CHARTERED PROFESSIONAL ACCOUNTANTS CANADA
COMPTABLES PROFESSIONNELS AGRÉÉS CANADA

Chartered Professional Accountants of Canada
277 Wellington Street West Toronto ON CANADA M5V 3H2
T. 416 977.3222 F. 416 977.8585
www.cpacanada.ca

Comptables professionnels agréés du Canada
277, rue Wellington Ouest Toronto (ON) CANADA M5V 3H2
T. 416 977.3222 Téléc. 416 977.8585
www.cpacanada.ca

September 11, 2024

Department of Finance Canada
Tax Policy Branch
Tax Legislation Division
90 Elgin Street, Ottawa, ON
K1A 0G5

Email: consultation-legislation@fin.gc.ca

Subject: Submission regarding Technical Amendments Legislation in Budget 2024 included in the August 2024 Draft Legislation

This submission sets out Chartered Professional Accountants of Canada's comments and recommendations on the Draft Legislation released on August 12, 2024 relating to various technical amendments.

About CPA Canada
CPA Canada and its legacy bodies have represented the views of professional accountants for many years as part of our mission to act in the public interest. CPA Canada works together with the Canada Revenue Agency ("CRA") toward making the administration of the Canadian tax system world-class. CPA Canada also regularly recommends tax policy positions to the federal government that we believe would improve the Canadian tax system. Our more than 220,000 professional accountants work in all sectors of the economy, in Canada and abroad. Many of them are tax intermediaries who taxpayers count on to represent their interests with integrity and competence, and to help them comply with Canada's complex tax laws.

We hope that you will consider our views and recommendation. We would be pleased to discuss our comments with you in greater detail, should you find that helpful.

Yours very truly,

John Oakey, CPA, CA, TEP, CC
Vice-President, Taxation
Tel: 416.204.3940
Email: joakey@cpacanada.ca

Summary of Issues identified
Technical Amendments Legislation

1. Shareholder debt

The draft technical amendments released on August 12, 2024 include certain proposed amendments to the shareholder debt rules in subsection 15(2). Among other things, the amendments provide clarification that the shareholder debt rule is not intended to apply to loans received by a partnership that is held, directly or indirectly, solely by corporations resident in Canada (CRICs). This includes loans to a partnership in a tiered partnership structure where all of the members are, directly or indirectly (through one or more other partnerships), CRICs. This aspect of the amendments applies to loans received and indebtedness incurred after October 31, 2011.

The amendments also address the potential concern that subsection 15(2) may unintentionally impact certain debtors belonging to the same foreign affiliate group as the particular corporation referred to in subsection 15(2) (or a person resident in Canada with which the particular corporation does not deal at arm's length). This includes commonly encountered situations involving a loan to a foreign affiliate holding company, as well as a loan to a partnership all of the members of which are foreign affiliates. This aspect of the amendments only applies to loans received and indebtedness incurred after the Announcement Date. While this is a welcome change, we are deeply concerned that there will continue to be a lack of clarity for loans received and indebtedness incurred prior to the Announcement Date involving certain debtors belonging to the same foreign affiliate group as the particular corporation referred to in subsection 15(2) (or a person resident in Canada with which the particular corporation does not deal at arm's length).

We are also quite concerned that this uncertainty will be further heightened by the way the draft technical notes have been drafted. Although the technical notes clearly indicate that it is not intended that subsection 15(2) impact these types of loans or indebtedness, the technical notes are drafted in a way that states that subsection 15(2) "would", in absence of the proposed amendments, apply in the case of certain examples depicted therein (with those examples not necessarily being exhaustive of all types of unintentionally impacted loans or indebtedness). While we are not readily aware of any instances where the Canada Revenue Agency (CRA) has attempted to raise an assessment in respect of unintentionally impacted loans or indebtedness, we are concerned that the CRA might be compelled to point to the blunt wording of the technical notes and challenge these types of loans or indebtedness notwithstanding that (i) the impact is clearly unintentional; and (ii) there is practitioner commentary that suggests that there might be, in certain circumstances, potential alternative interpretations. We find this uncertainty very troubling given the quantum and prevalence of these types of loans or indebtedness. Prior to the release of the August 12, 2024 draft legislation and explanatory notes, many taxpayers might not have even been aware of this uncertainty as it is simply not intuitive. Regardless of whether the CRA were to attempt to challenge unintentionally impacted loans or indebtedness that arose prior to the date of Announcement, in the absence of an earlier effective date for these proposed amendments (or clear administrative guidance from the CRA) the

uncertainty stemming from a clearly unintended impact is not only unfair to taxpayers but it also further distracts from the global competitiveness of Canadian taxpayers with foreign affiliates.

Also, while the amendments to subsection 15(2) address certain areas of concern, there continues to be uncertainty regarding the potential application of subsection 15(2) to certain commonly encountered situations involving debts owing by a foreign corporation below a partnership. This is because there is currently no rule that allows foreign affiliate status to be applied through a partnership for the purposes of applying subsection 15(2). In particular, the deeming rule in subsection 93.1(1) for shares of a foreign corporation held through a partnership does not extend to subsection 15(2), nor is there is an ownership attribution rule within subsection 15(2) itself, such as the rule in subsection 17(10) that attributes shares of a corporation held by a partnership to the members of the partnership for the purposes of determining whether a foreign corporation is a controlled foreign affiliate of a CRIC when applying certain exceptions to the income imputation rules in section 17.

To illustrate (see Diagram 1), assume two non-arm's length CRICs (or one or more foreign affiliates of the CRICs) are the sole members of a partnership that owns all of the shares of a foreign corporation, and either (i) the partnership makes a loan to the foreign corporation or (ii) one of the CRICs makes a loan to the foreign corporation. While we believe it is clear from a policy standpoint that such loans are intended to be outside the scope of subsection 15(2), the foreign corporation is not a foreign affiliate of the CRICs (because of the intervening partnership), or of a person resident in Canada with which the CRICs do not deal at arm's length (as the partnership is not considered to be a person for these purposes), and is therefore not covered by any of the exceptions in proposed paragraph 15(2.01)(a).

The same anomaly can also arise, for instance (see Diagram 2), where two non-arm's length CRICs are the sole members of a partnership (P1) that owns all of the shares of a foreign corporation (Forco1) that in turn owns all of the shares of two foreign corporations (Forco2 and Forco3) that are the sole members of a second partnership (P2). If one of the CRICs makes a loan to P2, there is a concern that subsection 15(2) could apply to the loan since P2 is connected with a shareholder (Forco1) of a particular corporation (Forco2) by virtue of P2 being affiliated with that shareholder (Forco1). The exception in proposed paragraph 15(2.01)(b) is insufficient in this case, as Forco2 is not, for purposes of section 15, a foreign affiliate of the CRICs because of the intervening partnership (P1), and therefore P2 is technically not a partnership each member of which is a person described in proposed paragraph 15(2.01)(a).

Diagram 1 – Loan to Foreign Corporation below Partnership

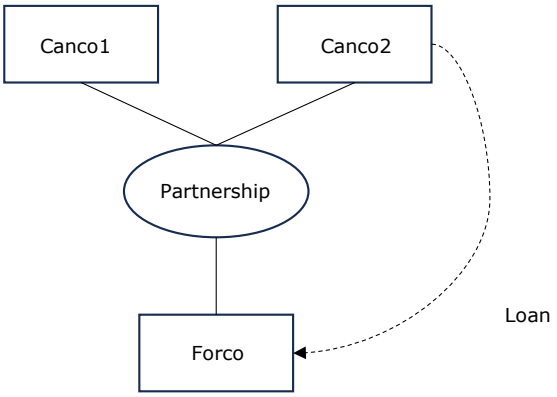
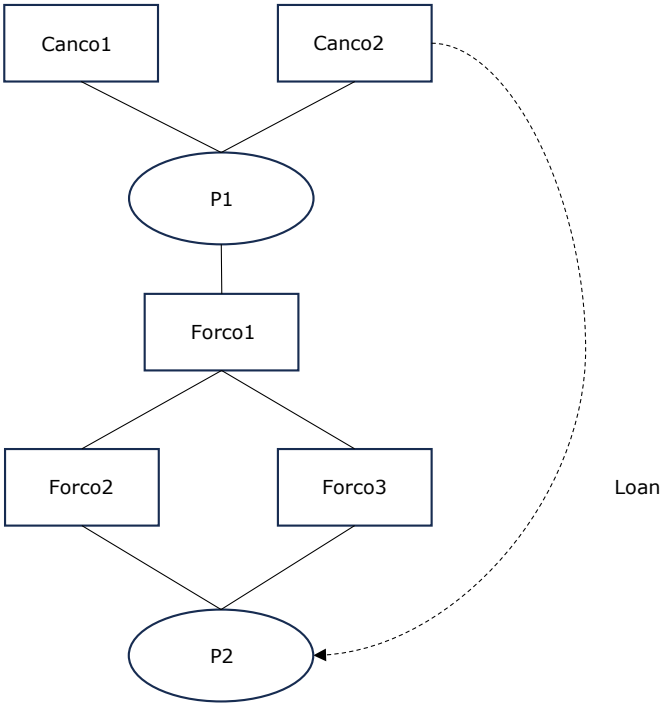


Diagram 2 – Loan to Partnership in FA group with Intervening Partnership



Recommendations

We recommend that the amendments relating to certain debtors belonging to the same foreign affiliate group as the particular corporation referred to in subsection 15(2) (or a person resident in Canada with which the particular corporation does not deal at arm's length) apply to loans received and indebtedness incurred after October 31, 2011, as opposed to being effective as of the Announcement Date. Given that this is a clarifying amendment to ensure that the shareholder debt rule does not apply in unintended and inappropriate ways (and the context and nature of these amendments is not dissimilar to the other aspects of the amendments that are proposed to apply to loans received and indebtedness incurred after October 31, 2011), we believe that this earlier effective date is appropriate and important. If this recommendation is not adopted, we recommend that (i) the wording of the explanatory notes be modified in regards to the potential application of subsection 15(2) to unintentionally impacted loans received, and indebtedness incurred, prior to the Announcement Date; and (ii) the CRA liaise with the Department of Finance to provide clear administrative guidance/relief to taxpayers regarding the treatment of such loans and indebtedness.

Further, we recommend that a partnership look-through rule apply for the purposes of subsection 15(2) when testing whether a foreign corporation qualifies as a foreign affiliate of the particular corporation or of a person resident in Canada with which the particular corporation does not deal at arm's length. This could be done by amending the existing partnership look-through rule in subsection 93.1(1) to extend to subsection 15(2) (i.e., by adding section 15 to the list of specified provisions in subsection 93.1(1.1)) or alternatively by introducing a look-through rule within section 15 itself, similar to the look-through rule in subsection 17(10) that applies for purposes of the imputed income rules in section 17. Similar to our recommendation above, we believe this change should also have the same earlier effective date, as it would simply be clarifying what has always been the intended application of subsection 15(2).

2. Alternative Minimum tax

Paragraphs 127.52(1)(d.1) and (d.2)

Section 127.52 contains the rules to compute adjusted taxable income for the purpose of the alternative minimum tax (AMT).

Paragraph 127.52(1)(d.1) adds to adjusted taxable income 30% of the capital gain relating to donated publicly traded securities that has been excluded from income under paragraph 38(a.1). The proposed legislation clarifies that this paragraph does not apply to a disposition of a "flow-through share class of property".

Proposed paragraph 127.52(1)(d.2) will add to adjusted taxable income 30% of the amount by which the taxpayer's capital gain for the year from the disposition of a flow-through share class of property exceeds the amount deemed to be a capital gain of the taxpayer from the disposition of another capital because of subsection 40(12).

The Explanatory Notes for paragraph 127.52(1)(d.1) on page 19 state that "donations of a flow-through class of property would not be subject to the AMT". This statement appears to be incorrect since both paragraphs 127.52(1)(d) and 127.52(1)(d.2) will add amounts relating to a flow-through class of property to adjusted taxable income.

Recommendation: Revisit the wording in the Explanatory Notes suggesting that donations of a flow-through class of property are subject to AMT.

Repeal of paragraphs 127.52(1)(e) and (e.1)

Subsection 24(3) of the proposed legislation will repeal paragraphs 127.52(1)(e) and (e.1) for taxation years beginning after 2023.

We note that the proposed amendment to subparagraph 127.52(1)(j)(ii) still includes a reference to paragraph 127.52(1)(e.1) which will no longer exist.

Recommendation: Remove the reference to paragraph 127.52(1)(e.1).

3. Post Mortem Planning

Subsection 164(6)

Subsection 164(6) allows a taxpayer's legal representative to elect that capital losses and terminal losses realized in the first year of the taxpayer's graduated rate estate (GRE) be treated as capital losses or terminal losses in the individual's terminal return.

One proposed amendment to subsection 164(6) will allow the taxpayer's legal representative to elect that capital losses or terminal losses realized in the first three taxation years of the GRE to be treated as capital losses or terminal losses in the individual's terminal return.

We recognize that the use of the first three taxation years of the GRE aligns with the general three-year carryback period permitted for losses in general. However, we submit that this election should be available for losses incurred for the entire period of the GRE's existence. As this period is limited to 36 months, the selection of a year-end matching the date of death of the testator would make losses realized for that full period available. However, this may force taxpayers to choose between these tax benefits and the selection of a more efficient or appropriate year-end that would be selected for non-tax reasons (for example, aligning with the calendar year for ease of reporting investment transactions).

Recommendation: Consider extending these provisions to all taxation years of a graduated rate estate

Summary of Issues identified
Budget Package Excluding Capital Gains

4. Canadian Entrepreneurs' Incentive

Subsection 110.63(1) definition of "excluded business"

The Canadian Entrepreneurs' Incentive (CEI) allows individuals that sell a "qualifying Canadian entrepreneur incentive property" to pay tax at an effective inclusion rate of one-third up to a maximum. The definition "excluded business" lists types of businesses that are not eligible for the CEI.

Paragraph (b) of the definition includes "a business whose principal asset is the reputation, knowledge or skill of one of more employees". This exclusion could plausibly be interpretated to exclude all service businesses or all businesses that compete based on technological innovation. The Explanatory Notes do not provide any additional commentary on how to interpret that paragraph.

Recommendation: The wording of that paragraph could be amended to provide greater clarity or, alternatively, the Explanatory Notes could be expanded to describe in greater detail the purpose of this exclusion and the types of businesses being targeted.

Interpretive rules in 110.63(7) for "related persons"

Proposed subsection110.63(7) contains interpretive rules for the CEI. Paragraphs (b), (c), (e) and (f) deem certain persons to be related. The only time these rules appear to be used is when interpreting subparagraph (a)(i) of the definition of "qualifying Canadian entrepreneur incentive property". But that paragraph also refers to the definition of "qualified small business corporation share" in 110.6(1) which itself contains similar interpretive rules in 110.6(14).

Recommendation: Clarify whether new subsection 110.63(7) is to replace subsection 110.6(14) when determining whether a CCPC meets subparagraph (a)(i).

Spousal rollovers

The definition of "qualifying Canadian entrepreneur incentive property" paragraph (b) requires an individual to have owned the relevant property for "a" period at least 24 continuous months before the disposition time.

This requirement prevents the spouse of a deceased entrepreneur from selling shares acquired via rollover within 24 months and claiming the CEI. Many other incentives in the ITA accommodate spousal ownership.

For example, the "TOSI" rules exempt the widow of a deceased shareholder to the extent that any split income received would have been an "excluded amount" to the deceased spouse[1].

Recommendation: Consider amending paragraph (b) to allow the CEI in cases where shares have been acquired and sold by a spouse.

The CEI and sole proprietorships

The CEI ostensibly rewards entrepreneurs for having built a successful business.

The CEI is not available to an entrepreneur who transfers the assets of a successful business to a corporation and sells the shares of the corporation within two years. As noted earlier, the definition of "qualifying Canadian entrepreneur incentive property" paragraph (b) requires an individual to have owned the relevant property (e.g., shares) for "a" period at least 24 continuous months before the disposition time.

This sole proprietor is no less an entrepreneur than the individual who builds the same business in corporate form.

Recommendation: Consider extending to CEI to entrepreneurs who build unincorporated businesses by allowing unincorporated entrepreneurs to transfer their business assets to a corporation followed by the sale of the corporation.

5. EIFEL

Definition of "purpose-built residential rental"

The EIFEL rules were passed in June 2024 and included an exemption for interest and financing expenses incurred in respect of arm's length financing for certain public-private partnership infrastructure projects.

Budget 2024 proposes to expand this exemption to include an election to exempt certain interest and financing expense incurred before 2036 in respect of arm's length financing used to build or acquire eligible purpose-built rental housing in Canada.

Paragraph (b) of the proposed amended definition of "exempt interest and financing expenses" will exempt from EIFEL an amount that is reasonably attributable to the portion of the borrowing that is used by the taxpayer or the partnership for the purpose of acquiring, building or converting a "purpose-built residential rental" provided other conditions are met.

[1] Subparagraph 120.4(1.1)(c)(ii).

The definition of “purpose-built residential rental” refers only to a building or part of a building and not the underlying land.

Recommendation: We recommend that the definition be amended to include the land subjacent to or immediately contiguous to the building or part of a building that is reasonably necessary for the use and enjoyment of the rented residential premises.

Definition of “exempt interest and financing expenses”

The proposed amendment to the definition of “exempt interest and financing expenses” at clause (b)(ii)(B) refers to “building a purpose-built residential rental.” The definition does not include capital repairs to the residential rental.

Recommendation: Clause (b)(ii)(B) should be amended to include improving a purpose-built residential rental.

If you have any questions, please contact Ryan Minor, Director, Tax at rminor@cpacanada.ca or 416.204.3355.