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US PARENT CORPORATIONS SENDING EMPLOYEES TO QUEBEC

— Emmanuel Sala, Partner, Dentons Canada LLP, Montreal

It is not uncommon today for employees of multinational corporations to be called upon to carry out duties in foreign countries. While cross-border transfers of employees may, from many standpoints, largely benefit corporations, executives must be made aware and remain alert about the legal responsibilities which can arise from transferring employees to foreign countries. This article aims to clarify the Canadian and Quebec fiscal rules and mechanisms governing US parent corporations with US employees employed in Canada.

Generally speaking, every person who is a non-resident of Canada is liable for income tax in Canada if he or she is employed in Canada, carries on a business in Canada, or disposes of a "taxable Canadian property".[1]

With that being said, provided that a US parent corporation has no "permanent establishment" ("PE") in Canada, within its meaning under *The Convention between Canada and the United States of America with respect to Taxes on Income and on Capital*[2] ("Treaty"), it is generally not subject to any Canadian federal or Quebec provincial income and payroll (if waivers are obtained) tax obligations in Canada, apart from the filing of a Canadian federal treaty-based return.

Canadian Federal and Quebec Provincial Payroll Tax Obligations

Federal

US parent corporations are required to withhold, remit, and report to the Receiver General for Canada, within the prescribed time and manner, Canadian federal income tax deducted at source from the salary, wages, or other remuneration paid to US employees employed in Canada ("Federal Income Tax Source Deductions").[3]

In addition, all US parent corporations, including those which have obtained a waiver of the Federal Income Tax Source Deductions,[4] must file an information return in prescribed form.[5]

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[1] *Income Tax Act*, RSC 1985, c.1, s. 2(3) (5th supplement), as amended ("**ITA**").

[2] *The Convention between Canada and the United States of America with respect to Taxes on Income and on Capital*, signed at Washington, DC on September 26, 1980, as amended by the protocols signed on June 14, 1983, March 28, 1984, March 17, 1995, July 29, 1997, and September 21, 2007.

[3] ITA, s. 153(1); *Income Tax Regulations*, CRC, c 945, ss. 100 and 101, as amended ("**ITR**").

[4] CRA Information Circular, 75-6R2 — Required Withholding from Amounts Paid to Non-Residents Providing Services in Canada, February 23, 2005.

[5] Pursuant to subsection 205(1) and section 209 of the ITR, two copies of the T4 Slip, Statement of Remuneration Paid, should be remitted to any employee who has performed services in Canada during a particular calendar year before the end of February of the following calendar year. Form T4Summ, Summary of Remuneration Paid, together with the related T4 slips, should also be filed with the CRA within the same time frame.

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Waivers of Federal Income Tax Source Deductions may be obtained where the non-resident employees' remuneration is exempt from income tax in Canada by virtue of Article XV(2)(a) of the Treaty ("XV(2)(a) Treaty Relief") or Article XV(2)(b) of the Treaty ("XV(2)(b) Treaty Relief").

Under the Treaty, the salaries, wages, and other remuneration of US residents are only taxable in the US, unless they are derived from employment in Canada. Accordingly, the remuneration of a US resident derived specifically from work carried out in Canada is, generally speaking, subject to Canadian income tax.[6] The allocation of employment income of non-resident employees is, for the purposes of Canadian federal income taxation, generally calculated on a *per diem* basis.

In relation to the specific factual situation addressed in this article, Article XV(2) of the Treaty should read as follows:

> [...] remuneration derived by a US Employee in respect of an employment exercised in Canada shall be taxable only in the US if:
>
> a) such remuneration does not exceed C$10,000; or
>
> b) the US Employee is present in Canada for a period or periods not exceeding in the aggregate 183 days in any 12-month period commencing or ending in the fiscal year concerned, and the remuneration is not paid by, or on behalf of, a person who is a resident of Canada and is not borne by a permanent establishment in Canada.

Article XV(2)(b) of the Treaty refers to remuneration paid by or on behalf of a "person". While the Treaty does not expressly indicate to whom such a person refers, the Canada Revenue Agency ("CRA") is of the view that, for the purpose of these provisions, it means the person exercising the functions of employer.[7]

The CRA issued the following statement with respect to the notion of "true employer":

> However, in order for the exemption in subparagraph 2(b) of Article XV of the Treaty to apply, the facts present must support the conclusion that the true and only employer of the Employee both in substance and in form is the US resident and not a Canco.[8]

Waivers may be obtained by completing and filing with the CRA, 30 days before either the start of the employment services in Canada or the initial payment of the remuneration, one of the following waiver applications, as applicable, together with the supporting documentation:

- Form R102J, Regulation 102 Waiver Application — Joint Employer/ Employee, if the employee and the employer are seeking to obtain a waiver under the XV(2)(a) Treaty Relief; or
- Form RI02R, Regulation 102 Waiver Application, if the employee (or the employer with the employee's authorization) is seeking to obtain a waiver under the XV(2)(b) Treaty Relief.

In addition, for identification purposes, Individual Tax Numbers should be obtained by completing and filing Form T1261, Application for a Canada Revenue Agency Individual Tax Number (ITN) for Non-Residents, with the CRA.

Waiver applications relying on XV(2)(b) Treaty Relief may be made after the start of payments. However, should a waiver be granted by the CRA, it would only apply to payments made after it is issued.[9]

In certain circumstances, XV(2)(a) Treaty Relief waivers may be issued retroactively (with effect before the date of the application of the waiver). However, under no circumstances can this retroactivity apply more than 60 days prior to the date on which the fully-completed waiver application was received by the CRA.[10]

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[6] *Supra* note 2, s. XV(1).

[7] CRA Doc. 2008-0300571C6 — Protocol — Changes to Article 15(2)(b), December 9, 2008.

[8] CRA, Technical Interpretation, 2011-0418281E5 — Employment income treaty exemption, January 23, 2012.

[9] Information Circular 75-6R2 — Required Withholding from Amounts Paid to Non-Residents Providing Services in Canada, February 23, 2005, para 89.

[10] CRA, Technical Interpretation, 2010 05 14 — Treaty-based waivers involving Regulation 102 withholding, May 14, 2010

Where a waiver application is approved, the CRA issues a letter to both the employee and the employer releasing the employer from its obligation to carry out Federal Income Tax Source Deductions.

In short, subject to the new legislative exemptions discussed hereinafter, absent a waiver, all US corporations must comply with the Canadian federal withholding, remitting, and reporting obligations.

With that being said, we should highlight the fact that the 2015 federal budget proposed new exemptions to the withholding, reporting, and remittance tax obligations for payments made to "qualifying non-resident employees" by "qualifying non-resident employers".[11]

Pursuant to these new rules, a US corporation can qualify as a "qualifying non-resident employer" where (1) it does not carry on business in Canada through a PE during the fiscal period, including the time of payment, and (2) it is certified by the Minister of National Revenue to that end.[12]

On the other hand, a US employee assigned to work in Canada can qualify as a "qualifying non-resident employee" where (1) the employee is eligible for XV(2)(a) Treaty Relief or XV(2)(b) Treaty Relief, and (2) the employee is not present[13] in Canada for 90 or more days in any 12 month period, including the time of payment.[14]

A US employee assigned to work in Canada could also qualify as a "qualifying non-resident employee" where (1) he or she is exempt from paying Canadian income tax pursuant to the Treaty, and (2) he or she works[15] in Canada for less than 45 days in the calendar year, including the time of payment.

These new rules greatly benefit corporations that do not have a PE under the Treaty and send employees on temporary assignments to Canada, given that, under such rules, they do not need to apply for waivers for each employee entering Canada.

Should it be determined that a US parent corporation has a PE in Canada, not only would the business profits attributable to the PE be subject to Canadian federal income tax, but relief under both the waiver procedure and the legislative exemption with respect to Federal Income Tax Source Deductions would become unavailable.

Giving the significance of the concept of PEs under Canadian fiscal legislation, often the true catalyst in determining whether US parent corporations have compliance obligations in Canada, we shall review the most common situations from which they arise.

Fixed Base PE

Under the Treaty, a PE means, *inter alia*, a fixed place of business through which the non-resident wholly or partly carries on its business.

Generally speaking, determining whether a US corporation has a Fixed Base PE in Canada will mean evaluating the extent and degree of control exercised by the US corporation over the premises used for its business activities in Canada.

Control may stem from rights of entry or occupancy.[16] It may also arise where US executives of a US parent corporation have day-to-day unrestricted access to the offices of a Canadian affiliate. Ultimately, from the CRA's

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[11] Bill C-15, *Budget Implementation Act, 2016, No. 1, An Act to implement certain provisions of the budget tabled on Parliament on March 22, 2016 and other measures*, which introduced these measures, was given its first reading in the House of Commons of Canada on April 20, 2016. The amendments it proposes would only apply to payments made after 2015.

[12] ITA, *supra* note 1, proposed s 153(6) and s 153(7); Form RC473 — Application for Non-Resident Employer Certification.

[13] The computation of the number of days present in Canada is based in part upon the OECD commentary "days of physical presence" method and includes any day during which the employee is present in Canada, even if the employee is only present for a portion of the day.

[14] ITA, *supra* note 1, proposed s. 153(6).

[15] The days worked in Canada include only days during which the employee is physically present in Canada and paid by his or her employer for the time spent in Canada, which generally excludes weekends, days off, and holidays.

[16] *Dudney v. The Queen*, 2000 DTC 6169 (FCA), affirming 99 DTC 127 (TCC).

standpoint, a Fixed Base PE exists where office space is made available to the US employees of a non-resident parent company, irrespective of whether it is made on a temporary basis (such as for the duration of an employee's particular trip to Canada).

Agency PE

A PE may also stem from the presence in Canada of agents (including executives or other employees of a US company) who have the authority to conclude contracts in Canada in the name of the US parent corporation.[17] It should therefore be understood that a US parent corporation, while not exercising its activities from a physical establishment in Canada *per se*, could nonetheless be considered as having a PE in Canada, namely an Agency PE. Put simply, headquarters and places of business are not the only factors in determining whether a US parent corporation has a PE in Canada.

Construction Site PE

Large-scale construction projects and infrastructure projects, wholly or partially carried out by US corporations, often entail the presence of a Construction Site PE in Canada. By way of illustration, these projects typically involve excavation and dredging activities, as well as the laying of pipelines, and often concern the construction of roads and bridges along with canals.

However, only projects that extend over a period of more than 12 months constitute Construction Site PEs for Canadian federal income tax purposes.

In addition, the commentary to the *OECD Model Tax Convention on Income and on Capital*[18] provides that a US subcontractor may be considered as having a Construction Site PE if his activities in Canada extend over a period exceeding twelve months. This suggests that ownership of the construction or the project site is not decisive in determining whether a US corporation has a Construction Site PE in Canada.

Furthermore, only services rendered on the construction site itself should be taken into account. For the CRA, such services would include on-site planning and supervising activities, even if they constitute the sole activity of the enterprise.[19]

Ultimately, to avoid Construction Site PE taxation, subject to entering into a secondment agreement (the conditions of which are more wholly described below),[20] US corporations should restrict the amount of work being carried out by US employees and subcontractors on Canadian construction sites.[21]

Finally, it should be noted that where a US parent corporation meets the criteria set out for both the Construction Site PE and the Service PE (discussed below), it is considered to have a Construction Site PE since its application supersedes the Service PE's application.

Service PE

A US parent corporation may be deemed to have a Service PE in Canada under the Treaty if its US employees and, in certain circumstances, its subcontractors enter Canada to provide services to its Canadian subsidiary:

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[17] *Supra* note 2, s. V(5).

[18] Condensed Version, 22 July 2010.

[19] CRA Views, Interpretation — Internal 2013-0475161I7 — Whether USCo has a permanent establishment in Canada, February 25, 2014.

[20] 2009-0319951I7, Article 15 and definition of permanent establishment, January 25, 2010. In this interpretation, the CRA expressly mentioned that its analysis applied only to employees who have not been seconded to the Canadian affiliates. By contrast, we are of the view that the employees under a secondment arrangement should not be considered in the determination of a Construction Site PE.

[21] Revenu Quebec Interpretation, IMP. 12-1/R3, Establishment of a Taxpayer, August 31st, 2005, para 25.

> where an enterprise of a Contracting State provides services in the other Contracting State [...] that enterprise shall be deemed to provide those services through a permanent establishment in that other State if and only if [...] the services are provided in that other State for an aggregate of 183 days or more[22] in any twelve-month period with respect to the same or connected project for customers who are either residents of that other State or who maintain a permanent establishment in that other State and the services are provided in respect of that permanent establishment.[23]

Under the Service PE rules, a US parent corporation is considered as having a PE in Canada if the services it provides on Canadian soil in connection with one project, through one or many of its US employees, exceed 183 days in any 12-month period.[24] However, as indicated earlier, the criteria pertaining to Construction Site PEs override those of Service PEs,[25] such that only services rendered in Canada outside the Construction Site PE ought to be considered in determining whether a US parent corporation also has a Service PE in Canada.[26]

In other words, if a US parent corporation has employees or agents (such as directors) on assignment in Canada in consideration of one specific project for more than 183 days[27] in a 365-day period, excluding the days on which the US employees, agents, or subcontractors render services on a Construction Site PE, it is deemed also to have a Service PE, and all profits attributable to that PE are taxable in Canada.

It is worth mentioning that if a US parent corporation sends several individuals simultaneously to provide services to a Canadian subsidiary located in the province of Quebec, their collective presence during one calendar day accounts for only one day of the US parent corporation's presence in Canada.[28]

Furthermore, the CRA is of the opinion that the days on which non-resident subcontractors provide services should also be considered in the Service PE 183-day threshold.[29]

Finally, although the Technical Explanation to the Treaty mentions that the Service PE provisions only apply to those services rendered for third parties, the CRA may consider a related party as being a "third party" under certain circumstances. If such is the case, the services it renders to that related party must be considered and could give rise to Service PE issues.[30]

Quebec

A person who at any time during a particular taxation year pays, allocates, grants, or awards a salary or wage or other remuneration to an employee must withhold and remit to the Quebec Revenue Agency an amount on account of the income tax payable by the employee for the particular taxation year, according to the prescribed terms and conditions[31] ("Quebec Income Tax Source Deduction").[32]

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[22] According to the Technical Explanation to the Treaty (TE2008-US-Canada), non-working days such as weekends or holidays would not count in determining whether or not the 183-days threshold is met, as long as no services are actually being provided in the foreign country on those days.

[23] *Supra* note 2, s. V(9)(b).

[24] *Supra* note 2, s. V(9)(b). The Service PE provisions seek to prevent US taxpayers from relying on the Federal Court of Appeal decision in *The Queen v. William A. Dudney*.

[25] *Supra* note 19.

[26] *Supra* note 20.

[27] Non-working days such as weekends or holidays would not count for purposes of subparagraph V(9)(b) of the Treaty, as long as no services are actually being provided while in Canada on those days.

[28] Technical Explanation to the Treaty (TE2008-US-Canada).

[29] 2013-0475161I7 — Whether USCo has a permanent establishment in Canada, February 25, 2014; 2010-0391541E5; Article V:9 of the Canada-US Tax Convention, April 13, 2011; 2011-0426591C6 — Deemed services permanent establishment, November 28, 2011

[30] CRA Doc. 2009-0319441C6 — Article V(9)(b) of the Canada-U.S. Treaty, August 5, 2009; CRA Doc 2009 0315151C6 — Canada U.S. Treaty XXIX-A:3 "customers", September 28, 2009; CRA Doc 2008-0300941C6 — Sub 9(b) of Article V of the Canada-US Treaty, December 9, 2008.

[31] *Regulation respecting the Taxation Act*, c. I-3, r. 1, s. 1015R and following ("QTA Regulation").

[32] QTA Regulation, *supra* note 31, s. 1015(a).

Every person who allocates, grants, or awards a salary or wage or other remuneration to an employee during a particular year must also file the returns and forms[33] prescribed under the QTA Regulation.[34] Much like Canadian federal income tax legislation, the term "employer" is very broad.[35] Therefore, the facts do not necessarily need to support the idea that he is the true employer of the employee, both in substance and in form.

That being said, the US corporation must have an "establishment"[36] in the Province of Quebec to be liable for:

(i) Quebec Income Tax Source Deductions obligations under QTA,

(ii) employees' source deductions obligations under *An Act Respecting the Quebec Pension Plan*[37] ("QPP Act") and *An Act Respecting the Quebec Parental Insurance Plan*[38] ("QPIP Act"), and

(iii) employer contribution obligations under the QPP Act, the QPIP Act, *An Act respecting the Régie de l'assurance maladie du Québec*[39] ("HSF Act"), *An Act to promote workforce skills development and recognition*,[40] *An Act respecting labour standards*,[41] and *An Act respecting industrial accidents and occupational diseases*.[42]

The concepts of the Service PE and the Construction Site PE do not exist under Quebec provincial income tax legislation. However, it should be noted that Quebec legislation does contain provisions with concepts similar to those of the Fixed-Base PE and the Agency PE.

In addition, a US corporation may have an "establishment" in Quebec where its employees use substantial machinery or material in a particular place at a particular time.[43] The determination as to whether this use of machinery constitutes an "establishment" is based on the quantity and type of property used by the taxpayer in its business. In certain fields, such as construction, the use of a substantial quantity of machinery or material is generally obvious, whereas in other industries it might not be.

A nonresident employer, which has no "establishment" in the Province of Quebec, is generally not required to make any Quebec Income Tax Source Deductions in respect of the salary or wages or other remuneration paid to its employees.[44]

Implementation of a Secondment Arrangement

US parent corporations may consider implementing secondment arrangements with the US employees and officers they assign to Canada (hereinafter collectively referred to as "Seconded Employees"). Such an agreement would have the

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[33] Form RLZ 1.s — Summary of Source Deductions and Employer Contributions, together with the related form RL 1 slip — Employment and other income — should be filed with the Quebec Revenue Agency on or before the last day of February of the following year. An RL 1 Slip shall be remitted to each employee, who performed services in Quebec during a particular calendar year, before the end of February of the following calendar year.

[34] QTA regulation, *supra* note 31, s. 1086R1.

[35] *Taxation Act*, RSQ., c. I-3. ("QTA"), s. 1.

[36] The term "establishment" has a similar meaning to that ascribed to it under the Treaty. The concepts of "Service PE" and "Construction Site PE" do not exist under Quebec income tax legislation.

[37] CQLR, c. R-9.

[38] CQLR, c. A-29.011.

[39] CQLR, c. R 5.

[40] CQLR, c. D-8.3.

[41] CQLR, c. N 1.1.

[42] CQLR, c. A-3.001; Premiums and contributions to the *Commission de la santé et de la sécurité du travail* are not administered by the Quebec Revenue Agency.

[43] *Supra* note 35, s. 15.

[44] *Supra* note 35, ss. 2 and 1015; Interpretation Letter 89-010684, February 14, 1990; Revenu Quebec Interpretation, IMP. 1015 1/R1, Deduction at Source in Respect of a Salary, Wages or Commission, July 31st, 1990.

effect of mitigating the risk of having a PE in Canada, given that the services provided by the US Seconded Employees may no longer be considered for the purposes of determining whether the US parent corporation has a Fixed Base PE, a Construction Site PE, or a Service PE in Canada.[45] Put simply, the work performed by the seconded employees is taken out of the equation altogether.

Properly structured secondment arrangements may also serve to track the work performed by senior executives. For example, an individual could be an officer of the US parent corporation while in the US, and an officer of the Canadian subsidiary when performing services in Canada.

That being said, we should clarify that where an individual employed by a US parent corporation is assigned to a Canadian subsidiary, and where the costs attributable to this individual are borne by the Canadian subsidiary, be it directly or indirectly, the latter is deemed by the CRA to be the employer of the US employee for the purposes of the Treaty.

As a result, unless the employee is able to prove otherwise, XV(2)(b) Relief is not available and Canadian income tax must be levied on the employee's earnings.

Finally, we should mention that for the CRA, a US employee who receives remuneration from his US employer (the US parent corporation) may also be considered an employee of the Canadian subsidiary when working in Canada for the purposes of XV(2)(b) of the Treaty. If such is the case, the XV(2)(b) Relief becomes unavailable to the employee, seeing that remuneration is in fact borne by a Canadian company.[46]

A number of tax lawyers from Dentons Canada LLP write commentary for Wolters Kluwer's Canadian Tax Reporter *and sit on its Editorial Board as well as on the Editorial Board for Wolters Kluwer's* Income Tax Act with Regulations, Annotated. *Dentons Canada lawyers also write the commentary for Wolters Kluwer's* Federal Tax Practice *reporter and the summaries for Wolters Kluwer's* Window on Canadian Tax. *Dentons Canada lawyers wrote the commentary for* Canada–U.S. Tax Treaty: A Practical Interpretation *and have authored other books published by Wolters Kluwer:* Canadian Transfer Pricing *(2nd Edition, 2011);* Federal Tax Practice*;* Charities, Non-Profits, and Philanthropy under the Income Tax Act*; and* Corporation Capital Tax in Canada. *Tony Schweitzer, a Tax Partner with the Toronto office of Dentons Canada LLP and a member of the Editorial Board of Wolters Kluwer's* Canadian Tax Reporter*, is the editor of the firm's regular monthly feature articles appearing in* Tax Topics.

CURRENT ITEMS OF INTEREST

Canada Signs Country-by-Country Reporting Agreement

On May 13, 2016, the Minister of National Revenue announced that she has signed the *Multilateral Competent Authority Agreement* ("MCAA") on country-by-country reporting. This is a further step towards implementing the government-endorsed action areas of the BEPS Project.Country-by-country reporting will require multinational businesses with aggregate revenue of a750 million (approximately C$1.1 billion) or more to provide a country-by-country report of key financial data for each jurisdiction in which they do business. This data will then be shared among tax treaty partners who have also implemented the reporting standard. 31 jurisdictions in addition to Canada have signed the agreement.

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[45] 2013-0475161I7 — Whether USCo has a permanent establishment in Canada, February 25, 2014; ITTN-44 — Income Tax Technical News, April 14, 2011.

[46] CRA Document ACC9672 — Meaning of "borne by an employer" of the other contracting state in applying subparagraph 2(b) of Article XV of the Canada-United States Income Tax Convention, September 1990; 2011-0418281E5 — Employment income treaty exemption, January 23, 2012; 2011-0403551E5 — Management services agreement, July 15, 2011.

Topical News Briefing: Continuity Canada: Flying The Free Trade Flag

by the Global Tax Weekly Editorial Team

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Canada has sometimes been criticized for not being quite as "low-tax" as it claims to be, despite having one of the lowest rates of corporate tax in the G20. But if there is one thing that it can't be accused of, it is protectionism; Canada's commitment to free trade seems to have survived the recent change in government after the Liberal Party soundly defeated the Conservatives last year.

Canada currently has 14 free trade agreements ("FTAs") in force, including with some key emerging economies. These include the agreements with South Korea, Honduras, Panama, Jordan, Colombia, Peru, Costa Rica, Chile, Israel, the European Free trade Association ("EFTA"— Iceland, Liechtenstein, Norway, and Switzerland), [and] Mexico and the United States under the auspices of NAFTA. However, its recently concluded and ongoing negotiations indicate a country with an ambitious free trade agenda. Concluded agreements include those with the EU, the Trans-Pacific Partnership, and Ukraine. Negotiations are ongoing with the Caribbean Community; Guatemala, Nicaragua, and El Salvador; the Dominican Republic; India; Japan; Morocco; and Singapore.

Continuity of this trade policy has been evidenced by some recent developments. Probably the most significant of these was the announcement by Canada's Minister of International Trade, Chrystia Freeland, that signing the FTA with the EU is a "top priority" for the Government this year — an FTA that was successfully negotiated by the previous Conservative administration. This agreement will ensure that the majority of duties on bilateral trade will be eliminated as soon as the agreement enters into force. By the end of the transitional period, Canada and the EU will liberalize 92.8 percent and 93.5 percent of trade lines in agriculture, respectively.

In other recent developments, the Canadian Government has also conducted exploratory talks with representatives of EFTA to expand their existing FTA — again, another agreement that was concluded and signed under the Conservatives. Canada also signed an investment promotion and protection agreement with Hong Kong in February, under which each government is committed to provide investors of the other side with a fair, equitable, and non-discriminatory treatment of investments, compensation for the expropriation of investments, and a right to free transfers abroad of investments and returns.

The Liberal Government has also carried the baton passed by the former Harper administration in other areas too. Periodically, Canada has introduced tariff relief for various economic sectors. For instance, in 2012, late Finance Minister Jim Flaherty announced the elimination of customs duties on a number of products used by Canadian manufacturers. Then, in April 2014, tariffs were removed on baby clothing and certain sports equipment. The incumbent government seems to be carrying on this tradition, having announced in April 2016 a public consultation on eliminating import tariffs on food production inputs.

The same cannot be said in other areas of tax policy. The Liberals have postponed a proposed cut in the small business corporate tax rate, and have increased the rate of tax for those with high incomes. However, for those Canadian firms trading goods and services in key foreign markets, things should continue to improve.

RECENT CASES

Commission income earned by company, not by taxpayer personally

The taxpayer was a retired businessman who became involved in a multi-level marketing or pyramid scheme through a company known as Treasure Traders International ("TTI"). The minister alleged that the taxpayer had received $21,000 in commission income during the 2004 taxation year in connection with such scheme, and that he had failed to report that income. The taxpayer was reassessed accordingly and gross negligence penalties were imposed. The taxpayer appealed from that assessment, on the basis that any income earned during 2004 from the scheme was earned by his company and not by him personally.

The appeal was allowed. The Court held that there was no dispute but that the taxpayer had been in some capacity involved as a distributor with TTI. The primary factual issue in the appeal was whether he had carried on such activities

personally or through his company, of which he was the sole shareholder. The appellant was the only witness on his own behalf, and the Court found him to be credible. The Court also found that the minister had, in raising his reassessment of the taxpayer, relied substantially on information obtained from the Chief Financial Officer of TTI, and that the taxpayer disputed the reliability of such information. The Court reviewed in detail the documentary evidence provided by each party before concluding that the taxpayer's position, that the pyramid operations were carried on by his company, was supported both by his testimony and by the company's accounting records and other financial documentation. That documentation clearly established, in the Court's view, that it was the taxpayer's intention to carry on the TTI activities in his company, and that those activities were in fact carried out by that company. Consequently, the taxpayer did not earn any commission income from the TTI activity personally, and any revenue and expenses from such activity were reported by the company. As the taxpayer had not therefore failed to report commission income, the issue of the imposition of gross negligence penalties was moot.

¶49,342, *David v. The Queen*, 2016 DTC 1062

Deduction for losses denied where taxpayer found not to have been a dealer in securities

On his 2012 and 2013 returns, the taxpayer claimed business losses and non-capital losses carried forward from previous years. Those losses arose from failed investments made in securities, and the taxpayer took the position that he was operating a business as a dealer in securities. The minister denied the business loss carryforwards claimed on the basis that the taxpayer was not operating a business and so he had no source of business income from which to deduct business expenses and incur business losses. Non-capital losses claimed by the taxpayer were also denied. The taxpayer appealed from that assessment.

The appeal was dismissed. The Court began by noting that where a taxpayer disputes an assessment issued by the minister, that taxpayer bears the onus of demolishing the assumptions made by the minister. As well, a taxpayer who is carrying on a business has a duty to keep books and records containing sufficient information as will enable taxes payable under the *Income Tax Act* to be determined. The Court reviewed the history of the appellant's investments in securities and concluded that, while he had undoubtedly intended to make a profit he was not, as he claimed, carrying on the business of a dealer in securities. The appellant had never showed a profit, had no formal training in securities trading, made investments based on tips, did not keep detailed books and records, and dealt only in one security. As well, the appellant had borrowed funds to make his investments at such high rates of interest that he could not have reasonably expected to have a return on investment greater than his interest costs and so could not have had any reasonable expectation of profit. With respect to the appellant's claim for non-capital losses, the Court held that there was no evidence that he had incurred any net capital losses from 2002 and onward and so had no such losses to carry forward. As well, since the appellant had not realized any capital gains in 2012 and 2013, any net capital losses could not be carried forward to those years. Overall, the appellant had not met the required onus of disproving the assumptions made by the minister and his appeal was dismissed.

¶49,340, *Turner v. The Queen*, 2016 DTC 1060

Deductions denied where taxpayer failed to provide sufficient documentation

The taxpayer owned and operated a cleaning business. He reported gross revenues in the amount of $3,458 and $7,251 for the 2010 and 2011 taxation years, respectively, as well as $32,792 in expenses for 2010 and $32,552 in expenses for 2011. On assessment, the minister accepted the gross revenue figures reported by the taxpayer, but reduced the deduction claimed for business expenses for each year by a significant amount. The taxpayer appealed from that reduction in deductible expenses.

The appeal was allowed in part. The Tax Court held that in an appeal of an income tax assessment, the taxpayer has the initial burden of proof to overcome the assumptions pled by the minister. It reviewed the testimony given by the appellant and held that such testimony was, in general, very weak and vague and that explanations provided on cross-examination were sometimes far-fetched and unconvincing. The Court also held that claims made for business expenses were very large, relative to the size of the business, and that claims made for motor vehicle expenses,

although very high, were not supported by any kind of contemporaneous documentation. As well, the amounts indicated on many of the receipts provided did not match the amounts claimed on the appellant's tax return, and many of the items for which a description was provided may have been purchased for personal use. The Court held that, overall, the evidence provided by the taxpayer in support of the appeal was very weak, and that the burden of proof had not been satisfied. The Court did, however, make one adjustment in favour of the appellant. The assessment had characterized certain expenses related to the purchase of equipment as being on capital rather than current account. However, in the Court's view, the Crown had not identified this issue in its Reply in a way which provided the appellant with sufficient notice that the Crown intended to raise the issue. Consequently, the Court determined that an adjustment to the assessment should be made to treat the expenses in question as being fully deductible.

¶49,341, *Kandasamy v. The Queen*, 2016 DTC 1061

Deduction denied where taxpayer not carrying on business in Canada

The taxpayer received shares through a stock option agreement with his employer and sold those shares for a loss. He claimed the losses incurred on his return for the 2008 taxation year, but his claim was denied. The minister's denial was based on the fact that such business losses were not deductible because the taxpayer was a non-resident of Canada and the losses did not arise from a business carried on in Canada. The taxpayer appealed from that denial, but his appeal to the Tax Court of Canada was dismissed. The taxpayer appealed from the judgment of the Tax Court to the Federal Court of Appeal.

The appeal was dismissed. The appellate Court held that the main issue for determination on the appeal was whether the appellant was carrying on business in Canada within the meaning of subsection 253(*b*) of the *Income Tax Act*, and that such issue had not been raised before the Tax Court. Subsection 253(*b*)provides that where a non-resident person offers anything for sale in Canada through an agent the person shall be deemed, for purposes of that disposition, to have been carrying on business in Canada throughout the year. The appellant had argued that, based on that subsection, the act of listing a sell order on a stock exchange in which a Canadian resident could purchase the shares was sufficient to bring the seller within the requirement that the non-resident offer the shares for sale in Canada. The Court held, however, that assuming that listing publicly traded shares for sale on a stock exchange constituted an offer, such solicitation or offer must take place within Canada. The taxpayer had offered shares listed on an American exchange through an American broker, and, in the Court's view, such actions did not constitute the offering of anything for sale in Canada by the offeror. The Court concluded that the contrary conclusion would be inconsistent with the purpose of section 253, which has been held to be "to subject non-resident persons to Canadian tax provided they carry out a minimum amount of commercial activity within Canada's borders". The appeal was therefore dismissed.

¶49,339, *Zhu v. The Queen*, 2016 DTC 5053

Matter returned for reconsideration where adjudicator failed to consider relevant issues

The applicant was an employee of the Canada Revenue Agency who was on long-term disability leave and a grievance related to that leave was pending. As part of her preparation for the hearing of that grievance, the applicant requested a copy of an e-mail from the "H" drive of her office computer. However the material provided to her on 16 CDs included the entire contents of that H drive, which contained confidential taxpayer information. The taxpayer kept all of the CDs and, at one point, used a non-CRA computer to make copies of the relevant CD. When the CRA became aware that the applicant had received, kept, and copied CDs containing confidential taxpayer information, an investigation was launched into whether she had breached section 241 of the *Income Tax Act*, and a 40-day disciplinary suspension was eventually imposed. The applicant filed a grievance in respect of that suspension, but it was dismissed by the adjudicator. She then applied to the Federal Court of Appeal for judicial review of that dismissal.

The application was allowed in part. The Court held that the adjudicator's decision was to be reviewed on a standard of reasonableness, and that reasonableness required that the outcome be justified by transparent and intelligible reasons. It concluded that the reasons given in respect of the 40-day disciplinary suspension did not meet that standard. Specifically, the Court held that the adjudicator failed to consider issues which were central to the allegations of misconduct that justified the 40-day suspension and, consequently, there was no factual basis on which it could be

concluded that section 241 of the *Income Tax Act* was breached. Section 241 is a criminal provision and a finding of a breach of that section would require a conclusion that the applicant had knowingly disclosed confidential taxpayer information by using the CD in the manner which she had. The applicant testified that she had not done so knowingly, but the adjudicator made no finding on that issue. The Court concluded that the adjudicator was required to consider the appropriateness of the length of the 40-day suspension in light of the two acts of misconduct that had been established — the removal of taxpayer information without express authority and the use of non-CRA devices to copy the CD containing the e-mail. He did not do so, and the matter was therefore returned to the adjudicator for re-determination.

¶49,337, *Lloyd v. AG of Canada*, 2016 DTC 5051

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