
TAX EXECUTIVES INSTITUTE, INC.
on
PENDING CANADIAN INCOME TAX ISSUES
Submitted to
THE DEPARTMENT OF FINANCE
NOVEMBER 18, 2015

Tax Executives Institute welcomes the opportunity to present the following comments and questions on income tax issues, which will be discussed with representatives of the Department of Finance during the November 18, 2015 liaison meeting. If you have any questions about the agenda in advance of the meeting, please do not hesitate to call Lynn Moen, TEI's Vice President for Canadian Affairs, at 403.232.6430, or Grant L. Lee, Chair of the Institute's Canadian Income Tax Committee, at 604.641.2502.

A. Legislative Update and Tax Policy Discussion

1. *Legislative Agenda*

TEI invites an update on the Department of Finance's (hereinafter "Department") legislative priorities over the coming months. TEI is generally supportive of the Department's proposal to reduce the compliance burden for taxpayers by developing rules to transition eligible capital property into a new Cost Allowance Class. Would the Department provide an update on the progress of this initiative?

ANSWER: TEI representatives and officials of the Department of Finance (Department) discussed priorities.

2. *Tax Policy*

The 2015 Budget contains the following statement about BEPS:

The Government will proceed in this area in a manner that balances tax integrity and fairness with the competitiveness of Canada's tax system. Improving business tax fairness and competitiveness has been a central element of the Government's approach to fostering an environment in which businesses can

thrive and compete in a global economy. Taxes are one of the main factors that drive investment decisions and the Government is committed to maintaining Canada's advantage as an attractive destination for business investment.

TEI invites a discussion of the Department's current views on the direction of Canadian tax policy in general, with a particular emphasis on the Canadian perspective on the OECD's BEPS initiative. What are the top three priorities from a Canadian perspective? In what areas should we be expecting legislation? What opportunities will there be for public consultation? What areas will be left aside for now?

What is the timeline for implementing country-by-country reporting and transfer-pricing documentation, as required by OECD BEPS Action 13? Will these requirements involve a change in law or administrative guidance? What is the expected timing for such changes? What are the expected lead times in such changes? What are the Department's plans to keep private information submitted pursuant to BEPS Action 13? Will information exchanges be regulated exclusively by the existing treaty network with its existing safeguards? Will the Department request information beyond what OECD BEPS Action 13 requires? Will the Department eliminate any existing disclosure requirements, such as Forms T1134 and T106?

ANSWER: TEI representatives and Department officials discussed the Department's perspective on the above matters.

B. Carryover Matters

1. Statute of Limitation: Loss Years

TEI recommended at the 2013 liaison meeting in its Question 7 that the Department consider amending the Income Tax Act to require the CRA to make initial determinations of losses for a taxation year at the same time and in the same manner as that year's initial determination of income. The Department responded that if the interpretation of subsection 152(1.1) does not allow this, it would consider amending the Act.

TEI followed up on this question with the CRA in 2014 (Question E.1). The CRA responded that it cannot issue a loss determination based solely on a taxpayer's request when the taxpayer files its return. The CRA's response to this question, as taken from *2014 TEI Liaison Meeting, Q.E1*, document number 2014-0550351C6 (Nov. 18, 2014) is listed below the following paragraph.

We recommend the Department amend the Income Tax Act to require the CRA to make initial determinations of loss for a taxation year at the same time and in the same manner as the initial determination of income for that year.

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PRINCIPAL ISSUES: Whether the Minister may issue a loss determination under subsection 152(1.1) at the time of filing the income tax return if the Minister accepts the return as filed

POSITION: No.

REASONS: Subsection 152(1.1) requires that the Minister ascertain that the loss is different from the loss reported by the taxpayer on its return of income.

2014 TEI-CRA Liaison Meeting

November 18, 2014

Question E1 – Statute of limitations: Loss Years

...

Is the CRA prepared to issue a determination of loss to a taxpayer who requests one upon the filing of its return?

Response:

Subsection 152(1.1) of the Act provides that two conditions must be satisfied for the Minister to issue a notice of loss determination.

These conditions are:

- (a) the Minister ascertains the amount of a taxpayer's non-capital loss for a taxation year to be an amount that differs from the one reported in the taxpayer's income tax return; and
- (b) the taxpayer requests that the Minister determine the amount of the loss.

When a taxpayer files its return of income and the Minister accepts the return as filed, the amount of the taxpayer's loss has not been "ascertained" by the Minister in an amount that differs from the one reported in the return. Therefore the first condition required for a loss determination is not met, and the Minister

cannot issue a loss determination upon the request of the taxpayer at the time of filing its return of income.

We note that this interpretation has been confirmed by the courts. The Act would need to be amended in order to require the Minister to issue a notice of loss determination where a taxpayer requested one at the time of filing its return of income.

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ANSWER: The Department is not prepared to recommend an amendment of this nature at this time as this would be a significant departure and would create an administrative burden on the CRA.

2. *Subsection 15(2.1) Partnerships*

What is the status of the Department's deliberations on and the development of legislation that would relieve concerns of overbreadth in defining who is considered connected with a corporation's shareholder in regard to subsection 15(2.1)?

In 2012 we asked the following question (Question 10) to the Department:

* * *

On October 31, 2011, the Department of Finance released an amendment to section 15(2.1) to include partnerships when determining who is considered connected with a shareholder of a particular corporation. The Explanatory Notes state that this clarification of subsection 15(2) will ensure that partnerships are included in the shareholder debt provisions.

Regrettably, the proposed legislation could produce harsh results for a partnership where the general partner (or a related party of that general partner) funds some of the expenses of a partnership that are widely held by arm's length limited partners. Under such circumstances, the general partner (or its related party) likely will not be dealing at arm's length with the partnership and the partnership would be considered "connected" with the shareholder of the general partner. Consequently, the loan to the partnership would be included in the partnership's income. This seems a harsh, though perhaps unintended, effect of the revision since the loan to the partnership does not create a benefit to the general partner or its shareholders. Indeed, the loan is benefitting

the arm's length limited partners since they are not required to fund the partnership.

While we agree that a related partnership (or partnership of related persons and entities) should be subject to the rules in subsection 15(2), we recommend removing the reference to "arm's length" in subsection 15(2.1) and replacing the term with a more specific description of the relationship between the partnership and the shareholder. Where a widely held partnership is involved, a test based on "relatedness" or ownership (in terms of the percentage of partnership units) may be more appropriate. We invite the Department's views on TEI's recommendation.

The Department answered (Answer 10) as follows:

The Department agrees that the policy intent of subsection 15(2.1) is not to capture the situation described but if other partners are connected to the shareholder of the General Partner, even if a small percentage, then it should be caught. This is not the only situation that has been brought to the Department's attention. Consideration is being given to all situations raised and whether to recommend appropriate relief in a future technical release.

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ANSWER: The Department indicated its intention to address this issue to TEI in 2012 and indicated again its intention to address this issue in a Comfort Letter [2013-05-02] issued in May 2013. The Department confirms that it remains its intention to address this issue in a future technical bill. However, the Department is unable to specify timing.

3. *Deemed Stock Option Benefit on Death*

Does the Department plan to amend Income Tax Act paragraph 110(1)(d) to reflect the CRA's newly permitting a tax deduction when a deemed stock-option benefit results from the application of paragraph 7(1)(e)?

In 2013 we stated in Question 6 to the Department that when an employee holds unexercised stock options at the time of death, paragraph 7(1)(e) deems the employee to have received an employment benefit in the year of death equal to the stock options' value at the time of the employee's death over the amount the employee paid for those options. When options provide that they automatically cancel upon an employee's death, they become worthless and add nothing to the deceased's income under paragraph 7(1)(e). However, when options provide that the estate may exercise them for a limited time period after the employee's death, paragraph 7(1)(e) may result in an income inclusion for the employee.

To claim the stock-option deduction, paragraph 110(1)(d) requires that the employee acquired the securities under a stock-option agreement. The CRA stated in documents 2011-0423441E5 and 2009-0327221I7 that a deduction under paragraph 110(1)(d) could not be claimed where the taxable benefit is deemed to have been received by the deceased employee under paragraph 7(1)(e), even if the deceased's estate or a beneficiary of the estate subsequently exercised the option and acquired the securities.

The Department responded in 2013 that it was aware of CRA's interpretation and had discussed it with them. The Department noted the situation may be an unintended consequence and was investigating an appropriate fix, while inviting taxpayers to contact it with requests for temporary relief.

In 2015 the CRA reversed its position listed above (see documents 2013-0484181E5 and 2013-0483471E5) to allow an employer to make an election under subsection 110(1.1) so the deceased employee's estate can claim the deduction under subparagraph 110(1)(d), provided the remaining conditions under paragraph 110(1)(d) are met. We understand the CRA will now administratively allow such a deduction under paragraph 110(1)(d) for a deemed stock option benefit arising under paragraph 7(1)(e) on the death of an employee where the employee's estate makes an election under subsection 110(1.1) to forgo the deduction.

ANSWER: It is the Department's intention to amend paragraph 110(1)(d) to allow a deduction for a deemed stock option benefit arising under paragraph 7(1)(e) on the death of an employee where the employee's estate makes an election under subsection 110(1.1) to forgo the deduction. In 2010, it was not the intention of the Department to remove this 110(1)(d) deduction.

C. New Matters

1. *Section 55*

TEI submitted on October 12, 2015 a comment letter regarding the Department's proposed revisions to Income Tax Act section 55 and we invite a discussion on that letter. We understand the Department has heard many concerns about these proposed revisions. Will the Department re-include into paragraph 55(3)(a) dividends effecting routine cash movements within a corporate group or otherwise exclude such dividends from proposed subparagraph 55(2.1)(b)(ii)? If not, would the Department explain its reasoning? If the Department does not intend to change the proposed revisions to section 55, would the Department provide comfort for the record about these concerns?

Ordinary commercial structures typically include a parent corporation with a number of subsidiaries and sub-subsidiaries, both domestic and foreign. A common and prudent cash-management practice is to move and manage cash within such a corporate group by paying intercorporate ordinary dividends.

Historically, Canadian companies could confidently pay a Canada-to-Canada intercorporate dividend knowing the dividend would not be taxed if truly part of an “intra-group” transaction, relying on the subsection 55(3) exception. Canadian companies could also rely on the “safe income” exception for this purpose. However, the safe-income exception is complex and generally uncertain, in large part because of the lengthy history of many Canadian subsidiaries, as well as case-law and enforcement-policy ambiguities surrounding the calculation of safe income. Canadian corporations typically have not needed to and therefore have not incurred the excessive time and expense required to determine a safe-income balance to support an ordinary intercorporate dividend.

Under the revisions to section 55 released on July 31, 2015, ordinary-course dividends paid within a corporate group are no longer protected by subsection 55(3)(a), which would only apply to share redemptions. Under the new rules, subsection 55(2) would apply if one of the purposes of the dividend is to reduce a capital gain or to reduce the fair-market value of a share, and the taxpayer is unable to establish that the dividend is attributable to safe income.

We have heard informally that the proposed revisions to the rules are not intended to require share reorganizations followed by share redemptions in the place of ordinary-course dividends. We have also heard that the proposed revisions are not intended to tax intra-group ordinary-course dividends that cannot be shown to derive from safe income. However, we remain concerned that, because all dividends result in a reduction of the fair-market value of shares and may increase the cost of property, the proposed revisions may tax ordinary-course dividends on the basis that every dividend has a tainted purpose. Taxpayers are now curtailing previously allowed internal fund movements for fear of not meeting the purpose test included in the proposed revisions, even though such fund movements are simply intended to be ordinary-course dividends.

ANSWER: The rules as proposed are intended to maintain the integrity over the taxation of capital gains. The fact that the result of each dividend may be to reduce the fair value of the payer’s shares and increase the value of the recipient’s cost of property should not taint the purpose of a dividend, as it is the purpose that matters and not the result. Public Co dividends, for example, will continue to be considered ordinary-course and are not in the purview of proposed subsection 55(2), but other dividends must be tested. Taxpayers can rely on safe income if they are uncertain as to when to apply the purpose test. The rule is not intended to be a results-based test. Alternatives to immediate taxation, such as a reduction to the adjusted cost base (ACB) are not considered viable options and a higher threshold than “one of the purposes,” such as one of the principle purposes will not be considered because of the results of court cases that were unfavorable to CRA.

2. *Regulation 102*

TEI also submitted on October 12, 2015 a comment letter regarding the Department’s proposed revisions to Regulation 102 and we invite a discussion on that letter. This comment letter followed up on another comment letter we submitted on June 12, 2015 regarding similar proposed revisions. We appreciate the improvements made to the proposed revisions to Regulation 102 since that first letter. We believe, however, the Department should make two

additional important changes to the proposed revisions: (i) removing the requirement to obtain certification from the CRA, instead allowing for self-certification, and (ii) eliminating the \$10,000 threshold for a T4 reporting exemption.

Regarding self-certification, non-resident employers must obtain advance certification from the CRA to be a “qualifying non-resident employer.” TEI believes this requirement should be eliminated, and the legislation should permit employers meeting the criteria set out in paragraph (a) of the definition of “qualifying non-resident employer” to self-certify, provided they notify the CRA in writing within a reasonable period following the end of their tax year. Such notification should simply require the qualifying non-resident employer to indicate its name, address, a contact person, and a list of the employer’s qualifying non-resident employees along with their countries of residence and number of days worked or present in Canada during the relevant year or period, as applicable. The CRA should not require employers to provide this information on a prescribed form, because a self-certification would provide the CRA with enough detail to request additional information if necessary and would reduce the compliance burden for both the CRA and qualifying non-resident employers.

Regarding the \$10,000 threshold for T4 reporting, under the proposed revisions, a “qualifying non-resident employer” would have to determine which of its employees qualify as “qualifying non-resident employee[s]” for the employer to be exempt from Regulation 102’s withholding and remitting requirements for those employees. However, to be exempt from T4 reporting of such employees, the employer must also determine whether each employee’s taxable income earned in Canada exceeds \$10,000. We emphasize an employer can pay an employee many forms of remuneration beyond simply salary and wages, such as pensions and medical benefits, all of which must be factored into determining whether an employee earned more than \$10,000 in taxable income. Additionally, employers might have to make this calculation several times throughout a year. This additional \$10,000-threshold test seems unwarranted in light of the proposed legislation’s objectives. To reduce the administrative burden associated with these non-resident employees, we believe the Department should streamline the proposed revisions so the T4 reporting exemption automatically applies for any qualifying non-resident employee.

ANSWER: Certification will be required. However it will be a short form containing a minimal amount of information and will not be overly burdensome. The objectives of the certification and T4 reporting obligations are to (1) ensure compliance and (2) provide the information necessary to develop good tax policy on a go-forward basis. The Department committed to balancing the needs of the taxpayers and the CRA and want to get it right rather than developing a set of rules that may reduce the red tape but lead to gaps.

3. *Functional Currency Reporting Rules*

Has the Department met with the CRA on whether Income Tax Act sections 261(20) and 261(21) should exclude bona fide business transactions? If so, what were the results of that discussion? The technical notes to subsections 261(20) and 261(21), which involve the

functional-currency tax, state they are intended to prevent abuses of the functional-currency tax reporting regime. We previously recommended exceptions to these subsections for bona fide business transactions. In response to question 1(d) in the 2013 liaison meeting, the Department acknowledged that rules may sometimes work in unintended ways and that it might meet with the CRA to determine whether the two subsections should include a business-purpose test. The Department also referenced legislation proposed on July 12, 2013, which addresses the timing of the foreign-currency election but not a business-purpose issue.

The following scenario demonstrates our concern on this issue:

- a. CANCO 1, a USD-functional currency entity resident in Canada makes a CAD-denominated loan (the “CAD Loan”) to a related CANCO 2, a CAD-functional currency entity resident in Canada. CANCO 2 uses the CAD Loan to fund its working capital.
- b. CANCO 1 hedges the CAD Loan for foreign-currency fluctuations (the “Hedge”) to avoid unwanted volatility in its Income Statement, because such currency fluctuations will be reported in the consolidated income statement and equity of the CANCO Group.
- c. CANCO 1 realizes a foreign-currency loss on the CAD Loan (the “FX Loss”) and an offsetting Hedge gain (the “Hedge Gain”) due to changes in the foreign-exchange rate.
- d. The FX Loss is denied pursuant to subsections 261(20) and 261(21).
- e. The Hedge Gain is taxed.

This is a common scenario. Canadian entities often have multiple businesses in Canada, some of which might be USD-functional and some of which might be CAD-functional. Transactions occur between them for business reasons, which requires these types of offsetting hedging to simply remove currency risk. Such transactions do not involve tax planning.

In light of this business purpose, would the Department consider the following?:

- a. Allowing a tax loss on the FX Loss when there is an offsetting related gain, such as the Hedge Gain? This would be similar to the treatment of a foreign-exchange loss on the disposition of foreign-affiliate shares, pursuant to paragraph 93(2.01)(b), where this loss is denied unless there is a realized offsetting foreign-exchange gain on repayment of debt issued in the acquisition of the foreign-affiliate shares, or

- b. Not taxing the Hedge Gain if it relates to the FX Loss in a fashion similar to the operation of paragraph 95(2)(g.01) as it relates to foreign currency losses described in paragraph 95(2)(g).

ANSWER: The Department works closely with CRA and Rulings on many matters and have had discussions on subsection 260(20) and (21). The Department view is that the functional currency regime is an accommodating regime and is not intended to facilitate or provide beneficial tax-planning opportunities. Therefore any requests to amend the above anti-avoidance provisions must be closely scrutinized and evaluated by the Department. The Department suggested that issues with the existing set of rules can be resolved with administrative solutions through discussions with CRA rather than through legislative changes. Certain TEI members stated that their experience was that CRA would not entertain resolution of this matter without legislative changes. At this time, the Department has no intention to introduce a “purpose” test for the anti-avoidance rules to apply but will continue to monitor the situation. The Department did indicate that they would consider a fuller submission by TEI on the specific matter highlighted but would require in-depth analysis before considering an amendment to the above anti-avoidance rule, including related parties involvements, rationale for the transaction, etc.

4. *Subsection 17(8)*

Would the Department consider the following proposed revisions to Income Tax Act subsection 17(8), which makes an exception to subsection 17(1) by not taxing a below-market interest rate loan to controlled foreign affiliates if the amount owing “arose as a loan or advance of money to the affiliate that the affiliate has used [for a qualifying purpose] throughout the period that began when the loan or advance was made....”:

- a. Allowing “amounts payable for property” to enjoy the same exempt treatment as “a loan or advance of money”?

The CRA has opined that a “loan,” as used in subsection 17(8) and quoted above, can only be created by a transfer of cash to a debtor obligated to repay the loan. However, a “loan” for this purpose is not created by an amount payable for property acquired even when the property acquired is a loan complying with all the requirements of subsection 17(8). While we agree the CRA has interpreted the law accurately, we believe subsection 17(8) could include the concept of “amounts payable for property” together with “loans and advances” in the fashion of clause 95(2)(a)(ii)(D).

- b. Allowing a lender time to cure the condition that the loan be for a qualifying purpose upon being made.

Currently under 17(8), a loan that is not made for a qualifying purpose at the outset will never qualify. For example, Parent funds affiliated Subco with a non-interest-bearing loan so that Subco can make the same loan to Target immediately before Subco buys Target’s shares.

The non-interest-bearing loan in this example does not benefit from subsection 17(8) treatment, because Subco did not control Target when Subco made the loan to Target. We believe that a taxpayer should be able to avail itself of subsection 17(8) once the defect is cured, in this example when Subco has acquired the Target shares. Again, this treatment would be in the fashion of clause 95(2)(a)(ii)(D).

ANSWER: This subsection has been in the Act for a number of years, and taxpayers seem to have been able to structure their transactions without the need for a legislative change. The Department does not believe that the example included in the TEI question is sufficiently detailed and therefore compelling enough for the Department to consider the need for an amendment, but would entertain more detailed examples that would include specific reasons or rationale of why a taxpayer could not comply with the existing rules.

5. *Partnership Rollover*

Would the Department consider amending the partnership tax-deferral rules so partnerships terminating upon the amalgamation of its corporate partners are treated similarly to partnerships terminating with the liquidation of one of its partners or to partnerships terminating by a distribution termination?

In the current economic environment, corporate partners might wish to streamline their organizational structures by terminating partnerships within a corporate group. This might happen in partnerships formed between a parent corporation and its wholly-owned subsidiary, or between two subsidiary corporations wholly owned by the same parent that combines the partners so that their operations continue under one consolidated entity.

Legally, there are three different ways to achieve this result:

a. *Amalgamation*

In an amalgamation, two or more corporate partners combine to form a legal entity, thereby terminating the partnership by operation of law because there are no longer two or more partners.

b. *Liquidation*

In a liquidation, a parent corporation that has partnered with its wholly-owned subsidiary winds up the wholly-owned subsidiary, thereby terminating the partnership by operation of law because there are no longer two or more partners.

c. Distributing Termination

In a distributing partnership, the partnership is terminated by agreement, its assets are distributed to the partners in proportionate undivided interests, and the two partners then combine to form a legal entity.

The most direct and simplest way to terminate a partnership within a corporate group is by amalgamation, because it involves continuity of asset-ownership and liabilities of the two corporate partners. The former partnership's assets and liabilities belong to the successor corporation by operation of law without additional conveyance. The former partnership's legal agreements and proceedings also remain with the successor corporation.

In contrast, both a liquidation and a distributing termination require asset conveyance. In a liquidation, all assets of the wholly-owned subsidiary partner are distributed to the parent partner prior to dissolution. In a distributing termination, the assets of the internal partnership are conveyed in proportionate undivided interests, and there is no continuity of legal agreements or legal proceedings. In some circumstances, the need to convey assets or assign legal agreements or proceedings can have serious business repercussions or be prohibitive.

Income Tax Act subsections 98(3) and 98(5) allow for partnership termination on a tax-deferred basis. Subsection 98(5) provides an automatic rollover where one pre-termination partner continues to operate the business of the partnership within three months after the termination. Subsection 98(3) provides an elective rollover where all of the property of the partnership is distributed to all pre-termination partners in undivided interests immediately before the partnership termination. Subsection 98(5) of the Act would generally apply to a liquidation, and subsection 98(3) can apply, upon election, to a distributing termination.

However, the CRA's folio *Income Tax Folio: S4-F7-C1 – Amalgamations of Canadian Corporations* makes clear an amalgamation does not result in the same tax deferral. It states in part the following:

* * *

1.43 No particular tax problems result where as a matter of law a Canadian partnership continues to exist following an amalgamation involving one or more of its corporate partners. However, where a Canadian partnership ceases to exist because of an amalgamation involving one or more of the corporate partners:

- subsection 98(5) will not be applicable to provide a rollover where the new corporation will carry on the business of the former partnership and

- subsection 98(6) will not be applicable to provide a rollover where a new partnership is formed having the new corporation as one of its partners.

This problem can generally be avoided by having the partnership dissolve prior to the amalgamation with each partner receiving undivided interests or for civil law, undivided rights (referred to in this paragraph as **undivided interests or rights**) in the partnership property so as to be eligible for the rollover under subsection 98(3). Those former partners that then amalgamate would have their undivided interests or rights in the various properties combined in the new corporation with the benefit of the various rollovers provided in subsection 87(2). Where it is proposed that the new corporation enter into a Canadian partnership, the rollover provided in subsection 97(2) may be available.

* * *

In essence, achieving the same legal, streamlined result directly – by amalgamation – results in more onerous tax consequences than achieving it indirectly – by liquidation or by distributing termination. Furthermore, streamlining by liquidation or a distributing termination is often impossible, or is possible but unduly onerous.

Assume for example parent company A (ACo) owns subsidiary B (BCo), which in turn owns subsidiary C (CCo). BCo and CCo are partners in a general partnership X. CCo operates a wholesale business with three locations in Alberta, Ontario, and British Columbia. X operates a retail business with hundreds of locations throughout Canada. In the interest of streamlining its organizational structure, ACo wishes to consolidate all operations under one subsidiary entity. These are the options available to ACo for accomplishing this objective:

- b. By amalgamation of BCo and CCo

In such an amalgamation, the CCo wholesale business and the X retail business of X would become the businesses of the amalgamated BCo by operation of law. However, the termination of X would be a taxable event because neither subsections 98(3) or 98(5) would apply.

- c. By liquidating CCo into BCo

In such a liquidation, X is terminated upon dissolution. Subsection 98(5) of the Act would apply, thus allowing for tax deferral, but CCo's wholesale business and its partnership interest in X would have to be legally conveyed to BCo. If any rights of first refusal exist, this

conveyance may inadvertently trigger such rights. Furthermore, if CCo is involved in any legal proceedings, a liquidation of CCo may not be possible.

d. Distributing termination of X

In such a distributing termination, X is terminated and its retail business is distributed to BCo and CCo in proportionate undivided interests so an election under subsection 98(3) is available. However, similar to a liquidation, this would involve the transfer of all assets, agreements, leases, licenses, permits, and, where real property is owned by X, transferring registered ownership at the local land titles office. Given the nature of X's retail business, the volume of this could be so overwhelming and administratively burdensome that it becomes prohibitive.

This disparate tax treatment of amalgamation compared to liquidation or distributing termination appears to be an unintended result. Would the Department consider amending the tax-deferral rules to extend the application of subsection 98(5) to partnerships terminating by operation of law as a result of the amalgamation of their corporate partners? This could be achieved with a provision that would deem, for the purposes of subsection 98(5), the amalgamated corporation to be one, but not more than one person, who was a member of the partnership immediately prior to its termination by amalgamation.

ANSWER: The Department's concern is that the parties would need to do their due diligence to ensure other provisions are not detrimentally impacted. AS this was a very specific and unique issue, the Department thought that taxpayers should be able to do some "self help" by structuring and planning the partnership terminations more effectively rather than requiring a legislative fix.

6. *Cap-and-Trade*

Climate change is a global issue that has compelled governments to review and develop strategies to reduce greenhouse gas emissions and drive energy efficiency. One strategy Quebec and, more recently, Ontario have adopted to reduce emissions is through a cap-and-trade system.

Under a cap-and-trade system, a cap is imposed on the taxpayer's annual emissions, and the taxpayer is required to own sufficient "units" to cover its emissions. The government provides the taxpayer with the number of units to establish the annual cap ("baseline units"); any remaining emissions must be offset by purchasing additional units through a regulated market or must be eliminated through energy efficiencies. The amount of baseline units provided are expected to progressively reduce over time such that the "cap" on emissions decreases over time. While the units do not expire, each unit can only be used once to offset the emissions produced, and the units must be surrendered back to the government at the end of the compliance period.

The CRA takes the position that the baseline units constitute an “inducement” under Income Tax Act paragraph 12(1)(x); and therefore, their value is included in the taxpayer’s income. Paragraph 12(1)(x) includes amounts received as inducements, whether as a grant, subsidy, or allowance. The basis for this suggestion is not clear, as the units provided under the cap-and-trade framework do not “induce” a taxpayer to emit greenhouse gases. Rather, it is the method for capping or limiting emissions.

The CRA takes the position that the baseline units will have no tax basis in the ordinary case where they are held on income account, because the rule giving cost to property, the value of which is included in computing income (subsection 52(1)), applies only to capital property. On the CRA’s interpretation, the value of the baseline units will be included in the taxpayer’s income when received, but no corresponding deduction is available to the taxpayer when the units are consumed and surrendered back to the government or sold to a third party. We believe a regime imputing no income inclusion on grant and recognizing no cost in disposing of the units would be fair. The CRA’s baseline-units interpretation to the contrary is unfair and inconsistent with the fundamental principles of Canada’s tax regime.

Would the Department clarify that the language of paragraph 12(1)(x) is not intended to apply to the baseline units received by the taxpayer under cap-and-trade? However, if the Department does consider paragraph 12(1)(x) broad enough to apply, would the Department be prepared to recommend a regulation to list the baseline units as amounts excluded from the operation of the provision as “prescribed amounts”?

ANSWER: The Department commented that they are currently working on the issue, in collaboration with the CRA. They are also reviewing other submissions that they have received. From a tax policy perspective, they think that double taxation is not appropriate. It is expected that the Department would eventually propose new legislation to rectify the issue. As for timing, the Department mentioned that they understood that there is an urgency associated with this matter.

7. *Related-Party Loan Assumptions and Repayments*

Would the Department consider amending ITA subsection 227(6.1) to allow a refund to a party repaying a loan that gave rise to a withholding tax under subsection 15(2) and paragraph 214(3)(a) if the repaying party is not the initial obligor, but rather, is related to the initial obligor?

When a corporate taxpayer makes a loan to a non-resident, and the loan is deemed a dividend under subsections 15(2) and 214(3) for Part XIII purposes, withholding tax generally must be paid on that loan/dividend. However, subsection 227(6.1) generally allows the non-resident, upon repaying the loan, to seek a refund up to the amount of the withholding tax paid.

However, if another party assumes the loan obligation before it is repaid, and that new obligor then repays the loan, without this repayment generally being part of a further series of

loans, subsection 227(6.1) does not allow the new obligor to seek a refund of the withholding tax paid, even if the new obligor is related to the initial obligor. Furthermore, taxpayers often cannot avail themselves of what might appear to be “self-help” to address this problem by arranging for a direct repayment of the original loan followed by a new loan to the new obligor, as such a transaction would risk being caught by the “series” rule in subsection 227(6.1). By contrast, if a loan that would otherwise trigger subsection 15(2) is repaid within the period referred to in subsection 15(2.6), regardless of whether it is repaid by the initial obligor or a party (related or not) that assumed the loan, generally provided it is not part of a series of loans, subsection 15(2.6) provides that subsection 15(2) will not apply.

ANSWER: The Department views the interpretation of subsection 227(6.1) as falling within the purview of the CRA, i.e., the CRA’s interpretation of the wording. To change a legislative provision, the Department would need to understand why taxpayers could not structure their affairs in a manner to comply with the wording of the legislation. The DOF would consider further discussions with the CRA, if TEI could provide examples why taxpayers cannot comply with the wording.

The Department is of the view that there are possibly other alternative forms of structuring that allow taxpayers to bring themselves within the wording of the law. TEI might consider whether to provide actual examples or more detailed examples to persuade the Department. For example, if the initial obligor (i.e., “on whose behalf” the loan is repaid) no longer exists, then the Department would entertain discussions with CRA and possibly revisit legislative options based on the CRA discussions.

The Department would want to be informed of all relevant commercial, legal, and other impediments before changing the legislation. With regard to options for “self-help,” the Department does not characterize “not doing a transaction” as “self-help.” The Department would consider examples demonstrating the reasons why “self-help” would not be available and why taxpayers may find themselves with debt assumed by a related party in the context 227(6.1) becomes an issue.

Conclusion

Tax Executives Institute appreciates the opportunity to present its comments on these pending income tax issues. We look forward to discussing our views with the Department of Finance during the November 18, 2015 liaison meeting.

Respectfully submitted,
Tax Executives Institute, Inc.

By:



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