CORPORATE Newsletter

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Recent CRA Thinking on Topics of Interest

The Canada Revenue Agency ("CRA") regularly releases its responses to queries from the general public on various tax matters. These responses give us insight into CRA's approach to the law, including the actual practices and policies of the government on the issues. Some recent queries and responses of interest to business owners are summarized below.

Loanback Provisions – Reduction of Fair Market Value of Charitable Gift

The Canada Revenue Agency ("CRA") was asked if the rules in s. 118.1(16) of the *Income Tax Act* (the "Act") applied in the following two situations:

1. A corporation makes a gift to a private foundation at a given time and, within 60 months of that time, the foundation makes loans to the corporation and an individual who does not deal at arm's length with the corporation. Under the loan agreement, the corporation (not the individual) makes interest payments to the foundation.
2. A private foundation loan funds to many corporations that are not dealing at arm's length with each other. The loans are supported by promissory notes under which corporations make interest payments to the foundation. Within 60 months after the notes are issued and before their repayment, the corporations make gifts to the private foundation.

The CRA confirmed that the loanback provisions applied to both cases since, within 60 months of the time the gift was made, the donor or the non-arm's length person used the property of a charity (i.e., private foundation) under an agreement made or modified after the time that is 60 months before the time of the gift. Subsections 110.1(6) and 118.1(16) of the Act apply to reduce the fair market value ("FMV") of a gift by a donor to a private foundation. The FMV of the gift is reduced by the unpaid balance at the time of the gift of any loan advanced by the foundation to the donor (or to persons or partnerships related to the donor) before the time of the gift under a contract entered into in the 60-month period before the time of the gift. The provisions apply to a new loan made by the foundation to the donor (or persons or partnerships related to the donor) within 60 months after the time of the gift. The payment of loan interest by the corporations has no impact on the application of the provisions. Note that the gift will not be reinstated for the purpose of applying the provisions for the sole reason that the property used by the donor is returned to the donee.

Source: CRA Document 2019-0801871I7

Capital Cost Allowance Calculation for Class 29 Property

The Canada Revenue Agency ("CRA") was asked to consider the following situation:

- ACO bought a depreciable asset for $100,000 in 2015 and included the asset in Class 29 of Schedule II of the *Income Tax Regulations* (the "Regulations"). There was no other asset in that class.
- ACO's undepreciated capital cost ("UCC") for Class 29 was $25,000 at the end of 2016.
- In 2017, ACO sold the asset to the non-arm's length corporation, BCO, at a fair market value price of $30,000, resulting in a CCA recapture of $5,000.

The CRA was asked in what taxation year the $30,000 capital cost of the asset would be included in BCO's Class 29 UCC, and what the maximum CCA claimable by BCO in that year and following years would be.

The CRA confirmed that, provided the asset qualified as a "designated property" not purchased in a "specified transaction", and did not qualify as a "leasing property" or "specified leasing property" for the purposes of the CCA calculation in s. 1100(1)(ta) of the Regulations, it would be deemed to have been purchased and become available for use by BCO in its 2016 taxation year.

Therefore, to calculate BCO's CCA calculation for 2017, the asset was deemed to have been bought in the immediately previous year (i.e., 2016), and not in the current year (i.e., 2017). As a result, the maximum CCA that BCO could claim for the asset in 2017 is $30,000, as calculated under s. 1100(1)(*ta*) of the Regulations. Since ACO owned the asset continuously from a day in 2015 to a day in 2017, the period met the requirements of s. 1100(2.2)(*f*) of the Regulations, and the asset was therefore a "designated property" for the purposes of s. 1100(2.2)(*j*)(i) and 1100(1)(*ta*) of the Regulations.

Source: CRA Document 2018-0785371E5

Private Health Services Plan – Stabilization Reserves

The situation considered by the Canada Revenue Agency ("CRA") involved an employer and its employees jointly funding many benefit programs, including a self-insured group health and dental program. The employer kept a separate insurance contract against major claims made by any one employee if they exceeded a pre-determined amount. A committee including the employer and some employee representatives determined the level of annual contributions required to fund those employee benefits. Any excess of the annual contributions over the claims made during the year was transferred to a stabilization reserve to mitigate the need for future contributions to fund the program. Note that the committee could require separate contributions to increase the reserve, refund a portion of the reserve to the employer or employees, or provide a contribution holiday.

The CRA was asked if the stabilization reserve could disqualify the plan as a "private health services plan" ("PHSP").

After noting that the question of whether an arrangement was a PHSP or not was one of fact, the CRA confirmed that the existence of a stabilization reserve within the program was not sufficient in itself to disqualify the plan as a PHSP, provided that:

- the other conditions to qualify as a PHSP are met;
- there is a separate accounting of the claims, premiums, and administrative charges;
- each plan is funded through the employer's investment account; and
- there is no cross-subsidization between the various benefit programs.

The CRA noted that using the reserve to refund amounts to the employer or the employees, or to provide additional benefits under the program, or to provide a contribution holiday would not taint the PHSP status of the plan, provided the following two conditions are met:

The amounts refunded or used for a contribution holiday for one party (i.e., employer or employees) are limited to contributions of the same party (i.e., employer or employees).

The plan continues to qualify as a PHSP after the addition of any new benefits.

Source: CRA Document 2018-0749261E5

Provincial Income Allocation for Insurance Corporations

The Canada Revenue Agency ("CRA") was asked to consider the following situation:

- The corporate taxpayer, ACO, filed Schedule 5 of the T2 form as an insurance corporation in accordance with s. 403 of the Income Tax Regulations (the "Regulations").
- ACO held partnership interests in many partnerships which kept permanent establishments ("PEs") in other provinces, but were not involved in any insurance business.
- Assuming that ACO reinsured policies issued by another primary insurer in Province X, it disregarded the PEs in its partnerships to prepare the calculations of Schedule 5.

More specifically, the CRA was asked whether ACO should ignore its partnership PEs when calculating its provincial income allocation under s. 403 of the Regulations.

The CRA confirmed that ACO could not ignore those PEs since any PE of a partnership of which ACO was a partner was also a PE of ACO. Further, s. 403 of the Regulations does not restrict ACO from using only PEs related to an insurance business. Since ACO is a member of a partnership which has a PE in Province X, ACO must make a taxable income allocation to Province X in accordance with s. 403 of the Regulations. The CRA also indicated that the allocation rules described above applied to both general and limited partnerships. In conclusion, since ACO is deemed to have a PE in Province X because it is a member of a partnership with a PE in Province X, s. 403 of the Regulations allocates ACO's taxable income proportionally to Province X.

Source: CRA Document 2018-0744881I7

Paragraph 55(3)(*a*) Reorganization

The Canada Revenue Agency ("CRA") ruled favourably on a s. 55(3)(*a*) (of the *Income Tax Act*) reorganization designed to separate and divide the ownership interest in certain assets used in a farming business carried on by a farm partnership (including the partnership interest). The assets were held in various corporations that Parent A and Parent B directly or indirectly controlled, proportionally amongst corporations owned by their adult children to facilitate the estate and business planning objectives of Parent A and Parent B and those of their children.

Parent A and Parent B continued to maintain their respective economic interests in such property (via preferred shares) and the non-farming assets held by the various corporations they directly or indirectly control. The reorganization included a partial freeze of most of the value of Parent A's and Parent B's shareholdings in Farmco 1, and the potential future extraction by Parent A and Parent B of their FMV from Farmco 1 in the form of non-interest-bearing demand promissory notes.

Source: CRA Document 2018-0789981R3