FORWARD

A QUARTERLY PUBLICATION OF THOMSON REUTERS TAX & ACCOUNTING CANADA

ISSUE 1 | MARCH 2015

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Phone: 416-847-7300 | Toll Free: 1-855-847-7300

Fax: 1-866-285-6527 | Email: info@taxchambers.ca

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Director/Group Publisher
Fred Glady

Editor-in-Chief
Heather Cant Woodward

Managing Editor
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Contributors
Ryan Keey
Paula Ideias
Alicia Bertrand

Marketing Manager
Lavern Walters

Project Coordinator/Product Marketer
Cheryl Waldner

Product Marketer
Michelle Chong

Layout & Design
Cynthia Choi

Production
Leila Dhara
Wendy Longsworth

Copy Editors
Frances Litwin, Karen Conners

For more information, visit
www.carswell.com/forward

One Corporate Plaza
2075 Kennedy Road
Toronto, Ontario M1T 3V4

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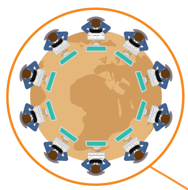

Contributing Author Bios

Ryan Keey, MAcc, CPA, CA
Ryan has practised taxation in public accounting firms in both large and small markets, and for both personal and corporate taxation. As a Senior Tax Writer for Thomson Reuters Tax and Accounting Canada in Toronto, he has written extensive tax commentaries on a wide variety of *Income Tax Act* provisions for the 18-volume *Canada Tax Service*.

Paula Ideias, B.A., LL.B., LLM (Tax)
Paula, a Senior Tax Writer with Thomson Reuters Tax and Accounting Canada in Toronto, writes technical income tax commentary, prepares updates for existing publications, and contributes to new tax products. Previously, she was a Tax Manager at PwC LLP specializing in Canada/United States cross-border estate planning.

Alicia Bertrand, M.A.
Alicia is also part of the Thomson Reuters Tax and Accounting Canada team in Toronto, where she is involved in monitoring regulatory and industry changes to ensure that Taxnet Pro™ is maintained and enhanced on an ongoing basis. She is responsible for adding value to the Corporate Tax Centre in the areas of Transfer Pricing, International tax, Indirect tax, Resource taxation and General Corporate.

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Director's Note

Welcome to the inaugural issue of *Forward*, a new quarterly magazine published by Thomson Reuters Tax and Accounting Canada. The name *Forward* speaks to our mission – to help you keep pace with the ever-changing world of tax and meet the tax challenges that come your way.

This first issue of *Forward* delivers tax articles to meet a variety of reader interests. Ryan Keey, MAcc, CPA, CA and a Senior Tax Writer at Thomson Reuters, provides a comprehensive analysis of the CRA Roundtable discussion from the 2014 Canadian Tax Foundation Annual Conference. The Roundtable is always a well-attended session and Ryan's summary will serve those who were not able to attend (as well as those who were and who wish to check their notes!).

Alicia Bertrand, M.A., is a newer member of Thomson Reuters Tax and Accounting Canada with a gift for simplifying the complex. Alicia's article provides a concise overview of the proposed OECD VAT/GST Guidelines and their potential impact on Canadian place of supply rules.

To assist you for the corporate tax season, we have included Ryan Keey's highlights of recent corporate tax changes affecting the 2014 taxation year. And for personal tax professionals, Paula Ideias, B.A., LL.B., LL.M. (Tax), our Senior Tax Writer on personal tax, provides a valuable article on 2015 automobile expense rules.

I am proud to be part of the team of seasoned tax professionals who created this issue.

Forward is written and published for you. Please let us know what you think and if there are topics you would like us to address in future issues.

Fred Glady, B.A., LL.B., LL.M.
Director, Market Segment Solutions
Carswell, a Thomson Reuters business

THE NUTS AND BOLTS OF 2015 AUTOMOBILE EXPENSE RULES

Paula Ideias (B.A., LL.B., LL.M.), Thomson Reuters

The *Income Tax Act*[1] provides various rules relating to the purchase, lease and use of company-owned automobiles. There are limitations on the amount that a business can deduct for tax purposes when purchasing or leasing an automobile. Additionally, there may be tax implications when an employer: provides company automobiles to employees to assist them in carrying out their employment duties, provides automobile allowances to employees, or reimburses employees' automobile expenses. For example, there are rules that impose tax on an employee's personal-use of an employer-supplied automobile and on certain automobile allowances, and limitations on the amount of automobile expenses that can be reimbursed to an employee on a tax-free basis. This article provides a brief discussion of these rules and limitations, which are summarized in Appendix A.

Automobile Expense Deduction Limits

Incorporated businesses may deduct all reasonable motor vehicle expenses, subject to the following prescribed limitations regarding the purchase or leasing of passenger vehicles:[2]

- The maximum cost amount for capital cost allowance (CCA) purposes is $30,000 plus applicable federal and provincial sales taxes (less any GST or HST input tax credits claimed),
- The maximum deduction allowed for monthly lease costs per passenger vehicle is $800 per month plus applicable federal and provincial sales taxes (less any GST or HST input tax credits claimed), and

Be prepared to talk tax benefit if employee regularly keeps company car overnight 'just for safe-keeping'

- The maximum allowable interest deduction for amounts borrowed to purchase a passenger vehicle is $300 per month.

Passenger vehicles are normally included in Class 10, which provides for a CCA rate of 30% (15% in the year of purchase). However, passenger vehicles costing greater than $30,000 are each required to be included in a separate class 10.1, which also allows CCA at a 30% rate (15% in the year of purchase and the year of disposal), calculated on the $30,000 (plus applicable taxes) cost limit.

A formula contained in section 67.3 of the Act must be applied to determine deductible lease costs in respect of a passenger vehicle. A lease cost deduction calculator is available in the Tools and Solutions section of the Corporate Tax Centre on Taxnet Pro.

Employee Taxable Benefits

When an employer (or a person related to the employer) makes a company-owned or -leased automobile available to an employee (or a person related to the employee) for personal use, the employee must pay income tax on the benefit related to the personal use of the vehicle. For example, when the motor vehicle is taken home by the employee, the travel between home and work is normally considered personal use of the vehicle by the employee, and the benefit from that use must be included in employment income as a taxable benefit. There are two components to the automobile employment taxable benefit: the standby charge benefit and the operating cost benefit.

Standby Charge Benefit[3]

The standby charge benefit recognizes that the employee is receiving a benefit by having the automobile available to them during the year for their personal use.

The standby charge is calculated based on:

- the original cost of a purchased automobile or the monthly lease cost of a leased automobile (including GST/HST and PST if applicable),
- the number of months the automobile is available to the employee for personal use (which normally includes driving to and from work),
- the number of kilometres driven for both personal and business purposes, and
- any reimbursement by the employee for the availability of the vehicle.

When the automobile is owned by the employer, the standby charge is:

- 2% x cost of automobile x # of months available to the employee in the year

Therefore, where the automobile is available 12 months of the year, 24% of the cost of the automobile is included in the employee's income each year.

When the automobile is leased by the employer, the standby charge is:

- 2/3 x monthly lease costs (excluding insurance) x # of months available to the employee in the year

The standby charge may be reduced if:

- the kilometres driven for business use are at least 50% of the total kilometres driven, and
- less than 20,004 km per year, or an average of 1,667 km per month, are driven for personal use

Operating Cost Benefit[4]

If the employer has paid the operating costs of an automobile which has been available for the personal use of an employee, an operating cost benefit must be included in the employee's income, less any reimbursements by the employee to the employer. The operating cost benefit is based on kilometres driven for personal use by the employee. For 2013, 2014 and 2015, the rate is $0.27 per kilometre.

If the employee uses the automobile primarily (at least 50%) for business purposes, the operating cost benefit may be calculated as 50% of the standby charge, less any reimbursements.

Tax-Free Automobile Allowances

The Act sets out a per kilometre amount that may be paid tax-free to employees as reimbursement for motor vehicle expenses incurred while travelling for business purposes where the employee is using their personal vehicle. For 2015, the limit on the deduction of tax-exempt allowances paid by employers to employees that use their personal vehicle for business purposes is 55 cents per kilometre for the first 5,000 kilometres driven and 49 cents for each additional kilometre (these amounts are 4 cents higher in the Northwest Territories, Nunavut and Yukon). The allowance amounts reflect the key cost components of owning and operating an automobile, such as depreciation, financing, insurance, maintenance and fuel costs.

EXAMPLE

An employee is provided with an employer-owned vehicle for all 12 months of 2015. The cost of the vehicle, including taxes was $28,000. The employee drives 30,000 total kilometres in 2015, 12,000 of which are for personal use (i.e., 40% personal use). The employee has not made any reimbursements to the employer.

The **standby charge benefit** for 2015 is $6,720 (2% x $28,000 x 12 months). However, since the automobile was used more than 50% for business and less than 20,004 km were driven for personal use, the standby charge benefit to the employee is reduced to **$4,031** (2% x $28,000 x 12 months x 12,000/20,004km).

The **operating cost benefit** for 2015 is $3,240 (12,000 km x $0.27 per km). However, since the automobile was used at least 50% for business purposes, the operating cost benefit can be calculated as 50% of the standby charge benefit, or **$2,016**.

Thus, the total taxable benefit to the employee is **$6,047** ($4,031 standby charge benefit + $2,016 operating cost benefit).

When a vehicle is used partially for business purposes and partially for other purposes, the CRA requires taxpayers to retain logbook records.

The CRA provides a calculator on its website to allow employers to estimate automobile benefits for withholding purposes (cra.gc.ca/autobenefits-calculator). Employees can also use the calculator to estimate the taxable benefit related to an employer-provided automobile. See also Form RC18, *Calculating Automobile Benefits* for 2015, and CRA Guide T4130: *Employers' Guide – Taxable Benefits*.

APPENDIX A

2015 Automobile Deduction Limits & Expense Benefit Rates

The federal government reviews these limits and rates annually, and announces any planned changes prior to the end of the calendar year.

Automobile Expense Deduction Limits

Maximum cost for capital cost allowance purposes	$30,000
Maximum deductible monthly lease payment	$800/month
Maximum deductible interest expense on vehicle loan to employee	$300/month

Employee Taxable Benefits[5]

Standby Charge Benefit: Employer-leased automobile Employer-leased automobile	 2% of original cost/month 2/3 of monthly lease cost
Operating Cost Benefit	$0.27/km

Tax-Free Automobile Allowances (per/km reimbursement rate)

Provinces	First 5,000 km: $0.55 >5,000 km: $0.49
Yukon, the Northwest Territories, Nunavut	First 5,000 km: $0.59 > 5,000 km: $0.53

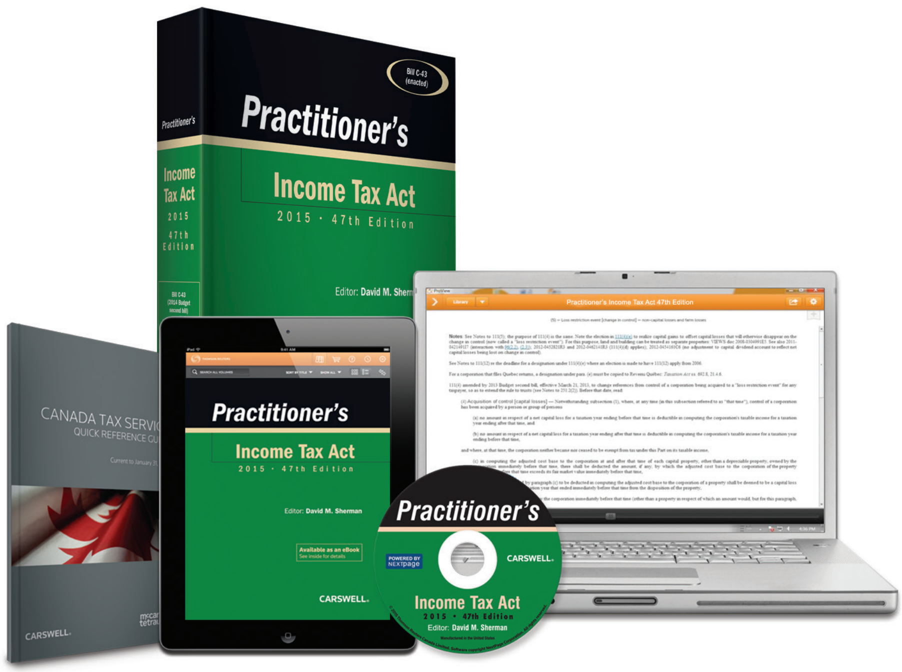
[1] RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act").

[2] For purposes of the Act, a "passenger vehicle" is an automobile that was purchased or leased after June 17, 1987. An "automobile" is a motor vehicle designed to carry people on highways and streets, and can carry a driver and no more than 8 passengers. Note that motor vehicles which are not considered passenger vehicles are not subject to these prescribed limitations. See also CRA Guide T4044 under "Vehicle definitions chart".

[3] See paragraph 6(1)(e) and subsection 6(2) of the Act.

[4] See paragraph 6(1)(k) of the Act and section 7305.1 of the *Income Tax Regulations*.

[5] If an individual is "employed principally" in selling or leasing automobiles, then the standby charge and operating cost benefits will be decreased as follows: (1) for the standby charge benefit, if the employer has purchased one or more automobiles in the year, then, at the option of the employer, 1.5% is used instead of 2%, and the cost of the automobile is the greater of the average cost of all new automobiles purchased by the employer during the year, and the average cost of all new and used automobiles purchased by the employer during the year; and (2) for the operating cost benefit, $0.24 is used instead of $0.27.



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STAY TUNED TO OECD VAT/GST DEVELOPMENTS

Proposed OECD guidelines could significantly alter Canadian place of supply rules

Alicia Bertrand (M.A.), Thomson Reuters

On December 18, 2014, the Organisation for Economic Co-operation and Development (OECD) released discussion drafts related to two new elements of the OECD International VAT/GST Guidelines: 1) The place of taxation of business-to-consumer (B2C) supplies of services and intangibles; and 2) Provisions to support the application of the guidelines in practice (supporting provisions). The guidelines have been developed to address issues of double taxation and unintended non-taxation resulting from inconsistencies in the application of VAT to international trade as part of BEPS Action 1 (tax challenges of the digital economy).

Looking for the public comments and submissions on the OECD discussion drafts? Find them on Corporate Tax Centre on Taxnet Pro.

On December 18, 2014 the Organisation for Economic Co-operation and Development (OECD) released two new draft elements of the OECD International VAT/GST Guidelines, which was prepared in the context of Action 1 of the BEPS Action Plan, *Guidelines on Place of Taxation for Business-To-Consumer Supplies of Services and Intangibles, Provisions on Supporting the Guidelines in Practice*.

The OECD's objective is to develop international guidance on value added tax/Goods and Services Tax (VAT/GST) to address the issues and minimize the potential for double taxation and unintended non-taxation resulting from differences in the way jurisdictions implement or interpret the application of VAT/GST to international trade.

The previous set of Guidelines regarding the inconsistent collection of VAT/GST internationally, were approved in January 2014, and endorsed by the OECD at the OECD Global Forum in April 2014. Those three previously endorsed chapters set the field for the release of the VAT/GST draft released in December 2014.

Public consultation has closed on both draft elements of the guidelines relating to: the place of taxation of business-to-consumer supplies of services and intangibles (B2C guidelines) and provisions to support the application of the guidelines in practice (supporting provisions). The discussion draft on the B2C guidelines responds to the conclusions on VAT/GST contained in the Report on Tax Challenges of the Digital Economy.

The discussion draft (B2C Guidelines, which is part of Chapter 3) relates to determining the place of taxation for business-to-consumer (B2C) supplies of services and intangibles in accordance with the destination principle. It also outlines the recommended approach for collecting the VAT/GST on those cross-border supplies, and focuses on creating a fair VAT/GST environment for domestic suppliers while creating a registration and compliance regime for non-resident suppliers so that the collection of VAT/GST on B2C supplies can be effectively coordinated between international jurisdictions. After registration, the non-resident suppliers could remit VAT/GST based on the jurisdiction of taxation. This guidance presents some of the key actions that taxing jurisdictions could take to simplify the administrative and compliance process of a registration-based collection regime for business-to-consumer supplies of services and intangibles by non-resident suppliers.

The draft also includes *Provisions on Supporting the Guidelines in Practice,* which provides approaches for international governments to institute the VAT/GST guidelines in their national legislation and revenue/tax administrations interpretation of the guidelines in order to combat double taxation or future tax disputes.

From a Canadian perspective, the place of supply with whom your transaction is completed could be a province with HST charges, or only PST charges. Our current GST/HST rules are more concerned with the service being from Canada; if these guidelines are to be implemented in Canadian tax legislation, the location of the recipient will significantly alter Canadian place of supply rules. The Canadian GST/HST system also has varied rates across the country, along with PST in certain provinces, which may cause issues in the place of supply rules proposed in the OECD's VAT/GST guidelines.

International neutrality and compliance is essential with the ever-growing digital economy and the ability to complete a transaction from anywhere in the world, whether it be downloading a song online, purchasing books from an international retailer, or real property, the VAT/GST guidelines will become important knowledge for tax practitioners and governments alike.

In conjunction with the release of the VAT/GST Guidelines, the OECD released a discussion draft BEPS Action 4: Interest Deductions and other Financial Payments, on December 18, 2014. Action 4 defines interest for inbound and outbound scenarios, the rules surrounding interest deductions, whether they should be limited in certain situations, and how interest deductions are treated in regards to double taxation.

On December 18, 2014, the OECD also released BEPS Action 14: Dispute Resolution, which is intended to enhance the effectiveness of the mutual agreement procedure (MAP) to resolve tax-treaty disputes, as well as develop greater dispute resolution mechanisms and processes.

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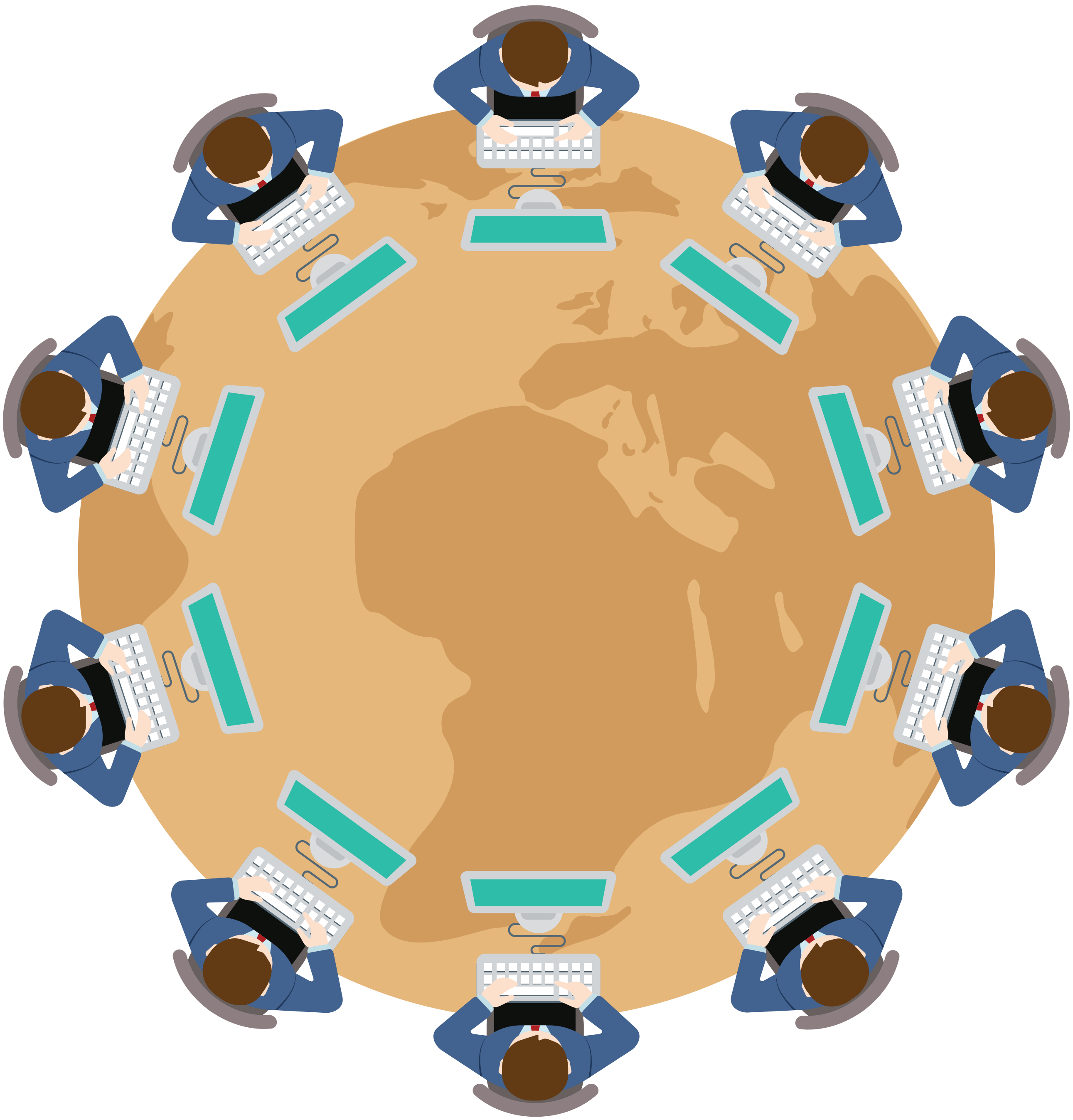
CTF ANNUAL CONFERENCE 2014 ROUNDTABLE DISCUSSIONS

Ryan Keey (MAcc, CPA, CA), Thomson Reuters



This article summarizes the questions and responses provided at the Canadian Tax Foundation (CTF) Annual Tax Conference CRA Roundtable held on December 2, 2014 in Vancouver. The 2014 Roundtable questions are available on the CTF's website. The CRA will provide official written responses to the questions at a future date. I attend the annual CTF Conference each year to ensure that the Corporate Tax Return and Provisions Guide reflects the latest views of the tax professional community, the CRA, and Finance on contemporary tax issues.

Each of the 2014 Roundtable questions is discussed below in the order the questions were presented. For ease of reference, below is a list of the question topics and my opinion as to whether the CRA provided a favourable or unfavourable response from a taxpayer perspective:

Questions & Responses

1	Derivative forward agreement (DFAs) – exchangeable shares	Generally favourable
2	Loss consolidation – update	Neutral
3	Restrictive covenants – allocation of nominal consideration	Favourable
4	ITA 212.1 and the GAAR	Unfavourable
5	Streaming partnership income	Unfavourable
6	ITA 97(2) and the "Canadian partnership" requirement	Unfavourable
7	Article XXIX-A(3) of the Canada-US Tax Convention	Unfavourable
8	Base erosion – services (ITA 95(2)(b)(ii))	Question skipped
9	ITA 95(6)(b) – post Lehigh	Generally favourable

1 **Derivative forward agreement (DFAs) – exchangeable shares** | **Generally favourable**

Background

Very generally, a "derivative forward agreement" (DFA) is defined in subsection 248(1) of the *Income Tax Act* (ITA) as an agreement entered into by a taxpayer that combines a derivative financial instrument with the purchase or sale of an otherwise unrelated capital property. The DFA rules were introduced to thwart so-called character conversion transactions (i.e., transactions that attempt to convert fully taxable income to a capital gain via the use of a derivative agreement). Applicable to agreements entered into after March 20, 2013, generally, any return arising under a DFA that is not determined by reference to the performance of the capital property being purchased or sold is treated as being on income account.

In congruence with the introduction of the character conversion rules, the October 2013 Technical Notes to the DFA definition included the following examples:

> A taxpayer owns 100 shares of Yco, a Canadian corporation. The terms of the Yco shares contain a right to redeem the shares (along with a limited right for Yco to retract) at any time in exchange for shares of Zco, a publicly traded foreign corporation, or an amount of cash determined by reference to the value of the Zco shares. The value of the Yco shares therefore tracks the value of the Zco shares. The taxpayer provides Callco, a Canadian corporation, with a call right that entitles it to purchase the taxpayer's Yco shares for a price determined by reference to the value of a corresponding number of Zco shares. In this situation, the taxpayer would retain a sufficient economic exposure to the Yco shares and the agreement to sell its Yco shares would therefore not be a derivative forward agreement.
>
> Conversely, if the Yco shares do not have an embedded exchange right and instead, the taxpayer enters into an agreement to sell the Yco shares more than 180 days in the future for a price determined by reference to the value of the Zco shares, the agreement would be a derivative forward agreement.

Roundtable Question

The CRA was asked to provide its views on the above examples. With respect to the first example, the CRA's position is that the agreement to sell the Yco shares is not a DFA because the agreement is outside of the scope of subparagraph (c)(ii) of the DFA definition, which provides that a DFA includes a sale agreement if "the agreement is part of an arrangement that has the effect — or would have the effect if the agreements that are part of the arrangement and that were entered into by persons or partnerships not dealing at arm's length with the taxpayer were entered into by the taxpayer instead of non-arm's length persons or partnerships — of eliminating a majority of the taxpayer's risk of loss and opportunity for gain or profit in respect of the property for a period of more than 180 days". With respect to the second example, the CRA's position is that the agreement is considered a DFA since the taxpayer did not retain a sufficient economic exposure to the Yco shares.

Acknowledging that the examples provided in the Technical Notes lack details and that the legislation is ambiguous, significantly, the CRA provided comfort that its general position is that most "standard" exchangeable agreements will not be considered DFAs (i.e., the CRA will generally not consider an exchangeable share agreement to constitute a DFA unless the agreement clearly fits within the scope of the types of transactions that the character conversion rules are intended to thwart).

The CRA also stated that, had the examples provided in the Technical Notes involved partnership interests instead of shares, the conclusions would have been the same. In other words, the CRA will focus on the perceived effects of the underlying agreements as opposed to the nature of the security involved when determining whether a particular agreement is a DFA.

2 **Loss Consolidation Update** | **Neutral**

Several loss consolidation questions were posed at the 2014 Roundtable generally to determine whether the CRA has changed any of its positions with respect to such transactions. The update was requested in part to assess the impact, if any, on the CRA's loss consolidation positions in light of the budget 2013 announcement that the Government will not be pursuing the introduction of formal loss consolidation provisions. In the Supplementary Information to the March 21, 2013 federal Budget, the Government stated:

> The examination of the taxation of corporate groups is now complete. The Government has determined that moving to a formal system of corporate group taxation is not a priority at this time. Going forward, the Government will continue to work with provinces and territories regarding their concerns about the uncertainty of the cost associated with the current approach to loss utilization.

At the 2014 Roundtable, the CRA confirmed that its previous stated positions with respect to loss utilization strategies continue to reflect the views of the Agency. More specifically, in the context of standard loss utilization transactions within a corporate group:

1. The CRA continues to require a positive spread between the dividend yield on preferred shares acquired with intercorporate debt and the interest rate on that debt for the interest to be deductible;[1]
2. The payor of the dividends must either have an independent source of income to pay the dividends, or, alternatively, the parent company of the company paying the dividends must have an independent source of income that funds the dividend payor;[2]
3. To receive a favourable ruling, corporations participating in a loss utilization strategy are not required to be both related and affiliated, however, if the corporations are affiliated but not related, the corporations must be affiliated for purposes of ITA 69(11);[3]
4. In the context of loss utilization transactions involving inter-provincial loss consolidation issues, the CRA will not issue a favourable ruling if it considers provincial income shifting to be one of the main purposes of the transactions;[4]
5. The CRA announced that it is in the process of developing an Income Tax Folio that will replace IT-533: *Interest Deductibility and Related Issues*.

   It is expect that the new Folio will be released in 2015. The Folio will include new commentary regarding the CRA's position on loss utilization transactions (details of this new commentary were not provided).

3 Restrictive covenants – allocation of nominal consideration — Favourable

Where ITA 56.4(7) applies, an amount in respect of a restrictive covenant may be included in computing the cumulative eligible capital of a taxpayer or of a taxpayer's eligible corporation. Generally, ITA 56.4(7) is applicable where a vendor grants a restrictive covenant that directly relates to a transfer of goodwill by the vendor to another taxpayer with whom the vendor deals at arm's length and several other conditions are met, including that "no proceeds are received or receivable by the vendor for granting the restrictive covenant".[5] In CRA Views Document (VD) No. 2014-0522961C6, the CRA stated that the allocation in a purchase and sales agreement of $1 of consideration to a restrictive covenant to ensure that the agreement constitutes a legally binding contract will constitute proceeds for the purpose of ITA 56.4(7)(d).[6] However, in a positive move, at the 2014 Roundtable, the CRA stated that it will revise its position set forth in VD 2014-0522961C6 and, as an administrative concession, the CRA will no longer consider the allocation of $1 to a restrictive covenant to constitute proceeds of disposition for purposes of ITA 56.4(7)(d) (or ITA 56.4(6)(e)).[7]

4 ITA 212.1 and the GAAR — Unfavourable

The CRA was asked whether the GAAR Committee has had the opportunity to consider its views on pre-acquisition PUC planning transactions since the issue was last discussed at the May 2013 International Fiscal Association (IFA) Conference. At the latter conference, in the context of several examples involving a non-resident parent company, the CRA took the position that the GAAR would apply to post-acquisition and non-acquisition PUC step-up transactions.[8] In respect of pre-acquisition PUC planning, the CRA indicated the

GAAR committee had not yet considered whether the GAAR would apply.

At the 2014 Roundtable, the CRA reported that after having had a chance to review standard pre-acquisition PUC planning transactions,[9] the position of the GAAR committee is that the GAAR would apply to such transactions. Essentially, the CRA's view is that the "side-stepping" of ITA 212.1(1) is abusive since it allows for the avoidance of future Part XIII tax that would otherwise have arisen upon the extraction of the surplus of the acquired Canadian company.

The CRA's position on standard pre-acquisition PUC planning transactions is questionable as such planning merely enables a non-resident acquiror to recover its investment in the acquired company without the incidence of Canadian tax.[10] The latter result should not be considered abusive as a fundamental and basic principle underlying the provisions of the ITA is that a shareholder should be able to extract its investment in a corporation on a tax-free basis; otherwise, double-taxation arises. The CRA's reasoning for applying the GAAR seemingly ignores the fact that the vendor is liable for tax on any gain upon the disposition of the shares of the acquired Canadian company. Standard pre-acquisition PUC planning transactions merely overcome a technical inefficiency of the ITA. The Courts have recognized that the GAAR should not apply to fill a legislative gap; similarly, the GAAR should not apply to transactions that overcome a legislative shortcoming.

5 Streaming partnership income — Unfavourable

Background

ITA 103(1) allows the CRA to adjust the basis of income allocations in a partnership agreement where the principal reason for the basis on which certain income or losses are shared may reasonably be considered to be the reduction or postponement of tax that might otherwise have been or become payable under the ITA. ITA 103(1.1) further provides that where two or more members of a partnership who are not dealing with each other at arm's length agree to share any income or loss of the partnership or any other amount in respect of any activity of the partnership that is relevant to the computation of the income or taxable income of those members and the share of any such member is not reasonable in the circumstances, then that share shall be deemed to be the amount that is reasonable in the circumstances. Whether or not the share is reasonable is to be determined having regard to the capital invested in or work performed for the partnership by members thereof or such other factors as may be relevant.[11]

Roundtable Question

The CRA was asked whether it accepts that the streaming of certain types of income (e.g., interest income) to a particular partner of a partnership where the partnership agreement provides for such allocation is acceptable. More specifically, the CRA considered an example involving the allocation of interest income to a partner with tax losses (Lossco), and an allocation of dividend income to another corporate partner without tax losses (Profitco). Interest allocated to Lossco would be non-taxable after taking into account the utilization of losses, and dividends allocated to Profitco would be deductible under ITA 112(1).

The CRA indicated that it receives many ruling requests dealing with situations similar to those in the above example and that, as a general rule, the CRA will not issue a favourable ruling. The CRA noted that in addition to applying ITA 103(1) to situations involving the amendment of an existing partnership agreement in order to stream income, the CRA would also consider applying ITA 103(1) or the GAAR in situations involving a new partnership agreement.[12]

6 ITA 97(2) and the "Canadian partnership" requirement — Unfavourable

Background

ITA 97(2) sets out rules allowing a taxpayer to transfer certain types of property on a tax-deferred basis to a "Canadian partnership". A "Canadian partnership" is defined in ITA 102(1) (for purposes of the Act by virtue of ITA 248(1)) as a partnership all of the members of which were, at any time in respect of which the expression is relevant, resident in Canada.

ITA 100(1) applies when a person that is exempt from tax under ITA 149 or a non-resident person acquires a partnership interest. Where ITA 100(1) applies and the underlying assets in the partnership include capital property other than depreciable property, such portion of the gain realized by the taxpayer on the disposition of the interest in the partnership as may reasonably be regarded as attributable to the increase in value of that property will receive normal capital gain treatment (i.e., the taxpayer will include in income only ½ of that gain); however, the balance of the gain on the disposition of the taxpayer's interest in the partnership is fully included in income. ITA 100(1) was extended to non-residents as proposed in the 2012 federal budget. Also, ITA 100(1.4) and ITA 100(1.5) were added to provide for an anti-avoidance rule that generally extends the application of ITA 100(1) to indirect transfers to tax-exempt persons and non-residents.

Roundtable Questions

The CRA was asked whether the formation of a partnership with only Canadian partners in order to meet the "Canadian partnership" requirement of ITA 97(2) followed by the admission of a non-resident as a partner soon after (e.g., the next day) would jeopardize the tax-free rollover. An example was provided based on a recent rulings request involving a transfer to a Canadian partnership of a property with a UCC of $50K and a FMV of $100K under ITA 97(2). The elected amount in respect of the transfer was $50K and the transferor took back a $50K note as consideration. Following the transfer, a non-resident was admitted into the partnership and contributed $50K, which was used to repay the note issued to the Canadian transferor.

In denying the issuance of a favourable ruling in the above example, the CRA took the position that the transactions were offensive since recapture of $50K would have been triggered had the property been transferred to the partnership subsequent to the admittance of the non-resident partner (i.e. the CRA's view was that the temporary exclusion of the non-resident partner to secure the ITA 97(2) rollover was abusive). In concluding that the GAAR would apply, the CRA stated it was influenced by the tax policy underlying ITA 100, including the recent additions of ITA 100(1.4) and (1.5). The CRA acknowledged that it was difficult to determine whether the GAAR should be applied in the above example.

7	Article XXIX-A(3) of the Canada-US Tax Convention	Unfavourable

Background

Paragraph 3 of Article XXIX-A of the Canada-US Treaty (i.e., the Limitation on Benefits (LOB) Article) provides that a US or Canadian resident that is not a qualifying person under paragraph 2 of the Treaty may claim treaty benefits with respect to certain items of income where an active trade or business test is met. When determining whether a trade or business in the US is substantial in relation to a business carried on in Canada, the CRA has stated it will consider, among other factors, the relative amount of assets, revenues, expenses, and employees in the US as compared to Canada.[13] Additionally, the CRA has stated that a favourable ruling with respect to the active trade or business test will only be applicable as of a particular date, and that the active trade or business in the US must continue to be carried on and remain substantial in relation to the activity carried on in Canada for the test to continue to be considered met after the ruling is issued.

In the context of Article XXIX-A(3), at the 2009 IFA Conference,[14] the CRA highlighted that the substantial business test does not contain a safe harbour component, stating:

> Neither the text of paragraph 3 of Article XXIX A nor the TE [(Technical Explanation to the Fifth Protocol)] refer to a safe harbour in the interpretation and application of the term "substantial". The CRA does not consider it relevant that other tax treaties concluded by the United States may contain other means of testing the "substantial" requirement, since that approach does not appear in the Treaty.
>
> CRA's view is that the guidance underlined above in the TE provides a basis for applying the "substantial" requirement. Taking this guidance into consideration, the CRA is of the view that, in applying the substantial requirement test: the size of the trade or business in the U.S. need not be "as

large as" the income-generating activity in Canada; but it must be more than "a very small percentage" of the size of that activity; the phrase, "a very small percentage" imports a de minimis standard, one that is to be applied in the context of all the facts and circumstances of each particular case, with a view to preventing treaty shopping; in comparing the size of the trade or business in the U.S. and the size of the income-generating activity in Canada, the CRA will consider factors such as income, assets, payroll expense, the size and nature of relevant markets or other similar measures.

Roundtable Question

The CRA was asked to describe the circumstances under which it would consider a US business to be "substantial" in relation to a Canadian business in a given situation, and in particular to consider this question in the context of a comparison of ratios of revenues, assets, and numbers of employees in each country. The CRA stated that since the introduction of Article XXIX-A(3), it has never denied a favourable ruling with respect to the substantial business test. A slide was provided with the Conference material illustrating three examples of business activity ratios in respect of which the CRA provided a favourable ruling. In general terms, the CRA indicated that the substantial business test is not intended to be difficult to meet.

8 Base erosion – services (ITA 95(2)(b)(ii)) — Question skipped

This question was skipped due to time constraints.

9 ITA 95(6)(b) – post Lehigh — Generally favourable

Background

ITA 95(6) provides for an anti-avoidance rule generally intended to prevent the avoidance of tax through the use of rights to acquire shares or the issuance of shares. Where applicable, the provision treats an acquisition or disposition of shares or partnership interests to have not taken place. Where the shares or partnership interests were previously unissued, the provision deems the shares or partnership interests to have not been issued.

In *Lehigh Cement Ltd*, 2014 CarswellNat 1180, the FCA found that ITA 95(6) did not apply to a series of debt and equity restructuring transactions in respect of which the CRA argued that the taxpayer had acquired shares of a US LLC principally to avoid tax (in the absence of the particular acquisition, the US LLC would not have qualified as an FA of the taxpayer and dividends it paid would not have been considered to have been paid out of exempt surplus). In finding in favour of the taxpayer, the FCA rejected the Crown's argument that ITA 95(6)(b) has a broad anti-avoidance purpose, stating that ITA "95(6)(b) is targeted at those whose principal purpose for acquiring or disposing of shares in a non-resident corporation is to meet or fail the relevant tests for foreign affiliate, controlled foreign affiliate or related-corporation status in subdivision i of Division B of Part I of the Act with a view to avoiding, reducing or deferring Canadian tax".[15]

Roundtable Question

The CRA was asked how the decision of the FCA in *Lehigh Cement* will affect its interpretation of ITA 95(6)(b) going forward, and whether the CRA will be revisiting its various published positions on ITA 95(6)(b). The CRA stated that while it "accepts" the decision in *Leigh Cement*, it continues to hold that the scope of the provision may be wider than suggested by the decision (the CRA acknowledged the contradictory nature of this response). The CRA intends to review its stated positions with respect to ITA 95(6) in light of the decision in *Leigh Cement*, including those set forth in ITTN-32, and *may* consider releasing revised views. The CRA emphasized that it will continue to review relevant transactions to assess whether ITA 95(6) applies.

Conclusion

The formal responses to the 2014 Roundtable questions should be released within the first few months of 2015. Reference should be made to the formal responses when they become available.

[1] See, for example, VD 2002-0177363 (2003).

[2] The CRA most recently addressed the independent source of income issue in VD 2014-0522251E5. The CRA's position with respect to this issue is set forth in ITTN–30, in which the CRA states: "While we have not reached the point where we would state that *C.R.B. Logging* is no longer good law, we have provided rulings on some upstream shareholding situations. The key criteria to be met in such situations is the existence of other assets in the parent company that can generate sufficient income to pay the dividends on the preferred shares held by the subsidiary." At the 2014 Roundtable, the CRA stated that its position in any particular situation will largely depend upon the facts; however, as a general rule, the CRA will issue a favourable ruling where the parent has an independent source of income to fund the dividend payor.

[3] ITA 69(11) is an anti-avoidance rule that is intended to prevent a vendor from disposing of property on a tax-deferred basis as part of a series of transactions one of the main purposes of which is to obtain the benefit of tax deductions or other entitlements available to a specified person (as defined in ITA 69(12)) in respect of a subsequent disposition of the property within 3 years of the original disposition. ITA 69(11) does not apply where, on a transfer of property, any tax deductions or entitlements that may apply on a subsequent disposition of the property are those available to a person that would be affiliated with the vendor of the property if the affiliation test set out in ITA 251.1 were read without reference to the extended definition of "controlled" in ITA 251.1(3). See also VD 9811750 and ITTN-30.

[4] The CRA is particularly concerned with transactions that shift income away from provinces with a relatively low corporate income tax base. Notably, the adoption of a formal loss consolidation scheme in the ITA was largely abandoned as a result of concerns raised by the provinces regarding the potential impact of such a regime on provincial tax bases and the interprovincial allocation of taxable income. The CRA highlighted at the 2014 Roundtable that it will issue rulings that both the federal GAAR and a relevant provincial GAAR do not apply to a particular loss utilization strategy (see, for example, VD 2010-0389321R3). Effectively, whether the CRA will issue a favourable ruling in a given situation involving the shifting of income among the provinces will depend upon the facts of the particular case.

[5] ITA 56.4(7)(d).

[6] To deal with this issue, some advisors have suggested that the non-competition agreement be signed under seal, rather than including nominal consideration ("peppercorn") language in the statement of consideration.

[7] The CRA emphasized that any amount of consideration in excess of $1 would violate its administrative position and would be considered proceeds of disposition. At the Annual Conference, Michael Coburn spoke at a session dealing with restrictive covenants (the formal paper, "Overview of Restrictive Covenant Provisions", will be released at a later date). At the session, it was noted that the purchaser may not be satisfied with nominal consideration being allocated to a non-compete agreement based on non-tax case law which generally provides that a non-competition agreement is more likely to be enforceable if challenged where meaningful consideration was allocated to the agreement.

[8] See VD 2013-0483771C6

[9] There are several ways to achieve a PUC step-up upon an acquisition of a Canadian target by a non-resident parent. The 2014 Roundtable slides considered a standard example involving the incorporation of a Canadian acquisition company to acquire the target and achieve a PUC step-up.

[10] The CRA's indicated that its view is that the acquiror should be expected to take on the "good" and "bad" attributes of the acquired shares and that avoiding the application of ITA 212.1 while achieving a PUC step-up is abusive.

[11] The CRA discusses its views on the application of ITA 103(1) and (3.1) in IT-231R2: *Partnerships — Partners Not Dealing at Arm's Length*. See also VDs 2013-0493971I7, 2011-0421261R3, 2010-0365421E5, 2010-0369581E5, 2004-0070001C6 and 3-2137.

[12] The CRA stated that taxpayers "should not take it for granted" that a partnership agreement "will pass the GAAR test" and that it takes a "close look" at partnership agreements. The CRA is particularly concerned with "ambiguous" agreements. There is limited caselaw dealing with these issues.

[13] See VDs 2014-0526711C6, 2011-0424211R3, 2012-0458361R3, 2011-0399351R3, 2012-0435211R3, 2010-0387001C6, 2012-0444151C6, 2009-0349701R3, 2009-0349141R3, 2009-0317941E5, 2009-0345881C6, and 2008-0272371C6.

[14] See VD 2009-0345881C6.

[15] Para. 68.

TAKE NOTE 2014 CORPORATE TAX RETURN DEVELOPMENTS

Ryan Keey (MAcc, CPA, CA), Thomson Reuters

As corporate tax season approaches, below is a highlight of some of the recent corporate tax return administrative developments to be aware of when completing corporate tax returns for the 2014 taxation year:

- **Amalgamations:** In December 2014, the CRA released Income Tax Folio S4-F7-C1: *Amalgamations of Canadian Corporations*;
- **Internet Business Activities:** Applicable for taxation years with a filing-due date after December 31, 2014, Schedule 88 of the T2 return must be completed by a corporation that earns income from one or more websites;
- **NPOs:** During 2014, the CRA released its *Non-Profit Organization Risk Identification Project Report* (NPORIP), in which a high-level of concern was expressed regarding the profit-making activities of entities in the NPO sector;
- **Amended Returns:** Corporations can now e-file amended T2 returns;

Corporations can now e-file amended T2 returns

- **Late-Filed Tax Elections:** The CRA has clarified that it will not consider a tax election to be late-filed where a filing-due date for the election is not specified in the ITA or ITR, the election is required to be filed "in the taxpayer's return of income for the year", and the election is filed in the taxpayer's tax return before or after the filing-due date of the tax return;

❖ **Transfers of Payments from One Tax Account to Another:** Form RC431: *Request for Re-appropriation of T2 Statute-barred Credit*, was introduced in 2014 to facilitate a corporation's request to re-appropriate T2 statute-barred credits under ITA 221.2(1) to an established tax debt;

❖ **Registration of Tax Preparers Program (RTPP):** The CRA is proposing to launch an RTPP that will initially apply to individuals who prepare income tax returns for a fee, including T1 and T2 returns. Employees who prepare their employer's T2 returns will not have to register. The CRA engaged in stakeholder consultations in 2014 with respect to the development of the RTPP – the program is expected to launch in 2015-2016;

❖ **PLOI Elections** (VDs 2013-0483751C6, 2014-0534541I7, 2014-0517151E5, 2014-0519431E5 and 2013-0482991E5): The CRA released several new CRA Views Documents (VDs) in 2014 dealing with its interpretation of the recently enacted PLOI rules;

❖ **Upstream Loans:** The CRA released several significant VDs during the year which provide insights into dealing with the foreign affiliate upstream loan rules;

❖ **Unreported Losses** (VDs 2013-0514331I7, 2013-0479161E5): Non-capital loss and net capital loss balances exist whether or not they are reported in a tax return for the taxation year in which the loss was incurred. Where a loss was not reported and the taxation year has since become statute-barred, the CRA will generally allow the non-capital loss carryforward to be utilized in a non-statute-barred taxation year;

❖ **Arm's Length Relationships:** During the year, the CRA released Folio S1-F5-C1: *Related persons and dealing at arm's length*, which canceled and replaced IT-419R2: *Meaning of Arm's Length*. Despite the various cases dealing with non-arm's length relationships heard since IT-419R2 was last updated, S1-F5-C1 generally did not contain any substantive changes;

❖ **Restrictive Covenants:** In a revised position, at the 2014 CTF Annual Tax Conference, the CRA stated it will no longer consider the allocation of $1 to a restrictive covenant to constitute proceeds of disposition for purposes of ITA 56.4(7)(d) or ITA 56.4(6)(e);

❖ **Transfer Pricing Documentation:** On March 28, 2014, the CRA released Transfer Pricing Memorandum TPM-05R: *Requests for Contemporaneous Documentation*, replacing TPM-05 (2004). TPM-05R sets forth the CRA's process for requesting contemporaneous transfer pricing documentation;

CRA revises position on restrictive covenants election

❖ **FAPI** (VDs 2013-0474431E5, 2014-0526771C6, 2012-0439661I7, 2014-0519801I7, 2013-0496841I7): The CRA issued several important interpretations during the period dealing with the FAPI rules, including the recharacterization rules under ITA 95(2)(a);

❖ **CCPC Status** (VD 2014-0523301C6): The CRA accepts the decision in *Bagtech*, in which a corporation was found to be a CCPC since a unanimous shareholders agreement gave Canadian residents *de jure* control of the corporation;

❖ **Capital Dividends** (VD 2013-0504951E5): The CRA has stated it will now generally hold in abeyance an ITA 184(3) election filed in a timely manner until the resolution of a related Notice of Objection and subsequent appeal to court, if any, of the Part III tax assessment;

❖ **Foreign Reporting:** The CRA updated its filing policies with respect to Form T1134: *Information Return Relating to Controlled and Not-Controlled Foreign Affiliates*, in 2014, including concessions intended to eliminate duplicate filing requirements in certain circumstances. Additional concessions with respect to the new version of Form T1135: *Foreign Income Verification Statement*, were also announced in 2014;

❖ **SR&ED Tools:** To assist in determining whether a corporation's R&D work qualifies as SR&ED under the ITA, the CRA provides various services, certain of which were enhanced in 2014. At the 2014 Annual CTF Tax Conference, during the closing plenary session, the CRA stated that if a first-time SR&ED claimant declines to meet with the CRA under the FTCAS program, the SR&ED claim will be held in abeyance pending review. Thus, it is generally advisable for a first-time claimant to participate in the FTCAS program;

❖ **Provincial Income Allocation:** The CRA's revised position is that volume rebates received from suppliers after the time of the purchase of goods should not be included in gross revenue for purposes of the provincial allocation formula; and,

❖ **Rulings:** IC 70-6R6: *Advance Income Tax Rulings*, was updated on August 29, 2014.

❖ These developments are discussed in more detail in the *Corporate Tax Return and Provisions Guide, 2015 Edition.*

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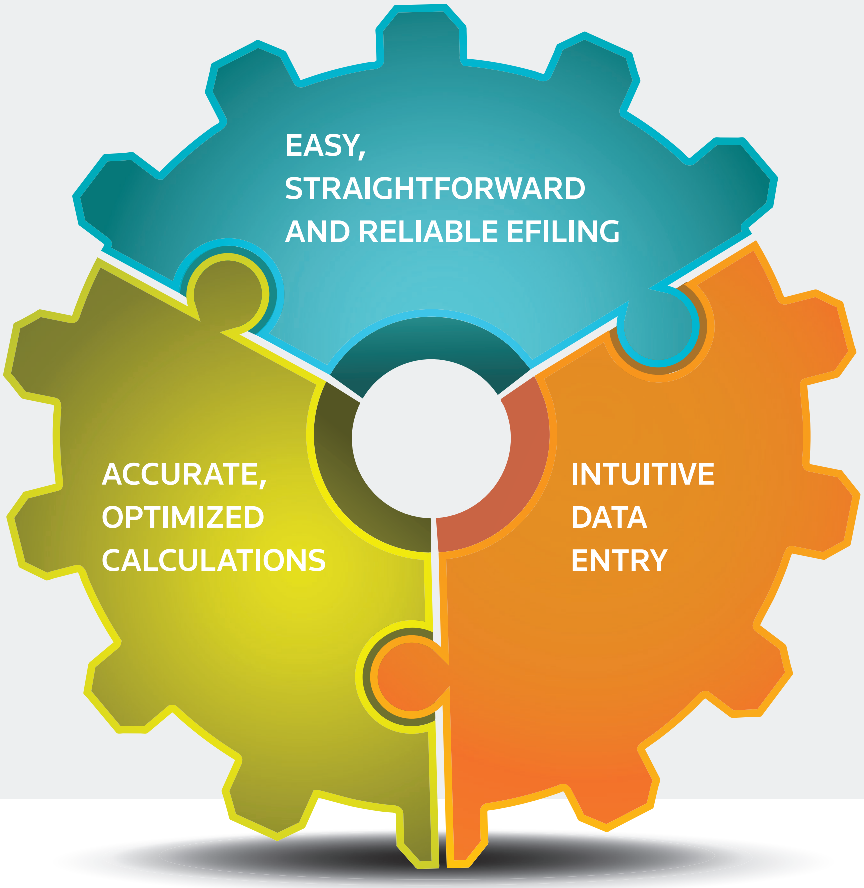

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March

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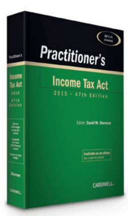
David Sherman, B.A., LL.B., LL.M.

Softcover | 978-0-7798-6465-2 | March 2015 | $122



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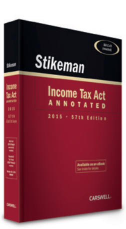
Stikeman Income Tax Act Annotated 2015, 57th Edition

Richard W. Pound, O.C., O.Q., Q.C., F.C.P.A.

Softcover | 978-0-7798-6466-9 | March 2015 | $122

Hardcover | 978-0-7798-6467-6 | March 2015 | $169



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McCarthy Tétrault LLP

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April

Portable Tax Court Practice, Act and Rules 2015 / Loi et Règles de procédure de la Cour canadienne de l'impôt

Robert McMechan, B.A., LL.B., LL.M., Ph.D., Gordon Bourgard, LL.B., LL.M.

Cerlux | 978-0-7798-6632-8 | April 2015 | $45

This handbook contains the Act, the Rules and Practice Notes in a portable version, which is easy to take to court. Used by tax litigators, this publication provides the rules on how to litigate in Tax Court and is an accompaniment to the *Tax Court Practice* looseleaf edition. Current subscribers to *Tax Court Practice* will receive this book at no cost with the next release.

May

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Lynn Biscott, CFP, R.F.P.

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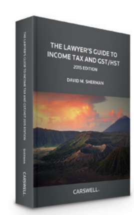
David M. Sherman, B.A., LL.B., LL.M.

Softcover | 978-0-7798-6661-8 | May 2015 | $102



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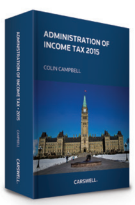
June

Administration of Income Tax, 2015

Colin Campbell, B.A., M.Sc., Ph.D., LL.B.

Softcover | 978-0-7798-6629-8 | June 2015 | $151



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David M. Sherman, B.A., LL.B., LL.M.

Softcover | 978-0-7798-6613-7 | June 2015 | $179

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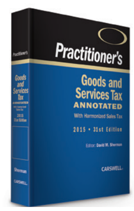
David M. Sherman, B.A., LL.B., LL.M.

Softcover | 978-0-7798-6611-3 | June 2015 | $139



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Giselle Feldman, M.BA.

Softcover | 978-0-7798-6631-1 | June 2015 | $115

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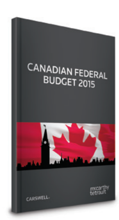
Canadian Federal Budget 2015

McCarthy Tétrault LLP

Softcover | 978-0-7798-6610-6 | Pub date TBC 2015 | $28



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MAY

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www.tei.org

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