SELECTED SAFE INCOME ISSUES: RELEVANT PERIOD, GLOBAL COMPUTATION AND ALLOCATION

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A. Introduction

This is one of two papers covering subsection 55(2) presented at the 2017 Canadian Tax Foundation (CTF) Prairies conference. The other paper, written by Anthony Strawson, discusses planning techniques practitioners could consider in order to manage s.55(2).[1]

One of the most alarming legislative changes impacting tax practitioners in recent years was the substantial overhaul of subsection 55(2), which applies to inter-corporate dividends received after April 20, 2015. The amendments greatly broadened the reach of subsection 55(2) primarily due to the addition of two new purpose tests and the restriction of the paragraph 55(3)(a) related party exception to only subsection 84(2) or (3) deemed dividends. Rather than attempt a comprehensive discussion of subsection 55(2),[2] this paper will focus on certain aspects of the safe income exception in paragraph 55(2.1)(c) which is the only objective safe harbour in dealing with revised subsection 55(2).

1. The Safe Income On Hand Exception

The underlying concept of safe income is that once corporate income has been taxed, corporations should be able to pass that income amongst themselves on a tax-deferred basis (subject to Part IV tax). Accordingly, paragraph 55(2.1)(c) provides that a dividend is not subject to subsection 55(2) if the amount of the dividend does not exceed an amount that is:

- the income earned or realized by any corporation, after 1971 and before the safe-income determination time (SIDT) for the series, and
- that could reasonably be considered to contribute to the shareholder's hypothetical capital gain on the share from which the dividend is received, at the moment immediately before the dividend.

The first part, the "income earned or realized by any corporation …" is often referred to as "safe income", and this amount represents corporate income that has been subject to tax, modified by adjustments in paragraphs 55(5)(b), (c) and (d). This paper uses the terms "income earned or realized" and "safe income" interchangeably.

The second part, the amount of safe income that must reasonably be considered to contribute to a hypothetical capital gain, is often referred to as the "safe income on hand" or "SIOH" – being the safe income that needs to remain "on hand" in order to contribute to a gain. The original purpose for this is

[1] [**ADD REFERENCE TO ANTHONY'S PAPER**]

[2] The following are a few of the Canadian Tax Foundation papers discussing subsection 55(2): Rick McLean, "Subsection 55(2): What Is the New Reality?," Report of the Proceedings of the Sixty-Seventh Tax Conference, 2015 Conference Report (Toronto: Canadian Tax Foundation, 2016), 22:1-71; Ron Dueck, Janette Pantry and Rosanna Lau, "Subsection 55(2): Practical Applications" 2016 British Columbia Tax Conference (Toronto: Canadian Tax Foundation, 2016), 10: 1-38; Kim G.C. Moody and Kenneth Keung, "Subsection 55(2) - The Road Ahead" 2016 Prairie Provinces Tax Conference (Toronto: Canadian Tax Foundation, 2016), 10: 1-43;Rick McLean, "Subsection 55(2) Amendments: What's the Purpose?," 2016 St. John's Tax Seminar (Toronto: Canadian Tax Foundation, 2016), 2:1-48; Marissa Halil, Alex Ghani, and Manu Kakkar, "Is Safe Income Really Safe?" 2016 Ontario Tax Conference (Toronto: Canadian Tax Foundation, 2016), 10: 1-27.

best understood by referring to subsection 55(2) as it read before April 21, 2015. The application of old subsection 55(2) was based on there being a reduction of capital gain of a share. However, old subsection 55(2) would only apply if the capital gain being reduced could reasonably be considered to be "attributable" to anything other than "income earned or realized". Therefore, for this exception to apply under the old rules, it was necessary that such "income earned or realized", i.e. safe income, must remain "on hand" for it to be attributable to the value, and thus the capital gain, of a share. This concept is retained under the current legislation through paragraph 55(2.1)(c), which provides that subsection 55(2) only applies if the inter-corporate dividend exceeds the income earned or realized that could reasonably be considered to "contribute" to a hypothetical capital gain. Income earned or realized that is no longer on hand to reasonably contribute to a hypothetical capital gain cannot protect a dividend against subsection 55(2).

Whether a capital gain could reasonably be considered to be "attributable" to safe income is arguably substantially the same as whether an amount of safe income can reasonably "contribute" to a capital gain. Indeed, according to the Department of Finance's technical notes, the change in wording was merely intended to accommodate the new purpose tests added to paragraph 55(2.1)(b). However, a subtle difference may exist between the two versions which may be relevant in some circumstances as discussed later in the paper.

Also, paragraph 55(2.1)(c) must now be read in conjunction with paragraph 55(5)(f). Prior to the amendments, paragraph 55(5)(f) allowed the filing of a designation to carve a single dividend into a series of smaller dividends, in order to protect against subsection 55(2) re-characterizing an entire dividend if SIOH happens to be less than the total amount of the dividend. Effective April 21, 2015, paragraph 55(5)(f) applies automatically to split a dividend that exceeds SIOH into two separate dividends: a dividend equal to the amount of the SIOH, and another dividend equal to the remainder. The former is protected by the safe income exception; the latter is subject to re-characterization under subsection 55(2) if one of the purpose tests in paragraph 55(2.1)(b) is met.

On the one hand, the automatic application of paragraph 55(5)(f) simplifies tax filings as a designation is no longer required. On the other hand, SIOH computation has become more important as the automatic application of paragraph 55(5)(f) suggests that a dividend must always first be applied against SIOH.[3] Of course, the limitation of the paragraph 55(3)(a) exception and the subjective nature of the new purpose tests also made the SIOH exception, which is relatively objective, a lot more applicable than before.

A full review of the computation and allocation of SIOH is beyond the scope of this paper. Instead, this paper reviews two key areas often faced by practitioners when dealing with the safe income exception:

- The relevant period for calculating SIOH;
- Computation of "global" SIOH, and allocation of SIOH to different shares and shareholders.

A common theme prevalent in these discussions is that most of the guidance around SIOH is derived from the CRA's administrative practices, the core of which comes from the so-called "Robertson Rules" which are the framework and guidance set out by John R. Robertson (then the head of the Rulings

[3] Automatic application of paragraph 55(5)(f) also prevents historical planning that relies on intentionally not filing paragraph 55(5)(f) to trigger capital gains as a result of the application of subsection 55(2) on the otherwise safe income portion of a dividend.

Directorate) at the CTF 1981 annual conference,[4] and later updated by other CRA officials. While these CRA's administrative practices are not law, and in some cases, may even appear inconsistent with judicial decisions, tax practitioners generally follow these administrative practices when dealing with safe income to avoid disputes with the CRA. Even then, these CRA administrative practices are sometimes not 'crystal clear' when they need to be applied in practice.

B. Relevant period for calculating safe income: when to begin and when to end

1. Starting point – acquisition date

At first glance, statutory guidance appears to be lacking in paragraph 55(2.1)(c) in terms of when the relevant period for computing SIOH begins, except for that it must be "after 1971". However, paragraph 55(2.1)(c) specifically refers to safe income that could reasonably be considered to contribute to a hypothetical capital gain. A gain on a share cannot arise before acquisition of the share, and only corporate earnings that arise after the acquisition could reasonably be considered to contribute to the shareholder's hypothetical capital gain on the share. Because of this, safe income is generally determined for a period that begins with the time of acquisition of the share, to the extent that acquisition date is after 1971. Therefore, no safe income dividend can be paid immediately after an acquisition even if SIOH was available immediately prior to the acquisition. Conceptually, any corporate earnings that were on hand prior to acquisition should form part of the shareholder's purchase price and therefore adjusted cost base (ACB) of the share.

2. Starting point – tax-deferred acquisition

There are a number of exceptions to the general rule discussed above; the most common being where a share is acquired by the shareholder on a tax-deferred share exchange. In a situation where a share is acquired on a fully tax-deferred share exchange (either under sections 51, 85, 85.1, 86 or 87), the SIOH of the old share flows to the new share.[5] This is a reasonable result since the entire accrued gain is transferred to the new share, and accordingly the income earned or realized prior to the acquisition (to the extent it reasonably contribute to a hypothetical capital gain of the old share at the time of the exchange) should reasonably be considered to contribute to the hypothetical capital gain of the new share immediately after the exchange. Of course, this also means that the amount of SIOH inherited can never exceed the amount of hypothetical capital gain of the old share at the time of the exchange.

This concept applies similarly to share mergers and splits. Where a shareholder exchanges, on a fully tax-deferred basis, two classes of old shares for one new class, the SIOH of the two classes will flow through to the one class.[6] Conversely, where a shareholder exchanges one class of old shares for two classes of new shares, the SIOH of the old class flows to the two new classes, allocated pro rata based on the relative amounts of the inherent gain of the two new classes at the time of the exchange.[7]

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[4] John R. Robertson, "Capital Gains Strips: A Revenue Canada Perspective on the Provisions of Section 55," in Report of Proceedings of the Thirty-Third Tax Conference, 1981 Conference Report (Toronto: Canadian Tax Foundation, 1982), 81-109.

[5] Robertson, supra; CRA document #9829500, #2016-0653001C6.

[6] CRA document #2005-0122691R3.

[7] CRA documents #2000-0007925, #2010-0374231E5.

For shares acquired through a partially tax-deferred transaction, the outcome is more ambiguous. Assume an individual holds shares in an operating company (Opco) and these shares have an amount of SIOH. The individual wishes to transfer these shares to a holding company (Holdco) and partially elect a gain under subsection 85(1). Since the Opco shares are now held by Holdco, the amount of SIOH associated with the Opco shares becomes a relevant issue as it potentially limits Opco's ability to repatriate funds to Holdco on a tax-free basis. However, how much of the SIOH is retained after the transfer?

This determination depends on how much of the pre-transfer safe income can reasonably be considered to contribute to the hypothetical capital gain post-transfer. Viewed inversely, if an amount of pre-transfer safe income contributed to the capital gain that is now realized, that amount of safe income can no longer be considered to contribute to any hypothetical capital gain (since that gain no longer exists after realization). The challenge with a partial recognition of gain is that there is no definitive way to trace whether each dollar of the gain realized is contributed from safe income or from an amount other than safe income. The CRA's long standing position is that a pro rata method should be used to apportion realized gain between safe income and amounts other than safe income. Under the CRA's approach, the amount of SIOH remaining after a partial rollover would be as follows:[8]

$$\text{Opco shares' SIOH immediately before transfer} \times \frac{\text{hypothetical gain remaining after transfer}}{\text{hypothetical gain immediately before transfer}}$$

Effectively, this approach eliminates a portion of pre-transfer SIOH on a pro rata basis based on the amount of capital gain triggered by the seller relative to the aggregate accrued gain immediately prior to the transfer.

This issue of partial rollover was considered by the Tax Court of Canada in *729658 Alberta Ltd. et al. v. The Queen*.[9] In *729658 Alberta Ltd*, the shares held by each shareholder had FMV of $12 million, a nominal ACB, and SIOH of $2 million. Each shareholder transferred their shares to a holding company, electing proceeds of $10 million under subsection 85(1). The issue was whether CRA's pro rata approach must be followed such that only 1/6th of the total safe income prior to the transfer remains after the transfer. The transactions occurred in 1997, so the relevant legislation was subsection 55(2) as it read prior to April 21, 2015.

In deciding the case, the Court reviewed the meaning of the phrase "reasonably be attributed" used in old subsection 55(2), found that it merely requires an allocation to be fair and moderate, and did not necessitate an averaging or proration approach. The Court particularly emphasized the original purpose of subsection 55(2), which was to ensure that a capital gain should arise at least to the extent sale proceeds reflect the untaxed appreciation in the value of underlying assets. The Court observed that the steps undertaken in *729658 Alberta Ltd* did not reduce tax beyond what the statutory scheme contemplated, i.e. there was no conversion of sale proceeds into an intercorporate dividend beyond the $2M SIOH. Therefore, the taxpayer's position that essentially the entire $10,000,000 gain triggered was reasonably attributable to something other than safe income was found by the Court to be a reasonable

[8] CRA document #9604235.
[9] 2004 TCC 474.

approach and consistent with the intent of subsection 55(2). This meant that the $2 million of SIOH continues to be available subsequent to the transfer.

The CRA however has not changed its administrative position relating to the pro rata approach as a result of the *729658 Alberta Ltd* case, preferring rather to limit that case to its specific facts. In an interpretation released by the CRA shortly after the decision in 729658 Alberta Ltd,[10] the CRA commented on a partial rollover transaction similar to 729658 Alberta Ltd. The CRA distinguished the transaction from 729658 Alberta Ltd and concluded that SIOH has to be eliminated pro rata based on the gain triggered.

The CRA did not elaborate why *729658 Alberta Ltd* was distinguished, but the primary difference between that case and the scenario described in the interpretation request appears to be that the capital gain exemption was claimed in the latter. It would appear that in the CRA's view, the ability to claim the safe income exception on the full SIOH while simultaneously claiming the capital gain exemption on the non-SIOH portion of the underlying corporate value is contrary to the intent of subsection 55(2). However, applying the reasoning from *729658 Alberta Ltd*, the position taken by the CRA is debatable since (i) there were ultimately no conversion of sales proceeds into intercorporate dividend beyond the total SIOH, and (ii) the scheme of the Act specifically permits the claiming of capital gain exemption on the sale of qualifying shares.

Needless to say, *729658 Alberta Ltd.* and the CRA's subsequent response has caused some uncertainty in dealing with partial rollover transactions, because it is not always clear when the tax result from a transaction or plan is sufficiently consistent with the intent of subsection 55(2) so that one can deviate from the pro rata approach.

Some practitioners have taken the view that the current wording of the safe income exception in paragraph 55(2.1)(c) has overrode *729658 Alberta Ltd.*[11] Under that line of reasoning, while the $10 million gain triggered in *729658 Alberta Ltd* could have been "attributable" to something other than the $2 million of SIOH, it is much more difficult to argue that the $2 million of SIOH did not reasonably "contribute" to that gain. From that perspective, the pro rata approach would be the correct approach under the current rules for shares acquired on a partially tax-deferred transaction.

However, it can also be argued that the "attributable" test and the "contribute" test are really the same in substance. As discussed earlier, Finance's technical notes suggest that the change in wording was merely intended to accommodate the new purpose tests added to paragraph 55(2.1)(b). Most importantly, the applicable standard continues to be what's "reasonable". In the author's view, it is not outside the realm of reasonableness to assert that a gain triggered on a partial rollover transfer of shares is contributed first from something other than safe income. As long as there is no conversion of sale proceeds into an intercorporate dividend beyond the total SIOH, *729658 Alberta Ltd* arguably continues to apply so that a pro rata approach is not mandatory.

3. *Unrealized appreciation prior to holding period*

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[10] CRA document #2005-0112141E5.

[11] Carolyn Engel, "A Review of Common Mistakes and Errors Made by Tax Professionals," 2015 Prairie Provinces Tax Conference, (Toronto: Canadian Tax Foundation, 2015), 7:1-25

A frequently overlooked aspect of safe income calculation is with respect to income earned within the relevant holding period, but that is attributable to unrealized appreciation accrued prior to the holding period.

Assume a situation where Holdco purchases the shares of Opco for full FMV at a time when Opco has unrealized appreciation in certain assets, such as inventory or capital property. Subsequent to that purchase, Opco sells the appreciated assets and recognizes the resulting income or gain for tax purposes. Even though this income or gain occurs after Holdco acquires the Opco shares for FMV, the CRA's view is that this gain cannot reasonably be considered to contribute to Holdco's hypothetical capital gain on the Opco shares because the appreciation of those property was already reflected in the price that Holdco paid for the Opco shares. [12] Since that appreciation is already part of the ACB, it cannot contribute to the hypothetical capital gain of the share so such income or gain needs to be removed from the calculation of SIOH.

It is questionable whether the CRA's position is correct in light of the 2003 Federal Court of Appeal decision in *The Queen v. Kruco Inc.*,[13] but the CRA has recently affirmed its position on this matter as recently as at the 2016 APFF Roundtable.[14] It is arguable that pursuant to *Kruco*, safe income should be computed in accordance with paragraph 55(5) and "on hand" adjustments can consist of only adjustments for cash outflows, and therefore a taxable income or gain realized during the holding period should be includable in SIOH regardless of the fact that the income or gain may have been attributable to the pre-acquisition period. That said, the legislation has also never explicitly required safe income earned prior to a FMV acquisition of share be excluded from SIOH, yet there appears to be no doubt that this practice represents a correct interpretation of the law. Excluding from SIOH any income arising on realization of pre-acquisition accrued gain follows a similar reasoning, and it is at the practitioner's peril to deviate from CRA's position on this issue.

Note also that if the CRA is correct that income arising on realization of pre-acquisition accrued gain should be excluded from SIOH, then arguably any ensuing tax paid on the realization of such income should not grind SIOH. Otherwise, the amount of that tax could potentially be subject to double taxation.

4. *Ending point for calculation – safe income determination time*

Paragraph 55(2.1)(c) specifies that the relevant period for computing SIOH ends before the "*safe-income determination time for the transaction, event or series…*". The term safe-income determination time (SIDT) for a transaction or a series is defined under subsection 55(1), and it is generally the earlier of the time that is

1) immediately before the earliest dividend paid as part of the series; and
2) immediately after the earliest of certain dispositions or increase in interests described in subparagraphs 55(3)(a)(i) through (v) that resulted from the series.

The challenge of dealing with this definition in practice is its reference to a "series". The concept of a "series of transactions or events" has been defined very broadly by the courts, and this broad definition

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[12] CRA document #2000-0053165.

[13] 2003 FCA 284.

[14] CRA document #2016-0653001C6.

is further expanded by subsection 248(10). Under the common law, transactions can constitute a "series" if the transactions are pre-ordained in order to produce a given result, and there is no practical likelihood that the pre-planned events would not take place in the order ordained.[15] Subsection 248(10) then expands the meaning to deem a series of transactions or events to include "any related transactions or events completed in contemplation of the series". In interpreting subsection 248(10), the Supreme Court of Canada in *Canada Trustco* stated that "in contemplation" is read not just in the sense of actual knowledge but also in the broader sense of "because of" or "in relation to" the series, and it can apply to events before or after.[16] Later, in *Copthorne Holdings Ltd. v R*, the Supreme Court of Canada clarified that the "because of" or "in relation to" tests do not require a strong nexus, but requires more than a "mere possibility" or a connection with "an extreme degree of remoteness". The Court in *Copthorne* also confirmed that a subsection 248(10) series allows either a prospective or retrospective connection of a transaction related to a common-law series.[17]

Given the expanded definition of "series" in subsection 248(10) and the broad interpretations by the Courts, practitioners must be cautious of historical events in computing SIOH. It should also be noted that there is no de minimis for the quantum of an event for it to qualify as a triggering event for SIDT. A taxpayer paying a significant inter-corporate dividend believing itself to be entitled to a certain amount of SIOH could be blind-sided if it is unaware that an immaterial historical dividend or transaction described in subparagraphs 55(3)(a)(i) through (v) was part of or resulted from the same series as the dividend. Once an event triggers a SIDT, any income earned or realized after the SIDT cannot be included in SIOH.[18]

It was welcome news when the CRA announced in 2016 that it generally does not view regular, recurring annual dividends to be part of a series of transactions.[19] As a result, the SIDT in respect of each of the annual dividends occurs immediately before each such dividend, meaning that each dividend can take into account the SIOH accumulated up to that point. Unfortunately the CRA did not provide further guidance beyond this general statement. For instance, how broadly can "regular" and "recurring" be interpreted? Also, would the CRA extend the same favourable statutory interpretation for dividends occurring at lower-tiered subsidiaries? Assume Parent Co owns Mid Co, which in turn owns Opco. Over time, Opco paid regular and recurring dividends to Mid Co – resulting in a cash build-up in Mid Co which Mid Co ultimately paid to Parent Co as a large dividend. At Midco's level, the Opco dividends appear to fall within the CRA's administration position on regular recurring dividends so that the SIDT for each dividend falls immediately before each such dividend. However, at Parent Co's level, the dividend it received from Mid Co was entirely in relation to the Opco dividends over the years. All of the Opco dividends that contributed to the cash build-up of Mid Co would appear to be part of the same "series", pursuant to the expanded meaning under subsection 248(10) and the Court's broad interpretation of the term. If that is the case, the SIDT would have occurred immediately before the first Opco dividend of

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[15] *OSFC Holdings Ltd. v R.*, 2001 FCA 260, *Canutilities Holdings Ltd. v R*, 2004 FCA 234, *Canada Trustco Mortgage Co. v R.*, 2005 SCC 54.
[16] *Canada Trustco Mortgage Co. v R.*, 2005 SCC 54, at paragraph 26.
[17] 2012 D.T.C. 5007, at paragraphs 47 and 56.
[18] Further, paragraph 55(5)(a) confirms that any income that is expected to be earned or realized after the SIDT is deemed to be excluded from SIOH. Therefore, amounts such as goodwill related to anticipated future revenues and accrued capital gain at the time of SIDT cannot be included in SIOH.
[19] CRA document 2016-0672321C6.

the series, and none of the income earned or realized by Mid Co and Opco after that time can be included in SIOH when assessing whether subsection 55(2) applies to Mid Co's dividend to Parent Co.

Proper consideration of SIDT is particularly important when implementing safe income dividend planning on a third party sale.

Assume Parent Co owns Mid Co, which in turn owns Opco. Mid Co has nominal ACB and paid-up capital (PUC) in the Opco shares, and the Opco shares currently has SIOH of $100. Mid Co plans to sell its shares of Opco to a third party for $300. In order to minimize capital gain, Opco will first pay a dividend of $100 to Mid Co reducing the FMV of Opco shares to $200. Subsequently, Mid Co sells the Opco shares to the third party for $200, incurring a $200 capital gain. Then, Mid Co pays a $300 dividend to Parent Co, consisting of the $100 Opco dividend and $200 sale proceeds.

While the $100 dividend paid by Opco to Mid Co is protected by the SIOH exception in paragraph 55(2.1)(c), that dividend is likely considered part of the same series of transaction or events as the latter dividend from Mid Co to Parent Co. As such, in determining the amount of SIOH available for that latter dividend, the SIDT occurs at the time that is immediately before the Opco dividend. This means that both the Opco dividend and the sale of Opco shares occur after the SIDT. Given that SIOH is calculated on a consolidated basis (because paragraph 55(2.1)(c) refers to income earned or realized by "any corporation"), the $100 of Opco's SIOH is still includable in computing the SIOH for the $300 Mid Co dividend. However, the $200 of capital gain earned by Mid Co on the sale would not be includable in SIOH. This means that $200 of the $300 dividend from Mid Co to Parent Co will be re-characterized into a capital gain under subsection 55(2), to the extent one of the three purpose tests in paragraph 55(2.1)(b) is met. This results in the same $200 of value being taxed twice as capital gain: once in the hands of Mid Co and another time in the hands of Parent Co.

A similar problem arises for dividends paid up the chain of a multi-tiered structure where a dividend at the lower-tier is recharacterized into capital gain by subsection 55(2) due to insufficient SIOH. If the SIDT with respect to the higher-tier dividend occurs immediately before that lower-tier dividend, the SIDT would occur immediately before the subsection 55(2) capital gain. In that case, the SIOH computation cannot include the subsection 55(2) capital gain, and the same portion of the higher-tier dividend can be subject to subsection 55(2).

Until further guidance is provided from the CRA, taxpayers should be cautious in structuring inter-corporate dividends in multi-tiered corporate structure to avoid inadvertently triggering the SIDT earlier than anticipated. The recent court case of *101139810 Saskatchewan Ltd. v Queen* is a good example where the Court has no sympathy for a taxpayer who walks inadvertently into subsection 55(2) and incurs tax twice within an ownership group on the same underlying gain.[20]

Sometimes, SIDT issues could even result from transactions conducted by third parties. For instance, assume Holdco owns Opco, and Opco owns business assets that it is planning to sell to a third party purchaser. Opco will then distribute the proceeds up to Holdco as a dividend. If, as part of the pre-closing arrangement, the purchaser undergoes a tax-deferred transfer within the purchaser's own group of entities and that transfer could be considered part of the same series as the sale and subsequent

[20] 2017 TCC 3. For a discussion of *101139810 Saskatchewan Ltd. v Queen*, refer to Kenneth Keung, "Capital Gains Taxed Twice", Tax for the Owner-Manager, pp. 2-3, Volume 17, Number 2.

dividend by Opco, a SIDT could be considered to have occurred at the time of the purchaser's internal transaction. This is because that internal transaction would be an event described in paragraph 55(3)(a)(i) – a disposition of property, at less than FMV proceeds, to an "unrelated person". The purchase's internal entity would be an unrelated person, as defined under paragraph 55(3.01)(a), since it is not related to Holdco, the dividend recipient. If the purchaser's pre-closing transaction is considered to have triggered the SIDT, then any capital gain or recapture income from the sale of the business assets by Opco would not be includable in the SIOH with respect to the dividend.

On a final note, the CRA recently announced a favourable administrative policy on recapture income under subsections 13(1) and 14(1). Under these two subsections, the recapture income arises in respect of income "for the year". If a corporation sells its assets and distribute the proceeds as a dividend after the sale but before the end of its fiscal year, it was unclear whether such recapture income occurs before the SIDT so that it could be included in the SIOH with respect to the dividend. In its recent announcement, the CRA confirms that, based on a textual, contextual and purposive interpretation, such recapture income (less the associated tax payable) would be added to SIOH as long as the sale of assets occurs before the SIDT.[21] On the flip side, the inverse would apply to any terminal loss on sale of assets occurring before the SIDT.

5. Stub Periods

Since the acquisition of shares and the SIDT do not always coincide with the beginning and end of taxation years, the relevant period for computing SIOH could contain two stub periods:

1) From the share acquisition date to the first taxation year-end, and
2) From the last taxation year-end to the SIDT.

Since paragraph 55(2.1)(c) refers to "income" generally rather than income for a taxation year, income earned during these stub periods should be includable in SIOH as long as they reasonably contribute to the hypothetical capital gain of the share. Indeed, the CRA's longstanding position is to require the inclusion of stub period income and losses computed on a reasonable and consistent basis as with the computation methods used in other periods within the holding period. The CRA has also stated that the proration of income on a daily basis for the stub period is often, but not always, a reasonable approach to the calculation.[22]

The CRA has however attempted a more arbitrary approach in *The Queen v. VIH Logging*,[23] arguing that income for the stub period up to SIDT was not includable in SIOH for the specific circumstances in question. In *VIH Logging*, the stub period income was never taxable because it was fully offset by a Canadian exploration expense (CEE) deduction from the acquisition of seismic data after the SIDT. The Courts rejected the CRA's argument and ruled that the taxpayer was entitled to include stub period income in SIOH and that the CEE deduction from the post-SIDT acquisition of seismic data does not reduce that SIOH.

[21] CRA document 2016-0633961E5.
[22] Robert J.L. Read, "Section 55: A Review of Current Issues," in Report of Proceedings of the Fortieth Tax Conference, 1988 Conference Report (Toronto: Canadian Tax Foundation, 1989), pages 18:5 and 18:6.
[23] 2005 FCA 36.

C. Computation of "global" safe income on hand

1. *Components of safe income and safe income on hand*

The mechanics of what constitutes safe income and SIOH have been written on extensively, so this paper will not attempt to elaborate on it. The table below summarizes the common components and adjustments relating to the SIOH. However, readers should be cognizant that the table is provided only for general reference and the items listed on the table are not necessarily comprehensive or set in stone. Most are derived from the CRA's administrative practices over the years. Different approaches may be required based on the particular facts and circumstances in order to arrive at the proper amount required under paragraph 55(2.1)(c), which is, the amount of safe income that could reasonably be considered to contribute to the hypothetical capital gain of the share immediately before the dividend.

Common components and adjustments	**References and comments**
Net income (loss) for income tax purposes (NIFTP) of dividend payor and any subsidiary corporations, for the relevant holding period including stub periods	
Subtractions to arrive at SIOH	
Non-allowable portion of capital loss	Only for corporations other than a private corporation; s.55(5)(b)
Taxable dividends paid or declared, including undeclared cumulative dividends (note that capital dividends and taxable dividends that were subject to s.55(2) do not reduce SIOH)	*Kruco*; Robertson Rules; CRA doc. #2001-0072765, #2015-0593941E5 and #2016-0655921C6
Losses (any type, including capital losses) incurred but not already included in NIFTP, irrespective of when they are claimed	Robertson Rules; CRA doc #9408795 and #2011-0395701E5
Non-deductible expenses ** (note that outlays to acquire capital property or eligible capital property do not reduce SIOH; life insurance premiums contributing to cash surrender value also do not reduce SIOH)	Robertson Rules; CRA Income Tax Technical News 37; CRA doc. #2015-0573821C6
Expenditures where deductibility is deferred ** (e.g. financing expense)	CRA doc. #9231575 and #2009-0330171C6.
Potential cashflows such as contingent liabilities and accounting reserves **	CRA doc. #2016-0672321C6, #9611245, and #9630155
Suspended or denied losses **	CRA doc. #9132625, #2000-0034037, and #9M19190 (Question 4)

In certain circumstances, SIOH could be reduced by unrealized losses representing amount "expended" e.g. anticipated bad debt on loan receivables that is realized after the SIDT, acquisition cost of a 'lossco' with no assets that is subsequently merged with the corporation **	CRA doc. #2011-0395701E5 and #2000-0034037
Federal and provincial taxes payable (including any refundable tax payable **). Deferred taxes do not reduce SIOH.	Robertson Rules; *Kruco*
Income or gains realized during holding period from pre- holding period appreciation	See earlier discussion.
Section 110.5 deemed inclusion to taxable income	CRA doc. #2011-0415071E5. Note this is not part of NIFTP to begin with.
Additions to arrive at SIOH	
Former research allowance s.37.1 amount	s.55(5)(b) & (c)
Former inventory allowance 20(1)(gg) amount	s.55(5)(b) & (c)
Non-taxable portion of capital gain	Only for corporations other than a private corporation; s.55(5)(b).
Non-taxable portion of pre-2017 eligible capital property recapture income	Only for corporations other than a private corporation; s.55(5)(b).
Safe income dividends received from a subsidiary	Robertson Rules
Refundable taxes from RDTOH received	Robertson; CRA doc #9429465
Recovery of taxes paid in prior years	CRA doc. 1990-70
Deductions for prior year expenses or reserves already deducted from SIOH in prior years (e.g. 20(1)(e) deductions, SRED carryforward, etc.)**	CRA doc. #2009-0330171C6, and #9731035
Loss carryforward claimed	CRA doc. #2000-0034037
Reduction of tax attributes due to application of debt forgiveness rules**	CRA doc. #2001-0115305

* Table does not consider investments in foreign affiliate.

** Debatable as to whether the CRA's administrative position is correct pursuant to *Kruco* and The Queen v Brelco Drilling Ltd.[24]

2. Concept of "global" safe income on hand and allocation of shareholders

An often challenging exercise that practitioners face when dealing with SIOH is determining how much SIOH is associated with each share. There is unfortunately little guidance from the Courts on this, and most of the guidelines on allocation of SIOH are derived from the CRA's administrative policies which are currently far from clear. While it is important to understand and consider the administrative guidance

[24] Ibid 13, *Kruco*, *The Queen v Brelco Drilling Ltd*, [1999] 4 F.C. 35

from the CRA, practitioners must always refer back to the legislative basis behind the allocation of SIOH to shares. The safe income exception in paragraph 55(2.1)(c) is limited to the safe income that could reasonably be considered to contribute to the "the capital gain that could be realized on a disposition at fair market value, immediately before the dividend" of the share on which the dividend is received. Rather than applying a "one size fits all" approach, practitioners need to consider all facts and circumstances when allocating SIOH to shares so that the result is consistent with the legislative requirements of paragraph 55(2.1)(c).

The traditional approach of computing SIOH, as set out in the Robertson Rules, is to compute SIOH on a share-by-share and shareholder-by-shareholder basis. Based on dividend entitlement of the class and all the terms and conditions in the share articles, each share of a corporation is entitled to its proportionate share of the safe income of the corporation during the relevant holding period of that share. The safe income with respect to shares held by one shareholder is independent of the safe income of shares of another shareholder.[25]

However, after the 2015 amendments to section 55, the CRA's approach appears to have shifted where SIOH of the dividend payor is generally computed on a global basis, then allocated to various outstanding shares based on the relative hypothetical capital gain of the shares. It is not entirely clear whether such a shift in policy by the CRA was a reflection of the amendment to section 55 or was just a change to the previous policy. As discussed, the safe income exception in paragraph 55(2.1)(c) is substantially the same as the old version of the exception in subsection 55(2) as it read prior to April 21, 2015. Paragraph 55(2.1)(c) refers to safe income that reasonably "contribute to" the hypothetical capital gain, where the old version refers to hypothetical capital gain that could reasonably be "attributable to" safe income – both versions appears to reconcile comfortably with the global allocation approach.

Yet, the computation of SIOH is not purely a global one, because shareholders are still only entitled to safe income earned after their respective relevant holding period begins for reasons discussed in earlier parts of the paper. The overlay of the two concepts will create complexity in certain situations. Furthermore, as part of the global SIOH approach, for corporations with multiple classes of shares, the CRA appears to be willing to attribute to the FMV of the shares any amount of dividend to be declared so as to increase the gain on the share up to which safe income could be allocated (i.e. a shift of value from one class of shares to the other). This effectively allows corporations to use discretionary dividend shares to "stream" SIOH as it sees fit. The CRA has however announced at the 2016 CTF National Conference that it is concerned about potential abuses that could arise from this and is currently studying the subject.[26] The Department of Finance has also announced during the 2017 federal Budget that it is studying the taxation of private corporations and dividend sprinkling. It is conceivable that the two studies are linked.

Where a corporation has only one class of shares outstanding, it is reasonable that all of the safe income for the taxation year is attributable to that class of shares. As a corporation earns income, the income contributes to the value of the corporation's net assets, so it is reasonable that such income also contributes to the FMV and hypothetical capital gain pro rata amongst that one class of shares. If all shareholders have the same holding period – for example, all shareholders obtained their shares on

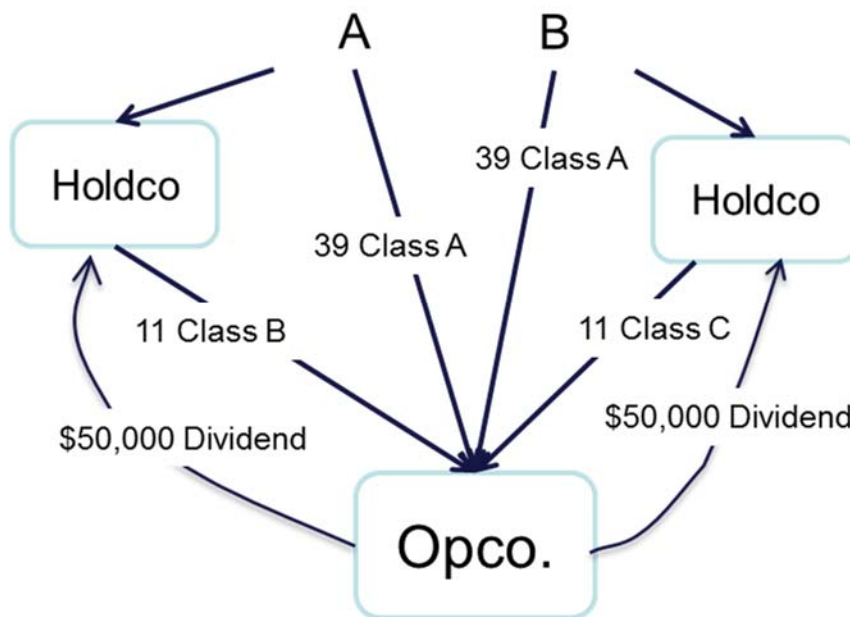
[25] Ibid xx, Robertson.
[26] CRA document #2016-0669651C6.

incorporation – then the SIOH is split equally amongst all the shares. If a shareholder acquires additional shares of that same class at a later time outside of a rollover, the purchase price of such shares should presumably include any SIOH of the corporation up to that point. Corporate earnings subsequent to the purchase will continue to contribute pro rata to the value and hypothetical capital gain to each share of the class. Accordingly, those additional shares acquired will be entitled only to a pro rata portion of SIOH subsequent to the purchase. The legislative amendments to section 55 and recent CRA pronouncements have not changed this result.

Allocation becomes more difficult when multiple classes of shares are involved. The best way to illustrate the current state of SIOH allocation is by analyzing several of the SIOH allocation examples provided by the CRA since the 2015 amendments.

3. *Participating discretionary dividend common shares with similar holding periods*

In CRA document #2015-0593941E5 released on December 3, 2015, the CRA described a number of fact patterns and one of them was as follows:



A and B are two unrelated individuals, each holding 39 Class A of Opco and their respective Holdcos. A's Holdco owns 11 Class B of Opco and B's Holdco owns 11 Class C of Opco. All three classes of Opco shares are voting, participating and entitled to discretionary dividends and all the shares have nominal ACB. The aggregate SIOH and FMV of the Opco shares are $100,000 and $120,100, respectively. Presumably, the holding period of all the shares are the same. Opco will pay a $50,000 dividend to each of the two Holdcos.

Under the traditional approach to SIOH allocation, the principle of equality amongst shares would likely dictate that the SIOH be allocated pro rata amongst all three classes given all three has similar attributes. In fact, this pro rata approach would seem to be consistent with the Federal Court of Appeal's decision in In *Nassau Walnut Investments Inc. v. The Queen* and the Tax Court of Canada's

decision in *Gestion Jean-Paul Champagne Inc. v. Minister of National Revenue*.[27] In both cases, the Court considered pro rata allocation of safe income among all shares to be the correct approach. However, in both cases, the allocation relates to a single class of shares and the Courts were not dealing with allocating SIOH to multiple classes of shares. Indeed, there appears to be no case law to date on disproportionate allocation of SIOH amongst different classes of shares.

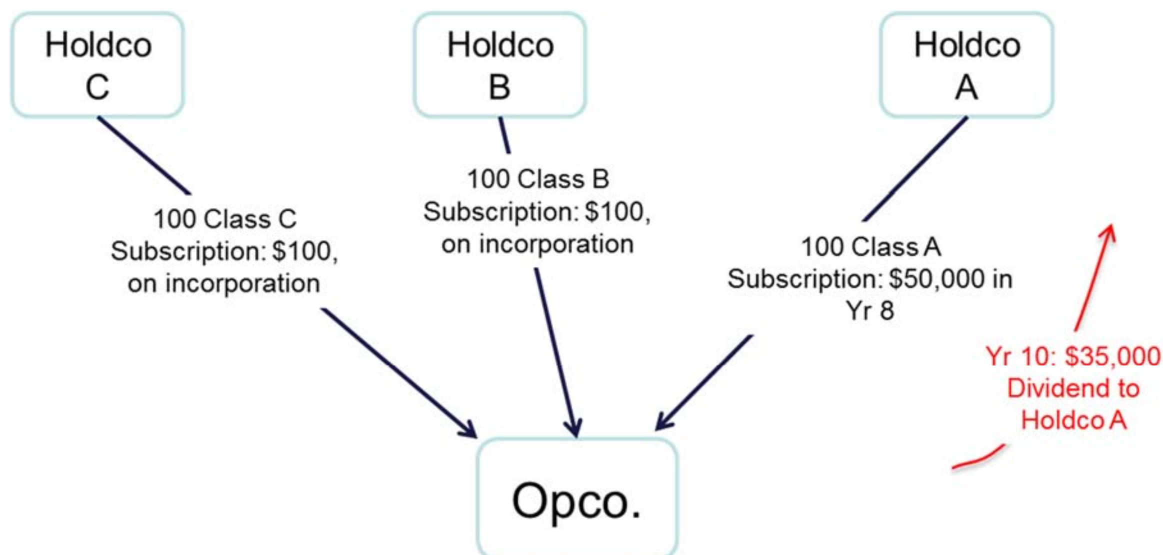
For the fact pattern described above, the CRA's view is that the hypothetical capital gain of the Class B and Class C shares, immediately before the dividends, takes into account the fact that those shares would have a right to an additional amount equal to the dividends declared. Taking into account this additional value, the 11 Class B shares should have an aggregate hypothetical capital gain of at least $50,000 at the moment immediately before the dividend; same for the 11 Class C shares. Accordingly, the CRA's view is that of the $100,000 of aggregate SIOH, $50,000 could reasonably be regarded as contributing to the hypothetical capital gain on the 11 Class B and the other $50,000 could reasonably be regarded as contributing to the hypothetical capital gain on the 11 Class C shares. Therefore, the $50,000 dividends paid on the Class B and Class C will not exceed the SIOH of those shares, and subsection 55(2) will not apply to those dividends.

This novel approach of allocating a global SIOH amount and consideration of the impending dividend payment in determining hypothetical capital gain allows for a lot of flexibility in directing the flow of SIOH. This flexibility is certainly welcomed by taxpayers in light of revised subsection 55(2) since safe income is now relied on much more broadly and multiple classes of shares are often employed in ownership structures. The legislative basis for this approach also appears to be sound based on the wording of paragraph 55(2.1)(c) and that an arm's length party should indeed be willing to pay an additional amount for a share that it knows will pay a dividend immediately after the purchase. However, as will be seen from later CRA pronouncements, the CRA has now issued a warning regarding the use of such discretionary dividends to disproportionately stream SIOH.

4. *Participating discretionary dividend common shares with different holding periods*

Another CRA technical interpretation that is instructive is CRA document #2016-0652981C6 released October 7, 2016 as part of the APFF Roundtable.

[27] *Nassau Walnut*, [1997] 2 F.C. 279; *Gestion Jean-Paul Champagne*, [1996] 2 C.T.C. 2537.



Holdco B and C were unrelated shareholders of Opco since inception, and they hold respectively 100 Class B and 100 Class C shares. Both classes are voting common shares with $100 ACB. In Year 8, Holdco A subscribed for 100 Class A voting common shares of Opco for $50,000. At that time, Opco's aggregate SIOH was $70,000 and the aggregate FMV of its shares was $100,000 (or $150,000 after the subscription). By Year 10, Opco's aggregate SIOH increased to $90,000 and the aggregate FMV of its shares became $170,300. At that time, a $35,000 dividend was paid on the Class A shares.

According to the CRA, in determining the hypothetical capital gain of the Class A shares immediately before the dividend, it can take into account the knowledge that the holder of these shares will be entitled to an amount equal to the dividend declared. Therefore, the hypothetical capital gain on the Class A shares immediately before the dividend should be $30,100, computed as follows:

Aggregate FMV of Opco	$170,300
Less, dividend to be paid	($35,000)
Subtotal before proration	$135,300
Proration amongst shares	100 / 300 common shares
Subtotal	$45,100
Add dividend declared	$35,000
FMV of Class A immediately before dividend is received	$80,100

FMV of Class A	$80,100
ACB of Class A	$50,000
Hypothetical gain immediately before dividend is received	$30,100

However, as discussed, the global SIOH concept needs to be overlaid with the relevant holding period of each shareholder. As such, the CRA stated that the SIOH on the 100 Class A shares cannot exceed the safe income earned after the issuance of Class A shares to Holdco A. Therefore, the maximum SIOH available to the Class A shares would be $20,000 (i.e. year 10 safe income of $90,000, minus year 8 safe income of $70,000), absent any downward adjustments to SIOH such as where any portion of the $20,000 relate to realization of income from gains accrued prior to the subscription of the Class A (see earlier discussion on unrealized appreciation prior to the holding period).

Therefore, $20,000 of SIOH should reasonably be considered to contribute to Holdco A's $30,100 hypothetical capital gain on the 100 Class A shares of Opco. As a result, paragraph 55(5)(f) would deem $20,000 to be a safe income dividend and $15,000 to be a separate dividend potentially subject to re-characterization into a capital gain if one of the purpose tests in paragraph 55(2.1)(b) is met. If subsection 55(2) does re-characterize the $15,000 into a capital gain, the CRA's view is that the aggregate SIOH of Opco is reduced only by $20,000. If subsection 55(2) does not apply to any part of the $35,000 dividend, then the aggregate SIOH would be reduced by the entire $35,000 dividend.

However, the CRA added its observation that the disproportionate dividend described in the example is unrealistic in an arm's length situation, and that the use of discretionary dividends to transfer value between classes of shares could trigger adverse consequences to the taxpayer under the benefit conferral provisions such as subsections 15(1), 56(2), 69(1) and 246(1), and potentially the application of GAAR. These cautionary comments from the CRA certainly should give practitioners pause before implementing plans to use disproportionate dividends to stream SIOH. However, disproportionate dividends, especially in a closely-held structure, are nothing new and have been considered by the Courts. A full discussion of benefit conferral rules are beyond the scope of the paper, but generally speaking, decisions such as *Neuman* established the principle that discretionary dividends on shares are allowed under the Act as long as the shares were initially acquired at their proper FMV.[28] Therefore, if proper planning is done and shares are acquired at their proper FMV, such as by obtaining properly prepared valuation or by properly executing estate freezes before the issuance of new shares, these benefit conferral provisions should not apply to the use of discretionary dividends. As for the GAAR, each situation would need to be assessed on their own merits.

5. *CRA's latest warning on discretionary dividend shares*

At the 2016 CTF National Conference Roundtable on November 29, 2016, the CRA repeated its previous warning about the potential application of benefit conferral provisions and the GAAR with respect to the use of discretionary dividends.[29] Also, the CRA made the statement that its previous comments on the allocation of safe income to discretionary dividends shares "were not intended to suggest that the CRA has no concerns about the use of those shares", and that the CRA is now studying the subject and will not provide additional views until the study is completed.

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[28] Neuman v Minister of National Revenue, [1998] 1 SCR 770.

[29] CRA document # 2016-0669651C6. The CRA also commented that this type of share structure would become problematic on a butterfly distribution since it could be impossible to determine whether the butterfly distribution would qualify as a distribution under subsection 55(1) because of the uncertainty in establishing the FMV of the shares.

This obviously put practitioners into a difficult spot. Until the CRA presents the result of its study, there is uncertainty as to whether the CRA will respect safe income exceptions that rely on discretionary dividends to add to the hypothetical capital gains of shares. In some circumstances, it may be possible for conservative practitioners to structure movement of cash as inter-company loans and wait for further clarification from the CRA. However, that may not be possible or practical in some cases. As discussed, the concept of global computation of SIOH and the inclusion of an impending dividend in determining FMV of a share appear to be consistent with paragraph 55(2.1)(c). Even if the CRA subsequently reverses these views, whether safe income exception applies to a situation is ultimately decided by the Courts. If reliance on the safe income exception is necessary in a situation and the application of the exception is dependent on a disproportionate dividend adding to the hypothetical capital gain of a share, incorporating the following may be helpful:

- Consider sequencing the date of record and the payment of a dividend chronologically after the declaration of the dividend (the date of record is the point in time the corporation establishes the shareholders of record entitled to receive the dividend declared). This may bolster the argument that the FMV and hypothetical capital gain of the share at the moment immediately before the dividend is received include the amount of the dividend, since the holder would have knowledge of the impending dividend due to the dividend declaration.

  At the same time, the right to the dividend should not represent a distinct legal right from the share. A right to the dividend does not arise upon the dividend declaration, but arises on the date of record. As long as the actual payment of the dividend occurs concurrently with the date of record, the right to the dividend should not represent a distinct legal right from the share. If the actual payment is after the date of record, then it is possible that the right to receive payment is based in debt and distinct from the share rights. Also, a promissory note that evidences the dividend payable could potentially be considered not to be a dividend received, and in fact could result in a separate legal right for the holder to collect, distinct from the share. Note that this is ultimately a legal question that depends on the statutes of the governing jurisdiction.

  Note that the issue of a distinct right arose from the CRA's discussion of when a discretionary dividend does not add to the FMV of a non-participating share, but it is prudent to consider the same for participating shares.[30]

- Ensure that the share on which the discretionary dividend is received was previously issued or acquired at FMV, in order to avoid benefit conferral issues.

- Document the business reasons for the dividend – if none of the purposes is one described in paragraph 55(2.1)(b) then subsection 55(2) does not apply irrespective of the safe income exception.

[30] CRA document #2015-0593941E5.

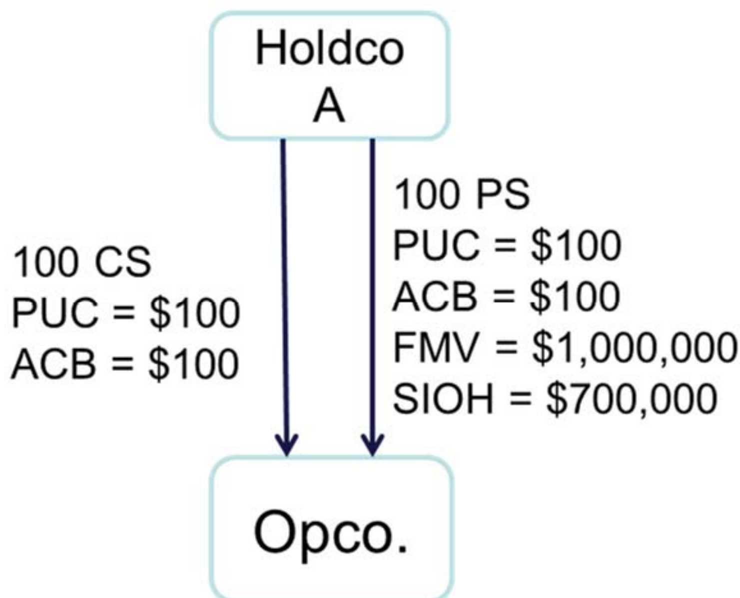
- Obtain a valuation or opinion from a Chartered Business Valuator for the FMV of the share immediately before the dividend is paid on the share, in order to support the amount of hypothetical capital gain to which SIOH can reasonably contribute.

It should be emphasized that the determination of hypothetical capital gain is a matter of valuation, which is facts and circumstances dependent. There could be situations where the entitlement to a discretionary dividend does not cause a shift of value to a dividend-paying share – see for example the scenario the CRA discussed in document #2016-0633101E5.

6. Non-participating shares with fixed dividend entitlement

Traditionally, the CRA's approach to allocating SIOH to non-participating shares is focused on dividend entitlement. Generally, a non-participating share is a preferred share that has a preferential dividend entitlement over common shares. This dividend entitlement can either be cumulative or non-cumulative. Where the dividend entitlement is cumulative, the dividend accrues to a share over the period it is outstanding. In that case, safe income in a particular year is allocated first to the cumulative non-participating preferred shares to the extent of their dividend entitlement, with the remaining safe income allocated to the other classes of shares outstanding.

Since the amendment to subsection 55(2) in 2015, the CRA's approach shifted its focus to allocating safe income based on hypothetical capital gain of the non-participating shares, immediately before the dividend (but with the knowledge that such a dividend will be paid). This often produces similar results as the approach in the past, but requires more careful consideration. To illustrate, below is a scenario described by the CRA at the 2016 APFF Roundtable on October 7, 2016.[31]



Holdco A holds 100 voting common shares and 100 estate freeze non-participating, non-voting preferred shares of Opco. The freeze transaction was undertaken historically whereby Holdco obtained the 100 Opco preferred shares on a tax-deferred basis. At the time of the freeze, Opco's SIOH was

[31] CRA document #2016-0653001C6.

$700,000. The 100 preferred shares have an aggregate redemption value of $1,000,000, and an annual dividend entitlement equal to 8% of the redemption value.

Opco shares currently have an aggregate FMV of $2,650,000 and an aggregate SIOH of $1,850,000 (including the $700,000 of safe income on hand attributable to the preferred shares held by Holdco A). Opco now declares an $80,000 dividend on the 100 preferred share.

In its comments, the CRA confirmed that the 100 preferred shares inherited the $700,000 of SIOH upon the tax-deferred share exchange. This $700,000 however could be reduced or increased by losses or income incurred by Opco subsequent to the freeze, but an increase would only possible if there is an increase in hypothetical capital gain on the preferred shares. Therefore, if the aggregate FMV of the 100 preferred shares immediately before the dividend remains at $1,000,000, then, in the CRA's view, none of the safe income earned by Opco subsequent to the freeze could reasonably be considered to have contributed to the hypothetical capital gain of the preferred shares (because the same amount of hypothetical capital gain existed at the time of the freeze). In that case, only the safe income of $700,000, less any previous reduction, would be considered to be on hand for the 100 preferred share. As such, the $80,000 dividend would be paid from the $700,000 SIOH, less any previous reduction. Future annual dividends on the preferred shares will continue to deplete the SIOH on those shares, and subsection 55(2), subject to the purpose tests, will apply once the future dividends exceed SIOH.

On the other hand, if the $80,000 dividend increases the FMV (and accordingly, the hypothetical capital gain) of the 100 preferred share at the moment immediately before the dividend is received, then up to $80,000 of safe income accumulated post-freeze could reasonably be considered to contribute to that $80,000 increase in gain. As such, the SIOH of those preferred shares would be the initial $700,000, plus additional safe income up to $80,000, less any previous reductions. This would allow for annual dividends on the preferred shares to be sheltered against safe income earned post-freeze, thereby preserving the $700,000 of initial SIOH for future use, such as on a future redemption of the preferred shares or if future dividends exceed post-freeze safe income.

It should be emphasized that the CRA's comments left the possibility of dividends adding to the hypothetical capital gain of the preferred shares open to facts and circumstances. It is therefore a matter of valuation, similar to the issue of whether a discretionary dividend adds to the hypothetical capital gain of participating shares. Therefore, recommendations provided above for discretionary dividends similarly apply to non-participating shares, i.e. sequencing the payment of the dividend chronologically after the declaration, ensuring shares were issued or acquired at FMV, obtaining valuation of the share immediately before the dividend is paid, and ensuring the right to the dividend does not represent a legal right distinct from the share.

7. Non-participating shares with discretionary dividends

The CRA appears to be generally adverse to discretionary dividends on non-participating shares, in terms of whether dividends on such shares can ever be considered to be covered under the safe income exception.[32] In CRA document #2015-0593941E5, the CRA discussed the determination of hypothetical capital gain on a non-participating share with discretionary dividends. The CRA indicates that it may be

[32] See CRA documents #2015-0593941E5 and #2015-0610661C6.

the case that hypothetical capital gain of the share cannot take into account the amount of the dividend. As an example of when that may be the case, the CRA said that this could occur if the unpaid dividend represented a distinct legal right from the shares to which it relates.

It is unclear what legislative basis the CRA has for treating participating and non-participating shares differently in terms of discretionary dividends. It would seem that the valuation of a share, participating or not, should take into account the amount of dividend to which a shareholder will be entitled. The correctness of differentiating the allocation of SIOH based on whether the dividend represents a distinct right is also unclear, when the right to the dividend originates from the holding of the share. Nevertheless, practitioners need to exercise additional caution when dealing with discretionary dividend on non-participating shares.

D. Concluding Thoughts

There are many uncertainties facing practitioners when dealing with the safe income exception. Even if the CRA provides further guidance down the road, such guidance will still merely be administrative and will be subject to change over time. At the same time, the CRA has clearly stated the taxpayer has the onus to properly compute and allocate SIOH, and that an incorrect claim can potentially lead to significant gross negligence, and even false statement, penalties.[33] Given the complexity, ambiguity and multitude of interpretation possible in the area of safe income, it is far fetched to conceive that the Courts will agree with such severe penalties for incorrect SIOH claims. Nevertheless, such statements from the CRA inevitably put a chilling effect on transactions, including innocuous inter-corporate cash movements where tax is not the primary motivation. However, business and transactions do not stop just because tax rules are unclear or unmanageable, so practitioners must be able to apply these rules with eyes wide open so that they and their clients understand and are able to manage risk to an acceptable level. Be careful out there and keep your eyes wide open.

[33] The CRA in document #2016-0672321C6 states that an incorrect claim relating to safe income could lead to application of subsections 152(4), 163(2), or 239(1). Note that subsection 239(1) could lead to imprisonment!