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When can you deduct interest on a loan?

Alan Roth, Toronto

If you borrow money to purchase a home, start a business or acquire an investment, can you claim the interest expense incurred in the year on the loan as a deduction on your tax return? The answer is not always straightforward.

For an amount of interest to be deductible for taxation purposes, it must meet the following criteria set out in paragraph 20(1)(c) of the *Income Tax Act* (the Act):

- It must be paid or payable[1] in respect of the year, pursuant to a legal obligation to pay interest
- It must be incurred in respect of borrowed funds used for earning business or property income[2] or to acquire property used in earning business or property income (the purpose test)
- The amount of interest must be reasonable[3,4]

[1] You can deduct interest expense on a paid or payable basis, provided you follow one basis consistently. Note, however, that compound interest must be paid in order to be deductible.

[2] Examples of income from property include dividend or interest income earned on investments such as stocks or bonds. It is not necessary that you currently earn income from the investments, but it must be reasonable to expect that you will.

[3] In Shell Canada Ltd. v The Queen, 99 DTC 5669 (SCC), the Supreme Court of Canada ruled that if an interest rate is established in a market of lenders and borrowers acting at arm's length from each other, it is generally a reasonable rate.

[4] Paragraph 20(1)(c) also provides a deduction for interest paid or payable on borrowed funds used to acquire an interest in certain annuity contracts.

However, there are numerous provisions in the Act that restrict or deny the deduction of interest even if it would otherwise be deductible under paragraph 20(1)(c). For example, pursuant to subsection 18(11), interest on funds that you borrow to contribute to a registered retirement savings plan (RRSP), specified pension plan (SPP), pooled registered pension plan (PRPP), tax-free savings account (TFSA), registered education savings plan (RESP), registered disability savings plan (RDSP), registered pension plan (RPP), retirement compensation arrangement (RCA) or deferred profit-sharing plan (DPSP) is not deductible, even if these plans generate property income.[5] Interest on funds you borrow to purchase a personal asset, such as a home or cottage (that you don't rent out), is not deductible, since you're not using the borrowings to earn business or property income.

Interest deductibility and the courts

Court cases over the years have addressed the question of whether borrowed funds meet the purpose test set out in paragraph 20(1)(c). The courts have stated the following:

- The borrowed funds on which interest is charged must generally be used directly to earn business or property income.[6] However, the courts have also stated that interest on borrowed funds used indirectly to earn business or property income may be deductible, but only in exceptional circumstances.[7]
- The actual current use of the borrowed funds, not their original use, determines whether interest is deductible.[8] The onus is on the taxpayer to demonstrate a link between the borrowed money and an eligible current use.
- The applicable criterion for determining whether borrowed funds are used for an income-earning purpose is reasonable expectation of gross income (not expectation of profit) at the time the investment is made. The amount of gross income does not need to exceed the interest expense for it to be deductible. In addition, the income-earning purpose need not be the primary or exclusive purpose of the borrowings.[9]

Examples of indirect uses of borrowed funds that the courts have accepted in the context of the purpose test include a corporation borrowing money to redeem shares, return capital or pay dividends to shareholders. The key to these exceptions is the concept of "filling the hole," or borrowing funds to replace capital or accumulated profits (that have been paid out to shareholders) that have been used for eligible purposes.

Another example of borrowed funds indirectly used for an eligible purpose would be funds borrowed to contribute capital to a corporation of which you are a shareholder, and the use of the funds can be shown to positively impact the recipient corporation's income-earning capacity.

Interest expense incurred on money that you borrow to buy common shares is generally deductible if there is a reasonable expectation at the time the shares are purchased that you will receive dividends. But this determination must be made on the basis of the specific facts involved.

The Canada Revenue Agency (CRA) has stated that if a company asserts that it does not pay dividends and that dividends are not expected to be paid in the foreseeable future, the income-earning purpose test will not be met. However, the purpose test will likely be met if a company has no stated dividend policy, or if its policy is that dividends will be paid when operational circumstances permit.[11]

In addition to various CRA technical interpretations released over the years, the CRA's discussion, guidance and interpretation of interest deductibility may be found in its Income Tax Folio, S3-F6-C1, Interest Deductibility.

Example of borrowed funds used for an eligible purpose

In 2017, Jenna borrowed $10,000 to acquire an investment in the common shares of a bank. The bank pays dividends to its common shareholders four times a year.

In January 2019, Jenna sold the shares for $10,000 and used the entire proceeds to acquire corporate bonds of a utility. The bonds pay interest to bondholders twice a year.

The entire amount of the loan remains outstanding at the end of 2019.

In this example, the original use of the borrowed funds relates to the bank shares, while the current use is in respect of the corporate bonds. Since the purpose test appears to be met in respect of the current use of the borrowed funds (since the bonds represent a source of interest income) – and assuming that the other interest deductibility requirements continue to be met – the interest expense incurred on the borrowings in 2019 should be deductible by Jenna.[10]

[5] See Income Tax Folio S3-F6-C1, Interest Deductibility, paragraph 1.100 for references to other provisions that restrict the deduction of interest.
[6] *Shell Canada Ltd. v The Queen* 99 DTC 5669 (SCC), and *The Queen v Singleton*, 2001 DTC 5533 (SCC).
[7] *The Queen v Bronfman Trust*, 87 DTC 5059 (SCC), and *The Queen v Canadian Helicopters Ltd.*, 2002 FCA 30.
[8] *Shell Canada Ltd. v The Queen*, 99 DTC 5669 (SCC), and *Canada Safeway Ltd. v MNR*, 57 DTC 1239 (SCC).
[9] *Ludco Enterprises Ltd. et al. v The Queen*, 2001 DTC 5505 (SCC).
[10] Income Tax Folio S3-F6-C1, Interest Deductibility, paragraphs 1.36 and 1.37.
[11] Income Tax Folio S3-F6-C1, Interest Deductibility, paragraph 1.70.

In some cases, it may be possible to convert non-deductible interest into deductible interest. Let's say you're paying interest on a mortgage on your home. If you have a portfolio of income-earning investments, consider selling your investments and using the proceeds to pay down or pay off the mortgage. You can then borrow funds to replace the investments. These borrowings will now be for an eligible purpose (i.e., earning investment income) and, therefore, the related interest expense should be deductible.[12]

Beware that if you realize a loss on the sale of securities and then wish to repurchase the same or identical securities, you must take into account the superficial loss rules which could, under certain circumstances, deny the loss until the replacement securities are sold.[13] Consult with your EY Tax Advisor before undertaking this type of planning.

Interest deductibility after investment is disposed or business ceases to operate

What if you borrow funds for an eligible purpose such as the purchase of income-earning investments, or the financing of your business operations, but you later sell those investments or you cease to carry on the business? If there is still a balance outstanding on the loan, is the related interest still deductible?

In this situation, the portion of the borrowed funds still outstanding when the investments are sold or the business ceases to operate may be deemed to continue to be used to earn income, provided that certain conditions are met. This would allow the related interest expense to continue to be deductible.

Under the so-called disappearing source rules found in section 20.1 of the Act, if you realize a loss on the disposition of an income-earning capital investment (other than an investment in real property or depreciable property), interest on any remaining related borrowing continues to be deductible if the proceeds are used to pay down the related debt or to purchase another income-producing investment. In certain circumstances, interest may continue to be deductible even after the borrowed funds are no longer used to earn income. For example, if a portion of the borrowed funds is effectively lost because the investment declines in value, the related portion of the interest may still be deducted.

Example of disappearing source rules in action

Amir borrowed $5,000 in 2016 to acquire shares of ABC Inc. for a total cost of $7,500. The borrowed funds were considered to be used to earn income from property (e.g., dividend income). In 2019, Amir sold his shares for $2,500 and used the entire proceeds to purchase shares of XYZ Inc.

Since Amir sold his ABC shares for one-third of their cost, he is considered to have used one-third of the original loan ($5,000 × 1/3 = $1,667) to buy the shares in XYZ. Interest on the $1,667 used to purchase XYZ Inc. shares can be traced to these shares, and since these funds are used to earn income from property, the interest will be deductible.

The remaining $3,333 of borrowed money is deemed to be used to earn income from the shares of ABC, and Amir may therefore continue to deduct interest on this amount. If Amir had instead used the proceeds of $2,500 for personal expenses, interest on the $1,667 would not be deductible.

Similar rules apply to the earning of business income from a business that has since ceased. If borrowed money has ceased to be used in a business because of the termination of the business, the money is considered to have been used to acquire each property remaining in the business. Interest on the portion of outstanding borrowings related to business properties that are later disposed of is not deductible if the proceeds of disposition are used for personal purposes.

In a recent Tax Court of Canada case,[14] an individual operated an accounting services business as a sole proprietor between 2002 and 2007. In 2007, he ceased to carry on the business personally when he incorporated the business. During the years that he operated the business personally, the taxpayer financed his business by drawing on a home equity line of credit used only for business purposes. From the end of 2005 to 2014, the line of credit was used solely to repay interest charged by the bank. The taxpayer successfully argued in court that in 2013 and 2014, the two taxation years in question in the case, the outstanding borrowed funds were deemed under the section 20.1 disappearing source rules to be used to earn income from a business and, therefore, the related interest expenses incurred during those two years were deductible.

[12] The conversion of non-deductible interest to deductible interest was the subject of *The Queen v Singleton*, 2001 DTC 5533 (SCC).

[13] If you dispose of a security and realize a loss, and the same or an identical security is acquired by you, your spouse or common-law partner, a company either of you controls or an affiliated partnership or trust (such as your RRSP, RRIF, TFSA or RESP) – within the period beginning 30 days before and ending 30 days after the disposition, and the security is still owned at the end of the period – the loss will be denied. This denied loss will, however, be added to the adjusted cost base of the same or identical security acquired in this period, which will result in you realizing the benefits of that loss when you later dispose of that security (subject to any further application of the superficial loss rules).

[14] *Moras v the Queen*, 2019 TCC 111.

Interest expense planning

Based on the above discussion, consider the following strategies to reduce the cost of borrowing:

- If you claim a deduction for interest expense on a paid basis, ensure that all necessary payments are made by 31 December.
- Convert non-deductible interest into deductible interest by using available cash to pay down personal loans and then borrowing for investment or business purposes. You should use excess funds to pay down personal debt, such as mortgages or credit card balances, before investment-related debt.
- Prevent the conversion of deductible interest into non-deductible interest by always ensuring that borrowed funds can be traced to an eligible use.[15]
- To reduce the cost of non-deductible debt, repay your most expensive personal debt first. Consider refinancing expensive debt like credit cards with a less expensive consumer loan.
- Set up a line of credit with a financial institution to provide emergency funds in case of temporary cash shortages.

Conclusion

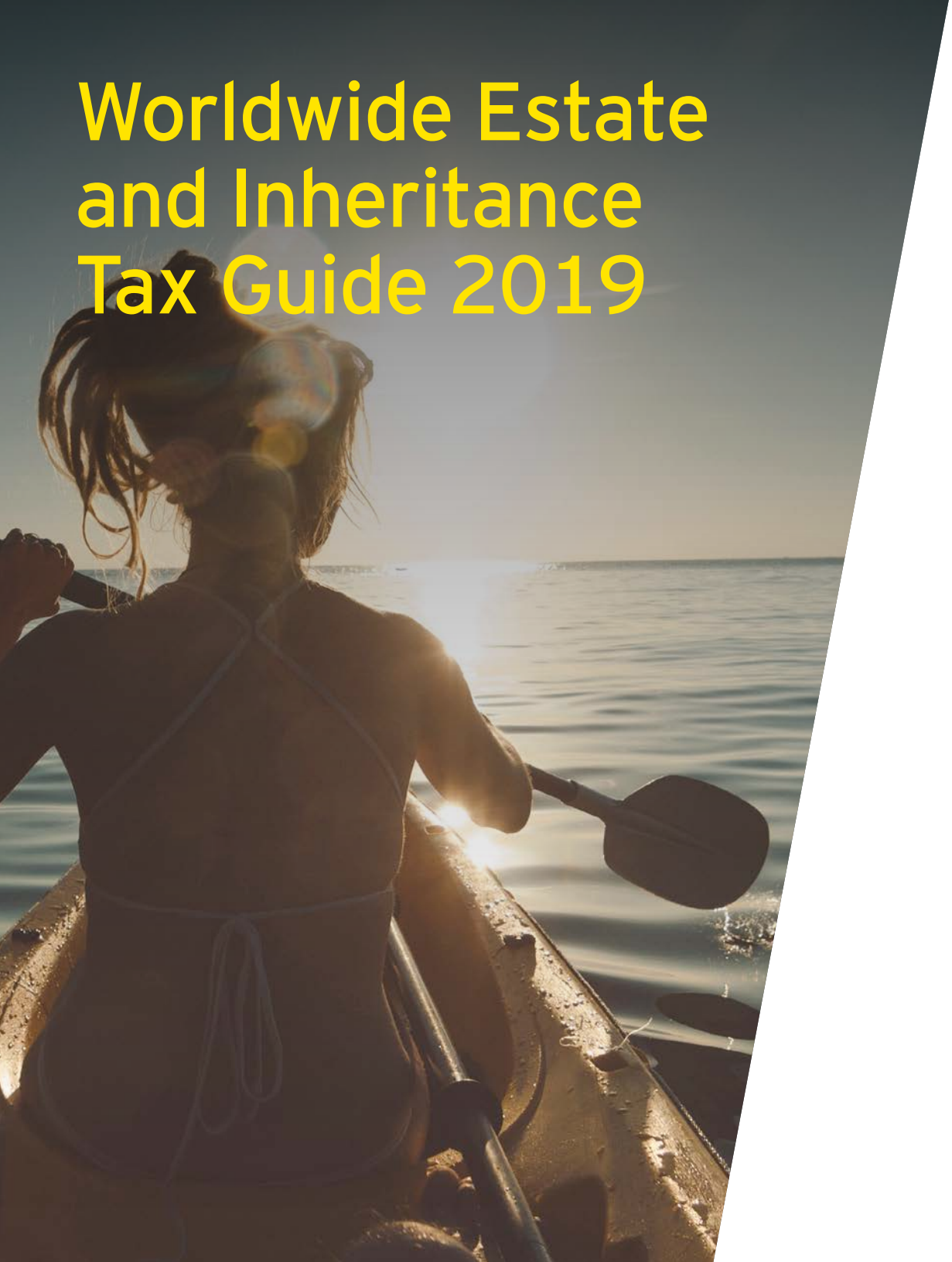
Paragraph 20(1)(c) of the Act sets out the fundamental requirements that must be met to deduct interest for taxation purposes. The courts and the CRA have provided guidance in interpreting the purpose test included in paragraph 20(1)(c) and applying it to various situations.

The disappearing source rules in section 20.1 illustrate the circumstances in which interest may continue to be deductible after the source of income no longer exists. In each situation, the determination of deductibility must be made on the basis of the specific facts involved.

For additional guidance, consult with your EY tax advisor.

[15] For example, ensure that any funds received as a return of capital on an investment acquired with borrowed funds are re-invested to continue to earn income. See the article on *Van Steenis v the Queen*, 2019 FCA 107, in the July 2019 edition of TaxMatters@EY.

Worldwide Estate and Inheritance Tax Guide 2019



EY's *Worldwide Estate and Inheritance Tax Guide* summarizes the estate tax planning systems and describes wealth transfer planning considerations in 39 jurisdictions around the world, including Australia, Canada, China, France, Germany, Italy, the Netherlands, the UK and the US.

The guide is designed to enable internationally positioned individuals to quickly identify the estate and inheritance tax rules, practices and approaches in their country of residence. Knowing these various approaches can help you with your estate and inheritance tax planning, investment planning and tax compliance and reporting needs.

The guide provides at-a-glance information as well as details on the types of estate planning in each jurisdiction. It includes sections on the following:

- Types of tax and who is liable
- Tax rates
- Various exemptions and reliefs
- Payment dates and filing procedures
- Valuation issues
- Trusts and foundations
- Succession
- Matrimonial regimes
- Testamentary documents and intestacy rules
- Estate tax treaty partners

You can view the complete *2019 Worldwide Estate and Inheritance Tax Guide* at ey.com/estatetaxguide.

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Five takeaways from the 2019 proxy season

Jamie Smith, EY Americas Center for Board Matters Investor Outreach and Corporate Governance Specialist

Adapted from the original published by the EY Center for Board Matters on ey.com

As the spotlight on board diversity intensifies, the pace at which women are joining boards is accelerating, and a growing number of companies are disclosing the board's racial and ethnic diversity.

At the same time, against a backdrop of increased focus on companies' efforts to create long-term value, enhanced proxy disclosures on corporate sustainability highlight how companies are protecting the environment, considering their social impact, investing in their people and promoting diversity and inclusion.

Investor outreach, often involving directors, has become a mainstay of leading governance practice among top companies. Overall, investors show notable support for directors and executive pay programs. A growing support for many environmental and social shareholder proposals highlights further opportunity for engagement.

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The following are five key takeaways for boards as they reflect on this proxy season and on evolving governance developments.[16]

High support for directors and executive pay programs

While director opposition has crept up in recent years, partly in connection with stricter board gender diversity and overboarding policies, we continue to see more than 90% average support for director elections and executive compensation programs.

- Only 6% of director nominees have received less than 80% support, and just 0.3% have not secured majority support.Only 8% of say-on-pay votes have secured less than 70% support, and just 2% have not achieved majority support.

1 | Gender diversity accelerates

Last year we reported on the advancement of gender diversity on boards in the wake of major institutional investors incorporating gender diversity expectations into their director voting policies. Since then, the pressure on boards to diversify has increased, partly due to state legislatures taking up the issue. In September, the California General Assembly passed a bill urging publicly traded state companies to add more women to their boards, and New Jersey is now considering similar legislation.[17] Against this backdrop, women are joining boards at a faster pace, all-male boards are disappearing among the largest companies, and more investors are demonstrating their board diversity views through proxy voting.

Rate of increase in women-held directorships doubles

After growing just one percentage point each year since 2013, the rate of increase in women-held directorships has doubled, increasing two percentage points in both 2018 and 2019 to reach 23%. If this pace sustains, gender parity will be reached across the S&P 1500 by 2033, versus 2046 at the previous pace.

All-male boards nearly extinct

Most S&P 500 boards (56%) now have at least three female directors, up from 37% in 2016. At the same time, all-male boards have nearly disappeared (fewer than 1%). A similar, but less dramatic, shift is underway across the S&P 1500. The portion of companies with three or more women on the board has grown from 20% in 2016 to 34% this year, and just 5% remain all-male.

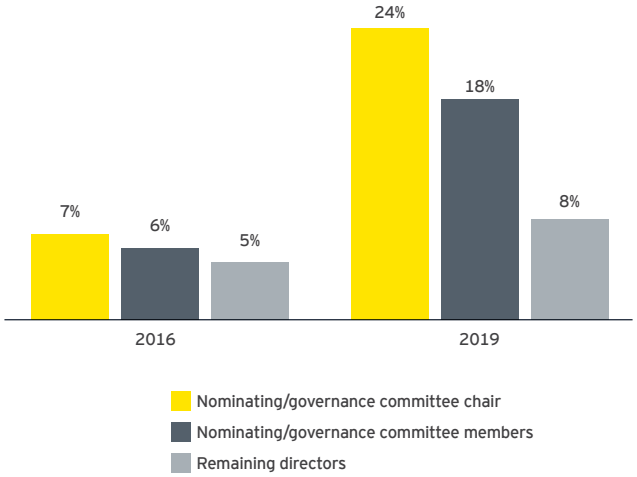
Women on S&P boards

Fifty-six percent of boards report three or more women, up from 37% in 2016.

Votes against all-male boards continue to climb

This year we continue to see increasing opposition to all-male boards. While director opposition votes typically average around 4% to 5%, average votes against all-male boards are significantly higher – and rising. Votes against nominating/governance chairs at all-male S&P 1500 boards have tripled since 2016, with those chairs receiving an average opposition vote of 24% this year.

Average director opposition votes at all-male S&P 1500 boards



[16] Vote results and shareholder proposal data for 2019 are available for meetings through June. Proxy disclosure data is based on 77 companies on the 2019 Fortune 100 list that filed proxy statements in 2016 and 2019 as of 1 July 2019. All other data is full year and based on the Russell 3000 index unless otherwise specified.

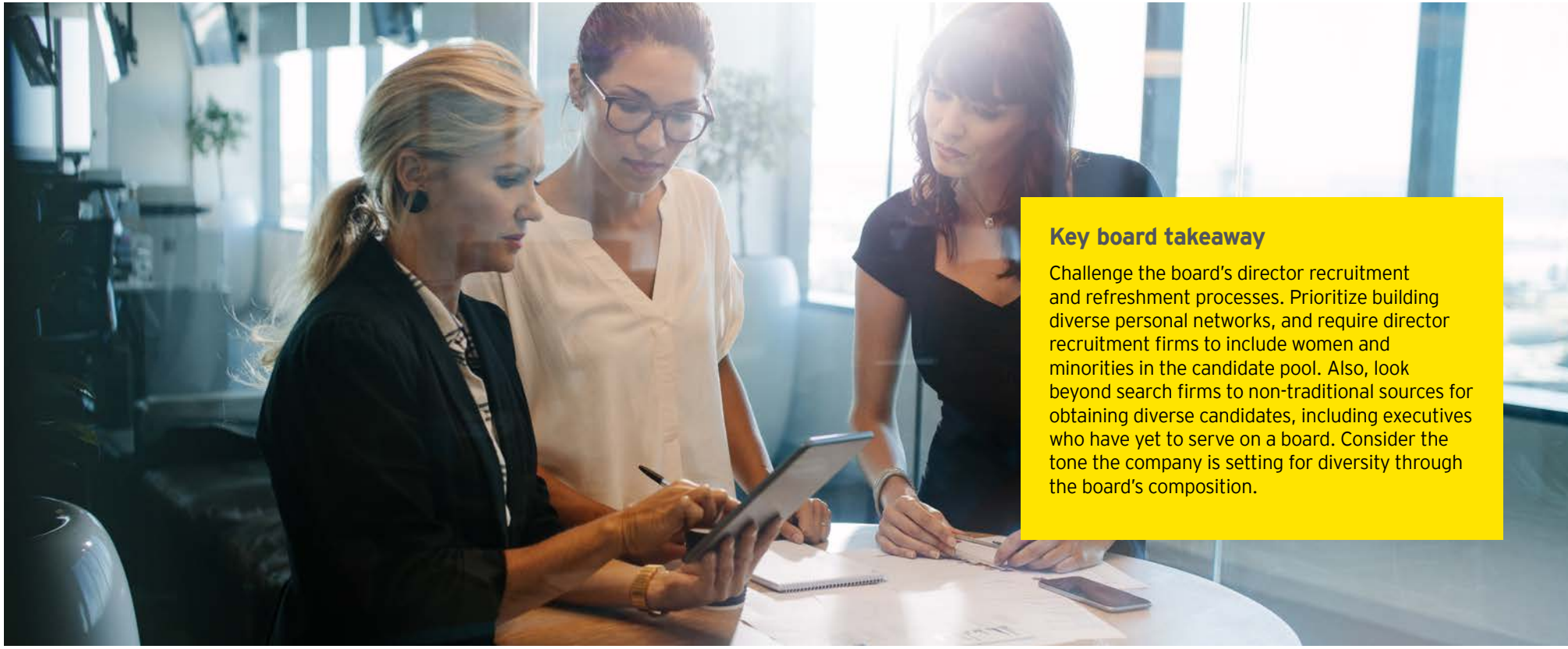
[17] See California SCR-62 and the New Jersey Bill.

By comparison, average opposition votes for nominating/governance chairs on boards that are at least 20% female were just 5% this year. Similarly, votes against nominating/governance committee members and all other board members at all-male S&P 1500 boards rose to 18% and 8%, respectively, compared with 4% and 3% for their counterparts at boards composed of 20% women.

Sector insights – board gender diversity

Leaders	Utilities (29%)	Consumer discretionary (27%)	Consumer staples (26%)
Laggards	Energy (18%)	Information technology (20%)	Telecommunication services (21%)
Most improved since 2018	Real estate went from being a laggard last year at 16% to the middle of the pack at 22%.		

Based on S&P 1500



Key board takeaway

Challenge the board's director recruitment and refreshment processes. Prioritize building diverse personal networks, and require director recruitment firms to include women and minorities in the candidate pool. Also, look beyond search firms to non-traditional sources for obtaining diverse candidates, including executives who have yet to serve on a board. Consider the tone the company is setting for diversity through the board's composition.

2 | Diversity disclosures on the rise

Racial/ethnic diversity disclosures climb

When we spoke with more than 60 investors this past fall, over half (53%) emphasized that boards should make diversity – primarily inclusive of gender, race and ethnicity – a top focus in 2019. Many noted that assessing racial and ethnic board diversity poses a challenge given the current lack of disclosure. According to these investors, gender can largely be inferred, but self-identification by directors and explicit disclosure in the proxy is needed for reliable racial and ethnic diversity information. Thirty percent of investors who said boards should focus on diversity also said they are asking companies for better disclosure of director demographics.

Responding to the call for disclosures

More companies are starting to respond: this year close to half (45%) of the Fortune 100 explicitly disclosed the board's racial/ethnic diversity, up from 23% three years ago. More boards are also disclosing their aggregated diversity, combining diversity across gender, race, ethnicity and sometimes other identity categories to provide an overall percentage of "diverse" directors. This year, 36% of the Fortune 100 disclosed the level of overall diversity on the board, up from just 13% in 2016.

More changes in board diversity disclosures could be forthcoming. The SEC's recently released Regulation S-K Compliance and Disclosure Interpretations (CDIs) states that where director nominees have self-identified diversity characteristics and consented to their disclosure, the company's disclosures should identify those characteristics, along with other qualifications or attributes, to the extent they were considered by the board or nominating committee in evaluating board membership. This guidance could lead to enhanced diversity disclosures in future proxy statements, but such change will hinge on director willingness to self-identify, and some directors may choose to not do so for personal reasons.

While the likelihood of passage is unclear, federal legislation has been introduced in the US that would require companies to disclose information related to the racial, ethnic and gender makeup of boards and senior executives, among other things.[18] The US *Improving Corporate Governance through Diversity Act* of 2019 relies on directors' voluntary self-identification.3 Similarly, a proposed diversity bill in Illinois would require companies to report on the self-identified gender and minority status of directors.[19]

More companies disclosing skill matrices

Investors remain focused on whether boards have a diversity of skills and experience that align to the company's evolving strategy and risk profile. Three quarters of the Fortune 100 now use a skills matrix to highlight the diversity of relevant director qualifications in an easily readable format, up from 30% in 2016.

The areas of expertise most frequently cited in independent nominees new to the board in 2018 were international business, corporate finance and accounting, and industry expertise. Nearly one-quarter of those directors were also recognized for their experience in innovation, transformation and navigating change.[20]

Key board takeaway

Enhance director diversity disclosures to highlight the board's current diversity across director characteristics and qualifications, and communicate any commitments to increasing diversity. Challenge whether the proxy statement effectively communicates why the company has the right directors at the right time and if it brings a diversity of relevant perspectives and expertise.

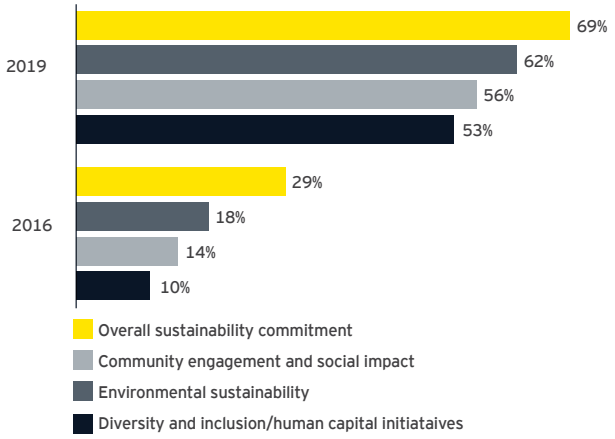
[18] H.R.1018 – *Improving Corporate Governance Through Diversity Act of 2019*. H.R. 3279 – *Diversity in Corporate Leadership Act of 2019*.
[18] Illinois Bill HB3394.

3 | Companies voluntarily enhance communication around corporate sustainability and citizenship

Proxy disclosures around how companies are creating broader, long-term value for their employees, communities and society are rapidly evolving. Since 2016, the number of Fortune 100 companies using the proxy to highlight their commitment to corporate sustainability and citizenship has more than doubled. Most leading companies now use the proxy to highlight the company's approach to environmental sustainability, people and culture, community investment and social impact.

This evolution aligns with growing investor interest in environmental, social and governance (ESG) considerations. Indeed, 63% of Fortune 100 companies that disclose engaging with investors over the past year say environmental and social factors were among the topics of focus. Many investors have also told us they are further integrating ESG considerations into their stewardship programs and broader approach, and want to see boards prioritize oversight of company-relevant environmental and social issues and human capital management.[21]

Voluntary proxy disclosures highlighting corporate sustainability and citizenship (% Fortune100*)*



These developments align with a broader, ongoing market shift: the view that the primary purpose of companies is to enhance and protect value for shareholders (shareholder capitalism) is evolving to the view that corporations are better able to deliver long-term value to shareholders when they understand their social impact and address the needs of their communities, customers, employees and other key stakeholders (stakeholder capitalism).[22]

The actions companies are highlighting in these voluntary disclosures — from environmental stewardship to the businesses' social impact — reflect how the companies are building long-term, broader value for multiple stakeholders. The disclosures vary widely in terms of depth and specificity and may include:

- **Overall sustainability commitment** – Nearly 70% highlight their overall commitment to corporate sustainability, responsibility or citizenship, more than double the amount that did so in 2016. Some include details regarding how these efforts are governed at the board level, and most link to the company's sustainability report or website for further information.
- **Environmental sustainability** – Sixty-two percent highlight their related goals and progress around topics such as emissions reduction, energy efficiency and renewable energy, recycling and waste management, and water as most applicable to the company's core business.
- **Community engagement and social impact** – More than half discuss their investments in the communities in which they operate (e.g., charitable giving, community partnerships and employee volunteer opportunities) and/or efforts to enhance the broader social impact of the business (e.g., privacy considerations for technology companies, access to medicines and efforts to address the opioid epidemic for health service companies, financing environmental solutions and investing in economically underserved areas for financial institutions).
- **Diversity and inclusion and other human capital initiatives** – More than half are highlighting their commitment to workforce initiatives around people and culture. Progress related to pay equity and workforce diversity, as well as workforce training and development programs, are key themes of these disclosures.

The most successful disclosures tie the company's environmental and social commitments to its core values and purpose, business and strategy, and ability to deliver long-term value.

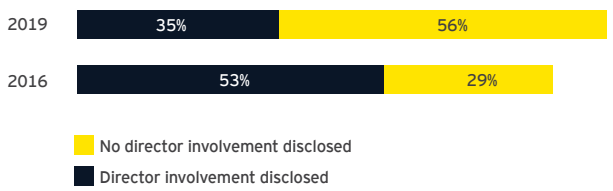
Key board takeaway

Consider the proxy statement as an opportunity to communicate the company's approach to corporate sustainability and citizenship. Brief, high-level disclosures can carry the message of the company's commitments and key progress regarding environmental sustainability, people and culture, communities and the social good, and direct stakeholders to other resources for more information.

[20] See our How the new class of 2018 independent directors shows that change is on the way for more information on the multiple dimensions of diversity the 2018 new class of independent directors is bringing to the boardroom.
[21] See our 2019 proxy season preview for more related information.
[22] See our How long-term value is being redefined and communicated for more related information.

4 | Investor engagement involving directors is now standard practice for leading companies

Fortune 100 companies that disclose investor engagement



Since company-investor engagement began to reshape the governance landscape, engagement on governance topics – and disclosure of these efforts in the proxy statement – continues to grow. Ninety-one percent of Fortune 100 companies have disclosed engaging with investors over the previous year, up from 82% three years ago. And director involvement in these efforts continues to increase. This year more than half of Fortune 100 companies said board members were involved in select engagement discussions, up from 29% in 2016. These directors most often include lead directors and compensation committee members.

The top five engagement topics disclosed are:

- Executive compensation
- Strategy and performance
- Sustainability/environmental and social topics
- Corporate governance
- Board composition, diversity and refreshment

Key board takeaway

Companies undertaking engagement should work toward anticipating and meeting investors' evolving expectations for maximizing the value and productivity of these meetings. They should also consider whether involving directors would be appropriate. Please see our 2019 proxy season preview for tips for more effective engagement based on what we're hearing from investors.

5 | With potential regulatory changes on the horizon, the shareholder proposal landscape continues to evolve

The SEC's current regulatory agenda includes amendments regarding the thresholds for shareholder proposals under Rule 14a-8, indicating that the Commission will consider the matter over the next year. It is generally expected that any changes will increase the current ownership and resubmission thresholds.[23] In the meantime, the shareholder proposal landscape continues to evolve.

Environmental and social shareholder proposals gaining traction

Environmental and social topics represent half of all proposals submitted to date, which is in line with recent years. Support for these proposals continues to climb, averaging 28% so far this year, up slightly from 27% last year and 22% in 2013.

The portion of these proposals reaching key support thresholds also continues to grow. So far, nearly half of the environmental and social shareholder proposals that have gone to a vote have secured at least 30% support, and 19% have attained at least 40% support. Thirty-percent support is the level at which many boards take note of a proposal topic, and at 50% support, if the board is deemed to take insufficient action in response, many investors will consider voting against incumbent directors at the next annual meeting.

Environmental and social proposal topics securing majority support so far this year include workforce gender and racial diversity, risks related to the opioid crisis, corporate political and lobbying expenditures, and inmate/detainee human rights.

Not reflected by these vote results is the significant number of shareholder proposals on environmental and social topics that are withdrawn each year, usually after the companies and proponents find common ground and reach an agreement. Around 40% of the environmental and social shareholder proposals we are tracking have been withdrawn so far this year, and that includes proposals on environmental topics such as climate risk that have received notable voting support in recent years.

Sector insights: environmental and social shareholder proposal topics

Which sectors faced the most shareholder proposals related to:

- Addressing corporate EEO/diversity: Consumer discretionary
- Greenhouse gas emissions: Energy, industrials, utilities
- Climate risk: Energy
- Pay inequality: Financials

Key board takeaway

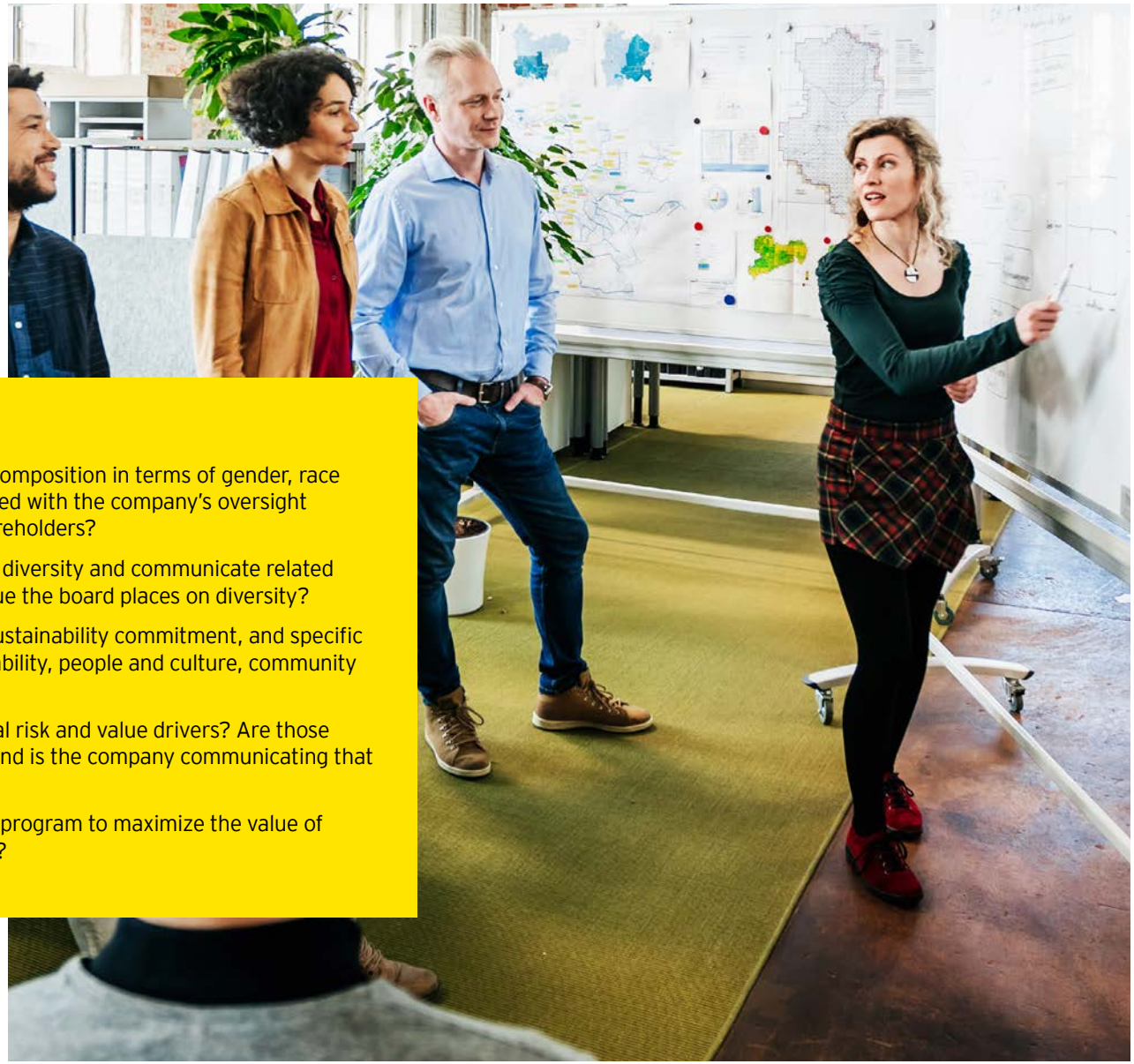
Engage with shareholder proponents to better understand their concerns and find areas of common ground. Recognize that many investors use the shareholder proposal process as an important part of their stewardship efforts. Also understand that some investors may share the concerns underlying a shareholder proposal even if they do not vote for the proposal as constructed. Engaging investors and making use of their publicly available policies and reports is key to understanding their views.

Explore the data

[23] SEC Agency Rule List- spring 2019, https://www.reginfo.gov/public/do/eAgendaViewRule?pubid=201904&RIN=3235-AM49. SEC Proposes Shareholder Proposal and Proxy Advisory Firm Rule Amendments, Gibson Dunn, 24 May 2019.

Conclusion

As the ES of ESG grows in prominence, topics such as the company's social impact, purpose, environmental sustainability and diversity (in the boardroom as well as across the workforce) are under the spotlight — and this year's proxy votes and proxy statements reflect these developments. Along with direct investor engagement, the proxy statement serves as a critical opportunity for communicating the company's long-term value proposition and highlighting how the company's governance practices align with and support that proposition.



Questions for the board to consider

- What is the board doing to proactively challenge its composition in terms of gender, race and ethnic diversity, as well as diversity of skills aligned with the company's oversight needs? How is it communicating these efforts to shareholders?
- How does the proxy statement showcase the board's diversity and communicate related goals and commitments to help demonstrate the value the board places on diversity?
- Are there opportunities to highlight the company's sustainability commitment, and specific goals and progress related to environmental sustainability, people and culture, community investment and efforts to benefit society?
- How is the board overseeing environmental and social risk and value drivers? Are those considerations integrated into long-term strategy — and is the company communicating that effectively to stakeholders?
- How is the company innovating its investor outreach program to maximize the value of those efforts and be responsive to investor feedback?

TCC finds due diligence defence applied where failure to file T1135 on a timely basis

Moore v The Queen, 2019 TCC 141

Winnie Szeto, Toronto, Allison Blackler, Vancouver

In this case, the Tax Court of Canada (TCC) found that the due diligence defence applied in the case of the taxpayer's late filing of Form T1135, Foreign Income Verification Statement.

Facts

As an employee of a Canadian company (Canco) since 2010, the taxpayer participated in its employer-sponsored share purchase plan to acquire shares of Canco's parent company (US Parent), which was a publicly traded US corporation. The shares were acquired gradually by way of biweekly payroll deductions with matched funding from Canco.

The taxpayer's participation in the share purchase plan ended in March 2016 because Canco was acquired by a third party. At this time, the taxpayer transferred his shares of US Parent to a Canadian brokerage account. It was after this transfer that the taxpayer realized that he should have filed a T1135 form starting in 2015 when the aggregate cost of his US Parent shares first exceeded CDN$100,000.

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All Canadian-resident taxpayers are required to file the T1135 form if at any time in the year the total cost amount of all specified foreign property to the taxpayer was more than $100,000. The form must be filed on or before the due date of the taxpayer's income tax return. The penalty for failing to file the T1135 is the greater of either $100 and $25 per day for each day that the return is late, up to a maximum of $2,500.

Shortly after his 2016 income tax return filing due date, the taxpayer wrote to the Canada Revenue Agency (CRA) informing them of his oversight and duly completed T1135 forms for both 2015 and 2016. He has continued to file T1135s annually since then as required.

The Minister of National Revenue (the Minister) assessed a penalty of $2,500 against the taxpayer for not filing his 2015 form on a timely basis.

The taxpayer appealed this assessment to the TCC.

TCC decision

At trial, the taxpayer presented blank copies of the CRA's 2015 income tax return form and relevant portions of the 2015 Income Tax Guide (the Guide). The court noted that on the income tax return, taxpayers were asked whether they owned specified foreign property at any time in the year where the total cost was more than $100,000. The form also indicated that one should refer to the Guide "for more information." The court found that the information in the Guide relating to specified foreign property was unhelpful to the average Canadian, and there is no mention of Form T1135.

The court then reviewed the relevant case law. The court in *Leclerc v The Queen*[24] concluded that Canadians could not be expected to know that the CRA would waive the T1135 late filing penalties only if the taxpayer formally applied under the CRA's Voluntary Disclosure Program, since these information forms do not involve fraud or non-disclosure of income.

In the current case, the court was of the view that the comments made in *Leclerc* were equally applicable to reasonable Canadians who did not necessarily find the correct information on foreign shares or understand it from the Guide and the income tax return's reference to the Guide. In addition, the court was of the view that the comments made in Leclerc were also relevant to the fact that the taxpayer may have voluntarily disclosed to the CRA his late filing, but was unaware it had to be done under the formal Voluntary Disclosure Program if he wanted to avoid coming to court.

The court found that the taxpayer was not cavalier about his income tax obligations and all income received on the shares was properly reported and tax was paid. The taxpayer did not misrepresent, mischaracterize or omit any amount on his 2015 tax return. And upon realizing that the T1135 was required to be filed for 2015, the taxpayer promptly filed it going forward and notified the CRA in writing about his 2015 filing obligation and filed a 2015 form.

For the above reasons, the court concluded that the due diligence defence was appropriate in this case and the appeal was allowed.

Lessons learned

Upon allowing the appeal, the trial judge asked the rhetorical question, "Is [the taxpayer's] disclosure to [the] CRA on a voluntary basis of his failure to file a 2015 information return not the type of compliance effort [the] CRA wants to encourage Canadians to follow?"

We are of the view that this was the trial judge's way of chastising the CRA for allowing this matter to go so far as to have the taxpayer appeal to the TCC.

The trial judge ends his decision by making one last statement: "I cannot imagine why in a case such as this the CRA would prefer to have [the taxpayer] appeal to this Court, lose, and then go back to [the] CRA's Fairness Review program armed with my comments."

Although this case is an informal decision and therefore has limited precedential value, it serves as a reminder to taxpayers to be mindful of their personal tax filing obligations and to take positive steps to ensure those obligations are met in a timely manner. It also shows how, in some circumstances, particularly when an honest oversight is made, taxpayers may still have success if they act immediately to remedy the situation with the CRA. However, even though this case had a happy ending for the taxpayer, we think that it is always advisable to seek professional tax advice before making a voluntary disclosure, as there may be other ways to find relief without having to end up in court.

[24] 2010 TCC 99.

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Publications and articles

Tax Alerts – Canada

Tax Alert 2019 No. 29 – CBCA changes: tax implications

As of 13 June 2019, private corporations incorporated under the *Canada Business Corporations Act* are required to maintain a register of shareholders who, directly or indirectly, exercise "significant control" over a corporation. These amendments are expected to be followed by similar amendments to the counterpart legislation in the provinces and territories.

The amendments are intended to improve corporate transparency, a goal that the Canadian federal, provincial and territorial finance ministers committed to when they signed an *Agreement to Strengthen Beneficial Ownership Transparency* in 2017.

Tax Alert 2019 No. 30 – Finance releases draft legislation for 2019 budget for comment

On 30 July 2019, the Department of Finance released for public comment draft legislative proposals (and accompanying explanatory notes) to implement measures remaining from the 2019–20 federal budget, as well as revisions to the recently enacted measures concerning accelerated capital cost allowance (CCA) and resource expenses.

Interested parties are invited to provide comments on these draft legislative proposals by 7 October 2019.

Tax Alert 2019 No. 31 – Trade compliance verification list update

The Canada Border Services Agency (CBSA) released its semi-annual list of trade compliance verification (audit) priorities in July 2019. The list is designed to update the importing community on ongoing verification priorities and set the stage for new priorities for the upcoming calendar year.

The CBSA continues to focus on tariff classification as a priority audit area, with the introduction of eight new rounds to the list of tariff classification priorities.

Tax Alert 2019 No. 32 - Non-Québec Canadian and foreign suppliers: less than one week to register for QST

Non-Québec resident Canadian suppliers and foreign suppliers registered for GST have until 1 September 2019 to register under the new specified registration system for QST purposes.

Publications and articles

Publications and articles

EY's Global Capital Confidence Barometer

The 20th edition of EY's Global Capital Confidence Barometer describes how 76% of Canadian respondents expect to pursue M&A in the next 12 months, the second-highest ever (behind April 2018) and the fifth consecutive year above the historical average of 50%.

EY's Worldwide Personal Tax and Immigration Guide 2018-19

This guide summarizes personal tax systems and immigration rules in more than 160 jurisdictions, including Australia, Brazil, Canada, France, Germany, Mexico, the Netherlands, the Russian Federation, the UK and the US.

EY's Worldwide Capital and Fixed Assets Guide 2019

This guide summarizes the complex rules relating to tax relief on capital expenditures in 31 jurisdictions and territories.

EY's Worldwide Estate and Inheritance Tax Guide 2019

EY's Worldwide Estate and Inheritance Tax Guide summarizes the gift, estate and inheritance tax systems and describes wealth transfer planning considerations in 39 countries.

Worldwide Corporate Tax Guide 2019

Governments worldwide continue to reform their tax codes at a historically rapid rate. Chapter by chapter, from Afghanistan to Zimbabwe, this EY guide summarizes corporate tax systems in 166 jurisdictions.

Worldwide VAT, GST and Sales Tax Guide 2019

This guide summarizes the value-added tax (VAT), goods and services tax (GST) and sales tax systems in 124 jurisdictions, including the European Union.

Worldwide R&D Incentives Reference Guide 2019

The pace at which countries are reforming their R&D incentives regimes is unprecedented. This EY guide summarizes key R&D incentives in 46 countries, and provides an overview of the European Union's Horizon 2020 program.

2018-19 Worldwide Transfer Pricing Reference Guide

Transfer pricing rules and regulations around the world continue to grow in number and complexity. Practitioners need to have current knowledge of a complex web of country tax laws, regulations, rulings, methods and requirements. This guide summarizes the transfer pricing rules and regulations adopted by 124 countries and territories.

Board Matters Quarterly

The June 2019 edition of Board Matters Quarterly highlights five ways boards can enhance their oversight of culture. It also includes a look at how long-term value is being redefined and communicated and offers five considerations as ISS looks at economic value-added metrics.

EY Trade Watch

EY Trade Watch is a quarterly communication prepared by EY's Customs & International Trade Practice. Highlights of this edition include:

Global

- What trade executives are currently thinking about global trade disruption

Americas

- Ripple effects of US Government export ban on Huawei
- The 2019 Trump trade agenda: adjusting US trade policy to the realities of the 21st century economy

Asia-Pacific and Japan

- Enhanced benefits of Australia's next generation AEO program

Europe, Middle East, India and Africa

- WTO Boeing dispute: EU issues preliminary list of US products considered for countermeasures
- Recent developments and changes to the European Union Customs Code
- Brexit update

Publications and articles

Websites

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Online tax calculators and rates

Frequently referred to by financial planning columnists, our mobile-friendly calculators on ey.com/ca let you compare the combined federal and provincial 2018 and 2019 personal tax bills in each province and territory. The site also includes an RRSP savings calculator and personal tax rates and credits for all income levels. Our corporate tax-planning tools include federal and provincial tax rates for small business rate income, manufacturing and processing rate income, general rate income and investment income.

Tax Insights for business leaders

Tax Insights provides deep insights on the most pressing tax and business issues. You can read it online and find additional content, multimedia features, tax publications and other EY tax news from around the world.

The Worldwide Indirect Tax Developments Map

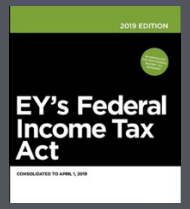
Updated monthly, our interactive map highlights where and when changes in VAT, global trade and excise duties are happening around the world. The map can be filtered by tax type, country and topic (e.g., VAT rate changes, compliance obligations and digital tax).

CPA Canada Store

EY's Complete Guide to GST/HST, 2019 (27th) Edition

Editors: Jean-Hugues Chabot, Sania Ilahi, David Douglas Robertson

Canada's leading guide on GST/HST, including GST/HST commentary and legislation, as well as a GST-QST comparison. Written in plain language by a team of EY indirect tax professionals, the guide is consolidated to 15 July 2019 and updated to reflect the latest changes to legislation and CRA policy. This edition has new commentary regarding duties on cannabis products under the *Excise Act*, 2001.



EY's Federal Income Tax Act, 2019 Edition

Editors: Albert Anelli, Warren Pashkowich and Murray Pearson

Complete coverage of Canada's Income Tax Act and Regulations. Included with this edition: interactive online features and purpose notes for selected provisions. Purchase of a print book includes access to an online updated and searchable copy of the federal Income Tax Act as well as the PDF eBook. This edition contains amendments and proposals from the 19 March 2019 federal budget, the 15 January 2019 proposed amendments to the *Income Tax Act* (salary overpayments) and 2018 legislation as passed and proposed.

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