Taxation of Corporate Groups

Issue

Many developed countries have a formal system to consolidate the tax reporting of corporate groups or to otherwise transfer corporate profits and losses among related companies. Canada does not. Instead, various tax-planning strategies are used to directly or indirectly transfer tax attributes between related entities. Techniques include intercompany financing arrangements, mergers of related companies, transfers of property between related corporations and the wind-up (dissolution) of a subsidiary into its parent company.

These techniques entail significant internal reorganization, are disruptive to normal business operations and are time consuming. They result in high compliance and administration costs—associated legal and accounting fees can be significant.

Not all corporations are able to use tax-planning strategies, making the system unfair and inequitable. For small and medium-sized businesses, the complexity of the existing system is particularly challenging and onerous because they do not have the resources—the time, money and management expertise—to engage in complex tax planning arrangements. Additionally, legislative and regulatory constraints may limit the ability of some corporations within corporate groups (for example, those operating in the banking and telecom sectors) from using mergers and windups to consolidate losses.

Canada Revenue Agency (CRA) auditors expend considerable resources auditing businesses to ensure loss consolidation techniques are legally effective and comply with the *Income Tax Act*. In November 1996, the Auditor General of Canada noted "one of the schemes we saw involved over 30 individual transactions to accomplish the loss consolidation. We question why taxpayers should have to go to such lengths if it is Parliament's intent that they be allowed to pay tax only on the net profits of the group."

Background

It has been three years since the federal government conducted extensive public consultations on whether new rules for the taxation of corporate groups—like the introduction of a formal system of loss transfers or consolidated reporting—could improve the functioning of the corporate tax system in Canada.

The Canadian Chamber of Commerce felt a formal system of group taxation, if adopted, would further enhance the competitiveness of the corporate tax system, simplify it to minimize compliance costs for businesses and facilitate the administration and enforcement by the CRA.[1]

The government, however, stated in Budget 2013 that discussions with provincial and territorial officials have not produced a consensus regarding how the government could move forward. Businesses are disappointed that the government concluded that moving to a formal system of corporate taxation is not a priority at this time.

While the Canadian Chamber of Commerce recognizes the concerns the federal and provincial/territorial governments have over the potential of reduced revenues and the likely upfront costs for all governments associated with introducing a new approach to the taxation of corporate groups, it also believes that re-engaging stakeholders in a more open dialogue can help the government resolve these and other concerns.

Designed properly, a new formal loss transfer system can increase tax certainty, reduce complexity, enhance flexibility and improve productivity for businesses of all sizes. It would enhance the global competitiveness of Canada's businesses and Canada's economy.

Recommendations

That the federal government continue to work with provincial/territorial governments to implement a formal loss transfer system with the following design attributes:

1. Degree of Common Ownership: To allow more corporate groups to participate, base it on >50 per cent common ownership of votes and value and use the concept of "affiliated person" as the basis for determining a control group.

2. Eligible Groups: Exclude trusts and Canadian branches of non-resident corporations. Limit it to domestic subsidiaries of corporate groups.

[1] The Canadian Chamber of Commerce believes a more formalized loss transfer system is the least disruptive to the current tax system and a practical approach for the taxation of corporate groups. It would be easier to design, implement, administer and comply with a loss transfer system than with a full consolidation system. The latter would be particularly complex as well as difficult to implement given Canada has both federal and provincial/territorial levels of corporate taxation.

3. Range of Attributes: Permit group utilization of current-year and prior year non-capital losses and investment tax credits (ITCs) in addition to allowing the transfer, on paper, of taxable income (net of deductions).

4. Elective Components: Ensure participation is voluntary and allow corporate groups to decide on a year-to-year basis (i.e. annual election) whether to participate.

5. Use of Previously Accumulated Attributes in a New System: Do not exclude previously accumulated losses, where both companies party to the loss transfer were part of the same economically integrated group when the losses arose. However, if there are significant revenue implications, consider phasing in the ability to transfer existing losses over a period of years.