Tax Topics

January 17, 2023
Number 2654

Current Items of Interest 4

International News 5

Recent Cases 6

UNTIL DEATH DO THEY PART: TAX ISSUES FOR CANADIANS OWNING AND DYING WITH FOREIGN REAL PROPERTY

— Michael Goldberg, B. Comm., LLB, TEP, FEA, Partner, Tax Lawyer, Minden Gross LLP, MERITAS© Law Firms Worldwide. Michael is also founder of "Tax Talk with Michael Goldberg", a quarterly conference call about current, relevant, and real life situations for professional advisors who serve high-net-worth clients.

— Kenneth Keung, CPA, CA, CPA (CO, USA), TEP, CFP, MTAX, LLB, is a Director of Moodys Private Client Law LLP. Kenneth's practice focuses on domestic and international tax advisory for private businesses and families.

What is a Canadian tax practitioner to do for their clients (or family) who intend to own real property outside of Canada and the US[1] ("Foreign Real Property") until death do they part?

Such holdings, while often a source of joy during a Canadian resident's lifetime, can create some serious tax problems for their estate and their heirs.

In the discussion that follows, we'll try and illustrate this issue and a possible solution using a fictional client named Maria and a number of hypothetical scenarios.

Facts — Maria's Algarve Property

Imagine that when Maria was 25 years old, she immigrated to Canada from Portugal.

Sadly, a number of years later, the last of Maria's parents passed away and left Maria a modest beach home in southern Portugal worth about $100,000 at the time (the "Algarve Property").[2]

Today, Maria is 60 years old and, to keep the illustration simple, let's assume that her estate is comprised solely of the Algarve Property, now worth $1,100,000, and a debt of $100,000 so that Maria's net estate is worth $1,000,000.

Scenario 1 — Sale of Algarve Property

If Maria were to sell the Algarve Property, both Portugal and Canada would have an opportunity to tax the capital gain of $1,000,000 that will be realized on the sale.[3]

---

[1] The issues described in this article will generally not be a concern in respect of US real property owned by Canadians on death because of unique features of Article XXIX-B in the Fifth Protocol to the *Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital*, which coordinate US estate tax and Canadian death taxes with one another and thereby can avoid double taxation issues and allow for US cost base adjustments to match those in Canada, provided the taxpayer in question is an individual and the election under Article XIII(7) is properly filed. Several treaties have similar provisions that coordinate a step-up in tax basis, but they only apply where an individual has ceased residency in a particular country — it is our understanding that none (or almost none) of Canada's other tax treaties contain step-up provisions for deemed disposition on death.

[2] Since Maria acquired the beach home by way of a bequest, Maria is deemed under paragraph 69(1)(*c*) of the *Income Tax Act* (Canada) (the "Act") for Canadian tax purposes to have acquired the property at an adjusted cost base ("ACB") equal to its fair market value of $100,000 at that time. It is assumed that for Portuguese tax purposes, Maria is considered to have a tax cost base of $100,000 as well.

[3] Both Canada and Portugal have capital gains tax regimes. For simplicity, we have assumed both Canadian and Portuguese capital gains will be calculated by netting the current $1,100,000 fair market value ("FMV") of the Algarve Property against its $100,000 ACB.

Our choice of Portugal to illustrate a non-US international jurisdiction in this article is random. All Portuguese tax and legal matters should be reviewed with professionals qualified to practice in those disciplines in Portugal.

Wolters Kluwer

However, pursuant to Article 13(1) of the Canada-Portugal Tax Treaty,[4] the first right to tax capital gains realized on certain immovable property, including real property, is provided to the country where the immovable is located.[5] Accordingly, since the Algarve Property is located in Portugal, Portugal would have the first right to tax the capital gains realized on the sale of the Algarve Property.

We understand that the capital gains tax in Portugal would be $280,000, being 28% of the $1,000,000 capital gain, leaving Maria with $720,000 to spend.[6]

Although Maria will also be taxable in Canada on the Algarve Property capital gain, to minimize incidents of "double taxation", Canada's income tax system has been designed so that, with respect to certain foreign income and gains, such as gains on dispositions of Foreign Real Property, Canada will provide a Canadian taxpayer with a foreign tax credit to offset taxes paid to a foreign government.[7] The result of the Canadian foreign tax credit system is that a Canadian taxpayer *should* only be required to pay tax on income or gains that qualify for a foreign tax credit at the higher of the tax rates of Canada and the foreign jurisdiction.

For convenience, let's assume that the combined effective Canadian federal and provincial tax rate applicable to capital gains realized by Maria in respect of the Algarve Property is 25%. Because the combined Canadian capital gains taxes will be less than the Portuguese capital gains taxes paid (see calculation above), Maria should be eligible to claim a foreign tax credit for the full amount of Portuguese tax paid by her, with the result that no Canadian tax should be payable by her on the Canadian capital gain.

Scenario 2 — Death of Maria Followed by Sale of the Algarve Property

If instead of selling the Algarve Property while she was alive, Maria was to have died and then her estate sold the Algarve Property, very different tax results would have arisen than those set out in Scenario 1.

These different tax results will arise due to the fact that, while Canada deems:

(1) capital property of a decedent to be disposed of immediately prior to death at the FMV of the capital property which will cause unrealized gains and losses to become realized for Canadian income and capital gains tax purposes; and

(2) the estate of a decedent to have acquired the decedent's capital property at its FMV for purposes of determining the ACB of the capital property transmitted to the estate,[8]

there are no similar deemed disposition rules that apply on the death of an individual in Portugal.

As a result, even though the Canadian capital gains tax was already paid, on a subsequent sale, Portuguese capital gains tax will be payable by Maria's estate or her heirs, as the case may be, since the original cost base of the Algarve Property for Portuguese capital gains tax purposes will not be increased on the death of Maria.

Furthermore, recall that under both the Canada-Portugal Tax Treaty and general international principles,[9] Portugal has the first right to tax Portuguese real property, such as the Algarve Property. Therefore, if there is to be a solution to this double tax problem, it would be necessary for Maria's estate or her heirs, as the case may be, to look to the Canadian tax authorities for tax relief. Unfortunately, the Act currently contains no provisions to grant foreign tax credits or any other relief to Maria, her estate, or her heirs for tax paid in Portugal on a subsequent disposition of the Algarve Property.

Having now explained how taxation would apply in this scenario, let's illustrate these principles with Maria's facts in mind, but assume that both at the time of death and at the time of the actual sale of the Algarve Property, its FMV is $1,100,000.

Based on the prior example:

(1) upon Maria's death, it is assumed that a $1,000,000 Canadian capital gain will arise giving rise to combined Canadian taxes of $250,000; and

---

[4] *Convention Between the Government of Canada and the Government of the Portuguese Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, E103231 — CTS 2001 No. 27 ("Canada-Portugal Tax Treaty").

[5] Terms similar to Article 13 of the Canada-Portugal Tax Treaty are common in Canada's treaty network for tax treaties that include capital gains tax provisions.

[6] Dollar amounts ignore costs of sale, stamp taxes in Portugal, etc.

[7] Pursuant to subsection 126(1). The foreign tax credit will not be limited to 15% of the foreign income amount because subsection 20(11) and paragraph (*b*) of the definition of "non-business-income tax" in subsection 126(7) do not apply to a capital gain.

Please note that, based on general international principles Canadian residents will usually be able to claim a subsection 126(1) foreign tax credit with respect to capital gains tax paid in connection with dispositions of Foreign Real Property regardless of whether the Foreign Real Property is situated in a treaty or a non-treaty jurisdiction (see, for example the views of the Canada Revenue Agency as set out in paragraph 1.62 of Income Tax Folio S5-F2-C1).

[8] Pursuant to subsection 70(5).

[9] *Supra*, footnote 5.

(2) if Maria's estate or heirs were to sell the Algarve property at some time in the future, a $1,000,000 Portuguese capital gain would be realized, giving rise to Portuguese taxes of $280,000.

As mentioned above, in this scenario, the Act provides no ability for Maria, her estate, or her heirs, as the case may be, to claim a foreign tax credit or any other relief in Canada against Portuguese taxes paid on this subsequent sale. As a result, nearly double the tax is payable in respect of the Algarve Property in this scenario than in Scenario 1. In particular, following the payment of total taxes of $530,000, from her original net FMV estate of $1,000,000, Maria's heirs will only be left with **$470,000** compared to the **$720,000** they would have inherited if Maria had died after selling the Algarve Property in Scenario 1.

Maria's situation, as described in this scenario, is likely to become a much more common one in the future. This is because many jurisdictions worldwide that have capital gains tax regimes do not tax unrealized capital gains on death, and more and more Canadians than ever before are inheriting or acquiring and dying with Foreign Real Property.

To our knowledge, there is no justification for such an inequitable tax result.

In fact, Parliament acknowledged the inequity in similar situations impacting both emigrating Canadians owning Foreign Real Property and beneficiaries of Canadian resident trusts that receive distributions of Foreign Real Property. As such, it statutorily fixed these inequities by enacting subsections 126(2.21) and 126(2.22), respectively.[10] In a nutshell, these two subsections allow a foreign tax credit deductible against tax payable on an individual's departure year Canadian tax return that is equal to the foreign taxes on a post-departure gain from a disposition of property, including Foreign Real Property, to the extent of the portion of the property gain that accrued while the individual was a Canadian resident.

The historical explanatory notes in respect of these provisions state, in part, that:

> Subsections 126(2.21) and (2.22) will apply, in most cases, only for taxes paid to countries with which Canada has a tax treaty. Exceptions are provided for taxes imposed by a foreign country on gains on real property situated in that country. *In keeping with the general international principle that the country in which real property is located has the first right to tax gains on that real property, Canada will always provide credit for such taxes*. Similarly, credit for those taxes will be available regardless whether Canada has a tax treaty with the particular country. (Emphasis added.)

In order to enable subsections 126(2.21) and 126(2.22) to operate outside of ordinary statutory limitation periods, consequential amendments were also made to subsection 152(6).

Scenario 3 — Emigration of Maria Followed by Sale of the Algarve Property

So, coming back to Maria, if she emigrated from Canada while still owning the Algarve Property, she would have been deemed to have disposed of the Algarve Property at its $1,100,000 FMV pursuant to paragraph 128.1(4)(*c*), giving rise to Canadian deemed capital gains taxes of $250,000.[11]

Assume that some years following emigration, Maria sold the Algarve Property for $1,100,000. As was the case in Scenario 1 and Scenario 2, Portugal would still collect $280,000 in capital gains taxes. However, provided that Maria amends her emigration year personal Canadian tax return as permitted pursuant to the interaction of subsections 126(2.21) and 152(6), she would be able to claim a tax credit and generate a refund of the $250,000 of taxes she paid upon her emigration, thereby eliminating the otherwise inappropriate double taxation.[12]

Subsections 126(2.21) and (2.22) Roadmap for a Fix?

It is worth repeating the highlighted portion of the explanatory notes to subsections 126(2.21) and (2.22) above:

> *In keeping with the general international principle that the country in which real property is located has the first right to tax gains on that real property, **Canada will always provide credit for such taxes**.* (Even more emphasis added.)

As illustrated by the example involving a sale of the Algarve Property in Scenario 2, this general international principle is currently inapplicable in the event of the death of a Canadian taxpayer such as Maria. Consequently, the Department of Finance's statement above (the "Statement of Principle") is untrue in a situation involving the death of a Canadian taxpayer.

---

[10] Bill C-22; S.C. 2001, c. 17, s. 117, applicable to the 1996 and subsequent taxation years.

[11] Subject to Maria deferring this tax by posting security acceptable to the Minister of National Revenue and otherwise satisfying the provisions in subsection 220(4.5).

[12] As no interest will be refunded to Maria, the time value of money will still negatively impact Maria's financial situation.

If the Department of Finance can be convinced to find a way to apply the Statement of Principle in post-mortem situations, it shouldn't be difficult to use the roadmap in subsections 126(2.21) and (2.22) to create a similar exception to allow foreign tax credits to be applied against a decedent's terminal year tax return. However, because this new exception needs to apply to property vendors who are an estate or heirs of a decedent, it needs to be designed so that the triggering event for the foreign tax credit is based on the sale by a taxpayer other than the decedent.

Since the Act already contains subsection 164(6), a provision to allow tax pools realized by an estate to be retroactively applied against income reported in a decedent's terminal year tax return, one would think that it should be possible to create a similar rule to allow the foreign tax credits to be retroactively applied against taxes paid or payable by a decedent in accordance with the decedent's terminal year tax return.[13]

As is the case with subsections 126(2.21) and (2.22), consequential amendments should be made to subsection 152(6) to eliminate any time limit on the claim of foreign tax credits against the terminal year deemed disposition tax.[14]

Concluding Thoughts

It is our sincere desire that the Department of Finance will address these inequities by taking steps to amend the Act. Hopefully, the roadmap set out in this article can provide the Department of Finance with a pathway to do so. However, until the Act is amended to resolve this inequity, practitioners should advise their clients who hold property that is subject to foreign taxation, such as Foreign Real Property, of this potential cross-border post-mortem tax-planning pitfall.

CURRENT ITEMS OF INTEREST

Reminder To Renew Access to CRA's Electronic Services

The CRA is reminding its EFILE registrants that they must renew their participation online to maintain their access in the coming year. The CRA conducts suitability screening each year before electronic filing applicants are permitted to electronically file income tax returns on behalf of their clients — this process may take up to 30 business days. If you do not pass the suitability screening process due to outstanding issues by January 28, 2023, you may encounter an interruption in electronic services. Therefore, the CRA is asking everyone to submit their renewals as early as possible to avoid unnecessary delays.

How To Renew

- Make an online request at canada.ca/efile.
- Click on the "EFILE Sign in" button located in the right side menu bar.
- To sign in, you will need your **current** EFILE number and **password**.
- Seconds after submitting your online renewal request, it will be validated and you will receive a confirmation page.
- The confirmation will include your **newly assigned password** and the EFILE Helpdesk responsible for your file.

Once you have successfully renewed your account, you must update your tax preparation software with your newly assigned password to ensure any future transmissions are successful.

Once your renewal request has undergone the suitability screening process, you will receive an email or letter to advise you of the result.

For further details go to https://www.canada.ca/en/revenue-agency/services/e-services/e-services-businesses/efile-electronic-filers/efile-news-program-updates.html.

Register for the CRA's Free Dedicated Telephone Service

The CRA offers a Dedicated Telephone Service for small and medium-sized income tax service providers across Canada. You can get free technical help simply by registering for this service.

---

[13] See subsection 164(6), which allows losses realized by an estate to be carried back and applied against income of a decedent in the terminal year tax return of a decedent.

[14] A limitation on time to claim the foreign tax credit would be contrary to the Statement of Principle. Although it is recognized that the ability to claim a subsection 164(6) deduction is currently time limited to the first taxation year of an estate, this time limitation has been the subject of much criticism by writers and legal scholars. Perhaps this is a good time to review the one-year time limitation in subsection 164(6) as well.

The service connects you with experienced CRA officers from the Income Tax Rulings Directorate who will be able to help you interpret the provisions of the *Income Tax Act*. After reviewing your tax issue, the officers will carefully consider your question and then send you helpful information and guidance. You will generally receive this information within three business days, depending on the complexity of the tax issue. Officers are ready to assist you in both English and French.

While the Dedicated Telephone Service is a valuable technical resource to help resolve your interpretive tax issues, officers do not have access to individual taxpayers' accounts.

If you are interested in using this service, you are invited to fill out a registration form. Please visit the "Help for income tax service providers" webpage (https://www.canada.ca/en/revenue-agency/campaigns/dedicated-telephone-service.html) for further information about the service, including eligibility criteria and more details on how the service can help you.

CRA Workers To Vote on Whether To Strike

According to various Canadian news sources, more than 35,000 CRA workers, who are members of the Public Service Alliance of Canada and the Union of Taxation Employees ("PSAC-UTE"), will soon begin voting on whether to go on strike. The strike votes will be held between January 31 and April 7. Negotiations apparently broke down over demands for higher wages and remote work policies.

INTERNATIONAL NEWS

US Republicans Back Law Opposing New Funds for IRS

The Republican Party majority in the US House of Representatives has backed new legislation that would block new funding for the US Internal Revenue Service ("IRS").

The Family and Small Business Taxpayer Protection Act would reverse a pledge made in the Inflation Reduction Act to provide the tax agency with considerably more funding.

Instead, the Republic legislation would cut funding for the agency by US$72 billion, reducing by 90 per cent the funds allocated by Democrats to the agency over the next ten-year window.

The legislation, which was approved narrowly along party lines, however, will not pass the Democrat-controlled Senate or be signed off by US President Joe Biden.

IASB Proposes Amendments to Income Tax Accounting Standard

The International Accounting Standards Board ("IASB") has proposed amendments to IAS 12 Income Taxes. The proposed amendments aim to provide temporary relief from accounting for deferred taxes arising from the imminent implementation of the Pillar Two model rules published by the Organisation for Economic Co-operation and Development ("OECD").

The amendments are in response to stakeholders' concerns about the potential implications of the rules for the accounting for income tax in financial statements. In particular, the IASB said stakeholders were concerned about the uncertainty over the accounting for deferred taxes arising from the rules. Stakeholders reportedly said there was an urgent need for clarity in the light of the imminent implementation of these rules in some jurisdictions.

The proposed amendments would introduce:

- a temporary exception to the accounting for deferred taxes arising from the implementation of the rules; and
- targeted disclosure requirements for affected companies.

Andreas Barckow, Chair of the IASB, said:

> The IASB is monitoring developments in this space and in response has proposed amendments that will provide timely relief for affected companies and will avoid inconsistent interpretations, and therefore inconsistent application, of IAS 12 while providing investors with useful information.

Due to the project's accelerated nature, the IASB said it aims to finalize any amendments in the second quarter of 2023, subject to comments on the Exposure Draft.

US Seeks Input on Potential CbC Report Changes

The US Internal Revenue Service ("IRS") has launched a consultation on potential changes to the country-by-country ("CbC") report.

The consultation has been launched under the Paperwork Reduction Act of 1995, which requires the agency to make efforts to reduce paperwork and the respondent burden.

The consultation concerns Form 8975, Country-by-Country Report, and Schedule A (Form 8975), Tax Jurisdiction and Constituent Entity Information.

The form is required from the ultimate parent entity of a US multinational enterprise ("MNE") group with annual revenue for the preceding reporting period of US$850 million or more, alongside their income tax return.

Form 8975 and Schedules A include a list of the US MNE group's constituent entities, indicating each entity's tax jurisdiction (if any), country of organization, and main business activity. Further taxpayers must provide financial and employee information for each tax jurisdiction in which the US MNE does business.

The financial information includes revenues, profits, income taxes paid and accrued, stated capital, accumulated earnings, and tangible assets other than cash.

Separate Schedules A (Form 8975) are filed for each tax jurisdiction in which a group has one or more constituent entities resident.

Input is being sought by June 3, 2023.

RECENT CASES

Appeal Partly Allowed Regarding Sales of Properties

The Appellant appealed assessments for three taxation years (2011, 2015, and 2016) on four real properties she owned at various times. The 2011 assessment was beyond the normal reassessment period. The CRA also imposed false statement penalties under section 163.2 of the *Income Tax Act* (the "ITA"). The Appellant had a turbulent, indeed abusive, marriage, and the first property (154 Cortleigh) served the Appellant as a refuge. She claimed it as her principal residence. When it was sold, the CRA asserted that the sale was in the nature of trade and therefore business income. As to the second and third properties (16 and 18 Linda Lane), the Appellant argued that she should get some credit for using a real estate agent in their sale. The issue with the fourth property (109 Lio) was that the Appellant claimed it as her principal residence after she sold the first property, but did not submit the required designation of principal residence forms (T-2019 and T-2092).

The Tax Court allowed the appeal in certain respects and remanded the matter to the CRA. With respect to 154 Cortleigh, the CRA maintained that its sale by the Appellant was in the nature of trade. The Court noted that she used the property intermittently as a refuge from her abusive marriage, and that her sales of all her properties were "objectively rooted" in that situation. Thus, she met none of the criteria for a seller in the nature of trade — most importantly, in the Court's view, the circumstances that led to the sales. The property was on account of capital, but was not the Appellant's principal residence. As far as the Appellant maintained that it was, entitling her to the principal residence exemption, she offered no documents or evidence, leading the Court to hold that the CRA could reopen the time-barred 2011 year. Finally, the Court held that, though the Appellant was clearly unfamiliar with the ways of business and tax, she did not act with indifference to compliance with the law, so the section 163.2 penalties were deleted. With respect to the Linda Lane properties, the issue was whether the Appellant was entitled to real estate commissions as she argued. The Court reviewed the numbers and noted that there was no such commission in the CRA's calculation of proceeds and expenses. Characterizing the commission as an "essential omitted expense", the Court held that even without invoices, credit needed to be given for this amount. With respect to 109 Lio, the issue was that under section 54 of the ITA, two properties can't be one person's/family unit's principal residence, and the Appellant's husband had designated a different property in 2012 and 2013. The Court held that after their divorce the Appellant and her ex-spouse could designate different principal residences. The Appellant failed to submit a T-2019, but under certain circumstances the CRA could accept a late filing per paragraph 220(3.21)(*a*.1).

¶50,983, *Nicosia v. The King*, 2022 DTC 1101

CRA Decision To Suspend Taxpayer's EFILE Privileges Violated *Vavilov* Intelligibility Requirement

Subsection 150.1(2) of the *Income Tax Act* authorizes taxpayers to file their returns electronically (under the so-called EFILE program) if they meet criteria specified by the CRA. After monitoring the Applicant's account since November

2019, the CRA suspended her from EFILE in March 2022. The Applicant sought judicial review, arguing that the decision contained in the CRA's suspension letter was not intelligible or transparent under *Vavilov*.

The Federal Court agreed and remanded the decision to a different CRA officer. Throughout its dealings with the Applicant, the CRA referred to the so-called Criterion 13, which disqualifies applicants from using EFILE if they have "engaged in fraud, dishonesty, breach of trust or other conduct of a disreputable nature." There was evidence that the Applicant processed EFILE applications for persons who were specifically excluded from participation ("Excluded Taxpayers"), circumventing an address requirement by using the "care of" indication. The CRA's March 2022 decision letter was clear that the basis of the decision was the Applicant's continuing to e-file returns for Excluded Taxpayers, violating Criterion 13. However, in its submissions the Respondent took the position that the case did not turn on the application of Criterion 13; instead, the Respondent's position was based on the list of Excluded Taxpayers on the CRA website. In the Respondent's view, Criterion 13 had only to do with the manner in which the Applicant e-filed the returns (the "care of" indication); the CRA list was a list of Excluded Taxpayers, which the Respondent took to be criteria "specified in writing by the Minister" pursuant to subsection 150.1(2). However, from the initial suspension of the Applicant to the March 2022 decision letter, the record was clear that the Respondent's analysis relied on Criterion 13. The Respondent's insistence now that Criterion 13 was not implicated in its decision itself raised questions about the intelligibility and transparency of the decision. The decision contained no analysis of how the Applicant's conduct fell under Criterion 13; since Criterion 13 discusses varying kinds of conduct, it was unclear which ones the Respondent was relying on to claim that it addressed the Applicant's conduct.

¶50,984, *Virgen v. Canada (AG)*, 2022 DTC 5112

Construction of Improved Hydrodynamic Eco-Energetic Assistance System Not Qualifying as SR&ED Expenses

This case is an appeal against a decision made by the Minister of National Revenue ("the Minister") denying the Appellant's claim for deduction of alleged scientific research and experimental development ("SR&ED") expenses and related investment tax credits ("ITCs"). The issue relates to expenses incurred with respect to the installation of a hydrodynamic eco-energetic assistance system to a residential building. The Appellant had purchased the patent of a person who had developed and patented such a system. The Appellant sought to improve the system, having found deficiencies in the system which he corrected and incorporated into a new residential building having allegedly resolved technological uncertainties from the original patent, thus, in the Appellant's view, qualifying as SR&ED.

The appeal was dismissed. Basically, the Court was required to determine whether or not the Appellant was involved in "experimental development" with respect to the expenses incurred in building the alleged improved hydrodynamic eco-energetic system. In essence, the Appellant needed to demonstrate on a preponderance of evidence basis that the technological uncertainties could not be resolved by current techniques or usual procedures. The original patent included, among others, solar panels, underground concrete water reservoirs, a thermopump, a control panel (computer), and probes to measure the water temperature in the reservoirs. The Appellant found that the reservoirs were too big and that the water could freeze. Accordingly, he developed a system of smaller reservoirs included in each other to alleviate the issue and modified the computer system as well as the probes (sensors). The Court found that the Appellant used current techniques to resolve the technological uncertainties he was facing. The Respondent's expert testified that the Appellant used available techniques and procedures at the time, and that his work did not qualify as experimental development. The Court agreed and after reviewing all the facts and evidence, ruled that the Appellant did not incur SR&ED expenses in respect of the improved hydrodynamic eco-energetic assistance system. Therefore, the Court dismissed the appeal.

¶50,988, *Gestion ACBK Inc. v. The King*, 2022 DTC 1103

Sums Paid to a Headhunter Deductible as Employment Expenses Pursuant to Paragraph 8(1)(*f*)

The Appellant worked for BMO Nesbitt Burns as a consultant in Estate Management. Her remuneration consisted of commissions. This appeal relates to the deductibility of employment-related expenses pursuant to paragraph 8(1)(*f*) of the *Income Tax Act*. With respect to taxation years 2015 and 2017, the Appellant had claimed employment-related expenses of $31,051 and $39,435 respectively. While the Minister allowed most of the expenses claimed, he refused to allow as deductible expenses those expenses incurred by the Appellant which had been paid to a headhunter to find her an associate who would help market her services and serve clients. This was the only issue in the Appeal.

The Appeal was allowed. After reviewing all the facts and jurisprudence, including the information included in Form T2200 signed by the employer, the Court disagreed with the Minister and ruled that the conditions required by paragraph 8(1)(*f*) were met. The Court further disagreed with the Minister's position that since this expense was incurred only once, it was a capital expense which would render subparagraph 8(1)(*f*)(i) inapplicable pursuant to

subparagraph 8(1)(*f*)(v). Accordingly, the Court allowed the appeal, allowing the expense incurred by the Appellant with the headhunter.

¶50,987, *Schofield v. The King*, 2022 DTC 1102

Court Order Created Obligation To Pay Child Support Arrears

Paragraph 118(1)(*b*) of the *Income Tax Act* sets forth the criteria for claiming the Wholly Dependent Person ("WDP") credit. Subsection 118(5) prohibits the claiming of the credit where the claimant pays a "support amount" with respect to the WDP; subsection 118(5.1) provides an exemption to the prohibition when nobody can claim the credit due to subsection 118(5). The Appellant and his common-law spouse had a child in 2009 and separated in 2011 or 2012, signing an agreement for shared custody and no child support. In 2019, the former common-law spouse filed an application for child support; in 2020 they signed a consent order that included child support payments. Because the judge used the Federal Child Support Guidelines, the Appellant owed arrears in child support.

The Tax Court dismissed the appeal. The Court distinguished between an obligation to pay retroactive child support and arrears of child support. The 2020 consent order met the criteria for an order to require child support arrears: (1) a recognition of a preexisting obligation to pay child support; (2) a recognition of a breach of that obligation resulting in the arrears; (3) an obligation to pay arrears set out in the court order. The period covered by the arrears was non-specific, leading the Court to infer that the order was meant to cover the whole period since the 2012 separation. Thus, in 2019 the Appellant was paying a support amount for a wholly dependent person and could not claim the WDP credit.

¶50,986, *Smith v. The King*, 2022 DTC 1100

TAX TOPICS

Published weekly by Wolters Kluwer Canada Limited. For subscription information, see your Wolters Kluwer Account Manager or call 1-800-268-4522.

For Wolters Kluwer Canada Limited

Email: cservice@wolterskluwer.com *Phone: 1-800-268-4522 or (416) 224-2248 (Toronto)*

Notice: *Readers are urged to consult their professional advisers prior to acting on the basis of material in Tax Topics.*

Wolters Kluwer Canada Limited
300-90 Sheppard Avenue East
Toronto ON M2N 6X1
1 800 268 4522 tel
1 800 461 4131 fax
www.wolterskluwer.ca

© 2023, Wolters Kluwer Canada Limited