

Definition of “arm’s length”

1) Related Persons

Related persons do not deal with each other at arm’s length. Related persons are connected by blood relationship, marriage, common-law partnership or adoption.

Blood relationship:

- parent-child (or other descendant such as grandchild), including step-child and adopted child
- brother-sister, brother-sister of spouse and spouse of brother-sister (but not sister-brother of spouse’s sister-brother)

Marriage:

- two persons are connected by marriage if one person is married to the other, or if an individual is connected by blood relationship to the person an individual is married to.

Common-law:

- treated as marriage, above, after one year living together.

Other relatives:

- An individual’s niece, nephew, aunt, uncle or cousin is not considered to be related by blood, marriage, common-law partnership or adoption to the individual unless one of the other connections above applies.

Corporations and Other Persons:

- A corporation will be related to another person (including another corporation) where:
 - a) That person controls the corporation;
 - b) That person is a member of a related group that controls the corporation; or
 - c) That person is a person who is related to a person described in a) or b) above.
- Two corporations will be related if:
 - a) The two corporations are controlled by the same person or group of persons;
 - b) Each of the corporations is controlled by one person (or group) and the person (or group) who controls one corporation is related to the person (or group) who controls the other corporation.

“control” is defined as *de jure* control i.e. ownership of the majority of the shares / votes in the election of the board of directors.

2) Unrelated persons

Sometimes unrelated persons may deal with each other at arm’s length, sometimes they may not, depending on all the circumstances. By providing general criteria to determine whether there is an arm’s length relationship between unrelated persons for a given transaction, it must be recognized that all-encompassing guidelines to cover every situation cannot be supplied. Each particular transaction or series of transactions must be examined on its own merits.

In general, two parties are not dealing at arm's length if:

- a) There was a common mind which directs the bargaining for both parties to a transaction;
- b) The parties to a transaction were acting in concert without separate interest; and
- c) There was "de facto" control.

Failure to carry out a transaction at fair market value may be indicative of a non-arm's length transaction, but is not conclusive. The key factor is whether there are *separate economic interests which reflect ordinary commercial dealing* between parties acting in their separate interests.

Note: The above information was extracted from the CRA bulletin for LearnSphere's purposes in defining "arm's length" when a consultant is hired by a company. Please see the complete bulletin for more details and descriptions of situations not included here. Source: Canada Revenue Agency *Income Tax Act* (Canada) (the "Act"), more particularly sections 251 and 252 of the Act, and as illustrated and explained in S1-F5-C1 under the Act, entitled "Related Persons and Dealing at Arm's Length".

LearnSphere's interpretation of additional specific situations:

Considered to be at arm's length:

- Past employee, with no current remuneration.
- Current or past consultant.
- Previous member of board of directors/advisors.

Considered to not be at arm's length:

- Current employee.
- Current member of board of directors/advisors.
- Minority shareholder / investor.
- Potential investor with option to invest.

Although the key to defining arm's length for tax purposes is whether a person has "controlling" interest, for the purposes of determining whether a consultant is at arm's length, LearnSphere has determined that any ownership of the company by the consultant (or option to invest) would deem the consultant to not be at arm's length.