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Canadian Indirect Tax News

January 17, 2012 (12-1)

Filing deadline in respect of pensions

As noted in the last ***Canadian Indirect Tax News***, this month marks an important deadline for employers that are monthly goods and services tax/harmonized sales tax (GST/HST) filers and have a December year-end. These employers must remit tax on the deemed supplies made to their pension plans on their December GST/HST returns, which are due January 31, 2012.

The calculation of tax on deemed supplies applies to employers whose pension plans meet the following criteria:

- The plan is a registered pension plan for purposes of the Income Tax Act
- The funding medium (fund) of the plan is a trust or corporation resident in Canada

These rules most commonly apply to defined benefit plans. Pension plans which are funded by a medium other than a trust or a corporation (e.g., an insurance contract) are not subject to the GST/HST deemed supply rules.

When an employer with a deemed tax calculation requirement has acquired pension-related goods or services, such as investment management, actuarial, or other services, or has expended internal resources on pension activities, the GST/HST rules effectively deem the employer to have made GST/HST taxable supplies to the pension trusts (or pension corporations). The tax on those deemed supplies is required to be calculated on the last day of the employer's fiscal year and remitted on the employer's GST/HST return for the period covering that day. The employer is also responsible for issuing a notice of the deemed supply to the pension entity, to assist the latter with its filing obligations. In some cases, employers that are administrators of the plans may also have elected to fulfill the pension entity's GST/HST filing obligations.

We recommend that employers begin reviewing their GST/HST requirements immediately in order to ensure that the correct remittance can be made. This is also a good time to ensure that all input tax credits (ITCs) related to pension expenses have been claimed. It should be remembered that if an employer is deemed to have made a supply in respect of an expenditure, the taxpayer will typically be able to claim an ITC for the GST/HST paid on that expenditure.

Holding companies' ITCs at risk

For GST/HST purposes, holding companies are generally not eligible to claim ITCs because they are not considered to be engaged in commercial activities. However, subsection 186(1) of the Excise Tax Act allows holding companies to claim ITCs on expenses "reasonably regarded as…in relation to shares of capital stock or indebtedness" of a related company upon meeting the specific criteria set out in the provision.

One might wonder: don't *all* or *almost all* the expenses of a holding company relate to the shares and debt of the subsidiaries? Shouldn't a holding company in the right circumstances be able to claim ITCs on all expenses? The Canada Revenue Agency (CRA) doesn't seem to think so. A bigger problem arises where the CRA's interpretation of the criteria is different than that of the Tax Court of Canada.

The CRA applies a "one step removed" test in determining whether an expense can reasonably be considered to be in relation to shares or debt of a related company. Generally, the CRA's view is that a holding company may claim ITCs on expenses directly related to purchasing shares of a subsidiary or loaning money to a subsidiary. However, if a holding company incurs legal or accounting expenses to raise capital (either by issuing its own shares or by borrowing money itself) to fund its investment in the related company, the expenses related to raising the capital would not qualify for ITCs as they would be considered to be "one step removed" from the shares or debt of the subsidiary. It is the CRA's position that by issuing its own shares or borrowing money itself, the holding company is consuming the legal or accounting services in relation to its own shares or debt and not that of the related company.

However, Justice Miller, in the *Stantec* case, had quite a different interpretation of subsection 186(1), finding no support for the CRA's "one step removed" doctrine. *Stantec* was decided in favour of the taxpayer, and ITCs were allowed even though the particular expense related to listing the shares of the holding company on a US stock exchange.

Prior to *Stantec*, the CRA relied on its Policy Statement P-196R to disallow ITCs in accordance with the specific examples provided therein. Justice Miller stated that he was "not persuaded by Policy P-196R" due to the lack of support for the "one step removed" test. In November 2011, the CRA released new GST/HST Memorandum 8.6 to replace Policy P-196R, likely as an effort to clamp down on the opportunities to claim ITCs based on the *Stantec* judgment. New Memorandum 8.6 appears to disregard much of the Tax Court's judgment and continues to invoke the "one step removed" test in applying subsection 186(1).

In Memorandum 8.6, the CRA also rationalizes that expenses related to the annual general meeting of a holding company do not qualify for ITCs because they relate to the shares of the holding company itself. The same approach may be taken by the CRA with respect to expenses related to investor relations, financial statement audits and most legal costs of the holding company. It appears that the CRA does not consider that investors will only be interested in investing in a holding company because of the activities of its subsidiaries, and that all or almost all of the expenses of the holding company can reasonably be regarded as being in relation to the subsidiaries.

The CRA does allow holding companies to claim ITCs on office and administrative "indirect" expenses related to the shares and debt of the subsidiaries. As well, to the extent that a holding company has other commercial activities, such as providing management services or resupplying accounting or legal services to subsidiaries, the holding company may be entitled to additional ITCs under the general provision for claiming ITCs.

What does this mean for holding companies? While the new Memorandum is not a "new" policy, there seems to be added focus by the CRA on a narrow application of ITC eligibility in the holding company context. In light of this added focus and recent experiences we have encountered relating to CRA audits of holding companies, now is the time to consider your holding company's position on its ITC entitlement and to consult your tax advisor to ensure that the position taken is defensible.

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