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WHAT IS AN LLC?

— Jessica Fabbro, Fraser Milner Casgrain LLP

The continued expansion of globalization and foreign investment has led to the use of, and investment in, non-traditional, foreign entities. One of the most prevalent entities in use in Canada is a limited liability company established under the laws of a state of the United States (a "US LLC"). Under US federal (and in some cases state) income tax law, a US LLC may elect to be treated (or in some cases is deemed to be treated) as a flow-through entity rather than as a corporation. An issue that arises in many contexts is whether a US LLC is a partnership or a corporation for Canadian tax purposes.

The two-step process for classifying a foreign entity is clear: first, one determines the essential characteristics of a Canadian entity of that type (e.g., partnership, corporation, trust) and then one determines if the foreign law which governs the foreign entity imbues the foreign entity with a sufficient number of those essential Canadian characteristics such that it may reasonably be classified as that kind of entity for Canadian purposes. The difficulty with the classification of a US LLC as either a partnership or a corporation, however, is that a US LLC structurally resembles a corporation but is taxed in the United States as a partnership. Where a US LLC carries on business in other countries or has foreign members, the classification of the US LLC outside the United States is extremely important for foreign tax purposes, particularly in the tax treaty context. While the classification of a Nevada LLC was the issue in *Boliden Westmin Ltd. v. British Columbia*, with the Court deciding that it most closely resembled a corporation,[1] there has not yet been a Canadian decision on the classification of US LLCs in the income tax context.[2] This issue did, however, recently arise in the United Kingdom, where the First Tier Tribunal (Tax Chamber)[3] held that a Delaware LLC was a partnership for UK tax purposes, but was reversed by the Upper Tribunal (Tax and Chancery Chamber),[4] who held it was a corporation.[5]

The Decision of the First Tier Tribunal in *Swift*

In *Swift*, the taxpayer was a non-domiciled resident of the United Kingdom. He was a member of HarbourVest Partners LLC ("HVLLC"), a Delaware LLC. HVLLC had elected to be treated as a partnership for US federal and state income tax purposes and thus Swift paid US tax on HVLLC's net income. When HVLLC distributed his share of its profits to him, he reported the distribution in the United Kingdom as a dividend but claimed a credit in the United Kingdom under the UK–US Income Tax Treaty for the US tax he paid.

The taxpayer was reassessed to disallow the credit. The key issue was the applicability or otherwise of this provision in the Treaty:

> 23(2) Subject to the provisions of the law of the United Kingdom regarding the allowance as a credit against United Kingdom tax of tax payable in a territory

outside the United Kingdom (as it may be amended from time to time without changing the general principle hereof) —

(a) United States tax payable under the laws of United States and in accordance with the present Convention, whether directly or by deduction, on profits or income from sources within the United States (excluding in the case of a dividend, tax payable in respect of the profits out of which the dividend is paid) shall be allowed as a credit against any United Kingdom tax **computed by reference to the same profits or income by reference to which the United States tax is computed.**

Thus, the issue was whether the UK tax imposed on the distribution which Swift had received was computed by reference to the same income on which he had been taxed in the United States. Swift argued, in essence, that HVLLC was "transparent" from a UK tax point of view, that its profits belonged to him in a proprietary, not merely a contractual, sense, and hence the income on which US tax was imposed was the same income on which UK tax was imposed. The Crown argued that HVLLC was "opaque", and therefore the source of the distribution was HVLLC, whereas the tax imposed on Swift in the United States was based on HVLLC's income which belonged to HVLLC. It was two different sources of income and therefore no credit was allowed.

The First Tier Tribunal began its analysis by looking at the guiding factors used by HMRC in determining whether a foreign entity is transparent or opaque:[6]

1. Does the foreign entity have a legal existence separate from that of the persons who have an interest in it?

2. Does the entity issue share capital or something else which serves the same function as share capital?

3. Is the business carried on by the entity itself or jointly by the persons who have an interest in it?

4. Are the persons who have an interest in the entity entitled to share in its profits as they arise; or does the amount of profits to which they are entitled depend on a decision of the entity or its members, after the period in which the profits have arisen, to make a distribution of its profits?

5. Who is responsible for debts incurred as a result of the carrying on of the business: the entity or the persons who have an interest in it?

6. Do the assets used for carrying on the business belong beneficially to the entity or to the persons who have an interest in it?[7]

The Crown and Swift agreed on HVLLC's classification with respect to four of the factors: HVLLC was a separate legal entity; it carried on business on its own behalf; it was the beneficial owner of HVLLC's assets; and it was solely liable for the debts of the business. They could not agree on whether HVLLC had share capital or whether the members of HVLLC had a proprietary interest in HVLLC's profits as they arose.

The First Tier Tribunal looked at a number of factors, but particularly at Delaware law, which *required* that HVLLC's profits be allocated amongst its members, and concluded that the taxpayer's interest in HVLLC was more akin to an interest in a partnership than to shareholdings in a corporation. The Tribunal noted that HVLLC's members were not permitted to transfer their interest in the entity without the consent of the other members but did not require consent to transfer their economic interests in HVLLC. The Tribunal also found that a member's interest in HVLLC was defined as their interest in the profits and losses of the entity. Based on these attributes, and others, the Tribunal found that HVLLC did not issue share capital or anything that served a similar function. With respect to entitlement to profits, the Tribunal found that HVLLC's Operating Agreement, in conjunction with the legislation governing Delaware LLCs, required that profits be allocated to their members as they arose. As allocation was mandatory, the Tribunal held that HVLLC's members owned the profits as soon as they arose and that HVLLC never had an ownership interest in the profits. Once the First Tier Tribunal had made conclusions with respect to all six factors, the Tribunal applied the approach used in *Memec v. IRC,*[8] and compared HVLLC to an English partnership, a Scottish partnership (which is a legal person under Scottish law), and a UK company, to determine whether HVLLC was transparent or opaque, based on where on the spectrum HVLLC fell. The Tribunal found that HVLLC fell somewhere between a Scottish partnership and a UK company. The Tribunal determined that HVLLC was closer to a Scottish partnership (which under UK law is taxed as a transparent entity even though it is legally a separate person from its members), than to a UK company, an opaque entity, and was therefore a transparent entity for UK tax purposes. In classifying HVLLC, the Tribunal placed particular importance on its determination that the members owned the profits of HVLLC as they arose.

The Decision of the Upper Tribunal in *Anson*

The Upper Tribunal in *Anson* generally agreed with the factors considered by the First Tier Tribunal in the classification of HVLLC and with the First Tier Tribunal's application of the *Memec* approach. The Upper Tribunal also did not disturb the First Tier Tribunal's conclusions with respect to the classification factors considered, with the exception, critically, of the taxpayer's interest in HVLLC's profits. The Upper Tribunal held that the First Tier Tribunal had erred in its determination that the allocation of profits to a member constituted ownership of such profits. The Upper Tribunal held that it was not possible to own "profits", as profits are not a distinct class of asset but an abstract calculation. The Upper Tribunal held that only by having a proprietary interest in the underlying assets representing the profits could the members have a proprietary interest in the profits themselves. The Upper Tribunal found that the First Tier Tribunal had failed to recognize the important distinction between a taxpayer's contractual right to be paid an amount equal to the profits under an LLC agreement and a proprietary right entitling a person to the profits of an LLC as they arise. In this case, the Upper Tribunal held that Anson had a contractual right to the monetary equivalent of HVLLC's profits, but had no right to the underlying assets of HVLLC. Therefore, he had no right to HVLLC's profits as they arose. The Upper Tribunal determined that HVLLC was not similar to a Scottish partnership, but instead was more similar to a UK company. As a result, the Upper Tribunal held that HVLLC was opaque for UK tax purposes. Accordingly, the income on which Anson had been taxed in the United States was different than the income on which he had been taxed in the United Kingdom, the former being HVLLC's profits and the latter being a distribution from HVLLC. No credits were available under the Treaty.

This decision is consistent with HMRC's administrative position that all US LLCs are opaque for UK tax purposes.[9] The *Anson* decision is also consistent with current Canada Revenue Agency ("CRA") policy on LLCs, although the CRA limits its analysis to separate legal existence, responsibility for liabilities, and ownership of assets.[10]

At the 2010 Canadian Tax Foundation Annual Conference, Mr. Ed Stuart CTA, a Senior Technical Adviser with HMRC, stated that it was not critical for UK tax credit purposes that tax be paid by the same person. That is, the fact that two different people may pay tax does not, in and of itself, disentitle one of them to a credit for the tax paid by the other. What is key is whether the income on which tax is imposed on both of them is the same. In this case, the Upper Tribunal held the sources of income were not the same, even though they obviously were related (if HVLLC had no profit there could not be a distribution).

Ownership Interests in US LLC

Curiously, the First Tier Tribunal's finding that HVLLC did not have anything akin to share capital was not challenged on appeal. This decision appears to contrast with the decision in *Boliden*, which held that a Nevada LLC had "shares of a sort, though of a different name".[11] The First Tier Tribunal in *Swift* and the Court in *Boliden* approached the question of whether an interest in a US LLC is similar to share capital in different manners. The Court in *Boliden* focused more on the overall structure of the entity, whereas the First Tier Tribunal focused on the specific attributes of the taxpayer's interest in HVLLC. Whether Canadian courts will follow the broader approach set out in *Boliden* or focus on the specific attributes of a member's interest as in *Swift* remains to be seen.

Applicability of *Anson* in Canada

The *Anson* decision is important for Canadian taxpayers, as it provides a number of useful, although not exhaustive, factors to assist in the classification of foreign entities as corporations or partnerships. As there have not been any Canadian decisions to date which discuss the issue of classification of US LLCs in the income tax context, the *Anson* decision provides useful guidance on the classification of US LLCs in this context.[12] While *Boliden* remains the most instructive Canadian decision on the classification of US LLCs, the *Anson* decision provides further insight into the treatment of foreign entities, and US LLCs in particular, in common law jurisdictions.

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A number of tax lawyers from Fraser Milner Casgrain LLP write commentary for CCH's Canadian Tax Reporter *and sit on its Editorial Board as well as on the Editorial Board for CCH's* Canadian Income Tax Act with Regulations, Annotated. *Fraser Milner Casgrain lawyers also write the commentary for CCH's* Federal Tax Practice *reporter and the summaries for CCH's* Window on Canadian Tax. *Fraser Milner Casgrain lawyers wrote the commentary for* Canada–U.S. Tax Treaty: A Practical Interpretation *and have authored other books published by CCH:* Federal Tax Practice*;* Charities, Non-Profits and Philanthropy Under the Income Tax Act*;* Corporation Capital Tax in Canada*; and* Canadian Transfer Pricing. *Tony*

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Notes:

[1] See "Oh Say Can You (LL)C? A Case Comment on *Boliden Westmin Ltd. v. British Columbia*", Tax Topics, No. 1836, May 17, 2007.

[2] It has been suggested that the decision in *Exida.Com Limited Liability Company v. The Queen*, 2010 DTC 5101 (FCA) proceeded from the premise that a US LLC is a corporation for Canadian tax purposes. See Marc Darmo and Angelo Nikolakakis, "The New Rules on Limitation on Benefits and Fiscally Transparent Entities", *Report of Proceedings of Sixty-First Tax Conference*, 2009 Tax Conference (Toronto: Canadian Tax Foundation, 2010), 26:1-59 at footnote 137.

[3] *Swift v. HMRC*, [2010] UKFTT 88 (TC).

[4] *HMRC v. Anson*, [2011] UKUT B21 (TCC).

[5] The *Swift* and *Anson* decisions involve the same taxpayer. The difference in names is due to the fact that the taxpayer had originally requested and received anonymity in the first decision (*Swift*). As anonymity was determined not to be required in the appeal to the Upper Tribunal, the taxpayer's real name, Anson, was used in the appeal. It is understood that Swift's appeal on a subsidiary issue decided against him by the First Tier Tribunal but not dealt with by the Upper Tier Tribunal will be heard by the Upper Tier Tribunal on January 27, 2012.

[6] HMRC International Manual INTM 180010 "Foreign Entity Classification for UK Tax Purposes: Factors to consider in classifying a foreign entity for UK tax purposes".

[7] *Swift* at para. 5.

[8] [1998] STC 754 (UKCA).

[9] HMRC International Manual INTM 180030 "List of Classifications of Foreign Entities for UK tax purposes".

[10] IT-343R, "Meaning of the term corporation".

[11] *Boliden* at para. 19.

[12] *TD Securities (USA) LLC v. The Queen*, 2010 DTC 1137 (TCC) did involve the classification of a US LLC, as the appellant was a US LLC seeking the application of treaty benefits under the *Canada–United States Income Tax Convention* and was therefore required to be classified as a corporation or partnership under Canadian law. However, this case did not involve the classification issue, as the parties agreed the LLC in that case was a corporation for Canadian tax purposes.

[13] I would like to thank Joel Nitikman of FMC LLP, Vancouver who has reviewed previous drafts of this article.

INCOME TAX REGULATIONS

Final Regulations

The *Income Tax Regulations* have been amended by P.C. 2011-935, SOR/2011-187, "Omnibus No. 2"; P.C. 2011-936, SOR/2011-188 "Omnibus No. 3"; and P.C. 2011-951, SOR/2011-195 "Gross Revenue (Miscellaneous Program)", all registered on September 22, 2011 and published in the *Canada Gazette* Part II on October 12, 2011.

Omnibus No. 2 adds section 7309 and amends Class 12 of Schedule II of the Regulations. Section 7309 prescribes certain penalty interest provisions in the *Excise Act*, the *Excise Tax Act*, and the *Air Travellers Security Charge Act* that are exempt from the prohibition of the deduction of fines and penalties in the *Income Tax Act* (the "Act"), applicable after March 22, 2004. For taxation years beginning after March 2007, only one provision of the *Excise Act* is prescribed for this exemption because amendments to the other two Acts in 2006 standardized the interest calculations and eliminated the penalties that were calculated as interest. Class 12 is amended (pursuant to proposals in the 2006 federal Budget) to increase the dollar limit to $500 for kitchen utensils, medical or dental instruments, and tools in paragraphs (*c*), (*e*), and (*h*), respectively, of that class. These assets are eligible for capital cost allowance at 100% with no half-year rule. The increased limit is applicable for such assets acquired after May 1, 2006. The amendments also specify that electronic communication devices or electronic data processing equipment do not qualify as tools in paragraph (*h*) unless the device or equipment can be used only for measuring, locating, or calculating.

Omnibus No. 3 implements amendments that were released in draft form in the *Canada Gazette* Part I on February 19, 2011 (see Tax Topics No. 2033). This package contains several technical amendments, including those that are consequential on previous changes to the Act. Provisions in the Regulations affected by the Omnibus No. 3 amendments include sections 202 and 210 concerning information returns relating to payments from mutual fund trusts to non-residents, sections 231, 3100, and 3101 regarding tax shelters; various provisions in Parts II and III regarding life insurance policies and prescribed annuity contracts, including amendments to improve the concordance between the French and English versions of the Regulations; Part XXIV regarding the Canadian investment fund of insurance companies and the calculation of an insurer's income; Part XXXII regarding patronage dividends; Part XLVIII regarding rules that are used in determining the status of corporations and trusts for purposes of the Act, including pension investment corporations, master trusts, and insiders of a corporation; subsection 4900(2) regarding prescribed credit rating agencies; section 5600 regarding prescribed distributions for purposes of section 86.1 of the Act; Part LXVII regarding prescribed venture capital corporations and prescribed qualifying corporations; section 8303 regarding rules for calculating past service pension adjustments for an individual; Part LXXXV regarding conditions for the registration of

pension plans; and section 8700 regarding conditions for the registration of a national service organization. According to the Regulatory Impact Analysis Statement released with these amendments, no substantive changes have been made to the amendments since the publication in February 2011 in the *Canada Gazette* Part I.

The amendments in the package entitled Gross Revenue (Miscellaneous Program) affect mainly the French version of the Regulations and relate to updates in the drafting style. The only amendment in the English version is to subsection 2603(3) concerning business income earned in a province.

Draft Regulations

Draft regulations were published in the *Canada Gazette* Part I on October 8, 2011 to renumber section 205.1 of the Regulations as subsection 205.1(1) and to add subsection 205.1(2), pursuant to subsection 150.1(2.1) of the Act regarding the requirement for certain corporations to file the T2 tax return in electronic form. Subsection 205.1(2) of the Regulations sets out that this requirement applies to a corporation with gross revenue in excess of $1 million except for an insurance corporation, a non-resident corporation, a corporation reporting in functional currency (under section 261 of the Act), and a corporation that is exempt from tax under section 149 of the Act. This provision is intended to reduce the CRA's costs spent on manually processing T2 returns. For corporations, the explanation states that electronic filing allows corporations to receive immediate confirmation that the T2 has been received by the CRA, improves the processing times of T2 returns and refunds, reduces mail, delivery, printing and storage costs for corporations, and improves accuracy of the returns. Subsection 162(7.2) of the Act sets out a penalty of $1,000 for failure to file a return in the manner required by subsection 150.1(2.1) of the Act.

REVISED INFORMATION CIRCULAR IC72-17R6

The CRA has released Information Circular IC72-17R6, "Procedures Concerning the Disposition of Taxable Canadian Property by Non-Residents of Canada — Section 116", dated September 29, 2011. This circular cancels and replaces IC72-17R5, dated March 15, 2005. The circular has been updated for several changes, including legislative changes. It includes a new discussion on treaty-protected and treaty-exempt property, including form T2062C and also an expanded discussion of purchaser's liability. Information Circular IC72-17R6 has bee posted on CCH's federal income tax News Tracker and updated on CCH Online under Bulletins, Circulars, Rulings. It will be available in the next update on DVD and in Volume 8 in an upcoming print report.

SUPREME COURT OF CANADA

On October 13, 2011, the Supreme Court of Canada granted the application for leave to appeal in the case of *Québec (Deputy Minister of Revenue) v. Services Environnementaux AES Inc. and Centre Technologique AES Inc.*, 2011 DTC 5045 (QCCA). This case concerns a request for a rectification order for documents relating to a corporate reorganization. The initial result of the transfer of shares did not give rise to the tax deferral that was intended. The Quebec Superior Court allowed the parties to amend the documents retroactive to the date of the initial agreement. The Court of Appeal of Quebec upheld this decision.

The Supreme Court dismissed the application for leave to appeal in the case of *Long v. The Queen*, 2011 DTC 5044 (FCA). This case concerned a motion requesting full disclosure of documents under Rule 82(1) of the *Tax Court of Canada Rules (General Procedure)*.

REMISSION ORDERS

Two income tax remission orders, both dated September 29, 2011 were recently granted under the *Financial Administration Act*. Under the Bela Revi Remission Order, P.C. 2011-1140, SI/2011-83, income tax and interest for 2008 were remitted. The additional tax was a result of a lump-sum payment from a government agency received in 2008 that related to years 1996 to 2008 and resulted in a financial burden to the taxpayer that would not have occurred if the payment had been made earlier. The Michele McGhie Remisission Order, P.C. 2011-1141, SI/2011-84, remitted interest that arose as a result of incorrect action by CRA officials.

RECENT CASES

Tax Court erred respecting taxpayer's burden of proof

The only issue on appeal was whether the associate chief justice ("ACJ") of the Tax Court of Canada made a reviewable error in concluding that the taxpayer received $305,000 as a shareholder benefit in 2003. The taxpayer argued that the amount was a long-term investment transferred to his spouse by his company, Hunt River, where he and his spouse were shareholders. He further argued that the amount received offset a shareholder loan by his spouse to Hunt River. The ACJ dismissed the taxpayer's appeal, on the basis that he did not meet the burden of proof and provided insufficient evidence to demolish the Minister's assumption that he received a $305,000 shareholder benefit (2009 DTC 1194).

The taxpayer's appeal was allowed with costs. The taxpayer had an initial onus to demolish the Minister's assumptions by presenting a *prima facie* case, which, if met, would then switch the onus to the Minister. The ACJ erred by confusing the taxpayer's initial onus to demolish the Minister's assumptions with the overall burden resting on the parties to prove their respective cases. The ACJ also erred in failing to consider the oral evidence put forth by the taxpayer's accountant.

¶47,834, *House*, 2011 DTC 5142

Application for time extension to file notice of objection denied because filed too late

On July 23, 2009, the Minister reassessed the taxpayer, disallowing charitable donation tax credits claimed for 2006 and 2007. On August 20, 2009, the taxpayer filed a combined notice of objection for 2006 and 2007. In a letter dated January 22, 2010, the Minister informed the taxpayer that a separate notice of objection for 2007 was required. On February 15, 2011, the taxpayer applied to the Minister for an extension of time to file her 2007 notice of objection but was refused, because the application was not made within one year from the expiration of the time period in which a notice of objection to the reassessment issued on July 23, 2009, could have been served. The taxpayer then applied to the Tax Court of Canada for the same extension.

The taxpayer's application was dismissed. The taxpayer's application for 2007 was not made in the one-year period and was therefore statute barred. The question of whether the taxpayer's original combined notice of objection for both 2006 and 2007 was valid for 2007 was not before the Court and, therefore, required no analysis.

¶47,835, *Johnson*, 2011 DTC 1291

Repeated failure penalty for not reporting income was justified

The taxpayer failed to report income on two occasions. The first occurred in 2005, in which employment income in the amount of $837 was not reported. The taxpayer explained that he inadvertently forgot to include this amount. The second was in 2008, in which employment insurance benefits in the amount of $14,071 were not reported. These were for supplementary benefits received after the regular benefits had expired. The taxpayer claimed that he never received a T4 slip for the omitted benefits. He did report the regular employment insurance benefits that were shown in another T4 slip. The taxpayer's return was prepared by a friend, who was an experienced tax return preparer, without compensation. The Minister imposed a 10% penalty for the second omission ($1,407). The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. The Court found that in order to avoid the strict liability penalty for a two-time failure to report income, a taxpayer must demonstrate that appropriate measures were taken to correctly report all income. The Court was not satisfied that the taxpayer had done so. The onus is on taxpayers to keep track of their income and properly report it. Reliance on T4 slips is not sufficient. In addition, in the tax return the taxpayer claimed a tax credit for tuition paid. This amount was actually part of the employment insurance benefits that were unreported. By claiming this amount as an expense for purposes of the credit, and by not reporting the government benefit as income, the taxpayer did not take proper care in the preparation of the tax return. While the tax filing was complex, a taxpayer is obligated to ensure that all income is properly reported. If a taxpayer is not aware of the proper tax

treatment of an amount received, competent advice should be sought. It was not suggested that the person who prepared the tax return for the taxpayer had undertaken to provide such advice. The penalty was properly imposed.

¶47,836, *Sheppard*, 2011 DTC 1292

Taxpayer who moved to Italy not resident in Canada and had to repay CCTB and GST credits

The taxpayer moved to Italy with her husband and son in 2001 and rented an apartment with an eight-year lease. They continued to rent the apartment on a month-to-month basis after the expiry of the lease. The taxpayer had relatives, including her parents, in Canada, had some loans and a bank account in Canada, and occasionally returned to visit. The Minister determined that the taxpayer was not a resident in Canada, and required her to repay child tax benefits and GST credits paid to her. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was dismissed. The Court found that when the taxpayer moved to Italy, that became the place in which her life was centred, and the few ties that she had to Canada since that time were insufficient to support a claim to continuing residence. There was no reason to believe that the few possessions that she had at her parents' apartment had any significant economic or emotional value. Her student loans were a liability that she could not move at will. Her bank account had a small balance, and there was no evidence that it was actively used on any significant basis. The Court gave little weight to the taxpayer's expressed intention to return someday to Canada. However, it was not the taxpayer's intention but the breadth and strength of her remaining ties with Canada that determined her claim to residence, and those ties were neither numerous nor strong. Her most significant tie to Canada was the presence of her parents and her sisters, but it required much more than simply the presence of relatives to maintain a claim to residence.

¶47,837, *Manotas*, 2011 DTC 1293

Payments to shareholders on life insurance policies purchased by corporation were taxable as shareholder benefits

The taxpayers, four brothers, were the shareholders and directors of a corporation (the "Corporation"). The Corporation purchased and paid premiums (the "Premiums") on life insurance policies on each of their lives (the "Policies"). The agent who had arranged this insurance (the "Agent") paid cash to each taxpayer, representing a return of a substantial portion of the Premiums paid for the first year on each policy. In reassessments, made beyond the normal reassessment period in some cases, the Minister added the unreported cash payments to one taxpayer's income for 2000 and 2002, and to each of the other three taxpayers' incomes for 2002, as s. 15(1) shareholders' benefits, and imposed penalties for gross negligence under s. 163(2). On appeal to the Tax Court of Canada, the taxpayers argued that the cash payments they received from the Agent were in essence discretionary gifts, so that no s. 15(1) shareholders' benefits accrued to them.

The taxpayers' appeals were dismissed. There was an adverse inference to be drawn from the fact that the Agent had not been called upon to testify. The taxpayers also knew or ought to have known that the cash they received from the Agent was the property of the Corporation, as the Corporation had initially paid the Premiums on the Policies. In addition, the taxpayers were grossly negligent in failing to report the cash as shareholders' benefits in their hands. The Minister's reassessments were affirmed accordingly.

¶47,838, *Lapalme*, 2011 DTC 1294

Taxpayer providing meals as part of educational courses did not have to reduce its catering costs deduction by 50%

The corporate taxpayer provided educational courses in various cities. Breakfast and lunch were served at these courses, although the course participants were not billed separately for these meals. On reassessment, the Minister disallowed the full deduction claimed for 2006 and 2007 for the catering expenses incurred by the taxpayer in providing meals at its courses, applying the half amount limitation in s.67.1(1) to those expenses. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was allowed. The taxpayer's ordinary course of business included the provision of meals at its educational courses, for compensation. The exception in s. 67.1(2)(*a*) therefore rendered the half amount limitation in s. 67.1(1) inapplicable to the taxpayer's situation. The taxpayer was entitled to deduct the full amount for catering expenses incurred. The Minister was ordered to reassess accordingly.

¶47,839, *Pink Elephant Inc.*, 2011 DTC 1295

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