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FOREIGN AFFILIATE ISSUES IN TROUBLED TIMES

- –Marc André Gaudreau Duval and Michael N. Kandev,[1] Davies Ward Phillips & Vineberg LLP, Montreal

INTRODUCTION

Measures imposed to contain the COVID-19 pandemic have resulted in an unprecedented economic strain that has caused governments to enact exceptional fiscal and monetary stimuli meant to avoid multiple bankruptcies and mass unemployment. In some countries, insolvent firm's obligations to file for bankruptcy have been suspended until the end of the summer while in other countries, major subsidies and significant financial bailouts have been provided to firms in need. Some will argue that these emergency measures are only buying time and the social and commercial repercussion of this crisis will permanently affect certain segments of the economy.

This article will review certain foreign affiliate issues that may arise in these troubled times, particularly in respect of debt forgiveness and governmental assistance related measures.

BACKGROUND

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Where a non-resident corporation is a controlled foreign affiliate ("**CFA**") of a Canadian-resident taxpayer at the end of a taxation year of the CFA, the Canadian resident taxpayer is required to include, in computing its income, its "participating percentage" of the foreign accrual property income ("**FAPI**") of the CFA for that taxation year. FAPI is calculated on an affiliate-by-affiliate basis and as such, foreign accrual property losses ("**FAPL**") of a CFA of a taxation year may only be used to reduce the FAPI of such CFA for another taxation year.

FAPI of a CFA is defined in subsection 95(1) of the *Income Tax Act* (Canada) (the "**Act**")[2] as generally including income from property, income from businesses other than active businesses, as defined, and taxable capital gains from dispositions of property other than "excluded property"[3] and is computed under the rules of the Act using the Canadian taxpayer's functional currency. The term "excluded property" refers to property of a foreign affiliate that is principally used in an "active business", shares of a foreign affiliate where all or substantially all of its assets are "excluded property", property all or substantially all of the income from which is deemed to be income from an active business,[4] and certain partnership interests.

The taxpayer to which the FAPI is imputed is generally permitted a deduction equal to "foreign accrual tax" ("**FAT**") applicable to the income that was not deducted in a previous year multiplied by the "relevant tax factor" ("**RTF**") for the year. This deduction is granted either in the year of imputation or in any of the subsequent five taxation years, so as to allow for different accounting or taxation procedures in the foreign country.[5]

DEBT FORGIVENESS

One of the major considerations when restructuring a corporate group or its capital structure is the application of the debt forgiveness rules.

The debt forgiveness rules generally apply where "a commercial debt obligation" is settled by the payment of an amount that is less than the principal amount thereof. In the domestic context, the difference between the principal amount and the consideration received for the settlement (the "**Forgiven Amount**") is generally applied to reduce the various tax attributes of the debtor pursuant to subsections 80(3) to (12), and half of the residual unapplied Forgiven Amount is included in income as result of subsection 80(13). While the same rules generally apply in the foreign affiliate context, major differences exist and stem from the definition of FAPI in the Act. The two major differences discussed below are that in the foreign affiliate context, the debt forgiveness rules only apply in respect of "FAPI debts" and never give rise to net FAPI.

Debt Forgiveness Rules only apply in respect of FAPI Debts

As mentioned above, the debt forgiveness rules may apply on the settlement of a "commercial debt obligation", which is defined at subsection 80(1) as any debt obligation where interest is deductible in the debtor's income, taxable income, or taxable income earned in Canada, or if interest is not actually payable, if interest had been payable that interest would have been so deductible. However, in the FA context, certain reading rules are to be applied to the definition of "commercial debt obligation". Paragraph 95(2)(*g*.1) provides that, in computing the FAPI of a foreign affiliate, the Act shall be read as if the expression "income, taxable income or taxable income earned in Canada, as the case may be" in the definition "commercial debt obligation" in subsection 80(1) were read as "foreign accrual property income (within the meaning assigned by subsection 95(1))".

Based on these rules, a debt used by a CFA to acquire the shares of another CFA should generally constitute a "commercial debt obligation". However, some confusion in that respect may exist given a position taken by the CRA in a now overridden technical position. In CRA Document 2002-0165195(E), dated December 5, 2003 (the "**2002 Technical**") the CRA took the position that the forgiveness of a debt made by Canco to CFA1, the proceeds of which were used by CFA1 to acquire shares of CFA2 would not give rise to the application of the debt forgiveness rules because the debt was used to earn dividends from an FA and that such dividends are not to be included in the FAPI given the carve out in (b) of Amount A of the definition of FAPI. However, the position of the CRA was overridden and replaced in CRA Document 2004-0062175(E), dated February 10, 2004 (the "**2004 Technical**"):

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> In the Earlier Letter [the 2002 Technical] we indicated that based on the above hypothetical facts, the forgiveness of the CFA1 debt would not affect the computation of FAPI. The rationale given was that under the provisions of section of 80 of the Act as modified by paragraph 95(2)(g.1), the CFA1 debt would not be a "commercial debt obligation" for the purpose computing FAPI. This analysis is incorrect. In applying the definition of "commercial debt obligation" in subsection 80(1) as modified by paragraph 95(2)(g.1), had interest been payable in respect of the CFA1 debt, an amount would have been included in the computation of the amount described in "D" of the definition of FAPI in subsection 95(1). In computing CFA 1's income from the shares of other foreign affiliates of Canco, any dividend derived by CFA1 from those shares would be excluded from the amounts described in "A" and "D" of the definition of FAPI. <u>However, the interest expense incurred on money borrowed to acquire those shares would nevertheless be deductible in computing its income or loss from such property. Accordingly, the CFA1 debt is a "commercial debt obligation" under the provisions of section 80, as modified by paragraph 95(2)(g.1), for the purpose of computing FAPI</u>. (our emphasis)

The main takeaway from the above is that one must look at whether the interest paid (or if interest is not actually payable, if interest had been payable) on the debt is deductible against FAPI and not at whether the asset acquired with the proceeds gives rise to FAPI. In these circumstances, the debt forgiveness rules may be a reason for Canadian MNEs to set up financing structures where a CFA of the group is financing the other CFAs rather than simply having the Canadian corporation finance the CFAs directly. This is mainly because the loans made by the CFA will generally qualify under 95(2)(*a*)(ii)((B)[6] and (D),[7] and thus the interest will not be deductible in computing FAPI.

Another element of confusion arising from the 2002 Technical is in respect of debt partly used for the purposes of earning FAPI and partly used for the purposes of earning active business income. In the 2002 Technical, the CRA took the position that the whole amount of such debt would constitute a "commercial debt obligation" (as modified by 95(2)(g.1). We note that this portion has not be overridden by the 2004 Technical. In our view, this conclusion is questionable in light of subsection 248(27) which should apply to treat the debt as two separate debts. The right result should be that only the part of the debt that was used for purpose of earning FAPI should give rise to the application of the debt forgiveness rules.

Debt Forgiveness does not give rise to FAPI

FAPI FORMULA

Given the formula pursuant to which FAPI of an FA is computed, a Canadian taxpayer will never be imputed FAPI in respect of the forgiveness of a "commercial debt obligation" of one of its CFAs. The Forgiven Amount resulting from such settlement will only be applied to reduce the FAPL of the CFA for the year and any remaining amount will be carried forward to reduce any future FAPL.[8] More specifically:

- Amount A (which is the amount that includes income from property of the FA) indicates that it must be computed as if the debt forgiveness rules in section 80 did not apply to the FA;
- Amount A.1 includes twice the total of all amounts included in computing the affiliate's income from property or a business other than an active business because of the application of subsection 80(13) (this amount is offset by Amount G below);
- Amount A.2 includes any amount determined under Amount G for the preceding taxation year (see next bullet);
- Amount G subtracts an amount, if any, by which the total of the amounts determined for amounts A.1 and A.2 exceed the total of all amounts determined under D to F (i.e., the FAPLs of the FA for the year).

Thus, the formula operates to ensure that the policy intent of reducing the losses created by the expenses funded by the debt forgiven is achieved.

95(2)(G.1)

Surprisingly, the legislator has chosen not to adopt the income inclusion rule or the grinding of the cost of the underlying properties rules that, in the domestic context, acts as a policing rule meant to ensure that the debtor transfers, under 80.04, the remaining Forgiven Amount to the taxpayer that benefited from the deductible expenses. We note that the domestic rules assume that if the debtor does not have the losses

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or the asset, it is because it transferred it to another related entity. In the author's opinion, the decision to ensure that the debt forgiveness does not generate FAPI was the right one given that (i) FAPI has to be computed without reference to 80.04, (ii) FAPI and FAPL are computed on an affiliate-by-affiliate basis, and (iii) any FAPL created at the level of another CFA by pushing down the deductible expenses would generally have given rise to FAPI to the first CFA.

Paragraph 95(2)(*g*.1) provides that FAPI of an FA is to be computed without reference to subsections 80(3) to (12) and (15) and 80.01(5) to (11) and sections 80.02 to 80.04 and thus a Forgiven Amount cannot be applied to reduce the various tax attributes of the debtor. The Forgiven Amount will either be applied against FAPLs or be carried forward to reduce any future year FAPLs.[9]

Effect on Surplus Accounts

Finally, there is no equivalent to paragraph 95(2)(*g*.1) that applies to compute the FA's surplus accounts. The 2002 Technical (discussed above) provides that the "exempt earnings" or "taxable earnings" would not pick up forgiveness of a commercial debt obligation that did not relate to FAPI and that 5907(2)(*f*) would not be available, thus resulting in such income not being included in the exempt or taxable surplus of the FA debtor. Again, this portion of the 2002 Technical was not overridden by the 2004 Technical. In our view, this position is questionable given Regulation 5907(2)(*f*) and the definition of "earnings" in Regulation 5907 and may give rise to double taxation.[10] Clarifications from the CRA would be welcomed.

GOVERNMENTAL ASSISTANCE

While the purpose of this paper is not to discuss the various types of governmental assistance measures implemented around the world, we identified three main types of measures that are relevant in the CFA context:

(1) Cash grants;
(2) Loan programs pursuant to which all or a portion of a loan received from a governmental entity can be forgiven on certain conditions; and
(3) Deferral of tax payments.

The first step to determine the tax consequences of incentive granted by foreign government to a CFA is to determine whether the payment pertains to or is incidental to the active business of the CFA or to its investment business, non-qualifying business, business deemed not to be active, or from income from property ("Non-Active Business"). If it relates to the former, it will not give rise to any FAPI and it will be treated as "income from an active business". However, if it relates to the latter, the FAPI of the CFA will have to be determined as if the CFA were a corporation resident of Canada at all relevant times under 95(2)(*f*). The treatment of the three types of measures identified above that pertains to a Non-Active Business is described below.

Cash Grants

In this case, paragraph 12(1)(*x*) will generally bring into income all "amounts received in respect of an outlay, an expense or the cost of a property, whether received as a refund, reimbursement, contribution, allowance, or as assistance of any kind (including assistance in the form of a grant, subsidy, forgivable loan or deduction from tax).[11]

One exception to 12(1)(*x*) is the election that is available under subsection 12(2.2), which provides that a taxpayer may elect to reduce the amount of an outlay or expense (whether deductible or not) made or incurred before the end of the following taxation year instead of including the amount under paragraph 12(1)(*x*).

Forgivable Loans

Similarly to the cash grants, forgivable loans and payments made by a government guarantor are to be included in income under 12(1)(*x*) at the time the loan is granted or the guarantor makes the payment.

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It is important to note that the debt forgiveness rules will not apply with respect to the Forgiven Amount under a debt the proceeds of which were already included in debtor's income under 12(1)(*x*) or deducted in computing any balance of undeducted outlays, expenses, or other amounts for the purposes of this Act.[12]

Deferral of Tax Payments

The deferral of tax payments may have an impact on the FAT deduction that is available to a CFA earning FAPI.

As noted above, a particular CFA's FAT generally includes the portion of any income or profits tax that was paid by the particular CFA that may reasonably be regarded as applicable to the FAPI. The definition of FAT is clear in that only an amount of foreign taxes paid will be considered. However, it is not clear in which year the FAT will be recognized and the deduction permitted once the foreign tax has been paid.

The CRA longstanding policy follows a textual interpretation of the above and only recognizes foreign taxes as FAT in the year in which foreign taxes are paid. [13]However, the CRA also seems to be providing relief in circumstances where the balance of the foreign taxes are paid after the end of the year at the time of the filing of the returns.[14]

While it may be possible to rely on an expansive view of the five-year carryforward rule contained in 91(4) to claim a deduction for foreign taxes that are not paid in the year (on which the CRA relief positions cited above seem to be based),[15] the more conservative position seems to be that FAT would not be recognized until the foreign taxes are paid. We are not aware of any indication from the CRA that it would follow its "relieving position" in respect of COVID-19-related deferral of tax payments.

Assuming that an amount is not recognized as FAT until it is paid, the deferral of tax payments may give rise to unexpected surprises to Canadian corporations that are generally not paying any Canadian taxes on the FAPI incurred by its CFA.[16] Generally, given that the RTF for 2019 or 2020 is equal to 4, any FAPI earned by a CFA that is paying tax at a rate of 25% of higher is fully offset by a FAT deduction. However, the result of deferring the payment of the foreign tax is that the FAT deduction will be reduced by four times the amount so deferred, thus potentially give rise to Canadian taxes.

NEW CRA TEMPORARY GUIDANCE ON INTERNATIONAL CORPORATE TAX CONCERNS CREATED BY COVID-19 TRAVEL RESTRICTIONS

- –Sabrina Wong and Rachel Gold, KPMG Law LLP

INTRODUCTION

The Canada Revenue Agency ("**CRA**") issued helpful guidance on May 20, 2020[17] to address a handful of potential cross-border income tax issues that arise due to travel restrictions imposed by the Canadian government and businesses to curb the spread of COVID-19. In this article, we outline the CRA's temporary administrative approach to the following income tax issues, which may affect Canadian multinational groups:

- Tax residency of corporations
- Carrying on business and the creation of permanent establishments in Canada[18]

We will also discuss actions that Canadian multinational groups may consider taking to manage and mitigate these potential Canadian income tax issues in the COVID-19 environment.

It is important to note that the CRA clarified that its guidance is time-limited, stating that it is intended to assist taxpayers during the COVID-19 crisis and not meant to establish a CRA interpretative position or broad CRA policy. The guidance initially released on May 20, 2020 stated that it will apply from March 16 until June 29, 2020, noting it may be extended past this period if necessary or rescinded if no longer required. On June 26, 2020, the CRA extended the application of the guidance until August 31, 2020 and continues to note that it may be further extended if necessary.

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TAX RESIDENCY OF CORPORATIONS

The Issue

Corporations that are not incorporated in Canada may have tax residency issues in the COVID-19 environment because they have directors, officers, or other parties undertaking board meetings or exercising decision-making authority for the company while physically present in Canada. This can result from individuals being prohibited from travelling to meetings in the relevant foreign jurisdiction or different individuals having to take over key decision-making during the crisis.

Subject to residency tie-breaker rules in an applicable income tax treaty,[19] corporations that are not incorporated in Canada will be considered a resident of Canada for purposes of the *Income Tax Act* (Canada) (the "**Act**")[20] where the corporation's "central management and control" is considered to be exercised in Canada. This corporate residency test is well-established in Canadian common law.[21] Where the "central management and control" of a corporation is exercised ultimately depends on the facts and circumstances of each case. However, past jurisprudence has typically found a corporation's central management and control to be located where the corporation's board of directors exercises its responsibilities to manage the corporation. Thus, the case law has typically placed heavy emphasis on the place where the directors meetings take place and where directors exercise their strategic decision making responsibilities in respect of the corporation.[22] Another factor that influences this analysis is if other parties (such as a shareholder) make significant management decisions for the corporation, in which case the corporation may be found to be resident where that other party resides.[23]

In the event that a corporation that was not incorporated in Canada is resident in Canada under the common law "central management and control" test, the corporation may nevertheless be deemed not to be resident in Canada due to the application of the residency tie-breaker rules of an applicable income tax treaty. For example, if the corporation is incorporated in the U.S., Article IV(3)(*a*) of the *Canada–U.S. Income Tax Convention* would deem the corporation to be resident only in the U.S. and not in Canada.

However, such residency tie-breaker rules would not be of assistance and the common law "central management and control" test would still need to be considered in the following circumstances:

- Income earned by a foreign affiliate of a Canadian resident corporation from carrying on an active business through a permanent establishment in a "designated treaty country" generates exempt surplus which can be repatriated to the Canadian resident corporation on a tax-free basis, provided that the foreign affiliate is considered resident in the "designated treaty country" for purposes of the foreign affiliate rules. Where the "designated treaty country" is a country with which Canada has entered into a bilateral income tax treaty, the foreign affiliate must be resident in the treaty country under both the common law "central management and control" test *and* resident in the treaty country for purposes of the treaty.
- A "designated treaty country" also includes certain countries with which Canada has entered into a tax information exchange agreement ("TIEA"), in which case the foreign affiliate must be considered resident in the TIEA country under the common law "central management and control" test for its income from an active business carried on in that country to generate exempt surplus.
- Apart from the foreign affiliate rules, the residency of corporation incorporated in a jurisdiction with which Canada has not entered into a bilateral income tax treaty would be determined under the common law "central management and control test" for other purposes of the Act.

CRA Guidance

The CRA guidance considers the following situation: a corporation that is tax resident in a foreign jurisdiction (pre-COVID-19 travel restrictions) has one or more directors physically present in Canada. These directors are unable to travel to the foreign jurisdiction to attend board of directors' meetings due to travel restrictions. The question asked of the CRA is: if the directors participate in board meetings of the corporation while in Canada, will the CRA consider the corporation's central management and control to be in Canada such that

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the corporation is resident in Canada for tax purposes and therefore a dual resident (i.e., resident of Canada and resident in the foreign jurisdiction)?

The CRA answers the question based on tax treaty rules, indicating that the CRA assumes a foreign incorporated corporation in this situation would otherwise be resident in Canada under the common law test. The CRA says that where the corporation's country of residence has a tax treaty with Canada, the treaty may resolve the dual residency issue under a corporate residency tie-breaker rule that tie-breaks to the country under whose laws the corporation was created. For example, the CRA expects that a corporation incorporated under U.S. law as "C-corporation" or "S-corporation" in the situation described above would be U.S. resident by virtue of the corporate residency tie-breaker rule in Article IV of the *Canada–U.S. Income Tax Convention*.[24]

The CRA notes that other tax treaties have a corporate residency tie-breaker rule based on the corporation's place of effective management (among other factors). For corporations covered by these tax treaties, the CRA confirms that, as an administrative matter, it will not consider the corporation to become resident in Canada solely because a director of the corporation must participate in a board meeting from Canada due to COVID-19-related travel restrictions.[25] The CRA does not expressly comment on treaties with a corporate residency tie-breaker rule that determines residency by mutual agreement of the competent authorities.

The CRA states that where the corporation is tax resident in a country that does not have a treaty with Canada, it will determine the corporation's residency on a case-by-case basis.

The CRA also comments that its administrative approach to corporate residency will apply to entities established in foreign jurisdictions that are considered corporations under Canadian tax law, such as limited liability companies.[26]

The CRA ends the corporate residency discussion with the caution that, notwithstanding the above comments, the location of board meetings is only one of a number of factors that is used to determine where a corporation's central management and control is located (for Canadian tax purposes) as well as where a corporation's place of effective management is located (for purposes of certain tax treaties).

The CRA "may still conclude that a corporation is resident in Canada where the actual management and control of the corporation takes place in Canada even though the board meetings have taken place elsewhere."

Managing Residency Risk

While the CRA's guidance provides helpful limited-time relief for determining the residency of corporations under treaties containing a residency tie-breaker that looks to factors including the corporation's place of effective management, the determination of corporate residency in the circumstances identified above would still need to be determined on a case-by-case basis. In these circumstances, Canadian multinational groups should carefully consider undertaking specific actions and deferring or ceasing certain other actions to manage and mitigate Canadian residency issues during the COVID-19 crisis.

It is ultimately a question of fact in each case as to where the central management and control of a corporation is exercised over the course of the life of the corporation. The following central management and control measures should be considered to mitigate any Canadian residency risk for foreign subsidiaries:

- if it is not already the case, ensuring that a majority of directors of the corporation are individuals resident outside of Canada and resident and located in the appropriate foreign jurisdiction;
- if possible, delaying board meetings, or at least board meetings where major strategic decisions are to be made, to a future date when COVID-19 related restrictions are lifted;
- ensuring that the majority of the directors making decisions at board meetings are participating from outside of Canada and the appropriate foreign jurisdiction; this may require the appointment of a local alternative director or proxy to which one or more Canadian directors temporarily delegate their voting or decision-making authority; and
- documenting and recording board meetings to ensure that there is clear evidence of a majority of directors exercising their decision making authority in the appropriate foreign jurisdiction and the

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fact that Canadian directors who would ordinarily attend in person are not able to do so due to the COVID-related travel restrictions.

The feasibility of these measures should be considered in light of the governing foreign corporate law and may require amendments to the constating documents of the foreign corporation.

PERMANENT ESTABLISHMENT AND CARRYING ON BUSINESS

The Issue

Non-resident entities may become subject to the Canadian income tax inadvertently by having employees stranded in and working remotely from Canada for a period of time because of international travel restrictions. Their actions while present in Canada could result in the non-resident employer not only carrying on business in Canada, but also having a permanent establishment ("**PE**") in Canada.

Non-residents of Canada that carry on business in Canada, at any time in the year are subject to Canadian tax on its taxable income earned in Canada for the year,[27] and have an obligation to file a Canadian tax return.[28]

However, a non-resident may be eligible for tax relief under an applicable tax treaty entered into between Canada and the non-resident's home country. Notably, many of Canada's income tax treaties provide that Canada has a right to tax a non-resident's business profits only if those profits are attributable to a PE situated in Canada.[29] These tax treaties will also have a definition of "permanent establishment" and specific rules that can deem a PE to exist in certain circumstances (e.g., where an employee, acting as a dependent agent, habitually exercises authority to conclude contracts on behalf of the non-resident, or where the conditions of a services PE are satisfied).

Covid-19-related travel restrictions may also give rise to PE issues under the foreign affiliate rules due to employees being stranded in a country that is not a "designated treaty country". As mentioned above, income earned by a foreign affiliate of a Canadian resident corporation from carrying on an active business through a PE in a designated treaty country generates exempt surplus provided the necessary residency requirements are satisfied. In comparison, where all the necessary requirements are not satisfied, such active business income would be included in "taxable surplus". Furthermore, income earned by a foreign affiliate through a PE in a "non-qualifying country" that would otherwise be active business income is income from a "non-qualifying business" and included in foreign accrual property income. A "non-qualifying country" is defined in subsection 95(1) to mean a country that has neither a tax treaty nor a TIEA with Canada and with which Canada initiated TIEA discussions more than 60 months before that time.

CRA Guidance

The CRA's guidance considers this potential situation: a non-resident entity employs individuals who regularly work outside of Canada, but as a result of COVID-19-related travel restrictions some of these individuals are fulfilling and exercising their employment duties in Canada. The tax question arising in this situation is whether the non-resident entity will be found to be carrying on business in Canada and possibly creating a PE in Canada.

The CRA states that in light of the extraordinary circumstances from COVID-19, where non-residents are resident in a jurisdiction with which Canada has a tax treaty and are carrying on business in Canada, the CRA will not consider the non-resident to have a PE in Canada solely because its employees perform their employment duties in Canada solely as a result of travel restrictions in force. Similarly, the CRA states that it will not consider the non-resident entity to have created an "agency" PE solely due to an employee concluding contracts in Canada on behalf of the non-resident entity (i.e., as a dependent agent of the entity) while travel restrictions are in place, if:

(1) these activities are limited to that period, and
(2) these activities would not have been performed in Canada but for the travel restrictions.

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The CRA clarifies that non-resident entities carrying on business in Canada, who are eligible for tax relief under an applicable treaty (i.e., their activities do not meet the threshold of a PE), still have an obligation to file a Canadian tax return, including for taxation years that overlap with the period in which travel restrictions are imposed.

As for Canada's tax treaties that have a services PE rule, such as Article V(9) of the Canada–U.S. treaty, the CRA advises that it will exclude an individual's days of physical presence in Canada due solely to travel restrictions when determining whether that individual meets the 183-day presence test for purposes of the services PE provision.

Finally, the CRA notes that it will evaluate the appropriateness of granting administrative relief on a case-by-case basis for non-resident entities that satisfy the threshold of "carrying on business" in Canada only because of the travel restrictions, but whose country of residence does not have a tax treaty with Canada. The CRA does not explain how taxpayers may seek or request this relief.

Managing Carrying on Business/PE Risk

Although the CRA guidance does not include a discussion on whether the non-resident is carrying on business in Canada, this is the first question a non-resident with employees present in Canada during COVID-19 must answer. If the non-resident is carrying on business in Canada, it must then consider whether it is exempt from Canadian taxation under an applicable treaty, if any.

The jurisprudence has developed several factors that courts will use to analyze to whether a person is carrying on business in Canada, including the place where the profit-producing contracts are made and the location of operations where profits arise. The Act also includes a rule[30] that deems certain activities in Canada to be "carrying on business in Canada" (which can override the common law). As this is primarily a fact-driven determination, non-residents' situations must be reviewed on a case-by-case basis having regard to the entity's business operations in and outside of Canada. In doing so, there may be strategies that can be employed to mitigate any potential risks.

The CRA has also indicated that it may provide relief to non-residents that are found to carry on business in Canada solely because of COVID-19-related travel restrictions but there is no applicable tax treaty to rely on. In any event, it is important to note again that by virtue of carrying on business in Canada, a non-resident would have an obligation to file a Canadian tax return, whether or not it has any Canadian taxes owing.

If a business is being carried on in Canada by a non-resident, the question then becomes whether the non-resident has created a PE in Canada under any applicable tax treaty. This PE risk appears to have been more or less mitigated by the CRA's favourable comments (which are notably aligned with the OECD's guidance that is based on the OECD Model Tax Convention).[31]

While the CRA's guidance provides helpful time-limited relief in the treaty PE context, relief may only be available on a case-by-case basis for non-residents found to be carrying on business in Canada and who have no applicable treaty to rely on. In addition, the CRA's guidance does not address PE issues that may arise in the context of the foreign affiliate rules due to COVID-19-related travel restrictions. Thus, Canadian multi-national groups may wish to take steps to set out temporary policies or procedures limiting its employees' responsibilities, functions and authority in such a manner to further mitigate their potential carrying on business and PE risk in Canada, as well as their foreign affiliates' residency or PE risk in countries that are not designated treaty countries. Limiting the amount and the relative importance of any activity in Canada or a country that is not a designated treaty country may also support a limited amount of profit being taxable in Canada or being attributed to a business carried on in a country that is not a designated treaty country even if the non-resident is otherwise carrying on a business in Canada or has a PE in a country that is not a designated treaty country.

CONCLUSION

With governments around the world imposing a variety of safeguards to reduce the devastating impact of the pandemic, the business world has experienced a significant shift in global mobility and been forced to adapt to a new way of working. The side effect of these safeguards is several international tax concerns

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impacting multi-national groups, including the risk of changes in corporate tax residency status and creation of business operations and PEs in Canada or in countries that are not designated treaty countries.

The CRA's long-awaited guidance on these concerns provides a certain level of comfort to taxpayers. Although there are still remaining uncertainties as these tax issues are highly fact-driven, the CRA guidance does indicate the possibility of relief on a case-by-case basis. It is hoped that the CRA will provide further administrative relief or guidance on the issues that are not specifically addressed,[32] or take a reasonable approach in these exceptional circumstances, perhaps similar to the approach taken by the U.K. tax authorities which places particular emphasis on the flexibility of existing common law and guidance.[33] Notably, the U.K. tax authorities indicate that occasional UK board meetings, or participation in such meetings from the UK, does not necessarily result in central management and control abiding in the UK. In addition, the U.K. tax authorities indicate that they "do not consider that a non-resident company will automatically have a taxable presence by way of permanent establishment after a short period of time. Similarly, whilst the habitual conclusion of contracts in the UK would also create a taxable presence in the UK, it is a matter of fact and degree as to whether that habitual condition is met. Furthermore, the existence of a UK PE does not in itself mean that a significant element of the profits of the non-resident company would be taxable in the UK".

TOWER WITH A TWIST DOES NOT GIVE RISE TO GAAR TAX BENEFIT: CANADA V. BANK OF MONTREAL

- –Ilana Ludwin, Osler, Hoskin & Harcourt LLP, Toronto

The Federal Court of Appeal has upheld the Tax Court of Canada's conclusion in favour of the taxpayer. Accordingly, the general anti-avoidance rule (**"GAAR"**) did not apply to reduce the taxpayer's capital loss that resulted from foreign exchange fluctuations upon the windup of a Canada–U.S. "tower" financing structure, and that was approximately equal to the capital gain realized elsewhere in the structure, because there was no tax benefit. This appeal is noteworthy for focusing on whether there was a tax benefit and answering that question as a matter of law, not fact, based on ordinary statutory interpretation and a variation of the usual 'alternative arrangement' approach.

FACTS

The Bank of Montreal ("**BMO**") established a so-called "tower" financing structure in order to fund certain indirect U.S. subsidiaries (the "**Harris Group**") with US$1.4 billion that was borrowed from third parties.

The relevant entities in the structure were:

- BMO (Canadian);
- BMO's wholly owned Canadian subsidiary (**"BMO GP"**);
- A U.S. partnership formed by BMO and BMO GP, treated as a corporation for U.S. tax purposes ("**Funding LP**");
- A Canadian NSULC wholly owned by Funding LP, a disregarded entity for U.S. tax purposes ("**NSULC**");
- A U.S. corporation wholly owned by NSULC, a disregarded entity for U.S. tax purposes ("**LLC**"); and
- The Harris Group, comprising indirect U.S. subsidiaries of BMO.

BMO and Funding LP borrowed U.S. dollars from third party lenders. The funds flowed through the structure to LLC (BMO invested its borrowing in Funding LP, Funding LP used those funds and its own borrowing to acquire shares of NSULC, and NSULC used those funds to acquire shares of LLC). LLC then loaned the funds to the Harris Group. The Harris Group used the proceeds of the loans to fund its U.S. banking business and to expand its operations through acquisitions.

The tower structure contained a natural economic hedge of BMO's foreign currency exposure to the U.S. dollar denominated funding that had been provided to the Harris Group. A concern arose that subsection

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112(3.1) of the *Income Tax Act* (Canada) (the "**Act**")[34] could apply on windup of the structure and cause BMO to be unhedged for tax purposes in the event that the Canadian dollar appreciated during the life of the transaction. Subsection 112(3.1) provides that where a partnership (Funding LP) disposes of shares (NSULC), the capital loss realized by any corporate partners (BMO and BMO GP) is reduced by the amount of any deductible taxable dividends received by the corporate partners on the shares. At the time, it was not clear whether subsection 112(3.1) would apply to reduce any capital loss that arose on the disposition of the NSULC shares solely due to foreign exchange fluctuations — namely, if the Canadian dollar appreciated relative to the U.S. dollar. This uncertainty arose from the unclear scope of former subsection 39(2), which deemed certain gains and losses attributable to fluctuations between foreign currencies and the Canadian dollar to be capital gains or losses from the disposition of currency.

In response to this concern, NSULC issued a stock dividend of preferred shares. From that point on, any amounts distributed by NSULC were paid as dividends on the preferred shares, not the common shares. On windup, if the U.S. dollar had decreased against the Canadian dollar, any capital loss would arise from the disposition of the common shares. Since the only dividend ever paid on the NSULC common shares was the stock dividend of preferred shares, subsection 112(3.1) would not reduce the loss by the amount of cash dividends paid on the preferred shares.

The final structure worked as follows:

- the Harris Group made interest payments on a quarterly basis to LLC;
- LLC used those funds to pay dividends to NSULC;
- NSULC paid dividends to Funding LP on the NSULC preferred shares; and
- Funding LP used the funds in part to pay interest on its loans from third parties, and in part to distribute income allocated to its partners, BMO and BMO GP, so that BMO could also pay interest on its loans from third parties.

When it came time to windup the tower structure in 2010, the Canadian dollar had appreciated relative to the U.S. dollar. As a result, BMO and BMO GP realized a capital loss on the disposition of the NSULC common shares by Funding LP. This capital loss was solely attributable to the foreign exchange fluctuation.

BMO also realized a capital gain on the repayment of the U.S. dollar denominated debts owing to third parties due to the same foreign exchange fluctuation. This capital gain was approximately equal to the capital losses reported by Funding LP.[35]

The Canada Revenue Agency ("**CRA**") reassessed BMO under the GAAR. The CRA argued that BMO had avoided subsection 112(3.1) by having NSULC pay dividends on its preferred shares rather than its common shares. The alleged tax benefit was the portion of the capital loss realized on the disposition of the NSULC common shares equal to the total of all dividends received on the preferred shares (CA$287.8 million).

PROVISIONS

For ease of reference, particularly in light of the subsequent substantive amendments to section 39 (which are discussed in greater detail below), the relevant provisions in force for the taxation year at issue are reproduced below. Subsections 112(3.1) and 39(2) are the key provisions, while subsections 39(1) and (3) are relevant to the statutory interpretation of subsection 39(2).

Subsection 112(3.1) reads as follows (emphasis added):

> (3.1) … [W]here a taxpayer … is a member of a partnership, the taxpayer's share of any loss of the partnership from the disposition of a share that is held by a particular partnership as capital property is deemed to be that share of the loss determined without reference to this subsection minus,
>
> (b) where the taxpayer is a corporation, the total of all amounts received by the taxpayer on the share each of which is
>
> (i) a taxable dividend, to the extent of the amount of the dividend that was deductible under this section … in computing the taxpayer's taxable income or taxable income earned in Canada for any taxation year,

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Subsection 39(2) (as of 2010) reads as follows (emphasis added):

(2) Notwithstanding subsection (1), where, by virtue of any [Canadian vs foreign currency] fluctuation … a taxpayer has made a gain or sustained a loss in a taxation year, the following rules apply: …

(b) the amount, if any, by which
(i) the total determined under subparagraph (*a*)(ii) [losses],

exceeds

(ii) the total determined under subparagraph (*a*)(i) [gains], and
(iii) if the taxpayer is an individual, $200,

shall be deemed to be a capital loss of the taxpayer for the year from the disposition of currency of a country other than Canada, the amount of which capital loss is the amount determined under this paragraph.

Subsection 39(1) (as of 2010) reads as follows (emphasis added):

(1) For the purposes of this Act,

(a) a taxpayer's capital gain for a taxation year from the disposition of any property is the taxpayer's gain for the year determined under this subdivision (to the extent of the amount thereof that would not, if section 3 were read without reference to the expression "other than a taxable capital gain from the disposition of a property" in paragraph 3(a) and without reference to paragraph 3(b), be included in computing the taxpayer's income for the year or any other taxation year) from the disposition of any property of the taxpayer other than…

Subsection 39(3) (as of 2010) reads as follows (emphasis added):

(3) Where a taxpayer has issued any bond, debenture or similar obligation and has at any subsequent time in a taxation year and after 1971 purchased the obligation in the open market, in the manner in which any such obligation would normally be purchased in the open market by any member of the public,

(a) the amount, if any, by which the amount for which the obligation was issued by the taxpayer exceeds the purchase price paid or agreed to be paid by the taxpayer for the obligation shall be deemed to be a capital gain of the taxpayer for the taxation year from the disposition of a capital property, and
(b) the amount, if any, by which the purchase price paid or agreed to be paid by the taxpayer for the obligation exceeds the greater of the principal amount of the obligation and the amount for which it was issued by the taxpayer shall be deemed to be a capital loss of the taxpayer for the taxation year from the disposition of a capital property…

TAX COURT OF CANADA DECISION

Since the Federal Court of Appeal largely upheld Graham J's reasons at trial, an understanding of the trial decision is useful to fully understand the appellate decision.

The GAAR applies if there is a "tax benefit", the transaction that give rise to the tax benefit (directly or through a series of transactions) is an "avoidance transaction", and the transaction may reasonable be considered to result in a misuse or abuse of the Act.

BMO disputed that any tax benefit arose from the transactions at issue. Had BMO lost that argument, the remaining dispute between the parties would have been whether there was misuse or abuse because BMO conceded that any tax benefit arose from an avoidance transaction.

Justice Graham determined that the central question was whether subsection 112(3.1) would have applied to reduce the capital loss in the absence of the impugned avoidance transaction — namely, the issuance of, and the payment of dividends on, the preferred shares of NSULC rather than its common shares. If subsection 112(3.1) would not have applied had the dividends been paid on the common shares, then there was no tax benefit for purposes of the GAAR.

The answer to this question depended on whether subsection 39(2) applied to the capital loss that arose on the disposition of the NSULC shares. If subsection 39(2) applied, subsection 112(3.1) could not concurrently apply to reduce that capital loss. This is because subsection 39(2) deems any capital gain or loss within

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its scope to be from the disposition of currency. Subsection 112(3.1) only applies to capital losses from the disposition of shares. As deeming provisions create a legal fiction, if subsection 39(2) applied then subsection 112(3.1) could not, even though the capital loss at issue in BMO, which was solely attributable to the foreign exchange fluctuation, arose on the disposition of the common shares.

The parties advanced competing interpretations of the scope of subsection 39(2). The Crown's position was that the provision only applied to gains and losses relating to obligations that are denominated in a foreign currency, and not property (the "obligation interpretation"). BMO's position was that the provision could apply to gains and losses relating to either obligations *or property* (the "broad interpretation").

To resolve this dispute, Graham J conducted a standard interpretation of subsection 39(2), taking into account its text, context, and purpose. He found that the text was inconclusive, but the context and purpose of subsection 39(2) both supported the broad interpretation.

Starting with the text, Graham J rejected several arguments that the broad interpretation would result in redundancies. He saw nothing wrong with the possibility that capital gains and losses would be split between the portions relating to foreign exchange fluctuations under subsection 39(2) and the underlying value of the property under subsection 39(1). He also rejected the Crown's argument that the broad interpretation was redundant given that subsection 261(2) already requires taxpayers to use Canadian dollars in determining Canadian tax results, including in computing the gains and losses on dispositions of property pursuant to subsection 40(1). Subsection 261(2) was only introduced in 2007. Before that time there was no general conversion rule in the Act, so on the introduction of subsection 39(2) in 1972, the broad interpretation would not have resulted in any redundancy.

Justice Graham considered the opening words of subsection 39(2), "Notwithstanding subsection (1)", and determined that they were inconclusive. In his view, this phrase could either mean "Notwithstanding that the gain/loss is already taxed under subsection (1)", which would support the broad interpretation, or "Notwithstanding how capital gain/loss has already been defined in (1)", which Graham J viewed as supporting the obligation interpretation. The latter reasoning is somewhat surprising given that subsection 39(1) only applies to capital gains and losses from the "disposition of any property" and does not purport to define all capital gains and losses for purposes of the Act.

Moving on to context, Graham J noted that subsection 39(3) applied to "any bond, debenture or similar obligation". In light of the explicit reference to "obligation" and the lack of the "Notwithstanding subsection (1)" language, Graham J viewed this context as supporting the broad interpretation. In particular, Graham J concluded that if the Crown's obligation interpretation were correct, it would not make sense to include the 'notwithstanding' language in subsection 39(2) but not in subsection 39(3). Instead, the better interpretation is that the 'notwithstanding' language indicates that subsection 39(2) covers dispositions of property that are already covered by subsection 39(1).

Finally, Graham J concluded the purpose of subsection 39(2) supported the broad interpretation. Justice Graham relied mainly on the $200 exemption/minimum for capital gains/losses set out in subparagraphs 39(2)(*a*)(iii) and (*b*)(iii). He pointed out that "Asking a taxpayer to record her daily dispositions of British pounds, French francs and German deutschmarks in order to ensure that she can correctly calculate her foreign currency gains and losses on her return from her European vacation would hardly have been a politically popular move."[36] Since there is no exemption for individuals under subsection 39(1), the obligation interpretation would, strictly speaking, require returning vacationers to determine and report their capital gains or losses from any currency exchanges.

The obligation interpretation would also result in a mismatch in some circumstances due to the $200 exemption. For example, if an individual borrows U.S. dollars (an obligation) to buy shares (property), then under the obligation interpretation the first $200 of currency fluctuations on the borrowing would be exempt while all currency fluctuations on the shares would be fully recognized. Under the broad interpretation, these amounts would be netted against each other. Although $200 does not seem like much money now, it is important to point out that the amount has remained unchanged since its introduction in 1972 when a $200 exemption would have been more generous.[37]

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Based on the above analysis, Graham J concluded that subsection 39(2) applied to deem the capital loss on the disposition of the NSULC shares to be from the disposition of currency. Since subsection 112(3.1) would never have applied whether or not the dividends were paid on NSULC's common shares, there was no tax benefit.

Justice Graham finished his analysis by noting—without relying on—subsequent amendments to subsection 39(2), the explanatory notes for which supported the broad interpretation. Amended subsection 39(2) explicitly only applies to debt and similar obligations that are denominated in foreign currencies and removed the $200 individual exemption. New subsection 39(1.1) provides individuals with a $200 exemption for capital gains or losses resulting from foreign exchange fluctuations on dispositions of foreign currency. The explanatory notes state that this new provision was added because subsection 39(2) no longer applied to dispositions of foreign currency.

FEDERAL COURT OF APPEAL DECISION[38]

On appeal, Webb JA (writing for Near and Mactavish JJA) relied on the basic framework used by Graham J and largely upheld his analysis. He also addressed several new arguments raised by the parties.

Although the issue on appeal was whether there was a tax benefit, which is usually thought of as a question of fact, the standard of review applied was correctness because, as discussed further below, the trial court's determination was based on a question of law, not fact. Applying this standard of review, Webb JA agreed with Graham J that there was no tax benefit because subsection 112(3.1) would not have applied even if the dividends had been paid on the common shares.

Beginning with the text of subsection 39(2), Webb JA concluded that the wording was broad enough to apply to property. Unlike the trial decision at the textual stage, Webb JA viewed the "Notwithstanding subsection (1)" language as supporting the broad interpretation as it indicates that some dispositions could fall under both sections, which necessarily means subsection 39(2) can apply to dispositions of property. He also considered the $200 individual exemption (albeit in the textual portion of the analysis rather that the purpose section) and agreed with Graham J that this indicates the provision can apply to dispositions of property.

On appeal, the Crown raised a new argument that subsection 39(2) could apply to dispositions of property, but only if that property were foreign currency. Justice Webb easily dismissed that argument as having no support in the text.

Turning to context, Webb JA largely focused on certain foreign accrual property income ("**FAPI**") rules that support the broad interpretation. In particular, former paragraph 95(2)(*g*.02) provided that in applying subsection 39(2) for purposes of computing FAPI, the gains or losses in respect of excluded property are computed separately from the gains or losses of non-excluded property. Old paragraph 95(2)(*f*.15) also referred to subsection 39(2), setting out certain modifications to its application in computing the capital gains and losses of excluded property (as required by subparagraph 95(2)(*f*.12)(i)).[39] Since "excluded property" is defined in subsection 95(1) as meaning certain types of property held by a foreign affiliate, including shares of certain other foreign affiliates and property used to produce active income, Webb JA concluded that this statutory context supported the broader interpretation.

Finally, with respect to purpose, Webb JA rejected the Crown's argument that the only property that subsection 39(2) was intended to apply to was foreign currency. The CRA documents on this point were inconsistent, and the subsequent amendments to subsection 39(2) and related provisions (including the FAPI provisions discussed above) not only could not be relied on, but were actually unhelpful to the Crown's argument. Not only did the amendments substantively change old subsection 39(2), the accompanying technical notes suggest that old subsection 39(2) did apply to dispositions of property.

The Crown raised one last argument that, even if subsection 39(2) applied to the capital loss arising from the disposition of the NSULC shares, subsection 112(3.1) could still apply. Justice Webb easily dismissed this argument, noting that the impact of the subsection 39(2) deeming rule was not restricted and instead applied for all purposes of the Act, including to oust the application of subsection 112(3.1).

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TAKEAWAYS

It is rare for a GAAR appeal to have an in-depth analysis of whether there was a tax benefit. BMO is rarer still for answering that question as a matter of law rather than fact. The reason the determination turned on a question of law was because it required a conclusion as to whether the impugned tax planning — the NSULC preferred share issuance — was necessary to avoid the application of subsection 112(3.1). Although the Tax Court and the Federal Court of Appeal concluded that the planning was not legally necessary, the length and complexity of their reasons make it clear that such planning was necessary, or at least beneficial, as a practical matter. At the time the planning was undertaken, there was considerable uncertainty among tax practitioners as to the scope of subsection 39(2) (particularly in light of some conflicting and inconsistent positions adopted by the CRA on the application of subsection 39(2)), thus making such planning prudent.

Although a GAAR case, the analysis conducted by both courts consisted of ordinary statutory interpretation rather than a GAAR analysis because the courts did not consider the misuse or abuse test under the GAAR. Several other GAAR decisions have noted that these are two distinct interpretive exercises because they have different purposes. Although the general approach is the same — text, context, and purpose — ordinary interpretation looks to these three factors to determine what the words mean, while GAAR interpretation uses them to determine the underlying object, spirit, or purpose of the provision beyond what is reflected in the words themselves.[40] This distinction was noted by Graham J during the 2018 CTF Judges' Panel, where he agreed that had he concluded there was a tax benefit and proceeded to the misuse or abuse stage, this would have required a distinct analysis of subsection 39(2) with a different goal.[41] The Federal Court of Appeal recently cautioned in Loblaw Financial that the rationale of a provision as determined by a GAAR analysis should not be conflated with the "purpose" stage of an ordinary statutory interpretation analysis.[42]

Finally, the analysis undertaken by both courts in BMO appears to be a variation of the "alternative arrangement" approach used to determine whether there was a tax benefit. Normally, as seen in *Copthorne*, this approach consists of picking an alternative arrangement that would not have resulted in the tax benefit and then determine whether, on the facts, it was feasible for the taxpayer to have entered into that arrangement. BMO, in contrast, picked a feasible alternative arrangement — paying the dividends on the commons shares instead of the preferred shares — then determined whether, on the law, it would have resulted in the tax benefit.

At the time of writing it is not known whether the Crown will seek leave to appeal this decision, particularly given the potential extension of time to appeal that may be available due to the COVID-19 pandemic. If the Crown does seek leave to appeal, given the significant subsequent amendments to subsection 39(2), it is questionable how the Crown could formulate a question of national importance in light of the limited future application of the Federal Court of Appeal's interpretation of old subsection 39(2). It is also hard to envisage what legal errors the Crown could raise given the thorough and consistent reasons provided by the lower courts.

Footnotes

[1] The authors wish to thank their colleague Nat Boidman for his valuable insight and contribution to this paper.

[2] *Income Tax Act*, R.S.C. 1985,c. 1 (5th supp.). All references to statutory provisions are references to the provisions of the Act, unless otherwise noted.

[3] Except where the "excluded property" is shares of a foreign affiliate and the gain arises in connection with certain corporate reorganizations.

[4] For example, an inter-affiliate receivable eligible for Clause 95(2)(*a*)(ii)(B) treatment.

[5] In the case of corporations, the RTF applicable to taxation years after 2011 is 4, meaning that any FAPI that was subject to a tax rate of at least 25% in the foreign country should be fully offset in the year, resulting in no additional tax.

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[6] Clause 95(2)(*a*)(ii)(B) generally recharacterizes the interest income received on a debt by one FA from another FA as active business income to the extent that the expenditures are deductible by the second FA in computing the amounts prescribed to be its earnings or loss from a taxation year from an active business carried on outside of Canada.

[7] Clause 95(2)(*a*)(ii)(D) generally recharacterizes the interest income received on a debt by one FA from another FA as active business income where the proceeds of the debt were used to acquire shares that qualify as excluded property. Also, see CRA Document 2003-0001351E5, dated August 30, 2004 in which the CRA takes the position that of a Clause 95(2)(*a*)(ii)(D) debt would not be a "commercial debt obligation".

[8] See Funt & Nitikman, "FAPI and Debt Forgiveness", 1724 Tax Topics (Wolters Kluwer) 1-4 (March 24, 2005) for a discussion of certain issues that may arise on the liquidation of the CFA, including the application of 15(1).

[9] Another interesting issue on which there appears not to be much guidance is whether the foreign taxes paid on the Forgiven Amount would constitute FAT if the debtor realizes FAPI in future years as a result of the FAPL grind down. See Coleman & Bellefontaine, "Forgiveness, Foreign Affiliates and FAPI", X(1) Resource Sector Taxation (Federated Press) 694-700 (2015) for a discussion on this point. While there is no guidance on point, we note that given the somewhat more inclusive definition of "underlying foreign tax", it is clear that foreign taxes paid on a Forgiven Amount included in "taxable earnings" would be included in the "underlying foreign tax" and thus give rise to a deduction under 113(1)(*b*) upon repatriation.

[10] See Angelo Nikolakakis, *Taxation of Foreign Affiliates*, loose-leaf (Toronto: Carswell, 2017-03-02) vol. 1, 3.5.4 for a discussion that there should be an inclusion of the forgiveness income in computing the "earnings" and on the application of Regulation 5907(2).

[11] See Interpretation Bulletin IT-273R2, dated September 13, 2000 for the CRA's positions on the application of 12(1)(x) in the domestic context.

[12] See subsection 80(1) for more details on the definition of "Excluded Obligation".

[13] CRA Document 2002-0134201I7, dated March 25, 2004.

[14] In CRA Document 9638878, dated November 22, 1996, the CRA took the view that if a foreign tax has not been paid during a Canadian taxation year but "has been paid at the time of filing the returns" for that taxation year, then the CRA will accept a FAT deduction with respect to that year. In CRA Document 9719055, dated October 29, 1997, the CRA recognised that where foreign taxes arise in one year and the foreign tax return must be filed (and the tax paid) in a subsequent year, it would allow for FAT to be deducted with respect to the year in which the foreign tax arose if such tax is "paid in due course". No indication of what "paid in due course" means has been provided.

[15] See Michael G. Bronstetter & Douglas R. Christie, "The Fickle Finger of Fat: An Analysis of Foreign Accrual Tax," International Tax Planning feature (2003) 51:3 Canadian Tax Journal 1317-1339. After citing these two previous interpretations and noting the lack of reasons provided by the CRA with respect to the positions outlined therein, the authors argue that they must either be evidence of the CRA's generally "providing a degree of relief", or they demonstrate a recognition by the CRA that events occurring after the end of a taxation year may affect the tax liability for that year. Preferring to adopt this latter position, the authors argue that the five-year carryforward rule should be read broadly to permit the FAT deduction to be taken "in the year in which the foreign tax liability arose, regardless of when the payment is actually made by the foreign affiliate", citing the decision in *The Queen v. The Bank of Nova Scotia*, 81 DTC 5115; [1981] CTC 162 (FCA).

[16] We note that a similar issue would arise with respect to the definition of "underlying foreign tax" in Regulation 5907(1). Thus, for greater certainty, Canadian taxpayers should wait until the foreign taxes are effectively paid before repatriating FAPI or income from an active business in a country that is not a designated treaty country earned by their CFAs (subject to any FAPI already included in income).

[17] CRA, "Guidance on international income tax issues raised by the COVID-19 crisis" (accessed May 31, 2020), online: https://www.canada.ca/en/revenue-agency/campaigns/covid-19-update/guidance-international-income-tax-issues.html.

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[18] The CRA's guidance also addresses individual tax residency, cross-border employment income, waiver requests for certain withholding taxes (Regulation 105 and Regulation 102), and the processing of section 116 certificates for non-residents' dispositions of "taxable Canadian property" which are not discussed in this article.
[19] However, as discussed below, for purposes of establishing that a foreign affiliate of a Canadian corporation is resident in a "designated treaty country", the foreign affiliate must be resident in the "designated treaty country" under the common law "central management and control" test, and in the case where the "designated treaty country" is a country with which Canada has entered into a bilateral income tax treaty, resident in that country for purposes of the treaty.
[20] R.S.C. 1985, c.1 (5th Supplement), as amended. All statutory references are to the Act unless otherwise noted.
[21] See *De Beers Consolidated Mines Ltd. v. Howe*, [1906] A.C. 455; and *Garron Family Trust (Trustee of) v. The Queen*, 2012 SCC 14.
[22] See e.g., *Garron Family Trust*, *supra* note 3.
[23] See e.g., Landbouwbedrijf Backx B.V. v. The Queen, 2019 FCA 310.
[24] See Article IV(3)(*a*) of the *Canada–U.S. Income Tax Convention*.
[25] The CRA's guidance on corporate residency under tax treaties due to COVID-19-related travel restrictions is generally consistent with that provided by the Organisation for Economic Co-operation and Development ("**OECD**"), as set out in OECD document, "OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis", dated April 3, 2020, online: https://read.oecd-ilibrary.org/view/?ref=127_127237-vsdagpp2t3&=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis. The OECD notes that the exceptional and temporary change of location where employees exercise their employment duties because of the COVID-19 situation is unlikely to create any changes to an entity's residence status under a tax treaty or any changes to a business's permanent establishment determination.
[26] The CRA also adds that it will consider adopting a similar approach to determine the residency of a commercial trust, where appropriate.
[27] Subsection 2(3).
[28] Subsection 150(1).
[29] See e.g., Article VII(1) of the *Canada–U.S. Income Tax Convention*.
[30] Section 253.
[31] *Supra*, note 10.
[32] In the submission dated June 11, 2020 of the Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada ("Joint Committee") to the CRA with respect to the Guidance, the Joint Committee submitted that it would be helpful if the CRA could confirm that the administrative approach in the Guidelines would also be applied in the context of the foreign affiliate rules.
[33] See https://www.gov.uk/hmrc-internal-manuals/international-manual/intm120185 and https://www.gov.uk/hmrc-internal-manuals/international-manual/intm261010.
[34] All statutory references are to the Act unless otherwise noted.
[35] Partial Agreed Statement of Facts at paras 32-33, attached as Appendix A to *The Bank of Montreal v. The Queen*, 2018 TCC 187 ("**BMO Trial**").
[36] BMO Trial at para 72.
[37] $200 in 1972 is equal to approximately $1,250 today.
[38] *Canada v. Bank of Montreal*, 2020 FCA 82.
[39] Paragraphs 95(2)(*f*.12) and (*f*.15) were amended, and paragraph 95(2)(*g*.02) was repealed, as a consequence of the amendments to section 39.
[40] *Copthorne Holdings Ltd v. Canada*, 2011 SCC 63 at para 70.
[41] Hon David Graham et al, "Judges' Panel" in *Report of Proceedings of the Seventieth Tax Conference*, 2018 Conference Report (Toronto: Canadian Tax Foundation, 2019).
[42] *Loblaw Financial Holdings Inc v. Canada*, 2020 FCA 79 at para 59.

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