the context of a takeover bid or a divestiture of capital property are capital expenditures. The TCC allowed a current deduction under subsection 9(1) for "oversight expenses"—defined by the court as expenses that pertain to advice given to the board of directors to assist it in the decision-making process undertaken as part of its oversight function. Oversight expenses include investment banking fees pertaining to valuation work, financial modelling, due diligence to evaluate the advisability of a specific transaction, and the preparation of a fairness opinion.

Oversight expenses contrast with "execution costs," which the court defined as costs incurred as part of the implementation of a transaction that leads to the acquisition or disposition of capital property. Execution costs are capital in nature and must be added to the ACB of the target shares, or they are disposition expenses under paragraph 40(1)(a) (unless they are deductible under a specific rule such as the rules set out in subsection 20(1)). The TCC concluded that execution costs include investment banking fees for negotiation with the target and for advice to ensure compliance with securities legislation following the approval of the specific transactions by the taxpayer's board of directors.

The TCC found support for a distinction between oversight expenses and execution costs in *Bowater Power Co. Ltd.* (71 DTC 5469 (FCTD)) and *Wacky Wheatley's TV & Stereo Ltd.* (87 DTC 576 (TCC)). The court also concluded that oversight expenses are currently deductible partly because of the increased demand from public corporation shareholders that a board of directors exercise greater oversight over corporate activities, notably by challenging proposals brought to it by management and by seeking independent professional advice to guide it in its decision-making process. The TCC concluded:

> Oversight Expenses are current expenses because they relate to the management of a corporation's income-earning process. Proper management includes the judicious allocation or reallocation of capital for the purpose of maximizing the income earned by the corporation. Ineffective oversight over the capital allocation process is a formula for disaster that often leads to a decline in earnings and cash flow and, as a result, the destruction of shareholder value. In this context, Oversight Expenses serve an income-earning purpose. Oversight Expenses per se do not create enduring benefits for taxpayers. Rather, it is the actual implementation of an approved capital transaction that creates the enduring benefit.

As a result of the court's finding that the allocation between oversight expenses and execution costs must be made on the basis of the primary purpose of the advisory work performed, a taxpayer is entitled to a current deduction to the extent that the taxpayer can show that a specific transaction expense, or a portion thereof, relates to work commissioned primarily to assist in the oversight process. A well-advised taxpayer will thus (1) draft an engagement letter that distinguishes the services to be provided with respect to the oversight function of the board of directors from those services that relate to the implementation of a capital transaction, and (2) retain documentary evidence of the nature of the services actually performed by the advisers and their specific allocation between oversight and execution.

The TCC also commented on some specific statutory provisions relied on by the taxpayer as alternative or supplemental bases for deductibility. The court concluded that a deduction under paragraph 20(1)(bb) may also be available in respect of advice in the context of the takeover of an entire entity. This conclusion directly contradicts the CRA's strict administrative policy that that provision only covers portfolio transactions. The court also implied that a deduction under paragraph 20(1)(e) may also be available to the extent that the taxpayer can justify the allocation of the investment banking fees to the services required with respect to its share consideration offered on the acquisition of another party's shares.

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US Debt Reclassified as Equity

In *American Metallurgical Coal Co.* (TC Memo 2016-139), the US Tax Court recharacterized a 1992 instalment sale of units of a California geothermal partnership by a non-resident, Lausanne, to an unrelated US company, Heimdal. The decision was surprising because it illustrated the IRS's willingness to challenge unrelated-party debt. Earlier in 2016, the Treasury issued proposed regulations on debt-equity recharacterization between related parties.

Heimdal claimed an interest expense of $7,229,930, paid to Lausanne as part of the instalment sale. In structuring the sale, Heimdal and Lausanne shared Heimdal's adviser. That adviser characterized the interest as portfolio interest, which is not subject to US withholding tax if the non-US payee holds less than 10 percent of the payer's equity.

Heimdal was part of the Norse Group—US related domestic corporations that filed on a consolidated basis and had significant net operating losses (NOLs). The profitability of the geothermal partnership meant that Lausanne must file US income tax returns; Lausanne offered the units to the Norse Group, with which it had previously worked. Heimdal's first director had been counsel to Lausanne before he joined the group, and in 1987 was the director of Lausanne; his son was a Lausanne director for the years in issue. The sale was initially structured at $5 million plus interest for seven years. Lausanne received an "equity kicker" of up to 50 percent of the annual partnership unit distributions (net of NOLs and interest) and a right to repurchase the partnership if certain developments occurred. Heimdal held no other assets.

Ten years later, the parties extended the note's term to December 31, 2005; on October 28, 2004, the parties amended the note, allowing Heimdal to accrue and not pay the interest of $600,000 for each of 2003, 2004, and 2005; they later extended the note to December 31, 2006, and then they extended it further, to December 31, 2009, when the rate was also cut in half from 12 percent. However, Heimdal continued to pay interest at the 12 percent rate. On January 29, 2008, Heimdal repaid the $5 million principal of the note.

The court said that the current test of whether a debt is equity is factual. The court focused on the fact that Heimdal repaid its debt to Lausanne from the partnership distributions that it received. The court said that Heimdal had no assets before the sale and required an advance of the entire purchase price from the vendor, Lausanne: both facts strongly suggested that the vendor's advance to Heimdal was equity and not debt. The fact that Lausanne did not enforce the note indicated that it did not consider the note to be genuine indebtedness. The court quoted from its decision in *Ambassador Apartments, Inc.* (50 TC 236, at 246 (1968); aff'd, 406 F.2d 288 (2d Cir. 1969)): "Where a debtor does not make required payments or a creditor does not enforce its right to receive payments, an advance appears more like equity than debt."

The decision is troubling. The sale was between arm's-length parties, and the fact that the sale was structured for the US purchaser to receive an interest expense and the foreign seller to be exempt from US withholding should not have been a factor in the court's consideration. Lausanne did receive its $5 million principal amount for the units on January 29, 2008. Although Lausanne had agreed to several extensions, the court neglected to take into consideration that Lausanne always had the option—as many third-party creditors do—of repossessing the partnership units if payment was not received.

The court commented on the issue of portfolio interest. Even if the interest was deemed portfolio interest under IRC section 881(c), withholding tax applied because Heimdal failed to meet the necessary reporting requirements: (1) to have received from Lausanne a completed W-8 form ("Certificate of Foreign Status") before making payment and (2) to have attached that form, along with form 1042-S, to form 1042 and then have filed them all with the IRS by March 15 of the following calendar year.

On April 4, 2016, the Treasury released proposed regulations under section 385 on debt-equity recharacterization. The proposed regulations impose a documentation requirement in an attempt to set specific guidelines on when an instrument is characterized as debt between affiliated parties: related parties of an expanded group must maintain timely documentation and obtain financial analysis that is similar to that created for unrelated parties. The proposals also allow a debt instrument to be treated as part debt and part equity. The proposed regulations are comprehensive and aim to ensure that one cannot circumvent them by the use of a partnership. Proposed reg. section 1.385-3(d)(5) adopts an aggregate approach to controlled partnerships. A partnership is a controlled partnership if 80 percent or more of the interest in the capital or profits of the partnership is owned directly or indirectly by one or more members of an expanded group. An expanded group refers to an affiliated group and includes a foreign and a tax-exempt corporation, and also a corporation held indirectly through a partnership. A corporation is a member of an expanded group if 80 percent of the votes or value is owned by a group member. The proposed regulations are far-reaching and have raised concerns among tax practitioners, as shown by the July 7, 2016 letter (signed by Deloitte Tax LLP, Ernst & Young LLP, KPMG LLP, and PricewaterhouseCoopers LLP) in which the big four request the withdrawal of the proposed regulations and recommend the reissuance of a more targeted package of proposals.

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Tuition Assistance Under Collective Agreement

A recent technical interpretation (2015-0623221E5, April 26, 2016) confirms that tuition assistance benefits provided under a collective agreement to an employee's family member are not necessarily taxable to the employee. The CRA outlines several factors that may indicate that the tuition assistance is not a substitute for salary, wages, or other remuneration and therefore is potentially not taxable under subparagraph 6(1)(a)(vi).

All benefits received or enjoyed by an employee (or by a person who does not deal at arm's length with the employee) from an office or employment are generally included in the employee's income under paragraph 6(1)(a), unless otherwise specifically excluded by the Act. Generally, a benefit received or enjoyed by a non-employee individual under a program provided by the taxpayer's employer is not a taxable benefit to the employee under subparagraph 6(1)(a)(vi) if the benefit is designed to assist the individual to further his or her education. This rule applies if the employee deals at arm's length with the employer and it is reasonable to conclude that the benefit is not a substitute for the employee's salary, wages, or other remuneration.

The subparagraph 6(1)(a)(vi) exclusion was enacted in 2013, and it is effective for benefits received or enjoyed after October 31, 2011. The exclusion generally applies to scholarships or bursaries provided to an employee's family member to attend elementary, secondary, or post-secondary school.

In the TI, an employer provides tuition assistance through a scholarship plan in a collective agreement. The agreement was negotiated by the employer and an employee union. Under the program, an eligible member of an employee's family (a spouse or a dependent child) is entitled to receive tuition assistance to further his or her post-secondary education (subject