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THE SECURITIES TRANSFER ACT AND THE INCOME TAX ACT: WHO OWNS PUBLICLY TRADED SECURITIES?¹

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The indirect holding system for publicly traded shares and bonds makes the issue of ownership for income tax purposes more complex than is generally appreciated. A report for the European Parliament on cross-border issues of securities law summarizes the basic principles:

What made a share or bond (i.e., security) different from a mere credit or other obligation is that it was documented in a certificate. This certificate was not meant to be the contract but had the function to render the various dealings surrounding the legal relationship more efficient and safer [. .] In legal terms, this result was achieved by assimilating the original rights and obligations, now incorporated in the certificate, to the law governing 'property' to movable things, under which the above principles traditionally applied. In other words, by this transformation, the original obligations to pay sums of money between the investor and the issuer were converted into 'property' as far as any disposition (transfer, pledge, etc.) of them was concerned. [. .]

For reasons of efficiency — i.e., avoiding the necessity of moving physical securities whenever a change in ownership of the various banks' clients took place — the first central securities depository ("CSD") for securities certificates was founded in 1882 in Berlin (which was modelled on the 18th century London Clearing House for cheques and bank notes). The centralized custody of security certificates, combined with the centrally organized services of keeping account balances for the participating banks and settling securities transfers between these accounts, was gradually adopted by all relevant financial markets. The institution of a CSD and the service of "clearing and settlement" of securities is therefore anything but a new development.

Put simply, the deriving general holding structure could be described as follows:

All, or part of the security certificates, are kept centrally in the CSD. The CSD maintains accounts for the participating banks, or "intermediaries", to whose accounts the relevant number of securities are credited. These intermediaries maintain accounts for their client-investors and for their client-intermediaries. The latter, again, maintain accounts for other persons, etc. From the perspective of the investor, there is at least one, but probably more, intermediaries involved. The investor holds his securities with his own bank, which holds them through a second bank, which holds with the CSD, which keeps the certificates.²

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² European Parliament, Directorate-General for internal policies, "Cross-border issues of securities law: European efforts to support securities markets with a coherent legal framework"; "Policy Department Economic and Scientific Policy A", 2011, URL: <https://www.europarl.europa.eu/document/activities/cont/201106/20110606ATT20781/20110606ATT20781EN.pdf>.

In 1994, Article 8 of the US *Uniform Commercial Code* was revised to provide a framework for the indirect holding system. The Prefatory Note to Revised Article 8 of the *Uniform Commercial Code* states:

The principal goal of the Article 8 revision project is to provide a satisfactory framework for analysis of the indirect holding system. The technique used in Revised Article 8 is to acknowledge explicitly that the relationship between a securities intermediary and its entitlement holder is *sui generis*, and to state the applicable commercial law rules directly, rather than by inference from a categorization of the relationship based on legal concepts of a different era.³

The framework provided in Revised Article 8 was the security entitlement system. A person acquires a securities entitlement if a securities intermediary indicates by book entry that a financial asset has been credited to the person's securities account. The Official Comment to Section 8-503 of the *Uniform Commercial Code* states:

Although this section recognizes that the entitlement holders of a securities intermediary have a property interest in the financial assets held by the intermediary, the incidents of this property interest, are established by the rules of Article 8, not by common law property concepts. These concepts do not work for the indirect holding system. A security entitlement is not a claim to a specific identifiable thing; it is a package of rights and interests that a person has against the person's securities intermediary and the property held by the intermediary. The idea that discrete objects might be traced through the hands of different persons has no place in the Revised Article 8 rules for the indirect holding system.⁴

In 2006, Ontario adopted the security entitlement system by enacting the *Securities Transfer Act*⁵ (the "STA"). Since then, the system has been adopted by all of the other Canadian provinces. The *Income Tax Act*⁶ (the "ITA"), however, has not been amended to deal with security entitlements and is still based on common law contract and property systems.

Prior to the enactment of the STA there may have been enough wiggle room for the ITA to accommodate the indirect holding system. The terms "beneficial ownership" and "beneficial interest" appear 18 and 29 times respectively in the ITA but are never defined. It would not have been a leap to hold that there were tiers of beneficial interests so that the investor held a beneficial interest in a beneficial interest. Support for this may have been provided by the decision of the Supreme Court in *McCreath*,⁷ where Justice Dickson stated: "I do not believe that the niceties and arcana of ancient property law should be fastened upon with mechanical rigidity to determine the effect of a modern taxation statute whose purpose is plain."⁸

The enactment of the STA removed the wiggle room. The recognition of the *sui generis* nature of a security entitlement is now mandated by the Supreme Court in the 2006 decision in *Shell Canada*:⁹

This Court has repeatedly held that courts must be sensitive to the economic realities of a particular transaction, rather than being bound to what first appears to be its legal form: *Bronfman Trust*, supra, at pp. 52 – 53, per Dickson C.J.; *Tennant*, supra, at para. 26, per Iacobucci J. But there are at least two caveats to this rule. First, this Court has never held that the economic realities of a situation can be used to recharacterize a taxpayer's bona fide legal relationships. To the contrary, we have held that, absent a specific provision of the Act to the contrary or a finding that they are a sham, the taxpayer's legal relationships must be respected in tax cases. Recharacterization is only permissible if the label attached by the taxpayer to the particular transaction does not properly reflect its actual legal effect: *Continental Bank Leasing Corp. v. Canada*, [1998] 2 S.C.R. 298, at para. 21, per Bastarache J.¹⁰

The failure to amend the ITA so as to accommodate the security entitlement system creates uncertainty in the application of fundamental provisions of the ITA. For example:

³ Prefatory Note to Revised UCC Article 8, at page 670.

⁴ Investment Securities, Uniform Commercial Code 661 (1994), at page 773.

⁵ *Securities Transfer Act*, 2006, SO 2006, c. 8.

⁶ *Income Tax Act*, R.S.C. 1985, c. 1.

⁷ *Minister of Revenue (Ontario) v. McCreath*, [1977] 1 S.C.R. 2.

⁸ *Id.*, at page 15.

⁹ *Shell Canada Ltd. v. Canada*, 99 DTC 5669 (SCC).

¹⁰ *Id.*, at para. 39.

- (1) Do dividends maintain their characterization as they work their way through the system to the end entitlement holder?
- (2) Are shares in an American corporation “specified foreign property”?
- (3) Is there a taxable disposition if a person delivers a share certificate to his or her broker in exchange for a security entitlement for the same number of shares?

Whether or not there will be retroactive legislation which accommodates the STA before the issues are litigated remains to be seen.

COVID-19 UPDATE

Federal

Technical Amendments to CEWS and CERS (February 24, 2021)

The Department of Finance published draft legislation to increase accessibility to the Canada Emergency Wage Subsidy (“CEWS”) and Canada Emergency Rent Subsidy (“CERS”).

Technical Change for Period 11

Earlier this year the *Income Tax Regulations* (the “Regulations”) were amended to address a timing mismatch that had been developing between claim periods (which correspond to fixed 28-day intervals) and reference periods (which correspond to calendar months). Had this gap continued to grow, the reference periods would be less economically relevant to the related claim period and would require eligible entities to wait longer to establish their change in monthly revenues to make a claim. To address this issue, the Regulations were amended such that the current and prior reference periods for Period 11 are the same as the reference periods for Period 10. Therefore, for both Periods 10 and 11, the current and prior reference periods are December 2020 and December 2019 respectively.

To provide certainty to employers, an entity’s percentage revenue decline for a qualifying period cannot be less than its percentage revenue decline for the immediately preceding qualifying period. In other words, if the revenue reduction percentage in a period is lower than the percentage in the immediate prior period, the entity can compute their entitlement for the CEWS using the revenue reduction percentage from that immediately preceding period.

The draft legislation proposes to reconcile this revenue look-back rule with the recent change to the timing of reference periods. It proposes that an applicant’s percentage revenue decline for Period 11 cannot be less than the applicant’s percentage revenue decline for Period 9. Since Periods 10 and 11 use the same reference months (December 2020/2019), an entity’s revenue reduction percentage will be the same for both periods.

Non-Arm’s Length Rent and Lockdown Support

The Lockdown Support is a supplement to the CERS that is available where an entity is required under a public health order to cease some or all of its activities at a qualifying property. However, businesses cannot access the Lockdown Support when the entity that operates the business rents the property from a non-arm’s length entity that owns the property. Since non-arm’s length rent is ineligible for the subsidy, and the property owner’s activities are not required to cease under a public health order, neither the tenant nor the owner is eligible for the subsidy.

Retroactive to September 27, 2020, the draft legislation proposes to amend the *Income Tax Act* so that the Lockdown Support is available to the entity that owns the property where activities of a non-arm’s length party party that rents the property from the entity are required to cease as a result of a “public health restriction”.

Provincial

Alberta

New Benefit for Families (February 24, 2021)

The government is introducing the new Working Parents Benefit, which will support families that used child care — including licensed or unlicensed daycare, day homes, out-of-school care, or preschool — from April to December of 2020.

Families will be eligible to apply for the Working Parents Benefit if they have:

- Children in any form of childcare, including licensed or unlicensed childcare.
- A household annual income of \$100,000 or less.
- Paid for three months of childcare between April 1 and December 31, 2020 (must provide receipts).

Applications can be made at alberta.ca/WorkingParentsBenefit starting March 1. Applications close March 31. A MyAlberta Digital ID is needed to apply for the benefit.

Saskatchewan

Tourism Sector Support Programs Renewed (February 25, 2021)

The government announced the renewal of the Saskatchewan Tourism Sector Support Program ("STSSP") and the extension of the Saskatchewan Small Business Emergency Payment ("SSBEP").

The STSSP provides financial assistance to eligible tourism businesses in the accommodations, attraction and tours, events, and major event facility sectors. The STSSP targets businesses that experienced a loss of sales revenue of at least 30 per cent in 2020 when compared to 2019. Applications are open from March 8 to April 30, 2021.

The SSBEP provides financial assistance to eligible small businesses in Saskatchewan that have been ordered to temporarily close or substantially curtail operations due to a public health order. Financial assistance in this extension includes a payment for both February and March 2021 of up to \$5,000 per month that can be used for any purpose.

CURRENT ITEMS OF INTEREST

EFILE Program Updates

With the commencement of tax season, the CRA has provided several updates and reminders for tax preparers. These updates relate to:

- additional information pertaining to e-signatures on Form T183,
- online transmission history,
- express notice of assessment,
- submitting documents for review programs online, and
- multifactor identification.

For the latest updates, see: <https://www.canada.ca/en/revenue-agency/services/e-services/e-services-businesses/efile-electronic-filers/efile-news-program-updates.html>.

Alberta Budget 2021

Alberta Budget 2021: Protecting Lives and Livelihoods, was tabled on February 25, 2021 by Minister of Finance Travis Toews. The budget proposes a continued freeze to property tax revenues and changes to the tourism levy. No other tax changes were announced.

Nunavut Budget 2021

Nunavut Finance Minister George Hickes presented the 2021-2022 Budget on February 23, 2021. The budget did not include any tax or tax-related announcements.

RECENT CASES

Order issued as requested by Parties in relation to admission of evidence

The factual background to this litigation may be found in two previous decisions dated November 29, 2019 (2020 DTC 5001) and June 15, 2020 (2020 DTC 5058). The case relates to ongoing litigation concerning a contract signed by the Parties in 1880 and specifically the tax exemption clause in that contract (Clause 16). Approaching the end of the evidentiary phase, the parties asked for a ruling on a few outstanding evidentiary objections they were unable to settle. These comprised a total of ten documents challenged by (i) the defendant, which opposed two qualifications to its read-ins, and (ii) the plaintiff, which opposed eight documents that the defendant wished to enter on the basis of relevance and hearsay.

The appeal was allowed in part. After reviewing the facts and arguments of the parties with respect to each document, the Court's ruling favoured inclusion over exclusion. Accordingly, the judge allowed the plaintiff's qualifying answer to one of the defendant's read-ins and allowed in the eight documents tendered by the defendant, as this would at best support legal positions to be advanced, and at worst, be accorded little to no weight from this Court. Given the large evidentiary record already in this trial, the judge found that the benefit of including this evidence outweighed the detriment of excluding it. However, the opposite conclusion applied to allowing in a qualifying answer to a question that was retracted, and the judge accordingly exercised his gatekeeping function to exclude that response with respect to the other read-in. The judge noted the parties' cooperative approach to these proceedings. Most areas of contention regarding the admissibility of evidence were resolved by the parties through diligent work before the resumption of the hearing.

¶50,606, *CPR v. The Queen*, 2021 DTC 5004

Taxpayers not entitled to deduct legal expenses to defend a claim they had been overpaid an amount already included in income

The Minister denied the taxpayers' attempt to deduct, under paragraph 8(1)(b) of the *Income Tax Act*, legal expenses incurred by them in defending a claim against them that they had been overpaid an amount that had already been included in their income from employment. The Tax Court of Canada dismissed their appeals (2018 DTC 1126), and they appealed to the Federal Court of Appeal.

The taxpayers' appeals were dismissed. Paragraph 8(1)(b) does not allow an employee to deduct legal expenses incurred to defend a claim related to an amount that that employee has already received.

¶50,607, *Barkley v. The Queen*, 2021 DTC 5007

Crown's appeal dismissed on basis of *res judicata*

This case involved two matters with a common issue: the appropriateness of costs awarded by the Tax Court for the proceedings in that court (2018 DTC 1044). In the First Matter, the taxpayer successfully appealed the Minister's assessments for certain taxation years to the Tax Court of Canada, and was awarded costs on the usual scale. The Crown successfully appealed to the Federal Court of Appeal (2018 DTC 5077), and the taxpayer's further appeal to the Supreme Court of Canada was dismissed (2020 DTC 5027). In the Second Matter, the taxpayer moved successfully in the Tax Court for an order for enhanced costs for the proceedings in the Tax Court because of a settlement offer he made. As a result, the Tax Court varied its judgment in the First Matter. The Crown then appealed to the Federal Court of Appeal seeking enhanced costs for the proceedings in the Tax Court because of a settlement offer it made that was not accepted.

The Crown's appeal was dismissed. *Res judicata* applied, inasmuch as the entitlement for costs in the proceedings in the Tax Court was raised and decided in the First Matter. Also when the Federal Court of Appeal allowed the Crown's appeal in the First Matter, it set aside the Tax Court's judgment (including the costs award) so that the entire basis for the Tax Court's ruling in the Second Matter fell away.

¶50,608, *The Queen v. MacDonald*, 2021 DTC 5008

INTERNATIONAL NEWS

G7 Countries Aiming for Digital Tax Consensus by Mid-2021

The G7 countries have reaffirmed their commitment to push for an international consensus on revamped tax rules for the digitalized economy by the middle of this year, in a statement issued following their February 19, 2021 meeting.

The group's statement opened:

Drawing on our strengths and values as democratic, open economies and societies, we will work together and with others to make 2021 a turning point for multilateralism and to shape a recovery that promotes the health and prosperity of our people and planet.

The G7, which consists of the United States, the United Kingdom, Canada, France, Germany, Italy, and Japan, said it would "strive to reach a consensus-based solution on international taxation by mid-2021 within the framework of the OECD."

Under pillar one of the OECD's current digital tax work, the OECD is formulating new rules that would allocate some taxing rights to market jurisdictions, regardless of whether a taxpayer has a physical presence there. Under the leadership of former president Donald Trump, the US withdrew from these negotiations.

Pillar two involves the development of a coordinated set of rules, including on a minimum effective tax burden for multinationals, to address ongoing BEPS risks from structures that allow MNEs to shift profit to jurisdictions where they are subject to no or very low taxation.

Given the US' opposition to the pillar one proposals, after previous meetings, especial focus was placed in earlier G7 statements on minimum tax proposals and the taxation of intangible assets transfers. The Biden administration has yet to indicate fully whether the US will return to the negotiating table on pillar one. However, the new, broader statement from the G7 may indicate that the US' stance may have softened.

Back at their July 2019 meeting, the G7 finance ministers and central bank governors expressed support only for enforcing at least a minimum level of effective taxation on multinational companies, highlighting the introduction in the US of the GILTI regime.

Parallels have been drawn between the GILTI regime and the OECD's proposals for a minimum tax burden for multinational companies, which the US supports.

The GILTI rules are intended to ensure a minimum tax on otherwise low-taxed income and to discourage US corporations from shifting high-yielding intangible assets such as intellectual property rights to low-tax jurisdictions.

GILTI, a new category of foreign source income added to corporate taxable income each year, is defined as the portion of the income of a controlled foreign corporation owned by US shareholders that exceeds a notional 10 per cent return — a rate that is intended to reflect the normal rate of return on tangible assets. After a 50 per cent deduction, GILTI is subject to an effective corporate tax rate of 10.5 per cent. Biden has consistently said he will bolster the GILTI regime during his term.

Earlier this year, in response to the election win of Biden, the European Commission and the EU High Representative previously called on the EU and the US to work "together to find global solutions for fair taxation and [address] market distortions in the digital economy."

The G7 is due to hold its next summit on June 11 – 13, 2021.

EU Council Agrees to Tax Blacklist Changes

Barbados has been removed from the European Union's list of non-cooperative jurisdictions and Dominica has been added.

The list includes jurisdictions worldwide that either have not engaged in a constructive dialogue with the EU on tax governance or have failed to deliver on their commitments to implement the reforms necessary to comply with a set of objective tax good governance criteria. These criteria relate to tax transparency, "fair taxation", and implementation of international standards designed to prevent tax base erosion and profit shifting ("BEPS").

The changes to the list take into consideration the ratings recently released by the OECD Global Forum for Transparency and Exchange of Information (the "Global Forum") as regards the exchange of information on request. For the purposes of the list, the EU requires jurisdictions to be at least "largely compliant" with the international standard on transparency and exchange of information on request ("EOIR").

Dominica has been included in the EU list as it received a "partially compliant" rating from the Global Forum and has not yet resolved this issue.

Barbados was added to the EU list in October 2020 after it received a "partially compliant" rating from the Global Forum. It has now been granted a supplementary review by the Global Forum and has therefore been moved to a state-of-play document, pending the outcome of the review.

The state-of-play document identifies jurisdictions that do not yet comply with all international tax standards but have made sufficient commitments to implement tax good governance principles. The document has also been updated to reflect various other changes endorsed by the Council.

For instance, Morocco, Namibia, and Saint Lucia have been removed from the state-of-play document as they have fulfilled all their commitments. Jamaica has been added as it has committed to amend or abolish its harmful tax regime (its special economic zone regime) by the end of 2022.

Australia and Jordan have been granted an extension to the deadline for fulfilling their commitments, until the assessment of their reforms by the OECD Forum on Harmful Tax Practices. Maldives, meanwhile, has been given four additional months to ratify the OECD Multilateral Convention on Mutual Administrative Assistance.

Turkey was requested to solve all open issues as regards effective exchange of information with all member states. The EU Council said Turkey is expected to commit at a high political level by May 31, 2021 to effectively activate its automatic information exchange relationship with all 27 member states by June 30, 2021.

Following the February 2021 update, there are 12 jurisdictions on the list of non-cooperative jurisdictions: American Samoa, Anguilla, Dominica, Fiji, Guam, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, the US Virgin Islands, and Vanuatu.

Nine jurisdictions have made commitments to reform their tax policies and currently appear in the EU's state-of-play document: Australia, Barbados, Botswana, Eswatini, Jamaica, Jordan, Maldives, Thailand, and Turkey.

BEPS MLI To Enter Into Force for Chile, Panama

The BEPS multilateral instrument ("BEPS MLI") is due to enter into force for Chile and Panama on March 1, 2021.

The MLI was developed through negotiations involving more than 100 countries and jurisdictions. The MLI enables countries to modify their existing tax treaties to include measures developed under the OECD/G20 BEPS project without having to individually renegotiate these treaties. The instrument will implement minimum standards to counter treaty abuse, prevent the artificial avoidance of permanent establishment status, neutralize the effects of hybrid mismatch arrangements, and improve dispute resolution mechanisms.

Jurisdictions may choose, when ratifying the BEPS MLI, which of their treaties they wish to amend through the MLI. These treaties are known as "covered agreements". Providing the other signatory territory has also selected that agreement as a covered agreement and the BEPS MLI has entered into force for that other signatory territory, changes will be immediately effective from March 1.

Panama has opted to list 17 double tax agreements signed with other countries as "covered agreements" for the purposes of the BEPS MLI, while Chile has selected 33.

TAX TOPICS

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