TAXATION OF CORPORATE GROUPS
SUBMISSION TO THE
DEPARTMENT OF FINANCE
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TAXATION OF CORPORATE GROUPS

SUBMISSION TO THE DEPARTMENT OF FINANCE

EXECUTIVE SUMMARY

1. A new system for the taxation of corporate groups would improve the fairness, efficiency, certainty and competitiveness of Canada’s corporate tax system, complementing recent initiatives by the federal and provincial governments to give Canada a “tax advantage” in increasing investment, economic activity and employment.

2. A new system for the taxation of corporate groups would be more transparent than the current system. This would allow for greater monitoring of the impact of profit and loss transfers within a corporate group on provincial income tax bases and a better assessment of what, if any, modifications are needed to deal with misallocations of income among provinces.

3. Canada should adopt a loss transfer system. Simply put, a loss transfer system would result in the least disruption to Canada’s tax system and it is the system to which taxpayers, in particular, small and medium-sized companies, and the federal and provincial revenue agencies can most easily transition.

4. A corporate group under the new system should include corporations that are “affiliated” or “related” to each other. This is consistent with current tax policy and would simplify the transition to the new system.

5. Non-capital losses, capital losses, investment tax credits and charitable donations should be eligible to be transferred within a corporate group in a loss transfer system, subject to certain conditions.

6. Participation in the loss transfer system should be elective.

7. Unused tax attributes should be eligible for transfer under a new system.
8. Taxpayers should be permitted to continue to undertake financing type arrangements to use tax losses if these strategies are in place at the time a new system is enacted, and if the new system restricts the ability for taxpayers to use unused tax attributes under the new system.

9. Compensation payments made in consideration for the transfer of tax attributes should be non-taxable to the recipient and non-deductible for tax purposes to the payor.
The following is our detailed response to the questions presented in the Consultation Paper released November 23, 2010.

1  Policy Objectives

The Government is interested in stakeholders’ views regarding the most important benefits that they expect would be obtained from a new system for the taxation of corporate groups.

1.1  Submission

We summarize below the most important benefits that we expect would be obtained from a new system for the taxation of corporate groups.

a. Enhanced fairness and neutrality—The fairness of Canada’s corporate tax system would be enhanced by ensuring comparable economic entities or groups are taxed on a comparable tax base.

Current Canadian tax policy generally treats a commonly controlled group of corporations as an economically integrated unit. Such a group that carries on business activities through two or more corporations is therefore comparable to a single corporation that carries on business activities through two or more divisions. However, these groups are currently at a disadvantage because they cannot efficiently, if at all, offset income and losses of group members, which can be done within a corporation that carries on business through two or more divisions.

Many Canadian corporations are able to operate through a single entity and establish separate divisions to accommodate different business ventures or operations. However, for a number of non-tax reasons, it is not always possible to carry on these activities through separate divisions and instead, the activities must be carried on through two or more corporations. These reasons include:
• limiting liability associated with certain business operations or ventures;
• financing considerations;
• satisfying federal or provincial regulations;
• accommodating minority shareholdings or third party partners in different business ventures; and
• maintaining separate profit centres and ensuring greater management autonomy and independence.

It is unfair to require solely for tax reasons that business activities be conducted by a single corporation, particularly when bona-fide business and federal and provincial government regulatory reasons dictate that certain activities be conducted through separate corporations.

A new system for taxing corporate groups would create a fairer and more neutral tax system for all Canadian corporations in structuring their business activities.

b. **Enhanced efficiency** – The absence of a comprehensive, legislative system for group taxation means many corporations are unable to monetize certain tax attributes (for example, by applying non-capital losses of one member against profits of another member) in a timely, efficient and cost effective manner.

As described in the Consultation Paper, provided certain conditions are met, taxpayers are permitted in certain circumstances to transfer income and losses among members of a commonly controlled group using various techniques and strategies, in particular intra-group financing arrangements. However, these arrangements can be time-consuming for taxpayers to plan and execute and costly to implement, particularly for small and medium-sized companies. In addition, they increase the administrative and compliance burden and costs for taxpayers and Canada’s tax agencies.

For non-tax reasons, a number of corporations are unable to implement intra-group financing arrangements and other loss utilization strategies and using currently available legislative techniques, such as amalgamating companies, may not be possible. Moreover, the current system does not easily accommodate the monetization of tax attributes such as investment tax credits (ITCs), thereby preventing taxpayers from realizing the intended tax benefits of related government incentives and making such programs less efficient.

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1 For example, in some situations, it is not possible to put in place inter-company loans because of existing banking covenants or because of the necessity to maintain a certain debt to equity ratio for contract bidding, etc.
A new system for the taxation of corporate groups would permit a more efficient use of tax attributes. The ability to use these attributes efficiently would reduce corporations’ cost of capital and increase the level of investment, productivity and jobs in Canada.\(^2\)

c. **Enhanced tax certainty, administration and compliance** - The current system as administered by the Canada Revenue Agency (CRA) gives rise to various degrees of uncertainty for taxpayers and the federal and provincial revenue agencies, such as whether certain transactions undertaken to transfer losses between group members are “commercial,” whether they result in an inappropriate shifting of profits and losses between provinces and whether they are consistent with the underlying intent and spirit of the federal and provincial tax acts. There is also some uncertainty as to the tax treatment of “compensation payments” between group members for use of a group member’s loss.

A new system for the taxation of corporate groups would add greater certainty of tax results for taxpayers while at the same time facilitate tax compliance and ease the administration burden and cost for taxpayers and federal and provincial tax agencies.

d. **Enhanced competitiveness** - A new system for the taxation of corporate groups that is fairer to Canadian corporations and leads to greater efficiency and tax certainty will further enhance the competitiveness of Canada’s corporate tax system. A more competitive tax system will lead to increased investment, economic activity and employment.

Most Organization for Economic Co-operation and Development (OECD) countries have adopted some form of group taxation. In fact, Canada is one of the few developed countries and the only G7 country that does not have a comprehensive system of group taxation. A new system for corporate group taxation would eliminate a competitive advantage that foreign corporations currently have over Canadian corporations and be another example of the federal government working with the provinces to give Canada and Canadian businesses a tax advantage.

e. **Enhanced transparency and monitoring** - We believe a new system for the taxation of corporate groups would lead to greater transparency and monitoring of loss and other tax attribute transfers within corporate groups and the impact such transfers have on provincial tax bases. Importantly, this will allow for a more open and constructive dialogue among the stakeholders about what actions, if any, are needed to deal with transfers that are considered to result in unfair income allocations among the provinces.

2 Loss Utilization in Canada Currently

The Government invites stakeholders to comment on the current approach, and the most significant types of costs and benefits related to this approach.

2.1 Submission

Although there is no formal, comprehensive system for corporate group taxation in Canada, the CRA has approved a number of strategies (generally involving intra-group financing arrangements) developed to permit corporations to transfer income and losses among members of a corporate group. These strategies are necessary for fairness and competitive reasons. Otherwise, many corporate groups would be unable to use certain tax attributes because, for example, they are unable to amalgamate or wind-up a group company with loss carry-forward pools with or into another group company that is profitable or they are unable to transfer, on a tax deferred basis, property with an accrued gain among members of a group to realize a gain on a final disposition of the property in a particular group member.

Conceptually, the approach allowing for the transfer of losses through intra-group financing arrangements has its attractions because when they can be implemented they provide the necessary level of consolidation within a group to achieve a higher degree of efficiency using the tax results of corporate members without introducing the complexity of having taxpayers do an actual consolidation for tax purposes.

However, the current system, specifically intra-group financing arrangements designed to move losses within a corporation, has a number shortcomings. These were identified in the previous section dealing with the benefits of moving to a new system and include:

a. Lack of fairness and efficiency - Certain corporate groups are required for regulatory and business reasons to operate through more than one corporation and are unable to use current techniques to move losses and other tax attributes within the group.

b. Compliance cost - Intra-group financing arrangements can be costly to implement and the time and resources devoted to design, implementation and compliance are significant, particularly for small and medium-sized companies.

c. Competitiveness - Canada is one of the few OECD countries without a formal, comprehensive system for the taxation of corporate groups. This puts Canadian companies at a competitive disadvantage vis à vis foreign corporations.
d. **Impedes operational efficiency** - Sometimes implementing a loss transfer plan can require changes in the group’s organization structure, disrupting normal business operations.

e. **Lack of certainty** - The tax results of using administrative techniques are not guaranteed.

f. **Timeliness of tax result** - The monetization of tax attributes under the current system is usually deferred.

g. **Lack of transparency** - The provinces are concerned that the current system may facilitate the erosion of a province’s tax base. The current system is not sufficiently transparent to allow for monitoring of transfers between corporations to assess the effects on provincial tax bases.

2.2 **Summary**

While a new system for corporate group taxation would eliminate the shortcomings of the current system, certain attributes of the current system can be incorporated into a new system. As discussed in greater detail below, this would reduce complexity and the transition to a new system.

3 **Provincial/Territorial Considerations**

*The Government invites stakeholders to comment on whether a new system of group taxation should incorporate changes to the method of determining provincial income allocation and, if so, how this could be accomplished.*

3.1 **Submission**

We have had the opportunity to discuss the taxation of corporate groups with officials of some of the provinces. From those discussions, we are aware of the provinces’ concerns about the adverse effect a new system for corporate group taxation might have on their income tax bases. We are also aware that the provinces view the current system as facilitating shifting of losses from one province to another province that can result in a permanent loss of the latter province’s tax base. In some circumstances they view this as an example of provincial tax avoidance.
We understand the provinces will not be receptive to a new system that perpetuates the problems they perceive with the current system and that does not provide, over the long run, for income and losses of a particular corporation to be shared equitably among provinces in which the corporation/group carries on business or economic activity. We also understand that the provinces are concerned about the lack of transparency under the current system, which prevents the provinces from monitoring the effect loss transfers have on their tax bases.

Still, we believe the provinces understand the benefits of moving to a new system. They recognize that a competitive tax system is crucial to attracting business investment and increasing economic activity in their province and nationally. Recent provincial budgets and tax policy initiatives are consistent with this view. The provinces understand that to enhance the competitiveness of Canada’s corporate tax system, the tax compliance and administrative burdens, as well as the tax inefficiency, uncertainty and unfair treatment of certain corporations under the current system must be addressed. We believe all stakeholders, including corporate taxpayers and the federal and provincial governments, will benefit from the enhanced competitive tax system resulting from a new system for the taxation of corporate group. These benefits have to be considered in dealing with provincial concerns.

### 3.2 Practical Considerations in Addressing Provincial Concerns

We believe the following additional factors should be considered in evaluating whether or how to modify any new system for taxing corporate groups to address provincial concerns.

a. Corporate groups operate within a single province

A number of corporate groups, particularly those involving small and medium-sized companies, operate exclusively or primarily within a single province. These companies would benefit tremendously from a new system for corporate group taxation and their ability to use the new system would not result in any shifting of the provincial tax base.

b. Monitoring loss transfers between provinces

We understand that it is not possible to determine the potential loss in a provincial tax base accurately under the current system. However, it should be possible to design a new system that is more transparent and will permit provinces to monitor the effect of a new system on their tax bases.
c. No significant provincial tax rate disparity

There is no longer a significant disparity in provincial income tax rates. This, along with other recent changes (for example, the federal and Quebec tax disclosure rules for aggressive tax planning (ATP)), should mitigate provincial concerns that taxpayers would use a new system to engage in ATP-type strategies to avoid provincial income tax. Although the effect may be to shift losses between provinces, this is not what taxpayers are seeking with a new system for corporate group taxation. Rather, they are looking for a new system to increase the efficiency in which they can use certain tax attributes within a corporate group in a cost effective manner.

d. Accurately allocate income among provinces

The challenge presented by provincial concerns, as the Province of Ontario stated in its 2010 Fall Economic Update, is that “[t]he taxation of corporate groups must not distort the principles of interprovincial income allocation and should treat losses in a fair and reasonable manner.”

However, when a corporate group operates in more than one province, it is not a simple exercise or an exact science to attribute activities and investments, and income derived from them, to each province. Indeed, because many corporations today are “global,” it is difficult to allocate their income among the countries in which they operate, let alone among provinces.

As a result, we believe some tax leakage is inevitable and some flexibility is needed in dealing with this issue. If the new system is made too “tight,” the potentially greater risk - even greater than the inevitable complexity it would introduce - is the adverse signal it projects for and the negative effect it could have on interprovincial trade and economic activity, which some observers contend is already inhibited by provincial barriers and lack of harmonization of provincial standards in a number of non-tax areas.

e. The current provincial allocation formula

Currently, the provincial income allocation formula in section 400 of the Regulations to the Income Tax Act (the Act) is used for allocating income of a corporation carrying on activities in more than one province. It has the benefit of being relatively straightforward and simple to apply and is generally applied uniformly among all the provinces.
We believe the current income allocation formula could be applied to tax groups of two or more corporations on the assumption that the group is one company. This would be similar to the treatment of a single corporation with two or more divisions in different provinces. It would also be consistent with the approach generally taken by the few jurisdictions where income tax is levied by sub-national levels of government. For example, Germany determines the amount to be allocated to a state/municipal government based on the latter’s share of total wages paid to employees of companies in the group. Japan takes a similar approach. However, under the U.S. system, there is no uniform income allocation formula. The states apply different allocation methods, which can lead to potential double taxation at the state level.

While some will argue that the current formula is outdated and in need of revision, we do not believe that changes to the formula are warranted for purposes of moving to a new system for corporate group taxation, because it will unduly complicate and delay the process in moving to a new system. Provincial concerns that it is possible for taxpayers to structure their activities in a manner that inappropriately avoids the income allocation formula should be addressed through separate consultations with taxpayers.

f. Maintaining simplicity

Modifications to any new system for corporate group taxation to deal with provincial concerns should not introduce a degree of complexity that is not commensurate with the issue/problem that the modifications seek to remedy. In the long run, this would not benefit taxpayers or the provinces and would not achieve the other benefits of moving to a new system.

3.3 Options to Address Provincial Concerns

Below we offer possible options for dealing with provincial concerns about moving to a new system for taxing corporate groups.

The options are based on the new system being a “loss transfer system.” As discussed more fully in the next section, we believe that a loss transfer system is preferred over a “tax consolidation system.” The options below are intended to illustrate that a loss transfer system could be modified, if necessary, to deal with the provinces’ concerns while ensuring that it still achieves the desired benefits of moving to a new system.


**Using the Provincial Income Allocation Formula**

One approach is to apply the existing provincial income allocation formula in section 400 of the Regulations to the Act at the individual group member level, based on the aggregate data of two or more members of the group, as if the corporations merged to form one corporation. For example, the provincial income allocation formula could be applied in aggregate to the “transferor” and “transferee” of the tax attributes being transferred. In effect, this would result in the same provincial income allocation that would occur if the transferor and the transferee(s) had amalgamated to form one corporation. This approach has the advantage of being relatively straightforward and transparent. Concerns it might still lead to potential provincial avoidance could perhaps be dealt with by ensuring the tax attributes are transferred first to group companies with a provincial income allocation similar to that of the transferor or that the relevant group be treated as a group for provincial tax purposes for some minimum period.

Another approach would be to allocate income among the provinces based on the provincial allocation formula applied to all companies eligible for a particular group (i.e., not just the transferor and transferee companies) as if they amalgamated to form a single corporation. In effect, this would be closer to the results, from a provincial allocation perspective, which would occur in a tax consolidation system. Invariably, this approach would be more complicated, especially for large groups, and would be the equivalent of a “mandatory consolidation” system for provincial purposes. It would raise questions such as whether intra-group transactions should be eliminated when calculating income and in determining the various components of the provincial income allocation formula, adding further complexity.

**Introduce a Provincial Commonality Requirement**

Another approach might be to tighten the group threshold for provincial purposes by introducing a provincial commonality element in addition to the group requirements described earlier.

For example, a company's loss attributable to a province (the loss province) would be determined based on the provincial income allocation formula. The loss attributable to a province could be transferred to one or more group companies, but only to the extent of the transferee company's income otherwise attributable to the loss province. Only if the loss attributable to the loss province exceeds the income of all other group companies attributable to that province, would the excess amount be transferred to another group company to reduce its income otherwise attributable to another province. Where the loss attributable to the loss

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3 See description in Laurin, supra note 7, pages 10-12.
province reduces the income of another province, the rules would provide for the other province to recapture the lost tax base in the future in some manner. This approach, however, would require detailed tracking of losses by province, including the transfer losses among provinces. This would increase the compliance burden not just on taxpayers but also on the CRA and provincial revenue agencies.

A different and perhaps simpler approach might be that each member of the group meet a common provincial allocation of income threshold, determined under a provincial allocation formula over a historical period of, say, three years before entering the group for provincial purposes. If a common provincial income allocation threshold were set at a certain level, all of the provinces might be satisfied that there would be less distortion of their tax bases.

We caution that a tighter group selection would almost certainly reduce the number of groups that can benefit fully from the new system for provincial tax purposes and, therefore, the system would not be as efficient defeating one of the objectives of moving to a new system.

**Holding Companies**

Holding companies may require special consideration or allocation rules, particularly if it is established that under the current system many employ loss transfer techniques to transfer head office stewardship, financing and scientific research and experimental development (SR&ED) costs that they do not or cannot otherwise charge out to group members. It might be reasonable to allocate such costs in a loss transfer system by reference to an objective criterion such as sales of group companies.

**Provinces Agreeing to Compensate Each Other**

At the beginning of this discussion, it was submitted that a significant benefit to moving to a new system for the taxation of corporate groups would be to improve the transparency and monitoring of loss transfers within a corporate group to determine the effect on provincial income tax bases.

If that is the case, then the optimal solution for all stakeholders may very well be for the provinces to agree among themselves to, in effect, periodically “exchange cheques” to reflect the fact that one or more provinces may have borne a disproportionate amount of the cost in moving to a new system for taxation of corporate groups. This would eliminate the compliance and administrative burden on taxpayers and the CRA and provincial revenue authorities that would otherwise arise if any of the other approaches are adopted.
3.4 Summary

We do not believe it is necessary for a new system of group taxation to incorporate changes to the method of determining provincial income allocation.

Moving to a new system for group taxation offers significant benefits for all stakeholders, including the provinces. We believe that a new system would be more transparent and would allow the provinces to better monitor the effect of tax attribute transfers on the provincial tax bases and to then better assess what modifications may be needed to ensure that the benefits of a new system are not mitigated. Any modification should be fair and simple for taxpayers and tax agencies to comply with and administer.

4 Possible Approaches

The Government is interested in stakeholders’ views on:

- How the efficiency and competitiveness of Canada’s current loss utilization rules compares to more explicit, but often less flexible, rules in other countries;

- How a new system of taxation for corporate groups would improve the efficiency and competitiveness of Canada’s tax system; and

- The approach Canada should take for a new system for the taxation of corporate groups.

4.1 Submission

In sections 1 and 2 above, we discussed the shortcomings of the current system and how a new system for the taxation of corporate groups would enhance the fairness, efficiency, certainty, competitiveness and transparency of Canada’s corporate tax system.

In moving to a new system for the taxation of corporate groups all stakeholders would have a strong desire to minimize the number of new rules (including transitional rules) and amendments to the federal and provincial income tax legislations, and to not add significantly to the compliance and administrative burden for taxpayers and federal and provincial revenue agencies. In our view, a loss transfer system can better meet these objectives than a tax consolidation system. A loss transfer system would address taxpayers’ concerns with the current system and could be modified as needed to address provincial concerns with the
current system.

Overall, a loss transfer system has the following advantages over a tax consolidation system.\(^4\)

a. A loss transfer system is closer to the current system that has been in place in Canada for a number of years. This would ease the transition to a new system for both taxpayers and tax administrators.

b. A loss transfer system would continue to require the computation of income and loss at the individual corporate member levels. Among other things, this would permit the continued use of familiar tax concepts, principles and jurisprudence that have developed over a number of years and, therefore, would result in fewer legislative changes. A loss transfer system would also continue to accommodate existing federal and provincial tax administration systems and practices.

c. A loss transfer system would maintain separate filings by each group member. While this filing burden would remain unchanged from the current system, taxpayers would continue to rely on their existing systems and processes to compute income and loss for tax purposes. This would promote greater compliance and administrative simplicity and certainty.

In any event, under a tax consolidation system - in particular one that is similar in design to the U.S. tax consolidation system - a necessary first step would be for taxpayers to compute the income or loss of each group member on an individual basis. In fact, even under the Australian “absorption” or “asset based” consolidation system, where individual members of a group lose their identities for tax purposes, in practice, the consolidated tax return is generally put together by producing income statements of each group company, computing a draft tax return in respect of that company and then consolidating that information for all members.

d. A tax consolidation system would require a significant investment of time and resources from both tax advisers and taxpayers and, invariably, the CRA and provincial tax authorities particularly in the transitional period. This was noted in Australia, which

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\(^4\) This analysis is based primarily on a comparison of the tax consolidation systems in place in Australia and the U.S. with a loss transfer system similar to that in place in the United Kingdom. These systems are described briefly in Annex 4 of the Consultation Paper.
introduced a tax consolidation system in 2002 to replace its loss transfer system.\textsuperscript{5}

e. Entries into and exits from a tax group under a loss transfer system could occur without tax consequences or adjustments at the group member level, which is typically not the case under a tax consolidation system. This would further promote greater tax compliance as well as administration simplicity and certainty.

f. Separate tax filings by each tax group member under a loss transfer system would eliminate the need to determine the individual components of the group tax results using aggregate numbers. This would avoid complex transitional rules, including the possibility of having to establish or recreate the appropriate tax cost of assets of members at a group level, which may require revaluing or rebasing of assets, as is the case under the Australian tax consolidation system. In addition, under the Australian system asset revaluations must be done virtually every time an asset is transferred outside the group. This is noted as being a time-consuming and costly procedure for taxpayers and would be a potential source of dispute with revenue authorities. More importantly, the revaluing or rebasing of assets is very different from current Canadian tax principles when shares of a company are sold or acquired.

g. In the U.S. tax consolidation system, the adjusted cost base of the shares of a group member is adjusted for its income or loss and for the payment of dividends. This is similar to what is required currently when a taxpayer has an interest in a partnership. This added compliance and administrative burden under a tax consolidation system would not be necessary under a loss transfer system.

h. The tax implications and current rules dealing with various intercompany/group transactions would have to be reconsidered if Canada introduced a tax consolidation system.

For example, under a tax consolidation system gains and losses on intercompany transactions would have to be eliminated but then restored or recomputed when assets are sold outside the group. These deferred gains and losses would have to be tracked in some manner. This would be very different from current Canadian tax rules and principles where, generally, gains arising on intercompany/group transactions are taxable and losses are deferred. As a result, a number of the current stop loss rules would have to be reconsidered and revised and new rules adopted to defer and track intercompany/group

gains under a tax consolidation system. No such changes should be necessary if a loss transfer system is implemented.

It might be suggested that a positive feature of a tax consolidation system could be the elimination of double counting of gains and losses when, for example, assets are sold by a corporation and the shares of that corporation are sold later. This is an inherent feature of the current Canadian tax system and was one of the reasons the Australians moved from a loss transfer to a tax consolidation system in 2002. However, this area is one of the most complex aspects of the U.S. tax consolidation system and has undergone significant refinements over the years to deal with avoidance transactions and anomalous situations. Moreover, the inherent complexity of the Australian system leads one to seriously question whether the “cure” was worse than the “disease.”

i. In Australia one of the stated goals in introducing a tax consolidation system was to ease taxpayer compliance. However, nine years after its introduction it appears many small and medium-sized Australian corporate groups that are eligible to form a consolidated group have elected to remain outside the consolidation regime. This is attributable to the significant cost of transitioning to a tax consolidation system and the ongoing cost and complexity of compliance.\(^6\) Ironically, because many corporate groups have remained outside the consolidation regime, when these groups include a company that incurs losses, loss utilization schemes similar to those undertaken currently in Canada must be used to gain access to the losses by other group members.

Given the number and significance of small and medium-sized companies in Canada, it would be inappropriate to adopt a system that would have the effect of excluding a significant number of these taxpayers because they are unable to afford the cost and are unable to deal with the complexity of such a system.

j. The fact that a group may prepare consolidated financial statements is not a relevant factor either in favour of a tax consolidation system or making it easier to adopt. Under both the Australian and U.S. tax consolidation systems, taxpayers do not compute their consolidated tax returns based on their consolidated financial statements. This is not surprising, because the rules for accounting consolidation are complex and are not suitable for tax purposes. Because the rules of law established by the courts and the rules in the relevant legislation are used to determine income for tax purposes of the group members, the use of financial results determined in consolidated financial statements is not a practical option. As well, the group members for accounting purposes may differ from the

\(^6\) The Australian government is now considering how to reduce the compliance burden on small and medium-sized companies in Australia so that more would be able to elect into the tax consolidation regime.
group members for Canadian tax purposes.

k. Although the Australian tax consolidation system was introduced, in part, to ease compliance for taxpayers (because, in particular, intra-group transactions such as dividends could be ignored) for the reasons mentioned above, it has not reduced the compliance burden on taxpayers significantly.

4.2 Summary

In our letter to the Minister of Finance dated January 14, 2009, we recommended that a loss transfer system be enacted. We continue to believe a loss transfer system is the appropriate approach in moving to a new system for the taxation of corporate groups.

In 1985, the federal government proposed a loss transfer system because it was considered the least disruptive to the current corporate tax system. We believe that this is still a compelling reason for adopting a loss transfer system.

An Australian or U.S. style tax consolidation system would significantly increase the compliance and administrative burden on taxpayers, particularly small and medium-sized taxpayers, and the federal and provincial revenue authorities without a commensurate added advantage over a loss transfer system. It would also involve significant transitional rules. A loss transfer system would not have this effect because, among other reasons, it would preserve many of the tax principles and administrative processes of the current tax system. A loss transfer system would address taxpayers’ concerns with the current system and it could be modified as needed to deal with provincial concerns without introducing the complexity of a tax consolidation system.

Below we comment on a number of the design features of a loss transfer system.

5 Design Parameters: Eligible Groups - Degree of Common Ownership

The Government is interested in stakeholders’ views regarding:

- The appropriate threshold of common ownership for a corporation to be included in a corporate group; and
• The appropriate meaning of ownership to be applied for determining if a corporation meets the ownership threshold (e.g. votes, value, or both).

5.1 Submission

The intent in moving to a new system for the taxation of corporate groups is to eliminate the shortcomings inherent in the current system.

To facilitate the transition to a new system and to not increase the complexity or the compliance and administration burden on taxpayers and federal and provincial revenue authorities, the new system should not result in significant changes in the federal and provincial income tax legislation. This would be accomplished if the principles underlying the new system were consistent with existing tax principles and rules. In this regard, we submit that the threshold for common ownership for a corporation to be included in a group be based on existing provisions that recognize the integration of interests of members of a corporate group.

We submit that throughout the Act, “common control,” has emerged as the proxy for “common ownership” although it is not its exact equivalent. De jure control is the dominant feature underpinning the definitions of “related persons” (subsection 251(2)), “affiliated persons” (section 251.1) and “associated corporations” (section 256), each of which in relevant circumstances are intended to capture persons with common ownership and economic interests. A “corporate group” for purposes of system of corporate group taxation is intended to include corporations with common ownership and economic interests. Accordingly, to be consistent with the scheme and spirit of the Act it is appropriate for corporations under common control to be included in a group.

As the Consultation Paper describes on pages 4-5,

“.....the Income Tax Act has express provisions which recognize the integration of the interests of members of a corporate group. In 1988, the Government noted that explicit exceptions in certain rules, including the corporate loss limitation rules, “are intended to apply with respect to transactions that would allow losses, deductions, and credits earned by one corporation to be claimed by related corporations”, and stated that “the scheme of the Income Tax Act as a whole, and the expressed object and spirit of the corporate loss limitation rules, clearly permit such transactions between related corporations where these transactions are otherwise legally effective and comply with the letter and spirit of these exceptions.”

The CRA has administered the rules in this manner as they describe in Income Tax – Technical News No. 9, dated February 10, 1997, where they stated in part,

“We have followed that approach when considering the application of section 245 to such transactions (see, for
example, examples 8 and 9 of Information Circular 88-2). The view that such transactions do not result in an abuse, having regard to the provisions of the Act read as a whole, is based on the fact that specific provisions of the Act, such as subsections 69(11) and 111(4) to (5.4), restrict the claiming of losses, deductions and other amounts by unrelated parties."

The CRA went on to note that the amendment to subsection 69(11) to deny rollover treatment on certain transfers of property to persons with which the transferor is not “affiliated,” rather than not “related,” was a change to the scheme of the Act relating to the ability to transfer losses between corporations. In their view, a series of transactions that results in the transfer of the benefit of the losses, deductions or other amounts from one corporation to a corporation with which it is not “affiliated” generally will be considered to result in an abuse having regard to the provisions of the Act read as a whole within the meaning of subsection 245(4).

More recently, however, the CRA issued a ruling permitting losses to be transferred among companies that are “related.”

The differences between a “related” and “affiliated” person are subtle and, generally, many corporations that are related are also affiliated. Both terms are used throughout the Act to recognize the integration of the interest of members of a corporate group in different circumstances. For example, a Part VI.1 tax liability and the paragraph 110(1)(k) deduction can be transferred among related parties and section 80.04 permits the transfer of a “forgiven amount” between related parties. Moreover, the stop loss rules apply when, among other things, a property is transferred between persons that are affiliated. To introduce a separate threshold test under a new system for the taxation of corporate groups would in effect introduce a parallel system giving rise to potential tax uncertainty.

5.2 Summary

It would be consistent with the object and spirit and existing Canadian tax principles of the Act if the threshold of common ownership were based on the corporations in a group being “affiliated” or “related.”

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8 For example, if under the new system the common ownership threshold is set at, say, 80 percent or more of the votes and value of the outstanding shares of a corporation, would there be a “GAAR” concern if a person transferred a property with an accrued gain (electing under section 85 for the proceeds to be less than fair market value) to another corporation in which the transferor owned less than 80 percent but the transferor and the transferee are “affiliated”?
Other Comments

1. Effect on Transitional Rules

A practical advantage in maintaining the same threshold as under the current system would be the need for fewer transitional rules, depending on the other design features of the new system. For example, a votes and value test requiring ownership of, say, 80 percent of the shares of a corporation would reduce the flexibility corporate groups have under the current system. Taxpayers with outstanding non-capital losses and capital losses at the time the new system is introduced would have to continue to rely on existing techniques to transfer such losses if the new system had such a higher threshold.

2. Federal and Provincial Revenue Impact

A new system that is more efficient in allowing corporate groups to use tax attributes within a group will raise concerns about the effect on federal and provincial revenue. Actually, a significant concern in this regard would illustrate the inefficiency of the current system.

In any event, data presented in Annex 3 of the Consultation Paper suggest that there would not be a significant cost if the ownership threshold were greater than 50 percent, because on average these groups accounted for $107.5 billion in non-capital loss closing balances, which is only $5.0 billion higher than the closing balances of groups with an ownership threshold greater than or equal to 90 percent. These data do not suggest that there would be a significant revenue loss to the federal and provincial governments if the group threshold is maintained at the current level.

6 Design Parameters: Eligible Groups - Non-Corporate Entities and Non-Resident Corporations

The Government is interested in stakeholders’ views regarding how trusts or other non-corporate entities and the Canadian branches of non-resident corporations that are part of a Canadian corporate group should be treated in a group taxation system.

6.1 Submission

Canadian branches

In our view, conceptually, it would be appropriate to treat a branch of a foreign corporation as
a corporation for the purpose of determining whether it is part of a Canadian corporate group. No doubt, special rules deeming the existence and ownership of shares would be required.

However, it is possible for Canadian corporations to own subsidiaries in a foreign country as well as having a branch in that country. In many situations, it is not possible for the Canadian company’s branch to be treated as a member of a group along with the Canadian corporation’s subsidiaries for foreign tax purposes. We therefore question whether the Canadian tax system should treat a foreign corporation with branch operations and subsidiaries in Canada more favourably than a Canadian company with a branch and subsidiaries in the foreign corporation’s country of residence. Consideration might be given to treating a Canadian branch of a corporation resident in another country as part of a Canadian group if reciprocal treatment were given to Canadian corporations in that country.

**Partnerships and other non-corporate entities**

We believe income and losses arising in partnerships and other non-corporate flow through entities should be treated in the same manner as under the current system, i.e., a corporate member or beneficiary, as the case may be, would pick up its share of the income and loss of the non-corporate entity and it would not be necessary for the member or beneficiary to be “affiliated” or related with the entity.⁹

### 7 Design Parameters: Eligible Groups - Common Parent Corporation

The Government is interested in stakeholders’ views regarding whether eligible groups of corporations should have a common parent corporation, and if not, how groups without a common corporate parent should be treated in a group taxation system.

#### 7.1 Submission

In section 5 above, we recommend affiliated or related corporations be eligible to form a corporate group. Both definitions presuppose that a person (“the controller”) controls the corporations in the group.

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⁹ We note that in the 1985 discussion paper, “A Corporate Loss Transfer System for Canada,” certain specialty corporations such as investment corporations, mortgage investment corporations, mutual fund corporations, non-resident-owned investment corporations, co-operative corporations, credit unions and deposit insurance corporations were not to be eligible to make or receive losses under the system proposed at that time. Some consideration will have to be given to these corporations under a new system.
We believe that under a loss transfer system it is not necessary for there to be a common parent corporation, although we expect for many of Canada’s corporate groups, this will be the case.

Under current rules, there is no need for a common parent. This feature is particularly beneficial for small and medium-sized companies where related family members separately own a group of companies. A number of provisions in the Act treat these groups as having an integration of interests and for consistency the same principle should apply to group taxation.

8 Design Parameters: Range of Attributes

The Government is interested in stakeholders’ views regarding the most important attributes which should be considered with respect to a new system for the taxation of corporate groups.

8.1 Submission

We believe that the tax attributes that should be incorporated into a group taxation regime are the following:

- non-capital losses;
- capital losses;
- ITCs; and
- charitable donations.

It would be too complex to devise a system that includes the transfer of unused capital cost allowances or SR&ED expenditures among group members. Instead, taxpayers could claim these amounts in a particular year to increase their non-capital loss available for transfer to another group company.

Consideration should also be given to whether it is appropriate to transfer foreign taxes paid between group companies for purposes of foreign tax credit calculations and deductions under subsection 91(4).

An adjustment to the tax attributes of the transferor and the transferee would be made to reflect the amount transferred and the amount used.

We would foresee that transferred tax attributes would be subjected to the same tax rules in respect of the transferee as they are in respect of the transferor.
9 Design Parameters: Elective Components

The Government is interested in stakeholders’ views on the extent to which participation in a group taxation regime should be voluntary or mandatory for the group and/or individual group members, and to what extent corporate groups should have flexibility in determining which attributes to transfer or consolidate.

9.1 Submission

Subject to the comments below, we strongly believe that in designing a new corporate group taxation system for Canada, participation should be elective and the participating members should have complete discretion in deciding which members to include and which of the eligible attributes to transfer. This is one way to ensure the new system is not overly complex and does not impose an unnecessary high compliance and administrative burden on taxpayers and revenue authorities.

We do think that it is appropriate to consider some or all of the following.

- A joint election should be required to be filed by each corporation involved in the transfer of tax attributes. The election would also specify the type and the amount of tax attributes transferred. Among other things, this filing will ensure greater transparency and monitoring of the effect of such transfers on a province’s tax base.

- In principle, transferable tax attributes would be restricted to tax attributes that arose while the transferor and transferee corporations are “affiliated” or “related” (see further discussion in section 10 below).

- Any tax attribute transferred in a particular year must be used by the transferee in that year or a previous year.

- A non-capital loss cannot be created in a transferee corporation in a taxation year as a result of transfer of a tax attribute to it from another group corporation.

- A direct or indirect acquisition of control of a member of a particular tax group by a person that is not related to or affiliated with all the group members would result in disqualification of the tax group member for membership in the particular group.
Possible anti-avoidance rules to prevent the inappropriate duplication of tax attributes.

10  Design Parameters: Pools of Unused Tax Attributes

The Government is interested in stakeholders’ views on what constraints would be appropriate on the use of existing pools of losses when an eligible group is formed, when a corporation enters or exits the group, and on a year-to-year basis.

10.1 Submission

The constraints, if any, that are appropriate on the use of existing pools of losses and other tax attributes has several aspects.

1. Creation of a group upon the enactment of a new system

We submit that there are no compelling tax policy reasons for the new system to restrict the ability to transfer non-capital and capital losses, arising before the enactment of the new system, between corporations if these losses could have been transferred under the current system.

In section 5, we recommend that the degree of common ownership within a group be based on the corporations being “affiliated” or “related.” Another reason for maintaining the same threshold as under the current system is that it would simplify the transition to a new system by allowing non-capital and capital losses that arose before the adoption of a new system to be transferred to another group member, to the extent these attributes arose when the transferor and transferee corporations were affiliated or related.

If the group threshold under the new system is higher than under the current system, taxpayers should have the ability to rely on the current system in transferring losses up to the end of the period when the losses expire.

To the extent a new system allows for the transfer of other tax attributes, we believe there should be no restrictions on the ability to transfer these attributes between corporations that were affiliated or related at the time the attributes arose.

The enactment of a new system could result in an upfront cost to the federal and provincial governments as a result of taxpayers being able to use their tax attributes more quickly and easily than under the current system. Indeed, this is one of the important reasons and benefits of moving to a new system. Still, we appreciate that in the current economic environment,
such a cost will be of concern to the federal and provincial governments if it is significant. Accordingly, we believe it may be appropriate to consider that these attributes be transferred among group members in a new system over a period of time. The length of the transitional period should take into consideration the other design features of the new system.

2. Entry to and exit from a group after the enactment of a new system

As described in the Consultation Paper, comprehensive rules in the Act govern the treatment of tax attributes of a corporation when there is an acquisition of control.

Under a new system for the taxation of corporate groups, when an acquisition of control results in the corporation being affiliated with or related to other corporations, the tax attributes of the corporation should be eligible for transfer to the other corporations, assuming the requisite conditions to preserve the attributes on the acquisition of control are met.

Under a loss transfer system, a corporation that has unused tax attributes when it ceases to be an eligible group member would retain those attributes.

3. Use of carryover of tax attributes within an eligible group

We do not believe it is necessary to restrict the ability of a corporation to transfer tax attributes to another eligible group company if the attributes arose in a particular taxation year and the transferee corporation uses the attributes in another year, provided both the transferor and transferee corporations are affiliated or related at the time the attributes arose, subject to 2 above, and at the time the attributes are used. See section 9 for other suggested restrictions.

11 Design Parameters: Existing Approach

The Government is interested in stakeholders’ views about the impact of combining the introduction of a formal group taxation system with a restriction on the ability to undertake loss utilization transactions amongst corporate group members outside of the formal system.

11.1 Submission

In dealing with this issue, it is relevant to remember, as summarized on page 5 of the Consultation Paper, that currently corporate groups in Canada may be able to transfer income or losses between group members using the following techniques or variations thereof:
Financing arrangements, under which money is borrowed by one member of a corporate group to invest in preferred shares of another member (with the interest deduction reducing income in the first corporation’s hands, and generating additional interest or other income in the second);

Amalgamations or wind-ups of a group member with loss carry-forward pools into another group member that is profitable; and

Transfers of property between group members on a tax-deferred basis, in order to shift income-producing activities to, or to realize a gain on the final disposition of the property in a particular group member.

A new system for the taxation of corporate groups with features discussed in this submission would closely resemble the current system that permits corporations to undertake financing type arrangements to use non-capital and capital losses within a corporate group. The new system would not be a substitute for the second and third techniques, which taxpayers should be able to continue to rely on.

If the new system does not limit the ability of corporations to transfer non-capital and capital losses to corporations that were eligible to be transferred under the current system using various financing arrangements, the need for grandfathering and transitional rules to permit the ongoing use of these arrangements would be minimal (see discussion in 10 above). However, should the new system be more restrictive than the current system (for example, if the ownership threshold is higher), it will be necessary to permit those financing arrangements, particularly if the structures have already been implemented because it can take a number of years to absorb losses.  

In this regard, we are hopeful that efforts to deal with provincial concerns in designing the new system do not impose undue restrictions on taxpayer’s ability to transfer tax attributes within a corporate group. As discussed in section 5, several alternatives are available to deal with these concerns. In deciding which should be used, or if others are appropriate, consideration should be given to ensuring that the efficiency or complexity of the new system is not adversely affected.

10 In this regard, it should be noted that corporations with existing plans to utilize losses under the current system may have set up the tax benefit of such losses on their balance sheets. If there are restrictions on the corporations’ ability to utilize such losses under the current system and the grandfathering provisions are not adequate, these corporations would likely be forced to reverse such benefits potentially resulting in a significant charge to their income statement. This in turn could have adverse consequences on stock values, etc.
12 Design Parameters: Use of Previously Accumulated Tax Attributes in a New System

The Government is interested in stakeholders’ views regarding what restrictions in a new system of group taxation would be appropriate regarding the use of losses and other attributes accumulated by corporate groups prior to the introduction of such a system.

12.1 Submission

See the discussion in section 10.

13 Other Matters

We submit that compensation payments made by the transferee to the transferor in respect of transfers of tax attributes should be permitted and should not be included in the income of the transferor or deducted from the income of the transferee. In part, this would help deal with possible shifting of values between corporations as a result of a loss transfer as well as address any concerns about minority shareholders receiving “value” for losses transferred. There is precedent for this type of treatment in section 191.3, with respect to Part VI.1 tax.

Consideration should also be given to how moving to a new system for the taxation of corporate groups will affect taxpayers that have filed an election under section 261.

PricewaterhouseCoopers LLP
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