Offshore Property Income, FAPI - Sas Ansari

Author : admin

Foreign Accrual Property Income of a Lending Business

CIT Group Securities (Canada) Inc v The Queen, 2016 TCC 163

At issue was whether the income earned by Controlled Foreign Affiliates (CFA) of the Taxpayer were Foreign Accrual Property Income (FAPI) or exempted from FAPI.

FACTS

The facts and structure of the Taxpayer and related entities is complex and not reproduced. See the first 84 paragraphs of the decision.

ANALYSIS

The Tax Court reviewed the relevant provisions of the *Income Tax Act*. The ITA subjects the world-wide income of Canadian residents to tax. The FAPI regime in Subdivision i of Division B of Part I deals with income earned on passive outbound investment by Canadian residents through non-resident corporations. The purpose is to subject to Canadian tax certain foreign passive or investment income that would otherwise erode the Canadian tax base, whether or not that income is distributed to Canada or not.

The FAPI regime starts by looking at the Canadian resident taxpayer's direct and indirect ownership interest in the foreign corporation to determine whether the corporation is a Foreign Affiliate (FA) or a Controlled Foreign Affiliate (CFA) of the Canadian resident. the FAPI regime only applies to CFAs. FAPI income must be included on an accrual basis, and included at the end of each taxation year of the CFA that ends in the taxpayer's taxation year.

The types of income captured by the FAPI regime are defined in subsection 95(1), one such income being income from property which includes income from an investment business, income from an adventure or concern in the nature of trade, but not income included in income from an active business by operation of subsection 95(2).

Paragraph 95(2)(l) includes certain amounts when calculating "income from property" for purposes of FAPI - including income from trading or dealing in indebtedness UNLESS the business is carried on by an affiliate of a foreign bank, a trust company, a credit union, an insurance corporation, or a trader or dealer in securities whose activities are regulated by the law. An "investment business" is defined in 95(1) to be a business the "principal purpose of which is to derive income from property (including interest, dividends, rents, royalties or any similar returns or substitutes therefor), income from the insurance or reinsurance of risks, income from the factoring of trade accounts receivable, or profits from the disposition of investment property, unless" it carries on such business as a foreign bank, trust company, credit

union, insurance corporation, or trader or dealer in securities whose activities are regulated by law. Subsection 95(1) also expands the definition of "lending of money" to include the acquisition of accounts receivable from arm's length persons or the acquisition or sale of "lending assets' (defined in 248(1)).

Clause 95(2)(a)(ii)(B) includes in Income from an Active Business interest paid or payable between related foreign corporations that wold be deductible in calculating their income from an active business (not carried out in Canada).

In interpreting these complex provisions, the court referred to the SCC decision in *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54 - the text, context, and purpose method of interpreting legislation:

> The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole. When the words of a provision are precise and unequivocal, the ordinary meaning of the words play[s] a dominant role in the interpretive process. On the other hand, where the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role. The relative effects of ordinary meaning, context and purpose on the interpretive process may vary, but in all cases the court must seek to read the provisions of an Act as a harmonious whole

With respect to the ITA, the FCA in *Lehigh Cement Limited v. The Queen*, 2011 FCA 120, stated that the Act is interpreted mostly textually:

> “[w]here Parliament has specified precisely what conditions must be satisfied to achieve a particular result, it is reasonable to assume that Parliament intended that taxpayers would rely on such provisions to achieve the result they prescribe”: *Canada Trustco*, *supra* at paragraph 11. Where the provision at issue is “clear and unambiguous,” its words “must simply be applied”: *Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622 at paragraph 40. In such circumstances, a supposed purpose “cannot be used to create an unexpressed exception to clear language” or “supplant” clear language: *Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*, 2006 SCC 20, [2006] 1 S.C.R. 715 at paragraph 23, citing P. W. Hogg, J. E. Magee and J. Li, *Principles of Canadian Income Tax Law* (5th ed. 2005), at page 569.

The Court proceeded to interpret paragraph 95(2)(l). The Court preferred the Respondent's interpretation of the preamble such that the phrasing expanded the meaning of "trading or dealing in indebtedness" to include the earning of interest on indebtedness (para 108). The preamble, therefore, requires the court to first determine whether the principal purpose of the business is to derive income from "trading or dealing in indebtedness".

The difference in position between the parties was whether the parenthetical phrase at the end of the preamble is part of the description of the business caught by the preamble or part of the description of the income from the business that is included in computing income from property. After breaking down the preamble into its constituent parts (as recommended by the Author HERE), the court held that the words describe the type of business by reference to its principal purpose, and the words in the parentheses of concern qualify the last word before it.

NOTE: The courts approach to interpreting this provision is superb and deserves a careful reading (paras 106 - 126).

The Court held that the principal purpose of the FA's business was to earn income from interest which is part of the business of earning income from trading or dealing in indebtedness. The next issue was whether the exception in subparagraph 95(2)(l)(iii) applied.

The relevant exemption would apply if the FA carried on business AS a foreign bank or a trust company. The word "as" in this context is used as a preposition to express a relationship between the noun phrase and the preceding words - thus means "In the capacity of" (para 139). To benefit from the exemption, therefore, two requirements must be met:

1. the business must be carried on in one of the listed capacities or forms; and
2. the business activities in that capacity must be regulated in the relevant foreign jurisdiction.

The phrase "foreign bank" is exhaustively defined ("means") in subsection 95(1) with reference to the *Bank Act*. Specifically, the definition of "foreign bank" is such that it "identifies not only entities that are banks in the traditional sense but also other entities that may not be banks as such under either Canadian law or the law of the relevant foreign jurisdiction" (para 157).

In this case, the FA met the definition of a foreign bank and, since it was regulated by the foreign government, it met the two requirements for the exemption.

NOTE: GAAR was not argued in this case.

- Sas Ansari, BSc BEd PC JD LLM PhD (exp) CPA In-Depth Tax 1, 2 &3

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