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PRESERVING WEALTH FOR PEOPLE AND PRIVATE COMPANIES

SEASON'S GREETINGS!

Once again, it is hard to believe that another year is about to come to a close.

As we always like to do with our year end issue, we start by thanking all those people who contributed articles. Without the efforts of dozens of contributors, we would not have a *Taxes & Wealth Management* newsletter. So, thank you to our many and wonderful contributors. They always provide us with proactive reading material and on more than one occasion, good advice!

The production of the newsletter is dependent on the hard work of many "behind the scenes" people. We want to especially thank Filomena Mendonca at Miller Thomson LLP and Charlane Vitez at Thomson Reuters. With their help, everything goes smoothly!

A new addition to our Editorial Team is Rahul Sharma. Rahul is a senior associate at Miller Thomson LLP. Many of our readers know Rahul and of his legal acumen. We are glad that he has joined the editorial team and know that he will be making valuable contributions in the years to come. Finally, from all of us to all of you – Happy Holidays! and may the coming year bring you and your family Health, Happiness and Prosperity!!!

The Editors

David, Hellen, Marty and Rahul

IN THIS ISSUE

2015 IBA ANNUAL CONFERENCE TAX SESSIONS – A BRIEF SUMMARY

By Ron Choudhury, Partner, Miller Thomson LLP

The 2015 Annual Conference of the International Bar Association was held in Vienna, Austria from October 4th to 11th. The IBA Annual Conference attracts thousands of lawyers from across the world who participate as delegates, offices, and speakers/panelists in various legal practice divisions or sections and regional and other specific fora. Tax panels and sessions are organized by the Taxation Section and the Individual Tax and Private Client Committee.

A number of panels were organized by the Taxation Section at this year's IBA Annual Conference in Vienna. The following is a brief summary of some of the more relevant panels. Each panel was generally chaired by two co-chairs and constituted of five to seven lawyers from different countries. Some panels were organized in conjunction with other committees (e.g., panels were organized this year in conjunction with the Business Crime Committee, the International Sales Committee, and the Maritime and Transport Law Committee).

MONDAY, OCTOBER 5

The Tax Committee organized or co-organized three panels on Monday, October 5. The Taxation of International Supplies of Goods and Services within Groups was the main panel of the day, the other two focussing on the impact of EU law on tax and a draft code of practice for FIFO. The Taxation of International Supplies of Goods and Services within Groups panel was co-chaired by lawyers from India and the Netherlands. The panelists were from Canada, U.K., Brazil, Austria and Germany. While the panel's aim was to discuss both VAT/sales tax and transfer pricing issues, a significant part of the discussion focussed on VAT issues (perhaps due to the presence of a number of VAT specialists on the panel). Each panelist and co-chair introduced the VAT systems in their jurisdictions following which the panel focussed on case studies involving the supply of services and goods within corporate groups.

The discussion of services focussed on insurance services being supplied from a service provider to a recipient located in a different country or to a branch of the recipient. The discussion also focussed on the tax treatment (primarily, VAT) of a re-supply of the same services. The treatment of the payments in the EU and Canada were the focus of this part of the presentation. The Canadian discussion focussed on whether the exported services could be subject to the federal GST and the EU discussion focussed on whether the VAT would be imposed when the service was rendered within the same entity (e.g., Canadian corporation to its EU branch) or the service was then rendered by the branch to a corporation within the same group. A second component of the same case study discussed the VAT treatment when a U.S. advisor was engaged by a U.S. entity to render services to another entity in the corporate group located in a different country. In each instance, the discussion focussed on whether the VAT treatment could vary if the payment was made by the service recipient or if the engagement was with the service recipient but the invoice was issued to the U.S. entity. The crux of this part of the discussion was whether the recipient of the service was the entity that engaged the advisor, the entity that received the services or the entity that was invoiced. Unlike the Canadian rules that focus on the definition of a recipient of a service, the EU jurisdictions consider numerous factors in determining where the VAT should be imposed. Transfer pricing considerations were also discussed.

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The second case study discussed a transfer of goods between related parties. The goods were transferred from a parent corporation to its subsidiary in a foreign country. Each jurisdiction discussed the applicable VAT rules and customs duties, where applicable, and whether the tax base was based on the actual price, a minimum price or an arm's length price. A second portion of the discussion dealt with whether a retroactive transfer pricing adjustment was possible to the value for duty or the value declared for customs purposes. While the transfer pricing practitioners were of the view that a retroactive transfer pricing adjustment could be beneficial in reaching an arm's length price, the VAT practitioners discussed the impact of any such adjustment on any tax paid upon the importation of the goods into the country of the purchaser and the issues associated with additional payments of VAT or an application for a refund.

TUESDAY, OCTOBER 6

The Tax Committee organized two panels on Tuesday, October 6. The Roundtable on Global Trends: Hot Topics in Taxation was organized as a number of roundtables with speakers comprised of national reporters from various countries. Roundtables were organized on the following topics: Trends in Anti-Avoidance Rules, Recent VAT Developments, Developments in Information Exchange, Transfer Pricing Trends, Innovation Incentives, Investment Fund Taxation, and Trends in Tax Enforcement. National reporters from Poland, Denmark, U.S.A., Mexico, Panama, Venezuela, Portugal, Bulgaria, Germany, Israel, Argentina, Austria, Switzerland, China, South

Africa, Finland, Ireland, Peru, Belgium, Uruguay, Luxembourg, Norway, Cyprus, Iceland, Chile, France and Japan participated. Other attendees to the conference had the option of moving between roundtables and taking active part in the discussion. In each instance, the focus was on discussing the basics of the topic under discussion in the relevant jurisdiction and providing an update on recent developments.

The Tuesday afternoon panel was entitled Recent Transactions and dealt with inversion transactions, loss utilization, and cross-border mergers. The co-chairs were from the U.S. and Austria whereas the panelists were from England, Australia, Japan, Mexico, Switzerland and Italy. The first part of this panel focussed on loss utilization transactions and a discussion of how an acquisition of control could impact future utilization or availability of losses in the target corporation. The panelists noted that utilization of losses were dependent on a number of factors like a same or similar business being carried on after an acquisition of control, certain substance tests being met, anti-avoidance rules that considered the reasons for an acquisition of control, or types of losses. Each country had one or more rules that impacted the utilization of losses but the application and interpretation of such rules varied across jurisdictions.

The discussion on inversion transactions focussed more on the U.S. response to inversion transactions and whether the global response to BEPS could impact inversion transactions. The impact of country-by-country reporting (discussed below) was also discussed.

WEDNESDAY, OCTOBER 7

Three panels were organized or co-organized by the Taxes Committee on Wednesday, October 7. The feature panel in the morning was on Tax Treaty Benefits. A panel entitled Tax Planning Structures and Cross-Border Transactions: Criminal Implications for the Members of the Corporate Bodies and for the External Advisors in case of Tax Audit was organized with the Business Crime Committee while a panel entitled Transfer Pricing – It's Tax and So Much More was organized with the International Sales Committee.

The Tax Treaty Benefits panel was co-chaired by lawyers from England and Argentina. The panelists were from Ghana, Spain, the Netherlands, Canada, India, and Austria. The focus of the panel was mainly discussing basic treaty issues in each jurisdiction, including residency, beneficial ownership, passive payments like dividends and royalties. Among the topics addressed was whether an inversion transaction may be an issue from a residency perspective, the use of newer commentaries to the OECD Model Tax Convention by courts in Argentina even though the treaties at issue were older treaties that were not negotiated on the basis of such newer commentaries, and the requirement in Argentina to register technology transfers in order to receive treaty benefits on royalty payments. An interesting aspect of the discussion was the impact of language on meanings of terms. The Austrian panelist referred to the meaning of beneficial owner in German (person entitled to use) and compared it to the English meaning (which refers to economic ownership) and discussed the impact of such difference on the use of the term in different jurisdictions.

The speakers also discussed the use of limitations on benefits clauses in tax treaties. Some countries, like Argentina, have occasional treaties with LOB clauses while others, like Austria, do not use LOB clauses in tax treaties but allow domestic laws to override treaty benefits where appropriate. Spain too referred to its domestic laws and the requirement for substance in combatting treaty abuse. The U.K. panelist referred to the *Indofood International Finance Ltd.* v. *JP Morgan Chase Bank N.A.* decision in explaining the use of the beneficial ownership concept in the U.K. and the difference in beneficial ownership in U.K. treaties. The U.K. too has the ability to override treaties with its domestic laws.

The panel on Tax Treaty Benefits perhaps lacked focus on the issues it sought to address. While the beneficial ownership concept underlined the discussion and was addressed in the context of residency, passive payments like dividends and royalties and treaty override, the discussion was on treaty benefits and would have benefitted from an analysis of treaty shopping issues and combat techniques, avoidance rules (including limitations on benefits) in addition to the discussion on beneficial ownership.

THURSDAY, OCTOBER 8

Three panels were also organized or co-organized on Thursday, October 8. The feature panel was entitled Recent Development in BEPS. The afternoon panels were entitled "Cash Financing Arrangements and Currency Risks for Multinationals" while a panel co-organized by the Maritime and Transport Law Committee was entitled "Tax for Shipping – Are Tax Haven Jurisdictions Really the Best Destinations for Shipowners and Vessel Operators?"

The BEPS panel was one of the most interesting panels and discussions in the entire conference. The panel was moderated by lawyers from Spain and Italy and included speakers from the OECD, the Mexican tax authority, Italy, Ireland, U.S.A., Austria, and the Netherlands. The Dutch panelist, an academic, offered a different perspective on the issues from those offered by practitioners on the other panels.

The first part of the panel was dedicated to a discussion by the OECD representative of the recently released BEPS report. The report itself was not discussed in detail. However, the parameters of the report, including the pace of the project (two years), the inclusivity (G20, OECD and developing countries), and its transparency, were highlighted. The OECD summarized the topics discussed in the report – reinforced international standards on tax treaties, transfer pricing, changes to the permanent establishment definition, minimum standards on dispute resolution, best practices, arbitration clause – and noted that implementation of the report would be the next step in the process. The OECD also clarified that it advocated the need for economic substance to drive allocation of profits but that legal arrangements should be respected where they reflected underlying economic realities.

An interesting, and perhaps contentious part of the package, is the requirement for country-by-country reporting that would require multinationals to report transactions and income/losses on a country-by-country basis. The OECD defended its recommendations in this regard, suggesting that this form of transparency would be useful in combating profit shifting but failed to clarify how the administrative complexities associated with such form of reporting could be addressed. The OECD also failed to adequately address the issues surrounding the digital economy, noting that it had clarified the BEPS issues and identified broader challenges. Finally, the OECD identified follow-up tasks including limitations on benefit enhancements, establishment of a minimum standard on treaty abuse, transfer pricing for financial industries, and clarifying rules for profit.

The remainder of the panel focussed on discussing some of the issues identified by the OECD. The Mexican panelist noted that their (i.e., the tax authorities) issues were similar but that their priorities differed from those of the OECD. Mexico's priorities involved addressing the high leveraging of multinationals in Mexico, more attention to economic substance, and combatting treaty shopping. The Mexican tax authorities were also considering whether VAT should be applicable to digital transactions and the concept of permanent establishment in e-commerce.

The academic from the Netherlands proposed a combined approach to treaty shopping that would involve a limitation on benefits clause and a principal purpose test. The remainder of the panelists focussed on discussing treaty issues in their countries in the context of the BEPS report. The consensus was that country-by-country reporting may be useful and provide information related to income allocation but that it would be difficult to implement and that compliance costs may be prohibitive. The U.S. panelist was also of the view that BEPS would foster source-country taxation and lead to less tax for residence-countries like the U.S.

This panel was one of the most eagerly-awaited and debated panels organized by the Tax Committee. The presence of a panelist from the OECD, a tax administrator and an academic added a unique perspective as well.

As in previous years, the panels organized at the IBA Annual Conference were thought-provoking and useful in providing an insight into the tax practices in various countries. Due to the case-study oriented approach, it is not always possible to understand the various tax systems in detail. However, the comparative analysis encouraged by such case studies is invaluable for those lawyers whose practice involves international tax issues. The next conference will be in Washington D.C. in September 2016.

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THE DECISION TO INCORPORATE: TAX AND NON-TAX CONSIDERATIONS

By Graham Purse, Associate, Miller Thomson LLP and Crystal Taylor, TEP, Partner, Miller Thomson LLP

INTRODUCTION

The decision whether to incorporate is nuanced. There are a myriad of factors to consider. In this article, we attempt to provide a concise overview of some of the tax and non-tax considerations that help inform such a decision. There are cases where a single issue may be dispositive of the inquiry. Typically, however, many factors must be considered in concert.

BENEFITS OF INCORPORATION

Tax Benefits

Deferral

One of the largest tax benefits of incorporating is the deferral achieved on income retained at the corporate level for Canadian-controlled private corporations ("CCPCs").[1] The tax rate for CCPCs is much lower than receiving income personally in the top tax bracket. This preference is effected by the small business deduction ("SBD"),[2] which applies in respect of the first $500,000 of active business income earned in Canada.[3] The rate is becoming better, and is set to drop to 9% (federally) by 2018.[4] The SBD is gradually phased out for larger corporations.[5]

1 ITA, ss. 125(7)
2 ITA, ss. 125(1)
3 ITA, ss. 125(2)
4 ITA, para. 125(1.1)(e)
5 ITA, ss. 125(5.1)

This lower rate allows owner-managers to defer tax if money is left in the corporation, as opposed to being paid out to shareholders as dividends. Only when dividends are paid,[6] will the ultimate reconciliation occur, through the process of integration. The longer the money can be retained at the corporate level without being paid as a dividend, the more tax savings.

Additional benefits of incorporation include cheaper access to capital for reinvestment, to obtain life insurance at the corporate level, or to repay commercial debt.

It is a common strategy for businesses to own real property in a separate corporation. By virtue of subsection 129(6) of the ITA, a real property corporation, which would otherwise not qualify for the SBD, that charges rent to the operating corporation may also enjoy the SBD.[7]

Two other forms of deferral should be considered. First, if a family farm is incorporated, income taxes can be deferred when the farm is transferred to children, either on a testamentary or *inter vivos* basis, just the same as if the farm were owned personally.[8] Second, subsection 78(4) of the *Income Tax Act* ("ITA") allows a deferral in respect of bonuses paid to employees by corporations with year-ends after July 6.

Finally, through the use of subsection 85(1) and 85(2) of the ITA both sole proprietors and partnerships are afforded an opportunity to incorporate on a tax-deferred basis subsequent to commencing business operations. One may be able to postpone incorporation and only incur the costs once it appears necessary, for example immediately prior to a sale, by reliance on the exception in subparagraph 110.6(14)(f)(ii) of the ITA. This allows losses in the start-up phase to be used to offset other income, rather than being trapped in the corporation.

Elimination

The best possible tax mitigation strategy is to eliminate tax. There are a number of ways in which corporations can be used to eliminate tax.

For most owner-managed businesses, the capital gains exemption is front and centre in tax elimination planning.[9] This indexed deduction provides for an offset of $813,600 against capital gains where an individual disposes of qualified small business corporation shares ("QSBC shares").[10] The lifetime capital gains exemption can mean over $200,000 in tax elimination per individual. The deduction can also be multiplied through the use of a family trust, by designating eligible taxable capital gains to beneficiaries of the family trust, where the family trust owns QSBC shares.[11]

In considering the lifetime capital gains exemption, a number of factors should be kept in mind. First, where a person claiming the deduction has little other income, alternative minimum tax may apply.[12] Second, the deduction may be limited or defeated where a person has a cumulative net investment loss.[13] Third, utilizing the capital gains exemption can also impair a taxpayer's ability to claim old age security.[14]

The elimination of tax can also be achieved by income splitting through a corporation. In order to achieve effective income splitting, the corporation needs articles that provide for different classes of shares for each shareholder. For instance, dividends may be paid to taxpayers who are at lower marginal rates than the owner-manager, such as a spouse, parent, or adult child. The Supreme Court of Canada implicitly endorsed dividend sprinkling in *Neuman v M.N.R.*[15] One must be cautious, however, of kiddie tax[16] in relation to dividends paid to minors. Likewise, one must be cautious of the potential application of the attribution rules where a corporation that is not a small business corporation issues shares to a family member that is a "designated person".[17]

Certain business investment losses, known as "allowable business investment loss[es]", in small business corporations can be deducted against all sources of income ("ABILs").[18] ABILs can affect the lifetime capital gains exemption, but those issues are not addressed herein.

Major shareholders may not be required to pay employment insurance premiums, where such shareholders control more than 40% of the voting shares of the corporation or where the employer and employee are not dealing with each other at arm's length.[19]

Potpourri

There are a number of additional tax benefits to incorporation.

There is a potential, in consultation with a corporation's accountants, for optimization of the salary/dividend mix to

6 Although beyond the scope of this article, income eligible for the small business deduction forms part of a corporation's low rate income pool ("LRIP") and does not receive eligible dividend treatment.
7 The association rules are discussed under the Burdens section, *infra*.
8 See, *inter alia*: *inter vivos*: ss. 73(3), (3.1), (4), (4.1) and *mortis causa*: ss. 70(9), (9.01), (9.2), (9.21)
9 ITA, s. 110.6
10 ITA, ss. 110.6(1)
11 ITA, ss. 104(21.2)
12 ITA, s. 127.5, *inter alia.*
13 ITA, ss. 110.6(1)
14 ITA, s. 180.2
15 *Neuman v. M.N.R.*, [1998] 1 S.C.R. 770
16 ITA, s. 120.4
17 ITA, ss. 74.4(2)
18 ITA, s. 3(d) and ss. 38(c)
19 *Employment Insurance Act*, S.C. 1996, c 23, para. 5(2)(b)

decrease tax. This potential exists and varies from year-to-year on account of imperfections in the system of integration.

While certain rules effectively put sole proprietors on a calendar year-end,[20] those rules are inapplicable to corporations, which are free to choose a non-calendar year-end. Choosing a non-calendar year-end may also allow a corporation to have its year-end during a less busy period of its business cycle, if applicable, and may allow for better bonus planning.[21]

Although beyond the scope of this article, partnership can function as an intermediary step between the sole proprietorship and incorporation. Where income splitting is desirable but start-up losses are still possible or personal expenses necessitate that deferral is not realistic, a partnership may be the preferred legal form, and incorporation can later be effected via subsection 85(2) of the ITA.

Finally, paid-up capital[22] ("PUC") – that is, the amount paid to the corporation for shares – can generally be paid back to shareholders tax free, subject to the fact that PUC is averaged across each class of shares.[23]

Non-tax benefits

The primary non-tax benefit of incorporation is liability protection. Underlying the entire concept of incorporation is the premise that corporations are treated as separate persons at law. A corporation is deemed by statute to be a person that is distinct from the natural individual that created it and its shareholders, who are the owners of the corporation. This results in limited liability for shareholders. Shareholders are not liable for the liabilities of the corporation beyond the funds specifically advanced to the corporation as shareholder loans or equity. If the nature of business is particularly high risk (e.g. human teleportation or wing-suit BASE jumping), then the liability shield may be key in the decision of whether to incorporate.

From a shareholder perspective, the liability shield means that a shareholder is usually only exposed to two forms of risk: (a) a loss in the amounts they have contributed to the company or (b) a loss in an accretion in value of their shares. Beyond that, a shareholder generally has no further liability. In contrast, partners and sole proprietors do not enjoy these benefits.

20 ITA, s. 34.1
21 ITA, ss. 78(4)
22 ITA, ss. 89(1)
23 For instance, where a person subscribes for 1 Class A share for $1, and a subsequent subscriber pays $9 for 1 Class A Share, then each shareholder will have a PUC of $5 (being 2 shares / $10 total PUC). This means that the second shareholder will not be able to withdraw all of the amount she paid in to the corporation tax free.

Directors also do not necessarily enjoy the same protection from liability as do shareholders.[24]

Unlike individuals, corporations do not experience a cessation of biological operation – specifically, they do not die. This can potentially make transitioning of a business from one generation to the next easier than that of a sole proprietorship or partnership or individuals. It may also be easier to bring employees into the business by, for example, offering them non-voting dividend-bearing shares or through a profit-sharing plan.

An additional benefit of incorporation is that it is a widely understood and accepted form of carrying on business. Persons generally feel comfortable entering business transactions with corporations, and this quality is valuable.

BURDENS OF INCORPORATION

Tax-related burdens

There are some negative aspects of incorporation.

Incorporation and Reorganization Costs

Incorporation and reorganization costs – which can be significant – are eligible capital property, 75% of which is amortized at 7% per year on a declining balance.[25] Thus, legal and accounting costs can take many years to deduct.

To maintain QSBC shares as qualifying for the lifetime capital gains exemption, ongoing purification is often necessary. Ongoing purification may involve the regular payment of dividends to shareholders (defeating the deferral discussed, *supra*) or require the use of a holding company (with all the attendant costs) into which dividends can be paid.[26] Use of inter-corporate dividends can run afoul of subsection 55(2). Moreover, routine creditor-proofing through the use of a holding company appears to be increasingly complex and expensive in light of recent proposed amendments to subsection 55(2), and may require reliance on safe income exception or the provisions of subsection 84(3).

Many types of corporate reorganizations are complex and expensive to implement. For example, it can be difficult to remove assets from a private corporation without incurring tax, such as splitting up a corporation through the use of a butterfly transaction. Amalgamation transactions can lead to additional year-ends. Year-ends mean more tax returns and accounting fees, on top of the legal fees to amalgamate.

24 Director's liability is discussed, *infra*.
25 ITA, para. 20(1)(b). Although these amounts are often deducted by accountants, the practice is technically often incorrect.
26 ITA, ss. 112(1)

Director / Owner-Manager Sources of Risk

Many small businesses run into problems with the Canada Revenue Agency. These problems include the personal service business rules, attacks on unreasonable management fees, shareholder benefits, and directors' liability issues. Many of these issues do not arise in the sole proprietorship context.

Where a person incorporates, but the relationship with their client/payor appears more akin to an employment relationship than that of independent contractor, the business may be reassessed as a personal service business ("PSB").[27] There are a host of negative consequences of being found to be a PSB, such as limits on deductions and ineligibility for the general rate reduction.

While incorporation generally allows for limited liability for shareholders, there are certain matters for which directors may still be personally liable. Although there are a number of established defences to director's liability, a director may find herself or himself personally liable for unremitted source deductions (CPP/EI) and GST.[28] There is also risk in respect of occupational health and safety and environmental liabilities. An individual choosing between the directors' personal liabilities and a sole proprietor or general partnership liabilities, would still generally prefer to incorporate and be subject to director liabilities.

The CRA regularly assesses small business owners for falling afoul of subsections 15(1) and 56(2). Oftentimes small business owners mix personal and business accounts and have poor or disorganized record keeping. Where a shareholder appropriates corporate property other than by payment of a dividend, the CRA often applies subsection 15(1), denying a deduction to the corporation and adding the amount to the shareholder's income. Similarly, in instances where a shareholder appropriates corporate property for the benefit of a third party (such as a relative), the CRA may assess under subsection 56(2) including that conferred benefit as "other income" of the shareholder. These provisions are both the subject of frequent litigation.

Small business owners are also often assessed for personal automobile use, improperly claimed home office expenses, and improperly claimed food, beverage, and entertainment expenses. All of these potential areas for reassessment are real risks for small business owners, particularly those unaware of the CRA's willingness to investigate and assess such behaviour.

27 ITA, ss. 125(7). For more on the topic of PSBs, see Mike Dolson's brilliant article, "Stop PSB Proliferation", Canadian Tax Highlights, vol. 22, no. 9 (Canadian Tax Foundation) (September 2014).

28 ITA, ss. 227.1 and *Excise Tax Act*, s. 323.

Limits on the Availability of the Small Business Deduction

There are a number of types of small businesses that do not have access to the small business deduction. In particular, a "specified investment business"[29] and a PSB are not eligible for the small business deduction.

Where corporations are associated, they must share the SBD.[30] Two corporations that are controlled by the same person or group of persons will be considered associated. So if an individual controls two separate operating companies, the two companies will be required to share the small business deduction. Some of the extended association rules can trigger association in surprising ways, such as through a trust under subsection 256(1.3) of the ITA or through an option to acquire shares under subsection 256(1.4) of the ITA.

Potpourri

A primary concern in the determination of whether to incorporate is the issue of trapped losses. Namely, if a corporation incurs significant expenditures at start-up, those losses are not available to be offset against other sources of income of the owner-manager. If losses are expected early on, then incorporation should be delayed.

On the death of a shareholder of a small business, there is an inherent potential for double taxation.[31] While there are workarounds, such as the loss carry-back and the 'pipe-line' strategy,[32] post-mortem planning is often expensive, time consuming, and complicated to implement.

Non-tax burdens

There are a number of expensive administrative aspects of incorporating, some of which are outlined below.

Corporations are separate taxpayers, distinct from their shareholders. Therefore, a corporation must also prepare and file tax returns annually. Corporations are also required to prepare financial statements, which, if audited, can be quite expensive. Corporations also require separate bank accounts and banking fees. There are also annual resolutions for corporations branch.

Incorporating costs can include fixed fees that vary with the respective corporations branch depending on the jurisdiction of incorporation. Rush fees may be applicable, particularly if the jurisdiction's corporations branch is inefficient.

29 ITA, ss. 125(7) "specified investment business"

30 ITA, ss. 256(1) and ss. 125(3) and (4)

31 ITA, ss. 70(5) and dividend provisions.

32 ITA, ss. 164(6) and ss. 84(2)

It may also be necessary to engage in a lawyer to incorporate, which involves legal fees. Where more than one shareholder is contemplated or income splitting is a preferred objective, it is recommended that a good corporate lawyer be engaged to provide for sophisticated articles of incorporation. Deficient articles of incorporation often require significant costs in the future where amendments are necessary.

Corporate reorganizations also lead to expenses with corporations branches, such as filing and rush fees. Amalgamations, incorporations, and dissolutions can all attract such fees. Likewise, transitioning corporations between jurisdictions can be time consuming and lead to additional expenses. Often legal representation is required in two provinces. Sole proprietors do not incur these costs.

Professional corporations can lead to interactions with intransigent regulatory bodies, who do not understand their governing legislation and/or lack legal training. Fees may be high, service may be slow, and the professional body may not know how to administer its own processes efficiently or at all.

CONCLUSION

As is evident from the foregoing, there are a number of tax incentives to incorporation. When a professional is consulted in respect of the determination whether to incorporate, it is important to take a holistic view of the facts and appreciate that there are, in fact, many possible disadvantages to incorporation. For owner-managed businesses, however, a number of tax incentives, such as the small business deduction and lifetime capital gains exemption, often tip the scales toward incorporation.

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CHECKLIST

Benefits	Burdens
- small business deduction	- alternative minimum tax
- tax deferral	- cumulative net investment losses
- low cost of re-investment	- OAS clawback
- real property corp may qualify for SBD	- slow amortization of eligible capital property
- does not eliminate farm rollover	- ongoing purification planning
- deferral on bonuses	- potential need for holding company
- capital gains exemption	- complex creditor proofing
- income splitting	- accounting and legal costs for reorganization
- allowable business investment losses	- can always incorporate later
- possible exemption from EI for owner	- personal service business rules
- salary/dividend planning	- specified investment business rules
- non-calendar year	- directors' liability (CPP/EI/GST/OH&S/etc.)
- tax free removal of paid-up capital	- 15(1) and 56(2) assessments
- liability protection	- gross negligence penalties
- unlimited life	- improper automobile usage
- employee profit sharing planning	- improper home office and food expenses
- widely accepted form of business	- association rules
	- trapped losses
	- double taxation on death
	- compliance costs (filings)
	- regulatory headaches
	- expensive amendments and continuances

PLANNING OPPORTUNITIES FOR DUAL EU AND CANADIAN NATIONALS: THE EU SUCCESSION REGULATION

By Carla Figliomeni, Associate, Miller Thomson LLP, and Rahul Sharma, Associate, Miller Thomson LLP

A major step in facilitating cross-border succession was the adoption of the *Regulation (EU) Nr. 650/2012* (hereinafter referred to as the "Succession Regulation") on jurisdiction, applicable law, recognition and enforcement of decisions and acceptance and enforcement of authentic instruments in matters of succession and on the creation of a European Certificate of Succession. This was adopted on July 4, 2012 and has now taken effect for deaths of residents of the succession countries taking effect after August 17, 2015.

Except for Denmark, the United Kingdom and Ireland, the Succession Regulation provides a direct application in all participating member states of the Succession Regulation (hereinafter referred to as the "Member States") and enjoys universal character, in that, the selected law can be the law of a Member State, a third state, or a non-Member State. On a practical level, the Succession Regulation is an important arm in ensuring predictability for estate planners. As discussed in this article, since the time that the authors first considered the Succession Regulation in the context of Canadian estate planning during the spring and early summer of 2015 (in the Miller Thomson LLP *Wealth Matters* publication), planning for dual Canadian and Member States citizens appears to have taken off in certain Member States. Although some questions still linger regarding the manner in which Wills made in reliance upon the Succession Regulation will ultimately be treated by the courts, practical planning opportunities involving dual nationals do exist and should be considered by advisors in appropriate circumstances.

OVERVIEW OF THE SUCCESSION REGULATION

The Succession Regulation introduces novel concepts for cross-border succession planning of individuals with multi-jurisdictional estates and ties to a Member State. The following is a brief overview:

1. **Habitual Residence:** The most significant criterion of the Succession Regulation is the adoption of the concept of "habitual residence" instead of nationality or domicile. This means that the law of the country where the deceased habitually lived just before death will govern inheritance issues. In the Member States, one law will govern the entire succession, regardless of the nature or location of the estate's assets. The default rule will, in general, apply the laws of the habitual residence of the deceased except if:

   (a) the deceased maintained closer ties with another state, established on a case-by-case basis;

   (b) state mandatory laws where the property is located overrule this general rule; and

   (c) "renvoi" to another jurisdiction is authorized, depending on the circumstances.

2. **Choice of Law:** The second major innovation of the Succession Regulation is Article 22, which allows the general rule of habitual residence to be overridden by the use of the concept of "party autonomy", in order to permit a testator or testatrix to designate his or her national law as the law governing his or her succession as a whole, by expressing his or her choice expressly and in testamentary form. Should a person have a double nationality, he or she may designate one of the two national laws.

3. **Jurisdiction in one Country:** While Article 22 allows for a testator or testatrix to select his or her national law to govern his or her succession, the Succession Regulation does not allow a testator to choose the jurisdiction to rule on the succession as a whole. Instead, the courts of the jurisdiction in which the deceased had his habitual residence at the time of death shall have jurisdiction to rule on the succession as a whole.

Where the deceased made a choice of law in accordance with the Succession Regulation and the law chosen by the deceased was of a Member State, the parties concerned may agree that the courts of that Member State are to have exclusive jurisdiction to rule on any succession matter. The courts of the Member State in which the deceased had his or her habitual residence at the time of death can also decline the jurisdiction to govern the succession if the courts of the Member State of the chosen law are better placed to rule on the succession, taking into account the practical circumstances of the succession, such as the habitual residence of the parties and the location of the deceased's assets.

1. **Loi Uniforme:** Article 20 of the Succession Regulation provides that any law specified by the Succession Regulation shall be applied whether or not it is the law of a Member State.

2. **European Certificate of Succession:** The Succession Regulation creates a European Certificate of Succession. This standard form certificate will allow heirs, legatees, executors or administration to prove their legal status and/or rights in any of the Member States and benefits

from direct circulation, as no formality is needed for its recognition in the destination state.

WHAT CANADIAN ADVISORS SHOULD KNOW

The Succession Regulation may impact Canadian nationals who own property in a participating EU member state (and who may also be nationals of that state). Canadian estate planners and advisors should be cognizant of the Succession Regulation if they are approached by a client who meets this general profile, particularly if they or the client is concerned about the potential application of a forced heirship or other particular legal regime to the succession of the client's EU-based property. It is possible and may be prudent for Wills prepared for dual Canadian and EU nationals to specify that the law of a particular Canadian province should apply to the succession of the testator or testatrix's property.

Particularly given the changing nature of EU law and the jurisprudence which is likely to ultimately emerge from the Succession Regulation, it may be most advisable to involve a lawyer who practices in the EU member state in which a client may have property (and of which he or she may be a national) in order to determine, *inter alia*, whether:

1. A separate Will (other than a potential Canadian Will) should or needs to be prepared in respect of the property located in the EU member state, which Will may specify that the law of the Canadian province in which the client is otherwise resident should apply. Although the Succession Regulation appears to permit such an election to be made, many aspects of the general law of the jurisdiction in which property is located might nevertheless apply to its succession. This appears to also be contemplated in Article 10 of the Succession Regulation. As an example, transfers or conveyances of real property would quite likely need to proceed under the local laws of the jurisdiction in which the property is situated. Similar considerations may apply to the shares of corporations governed by the laws of a Member State. It is not clear that the Succession Regulation permits a testator or testatrix to divert himself or herself from the application of local law in such cases; and

2. Whether other aspects of the law of the Member State in question (such as matrimonial laws, for example) or public policy considerations may impact the effect of any elections made under and in keeping with the Succession Regulation.

Since the Succession Regulation came into force, it is understood that practitioners in Member States have, in fact, suggested to their clients who are dual Member State and Canadian nationals that they consider having a Will prepared in the Canadian province to which they have the closest connection. This is clearly the case if the testator or testatrix in question does not wish to abide by the principles of any forced heirship regime that might otherwise apply to his or her succession in a Member State. Canadian practitioners may have already been contacted in this regard or, it may only be a matter of time before they are.

POINTS FOR ADDITIONAL CONSIDERATION

Given its novelty, many questions remain unanswered in relation to the Succession Regulation, both in Europe and with respect to the ultimate treatment of a Will made under the regulation by a Canadian court. On the European side, the principle of Public Policy is a recognized "national" safeguard in Private International Law. It is generally possible to set aside a provision of an otherwise applicable law if said law should be obviously incompatible with the Public Policy of the State. Contrary to Public Policy would mean a significant contradiction to a State's basic social principles. The right to choose the law of the nationality under the Succession Regulation may trigger questions as to what constitutes a contradiction to basic social principles and whether the concept of forced heirship, prevalent in countries like France, Italy and Germany, might be ruled as being a basic social principle which cannot be trumped by a deceased's testamentary choice of law. If the concept of forced heirship is ruled to constitute a matter of Public Policy, the autonomy provided to a testator or testatrix under the Succession Regulation may be curtailed.

In spite of Public Policy concerns, it is understood that the prevailing opinion in certain Member States, including Germany, is that Public Policy arguments against the Succession Regulation are not likely to succeed. Planning involving the Succession Regulation is accordingly understood to be proceeding in certain Member States, although it would be interesting to see how, if at all, the courts in one or more Member States deal with any Public Policy considerations relating to the Succession Regulation. It would also be interesting to know which law is ultimately determined to govern matters incidental to Will an estate planning, such as testamentary capacity, revocation, children's rights and legitimacy, adoption, status of spouses, recognition of foreign divorces, family allowances, matrimonial property regimes, and the ranking of creditors of the estate. The Succession Regulation suffers from exceptions, which underline a renewal of conflict of laws and legal issues that practitioners must keep in mind when implementing a multijurisdictional estate plan.

On the Canadian side, the concept of domicile may need to be considered. Regard may also need to be given to provincial succession legislation and the ultimate recognition and treatment of a Will governed by the law of a Canadian province to which a testator or testatrix may have some connection, but where he or she may not, in fact, be domiciled. It is hoped that, as more planning involving the Succession Regulation is implemented, additional guidance, including from the courts, will be provided regarding, in particular, the conflict of laws issues which continue to surround it.

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PLANNING FOR CANADIAN PARENTS WITH U.S. CHILDREN

By Kenneth Lobo and Stanley C. Ruchelman, Ruchelman P.L.L.C.

IN GENERAL

U.S. citizens, and non-U.S. citizen individuals that are domiciled in the U.S., are subject to the U.S. estate tax on global assets held at the conclusion of their lifetimes and other assets transferred during life for less than fair value when certain interests or powers are retained. A person acquires a domicile in a place by living there, for even a brief period of time, without the presence of a definite intention to leave. A facts and circumstances test is used to determine domicile. Generally, permanent residents ("green card holder") are presumed to be domiciled in the U.S. in the absence of unusual circumstances.

U.S. ESTATE TAX BASICS

U.S. Citizen or Domiciliary

The U.S. estate tax base (the "gross estate") of a U.S. citizen or resident covers all property, no matter where located. This includes tangible property, personal property, and real property. The gross estate tax value is reduced by various deductions for expenses and claims to arrive at a taxable estate.

If the property is located outside the U.S., a foreign tax credit may be claimed for the amount of any estate, inheritance, legacy or succession taxes actually paid to a foreign country in respect of any property situated within that foreign country and included in the gross estate of the decedent under foreign law.

Nonresident, Non-citizen ("N.R.N.C.")

In General

The gross estate for an N.R.N.C., on the other hand, consists solely of U.S. *situs* assets that would be included in a gross estate under the principles enunciated above. The gross estate tax value for the estate of an N.R.N.C. is reduced by the same type of deductions that may be claimed by citizens and residents, but only on a *pro rata* basis that takes into account global assets and deductions. In other words, all assets bear a *pro rata* charge for all expenses and claims giving rise to deductions.

U.S. Situs Assets

As noted above, only U.S. *situs* assets (meaning assets considered to be situated in the U.S.) are included in the N.R.N.C. decedent's gross estate and are subject to U.S estate tax. U.S. real estate and tangible personal property physically located within the United States are considered to be U.S. *situs* assets for both U.S. gift and estate tax purposes.

With respect to intangible property, U.S. *situs* assets include stock issued by a domestic corporation and claims against a U.S. debtor. For U.S. *situs* purposes, it is only relevant as to where the company or the debtor is organized or resides (for an individual debtor), not where the shares are traded or located or where the funds are borrowed.

The U.S.-Canada Income Tax Treaty ("Treaty") addresses certain aspects of U.S. estate tax. This reflects the absence of estate tax in Canada and the imposition of capital gains taxes at death. The Treaty contains a reciprocal foreign death tax credit. Thus, upon death, if a Canadian capital gains tax is imposed on a U.S. *situs* asset and a U.S. estate tax is imposed on the same U.S *situs* asset, the U.S. estate tax may offset the Canadian federal tax due. Note that this is a unique blending of income taxes and estate taxes that is not found elsewhere in U.S. jurisprudence.

Since the U.S. estate tax is often higher than the Canadian capital gains tax, there may still be some U.S. estate tax due. Further, certain Canadian provinces such as British Columbia do not recognize the U.S. estate tax death credit. Therefore, there may be some double taxation with regard to Canadians residing in these provinces.

U.S. ESTATE TAX: EXEMPTION AMOUNT

U.S. Citizens

The lifetime gift tax/estate tax exemption for U.S. citizens and domiciliaries ("U.S. individual(s)") is U.S. $5,000,000, which is indexed for inflation beginning in 2011. For 2015, the exemption amount is U.S. $5.43 million. Thus, U.S. individuals may transfer assets not exceeding the indexed amount free of U.S. gift tax during life or at death. Cumulative lifetime taxable gifts are added to the taxable estate in order to unify the gift and estate tax system.

N.R.N.C.

N.R.N.C.'s are generally allowed a reduced estate tax exemption amount of only U.S. $60,000 for a limited unified credit of U.S. $13,000. However, this amount may be increased by an applicable tax treaty.

The Treaty provides that Canadian residents that are not U.S. citizens will be able to claim the same exemption amount (U.S. $5.43 million in 2015) as U.S. citizens and residents. However, the exemption is prorated based on the relative value of U.S. *situs* assets to worldwide assets.

Upon death of the first spouse, there also exists a marital credit under the Treaty. The credit results in an effective doubling of the prorated exemption. The marital credit is available if property passes to an N.R.N.C. in a way that would have qualified for the U.S. marital deduction. The marital credit is only available if the estate foregoes use of the marital deduction that passes to a Qualified Domestic Trust ("Q.D.O.T.").

As with the Canadian deemed disposition tax on death, the estate tax may be deferred until the death of the second-to-die of a married couple. The use of a spousal trust/marital trust with an ascertainable standard can allow the surviving spouse the ability to access income while excluding the assets of the spousal trust from his/her gross estate.

THE IMPLEMENTED PLAN

Canadian Parents

As N.R.N.C.'s, the parents will be subject to U.S. estate tax only on U.S. *situs* assets. Therefore, to avoid U.S. estate taxation, direct ownership of U.S. *situs* assets should be avoided.

Where estate tax would exist on the death of the first spouse and the exemption, even after including the marital credit, is insufficient to preclude tax, a marital deduction must be used. Since the surviving spouse is an N.R.N.C., the deferral can be obtained only through a Q.D.O.T. Clients should realize that the use of a Q.D.O.T. may limit flexibility if employed, due to various administrative/logistical requirements.

U.S. Children

Unlike the parents, the U.S. children will have their lifetime gifts taxed during life and worldwide estate taxed at death (not just their U.S. *situs* assets). A dynasty trust effective during life or at death is a trust that exists for several generations without violating a rule against perpetuities or becoming subject to a generation skipping tax. That is a transfer tax that is imposed when an individual establishes a trust for more than one generation as a means of eliminating estate tax at the level of the children in the first generation. The generation skipping tax is not imposed on the estate of an N.R.N.C individual when the transfer involves assets that are not subject to U.S. estate tax for the N.R.N.C. In other words, the generation skipping tax is not imposed when the assets are not U.S. *situs* assets.

Typically, a dynasty trust can last for a period of 100 or more years and in some states it may last forever for some or all assets. Thus, it can last for a child's lifetime, then a grandchild's lifetime, and possibly a great grandchild's lifetime without having the value of the trust included in the gross estate of any of the foregoing beneficiaries.

Design

The first step is to determine whether the Canadian parents have a possible U.S. estate tax. If they do, the estate plan should apply the Treaty pro-rated unified credit while maximizing flexibility for the client through the application of marital credit in conjunction with a marital/spousal trust. A Q.D.O.T. should remain an option, but not a certainty, in the drafting of the will and should be used only if the first spouse to die had a worldwide estate of more than twice the amount sheltered by the two applicable credit amounts, taking into account the use of death tax credits and the allowable estate tax deduction (other than the marital deduction).

Upon the death of the second spouse, the assets from the combined estate should be distributed to a separate inheritance trust for each child and descendant.

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AN INSURANCE PRIMER: DISCLOSURE AND PRODUCTION OF AN INSURER'S UNDERWRITING, CLAIMS AND INVESTIGATION FILES

By Ana Simoes, Associate, Miller Thomson LLP

Full disclosure and corresponding production of documents is normally in issue in the context of an insured's claim against its insurer for coverage and bad faith. This is important for business owners because it determines whether they will receive coverage in "unusual" circumstances.

In *Sky Solar (Canada) Ltd. v. Economical Mutual Insurance Company*,[1] Sky retained Marnoch Electrical Services Inc. (a solar energy developer) to provide and install two transformers. As a term of its contract, Marnoch had to provide certain general liability insurance, with Sky being named as an additional insured under Marnoch's policy, which had been issued by Economical Insurance. Pursuant to the policy's Additional Insured Endorsement, coverage had been afforded to Sky as an additional insured, but only for "liability arising out of the operations of the Named Insured [Marnoch]." The transformers caught fire.

As a result of the two losses, Sky claimed damages under the policy. Economical denied coverage on the basis that the loss arose from Sky's independent acts of negligence, not from "liability arising out of" Marnoch's operations. There was no coverage for Sky's loss.

Sky sued Economical (and its broker), for denial of coverage, and also claimed damages for the Defendants' breach of duties of utmost good faith and fair dealing.

During the course of the litigation, the Defendants refused to produce their underwriting, and claims and investigation files (which included the files of their internal claims adjusters) relating to the loss. Accordingly, Sky brought a motion for, *inter alia*, disclosure and production of those files.

Sky asserted that the underwriting file was critical to understanding "Marnoch's operations," which, in turn, would have a bearing on the coverage available to Sky under the policy. Economical countered that as it was not denying coverage based on the scope of Marnoch's operations but on the fact that the loss arose from Sky's independent acts of negligence (for which the policy did not provide coverage), the file was not relevant. In any event, the scope of Marnoch's operations was clearly defined on the Declarations page of the policy, so no further inquiry was necessary. It further argued that the underwriting process had nothing to do with Sky.

The Court disagreed with the Defendants, concluding that the underwriting process is important in order for an insurer to properly assess the risk, and determine the premium and the scope of coverage. Accordingly, all of the documents and information received by the Defendants in relation to the issuance of the policy were relevant to the Court's interpretation of Marnoch's operations as underwritten by Economical, to the interpretation of the policy, and to the scope of the Additional Insured Endorsement. The description of Marnoch's operations on the face of the policy did not provide an answer regarding the underwriting process as to the assessment of risk, the determination of the premium and, in this case, the determination of coverage.

The complete file was relevant and ordered to be produced, because Economical had taken an off-coverage position and had relied, in part, on the allegation that Sky's losses did not arise from Marnoch's operations.

In addition, Sky sought disclosure and production of the Defendants' claims and investigations files in respect of both failures. Sky pleaded that Economical had breached its duty of utmost good faith and had denied coverage "without conducting any adequate or competent investigation." In the Defendants' statement of defence, Economical disputed this allegation, and asserted that Economical had fully investigated the losses before concluding that the fires did not arise from Marnoch's operations.[2] Sky submitted that, as the Defendants had pleaded to having fully investigated both failures, they ought to produce the claims and investigation files.

The Defendants claimed that the files were subject to litigation privilege. In order for litigation privilege to attach, the Defendants would have had to demonstrate that (a) litigation by Sky was contemplated,[3] and (b) the documents over which privilege was sought were created for the "dominant purpose"

1 2015 ONSC 4714

2 If an allegation is pleaded, then any related evidence becomes relevant and thus producible unless privileged.

3 An insurer's investigation of an insured's loss would not be construed as anticipated litigation. The mere submission of a claim does not cast the parties in an adversarial role. It is the denial of coverage that starts the clock ticking in terms of a claim for litigation privilege: see *General Accident Assurance Company v. Chrusz*, 1999 CarswellOnt 2898 at paras. 38 and 50 (C.A.).

of litigation (a conjunctive test).[4] Sky asserted that there could be no such privilege because many of the documents had arisen before Sky had made its demand for coverage, such that the documents could not have been created for the "dominant purpose" of litigation. Furthermore, the Defendants had failed to provide a sufficient description of the documents, the circumstances of their creation, and their dominant purpose.

The Court disagreed, once again, with the Defendants. It reasoned that there were two primary claims, namely (1) coverage and (2) bad faith. In terms of the bad faith claim, a court will "look at the conduct of the insurer throughout the claims process to determine whether, in light of the circumstances as they then existed, the insurer had acted fairly and promptly in responding to the claim". Ontario courts have found that the only way that an insured can ascertain whether the coverage investigation was handled improperly and in bad faith is by the production of the insurer's and broker's internal files showing how they handled, or should have handled, the coverage request and the information available to them at the material time. This makes almost every document in the insurer's file critical and relevant to a claim of bad faith.[5]

The Court held that the issues of coverage and the duty of utmost good faith were commingled in the pleadings, and the Defendants had to produce their entire claims and investigation files prior to the denial of coverage.

What does this mean for you? When making a claim for coverage, the classic insurer's first move is to provide some parts of its file and deny the existence of an underwriting file. The next move is to assert litigation privilege. When litigation privilege is claimed, the onus is on the insurer to justify the privilege. As the *Sky* case illustrates, sweeping, vague assertions of privilege are routinely rejected by the court, on the basis that the burden of proof was not met. In the context of your claim for coverage, you should be satisfied with nothing less than an itemized list of the documents over which privilege is being claimed, including a short summary of the document, the circumstances of its creation and its dominant purpose. By reviewing the itemized list you can understand two things: (i) the information and documents your insurer had available to it in determining coverage; and, (ii) the steps your insurer undertook when making its determination for coverage, ie. was your claim handled in good faith or was it rejected outright. Obtaining this information may save you from having to retain a lawyer to perform essentially the same task–saving you money!

4 Courts have refused to accept a claim of litigation privilege over documents prepared after litigation was contemplated, in circumstances where there was no evidence that the subject documents were prepared for the dominant purpose of litigation: *Kennedy v. McKenzie*, 2005 CarswellOnt 2109 at paras. 20 and 23 (S.C.J.). Documents created for the purpose of investigation would not be protected by litigation privilege simply because there was a contemplation of a denial of coverage, and anticipated litigation to the anticipated denial: *Heasley v. Labelle*, 2013 CarswellOnt 17572 at para. 13.

5 *Royal & SunAlliance Insurance Co. of Canada v. Fiberglas Canada Inc.*, 2002 CarswellOnt 3232 at para. 16, aff'd 2002 CarswellOnt 8491 (S.C.J.). See also *Mamaca (Litigation Guardian of) v. Coseco Insurance Co.*, 2007 CarswellOnt 1828 at para. 12 (S.C.J.), aff'd 2007 CarswellOnt 8133 (S.C.J.), leave to appeal denied (S.C.J. Div. Ct.).

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GRAMIAK v. THE QUEEN: FEDERAL COURT OF APPEAL SETS THE BAR HIGH ON THE "PLAIN AND OBVIOUS" TEST

By Benjamin Mann, Student-at-Law, Miller Thomson LLP

INTRODUCTION

In a judgment delivered on February 6, 2015, the Federal Court of Appeal (the "FCA") upheld a decision dismissing a taxpayer's motion to strike portions of the Minister of Justice's pleadings. The FCA's decision, reported as *Gramiak v. The Queen*,[1] addresses the circumstances in which pleadings might be struck, but also gives an example of the way courts may treat waivers allowing the Canada Revenue Agency (the "CRA") to reassess outside its statutory reassessment period.

BACKGROUND

The Appellant, David Gramiak, was accused of carrying out an "RRSP stripping" transaction. Gramiak began his alleged strip by opening a self-directed Registered Retirement Savings Plan ("RRSP") account with Olympia Trust Company as its trustee. Then in 2002 and 2003, Gramiak removed $130,500 and $8,500, respectively.

The determination of what precisely occurred next was the root of these proceedings. The CRA originally claimed that these amounts were used to purchase non-qualifying investments for Gramiak's RRSP, specifically debenture units with PI Ventures Inc. These had a nil or nominal fair market value, but a series of subsequent transactions eventually allowed Gramiak to access the funds removed from his RRSP to purchase them.

In January 2006, the CRA sent Gramiak a Proposal Letter stating its intention to reassess him for the 2002 and 2003

1 2015 FCA 40 [*Gramiak* (FCA)].

taxation years, and obtained waivers with respect to the normal three-year reassessment period for these years. The waivers covered the normal reassessment period in respect of the income inclusion of the amounts withdrawn from the RRSP in those years, but, at the request of Gramiak and his counsel, stated that the inclusion would be in relation to the acquisition of investments not qualifying for an RRSP. The waivers specifically mentioned subsections 146(9) and 146(10) of the *Income Tax Act*[2] (the "ITA"), which would have worked to include in Gramiak's income those amounts taken from his RRSP to purchase the debentures.

By the time the CRA issued its reassessments in January 2007, the reassessment for 2002 was outside the normal reassessment period and so required a valid waiver.

Gramiak maintained that the debentures had been acquired by his RRSP up until he filed his Notice of Appeal on January 12, 2012. Therein he took the position for the first time that the debentures had not been acquired at all and that he had simply moved the funds from his RRSP to his lawyer's trust account. Therefore, no amount could be included in his income pursuant to subsections 146(9) and 146(10) and his waiver did not apply.

In response to this new argument, the Respondent Minister, in her Reply to the Notice of Appeal, raised an alternative argument under subsection 152(9) that if the RRSP had not acquired the debentures, Gramiak was nevertheless in constructive receipt of a taxable benefit in the same amounts as those reassessed, and these amounts could be included in his income pursuant to subsection 146(8).

Gramiak brought a motion to strike the paragraphs setting out this alternative argument. He took the position that the Minister could not argue that no debentures had been acquired because that argument rested on a transaction that was different from the one on which the reassessments were premised. He also argued that the alternative argument fell outside the scope of the waiver given to the CRA, and so was outside its statutory reassessment period.

The Tax Court judge denied Gramiak's motion,[3] and Gramiak appealed to the FCA.

The Test for Striking Out Pleadings

The Tax Court judge described the test applied in a motion to strike as whether it is "plain and obvious" that, and he cited multiple authorities on this point, a position has no hope of succeeding, a claim has no reasonable hope of success, a pleading discloses no reasonable cause of action or that a position contains a radical defect.[4]

He then remarked that the decision on the "plain and obvious" test should be reached "without hesitation" and "does not require lengthy deliberation" (albeit thirty paragraphs before he made his decision on its applicability here).[5] The issue was ultimately whether it was plain and obvious that the Minister was not entitled to plead the alternative argument.[6]

The FCA took issue with Tax Court judge's description of the "plain and obvious" test as not requiring lengthy deliberation or a careful analysis of the issues, agreeing with Gramiak that this suggests the judge misunderstood the applicable test. Nevertheless they noted that his actual reasons were somewhat lengthy, and that they demonstrated unequivocally that his conclusions were based on a full analysis of the issues.[7]

The FCA did not address the issue of exactly what must be "plain and obvious". As discussed, the Tax Court judge cited several examples, none of which were discussed on appeal. But the decision does clarify that judges addressing the test must still engage in a careful analysis, even if they ultimately determine that it is "plain and obvious" a motion should be granted.

Applying the "Plain and Obvious" Test

Advancing an Alternative Argument Under Section 152(9)

The Tax Court reviewed the jurisprudence, particularly *Walsh v. The Queen*,[8] and concluded that subsection 152(9) allowed the Minister to advance an alternative argument so long as the transactions underpinning it were not materially different from the ones underpinning the original reassessment.[9]

Because a transaction by which the taxpayer would have diverted funds out of his RRSP account directly was not materially different from doing so by purchasing non-qualifying debentures, the alternative argument was permissible. As the FCA stated: "the bottom line is that the appellant engaged in RRSP stripping transactions and that is the factual basis relied on by the Minister in issuing the reassessments."[10]

The FCA took a broad view of the factual basis for the reassessments, but supported this through the language of the Proposal Letter that the CRA sent to Gramiak, which referred

2 RSC 1985, c. 1 (5th Supp.).
3 *Gramiak v. The Queen*, 2013 TCC 383 [*Gramiak* (TCC)].
4 *Ibid* at paras 30-32.
5 *Ibid* at paras 33-34.
6 *Ibid* at para 37.
7 *Gramiak* (FCA), *supra* note 1 at para 31.
8 2007 FCA 222.
9 *Gramiak* (TCC), *supra* note 3 at para 44.
10 *Gramiak* (FCA), *supra* note 1 at para 37.

both to an accusation of an RRSP strip generally and the notion of sham.[11]

The Waiver

In addressing the waiver, the Tax Court judge stated that the text was not necessarily determinative, and that extrinsic evidence may also be relevant. In reviewing the Proposal Letter, the judge noted that it addressed as a concern RRSP stripping, not just an acquisition of non-qualifying debentures.[12]

Gramiak was entirely aware of the CRA's suspicions when he signed the waiver, and so the Tax Court judge decided that the matter specified therein was the income inclusions for the 2002 and 2003 taxation years. These were not limited to inclusions based on the purchase of non-qualifying debentures.[13]

The FCA was particularly concerned that it was Gramiak and his representative who convinced the CRA to limit the scope of the waiver to the debenture issue, and they did so "consciously and deliberately."[14] To allow them to now rely on the waiver's limited scope to argue that it precluded reassessment on the basis that debentures were never purchased, and that the funds were directly removed from the RRSP account, would lead to an absurd result.[15]

Having come to these conclusions, both Courts readily agreed that it was not "plain and obvious" that the Minister was not entitled to plead them.

CONCLUSION

The Court's decision in *Gramiak* seems necessary, and any other conclusion would have led to the absurd result that a taxpayer could deliberately mislead the CRA as to their tax avoidance scheme, and then rely on that misdirection to take the position that the CRA was out of time to reassess him, all at the striking pleadings stage.

Of some concern though is that both the Tax Court and FCA did more than simply decide that it was not "plain and obvious" that the Minister could not advance an alternative argument. In an extensive judgment, the Tax Court judge all but ruled that the alternative argument was entirely appropriate, and that the appellant's arguments should not only lose on the motion, but at trial. The Tax Court judge wrote 81 paragraphs and 20 pages, which the FCA seemed to suggest was appropriate. While motions judges may not have the same fact-finding opportunities as trial judges, this case suggests that they may be required to undertake the same careful analysis on a motion governed by the "plain and obvious" standard that a trial judge would in proceedings decide on a balance of probabilities.

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11 *Ibid* at para 38.
12 *Gramiak* (TCC), *supra* note 3 at para 58.
13 *Ibid* at para 67.
14 *Gramiak* (FCA), *supra* note 1 at para 46.
15 *Ibid* at para 41.

NEW RULES ON INTER-CORPORATE DIVIDENDS

By Jin Wen, Tax Manager, Grant Thornton LLP

The 2015 Federal Budget expanded the potential application of the anti-avoidance rules in subsection 55(2) of the *Income Tax Act* (Canada). This article will discuss the existing rules, the new rules and their implications on inter-corporate dividends.

THE EXISTING RULES

The anti-avoidance rules in existing subsection 55(2) target abusive transactions generally known as "capital gains stripping". In a typical scenario, a holding corporation (Holdco) owns all the outstanding shares of the operating company (Opco) and intends to sell the shares of Opco to a third party (the buyer). The Opco would first pay a tax-free inter-corporate dividend to Holdco, using funds borrowed from the buyer. This dividend would reduce Opco's fair market value (FMV) and in turn reduce any capital gains which may be realized on the disposition of the shares of Opco.

To prevent capital gains stripping, subsection 55(2) operates to re-characterize a dividend paid by Opco to Holdco as a capital gain when one of the purposes of the dividend was to significantly reduce the capital gain that would otherwise be realized on a disposition at FMV of any shares of Opco immediately before the dividend was paid. This is generally referred to as the "purpose test". For deemed dividends arising on share redemptions, acquisition or cancellation, subsection 55(2) would apply if one of the results of the deemed dividends was to significantly reduce what otherwise would be treated as a capital gain. This is generally referred to as the "result test".

The existing rules would not apply if any of the following exceptions is met:

1. A dividend is received in transactions that do not involve unrelated parties.
2. A dividend could reasonably be attributed to safe-income-on-hand (i.e., after-tax retained earnings).
3. A dividend is subject to refundable Part IV tax if the Part IV tax is refunded by paying dividends to individuals.

4. A dividend is received as part of a divisive reorganization known as "butterfly" transaction, under paragraph 55(3)(b) of the *Income Tax Act*.

THE NEW RULES AND THEIR IMPLICATIONS

Narrowed exception for related-party transactions

Under the existing rules, the related-party exception is often relied on for transactions where the Opco pays a dividend to the Holdco, which in turn lends the funds back to the Opco for asset protection and credit proofing purposes. The dividend can be a cash dividend, stock dividend, deemed dividend or a dividend-in-kind. Since there is no unrelated party involved, the inter-corporate dividend, irrespective of its type, would be tax-free.

In general, the new rules provide that the related-party exception only applies to deemed dividends arising on the windup of a corporation, or on the redemption, acquisition or cancellation of a share by a corporation. Any other inter-corporate dividend may now be deemed to be a capital gain if one of the purpose tests (discussed below) is met, even if there is no unrelated person involved. Taxpayers often rely on the related-party exception to avoid the necessity of tracking safe income. The narrowed scope of related-party exception would require taxpayers and their advisors to reconsider calculating safe income annually and alternative ways to use inter-corporate dividends to accomplish internal reorganizations and certain routine transactions.

New purpose test

Under the existing rules, subsection 55(2) would only apply to treat an inter-corporate dividend as proceeds of disposition of the shares if the purpose of the dividend was to reduce the capital gain on the shares that would otherwise arise on a disposition immediately before the dividend.

Although this test continues to apply, the new measures in the 2015 Federal Budget provide that an inter-corporate dividend (with some exceptions) would be treated as a capital gain if one of the purposes of the dividend is to:

(1) significantly reduce the FMV of any share, or

(2) significantly increase the total cost of properties of the dividend recipient.

This new "one of the purposes" test poses considerable uncertainty as far as inter-corporate dividends are concerned. Arguably, one of the purposes and consequences of every cash dividend is to reduce the FMV of the shares on which the dividend is paid. In addition, it can be argued that the purposes of every cash dividend is to effect an increase in the recipient's total tax cost of property (i.e., giving the shareholder cash without reducing their share investments). Although the reduction in FMV or increase in cost must be "significant" for the new rules to apply, the subjectivity involved as to what would constitute a "significant" reduction or increase further creates uncertainty as to how the Canada Revenue Agency (CRA) will interpret the new rules.

Stock Dividends

Under the existing rules, the amount of a stock dividend is equal to the paid-up capital (PUC) of the shares issued on the payment of the stock dividend. Since the PUC is usually a nominal amount, high-low inter-corporate stock dividends are often used to effect an estate freeze while avoiding subsection 55(2), as the amount of any taxable dividend would be nominal.

The new rules provide that the amount of stock dividend would be the greater of the PUC and the FMV of the stock dividend shares. As a result, all types of inter-corporate stock dividends would be subject to the potential application of subsection 55(2). This would limit the ability to use high-low inter-corporate stock dividends in an estate freeze.

It is of some comfort to know that the new rules on stock dividends do not apply to stock dividends paid to individuals. Certain reorganizations can still be accomplished by paying individuals high-low stock dividends as part of a series of transactions.

Safe Income

Under the existing rules, subsection 55(2) does not apply to a dividend paid out of income earned or retained by a corporation (i.e., safe income) when the dividend reduces a gain on the shares that would otherwise arise on a disposition of such shares. This is because income realized and taxed in a corporation can be distributed to another corporation without an additional layer of corporate tax.

The new rules provide that subsection 55(2) can apply where the FMV of the shares is equal to or is less than the adjusted cost base of the shares. In the meantime, since safe income can only be applied to shares with an accrued gain, no safe income can be allocated to loss shares or shares with FMV equal to the adjusted cost base. In other words, the new rules restrict the access to safe income in situations where there is no accrued gain on the shares.

Part IV Tax

Under the existing rules, subsection 55(2) would not apply if the dividend recipient is subject to Part IV tax on the dividend but receives a dividend refund by paying a dividend to an individual shareholder. This is because tax leakage would be minimized if an individual shareholder would pay personal income taxes on dividends received.

The new rules have removed the Part IV tax exception. As a result, this exception is no longer available if there is a dividend refund to the corporate dividend recipient, even if the dividend refund is a result of paying a dividend to an individual.

In summary, the proposed amendments to subsection 55(2) would pose significant challenges and uncertainty to routine transactions that include: (i) distributing excess cash from Opco to Holdco, (ii) crediting proofing by paying a dividend from Opco to Holdco, (iii) purification for capital gains exemption by paying a dividend to remove non-active assets from Opco, and (iv) paying a dividend to enable the corporate group to utilize losses.

A silver lining is that deemed dividends arising under subsection 84(2) and (3) (i.e., the windup of a corporation, the redemption, acquisition or cancellation of a share by a corporation) are still exempted from the proposed amendments to subsection 55(2). As such, consideration should be given to stock splits or reorganizations followed by the redemption of shares as alternative transactions. However, since it may not always be practical to effect such transactions, additional clarification from the Department of Finance and/or a comfort letter from the CRA regarding the particular manner in which the new rules would be interpreted would be appreciated. In the meantime, taxpayers should consult their tax advisers if they are contemplating transactions or reorganizations that involve the payment of inter-corporate dividends.

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TAX INCENTIVES FOR DONATING ART TO CHARITY

By Tina Tehranchian, Senior Financial Planner and Branch Manager, Assante Capital Management Ltd.

Some works of art may hold personal or emotional value for the owner but some artwork has cultural significance to Canadians. For this reason, the Canadian government has established the Canadian Cultural Property Export Review Board (the "Board") to certify artwork or other items of cultural value to Canadians.

When you sell a work of art you have to pay capital gains taxes on proceeds of sale minus your cost. When you gift it, from a tax perspective a deemed disposition or sale at market value occurs. The proceeds of disposition or fair market value of the object minus your cost would be considered capital gains and 50% of that gain would be included in your income in the year when the gift is made and you would have to pay tax on it based on your highest marginal tax rate.

If you own a work of art or item that is certified by the Board and you donate it to a designated institution, there would be no tax payable on the disposition.

Institutions are categorized as Category A or B institutions. Category A designated institutions are institutions that meet all relevant criteria with regards to legal, curatorial and environmental requirements.

Category B is granted to institutions that are involved in the acquisition of an object or collection, which do not meet all the criteria for designation but have demonstrated their capability to effectively preserve and care for the specific property for which certification is desired.

If you own an asset which is certified by the Canadian Cultural Property Export Review Board as "certified cultural property", and you donate it to a designated institution, you will not have to pay any tax on the gift. In addition, you will be entitled to a tax receipt for the full value of the gift as determined by the Board.

For example, let's say Lucy owns a Lawren Harris painting that she purchased in 1960 for $100,000. Knowing that this painting has significant cultural value, she asks the Canadian Cultural Property Export Review Board to assess it. The Board conducts an assessment and determines that the painting has indeed significant cultural value and has a fair market value of $1,100,000.

Lucy decides to donate the painting to her favourite charity that happens to be a hospital and notifies the charity of her intention. The charity is thrilled but they let Lucy know that they do not have "designated institution" status. Lucy considers the tax consequence of her donation to a designated institution versus one without that status, taking into account that the capital gains would be taxed at 24.76% or 50% of her highest combined (federal and provincial) marginal tax rate of 49.53% in her home province of Ontario:

	Charity A	Charity B (designated institution)
Proceeds of Disposition	$1,100,000	$1,100,000
Cost Base	$100,000	$100,000
Capital gain	$1,000,000	$1,000,000
Taxes owing	$247,650	$0
Tax Credit	$544,830	$544,830
Net Taxes	$0	$0
Leftover Credit	$297,180	$544,830

Once Lucy realizes that if she makes a gift to a charity that is not a "designated institution", she would have to pay $247,650 tax on her gift, she contacts another charity which is an art museum and qualifies as a designated institution. By making a donation to a designated institution, she would have no net taxes to pay and would also end up with a leftover tax credit of $544,830.

Clearly, Lucy has an incentive to make the gift to a designated institution. This was designed to motivate Canadians to make gifts of cultural property to institutions that would ensure the preservation and proper care of significant Canadian art and cultural objects. The same rules apply to bequests and gifts made by will.

In recent years Canada Revenue Agency (CRA) has been clamping down on all sorts of donation schemes, including tax shelter gifting arrangements involving donation of art. These tax shelters typically provide a tax receipt for an amount larger than the cash investment of the donor/investor and use various approaches such as buy-low, donate-high arrangements, gifting trust schemes and leveraged cash donations. Until recently, certified cultural property was exempt from the rule that donated property acquired as part of a tax shelter gifting arrangement has a value no greater than the price paid for it by the donor. This exemption was removed as a result of Budget 2014. Therefore, any donation of certified cultural property that is made on or after February 2014, where the property was acquired as part of a tax shelter gifting arrangement will no longer be exempt and will be subject to this rule.

You should seek the advice of qualified tax and financial planning professionals before you make a gift of cultural property or include it in your will and estate planning to ensure that you maximize your tax benefits.

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KEEPING UP WITH REPORTING OBLIGATIONS, ROUND ONE: EXCHANGE OF FATCA INFORMATION LEGALLY AUTHORIZED IN CANADA

By Raquiya Austin, Student-at-Law, Miller Thomson LLP

INTRODUCTION

On September 16, 2015, the Federal Court held that the collection and automatic disclosure of account holder information to the United States (U.S.) is legally authorized pursuant to the *Canada-United States Enhanced Tax Information Exchange Agreement Implementation Act* ("*IGA*").[1] The Court's decision in *Hillis et al v The Attorney General of Canada* ("*Hillis*")[2] is the first case of its kind, in Canada, to uphold the exchange of information under the U.S. *Foreign Account Tax Compliance Act*[3] ("FATCA"). The decision has significant implications for an estimated 750,000 to 2 million residents, also U.S. nationals, who must comply with Canadian and U.S. reporting obligations. The injunctive relief sought by the plaintiffs was denied; however, it remains open to the plaintiffs to pursue their constitutional arguments at a later time. In the interim, it remains to be seen how future constitutional remedies, if any, will affect those persons who are now subject to disclosure of their account information and the corresponding tax liability that may result from such disclosure.

THE BACKGROUND FACTS AND ARGUMENTS

Virginia Hillis and Gwendolyn Louis Deegan are both residents of Canada who possess U.S. citizenship. While both women have retained their dual citizenship, neither plaintiff has a significant economic connection to the U.S. On August 11, 2014, the plaintiffs filed a claim seeking a declaration that the *IGA* as well as sections 263 to 269 of the *Income Tax Act* ("*ITA*"),[4] hereinafter referred to as the "impugned provisions," contravened the *Charter of Rights and Freedoms* ("*Charter*"). On October 9, 2014, the plaintiffs filed an amended statement of claim adding in non-constitutional arguments challenging the legality of the disclosure of personal information of U.S. persons collected for the year 2014 by Canadian financial institutions and the Canadian Revenue Agency ("CRA"). The plaintiffs base their objection on three main points:

1 S.C. 2014, c. 20, s.99.
2 2015 FC 1082.
3 26 USC § 6038D.
4 R.S.C. 1985, c. 1 (5th Supp.).

1. First, the plaintiffs argued that, pursuant to the *Convention between the United States and Canada with Respect to Taxes on Income and Capital* ("Canada-U.S. Tax Treaty"), Canada should not provide the U.S. with assistance in the collection of revenue claims to the extent that the taxpayer was a Canadian citizen at the time that the claim arose;[5]

2. Second, the plaintiffs argued that the CRA should not rely and be satisfied that the account holder information collected by the reporting institutions on U.S. persons is authorized by the terms by the *IGA*;[6] and

3. Lastly, the collection and disclosure of the taxpayer information contemplated by the *IGA* is more onerous than the taxation requirements of those who are resident in Canada. In addition the prohibition in section 241 of the *ITA*, subject to exceptions, prohibits officials or government agencies from providing taxpayer information to any person.[7]

The Minister of National Revenue and the Attorney General of Canada defended the action. They argued that the collection of relevant information authorized by the IGA, and its disclosure to the IRS is not inconsistent with the Canada- U.S. Tax Treaty or in violation of section 241 of the *ITA.*

EFFECTS OF THE IMPUGNED PROVISIONS

In 2014, the Canadian and U.S. governments concluded the intergovernmental agreement. The purpose of the agreement was to impose an obligation between the governments to obtain and exchange information in respect of reportable accounts. Specifically, Article 2 of the *IGA* imposes a reciprocal obligation on each party and requires both the U.S. and Canadian governments to collect account holder information about accounts in both Canadian and U.S. reporting financial institutions. In Canada, Part XVIII of the *ITA*, subsections 263-269, codifies a financial institution's obligation to implement the due diligence procedures outlined in the *IGA*.

As part of their due diligence, Canadian financial institutions are required to search their account records to determine whether any account holder falls within the definition of a 'U.S. person.' Once the reportable account has been determined, the financial institution is required to collect particulars with respect to each account. The reporting institution must annually file the prescribed information with the CRA relating to each reportable account held with the financial institutions. The CRA is then responsible for turning the information over to the Internal Revenue Service ("IRS").

5 *Supra* note 2 at para. 57.
6 *Ibid* at para. 59.
7 *Ibid* at para. 62.

THE DECISION

The decision focuses mainly on the practical implications of reporting taxable income and places little significance on the factors that define the plaintiffs' U.S. citizenship. Justice Martineau acknowledges that while the reporting obligations mandated by the U.S. government and the provisions at issue may be 'harsh'[8], they are the law. U.S. citizens, regardless of their residency status, are subject to reporting obligations imposed under *FATCA*. In 2010, *FATCA* came into force legislating the information reporting of foreign financial institutions holding reportable accounts held by U.S. Citizens. Failure to comply with the obligations imposed by *FATCA* attracts a variety of severe penalties. Notably, foreign financial institutions are subject to a 30% withholding tax for failure to comply. While the decision does point to the scope of *FATCA*s' reach, the Court is careful not to criticize the U.S. tax regime.

Further, Justice Martineau was unconvinced by the plaintiffs' narrow interpretations of the impugned provisions. He stated that the authority to obtain and exchange information on the basis set out in the *IGA* derives authorization from the Canada-U.S. tax treaty. In addition, provisions of the IGA have force in Canadian law, and sections 266-269 of the *ITA* codify the obligations imposed on financial institutions. In finding this, the Court was clear that the *IGA* is explicit in its application and the intention between the contracting governments are clear: "they agree to obtain and exchange annually on an automatic basis all relevant information respecting reportable accounts subject to … Canada-U.S. Tax Treaty."[9] Ultimately, the Court was satisfied that as a lawfully enacted regime, the *IGA* extends *FATCA*'s scope north of the border in a manner that is both consistent with the Canada-U.S. tax treaty and the *ITA.*

In his closing remarks, Justice Martineau held that there were no remedies available at this level of Court that would allow for a determination that the impugned provisions are held to be *ultra vires* or inoperative. However, he stated:

> [77] The declaratory and injunctive relief requested by the plaintiffs in their motion for summary judgment shall be denied by the Court, without prejudice to the plaintiffs' right to pursue their claim that the impugned provisions are *ultra vires* or inoperative because they are unconstitutional or otherwise unjustifiably infringe *Charter* rights.[10]

ANALYSIS

In an age where information sharing has become the norm, it is not surprising that the Canadian government has entered into

8 *Ibid* at para 45.
9 *Ibid* at para 67.
10 *Ibid* at para 77.

agreements like the *IGA* to identify and exchange information across boards. FATCA has a broad scope and "is now the law of land."[11] With the timely release of this decision, one can assume that the automatic transfer of account information to the IRS has already taken place. Unfortunately, the concerns of those in similar positions as the plaintiffs remain at odds with the Legislature. Among these concerns is the exposure to tax liability. There is little guarantee that Canadian financial institutions will be required to give notice to account holders; as a result, it may come as a surprise to taxpayers who are exposed to U.S. tax liability.

It remains to be seen what, if anything, will happen once the constitutional questions have been decided. This decision is problematic because a number of Canadian residents are presently subjected to the disclosure of reportable account information and exposed to the corresponding liability. Those affected have to 'wait and see' what resolution future constitutional remedies may provide.

In light of the *Hillis* decision, dual citizens should not be so quick to relinquish their citizenship as the decision is likely to move onto round two! *Hillis* affirms the legality of the impugned provisions, but the Court's decision leaves open to the plaintiffs their right to pursue a claim challenging the constitutionality of the impugned provisions. So for now, we wait!

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11 *Ibid* at para 45.