerated Investment Incentive

In the Fall Economic Statement, the Government proposes to invest in economic fundamentals and create a business-friendly economic environment by providing a five-year reinstatement of the Accelerated Investment Incentive.

Currently, the Accelerated Investment Incentive begins phasing out in 2024 and will be completely eliminated by 2027. Under the proposed extension of the Accelerated Investment Incentive the phase-out period would begin in 2030 and end in 2033.

The Accelerated Investment Incentive provides an enhanced capital cost allowance deduction in the first year for qualifying depreciable capital property. The Fall Economic Statement proposed to extend the application of the Accelerated Investment Incentive to qualifying property acquired on or after January 1, 2025, and that becomes available for use before 2030. An enhanced rate of two or three times the normal rate would be available for property subject to the half-year rule, and an enhanced rate of one-and-a-half to one-and-a-quarter would be available for property not normally subject to the half-year rule.

Immediate Expensing Measures

The Fall Economic Statement proposed to re-instate the immediate expensing measures, which are currently set to be reduced to 75% in 2025 and completely eliminated by 2028. These immediate expensing measures provide for an enhanced first-year capital cost allowance deduction of 100% for specified manufacturing or processing machinery and equipment, clean energy generation and energy conservation equipment, and zero-emission vehicles. As proposed, eligible property will qualify for this immediate expensing measure if it is acquired on or after January 1, 2025 and is available for use before 2030. The reinstated full 100% first-year deduction will be phased out starting in 2030 and fully eliminated for property that becomes available for use after 2033.

The Fall Economic Statement did not propose any changes with respect to the half-year rule for immediate expensing measures, and thus the rule would remain effectively suspended for property eligible for immediate expensing.

Corporation Share Ownership Rules for Canadian Pension Funds

Budget 2024 announced that the Government would explore ways to provide greater domestic investment opportunities to Canadian pension funds. The Fall Economic Statement announced the Government's intention to remove the 30% rule in respect of investments in Canadian entities by pension funds that are subject to the *Pension Benefits Standards Act, 1985* (Canada) and that it will consult with the provinces regarding the treatment of provincially regulated plans.

The 30% rule limits the percentage of a corporation's director voting shares that may be owned by a pension fund. The Fall Economic Statement also announced the Government's intention to consider lowering the 90% share ownership condition that applies to municipally owned utility corporations in order to allow Canadian pension funds to acquire a higher ownership interest in such entities.

Canada Carbon Rebate for Individuals

The Canada Carbon Rebate provides a partial rebate on fuel charges for individuals that live in provinces where the fuel charge applies. Rural Canadians receive an additional 20% top-up to the Canada Carbon Rebate in recognition of the fact that living in rural areas and small communities requires increased energy consumption. The Fall Economic Statement announced expanded eligibility for the rural top-up to include Canadians living in census rural areas and small population centres that are within a Census Metropolitan Area.

Commodity Tax Developments and Outlook

CANADIAN DIGITAL SERVICES TAX ACT ENTERS INTO FORCE

On June 28, 2024, the DSTA entered into force pursuant to an Order in Council issued on that date. Consequently, the first year of application of the Digital Services Tax ("DST") is the 2024 calendar year with the DST applying retroactively to January 1, 2022.

Businesses that exceed the registration thresholds, which are set out below, will be required to register by January 31, 2025, and the first deadline for returns and DST payment, where applicable, will be June 30, 2025.

OVERVIEW OF THE DST

The DST applies at a rate of 3% on Canadian digital services revenue earned by a taxpayer (or members of a consolidated group (*i.e.*, an ultimate parent entity and one or more other entities that are generally required to prepare consolidated financial statements)) in the particular calendar year beginning January 1, 2022, but only if the following two revenue thresholds are met:

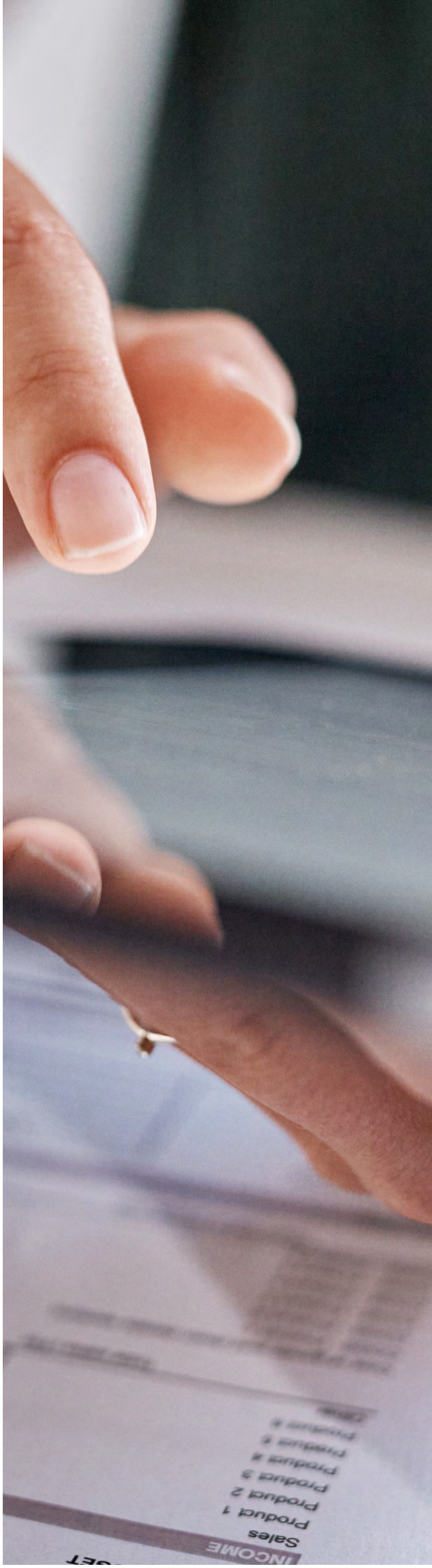
— Total global revenue of the taxpayer, or if applicable the consolidated group, from all sources exceeded €750 million in a fiscal year ending in the previous calendar year; and

— Canadian in-scope digital services revenue of the taxpayer, or if applicable the consolidated group, exceeds $20 million in the calendar year. Digital services revenue earned from another member of the consolidated group is generally excluded from the computation of the in-scope digital service revenue.

Therefore, both Canadian and non-Canadian taxpayers are subject to the DST regime if their revenues exceed the above thresholds. The DST applies to Canadian digital services revenue, which is derived from four different revenue streams sourced to online users in Canada: (i) online marketplace services revenue; (ii) online advertising services revenue; (iii) social media services revenue; and (iv) user data revenue. The DSTA contains detailed definitions and exclusions for each revenue stream along with complex application rules to determine the revenues derived from Canadian users, as well as further provisions to determine a taxpayer's Canadian digital services revenue.

A taxpayer must register under the DSTA if the taxpayer or its consolidated group (i) exceeds the total global revenue threshold of €750 million and (ii) earns Canadian digital services revenue of at least $10 million.

As the registration threshold is lower than the DST liability threshold, taxpayers and members of a consolidated group may have registration and filing obligations without having any DST liability until the $20 million Canadian digital services revenue threshold is reached (shared amongst members of the



consolidated group). Taxpayers who fail to register, file and/or pay DST within the prescribed time are subject to interest and/or penalties. If a taxpayer is a member of a consolidated group, each member of the consolidated group is generally jointly and severally liable for unpaid DST.

For additional information on the DST see the previous articles written by our Indirect Tax Team (**here**, **here** and **here**).

2024 GST/HST RELIEF TAX HOLIDAY

On November 21, 2024, the Government announced the GST/HST Holiday Relief. Bill C-78, the *Tax Break for All Canadians Act* became law on December 12, 2024.

The GST/HST Holiday Relief will apply from December 14, 2024 to February 15, 2025 (the "Eligible Period"), and will temporarily zero-rate GST/HST on qualifying goods that are commonly purchased during the holiday season. The "qualifying goods" include:

- Certain types of children's clothing, footwear, diapers, and car seats;
- Print newspapers, excluding electronic publications, flyers, and more;
- Printed books, with several exclusions such as most magazines and writing journals;
- Christmas trees;
- Food or beverages, including alcoholic beverages, restaurant meals, candies, and more;
- Select children's toys, such as board games and dolls, intended for children under 14 years of age;
- Jigsaw puzzles; and
- Video-game consoles, controllers, and physical video games.

To qualify for the relief, all amounts payable for the goods must be paid during the Eligible Period and the goods must be delivered or made available to the purchaser during the Eligible Period. The introduction of the GST/HST Holiday Relief with very little advanced notice has proven to be a challenge for many businesses.

For further information on the GST/HST Holiday Relief, see our article **here**.

Tax Disputes and Litigation Developments and Outlook

In this section, we review proposed legislation that could significantly impact audit risk and management for taxpayers, and also discuss important recent case law dealing with both income tax and GST.

PROPOSED NEW CRA AUDIT POWERS

The August 2024 proposed measures give the CRA additional powers to obtain information and compel compliance with domestic and foreign-based information requirements. These proposed measures will give the CRA new tools to obtain information from taxpayers and, perhaps more significantly, new powers to extend the re-assessment period and give the CRA more time to audit.

Notice of Non-Compliance

First, the proposed legislation will give CRA the power to issue a "notice of non-compliance" if the Minister determines that a taxpayer has not complied with a request for information. While a notice of non-compliance is outstanding:

- The normal reassessment period of the taxpayer and each person that does not deal at arm's length with the taxpayer will be suspended for any taxation year to which the notice relates; and
- A penalty of $50 will apply each day, to a maximum of $25,000.

To challenge a notice of non-compliance, a taxpayer can ask the Minister to vacate the notice of non-compliance. However, the taxpayer must demonstrate that the initial request for information was unreasonable (for example, that the CRA did not provide sufficient time to respond) or that the taxpayer reasonably complied with the request for information prior to the issuance of the notice of non-compliance. If the Minister upholds the notice of non-compliance, the taxpayer can seek judicial review in the Federal Court of the Minister's decision.

The notice of non-compliance is a significant new power for the CRA which will pose new risks for taxpayers. Previously, if the CRA felt that a taxpayer had not complied with a valid request for information, the CRA would have to seek a compliance order and persuade a court that the information should be provided. If this proposed change is implemented, then if the CRA feels that a taxpayer has not complied with a request for information, the CRA has the power (and discretion) to issue a notice of non-compliance, at which point the taxpayer must pursue legal remedies to have the notice lifted.

Further, the process that the taxpayer must follow to have the notice lifted will result in significant costs and delays, all the while the reassessment period is suspended not only for the taxpayer, but also for non-arm's length parties who may not even be aware that their reassessment period is suspended.

Compliance Order for Foreign-Based Information

Currently, if a taxpayer does not provide foreign-based information to the CRA when requested, the consequence is that such information cannot be used in the TCC to assist the taxpayer. The new measures propose to allow the CRA to obtain a compliance order to force the production of foreign-based information, irrespective of whether such information is within the power, possession, or control of the taxpayer. In addition, such information must be obtained at the taxpayer's own cost. It is unclear how exactly this new power will work. If the information is not within the power, possession, or control of the taxpayer, then how can the taxpayer obtain it? And should the taxpayer be subject to penalties (or a notice of non-compliance) if it is unable to do so. It will be important for taxpayers to carefully document the steps it takes to try to obtain this type of information in response to a request from CRA, particularly in light of the new proposed compliance order penalty (described below).

Compliance Order Penalty

There will be a new automatic penalty if an order is issued by the Federal Court requiring a taxpayer to comply for an information request (both domestic and foreign-based). The penalty will:

— Apply only if the taxpayer had tax owing of $50,000 or more for any one taxation year in respect of the compliance order; and

— Be equal to 10% of the total tax payable by the taxpayer in respect of the taxation year(s) to which the order relates.

This proposed penalty could have a chilling effect on taxpayers' decision to validly withhold information that is not producible to CRA (such as information subject to solicitor-client privilege). For that reason, we expect that this proposed penalty could be subject to legal challenge.

Providing Information Under Oath or Affirmation

The CRA will have the ability to require a taxpayer to answer information requests, either written or oral, under oath or affirmation, or by affidavit. In effect, the power will enable the CRA to conduct a quasi-discovery through a process that lacks the necessary procedural safeguards and rules that normally govern discoveries in the TCC.

A taxpayer will carefully have to consider their responses to information requests when given under oath or affidavit, as there is a chance that such answers would be used to impeach the taxpayer later if the matter goes to litigation.

Learnings and Outlook

The Audit Powers Working Group of the Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada recommended to Finance, changes to the CRA audit powers in September 2024.

While the new powers are not yet law, they will potentially change the way taxpayers deal with auditors, as well as the time, effort, and cost that taxpayers will need to incur to respond to audit queries. In addition, taxpayers should expect more disputes and litigation.

For more details on the proposed amendments to the audit powers, please see:

— **The CRA's Proposed New Audit Powers: More Discretion, More Time to Reassess, Less Judicial Oversight**

— **More Discretion, More Time to Reassess, Less Judicial Oversight: Budget 2024 Proposals to Give the CRA Enhanced Audit Powers Also to Apply for GST/HST Purposes**

Draft Subsections 160(6) to 160(8) – Increasing Collection of Taxes

Overview

On August 12, 2024, as part of the updated draft legislation further to the Budget 2024 proposals, the Minister of Finance proposed new subsections 160(6) to 160(8) to broaden the CRA ability to collect taxes under section 160 of the Act. The proposed provisions introduce a "deemed transfer" rule to address circumstances where a tax debt avoidance "planner" facilitates the indirect transfer of property from a tax debtor (transferor) to a non-arm's length party (transferee).

Background on Section 160 Liability

Individuals or corporations that seek to avoid paying their tax debts sometimes transfer property to non-arm's length persons, such as friends and family, at less than fair market value. In these circumstances, section 160 of the Act allows the CRA to assess the transferee of such property for the amounts owing by the transferor taxpayer. Section 160 generally applies when:

— There has been a transfer of property from the transferor to their spouse or common law partner (or any person who has since become the transferor's spouse or common law partner), any minor, or any person dealing not at arm's length with the transferor; and

— The transferor has any "amounts" owing under the Act.

Subsection 160(2) gives the Minister the power to assess the transferee for such a tax liability. The transferee is jointly and severally liable for the amount of their "underpay" for the property relative to fair market value (i.e., the fair market value of the property transferred less the fair market value of the consideration transferred in exchange).

Section 160 Avoidance Transactions and Proposed Subsections 160(6) to 160(8)

Proposed subsections 160(6) to 160(8) are intended to target "section 160 avoidance transactions." For example, transactions where taxpayers make transfers through an arm's length facilitator or "planner" (i.e., property is transferred from the transferor to the planner, and then from the planner to the transferee) thereby avoiding the application of section 160 as the transfer was not to a non-arm's length person. The proposed legislation establishes a "deemed transfer" from the transferor to the transferee.

First, proposed subsection 160(6) identifies the circumstances in which a "deemed transfer" arises:

— An intermediary "planner" transfers property to a transferee (or person not dealing at arm's length with a transferee);

— A transferor has transferred the "particular property" to the planner or any other person; and

— It is reasonable to conclude that one of the purposes of the transaction is to avoid joint and several liability of the transferee and transferor for an amount payable under the Act.

Then, proposed section 160(7) operationalizes the "deemed transfer" from the transferor to the transferee:

— "(7) If this subsection applies in respect of a transaction or series of transactions, for the purposes of this section, the transferor (within the meaning of subsection (6)) is deemed to have transferred the particular property to the transferee (within the meaning of subsection (6)) as part of the transaction or series of transactions."

As a result of proposed subsection 160(7), the transferee would have joint and several liability for the transferor's tax debts, even though the transactions were completed through the arm's length facilitator. Finance also proposes to amend the definition of a "section 160 avoidance transaction" to include a transaction captured by section 160(7).

Finally, proposed subsection 160(8) makes the transferee liable for even more of the transferor's tax debt than they otherwise would have been with a direct transfer. While transferees are only liable under subsection 160(1) for the amount of the underpay for the property relative to fair market value (i.e., the FMV of the property minus anything that was transferred in exchange), subsection 160(8) deems the consideration for property to be nil if it is "reasonable to conclude that one of the purposes" of the transaction is to avoid section 160 liability (or the transaction is otherwise captured by the section 160 avoidance provisions, paragraphs 160(5)(a), 160(5)(b), or subsection 160(7)). This means that the transferee is liable for taxes up to the full fair market value of any property transferred, regardless of how much the transferee paid in exchange for the property.

Ultimately, the proposed changes give the CRA a broader scope to collect against transferees in the face of section 160 avoidance transactions that artificially impose an arm's length facilitator to avoid the application of section 160. When these provisions take force, transferees that attempt to plan around section 160 are at risk of increased tax liability per subsection 160(8).

These proposed changes apply in respect of transactions that occurred on or after April 16, 2024.

Learnings and Outlook

In acquisitions or sales of a business, either party may facilitate additional tax planning that may involve arm's length parties. Clients should consider the new proposed subsection 160(6) to (8) and whether the purpose of such planning could be perceived to avoid joint and several liability of the transferor and transferee for an amount payable under the Act. In such a case, the transferee may have an increased liability as a result of the proposed deemed transfer rules.

INCOME TAX CASES

Dow Chemical And Iris Technologies – When To Go To The TCC And When To Go To The FC (SCC)

Overview

On June 28, 2024, the Supreme Court of Canada ("SCC") released its long-anticipated companion decisions in *Dow Chemical Canada ULC v. Canada*, **2024 SCC 23** and *Iris Technologies Inc. v. Canada*, **2024 SCC 24**. These decisions clarify the jurisdictional boundaries between the Tax Court of Canada ("TCC") and the Federal Court ("FC") in tax disputes.

Central to the majority's reasons in both decisions is the distinction between a tax assessment and the exercise of discretionary powers by the Minister under tax legislation. According to the SCC:

- The TCC has exclusive jurisdiction to determine the correctness of a tax assessment, which involves a non-discretionary determination of a taxpayer's tax liability.
- The FC has exclusive jurisdiction to review discretionary decisions of the Minister, except where Parliament has expressly provided otherwise.

Dow Chemical

Dow Canada, a Canadian resident corporation, incurred interest expenses under a loan agreement with a related Swiss company (Dow Europe), and also earned income from services provided to Dow Europe. The Minister reviewed the transactions between Dow Canada and Dow Europe and reassessed Dow Canada to increase its services income under subsection 247(2) of the Act. In response, Dow Canada requested a downward transfer pricing adjustment to account for the additional interest expenses it would have incurred under the loan agreement if it had been dealing at arm's length with Dow Europe. The Minister refused the requested adjustment under subsection 247(10).

Dow Canada appealed the reassessment to the TCC and challenged the Minister's decision to deny the downward adjustment under subsection 247(10). The TCC held that it had jurisdiction to consider decisions made by the Minister under subsection 247(10) of the Act due to the TCC's exclusive jurisdiction to determine the correctness of an assessment.

The Minister appealed to the Federal Court of Appeal ("FCA"). The FCA overturned the decision of the TCC and concluded that the FC retains jurisdiction to judicially review the Minister's discretionary decisions.

The majority of the SCC held that the Minister's opinion under subsection 247(10) to deny a downward pricing adjustment is a discretionary decision that falls outside the TCC's jurisdiction. The SCC distinguished the TCC's jurisdiction to determine the correctness of an assessment, which is a "purely

non-discretionary determination" that flows from the facts and the law, from the FC's jurisdiction to review other discretionary decisions guided by policy considerations.

Writing for the dissent, Justice Côté concluded that a challenge of the Minister's decision under subsection 247(10) could be considered by the TCC as it directly impacts the amount of tax owing and therefore the correctness of a taxpayer's assessment.

<u>*Iris Technologies*</u>

Iris Technologies claimed substantial input tax credits under the *Excise Tax Act* ("ETA"), which the Minister disallowed by way of assessment. Iris Technologies brought an application for judicial review to the FC, seeking three declarations regarding the conduct of the Minister in issuing the assessments: (1) the Minister failed to afford procedural fairness in the audit; (2) the assessments were issued without evidentiary foundation; and (3) the assessments were issued for improper purpose to deprive the FC of jurisdiction.

The Government brought a motion to strike Iris Technologies' application on the basis that the essential character of the application was a challenge to the correctness of the assessment, which falls within exclusive appellate jurisdiction of the TCC.

The Crown's motion to strike was dismissed by the FC on the basis that the taxpayer's application for judicial review of the Minister's conduct was "not an attack on the assessment but on the procedural fairness of the assessment."

The Minister appealed to the FCA. The FCA overturned the decision of the FC on the basis that the application for judicial review was essentially a collateral attack on the validity of the assessment, which falls within the exclusive jurisdiction of the TCC.

The SCC agreed that the essential nature of the application for judicial review was an attack on the correctness of the assessment which was within the exclusive jurisdiction of the TCC. According to the majority, the express appeal route to the TCC precludes Iris's application for judicial review to the FC for its first two complaints. Since Iris Technologies would have an opportunity to respond on appeal, an appeal to the TCC constitutes an "adequate, curative remedy" to the procedural fairness claim. The TCC could also consider the alleged lack of evidentiary support underlying the assessments on an appeal before it. As for Iris Technologies' third claim, that the Minister acted with an improper purpose, the majority of the SCC stated that the FC could consider an application for judicial review on this basis. However, Iris Technologies' claim should nevertheless be struck because it did not allege facts in its application that, if taken to be true, would give any support to this claim.

The SCC was unanimous in concluding that Iris Technologies' application should also be struck because the requested declarations would have no practical effect. The only live controversy remaining between the parties is the amount of tax under the assessments.

<u>*Learnings and Outlook*</u>

There are three key takeaways from these decisions:

— Appeals to the TCC are available from assessments only. Assessments are the "product" of the audit process. Complaints about the Minister's decisions during the course of the audit "process" cannot be appealed to the TCC.

— Decisions assigned by statute to the Minister's "opinion" or discretion are properly understood as part of the "process" and are reviewable by the FC.

— Judicial review is not permitted if it amounts to an attack on the Minister's assessment, even where the relief sought is strictly declaratory.

Taxpayers must carefully choose the appropriate forum for advancing their grievances. A taxpayer may be required to seek judicial review before the FC, appeal an assessment to the TCC, or potentially bring a civil suit before a provincial Superior Court.

Clients need to think carefully and strategically about which forum and what remedy they are seeking. Choosing the wrong forum could result in significant delays and costs.

3295940 – Alternative Transactions: Increasingly Relevant to Support the Absence of Abuse Under the GAAR

Overview

On November 21, 2024, the SCC confirmed that it would not grant leave to appeal from the FCA decision in *3295940 Canada Inc.*, **2024 FCA 42**. While there was no dispute that alternative transactions may play a role in a GAAR analysis, this decision provides long-awaited clarifications on the relevant factors to determine the relevance of transactions to support the absence of abuse, the third and most litigated condition under the GAAR.

Facts

The case involved the sale of a generic drug business held by two shareholders to a third party, Novartis Pharmaceuticals Canada Inc. ("Novartis"). The minority shareholder, Gestion Micsau Inc. ("Micsau"), held its shares in the operating target through 3295940 Canada Inc. ("3295").

Since the adjusted cost base ("ACB") of the shares of 3295 was higher than the ACB of the shares of its subsidiary, Micsau wanted to sell 3295 directly to Novartis, but Novartis was not interested. Micsau entered into a series of transactions in order to replicate the lower capital gain it would have realized through the direct sale of 3295.

The plan involved transferring the balance of 3295's capital dividend account ("CDA") on the redemption of its shares, which was then transferred back to it on a subsequent redemption immediately thereafter. Through such "CDA recycling," 3295 indirectly obtained a $31.5-million bump of its subsidiary's low basis shares prior to their sale without triggering a corresponding gain, in a context where paragraph 88(1)(d) was otherwise unavailable.

TCC Decision

At trial, the TCC concluded that the purpose of the CDA regime is to trace corporate surpluses that can be distributed tax free to shareholders. In the present case, the CDA regime did not allow the tracing of surpluses towards the top of the corporate structure: a CDA balance was artificially circulated in a corporate group back to its original starting point. The application of subsection 55(2) was avoided in the process as capital dividends are not targeted by that provision.

The trial judge focused on the cross-redemption of shares to find that it was a way for Micsau to declare a dividend that would reduce the capital gain resulting from the sale of the generic drug business, which would be against the object, spirit and purpose of subsections 55(2), 83(2) and 89(1). The Court also found that no double taxation resulted from the fact that the taxpayer was not able to benefit from the cost in its own shares as part of the sale of its assets.

FCA Decision

Justice Goyette did not agree with those findings. Instead of focusing on the cross-redemption, her analysis was based on the whole series of transactions: the final capital gain realized on the sale to Novartis did not significantly change compared to the direct sale of the 3295 shares. Therefore, the object, spirit and purpose of the capital gains regime (i.e., the taxation of real economic gains) was still accomplished through the series of transactions.

Furthermore, the FCA emphasized that the difference between the capital gain that would have resulted from the sale of 3295 subsidiary's shares compared to the sale of 3295 shares, did not escape Canadian taxation. The difference comes from Micsau lawfully isolating its higher ACB in the 3295 shares, not from the cross-redemption in itself.

Learnings and Outlook

Since Univar, it is well established that alternative transactions can be taken into account to determine whether there is an abuse for a GAAR analysis.

Before Justice Goyette's decision in 3295, there was no clear indications as to what types of alternative transactions should be considered as relevant for a GAAR abuse analysis. For example, at trial, the judge found that the four alternative transactions proposed by Micsau were not valid because (1) the sale of 3295 subsidiary's shares was essential to the transaction since Novartis refused to buy 3295 shares and (2) the purpose of the sale, the price and the business implications would have been different.

Beyond the rejection of the Tax Court arguments, the FCA established five criteria to take into consideration when determining the relevance of alternative transactions in a GAAR abuse analysis:

They are available under the Act;

- They are not so remote as to be practically infeasible;
- They have a high degree of commercial and economic similarity;
- They generate tax consequences approximately as favourable as the series at issue; and
- They are not abusive of the GAAR.

These criteria were all found to be met for the alternative transactions submitted. In light thereof, the FCA reiterated that there was no abuse.

It is worth noting that all the alternative transactions presented involved the sale of 3295, which was ultimately not sold by Micsau. Assets of 3295 were. By considering that the sale of a corporation's asset is comparable to the sale of its shares, the decision clearly invites courts to be flexible in accepting comparable transactions for the purposes of the abuse analysis. This should have an important impact on tax disputes and case law as this step of the GAAR analysis is the most contentious.

Kone – Repo Transactions Are Not Shams and Not Subject to GAAR (QCCA)

Overview

On May 31, 2024, the QCCA confirmed in *Agence du revenu du Québec c. Kone inc.*, **2024 QCCA 678**, that a cross-border financing arrangement effected by way of a repurchase (or "repo") transaction was not a sham and was not subject to the Québec GAAR.

Facts

As part of a financing strategy to allow an international group to finance acquisitions in Europe, a Canadian taxpayer corporation ("Kone Canada") used borrowed funds to purchase various classes of cumulative dividend preferred shares of a US-resident ("Kone USA") from a Dutch affiliate ("Kone BV"). At the same time, Kone Canada entered into a repurchase agreement with Kone BV, with respect to the preferred shares of Kone USA preferred shares ("Repo Shares"). In accordance with the repurchase agreement, Kone BV repurchased the Repo Shares at a later date at the same price, together with all accrued and unpaid and undeclared dividends.

While holding the Repo Shares, Kone Canada received dividends on the Repo Shares, which were fully deductible as they were paid out of Kone USA's exempt surplus. At the same time, Kone Canada deducted interest paid on its intercompany debt, generating non-capital losses.

Under the "substance over form" doctrine in U.S. federal income tax law, the repo transaction was viewed as a loan made by Kone Canada to Kone BV, secured by the Repo Shares.

The Québec Revenue Agency challenged the transactions both on the basis of sham and GAAR, alleging that the repo transactions were "equivalent to loans."

The Court of Québec agreed with Kone Canada that neither sham nor the Québec GAAR applied. The Québec Revenue Agency appealed to the QCCA.

QCCA Decision

The QCCA concluded that:

- The Repo transaction did not result in a sham because "the parties acted in accordance with the rights and obligations established by the documents"; the fact that U.S. tax law considers the economic substance of the repo transaction to be a secured loan does not mean that it is a sham to treat the transaction as a sale for Canadian tax purposes in accordance with its legal form.
- The Québec GAAR did not apply because there was no abuse of the object, spirit and purpose of the Québec equivalent of section 17 of the Act. The Repo transaction did not defeat the purpose of that

provision as it provided for a reasonable form of return in the form of dividends.

The QCCA confirmed that Kone Canada was entitled to choose the financing structure that provided the most favourable tax outcome, and that doing so does not trigger the application of the GAAR. Repo transactions are widely known and used financing instruments on the international market and it was up to Parliament to provide clear rules governing the tax treatment of these instruments. In absence of those specific rules, it would be inappropriate for the QCCA to apply the GAAR to impute interest.

The Québec Revenue Agency made an application for leave to appeal to the SCC on August 30, 2024.

Learnings and Outlook

As Repo transactions are very common and well-known financing instruments, this decision confirms that for Canadian purposes, the legal form of a transaction governs over the economic substance and must be respected by the tax authority.

We understand that the CRA has also challenged similar Repo transactions.

Glencore – Break Fees Are Taxable As Inducements (FCA)

Overview

This decision concerns the tax treatment of a "break fee," which is a contract termination fee paid by a target to a bidder if a public merger and acquisition falls through. These types of fees are a common deal protection measure in Canada.

Facts

The dispute arose in 1996 after Falconbridge Limited (Glencore's predecessor) offered to acquire publicly traded shares of Diamond Fields Resources Inc. The merger agreement provided for a commitment fee of $28 million payable upon entering into the merger agreement and a break fee of $73 million that was not payable unless a competing offer was accepted. Diamond Fields accepted a competing offer by Inco Ltd. As a result, Diamond Fields owed and paid Falconbridge fees including a "Non-Completion Fee" (i.e., a break fee) in the amount of $73 million.

TCC Decision

At the TCC, Glencore argued that the break fee was not taxable as it was not from a source of income. In the alternative, Glencore argued that the break fee was taxable as a capital gain because the break fee was compensation for disposition of its right to merge with Diamond Fields.

The Crown argued that the break fee was business income under subsection 9(1) of the Act, or in the alternative, income from a business or property pursuant to paragraph 12(1)(x) of the Act.

The TCC found that since Glencore was in the mining business, it received the break fee in the course of trying to acquire a mine and thus, the break fee was business income under subsection 9(1) because the fee was "inextricably linked to Falconbridge's ordinary business operations." As a result, the TCC did not consider whether the break fee was income from a business or property under paragraph 12(1)(x).

Glencore appealed to the FCA.

FCA Decision

On January 5, 2024, the FCA released its decision in *Glencore Canada Corporation v. Canada*, **2024 FCA 3**.

The FCA disagreed with the TCC that the break fee was business income under subsection 9(1) of the Act, but concluded that the break fee was taxable as an inducement under paragraph 12(1)(x) of the Act:

- **The break fee was not business income under subsection 9(1)** because of the distinction between capital (not business income) and revenue receipts (business income). The FCA found that the break fee had "no linkage to revenue" but was instead linked to acquiring shares – a capital asset – and therefore could not be business income. In other words, Glencore was in the business of mining, but not in the business of acquiring mines.
- **The break fee did not give rise to a capital gain.** Despite being tied to a capital asset (the shares), the FCA held that the disposition of the right to acquire the target did not give rise to a capital gain. The FCA held this determination depends heavily on the terms of the merger agreement between Falconbridge and Diamond Fields. Glencore had argued that the break fee was compensation for giving up its right to merger with Diamond Fields. The FCA found that Falconbridge did not have a "right to merge" with Diamond Fields since Falconbridge's offer was directed at Diamond Fields' shareholders, and Diamond Fields' board of directors was not obligated to support Falconbridge's bid. The "right to merge" was conditional upon there being no superior bids and the approval of Diamond Fields' shareholders.
- **The break fee is income from business as an "inducement"** received by the taxpayer pursuant to subparagraph 12(1)(x)(iii) of the Act. The FCA concluded that break fees are intended to entice bidders to participate in an auction and that Falconbridge would not have made an offer save for the break fee. In other words, the break fee was an inducement for Falconbridge's offer and captured by subparagraph 12(1)(x)(iii).

SCC Decision

On August 8, 2024, the SCC denied the application for leave to appeal.

Learnings and Outlook

The decision of the FCA came as a surprise to most tax practitioners for two reasons.

First, it is commonly understood that break fees are for the right to terminate the merger agreement. In the *Glencore* case, the Arrangement Agreement did not explicitly articulate that, so clients are reminded to carefully consider how their agreement is drafted.

Second, subparagraph 12(1)(x)(iii) includes an amount received as income from a business where the amount can reasonably be considered to have been received as an inducement. In Glencore's case, the break fee was received after the offer was made. That is, it is unclear how the receipt of the break fee, which occurred after the deal fell through, was an inducement to make an offer, as receipt occurred after the offer was made.

The unique characterization of break fees by the FCA and the FCA's reasoning arguably sweeps any contractual condition that one party considers essential into the ambit of paragraph 12(1)(x). Taxpayers should be mindful of potential uncertainty around both the breadth of paragraph 12(1)(x) when considering fee payments and the drafting of contracts to make it clear for what is the fee payment.

GST/HST CASES

President's Choice Bank – Redemption Payments Were Made in the Course of a Commercial Activity (FCA)

Overview

This tax dispute arose in the context of PC Bank's loyalty program with Loblaws Inc. ("Loblaws") and the statutory regime governing the tax treatment of goods purchased using coupons.

Under its loyalty program with Loblaws, PC Bank issued PC Bank-branded Mastercards to its customers and issued PC Points to customers whenever they used the card. However, the cardholders could only redeem the points at Loblaws stores. This was a deliberate strategy to incentivize cardholders to shop at Loblaws and thereby increase retail traffic in the stores.

When a customer shops at Loblaws stores and uses PC Points to get a discount, PC Bank reimburses Loblaws the cost of the discount that Loblaws provided the customer (the Redemption Payment). To compensate PC Bank for driving retail traffic to Loblaws, Loblaws paid PC Bank $0.35 for every $1.00 worth of PC Points redeemed.

Paragraphs 181(2)(a) and (b) of the ETA create an overpayment of tax as they deem tax collectible and collected by the retailer to be the tax that would have been collected without the coupon. For example, if a customer in Alberta bought shampoo for $10 and uses a $1 coupon, GST (5%) of $0.50 is calculated based on the $10, not the $9, resulting in an overpayment of GST. To remedy this situation, subsection 181(5) of the ETA permits the issuer of the coupon (in this case, PC Bank who issued the PC Points) to recover the excess tax through a notional input tax credit if certain criteria are met. One of the criteria is whether the issuer of the coupon pays the retailer for the cost of the coupon when it is redeemed by the customer "in the course of a commercial activity."

The Minister denied PC Bank's notional input tax credits on the basis that PC Bank did not make the Redemption Payment "in the course of a commercial activity." The Minister claimed that PC Bank issued the PC Points and made the Redemption Payment to increase use of the PC MasterCard and therefore increase profits from its financial services business. As the provision of financial services are exempt supplies, they are excluded from the definition of "commercial activity" in the ETA.

PC Bank argued that it issued the PC Points not only to help its credit card business, but also to drive traffic to Loblaws and that was the reason for the Redemption Payment. The activity of driving traffic to Loblaws was a commercial activity. In particular, PC Bank argued that subsection 181(5) did not require that the activity be exclusively commercial.

The TCC concluded that PC Bank made the Redemption Payment in the course of its financial services business.

<u>*Federal Court of Appeal*</u>

On August 21, 2024, the FCA issued its decision in *President's Choice Bank v. His Majesty The King*, **2024 FCA 135**. The FCA concluded that on a proper interpretation of subsection 181(5), which did not require the activity to be exclusively commercial, PC Bank made the Redemption Payment in the course of a commercial activity. As a result, PC Bank was entitled to the notional input tax credits.

<u>*Learnings and Outlook*</u>

The text, context, and purpose of a provision will likely dictate the outcome. In this case, the text of subsection 181(5) did not use the word "exclusively," allowing taxable activities to be captured even where the person simultaneously provides exempt services. In addition, the fact that there was an overpayment of GST and Parliament created a specific regime to allocate that overpayment, helped to solidify a win for the taxpayer.

Toronto-Dominion Bank – Aeroplan Miles Are Not Gift Certificates (TCC)

<u>*Overview*</u>

In this case, the TCC considered whether an Aeroplan Mile is a "gift certificate" within the meaning of section 181.2 of the ETA. The decision established characteristics that a device must have in order to be a gift certificate, which is not defined in the ETA.

TD Bank entered into an Affinity Program Agreement with Aeroplan which allowed TD Bank to offer Aeroplan Miles to users of certain TD Visa Cards. Aeroplan Miles are points that can be redeemed through Aeroplan in exchange for travel rewards and various other goods and services.

Aeroplan invoiced TD Bank for various amounts under the Agreement and applied GST/HST to the amounts charged.

TD Bank paid the GST/HST invoiced, but later applied for rebates on the basis that it had paid the GST/HST in error.

TD Bank asserted that Aeroplan supplied it with Aeroplan Miles and that Aeroplan Miles were gift certificates. Under section 181.2 of the ETA, the issuance or sale of a gift certificate for consideration is deemed not to be a supply.

The Government took the position that Aeroplan was making a taxable supply of promotional and marketing services to TD Bank. In the alternative, the Government argued that Aeroplan Miles did not meet the criteria for gift certificates.

The TCC rendered its decision in *Toronto-Dominion Bank v. The King*, **2024 TCC 50**.

First, the TCC concluded that under the Agreement, Aeroplan supplied TD Bank with several different goods and services. The TCC agreed with the parties that the goods and services supplied were part of a single compound supply. The TCC then determined that the predominant element of the single supply was the Aeroplan Miles as there was no commercial efficacy to the Agreement without the Aeroplan Miles.

Second, the TCC concluded that Aeroplan Miles were not gift certificates. To determine whether Aeroplan Miles were gift certificates, a term not defined in the ETA, the TCC concluded that while the term "gift certificate" encompasses both pre-paid cards and vouchers for goods or services, Parliament only intended for pre-paid cards to be treated as gift certificates. The TCC found that the characteristics of a gift certificate include:

- a stated monetary value that either appears on the device's face or is retrievable electronically;
- the device must be transferable without additional payment to the issuer;
- the bearer must be entitled to apply some or all of the balance of the stored monetary value to the purchase price; and
- the device may have some conditions, but they must not detract from the money-like attributes.

According to the TCC, an Aeroplan Mile had none of these characteristics: it did not have a stated monetary value, it was not transferable without paying a significant fee to Aeroplan, and there was a significant condition on their use – a need to accumulate more Aeroplan Miles to use a single Aeroplan Mile.

TD Bank has appealed to the FCA.

Learnings and Outlook

The term "gift certificate" is not defined in the ETA. Cases about gift certificates have not been consistent about what characteristics are necessary. Even CRA's administrative policy has not been consistent.

This decision may have repercussions for other loyalty points programs, particularly where points/vouchers have been treated as gift certificates, as well as situations where vouchers for goods or services are provided – which would no longer be considered to be gift certificates under the TCC's interpretation.

Entrepôt Frigorifique International – CRA Cannot Impose Additional Obligations To Claim ITCs (TCC)

Overview

On May 27, 2024, the TCC issued its decision in *Entrepôt Frigorifique International c. Le Roi*, **2024 CCI 78**. In this case, a GST registrant paid certain employment staffing agencies for the supply of temporary workers. The staffing agencies issued invoices to the registrant, which contained all the information prescribed by the legislation and collected GST on the supply of their services. However, the staffing agencies did not remit the GST collected. The registrant, who had paid the GST on the services, claimed input tax credits.

Instead of seeking out the staffing agencies and assessing them for the unremitted GST, the Minister reassessed the registrant by disallowing all of the input tax credits claimed by the registrant on the basis that the invoices issued by the staffing agencies were false invoices, the staffing agencies did not have the resources necessary to supply the services for which they were retained by the registrant and that the whole arrangement was a sham in which the registrant was a participant.

The key issue was whether a GST registrant is required to exercise additional due diligence on its suppliers, including ensuring that the supplier has remitted all GST collected by it, in order to claim input tax credits.

The TCC allowed the taxpayer's appeal and reaffirming that, except where a registrant is an actual participant in a fraud or sham, a registrant's entitlement to claim input tax credits is not dependent on exercising additional due diligence on its suppliers. Rather, if the registrant meets the documentary requirements set out in the ETA and regulations, they are entitled to input tax credits.

Learnings and Outlook

Where a supplier provides services to a purchaser and collects GST but does not remit GST to the Government, the CRA has increasingly tried to go after the purchaser to deny input tax credits, instead of going after the supplier who has wrongfully kept the GST. A purchaser who has already paid the GST should not also be denied input tax credits unless they are a direct participant in a fraud. There is no additional requirement for a purchaser to undertake additional due diligence to ensure that the supplier has remitted the GST.

In certain industries where such fraud is high, the CRA can take measures to inform a purchaser or put in place requirements for a supplier to obtain a certification to ensure that GST is properly remitted or revoke the supplier's registration, in which case no input tax credits can be claimed.

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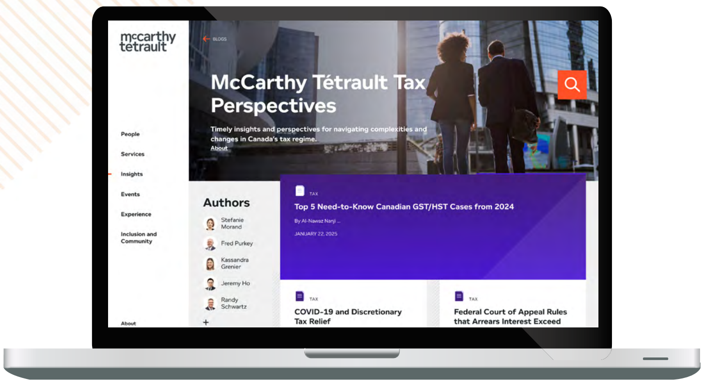

https://www.mccarthy.ca/en/insights/blogs/mccarthy-tetrault-tax-perspectives

About Us

Our Tax expertise and our knowledge of Canada's tax regime is widely recognized. Helping our clients navigate the tax aspects of domestic and cross-border public and private mergers and acquisitions, corporate reorganizations, financings and securitizations, and other transactions, we bring clarity and pragmatism to complicated tax issues that could otherwise derail business goals. We have assisted on Canada's most innovative, high-profile business transactions

McCarthy Tétrault LLP is a premier full-service Canadian law firm advising on large and complex transactions and disputes for domestic and international clients. The firm has offices in every major business center in Canada, and in New York and London. The firm's industry-based team approach and depth of practice expertise helps our clients achieve exceptional commercial results.

> **"It is an excellent team – very thorough and very detailed. They did fantastic work and were the best I ever worked with. McCarthy would absolutely be my first choice for tax matters."**
>
> – *Chambers Global Client Interview (Tax)*

VANCOUVER
Suite 2400, 745 Thurlow Street
Vancouver, BC V6E 0C5

CALGARY
Suite 4000, 421 7th Avenue SW
Calgary, AB T2P 4K9

TORONTO
Suite 5300, TD Bank Tower
Box 48, 66 Wellington Street West
Toronto, ON M5K 1E6

MONTRÉAL
Suite MZ400
1000 De La Gauchetière Street West
Montréal, QC H3B 0A2

QUÉBEC CITY
500, Grande Allée Est, 9e étage
Québec, QC G1R 2J7

NEW YORK
55 West 46th Street, Suite 2804
New York, New York 10036
United States of America

LONDON
1 Angel Court, 18th Floor
London EC2R 7HJ
United Kingdom