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September 28, 2018

Sales Tax Division
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Via Email: fin.gsthst2018-tpstvh2018.fin@canada.ca

Re: Consultation Concerning the GST/HST Holding Corporation Rules

Dear Sir or Madam:

On behalf of Tax Executives Institute (TEI), we write to respond to the *Consultation Concerning the GST/HST Holding Corporation Rules (Consultation)* released by the Department of Finance (Finance) on July 27, 2018, which solicits feedback on the *Legislative and Regulatory Proposals Relating to the Excise Tax Act, the Excise Act, 2001 and the Air Travelers Security Charge Act (Proposed Legislation)*. TEI appreciates the opportunity to provide feedback on the Proposed Legislation and questions raised in the Consultation and welcomes the opportunity to meet with you to discuss these comments.

About Tax Executives Institute, Inc.

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organization has 57 chapters in Europe, North and South America, and Asia, including four chapters in Canada. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, and the fair and efficient administration of the tax laws, at all levels of government. Our nearly 7,000 individual members represent over 2,800 of the leading companies in the world. Approximately 15 percent of TEI's members are resident in Canada and many of our non-Canadian members' companies do business in Canada.

Comments on Proposed Legislative Changes to Section 186

Section 186 of the Excise Tax Act (ETA) currently permits corporations related to a subsidiary involved exclusively in commercial activities to claim

input tax credits (“ITCs”) for tax paid on costs reasonably regarded as consumed or used in relation to the holding of the shares or indebtedness of the subsidiary. TEI views this rule as a “look-through” provision recognizing businesses should be able to fully recover GST/HST paid with respect to an exclusively commercial activity, regardless of the structure of the organization. Businesses operating via a parent-subsidiary relationship should not be penalized because of their business structure and should be permitted to claim the same ITCs they could claim if they operated as a single corporate legal entity.

A. Proposed Purpose Test

The Proposed Legislation would require the parent corporation to meet certain conditions regarding the purpose for which the property or service was acquired, in addition to meeting the current requirement that the subsidiary be involved exclusively in commercial activities. This change would create unfairness because the ability to claim ITCs might depend on how businesses are structured.

For example, if a single entity acquired a property or service, and it was involved exclusively in commercial activities, section 169 (when read with section 185) would allow the entity to recover 100% of the GST/HST paid in relation to property and services acquired for consumption, use, or supply in its commercial activities. Under the Proposed Legislation, parent corporations might not be entitled to claim the same ITCs a single entity could claim. For example, under the Proposed Legislation, a parent corporation might not be entitled to claim ITCs for accounting, audit fees, or board of director’s expenses paid on behalf of its subsidiaries even though the only purpose of the parent corporation is to hold the shares or indebtedness of its subsidiaries. TEI members’ experience and the Canada Revenue Agency (CRA) audit positions in the Meidzi Copper and Stantec Inc tax court cases support this concern.

Further, it is unclear when (or if) the parent corporation may claim ITCs on GST/HST paid for property or services acquired or imported in month one when funds are raised for a large project and the funds may be spent over several months or years. It is also not clear whether the purpose or intent of the funds for the underlying expense must be evidenced when the ITC is claimed or whether adjustments are required after the fact if the intent changes.

For all of the above reasons, TEI does not support the changes in the Proposed Legislation and recommends that section remain intact.

B. Proposed Change of “Related” to “Closely Related”

Section 186 currently requires a parent corporation to be “related” to a subsidiary to claim the ITCs mentioned above, which generally requires 50 percent common ownership among the corporations. The Consultation requests feedback on replacing the “related” requirement with the requirement that the parent corporation and subsidiary be “closely related,” which would require 90 percent common ownership among the corporations.

Corporations are created to carry on specific activities for many commercial and legal reasons. Corporations holding over 50 percent common ownership in a subsidiary are generally actively involved in their subsidiary's business and do not merely hold the subsidiary to earn investment income but to generate growth for shareholders. It is widely accepted that a parent corporation can influence how an operating corporation carries on its affairs when it has over 50 percent control of the operating corporation's voting shares. The current version of section 186 thus makes sense because a parent corporation with over 50 percent common ownership is likely the shareholder responsible for acquiring properties or services that relate to the shares of a subsidiary operating corporation and therefore should be entitled to recover GST/HST paid on the property or service acquired.

Increasing the common ownership threshold from "related" to "closely related" would significantly impair a parent corporation's ability to fully recover GST/HST if it creates a subsidiary with a third party to conduct business operations. The proposed change would be, in effect, a new tax and expense upon entities employing such structures (including parent and operating corporations exclusively involved in commercial activities) and which currently rely upon the current holding corporation rules of section 186. The Proposed Legislation would thus eliminate corporations as a means for third parties to work collectively, force third parties to create joint ventures or partnerships to work together, and effectively limit the use of corporations to internal structures.

The Consultation indicates that part of the rationale for this proposed change is that using "related" results in an inappropriate policy outcome because shareholders with less than 50 common ownership are not entitled to claim ITCs. However, "related" shareholders typically have more risk and are more actively involved when incurring the type of expenses for which section 186 currently permits recovery of ITCs relative to minority shareholders. Requiring entities to be "closely related" would further restrict ITCs available to parent corporations because all shareholders holding over 50 but less than 90 percent common ownership could no longer claim previously claimable ITCs. The proposed change would thus negatively affect parent corporations whose sole purpose is to hold shares or indebtedness of operating corporations but fail to meet this new ownership test. TEI maintains that a reduction of the common ownership threshold from the current "related" party level would more successfully address the intended policy outcome.

Accordingly, TEI does not support the amendment of section 186 to require that a parent corporation and subsidiary be "closely related."

C. Passive Holding Companies

The Proposed Legislation also contains language in proposed subsection 186(0.1) (1)(c) that appears to restrict certain ITCs to parent corporations that are passive holding companies. TEI maintains that the holding company rules of section 186 should equally apply to parent corporations with commercial activities of their own for which they own and use significant

assets to make taxable supplies. There is no principled basis for denying ITCs to parent corporations conducting commercial activities.

D. Addition of Partnerships and Trusts

The Consultation also seeks feedback on whether the Ministry should expand the holding corporation rules of section 186 to partnerships and trusts.

Corporations and partnerships are the two primary vehicles through which more complex organizations carry out business in Canada. Partnership structures allow businesses to segregate the financial reporting and operations of various business units while reducing the burdens of corporate income tax compliance. The ETA should not penalize partnership structures by limiting their entitlement to ITCs, particularly where partnerships are exclusively engaged in commercial activities.

TEI maintains that Finance can develop rules to determine whether partnerships, trusts, and their owners are “related” based upon their partnership interest. TEI also maintains there is no principled basis for treating these entities differently under section 186.

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TEI’s comments were prepared under the aegis of TEI’s Canadian Commodity Tax Committee, whose chair is Chantal Groulx and whose legal staff liaison is Pilar Mata. If you have questions about our recommendations, please call Ms. Groulx at (514) 399-7877 or email her at chantal.groulx@cn.ca.

Respectfully submitted,

Tax Executives Institute



James P. Silvestri
International President