JANUARY 31, 2019

Canadian Tax Laws: A Review of 2018 and a Look Ahead to 2019

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Each year at this time we offer a look back at some of the more significant income tax developments in Canada affecting domestic and international business over the past year and a look ahead to possible Canadian tax developments in the coming year.

Legislative Developments in 2018

Budget 2018

A. Private Company Passive Investment Income

In 2017, the Department of Finance released a set of controversial and convoluted proposals aimed at addressing its concern that individuals who carry on business through a corporation can obtain a tax deferral advantage by retaining their after-tax business income in the corporation to make passive investments. The 2017 proposals were exceedingly complex and effectively proposed a punitive tax on income generated from investments made using after-tax business earnings of a Canadian-controlled private corporation (CCPC) in excess of $50,000 per year. Budget 2018 presented a much simpler set of proposals. These new rules, applicable to taxation years that begin after 2018, phase out access to the small business deduction (SBD) for CCPCs that earn more than $50,000 in investment income, and modify the current rules for the refundable tax on dividends paid by CCPCs.

Limit on the Small Business Deduction

A CCPC is entitled to a preferential tax rate on up to $500,000 of qualifying active business income, referred to as the SBD. This amount must be shared by associated corporations and is reduced where the CCPC and its associated group have taxable capital employed in Canada in excess of $10 million. Budget 2018 further reduced the amount of the SBD for a CCPC that, together with other corporations within its associated group, earns investment income in a taxation year in excess of $50,000. For each $1 of investment income over $50,000, the SBD limit is reduced by $5. The reduction to the SBD is now the greater of the reductions under these two rules.

Refundable Taxes and Dividend Refund Rules

For purposes of the *Income Tax Act* (Canada) (ITA), a CCPC is subject to additional refundable taxes on its investment income, and these taxes are included in the CCPC's refundable dividend tax on hand (RDTOH) account. The CCPC is entitled to a refund of $38.33 of the refundable taxes included in its RDTOH account for every $100 of dividends paid to its shareholders. The purpose of the additional refundable tax and dividend refund mechanism is to provide integration of the corporate and personal tax payable on investment income earned by a CCPC, so that a shareholder should generally be indifferent as to whether the investment income is earned personally or through a corporation.

The Department of Finance's 2017 passive investment proposals would have eliminated or restricted the availability of the RDTOH rules where a CCPC reinvests active business income in passive assets. These proposals, which would have imposed an effective tax rate of approximately 73% on investment income earned by a CCPC, were heavily criticized by the business community and the press.

Budget 2018 proposed a more limited restriction of the RDTOH system, intended to ensure a CCPC will not be entitled to claim a dividend tax refund in respect of "eligible dividends" that were generated out of the CCPC's active business income taxed at the general corporate rate.

In short, Budget 2018 eliminates any dividend refund on eligible dividends paid by a CCPC, unless the eligible dividend is paid out of eligible dividends received by the CCPC on portfolio investments that were subject to the additional refundable tax. To implement this proposal, Budget 2018 created two separate RDTOH accounts to track the refundable taxes paid by a CCPC from different sources. The first RDTOH account tracks refundable taxes paid on eligible portfolio dividends received by a CCPC. A CCPC is entitled to a dividend refund for taxes in this RDTOH account when it pays an eligible or a non-eligible dividend. The second RDTOH account tracks refundable taxes on all other sources of investment income. A CCPC is entitled to a dividend refund for taxes in this RDTOH account when it pays a non-eligible dividend. There is a mechanism that preserves the character of dividends paid out of these two accounts between connected corporations.

B. New Reporting Requirements for Trusts

Budget 2018 introduced new tax reporting requirements for trusts, which are intended to improve the collection of beneficial ownership information by the government. A trust that does not earn income or make distributions in a taxation year is generally not currently required to file an annual T3 trust return. The new reporting requirements will apply to express trusts that are resident in Canada and to non-resident trusts that are currently required to file a T3 return (with certain exceptions); they require each such trust to report the identity of all of its trustees, beneficiaries and settlors, as well as each person who has the ability (whether through the trust terms or a related agreement) to exercise control over trustee decisions regarding the appointment of income or capital of the trust, such as a protector. These reporting requirements will apply in respect of the 2021 and subsequent taxation years.

C. Tiered Partnerships and At-Risk Rules

The ITA provides for an allocation of any losses of a partnership from various sources to its members. However, a taxpayer who is a limited partner of a partnership may deduct a loss of the partnership only to the extent of the taxpayer's "at-risk amount" as of the end of the partnership's fiscal period ending in that year. Broadly speaking, a taxpayer's at-risk amount reflects the partner's adjusted cost base of its partnership interest, as adjusted for the taxpayer's share of current-year income, losses and distributions. Generally, losses that exceed a taxpayer's at-risk amount are deemed to be the taxpayer's "limited partnership losses" and are allowed to be deducted in later years to the extent they no longer exceed the taxpayer's at-risk amount (e.g., because the partnership has generated income or the taxpayer has made additional contributions of capital to the partnership). How the at-risk rules apply where a partnership is itself a partner in a lower-tier partnership has been uncertain.

The Canada Revenue Agency (CRA) has historically taken the position that the losses of a lower-tier partnership that exceed an upper-tier partnership's at-risk amount in respect of the lower-tier partnership could not be carried forward as limited partnership losses and applied to offset income in future years because the rules allowing them to be carried forward did not apply to partners that are partnerships. In a recent case (*Canada v Green*), the Federal Court of Appeal disagreed with the CRA's approach and instead looked through the tiered partnerships to allow restricted losses to be claimed by the partners of the upper-tier partnership. While addressing this inequity, this decision also appeared to allow partnership losses to be claimed in circumstances that were arguably inconsistent with the purpose of the at-risk rules, and so a legislative response was expected.

Unfortunately, the Department of Finance has taken an approach that appears to be harsher than is necessary to protect the integrity of the at-risk rules. Rather than allow an upper-tier partnership to maintain a suspense account so that losses could be used in future periods if the at-risk amount increases – in the way other partners can – Budget 2018 proposed that any excess losses will simply be disallowed. The denied losses will not reduce the upper-tier partnership's tax cost of its interest in the lower-tier partnership, meaning that in many cases the losses effectively will be converted to an increased capital loss or reduced capital gain at the time the partnership interest is disposed of. This is consistent with CRA's position prior to the decision in *Green*. Budget 2018 did not explain why this more restrictive approach has been taken.

D. Cross-Border Surplus Stripping Using Partnerships and Trusts

Budget 2018 introduced rules that are intended to backstop the existing cross-border corporate surplus-stripping provisions in section 212.1 of the ITA in respect of transactions involving partnerships and trusts. The current rules prevent a non-resident shareholder of a Canadian-resident corporation from extracting corporate surplus in excess of the paid-up capital (PUC) of its shares on a tax-free basis, or artificially increasing the PUC of its shares, by transferring the shares to another Canadian resident corporation with which the non-resident shareholder does not deal at arm's length. Where applicable, the provisions can result in a deemed dividend to the non-resident shareholder or may suppress the PUC that would otherwise be created as a result of the transaction. Budget 2018 extended these provisions by adding look-through rules that will apply where a non-resident disposes of an interest in a partnership or trust that owns shares of a Canadian corporation, to preclude avoidance of the rule through internal reorganizations involving a transfer of shares to or from an intermediate entity such as a partnership or trust. The proposed amendments will allocate the assets, liabilities and transactions of a partnership or trust to its members or beneficiaries on the basis of the relative fair market value of their respective interests. This measure will apply to transactions that occurred on or after February 28, 2018 (Budget Day).

E. Foreign Affiliate Regime

Extended Reassessment Period

The CRA generally has the right to reassess taxpayers within three or four years from the date of the initial assessment of their tax returns. However, in certain cases, the CRA is afforded an additional three years to reassess. Budget 2018 extended the reassessment period of taxpayers for taxation years beginning on or after Budget Day in respect of income arising in connection with their foreign affiliates (FAs) on the basis that audits in respect of FAs are often time-consuming because of their complexity and the challenge of obtaining foreign-based information.

Reporting Requirements

Canadian taxpayers are currently required to file information returns (i.e., Form T1134) in respect of their FAs within 15 months of their taxation year-end. This extended filing period was provided to accommodate the significant amount of time and resources required for taxpayers to comply with the FA rules. The enacting legislation for Budget 2018 shortened the filing requirements to 12 months for periods beginning in 2020, and to 10 months for periods beginning thereafter.

Anti-Avoidance Measures

The implementing legislation for Budget 2018 introduced certain anti-avoidance measures relevant to Canada's FA regime, applicable for taxation years of an FA that begin on or after Budget Day, as follows:

- A rule that deems there to be a separate business in respect of specific activities carried out by an FA if income attributable to such activities accrues to the benefit of a specific taxpayer under a tracking arrangement. As a result, the FA will need to satisfy each relevant condition under the investment business definition, including the six-employee test, in order for the FA's income from that business to be excluded from foreign accrual property income (FAPI).
- A similar rule that deems an FA of a taxpayer to be a controlled foreign affiliate of the taxpayer if FAPI attributable to activities of the FA accrues to the benefit of the taxpayer under a tracking arrangement. This measure effectively substitutes the mechanical FAPI attribution rules for the more subjective offshore investment fund property rules that might otherwise apply.
- A rule that imposes a minimum capital requirement as part of the "trading or dealing in indebtedness" rules that is similar to the one required in order to qualify for the regulated foreign financial institutions exception under the "investment business" definition.

F. Cannabis and the Excise Duty Framework

Budget 2018 introduced a new federal excise duty framework for cannabis products. The duty generally applies to all products available for legal purchase, although there are exceptions for certain packaged products containing concentrations of no more than 0.3% tetrahydrocannabinol (THC) and certain prescription cannabis products.

Cannabis producers (cultivators, producers and packagers) are required to obtain a cannabis licence from the Canada Revenue Agency and remit any excise duty payable. The excise duty amount is the higher of a flat rate based on the quantity and type of cannabis material in the final product and a percentage of the dutiable amount (generally being the sale price of the product without the excise duty amount). Although the flat rate is imposed when the product is packaged in a container for final retail sale and the percentage rate is imposed when that producer delivers the packaged product to a purchaser (such as a provincially authorized distributor), only the higher of the two amounts is payable by the producer at the time of delivery. All packaged cannabis products removed from the premises of a cannabis licensee to enter the Canadian duty-paid market for retail sale are required to have a cannabis excise stamp to demonstrate to consumers, retailers and other stakeholders that the applicable cannabis duties have been paid.

Under a coordinated cannabis taxation framework agreement reached between the federal government and most provinces and territories, both a federal excise duty rate and an additional rate will apply in participating provinces and territories.

Canada's Response to U.S. Tax Reform

In its Fall Economic Statement released on November 20, 2018 (Fall Update), the Department of Finance announced a series of tax measures intended to encourage investment in Canada. These measures were widely viewed as Canada's response to the enactment of the surprisingly broad and complex tax reform legislation in the United States called the *Tax Cuts and Jobs Act*, which among other things significantly reduced U.S. federal income tax rates applicable to corporations and individuals who do business through passthrough entities, and introduced measures allowing businesses to depreciate certain capital property at a much faster rate.

The announced measures do not propose any significant changes to Canadian corporate or personal income tax rates. Instead, Canada's response to U.S. tax reform is focused on measures permitting the accelerated deductibility of various depreciable capital expenses. These new measures were effective as of November 20, 2018, and will continue to have full effect until the end of 2023, at which point they will slowly be reduced until they are ultimately eliminated by the end of 2027.

A. Accelerated Investment Incentive

Under the ITA, a taxpayer is generally entitled to deduct capital cost allowance (CCA) in respect of depreciable property that is subject to the CCA rules (referred to as "eligible property"). The rate at which CCA may be deducted depends upon the class of property, and is subject to the exception that a taxpayer may deduct only one-half of the amount that is normally deductible in the year of acquisition (the "half-year rule").

The Accelerated Investment Incentive will effectively suspend the half-year rule in respect of eligible property. The allowance will then generally be calculated by applying the prescribed CCA rate for a class to one-and-a-half times the net addition to the class for the year. As a result, property currently subject to the half-year rule will, in essence, qualify for an enhanced CCA equal to three times the normal first-year allowance, and property not currently subject to the half-year rule will qualify for an enhanced CCA equal to one-and-a-half times the normal first-year allowance.

For example, prior to the introduction of the Accelerated Investment Incentive, a property in Class 8, which has a prescribed rate of 20%, would be eligible for CCA of 10% of the cost of the property in the year it becomes available for use, as a result of the half-year rule. Under the Accelerated Investment Incentive, the taxpayer will be eligible for CCA of 30% of the cost of the property – that is, one-and-a-half times the CCA calculated using the prescribed rate of 20%, or three times the 10% CCA that could otherwise be claimed in the first year.

B. Expensing of M&P Investments and Clean Energy Investments

Prior to the Fall Update, machinery and equipment generally qualified for a temporary accelerated CCA rate of 50% calculated on a declining-balance basis under Class 53 if they were acquired by a taxpayer after 2015 and before 2026 for use in Canada primarily in the manufacturing or processing of goods for sale or lease. Similarly, specified clean energy equipment acquired by a taxpayer after February 21, 1994, qualified for an accelerated CCA rate of 30% calculated on a declining-balance basis under Class 43.1. If acquired after February 22, 2005, and before 2025, most equipment that would otherwise be eligible for Class 43.1 could be depreciated at an accelerated CCA rate of 50% under Class 43.2.

In the Fall Update, the Department of Finance proposed providing an enhanced first-year allowance for such property if it is acquired after November 20, 2018, and becomes available for use before 2028. The enhanced allowance will initially provide a 100% deduction, with a phase-out for property that becomes available for use after 2023.The half-year rule will effectively be suspended for property eligible for this measure.

Update Regarding the Multilateral Instrument (MLI)

As previously reported, Canada signed the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (MLI) in 2017. The MLI is not a stand-alone tax treaty; rather, it implements certain treaty measures outlined in the OECD's Base Erosion and Profit Shifting (BEPS) initiative without the need for treaty-by-treaty bilateral negotiations. Seventy-five of Canada's tax treaties are covered by the MLI, referred to as covered tax agreements (CTAs), which will be affected by the MLI once Canada and the relevant CTA partner ratify the MLI under their respective domestic laws.

The Canadian ratification process was initiated on May 28, 2018, when the MLI was tabled as a Notice of Ways and Means Motion in the House of Commons as Bill C-82. Bill C-82 was subsequently agreed to on second reading on October 10, 2018, and referred to the Standing Committee on Finance.

Once approved by Parliament, the instrument of ratification must be deposited by Canada with the Secretary-General of the OECD. After the expiration of a period of three calendar months starting on the date the instrument of ratification was deposited, it will enter into force.

Once in force, the MLI will enter into effect for Canada's CTAs for which instruments of ratification, acceptance or approval have been deposited by the relevant CTA partner as follows:

- on or after the first day of the next calendar year for withholding taxes purposes; and
- for tax years beginning on or after the expiration of a period of six months from the latest of the dates on which the MLI enters into force for each CTA partner for all other tax purposes.

Because of the delay in the ratification of Bill C-82, the MLI should likely not have any effect before 2020 (or maybe even 2021).

Upon signature of the MLI, Canada had indicated that it would adopt the OECD agreed minimum standards on treaty abuse and dispute resolution, and mandatory binding arbitration provisions. Canada also initially entered reservations rendering the optional MLI provisions inapplicable to its CTAs. On May 28, 2018, however, Canada announced its intention to remove certain reservations and adopt four optional MLI provisions:

- a 365-day holding period ensuring that lower treaty-based rates of withholding tax on dividends will only be made available for companies holding shares for over 365 days (article 8);
- a 365-day lookback testing period for the purposes of determining whether capital gains on a sale of shares (or similar rights in an entity) that do not derive a certain percentage of their value from real or immovable property are exempted from tax (article 9);
- a provision on methods of resolving dual-resident entity cases (article 4); and
- a provision intended to allow treaty partners to move from a tax exemption system to a foreign tax credit system as their method of providing relief for double taxation (article 5).

With respect to the OECD agreed minimum standards, Canada will adopt the principal purpose test (PPT) into each tax treaty listed as a CTA. The PPT is a general anti-abuse rule that considers whether one of the principal purposes of an arrangement or transaction is to obtain treaty benefits in a way that is not in accordance with the object and purpose of the relevant treaty provisions. The federal government has announced its intention, where appropriate, to negotiate detailed "limitation of benefit" provisions into its treaties on a bilateral basis either in addition to or to replace the PPT. The OECD commentary on the PPT is not particularly instructive, and the scope and effect of the PPT currently is a matter of great interest and uncertainty in international tax planning.

Once the MLI is ratified by Canada, it will no longer be possible for Canada to add further reservations limiting the application of the MLI to its CTAs. However, it may remove certain reservations in order to render previously inapplicable provisions of the MLI applicable. Thus, even after ratification, additional MLI provisions may enter into force and affect certain CTAs.

E-Commerce and Sales Tax

2018 witnessed significant developments with respect to the taxation of e-commerce businesses and transactions. This trend is expected to continue in 2019 and may result in substantial costs for Canadian e-commerce businesses to ensure proper compliance with applicable sales tax legislation, both in Canada and abroad.

For instance, in its 2018-2019 provincial budget announced on March, 27, 2018, Québec announced the implementation of a sales tax regime targeting e-commerce businesses, which came into effect on January 1, 2019. Accordingly, non-resident e-commerce businesses transacting with Québec consumers may now be required to register for QST purposes and comply with any corresponding collecting, remitting and reporting obligations.

A few months after the Québec rules were first announced, the U.S. Supreme Court issued its landmark decision in *South Dakota v Wayfair Inc.*, which found that e-commerce businesses may be required to collect and remit South Dakota sales tax for sales made to South Dakota consumers, even if such vendors did not have any offices, warehouses or employees in that state.

Judicial Developments in 2018

GAAR Applied Where Permanent Deferral of Tax

In *The Queen v Oxford Properties Corp Inc.*, the taxpayer engaged in a complex series of restructuring transactions involving a subsection 97(2) rollover of real estate properties through a tiered partnership structure, bumps in the ACB of partnership interests in first- and second-tier partnerships (by operation of subsections 88(1) and 98(3)) and then a sale of those interests to tax-exempt entities without tax being paid on the latent recapture and accrued gains in the property held by the partnerships. The Minister reassessed under the general anti-avoidance rule (GAAR) on the basis that the rollovers and bumps were used to increase the ACB of the partnership interests in a manner that allowed the taxpayer to avoid recapture under subsection 100(1).

The Federal Court of Appeal reversed the decision of the Tax Court and held that the transactions abused subsections 100(1), 98(3), 97(2) and 88(1)(d). The abuse identified by Chief Justice Noel was that the latent recapture in the real estate assets held by the second-tier partnerships would forever go unpaid by virtue of the fact that the bumped partnership interests were sold to tax-exempt entities. He found that the overall result was the circumvention of subsection 100(1) by eliminating the capital gain that would otherwise have resulted from the sale of the partnership interests. This was achieved by bumping the tax cost of the partnership interests so as to approximate their fair market value, thereby eliminating any gain on which subsection 100(1) could apply and making the deferral of accrued gains and latent recapture permanent.

The Court noted that an amendment to a statutory provision does not necessarily affect the determination of the object, spirit and purpose of the prior law. The practical result of the amendment may simply be that the GAAR will no longer have to be resorted to in order to prevent the tax benefit. Leave to appeal to the Supreme Court of Canada was denied.

GAAR Did Not Apply Where Surplus Was Not Distributed

In *1245989 Alberta Ltd. v The Queen*, the taxpayer implemented a corporate reorganization whereby he rolled over his shares in a small business corporation to a new Holdco in exchange for preferred shares. He made a section 85 election to use up his capital gains exemption and transferred high basis assets to the Holdco to trigger a substantial increase to the PUC and ACB of his preferred shares due to the PUC-averaging mechanism in subsection 89(1) and without any new capital contributions. The Minister applied the GAAR. The issue was whether the transactions abused section 84.1, which was intended to prevent the inappropriate increase of PUC and the tax-free distribution of a corporation's retained earnings or surplus.

In reversing the decision of the Tax Court, the Federal Court of Appeal found that although the corporate reorganization changed the tax attributes of the preferred shares and created the potential for a tax-free distribution of Holdco's surplus, such a distribution hadn't yet happened. This was a key factor. The Court held that since the tax-free distribution that section 84.1 was intended to prevent had not occurred, section 84.1 had not been misused or abused. The Court noted that the ruling did not preclude the Minister from reassessing the taxpayer if he subsequently removed the corporate surplus as a tax-free return of capital.

Hedging Transactions Reconsidered

In *The Queen v. MacDonald*, the Federal Court of Appeal considered the tax treatment of a loss realized on a cash-settled forward contract. The case involved a taxpayer who had a significant investment in Bank of Nova Scotia (BNS) shares since 1988. He had no intention of selling the shares, but in 1998 (anticipating a decline in the share price), he entered into a cash-settled forward contract in respect of BNS shares. The BNS share price went up, the taxpayer settled the contract over time, and he suffered losses. At issue was whether the losses were on capital or income account.

The trial judge made a finding of fact that the taxpayer's sole purpose and intention for entering into the forward contract was to speculate and profit from the potential drop in the stock price. Consequently, the trial judge held that the taxpayer had engaged in an adventure in the nature of trade such that his losses were deductible on income account. She rejected the Crown's argument that the forward contract was a "hedge" transaction because: i) the taxpayer did not have the requisite intent to hedge, and ii) the forward contract was not linked to the taxpayer's long-term holdings of BNS shares.

The Federal Court of Appeal reversed the trial judge's decision on the basis that the forward contract was hedged to the taxpayer's underlying BNS shares. The Court held that a hedge is a transaction that has the effect of neutralizing or mitigating market fluctuation risk in relation to underlying assets or liabilities (i.e., protecting one's financial position against an identified risk over time), and that an intention to hedge is not a prerequisite for hedging. The Court reasoned that a person can neither gain nor lose by entering into hedging instrument while owing assets whose value is protected by that instrument. Since the taxpayer held more BNS shares than were covered by the forward contract, the forward contract was found to be a hedge of those shares, and accordingly the losses were on capital account. The taxpayer has sought leave to appeal to the Supreme Court of Canada.

"Investment Business" for FAPI Purposes Defined

In *Loblaw Financial Holdings Inc. v The Queen*, the Tax Court of Canada considered whether the earnings of a Barbados bank subsidiary of a Canadian corporation constituted foreign accrual property income (FAPI) to the Canadian taxpayer (i.e., income currently taxable in Canada). The Barbados Bank was a controlled foreign affiliate (CFA) of the Canadian taxpayer and carried on an "international banking business" under a licence granted by the Central Bank of Barbados. The Minister considered that the CFA engaged in investment business and thus reassessed the taxpayer for approximately $473 million of FAPI earned during the 2001-2010 taxation years. The issue was whether the CFA satisfied the regulated financial institution exemption to FAPI. The Tax Court found that all of the requirements of the FAPI exemption were met except one – the CFA conducted business principally with its parent company, not with arm's-length persons. The Court held that this was inconsistent with the underlying rationale of the exemption, which was to facilitate the ability of Canadians to compete internationally. The case is currently under appeal to the Federal Court of Appeal.

Treaty Shopping Not Inherently Abusive

In *Alta Energy Luxembourg S.a.r.l. v The Queen*, the Tax Court of Canada held that GAAR did not apply to deny benefits under the *Canada-Luxembourg Tax Treaty* (Treaty).

The appellant, a Luxembourg-resident corporation, owned the shares of an operating company (Alta Canada) which held licences to explore, drill and extract shale oil from regions in Northern Alberta. After the oil reserves were proven, the value of the licences (and the value of Alta Canada shares) increased by approximately $380 million. The shares of Alta Canada were both taxable Canadian property and treaty-protected property. Prior to the sale of the Alta Canada shares to an arm's-length purchaser, they were first transferred to the appellant.

The Tax Court found that the $380 million capital gain was not taxable in Canada because the appellant satisfied the exception found in article 13(4) of the Treaty. That article precludes Canada from taxing gains related to immovable property "in which the business of the company was carried on." The Court rejected the Minister's argument that to qualify for the exception a taxpayer must carry on business spatially inside the immovable property in Canada (e.g., hotel or manufacturing plant). The Minister's interpretation could not apply to licences to exploit natural resources since rights don't have physical substance and cannot be occupied. The Court found that the Minister's position reflected "a lack of understanding of how resource assets are developed and exploited in Canada."

Further, on the issue of GAAR, the Court held that there is nothing in the Treaty that suggests that a single purpose holding corporation resident in Luxembourg cannot avail itself of the benefits of the Treaty, even if its individual shareholders are not residents of Luxembourg. There is also no anti-treaty-shopping rule in the applicable article of the Treaty, so becoming a Luxembourg resident solely to access the benefit of article 13(4) of the Treaty was not an abuse of the underlying policy. Finally, the Minister's complaint about "double non-taxation" was irrelevant since the GAAR does not apply to avoidance of foreign tax. The Minister has appealed to the Federal Court of Appeal.

Transfer Pricing and Sham Rejected

In *Cameco v The Queen*, the Tax Court of Canada considered whether the taxpayer had used sham transactions to violate transfer pricing rules. The taxpayer was a very large producer and supplier of uranium, a rare commodity that was bought and sold in an unregulated market under bilateral contracts but was not traded on a commodity exchange. Prior to a substantial price increase, the taxpayer had entered into long-term contracts with its European subsidiary for the purchase and sale of uranium based on fixed prices. Following market price increases, the subsidiary earned substantial profits. The Minister alleged that the fixed-price contract was a sham and reassessed the taxpayer for transfer price adjustments under section 247 of the ITA totalling approximately $483 million for the 2003–2006 tax years.

The Court found that the taxpayer did not factually represent the legal arrangements in a manner that was different from reality, and the required element of deceit was not present. Further, the Court held that the transactions at issue were commercially rational and accepted the expert evidence that the taxpayer's sale of uranium was conducted at a price that was within the arm's-length range of prices. The Minister has appealed to the Federal Court of Appeal.

Common Interest Privilege Reaffirmed

In *IGGillis Holdings Inc. v Minister of National Revenue*, the issue was whether solicitor-client privilege was lost where a legal opinion was obtained by a taxpayer from another party with a common interest in the same transactions. Generally, privilege applies where there is (i) a communication between solicitor and client, (ii) which entails the seeking or giving of legal advice and (iii) which is intended to be confidential by the parties. In the context of commercial transactions in Canada, privilege is not lost when legal opinions are shared by parties with mutual interests in commercial transactions; this is known as common interest privilege (CIP).

In *IGGillis*, a third party acquired certain corporate shares from the taxpayer. Counsel for the third party prepared a tax-planning memo (with input from the taxpayer's counsel) that was shared with the taxpayer. The Minister served a requirement for information upon the taxpayer demanding production of the memo. The taxpayer refused on the grounds that the memo was protected by CIP.

The Federal Court of Appeal reversed the Federal Court's ruling and reaffirmed the normal rule that solicitor-client privilege is not lost or waived when a legal opinion obtained by one taxpayer is disclosed, on a confidential basis, to other parties with sufficient common interest in the same transactions. Although the parties to a purchase and sale agreement are generally adverse in interest, the FCA noted that it may well be beneficial to the respective parties if their lawyers collaborate on the opinion relating to the application of the ITA to the series of transactions to be completed. The Minister's leave request was dismissed by the Supreme Court of Canada.

Outlook for Canadian Tax Developments in 2019

While Justin Trudeau's federal Liberal government has enjoyed relative stability and high popularity over the past three years, its tax policy initiatives and in particular the proposals dealing with private corporations and passive income have been subject to criticism. In the next couple of months, the government is expected to table its last budget before the upcoming federal election in October 2019. Normally, governments reserve electoral "candy" for this occasion, and it is hoped that measures favourable to businesses and their owners will make their way into the budget prior to the election and as a further tax-competitiveness adjustment in response to U.S. tax reform. There have also been calls for a tax reform commission, which is seen by many in the tax community as being overdue – [it has been] nearly 50 years after Canada's last major tax law rewrite. It is unlikely, however, that one would be announced before the election.

Political changes at the provincial level are also expected to have an impact on economic policy-making throughout the country. Conservative parties swept to power in Ontario and Québec in 2018, ending nearly 15 years of Liberal rule in Canada's two largest provinces. Ontario Premier Doug Ford and Québec Premier François Legault have both made economic growth and competitiveness the centrepiece of their respective agendas, promising to reduce regulation and tax rates. A provincial election is also expected this spring in Alberta, with polls showing the free-market Conservative opposition having a significant lead over the incumbent NDP government. Canadian businesses can expect more favourable tax and regulatory changes at the provincial level in the coming years.

Read our U.S. Tax Review and Outlook.

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