
Policy Forum: Group Relief for Canadian Corporate Taxpayers—At Last?

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ABSTRACT

More than 25 years ago, the Canadian government appeared to be on the verge of finally reinstating a legislated loss transfer system for Canadian corporate groups. However, today Canada remains one of a small number of OECD countries without any formal system allowing for the sharing of tax attributes within a defined corporate group. Over the intervening years, both public and private consultations have taken place, resulting in recommendations for the implementation of a corporate loss transfer system. Two concerns are consistently raised in arguments against such implementation: first, the increased complexity that would be added to an already complex system; and second, the impact on provincial tax revenues, particularly through income shifting between provinces. This article is a response to the government's latest consultation paper, issued in November 2010. The purpose of the article is to provide input into the consultative process and, in particular, to make recommendations regarding the adoption and implementation of a new system of corporate group relief. The authors note that operating losses are now in excess of \$100 billion annually, and since they see little evidence that stakeholders are interested in a system of fully integrated tax consolidation, they propose a modest start for a loss transfer system that is user-friendly for experienced tax professionals.

KEYWORDS: CONSOLIDATION ■ CORPORATE TAXES ■ GROUP TAXATION ■ LOSSES ■ TRANSFERS

CONTENTS

| | |
|---|-----|
| Introduction | 240 |
| The Current State of Corporate Group Taxation in Canada | 241 |
| The History of Corporate Group Taxation in Canada | 243 |
| 1932-1952 | 243 |
| The Carter Commission | 243 |
| 1977-1978 | 244 |
| 1985 Legislation | 245 |
| The 2010 Consultation Paper | 246 |
| Design Parameters | 246 |
| Who—The Sharers | 247 |
| What—The Shared | 249 |
| How—The Sharing | 251 |

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| | |
|---|-----|
| Recommendations: The Right Tool for the Right Job | 254 |
| Who—The Sharers | 255 |
| What—The Shared | 256 |
| How—The Sharing | 256 |
| Illustrating Our RLTA | 257 |
| Entry and Exit | 259 |
| Conclusion | 262 |

Increasing the ability to transfer tax deductions and credits within corporate groups deserves serious consideration.

Michael Wilson, minister of finance

Canada, Department of Finance, *A New Direction for Canada: An Agenda for Economic Renewal* (Ottawa: Department of Finance, November 1984), at 41.

[T]he Government has heard various concerns from the business community and from the provinces regarding the utilization of tax losses within corporate groups. Going forward, the Government will explore whether new rules for the taxation of corporate groups—such as the introduction of a formal system of loss transfers or consolidated reporting—could improve the functioning of the tax system.

James Flaherty, minister of finance

Canada, Department of Finance, 2010 Budget, Budget Plan, March 4, 2010, at 386.

This is like déjà vu all over again.

Yogi Berra

INTRODUCTION

In November 2010, Canada's Department of Finance launched public consultations on the taxation of corporate groups, "to explore whether changes to the tax system can be made to improve its efficiency and to support economic growth."¹ The accompanying consultation paper aimed to elicit stakeholder responses that would help the department

to gauge the importance of various issues and the breadth of support for a new system of group taxation, to better define the issues such as the type of group taxation system favoured by stakeholders, and to increase understanding of some of the possible implications of a new system of group taxation.²

The purpose of this article is to provide input into the consultative process and, in particular, to make recommendations regarding the adoption and implementation of a new system of group taxation for Canada.

1 Canada, Department of Finance, "Minister of Finance Announces Public Consultations on the Taxation of Corporate Groups," *News Release* 2010-112, November 23, 2010.

2 Canada, Department of Finance, *The Taxation of Corporate Groups*, consultation paper (Ottawa: Department of Finance, November 2010) (www.fin.gc.ca/activity/consult/tcc-igs-eng.asp) (herein referred to as "the consultation paper"), at 2.

THE CURRENT STATE OF CORPORATE GROUP TAXATION IN CANADA

Canada's federal corporate income tax system treats each corporation as a single entity. Adherence to this single entity concept means that there is no formal loss transfer system under the Canadian Income Tax Act.³ Corporations within a defined group of common ownership cannot look to the legislation for guidance when attempting to offset profits and losses between members of the group.⁴ Corporate taxpayers have, however, been relatively successful in effecting a de facto group reporting system that fills the legislative void. The Canada Revenue Agency (CRA) administratively sanctions the use of this de facto system; the result is a group loss utilization system that operates by way of administrative fiat. Both the corporate taxpayer and the government agency charged with administering the Act bridge the legislative gap by relying on notes to draft legislation issued by the minister of finance on June 30, 1988.⁵ In a discussion of the application of the then proposed general anti-avoidance rule, the minister gave the following example to distinguish between legitimate tax planning and abusive tax avoidance in the area of group loss utilization.

There are a number of provisions in the Act that limit the claim by a taxpayer of losses, deductions and credits incurred or earned by unrelated taxpayers, particularly corporations. The loss limitation rules . . . that apply on a change of control of a corporation . . . are generally restricted to the claiming of losses, deductions and other amounts by unrelated parties. There are explicit exceptions intended to apply with respect to transactions that would allow losses, deductions or credits earned by one corporation to be claimed by related Canadian corporations. *In fact, the scheme of the Act as a whole, and the expressed object and spirit of the corporate loss limitation rules, clearly permit such transactions between related corporations.*⁶

Figure 1 presents an example, based on income tax ruling ATR-44,⁷ that illustrates the type of transaction series carried out by corporate taxpayers and approved by the CRA under the current Canadian de facto group reporting system. In a straightforward corporate structure, ParentCo wholly owns a subsidiary (StartupCo) that has incurred business losses in the year. The goal of the transaction series is to create income in the loss corporation to absorb non-capital losses that may go unutilized

3 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this article are to the Act.

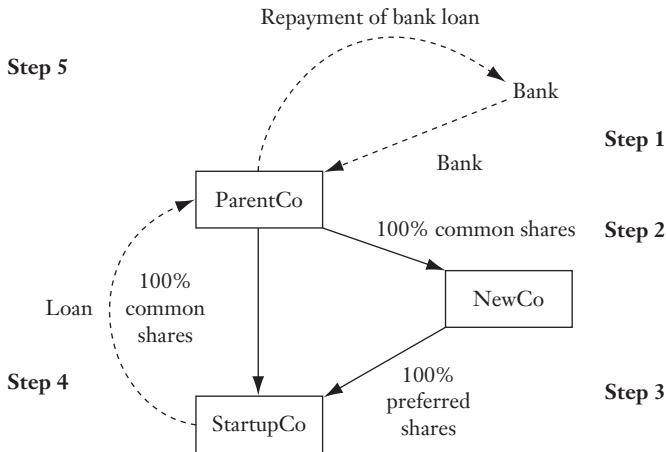
4 Subsection 88(1) (windups) and section 87 (amalgamations) allow corporations to share losses as part of a restructuring of the corporate group. This will be discussed later in the article.

5 Canada, Department of Finance, *Explanatory Notes to Draft Legislation Relating to Income Tax Reform* (Ottawa: Department of Finance, June 1988).

6 *Ibid.*, at clause 186 (emphasis added).

7 Canada Revenue Agency, *Income Tax Ruling* ATR-44, February 17, 1992.

FIGURE 1 Example: Approved Series of Intragroup Transactions Under the Current System



within the carryover period. All entities shown in the figure are taxable Canadian corporations.

The following describes the five steps shown in the example:

- **Step 1.** ParentCo borrows \$100 million from a bank at a commercial interest rate.
- **Step 2.** ParentCo incorporates NewCo and subscribes for 100 percent of its dividend-paying common shares for \$100 million.
- **Step 3.** NewCo subscribes for \$100 million of dividend-paying preferred shares of StartupCo. The dividend payout rate exceeds the interest paid on the bank loan.
- **Step 4.** StartupCo lends \$100 million to ParentCo at the same rate of interest that ParentCo agreed to pay on the bank loan.
- **Step 5.** ParentCo repays the \$100 million bank loan.⁸

Rather than transfer the business losses to the parent (as allowed, for example, in the United Kingdom) or consolidate the subsidiary's losses with the parent's profits (as permitted, for example, in the United States or Australia), the Canadian way requires five steps: securing a bank loan, forming a new corporation, subscribing for preferred shares, initiating a second loan, and, finally, repaying the bank loan. Once the non-capital losses are absorbed, the transactions are undone by winding up the new corporation. Since ATR-44, there have been 126 rulings on group loss-utilization

⁸ Provided that ParentCo has a legal obligation to pay interest on the loan and continues to hold the preferred shares for the purpose of gaining or producing income therefrom, ParentCo may deduct the interest pursuant to paragraph 20(1)(c) of the Act.

schemes. More than 80 percent (104) involved financing arrangements similar to those illustrated above.⁹ Corporations are forced to carry out complex transactions that require investments in time, administrative resources, and professional fees to ensure that each step in the series is legally effective. How did Canada arrive at such a complex system? Ironically, the present de facto system can be linked in part to the quest by successive governments for tax simplification, a quest that began with the 1952 repeal of consolidated tax reporting.

THE HISTORY OF CORPORATE GROUP TAXATION IN CANADA

1932-1952

Consolidated tax reporting became part of Canada's federal tax system in 1932.¹⁰ A review of the consolidation provision at the time of its repeal¹¹ reveals a relatively straightforward set of rules outlining eligibility requirements for the filing of a consolidated return by a group of corporations. Eligibility was restricted to a parent and any wholly owned subsidiary carrying on the same general class of business in Canada whose year-ends were substantially the same. There is some confusion as to why consolidated reporting was repealed. The official reason issued by then Minister of Finance Douglas Abbott was that with the introduction of business loss carryover rules,¹² consolidated reporting was no longer necessary.¹³

The Carter Commission

The issue resurfaced with the report of the Carter commission in 1966, which recommended that “the legislation should be amended to permit companies having common ownership to aggregate their incomes and losses for tax purposes.”¹⁴ One of the reasons cited in support of this recommendation was “that many groups of

9 Our list of rulings was derived from searching and cross-referencing two database sources: TaxPartner (Toronto: Carswell) and Knotia (Toronto: Ernst & Young).

10 SC 1932-33, c. 41, section 13.

11 SC 1948, c. 52, section 75, repealed by SC 1951, c. 51, section 26.

12 Canada, House of Commons, *Debates*, June 18, 1951, 4232-33. Carryover of business losses was introduced in 1943. Initially, a one-year carryforward was allowed when the same business continued to be carried on. By 1949, the carryover had been expanded to five years forward and one year back, but only against income from the same business. See Stephen R. Richardson, “Transfers of Deductions, Credits, or Losses Within Corporate Groups: A Department of Finance Perspective,” in *Report of Proceedings of the Thirty-Sixth Tax Conference*, 1984 Conference Report (Toronto: Canadian Tax Foundation, 1985), 737-54.

13 This explanation was, however, met with skepticism during debate in the House, where it was suspected, in some quarters, to be more a matter of administrative convenience. Cohen, for example, asserts that the real reason for repeal was “the difficulty of applying consolidation to certain new tax arrangements.” Marshall A. Cohen, “Consolidated Tax Returns” (1968) 16:5 *Canadian Tax Journal* 370-78, at 371.

14 Canada, *Report of the Royal Commission on Taxation*, vol. 4 (Ottawa: Queen's Printer, 1966), at 261.

companies have been forced to adopt artificial means of offsetting losses against profits within the group.”¹⁵ In the subsequent white paper on tax reform, the government rejected the consolidated reporting recommendation in favour of another of the commission’s recommendations, called “the partnership option.”¹⁶ Neither of the recommendations was ultimately enacted. As a result, the separate entity concept of taxing corporations survived the most comprehensive tax reform measures in Canadian history. The “artificial transaction” route remained the only option.

1977-1978

Twenty-five years after the government eliminated the right of corporate groups to file a tax return as one, a modified form of legislation sanctioning group reporting was reintroduced. The budget of March 31, 1977 allowed the transfer of losses from one corporation to another under a subsection 88(1) windup and a section 87 statutory amalgamation. Where a parent company owns at least 90 percent of all outstanding shares of a subsidiary and effects a windup of the subsidiary, the subsidiary’s losses are deemed to be losses of the parent. As such, they can be carried back and/or forward and applied to the parent’s income. A section 87 amalgamation does not require a certain threshold of share ownership in order for the new amalgamated corporation to access the losses of the predecessor corporations. The amalgamated corporation is deemed to be a continuation of the predecessor corporations; as a result, losses of the latter can be carried forward to post-amalgamation income.¹⁷

The tax community welcomed these amendments as an end to the artificial transaction route that advisers had been using to access losses of related corporations; but at the same time as these measures were being praised for reducing compliance complexity, they were also being criticized for the requirement that the group structure be altered before group offset could be accessed.¹⁸ While the liberalization of loss utilization was seen as a positive first step, the tax community wanted more. The push was on for re-enactment of consolidated reporting:

15 Ibid., at 260. As we have seen, this need for groups of companies to engage in artificial transactions to achieve de facto group taxation is still present 45 years later.

16 E.J. Benson, *Proposals for Tax Reform* (Ottawa: Queen’s Printer, 1969), at 63-64 and 68-70.

17 Where predecessor corporations are not related and the controller of the amalgamated corporation is not the controller of the loss corporation, the acquisition-of-control rules under subsections 111(4) through (5.5) will apply. The restriction on the carryback of non-capital losses is relaxed under subsection 87(2.11) for “vertical short-form amalgamations.” This provision permits the carryback of non-capital losses upon amalgamation with a wholly owned subsidiary.

18 See, for example, Glen E. Cronkright, “The Utilization of Losses in Corporate Groups and Further Relief That Might Be Taken,” in *Report of Proceedings of the Thirty-First Tax Conference*, 1979 Conference Report (Toronto: Canadian Tax Foundation, 1980), 316-27, at 321: “These amendments have provided the opportunity to effect a consolidation of many corporate groups who previously were inhibited from such consolidation by the existence of the previous constraining tax rules. At the same time, there is one feature of these amendments that may not be totally desirable. That is the basic requirement inherent in these provisions to effect a complete corporate consolidation.”

[T]he amendments do not go far enough in ensuring that within a corporate group income tax is paid only on the consolidated net income of the group. The consolidation of profits and losses for corporations within a related group is allowed in both the United Kingdom and the United States. The government should amend the *Income Tax Act* to provide the same or similar relief for Canadian corporations.¹⁹

In response, the government acknowledged in its budget of November 16, 1978 that the “existing system does produce some undesirable results,”²⁰ but it continued to hold the line against further liberalization, maintaining that “in a majority of cases companies can utilize losses within present tax laws.”²¹ The tax community’s hopes for decisive legislative action on this issue vanished when the government announced its reluctance to review the return of consolidated reporting “at a time when [we are] . . . attempting to simplify the body of technical rules applying to business.”²² Corporate taxpayers were left once again with the de facto reporting system that had been born 26 years earlier.

1985 Legislation

The government’s 1984 economic statement suggested a renewed government commitment, stating that “[i]ncreasing the ability to transfer tax deductions and credits within corporate groups deserves serious consideration.”²³ At Finance Minister Michael Wilson’s initiative, the Tax Policy Branch of the Department of Finance undertook an in-depth review of the group taxation system, which resulted in the most extensive government examination of loss utilization undertaken up to that time. A discussion paper issued in May 1985²⁴ contained not only background information on corporate group organization and tax loss utilization, but also draft legislation for a loss transfer system. The lack of equity and efficiency in the existing system were acknowledged,²⁵ and corrective action seemed imminent. The following

19 Brian J. Arnold and David C. Poynton, “Tax Treatment of Losses on Amalgamation and Winding-Up” (1978) 26:4 *Canadian Tax Journal* 444-59, at 459.

20 Canada, Department of Finance, 1978 Budget, Budget Papers, Notice of Ways and Means Motions and Supplementary Information on the Budget, November 16, 1978, at 50.

21 *Ibid.*, at 49.

22 *Ibid.*, at 50.

23 Canada, Department of Finance, *A New Direction for Canada: An Agenda for Economic Renewal* (Ottawa: Department of Finance, November 1984), at 41.

24 Canada, Department of Finance, *A Corporate Loss Transfer System for Canada* (Ottawa: Department of Finance, May 1985). This document was released with the May 23, 1985 federal budget.

25 On the issue of equity, the government stated, *ibid.*, at 1, “The Canadian corporate income tax system taxes each corporation as a separate entity. This means that some corporations in a commonly-owned group may be paying taxes while others may have available tax losses.” On the issue of efficiency, the government stated, *ibid.*, “[E]ven where available techniques are used, there are undesirable aspects. These include associated legal and accounting costs, the management time involved, uncertainty about eventual tax results and artificiality.”

comment in a submission by the Tax Executives Institute captured the positive response of the tax community: “Adoption of such a system would represent a significant step forward in . . . making the tax system and tax administration more equitable and efficient for government as well as taxpayers.”²⁶ However, attendees at the Canadian Tax Foundation’s 1985 annual conference had their enthusiasm seriously dampened. When government representatives were asked when group reporting would start, the vague answer was “[N]ot today and sometime in the future.”²⁷

THE 2010 CONSULTATION PAPER

Twenty-five years later, does the release of the November 2010 consultation paper signal that the future is finally upon us? Again citing the need to respond to “concerns from the business community and from the provinces regarding the current transaction-based approach,”²⁸ the government is asking stakeholders for feedback on all aspects of a new approach, ranging from general policy considerations to technical details. This part of the article will canvass what we consider to be the most significant aspects.

The consultation paper refers to a “spectrum of options,” with a consolidation system at one end and a loss transfer system at the other.²⁹ Placement along the spectrum between these two “endposts” of full consolidation (or fiscal unity) and simple loss transfer (or group relief) is described as being dependent upon policy choices involving tradeoffs between efficiency and complexity—in particular, the “*economic efficiency* of better recognizing corporate groups as integrated economic units versus the *complexity* that could come with departing from the current approach of taxing corporations on a separate-entity basis.”³⁰ The two ends of the spectrum as described are depicted in figure 2.

Design Parameters

The placement along the spectrum of any variation of a system of tax attribute sharing is a function of key design choices or “design parameters.” In developing a system,

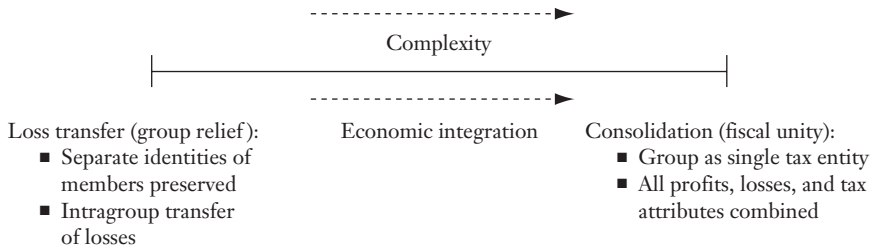
26 Tax Executives Institute, comments on *A Corporate Loss Transfer System for Canada*, submitted to the Department of Finance, November 6, 1985.

27 Nicholas LePan, “Federal and Provincial Issues in the Corporate Loss Transfer Proposal,” in *Report of Proceedings of the Thirty-Seventh Tax Conference*, 1985 Conference Report (Toronto: Canadian Tax Foundation, 1986), 13:1-11, at 13:1. LePan was general director, analysis, in the Department of Finance’s Tax Policy Division, Legislation Branch. On the same panel, Stephen Richardson cautioned the audience that “[t]here has been no further indication by the government as to when or if these provisions will be enacted.” Stephen R. Richardson, “A Corporate Loss Transfer System for Canada: Analysis of Proposals,” in the 1985 Conference Report, *supra*, 12:1-14, at 12:2.

28 Consultation paper, *supra* note 2, at 1.

29 *Ibid.*, at 7.

30 *Ibid.* (emphasis added).

FIGURE 2 Spectrum of Options for Group Taxation

decisions must be made on three design fundamentals: who will share, what will be shared, and how the sharing will work. More specifically, the design parameters listed in the consultation paper can be organized under three headings and will be discussed as follows:

1. Who—The Sharers:
 - a. degree of common ownership;
 - b. meaning of ownership;
 - c. non-resident and non-corporate members.
2. What—The Shared:
 - a. tax attributes to be shared;
 - b. the treatment of already accumulated losses.
3. How—The Sharing:
 - a. electivity;
 - b. entry and exit.

In the next part of the article, we will survey these elements and, in particular, identify the implications of particular system design choices with respect to the competing policy elements of efficiency and complexity.

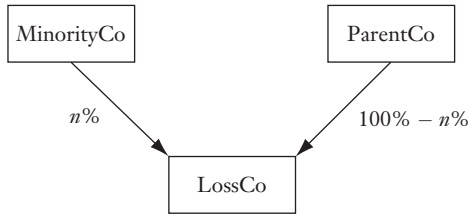
Who—The Sharers

DEGREE OF COMMON OWNERSHIP

If Canada were to make a “modest start”³¹ at group relief, the simplest definition of a corporate group would choose to use a 100 percent threshold of common share ownership. In terms of economic efficiency, this choice is inflexible and does not go very far at all toward recognizing real economic integration in corporate relationships; however, significantly relaxing the 100 percent requirement could introduce a set of complexities regarding the treatment of minority shareholders.

Consider the example illustrated in figure 3, where MinorityCo owns less than 50 percent of LossCo. What are the implications for MinorityCo of a transfer of a

31 Robert Couzin, “Income Taxation of Groups of Corporations: The Case for Consolidation,” in the 1984 Conference Report, *supra* note 12, 715-37, at 737.

FIGURE 3 Example: Shared Ownership of LossCo

loss amount from LossCo to ParentCo? The clear options, in order of increasing complexity, are as follows:

1. The loss is transferred at 100 percent of its value, and no compensation is made to either MinorityCo or LossCo.
2. The loss is transferred at 100 percent of its value, and compensation is made to either MinorityCo or LossCo.
3. The loss is transferred at $(100 - n)$ percent of its value, and n percent is simply left in LossCo.

MEANING OF OWNERSHIP

In determining whether a corporation meets the ownership threshold, “ownership” must first be defined. Again, a range of approaches is available, starting with the least complex—a simple tally of voting rights. This test is crude but simple, once again suffering from inflexibility and allowing for little recognition of the wide variety of forms in which real economic corporate ownership presents itself. All equity owners, not just voting shareholders, are the potential beneficiaries of the tax attributes of the corporation in which they hold an interest. As we move toward a more economically integrated approach and attempt to cast the widest possible net for group membership, the current rules for associating corporations represent a rational starting point. There we find rules already in place to provide for not only an expanded definition of control (*de jure*, *de facto*, and deemed), but also deemed share ownership by way of intermediaries, options and rights, and shares held by minor children. Still more inclusive group membership could be produced by incorporating other share attribution rules currently found in the Act—for example, the definition of “specified shareholder,”³² which aggregates the share ownership of all related persons.

The consultation paper presents basic statistics on corporate groups. The data show that in the majority of corporate groups in Canada, group members are wholly owned:

32 Subsection 248(1).

Between 2005 and 2008, of the corporate groups that met a common ownership threshold of greater than 50 percent, about 85 percent contained corporations with 100 percent common ownership. In addition, the corporations with 100 percent common ownership accounted for more than 90 percent of taxable income, Part I Tax payable and non-capital losses incurred by corporate groups which met the test for having more than 50 percent common ownership.³³

NON-RESIDENT AND NON-CORPORATE MEMBERS

A “full-blown,” conceptually pure system of consolidation would arguably require the inclusion of all types of taxpayers regardless of type of entity or jurisdiction of residence. Starting from a system restricted to taxable Canadian corporations, baby steps in this direction would include Canadian branches of non-resident corporations that are otherwise part of a Canadian corporate group earning taxable income in Canada. The next group to be embraced as we move along the spectrum would most likely be foreign branches of taxable Canadian corporations, with foreign parents as the final entry. (Could a corporation already consolidating in the United States be a group member in Canada?)

Any proposal to include taxpayers that are not corporations could be seen as breaching the “final frontier”—with full recognition of all types of parties in single, economically integrated groups—including individuals.

What—The Shared

TAX ATTRIBUTES TO BE SHARED

According to the latest statistics presented in the consultation paper, the majority of unused tax attributes that could be shared in the simplest version of group relief would be in the form of non-capital losses. For the 2008 taxation year, of the approximately \$180 billion in listed tax attributes, approximately \$104 billion (58 percent) are non-capital losses incurred in the year.³⁴ In descending order of value, other suggested potentially shareable attributes are the following: net capital losses, \$28 billion; scientific research and experimental development (SR & ED) deductions, \$22.3 billion; capital cost allowance, \$20.1 billion; SR & ED investment tax credits (ITCs), \$3.8 billion; and other ITCs, \$0.4 billion. Of the approximately \$336 billion in unused tax attributes accumulated by the end of the 2008 taxation year, approximately two-thirds was in the form of non-capital losses. In fact, almost all of 2008 corporate taxable income (\$209 billion) would have been eliminated had the non-capital loss pool (\$206 billion) been fully utilized. In other words, a system that offered only intragroup transfers of non-capital losses would address the lion’s share of the business community’s concern over unused tax benefits within its corporate families and would go a long way toward providing a response to the fundamental policy

33 *Supra* note 2, at 27; annex 3, table 3.

34 *Ibid.*, at 24; annex 2, table 1.

question: Why should a profitable corporation pay tax when it is economically integrated with a corporation in a loss position?

As stated in the consultation paper,

a transfer system that applies to other tax attributes in addition to losses (e.g. investment tax credits) would come closer to treating the group as a single economic unit, and would move a system along the spectrum closer to a consolidation system.³⁵

Of course, the longer the list of shared attributes, the greater the complexity involved and the higher the cost in terms of forgone revenue. The amounts available for sharing beyond non-capital losses may not be worth the inevitably resulting sets of rules necessary to make them accessible.

THE TREATMENT OF ALREADY ACCUMULATED LOSSES

Depending on the placement of a particular group taxation system along the spectrum of options, it may be necessary to consider the appropriate treatment of the losses that have been accumulated in corporate groups (however defined) prior to the introduction of the new system. In the simplest system, where group member corporations retain their separate identities, accumulated losses would remain with the corporation within which they arose, and their utilization would continue to be governed by the existing rules—that is, accumulated losses would be ring-fenced, and only subsequent losses would be available for transfer. By contrast, in a full consolidation system where all subsidiary corporations lose their identities (as in Australia, for example), the accumulated loss pools would become tax assets of the integrated unit.

As noted above, non-capital loss pools are now in the hundreds of billions of dollars. Given the current availability of an ad hoc informal system, to deny all losses accumulated by corporate groups prior to the introduction of a new system could be seen as unduly harsh, assuming that the two systems do not continue to coexist. On the other hand, the revenue implications of unfettered use of the pre-existing loss pools are considerable. The consultation paper refers to the significant resulting reduction in revenues and the possibility of windfall gains if corporations were allowed to utilize losses under one system that arose under another. The paper therefore suggests that “the ability to access existing pools of losses . . . in a formal group taxation system would likely need to be constrained in some manner.”³⁶ Let us consider the additional complexity raised in the following example.

Assume that on the first day of the new system (say, January 1, 2012), ParentCo has taxable income of \$100,000 and owns 100 percent of LossCo, which has \$100,000 of non-capital losses available for carryforward. The transfer to ParentCo

35 Ibid., at 7.

36 Ibid., at 19.

of LossCo's non-capital losses is perfectly straightforward. The only real question is one of fiscal affordability.

Now assume instead that, at the time the \$100,000 was accumulated in the non-capital loss pool of LossCo, ParentCo's ownership stood at 80 percent.

- Is the amount eligible for transfer only \$80,000?
- Is the transfer to be subject to a form of same business test?
- Is the transferred amount to be calculated using some form of fair market value test?³⁷
- Is the transfer to be reduced to an arbitrary percentage of the accumulated losses or spread over a number of taxation years in order to soften its revenue impact?

How—The Sharing

ELECTIVITY

Should it be mandatory for a corporation that meets the chosen definition for membership in a corporate group to participate in a corporate group taxation regime?

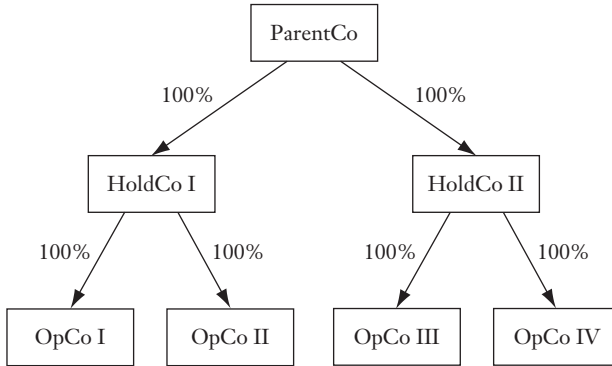
Arguably, the simpler answer is yes. Under an elective regime, further rules would have to be introduced to regulate the election process, and additional complexity would arise. For example, rules regarding the following aspects would be required:

- Would corporations be required to apply, and to give reasons to opt out? If so, what reasons would be appropriate?
- How often must the election be exercised?
- Could the parent company revoke the election on behalf of the group?
- For those corporations who elected out, would the current informal system continue to be available?
- Would all corporations that met the predetermined threshold be required to be included in a single group?

Consider the example in figure 4 where all subsidiary corporations are wholly owned. The “all-in” group would include all seven corporations; however, both HoldCo I and HoldCo II are also parent corporations to their respective OpCos. Could a subgroup headed by HoldCo I elect group treatment in the absence of ParentCo's participation; or could the four corporations of ParentCo, HoldCo I, OpCo I, and OpCo II be a group absent HoldCo II's participation?

This simple example provides a number of possible group formations under an elective system, even assuming the 100 percent threshold requirement. If the

37 For example, under Australia's consolidation regime, pre-existing losses are transferred into the group and their utilization is dependent upon the loss corporation's “loss factor”—that is, the ratio of the fair market value of its assets to the fair market value of the assets of the group.

FIGURE 4 Example: Corporate Group with Wholly Owned Subsidiaries

ownership threshold is lowered or otherwise relaxed, it may easily occur that a single corporation could meet the definition of member in more than one group. Recall the possibility discussed earlier that either votes or value (or some combination of the two) could constitute the threshold test. Consider the following scenario, illustrated in figure 5.

- Individuals X and Y are in no way related for tax purposes.
- VoteCo has one class of shares outstanding; all are owned by X.
- ValueCo has one class of shares outstanding; all are owned by Y.
- LossCo has two classes of shares outstanding—common shares of nominal value and hi/lo preferred shares, all held by ValueCo.

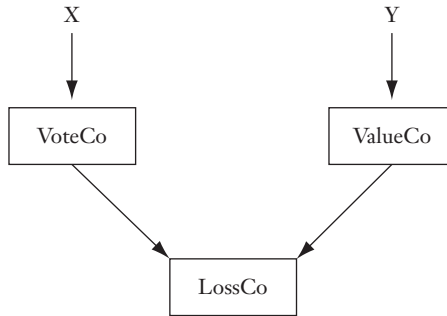
Assuming a votes-or-value ownership test for group membership, LossCo may be grouped with either VoteCo or ValueCo.

ENTRY AND EXIT

Corporate group taxation would be much simpler to legislate and to administer if corporate groups were static phenomena. Complexity has the potential to run wild in the form of rules to govern entry and exit. In a regime of full consolidation, the entry of a new loss corporation presents new and more complex challenges. The fundamental question is this: Who is the owner of the new member's pre-existing losses, and how are they to be utilized within the group? If the losses remain the property of the legal entity by which they were incurred, what restrictions should be placed upon their use?

Entry of a loss corporation into an existing group could occur in one of (at least) three ways:

1. entry by a corporation that could have been included in the group in an earlier taxation year (that is, it met the ownership criteria but opted out, assuming an elective system);

FIGURE 5 Example: Votes or Value Threshold Test

2. entry by a corporation that, when the group was first formed, was controlled but did not meet the ownership criteria; or
3. entry by a corporation that, when the group was first formed, was non-controlled and non-related.

Consider the following fact situation. For all three scenarios surveyed below, ParentCo, a holding company, has two wholly owned subsidiaries, SubCo I and SubCo II. When group taxation is introduced on the assumed date of January 1, 2012, ParentCo, SubCo I, and SubCo II form a corporate group for the purpose of transferring losses. On January 1, 2014, SubCo III joins the group for the purpose of delivering up its accumulated losses for sharing with the other group members. To illustrate our three scenarios, we will simply change the percentage of SubCo III that is owned by ParentCo.³⁸ The issue is the quantum of SubCo III's losses incurred in 2012 and 2013 that can be utilized by the existing group.

- *Scenario 1.* At all relevant times, ParentCo owns 100 percent of SubCo III. The group should be able to fully access SubCo III's losses that arise in 2012 and 2013, since SubCo III could have been a "charter member" of the group. Under current legislation, ParentCo could have accessed these losses by either a statutory amalgamation or a windup. No new policy ground would be broken by allowing full access.
- *Scenario 2.* Assume a threshold test of 100 percent and initial ownership (at January 1, 2012) by ParentCo of 80 percent of SubCo III. ParentCo increases its ownership to 100 percent on January 1, 2014, and SubCo III joins the group. In this change-of-control scenario, will it be 100 percent or 80 percent of SubCo III's losses that will be accessible by the group? Do we require some type of continuity-of-ownership or same business test to answer this question?

38 Where ParentCo's ownership is less than 100 percent, assume that the balance is owned by non-related persons.

- *Scenario 3.* Assume a threshold test of 100 percent and initial ownership (at January 1, 2012) by ParentCo of 49 percent of SubCo III. ParentCo increases its ownership to 100 percent on January 1, 2014, and SubCo III joins the group. In this acquisition-of-control scenario, will it be 100 percent or 49 percent, or indeed any, of SubCo III's losses incurred in 2012 and 2013 that will be accessible by the group? Do we rely on the current acquisition-of-control rules, or do we require a new test to answer this question?

Similarly, when a corporation exits the group, there are two fundamental questions that again turn on how we determine the ownership of the losses:

1. Can the exiting corporation leave with the losses it brought in?
2. Can the exiting corporation leave with the losses it incurred while in the group?

RECOMMENDATIONS: THE RIGHT TOOL FOR THE RIGHT JOB

In order to evaluate the consultation paper and the Finance decision-making process, commentators must have insight into what the government was seeking to achieve when the consultation was initiated. For example, if the purpose was to replace the current transaction-based ad hoc system permitting the transfer of non-capital losses between members of a corporate family, then that goal could be relatively straightforward in its implementation.³⁹

Group loss utilization is one thing; consolidation for tax purposes is something very different. The former has a narrow focus and a specific purpose. Much of what we take for granted in our current corporate tax system in Canada would be turned on its head by the introduction and implementation of a tax consolidation regime. Even the briefest consideration turns up the following examples of tax measures and treatments that would be called into question:

- intercorporate dividends,
- tax-free asset transfers,
- windups, and
- deemed dividends.

Enormous questions leap to mind. What would become of all the other ways that the Act recognizes corporate interrelationships—for example, would the sharing of the small business deduction require a differently defined relationship than the sharing of ITCs? Would a consolidated system supplant or supplement our existing

³⁹ The 1985 draft legislation accomplished that goal with the addition of a single section (section 111.2) to division C. Canada, Department of Finance, "Draft Legislation," in *A Corporate Loss Transfer System*, supra note 24, at clause 2.

system? Would the individual corporation cease to exist, for all intents and purposes, from a tax point of view? If a reporting group with non-resident and non-corporate members were fully recognized as an economically integrated unit, what would be the consequences of such integration? Are we ready, in the name of economic efficiency, to set aside the basic legal principles around the separate legal existence of the corporation, such as limited liability and the separation of ownership and management? How are economically integrated corporations not jointly liable for each others' debts and obligations?

The implications of a wholesale shift to economic integration as the test for a tax unit cannot be overstated. If the goal is to offer a relatively quick and simple mechanism for the utilization of operating losses that now total more than \$100 billion annually, then that simple goal becomes exponentially more complex within a consolidated regime. In our opinion, the adoption of a regime of tax consolidation is far beyond what is necessary for an adequate response to the concerns of the business community, whose members have long called upon the government for a legislated loss transfer system. In October 2010, the Tax Executives Institute, a tireless advocate on this issue, once again urged the Department of Finance “to pick up its 1985 proposal, revise it as necessary, and issue an updated proposal for discussion in early 2011.”⁴⁰ In the same month, at the same forum, the Canadian branch of Financial Executives International asked for “improvements to the tax system that would help Canadian businesses thrive includ[ing] some form of group tax reporting for companies, such as the implementation of a loss transfer system.”⁴¹

Since there is little to no evidence that the business community wants tax consolidation and the complexity that would inevitably result, and since the volume of new rules would be minimized by relying to the extent practicable on rules already in place in the Act, we recommend a system with the design parameters described below.

Who—The Sharers

Corporate group formation will be based on the rules currently contained in subsection 88(1) for the tax-free windup of a subsidiary. A corporate group will consist

40 Tax Executives Institute, letter to the Honourable James M. Flaherty, minister of finance, October 6, 2010 ([www.tei.org/news/Documents/Loss_transfer_mechanism_2010%20\(final%20trhd\).pdf](http://www.tei.org/news/Documents/Loss_transfer_mechanism_2010%20(final%20trhd).pdf)), at 7. The letter identifies the Tax Executives Institute as “the preeminent international association of business executives . . . [whose] 7,000 professionals manage the tax affairs of 3,000 of the leading companies in North America, Europe, and Asia,” *ibid*.

41 Financial Executives International, “FEI Calls on the Federal Government To Simplify the Tax System: Media Advisory,” *News Release*, October 5, 2010 (www.feicanada.org/pdfs/FEI%20Canada%20News%20Release%20-%20October%205%202010.pdf). Financial Executives International is an all-industry professional association for senior financial executives and has more than 2,000 Canadian members. According to the website of the Canadian branch (www.feicanada.org/page/about), the membership comprises chief financial officers, controllers, treasurers, tax executives, and finance and accounting professors, and represents 8,000 of North America’s leading and most influential corporations.

of a parent corporation and all subsidiaries where the parent owns “not less than 90% of the issued shares of each class of the capital stock of the subsidiary.”⁴² Excluded from the 90 percent threshold will be specified shares as currently defined in subsection 256(1.1), since they are “normally associated more with debt instruments than equity.”⁴³ Only taxable Canadian corporations will be included.

What—The Shared

As a starting point to address the single largest concern, we propose the sharing of non-capital losses. Only those losses that arise subsequent to the group’s entry into the new regime will be available for use by member corporations other than the one that incurred the loss. This recommendation is motivated largely by concern about the affordability of launching the new system.

How—The Sharing

We propose a system that is partly elective and partly mandatory. The group parent will elect on behalf of the group to participate in the new loss transfer system; however, once that election is made, all subsidiaries that meet the definition must participate. The parent may review the group’s election status every fifth taxation year. The current ad hoc system would cease to exist upon the coming into effect of the new system.⁴⁴

Non-capital losses that arise within the group subsequent to its entry into the new system will be subject to the following treatment:

- Apart from the sharing of non-capital losses, the separate identities of member corporations are maintained. All corporations still continue to file separate tax returns.
- Taxable incomes and non-capital losses are pooled and administered at the parent level.⁴⁵
- For provincial reporting purposes, net taxable income of the group is allocated to the provinces where the subsidiaries are located. To address provincial

42 Subsection 88(1), preamble.

43 Supra note 24, at 13. The threshold of ownership proposed in 1985 was 95 percent of the outstanding shares of each class, with the exclusion of fixed-value preference shares. These would be similar to today’s specified shares representing debt rather than equity.

44 Although this rule may seem harsh, there would be overall gains in efficiency, equity, and certainty. Losses could still be utilized through tax-free transfers of assets, windups, and amalgamations.

45 This feature is based on Germany’s *organschaft* system, which requires that both the income and the losses of subsidiaries be “rolled up to the parent corporation after the income or loss of the subsidiary is determined.” Supra note 2, at 9. For a more detailed description, see Helmut Bredeek, “Utilization of Losses in Corporate Groups—Is Relief Needed—Under German Tax Law,” in the 1979 Conference Report, supra note 18, 365-80.

concerns regarding income shifting, we introduce a new mechanism, the “refundable loss transfer account” (RLTA).⁴⁶

Illustrating Our RLTA

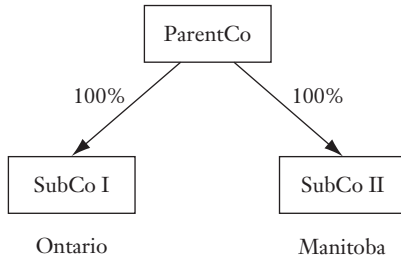
Consider the example in figure 6 where ParentCo, a holding company, has two wholly owned subsidiaries, SubCo I and SubCo II. ParentCo elects under the new regime on the date at which it comes into effect, which is assumed to be January 1, 2012. SubCo I is located in Ontario; SubCo II, in Manitoba. Operating results for taxation years 2012 through 2016 are as follows.

| | SubCo I (Ontario) | SubCo II (Manitoba) |
|------------|-------------------|---------------------|
| | <i>dollars</i> | |
| 2012 | (10,000) | 6,200 |
| 2013 | (12,000) | 17,500 |
| 2014 | 27,000 | (15,000) |
| 2015 | 5,800 | 6,000 |
| 2016 | 3,000 | (19,300) |

Without a loss transfer system, under current legislation, SubCo I would have non-capital losses of \$10,000 and \$12,000 in 2012 and 2013, respectively, which would be carried forward and applied in 2014, resulting in taxable income of \$5,000 taxed in Ontario. SubCo I would have taxable income of \$5,800 and \$3,000 in 2015 and 2016, respectively. SubCo II would initially report taxable income of \$6,200 and \$17,500 in 2012 and 2013, respectively, but would then carry back the 2014 non-capital loss of \$15,000, resulting in taxable income of nil in 2012 and \$8,700 in 2013. SubCo II would initially report \$6,000 in 2015 but would then carry back its 2016 non-capital loss, using \$8,700 to reduce its taxable income in 2013 and \$6,000 in 2015. SubCo II’s non-capital loss available for carryforward at the end of 2016 would be \$4,600. In aggregate, the ParentCo group would report taxable income of \$13,800 over the period as follows:

46 Our RLTA is derived from the European Union’s “deduction/reintegration method” proposed to deal with the tax treatment of losses in cross-border situations. See Commission of the European Communities, *Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee: Tax Treatment of Losses in Cross-Border Situations*, COM (2006) 824 final (Brussels: Commission of the European Communities, December 19, 2006). “Under this scheme a loss incurred by a subsidiary situated in another Member State . . . is subsequently recaptured once the subsidiary returns to profitability. This results in a temporary transfer of losses. . . . The advantage of this method is that it is relatively easy to operate. First, the losses are deducted, and later, when the subsidiary returns to profit, the loss previously deducted is recaptured through a corresponding additional tax burden.” *Ibid.*, at paragraph 3.4.2.

FIGURE 6 Example: Corporate Group with Subsidiaries in Ontario and Manitoba



| | SubCo I (Ontario) | SubCo II (Manitoba) |
|------------|-------------------|---------------------|
| | <i>dollars</i> | |
| 2012 | nil | nil |
| 2013 | nil | nil |
| 2014 | 5,000 | nil |
| 2015 | 5,800 | nil |
| 2016 | 3,000 | nil |

Under our proposed loss transfer system, profits and losses are rolled up to ParentCo, where the RLTA is maintained. In 2012, SubCo I's \$10,000 loss offsets SubCo II's \$6,200 profit. The group result is nil taxable income and a non-capital loss of \$3,800, which is carried forward. The \$6,200 loss transferred from SubCo I to SubCo II increases the RLTA from Ontario to Manitoba. In 2013, SubCo I's loss offsets SubCo II's \$17,500 profit, resulting in a net profit of \$5,500, which is then reduced by the \$3,800 loss carried forward. The RLTA is increased by \$15,800 (the \$3,800 carried forward plus the \$12,000 of current losses), so that the RLTA (Manitoba) balance at the beginning of 2014 is \$22,000 (\$15,800 + \$6,200). Group taxable income in 2013 is \$1,700 reported in Manitoba; the non-capital loss pool is zero. In 2014, SubCo I returns to profitability, and as a result, the \$22,000 of non-capital losses previously transferred to SubCo II in Manitoba is recaptured. This \$22,000 transfer is subtracted from SubCo I's profits and at the same time added to SubCo II's results, moving them from a loss position of \$15,000 to a profit of \$7,000. Group taxable income is \$12,000: \$5,000 reported by SubCo I in Ontario and \$7,000 reported by SubCo II in Manitoba. The balance in the RLTA (Manitoba) is now nil. In 2015, group taxable income is \$11,800 (SubCo I's \$5,800 + SubCo II's \$6,000). In 2016, SubCo II's \$19,300 loss is carried back first to 2013, then to 2014, then to 2015, eliminating its own taxable income in those years (\$1,700, \$7,000, and \$6,000, respectively); the remaining \$4,600 is offset against SubCo I's \$3,000 in 2016 taxable income, reducing group taxable income to nil. The \$1,600 remainder is then carried back to SubCo I's 2014 taxable income, reducing it to \$3,400 (\$5,000 - \$1,600). The RLTA (Ontario) increases to \$4,600, the amount of SubCo II's loss

applied to reduce SubCo I's taxable income in Ontario. In aggregate, the ParentCo group will report taxable income of \$9,200 over the period as follows:

| | SubCo I (Ontario) | SubCo II (Manitoba) |
|------------|-------------------|---------------------|
| | <i>dollars</i> | |
| 2012 | nil | nil |
| 2013 | nil | nil |
| 2014 | 3,400 | nil |
| 2015 | 5,800 | nil |
| 2016 | nil | nil |

As described above, in the absence of the proposed loss transfer system, the ParentCo group would report \$13,800 over the same period, with SubCo II ending the period with a non-capital loss carryforward of \$4,600. The proposed system effectively allows \$4,600 to be used by SubCo I, reducing the group taxable income to \$9,200 (the net of all profits and losses in the group over the five-year period). The balance of the RLTA (Ontario) is \$4,600—the same as the non-capital loss carryforward balance held by SubCo II under the old system—and can be recaptured by SubCo II in the event that it returns to profitability.

Entry and Exit

The entry of corporations into and the exit of corporations out of existing groups will be subject to the following rules:

- Where a corporation *enters* an existing group upon a change of control, its non-capital losses will be transferable to the group to the extent that those losses arise in taxation years subsequent to the coming into effect of the new system. Where a corporation enters an existing group upon an acquisition of control, its non-capital losses will be transferable to the group to the extent that those losses arise in taxation years subsequent to the coming into effect of the new system and to the extent that the existing acquisition-of-control rules are otherwise satisfied.⁴⁷

Say, for example, that ParentCo's ownership at January 1, 2012 is 80 percent of SubCo. On January 1, 2014, ParentCo's ownership increases to the requisite 90 percent and SubCo joins ParentCo's existing group. The group should have access to 100 percent of SubCo's 2012 and 2013 losses because ParentCo purchased those losses from the seller.

- Where a corporation *exits* a group, the corporation will take with it all losses that remain unutilized at the time of its departure⁴⁸—both those losses that it brought in when it entered the group and those that it incurred while a member

47 See subsections 111(4) through (5.5).

48 Subject to the deemed taxation year-end suggested below.

of the group. Consistent with our recommendation that the separate identities of the member corporations be maintained, ownership of unused losses is not surrendered either to the group or to its parent corporation. The issue of loss duplication will be handled using the RLTA introduced above in our discussion of provincial allocation.

Consider the following example. On January 1, 2012, ParentCo elects on behalf of its existing group into the new loss transfer system. The table below shows the profits and losses of the individual group member corporations before any carryover or transfer of loss amounts.

| | SubCo I | SubCo II | SubCo III |
|---------------------|----------------|----------|-----------|
| | <i>dollars</i> | | |
| 2012 | 4,800 | 5,200 | (35,000) |
| 2013 | 3,600 | 6,900 | 27,200 |
| June 30, 2014 | 7,400 | nil | (11,800) |

The group (SubCo I and SubCo II) has taxable income of \$10,000 in 2012 before the admission of SubCo III. On January 1, 2013, SubCo III joins the group through a change of control. SubCo III incurred a \$35,000 non-capital loss in its 2012 taxation year; \$10,000 of that loss is immediately utilized by the group, leaving \$25,000 to carry forward. In 2013, the group’s profits are \$37,700; SubCo III applies its \$25,000 carryforward to its own 2013 profit, leaving a balance of \$2,200. Assume that on July 1, 2014, ParentCo sells its interest in SubCo III and SubCo III leaves the group. We recommend that SubCo III be deemed to have a taxation year-end⁴⁹ of June 30, 2014; assume that at that date, SubCo III has an \$11,800 loss. We further recommend that any member(s) of the group be allowed to elect a deemed year-end in order to maximize group utilization of SubCo III’s 2014 non-capital loss. Since SubCo I has a profit as at June 30, 2014, it elects to trigger a taxation year-end on that date and utilizes \$7,400 of SubCo III’s loss. SubCo II has no profit and opts not to make the election. SubCo III then leaves the group, taking with it its remaining \$4,400 (\$11,800 – \$7,400) in non-capital losses. The balance in SubCo III’s RLTA is \$15,200 as at June 30, 2014, calculated as follows.

- 2012. Of SubCo III’s \$35,000 loss, \$10,000 is used immediately by other group members: SubCo I uses \$4,800; SubCo II uses \$5,200. Total transferred losses of \$10,000 are recorded in SubCo III’s RLTA.
- 2013. SubCo III returns to profitability, and \$2,200 is recaptured from other group members; the resulting RLTA balance is \$7,800 (\$10,000 – \$2,200).⁵⁰

49 Pursuant to subsection 249(4).

50 Since the \$10,000 that went into SubCo III’s RLTA was a total of the \$4,800 of SubCo III’s losses that was used by SubCo I and the \$5,200 used by SubCo II, when, in 2013, the \$2,200 is recaptured, the amount would be allocated as between SubCo I and SubCo II pro rata on the

- 2014. SubCo III's loss at its deemed taxation year-end is \$11,800, of which \$7,400 is utilized by SubCo I. The June 30, 2014 balance in SubCo III's RLTA is \$15,200 (\$7,800 + \$7,400).

Assume that when ParentCo sells its interest in SubCo III, it incurs an allowable capital loss on the sale of \$13,750. To avoid duplication of SubCo III's losses that were utilized by the group, the \$13,750 allowable capital loss is reduced to nil by applying SubCo III's RLTA balance to it.⁵¹ The balance in SubCo III's RLTA is now \$1,450 (\$15,200 – \$13,750). The amounts refundable to SubCo III from both SubCo I and SubCo II are reduced on a pro rata basis for the \$13,750 applied to ParentCo's allowable capital loss. The table below summarizes the calculation of SubCo III's RLTA.

| | SubCo I | SubCo II | Total: SubCo III's RLTA |
|---------------|-----------------------------|----------------------------|----------------------------|
| | <i>dollars</i> | | |
| 2012 | 4,800 | 5,200 | 10,000 |
| | <u>(1,056)^a</u> | <u>(1,144)^a</u> | <u>(2,200)</u> |
| 2013 | 3,744 | 4,056 | 7,800 |
| | <u>7,400</u> | <u>nil</u> | <u>7,400</u> |
| 2014 | 11,144 | 4,056 | 15,200 |
| June 30 | <u>(10,081)^b</u> | <u>(3,669)^b</u> | <u>(13,750)</u> |
| July 1 | <u>1,063</u> | <u>387</u> | <u>1,450</u> |

^a SubCo I: $(\$4,800/\$10,000) \times \$2,200 = \$1,056$. SubCo II: $(\$5,200/\$10,000) \times \$2,200 = \$1,144$.

^b SubCo I: $(\$11,144/\$15,200) \times \$13,750 = \$10,081$. SubCo II: $(\$4,056/\$15,200) \times \$13,750 = \$3,669$.

In the event that SubCo III is located in a different province than either SubCo I or SubCo II, SubCo III's RLTA balance should be carried forward⁵² so that if, during the carryforward period, another corporation from SubCo III's province joins the group, the new entrant will assume SubCo III's RLTA. The carryforward of the RLTA

basis of their relative profits for 2012 (that is, 48 percent to SubCo I, which used \$4,800 of the \$10,000 used by the group, and 52 percent to SubCo II, which used \$5,200 of the \$10,000 used by the group).

51 This recommendation is similar to proposed subsection 111.2(6) in the draft legislation of 1985. "Subsection 111.2(6) provides for an adjustment on the disposition of a share where a loss is transferred without adequate compensation and the result of the transfer is to create a loss, increase the loss or reduce the gain from the disposition." Canada, Department of Finance, "Draft Legislation: Technical Summary," in *A Corporate Loss Transfer System*, supra note 24, at 19.

52 The carryforward period could be the same as the carryforward period for a non-capital loss—20 years pursuant to existing paragraph 111(1)(a).

balance is required only for the purpose of allocating income among provinces. Where all three of our SubCos are located in the same province, the RLTA will be closed when SubCo III leaves the group.

CONCLUSION

From our review of the corporate loss transfer issue in Canada, we conclude that the major barriers to the adoption of a formal system have been twofold: first, the fear of additional complexity; and second, the provincial concerns for equitable income allocation. It is within these two overarching parameters that our recommendations are formulated. We have attempted to address the concerns of the provinces through the introduction of the RLTA and to balance efficiency and complexity as suggested in the consultation paper.

In the Canadian context, group taxation is an area in which complexity has in fact been heightened by the absence of legislation. Earlier in this article, in our discussion of the history of the group taxation debate in Canada, we set out an account of the federal government's continuing failure to make formal provision for the transfer of losses within a commonly owned group of corporations. Although it has been acknowledged that a system allowing the transfer of losses within corporate groups "has the potential of reducing the complexity of business operations,"⁵³ it has not been implemented. Over 25 years ago, when such a system was proposed in the name of simplification, with draft legislation in hand, the government's failure to proceed was based partly on its assessment that the proposed system was too complex.⁵⁴ Canadian corporations continue to adjust their affairs to achieve the same tax result as they would under a formal loss transfer system; however, with no legislation to provide the system, they are forced to carry out multiple time-consuming, costly, and inefficient series of transactions and to rely on the goodwill of tax administrators to sanction the results.

Legislation to implement a regime allowing loss utilization by members of a corporate group would undeniably add complexity to the Act. The Act would get

53 *Supra* note 24, at iii. This sentiment is echoed in the 2010 document: "A new system of group taxation may also address concerns expressed by stakeholders that the current approach is unduly complex." *Supra* note 2, at 3.

54 Although the subject of corporate group taxation may be a complex one, the enabling legislation proposed in 1985 satisfied many other facets of simplicity: the policy objectives were clearly articulated, consistent, and compatible with business and commercial reality; the structural design was straightforward; the statutory language was clear; and no extraordinary difficulties with compliance and administration were identified. (These criteria are taken from William J. Strain, David A. Dodge, and Victor Peters, "Tax Simplification: The Elusive Goal," in *Report of Proceedings of the Fortieth Tax Conference*, 1988 Conference Report (Toronto: Canadian Tax Foundation, 1989), 4:1-63, at 4:3-5.)

longer: concepts would have to be defined in terms of the definition of the “group,” the consequences when a corporation enters or leaves a group, the extension (or not) of relief to non-resident corporations—these are only a few of the “complexities” that have been canvassed in this article. At the same time, much would be gained in another dimension of simplicity, namely, certainty.⁵⁵

The amount of added complexity is largely a function of the type of system. Speaking to Canadian tax professionals more than 30 years ago, British tax adviser Michael Aidin described his country’s loss relief system. Although not perfect (what tax system ever is?), he concluded that it “seems to work reasonably well”:

Some system for the allocation of profits and losses within groups of companies is a necessary part of the tax code in a sophisticated economic system. However, as so often is the case in tax reform, the best may be the enemy of the good. Tax reform, like diplomacy, is the art of the possible. In making changes, it may be better to accept some improvement rather than attempt to meet all cases through a complex series of provisions that are cumbersome to administer and difficult to interpret.⁵⁶

With the majority of the member nations in the Organisation for Economic Co-operation and Development now using some form of group taxation, it should not be that difficult for Canadian law makers to articulate a group relief system that is “user-friendly” for experienced tax professionals. For some commentators, that is the essence of tax simplification:

The challenge is not to make the tax system simple, because that is neither possible nor desirable. Rather the goal, expressed in the jargon of the computer age, should be to make the system more “user friendly.” . . . Experienced tax professionals should be able to read, interpret, understand, and apply the statutory provisions in respect of a wide variety of business and commercial transactions, with a reasonable expenditure of time and effort and with reasonable assurance that their conclusions are correct.⁵⁷

55 Cohen lists four causes of complexity: the increasing complexity and sophistication of society and the world of business; the desire for equity; the desire for certainty; and the use of the tax system to achieve fiscal and economic policy objectives. M.A. Cohen, “Tax Simplification: A Government Perspective,” in *Report of Proceedings of the Twenty-Seventh Tax Conference, 1975 Conference Report* (Toronto: Canadian Tax Foundation, 1976), 7-20.

56 Michael Aidin, “Provisions for the Utilization of Losses Within Corporate Groups Under the United Kingdom Tax Law,” in the 1979 Conference Report, *supra* note 18, 351-64, at 364.

57 Strain et al., *supra* note 54, at 4:5-6.

