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Wolters Kluwer

COVID-19 UPDATE

Given the rapidly changing information related to COVID-19 we are providing continuously updated information at https://wolterskluwer.ca/learning/covid-19/.

Canada

CRA Provides Relief From Late-Filing Penalty (May 22, 2020)

The deadline for most individuals (not self-employed) to file their 2019 taxes was previously extended to June 1, 2020. The deadline to pay amounts owed has also been extended, to September 1, 2020. Penalties and interest will not be charged if payments are made by the extended deadline of September 1, 2020. The CRA has now clarified that the late-filing penalty will not be applied for a return filed after the June 1, 2020 deadline as long as the return is filed by September 1, 2020.

CRA Extends Return Filing Deadline for Corporations and Trusts (May 22, 2020)

On May 22, 2020, the CRA extended the filing deadlines for corporations and trusts. The CRA is deferring the deadline for T2 corporation income tax returns otherwise due in June, July, or August to September 1, 2020. The deadlines for T3 trust returns that would otherwise be due in June, July, or August are also extended to September 1, 2020.

Previously, the CRA extended the deadline to June 1, 2020 for corporations that would otherwise have a filing due date after March 18 and before June 1, 2020. Similarly, the date was extended to June 1, 2020 for trusts that would otherwise have a filing due date on March 31, or in April or May 2020. Also, the filing date was extended to May 1, 2020 for trusts that had a year end of December 31, 2019.

CEWS: Government Extends, Expands, and Clarifies (May 15, 2020)

The federal government has announced that it plans to extend the Canada Emergency Wage Subsidy ("CEWS"), expand it so that additional types of employers are eligible, and make a few clarifying amendments.

First, though originally applicable for the 12-week period from March 15 to June 6, the CEWS will be extended for another 12 weeks to August 29, 2020. The government will also consult with stakeholders with respect to any adjustments that could be made with a view to incentivize growth and job creation. The only potential adjustment that the Department of Finance's backgrounder mentions is an unspecific adjustment to the requirement that the revenue of a business decline by 30%.

Second, the government has prescribed additional types of employers that qualify for the CEWS by enacting new regulations. The new types of eligible entities are:

- Partnerships that are up to 50 per cent-owned by non-eligible members;
- Indigenous government-owned corporations that are carrying on a business, as well as partnerships where the partners are Indigenous governments and eligible employers;
- Registered Canadian amateur athletic associations;
- Registered journalism organizations; and
- Non-public colleges and schools, including institutions that offer specialized services, such as arts schools, driving schools, language schools, or flight schools.

And third, the government proposes to make a few technical changes to the existing CEWS rules to ensure that the CEWS meets its objectives. Each change is briefly discussed below.

Seasonal Staff and Employees Returning From Leave

The CEWS for a specific employee is limited to 75% of their weekly pre-crisis remuneration. Pre-crisis remuneration is the weekly average remuneration of an employee that was paid between January 1 and March 15, but it excludes any seven-day periods in respect of which the employee was not remunerated. An unfortunate result of this computation is that certain employees may not qualify for the CEWS because they had insufficient pre-crisis remuneration. More specifically, the government is concerned for employees who work on a seasonal basis or who are returning from parental, disability, or unpaid leave. To prevent an unintended outcome, employers can alternatively compute an employee's baseline remuneration using the average weekly remuneration paid between March 1, 2019 and May 31, 2019. Therefore, an employer can calculate baseline remuneration using the average weekly remuneration from either January 1 to March 15 of 2020, or from March 1 to May 31 of 2019. An employer can choose whichever period to use on an employee-by-employee basis. This change will apply retroactively to the first qualifying period that began on March 15.

Amalgamations

A corporation formed by the amalgamation of two or more predecessor corporations (an "Amalco") might not qualify for the CEWS by virtue of not having benchmark revenues to compare to in order to determine if the corporation has realized a 30% decline in revenue. To fix this potential issue, the government proposes to allow an Amalco to determine its qualifying revenue using the combined revenue of the predecessor corporations, unless it is reasonable to consider that one of the main purposes of the amalgamation (or a winding-up) was to qualify for the CEWS. This change will apply retroactively to the first qualifying period that began on March 15.

Tightening Rules for Trusts

To better align the tax treatment of trusts to that of corporations (at least in respect of the CEWS), the government intends to add the following exceptions:

- Where the trust is a tax-exempt entity (other than a public institution), it would qualify for the CEWS only if it is a registered charity or one of the other types of eligible tax-exempt entities.
- Where the trust is a public institution, it qualifies only if it is a prescribed organization.

This change will apply in respect of the third qualifying period (May 10 to June 6) and the periods thereafter.

CCB and GST/HST Credit Payments Extended (May 15, 2020)

The federal government announced that Canadians who are presently receiving the GST/HST credit and/or Canada Child Benefit ("CCB") payments will continue to receive these payments until the end of September 2020 — a three-month extension. Therefore, benefit payments starting in July 2020 and those scheduled for August and September will not be interrupted if an individual takes advantage of the extended filing deadline of June 1, 2020. If the 2019 tax return is not assessed, and to allow time to calculate benefits and/or credits for the July to September 2020 payments, payment amounts will be based on information from 2018 tax returns.

If an individual receives an estimated benefit and/or credit payment based on the 2018 tax return, they are still required to file a return for 2019. If the CRA is unable to assess the 2019 return by early September 2020, the estimated benefits and/or credits will stop in October 2020 and the individual must repay the estimated amounts that were paid beginning in July 2020. The CRA encourages Canadians to file their tax returns by June 1, 2020 or as soon as possible in order to receive the right amount of benefits based on their 2019 tax return, and in order to ensure continuity of benefits beyond September 2020.

CCB Amount Increased (May 16, 2020)

The federal government announced that the Canada Child Benefit ("CCB") will increase again, beginning in July 2020. For the 2020–21 benefit year, the maximum benefit will increase to $6,765 per child under age 6, and $5,708 per child aged 6 through 17. This increase is in addition to the one-time $300 per child special payment that was made to parents for the month of May.

CRA Provides Guidance on International Tax Issues (May 19, 2020)

The CRA has added a page to its website that provides guidance on international income tax issues raised by the COVID-19 crisis (https://www.canada.ca/en/revenue-agency/campaigns/covid-19-update/guidance-international-income-tax-issues.html). Domestic and international travel restrictions could create specific income tax issues, so this document describes each potential issue and outlines the CRA's approach to the issue. The tax issues considered are:

- Income tax residency;
- Carrying on business in Canada/permanent establishment;
- Cross-border employment income;
- Waiver requests — payments to non-residents for services provided in Canada;
- Disposition of taxable Canadian property by non-residents of Canada.

Expanded Eligibility for the CEBA (May 19, 2020)

The federal government has revealed that it will expand the eligibility criteria for the Canada Emergency Business Account ("CEBA") to include many owner-operated small businesses. To qualify under the expanded eligibility criteria, applicants with payroll lower than $20,000 would need:

- A business operating account at a participating financial institution
- A Canada Revenue Agency business number, and to have filed a 2018 or 2019 tax return.
- Eligible non-deferrable expenses between $40,000 and $1.5 million. Eligible non-deferrable expenses could include costs such as rent, property taxes, utilities, and insurance.

Expenses will be subject to verification and audit by the Government of Canada. Funding will be delivered in partnership with financial institutions. More details, including the launch date for applications under the new criteria, will follow.

Tax Court Cancels More Sittings and Conference Calls (May 20, 2020)

In a new Notice to the Public and Profession, the Chief Justice of the Tax Court of Canada, Eugene Rossiter, advised that he will issue a new Practice Order and Direction by May 27, 2020. Furthermore, the Chief Justice has cancelled all sittings and conference calls scheduled between June 1, 2020 and July 3, 2020, inclusively. Affected parties should contact registry staff in the coming days. The Court and its Registry offices remain closed for the transaction of business until further notice. However, sittings that are scheduled beyond July 3, 2020 are currently expected to proceed.

Large Employer Emergency Financing Facility Opens (May 20, 2020)

The government announced the opening of the application process for the government's Large Employer Emergency Financing Facility ("LEEFF") on May 20, 2020. The program will support Canada's largest employers, whose needs during the pandemic are not being met through conventional financing. The LEEFF will be delivered by a subsidiary of the Canada Development Investment Corporation ("CDEV"), in cooperation with Innovation, Science and Economic Development Canada ("ISED") and the Department of Finance. Additional information on the application process is available on the CDEV website. Broader sectoral dynamics for LEEFF applicants will be considered through processes led by ISED.

CECRA Opens, Criteria Update (May 25, 2020)

Applications for the Canada Emergency Commercial Rent Assistance ("CECRA") opened on May 25, 2020. Moreover, additional information pertaining to the criteria has been added to the Canada Mortgage and Housing Corporation ("CMHC") website.

Provincial

Alberta

Tourism Levy Relief (May 19, 2020)

The Alberta government is providing a new abatement for hotels and other lodging providers that allows them to keep tourism levy amounts collected between March 1 and December 31, 2020. Amounts collected prior to March 1, 2020 that are being deferred under the previously announced deferral program can continue to be deferred until August 31, 2020. The abatement does not apply to amounts collected by operators from persons paying the tourism levy on accommodation purchased before March 1, 2020 (remitting these amounts may be deferred until August 31, 2020). Operators that have already remitted the tourism levy collected in respect of accommodation purchased on or after March 1, 2020 are entitled to a refund of those amounts. Deferral does not apply to any amounts of tourism levy that have already been remitted for accommodation purchased before March 1, 2020, and refunds will not be issued for these amounts.

British Columbia

Support for Aquaculture and Seafood (May 15, 2020)

On May 15, 2020, the Ministry of Agriculture and Agri-Food announced that agriculture, seafood, and food processing businesses in British Columbia can begin to access consulting and planning services to help with COVID-19 response and recovery, through a program offered by the federal and provincial governments. The latest intake of the B.C. Agri-Business Planning Program is open to applications and has been expanded to include aquaculture and seafood companies in developing COVID-19 business recovery plans. BC agriculture, seafood, and food processing business owners are encouraged to apply if their revenues have decreased by at least 30% as a result of COVID-19. The funding available includes up to $5,000 in business planning services and coaching for individuals, and up to $20,000 for groups, from a qualified business consultant, to develop an immediate and long-term recovery plan. Eligible applicants may also apply to the specialized business planning stream of the program to further strengthen their business. Information and application details for the B.C. Agri-Business Planning Program is available at: www2.gov.bc.ca/gov/content/industry/agriculture-seafood/programs/agri-business-planning-program.

Manitoba

Manitoba Works Capital Incentive (May 16, 2020)

On May 16, 2020, Economic Development and Training Minister Ralph Eichler announced the new Manitoba Works Capital Incentive, a new approach to tax increment financing ("TIF") that levers incremental education property tax rebates to stimulate economic growth and job creation. A new or existing business interested in getting established or expanding in Manitoba may apply to the program if:

- the business is prepared to make a minimum capital investment of $10 million to a specific property, which will be designated for tax increment financing benefits;
- a minimum of 65% of total project costs are from private sources; and
- there is demonstrable potential to create and/or maintain jobs in Manitoba, or the new business activity will have a substantial and measurable net economic benefit to the province.

The Manitoba Works Capital Incentive carries no risk in that it provides no up-front money to the developer, and the province pays only what is collected in incremental education property tax as a result of the development. For more information contact Manitoba Government Inquiry: 1-866-626-4862 or 204-945-3744.

Miscellaneous Changes to Government Services (May 14, 2020)

On May 14, 2020, the province introduced the following temporary measures:

- extending deadlines to apply for the 2019 farmland school tax rebate and to appeal tax assessments to the earlier of September 21, 2020 or the end of the state of emergency associated with COVID-19;
- providing exemptions to current license requirements for child care so that early childhood educators can offer child care in their homes and in the community; and
- introducing temporary suspensions for in-person commissioning and witnessing provisions related to oaths, affirmations, statutory declarations, health-care directives, powers of attorney, land titles documents, and wills.

Newfoundland and Labrador

New Hiring Grants (May 15, 2020)

On May 15, 2020, the Minister of Advanced Education, Skills and Labour announced $300,000 in funding to launch a new Students Supporting Communities Program. The program provides a $3,500 grant to organizations that enables them to hire students to help seniors and other vulnerable groups facing social isolation during the COVID-19 pandemic. This includes:

- $2,880 to hire a 30-hour-per-week position for eight weeks at $12.00/hour (this can be one position at 30 hours or two part-time positions);
- $432 for mandatory employment-related costs; and,
- $188 for incidentals related to position (e.g., gas allowance, long distance charges).

The call for applications from employers, including community organizations, opened May 15, 2020. For more information or to submit an application, visit www.gov.nl.ca/aesl/students-supporting-communities/.

Quebec

Support for Aquaculture (May 13, 2020)

The Minister of Agriculture, Fisheries and Food (“MAPAQ”) and the Minister of Forests, Wildlife and Parks (“MFFP”) announced the launch of an initiative to reduce the spring stocks of aquaculture companies that supply the stocking market. This measure is accompanied by a budgetary increase of $450,000 shared equally between the MAPAQ and the MFFP. The initiative, managed by the MAPAQ, consists of offering support to Quebec businesses in the freshwater aquaculture sector as well as to the clientele who buy the fish in order to promote the sale of seed fish to traditional private customers who have currently ceased their activities. The measure also provides for the possibility of stocking fish in public access water bodies. See www.mapaq.gouv.qc.ca/fr/Peche/md/Programmes/Pages/Initiative-ministerielle-entreprises-piscicoles-ensemencement.aspx for additional information.

Temporary Continuance of Solidarity Credit Payments (May 15, 2020)

For individuals who are unable to file their 2019 income tax return on time, the solidarity tax credit will be calculated using their 2018 income tax return and the information in Revenu Québec’s files. The individuals in question will continue to receive payments until September 2020, unless Revenu Québec determines that they are no longer entitled to them.

Relief for Tax Credit for Home-Support Services for Seniors (May 15, 2020)

Individuals receiving the tax credit for home-support services for seniors were given an extension to apply for renewal of their advance payments. This measure will remain in effect until Revenu Québec decides otherwise, depending on how the current situation evolves. Advance payments of the tax credit will continue in the meantime, even if a 2019 income tax return was not filed. However, Revenu Québec may end the payments following a review of the applicable information.

Shelter Allowance Program Renewal Deadline Extended (May 15, 2020)

The deadline for filing a renewal application has been extended by two months. The new deadline is therefore December 1, 2020. There will be no impact on program beneficiaries if they file their 2019 income tax return by October 1, 2020.

PACME Budget Increased (May 15, 2020)

The Programme actions concertées pour le maintien en emploi ("PACME") program was introduced April 6, 2020, to provide grants to employers for employee training (language, digital training, professional training, and so on) and to improve human resource management. Applications to the program will be accepted until September 30, 2020, or when the budget is exhausted. On May 16, it was announced that the budget is being increased from $100 million to $150 million. With this enhancement, the total envelope for the Program increases to $150 million. Applications are made directly by the companies themselves or through collective promoters (www.cpmt.gouv.qc.ca/reseau-des-partenaires/comites-sectoriels.asp).

Saskatchewan

SSBEP Extended (May 11, 2020)

The Saskatchewan Small Business Emergency Payment ("SSBEP") has been extended to the month of May to provide payments to businesses that continue to be ordered to temporarily close or significantly curtail operations through a public health order following May 19, 2020. Businesses that previously applied and qualify for the SSBEP will automatically receive a second payment after May 19.

International

UK Reportedly Mulling Record Tax Hikes To Fund COVID-19 Efforts

COVID-19 could create a gulf of almost £300 billion (US$367 billion) in the UK's public finances that will need to be filled with tax and spending measures, according to a leaked report seen by UK daily The Telegraph.

The report, drawn up for the UK Chancellor, Rishi Sunak, reportedly recommends that the Government could look to a multi-year plan to increase taxes that could include a combination of a one to five per cent hike in personal income tax rates, changes to pension tax rules, a value-added tax increase, and a hike in social security contributions, among other measures.

The Telegraph reported that measures could be announced within weeks. It comes shortly after the Government confirmed that it would maintain payments to furloughed workers until October 2020.

Finland Considers COVID-19 Tax Increases

On May 8, 2020, the Finnish Government published a report which explores the economic and fiscal consequences of the COVID-19 pandemic for Finland and considers what taxes could be increased to help restore the public finances.

The report observes that Finland already has one of the highest tax burdens in the world, especially on labour. Therefore, raising taxation poses the risk of damaging Finland's competitiveness, it warns. Nevertheless, the report identifies certain taxes where there is scope for revenue increases without threatening the economy. These are:

- Property taxes, because these tend not to be economically distortive and affect largely wealthier taxpayers;
- Corporate tax, with scope available to reduce the tax advantages of unlisted companies;
- Environmental taxes, with the taxation of fossil fuels increased further;
- Value-added tax, focusing on reduced VAT rates rather than the standard rate.

While the report's authors state that the exact size of the necessary post-COVID fiscal adjustment is currently unclear, it is likely to be in the range of three to four per cent of GDP to stabilize Finland's debt-to-GDP ratio below 90 per cent in 2020.

IRS Issues Fact Sheet On COVID-19 Tax Credits

The United States Internal Revenue Service ("IRS") has issued a fact sheet providing information on the tax credits available to employers to help fund COVID-19-related sick leave.

The Families First Coronavirus Response Act provides tax credits to reimburse employers for the costs of providing paid sick leave and paid family and medical leave to employees unable to work because of COVID-19. These credits are refundable, meaning that if the amount of the credit exceeds the amount of tax owed, the remainder is refunded to the business or organization, the IRS said.

The tax credits are available to eligible employers beginning April 1, 2020, for qualifying leave they provide between April 1, 2020, and December 31, 2020.

Eligible employers are businesses and tax-exempt organizations with fewer than 500 full-time and part-time employees within the United States or any US territory or possession and that have to meet employer paid leave requirements.

Employees of eligible employers who are unable to work or telework because they're quarantined or experiencing COVID-19 symptoms and seeking a medical diagnosis can receive up to 80 hours of paid sick leave. This pay is at their regular rate of pay or, if higher, the applicable minimum wage, up to US$511 per day and US$5,110 in total.

In addition to the paid sick leave credit, an employee who is unable to work or telework because of a need to care for a child whose school or place of care is closed or whose child-care provider is unavailable due to COVID-19, is entitled to paid family and medical leave equal to two-thirds of the employee's regular pay, up to US$200 per day and US$10,000 in total. Up to 10 weeks of qualifying leave can be counted toward the paid family leave credit.

Eligible employers report their total qualified leave wages and the related credits for each quarter on their federal employment tax return, usually Form 941, "Employer's Quarterly Federal Tax Return".

The fact sheet includes further information on:

- Covered employers;
- Paid sick leave requirements and the credit;
- Paid family and medical leave requirements and the credit; and
- How to claim the credits.

US House Passes COVID-19 Stimulus Bill With Tax Measures

On May 15, 2020, the United States House of Representatives approved the Health and Economic Recovery Omnibus Emergency Solutions ("HEROES") Act, which amends previous COVID-19-related stimulus legislation by changing loss carryback rules and providing further tax support for businesses and individuals.

Highlights of the bill include the following:

Losses

The Coronavirus Aid, Relief, and Economic Security ("CARES") Act, signed by President Trump on March 27, 2020, included a provision expanding the net operating loss carryback rules by allowing taxpayers to carry back NOLs arising

in a tax year beginning in 2018, 2019, or 2020 for five years. The provision also temporarily removed the taxable income limitation to allow an NOL to fully offset income, up from 80 per cent previously.

The HEROES Act would amend the CARES Act by limiting carrybacks to taxable years beginning on or after January 1, 2018. In addition, this provision prohibits taxpayers with excessive executive compensation or excessive stock buybacks and dividends from carrying back losses.

Business Interruption Tax Credits

The HEROES Act would make the following improvements to tax credits intended to prevent business interruption:

- Increase the applicable percentage of qualified wages reimbursed through the employee retention credit from 50 per cent to 80 per cent, and increase the limit on wages taken into account per employee from US$10,000 for the year to US$15,000 per quarter (limited to US$45,000 for the calendar year).
- Provide a 50 per cent refundable payroll tax credit for qualified fixed costs, to include covered rent obligations, covered mortgage obligations, and covered utility payments. This credit would be limited to employers with no more than 1,500 full-time equivalent employees or no more than US$41,500,000 in gross receipts in 2019.
- Provide a 90 per cent refundable individual income tax credit for certain self-employed individuals who have experienced a significant loss of income.

Credits for Paid Sick Leave and Family Leave

The HEROES Act would extend the refundable payroll tax credits for paid sick and family leave, enacted in the Families First Coronavirus Response Act, through the end of 2021.

Other Provisions

In other notable proposals, the bill would:

- Eliminate the limitation on the deduction for state and local taxes for taxable years beginning on or after January 1, 2020, and on or before December 31, 2021.
- Make the child tax credit fully refundable for 2020 and increase the amount to US$3,000 per child (US$3,600 for a child under age 6).
- Expand the eligibility and the amount of the earned income tax credit for taxpayers with no qualifying children for 2020.
- Provide a US$1,200 refundable tax credit for each family member, paid out in advance payments, similar to the Economic Impact Payments in the CARES Act. The credit is US$1,200 for a single taxpayer (US$2,400 for joint filers), in addition to US$1,200 per dependant up to a maximum of three dependants.

Next Steps

The HEROES Act must also be passed by the Senate. However, given that the bill was approved by the Democrat-controlled House along bipartisan lines, and that the Republicans hold a majority in the Senate, the bill is not expected to be approved — at least not in its current form.

Netherlands To Zero-Rate COVID-19 Face Masks

The Dutch Government has announced that value-added tax on sales of protective face masks will be temporarily reduced to zero per cent.

The measure will apply to all types of face masks, including those intended for medical and non-medical use, from May 25, 2020. Currently, these items are subject to the 21 per cent standard rate of VAT.

The measure is being introduced ahead of a requirement that face masks be used on public transport from June 1, 2020.

According to the Government, VAT on face masks will remain at zero per cent until "at least" September 1, 2020.

The Government also reminded those supplying personal protective equipment ("PPE") that PPE can be imported free from customs duties.

US IRS Sets Out Details of COVID-19 Tax Breaks

On May 7, 2020, the United States Internal Revenue Service ("IRS") issued a reminder to employers affected by COVID-19 about the tax credits made available to them under the Coronavirus Aid, Relief, and Economic Security Act.

These relief measures include:

The Employee Retention Credit

The employee retention credit is designed to encourage businesses to keep employees on their payroll. The refundable tax credit is 50 per cent of up to US$10,000 in wages paid by an eligible employer whose business has been financially impacted by COVID-19.

The credit is available to all employers regardless of size, including tax-exempt organizations. There are only two exceptions: state and local governments and their instrumentalities, and small businesses who take small business loans.

Qualifying employers must fall into one of two categories:

- The employer's business is fully or partially suspended by government order due to COVID-19 during the calendar quarter.
- The employer's gross receipts are 50 per cent below those of the comparable quarter in 2019.

Once the employer's gross receipts are 80 per cent of those in a comparable quarter in 2019, they no longer qualify after the end of that quarter.

Paid Sick Leave Credit

The paid sick leave credit is designed to allow businesses to get a credit for an employee who is unable to work (including telework) because of COVID-19 quarantine or self-quarantine or because they have COVID-19 symptoms and are seeking a medical diagnosis. Those employees are entitled to paid sick leave for up to 10 days (up to 80 hours) at the employee's regular rate of pay, capped at US$511 per day and US$5,110 in total.

The employer can also receive the credit for employees who are unable to work due to caring for someone with COVID-19 or caring for a child because the child's school or place of care is closed, or the paid childcare provider is unavailable due to COVID-19. Those employees are entitled to paid sick leave for up to two weeks (up to 80 hours) at two-thirds the employee's regular rate of pay, or up to US$200 per day and US$2,000 in total.

Employees are also entitled to paid family and medical leave equal to two-thirds of the employee's regular pay, up to US$200 per day and US$10,000 in total. Up to 10 weeks of qualifying leave can be counted towards the family leave credit.

Employers can be reimbursed immediately for the credit by reducing their required deposits of payroll taxes that are withheld from employees' wages.

Eligible employers are entitled to receive a credit in the full amount of the required sick leave and family leave immediately, plus related health plan expenses and the employer's share of Medicare tax on the leave, for the period of April 1, 2020 through December 31, 2020. The refundable credit is applied against certain employment taxes on wages paid to all employees.

Eligible employers will report their total qualified wages and the related health insurance costs for each quarter on their quarterly employment tax returns or Form 941 beginning with the second quarter. If the employer's employment tax deposits are not sufficient to cover the credit, the employer may receive an advance payment from the IRS. Eligible employers can also request an advance of the Employee Retention Credit.

CURRENT CASES

Each month *Tax Topics* examines recent cases of special interest. This month's case reviews were provided by *Joseph Frankovic* of Toronto.

Director's Liability Arose When Corporation Failed To Remit Source Deductions; Spouse Jointly and Severally Liable

***The Queen v. Caroline Colitto*, 2020 DTC 5039 (Federal Court of Appeal)**

In *Colitto*, the taxpayer's spouse, Mr. Colitto, was a director of a corporation when the corporation failed to remit source deductions in 2008. The Canada Revenue Agency (the "CRA") took various actions under the *Income Tax Act* (the "Act") to collect these amounts from the corporation between 2008 and 2011. Ultimately, in 2011, a certificate for the amount of the corporation's liability was registered under section 223 of the Act, but execution for the amount was returned unsatisfied.

After the corporation's tax liability was executed and not satisfied, the CRA assessed Mr. Colitto under the directors' liability provisions of subsection 227.1(1). Generally speaking, under subsection 227.1(1), a director of a corporation is liable for the corporation's unremitted source deductions, subject to a due diligence provision and other conditions. Mr. Colitto did not fall within the due diligence provision, did not file a notice of objection, and apparently did not pay the tax assessed to him.

Subsequently, in 2016, the CRA assessed the taxpayer under the joint liability rules of subsection 160(1). That provision can apply where a person ("transferor") transfers property to the transferor's spouse for inadequate consideration. Mr. Colitto had transferred properties to the taxpayer in 2008 for inadequate consideration. Under subsection 160(1), the transferee spouse is jointly and severally liable with the transferor for the transferor's tax liability "in or in respect of the taxation year in which the property was transferred or any preceding taxation year". The transferee's liability is limited to the amount by which the fair market value of the transferred property exceeds the consideration given for the property.

It was agreed that Mr. Colitto was liable to pay the corporation's unremitted source deductions by virtue of subsection 227.1(1). The only issue before the Federal Court of Appeal was whether his liability was in respect of 2008, when the corporation failed to remit the source deductions, or 2011, when the execution of the corporation's tax debt was returned unsatisfied. If his liability was in respect of 2008, the taxpayer was liable under subsection 160(1) because Mr. Colitto transferred the properties to her in that year. If his tax liability was in respect of 2011, the taxpayer was not liable because the transfer of properties took place in a prior year.

In the Tax Court of Canada decision (2019 DTC 1064), the trial judge held that the tax liability of Mr. Colitto was in respect of 2011. As such, the taxpayer was not liable under subsection 160(1). The trial judge based his decision largely on subsection 227.1(2), which provides that "a director is not liable under subsection 227.1(1) unless . . . a certificate for the amount of the corporation's liability referred to in that subsection has been registered . . . under section 223 and execution for that amount has been returned unsatisfied in whole or in part". According to the trial judge, subsection 227.1(1) is silent as to the timing of a director's liability. However, the clear and unambiguous language of subsection 227.1(2) suggests that a director's liability does not arise until the conditions in that provision are met. Since those conditions were met in 2011, Mr. Colitto's tax liability did not arise until 2011.

The Federal Court of Appeal (the "Federal Court") disagreed. The Federal Court held that subsection 227.1(1) is, at the least, ambiguous about timing. Moreover, subsection 227.1(2) is not a timing provision, but rather a relieving provision that sets out specified circumstances when the liability otherwise imposed by subsection 227.1(1) may be avoided. In particular, subsection 227.1(2) "does not state that a director is not liable for the corporation's default 'unless and until' the specified actions take place. This is the language that would be required to effect the result found by the Tax Court. The Tax Court impermissibly read the words 'and until' into subsection 227.1(2)."

More generally, the Federal Court held that the purpose of subsection 227.1(2) is to avoid double taxation, by prohibiting the CRA from recovering a corporation's unremitted source deductions from a director unless the corporation has failed to pay those amounts (e.g., unless the execution for the amounts has been returned unsatisfied). Furthermore, subsection 227.1(1) was "based on the presumption that a decision by a corporation to default on its remittance obligations would originate with the directors". The trial judge's interpretation of the provision would render that purpose "nugatory and pointless", as it would allow directors to re-arrange their affairs to avoid liability after the failed remittance.

Lastly, the Federal Court effectively overturned (or perhaps fine-tuned) a finding in the previous *McKinnon* case (2000 DTC 6593 (FCA)). In that case, the court held that ". . . the liability of a director for unremitted source deductions and GST does not crystallize until the conditions prescribed in subsection 227.1(2) have been satisfied." The Federal Court in *Colitto* held that this comment was made *in obiter*, and therefore not binding as a matter of law. Additionally, the fact that a director may be required to pay a debt under subsection 227.1(1) only after collection efforts have been exhausted against the corporation is not inconsistent with the director's liability arising in or in respect of an earlier taxation year.

The Federal Court concluded that Mr. Colitto's liability arose in 2008. As a result, the taxpayer was jointly and severally liable for the amount assessed under subsection 160(1).

The *Colitto* decision is interesting mainly from a statutory interpretation perspective. The so-called plain meaning of subsections 227.1(1) and (2) might lead one to agree with the Tax Court decision. But considering the scheme of those provisions in particular and the Act in general, it is hard to quarrel with the Federal Court decision.

Receipt of Equity and Debt Capital by Foreign Affiliate Not "Investment Business"

***Loblaw Financial Holdings Inc. v. The Queen*, 2020 DTC 5040 (Federal Court of Appeal)**

In *Loblaw*, the Federal Court of Appeal allowed the taxpayer's appeal and overturned the previous Tax Court of Canada decision (2018 DTC 1128), which had held that the business income of the taxpayer's controlled foreign affiliate was foreign accrual property income ("FAPI") and therefore included in the taxpayer's income.

Under the *Income Tax Act* (the "Act"), the FAPI rules can apply where a controlled foreign affiliate of a Canadian resident taxpayer earns income from a business other than an "active business". An "investment business" is not an active business. However, a business is not an investment business if it is carried on by the foreign affiliate as a foreign bank ("foreign bank exception") and certain other conditions are met (paragraphs (*a*), (*b*), and (*c*) of the definition of "investment business" in subsection 95(1) of the Act).

However, the foreign bank exception does not apply if the foreign affiliate's business is conducted principally with persons with whom the affiliate does not deal at arm's length (the "non-arms length exclusion"). In other words, where the non-arm's length exclusion applies to the foreign affiliate's business that is otherwise an investment business, the foreign bank exception does not apply, and the income from the business is FAPI.

The taxpayer, Loblaw Financial Holdings Inc., is resident in Canada and is an indirect wholly-owned subsidiary of Loblaw Companies Limited ("Loblaws"). In the taxation years in question, the taxpayer was the parent corporation of the Barbados subsidiary corporation Glenhuron Bank Limited ("GBL"). For purposes of the Act, both the taxpayer and GBL were related to, and therefore did not deal at arm's length with, Loblaws and various members of the Loblaws group of corporations (the "Loblaws Group"). Under Barbados law, GBL was a bank subject to Barbados international banking legislation.

In the taxation years in question, GBL engaged in various investment activities, including investments in short-term securities and interest-rate and currency swap contracts. It was accepted that the investment activities formed part of GBL's business. GBL earned significant income from these activities.

GBL was financed or "capitalized" prior to the taxation years with funds received from non-arm's length members of the Loblaws Group on the issuance of GBL shares and debt ("capitalized" is used tentatively here, since whether these receipts were capital or formed part of GBL's business was one of the main issues in the case). However, GBL's investments in the taxation years were made largely from GBL's retained earnings.

The only issue before the Federal Court of Appeal (the "Federal Court") was whether GBL's business was conducted principally with members of the Loblaws Group, and therefore with non-arm's length persons, so as to fall within the non-arm's length exclusion and outside of the foreign bank exception. If the non-arm's length exclusion applied, GBL's income from its business was FAPI. If it did not apply, GBL's income from its business was not FAPI.

The Federal Court (Woods, JA, speaking for the Court) overturned the Tax Court judge's decision that the non-arm's length exclusion applied. The Federal Court held that the Tax Court judge erred in at least two aspects.

First, the Federal Court disagreed with the trial judge's finding that GBL's receipts of equity and debt capital, being the "receipt of funds side" of its activities (the trial judge's term), formed part of GBL's business. The trial judge's finding in this regard was significant to his decision that the non-arm's length exclusion applied, since the receipts came entirely from non-arm's length members of the Loblaws Group. The Federal Court felt otherwise. The "capital invested by the Loblaw group" was not part of GBL's business, simply because GBL was not in the business of receiving such investments. As such, the receipts from the Loblaws Group were not relevant in determining whether GBL's business was conducted principally with non-arm's length persons. In making this determination, the Federal Court held that the meaning of "business" for the purposes of the Act was applicable, rather than the meaning of "business" under Barbados law.

The trial judge's decision on the "receipt side" of GBL's activities is difficult to rationalize. It appears that the judge relied largely on the definition of "international banking business" in the Barbados legislation that governed the activities of GBL at the time. Under that definition, an international banking business included, among other things, "the business of receiving foreign funds" through various means. Apparently, the trial judge felt that since GBL received foreign funds from the Loblaws group, those receipts formed part of GBL's business. However, the Barbados legislative definition referred to the "business" of receiving foreign funds; it did not define or deem the receiving of foreign funds to be a business. In other words, the trial judge put the cart before the horse, so to speak. In any event, as noted above, the Federal Court held that Barbados law was not relevant in determining whether GBL was conducting business.

At this point, the Federal Court was on solid ground in dismissing the trial judge's finding on the "receipt side" issue. It is unfortunate that the Federal Court took a tangential turn regarding the meaning of "banking" in order to (apparently) bolster its finding on the issue. The Federal Court referred to the Supreme Court of Canada decision in *Canadian Pioneer Management Ltd. v. Labour Relations Board of Saskatchewan* ([1980] 1 S.C.R. 433) in concluding that the meaning of banking "should be based on a formal, institutional approach rather than a substantive approach, in the sense of the functions of banking. It follows that the use of the term 'bank' in the name of the entity, and whether it is regulated, are factors to be considered, *rather than the actual activities that are conducted*." (Emphasis added.) Based on the formal, institutional approach of *Canadian Pioneer*, the Federal Court felt that "there is no reasonable basis to conclude that the arm's length test requires both business receipts and uses."

There are at least a couple of problems with the Federal Court's conclusion as to "banking". First, the "actual activities that are conducted" by a foreign affiliate are surely relevant in determining whether it is conducting an investment business or whether its business is conducted with non-arm's length persons. (Not to mention that "banking" involves the receipts of funds?) Second, in *Canadian Pioneer*, a constitutional law case, the issue was whether a trust company was engaged in banking so as to come within federal jurisdiction over banks and "banking" under subsection 91(15) of the *British North America Act*. Essentially, the Supreme Court in *Canadian Pioneer* held that "banking" for these purposes applied to banks and their activities, and not to trust companies that carried on similar activities. It is difficult to see how the "formal, institutional" reasoning that was applied in *Canadian Pioneer* for constitutional law purposes has anything to do with the rationale underlying the non-arm's length exclusion. The Federal Court engaged in a classic exercise of conflating the purposes and objectives of one area of law with another, and an unnecessary one at that.

On the "receipt side", the trial judge's decision in *Loblaw* also focused on an element of competitiveness. The trial judge felt that ". . . in looking at both aspects of a foreign bank's business, the receipt of funds and use of funds, there should be emphasis on the receipt side as that is where one would expect to find the competition element . . . It remains to determine whether GBL, in all aspects of the conduct of business, though with an emphasis on its competitiveness . . . dealt primarily with non-arm's length persons." The judge went on to hold that the receipt side of GBL's business involved no competition.

The competition argument is difficult to comprehend. The trial judge felt that the receipt side is where one would expect most of the competition, so that emphasis should be placed on the receipt side. But the judge concluded there was no competition on the receipt side, and went on to emphasize it anyway. Regardless, the Federal Court dismissed the trial judge's analysis on this point, holding that Parliament has not explicitly required competition as an element of the foreign bank exception.

Turning to the "use of funds side" of GBL's activities (again, the trial judge's term), namely its investment activities, the trial judge was not satisfied "that even the use of funds side of the conduct of banking business was not principally conducting business with non-arm's length persons." The Federal Court also overturned this aspect of the trial decision. The Federal Court held that GBL's investments in short-term securities and interest-rate and currency swaps were conducted entirely with arm's length parties. The fact that the non-arm's length taxpayer may have "provided direction, support and oversight" to GBL with respect to these investments was not particularly relevant: "Parliament could not have intended that the foreign bank exclusion should be denied as a result of support and oversight provided by a parent corporation."

Lastly, although GBL engaged in other investment activities, the Federal Court held that its main business consisted of the investments in short-term securities and interest-rate and currency swaps, such that the other investments did not affect the application of the foreign bank exception.

In summary, the Federal Court concluded that GBL's business of investing was not conducted principally with non-arm's length parties. As such, the foreign bank exception applied and GBL's income from the business was not FAPI.

THE PANDEMIC DEFICIT: HOW WILL THE PIPER BE PAID?

— Jonathan Éthier[1] and David H. Sohmer[2], Spiegel Sohmer Inc., Montreal

The extent of the deficit being incurred to fund COVID-19-related programs is overwhelming. The Canada Emergency Response Benefit program (the "CERB") has already cost approximately $35.8 billion as a result of the 13.77 million applications received.[3] Given that the decrease in tax revenues will deepen the hole, it is not premature to consider the tax measures which may be adopted to bail out the public treasury.

In 2015, the Liberal government demonstrated its willingness to target the most fortunate when it proposed the adoption of a new top personal income tax rate of 33% on taxable income in excess of $200,000[4] (a fifth tax bracket at the time). Two years later, in 2017, 1% of Canadian tax filers were in this tax bracket and the tax paid by them accounted for 26% of federal personal income tax revenues ($36.3 billion).[5] The government may be tempted to create a sixth level of taxation directly targeting the wealthiest members of society. The pandemic has removed the political constraints so that a federal tax rate of, say, 40% applicable on the portion of taxable income exceeding $500,000 may be considered.

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[3] Government of Canada, Canada Emergency Response Benefit statistics, May 15, 2020.

[4] Government of Canada, Government of Canada Announces Tax Cut to Strengthen the Middle Class, December 7, 2015.

[5] Department of Finance Canada, "Report on Federal Tax Expenditures — Concepts, Estimates and Evaluations" (2020), page 42.

The Harper government introduced a reduction in GST to provide economic stimulus and the Liberals were far from supportive of the measure.[6] The GST was reduced from 7% to 6% on July 1, 2006 and from 6% to 5% on January 1, 2008. For the period 2018–2019, GST revenues accounted for 11.5% of total federal revenues, approximately $38.2 billion.[7] Bringing the rate back to 7% would be consistent with the Liberal's objections to the Harper reductions.

For almost 20 years, the capital gain inclusion rate was 50%. Professor David Duff argued that low inflation and substantial reductions in corporate income tax dilute the main arguments in favour of partial taxation of capital gains, namely, to reduce the impact of the tax on inflationary gains and to take into account the corporate income taxes that are assumed by shareholders.[8] In a pre-pandemic context, he argued that an 80% inclusion rate would be appropriate.[9] The cost of the partial inclusion was projected to be $21.645 billion in 2020.[10] Author John Lester pointed out that in 2019 "[m]easures related to the taxation of capital income [. . .] account for more than half of the total tax revenue forgone".[11] The inclusion rate could be raised to 75% as was the case from 1990 to 1999. Whether accrued gains would be protected is a more difficult call.

The cost associated with the non-taxation of capital gains on principal residences is also significant. The Department of Finance projected that it will cost $5.87 billion in 2020.[12] Wealthier taxpayers can acquire more expensive residences and so benefit disproportionately from the exemption.[13] The exempt portion of the capital gain could be capped at the lesser of the actual capital gain and a fixed amount.

The morality of tax planning to mitigate the impact of anticipated tax increases is an issue with which the tax community will have to grapple.

INTERNATIONAL NEWS

IRS Clarifies Tax Treaty References to NAFTA

On May 19, 2020, the United States Treasury Department and the Internal Revenue Service ("IRS") issued an Announcement which clarifies the interpretation of references in US income tax treaties to the North American Free Trade Agreement ("NAFTA") once it is replaced by the Agreement between the United States, Mexico and Canada ("USMCA").

Announcement 2020-26 states that this clarification is necessary because limitation of benefits clauses in numerous US tax treaties contain explicit references to the NAFTA, which will be replaced by the USMCA when the latter enters into force.

By way of example, the Announcement cites the "derivative benefits test" in the US-Germany double tax treaty, under which a resident company not otherwise entitled to benefits may claim treaty benefits if it is at least 95 per cent owned by seven or fewer "equivalent beneficiaries", who must be resident of a country that is a party to either the NAFTA, the European Union, or the European Economic Area.

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[6] *Cf*. Philip Demont, "Ottawa's GST cut hiked deficit by as much as $10B", *CBC News*, June 19, 2009 (updated on June 22, 2009).

[7] Department of Finance Canada, Annual Financial Report of the Government of Canada (Fiscal Year 2018–2019), page 11.

[8] *Cf*. David Duff, "Time for Liberals to limit tax breaks that favour highest earners", *The Globe and Mail*, February 6, 2017 (updated on April 13, 2017).

[9] *Id*.

[10] Department of Finance Canada, "Report on Federal Tax Expenditures — Concepts, Estimates and Evaluations" (2020), page 218.

[11] John Lester, "Tax Expenditures in Canada — Historical Estimates and Analysis", in *Finances of the Nation* feature (2019) 67:3 Canadian Tax Journal 755-73.

[12] Department of Finance Canada, "Report on Federal Tax Expenditures — Concepts, Estimates and Evaluations" (2020), page 196.

[13] The non-taxation of imputed rent on owner-occupied property also disproportionately benefits the well-off. Imputed rent is the amount it would cost to rent an otherwise owner-occupied property. The more expensive the property, the higher the imputed rent. The Carter Report proposed taxing imputed rents, but the proposal was rejected. It is reasonable to assume that the proposal continues to face insuperable political obstacles.

The Announcement states that, upon the USMCA's entering into force, the Treasury Department, the IRS, and the US Competent Authority believe that any reference to the NAFTA in a US bilateral income tax treaty should be interpreted as a reference to the USMCA.

The Treasury Department and the IRS intend to reach out to countries that have an applicable tax treaty containing references to the NAFTA to confirm that they agree with this interpretation.

On April 24, 2020, the US Trade Representative notified Congress that the USMCA will enter into force on July 1, 2020.

France To Press on With Digital Tax

French Finance Minister Bruno Le Maire has said that the Government intends to introduce a digital services tax this year.

The French DST is a three per cent tax on the revenue of digital companies providing advertising services, selling user data for advertising purposes, or performing intermediation services. Companies with global revenues of €750 million (US$811 million) or more and French sales of at least €25 million are required to pay the tax.

The tax, approved by the French parliament on July 11, 2019, applies to turnover realized in France since January 1, 2019. Le Maire subsequently confirmed that France will suspend collection of the DST until December 2020 to prevent the United States from applying retaliatory tariffs on a range of French goods.

France's digital services tax would apply in the absence of an international agreement on a global levy, Le Maire said.

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