

December 7, 2011

Change in CRA Administrative Policy for Joint Venture Fiscal Periods

The Canada Revenue Agency (the "CRA") had a longstanding administrative policy that permitted the participants in a joint venture (e.g. a real estate co-ownership or co-tenancy) that is not a partnership to establish a fiscal period that may differ from the fiscal periods of the joint venture participants where the participants have different fiscal periods and there was a valid business reason to justify a different fiscal period for the joint venture. Under this administrative policy, it was possible for co-owners of a real estate joint venture to defer income tax. If, for example, a co-owner had a December 31st year-end and the joint venture had a January 31st year end, then an 11-month deferral in the recognition of income from the joint venture could be achieved by the co-owner.

A similar tax-deferral opportunity existed for corporations (other than professional corporations) having an interest in a partnership where the partnership's fiscal period is different than the corporation's taxation year. The 2011 federal Budget (first introduced on March 22, 2011 and re-introduced on June 6, 2011) contains a proposed change to eliminate the deferral of tax on partnership income allocated to a corporate partner. The 2011 federal Budget will eliminate this tax deferral advantage for certain corporate members of partnerships and will provide transitional relief allowing a corporate partner to recognize the stub period income over 5 years.

Consistent with the 2011 Budget proposals, the CRA announced on November 29, 2011 that, assuming the 2011 Budget proposals (contained in Bill C-13) are enacted, the administrative policy of the CRA on joint ventures will no longer apply. More specifically, taxpayers who are members of a joint venture will no longer be eligible to compute income as if the joint venture had a separate fiscal period. It should be noted that a joint venture can involve a non-corporate taxpayer, such as individuals and trusts, who would also be affected by the change in CRA administrative policy. This change in administrative policy could result in joint venture participants being required to include the income for up to 2 fiscal year ends of the joint venture on their next tax return. The CRA stated, however, that it will allow transitional relief for joint venture stub period income similar to the transitional rules under the 2011 Budget for corporate partners (i.e. recognition of stub period income over 5 years – 15% of additional income in 2012, 20% in 2013, 2014 and 2015, and 25% in 2016). The income that may generally qualify for this transitional relief will be based on the actual additional income for the stub period to the extent the amount would not have otherwise been included in income for the first taxation year of the participant taxpayer that ends after March 22, 2011.

For greater clarity, the CRA has stated (CRA Document No. 2011-0429581E5):

- All participant taxpayers of joint ventures will be expected to include in income all amounts that had been deferred as a result of fiscal periods of joint ventures that differed from the taxation years of the participant taxpayer, including those structures in which the

participant taxpayer has taken the position that income was deferred as a result of tiered structures.

- In order for a participant taxpayer to avail itself of this joint venture transitional relief for the first taxation year ending after March 22, 2011, a participant taxpayer will be required to file an election in writing, on or before the filing due date for that taxation year, by attaching a letter to their tax return for that taxation year. The letter should indicate that the participant taxpayer is including income from the joint venture for which it is seeking transitional relief. If a tax return has already been filed, to be eligible, a participant taxpayer will be required to send a letter to their Taxation Centre indicating their election to benefit from the transitional relief under the CRA's new administrative policy.
- Failure to report all of the accrued income in a participant taxpayer's first taxation year that ends after March 22, 2011 in accordance with the new CRA administrative policy will result in the participant taxpayer's ineligibility for transitional relief.

There are some practical problems that can arise under the new CRA administrative policy for joint ventures. It will be necessary for each participant in a joint venture to calculate its income from the joint venture to the period that coincides with the participant's taxation year-end. This will impose an additional administrative burden where there are many participants in a joint venture who have different taxation year ends. It may be necessary to prepare financial statements for the joint venture perhaps as frequently as on a monthly basis so as to provide each participant with the relevant financial information required in order to calculate each participant's income from the joint venture that coincides with its taxation year-end.

The CRA states that the stub period income that will qualify for the transitional relief will be based on the actual additional income for the stub period. This differs from the proposals contained in the 2011 federal Budget which will eliminate the deferral of tax on partnership income allocated to certain corporate partners. Under those proposals, the stub period income is based on a proration of partnership income for its fiscal period ending in 2011. In the case of joint ventures with a fiscal period ending in 2011, it will be necessary for the joint venture participant who seeks to obtain transitional relief to compute actual additional income for the stub period ending on the participant's taxation year-end.

Also, it would appear that where a joint venture participant is forced to recognize income for a period that exceeds 365 days, the participant may not be entitled to claim additional capital cost allowance ("CCA") in respect of the stub period income. Hopefully, the CRA will confirm that it will administratively allow additional CCA to be claimed in respect of the stub period.

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