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PLEADING NOT GILTI — DEFERRAL STRATEGIES FOR CANADIAN RESIDENT US CITIZENS

— *Max Reed*[1]

The new US tax rules will make US citizens in Canada who run a business feel GILTI.

GILTI is an acronym for "Global Intangible Low-Taxed Income". GILTI is part of the new US international corporate tax regime. Under the new US corporate tax system, US corporations like Apple are now generally only being taxed on the income of the US company itself, and dividends received from a foreign subsidiary are tax free. The purpose of the GILTI regime is to make sure that companies like Apple do not try to shift profits from the US to foreign subsidiaries in a low tax country to then be repatriated back to the US tax free. That's a laudable goal as applied to Apple and other large multi-nationals, but as is often the case, US individual taxpayers living abroad are also caught up in these complicated rules.

This article does not purport to describe all of the details of the GILTI regime. That has been done very well in other articles. Instead, I set out a few key details and then outline some planning ideas to try and preserve as much total tax deferral as possible. The central thrust of the article is that for many US citizens in Canada and their advisors, GILTI is so complex and punitive that it may be wise to adopt a plan that sidesteps it entirely rather than trying to navigate the regime. For those with a higher tolerance for complexity, an election under US Internal Revenue Code section 962 may provide some relief.

The article is organized as follows:

- Basics of the GILTI regime
- Option 1 — Renounce US citizenship
- Option 2 — Convert the Canadian corporation to an unlimited liability company ("ULC")
- Option 3 — Subpart F position
- Option 4 — Restructure share ownership of the company
- Option 5 — A Code section 962 election
- Conclusion

To start out, let's review the basics of the GILTI regime and its implications.

Overview of the GILTI Regime

This section summarizes some, but not all, of the important details of the GILTI regime. For a full description, I suggest the article "A New Tax Regime for C.F.C.'s: Who Is

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G.I.L.T.I.?” by Elizabeth V. Zanet and Stanley C. Ruchelman, who have done an excellent job of outlining the technical mechanics of the GILTI formula.[2]

a. Who the GILTI regime applies to

The GILTI regime applies to US taxpayers (including individual US citizens resident in Canada) who are US shareholders in a controlled foreign corporation (“CFC”). A CFC is a foreign corporation where more than 50% of the voting power or value of stock is owned by “US Shareholders”. A “US Shareholder” is a US taxpayer that owns 10% or more of the votes or value of the total shares of a foreign corporation. Thus, the GILTI rules apply to a US citizen in Canada who owns 10% of a corporation that is more than 50% owned by US taxpayers who each own at least 10%.

b. Basics of the GILTI formula

Overly simplified, profits are GILTI if they exceed a 10% return on depreciable tangible assets owned by the corporation. While the formula is complex, it essentially works as follows:

GILTI = Net CFC tested income – net deemed tangible return income.

Net CFC tested income is essentially the profits of the CFC. This includes active business income. Net deemed tangible return income is a complex formula that is discussed briefly below, but a more detailed description can be found in the Zanet and Ruchelman article. Certain types of income are categorically not GILTI. This is addressed next.

c. There is no high tax exception to the GILTI formula

Certain types of income are excluded from the GILTI formula:

- Income that is effectively connected to a US trade or business;
- Subpart F income;
- Income that is excluded from foreign base company income[3] by virtue of the high tax exclusion found in Code section 954(b)(4).
- Dividends from a related person;
- Foreign oil and gas extraction income.

Of these, the most relevant and confusing is the third bullet point. It is important to note that, unlike Subpart F, the statutory language does not provide for a general high tax exclusion that would apply to all income. Instead, the high tax exclusion only applies to income that would otherwise qualify as foreign base company income. Here is the technical logic for that conclusion. Code Section 951A(c)(2)(A) sets out what items are not included in net CFC tested income (the income that is part of the GILTI formula). More specifically, Code section 951A(c)(2)(A)(i)(III) reads:

> . . . any gross income excluded from the **foreign base company income** (as defined in section 954) and the insurance income (as defined in section 953) of such corporation by reason of section 954(b)(4).

This cannot be read as a general high tax exclusion for GILTI income. Instead, it means that income that would otherwise be foreign base company income or insurance income, but is excluded from foreign base company income by reason of the high tax exclusion in Code section 954(b)(4), is not included in the GILTI formula. Because the active business income of a CFC would not normally fall under the category of foreign base company income, even absent the Code section 954(b)(4) exclusion, it is not excluded from foreign base company income by reason of section 954(b)(4). Therefore, there is no blanket exclusion from the GILTI formula for income that is taxed in Canada at more than

[2] Zanet and Ruchelman, A New Tax Regime for C.F.C.’s: Who Is G.I.L.T.I.?, *Insights*, Vol. 5 No. 1, January 26, 2018; online at: http://publications.ruchelaw.com/news/2018-01/tax-reform-gilti-fdii.pdf

[3] This is a technical term that includes (but is not limited to): income from dividends, interest, certain rents, certain royalties, capital gains from the sale of passive assets, commodities transactions, net foreign currency gains, and income from notional principal contracts and certain personal service contracts, as well as (a) the sale of certain property purchased from a related person; (b) the sale of personal property to, or on behalf of, a related person; or (c) the purchase of personal property on behalf of a related person, where the property is (i) manufactured, produced, grown, or extracted outside the country in which the CFC is organized, and (ii) sold or purchased, as the case may be, for use, consumption, or disposition outside such non-US country. Finally, foreign base company income also includes income derived in connection with the performance of technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services which are performed (A) for or on behalf of a related person and (B) outside the country in which the CFC is organized.

18.9%. That means that, subject to the other exceptions, all income earned by the CFC, unless it would otherwise be foreign base company income subject to a tax rate in Canada of at least 18.9%, is included in the GILTI formula.

d. Net deemed tangible return income

The second part of the GILTI formula is net deemed tangible return income. Overly simplified, this essentially represents a 10% return on depreciable trade or business assets. This formula is complex and a full discussion of it would take us away from our focus on simpler solutions. It is fully discussed in the Zanet and Ruchelman article cited above.

The salient point is that many Canadian corporations controlled by US individuals will have little in the way of depreciable trade or business assets. For instance, a doctor who is a Canadian-resident US citizen performing services through a Canadian corporation typically will not have much in the way of assets. The corporation's business assets may be limited to computers and some medical equipment, and the profits of the doctor's corporation will be GILTI income to the extent that they exceed 10% of its tax basis in these depreciable tangible assets. From a practical perspective, however, trying to calculate what that amount is on an annual basis will prove complex for many advisors to small- and medium-sized Canadian businesses that have depreciable tangible property owned by US citizens. Many business owners will not want to incur the expense of this exercise. Thus, it may be best to try and avoid the application of the GILTI regime altogether. I will return to this point later.

e. Effect of GILTI income

Income that is judged to be GILTI is taxed in the hands of the US taxpayer personally even if it is not distributed. This will effectively deny the deferral of income from personal taxation and dramatically increase the annual US tax cost to the US Shareholder.

f. Foreign tax credits are limited

To make matters worse, the GILTI rules place restrictions on how foreign tax credits can be used. Put simply, Code section 904(d)(1)(A) states that GILTI income is includible in a separate foreign tax credit "basket". That means that existing foreign tax credit carryforwards cannot be used to offset the resulting US tax. Without an election under Code section 962 (discussed below), there is no credit for the Canadian corporate taxes paid by the CFC. However, a dividend paid out in the same year as the GILTI inclusion should generate Canadian tax that can be used to offset that inclusion. The reason being, after the application of the GILTI rules, the dividend on which Canadian tax is paid is, for US tax purposes, considered to be previously taxed income under Code section 959.[4] Thus, the dividend itself is not US taxable income (although it is subject to the net investment income tax). The Canadian tax on the dividend can be allocated to the basket that relates to the previously taxed income.[5] In this case, since the inclusion is caused by GILTI, presumably the tax generated by the dividend can be allocated to the new GILTI basket. What that means is that the double tax risk can be negated — albeit only at the cost of a significant tax hit.

g. Example of GILTI rules in action

Consider the following simple example to illustrate the above rules. Dr. Jones is a US citizen living in Canada. She uses a Canadian corporation to conduct her medical practice. She earns profits of C$500,000, but only takes a salary from the corporation of C$100,000. Prior to the new US tax law, she was able to defer the remaining C$400,000 from personal tax until she needed the money. However, because she is a doctor working in a hospital her company's tangible assets are limited to a laptop worth $3,000. Under the new GILTI rules, all profits earned by the company ($400,000) in excess of a 10% return on her laptop ($300) would be taxed to her personally in the US. Because of the separate foreign tax credit limitations, Dr. Jones would not be able to use previously generated foreign tax credits to offset the GILTI inclusion tax. Nor would she be able to take a credit for the Canadian tax that her corporation pays. Next, I look at some planning ideas that Dr. Jones could use to achieve some tax deferral.

Option 1 — Renouncing US citizenship

One way to avoid being GILTI is to renounce US citizenship. The rules on renunciation have largely not changed with US tax reform. The Tax Cuts and Jobs Act ("TCJA") does, however, allow more people to renounce US citizenship

[4] GILTI is treated for certain purposes of the Code as Subpart F income and the ordering rules suggest that Subpart F income is taxed to the recipient prior to the dividend.

[5] Reg section 1.904-6(b)(2)

without incurring additional taxes. In order to renounce without tax exposure, a US citizen's net worth has to be less than US$2 million. It is now possible to make gifts of up to US$11.2 million (up from US$5.6 million under prior law) to reduce a US citizen's net worth to below the US$2 million threshold. Thus, with proper advice, it should be possible for Dr. Jones to renounce her American citizenship without paying any taxes and without any border risk. If the practical and emotional value of the citizenship is less than the tax headaches caused by the GILTI regime, then that may be a wise decision.

Option 2 — Convert the Canadian corporation to a ULC

Certain Canadian provinces (British Columbia, Alberta, and Nova Scotia) allow for the creation of unlimited liability companies ("ULCs"). For incorporated professionals in other provinces, the professional regulatory body of the other province may allow for the continuation in that province of a ULC formed in BC while it maintains its characteristics as a ULC. From a corporate law perspective, a regular corporation may be converted to a ULC without the creation of a new entity. Such a conversion would be tax neutral from a Canadian tax perspective because from a Canadian tax perspective the corporation would still be a taxable corporation. After the mandatory repatriation tax of the TCJA,[6] from a US tax perspective there may be minimal tax cost to such a conversion, unless there are assets in the corporation with significant unrealized gains or the corporation has significant goodwill.

The benefits of such a conversion are:

- A ULC is not treated as a corporation for US federal tax purposes. Thus, it is not subject to the GILTI regime. The annual compliance work is thus simpler.
- There would still be some tax deferral possible. Under a ULC, the goal is to make sure that the total Canadian tax (corporate and personal) equals the US personal tax. Otherwise, there is double tax exposure because US tax is paid in year 1 and Canadian tax is paid when the income is taken out of the corporation.
- Under the ULC option, there are no foreign tax credit limitations. You get a full credit for all Canadian corporate tax paid. Further, general basket foreign tax carryforwards can be used to offset the US tax. Finally, all Canadian personal tax generated (whether it be by salary or dividends) can be used as a credit against the US personal tax.

The drawbacks of this option are:

- There may be some US tax cost to the conversion if the corporation has assets with unrealized gain or goodwill.
- ULCs do not offer liability protection (although a ULC might be combined with an LP to combat this).
- ULCs are not widely available.

Option 3 — Profits are not GILTI because of the high tax exemption

As noted above, one of the categories of income that is not subject to GILTI is income that would otherwise qualify as foreign base company income and is subject to Canadian corporate tax of at least 18.9%. The second possible planning tool would be to take the position that an item of income is foreign base company income and make sure that it is subject to tax in Canada of at least 18.9%. This could work for income from professional services or rental income[7] that was previously classified as active business income. Let's use income from professional services as an example.

To review, foreign base company income is a broad category that includes foreign personal holding company income. In turn, foreign personal holding company income includes personal service contract income ("PSCI") under Code section 954(c)(1)(H) (essentially, income from personal services). Under prior law, it was generally more favourable to take the position that income from professional services (e.g., medical income earned by Dr. Jones) was not classified as

[6] The exact mechanics of this are complex, but put generally the conversion of a Canadian corporation to a ULC is a liquidation for US federal tax purposes. After the application of Code section 965, the US taxpayer should have high basis in the CFC shares, because Code section 965 increases the US shareholder's basis in the CFC to the extent of the Subpart F inclusion under Code section 965. Alternatively, if the gain is considered to be a dividend under Code section 1248, then the dividends (to the extent of the 965 inclusion) should be distributable tax free to the US shareholder. The results of such a conversion are fact specific and shouldn't be undertaken without a full analysis.

[7] Rental income could be considered Subpart F income if the management of the rental properties is delegated to a third party. See Treas. Reg. section 1.954-2(c)(3) Example 3.

PSCI. With the advent of GILTI, that may have changed. It might be better to take the position that the professional services income is PSCI and opt out of the Canadian corporate small business tax rate. The legal basis for such a position is beyond the scope of this article. This would result in the medical services income a) being classified as foreign base company income, and b) being taxed at a Canadian corporate tax rate of higher than 18.9%. That would mean that it is not GILTI income. Assuming all active business income can be classified as foreign base company income, the benefits of this strategy would be:

- There is still some deferral of income from personal tax, although this is reduced since the Canadian corporate rate is increased.
- The dividends should be eligible dividends so the Canadian tax cost of withdrawing the money from the corporation is lower and should fully offset the US personal tax on the dividend.
- No restructuring of the corporation is necessary.
- Liability protection is preserved (compared to the ULC option).
- The compliance is straightforward as no income is subject to the GILTI formula.

The downsides to this approach are:

- Some risk in taking the position that what was previously not Subpart F is now changed.
- Modestly higher total Canadian tax as integration is not perfect.
- Less deferral than if the US citizen simply renounces.

Option 4 — Restructure the share ownership of the corporation

The GILTI rules allocate GILTI inclusions to US Shareholders the same way that *pro rata* shares of Subpart F are allocated to different shareholders.[8] This means that if a particular US shareholder has no distribution rights, meaning no rights to a dividend, then there would be no GILTI inclusion.[9] One strategy, then, for a couple where one spouse is a US citizen and one spouse is not would be to have the US-citizen spouse own only voting shares of the corporation. This prevents the corporation from becoming a passive foreign investment company ("PFIC"),[10] but also limits the GILTI inclusion. It also complies with professional regulations under which an incorporated professional normally must own all of the voting shares of the corporation. The US citizen could then be paid a salary or bonus.

The benefits of this strategy would be:

- It would maximize the deferral since there would be no GILTI inclusion;
- The US-citizen spouse would be paid a salary which does not trigger net investment income tax;
- The newly enhanced US estate tax exemption provides more flexibility in making gifts to a spouse on a tax-free basis.

The downsides of this approach are:

- It may require restructuring the corporation, which is costly and complex;
- The newly expanded Canadian TOSI rules may make this plan unduly expensive.

Option 5 — Code section 962 election

Put generally, Code section 962 allows an individual US taxpayer to be subject to US tax as if she was taxable as a US corporation on Subpart F income. The downside to Code section 962 is that when the income is later distributed by way of dividend, a portion of it is also taxable (as opposed to subsequent distributions of Subpart F inclusions which are normally not taxable) to the extent that the distribution exceeds the tax paid with the 962 election in place. Prior to the TCJA, Code section 962 was generally not used as it resulted in a higher overall US tax rate. Undoubtedly, an

[8] Code section 951A(e).

[9] Reg. section 1.951-1(e)(3)(i).

[10] Code section 1297(d).

individual US taxpayer can use Code section 962 to access the new, lower, corporate tax rate for the GILTI inclusions. This is because under Code section 951A(f), GILTI is treated as Subpart F income for a variety of purposes including Code section 962. However, on its own, without the deduction, this is not attractive, because: a) the 21% corporate tax rate may in some cases be higher than the individual tax rate, and (b) even if it is not, there would be subsequent US tax when a distribution is made to the US taxpayer personally.

The GILTI rules provide a 50% deduction against the GILTI inclusion for US domestic corporations. It is unclear whether the 50% deduction is available to individual US taxpayers filing a section 962 election. My view is that there is a reasonable case that it is, but that this has risk to it. Here is why. On one hand, the express text of Code section 962 provides for the substitution of the corporate tax rate for the individual tax rate. However, it says nothing about allowing an individual US taxpayer to qualify for corporate *deductions* as well as the corporate tax rate. Further, there is no express reference in Code section 951A or the legislative history to that section that would suggest Congressional intention to allow an individual US taxpayer to qualify for the deduction. These two points suggest at least some risk to taking the view that an individual US taxpayer would qualify for the deduction. On the other hand, the entire point of Code section 962 is to equalize treatment between individual CFC owners and corporate CFC owners. That, and the express reference to Code section 962 in Code section 951A(f), strongly implies that as a policy matter individual US citizens should be eligible for the GILTI deduction under Code section 962. There is a technical argument to support this position,[11] although it is less convincing than the competing technical argument. Thus, my view is that while there is an arguable case that the deduction would apply, this position is not without risk. The advantages of the Code section 962 approach are:

- If individual taxpayers are eligible for the deduction, then short of renouncing, this is likely the best way to preserve deferral.
- With the indirect tax credit (even at an 80% limitation) and the 50% deduction, even income taxed at the small business tax rate in Canada should fully offset the GILTI inclusion.
- When paid out, the dividends should be qualified dividends and thus fully offset by the Canadian tax paid on those same dividends.

The downsides are:

- The compliance work is complex. Put generally, to use the 962 election, a US tax advisor would have to: 1) Calculate the GILTI inclusion using the GILTI formula; 2) Calculate the effects of the 962 election in year 1 (inclusion taxable as a corporation, GILTI deduction, and foreign tax credit limitation); and 3) track the US tax when the income is paid out and make sure it is offset by Canadian tax.
- The foreign tax credit is limited to 80% of the Canadian corporate tax paid. The ULC conversion option has no such limitation.
- There is at least some risk that the IRS could deny the deduction; thus there is some risk of an overall higher tax rate.

Conclusion

There is no doubt that the GILTI inclusion increases the complexity for US citizens who own Canadian businesses. Left unaddressed, the GILTI rules can create substantially more tax even to the point of double tax exposure. This article has

[11] Summarized briefly, the technical argument runs as follows. Code section 962 states that an individual US taxpayer can elect to be subject to "an amount equal to the tax which would be imposed under section 11 if such amounts were received by a domestic corporation." Under Section 11(a), "a tax is hereby imposed for each taxable year on the taxable income of every corporation." A corporation receiving the 951A inclusion would be eligible for the section 250 deduction, so an amount equal to the tax imposed under section 11 if the 951A inclusion was received by a domestic corporation also implicitly includes the deduction. There are regulations under Reg section 1.962-1(a) that outline the benefits of the Code section 962 election (corporate tax rates and foreign tax credits), but they do not expressly state that this is all the benefits that the taxpayer receives. In turn, Reg. section 1.962-1(b) defines taxable income under section 11 to mean the sum of the income included by S. 951A and section 78. On its face, that would seem to preclude any deductions. However, the final words of Reg. section 1.962-1(b) are "For purposes of this section, such sum shall not be reduced by any deduction of the United States shareholder even if such shareholder's deductions exceed his gross income." That would imply that the taxable income cannot be reduced by any deductions of the US shareholder, rather than simply no deductions period. This distinction is important because the section 250 deduction is not a deduction of the US shareholder as it is not found in Part V or VI (the parts of the tax law relating to individuals). Instead, it is a deduction against the 951A inclusion. Further, the regulations under Code section 962 were enacted prior to the enactment of the GILTI regime so one questions whether or not they are still valid. The point remains that while there is an equity based argument in favour of the deduction being available to individual US citizens, that position is not without risk.

outlined, at a conceptual level, some possible strategies for preserving tax deferral. Stated simply, the following conclusions can be reached:

- Renouncing US citizenship is the most effective way of preserving the deferral from personal tax.
- If renunciation is not palatable, then the best strategy will depend on the specific facts.
  - Taxpayers who have relatively low corporate income may prefer the ULC plan.
  - Taxpayers who have a moderate amount of corporate income may prefer the Subpart F plan.
  - Assuming a taxpayer is comfortable with the uncertainty as to the availability of the deduction, the Code section 962 election may deliver the best results.

Whatever option is chosen, taxpayers should plead not GILTI to try and maintain some semblance of personal tax deferral.

BRIEF SUMMARY OF BUDGET 2018 MEASURES

Federal Minister of Finance Bill Morneau tabled the 2018-2019 Budget on February 27, 2018. Wolters Kluwer's *2018 Federal Budget Special Report* is available to IntelliConnect subscribers at https://wolterskluwer.ca/learning/federal-budget/. Print copies of the report can be ordered at http://www.cch.ca/product.aspx?WebID=5295. Budget content will soon be distributed to DVD subscribers.

The Notice of Ways and Means Motion contains 35 resolutions pertaining to federal income tax, though some of the proposed measures do not yet have proposed legislation. The proposed measures are summarized below.

Credits and Deductions

- The Working Income Tax Benefit will be enhanced and renamed to the Canada Workers Benefit, effective 2019.
- The eligibility of service animals for the medical expense tax credit will be expanded.
- Foreign-born status Indians can retroactively apply for the Canada Child Benefit as far back as 2005.
- Effective for 2019, taxpayers can deduct the employee portion of enhanced QPP contributions.
- The mineral exploration tax credit for flow-through share investors is extended for an additional year.

Business Tax Measures

- Budget 2018 announced the anticipated proposals affecting corporations that earn passive income. These proposals contain two separate measures. First, a corporation's small business limit is essentially reduced by $5 for every $1 of investment income over $50,000 earned by the corporation or an associated corporation. Second, private corporations will have two RDTOH accounts going forward: eligible and non-eligible. Whether each tax pool can be refunded is dependent upon what type of dividend is paid by the corporation. These measures apply to taxation years beginning after 2018.
- Class 43.2, which provides accelerated CCA for clean energy equipment acquired before 2020, is extended to property acquired before 2025.
- Budget 2018 clarified that the at-risk rules apply to a partner of a limited partnership that is also a partnership (i.e., tiered partnerships). This overrides the Federal Court of Appeal's decision in *The Queen v. Green et al*. (2017 DTC 5068).
- A "look through rule" will be added to the non-resident surplus stripping rules (section 212.1) in order to target transfers of an interest in a partnership or trust that holds shares (rather than transferring the shares directly).

- Budget 2018 proposes to make various modifications to the foreign affiliate rules. Proposed amendments relate to income of an investment business, controlled foreign affiliate status, trading or dealing in indebtedness, extending the reassessment period in certain circumstances, and aligning deadlines for a taxpayer's income tax return and foreign affiliate information return.

Administrative Measures

- To improve the collection of beneficial ownership information with respect to trusts, trusts not currently required to file a T3 return will be required to do so and to disclose certain information.
- Where a CRA compliance order or information requirement is contested, a new rule will "stop the clock" to prevent the tax year from being statute barred.

RECENT CASES

Denial of penalty and interest relief returned to Minister for redetermination in part

The applicant corporation, which had been assessed a penalty and interest for failure to file a required T1135 form for the 2005 through 2013 taxation years in respect of its foreign property holdings, requested relief from such interest and penalties under the Voluntary Disclosure Program (VDP). Such relief was denied by the Minister's delegate on the basis that the disclosure made did not meet the definition of "voluntary", as the Minister had already commenced enforcement action against the taxpayer which would have likely uncovered its T1135 disclosure obligations. The corporation applied for judicial review of that denial.

The application was allowed in part. The Federal Court held that the standard of review of the decision of the Minister's delegate was that of reasonableness and that the only issue in dispute was whether the applicant's disclosure was voluntary. The key issues for determining voluntariness were whether the CRA was engaged in enforcement action, and, if so, whether that enforcement action was likely to uncover the disclosed T1135 returns. The Court reviewed the filing history of the applicant and the actions taken by the Minister with respect to those filings. It concluded that the decision of the Minister's delegate regarding the applicant's 2011, 2012, and 2013 T1135 returns was reasonable, as enforcement action taken by the Minister would likely have uncovered the applicant's obligation to file such returns. The Court also held, however, that adequate reasons to support the conclusion that similar enforcement action would likely have uncovered the applicant's T1135 filing obligation for the 2005 to 2010 years had not been provided. The application for judicial review was allowed and the matter returned to the Minister for redetermination in accordance with the Court's reasons.

¶49,883, *Boadi Professional Corp. v. Canada (AG)*, 2018 DTC 5013

Applications for extension of time to file appeal dismissed

Each of the taxpayers had participated in a charitable donation program and claimed tax credits with respect to their participation, and each was reassessed. Each of the applicants filed a Notice of Objection, but none of them filed an appeal within the statutory 90-day period following the reassessments. The taxpayers subsequently applied to the Tax Court for an extension of time to file their appeals and their applications were heard on common evidence.

The applications were dismissed. The Tax Court held that the sole issue on the applications was whether each of the applicants should be granted an order extending the time to file an appeal, pursuant to section 167 of the *Income Tax Act* and based on the criteria set out in that provision. It was agreed that the applicants had filed their application for an extension within the requisite one-year time period and that there were reasonable grounds for the underlying appeal. The Court was therefore required to determine whether the applicants had met the three remaining criteria for an extension, and it held that they had not. While the Court was satisfied, on the evidence, that the applicants had a genuine intention to appeal within the 90-day period, it could not conclude that the applicants had exercised the required diligence in filing their applications. The statute requires that such application be filed as soon as

circumstances permitted, and the Court held that such criterion had not been met. In addition, the Court held that each of the applicants had ample time to file their Notice of Appeals within the 90-day period and that they had not adequately explained their failure to do so. Consequently, the Court concluded that allowing an extension of time to appeal would not satisfy the statutory requirement that granting the application would be "just and equitable" in the circumstances of the case. The applications were therefore dismissed.

¶49,882, *Amrite et al. v. The Queen*, 2018 DTC 1026

Reassessment resulting from retroactive revocation of individual pension plan upheld

In 2009, the taxpayer established an individual pension plan ("IPP") and transferred the commuted value of his employer pension plan into that IPP. In November 2013 the Minister issued a notice of revocation for that IPP but later acknowledged that such notice was ineffective as having been issued prematurely. On the same day the notice of revocation was issued, the Minister reassessed the taxpayer to include the commuted value of his RPP in income for 2009, on the basis that the IPP had been revoked. Subsequently, in June 2017, the Minister issued a valid notice of revocation for the IPP, which was made retroactive to January 1, 2009. The taxpayer challenged the Notice of Reassessment issued in 2013 on the basis that the IPP was still in existence when that reassessment was issued, as the notice of revocation then in place was invalid. He also argued that the Minister was precluded by section 152(9) of the *Income Tax Act* from relying on the June 2017 notice of revocation as a new basis for reassessment.

The appeal was dismissed. The Tax Court of Canada held that the taxpayer's argument failed because of the retroactive nature of the June 2017 notice of revocation. In the Court's view, the facts necessary to support the reassessment existed at the time it was issued in 2013, because of the retroactive effect of the notice of revocation issued in 2017. On the question of whether the Minister had the authority to pursue the reassessment in 2017, the Court held that the reassessment was issued within the normal reassessment period and that the factual basis of the reassessment was and had always been that the commuted value of the appellant's registered pension plan had been transferred to a non-registered pension plan. Due to the retroactive nature of the revocation the facts underlying the basis of the reassessment were always present. As there was no change to the factual basis of the reassessment the Court therefore concluded that the restrictions contained in section 152(9), on which the taxpayer relied to dispute the Minister's authority to issue that reassessment, did not apply in the circumstances.

¶49,880, *Mammone v. The Queen*, 2018 DTC 1024

Taxpayer granted joint custody of his children by court, but not residing with them on an equal or near equal basis, and thus not entitled to Canada Child Benefit

The taxpayer and his former spouse MLP, who were the parents of three children, were living separate and apart since 2007. Under a Quebec Superior Court order they were granted shared custody of their children. The Minister determined that the taxpayer was not entitled to the Canada Child Benefit for the period from January 2014 to September 2016 because he did not reside during that period with his children on an "equal or near equal basis" within the meaning of section 122.6 of the Act. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. Although the phrase "on an equal or near equal basis" in section 122.6 is not defined; "near equal basis" refers to the sharing of custody on an approximately 60:40 basis, but not less than 40% (see *Morrissey v. The Queen*, 2016 DTC 1152 (CCI)). In the present proceedings, the periods during which the taxpayer had custody over his children did not exceed 37% for 2015 and 39% for 2016. In the *Morissey* case the court also emphasized that, in cases involving an "equal or near equal basis" analysis, a quantitative analysis relating to the actual time spent by children with each of their parents is of primordial importance. The quantitative analysis adduced in this case to the effect that the taxpayer had custody of his children for less than 40% of the time therefore prevailed over the qualitative portions of the remaining evidence adduced by the taxpayer. The Minister's determination was affirmed accordingly.

¶49,881, *Théodore v. The Queen*, 2018 DTC 1025

INTERNATIONAL NEWS

EU Angling for New Digital Tax in March

This article originally appeared in Wolters Kluwer's Global Tax Weekly Issue 277.

The European Commission is to propose that the revenues of large digital companies be taxed based on where their users are located, according to reports.

Reuters said that it had seen a draft Commission document in which the Commission argued that the tax should be applied to companies with revenues of more than €750 million (US$925.2 million) worldwide and with EU digital revenues of at least €10 million a year.

According to Reuters, the tax would be calculated on the "aggregate gross revenues" of a business and would be charged at a rate of between 1 and 5 per cent. Revenues would be taxed based on where the company's users are located, rather than on where the company is headquartered.

"This would entail additional reporting requirements so that the authorities of member states can calculate how much is due in their jurisdiction," the document explained.

As regards online shopping, the document recommended that the tax be collected in countries "where the user paying for being able to access the platform (or to conclude a transaction within the platform) is located."

In the case of online advertisers, the tax would be levied "where the advertisement is displayed [and] where the users having supplied the data which is being sold are located."

The proposal is expected to be published next month, Reuters said. It added that the tax is envisaged as a temporary measure that would be applied until a more comprehensive package of measures on digital taxation is approved.

OECD Urges Countries Not To Go It Alone on Digital Tax

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The problems posed by the digitalization of the economy should be addressed collectively and any interim measures taken by countries unilaterally should be "as little damaging as possible," the OECD's Director of Taxation has said.

Pascal Saint-Amans told the *Irish Independent* that to "find a long-term solution, you need to change tax treaties, you need to adopt transfer pricing rules and that's going to take time."

"You need to get the right analysis of the challenges of the digitalization of the economy, and things are not stabilizing there. So I think there is an agreement that we need to address this collectively," he said.

According to Saint-Amans, this process "will take a few years." He did however acknowledge that, if it takes too long, countries will be faced with the challenge of how to address the concerns of citizens.

Saint-Amans noted that there is some expectation that certain countries will take "interim measures," but stressed that these measures should be "as little damaging as possible."

Earlier this month, EU Tax Commissioner Pierre Moscovici said that the situation calls for "a fundamental overhaul of our corporate tax systems." He argued that while, ideally, progress should be achieved at an international level, this "is not a prerequisite."

Moscovici said that although the Commission is working closely with the OECD on the issue, "international progress does not give much cause for optimism."

European Parliament Economics Committee Approves CCCTB

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The European Parliament's Economics and Monetary Committee has approved the Commission's proposed Common Consolidated Corporate Tax Base ("CCCTB").

The Committee voted in favor of the measure by 38 votes to 11, with five abstentions. A separate, complementary measure — the Common Corporate Tax Base — was approved by 39 votes to 12, with five abstentions.

Under the proposals, companies would calculate their tax bills by adding up the profits and losses of their constituent companies in all EU member states. Taxable profits would then be allocated to each member state where the firm operates according to a sharing formula based on sales, assets, and labor, as well as the use of their personal data.

A single set of tax rules would apply in all member states. Companies would be accountable to a single tax administration (a one-stop shop).

The proposed legislation would cover groups of companies with a consolidated turnover threshold exceeding €750 million (US$921.3 million). MEPs want the threshold to be lowered to zero within seven years.

The proposals also include benchmarks to determine whether a firm has a "digital presence" within an EU member state which might make it liable for tax even if it does not have a fixed place of business in that country.

The Committee recommended that the Commission monitor technical standards for the number of users, digital contracts, and the volume of digital content collected which a company exploits for data-mining purposes. It said that these measures should produce a clearer picture of where a firm generates its profits, and where it should be taxed.

Rapporteur for the CCCTB, Alain Lamassoure, said: "This is a fabulous opportunity to make a giant leap in the field of corporate taxation; not only would this legislation create a model that is more suitable to today's economies through the taxing of the digital economy, but it would also put a halt to unfettered competition between corporate tax systems within the single market, by targeting profits where they are made."

TAX TOPICS

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