Connect. Engage. Impact.

1200 G Street, N.W., Suite 300
Washington, D.C. 20005-3814
202.638.5601
tei.org

13 September 2023

The Honourable Chrystia A. Freeland, P.C., M.P.
Deputy Prime Minister and Minister of Finance
Department of Finance Canada
90 Elgin Street
Ottawa, Ontario K1A 0G5
Canada

RE: Proposed EIFEL Rules

Via email: Consultation-Legislation@fin.gc.ca

Dear Minister Freeland:

On behalf of Tax Executives Institute, Inc. ("**TEI**"), I am pleased to share our comments on the revised draft legislative proposals (the "**Revised Draft Legislation**") released on August 4, 2023, to implement new limitations on the deduction of business interest expense.[1] These limitations are referred to as the Excessive Interest and Financing Expenses Limitation ("**EIFEL**"). We appreciate that the Department of Finance ("**Finance**") took into consideration many of our comments provided in response to prior consultations.[2] While many issues have been addressed in the Revised Draft Legislation, the EIFEL rules continue to be complex and we appreciate the opportunity once again to provide comments. We would also be pleased to discuss these comments further with the Finance.

About TEI

TEI was founded in 1944 to serve the professional needs of in-house tax professionals. Today, the organization has 56 chapters across North and South America, Europe, and Asia, including four chapters in Canada. Our over 6,000 members represent 2,800 of the world's leading companies, many of which either are resident or do business in Canada. Approximately 15% of TEI's membership comprises tax professionals who work for Canadian businesses in a variety of industries across the country. The following recommendations reflect the views of TEI as a whole but, more particularly, those of our Canadian constituency.

---

1 Dep't Fin. Can., *Legislative Proposals Relating to the Income Tax Act,* (Aug. 4, 2023)

2 *See* TEI EIFEL Submissions, (May 6, 2022 and Jan. 31, 2023). These submission are available at:

As the preeminent association of in-house tax professionals worldwide, TEI is dedicated to the development of sound tax policy, compliance with and uniform enforcement of tax laws, and minimization of administration and compliance costs to the mutual benefit of government and taxpayers. TEI is committed to fostering a tax system that works—one that is administrable and with which taxpayers can comply in a cost-efficient manner. The diversity, professional training, and global viewpoints of our members enable TEI to bring a balanced and practical perspective to the legislative proposals discussed herein.

<u>TEI Comments</u>

Canada has a robust taxation system with several limitations on interest deductibility (e.g., "Thin Cap," "Foreign Affiliate Dumping," "Upstream Loans"). Canadian taxpayers will, of course, structure their businesses in accordance with Canadian tax law, including the proposed EIFEL rules. An appropriate EIFEL implementation plan is necessary so taxpayers have adequate time to adjust their capital structures to the legislation and avoid any significant fiscal disruption or other material adverse consequences inconsistent with the policy of the proposed EIFEL regime, as discussed below.

1. *Implementation Timing and Transition*

The EIFEL rules are expected to apply to taxation years beginning on or after October 1, 2023. While the deferral of the EIFEL rules from the original effective date of January 1, 2023, was welcome, the October date continues to be problematic. Taxpayers require enacted or substantively enacted legislation to reflect any current or future impact in their financial statements. Companies cannot undertake any restructuring to address the EIFEL legislation unless it is substantively enacted. With less than 30 days until the EIFEL legislation effective date of October 1, 2023, the current EIFEL implementation runway provides no time for taxpayers to understand the impact of the legislation and undertake any measures to address their capital structures.

We recommended in our January 31, 2023, submission that if final legislation was not introduced by March 2023, then the implementation date should be shifted accordingly. The timing of the original EIFEL legislation effective date was set to provide taxpayers sufficient time to appropriately assess the legislation's impact and undertake any necessary restructuring of existing capital structures. Taxpayers cannot be expected to undertake costly debt restructurings in advance of final, let alone draft, legislative language. In addition, the Revised Draft Legislation mentions prescribed forms and elections, but such compliance forms or elections are unavailable so taxpayers cannot address compliance processes necessary to complete such forms or elections. Accordingly, the EIFEL implementation plan should contemplate an appropriate implementation runway.

<u>**Recommendation #1**</u>: Given that final enacted legislation is not expected to be available before the current effective date of October 1, 2023, TEI recommends that the effective date of the EIFEL rules be deferred, and that the proposed rules only take effect for taxation years beginning after June 30, 2024. Any decision regarding deferral should be announced as soon as possible so taxpayers have the

appropriate time to assess impacts, develop compliance procedures, and undertake appropriate restructuring.

As noted, the date of release of the final enacted legislation is still uncertain and will most likely be after the effective date of October 1, 2023. Thus, taxpayers will be left with essentially no time to restructure existing debt arrangements or reorganize corporate operations in a timely and cost-efficient manner. In many cases, premature restructurings of existing debt arrangements (if even possible given regulatory and other constraints) would result in significant financial penalties and impose a punitive lack of leverage in negotiating new debt facilities. In some cases, unwinding existing debt structures requires incurring debt in other jurisdictions, which takes significant time and may entail repatriating funds to repay the existing debts. In some cases, taxpayers may not have structures permitting cost efficient cash repatriation and, moreover, such repatriation may be restricted under local law.

As noted, the Canadian tax system includes a myriad of interest deductibility limitations. Taxpayers have structured their operations in accordance with existing rules in good faith, including entering multi-year debt instruments that may have punitive penalties for premature payment or cancellation. Recognizing these challenges, Finance provided a lengthy transition period when the upstream loan rules were introduced in 2011.[3] The transition rule provided a 5-year exemption for loans in place when the upstream loan draft rules were released. Finance acknowledged that the transition rule was intended to ensure that pre-regime loans were entitled to a five-year repayment window so that companies did not need to restructure or repay their debt obligations immediately to comply with the upstream loan legislation.

Taxpayers once again face legislation significantly limiting interest deductibility. Given the current uncertain capital market environment with high interest rates and the potential tax impact, the application of the EIFEL rules will significantly increase companies' effective debt cost. Corporate debt and capital structures were put in place based on the relevant regulatory environment and tax laws at the time. Since the first introduction of the EIFEL draft legislation, interest rates have significantly increased and it is apparent that financing with debt is now, and may continue to be, far more expensive than it has been in recent years. In view of the current interest rate and inflationary environment, restructuring long-term third-party debt may be cost prohibitive. In addition, higher interest rates will subject even more interest to the non-deductibility regimes in any particular year.

Recommendation #2: Given the impediments to the efficient restructuring of existing debt obligations, a transition period should be provided so the EIFEL legislation does not apply to debt or financing obligations existing on or before February 4, 2022, the date of the first EIFEL draft legislation, until the earlier of the debt maturity date or January 1, 2027.

In the EIFEL draft released on November 22, 2022, 40% transition relief was provided only for taxpayers where the EIFEL rules apply for taxation years that begin before January 1, 2024. Postponing the implementation date for the EIFEL rules as recommended above provides companies with a

---

3 *See* Income Tax Act (Canada) subsections 90(6) to 90(15).

reasonable amount of time to adapt to the new interest limitation rules; however, given the high inflationary environment, this may still preclude some companies from restructuring and could result in significant tax costs. Providing the 40% transition relief to all companies in their first year of applicability of the EIFEL rules could help mitigate some of the tax costs.

Recommendation #3: Provide 40% transition relief for taxpayers in their first year of EIFEL applicability. (e.g., based on current effective date, the 40% limitation rate should apply for all taxation years beginning on or after October 1, 2023, and begin on or before September 30, 2024).

2. *Anti-Avoidance*

The EIFEL rules contain a series of broadly drafted provisions intended to target transactions that would reduce a taxpayer's interest or financing expense, increase a taxpayer's interest and financing revenue, and prevent manipulation of group status or the definition of excluded entity. TEI has significant concerns with the overly broad nature of the anti-avoidance provisions as they make it extremely difficult for taxpayers, and the CRA, to delineate between acceptable planning undertaken to comply with the rules and planning designed to inappropriately circumvent the rules. In our view, legitimate commercial transactions should be respected under the EIFEL rules unless there is an abusive element inherent in the planning.

Recommendation #4: More examples should be included in the Explanatory Notes to provide guidance to taxpayers on acceptable planning to comply with the rules and unacceptable planning to circumvent the rules.

3. *The Group Ratio*

New Act section 18.21 provides the "group ratio" rules. When the conditions of new subsection 18.21(2) are met, the Canadian members of a group of corporations and/or trusts can jointly elect into the group ratio rules for a taxation year.

One of the conditions in subsection 18.21(2) is that the consolidated financial statements of the group be audited financial statements. "Consolidated financial statements" is defined in subsection 18.21(1) as "financial statements prepared in accordance with a relevant acceptable accounting standard in which the assets, liabilities, income, expenses and cash flows of two or more entities are presented as those of a single economic entity and, for greater certainty, the financial statements include the notes to the financial statements".

"Consolidated group" is defined in subsection 18.21(1) as "two or more entities (each referred to in this section as a "member of the consolidated group"), including an ultimate parent, in respect of which consolidated financial statements are required to be prepared for financial reporting purposes or that would be so required if the entities were subject to International Financial Reporting Standards. For these purposes, an equity-accounted entity is not considered to be a member of the consolidated group."

"Ultimate parent" is defined in subsection 18.21(1) as "a particular entity if (a) the particular entity is not His Majesty in right of Canada, His Majesty in right of a province or an entity referred to in any of paragraphs 149(1)(c) to (d.6); (b) it holds directly or indirectly an interest in one or more other entities in respect of which it is required to prepare consolidated financial statements for financial reporting purposes, or would be so required if it was subject to International Financial Reporting Standards; and (c) no entity (other than an entity described in paragraph (a)) holds, directly or indirectly, in the particular entity an interest that is described in paragraph (b)."

The definition of "consolidated financial statements" refers to "relevant acceptable accounting standard" which includes both International Financial Reporting Standards ("IFRS") and Generally Accepted Accounting Standards ("GAAP"). However, the definitions of "consolidated group" and "ultimate parent" only refer to IFRS. The discrepancy of the accounting standards in different definitions creates uncertainties for taxpayers attempting to comply with the legislation.

In particular, a privately parented corporation holding directly or indirectly controlling interests in one or more other entities, including publicly listed entities, would need to prepare audited consolidated financial statements under IFRS. Otherwise, the public entities would be unable to access the group ratio regime.

This requirement imposes disparate tax results for entities in the group. Because the group ratio would be calculated at the private parent company level, the operations and activities of private corporations would impact (favorably or unfavorably) the group ratio available to the public entities. This result may deviate from the intended policy when there are public entities in the group with different business lines and different public investors.

In addition, this requirement creates significant financial costs and administrative burdens for the private parent corporation given that the public entities in the group already prepare audited consolidated financial statements, as required for public reporting purposes. A private corporation is not required to prepare audited consolidated financial statements.

Further, the requirement to prepare IFRS financial statements imposes challenging time constraints for all the entities in the group. The public entities in the group must release audited consolidated financial statements of their own group within certain time parameters. However, without audited consolidated financial statements for the entire group (including private corporations), the public entities cannot properly calculate the group ratio and therefore the denied interest and financing expenses, which must be presented as part of the public entities' group audited financial statements. This time constraint is even more challenging for public trusts or partnerships because such entities must comply with Regulation 204.1(2) to report the tax breakdown of distributions to the public 60 days after the end of the previous taxation year.

Recommendation #5: If there are public entities in a group, the ultimate parent entity should be defined to be the highest public entity in the chain that is required to prepare audited consolidated financial statements under IFRS. We would be pleased to provide drafting suggestions in this regard. With this recommendation:

(i) Public entities can use their audited consolidated financial statements already required under IFRS for purposes of public reporting;

(ii) Undue time and financial constraints arising from the preparation and audit of additional consolidated financial statements can be avoided; and

(iii) Operations and activities of private corporations will not impact a public entity's group ratio.

4. *Transfers of Capacity Under Paragraph 18.2(4)(e)*

The Joint Committee on Taxation of The Canadian Bar Association and Chartered Professional Accountants of Canada, in its May 5, 2022, letter to Finance, noted on page 36 that pursuant to paragraph 18.2(4)(e):

> [a]ll of the transferor's transfers for a taxation year are invalid if the total of the transferred capacity amounts designated by the transferor in elections for the year exceeds its cumulative unused excess capacity for the year. As a consequence, all of the amounts of received capacity otherwise accruing to the transferees under those elections would be nullified. This would be the case even if the excess is a nominal amount.[4]

If an amount is denied, a taxpayer can amend an election. However, the right is subject to discretion on the part of the CRA to determine that the transferor and transferee made reasonable efforts to determine amounts, the election was filed as soon as circumstances permit, and the circumstances are such that it is just and equitable.

We suggest instead a model based on paragraph 55(5)(f) that would deem an existing election to be reduced automatically to the amount of the cumulative unused excess capacity for the year; or to allow for multiple elections to be filed sequentially and those that are in excess would be denied (like the former practice for paying multiple safe income dividends) unless the taxpayer satisfies the reasonable efforts requirement in respect of those excess amounts which are denied.

Recommendation 6: Amend paragraph 18.2(4)(e) to allow for an existing election to be reduced automatically to the amount of the cumulative unused excess capacity for the year; or to allow for multiple elections to be filed sequentially and those that are in excess would be denied unless the taxpayer satisfies the reasonable efforts requirement in respect of those excess amounts which are denied.

• • •

TEI appreciates to opportunity to, once again, provides its comments on the EIFEL ules and would be pleased to discuss our comments with Finance officials. TEI's comments were prepared under the aegis of its Canadian Income Tax Committee, whose Chair is Steve Saunders of ATCO. Should you

---

[4] The Committee's letter is *available at* file:///C:/Users/BenjaminRShreck/Downloads/01119-TX_May%202022_Joint%20Committee%20-%20EIFEL%20Submission%20(1).pdf.

have any question regarding TEI's comments, please do not hesitate to reach out to Mr. Saunders at Steve.Saunders@atco.com or Benjamin R. Shreck of TEI's legal staff at bshreck@tei.org or 202.464.8353.

Respectfully submitted,

Sandhya Edupuganty

Sandhya Edupuganty
International President
TAX EXECUTIVES INSTITUTE