



[2022] 2 F.C.R. D-15

## INCOME TAX

### INCOME CALCULATION

#### *Deductions*

Appeal from Tax Court of Canada (T.C.C.) decision (2021 TCC 23) upholding Minister of National Revenue's decision to deny appellant deduction for withholding taxes — Appellant implemented structure to acquire U.S. corporation UP&UP — More specifically, appellant formed general partnership under laws of Delaware (USGP); USGP incorporated Nova Scotia unlimited liability company (NSULC), USGP and NSULC incorporated limited liability company (LLC) under laws of Delaware; Delaware company (US Holdco) incorporated by appellant; US Holdco acquired shares of Acquisitionco; US Holdco also acquired the shares of Jetco Inc. (corporation incorporated by appellant under laws of Delaware) from appellant, then transferred these shares to Acquisitionco — Funding for acquisition of UP&UP flowed from appellant through structure, including loan from appellant to USGP (Appellant Loan) — Jetco merged with UP&UP, merged company then merged with Acquisitionco to form US Amalco — As result, US Amalco indebted to LLC for US \$300 million — Transactions giving rise to appeal herein including interest payments on debt owed to LLC, dividends paid to NSULC, USGP, interest paid to appellant — Appellant included in income interest paid by USGP on Appellant Loan, claimed deduction under *Income Tax Act*, R.S.C., 1985 (5th Supp.), c. 1 (Act), s. 20(12) for withholding taxes paid to U.S. Government on this interest — Exception in s. 20(12) providing that "... other than any such tax, or part thereof, that can reasonably be regarded as having been paid by a corporation in respect of income from a share of the capital stock of a foreign affiliate of the corporation." — T.C.C. found that while words "in respect of" very broad, still necessary to find connection between U.S. taxes paid by appellant, dividend income received by NSULC — Stating that taxpayer cannot claim relief under more than one provision for any foreign taxes paid in relation to particular item of income — Whether appellant entitled to deduction under s. 20(12) for taxes paid to U.S. Government on interest paid by USGP to appellant — In particular, interpretation of exception provided in s. 20(12) at issue — Nothing in context of s. 20(12) militating against deduction therein being available to appellant — First part of s. 20(12) identifying deduction in issue as "the non-business income tax paid by the taxpayer for the year to [a foreign] government" — Second part setting out exception — As result, questions needing to be addressed in this issue are what tax was paid by appellant to U.S. Government; whether reasonable to conclude that this tax was in respect of income from share of capital stock of foreign affiliate of appellant — T.C.C. erred in concluding that wording of s. 20(12) "clearly suggests to consider whether the income from shares received by a corporation other than the taxpayer can reasonably be regarded as the one in respect of which the US tax [was] paid by the taxpayer claiming the deduction" — Nothing in language of s. 20(12) explicitly provides that separate existence of two corporations (appellant, NSULC) to be ignored, that income of NSULC to be considered as income of appellant — Text of s. 20(12) insufficient to displace general rule that assets, income of corporation not assets, income of its shareholders — Therefore, no basis to find that s. 20(12) explicitly provides that NSULC's income from its LLC shares should be treated as income of appellant, hence as income on which appellant paid taxes to U.S. Government — Text of s. 20(12) supporting finding that taxes paid by appellant to U.S. Government cannot reasonably be regarded as taxes paid by appellant in respect of income from shares of LLC — Appellant had two sources of income for purposes of Act relevant in this appeal: shares in NSULC (held by USGP), Appellant

Loan — T.C.C. conclusion that appellant was claiming both ss. 112(1), 20(12) deductions in respect of same “item” of income unfounded — Income allocated to appellant, which included dividends paid by NSULC to USGP, distinct from interest payments resulting in taxes paid to U.S. Government — Finally, USGP’s payment of interest to appellant not payment by appellant to itself — Legal character of amount paid by partnership to partner function of legal obligation being discharged, not economic substance of transaction — Since appellant paid withholding tax to U.S. Government on this interest, appellant entitled to deduction pursuant to s. 20(12) in respect of these taxes — Granting this deduction not amounting to Canada subsidizing U.S. Government nor offending purpose of s. 20(12) — Allowing appellant to benefit from s. 20(12) deduction in line with purpose of this provision — Appeal allowed.

EMERGIS INC. v. CANADA (A-109-21, 2023 FCA 78, Webb and Goyette JJ.A., reasons for judgment dated April 13, 2023, 18 pp.)