the link

No.33 June 2010 www.bijurilex.qc.ca

The Bijural Revision Services Unit (Taxation and Comparative Law) of the Legislative Services Branch of the Department of Justice is pleased to keep you posted on the most recent harmonization and bijuralism news.

Income Tax Act

Round Table of Extended Tax Group Offers Opportunity for Exchange

On June 15, 2010, the Bijural Revision Services Unit (Taxation and Comparative Law) played host to a meeting of the Extended Tax Group, bringing the Unit's members together with colleagues at the Canada Revenue Agency, the Department of Finance and Revenue Quebec. The aim of the meeting is to provide a forum for exchange with those who are routinely faced with bijural issues in their day-to-day activities.

Topics discussed included: TFSAs and Quebec civil law restrictions regarding beneficiary designations; the concept of acquisition; self-benefit trusts (without age requirement) and the civil law; the tax consequences of emphyteusis; recent legislative developments and jurisprudence in tax matters.

Jurisprudence

"Set-off" at Section 224.1 Does Not Bring Civil Law Compensation into Play

Mr. Bouchard (the "Taxpayer") had a tax debt at a time that he was also receiving monthly Canada Pension Plan and Old Age Security benefits. Beginning in March 2008, the Minister deducted 30% of the CPP and OAS amounts payable to the Taxpayer and applied said amount to reduce the tax debt. Section 224.1 of the *Income Tax Act* (Canada) (hereinafter the "Act")[1] allows the Minister to retain by way of deduction or set-off/*par voie de déduction ou de compensation* "such amount as the Minister may specify out of any amount that may be or become payable to the person by Her Majesty in right of Canada."

The Taxpayer sought judicial review of the Minister's decision, arguing that set-off could not be invoked, as the *Civil Code of Québec* states that compensation (the civil law equivalent to set-off) cannot operate against payments that are exempt from seizure.[2] The Taxpayer also argued that the CPP and OAS amounts were held in trust on his behalf, and therefore not debts susceptible to set-off under section 224.1. His arguments were rejected by the Federal Court. Before the Federal Court of Appeal, the Taxpayer argued that the

[1] Unless otherwise stated, statutory references throughout are to the Act.
[2] Article 1676 of the *Civil Code of Québec*.

Federal Court erred in failing to apply the civil law rules respecting compensation as suppletive law.

In dismissing the appeal,[3] Noël J.C.A. concluded that in the circumstances, section 8.1 of the *Interpretation Act*[4] does not mandate reliance on the civil law. Applying principles of statutory interpretation, he noted that where the Minister has wished to be subject to provincial rules regarding exemptions from seizure, such an intention has been stated expressly. Furthermore, Justice Noël observed that the set-off/*compensation* envisaged at section 224.1 is clearly something other than civil law "compensation." For example, while civil law compensation operates automatically to extinguish the lesser of mutual debts, section 224.1 gives the Minister discretion to both invoke (or not invoke) set-off and discretion to determine the amount of set-off. Justice Noël concludes as follows:

> *[25] These characteristics reveal that the statutory set-off described in section 224.1 is inspired by common law and is a complete departure from the civil law concept of compensation. Not only is it unnecessary to refer to civil law to give effect to section 224.1, but the law underlying this provision, in particular the concept of set-off borrowed from common law, requires otherwise. In my respectful view, the argument that Parliament relied on civil law as suppletive law cannot succeed, and the Federal Court judge was correct in law in rejecting it.*

The Taxpayer did not seek leave to appeal.

The Meaning of "Beneficiary"

The Supreme Court of Canada (docket #33435) has dismissed the taxpayer's application for leave to appeal from the decision *Propep inc. v. The Queen.*[5] In that case, the Federal Court of Appeal (overturning the Tax Court of Canada) held that a Quebec-resident individual with a second-ranking, contingent interest in a trust, was nonetheless a beneficiary of a trust for income tax purposes. This conclusion was based on the definitions of "income interest" at subsections 108(1) and 248(1) of the Act, and of "beneficially interested" at subsection 248(25). Given the existence of these provisions, specific to the Income Tax Act, it was not necessary to consider whether the individual would be considered a beneficiary in civil law.

Having determined that the individual with a second-ranking interest was a beneficiary, the Court also found that paragraph 256(1.2)(f) applied to deem him to be the owner of the shares held in trust, as his entitlement to the shares was dependent on the trustees' exercise of their discretion to wind-up the first-ranking corporate beneficiary.

ETA Subsection 123(1) "Security Interest"

In the previous issue of this publication, we considered the Supreme Court of Canada's assessment of the definition of "security interest" at ITA subsection 224(1.3).[6] This notion has been considered again, in *SMRQ c. Polymère Epoxy-Pro inc. et Frare & Gallant Ltée*,[7] this time in the context of the *Excise Tax Act* (the "ETA")[8] and this time it was the Federal Court that expressed a readiness to give the term a broad meaning, allowing the Minister's deemed trust to prevail over a contractor's security interest, which in the circumstances of the case referred to his claim to holdbacks. There was considerable uncertainty on the matter of whether the third-party garnishee even had an established right of retention, whether contractual or legal, however, the Federal Court ultimately determined that the matter was moot given the scope of the deemed trust established under the *Excise Tax Act*, where a tax debtor fails to comply with its obligation to remit goods and services tax:

> *[27] These particular provisions displace and supersede the provisions of provincial legislation, including the Civil Code of Québec, as well as any legal principle and create a priority in Her Majesty in right of Canada, not only in relation to ordinary creditors of the tax*

[3] *Bertrand Bouchard v. AG Canada*, 2009 FCA 321.
[4] R.S.C. 1985, c. I-21.
[5] 2009 FCA 274.
[6] "The Other Principle of Legislative Bijuralism" *The Link*, No. 32 (September 2009), discussing *Caisse populaire Desjardins de l'Est de Drummond and in right of the Caisse populaire du Bon Conseil v. Her Majesty the Queen in Right of Canada*, 2009 SCC 29.
[7] 2009 FC 912.
[8] R.S.C. 1985, c. E-15.

debtor, but also in relation to secured creditors. (…)

[30] Based on the clear wording of the ETA, there appears to me to be no doubt that the garnishee cannot set up its alleged right to retain the moneys owing to the judgment debtor against the garnishment issued in favour of the Deputy Minister of Revenue of Québec, acting for Her Majesty in right of Canada. This finding may appear harsh in that it puts the garnishee at risk of paying amounts due to unpaid suppliers twice. But that is the effect of the Act, and it is not for this Court to amend it.

Case Update: Go ahead for *Velcro Canada Inc.*

On May 18, 2010, the *Velcro Canada Inc.* file (2007-1806 (IT)G) was removed from pending cases list and is now ready to be scheduled for hearing. The case had been held in abeyance pending final decision in *The Queen v. Prévost Car*[9]. In *Prévost Car*, the Federal Court of Appeal concluded that a Dutch holding company was the "beneficial owner" of dividends for purposes of the Canada/Netherlands tax convention and therefore entitled to reduced rate of withholding tax. In *Velcro Canada*, the issue is whether a resident of the Netherlands is the beneficial owner of royalties arising in Canada.

Publication

The Argument for a Definition of "Acquisition"

A recent issue of the McGill Law Journal includes an article by **Professor David Duff** entitled "Canadian Bijuralism and the Concept of an Acquisition of Property in the Federal Income Tax Act" (2009) 54 McGill L.J. 423. The author concludes that the current reliance on a test for "acquisition" which has its foundations in the common law is incompatible with Canadian bijural principles. He however also points out that the strict application of bijural principles may in certain circumstances give rise to tax consequences, for similar transactions, that vary from province to province. The solution proposed by the author: A statutory definition of acquisition, to provide for both uniformity and certainty in the application of ITA provisions that rely on this concept.

[9] 2009 FCA 57. The Crown did not seek leave to appeal.