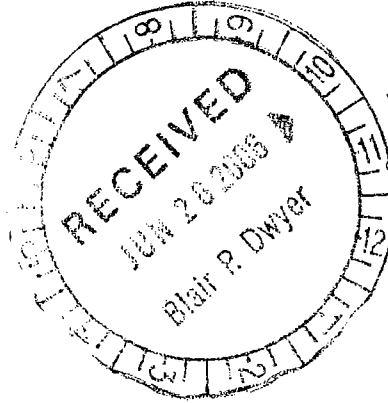




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Your file / Votre référence

Our file / Notre référence

2005-017235  
S. Lewis  
(613) 941-7239

Blair P. Dwyer  
B. Dwyer Tax Lawyers  
900-1175 Douglas Street  
Victoria BC V8W 2E1

June 14, 2006

Dear Mr. Dwyer;

Re: Technical Interpretation of the status of payments from  
BC Forestry Revitalization Trust

This is in response to your letter of February 17, 2006 inquiring as to how payments made under the BC Forestry Revitalization Trust (the "Trust") to contractors and sub-contractors, in the forestry business, are treated for tax purposes.

Hereinafter all references to provisions are in the *Income Tax Act*, R.S.C. 1985 (5th Supp.), c.1, as amended (the "Act"), unless stated otherwise.

We have the following understanding of the salient facts:

1. The British Columbia provincial government (the "Government") established the Trust on March 31, 2003.
2. The purpose of Trust is to mitigate adverse financial impacts suffered by workers and contractors who are negatively affected by the restructuring of the forestry sector within British Columbia. This restructuring was effected under the provisions of the *Forest Revitalization Act* (the "FRA"), S.B.C. 2003 c. 17.
3. The Government funded the Trust with a contribution of \$75,000,000. This original contribution was allocated among the "Forest Worker Mitigation Account", the "Contractor Mitigation Account", (collectively, the "Mitigation Accounts") and the "Administration Account".
4. The Mitigation Accounts will provide payments to mitigate the adverse financial effects to contractors and their employees resulting from the forestry restructuring. The Administration Account will pay the administrative expenses of the Trust.

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5. The trustee of the Trust (the "Trustee") was appointed by the Government and has broad discretion to deal with the fund in any manner that the Trustee considers best, provided that the Trustee is satisfied that the use of the funds would further the Trust purpose; the payment or distribution is likely to be of benefit to one or more "Eligible Forestry Workers" or "Eligible Contractors"; and the payment or distribution must not be inconsistent with any advisory board guidelines or recommendations that are then in effect.
6. The Trustee reports to the Government within 60 days after the end of each Trust fiscal year and must provide the Government with annual audited financial statements.
7. The Trustee will make "Employee Mitigation Payments" and "Contractor Mitigation Payments" to various contractors for the purpose of funding severance payments to employees who have lost their jobs due to FRA restructuring.
8. The Trustee will make Employee Mitigation Payments to the contractor who is the employer of the employees in question. The employer will then use the payments to pay severance to the employees.
9. The contractor is not required to provide any service or other supply to the Trustee in exchange for payment. The only obligation of the contractor is to use the payments to make severance payments.
10. The Trustee will make Contractor Mitigation Payments to various contractors.
11. The Contractor Mitigation Payments may have the following three separate components:
  - (a) "Lost Opportunity Amount": a compensatory payment made directly to the contractor to compensate the contractor for opportunities lost as a result of forestry restructuring;
  - (b) "Aggregate Specified Sub-Contractor Amount": a payment to a contractor to be used to compensate sub-contractors for opportunities lost as a result of forestry restructuring; and
  - (c) "Redundant Equipment Amount": a compensatory payment made directly to the contractor to compensate the contractor for equipment that has been made redundant as a result of forestry restructuring.

You have asked for our view on the taxable status of the aforementioned payments so that you may provide the recipients with some guidance as to how they are treated for income tax purposes.

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Your primary concerns are how the Employee Mitigation Payments and each component of the Contractor Mitigation Payments will be taxed.

### **Your Opinion**

It is your opinion that the Employee Mitigation Payments are taxable pursuant to paragraph 12(1)(x) of the *Act* for the following reasons:

- the contractor receives the payments in the course of earning income from a business;
- the payments are described as being from either a public authority or from a person (the Trust) in circumstances where it is reasonable to conclude that the Trust would not have paid the amount but for the receipt by the payer of amount from, *inter alia*, a government; and
- the payment is received as assistance in respect to an outlay or expense (the severance payment), which satisfies subparagraph 12(1)(x)(iv).

It is also your opinion that the contractor who receives Employee Mitigation Payments will have offsetting deductions when it makes the severance payments to the employees.

Further, it is your view that some Contractor Mitigation Payments may be taxable pursuant to subparagraph 12(1)(x)(iv) if the amount was received in respect of the specific cost of a particular property. In particular:

1. The Lost Opportunity Amount would be taxable under paragraph 12(1)(x) because the payment is a global amount and is not tied to any specific cost or outlay or expense.
2. The Aggregate Specified Sub-Contractor Amount relates to payments made by the contractor to the subcontractor and thus is in respect of that specific outlay or expense and would be taxable pursuant to paragraph 12(1)(x). The contractor would have the option of electing under subsection 12(2.2) to reduce the outlay or expense.

The sub-contractor, who receives the payment from the contractor, would have to deal with the general principles in respect of damage payments in determining whether to include its share of the Aggregate Specified Sub-Contractor Amount in income. In making this decision, the sub-contractor would have regard to the principles enunciated in Interpretation Bulletin IT-365R2 (dealing with damages, settlements and similar receipts) and, in particular, paragraphs 8-10 of that bulletin. Given that the receipt by the sub-contractor will usually relate to the loss of an entire contract, the payment will often be considered to be a capital receipt. However, this will potentially vary on a case-by-case basis.

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3. The Redundant Equipment Amount is tied to the cost of redundant equipment and so would be included in income under paragraph 12(1)(x). The recipient would be able to elect to reduce the cost of that redundant equipment by the Redundant Equipment Amount. If the recipient elected to reduce the cost of the redundant equipment, the recipient might realize recaptured depreciation or capital gain (depending on the circumstances) as a consequence of the sale of the redundant equipment. The applicable elections would be under subsection 13(7.4) and paragraph 53(2)(s).

### Our Comments

We generally agree with your comments with respect to the tax treatment of payments of Employee Mitigation Payments to the contractor. Such payments would constitute government assistance as discussed in paragraphs 2 and 3 of Interpretation Bulletin IT-237R2 *Government Assistance*. Please note, however, that the contractor may also elect to reduce the amount of the severance payments, as deemed outlays or expenses, pursuant to subsection 12(2.2).

We agree with your comments with respect to the tax treatment of the Lost Opportunity Amount.

With respect to the Aggregate Specific Sub-Contractor Amount we agree that the sub-contractor would have the option of electing under subsection 12(2.2) to reduce the outlay or expense as discussed in paragraphs 14 and 15 of Interpretation Bulletin IT-273R2 *Government Assistance*. While the sub-contractor would have to determine whether its share of the Aggregate Specific Sub-Contractor Amount is in respect of income or capital, we disagree with the general statement that when a loss relates to an entire contract the payment will often be considered to be a capital receipt. The general rule is that compensation received for the cancellation of a trade contract is on income account. In situations where the contracts formed a significant part of the structure of the sub-contractor's business it is likely that the contract will be considered a capital receipt; however, as you noted, such a determination will be on a case-by-case basis.

We agree with your conclusion that the Redundant Equipment Amount appears to be tied to the cost of the equipment and will be included in income pursuant to paragraph 12(1)(x) unless the taxpayer makes the appropriate elections. It should be noted, however, that the applicable elections are subsection 13(7.4) for depreciable property, and subsection 53(2.1) for non-depreciable property.

We trust that these comments will be of assistance.

Yours truly,



Randy Hewlett  
For Director  
Business and Partnerships Division  
Legislative Policy and Regulatory Affairs Branch