



Foreign Controlled Corporations – Proposed Changes to Foreign Affiliate Dumping

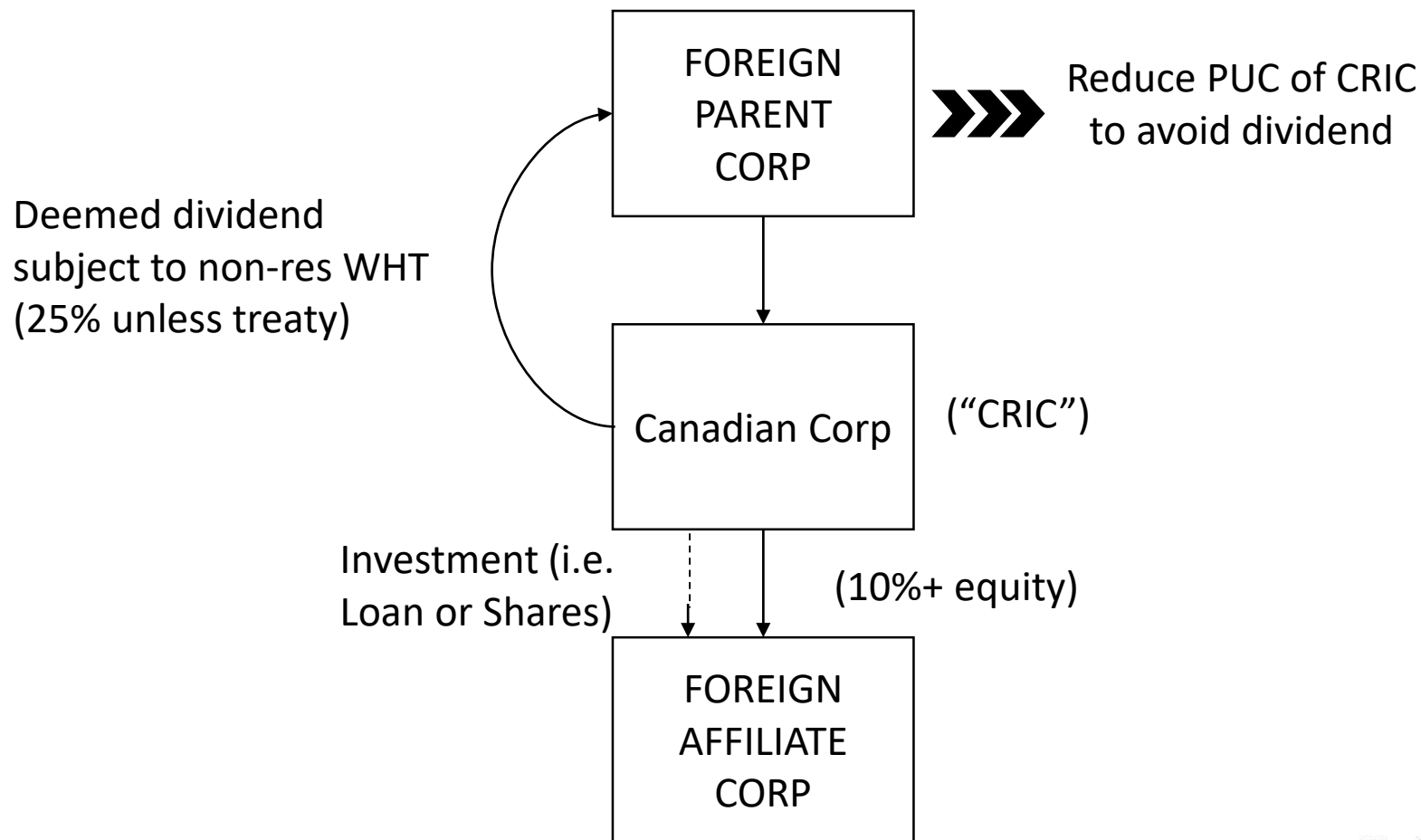
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Overview

- Foreign affiliate dumping rules
 - Aim to prevent tax-free removal of surplus earnings from Canadian companies involved in international tax structures.
- Prior to 2012, often used by foreign corporations to hold investments in non-Canadian subsidiaries with the goal of:
 - reinvesting Cdn earnings outside Canada; and/or
 - creating Canadian tax losses to shelter funds transferred up from other foreign affiliates.

Foreign Affiliate Dumping (pre-2019)



Foreign Affiliate Dumping - Background


- Originally introduced March 2012 – “Double Dip” response
- Pre-2019 Rules:
 - Cdn corporation controlled by foreign corporation (“CRIC”)
 - CRIC invests (debt and/or equity) in foreign affiliate
 - Foreign affiliate = 10%+ equity
- Deems investment by CRIC to foreign affiliate to be dividend to foreign parent
 - Subject to 25% Non-res Withholding Tax (reduced by treaty)

Foreign Affiliate Dumping - Background

- Exceptions:
 - Pertinent Loans or Indebtedness (“PLOI”) at or above prescribed interest rate
 - Certain Reorganizations (no new investment)
 - Cdn-centric business expansions (“more closely-connected” to foreign affiliate’s business)
- Recourse – PUC reduction of CRIC shares held by foreign parent

Foreign Affiliate Dumping – 2019 Changes

- Federal Budget - March 18, 2019 - proposes to extend CRIC's to not only to include corp's, but also:
 - Non-resident individuals
 - Non-resident trusts
 - Group of related non-resident individuals, trusts, corporations, or any combination of
- Revised definition of “related” with respect to determining non-resident trust related to corp.

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GST Issues – Input Tax Credits & Holding Corporations

GST Issues – Input Tax Credits & Holding Corporations

- General Rules for ITC Claims:
 - GST registrants eligible to recover GST paid on expenditures to the extent “engaged in commercial activities” (i.e. business carried on by a corp)
 - *Exempt* transactions are excluded from the “commercial activity” definition >>> financial securities
 - Cdn public companies doing business worldwide through foreign subsidiaries and raising capital in Cdn public markets >>> **not considered** engaged in commercial activity on its own since business is in sub, **absent special look-through rules....**

GST Issues – Input Tax Credits & Holding Corporations

- Pre-amendment special relieving provisions to allow Cdn holding companies to claim ITC's (ETA S.186)
 1. Expenditures must reasonably be “in relation to” the shares or debt of its subsidiary; *and*
 2. All or substantially all of the sub's assets must be used in commercial activities
- Examples provided by CRA included accounting & legal fees on acquisition or sale of shares in sub and certain admin costs
- Pre-July 28, 2018 taxpayer argument was the parent corp's main reason for existence was to hold shares and/or debt of sub so all costs considered “in relation to” sub's shares/debt

GST Issues – Input Tax Credits & Holding Corporations

- Ongoing issue – CRA auditors assessed based on a narrow interpretation of the legislation to restrict ITC claims by holding companies
- Tax advisors/taxpayers have a broader interpretation of the legislation to allow ITC claims
- Court cases recently favored a broader interpretation (i.e. *Miedzi Copper Corp, Stantec Inc.*), however, still challenged at CRA audit level, and now proposed....
- Significant restrictive amendments effective July 27, 2018

GST Issues – Input Tax Credits & Holding Corporations

- **New proposed rules to limit HoldCo eligible ITC's to:**
 - Transactions involving the shares and debt of the subsidiary/operating corporation
 - Costs involving issuance or sale of shares or debt of the holding company to the extent that the proceeds are transferred to the subsidiary/operating corporation, and
 - Other activities of the holding company if the holding company meets a new property test, which requires that all or substantially all (90%+) of the property of the holding company is shares or debt of the operating corporations.

GST Issues – Input Tax Credits & Holding Corporations

- **New proposed rules continued....**
- Substantial changes in wording involve replacement of “reasonably” and “in relation to” in reference to shares/loans of subsidiary, with more specific provisions to determine eligibility of ITC’s
- Other proposed amendments include revising ownership test of operating corporation from “related” (i.e. 50%+) to “all or substantially all” (i.e. 90%+)



Questions?