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THE MANDATORY REPATRIATION TAX AND INDIVIDUAL US TAXPAYERS

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With the enactment of the *Tax Cuts and Jobs Act* in the United States, US Internal Revenue Code ("Code") section 965 imposes a mandatory repatriation tax on US taxpayers that own controlled foreign corporations ("CFCs"). While designed for multinationals, as discussed below, this includes individual US taxpayers who own CFCs. The rules are very complex and the results can be quite punitive. This article addresses some of the key issues in the application of Code section 965 to individual US taxpayers. We conclude with a summary that represents a reasonable approach to dealing with this issue.

The Mandatory Repatriation Tax Applies to Individual US Taxpayers Who Own CFCs

While the application of Code section 965 to individual US taxpayers is not self-evident or necessarily justifiable from a policy perspective, the law is clear that this is the correct interpretation. Put simply, Code section 965 applies to a "US Shareholder" of a CFC. The term "US Shareholder" is a term of art with a specific meaning. Under current law, a US Shareholder with respect to any foreign corporation, is defined as a United States person (so that would include individual US citizens, green card holders, US residents, US trusts, etc.) who owns, or is considered to own, 10% or more of the total vote of a foreign corporation.[2] Code section 965 applies to US Shareholders in deferred foreign income corporations ("DFIC"). A DFIC is then defined with respect to any US Shareholder, as any specified foreign corporation of the US Shareholder that has accumulated post-1986 deferred foreign income greater than zero. A specified foreign corporation is defined under Code section 965(e) to include any Controlled Foreign Corporation. Thus, the mandatory repatriation tax applies to individual US taxpayers who are US Shareholders in a CFC.

All Post-1986 Earnings and Profits Are Included in Income to the Individual US Shareholder as a New Category of Subpart F Income

The additional tax under section 965 is triggered by a one-time inclusion of the Post-1986 Deferred Foreign Income of the applicable corporation in its Subpart F income

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[2] The definition of US Shareholder changed to encompass 10% or more of the total votes or value of a foreign corporation. However, this change is effective for taxable years of foreign corporations beginning after Dec. 31, 2017, while Code section 965 applies to the last tax year which begins before Jan 1, 2018, so the old definition is still used for Code section 965 purposes.

for the tax year. Put differently, the CFC's post-1986 earnings and profits ("E&P") becomes a new category of Subpart F income. The US Shareholder then includes this income in their pro-rata share of the corporation's Subpart F income on their personal income tax return. The pro-rata share is calculated according to the existing Subpart F rules. Overly simplified, that means that if a US shareholder does not own 100% of the value of the CFC, they will not be subject to 100% of the income inclusion. Instead, the income inclusion will be pro-rated according to the rules under Code section 951. The amount of the inclusion is more or less the pro-rated post-1986 retained earnings. From a technical perspective, the term "Post-1986 Deferred Foreign Income" is defined in Code section 965(d)(2) to mean the post-1986 earnings and profits, excluding that which is attributable to effectively connected income of a trade or business within the United States that was already subject to US tax, or that if distributed would be excluded from gross income of the US Shareholder under section 959 (i.e., income that had already been subject to Subpart F inclusion). Post-1986 earnings and profits are currently tracked on Schedule J of IRS Form 5471. Schedule J may thus effectively be a short-hand method for calculating the amount of income that is subject to the 965 inclusion. Note that post-1986 E&P is calculated as of November 2, 2017 or December 31, 2017 — whichever amount is greater. In short, section 965 creates a new category of Subpart F income that consists of all earnings and profits of a CFC after 1986, measured on November 2, 2017 or December 31, 2017. Note that dividends paid in 2017 do not reduce 2017 E&P because of an express limitation in Code section 965. Further, salary or bonuses paid after November 2, 2017 would not reduce E&P either because post-1986 E&P is measured as of the higher of the November 2, 2017, or December 31, 2017, E&P amounts.

The 965 Inclusion Tax Applies to Tax Year 2017 for Individual US Shareholders

Code section 965 applies to tax years for CFCs that start prior to January 1, 2018. For individuals, this means that the tax applies in tax year 2017. The general rule in Code section 898 suggests that CFCs owned by individual taxpayers should follow a December 31 tax year end since that is the tax year of the majority shareholder (the individual US taxpayer). The IRS has recently issued a notice confirming that Code section 898 applies to determine the applicable tax year for the transition tax although it does not comment on the proposed regulations.[3] There is a proposed regulation from 1992 that suggests a different year end may be possible if the CFC has no Subpart F income. To our knowledge, these regulations have not been finalized. Generally, the IRS's position as expressed in the Internal Revenue Manual is that a taxpayer cannot rely on proposed regulations unless those regulations expressly state it. There is a line of cases to support the proposition that proposed regulations are not law and are not binding. Thus, the most correct position is that the tax applies to the 2017 tax year for individual US shareholders who own a CFC. This may be beneficial as the tax may actually be higher if triggered in tax year 2018 because the deduction is calculated based on a 21% corporate tax rate rather than a 35% corporate tax rate. Taken together, our view is that the more correct and more beneficial position is to apply the tax to the 2017 tax year for an individual US shareholder.

The Top Tax Rate Is Higher Than 15.5% for Individuals

While the mechanics of the calculation of the inclusion are complex, the result is a tax rate that may be higher than 15.5% for individuals. Overly simplified, the calculation works as follows. As discussed above, all post-1986 E&P is included as a new category of Subpart F income to the US Shareholder. Then a deduction is applied to a certain percentage of that inclusion. This deduction is meant to yield an effective tax rate of 15.5% for the portion of E&P attributed to cash and cash equivalents, and an 8% corporate tax equivalent rate for other assets for a US Shareholder that is a US corporation otherwise subject to an effective corporate tax rate of 35%. Individual taxpayers have a higher tax rate than corporate taxpayers, so the net effect of the deduction will be less for them. For an individual in the top bracket of 39.6%, this translates to a tax rate of approximately 17.5% for cash and cash equivalents, and approximately 9% for other assets. The calculation needs to be done for each taxpayer as it is specific to their individual tax bracket.

[3] Rev. Proc. 2018-17.

The Definition of Cash Assets Is Quite Broad and Includes More Than Just Cash

The higher rate is applicable to assets including: (i) cash; (ii) the net accounts receivable of such corporation, and (iii) the fair market value of the following assets held by such corporation: (I) personal property that is of a type that is actively traded and for which there is an established financial market; (II) commercial paper, certificates of deposit, the securities of the US federal government, and of any US state or foreign government; (III) any foreign currency; (IV) any obligation with a term of less than one year; and (V) any asset that the US Treasury Secretary identifies as being economically equivalent to any asset described in section 965(c)(3)(B).

There Is a Significant Double Tax Risk

Code section 965 imposes tax in the US on the US citizen shareholder in the 2017 tax year. If no Canadian tax is generated to fully offset the US tax, then tax will be owing when the money is paid out in Canada at a later date. This represents a significant double tax risk.

General Basket Foreign Tax Credit Carryforwards (and Carrybacks) Can Be Used To Offset the 965 Inclusion

The income generated by the Code section 965 inclusion is foreign source. For Subpart F income, the determination of what foreign tax credit ("FTC") "basket" it falls into is determined by the character of the underlying income. All income subject to the 965 inclusion should be active business income; otherwise it would have been Subpart F income and taxed in the year earned.[4] Consequently, general basket foreign tax credits from the prior 10 years can be used to offset any tax generated by the Code section 965 inclusion. There is no grind down applied to these credit carryforwards so they should reduce the tax generated by the Code section 965 inclusion on a dollar for dollar basis.[5] The same is true of tax generated in 2018 and carried back against the 2017 US tax liability.

Any Foreign Tax Credit Generated by Additional Canadian Tax Triggered To Offset the 965 Inclusion Should Not Be Ground Down

Given the double tax exposure, most individual US taxpayers in Canada will want to generate sufficient Canadian tax to fully offset the Code section 965 inclusion. Our view, expressed in detail elsewhere,[6] is that there is no grind down of foreign tax generated by a subsequent distribution and that the grind down in Code section 965(g) only applies to the indirect credit granted by Code section 960 which is generally inapplicable to individuals. This means that the Code section 965 inclusion can be offset by a Canadian bonus or dividend paid out at the end of 2017 to eliminate the risk of double tax. One other idea is to generate Canadian tax in 2018 through a bonus or dividend and carry it back against the 965 inclusion. The downside of carrying back FTCs would be that the taxpayer might owe the tax twice (once to the US in 2017 and once to Canada in 2018) and recovering from the IRS may prove administratively cumbersome if the 2017 tax is paid.[7] To be clear, if the 965 inclusion is fully covered off by the FTC carryforwards or carrybacks, no extra Canadian tax is required to be generated. Generating extra Canadian tax is only advisable if there are insufficient carryforwards.

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[4] To expand further, CFC income that was not previously includible would generally be either active business income or subject to high tax exclusion. Per Reg. s. 1.904-5(d)(2), income subject to the high tax exclusion is, for look-through rule purposes, general basket income.

[5] This is confirmed by pages 610 and 620 of the *Conference Report on the Tax Cuts and Jobs Act*. Footnote 1500 on page 610 of the Conference Report reads, "Other foreign tax credits used by a taxpayer against tax liability resulting from the deemed inclusion apply in full." The full report can be found at https://www.gpo.gov/fdsys/pkg/CRPT-115hrpt466/pdf/CRPT-115hrpt466.pdf. In a US Ways and Means Committee report (available online at: https://www.congress.gov/congressional-report/115th-congress/house-report/409/1?overview=closed), the Committee notes, "The Committee also understands that the existing. . .foreign tax credit carry-forward rules may interact with income inclusions arising from section 965 in ways that may not be appropriate and that require additional consideration." This shows limiting the applicability of foreign tax credit carryforwards was considered, but not applied.

[6] The technical logic for this conclusion can be found in detail at http://www.skltax.com/grind-foreign-tax-credits-code-section-965-inclusion/.

[7] It may be possible to carry back the tax credits to 2017 without paying the tax twice. This is alluded to in Publication 514, but it is not clear. Alternatively, a taxpayer could just simply not pay the 2017 US liability and then fully offset it with a 1040X once the 2018 tax is generated. That should wipe out any liability and associated interest.

The Anti-Avoidance Rules Should Not Interfere With Using Foreign Tax Credits

There is an anti-abuse rule found in Code section 965(c)(3)(f) that should not deny the ability to use a foreign tax credit. That anti-abuse rule states, “If the [US Treasury] Secretary determines that a principal purpose of any transaction was to reduce the aggregate foreign cash position taken into account under this subsection, such transaction shall be disregarded for purposes of this subsection.” As the plain meaning indicates, this anti-abuse rule is primarily concerned with an avoidance motivated transaction that is designed to convert cash and cash equivalent assets, which are subject to a higher repatriation tax rate, into other assets that are subject to a lower repatriation tax rate. What this provision seems to be reasonably aimed at is something like a CFC converting liquid investments into real property investments with no business purpose. The cash position is determined at year end and not the retained earnings measurement dates. As such, a current-year cash dividend paid prior to the end of 2017 might reduce the cash position.[8] However, a dividend or bonus paid in 2018 and carried back would not reduce the cash position. Regardless, from an overall tax perspective, it should also be apparent that even should a dividend be tax motivated, the motivation is one of preventing double tax, which is a legitimate motivation and the reason why the foreign tax credit and treaty exist. A Canadian resident with a CFC with large retained earnings would generate FTCs far in excess of what would be required to offset the repatriation tax by distributing all cash and cash-related assets. Even if the principal purpose was determined to be the reduction of the cash position, the effect would be that “such transaction shall be disregarded for purposes of this subsection” — meaning the calculation of the cash position not the generation of foreign tax credits that occurs under section 901.

A further anti-avoidance rule is found in Code section 965(o)(2). It provides the US Treasury the power to enact regulations to “regulations or other guidance to prevent the avoidance of the purposes of this section, including through a reduction in earnings and profits, through changes in entity classification or accounting methods, or otherwise.” No regulations have been prescribed yet. The *Conference Report on the Tax Cuts and Jobs Act* indicates the intent of this section is to combat any attempt to reduce the amount of post-1986 earnings and profits.[9] Generating foreign tax credits by way of a bonus or dividend does not reduce the amount of the inclusion under Code section 965.[10] The only effect is to prevent double taxation. That is entirely congruent with US treaty obligations under the Canada–US Tax Treaty.[11] In short, our view is that the anti-avoidance rules in Code section 965 do not limit the applicability of foreign tax credits.

Code Section 962 Is Unlikely To Be Beneficial — Code Section 962 Allows an Individual US Shareholder To Be Subject to Tax in the Same Manner as a Domestic Corporation With Respect to Subpart F Income

Since the mandatory repatriation tax is a Subpart F inclusion, it would be eligible for a Code section 962 election. This allows for a slightly lower tax rate under the Code section 965 inclusion and the ability to claim a foreign tax credit for the corporate tax paid by the CFC. The foreign tax credit is limited to years in which there was a 962 election in place.[12] The utility of such foreign tax credits is marginal as they are ground down by Code section 965(g). Further, when the retained earnings are distributed they are taxable to the individual US taxpayer to the extent that the distribution exceeds the tax paid with the 962 election in place. While the benefits of a 962 election would have to be evaluated on a case-by-case basis, given the above factors it generally does not appear to be beneficial.

[8] If the dividend were paid December 31, and the taxpayer took the (reasonable) position that it was paid out after the cash position was calculated, then it would not reduce the cash position and there would be no risk of the application of the anti-avoidance rule.

[9] Rev. Proc. 2018-17 at s. 11.

[10] In the case of a dividend, it would not reduce post-1986 E&P per Code section 965(d)(3)(B). A bonus might reduce E&P as measured at December 31, 2017, if paid prior to that date but may not meaningfully reduce the post-1986 E&P number as the November 2 measurement date would still be operative. A 2018 bonus or dividend would obviously have no effect on E&P as measured on November 2, 2017, or December 31, 2017.

[11] A discussion of whether there is a treaty override available to ensure double tax relief under the Canada–US Tax Treaty is available online at: http://www.skltax.com/grind-foreign-tax-credits-code-section-965-inclusion/.

[12] Reg s. 1.962-1(b) indicates that the Code section 962 election is made each year. Reg s. 1.962-1(b)(iii) suggests that there is no carryback or carryforward of a credit unless a 962 election is in place for a given year. Thus, the logical conclusion is that the indirect tax credit is limited to years in which there was a 962 election in place (i.e., only tax year 2017).

The Eight-Year Extension Is Not That Beneficial

The US tax on the Code section 965 inclusion can be spread out over eight years. But this is of limited benefit where the taxpayer has a double tax risk since all FTCs would have to be generated in 2017. Under section 965(h)(6)(B), "the term 'net income tax' means the regular tax liability reduced by the credits allowed under subparts A, B, and D of part IV of subchapter A." A foreign tax credit is allowed under section 901 which is found in section 27 in subpart B, therefore, the available FTC is already taken into account when calculating the net income tax liability in year 1. That means that any FTC to offset the 965 inclusion has to be paid out in tax year 2017. That somewhat defeats the purpose of spreading the tax out over eight years and makes that option less attractive since the Canadian tax would have to be paid in 2017 or 2018 to avoid a double tax risk.

The Net Investment Income Tax ("NIIT") May Apply to Equalization Dividends

While dividends paid to equalize out the 965 inclusion are exempt from US tax under Code section 959 as previously taxed income, they are not exempt from NIIT. Reg s. 1.1411-10 states that even though the dividend is excluded from gross income under Chapter 1, it is included as a dividend for NIIT purposes if the income related to it was earned after 2013. Since the 965 inclusion applies to all income earned after 1986, not all of the dividend will necessarily be subject to NIIT. Taxpayers may wish to rely on the position that the NIIT does not apply to US citizens resident in Canada.[13]

It Is Unclear Whether There Will Be Future Legislation or Guidance That Will Improve the Situation

What is clear, however, is that under current law the 965 inclusion is owed in tax year 2017, so waiting for future legislative relief carries a significant double tax risk. Waiting for IRS guidance may be cautious. However, our view is that none will be forthcoming that particularly illuminates the situation for individual taxpayers. The transition tax was designed to apply to large multinationals. Several pieces of guidance have been issued. The IRS has a tremendous amount of work to do to implement the new US tax reforms as they apply to the majority of US-based taxpayers (pass-through deduction, anti-hybrid rules, GILTI, anti-abuse rules for transition tax, and on and on). US citizens abroad are not the intended targets of the transition tax and the IRS is generally slow to address issues that apply to non-resident US citizens.[14]

Summary

To recap, a reasonable approach to addressing the mandatory repatriation tax may be:

- Identify those CFC owners who have exposure;
- Calculate the post-1986 earnings and profits based on Schedule J of Form 5471;
- Calculate the tax exposure by working through the formula as it applies to individual US citizens based on cash and non-cash assets, keeping in mind the broad definition of cash assets;
- See if the tax exposure is fully offset by general basket foreign tax credit carryforwards;
- If yes, the taxpayer is in the clear. Note that any Canadian tax generated by paying a dividend or bonus effective December 31, 2017, will act to offset the US tax. If there is insufficient Canadian tax generated in 2017, another possibility is to generate additional Canadian tax in 2018 and then carry back the associated FTC to the 2017 tax year. The downside is that the taxpayer may be exposed to temporary double tax and could face an administrative hurdle in trying to recover from the IRS.

[13] See Kevyn Nightingale, *Americans Living Abroad and the Net Investment Income Tax*, The Tax Adviser, March 31, 2014, available online at: https://www.thetaxadviser.com/issues/2014/apr/nightingale-april2014.html.

[14] For instance, it took many years to clarify the approach to RRSPs — a far more common issue than the applicability of the transition tax to individual US citizens.

RECENT CASES

Appeal from denial of personal tax credit claims by non-resident dismissed

The taxpayer was an Irish National and Irish resident who had worked in Canada for a period of time during 2014, earning employment income in the amount of approximately $33,000. During the balance of the year, during which he resided in Ireland, he received non-taxable payments from the Government of Ireland by way of social assistance, which totalled approximately $23,000 CDN. He filed a Canadian tax return for 2014 in which he reported his Canadian source income and claimed non-refundable personal tax credit amounts totalling $29,000. The Minister reassessed, denying the majority of those credit claims on the basis that, under section 118.94 of the *Income Tax Act*, such claims could not be made by a non-resident individual unless "all or substantially all of the individual's income for the year is included in computing taxable income earned in Canada for the year". As the taxpayer's Canadian-source income was just over half of his total income for the year, the Minister concluded that he was not eligible to claim such personal tax credits. The taxpayer appealed from that reassessment.

The appeal was dismissed. The Tax Court of Canada held that the determination of the appeal turned on the definition of "income for the year" for purposes of section 118.94. The appellant had argued that such term included only taxable income and that, as the social assistance payments received in Ireland did not have to be reported for tax purposes, they should not be considered income for purposes of section 118.94. The Court held, however, that an analysis of the legislative provision did not support such conclusion, and that in computing income for the year under that provision there was no basis on which to find that the non-taxable foreign social assistance payments were not income. Consequently, the evidence showed that the appellant's taxable income earned in Canada represented approximately 60% of his total income. The Court noted that the Canada Revenue Agency has, for administrative purposes, used an arbitrary 90% ratio to determine what is meant by "substantially all". While the 60% figure represented a majority of the individual's income, that was not the same as "substantially all". The Court concluded, therefore, that the appellant was caught by the application of section 118.94, and was not entitled to a claim for personal tax credits beyond that which was allowed by the Minister.

¶49,868, *Kenny v. The Queen*, 2018 DTC 1015

Judicial review application allowed where refusal to exercise Ministerial discretion unreasonable

The corporate taxpayer failed to file income tax returns as required. The Minister consequently issued an arbitrary assessment of the taxpayer's tax liability and garnished a sum of money from its bank account in satisfaction of that liability. The taxpayer then requested that the Minister exercise discretion under section 221.2 of the *Income Tax Act* to re-appropriate certain statute-barred credits against future tax liability in an amount equal to the balance of taxpayer's funds remaining in the Minister's possession. That request was refused by the Minister's delegate, and the taxpayer applied for judicial review of that decision.

The application was allowed. The Federal Court held that the issue for determination was whether the decision made met the standard of reasonableness. It reviewed the guidelines contained in the User Guide with respect to the re-appropriation of corporate statute-barred credits and noted that such guidelines indicated that each case was to be reviewed based on its own circumstances. The uncontested facts of the taxpayer's circumstances, which had been communicated to the Minister's delegate, included serious problems in re-structuring its financial affairs, owing to issues not of its own making. In the Court's view, there was no evidence that the applicant had intentionally neglected or avoided its responsibility to maintain proper records. Rather, the evidence established that it had made active efforts to meet its responsibilities, and, once its financial affairs were in order, had done so by paying all taxes and penalties without objection or request for relief. The Court then considered the obligations placed upon the Minister's delegate in making and communicating the impugned decision. It held that the delegate was, in denying the applicant's re-appropriation request, required to state a clear and supportable justification. The Court reviewed the decision sent to the taxpayer and held that it was clear that the delegate's decision-making was centred on compliance with the statutory requirement to keep books and records and that relief was refused owing to the taxpayer's failure to meet expectations in that regard. In the Court's view, however, those expectations were unclear and no clarification was provided with respect to what constituted "sufficient action" or a "reasonable timeframe". The Court held that the refusal of the applicant's request constituted delivery of a punishment for its perceived failure to meet the delegate's unclear and subjective expectations. The Court concluded that there was no justification for the decision rejecting the applicant's request and, in addition, that the delegate's delivery of that decision rendered it unreasonable.

¶49,878, *Referred Realty v. Canada (AG)*, 2018 DTC 5015

Appeal from assessment for gross negligence penalties allowed

In her return for 2008, the taxpayer claimed a non-existent business loss, and that loss was denied on assessment by the Minister. Interest and penalties for gross negligence in the amount of $41,000 were also imposed, and the taxpayer, while not contesting the disallowance of the business loss, appealed from the penalty portion of the assessment.

The appeal was allowed. The Tax Court of Canada reviewed the circumstances in which the taxpayer had filed a return which included the claim for non-existent business losses. It noted that she had been convinced to do so by the experience of another taxpayer of her acquaintance who had made the same business loss claims and had received a tax refund of approximately $50,000. The taxpayer, prior to signing her own return, had taken the step of confirming that a cheque in such amount had actually been received as a tax refund by that acquaintance and was consequently convinced of the legality of the claims made. The Court reviewed the background and education of the taxpayer before concluding that such was a significant and reasonable step to be taken by a person who was unsophisticated in tax matters and that the appellant would not have been aware that the payment of that refund could be subject to a future reassessment and a requirement to repay that amount. While the taxpayer had signed both a return and a T1 Adjustment request in blank the Court concluded that, in the overall context of the case, the enquiries she made were extensive enough, in light of her background, education and experience, to suffice for purposes of negating a finding of wilful blindness. As well the Court was satisfied that the appellant had genuinely not known that she was signing a return that included a fictitious claim for a substantial business loss. The actions taken by the taxpayer kept her from crossing the line to gross negligence, including wilful blindness that is tantamount to intentional acting. The Court was therefore unable to conclude that, in the particular circumstances of her case, the appellant should be liable for penalties under section 163(2), and her appeal was allowed.

¶49,876, *Kajtor v. The Queen*, 2018 DTC 1020

Appeal from denial of tuition tax credit for part-time online degree program dismissed

The taxpayer, who had completed an online MBA degree through a foreign university, claimed a tuition tax credit for tuition fees incurred. Her claim was denied on assessment and that denial was upheld by the Tax Court of Canada. The Tax Court held that the taxpayer was not, as required, enrolled on a full-time basis, and based its conclusion on the documentation issued by the foreign university that gave credits for the on-line course at a rate of 30% to 40% of the rate that credits were accumulated for equivalent on-campus studies. As a result, the online program took three years to complete whereas the equivalent on-campus program took one year. The taxpayer appealed from the Tax Court decision.

The appeal was dismissed. The Federal Court of Appeal held that the Tax Court decision must be upheld unless that Court made an error in determining a question of law or made a palpable and overriding error in respect of questions of fact or mixed fact and law. The appellate Court concluded that the Tax Court had not made a reversible error with its approach which gave significant weight to the policy of the university in characterizing the nature of its online MBA program, and accordingly there was no reviewable error in the Tax Court's conclusion that the appellant did not attend the university on a full-time basis and was therefore not entitled to a claim for a tuition tax credit.

¶49,872, *Archibald v. The Queen*, 2018 DTC 5011

Amount received as surplus from winding-up of pension plan properly included in income

In 2013, the taxpayer, who was a former Bell Canada employee, received an amount of approximately $36,000 arising from the winding up of a registered pension plan of which she was a member. In receiving that payment, she chose the option of having the full amount transferred directly to her registered retirement savings plan. A T4A slip was issued for that full amount, as well as a "confirmation of payment" indicating that the amount had been transferred to the taxpayer's RRSP. The taxpayer did not report the amount on her return for 2013 but did claim a deduction for an RRSP contribution in that amount. On reassessment, the Minister included the amount in income and the taxpayer appealed, arguing that the amount received was a non-taxable amount as it was not payment of a pension surplus. The appellant argued that the transaction should be characterized as a direct transfer from one registered investment vehicle to another, without any tax consequences.

The appeal was dismissed. The Tax Court of Canada reviewed the provisions of section 147.3 of the *Income Tax Act*. It noted that section 147.3(4) provides, in part, that an amount can be transferred from an RPP to an RRSP on a tax-exempt basis if "no portion of that amount relates to an actuarial surplus". The Court therefore considered whether the amount received by the appellant related to an actuarial surplus and concluded that it did. As a result, the payment did not qualify for the exemption set out in subsection 147.3(4) of the *Income Tax Act*, and such amount was consequently deemed by subsection 147.3(10) to have been received by the appellant and to have been contributed to her RRSP. The T4A was therefore properly issued and the amount constituted income to the taxpayer for that year.

¶49,874, *Mangal v. The Queen*, 2018 DTC 1018

In 2000 taxpayer's father transferred to her two condominiums without consideration while owing tax; Minister's transferor-transferee tax liability assessment of taxpayer made in 2014 not statute-barred

On October 24, 2000, the taxpayer's father F transferred to her two condominiums without consideration. On April 19, 2006, the Minister reassessed F for tax owing for 2000 and imposed penalties for gross negligence. On September 22, 2009, F made an assignment into bankruptcy. On June 9, 2014, the Minister assessed the taxpayer under section 160 of the Act for the tax previously reassessed as owing by F for 2000. On her appeal to the Tax Court of Canada, the taxpayer chose not to contest the Minister's reassessment of F for 2000, but instead sought to impugn her own assessment made in 2014 by the Minister under section 160. Her concern was with the lengthy delay between October 24, 2000, when the two condominiums were transferred, and the Minister's assessment under the transferor-transferee joint liability rules in section 160, which was ultimately made on June 9, 2014. Her principal arguments were that: (a) she was being assessed in 2014 under section 160 for a tax debt reassessed in 2006 as owing by F for the 2000 taxation year; (b) this delay from 2000 to 2014 was considerable, with the result that she was actually being assessed in 2014 for a tax debt relating to F's 2000 taxation year; (c) the limitation period within which the Minister was entitled to recover the tax assessed as owing by F for 2000, was ten years under section 222 of the Act; (d) the section 160 assessment against her should therefore be vacated since the ten year tax collection limitation period provided in section 222 applied, and had begun to run on October 24, 2000, when F transferred the condominiums to the taxpayer; and (e) apart from the argument based on section 222, she should not be held liable for the penalties for gross negligence imposed on F in the reassessment made in 2006.

The taxpayer's appeal was dismissed. Subsection 160(2) of the Act very simply and clearly states that the Minister may assess "at any time" under the transferor-transferee tax liability rules. As a result an assessment under section 160 cannot be statute-barred (See *The Queen v. Addison & Leyen Ltd*., 2007 SCC 33). Also the 10-year prescription period in section 226 began to run in this case from April 19, 2006, which was the date on which the Minister reassessed F for his 2000 tax owing. Consequently that period had not expired on June 9, 2014, when the section 160 assessment was made, which meant that it was valid. Furthermore, under paragraph 222(5)(c) the 10-year period is interrupted whenever an assessment under subsection 160(2) is made. This interpretation of section 222 accords maximum respect to the phrase "at any time" in subsection 160(2), and to the interpretation of that phrase in the *Addison & Leyen* case.

¶49,875, *Bourgeois v. The Queen*, 2018 DTC 1019

Appeal dismissed where proceeds of condo sale on income account

Two taxpayers, an individual and her granddaughter, who was a minor, each purchased a condominium unit in a building under construction, and both purchases closed in June 2010. One unit was sold that month and the other was sold one month later. Neither individual reported any income relating to the sale of the condos in their returns for 2010. The Minister reassessed both taxpayers on the basis that each had failed to report business income for the year, and penalties for gross negligence were imposed on both taxpayers. Both taxpayers appealed from the assessments, arguing that the sale proceeds received were on capital account.

The appeals were dismissed in part. The Tax Court of Canada rejected the arguments put forward by the appellants that they intended to hold the condominium properties on a long-term basis for several reasons. The Court held first that the adult taxpayer was not a credible witness and that her evidence with respect to their common intentions was vague, contradictory, and bordering on evasive. Although the granddaughter was a credible witness, the Court held that her knowledge about the transactions was limited to what she had been told, and so she could not provide independent evidence on which the Court could rely. Second, the objective facts with respect to the financial resources of the taxpayers made it clear that holding the condos on a long-term basis would never have been an option for them. Finally, each condo was listed for sale prior to the time at which either of the appellants took ownership of the property. The situation was not one in which the appellants planned to hold the property on a long-term basis but such intention was frustrated by the occurrence of an unexpected event. The Court concluded that the primary intention had always been to sell the condos at a profit. As a result, the property was held on income account and the Minister's assessments of the proceeds as business income were affirmed. The Court held as well that penalties for gross negligence for failing to report income were properly assessed against the adult taxpayer. However, the Court concluded that it was unlikely that the granddaughter knew or had been made aware of the need to report income, and, in the circumstances, she was not liable to penalties for gross negligence.

¶49,870, *DaCosta et al. v. The Queen*, 2018 DTC 1017

Appeal from denial of deduction of employment expenses dismissed

The taxpayer was employed as a market dealer with a securities firm. In his returns for each of the 2012 and 2013 taxation years, he claimed an employment expense deduction for $12,000, amounts that he maintained were paid to his wife as salary. Such salary was paid for administrative work done to assist him in his employment duties. The Minister denied the claims for both years on assessment, and the taxpayer appealed from that denial.

The appeal was dismissed. The Tax Court of Canada held that the issues for determination were whether the amounts claimed were actually paid, and, if so, whether the statutory requirements for a deduction claim were met. The statutory requirements for making such a claim include a condition that the taxpayer be required, by his contract of employment, to pay such expenses. In the Court's view, there was no evidence that supported such a finding and, in addition, the relevant form prepared by the taxpayer's employer indicated that he was not required to pay for an assistant. The Court also reviewed the evidence provided with respect to the couple's financial arrangements, and noted that there was not, as required, any evidence of a salary being paid, and that no T4 was issued by the taxpayer to his spouse. Finally, no evidence was provided of the actual administrative work done by the taxpayer's wife. The Court concluded, on balance, that while the appellant was a straightforward witness who had not acted unreasonably, he had not provided sufficient evidence of an employment agreement which required him to hire an assistant, a real payment of salary or evidence of work done. The appeal was therefore dismissed.

¶49,867, *Blott v. The Queen*, 2018 DTC 1014

Motion for Rule 58 hearing for determination of a question dismissed

The corporate taxpayer claimed scientific research and experimental development ("SR&ED") tax credits for the 2009, 2010, and 2011 tax years, related to its work in using alternative fuels in its cement kiln operation. Those credits were denied by the Minister on the basis that there were not, as required, any technological uncertainties or advancements, as it was common practice in the industry for such cement kilns to use alternative fuels. The taxpayer appealed from that denial, and, in the course of the appeal, brought a Rule 58 motion before the Tax Court. That motion sought determination of the question of whether, in effect, experimental development should be analyzed based on the activities carried on by the taxpayer alone or the activities of others in the same industry.

The motion was dismissed. The Tax Court held that in order for a Rule 58 motion to be granted, the question posed must be one of law, fact, or mixed fact and law, and be one raised in the pleadings. Moreover, it must appear to the Court that the determination of the question may dispose of all or part of the proceeding or result in a substantially shorter hearing or a savings of costs. The onus to demonstrate that all three conditions were satisfied rested with the applicant, and the Court held that such onus had not been met. While it was agreed that the question raised was a question of law, the second and third tests under Rule 58 had not been satisfied. The Court observed that the question, as framed, was not raised as an issue in the pleadings, and that it was unable to discern from the pleadings a clear focus as to the issue that aligned with the question in the motion. Finally, the Court held that it was being asked to answer the question without additional material facts that were necessary to formulate a dispositive question. In the Court's view, it would be inappropriate to determine the question in the abstract, in a factual vacuum isolated from an overall determination of whether the taxpayer's activities satisfied the definition of SR&ED In the Court's view, facts relating to experiments were critical to an SR&ED analysis and without such facts, it was unlikely that the Court could provide either an affirmative or a negative answer to the question. Consequently, a determination of the question might not dispose of all or part of the proceeding, result in a substantially shorter hearing, or result in substantial costs savings. The question therefore failed to satisfy the third step of the test under Rule 58 and the motion was dismissed.

¶49,869, *Lehigh Hanson Materials Ltd. v. The Queen*, 2018 DTC 1016

Second dismissal of appeal of net worth assessment

When the taxpayer was originally assessed for under-collected GST over a five-year period, the Minister used a net worth method of calculating the assessment because the taxpayer's records were grossly inadequate. Gross negligence was also assessed due to the high value of net worth, no evidence of a non-taxable source of funds, and failure to keep proper records. After a largely unsuccessful appeal to Tax Court, she has brought to the FCA her arguments of errors of law on the part of the Court, specifically in admitting gambling records and requiring proof of non-taxable sources.

The Taxpayer's appeal was dismissed. In this appeal, the Court must uphold the decision of the Tax Court unless there was an error in a question of law, a palpable and overriding error in questions of fact, or an error in a factually suffused question of mixed fact and law. The FCA found it reasonable that the Court had accepted net gambling losses as evidenced by casino records (of over $750,000) as an addition to the net worth estimate. The taxpayer also failed to establish any foundation for an allegation of bias on the part of the Tax Court judge, which was viewed as "serious allegations which should not be made lightly". In dismissing the appeal, tax and gross negligence assessments were upheld, and costs were awarded to the respondent.

¶49,871, *Truong v. The Queen*, 2018 DTC 5010

INTERNATIONAL NEWS

US Seeks To Prevent Transition Tax Deferral, Avoidance

This article originally appeared in Wolters Kluwer's Global Tax Weekly Issue 276.

The Treasury Department and the Internal Revenue Service (IRS) on February 13 announced modifications to the procedures for changing the accounting period of foreign corporations owned by US shareholders that are subject to the transition tax.

Provided for in section 965 of the Internal Revenue Code, the new transition tax functions by deeming to have been repatriated any untaxed foreign earnings of US companies' foreign subsidiaries. Foreign earnings held in the form of cash and cash equivalents are taxed at a 15.5 per cent rate, and the remaining earnings are taxed at an 8 per cent rate. The IRS and Treasury have said the transition tax may be paid in instalments over an eight-year period.

Initial guidance was provided by the IRS in December 2017 on how to compute the transition tax, followed by further guidance from the IRS and Treasury in January 2018.

The latest revenue procedure (RP-2018-17), to be published in the next Internal Revenue Bulletin on February 26, prevents changes to the annual accounting periods of certain foreign corporations in 2017 under either the existing automatic or general procedures if such change could result in the avoidance, reduction, or delay of the transition tax.

US Taxpayers ' Failing To Disclose Crypto Gains'

This article originally appeared in Wolters Kluwer's Global Tax Weekly Issue 276.

Very few US taxpayers are reporting cryptocurrency gains in their tax returns, according to preliminary figures published by a tax return preparation company.

Credit Karma said that, of 250,000 taxpayers who have used its software recently to file US tax returns, fewer than 100 reported taxable gains from virtual currency trading.

This is despite estimates that some 7 per cent of US taxpayers have gains to report.

In March 2014 the IRS issued a notice ruling that virtual currencies such as Bitcoin are to be treated as property rather than as fiat currency for tax purposes.

Multinationals Set Out ' Responsible Tax Practice' Benchmarks

This article originally appeared in Wolters Kluwer's Global Tax Weekly Issue 276.

With support from civil society organizations, institutional investors, and international institutions, a group of major multinationals has developed a list of best practices on good tax governance.

These best practices are set out in a new report from the so-called "B Team," titled "A New Bar For Responsible Tax," which has been endorsed by founding group companies Allianz, BHP, A.P. Moller–Maersk, Natura Cosmeticos, Repsol, Safaricom, Royal Dutch Shell Plc, Unilever, and Vodafone Group Plc.

"We need to build a new business consensus around responsible tax practice, and communicate that clearly and proactively," explained Bob Collymore, Safaricom CEO. "We want to lead from the front and encourage others to join us — that's what these principles are all about."

The new report makes the case for companies to follow transparent, responsible tax strategies and practice and sets out seven key principles, including that companies should:

- Make boards accountable for tax policy;
- Publish a tax strategy and be transparent about its implementation;
- Be transparent about entities owned around the world; and
- Provide information on the company's overall effective tax rate, and on the taxes paid where they do business.

The group said: "The principles offer a framework that details what good tax practice should look like and sets a new benchmark for businesses to work towards practicing. They cover key areas such as tax management strategy, interactions with authorities, and reporting." Its nine founding members are seeking support for the principles from more multinational groups, to drive forward change.

"We recognize that public trust in multinationals remains low, and that tax poses an increasing reputational risk for companies. Too few prominent business voices have . . . articulated the case for responsible tax practice in building trust. The time to do that is now," it said.

The principles cover numerous areas. As well as covering transparency in depth, including on cooperating with local tax authorities, in the area of international tax planning, the principles set out that groups should be transparent about their corporate structure and the entities owned in different jurisdictions; that they should renounce the use of so-called tax havens; and that they will pay tax to the jurisdiction wherein substantial economic activity is undertaken.

TAX TOPICS

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