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WHAT'S NEW? CANADA AND EUROPE—INTERNATIONAL TAX REPORTING AND EXCHANGE OF INFORMATION RULES FOR CRYPTO-ASSETS

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BRIEF OVERVIEW

In October of 2022, the Organisation for Economic Co-operation and Development ("**OECD**") published its crypto-asset reporting framework ("**CARF**"), which aims to facilitate the disclosure and exchange of tax information in respect of crypto-asset transactions. Also in 2022, the OECD adjusted its Common Reporting Standard ("**CRS**") to include e-money and central bank digital currencies. It is expected that Canada's Department of Finance will likely draft legislation to implement the CARF and changes to the CRS at some point in the future. Europe's updates to the Directive on Administrative Cooperation ("**DAC**") can be seen as the European Commission's initiative to integrate both the CARF and the latest changes to the CRS into the European Union's ("**EU**") tax reporting framework. The swift adoption of DAC8 makes EU the first mover in this area.

CANADA—TAX REPORTING AND EXCHANGE OF INFORMATION

OECD Updates the CRS

The CRS, developed by the OECD in 2014, is an international standard for the automatic exchange of financial account information between tax authorities in participating jurisdictions. Canada is one of over 100 jurisdictions that has signed on to the CRS. The CRS was implemented by the addition of Part XIX to the *Income Tax Act* (Canada) ("**ITA**").[1]

The current CRS framework, as implemented in the ITA, focuses on traditional financial assets and currencies. Crypto-assets in most cases do not fall within the scope of the current CRS framework. Where crypto-assets may fall within the definition of financial assets under the CRS, these assets remain outside the reporting framework and largely go unreported given that they are owned by individuals through cold-wallets or via crypto-asset exchanges that do not have the CRS reporting obligations (as they are not "financial institutions" under the CRS).[2]

In 2022, the OECD put forward to the G20 a set of amendments to the CRS framework to include certain digital financial products that facilitate the transfer or sale of crypto-assets.[3] The OECD's changes included broadening the definitions of "financial institution", "financial account", and "financial asset" to cover "specified electronic money products", "central bank digital currencies", and "relevant crypto-assets".[4]

The CRS amendments have been finalized and agreed to by 38 member countries of the OECD, along with the G20 countries.[5] A suggested implementation date has not yet been announced.

OECD Introduces the CARF

In 2022, the OECD also introduced the CARF for the disclosure and exchange of information in respect of crypto-asset transactions. To reduce the tax compliance burden, the OECD has made efforts to avoid duplication between the CARF and the CRS framework.

Under the CARF, the definition of "**Relevant Crypto-Assets**" focuses on the use of cryptographically secured distributed ledger technology or similar technology and targets assets that can be held and transferred in a decentralised manner, without the intervention of traditional financial intermediaries (e.g., stablecoins, NFTs). To avoid duplication, "central bank digital currencies" and some "specified electronic money products", which are covered by the updated CRS, are not included in the CARF.[6]

Entities required to report include intermediaries which provide services effectuating crypto-asset transactions for or on behalf of customers (e.g., crypto-asset exchanges, brokers and dealers in crypto-assets, wallet providers).

The reporting intermediaries are required to report:

(i) exchanges between Relevant Crypto-Assets and fiat currencies;
(ii) exchanges between one or more forms of Relevant Crypto-Assets;
(iii) transfer of Relevant Crypto-Assets in consideration of goods or services (with minimum thresholds); and
(iv) transfers of Relevant Crypto-Assets (even with no knowledge of consideration paid or received). [7]

The OECD is currently working on the implementation package of the CARF which will consist of:

- IT solutions to support the exchange of information;
- further elaboration of the rules and administration of the CARF; and
- a framework for bilateral or multilateral competent authority agreements or arrangements for the automatic exchange of information collected under the CARF.

The CARF has been finalized and agreed to by 38 member countries of the OECD, along with the G20 countries.[8] A suggested implementation date has not yet been announced.

Next Steps for Canada

It is expected that Canada's Department of Finance will likely draft legislation to implement the CARF and changes to the CRS at some point in the future. To prepare for this change, current reporting entities under the CRS and potential reporting entities under the CARF and amended CRS should consider how the new rules may affect their operations.

EUROPE—TAX REPORTING AND EXCHANGE OF INFORMATION

Europe's Finance Ministers met on May 16, 2023 for a European Economic and Financial Affairs Council meeting and agreed to the proposed changes to the DAC.[9]

By way of background, the DAC dates back to 2011 and allows for the collection and exchange between the EU member states ("**Member States**") of tax related information about individuals and companies. This allows Member State tax authorities to track and cross-check income streams, impose taxes according to national legislation, and monitor for tax fraud and tax evasion.[10]

The DAC operates with tax identification numbers ("**TINs**"). The TINs allocate a unique EU-wide number code to the individuals or entities whose data is being reported to the tax authorities. When tax authorities exchange the data between themselves afterwards, the use of the TIN can allow for quick cross-checking of information (for example, cross-border income streams). When the DAC was recently evaluated, it was found that only a small portion of Member States were actively collecting TINs and sending them to the other Member States. As a result, DAC8 requires Member States to ensure that TINs are included when Member States exchange data under the DAC.[11]

The DAC has been revised seven times in the last decade ("**DAC1 – DAC7**"): following the financial crisis of 2008 and several tax scandals (Luxleaks, Panama papers, etc.), and due to increased digitalisation. These revisions have expanded both the scope of taxpayers and the type of data about which reporting is required. The type of reported data ranges from individuals' bank account details to the income earned by sellers on digital sales platforms.[12]

While revisions to the DAC have primarily focused on the expansion of the exchange of information, recent updates have also strived to improve member state cooperation. For example, DAC7 established a legal framework for Member States to carry out joint audits, allowing two tax authorities (or more) to work together in auditing a taxpayer.[13]

The crypto-market was not covered under earlier DAC provisions. As such, any proceeds from crypto-assets are not considered as reportable income under the current legal framework, nor are crypto-asset providers considered to be financial institutions subject to reporting.[14]

In October of 2022, the OECD published the CARF, which is a set of model rules that countries can transpose into domestic legislation. Also in 2022, the OECD adjusted the CRS to include e-money and central bank digital currencies.[15] The DAC8 proposal can be seen as the European Commission's initiative to integrate both the CARF and the latest changes to the CRS into the EU's tax reporting framework. The swift adoption of DAC8 makes EU the first mover in this area.

DAC8—In Greater Detail

DAC8 allows Member States to exchange information about the gains and income made from crypto-transactions by EU users. DAC8 does not oblige Member States to impose a minimum level of direct or indirect taxes on the transactions. The rules contained in DAC8 are largely consistent with the CARF.

DAC8 identifies two types of entities that would be obliged to report information to the local authorities:

- Crypto-asset providers: any legal person or undertaking whose professional activity is the provision of one or more crypto-asset services to third parties.
- Crypto-asset operators: a provider of crypto-asset services other than a crypto-asset service provider.

These entities (i.e., reportable crypto-asset service providers or "**RCASPs**") would be subject to the DAC's reporting requirements if they have reportable users within the EU. This is regardless of the size of the RCASP or their residence (within or outside the EU).

DAC8 requires information to be reported on individuals or entities that are resident in EU Member States and are customers of the RCASPs ("**Reportable Users**").

The type of crypto-assets that need to be reported are all crypto-assets that can be used for investment and payment purposes, including e-money, e-money tokens, stablecoins, non-fungible tokens, and central bank digital currencies ("**Reportable Crypto-Assets**").

Transactions that the RCASPs would need to report are any exchange transactions and transfers of Reportable Crypto-Assets (both domestic and cross-border transactions), including transactions of Reportable Crypto-Assets for fiat currencies, and transactions between Reportable Crypto-Assets.[16]

The data that RCASPs would need to provide are listed in the table below.[17]

Reportable crypto-asset service providers	Reportable user (individual)	Reportable crypto-assets
• Name • Address • TIN • Identification number and global legal entity identifier (if available)	• Name • Address • TIN • Member State of residence • Date and place of birth	• Full name of the crypto-assets and their type • Amounts paid or received from exchanging crypto-assets for fiat currency, number of such transactions, number of units transacted • Value of the crypto-asset (at acquisition) and the gross proceeds (upon disposal), in case of crypto-to-crypto transactions (information has to be reported on both crypto-assets exchanged in the transactions), number of such transactions, number of units transacted • Transfers to un-hosted distributed ledger addresses • Reportable retail payment transactions

The European Commission estimates that the introduction of an EU crypto-asset reporting framework could raise additional tax revenue of €1 – €2.4 billion per year.[18] Once the European Parliament presents its non-binding opinion on the DAC8 proposal following final legal checks, the proposed changes can be formally adopted.[19]

DAC8 may serve as an early indicator of the type of information regarding cross-border crypto-asset transactions that may soon be required to be reported by Canada.

CRA TECHNICAL INTERPRETATION 2019-0813761E5: REIGNITING DISCUSSIONS ON THE STATUS OF ELECTRIC POWER GENERATING EQUIPMENT AS TAXABLE CANADIAN PROPERTY

- –Benjamin Mann and Samantha Holloway, Torys LLP[20]

INTRODUCTION

The Canada Revenue Agency (the "**CRA**") recently released Technical Interpretation 2019-0813761E5 on June 7, 2023 (the "**Technical**").[21] The Technical provided the CRA's views on whether utility-scale solar electric power generating projects ("**Solar Projects**") and wind electric power generating projects ("**Wind Projects**"), either as a whole or in respect of their separate parts, should be treated as "taxable Canadian property" ("**TCP**").[22]

The CRA concluded that the operation of the Solar Projects and the Wind Projects would constitute businesses being carried on in Canada and therefore, if operated directly by a non-resident, the assets would fall within paragraph (b) of the definition of TCP. The CRA also concluded that the equipment used in Solar Projects (the "**Solar Equipment**") and Wind Projects (the "**Wind Equipment**") constitutes "real or immovable property" within paragraph (a) of the definition of TCP. These conclusions may not be shared among industry participants who view some Solar Equipment and some Wind Equipment as personal property and not as real property or interests in land.

The CRA further considered whether contractual rights granted under power purchase agreements could be TCP but declined to answer—although we note that the summary issued with the Technical states that it would be a "question of fact; possibly yes". Finally, the CRA indicated that whether an analysis of the TCP issue should be conducted by reviewing the Solar Projects and the Wind Projects as a whole or as separate parts for purposes of the TCP definition, would not "be determinative" of the issue.

This article deals with the Technical's analysis and conclusion regarding paragraph (a) of the definition of TCP.

TAXABLE CANADIAN PROPERTY

"Real or immovable property" for purposes of the definition of TCP is not defined in the Tax Act. Therefore, to determine whether the Solar Equipment or Wind Equipment is real or immovable property for purposes of the TCP definition, it is necessary to review the common law principles applicable to "real or immovable property" and, in particular, the common law principles applicable to "fixtures" (personal property that becomes sufficiently affixed to real property such that it becomes in law part of that real property). The determination of whether a particular item of property is "real or immovable property" is highly fact specific.

In a prior technical interpretation,[23] this was generally the approach that the CRA adopted. The CRA stated that in determining whether something is "real property" for purposes of the Tax Act, "provincial real property law would seem completely relevant when determining the ordinary meaning of that term". In the treaty interpretation context of the technical interpretation in which those statements were made, the CRA was specifically concerned with the degree of annexation and purpose of annexation of the fixture to the land or building. However, the CRA was nonetheless careful to qualify that a definitive opinion on this issue would require "a detailed review of i) the nature of the asset; ii) the particular method of affixation; and iii) the reason or purpose for affixing the asset to the building or land."[24] The CRA further qualified that "[i]n some circumstances an inspection of the asset would be necessary."[25]

CRA'S REASONING

In the Technical, the CRA made more general, rather than specific, observations about Solar Projects and Wind Projects, basing its analysis on very general facts without a detailed review of a particular project or its assets. Moreover, certain aspects of the CRA's analysis appear to be based on assumptions about how the equipment operates as a whole. For example, the CRA indicated that "all components of the Solar Equipment would be required to function effectively in order to provide power generation and transmission". In respect of wind turbines, the CRA also assumed that "[a]lthough each component part of a Wind Turbine may be removed without damage to the land upon which the Wind Turbine is located and may have marketable value, all of the component parts are attached and are necessary for the Wind Turbine to function for its intended purpose".

The CRA cited *Stack v. T Eaton Co.*,[26] a seminal case in property law for general propositions about the law of fixtures. However, the main thrust of the CRA's reasons appears to rely most heavily upon the British Columbia Supreme Court's decision in *Royal Bank of Canada v. Maple Ridge Farmers Market Ltd.*,[27] another case which sets out a distillation of principles regarding the law of fixtures. In particular, the CRA indicated that the question of whether the equipment is considered "real or immovable property" "can be informed by the application of the guidance provided in the Maple Ridge case", being:

(1) (1)
Any item which is unattached to the property, except by its own weight, and can be removed without damage or alterations to the fixtures or land that will need repair, is a chattel.

(2) (2)
Any item which is plugged in and can be removed without any damage or alteration is a chattel.

(3) (3)
Any item which is attached even minimally (i.e., it cannot simply be unplugged) is a fixture.

(4) (4)
If a piece of equipment is attached to a structure, a part of which could be removed but which would be useless without the attached part, then the entire piece of equipment is a fixture. In other words, the item will be a fixture if it loses its essential character because it is of no use unless attached to a permanent and substantial improvement to the premises of which it formed part. The converse is also true. If an item can be detached without damage or alteration, and if the item retains its essential character without the attached part, then it will be a chattel.

(5) (5)

Where an item is determined to be a fixture, it may nevertheless be removed if it can be shown that it is a tenant's fixture. A tenant's fixture may be removed from the premises during the currency of the tenancy provided that the tenant leaves the premises in exactly the same condition as he or she received them.

(6) (6)
In very exceptional circumstances not covered by these rules the court should have resort to the purpose test. For example, a mobile home may be resting on the land by its own weight but it may be clearly established that it was intended to be a fixture. These circumstances should only arise rarely and in relation to very large or expensive items.[28]

The CRA placed great emphasis on one factor from the above principles—that the equipment could not "effectively function for its intended purpose" if it was not attached to the land.

More specifically, regarding the Wind Equipment, the CRA stated that a wind turbine cannot function unless it is attached to its concrete foundation and therefore would be TCP. Regarding the Solar Equipment, the CRA stated that in the context of utility-scale power generation equipment,

> all components of the Solar Equipment would be required to function effectively in order to provide power generation and transmission. As noted in the Maple Ridge case, any item which is attached even minimally (such as with screws or bolts) is a fixture and if a piece of equipment is attached to a structure, a part of which could be removed but which would be useless without the attached part, then the entire piece of equipment is a fixture. Solar panels would not lose their essential character nor be useless without the racking system however, they could not effectively function in the context of utility-scale power generation without the racking, which itself serves no purpose unless used with the attached framed solar panels.[29]

Based on this reasoning, the CRA concluded that the Solar Equipment was real property.

The CRA's reliance on this one particular factor may be a surprise to many. While the CRA based its decision on the guidance provided in *Maple Ridge*, it is clear that the CRA did not give equal weight to the various principles. Specifically, the CRA stated that the Wind Turbines were real property despite the fact that each component of the Wind Turbine may be removed without damage to the land and may have marketable value. In practice, entire wind turbines are commonly removed and substituted. The CRA further concluded that the Solar Equipment was TCP even though the equipment would not lose its essential character nor be useless without the racking system (which was indirectly attached to the land).

COMMON LAW PRINCIPLES OF THE LAW OF FIXTURES

Respectfully, the Technical may have placed too much weight on that single factor. Canadian courts use various common law frameworks and factors to determine whether an item should be construed as movable personal property, on the one hand, or a fixture affixed to the land, on the other. Moreover, to further complicate matters, the case law is not entirely clear as to how this determination should be made in all cases.

As noted above, the CRA referred to the *Stack* decision, a decision of the Ontario High Court of Justice (Divisional Court) from 1902. *Stack* set out five criteria for determining whether a particular item is a fixture or a chattel, two of which are as follows:

(1) (1)
That articles affixed to the land even slightly are to be considered part of the land unless the circumstances are such as to shew that they were intended to continue chattels.

(2) (2)
That the circumstances necessary to be shewn to alter the *prima facie* character of the articles are circumstances which shew the degree of annexation and object of such annexation, which are patent to all to see.[30]

While *Stack* remains as a leading authority, there have been many subsequent appellate court decisions that have considered various facts and circumstances against the *Stack* principles. Cases that follow *Stack* are generally consistent with the following two step approach: (i) is the object affixed to the land; and (ii) if so, what is the purpose of the affixation and, in particular, does it serve to permanently improve the land? In that regard, the manifestation of intention is taken from what a reasonable person would infer looking at the property and the relationship between the item and the land. Under that analysis, an emphasis is placed on whether the items of personalty when affixed to the land are done to improve the land or the use of the land.

As noted above, the CRA relied heavily on the guidance and rules provided by the Chambers Judge in *Maple Ridge*. For context, *Maple Ridge* was a case involving a dispute between a trustee in bankruptcy and a mortgagee as to whether certain items of restaurant equipment should be classified as fixtures or chattels. In an effort to bring more certainty into the determination of whether an item should be construed as movable personal property or a fixture, the Chambers Judge sought to reconcile the many authorities. In doing so, the Chambers Judge recognized that his summary was not necessarily in accord with other decisions, but that it was aspirational. Specifically, he stated that,

> The consequence of these ostensibly conflicting decisions is that there are no clear rules for classifying an article as a fixture or as a chattel, and accordingly the parties must come to court for a determination on a case-by-case basis. […]
>
> Resolving disputes of this nature are time consuming and expensive and will often further deplete the resources of an already financially troubled or bankrupt company or individual.
>
> In an effort to reduce litigation in these types of matters, I will articulate some rules that favour commercial certainty over a subjective case-by-case approach. I recognize that it is impossible to remove all uncertainty.
>
> I recognize also that my approach will not necessarily be consistent with all previous appellate decisions. My hope is that our Court of Appeal will agree that these rules will provide more certainty and therefore reduce litigation over matters where the cost of litigation may exceed the value of the goods.
>
> Finally, I recognize that rigid rules can result in hard cases. However, those cases must be balanced against the many cases that are litigated merely because of the uncertainty. One can imagine, for example, a trustee in bankruptcy feeling the pressure to litigate where the bankrupt him or herself might not have chosen to litigate because of the cost.[31]

The CRA did not consider any other decisions, despite the existence of many cases on the law fixtures, including relatively recent appellate court decisions[32] that have questioned the principles listed above and decisions involving specific factual findings on industrial equipment.

CONCLUSION

Given the various approaches that the Canadian courts use for determining whether an item should be construed as movable personal property or a fixture, the Technical arguably oversimplifies the analysis and overstates the importance of the need for the Wind Equipment and Solar Equipment to be attached to the land as a “system” in order to function. Nevertheless, the Technical represents the CRA’s most recent articulation of how to apply a TCP analysis to a Solar Project or to a Wind Project. Taxpayers seeking to determine the TCP status of Solar or Wind Projects (and shares of corporations which own such projects)[33] will need to consider the relevant jurisprudence, how it applies to their particular facts and circumstances, and whether it accords with the CRA’s Technical.

CIBC V. THE KING: DOES THE FCA UNDERMINE ITS DECISION IN THE QUEEN V. BANK OF MONTREAL?

- –Marc Pietro Allard and Taj Kudhail

INTRODUCTION

On May 4, 2023, the Canadian Federal Court of Appeal (the “**FCA**”) rendered its decision in *Canadian Imperial Bank of Commerce v. His Majesty The King* (“ ***CIBC*** ”).[34] The case is of interest because it attempts to clarify fundamental principles of statutory interpretation relating to the computation of taxable capital gains and allowable capital losses under the *Income Tax Act* (Canada)[35] (the “**Act**”), and, in particular, the order in which the various gain and loss provisions of the Act should generally be applied.

The principal issue before the FCA was whether a foreign exchange loss realized by the Canadian Imperial Bank of Commerce ("**CIBC**") on a disposition of shares should be treated as a capital loss, or deemed *nil* under the stop-loss rule in subsection 40(3.6). The result hinged on whether subsection 39(2) (as it read prior to its amendment in 2013)[36] had precedence over subsection 40(3.6), or *vice versa*.

CIBC argued that subsection 39(2) was paramount, as it was in *The Queen v. Bank of Montreal* (" ***BMO*** ")[37] with respect to another stop-loss rule, subsection 112(3.1). As such, the foreign exchange loss was deemed to be a capital loss from the disposition of foreign currency, and subsection 40(3.6) (which only applies to a loss realized on a disposition of shares) could not operate. In contrast, the Crown asserted that subsection 40(3.6) deemed the foreign exchange loss to be *nil* prior to the application of subsection 39(2).

The FCA rejected CIBC's appeal, holding that subsection 40(3.6) deemed the foreign exchange loss to be *nil*prior to the application of subsection 39(2). In rendering its decision, the FCA distinguished its earlier decision in *BMO*, in which, in contrast, it held that the stop-loss rule in subsection 112(3.1) must be applied after the application of subsection 39(2).

The following sections provide a brief overview of the relevant statutory provisions at issue, a summary of the FCA's decision, and question whether the opposing results in *BMO* and *CIBC* are appropriate.

FACTUAL BACKGROUND

The facts of the case are straightforward. At all relevant times, CIBC held, directly or indirectly, all of the shares of CIBC Delaware Holdings Inc. ("**DHI**") and was, thus, affiliated with DHI for the purposes of the Act.

On November 8, 2006, CIBC subscribed for shares of DHI for US$1 billion. Less than a year later, on September 25, 2007, DHI redeemed those shares for an equivalent amount. The Canadian dollar equivalent of the subscription price on the date of subscription was CDN$1.13 billion, whereas the Canadian dollar equivalent of the redemption price on the date of redemption was CDN$1,003,600,000, resulting in a foreign exchange loss of CDN$126.4 million.

On its income tax return for its 2007 taxation year, CIBC reported an allowable capital loss of CDN$63,200,000 in respect of the foreign exchange loss. However, the Minister of National Revenue denied the allowable capital loss on the basis that subsection 40(3.6) reduced the loss to *nil*.

BRIEF OVERVIEW OF APPLICABLE LAW

Subsection 39(2)

Prior to its amendment in 2013,[38] subsection 39(2) generally deemed a gain or loss realized by a taxpayer "by virtue of any fluctuation … in the value of the currency or currencies of one or more countries other than Canada relative to the Canadian currency" to be a capital gain or capital loss of the taxpayer from the disposition of currency.

It was generally understood that subsection 39(2) applied on a repayment of foreign currency-denominated debt. However, there was considerable debate and ambiguity as to whether it also applied to a disposition of property. Furthermore, if applicable to a disposition of property, it was unclear whether its application was limited only to a disposition of foreign currency, or whether it applied more broadly to any disposition of property (such as a disposition of shares).

In *The Bank of Montreal v. The Queen*,[39] Graham J. of the Tax Court of Canada (the "TCC") held that subsection 39(2) should be broadly construed as applying to any disposition of property, including a disposition of shares. The TCC's decision was subsequently affirmed by the FCA.

It should be noted that the 2013 amendments have altered this paradigm. Now, foreign exchange gains and losses realized on a disposition of property (including a disposition of foreign currency) are exclusively governed by subsections 39(1) and (1.1), and the application of subsection 39(2) is primarily limited to foreign exchange gains and losses realized on a repayment or settlement of a debt obligation.

Subsection 40(3.6)

In general, subsection 40(3.6) deems a loss to be *nil* where it is realized by a taxpayer on a disposition of shares to the corporation that issued the shares (i.e., a share redemption) and the taxpayer is affiliated with the corporation immediately after the disposition. The amount of the loss is added to the adjusted cost base of any remaining shares held by the taxpayer in the affiliated corporation. The loss is therefore not realized in the year of disposition, but is instead deferred until such time as the taxpayer disposes of any remaining shares to a third party. If no shares of the issuer are held by the taxpayer after the disposition to which subsection 40(3.6) applies, the loss is permanently denied.

THE DECISION

The FCA held that subsection 40(3.6) must be applied in precedence to subsection 39(2), and as such, the loss sustained by CIBC on the disposition of shares was deemed to be *nil* before it could be recharacterized as a capital loss from the disposition of foreign currency. The FCA's decision was rooted in principles of statutory interpretation.

First, the FCA noted that the legislative scheme in subdivision c of Division B of Part I (taxable capital gains and allowable capital losses) uses different terms for gains and losses arising on a disposition of capital property, such as: "gain", "loss", "capital gain", "capital loss", "business investment loss", "taxable capital gain", "allowable capital loss", and "allowable business investment loss". Each term must be given its own meaning and must not be viewed as interchangeable.

Having regard to the above, the FCA stated that the computation of gains and losses arising on a disposition of capital property is generally determined under the following legislative hierarchy:

- The formula in subsection 40(1) is the starting point in computing a taxpayer's "gain" or "loss". Importantly, however, the amount determined by formula is subject to the provisions of Part I that expressly provide otherwise, based on the preamble of subsection 40(1).
- Once the taxpayer's "gain" or "loss" is determined, subsection 39(1) generally provides that such amount constitutes a "capital gain" or "capital loss", subject to certain exceptions, and a "capital loss" may constitute a "business investment loss" if certain conditions are satisfied.
- Finally, the "capital gain", "capital loss", or "business investment loss" is then generally determined to be a "taxable capital gain", "allowable capital loss", or "allowable business investment loss" under section 38, which in turn feeds into the calculation of the taxpayer's income under paragraph 3(b) or (d), as applicable.

This was the general backdrop against which the FCA interpreted the ordering of subsections 39(2) and 40(3.6). Following this logic, the FCA explained that subsection 40(3.6) must apply before subsection 39(2) when computing CIBC's foreign exchange loss on the redemption of shares because subsection 40(3.6) is a *loss* determination provision that overrides the general *loss* formula in subsection 40(1).

Given that CIBC's loss was deemed to be *nil* pursuant to the application of the loss computation rules at subsections 40(1) and (3.6), no amount could be deemed to be a *capital loss* under subsection 39(2).[40]

Second, the FCA pointed to the absence of a particular phrase in subsection 40(3.6) to justify its precedence over subsection 39(2). Indeed, subsection 112(3.1)—which was the stop-loss rule at issue in *BMO*—contains the expression "the loss determined without reference to this subsection," and is noticeably absent in subsection 40(3.6). According to the FCA, such language justified giving precedence to subsection 39(2) over subsection 112(3.1). However, without such language in subsection 40(3.6), the FCA held that the order of application of subsection 39(2) in *CIBC* should be reversed.

Without providing any detailed analysis, the FCA attempted to reconcile the results in *CIBC* and *BMO* by pointing to the net effect of the stop-loss rules in subsections 40(3.6) and 112(3.1).[41] It explained that although subsection 40(3.6) deems a loss to be *nil*, such loss could be recovered on a subsequent disposition of shares, as the denied loss is generally added to the adjusted cost base of any remaining shares held by the taxpayer in the corporation whose shares were redeemed. However, subsection 112(3.1) reduces the loss realized on a disposition of shares by the amount of certain dividends received, and in contrast to subsection 40(3.6), such reduction cannot be later recovered.

COMMENTARY

Although the interpretive issue considered in *CIBC* has been resolved by the 2013 amendment to subsection 39(2), the interpretive principles enunciated in this decision may nonetheless be impactful going forward.

Can *CIBC* and *BMO* be reconciled?

In *BMO*, the dispute focused on whether subsection 39(2) could apply to a disposition of shares. Unlike in *CIBC*, the ordering of subsections 39(2) and 112(3.1) were not at issue, as the parties had conceded that subsection 39(2) took precedence.[42] However, that concession may have been incorrect at law in light of the FCA's decision in *CIBC*.

First, as mentioned above, the FCA held that subsection 40(1) is the starting point for determining a taxpayer's gain or loss from a disposition of property, but that the amount determined under the general formula remains subject to provisions that expressly provide otherwise under Part I. Similar to subsection 40(3.6), subsection 112(3.1) may be viewed as one of those provisions, as it affects the computation of a taxpayer's loss. Thus, based on the FCA's reasoning, it should arguably apply prior to the deeming rule in subsection 39(2).

Second, this view is further supported by the FCA's own statements in *BMO* and *CIBC*. In *BMO*, it effectively states that subsection 39(2) should only apply to a loss that is finally determined (i.e., after all loss computation provisions are applied):

> [41] Subsection 39(2) of the Act, in 2010, did not address how a gain or loss was to be calculated, but rather only addressed the source of that gain or loss. The gain or loss arising as a result of a disposition of a particular property was (and still is) determined under subsection 40(1) of the Act. There was no conflict between subsections 40(1) and 39(2) of the Act with respect to the computation of the amount of a gain. <u>Subsection 39(2) of the Act was premised on the assumption that the gain or loss had already been determined.</u> The question for subsection 39(2) of the Act was: why did the taxpayer realize the particular gain or sustain the particular loss? If it was because of a change in the value of Canadian currency relative to a foreign currency, then the condition for the application of the subsection was satisfied.

This view is reaffirmed in *CIBC*.[43] Assuming the FCA is correct that subsection 39(2) should only be applied to a loss as finally determined (as stated in *BMO* and *CIBC*), the loss computation rule in subsection 112(3.1) should arguably apply in priority to the deeming rule in subsection 39(2). However, in *BMO*, the FCA held otherwise.

The FCA attempts to reconcile the results in *BMO* and *CIBC* on the basis that the phrase "the loss determined without reference to this subsection" in subsection 112(3.1) justifies the application of subsection 39(2) prior to that stop-loss rule. It states that the quoted phrase has the effect of not only having subsection 112(3.1) apply after all loss computation rules are applied, but also after all loss characterization rules (such as subsection 39(2)) are given effect:

> [37] The reference to "the loss determined without reference to this subsection" means that the loss from a disposition of shares is first determined as if the ITA did not include subsection 112(3.1). The loss reduction provision of subsection 112(3.1) of the ITA is only applied after the application of any other provision of the ITA that could change either:
>
> (a) the amount of the loss; or
> (b) <u>the characterization of what would otherwise be a loss from the disposition of shares</u> .

Although there is a logical appeal to applying a loss computation provision prior to subsection 112(3.1) based on the quoted phrase, it is not clear that such phrase also implies that loss characterization rules such as subsection 39(2) have precedence.

Third, the FCA posits that the net effect of subsections 40(3.6) and 112(3.1) may explain why the latter applies after subsection 39(2), but not the former. It states that subsection 40(3.6) merely defers the realization of a loss, whereas subsection 112(3.1) results in a permanent reduction which cannot be later recovered. However, the FCA does not expand on policy considerations and fails to mention that subsection 40(3.6) may result in a denied loss being permanently lost if the taxpayer has no remaining shares in the relevant corporation.

FCA Debunks Statutory Interpretation Proposed by Crown

One of the arguments advanced by the Crown to justify the application of subsection 40(3.6) prior to subsection 39(2) and the different treatment of subsections 40(3.6) and 112(3.1) was the construction of the Act. The Crown submitted that a taxpayer's *income* must first be determined under Division B of Part I (which includes subsection 40(3.6)) before its *taxable income* is determined under Division C (which includes subsection 112(3.1)).

Although the FCA noted that subsection 2(2) is potentially supportive of the argument because it states that "[t]he taxable income of a taxpayer for a taxation year is the taxpayer's income for the year plus the additions and minus the deductions permitted by Division C", the Crown's interpretive argument was rejected.

First, the court noted that subsection 112(3.1) does not provide for an addition or a deduction in computing taxable income. Rather, it deems the loss realized by the taxpayer to be the loss determined without reference to that subsection, minus certain dividends.[44]

Second, it also noted that after subsection 112(3.1) is applied, subsection 39(1) and section 38 (which are both in Division B) must be applied to arrive at the allowable capital loss used in the determination of a taxpayer's income under section 3. The FCA therefore dismissed the theory that Division B and Division C are two separate self-contained parts of the Act.

The Crown's argument may have been derived from the following comments made by the TCC in *BMO*:

> [26] The Respondent accepts that subsection 112(3.1) applies after subsection 39(2) applies and thus that a loss deemed by subsection 39(2) to be a loss from the disposition of currency would not be a loss from the disposition of shares for the purpose of subsection 112(3.1). Capital gains and losses determined under section 39 are used to determine a taxpayer's income under section 3. A taxpayer's income under section 3 is then used to calculate the taxpayer's taxable income under section 2. Under subsection 2(2), the additions to and deductions from income found in Division C are made when calculating a taxpayer's taxable income. Subsection 112(3.1) is found in Division C. Therefore, subsection 112(3.1) applies after subsection 39(2).

To the extent that the TCC's comments stood for the proposition that the provisions of Division B must, in all cases, be applied prior to the provisions of Division C, that proposition appears to have been overruled.

Notes de bas de page

[1] CRA, Guidance on the Common Reporting Standard, https://www.canada.ca/en/revenue-agency/services/tax/international-non-residents/enhanced-financial-account-information-reporting/reporting-sharing-financial-account-information-other-jurisdictions/guidance-on-common-reporting-standard-part-income-tax-act.html.

[2] KPMG, "Introduction of the Crypto-Asset Reporting Framework and the proposed amendments to the Common Reporting Standard", https://kpmg.com/cn/en/home/insights/2022/11/tax-alert-23-hk-introduction-of-the-crypto-asset-reporting-framework-and-the-proposed-amendments-to-the-common-reporting-standard.html.

[3] OECD, "Crypto-Asset Reporting Framework and Amendments to the common Reporting Standard", https://www.oecd.org/tax/exchange-of-tax-information/crypto-asset-reporting-framework-and-amendments-to-the-common-reporting-standard.pdf; RSM Canada, "Crypto-Asset Reporting Framework: Answers to fundamental questions", https://rsmcanada.com/insights/services/business-tax-insights/crypto-asset-reporting-framework-answers-to-fundamental-question.html.

[4] *Supra* note 3, at pages 63-64; RSM Canada, "Crypto-Asset Reporting Framework: Answers to fundamental questions", https://rsmcanada.com/insights/services/business-tax-insights/crypto-asset-reporting-framework-answers-to-fundamental-question.html.

[5] KPMG, "OECD unveils transparency framework for crypto-assets and CRS amendments", https://kpmg.com/ca/en/home/insights/2022/10/oecd-unveils-transparency-framework-for-crypto-assets.html.

[6] *Supra* note 3, at page 11 and 13.

[7] *Supra* note 3, at pages 12–13.

[8] *Supra* note 5.

[9] Press Release, Council of the European Union, "Cooperation between national taxation authorities: Council puts the spotlight on crypto-assets and the wealthiest individuals", https://www.consilium.europa.eu/en/press/press-releases/2023/05/16/cooperation-between-national-taxation-authorities-council-puts-the-spotlight-on-crypto-assets-and-the-wealthiest-individuals/; KPMG, "EU Council agrees on DAC8—crypto-assets reporting and cross-border tax rulings to individuals", https://kpmg.com/mt/en/home/insights/2023/06/eu-council-agrees-on-dac8-crypto-assets-reporting-and-cross-border-tax-rulings-to-individuals.html.

[10] Briefing, EU Legislation in Progress, "Tax transparency rules for crypto-asset transactions (DAC8)", page 2, https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI(2023)739310.
[11] *Supra* note 10, at page 4.
[12] *Supra* note 10, at page 2.
[13] *Supra* note 10, at page 2.
[14] *Supra* note 10, at page 3.
[15] *Supra* note 5.
[16] *Supra* note 10, at page 5.
[17] *Supra* note 10, at page 6.
[18] *Supra* note 10, at page 5.
[19] *Supra* note 9.
[20] The authors would like to thank Andrew Wong of Torys LLP for his assistance in preparing this article.
[21] For greater clarity, we note that while Technical Interpretation 2019-0813761E5 was only recently released, it is dated as of May 26, 2022.
[22] Pursuant to subsection 248(1) of the *Income Tax Act*, RSC, 1985, c 1 (5th Supp) (the "**Tax Act**"). All statutory references are to the Tax Act.
[23] Technical Interpretation 9629865—Meaning of "real property" (machinery affixed) (September 29, 1997).
[24] *Ibid*.
[25] *Ibid*.
[26] [1902] OJ No 155; 1 OWR 511 (*Stack*).
[27] [1995] BCWLD 2244; [1995] BCJ No 1696 (*Maple Ridge*).
[28] *Ibid* at para 11 (emphasis added).
[29] Technical Interpretation 2019-0813761E5 at pp 4–5.
[30] *Stack*, *supra* note 6 at para 16 (emphasis added).
[31] *Maple Ridge*, *supra* note 7 at paras 5–9.
[32] For example, *Zelstoff Celgar Ltd v. British Columbia*, 2014 BCCA 279.
[33] We note that the Technical also identified that many utility-scale solar and wind projects may be held by a corporation in which case the TCP analysis would depend on whether shares of the corporation derive their value from TCP.
[34] 2023 FCA 91.
[35] RSC, 1985, c 1 (5th Supp). Unless otherwise noted, all statutory references are to the Act.
[36] Unless otherwise specified, all references to subsection 39(2) herein are to the version in force in 2007.
[37] 2020 FCA 82.
[38] Which applies to taxation years beginning on or after August 19, 2011.
[39] 2018 TCC 187.
[40] *CIBC v. The King*, *supra* note 1 at para 45.
[41] *CIBC v. The King*, *supra* note 1 at para 47.
[42] *The Bank of Montreal v. The Queen*, 2018 TCC 187, paras 26–27.
[43] *CIBC v. The King*, para 30.
[44] The FCA's reasoning here is perhaps overly literal, as the deeming rule effectively captures a deduction.