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**Re: Guidance from the Supreme Court of Canada is Required to Avoid Adverse Uncertainty for Canadian Businesses Caused by the New “Actual Control” Standard Created, But Not Defined, by the Federal Court of Appeal in *Deans Knight Income Corporation v. Her Majesty the Queen***

Dear Ms. DiGregorio:

The decision rendered by the Federal Court of Appeal in *Deans Knight Income Corporation v. Her Majesty the Queen*, 2021 FCA 160 (the “FCA Decision”), creates significant uncertainty that will negatively impact many businesses across Canada. On behalf of Tax Executives Institute (“TEI”), therefore, I write in strong support of the application for leave to appeal by Deans Knight Income Corporation (“Deans Knight”) to the Supreme Court of Canada.

**About TEI**

TEI was founded in 1944 to serve the professional needs of in-house tax professionals. Today, the organization has 57 chapters across North and South America, Europe, and Asia, including four chapters in Canada. Our approximately 7,000 members represent 2,800 of the world’s leading companies, many of which either are resident or do business in Canada. Over 15 percent of TEI’s membership comprises tax professionals working for Canadian businesses in a variety of industries across the country. TEI members are responsible for the tax affairs of their employers and must contend daily with provisions of the tax law relating to the operation of business enterprises. The following recommendations reflect the views of TEI as a whole but, more particularly, those of our Canadian constituency.

As the preeminent association of in-house tax professionals worldwide, TEI is dedicated to the development of sound tax policy, compliance with and uniform enforcement of tax laws, and minimization of administration and compliance costs to the mutual benefit of government and taxpayers. TEI is committed to fostering a tax system that works—one that is administrable and with which taxpayers can comply in a cost-efficient manner. The diversity, professional training, and global viewpoints of our members enable TEI to bring a balanced and practical perspective to the issues discussed herein.

### **The FCA Decision’s new “actual control” standard creates significant uncertainty for Canadian businesses**

For over 50 years, since the Exchequer Court of Canada’s decision in *Buckerfield’s Ltd. v. Minister of National Revenue*, 64 D.T.C. 5301 (Ex. Ct.), the term “control” in the Income Tax Act<sup>1</sup> has been understood to mean *de jure* control. Indeed, the *de jure* control concept articulated in *Buckerfield’s Ltd.* has been repeatedly cited—with approval—by the Supreme Court of Canada.<sup>2</sup>

In *Buckerfield’s Ltd.*, the court held that while many approaches might conceivably be adopted in applying the word “control” in the Act to a corporation, including control by management or *de facto* control by one or more shareholders, “control” for purposes of the Act contemplates *de jure* control—the legal right of control that rests in ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the board of directors.<sup>3</sup>

In addition to the *de jure* control test, Parliament has statutorily incorporated the *de facto* control test as a second control standard that applies only to certain specified provisions in the Act.<sup>4</sup>

Despite acknowledging that the term “acquisition of control” in subsection 111(5) had been judicially determined to mean *de jure* control, the FCA Decision concluded that the object, spirit and purpose of the provision is for it to apply where there has been an acquisition of “actual control.” In so concluding, the FCA Decision established a new, third standard of control (“New Actual Control Standard”):

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<sup>1</sup> Unless otherwise indicated, all references to “section” or “subsection” herein are to sections or subsections of the Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), as amended (the “Act”).

<sup>2</sup> E.g., *Duha Printers (Western) Ltd. v. R.*, [1998] 1 S.C.R. 795, para. 35 (“It has been well recognized that, under the Income Tax Act, “control” of a corporation normally refers to *de jure* control and not *de facto* control.”); see also *Minister of National Revenue v. Dworkin Furs (Pembroke) Ltd.*, [1967] S.C.R. 223; *Vina-Rug (Can.) Ltd. v. Minister of National Revenue*, [1968] S.C.R. 193; *The Queen v. Imperial General Properties Ltd.*, [1985] 2 S.C.R. 288; *Atco Ltd. v. Calgary Power Ltd.* [1982] 2 S.C.R. 557; *Minister of National Revenue v. Consolidated Holding Co.*, [1974] S.C.R. 419.

<sup>3</sup> *Buckerfield’s Ltd.* at para. 10.

<sup>4</sup> Subsection 256(5.1), which applies for taxation years commencing after 1988. The standard applies only where the expression “controlled, directly or indirectly in any manner whatever” is used.

For these reasons, I conclude that the object, spirit and purpose of subsection 111(5) is, at least in part, to restrict the use of specified losses, including non-capital losses, if a person or group of persons has acquired actual control over the corporation's actions, whether by way of *de jure* control or otherwise.<sup>5</sup>

By substituting the New Actual Control Standard for the well-understood *de jure* control standard, the FCA Decision encroached on a fundamental aspect of the concept of control—its clarity in application. Unlike the *de jure* control test, which has been subject to decades of jurisprudence, and the *de facto* control test, which has been codified in the Act for over 30 years, this New Actual Control Standard was introduced with essentially no definition or description. The FCA Decision provided no guidance other than to acknowledge that the New Actual Control Standard includes forms of *de jure* and *de facto* control.<sup>6</sup> This is inadequate guidance for taxpayers seeking to interpret and apply this novel standard.

TEI is concerned about the uncertainty created by the FCA Decision, which introduced the New Actual Control Standard without defining its parameters. If the New Actual Control Standard defines the object, spirit, and purpose of subsection 111(5), even though the text of the provision is limited to *de jure* control, then it's possible to envision similar applications of the New Actual Control Standard to other provisions in the Act with *de jure* control standards.

Examples of the far-reaching technical uncertainty caused by the FCA Decision and its New Actual Control Standard include the following.

- Businesses will not know how to assess those regimes in the Act that apply rights and restrictions on the basis of whether an entity is controlled by another entity. It is unclear how the New Actual Control Standard could impact or alter this assessment. The scope of application of rules in the Act applicable to large multinational corporations (e.g., the controlled foreign affiliate regime) and to small Canadian businesses (e.g., the Canadian-controlled private corporation regime and entitlement to the small business deduction) is now less clear.
- Foundational rules respecting the computation of business taxes require the ability to determine when control of a corporation has been acquired. It is unclear how to assess these rules in the wake of the FCA Decision and its New Actual Control Standard. Examples of where the New Actual Control Standard would create uncertainty include:

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<sup>5</sup> FCA Decision at para. 93.

<sup>6</sup> See FCA Decision at para. 83.

- when non-capital losses,<sup>7</sup> scientific research expenses<sup>8</sup> and investment tax credit pools,<sup>9</sup> undeducted Part I tax credits, and unused surtax credits<sup>10</sup> are streamed to income from the same business or a similar business;
  - when depreciable property with inherent losses will be written down to fair market value (“FMV”) and doubtful debts will be written down;<sup>11</sup>
  - when properties with inherent capital losses will be written down to FMV and inherent capital losses triggered;<sup>12</sup>
  - whether foreign currency losses on debts payable are triggered;<sup>13</sup>
  - whether resource pools are streamed to income or proceeds of disposition from the resource properties owned;<sup>14</sup> and
  - whether there has been a deemed taxation year end.<sup>15</sup>
- Businesses will not have clarity on whether they are subject to certain regimes in the Act whose application is dependant on whether entities are related, as the concept of “related” is currently based on the *de jure* control standard.<sup>16</sup> This uncertainty would extend to the qualification for and computation of certain subsidies, like CEWS,<sup>17</sup> and incentives, like the small business deduction and investment tax credits.<sup>18</sup>

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<sup>7</sup> Subsection 111(5).

<sup>8</sup> Subsections 37(1)(h) and 37(6.1).

<sup>9</sup> Paragraphs (j) and (k) of the definition of “investment tax credit” in subsections 127(9), (9.1), and (9.2).

<sup>10</sup> Subsections 181.1(7) and 190.1(6).

<sup>11</sup> Subsections 111(5.1) and 111(5.3). The amount written down is generally deductible in the year of the acquisition of control with any resulting loss treated in the same manner as other non-capital losses following the acquisition of control.

<sup>12</sup> Subsection 111(4).

<sup>13</sup> Subsection 111(12).

<sup>14</sup> Subsection 66.7(10).

<sup>15</sup> Subsection 249(4)(a).

<sup>16</sup> Subsection 251(2).

<sup>17</sup> Certain rules in the Canada Emergency Wage Subsidy apply based on whether entities are part of an affiliated group, which includes corporations that are controlled (both *de jure* and *de facto*) by the same person.

<sup>18</sup> Entitlement to the small business deduction (subsection 125(2)–(4)) and certain enhanced investment tax credits (subsection 127(10.2)–(10.4)) is shared by associated corporations. Whether two entities are associated is based on an expanded *de facto* control standard set out in subsection 256(1).

- Businesses will have less certainty that rules understood to apply only between non-arm's length persons do not apply to commercial transactions undertaken by them.<sup>19</sup> That is, related persons are deemed not to deal at arm's length, and the concept of related is based on the *de jure* control standard.
- The permissibility of the deduction under subsection 112(1) for deemed inter-corporate dividends between related corporations is now less clear. That is, the exception to subsection 55(2) in paragraph 55(3)(a) does not apply where, *inter alia*, there are certain dispositions to unrelated persons.
- Businesses do not know if and how the New Actual Control Standard might apply to joint ventures and partnerships.

These technical uncertainties resulting from the FCA Decision give rise to adverse business risk and could render incentive regimes less effective, as described below.

- The uncertainty around the application of various technical rules in the Act gives rise to incremental business risk, which could derail economically beneficial investment in Canada. For example, the uncertainty around if and how the New Actual Control Standard might apply to joint ventures and partnerships could unnecessarily hinder—and may ultimately derail—otherwise economically beneficial joint projects of significant scale in Canada.
- The uncertainty could also hinder the ability of Canadian businesses to raise capital, find investment, and transact with parties that may request some level of commercial or corporate influence over their business as a condition of investment, even in cases where such levels of influence fall short of the existing control tests.
- The uncertain application of the New Actual Control Standard creates administrative complexity that will consume scarce business investment resources that could be better deployed elsewhere.
- The uncertain application of the New Actual Control Standard will consume scarce judicial resources as taxpayers and the Canada Revenue Agency grapple with how to apply this ill-defined new standard.

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<sup>19</sup> For example, subsection 69(1) deems FMV proceeds to arise on transfers of property between persons not dealing at arm's length. The benefit conferral provisions in subsections 56(4) and 246(1) also potentially apply to parties not dealing at arm's length.

- The scope of potentially relevant documentation required for due diligence in ascertaining whether the New Actual Control Standard might apply in mergers and acquisitions could derail economically beneficial transactions.
- The movement of cash between Canadian corporations within a Canadian corporate group, which is desirable for business efficacy, could be further constrained as the availability of the deduction under subsection 112(1) for inter-company deemed dividends is now subject to further uncertainty.
- With the qualification and computation of incentive regimes less certain, the effectiveness of these regimes in inciting small businesses to conduct scientific research and experimental development could decrease.

**Guidance from the Supreme Court of Canada regarding the New Actual Control Standard is required to avoid adverse uncertainty for Canadian businesses cause by the FCA decision**

In the wake of the FCA Decision, additional guidance is needed from the Supreme Court of Canada regarding the meaning, formulation, and applicability of the New Actual Control Standard as a new control standard in the Act. TEI is deeply concerned about the adverse business risks created by the FCA Decision, which could hinder economically beneficial investments and transactions in Canada. TEI is similarly concerned about the potential for increased, unproductive use of scarce taxpayer and judicial resources to address the uncertainties caused by the ill-defined New Actual Control Standard.

For all these reasons, TEI strongly supports Deans Knight's application for leave to appeal the FCA Decision to the Supreme Court of Canada.

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These comments were prepared under the aegis of TEI's Canadian Income Tax Committee, whose Chair is Patricia Likogiannis. Watson M. McLeish, Tax Counsel for TEI, coordinated their preparation. If you have questions about TEI's comments, please contact Ms. Likogiannis at (905) 431-4565 or [patricia.likogiannis@gm.com](mailto:patricia.likogiannis@gm.com), or Mr. McLeish at (202) 470-3600 or [wmcleish@tei.org](mailto:wmcleish@tei.org).

Respectfully,



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