

Holding Corporations and GST and QST Claims – Where Do We Stand?

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BACKGROUND

Under the commodity tax regime, an individual is entitled to claim an input tax credit (ITC) with respect to the purchase of goods and services only if they are used in connection with commercial activities (i.e., in the provision of taxable and/or zero-rated supplies).

A holding corporation whose sole activity is to hold investments could, therefore, not claim ITCs on its expenses since it does not carry on commercial activities because financial services are considered to be an exempt activity.

However, Section 186 of the *Excise Tax Act* (ETA) provides that a holding corporation that does not make any taxable supplies may claim ITCs on goods and services to the extent it is considered that they were acquired for consumption or use in relation to the shares of capital stock or indebtedness of another corporation that is at that time related to it, if that other corporation carries out commercial activities exclusively (i.e. 90% or more).

Application of this provision has led to considerable discussion with respect to the question of whether a good or a service acquired by a holding corporation can reasonably be considered to be acquired for consumption or use in relation to the shares of capital stock or indebtedness of another corporation.

PROPOSED AMENDMENTS

Case law provides a fairly flexible interpretation of this provision, whereas the Canada Revenue Agency (CRA) has a more restrictive application. Naturally, taxpayers use the Court interpretation to justify their ITC claims.

In such a context, the Canadian Finance Department published draft legislation to clarify ITC recovery options for holding corporations. The draft legislation was published in July 2018, amended last May and is expected to be retroactive to July 28, 2018 when it is adopted.

The Department is amending the rules to allow a holding corporation that uses a trust or a partnership to benefit from the ITC recovery

options under ETA Section 186. More specifically, the Department has introduced the definition of a “unit”, which includes a share of a corporation, an interest in a partnership or a unit of a trust. Accordingly, a trust or a partnership that is related to another corporation which carries on commercial activities exclusively could recover ITCs on its expenditures provided they meet other conditions prescribed by the CRA.

CIRCUMSTANCES WHERE A HOLDING CORPORATION COULD CLAIM AN ITC

Under the draft legislation, a holding corporation can claim ITCs under ETA Subsection 186(1) only in the three situations described below.

1. The holding corporation acquired the goods or services in connection with the purchase, sale or holding of units or indebtedness of the operating corporation

The holding corporation acquired the goods or services to:

- Sell or dispose of units or indebtedness of the operating corporation;
- Purchase or otherwise obtain from any other corporation units or indebtedness of the particular corporation;
- Hold units or indebtedness of the particular corporation;
- Make it possible for the operating corporation to redeem, issue or convert or otherwise modify its units or indebtedness.

2. The holding corporation acquired the good or service in connection with the units or indebtedness of the parent

The holding corporation acquired the good or service in circumstances where:

- The acquisition relates to the issuance or sale of units or indebtedness of the holding corporation; and
- The proceeds from the issuance or sale are transferred by the holding corporation to the particular corporation, either by lending

money to the particular corporation or by purchasing or otherwise obtaining the units or indebtedness of the particular corporation; and

- The proceeds transferred to the particular corporation are for use by it in the course of its commercial activities.

As a result of this second situation, going forward, the holding corporation will be required to transfer the proceeds from its transactions to the operating corporation and ensure that the latter will use the funds in the course of its commercial activities. Failing this, the portfolio corporation will not be entitled to ITCs.

Example¹

A portfolio corporation acquires legal services, 85% of which are acquired for the purpose of issuing bonds, which in turn generate \$1,000,000 in net proceeds. The holding corporation then transfers \$800,000 of those proceeds (i.e., 80%) to the operating corporation through the purchase of common shares of the operating corporation. From that transfer, \$600,000 (i.e., 75%) are used to purchase equipment used exclusively in the course of its commercial activities. In this case, the portfolio corporation is entitled to claim 51% of the ITCs in respect of the legal services (85% X 80% X 75%).

3. All or substantially all (90% and more) of the holding corporation's goods consist of units and/or indebtedness of the operating corporation and/or goods acquired or held exclusively for commercial activities

In this third situation, provided the criterion regarding the holding of goods is met, the holding corporation can claim ITCs on expenses incurred in carrying out activities other than those provided in situations 1 and 2 above.

This ITC recovery options based on goods is less restrictive. However, it leads us to ask how the Department will determine if a holding corporation holds all or substantially all of the units of the particular corporation. Will it consider the number of units or their value? The explanatory notes released by the Finance Department are silent on this aspect as this time.

CONCLUSION

We can anticipate interpretation and application issues given the complexity of the new measures. Analyzing ITC claims by holding corporations will require considerable diligence in the future.

While recovery options are available, the proposed amendments to ETA Section 186 result in qualifying and limiting them to very specific situations.

Your Raymond Chabot Grant Thornton advisor can help you determine which measures apply to your business and undertake the necessary steps to use them. Do not hesitate to contact us.

For more information, visit our Web site: rcgt.com.

¹ Example taken from the Finance Department's Explanatory Notes.