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Tax Perspectives

Review of 2025 and 2026 Outlook

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Introduction: Review of 2025 and 2026 Outlook

Over the past years the Government of Canada ("Government") has furthered tax reform by announcing legislative proposals and draft legislation and enacting technical amendments to Canadian tax law addressing a wide range of tax measures. 2025 continued that trend.

Following the announcement of Prime Minister Justin Trudeau's resignation as Prime Minister and leader of the Liberal Party of Canada, Parliament was prorogued until March 24, 2025, which resulted in the termination of Parliamentary business. With the subsequent election of Prime Minister Mark Carney's minority Liberal government, Canadians anticipated the Government's legislative proposals aimed at fulfilling its election platform promise to "build Canada strong".

With minimal Parliamentary business for much of the year, the pace of legislative proposals was slower in 2025 than in prior years. However, we did see the introduction of significant legislative packages, implementing many of the tax measures proposed by the prior Liberal government and new measures which reflect the stated priorities of the current Government. As opposed to relying on broad corporate tax rate reductions to encourage growth in the private sector, the Government's fiscal measures are aimed at promoting growth and Canadian investment through targeted incentives, such as the accelerated deduction of certain capital expenses, which are meant to reduce marginal effective tax rates for capital-intensive businesses. The Government is also prioritizing large, nation-building and infrastructure projects. The Government hopes that these efforts will mitigate Canada's economic reliance on the United States, while encouraging greater corporate investment in Canada.

Although the effect of the Government's 2025 fiscal measures remains to be seen, it has signaled a willingness to drive internal economic productivity and growth through investment in Canadian industry and its natural resources. Given economic uncertainties and trade tumult, it is unclear whether the Government's priorities will be advanced by such measures, or if more sweeping policy changes are required.

This publication provides an overview of the important Canadian legislative and judicial tax developments of 2025, and looks ahead to potential significant Canadian tax changes in 2026. The goal is not to be comprehensive, but rather to highlight the developments we consider to be most impactful to a broad audience of our clients.

Our commentary is divided into the following sections:

— Income Tax Legislative Developments and Outlook

— Commodity Tax Developments and Outlook

— Tax Disputes and Litigation Developments and Outlook

— Charities and Non-Profits Developments and Outlook

Income Tax Legislative Developments and Outlook

The significant volume of new proposals, draft legislation and tabled legislation implementing previously announced proposals included the following.[1]

— On January 31, 2025, Finance announced a **deferral** to the implementation of the proposed capital gains inclusion rate increases from June 25, 2024 to January 1, 2026. Then, on March 21, 2025, Prime Minister Carney announced that the Government would **cancel** the proposed capital gains inclusion rate change.

— On February 21, 2025, Finance released draft legislation to implement the electric vehicle supply chain investment tax credit ("EV ITC").

— On March 3, 2025, the Government announced the **extension** of the mineral exploration tax credit for an additional two years, until March 31, 2027.

— On August 15, 2025, Finance released draft legislation for a number of previously announced proposals ("August 15 Proposals") such as proposed amendments to the ***Global Minimum Tax Act*** ("GMTA"), proposed amendments to the Act and the Regulations relating to **Budget 2024 and other proposals**, including the implementation of a crypto-asset reporting framework and the common reporting standard, enhanced Canada Revenue Agency ("CRA") audit and information-gathering powers, elective exemptions from the excessive interest and financing expenses limitation ("EIFEL") rules for interest and financing expenses incurred for arm's length financing used to build, acquire, or convert a property into eligible purpose-built rental housing or carry on a Canadian regulated energy utility business, enhanced tax incentives for scientific research and experimental development ("SR&ED") and other **technical amendments** including clarifications to the bare trust reporting rules.

— On August 20, 2025, the CRA released an update to its **guidance** on the mandatory disclosures rules.

— On September 10, 2025, the CRA announced administrative **changes** to its voluntary disclosures program ("VDP"), which came into effect on October 1, 2025, to expand eligibility criteria and provide additional relief for income tax and GST/HST applicants.

— On November 4, 2025, the Government released the **2025 federal budget** ("Budget 2025") which included a number of measures to allow for the immediate expensing for manufacturing and processing buildings, the modernizing of Canada's transfer pricing rules and amendments to and extensions of, the clean economy tax credits. The **McCarthy Tétrault LLP overview of Budget 2025** provides a more detailed review.

— On November 17, 2025, the Minister of Finance and National Revenue ("Minister") tabled a **Notice of Ways and Means Motion** in the House of Commons to seek approval of the Government's fiscal policy as outlined in Budget 2025.

1 All statutory references herein are to the *Income Tax Act* (Canada) ("Act") unless specifically otherwise noted.

— On November 18, 2025, Bill C-15, the *Budget 2025 Implementation Act, No. 1*, was tabled and received first reading in the House of Commons in the First Session of the 45th Parliament. Bill C-15 introduced a number of previously announced tax measures including, among other measures, the clean electricity investment tax credit ("CE ITC"), significant enhancements to the SR&ED program, discretion for the CRA to waive the withholding requirement for payments made to a non-resident service provider where certain conditions are satisfied, and an increase in the lifetime capital gains exemption to $1.25 million.

— On November 25, 2025, Finance released **explanatory notes** relating to the measures set out in the November 17, 2025 Notice of Ways and Means Motion.

REPEAL OF PROPOSED INCREASE TO CAPITAL GAINS INCLUSION RATE

Cancellation of Ancillary Measures

On March 21, 2025, Prime Minister Carney announced that the Government would abandon the proposed increase to the capital gains inclusion rate from one-half to two-thirds for capital gains realized on or after June 25, 2024, as contemplated in the 2024 federal budget ("Budget 2024") proposals. These proposals were included in a Notice of Ways and Means Motion on September 23, 2024 (the "Capital Gains Proposals") but were never enacted. In light of the cancellation, Finance announced that several ancillary measures relevant to the Capital Gains Proposals would also be cancelled, including:

— the Canadian Entrepreneur Incentive, which would have permitted certain individuals to reduce by half the capital gains inclusion rate applicable to a disposition of certain shares or qualified farm or fishing property, up to a maximum of $2,000,000 of capital gains in 2029 and subsequent taxation years; and

— proposed amendments to the alternative minimum tax ("AMT") which would have removed a rule that proposed to limit the deduction of certain resource expenses in computing "adjusted taxable income" to specified resource income of a taxpayer. As part of the Capital Gains Proposals, the Government proposed to limit the add-back (for purposes of computing a taxpayer's adjusted taxable income) on the disposition of flow-through shares to the "true" capital gain realized on the disposition of such shares as opposed to three-tenths of the capital gain that would have been realized by a taxpayer.

For more details regarding these measures, please see:

— **2025 Canadian Federal Budget Commentary – Tax Initiatives**

PRODUCTIVITY SUPER-DEDUCTION

As part of its commitment to encourage productivity and growth in Canada, Budget 2025 introduced a "productivity super-deduction" comprised of several previously announced measures, including the immediate expensing of SR&ED capital expenditures, and two new measures: (i) the immediate expensing of manufacturing or processing machinery and equipment, and (ii) the reintroduction of accelerated capital cost allowance

("CCA") for liquified natural gas ("LNG") equipment and other non-residential buildings.

Budget 2025 asserted that the productivity super-deductions will reduce Canada's marginal effective tax rate ("METR") for corporations to 13.2%, which would be the lowest METR in the G7, and below the average METR as measured by the Organisation for Economic Co-operation and Development ("OECD").

As a result, the Government anticipates that the productivity super-deduction will make Canada's overall METR lower than the United States' METR, which it hopes will increase Canadian competitiveness vis-à-vis the United States.

Immediate Expensing for Manufacturing and Processing Buildings

Budget 2025 proposed to temporarily increase the CCA rate for buildings used or acquired for use for eligible manufacturing or processing (including eligible additions and alterations) up to a maximum of a 100% deduction for the first taxation year that such property is used for manufacturing or processing. In general, eligibility for immediate expensing would require: (i) the property to be acquired on or after November 4, 2025, (ii) the property be first used for manufacturing or processing before 2030, and (iii) a minimum of 90% of the floor space of the property be used to manufacture or process goods for sale or lease.

Property which has been used prior to its acquisition by the taxpayer will be eligible for the enhanced accelerated rates for the first taxation year if the following conditions are satisfied: (i) the taxpayer nor any person with whom the taxpayer does not deal at arm's length previously owned the property; and, (ii) the property was not transferred to the taxpayer on a tax-deferred basis.

Where eligible property was acquired on or after November 4, 2025, and is first used for manufacturing or processing in 2030 or later, the enhanced first-year CCA rates are gradually reduced as follows:

— eligible property that is first used for manufacturing for processing in 2030 or 2031 will be eligible for an accelerated 75% first-year deduction; and

— eligible property that is first used for manufacturing for processing in 2032 or 2033 will be eligible for an accelerated 50% first-year deduction.

The enhanced first-year CCA rates will be entirely phased out for property first used in manufacturing or processing after 2033.

Accelerated CCA Rates for LNG Equipment and Related Buildings

Budget 2025 also proposed to reinstate accelerated CCA rates for LNG equipment and facilities, which expired in 2024. A prior temporary measure had increased the CCA rate for LNG equipment from 8% to 30%, and the CCA rate on certain LNG buildings from 6% to 10%.

In contrast, Budget 2025 introduced new CCA measures which provide for an accelerated CCA rate for LNG equipment and buildings acquired on or after November 4, 2025, and before 2035. In order to qualify for accelerated rates of CCA, the relevant LNG equipment or facility must satisfy certain emissions performance standards:

— LNG facilities that are in the top 25% of emissions performance are eligible for an accelerated CCA rate of 30% for certain LNG equipment and 10% for related buildings; and

— LNG facilities that are in the top 10% of emissions performance are eligible for an accelerated CCA rate of 50% for certain LNG equipment and 10% for related buildings.

LNG facilities that do not satisfy the top 25% threshold for emissions performance are not eligible for the enhanced CCA rate.

For more details on the productivity super-deduction, please see:

— **2025 Canadian Federal Budget Commentary – Tax Initiatives**

PILLAR TWO – GMTA

In October 2021, the members of the OECD and the Inclusive Framework confirmed their intention to move forward with a Two-Pillar solution to address the digitalization of the economy. Pillar One proposes to reallocate a portion of the profits of large multinational enterprises ("MNEs") to market jurisdictions, while Pillar Two imposes a 15% global minimum tax on MNEs with consolidated financial accounting income of €750 million or more.

UTPR

On August 12, 2024, Finance released draft legislative proposals ("GMTA Proposals"), which among other things, contained amendments to implement the undertaxed profits rule ("UTPR") into the *Global Minimum Tax Act* ("GMTA").

Very generally, the UTPR is a backstop to the income inclusion rule ("IIR") and ensures that MNE groups are subject to top-up tax on the profits of low-tax constituent entities that do not have a relevant parent entity in a participating jurisdiction. The UTPR allows other adopting jurisdictions (*e.g.*, Canada) in which the MNE group is located to impose a top-up tax on under-taxed income in foreign jurisdictions.

The Government did not introduce legislation to implement the UTPR in 2025. However, it did confirm its intention to implement the GMTA Proposals in connection with the GMTA (including the UTPR) in Budget 2025. Further, Budget 2025 also affirmed the Government's intention to enact certain measures, including administrative guidance released by the OECD since the enactment of the GMTA.

On June 28, 2025, the G7 announced that it had reached an agreement to introduce a "side-by-side" system ("G7 Statement") whereby the Pillar Two rules and the United States' global intangible low-taxed income ("GILTI") minimum tax would continue to co-exist. In particular, the G7 Statement provides that U.S.-parented groups, including their foreign subsidiaries, would be exempt from the IIR and the UTPR. In exchange for this concession, the United States agreed to remove proposed *Internal Revenue Code* Section 899 from the *One Big Beautiful Bill Act*. Of note, the GILTI and Pillar Two rules have material differences, which may have an impact on Canada's implementation of the UTPR.

As of the date hereof, there have been no further details announced regarding the implementation of the side-by-side approach[2].

For more details regarding these measures and the UTPR, please see:

— **2025 Canadian Federal Budget Commentary – Tax Initiatives**

— **A Big Beautiful Blog: Base Erosion, Canada, and Big American Bill**

CRYPTO-ASSET REPORTING FRAMEWORK AND COMMON REPORTING STANDARD

As part of the August 15 Proposals, Finance released draft legislative proposals to create new Part XXI of the Act, implementing the OECD's crypto asset reporting framework ("CARF") and related amendments to the common reporting standard.

The proposed amendments to the CARF would, among other things:

— expand the reach of the common reporting standard to cover central bank digital currencies (*i.e.*, digital fiat currency issued by a central bank) and "specified electronic money products" (*e.g.*, a digital representation of a fiat

2 Prior to publication, the OECD released administrative guidance on the side-by-side approach and other Pillar Two issues on January 5, 2026, and Finance released draft legislation to modify the UTPR on January 29, 2026.

currency), which are currently not reportable under the CARF;

— exempt custodians from reporting the gross proceeds from the sale of a financial asset (including a "relevant crypto asset") under the common reporting standard, provided that such amounts are reported under new Part XXI of the Act; and

— impose additional reporting requirements in respect of financial accounts and accountholders.

Budget 2025 confirmed the Government's intention to implement the CARF and common reporting standard amendments with the application deferred until January 1, 2027.

For more details regarding the CARF, please see:

— **Federal Government releases proposals relating to information reporting of crypto-assets and certain clean technology and resource tax credits**

SR&ED PROGRAM UPDATES

Budget 2025 confirmed the Government's intention to enact amendments to the SR&ED program, previously announced in the 2024 Fall Economic Statement ("2024 FES").

The federal SR&ED tax incentive program has been a cornerstone of Canada's economic development and innovation strategy since 1987. The program is based on the concept of qualified SR&ED expenditures, which generally include labour costs, contract payments to third-party companies performing qualified work in Canada, the cost of materials consumed or transformed during the SR&ED process, and third-party payments to research institutions, universities or labs conducting SR&ED.

The proposals set out in FES 2024 include the following updates:

— restoring the eligibility of certain capital expenditures to qualify for deductions and investment tax credits, reversing changes made in 2014, for property acquired after December 15, 2024;

— expanding eligibility for the enhanced 35% refundable SR&ED investment tax credit ("SR&ED ITC") to eligible Canadian public corporations for taxation years that begin after December 15, 2024; and

— an increase to the existing $10 million and $50 million taxable capital employed in Canada thresholds at which the 35% refundable tax credit is eliminated to $15 million and $75 million, respectively, for taxation years that begin after December 15, 2024.

In addition, applicable to taxation years beginning after December 15, 2024, Budget 2025 proposed further increases to the annual expenditure limit for the 35% refundable SR&ED ITC from $3 million to $6 million.

Enhancements to the SR&ED ITC represent the Government's commitment to further promote investment, innovation, and economic growth through tax incentives. However, businesses advancing beyond early-stage research and development ("R&D") or with sustained, long-term R&D needs have often struggled to fully leverage its benefits. Ideally, the expansion of SR&ED to include scale-up activities and to include some public corporations will create a more supportive environment for Canadian business.

For more details regarding updates to the SR&ED, please see:

— **Budget 2025 includes tax incentives to promote investment and innovation in Canada**

— **2025 Canadian Federal Budget Commentary – Tax Initiatives**

CLEAN ECONOMY TAX CREDITS

The Government has proposed six Clean Economy Investment Tax Credits to promote investment in clean energy technology in Canada in prior years.

In particular, a suite of Clean Economy Tax Credits were implemented by Bill C-59 and Bill C-69 in the First Session of the 44th Parliament, which both received Royal Assent on June 20, 2024:

— the investment tax credit for Carbon Capture, Utilization and Storage ("CCUS ITC") available in respect of the capital cost of eligible property acquired on or after January 1, 2022;

— the Clean Technology Investment Tax Credit ("CT ITC") available in respect of the capital cost of eligible property acquired and available for use on or after March 28, 2023;

— the Clean Hydrogen Investment Tax Credit ("CH ITC") available in respect of the capital cost of eligible property acquired and available for use on or after March 28, 2023; and,

— the Clean Technology Manufacturing Investment Tax Credit ("CTM ITC") available in respect of the capital cost of eligible property acquired and available for use on or after January 1, 2024.

For more details regarding these Clean Economy Tax Credits, please see:

— **Federal government proposes expansion of clean economy tax credits and other tax incentives in Budget 2025**

— **Clean Economy Tax Credits: Clean Technology Investment Tax Credit as updated by 2023 Fall Economic Statement and Bill C-59**

In Budget 2025, the Government confirmed its intention to move forward with prior legislative proposals which would expand eligibility for the CT ITC, CTM ITC and CH ITC with retroactive effect, including:

— expanding eligibility under the CTM ITC for eligible property acquired for use in polymetallic mining activities on or after January 1, 2024. In addition, Budget 2025 extended the availability of the full CCUS ITC rates until December 31, 2035. Eligible expenditures incurred between January 1, 2036 and December 31, 2040 would be subject to reduced rates;

— expanding eligibility under the CT ITC for eligible property acquired for use in certain waste biomass generation projects on or after November 21, 2023;

— expanding eligibility under the CT ITC for eligible property relating to small modular nuclear reactors that is acquired and becomes available for use on or after March 28, 2023; and

— expanding eligibility under the CH ITC for eligible property used in methane pyrolysis projects that is acquired and becomes available for use on or after December 16, 2024.

In Budget 2025, the Government indicated that it would release legislation regarding the previously announced CE ITC "soon". That occurred on November 18, when the Government tabled Bill C-15 in the House of Commons. The CE ITC is proposed to be available in respect of the capital cost of eligible property acquired on or after April 16, 2024, unless the relevant project commenced construction before March 28, 2023. The tabled legislation for the CE ITC also reflects the Government's Budget 2025 proposals to:

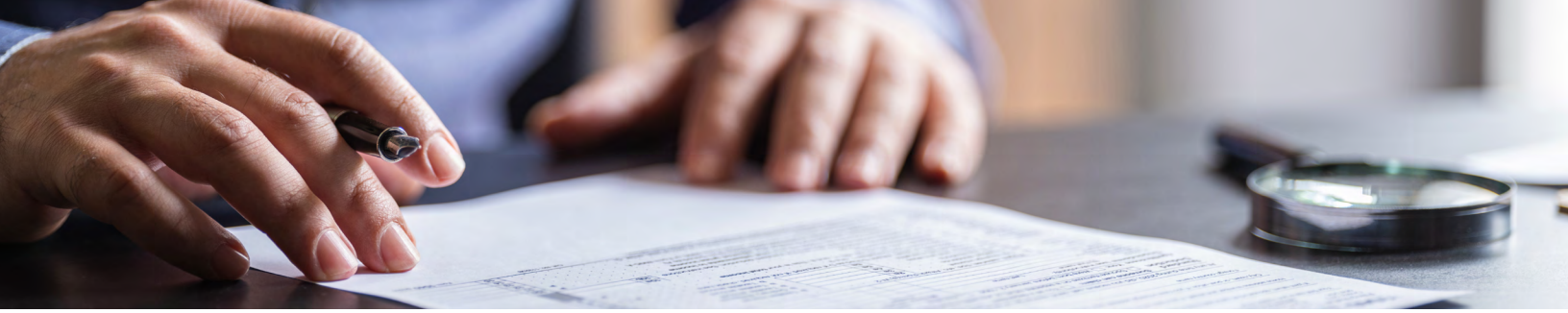
— include the Canada Growth Fund as an eligible entity under the CE ITC and create an exemption such that financing provided by the Canada Growth Fund will not reduce the capital cost of clean energy property for purposes of computing the CE ITC. Such measures would apply for eligible property that is acquired for use on or after November 4, 2024; and

— removing the net-zero commitment and the requirement to pass along the benefit of the CE ITC to ratepayers as conditions imposed on provincial and territorial governments for their Crown corporations to be eligible to claim the CE ITC.

Despite having been included in Prime Minister Carney's election platform, the EV ITC first announced in Budget 2024 was conspicuously absent from both Budget 2025 and the Government's timeline for the delivery of Clean Economy Tax credits, leading to some uncertainty regarding its ultimate implementation.

For further details, please see:

— **2025 Canadian Federal Budget Commentary – Tax Initiatives**



TRUST REPORTING RULES DEVELOPMENTS

First announced in Budget 2018, enhanced trust reporting rules were enacted by Bill C-32 in the First Session of the 44th Parliament and came into force on December 15, 2022 ("Bill C-32 Rules").

Under the Bill C-32 Rules, most trusts were required to file a T3 Return and new Schedule 15 annually for taxation years ending on or after December 31, 2023. Schedule 15 requires the provision of information including the trust's trustees, beneficiaries and settlors and controlling persons (*e.g.*, a protector), subject to limited exceptions. Key changes under the Bill C-32 Rules was that most bare trusts appeared to be subject to the enhanced reporting requirements, and that other express trusts could be required to file T3 Returns (including Schedule 15) in taxation years in which those trusts did not have income.

Without sufficient guidance in the lead up to the filing deadline for the 2023 T3 Returns, including Schedule 15, many taxpayers perceived the filing requirements and potential penalties for bare trusts to be onerous and unclear. In an effort to address these concerns, the CRA announced on March 12, 2024 that it would waive the late-filing penalty for the 2023 taxation year in respect of late-filed T3 Returns, including Schedule 15, barring gross negligence. Then, on March 28, 2024, only a few days before the filing deadline, the CRA announced that it would not require bare trusts to file a T3 Return, including Schedule 15, for the 2023 taxation year, unless directly requested by the CRA. On October 29, 2024, the CRA announced that bare trusts would not be required to file a T3 Return and the accompanying Schedule 15 for the 2024 taxation year, unless directly requested.

The August 15 Proposals included amendments to the bare trust reporting rules, meant to provide additional clarity regarding the beneficial ownership arrangements that are subject to the reporting rules. Subject to certain exceptions, the draft legislation deems certain trusts to be subject to the bare trust reporting rules where (i) one or more persons is considered to be a trustee of the trust and legally owns property that is held for the use or benefit of one or more persons or partnerships, each of which is considered to be a beneficiary of the trust, and (ii) the trustee may reasonably be considered to act as an agent on behalf of the beneficiaries of the trust (generally aligning with characteristics of a bare trust). The August 15 Proposals also proposed to exclude the following arrangements (among others) from the bare trust reporting rules:

- a trust whereby each beneficiary is also a legal owner of the trust property and there are no legal owners that are not beneficiaries of the trust;
- a trust whereby (i) the property is held throughout the year solely for the use or benefit of a partnership, (ii) each legal owner of the property is a partner of the partnership, and (iii) a member of the partnership is (or would be, but for subsection 220(2.1)) required to file an information return for a fiscal period of the partnership that includes December 31 of the relevant taxation year; and
- a trust whereby all or substantially all of the trust property is comprised of "Canadian resource property" held for the use or benefit of one or more publicly listed companies (or the subsidiaries or partnerships of such companies).

The amendments to the bare trust reporting rules contained in the August 15 Proposals were included in Bill C-15. The draft legislation contained in Bill C-15 will apply to require certain bare trusts to file a T3 Return and Schedule 15 for taxation years ending on or after December 31, 2026. However, bare trusts will not be required to file either a T3 Return or Schedule 15 for taxation years ending in 2025, effectively extending the exemption from reporting for bare trusts for the 2025 taxation year.

For more details regarding the bare trust reporting rules, please see:

- **2025 Canadian Federal Budget Commentary – Tax Initiatives**
- **Key Takeaways from McCarthy Tétrault Tax Perspectives: September 2025**
- **A Closer Look at the Proposed Changes to the Trust Reporting Rules**

MODERNIZING THE TRANSFER PRICING RULES

Transfer Pricing

Canada's transfer pricing rules are receiving an overhaul. The new transfer pricing rules focus on whether "actual conditions" are different from "arm's length conditions" and consolidates the current "repricing" rule and "recharacterization" rule into a single rule.

The "actual conditions" of a transaction or series would not be limited to the contractual terms of the transaction or series, but would be determined based on "economically relevant characteristics," which include:

- the contractual terms of the transaction or series, and other relevant transactions or series involving any of the participants or another member of the multinational enterprise group, but only to the extent that those terms are "not inconsistent with the actual conduct of the participants";
    - the actual conduct and functions of the participants, including: (i) assets and assumed risks; (ii) the relationship of those functions to the value generated by the multinational enterprise group as a whole;
      (iii) surrounding circumstances; and (iv) industry practices;
    - the characteristics of property transferred or services performed;
    - the economic circumstances of the participants and market context; and
    - the business strategies of the participants.

The "arm's length conditions" are the terms and conditions that would have been entered into between the participants had they been dealing at arm's length in comparable circumstances, but is intended to apply to the actual participants, and not hypothetical arm's length parties. The definition of arm's length conditions also contemplates circumstances in which the participants would have entered into a different transaction or series, or no transaction or series at all, providing the ability to disregard a transaction.

The actual conditions are deemed to be different from arm's length conditions where a condition does not apply to the transaction or series, but would have applied, had the participants been dealing at arm's length.

The new transfer pricing rule is to be applied with reference to the "Transfer Pricing Guidelines", a defined term that incorporates the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, as adopted by the Committee on Fiscal Affairs on January 7, 2022, or as prescribed by regulation.

Transfer Pricing Penalties

The threshold for the application of the transfer pricing penalty in subsection 247(3) is being increased. Currently, the penalty applies where the total transfer pricing adjustment exceeds the lesser of $5 million and 10% of the taxpayer's gross revenue for the year. The new threshold will be raised to the lesser of $10 million and 10% of the taxpayer's gross revenue for the year.

Transfer Pricing Contemporaneous Documentation

A taxpayer will be required to include new content in their contemporaneous documentation, which generally reflects the economically relevant characteristics to be considered in applying the new transfer pricing rule. In addition, the time within which contemporaneous documentation must be provided to the Minister upon written request would be reduced from three months to 30 days. This is a significant change that will increase the effort required to comply.

Where a taxpayer meets certain prescribed conditions, the documentation requirements would be simplified. The simplified contemporaneous documentation requirements are presumably intended to apply to small businesses, although draft regulations containing the prescribed conditions have not yet been released.

Learnings and Outlook

Taxpayers must ensure that they document any transactions with non-arm's length non-residents and have all contemporaneous documentation ready in advance, given the new 30-day window to provide such information upon request. The consequence of not providing contemporaneous documentation is that the taxpayer is deemed not to have made reasonable efforts to transact based on arm's length conditions for purposes of the transfer pricing penalty.

Taxpayers must carefully consider what terms and conditions to put into agreements and consider what arm's length parties would include as terms and conditions, as well as ensuring that the terms and conditions reflect the

actual conduct of the parties. The consequence of missing an arm's length term or condition is that the actual conditions are deemed to be different from arm's length conditions, and amounts relevant to the application of the Act may be adjusted accordingly.

For more details on the new transfer pricing legislation and other transfer pricing information, please see:

— 2025 Canadian Federal Budget Commentary – Tax Initiatives

— Charting the Strategic Path Through a Transfer Pricing Dispute

QUALIFIED INVESTMENTS FOR REGISTERED PLANS AND DEFERRED PROFIT SHARING PLANS

Harmonization of Small Business Investments and Qualified Investments

Budget 2024 invited input from stakeholders in respect of "qualified investments" for registered plans. The Act allows for the existence of tax-assisted plans aimed at promoting savings and investment including registered retirement savings plans ("RRSPs"), registered retirement income funds ("RIFFs"), registered education savings plans ("RESPs"), tax-free savings accounts ("TFSAs"), registered disability savings plans ("RDSPs") first home savings accounts ("FHSAs", and together with RRSPs, RIFFs, RESPs, TFSAs, and RDSPs, "registered plans") and deferred profit sharing plans ("DPSPs").

In general, a registered plan or a DPSP must limit its investments to "qualified investments" of a particular plan and may be subject to adverse tax consequences where it acquires or holds an investment that is not a qualified investment in respect of a particular plan ("non-qualified investment"). For instance, where a registered plan acquires a non-qualified investment, the holder of that plan ("controlling individual") may be subject to a penalty tax that is refundable in certain circumstances. Similarly, where a DPSP acquires a non-qualified investment, it may be subject to a penalty tax that is also refundable in certain circumstances.

Following consultation, Budget 2025 proposed to simplify and harmonize the types of investments that may be held by a registered plan or by a DPSP, particularly as they relate to the qualified investment rules for small business investments. These measures would, among other things:

— amend the RRSP, RESP, RRIF and RDSP rules to remove their separate definitions of "qualified investment" and instead refer to the definition of "qualified investment" and "non-qualified investment" in subsection 207.01(1) already applicable to FHSAs and TFSAs;

— amend the definition of "qualified investment" in subsection 207.01(1) such that it applies to all registered plans; and

— remove the "small business investment limited partnership", "small business investment trust" and "eligible corporation" categories of qualified investment, except where interests in investments of these types were acquired before January 1, 2027 and were qualified investments both at the time of their acquisition and on December 31, 2026.

Registered Investment Repeal and Replacement

Budget 2025 also proposed to replace the registered investment regime with two new categories of qualified investments that do not require registration:

— units of a trust that is subject to, and substantially complies with, the requirements of *National Instrument 81-102 Investment Funds* published by the Canadian Securities Administrators; and

— units of a trust that is an "investment fund" that is managed by a registered investment fund manager as contemplated by *National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations* published by the Canadian Securities Administrators.

These new categories have an effective date of November 4, 2025; the remainder of the registered investment regime will be effective January 1, 2027.

Prior to the proposed amendments, the registered investment regime only contemplated six types of trusts or corporations which could become registered investments. In response to input solicited from stakeholders during the consultation process, the Government indicated that the registration process applicable to the registered investment regime "[did] not add sufficient value to justify its associated compliance and administration burdens".

For further details on these measures, please see:

— **2025 Canadian Federal Budget Commentary – Tax Initiatives**

— **Budget 2025 proposes changes to qualified investment rules for registered plans such as RRSPs**

OTHER TAX PROPOSALS AND TECHNICAL AMENDMENTS

Other key new proposals and draft legislation implementing previously announced proposals include the following:

— amendments to subsection 104(5.8) to expand the scope of that anti-avoidance rule to address indirect trust-to-trust transfers made in contemplation of the deemed disposition on the 21st anniversary of a trust;

— the introduction of new subsection 129(1.3) to suspend the deferral of refundable tax on investment income earned by a Canadian-controlled private corporation through the use of a tiered corporate structure with staggered year-ends;

— the expansion of the foreign accrual property income ("FAPI") rules to include investment income earned by an affiliate in connection with the insurance or reinsurance of specified Canadian risk, subject to certain safe harbours;

— amendments to the Act and the *Excise Tax Act* (Canada) ("ETA") to permit for the sharing of taxpayer information with Employment and Social Development Canada solely for the administration and enforcement of the Canada Labour Code; and,

— the phasing-out of the Canada Carbon Rebate by providing that no such payments will be made in respect of tax returns or adjustment requests filed after October 30, 2026.

Please see our Firm's commentary on **Budget 2025** for background information on these proposed measures.

Commodity Tax Developments and Outlook

The following commodity and indirect tax measures and proposals were implemented in 2025:

— In March 2025, the Manitoba Ministry of Finance updated **Information Bulletin RST 033 – *Computer Software and Online Services*** to reflect that cloud computing services would be subject to Manitoba retail sales tax effective January 1, 2026.

— On May 27, 2025, the Minister tabled a **Notice of Ways and Means Motion** in the House of Commons to eliminate the GST applicable to first-time home buyers on new homes valued up to $1 million and lower the GST incurred on new homes valued between $1 to $1.5 million and to remove the consumer carbon price from law following its prior cancellation on April 1, 2025.

— On June 29, 2025, Finance announced that the *Digital Services Tax Act* ("DSTA") would be rescinded in anticipation of a comprehensive trade arrangement with the United States.

GST/HST MEMORANDUM 14-9-1 PARTNERSHIPS - DETERMINING THE EXISTENCE OF A PARTNERSHIP

In March 2025, the CRA issued GST/HST Memorandum 14-9-1 *Partnerships - Determining the Existence of a Partnership* ("Memorandum"). As a partnership is a "person" under the ETA for GST/HST purposes, it is generally the partnership, and not the partners, that must be registered to collect GST/HST and remit net tax arising from the partnership's activities. In this way, partnerships have different operational considerations for GST/HST purposes than in other legal contexts where a partnership acts through its partners. However, there are other kinds of business arrangements, notably joint ventures and co-tenancies, may be functionally equivalent to partnerships without being considered a "person" for GST/HST purposes. For this reason, the Memorandum aims to summarize the requirements for determining the existence of partnership at common law and under provincial statutory law across Canada.

The summary provided by the Memorandum is helpful in many respects, but also reflects errors that the CRA commonly makes and relies on in its audits and assessments to disallow input tax credits ("ITCs"). Most notably, at paragraph 33, the Memorandum incorrectly states that "under partnership law, a limited partner in a limited partnership is not an agent of the partnership".

The CRA commonly relies on this misunderstanding of the law to improperly conclude that a limited partner cannot incur expenses on behalf of a partnership and thus that a limited partner's expenses are not incurred in the course of the partnership's commercial activities. The CRA's error in respect of the ability of limited partners to act as agents of a limited partnership was recently addressed in *ONR Limited Partnership v. The King,* **2024 TCC 156**, further discussed below, and this error in the Memorandum has been brought to the CRA's attention.

Manitoba RST Update Year-In-Review Article:

Cloud Computing Services to be subject to Manitoba Retail Sales Tax

The Manitoba Ministry of Finance updated **Information Bulletin RST 033 – *Computer Software and Online Services*** (the "Bulletin") in March 2025, and in doing so announced that cloud computing services would be to Manitoba retail sales tax ("RST") effective January 1, 2026. Section 4 of the Bulletin defines "cloud computing services" as Software as a Service ("SaaS"), Platform as a Service ("PaaS"), and Infrastructure as a Service ("IaaS"). SaaS, PaaS, and IaaS are further defined as follows:

- SaaS: the provision of ready-to-use software applications over the internet, with the provider managing all aspects of the software, including infrastructure, application, and data.
- PaaS: the provision of hardware and software resources to develop applications through the cloud.
- IaaS: the provision of on-demand infrastructure via the cloud, such as compute, processing, storage, networking, and virtualization.

Some common examples of cloud computing services are video game subscription services, cloud storage services, and website hosting services. Resident and non-resident providers of the foregoing cloud computing services are required to collect RST on these services when they are sold for consumption or use in, or relating to, Manitoba.

Manitoba RST will also generally apply to computer hardware, software and services acquired for own use or use in providing cloud computing services by providers of cloud computing services located in Manitoba. The Bulletin states that these purchases are not considered to be purchases for resale because the providers retain possession and control and their customers only acquire the right to access or use the cloud computing services.

On November 6, 2025, **Bill 46** was enacted by the Legislative Assembly of Manitoba. Bill 46 amended certain parts of the Manitoba *Retail Sales Tax Act* (the "RSTA"), as announced in the Bulletin, to subject cloud computing services to RST by expanding the definition of "software" and "use". Bill 46 also added the defined term "electronic device" and a provision that deems software to be delivered in Manitoba if certain conditions are met.

Beginning January 1, 2026, providers of cloud computing services must collect RST on these services when they are purchased for use on an electronic device or by an individual that is ordinarily situated in Manitoba. Manitoba thus joins British Columbia and Saskatchewan, the other two Western Canadian provinces with a provincial sales tax, to impose the tax on cloud computing services.

TEMPORARY FIRST-TIME HOME BUYERS' GST REBATE

On May 27, 2025, the Minister tabled legislation to eliminate the GST (or the federal portion of the HST) for first-time home buyers that meet certain conditions for new homes valued up to $1 million. The rebate is phased out gradually for homes valued between $1 million and $1.5 million. Once the legislation receives Royal Assent, it will come into force with retroactive effect as of May 27, 2025.

To be eligible for the rebate, the agreement of purchase and sale for the new home must be entered into after May 26, 2025 and before 2031. In addition, ownership must be transferred to the individual purchaser and construction of the residential complex must be substantially completed before 2036. The legislation includes anti-avoidance rules designed to prevent agreements of purchase and sale entered into before May 27, 2025 from being terminated, varied, altered or assigned in order to access the rebate.

The Ontario Finance Minister announced the temporary removal of the corresponding provincial portion of HST (8%) for first-time home buyers on eligible new homes valued up to $1 million ("Ontario Rebate") in the **2025 Ontario Economic Outlook and Fiscal review: A Plan to Protect Ontario**. The Ontario Rebate would be similarly phased out for homes valued between $1 million to $1.5 million, and no relief would be available for homes valued above $1.5 million. The Ontario Rebate is intended to mirror its federal counterpart, and would apply to agreements of purchase and sale entered into on or after May 27, 2025 and before 2031. To qualify for the Ontario Rebate, construction of the applicable home must commence before 2031 and the home's substantial completion must occur before 2036.

For more information on the Ontario Rebate, please see:

- **2025 Ontario Economic Outlook and Fiscal Review – Tax Highlights**

CANADIAN DIGITAL SERVICES TAX ACT TO BE REPEALED

On June 28, 2024, the DSTA entered into force pursuant to an Order in Council issued on that date. The Digital Services Tax ("DST") applied a rate of 3% on Canadian digital services revenues earned by a taxpayer if certain revenue thresholds were met. Businesses were required to register by January 31, 2025 and to file returns and remit DST payments by June 30, 2025.

In an effort to resume bilateral trade discussions with the U.S. and to avoid the imposition of threatened tariffs against Canadian goods, Finance announced its intention to repeal the DSTA on June 29, 2025 and the CRA paused the collection of the DST. The DST had been a conspicuous irritant for the U.S. and U.S. Commerce Secretary Howard Lutnick indicated that it would have been a "deal breaker" to any trade agreement.

Unfortunately for those businesses that made payments of DST, the CRA concluded that it could only refund any DST payments, with interest, once the legislation is formally repealed and a refund mechanism is enacted. Legislation to repeal the DSTA was contained in the Notice of Ways and Means dated November 17, 2025 and subsequently included in Bill C-15. The repeal legislation provides that if a person has paid an amount under the DSTA, the Minister must refund to the person the amount remitted, with interest.

For more information on the DST, please see:

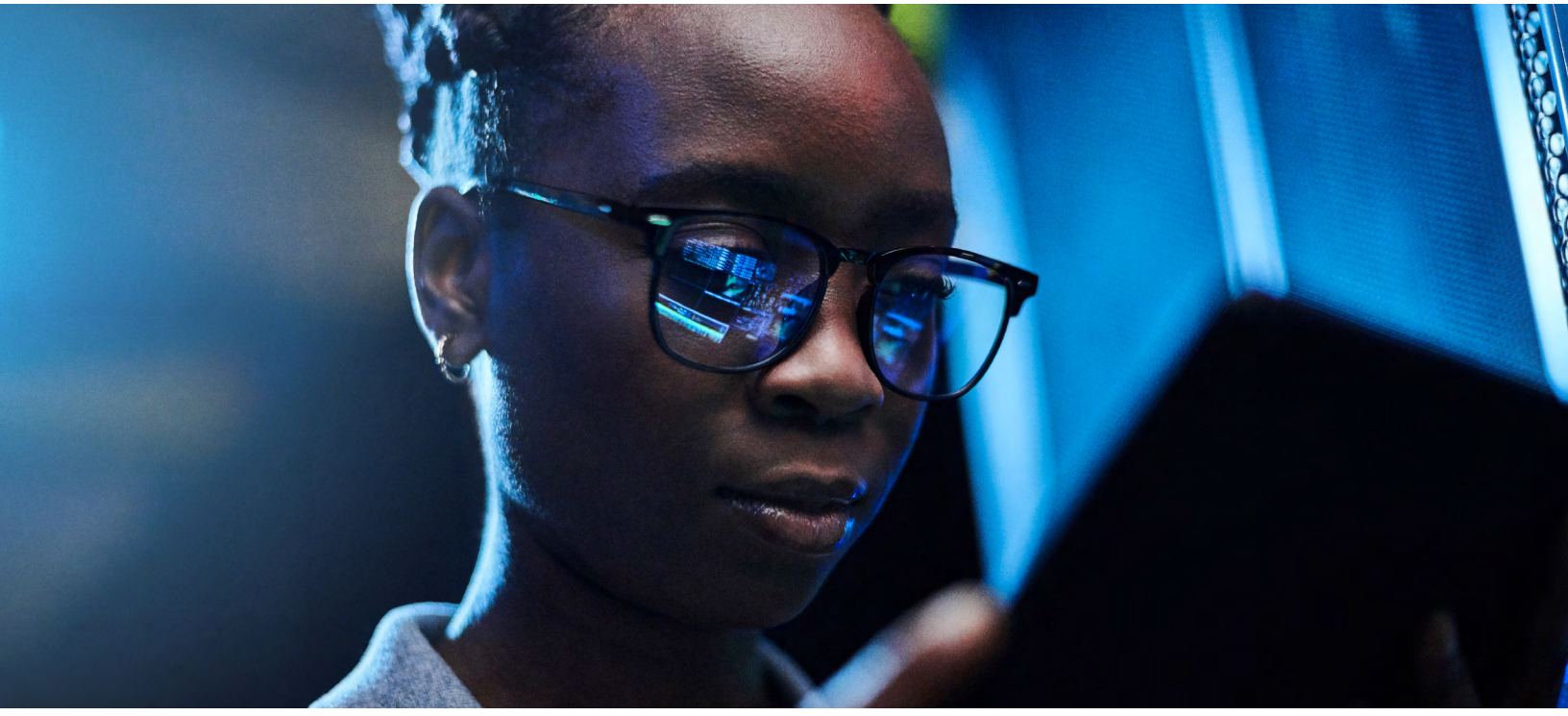
- **The Canadian Digital Services Tax Act Comes Into Force. Time to Take Action!**
- **Canadian Digital Services Tax – Part I: Get Ready To Comply As Soon As January 1, 2024**
- **Canadian Digital Services Tax – Part II: Updated Draft Legislation Released – What You Need to Know!**

UNDERUSED HOUSING TAX

The Underused Housing Tax ("UHT"), which came into effect as of January 1, 2022, is an annual tax of 1% of the value of vacant or underused property in Canada owned by non-residents, subject to many exceptions. Non-resident owners who fail to pay the UHT or file a UHT return may be subject to penalties and arrears interest.

Budget 2025 proposed to eliminate the UHT for the 2025 calendar year onward. However, the obligations for non-resident property owners under the UHT for the 2022 to 2024 calendar years will remain, and penalties and/or arrears interest will continue to be imposed on persons who fail to file the required returns and/or pay the tax owing for those years.

The November 17, 2025 Notice of Ways and Means Motion contained legislation to end the UHT in respect of the 2025 taxation year and future calendar years



and to subsequently repeal the *Underused Housing Tax Act* and regulations thereunder. These proposals were subsequently included in Bill C-15.

For more information on the application of the UHT, see the following articles written by our Indirect Tax Team:

- **New Canadian Underused Housing Tax and Prohibition on the Purchase of Residential Property by Non-Canadians Act Legislation**
- **The Underused Housing Tax Act Filing Deadline is Almost Here**
- **Underused Housing Tax Act Deadline Extended One More Time!**

LUXURY TAX ON AIRCRAFT AND VESSELS

As of January 1, 2022, the *Select Luxury Items Tax Act* (Canada) ("SLITA") imposes a luxury tax on aircraft and vehicles valued over $100,000, and vessels over $250,000 (collectively "Subject Property"). The tax generally applies to sales, importations, leases and certain improvements to Subject Property and is equal to the lesser of 10% of the total value of the Subject Property, and 20% of the value above the relevant threshold.

In the Budget 2025, Finance announced its intention to repeal the luxury tax on aircraft and vessels as of November 5, 2025. However, the tax will continue to apply to vehicles valued over $100,000. The November 17, 2025 Notice of Ways and Means Motion contained legislation to amend the SLITA accordingly. These proposals were subsequently included in Bill C-15.

For more details on the proposed elimination of the luxury tax on aircraft and vessels, please see:

- **2025 Canadian Federal Budget Commentary – Tax Initiatives**

CAROUSEL FRAUD

Carousel fraud has proven to be a significant challenge for tax authorities in administering value-added taxes, including the GST/HST. A carousel fraud scheme commonly involves a group of GST/HST registrants participating in a series of real or fraudulent transactions to evade GST/HST. As is normally the case, each supplier in the chain charges GST/HST to a recipient which recovers the GST/HST paid by way of ITC. However, in a carousel fraud scheme, one or more of the suppliers that collects GST/HST, often referred to as the "missing trader", disappears without remitting the GST/HST it collected.

To combat carousel fraud, the 2025 Federal Budget proposes to introduce a new "reverse charge mechanism" ("RCM") in the ETA.

If the proposals become law, the RCM will apply to certain telecommunication services (*e.g.*, voice-over internet protocol minutes). Suppliers of these specified telecommunication services will not be required to collect the GST/HST payable in respect of the supply if the recipient is registered for GST/HST and is acquiring all or substantially of those services for purposes of resupplying them. Instead, the recipient will be required to self-assess and report the GST/HST payable, and may be able to claim an off-setting ITC on the same GST/HST return, subject to limitations.

A consultation regarding these proposals will remain open until January 12, 2026, and additional supplies may be included under the RCM through regulations.

For more details on the RCM and a recipient's ability to claim an off-setting ITC, please see:

- **2025 Canadian Federal Budget Commentary – Tax Initiatives**

Tax Disputes and Litigation Developments and Outlook

In this section, we review proposed legislation that could significantly impact audit risk and management for taxpayers and also discuss important recent case law dealing with both income tax and GST.

NEW VOLUNTARY DISCLOSURES PROGRAM

Income Tax

The CRA announced changes to the VDP, which came into effect on October 1, 2025 ("New VDP"). The VDP provides taxpayers with an opportunity to seek relief from the CRA for any errors or omissions made while complying with their tax obligations.

The changes introduced in the New VDP will (a) provide enhanced penalty and interest relief, (b) create less restrictive program tracks, and (c) improve accessibility for VDP applicants, including large corporations and repeat applicants.

The New VDP replaces the previous "Limited Program" and "General Program" categories with two new categories of voluntary disclosure: (1) prompted; and (2) unprompted.

An application will generally be considered prompted where the taxpayer has received verbal or written communication about an identified compliance issue, which may include letters or notices, other than education letters, with one or more of the following: (i) the specific error or omission is identified; (ii) a deadline to correct the error or omission is listed; or (iii) the CRA has already received information from third-party sources regarding potential non-compliance.

An application is generally considered unprompted where: (i) there has been no written or verbal communication about an identified compliance issue related to the disclosure; or (ii) the taxpayer has received an education letter or notice that offers general guidance and filing information related to the topic at issue.

Unpromoted applications are generally eligible for general relief (*i.e.*, 75% relief of the applicable interest and 100% relief of the applicable penalties). Prompted applications are normally eligible for partial relief (*i.e.*, 25% relief of the applicable interest and 100% relief of the applicable penalties.

In addition to increasing the relief available, large corporate taxpayers are no longer restricted to limited relief, and taxpayers may apply for relief under the program more than once (provided the circumstances are beyond the taxpayer's control or the subsequent application relates to a different matter than the previous application).

GST/HST

In connection with the New VDP, the CRA also released updated guidance with respect to voluntary disclosures made in the context of various indirect tax acts, including the ETA.

The New VDP for GST/HST replaces the existing "General Program" and "Limited Program" with "general relief" and "partial relief" based on whether the voluntary disclosure application is unprompted or prompted. Unprompted applications will typically be eligible for general relief comprised of 75% interest relief and 100% relief from applicable penalties, while prompted applications will normally be eligible for 25% interest relief and up to 100% relief from applicable penalties (*i.e.*, partial relief).

The New VDP continues to provide enhanced relief for applications involving qualifying GST/HST wash transactions. Relief for wash transactions remains at 100% for applicable interest and penalties where the "wash transaction" would be eligible for a reduction of penalty and interest.

Corporate taxpayers with gross revenue in excess of $250 million in at least two of their last five taxation years (and any related entities) should no longer be restricted to lesser relief. Moreover, registrants may make a second voluntary disclosure under the GST/HST program as long as the circumstances are beyond the taxpayer's control or the second disclosure concerns a different issue.

For more details on the new VDP, please see:

— **Significant Positive Changes to Reinvigorate the Voluntary Disclosures Program for Income Tax and GST/HST**

— **Key Takeaways from McCarthy Tétrault Tax Perspectives: September 2025**

PROPOSED NEW CRA AUDIT POWERS

Budget 2025 confirms the Government's intention to give the CRA additional powers to obtain information and compel compliance with domestic and foreign-based information requirements, as well as a new tool to extend the re-assessment period and give the CRA more time to audit. While Finance has drafted legislation, no bill has yet been introduced in Parliament.

Notice of Non-Compliance

The CRA will get the new power to issue a "notice of non-compliance" if the CRA determines that a taxpayer has not complied with a request for information. While a notice of non-compliance is outstanding:

— The normal reassessment period of the taxpayer and each person that does not deal at arm's length with the taxpayer will be suspended for any taxation year to which the notice relates; and

— A penalty of $50 will apply each day that the notice is outstanding, to a maximum of $25,000.

To challenge a notice of non-compliance, a taxpayer can ask the Minister to vacate the notice of non-compliance. However, the taxpayer must demonstrate that the initial request for information was unreasonable (for example, because the CRA did not provide sufficient time to respond) or that the taxpayer reasonably complied with the request for information prior to the issuance of the notice of non-compliance.

If the Minister upholds the notice of non-compliance, the taxpayer can seek judicial review of the Minister's decision in the Federal Court. If the Minister vacates the notice of non-compliance, the normal reassessment period is not extended. If the Minister confirms the notice of non-compliance and the taxpayer seeks judicial review and the notice vacated by the Federal Court, the normal reassessment period is still paused from the day on which the taxpayer applied for judicial review and the date that the notice is vacated.

The suspension of the normal reassessment period applies to all potential issues in the taxation year, and not just in relation to the issue to which the notice of non-compliance relates.

No penalty applies if one of the reasons for the person not complying was the reasonable belief that the information, documents, or answers were protected from disclosure by solicitor-client privilege. While no penalty applies if a document is not provided on the reasonable belief that solicitor-client privilege applies, the normal reassessment period is still suspended until there is compliance with the notice of non-compliance.

Compliance Order for Foreign-Based Information

Currently, if a taxpayer does not provide foreign-based information to the CRA when requested, the consequence is that such information cannot be introduced as evidence by the taxpayer in any civil proceeding. A proposed amendment would allow the CRA to obtain a compliance order to force the production of foreign-based information, irrespective of whether such information is within the power, possession, or control of the taxpayer.

Taxpayers should carefully document the steps taken to try to obtain this type of information in response to a request from CRA, particularly in light of the new proposed compliance order penalty (described below).

Compliance Order Penalty

The CRA will be able to assess a new penalty if an order is issued by the Federal Court requiring a taxpayer to comply with an information request (both domestic and foreign based). The penalty will:

— Apply only if the taxpayer had tax owing of $50,000 or more for any one taxation year to which the compliance order relates; and

— Be up to 10% of the total tax payable by the taxpayer in respect of the taxation year(s) to which the order relates.

A compliance order penalty does not apply if one of the reasons for not complying with the request was the taxpayer's reasonable belief that the information, documents or answers requested were protected from disclosure by solicitor-client privilege.

If a taxpayer objects to a compliance penalty, the Minister shall vacate or vary the penalty if the Minister determines that the penalty is, in the circumstances, disproportionate or unfair.

Providing Information Under Oath or Affirmation

The CRA will have the ability to require a taxpayer to answer information requests, either written or oral, under oath or affirmation, or by affidavit.

A taxpayer will carefully have to consider its responses to information requests when given under oath or affidavit, as there is a chance that such answers would be used to impeach the taxpayer later if the matter goes to litigation.

Learnings and Outlook

Despite **submissions** by the Audit Powers Working Group of the Joint Committee on Taxation of Canadian Bar Association and Chartered Professional Accountants of Canada, the proposed new CRA audit powers are largely unchanged. Finance did change the compliance order penalty to be up to 10% rather than a flat 10%, and did make an exception for the penalty for refusing to provide information, documents, or answers on the basis of solicitor-client privilege.

While the new powers are not yet law, they will change the way taxpayers deal with auditors, as well as the time, effort, and cost that taxpayers will need to incur to respond to audit queries. In addition, taxpayers should expect more disputes and litigation relating to the conduct of audits.

For more details on the proposed amendments to the audit powers, please see:

— **The Notice of Non-Compliance: CRA Gets a New Tool to Help Audit Taxpayers**

— **The CRA's Proposed New Audit Powers: More Discretion, More Time to Reassess, Less Judicial Oversight**

— **More Discretion, More Time to Reassess, Less Judicial Oversight: Budget 2024 Proposals to Give the CRA Enhanced Audit Powers Also to Apply for GST/HST Purposes**

INCOME TAX CASES

Bank of Nova Scotia - Arrears Interest may Accrue even when a Loss Carryback Offsets most of the Tax Liability (FCA)

Overview

In *Bank of Nova Scotia v His Majesty the King*, **2024 FCA 192**, the Federal Court of Appeal ("FCA") upheld the decision of the Tax Court of Canada ("TCC") that arrears interest can accrue to the date of a long-delayed reassessment, even though the increased tax liability was almost entirely offset with a loss carryback. The interest imposed (almost $8 million) far exceeded the taxpayer's tax owing after the loss carryback (about $1 million).

On May 22, 2025, the Supreme Court of Canada ("SCC") granted leave to appeal to the Bank of Nova Scotia ("Bank"). The SCC appeal is scheduled to be heard on January 21, 2026.

Facts

As a result of a transfer pricing audit, the Minister reassessed the Bank for its 2006 to 2014 taxation years to include additional amounts in its income. The Minister and the Bank reached a settlement agreement on March 13, 2015, which resulted in an addition to the Bank's income of about $55 million for the 2006 taxation year ("Transfer Pricing Adjustment"). One day prior to entering the settlement agreement, the Bank requested the carryback of a $54 million non-capital loss that arose in its 2008 taxation year ("Loss Carryback") to offset the additional taxable income resulting from the Transfer Pricing Adjustment for 2006.

The Minister issued a notice of reassessment on March 20, 2015 reflecting both the Transfer Pricing Adjustment

and the Loss Carryback. However, the Minister assessed interest in the amount of approximately $8 million accruing from the Bank's balance-due day for 2006 until March 12, 2015, being the date on which the Bank requested the Loss Carryback.

The Bank appealed from the reassessment, arguing that the Loss Carryback should have been applied to stop the "interest clock" in respect of the Transfer Pricing Adjustment on the date that the Bank filed its tax return for its 2008 taxation year. The Bank lost at the TCC and appealed to the FCA.

FCA Decision

The issue was whether the interest clock stopped when the return for the Loss Carryback was filed (under subparagraph 161(7)(b)(ii)) or when the taxpayer requested the Loss Carryback (under subparagraph 161(7)(b)(iv)), with the latter resulting in a larger arrears interest balance.

The FCA held that the interest clock stopped when the Bank requested the Loss Carryback even though the reassessment in issue was the result of the Transfer Pricing Adjustment.

The FCA concluded that:

— The text of subparagraph 161(7)(b)(iv) is silent on whether reassessments caused by audit adjustments (incorporating a loss carryback request) are different than other requests for loss carrybacks.

— Parliament intended to stop the clock at the later time even if a loss carryback was requested as a result of an audit adjustment.

— Parliament did not establish a harmonious scheme for the calculation of interest, as there is an inconsistent income tax treatment of loss carryforwards (no interest is imposed) versus loss carrybacks (interest is imposed).

— Stopping the clock when the loss year return was filed would be anomalous as it may potentially result in starting the interest clock in a different year when the audit adjustment and loss carryback were imposed by two separate reassessments as opposed to a single reassessment.

— Parliament was likely aware that subparagraph 167(1)(b)(iv) could produce punitive results.

Learnings and Outlook

The FCA decision clarifies when the interest clock stops if loss carrybacks are applied: interest from an audit adjustment will continue to accrue until the taxpayer requests the loss carryback, even if the effect of the loss carryback is that there is no tax payable. The FCA's conclusion is particularly relevant in situations where there is an extended or unlimited reassessment period, as the passage of time can lead to substantial arrears interest. Accordingly, taxpayers may consider requesting the waiver or cancellation of interest under subsection 220(3.1).

The SCC will have the last word on whether the FCA decision is correct, and Parliament intended this punitive result.

For more details on this case, please see:

— **Federal Court of Appeal Rules that Arrears Interest Exceed Tax Payable Following Audit and Loss Carryback Request**

Vefghi – Timing of Trust Designations

Overview

In *Canada v. Vefghi Holding Corporation*, **2025 FCA 143**, the FCA held that the determination of whether a particular corporation and a payer corporation are connected for the purposes of Part IV is made at the end of the trust's taxation year, when the dividend is made payable to the particular corporation as a beneficiary of a trust that has made a designation under subsection 104(19).

This clarification is significant for private corporations where there is a trust in a "sandwich" structure. Additional steps need to be taken when dividends are paid through a trust to a corporate beneficiary in circumstances where the payer corporation and the corporate beneficiary will cease to be connected during the trust's taxation year (for example, because the shares of the payer corporation are sold to a third party).

Facts

Vefghi involved two corporate taxpayers in similar structures. In each case, Vefghi Environmental Consultant Inc. ("Consultant Inc.") and M & R Environmental Ltd. ("Environmental Ltd.", and together with Consultant Inc., "payer corporations") paid dividends on shares held by the Vefghi Family Trust ("Vefghi Trust") and the Mate Family Trust ("Mate Trust", and together with Vefghi Trust, "trusts"), respectively. The trusts sold their shares of the payer corporations to arm's-length purchasers. The trusts made their income payable to their corporate beneficiaries, Vefghi Holding Corp. ("Vefghi Holding") and SONS Environmental Ltd. ("SONS") (together, "beneficiary corporations").

In filing their T3 income tax returns (which had December 31 taxation year-ends), the trusts designated amounts as taxable dividends received by the beneficiary corporations under subsection 104(19). In filing their T2 income tax returns, (SONS had an August 31 taxation year-end and Vefghi Holding had a December 31 taxation year-end), the beneficiary corporations did not report any Part IV tax on the dividends designated by the trusts.

The CRA reassessed the beneficiary corporations for Part IV tax payable on the dividends received via the trusts. Because the shares of the payer corporations had been sold to a third party, the payer corporations and the beneficiary corporations had ceased to be connected between the date of the dividend payment and the end of the trusts' taxation years, the point at which the CRA said the dividends were received by the beneficiary corporations.

TCC Decision

The TCC determined that, for the purposes of Part IV, the point in time relevant to determining whether two corporations are connected in respect of a dividend paid through a trust is the point in time when the trust receives the dividend.

As there was no point-in-time requirement in subsection 104(19), the TCC held that if a dividend is received by a trust on a specific date, the dividend is deemed to be received by the corporate beneficiary on the same date—unless the legal fiction created by subsection 104(19) specifically results in the dividend being received on a different date.

As a result, the TCC concluded that Vefghi Holding and Consultant Inc. were connected at the relevant time because Vefghi Holding was deemed to have received the dividend on the same day that Vefghi Trust received it—before the share sale.

The outcome was different for SONS; the TCC concluded that SONS and Environmental Ltd. were not connected at the relevant time. Because SONS had a different taxation year-end (August 31, 2015) from the Mate Trust (December 31, 2015), subsection 104(19) deemed SONS to have received the dividend in its subsequent taxation year—after the share sale. Therefore, SONS and Environmental Ltd. were not connected at the relevant time for Part IV purposes.

The Crown appealed and the taxpayers cross-appealed the TCC decision.

FCA Decision

The FCA reversed the TCC decision, allowing the Crown's appeal and dismissing the taxpayers' cross-appeal. The FCA held that the correct time for determining whether a corporate beneficiary is connected with a payer

corporation is the end of the particular taxation year of the trust in which it received the dividend subject to the subsection 104(19) designation.

The FCA held that the TCC erred in its interpretation of subsection 104(19). The FCA concluded that subsection 104(19) stipulates that the deemed dividend is received in the beneficiary corporation's taxation year in which the trust's taxation year ends.

As all of the conditions in subsection 104(19) must be met for the deeming rule to apply, the FCA held that the designation cannot be made before the trust's year-end. The last day of the trust's taxation year is the earliest date on which the designation can be made and the conditions of subsection 104(19) can be satisfied, and therefore, the earliest date on which the dividend can be deemed to be received by a corporate beneficiary.

The FCA also clarified that using the date of designation as the dividend date for Part IV purposes could pose problems. Because the designation date (which is the date the trust files its T3 income tax return) is always after the end of the trust's relevant taxation year, using the actual designation date would be inconsistent with subsection 104(19), which deems the dividend to be received in the taxation year of the beneficiary in which the trust's taxation year ends. Accordingly, the FCA held that the actual date of designation cannot be the relevant date.

The FCA explained that using the date the trust received the dividend as the date for determining whether the payer corporation and the particular corporation are connected—but only if the dividend was received during the corporate beneficiary's taxation year in which the trust's taxation year ended—could lead to inconsistent results. The FCA seemed to favour an interpretation of subsection 104(19) that would produce the same result regardless of whether the taxation years of the trust and corporate beneficiary are aligned.

The FCA concluded that "the only date on which the dividend could be deemed to be received by a corporate beneficiary without resulting in a potential conflict between the date of deemed receipt and the stipulation that the dividend is deemed to be received in the taxation year of the beneficiary in which the trust's taxation year ends, is the last day of the trust's taxation year."

Vefghi Holding filed an application for leave to appeal to the SCC on October 10, 2025.

Learnings and Outlook

The FCA's decision focuses on the text of the Act, over the underlying purposes of the relevant provisions. While the result allows for a consistent application of subsection 104(19), it is not clear that this represents the most reasonable interpretation of the provision's text in light of the context and purpose of subsection 104(19) and Part IV.

The decision in *Vefghi* does not necessarily make a trust in a sandwich structure undesirable. However, taxpayers and their advisers will need to ensure that the corporate beneficiary remains connected with the payer corporation where the payer's shares will be disposed of during the trust's taxation year.

DEML Investments – GAAR Applies to Bump of Partnership Interests that Derive Value from Canadian Resource Properties

Overview

In *DEML Investments Limited v. Canada,* **2025 FCA 204**, the FCA partially allowed an appeal from the TCC's decision to disallow certain capital losses on the basis that the losses were "artificial" and therefore the general anti-avoidance rule ("GAAR") in section 245 of the Act applied. However, the FCA focused instead on whether the losses generated by DEML Investments Limited ("DEML") on a sale of an interest in a partnership holding Canadian resource properties misused or abused the "bump" rules in paragraph 88(1)(d) because DEML relied on a bump of a partnership interest that derived its value from "Canadian resource property" ("CRP"), as defined in subsection 66(15) of the Act.

Facts

In 2008, Direct Energy Marketing Limited ("Direct Energy") (the parent company of DEML) entered into an agreement with Transglobe Energy Corporation ("Transglobe") to acquire certain CRPs ("Resource Properties").

To implement the agreement, Transglobe and Direct Energy undertook the following transactions:

— Transglobe incorporated two numbered companies ("137" and "138");

— 137 and 138 formed a partnership ("DERP2");

— Transglobe transferred a 99% interest in the Resource Properties to 137 pursuant to subsection 85(1) and elected to have the depreciable property transferred at $11,286,000 and the CRP transferred at $34,859,099;

— Transglobe transferred a 1% interest in the Resource Properties to 138 pursuant to subsection 85(1) and elected at nominal amounts;

— 137 and 138 transferred their respective interests in the Resource Properties to DERP2 pursuant to subsection 97(2) with elected amounts for 137 of $11.3 million for its 99% interest in the depreciable property and $1 for its 99% interest in the CRP; and

— Direct Energy then acquired the shares of 137 for $50,688,330 and the shares of 138 for $512,003.

Following the acquisition from Transglobe, Direct Energy caused the following transactions to be implemented over the course of the next 22 months:

— Direct Energy transferred the shares of 137 to DEML pursuant to subsection 85(1) and elected at $50.7 million;

— 137 distributed its property to DEML, including its 99% interest in the DERP2 partnership, and was wound up;

— On the distribution of 137's property, the adjusted cost base ("ACB") of DERP2 was "bumped" pursuant to paragraph 88(1)(d) by $39,402,000 (from approximately $11M to approximately $50M);

— DERP2 distributed the Resource Properties to DEML;

— DEML transferred its assets acquired from DERP2 to another partnership;

— DEML transferred other Canadian resource properties worth $6.7M to DERP2 and sold its DERP2 partnership interest to an arm's length third party for $6.7M;

— The sale of the DERP2 partnership interest resulted in a $45M capital loss, which DEML carried back and deducted in computing in its taxable income for its 2007 taxation year.

The end result of the transactions was that DEML obtained a capital loss of $45M arising from the sale of the partnership interest but retained possession of the Resource Properties and a balance of $40M in its cumulative Canadian oil and gas property expense ("CCOGPE") pool in relation to the Resource Properties.

The Minister applied the GAAR to deny the capital loss on the basis that the capital loss abused sections 38, 39, and 40 because it did not correspond to a real economic loss (*i.e.*, an "artificial" or "paper" loss). The Minister asserted that the ACB used to generate the loss was effectively the cost that DEML paid to acquire the Resource Properties, but DEML used that cost to obtain a loss while keeping the Resource Properties and the CCOGPE pool. The Minister also alleged that DEML misused or abused paragraph 88(1)(d) because the bump was the mechanism used to generate the disputed loss.

TCC Decision

The only question before the TCC was whether any of the avoidance transactions were abusive. The TCC held that the transactions abused the capital loss provisions of the Act, as the capital loss was an artificial loss since DEML still held the Resource Properties. The TCC relied on the FCA's decision in *Triad Gestco Ltd v. Canada*, **2012 FCA 258** for the proposition that it is an abuse of the capital loss provisions to deduct losses that do not correspond with an economic loss. The TCC also concluded that the bump rules in subsection 88(1) of the Act were abused. As a result, the TCC dismissed DEML's appeal.

FCA Decision

The FCA allowed the appeal in part. The FCA did not find that there was an abuse of the capital loss rules and set aside the TCC decision in this respect. However, the FCA held that allowing a bump of $39M to the ACB of DEML's partnership interest in DERP 2 was inconsistent with the rationale underlying paragraphs 88(1)(c) and (d) of the Act, and was therefore abusive. The FCA held that the rationale for these provisions is to allow a corporate parent to avoid the loss of the ACB of the shares of a subsidiary company on the winding-up of that subsidiary corporation. That purpose was not met in this case. Rather, the bump was used to allow DEML to obtain both ACB in the partnership interest while preserving its CCOGPE pool. The FCA held that the goal of paragraph 88(1)(d) is not to allow a corporate parent to benefit both from an increased ACB of a partnership interest held by a subsidiary and access to the CCOGPE pool of that subsidiary.

In determining the rationale of the bump rules, the FCA considered the 2012 amendment to paragraph 88(1)(d), which added subparagraph 88(1)(d)(ii.1). That subparagraph precludes bumping a partnership interest where the partnership holds CRP. Although the transactions in *DEML* took place prior to the 2012 amendment, at a time when paragraph 88(1)(d) did not expressly preclude bumping an interest in a partnership that holds CRP, the FCA relied on its prior decision in *Canada v. Oxford Properties Group Inc.*, **2018 FCA 30**, for the proposition that: "new subparagraph 88(1)(*d*)(ii.1) conveys in express terms a rationale which was already present in these provisions' is equally applicable here."

Accordingly, the FCA allowed the appeal in part and held that DEML's $45M capital loss should be reduced by $39M, which reflects the amount added to the ACB of

DEML's partnership interest in DERP 2 under paragraph 88(1)(d) on the winding-up of 137.

Learnings and Outlook

This case demonstrates that the proposition in *Oxford Properties* extends broadly such that the GAAR may apply to transactions that took place prior to the 2012 that would have otherwise been prevented by new subparagraph 88(1)(d)(ii.1)). However, the FCA's decision is a welcome move away from the TCC's conclusion that the transactions abused the capital loss rules because the capital loss did not correspond to an economic loss; the TCC's conclusion was not supportable on the facts in *DEML* since both the acquisition and disposition of the DERP2 interest occurred in the context of arm's length transactions.

Brookfield Renewable Power Inc. – Reasonability in the Context of Loss Consolidation Arrangements between Related Parties in Quebec

Overview

In *Brookfield Renewable Power Inc. v QRA*, **2025 QCCA 234**, the Quebec Court of Appeal ("QCCA") confirmed the Court of Quebec's ("CQ") decision in *Brookfield Renewable Power Inc. v QRA*, **2019 QCCQ 10239**, that although loss consolidation arrangements through loans between related parties are possible, considering the specific facts of the case, 14% was not a reasonable interest rate in the circumstances.

Facts

As part of a series of loss consolidation arrangements, Brookfield Power Wind Corporation ("BPWC") and Brookfield Energy Marketing Inc. ("BEMI") entered into loan agreements with Brookfield Renewable Power Inc. ("BRPI"), a related corporation, pursuant to which income became payable at a 14% rate. At the time, BPWC, BEMI and BRPI were part of the larger Brookfield corporate group. BEMI and BPWC deducted from their income the interest paid on the loans from BRPI.

The Quebec Revenue Agency ("QRA") reassessed BPWC and BEMI on the basis that the interest rate of 14% was unreasonable and substituted a rate of 6%.

At trial, the QRA requested that the assessments be varied and the matter returned to the Minister so that a rate of 8.75% be applied, consistent with its experts' conclusions that a reasonable rate could be between 6.00% and 8.75%.

CQ Decision

The CQ agreed with the QRA that the interest rate of 14% used by BPWC and BEMI was unreasonable and applied the 8.75% rate proposed by the QRA's experts.

The CQ's decision was largely based on expert evidence. The CQ concluded that the transactions entered into by BPWC and BEMI could not be considered in isolation and that the particular facts of the file, including the context of a broader loss consolidation arrangement, needed to be taken into account when establishing objective reasonableness. The CQ concluded that the expert witness for BPWC and BEMI failure to take into account the broader context and that the financing costs of the parent company and BRPI needed to be addressed as objective factors instead of market financing costs.

BPWC and BEMI appealed to the QCCA.

QCCA Decision

The QCCA concluded that the CQ had not erroneously applied the arm's length principle instead of the reasonability test. The CQ considered the QRA's experts' evidence to be probative and preferred an approach based on appropriate factors, taking into account the specific nature of the transactions carried out by the Brookfield corporate group and treating the financing costs incurred by the parent company and BRPI as a relevant objective factor in the circumstances.

Learnings and Outlook

This decision reminds us that the reasonability of interest rates is fact-driven. All circumstances specific to the transaction may be relevant and, in a non-arm's-length situation, contextual items can be considered in addition to the specific characteristics of the loan.

Uppal Estate – Minister cannot Add Inconsistent Assumptions of Fact or a New Penalty as an Alternative Basis for Assessment

Overview

In *Uppal Estate v The King*, **2025 TCC 34**, the TCC concluded that the Crown must accurately state assumptions of fact made by the Minister in assessing the taxpayer. The Crown cannot: (i) add assumptions of fact at the TCC stage that are inconsistent with the Minister's primary assessment position; and (ii) ask the TCC to impose a penalty that was not assessed by the Minister.

Facts

Mr. Uppal passed away prior to the hearing of the appeal and, as a result, the appellant was his estate. The Minister alleged that the taxpayer failed to report income from the sale of shares of Ranger Gold Corp ("Ranger"), because Mr. Uppal was the beneficial owner of both the shares registered in his own name and the shares registered in the name of Chambord Media Inc. ("Chambord"), a corporation controlled by Mr. Uppal. The Minister also assessed gross

negligence penalties. The taxpayer appealed to the TCC.

In its Reply to the Notice of Appeal, the Crown stated that:

— The Minister's primary assessing position was that Mr. Uppal was the beneficial owner of both the shares registered in his name and the shares registered in the name of Chambord; and

— The Minister's alternative position was that Chambord was the beneficial owner of the shares registered in its name.

The Crown stated that the Minister, in assessing the taxpayer, assumed as a fact in the alternative that the taxpayer acted "either singly or jointly with Chambord" in the purchase of the shares. The Crown also pleaded in the alternative that the taxpayer should be liable for additional penalties for failing to file T1134/T1135 forms, even though the Minister only assessed gross negligence penalties and no other penalties.

The taxpayer moved to strike the assumptions pertaining to the beneficial ownership of the shares on the basis that the assumption of fact was inconsistent with the Minister's primary assessing position (*i.e.*, that Mr. Uppal was the beneficial owner of the shares) and that the Minister cannot make assumptions of fact in the alternative. The taxpayer also sought to strike the alternative penalties because the Crown was asking the TCC to apply penalties that were not imposed by the Minister on assessment.

TCC Decision

The TCC agreed with the taxpayer on both issues, allowing the motion to strike with permission for the Crown to amend its reply.

Regarding the assumptions, the TCC highlighted the unique role that assumptions of fact play in a Crown's reply. The taxpayer must rebut assumptions of fact that make up the Minister's primary assessing position, as those assumptions of fact are otherwise deemed to be true. The taxpayer does not bear the onus of rebutting facts pled by the Crown that do not make up the Minister's primary assessing position, and the Crown must prove these alleged facts on a balance of probabilities. Recognizing this distinction, the Crown should have pled the assumptions that support the Minister's primary assessing position in the assumptions of fact and pled the alternative facts necessary to support the alternative assessing position in a separate part of the Reply.

The TCC found the Crown's inappropriate use of assumptions of fact to be prejudicial to the taxpayer as they were inconsistent. It cannot be true that both Mr. Uppal was the beneficial owner of the shares (the primary assessing position) and that Chambord was the beneficial owner of the shares (the alternative position). The tax results from the two different assumptions of fact would be different:

— If Mr. Uppal was the beneficial owner of the shares, his unreported income could be reduced by the cost of the shares, and his unreported income would be a taxable capital gain if the shares were held on capital account.

— If Chambord was the beneficial owner of the shares, Mr. Uppal's unreported income could be based on the sale proceeds direct without any reduction for the cost of the shares, and that amount would have been a shareholder benefit and not a taxable capital gain.

On the penalties issue, the TCC concluded that it does not have the power to either increase the amount of an assessment or impose a penalty that was never imposed by the Minister. The Act only gives the power to assess penalties to the Minister. The alternative basis of an assessment or alternative basis in subsection 152(9) cannot require the TCC to assess new penalties. As the T1134/T1135 penalties had nothing to do with the gross negligence penalties assessed, the TCC struck the alternative new penalties.

Learnings and Outlook

This decision demonstrates that the Minister cannot make assumptions of fact that are inconsistent with the Minister's primary assessing position. Where the Minister has alternative theories, the Crown should be separately pleading additional facts and the onus to prove those facts is on the Crown, not the taxpayer.

Only the Minister can impose penalties, not the TCC, so the Crown cannot ask the TCC to impose new penalties.

For more details on this case, please see:

— **Tax Court Strikes Minister's Pleadings of Inconsistent Assumptions and New Penalties**

MEGlobal – Jurisdiction of the Tax Court of Canada

Overview

In *MEGlobal Canada ULC v. The King*, **2025 TCC 50**, the TCC concluded that it lacked jurisdiction to hear the taxpayer's appeal, in which the taxpayer sought to challenge the Minister's refusal to grant a downward transfer pricing adjustment under subsection 247(10). This decision reinforces the split jurisdiction between the TCC (where taxpayers can challenge an assessment) and Federal Court (where taxpayers can review discretionary decisions by the Minister).

The taxpayer has appealed to the FCA.

Facts

The Minister reassessed the taxpayer to reflect an upward transfer pricing adjustment under subsection 247(2) for its 2008, 2010, and 2011 taxation years. Around the same time as the reassessments, the taxpayer's parent company discovered that it overpaid for certain property and services. Accordingly, the taxpayer objected to the notices of reassessment and argued that there should instead be a downward adjustment.

The Minister vacated the upward adjustments but refused to make a downward adjustment pursuant to subsection 247(10). The taxpayer appealed the reassessments to the TCC and also brought a parallel application for judicial review to the Federal Court.

The taxpayer and the Crown jointly requested that the appeal be held in abeyance pending the outcome of *Dow Chemical ULC v. Canada*, **2024 SCC 23**.

SCC Guidance from Dow Chemical and Iris Technologies

On June 28, 2024, the SCC rendered its decisions in *Dow Chemical* and *Iris Technologies Inc. v. Canada*, **2024 SCC 24**. The SCC held in *Dow Chemical* that decisions made under subsection 247(10) are discretionary, outside of the jurisdiction of the TCC, and can only be reviewed by the Federal Court. In *Iris Technologies*, the SCC held that challenges to the correctness of a tax assessment, where the dispute turns on a non-discretionary determination of liability, fall within the jurisdiction of the TCC.

TCC Decision

The Crown brought a motion to quash the taxpayer's appeal on the basis that the TCC did not have the jurisdiction to rule on the Minister's exercise of discretionary decision-making. The TCC agreed with the Crown, concluding that the SCC decision in *Dow Chemical* is clear that the TCC has no jurisdiction to review the Minister's decision to deny a downward transfer pricing adjustment.

Since the TCC held that it did not have jurisdiction to hear the appeal, the Taxpayer sought leave to amend its notice of appeal so that it could ask the TCC to at least decide on the correct transfer pricing methodology to be

applied under subsection 247(2). If, in the absence of the application of subsection 247(10), the result would be a downward adjustment, the taxpayer asked the TCC to refer the matter back to the Minister for reconsideration. The TCC denied the taxpayer's motion on the basis that it may only refer assessments back to the Minister if both a reconsideration and a reassessment will necessarily follow, and in the case of a 247(10) adjustment, reassessment would be in the discretion of the Minister.

The TCC quashed the taxpayer's appeal, denied the taxpayer's request to amend the notice appeal, and awarded costs to the Crown.

The taxpayer has appealed to the FCA.

Learnings and Outlook

This case reinforces that the appropriate jurisdiction to seek a legal remedy depends on whether the issue involves the correctness of an assessment (which goes to the TCC) or the reasonableness of a Minister's decision (which goes to the Federal Court). It also reinforces the limited powers of the TCC in disposing of an appeal, which restrict the TCC to deciding cases where an assessment is upheld or vacated or where a reassessment must be issued based on the TCC's findings of fact or conclusions of law.

Taxpayers must be aware of timing issues when pursuing a review of the Minister's discretion at Federal Court. The Minister cannot, absent a waiver, reassess a taxpayer outside of the normal reassessment period. If the Federal Court judicial review process is lengthy enough (and the taxpayer fails to file a proactive waiver of the normal reassessment period), this can result in the taxpayer being precluded from obtaining relief through a reassessment even if their judicial review of the Minister's decision is successful.

For more details on this case, please see:

— ***MEGlobal Canada ULC v. The King*: When Split Jurisdiction Leaves a Gap in Relief**

Wuswig – GAAR Applied to Stop-Loss Rules

Overview

In *Wuswig Inc v. His Majesty the King*, **2025 TCC 147**, the TCC applied the GAAR to deny a capital loss carry forward resulting from a series of transactions undertaken by the taxpayer in 2007. The decision turned on the TCC's determination of the object, spirit, and purpose of subsections 93(2) and (2.01) of the Act, which are stop-loss rules meant to apply where a Canadian corporation disposes of shares of a foreign affiliate at a loss after receiving tax-free dividends.

Facts

From 1993 to 2001, the taxpayer received tax-free dividends from two U.S. subsidiaries, Noro Holdings and Southridge Holdings, and made corresponding deductions under subsection 113(1) of the Act. Over time, the fair market value of the taxpayer's investment in Southridge Holdings declined to $2,691,086; the taxpayer asserted that this decline in value was independent of the payment of the dividends.

In 2007, the taxpayer incorporated a new wholly-owned U.S. subsidiary, Southridge 2007, which merged with Southridge Holdings. Southridge 2007 was continued into Canada and was deemed to have disposed of, and reacquired, its shares in Noro Holdings at fair market value immediately prior to immigration. Southridge 2007 was renamed Wuswig 2007 and issued 100,000 preferred shares to a shareholder of the taxpayer. Finally, Wuswig 2007 was wound-up. Because of the preferred share issuance, the winding-up of Wuswig 2007 occurred on a taxable basis as the conditions of application in subsection 88(1) were not satisfied.

As a result of the reorganization, the fair market value and the adjusted cost base of the Wuswig 2007 shares were $2,691,086 and $7,777,125, respectively. When Wuswig 2007 was wound-up, the taxpayer was deemed to have disposed of the shares at fair market value, realizing a capital loss of $5,086,039.

In 2015, the Minister issued a notice of determination to reduce the taxpayer's capital loss carry forward balance from 2007 by $4,463,307. The Minister also issued a Notice of Reassessment in 2018, denying the taxpayer's capital loss carry forward from 2007.

TCC Decision

The main issue on appeal was whether the 2007 reorganization abused subsections 93(2) and (2.01). In determining the object, spirit, and purpose of the provisions, the TCC concluded:

— The text of the provisions did not reveal whether the rules should limit losses on shares of a Canadian corporation that had formerly been a foreign affiliate, nor did the text distinguish between real and artificial losses.

— The context of the provisions revealed that the rules operate within the capital gains regime, which seeks

to *allow* capital losses, unless specified in the Act. The TCC also examined the domestic counterpart to the provisions and found both sets of rules limit the use of capital losses by subtracting tax-free dividends from these losses.

— There was no indication Parliament had intended subsections 93(2) and (2.01) not apply where taxpayers realize real economic losses.

In the TCC's view, the object, spirit and purpose of subsections 93(2) and (2.01) was to limit the recognition of capital losses on shares of a foreign affiliate of a Canadian taxpayer where such losses were created on the "extraction of corporate value on a tax-free basis", through the payment of tax-free dividends.

The taxpayer argued in the alternative that the GAAR should not apply because the same result could have been obtained non-abusively through a loan arrangement. Applying the alternative transactions framework set out in *3295940 Canada Inc. v. Canada*, **2024 FCA 42**, the TCC held all five parts of the test must be met for an alternative transaction to be relevant to the GAAR analysis. The TCC found there was a "significant" discrepancy of 15% between the tax benefits realized by the taxpayer in the 2007 reorganization and those possible through the alternative transactions. On this basis, the proposed alternative transactions were not relevant to the GAAR analysis.

The TCC concluded the 2007 reorganization resulted in the taxpayer circumventing the application of subsections 93(2) and (2.01) in a manner that frustrated the object, spirit, and purpose of the rules, as it allowed the taxpayer to extract corporate value on a tax-free basis through the payment of tax-free dividends, without a corresponding reduction in the capital losses realized.

Learnings and Outlook

The TCC may take a case-by-case approach to determine what type of loss is contemplated by provisions in the Act, and if economic substance plays a role in that analysis when applying the GAAR.

Further, the TCC's focus and reliance on the alternative transactions analysis underscores its increasing importance to the GAAR analysis, and the potentially high threshold taxpayers have in establishing their proposed alternative realizes sufficiently similar tax consequences.

BMO – TCC Confirms that Interest on Income Taxes are not Deductible, Whether Foreign or Domestic

Overview

In *Bank of Montreal v. The King*, **2025 TCC 113**, the TCC upheld a reassessment denied a deduction for arrears interest paid to the United States by the Bank of Montreal ("BMO") on unpaid foreign taxes. The decision applied the principle that interest arising because of unpaid taxes is not incurred to earn income. The TCC concluded that the fact that an arrears interest expense arose as a consequence of a business activity does not equate to an income-earning purpose.

Facts

In the 1997-2001 taxation years, BMO conducted business in the United States through a permanent establishment in New York. Due to its U.S. business operations, BMO was subject to U.S. federal income tax on the business profits attributable to its U.S. permanent establishment. BMO paid all outstanding tax balances it reported as owing in its U.S. tax returns, as filed, by the applicable payment date.

In 2004, the Internal Revenue Service ("IRS") audited BMO's U.S. branch for its 1997-2000 taxation years, and in 2006, the IRS audited BMO's U.S. branch for its 2001 taxation year. The IRS assessed BMO for additional U.S. federal income tax and interest on its business profits attributable to its U.S. permanent establishment. BMO was also assessed for additional New York municipal income tax and interest.

For Canadian tax purposes, BMO claimed a deduction of the foreign interest paid to the United States in calculating its income for its 2004 and 2006 taxation years. The Minister disallowed these deductions, pursuant to section 9 and paragraph 18(1)(a).

BMO appealed to the TCC on the basis that the deduction of foreign interest in 2004 and 2006 provided an accurate picture of income and it was a business decision to risk incurring arrears interest on foreign taxes. As foreign business-income tax may be deductible under the Act, nothing explicitly prohibits the deduction of foreign interest.

TCC Decision

The TCC agreed with the Minister, following the FCA's decision in *Potash Corporation of Saskatchewan Inc. v. The King*, **2024 FCA 35**, that affirmed the principle in *Roenisch v. Canada (Minister of National Revenue)*, **1930 CanLII 311**: taxes on income are generally not incurred for the purpose of gaining or producing income, but rather as a consequence of the income-earning process. In other words, arrears interest is "an after-the-fact expense" and the deduction of such amounts is prohibited by paragraph 18(1)(a).

The TCC also concluded that paragraph 18(1)(a) acts as a general, catch-all provision, that can overlap with a more specific deduction prohibition set out in the Act. For example, paragraph 18(1)(t) prohibits the deduction of any amount paid or payable under the Act. In this case, the silence of paragraph 18(1)(t) on the deductibility of foreign taxes and interest on foreign taxes did not preclude paragraph 18(1)(a) from operating.

Learnings and Outlook

This decision confirms that, unless explicitly permitted by the Act, arrears interest on unpaid foreign taxes is not deductible, even though there are provisions that allow for a portion of the underlying foreign tax to be deducted.

For more details on this case, please see:

— **Tax Court Confirms that Interest on Income Taxes are Not Deductible, Whether Foreign or Domestic**

GST/HST CASES

ONR Limited Partnership

Overview

In *ONR Limited Partnership v. The King*, **2024 TCC 156**, the TCC concluded that a limited partnership was entitled to ITCs for the GST/HST paid on some of the supplies acquired in the name of one of its limited partners. The TCC agreed that the limited partner was an agent of the limited partnership, and so the limited partnership was entitled to ITCs for supplies that related to its activities. However, the limited partner was not acting as the agent of the limited partnership in respect of supplies related to the limited partner's activities.

Facts

The registrant limited partnership claimed ITCs on supplies acquired in the name of its limited partner, a real estate investment trust ("REIT"). The claimed ITCs were generally for supplies of:

1. Services relating to acquisitions or appraisals of the limited partnership's investment properties.
2. Services relating to the REIT's financing (including the issuance of REIT units), its financial statements, and other REIT matters.

TCC Decision

For the first category of supplies, the TCC agreed that the REIT was the limited partnership's agent, both under an agreement in writing, and also under section 6 of the Ontario *Partnerships Act*.

For the second category of supplies, the TCC held that the supplies were not acquired by the REIT as agent

of the limited partnership in the course of the limited partnership's commercial activities. The TCC concluded that "an agent does not have the legal capacity to do for a principal that which the principal does not have the legal capacity to do itself" (*e.g.*, the limited partnership could not issue REIT units).

Even though the agency agreements were valid contracts, and even though the REIT issued units in order to raise money for the limited partnership's activities, it was the REIT who consumed or used the second category of supplies. The REIT was therefore not the limited partnership's agent for the purpose of receiving these supplies.

Learnings and Outlook

This decision is a reminder of the importance of properly understanding agency law and its application to relationships between entities and ensuring that ITCs are claimed by the correct entity. There is no limitation under GST/HST law on who may act as agent of another, but a principal does not have the power to delegate to an agent something that it could not do on its own account.

For more details on this case, please see:

— **ONR Limited Partnership: What Can't an Agent Do?**

LBL Holdings – GST Exemption Upheld for Sales to Status Indians Despite Immediate Resale to Third Parties

Overview

In *Canada v. LBL Holdings Limited*, **2025 FCA 186**, the FCA upheld the TCC's decision that GST does not need to be collected on sales of goods to status Indians on a reserve, pursuant to section 87 of the *Indian Act*. The Court determined that LBL Holdings Limited ("LBL") was not required to collect GST on tobacco products sold to the MacNaughton family that were delivered on reserve, because the section 87 exemption applied despite immediate "flash sales" of the goods to third parties.

Facts

Between January 1999 and February 2000, LBL sold approximately $98 million in tobacco products to members of the MacNaughton family who operated a retail business on the Six Nations Reserve. The tobacco products were delivered to the reserve. LBL did not collect GST, relying on the exemption under section 87 of the *Indian Act* for sales to status Indians on a reserve. The Minister reassessed LBL, arguing that the products were in fact sold to unidentified third parties who were not status Indians, and

that GST should have been collected. The total amount in dispute was $13.6 million, including interest and penalties.

The key issue was whether the MacNaughtons were the "recipients" of the supply under subsection 123(1) of the *Excise Tax Act*, and whether the MacNaughtons were the owners of the tobacco.

TCC Decision

The TCC agreed with LBL's position that the MacNaughtons were the recipients of the supplies and thus qualified for the section 87 exemption from tax. The Court determined that Roberta MacNaughton was liable to pay for the products, which were delivered on reserve lands. The immediate resale of these products to third parties did not alter the fact that the MacNaughtons remained the recipients.

FCA Decision

The FCA considered whether the products were sold and delivered to the MacNaughtons and whether the section 87 exemption was available. The FCA found no palpable and overriding error in the TCC's conclusions that the MacNaughtons were the recipients of the supply of tobacco products, and that the tobacco products were delivered to the MacNaughtons on a reserve. The immediate resale to third parties was not relevant. The "owner" and "recipient" of the tobacco products was bound to be one and the same person, and for purposes of determining whether the TCC was correct in concluding that the tobacco products were sold and delivered to the MacNaughtons, it was only necessary to focus on the meaning of "owner" and not the term "recipient".

Learnings and Outlook

In addition to confirming the requirements for the exemption under section 87 of the *Indian Act*, the LBL Holdings decision affirms that valid legal relationships cannot be disregarded. The FCA decision affirms the principle that an allegation of "GST leakage" somewhere in the supply chain is not relevant in determining whether a supplier complied with its obligations under the ETA. Where goods are sold and delivered to status Indians on a reserve, the exemption under section 87 of the *Indian Act* may apply even if the goods are immediately resold.

Jennings-Clyde (Vivatas, Inc.) v. Canada (Attorney General)

Overview

In *Jennings-Clyde (Vivatas, Inc.) v. Canada (Attorney General)*, **2025 FCA 225**, the FCA allowed the taxpayer's appeal of a decision of the Federal Court, which dismissed the taxpayer's application for judicial review of a CRA's decision not to exercise its discretion to extend a deadline.

The FCA set aside the Federal Court's judgment and granted the taxpayer's application for judicial review, ordering the CRA to give the appellant a fair opportunity to make submissions, to consider those submissions, and to redetermine the matter with adequate reasons.

Facts

The taxpayer was a U.S.-based corporation had filed its income tax returns for 2012-2015 in 2018 and sought a refund for taxes withheld at source during those years. The relevant returns were filed after the three-year deadline to claim a refund by filing tax returns under subsection 164(1).

The CRA denied the taxpayer's subsequent request that the Minister exercise its discretion under subsection 220(3) to extend the three-year deadline in subsection 164(1) of the ITA, which would have allowed the taxpayer to claim the refunds sought. The CRA officer had concluded that subsection 220(3) cannot be relied upon to extend the deadline in subsection 164(1) on the basis that the Minister's discretion to extend the deadline under subsection 164(1.5) does not apply to corporations.

Federal Court Decision

The Federal Court dismissed the taxpayer's application for judicial review on the basis that the CRA officer's interpretation of the relevant legislative provisions was not unreasonable and was consistent with well-established principles of interpretation. The Federal Court also rejected the taxpayer's argument that there was a breach of procedural fairness in the decision-making process.

FCA Decision

The FCA concluded that the taxpayer did not get an adequate explanation for the refusal from the CRA. The FCA held that there are good reasons why administrative decision-makers, like the CRA, must give adequate explanations when people's rights and interests are at stake, including that adequate explanations help discover gaps and flaws in reasoning and further transparency and accountability. The CRA concluded that subsection 220(3) of the ITA did not apply because the taxpayer's case was distinguishable from another FCA decision that dealt with a different refund provision. However, the CRA did not provide any analysis or reasoning why subsection 220(3) cannot be relied upon to extend a deadline in subsection 164(1). The CRA's decision also claimed that the taxpayer raised the FCA decision that the CRA had relied on, but there was nothing in the record to substantiate that assertion. Nor did the CRA ask the taxpayer to make any submissions on that case before deciding the matter.

The FCA held that the CRA's decision "falls below standard, especially given the six-figure amounts at stake."

With respect to the remedy, the FCA held that the CRA, not the FCA, must decide whether to allow for the filing of late returns.

Learnings and Outlook

This FCA decision contains welcome statements that will be helpful in the context of discretionary decisions for which reasons must be given, such as those dealing with interest and penalty relief. It also serves as a reminder that the FCA or Federal Court has limited power even in a successful judicial review application as they can only send the decision back to the CRA for reconsideration.

Charities and Non-Profits Developments and Outlook

Throughout 2025, Finance and the CRA were focused on putting forward measures to achieve broader economic stabilization, implicitly signaling that major legislative and policy change for the charitable sector remained a low priority. With the Government's attention directed toward these large-scale priorities, Budget 2025 and subsequent legislative proposals contained few significant changes for charities.

Instead, the Government mostly reaffirmed its intention to proceed with previously announced minor technical adjustments—like the extension of the 2024 donation deadline and the anti-money laundering prohibition on large cash gifts—while delaying the implementation of expanded reporting for non-charitable non-profit organizations until 2027 or later. In the coming year, major structural evolution in the Canadian charitable landscape may continue to be driven primarily by impactful case law (such as the decisions in *Priority Foundation* and *Stamford Kiwanis*; discussed below), rather than by proactive legislative and policy amendments.

CHARITIES AND NON-PROFITS CASES

Stamford Kiwanis: Ontario Court of Appeal Expands Access to Charitable Property Tax Exemptions

Overview

The Ontario Court of Appeal released a landmark decision in *Stamford Kiwanis Non-Profit Homes Inc. v. Municipal Property Assessment Corporation*, **2025 ONCA 450**, expanding access to charitable municipal property tax exemptions under Ontario's *Assessment Act*. In a unanimous five-judge ruling, the Court overturned its previous decision in *Religious Hospitallers of St. Joseph Housing Corp. v. Regional Assessment Commissioner, Region 1*, **1998 CanLII 2943**, which had imposed a restrictive interpretation on what it means for a corporation to be "organized" for the relief of the poor such that it qualifies for the exemption.

ONCA Decision

The case involved Stamford Kiwanis Non-Profit Homes Inc. ("Stamford Kiwanis"), a charitable, non-profit philanthropic corporation that provides affordable housing to low-income residents in Niagara Falls, whose application for an exemption from property taxes was initially denied. The central issue before the Court was whether Stamford Kiwanis met the criteria for exemption under subparagraph 3(1)12(iii) of the *Assessment Act*, which included being organized for the relief of the poor. The Court held that the interpretation of this requirement set out in *Religious Hospitallers* – namely, that organizations needed to provide relief to the poor by undertaking some form of endeavour – was not supported by the statute's language or legislative intent. Instead, the Court clarified that to qualify for the exemption and show it is organized for relief of the poor, a corporation must show that the primary purpose or use of the property is relief of the poor, that it operates at least in part for this purpose, and that its intended beneficiaries experience an element of economic

deprivation. Applying this new test, the Court found Stamford Kiwanis met the exemption requirements and so granted Stamford Kiwanis's application.

Learnings and Outlook

This decision marks a significant development for charitable and non-profit organizations in Ontario, especially those providing affordable housing. Organizations previously ineligible for the exemption from property taxes may now qualify, and those that restructured to meet the old requirements may wish to revisit their arrangements.

Priority Foundation: Federal Court of Appeal Clarifies Limits on Cross-Border Charitable Gifts

Overview

In *Priority Foundation v. Canada (National Revenue)*, **2025 FCA 180**, the Federal Court of Appeal addressed whether Canadian registered charities can make gifts to U.S. organizations exempt from tax under section 501(c)(3) of the U.S. *Internal Revenue Code* ("Code") without jeopardizing their charitable status. Priority Foundation argued that Article XXI(7) of the *Canada-U.S. Tax Convention* should allow these gifts to be treated as if they were donations to a registered charity under the Act and hence donations to a "qualified donee" under the ITA. This would permit Canadian charities to support U.S. entities directly.

FCA Decision

The FCA, however, rejected Priority Foundation's proposed interpretation, ruling that while Article XXI(7) allows a Canadian resident to claim tax relief for making gifts to U.S. charities, "the relief from tax that the resident of Canada may claim for Canadian tax purposes is limited to the relief that would be available under the [Act] if the only income of the resident were the resident's income from sources in the United States and only to the extent permitted under the percentage limitations under the [Act] for gifts to registered charities". The Court held that Article XXI(7) does not deem section 501(c)(3) entities to be qualified donees under Canadian law, nor does it aim to override or replace the ITA's requirements for maintaining charitable registration. The Court's reasons emphasized that Canadian charities must restrict their gifts to qualified donees as defined by the Act, and that this enables regulatory oversight, which is essential to prevent misuse of charitable funds.

Learnings and Outlook

Ultimately, the Court upheld the CRA's decision to revoke Priority Foundation's charitable status for making gifts to non-qualified donees and dismissed Priority Foundation's appeal. This decision clarifies that cross-border charitable giving by Canadian charities remains tightly regulated, and that the *Canada-U.S. Tax Convention* does not expand the definition of qualified donees beyond what is set out in Canadian legislation.

2024 CHARITABLE DONATION DEADLINE EXTENDED INTO 2025

Responding to the disruption caused by the four-week Canada Post mail stoppage in late 2024, on January 23, 2025, Finance proposed an extension to the charitable donation deadline for 2024, allowing Canadians to claim eligible gifts made up to February 28, 2025 in their 2024 taxation year. This temporary measure was intended to mitigate the financial impact on charities who rely heavily on year-end holiday fundraising by giving donors sufficient time to process and submit contributions via cash, cheque, credit card, or electronic payment.

Budget 2025 subsequently reaffirmed the government's intention to proceed with implementing this extended deadline, which was then incorporated in proposed subsection 118.1(29) under Bill C-15. The credit for donations made during the extended period (January 1 to February 28, 2025) can be claimed in either the 2024 tax year or the 2025 tax year.

Initially, there was a degree of uncertainty and disappointment among high-net-worth donors and financial planners regarding the scope of the extension. While the initial government announcement was broad, the draft legislation clarified that the extension only applied to gifts of money or cash equivalents (cash, cheque, credit card, or electronic payment). This necessarily excludes gifts-in-kind, such as donations of publicly listed securities (like stocks or mutual funds). Consequently, any security donation made after December 31, 2024, but before February 28, 2025, can only be claimed in the donor's 2025 tax return.

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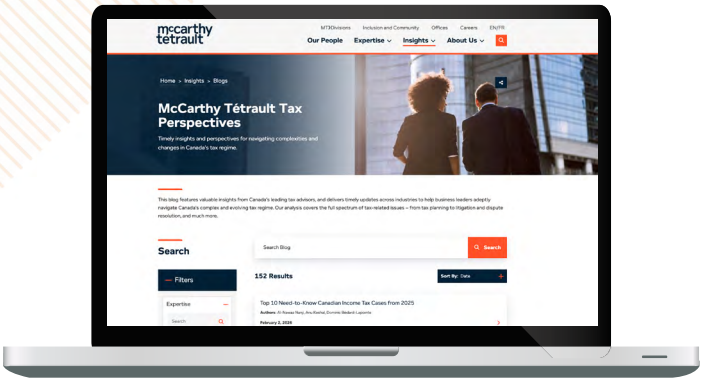

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