

VIA EMAIL: fin.gsthst2018-tpstvh2018.fin@canada.ca

Tax Policy Branch
Department of Finance Canada
90 Elgin Street
Ottawa, Ontario
K1A 0G5

Dear Sirs/Madams:

Re: July 27, 2018 Proposals for Comments concerning the GST/HST and Excise Duty Draft Legislative and Regulatory Proposals (“Proposals”)

On July 27, 2018, the Department of Finance Canada (“Finance Canada”) released proposed amendments to section 186 the *Excise Tax Act* (“ETA”) (“Proposals”). In addition, Finance Canada released the Consultation Paper Concerning the GST/HST Holding Corporation Rules (“Consultation Paper”). This submission will focus on the Proposals, and we will follow up with a separate letter providing our comments on the Consultation Paper by September 28, 2018.

Chartered Professional Accountants of Canada (“CPA Canada”) supports Finance Canada’s ongoing and continuing efforts to improve and refine the Goods and Services Tax/Harmonized Sales Tax (“GST/HST”) legislation and its associated regulations, and appreciates the opportunity to contribute to this through the public consultation process.

About CPA Canada and the Commodity Tax Committee

CPA Canada is one of the largest and most respected national accounting organizations in the world, representing more than 210,000 Canadian chartered professional accountants (CPAs) at home and abroad. CPAs work in every sector of the economy. They are the business and accounting leaders that Canadian taxpayers count on to represent their interests with integrity and competence, and to help them comply with Canada’s complex tax laws. CPA Canada also works collaboratively with the Government of Canada, including the Canada Revenue Agency (CRA) and Finance Canada, with a view to improving the tax system for all Canadians.



CPA Canada's Commodity Tax Committee is composed of representatives from some of Canada's larger accounting firms. The committee provides input to CPA Canada on indirect tax, customs and trade policy and administration issues in Canada, with the objective of improving the indirect taxation system for all Canadians.

General Concerns - Departure from sound VAT policy

For a number of commercial and legal reasons, businesses have to operate through various entities and relationships rather than through a single operating entity. It is our understanding that section 186 was designed to recognize that fact and to maintain tax neutrality between different operating structures where the ultimate source of revenues is primarily from commercial activity. It does so by recognizing that all businesses need capital to operate and finance the purchase of technology, services, machinery, equipment or inventory. As such, even businesses whose sole revenues are from the creation of taxable or zero-rated supplies make "financial services" for purposes of the ETA; they issue debt or shares to investors, and may also earn interest when they temporarily invest their operating capital. Because of section 185 and the various exceptions to the concept of *de minimis* financial institution in paragraphs 149(1)(b) or (c), an operating company ("**OPCO**") is not usually precluded from claiming input tax credits for expenses related to raising their operating capital.

Section 186 effectively preserves neutrality by allowing a holding company ("**Holdco**") to raise capital on behalf of its Opcos without incurring additional GST/HST costs (since the OPCOs would not incur any GST/HST by raising the capital directly). This, we understand, is consistent with, and part of the fundamental foundation of sound general "VAT" policy.

With this in mind, we would like to better understand Finance Canada's policy rationale behind some of the proposed amendments to section 186. From our perspective, we do not see a risk of GST/HST revenue leakage with the way the provision stood before the proposed amendments. In particular, the restrictions imposed by the "property test" in proposed 186(1)(c) in the Proposals and the suggested move from a "related" to "closely related" condition as described in the Consultation Paper go against sound VAT policy to not "trap" GST/HST that ultimately relates to commercial activities. It clearly leads to the narrowing of the relief that exists under the current law.

Specific Technical Issues with the Proposed Amendments

We would like to highlight several potential technical concerns with the Proposals that, perhaps unintentionally, narrow the scope of the current rules. Although there may be work-arounds that could be



used to deal with some of the concerns we raise, this could significantly complicate the management of common expenses within a corporate group. As most of our comments are questions/observations as opposed to suggested changes at this point, we would be pleased to discuss these concerns once you have had a chance to consider our comments.

- a) **The property test in 186(1)(c)** – We question the rationale for the property test for Holdcos in this paragraph. For example, why should a Holdco that also has significant assets used in commercial activity be precluded from using section 186? More specifically, a Holdco may own an operating division or commercial real estate.

Under current rules, the “reasonably relates” test would preclude a Holdco from claiming input tax credits (ITCs) for expenses related to shares of financial institutions or expenses incurred in the course of exempt activities unrelated to the shares of an Opco. Under revised rules, a Holdco is not even allowed to have any shares or debts of entities that do not qualify under subsection 186(0.1) or other investments. Moreover, a Holdco is not allowed to own interests in trusts or partnerships.

This creates significant horizontal neutrality issues between different kinds of holding structures. Furthermore, the expenses in question are such that, if resupplied or incurred by an Opco directly, would give rise to full ITCs for an Opco.

- b) **Residency test** – Although no change is made to that effect in the draft amendments, page 8 of the Draft Technical Notes specifies that section 186 is only intended to be available to corporations resident in Canada “within the meaning of paragraph 132(1)(a).” This is a departure from the statutory text insofar as there can also be corporations resident in Canada at common law, under the mind/management/control test, even if they are not incorporated in Canada. For example, a Canadian resident company may be incorporated in Delaware and listed on the New York Stock exchange, and headquartered in Toronto. There does not appear to be a policy rationale as to why that corporation should be precluded from using section 186.

Similarly, it is not clear to us why a Holdco that has a branch in Canada and is resident solely by virtue of subsection 132(2) is precluded from using section 186. For example, a foreign mining conglomerate may have an office in Vancouver to manage its Canadian mining Opcos. It incurs expenses in Canada related to the Canadian operations of these Opcos. In our view, there is no policy reason to deny the application of section 186 in this situation. Even where the expenses relate to foreign Opcos, this should not matter as a resupply by the Holdco branch to foreign Opcos should be a zero-rated export and thus give rise to ITCs.

- c) **Derivatives** – Although paragraphs 186(1)(a) and (b) appear to be targeted at capital raising activities of the parent company, these revised paragraphs are narrower than the existing provisions. For example, in the course of raising debt capital for an Opco, the Holdco may enter into options or swaps to hedge against fluctuations in currency or interest rates on the debt. This situation does not appear to be covered by either paragraphs (a) or (b). There is also uncertainty as to whether such an expense would qualify under paragraph (c). Is a currency or interest rate swap a property or liability of the Holdco? Is it a prohibited financial service of the Holdco under subparagraph (c)(ii)?
- d) **For the purpose of holding shares** – The meaning of this proposed language was unclear to us – what kind of expenses would qualify as being for the purpose of holding shares? As discussed above, many Holdcos act to incur common expenses for the corporations that it owns as one of its key functions.
- e) **Subparagraph 186(1)(b)(ii)** – Although the words “to the extent” usually implies some sort of apportionment, the phrase “to the extent that the following conditions are met” does not; it implies an all or nothing test, either the conditions are met or they are not. For example, what is the outcome if the Holdco were to raise capital, but did not transfer all of the proceeds to the Opco (e.g., it intends to purchase another company in the future, or uses the proceeds to repay existing debt)? Since the “to the extent” qualifies “the conditions” and not the proportion of the capital paid down to the Opco, would any ITCs be available?
- f) **Subparagraph 186(1)(b)(iii)** – Is this proposed subparagraph redundant? If the Opco meets the requirements of subsection 186(0.1), does it not also meet the requirements of subsection 141(2) and section 185? If that is the case, the Opco would be able to claim full ITCs on its expenses, so why deny the ITCs to the Holdco?

Also, how is the “are for use” test in that subclause to be interpreted? The Holdco must determine the “extent of its purpose” at the time of acquisition of the input, but how is the use by the Opco determined by Holdco at that time? What if the Opco is just starting its operations and does not have any revenues at the time the expense is incurred by the Holdco?

As noted, most of the comments made in this submission are questions/observations as opposed to suggested changes. We would be pleased to work with Finance Canada in the ongoing development of these new rules, and would welcome the opportunity to discuss with you the concerns raised in this letter in greater detail.



We thank the Department of Finance Canada for the opportunity to provide comments to the proposed legislative and regulatory amendments and we look forward to continued collaboration on efforts to improve and refine the GST/HST legislation.

Yours truly,

A handwritten signature in black ink, appearing to read "Heather Weber".

Heather Weber, CPA, CGA
Chair, Commodity Tax Committee
Indirect Tax Services Leader, MNP LLP

A handwritten signature in blue ink, appearing to read "Bruce Ball".

Bruce Ball, FCPA, FCA
CPA Canada, Vice President, Taxation

Cc:

- CPA Canada Commodity Tax Committee (CTC)
 - Sania Ilahi, CTC Past Chair and Partner, Tax Services, Ernst & Young LLP
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