

# ***EIFEL***

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# **IFA CANADA** **INTERNATIONAL** **TAX CONFERENCE**



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**MAY 16-17, 2023 | CALGARY, ALBERTA**

# OUTLINE

1. Overview
2. Foreign Affiliates
3. Partnerships
4. Pre-regime Election
5. Group Ratio
6. Non-capital Losses

# OVERVIEW

RE-CAP OF DRAFT LEGISLATION

# Overview of the EIFEL Rules

- What?

- Finance contends that EIFEL is consistent with recommendations found in BEPS Action 4 report
- Reminder – BEPS Action 4 Report: Recommends limitations on deductibility of interest and other financing costs

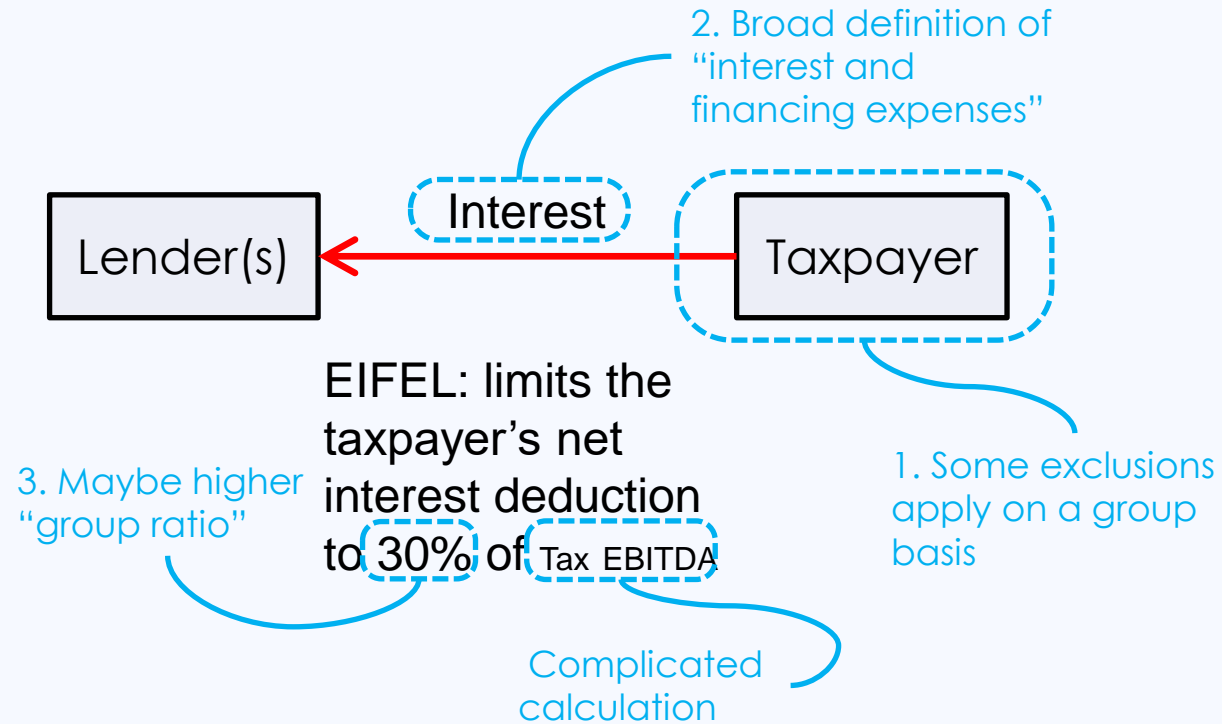
- Why?

- “...the objective of the EIFEL regime is to address issues arising from taxpayers deducting for income tax purposes excessive interest and other financing costs, principally in the context of multinational enterprises and cross-border investments”

- How?

- Rules adopt an “earnings-stripping” approach: Limits the amount of net interest and financing expenses that may be deducted in computing a taxpayer’s income to no more than a fixed ratio of EBITDA

# Overview



## Excluded Entity (group)

- Small CCPC:
  - taxable capital of associated group is less than \$50 million
  
- De minimis:
  - total net IFE (including exempt IFE) for the year of \$1 million or less

**OR**

- “Purely Domestic CCPC”:
  - substantially all of the businesses, undertakings and activities of the taxpayer’s group is carried on in Canada
  - no material FA (\$5M FMV or book)
  - no non-resident shareholder with 25% or more of the vote or FMV
    - includes a partnership with more than 50% of the FMV of all interests in which it can be reasonably considered to be held (directly or indirectly) by non-residents.
  - Substantially all of the IFE of the taxpayer and of any eligible group entity – paid/payable to non-arm’s length persons/partnerships that are not tax –indifferent investors

## Section 216 Issues

- Will a 216 filer be a person resident in Canada for purposes of the EIFEL rules?
  - If yes, possibility that filer will be eligible for provisions likely intended only to actual Canadian residents: For example:
    - ability to qualify as an “excluded entity”
    - If filer is a “fixed interest commercial trust”, ability to transfer and receive excess capacity from other eligible group entities
  - If no, the 216 filer would have no “adjusted taxable income” (“**ATI**”) as it would have no “taxable income earned in Canada”
  - In addition, by virtue of 216(1)(c), a 216 filer cannot claim any deductions in computing its taxable income – therefore, restricted interest and financing expenses (“**RIFE**”) for a year cannot be claimed as a deduction in any subsequent year even if the 216 filer has excess capacity

# Interest & Financing Expenses (“**IFE**”)

- IFE broadly includes:
  - regular interest expenses
  - 20(1)(e) and other financing fees
  - depreciation that can reasonably be considered to be attributable to interest deduction or 20(1)(e) interest
    - 18.2(3): deduction for depreciation and depletion deemed to have been taken
  - partnership financing expenses
  - lease financing amount (other than **excluded leases**)
    - Excluded leases refers to Regulation 1100 (Capital Cost Allowance), which does not contain any reference to land. Thus:
      - Lease in respect of land =/ excluded lease
      - Lease in respect of building = excluded lease



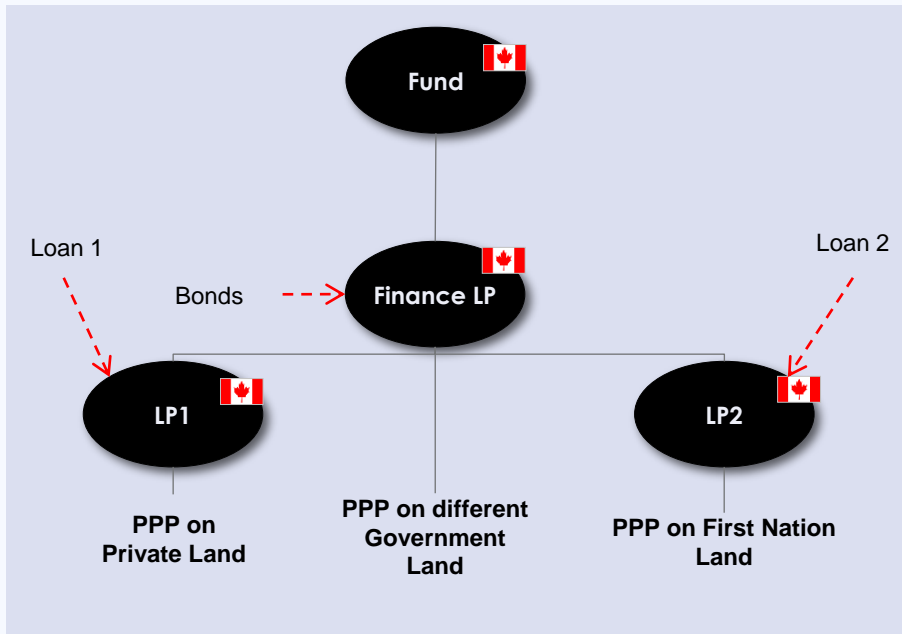
# Interest & Financing Revenue (“**IFR**”)

- IFR broadly includes:
  - regular interest income (other than excluded interest)
  - income inclusion due to deeming rules in 12(9) or 17.1
  - guarantee fees and similar
  - certain lease revenues

## Exempt IFE

- New term introduced to exclude certain IFE arising from agreements entered into with a public sector authority:
  - a) the borrower entered into an agreement with a public sector authority to design, build and finance, or design, build, finance, maintain and operate, real or immovable property **owned by a public sector authority**
  - b) the borrowing or other financing was entered in respect of the agreement
  - c) It can reasonably be considered that all or substantially all of the expenses were directly or indirectly **borne by** the public sector authority
  - d) The expenses were paid or payable to arm's length persons (other than any person or partnership that is, or does not deal at arm's length with, a person or partnership that has a **direct or indirect equity interest**)

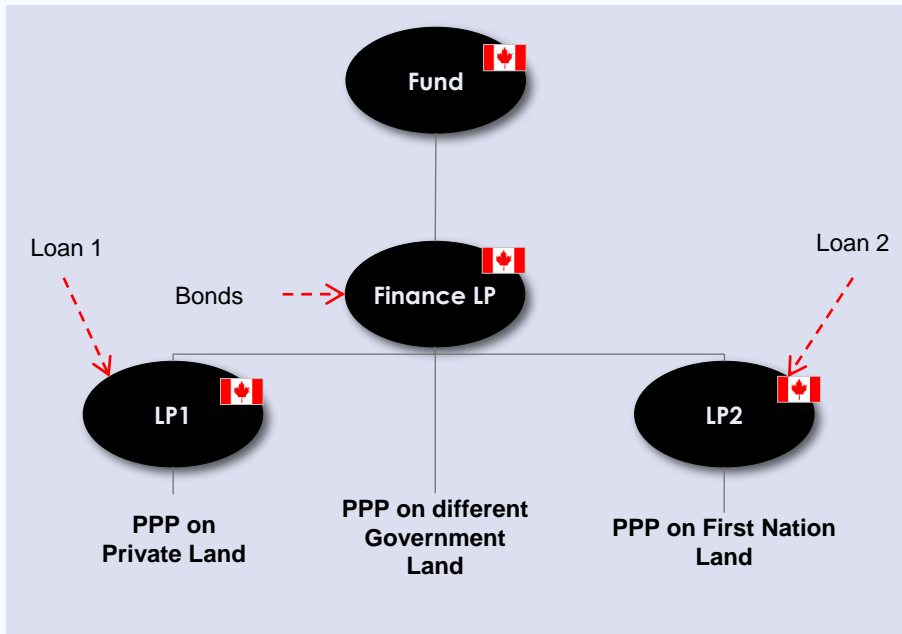
# Exempt IFE - Example



“(a) the borrower entered into an agreement with a public sector authority to design, build and finance, or **design, build, finance, maintain and operate**, real or immovable property **owned by a public sector authority**”

- Project Ownership Requirement
  - The interest on the Bonds that relates to the PPP of LP1 and LP2 may not be an “exempt IFE” because Finance LP does not “design, build, maintain and operate” those projects.
- Land Ownership Requirement:
  - Interest on Loan 1 would not be “exempt IFE” because of private land
  - Interest on Loan 2 would not be “exempt IFE” because First Nations are not a public sector authority as defined in 18.2

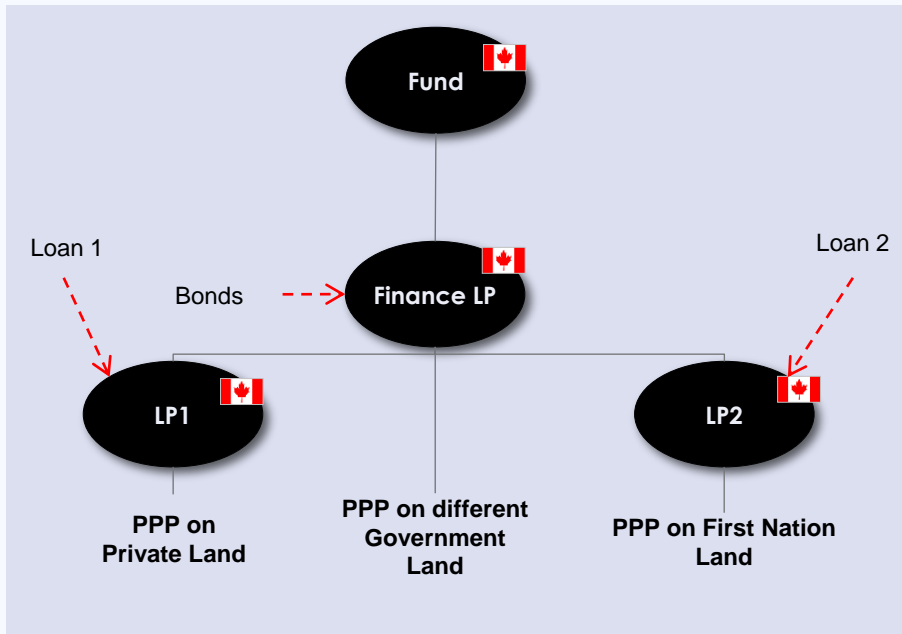
## Exempt IFE - Example



“(c) It can reasonably be considered that all or substantially all of the expenses were **directly or indirectly borne** by the public sector authority”

- “Borne” by “the public sector authority”:
  - Degree of connection not clear (e.g. late delivery of project penalty - may not be “exempt IFE”)
  - Use of “the” seems to indicate that the land has to be held by the same public sector authority that has entered into the PPP contract (federal and municipal or provincial would be an issue)

## Exempt IFE - Example



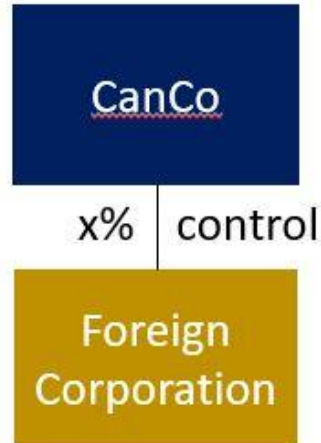
“(d) The expenses were paid or payable to arm’s length persons (other than any person or partnership that is, or does not deal at arm’s length with, a person or partnership that has a **direct or indirect equity interest**)”

Equity interest = share, interest as a member or a partnership or interest as a beneficiary

- Any interest on the Bonds would not be “Exempt IFE” to the extent any Bondholder is also a partner of the Fund
  - Market practice to finance infrastructure projects is to issue bonds. However, there is no way for investment funds to monitor whether one of its investors acquired some of the publicly traded bonds
  - Given that most infrastructure funds are marketed as “yield” funds, it is reasonable to assume that the investors could acquire the bonds or even finance these type of projects

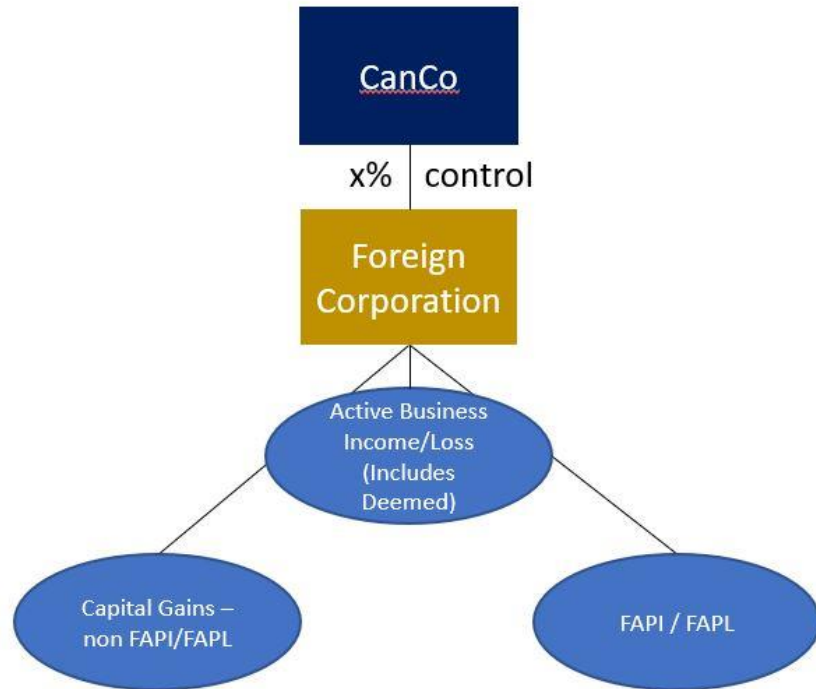
# FOREIGN AFFILIATES

## Applying EIFEL to CFAs



- The rules explicitly provide for the application to controlled foreign affiliates (CFAs) of a Canadian taxpayer as part of its EIFEL calculations.
- No separate EIFEL proportion calculation required for the CFA.
- The Canadian taxpayer is required to bring into IFE / IFR its proportionate share (x%) of the IFE and IFR of the CFA which is relevant in computing the CFA's FAPI
  - (“relevant affiliate interest and financing expenses” or “relevant affiliate interest and financing revenues” (“**RAIFE**” and “**RAIFR**”))

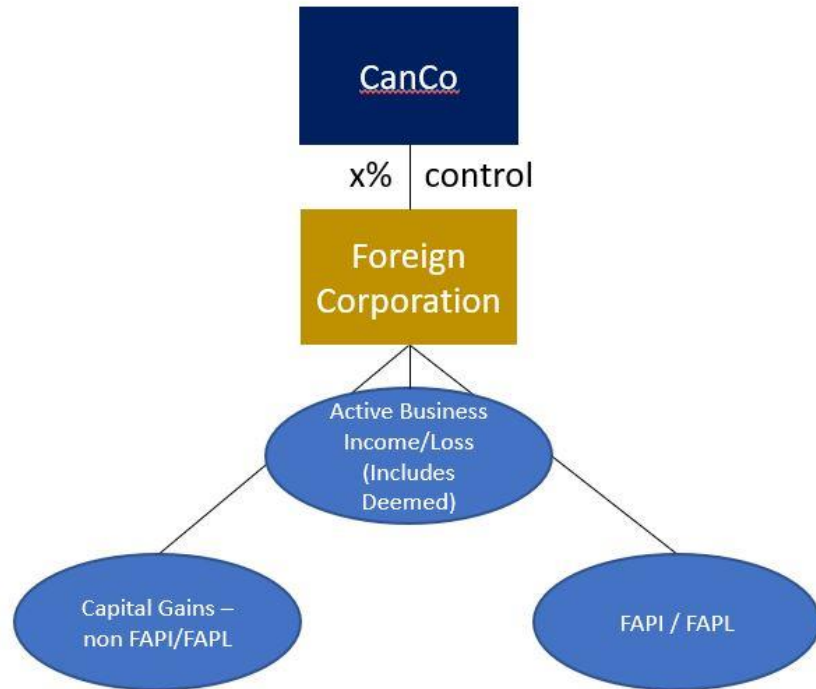
# Applying EIFEL to CFAs



- How to determine proportion of IFE and IFR of the CFA relevant to FAPI
  - FAPI / FAPL of a CFA includes its income / loss from property (that is not recharacterized as a loss from an active business).
  - FAPI / FAPL is computed under the rules in Part I of the Act (i.e. A hypothetical Canadian taxable income computation)
  - Income / loss from property could, among other types be:
    - Expenses or income related to ownership of a subsidiary (expenses of a holding company and dividend income);
    - Expenses and income from a rental business;
    - Expenses and income from a lending/financing business.



# Applying EIFEL to CFAs



- Any interest/financing expenses deductible in the computation of FAPI / FAPL of a CFA should be assessed for EIFEL considerations.
  - Currently RAIFE includes amounts deductible under 20(1)(c).
  - 95(2)(a)(ii)(D) recharacterizes interest income on a loan to a foreign affiliate used to purchase certain shares as active business income. The corresponding interest expense is excluded from the payor's FAPI/FAPL computation. However, not currently excluded from RAIFE.

# Applying EIFEL to CFAs



STEP 1  
CFA computes its **RAIFE** and **RAIFR** (being only interest relevant in computing FAPI, not active business income)

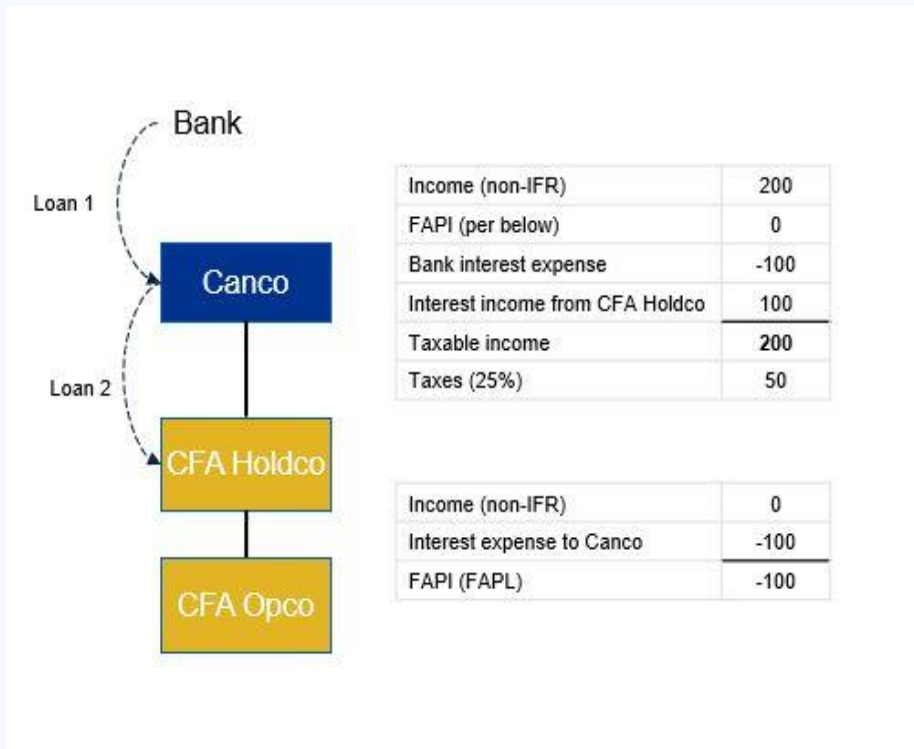
STEP 2  
Canadian taxpayer (“**the tax payer**”) includes **its share** of RAIFE and RAIFR in its EIFEL calculation to determine the taxpayer's 18.2(2) restriction percentage

STEP 3  
The taxpayer's 18.2(2) percentage is applied to the CFA's RAIFE **deeming this proportion of RAIFE to be non-deductible** in computing FAPI (similar rule to include FAPI income inclusion if CFA is a partner in a partnership incurring IFE)

STEP 4  
Denied RAIFE is **added to the taxpayer's indefinite RIFE carryforward** (no separate attribute for the CFA). Similarly, if RAIFR is instead generating excess capacity, this is an attribute of the taxpayer.

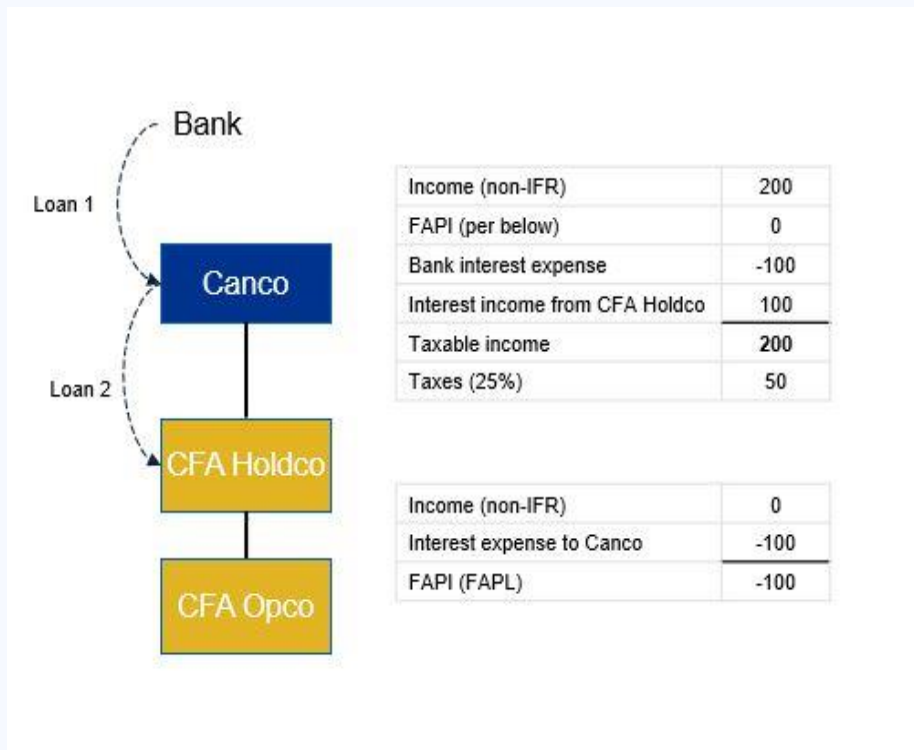
- Foreign accrual tax (“**FAT**”) is taken into account in determining RAIFR, **but only** for the year in which the RAIFR is included in the EIFEL calculations
- No excluded interest election at the CFA level or between the Canadian taxpayer and the CFA.

# Foreign Affiliates – Example 1



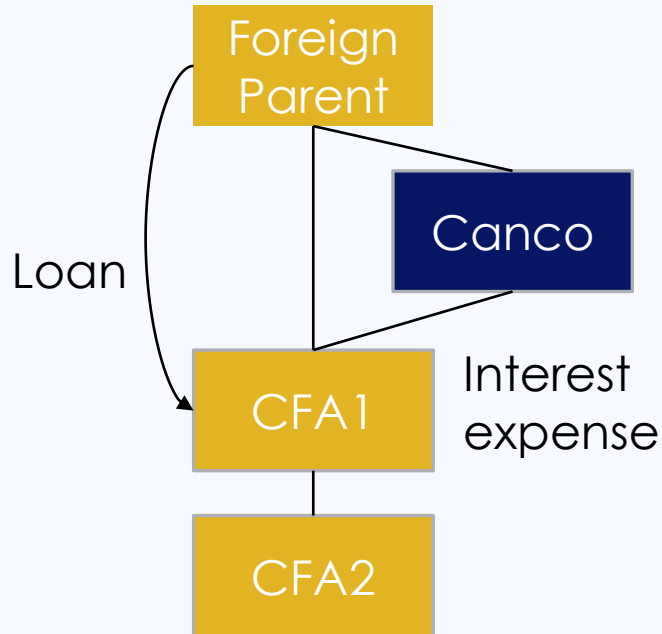
- Canco borrows from Bank and makes a loan to CFA Holdco to acquire shares of CFA Opco which are excluded property
- Canco's ATI = A + B – C = \$200
  - A = \$100 (\$200-\$100)
  - “taxable income” pre EIFEL rules less current year FAPL of CFA Holdco pre EIFEL rules
  - B = \$200 (\$100 + \$100)
  - “IFE” (includes RAIFE \* specified participating percentage of CFA)
  - C = \$100
  - “IFR”

# Foreign Affiliates – Example 1



- % of disallowed interest per ss.18.2(2) = 20%  $[(IFE - (\text{ratio} * \text{ATI} + \text{IFR})) / \text{IFE}]$ 
  - Denied interest at Canco = \$20
  - Added to taxpayer's RIFE balance carryforward
  - Denied interest at CFA Holdco = \$20
  - FAPL (post EIFEL) = \$80
- Canco's taxable income (post EIFEL) = \$220
- Potential fix recommended by the Joint Committee

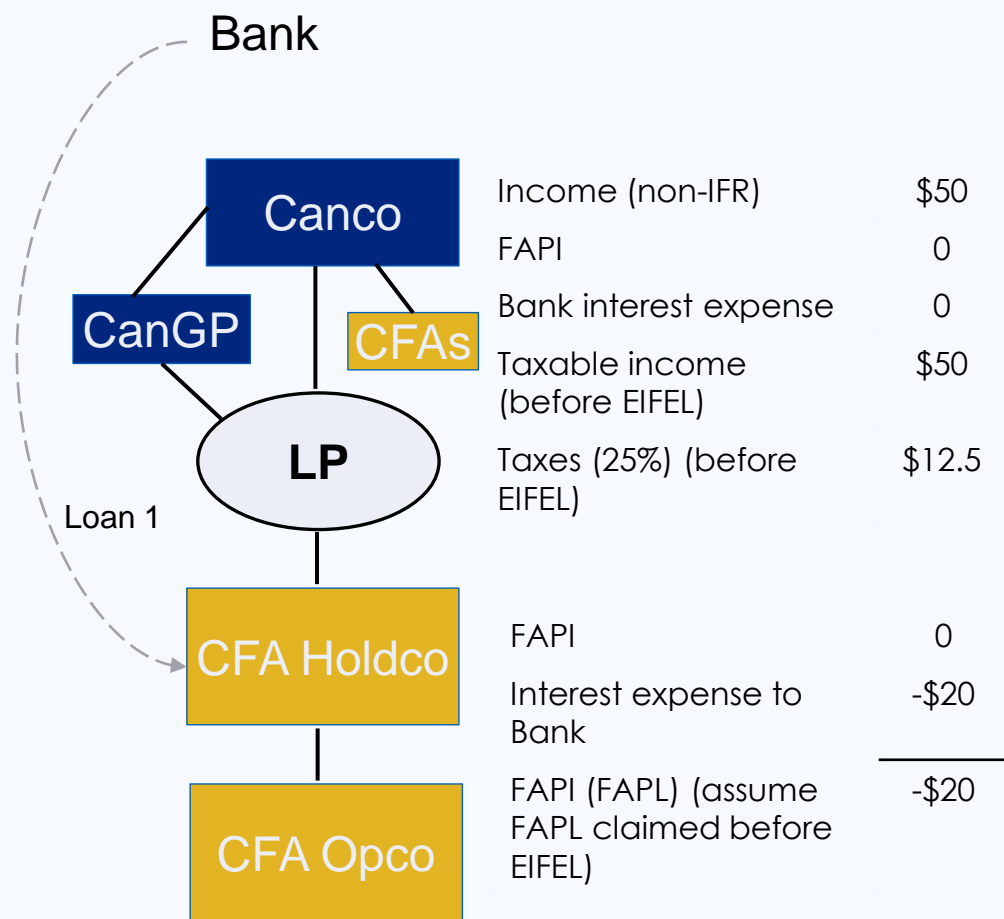
## Foreign Affiliates – Example 2



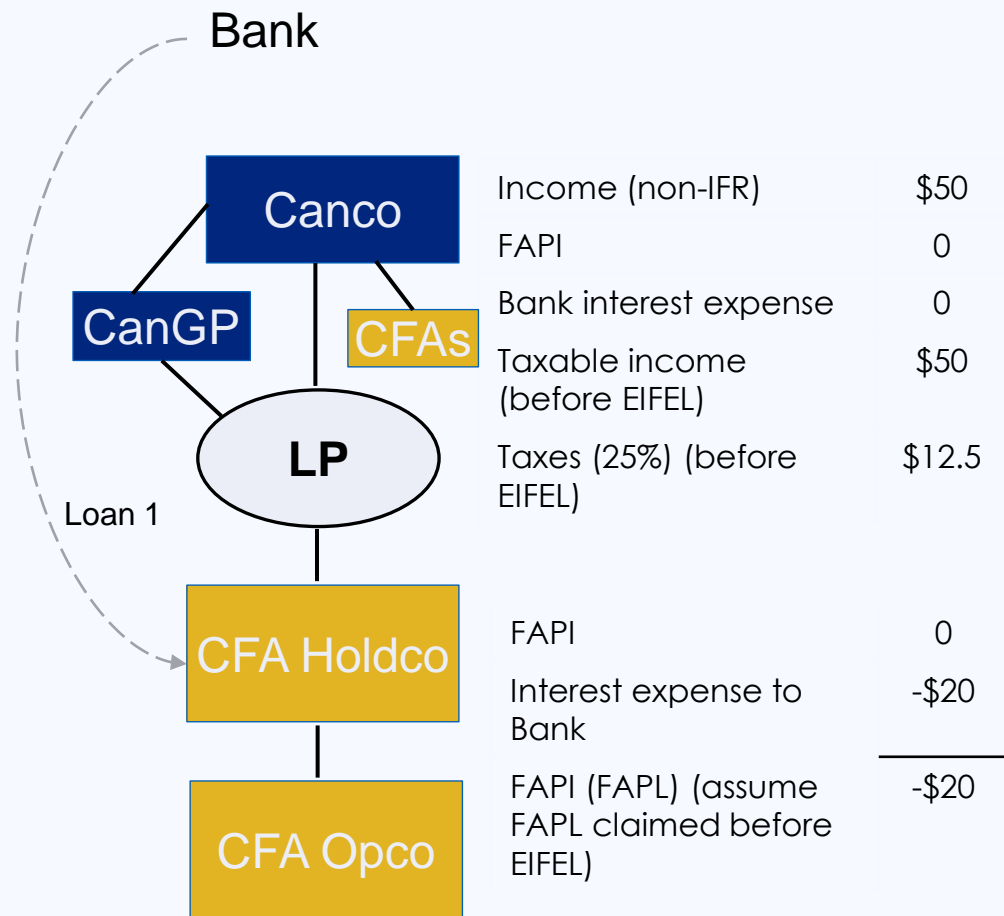
- Assume Canco has a denial under 18.2(2) of 20% (after performing its own EIFEL calculations).
- The same percentage is applied to IFE incurred by CFA1 in earning FAPI - i.e. if Canco has a limitation percentage of 20%, then 20% of CFA1's IFE will be denied as a deduction against CFA1's FAPI.
- A determination of specified participating percentage may be required. Consider complexities of determining participating percentage where there are multiple classes of shares and a loss.

# PARTNERSHIPS

# Partnerships – Example 1



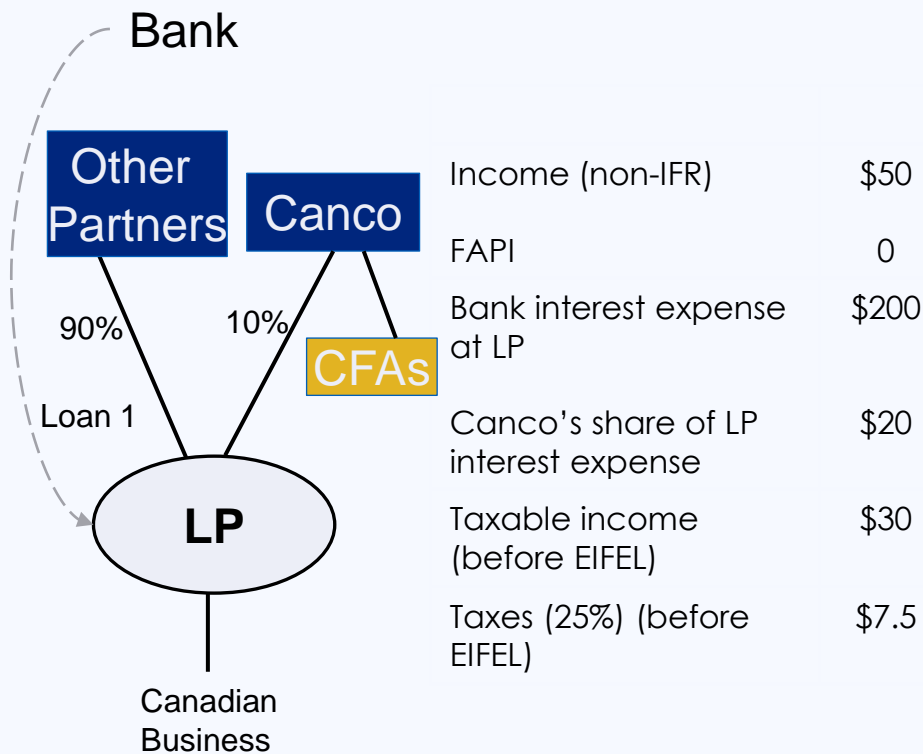
- Canco earns income from its Canadian business and owns CFAs directly and indirectly through LP
- CFA Holdco borrows from the bank to acquire shares of CFA Opco which are excluded property
- Canco's ATI = A + B – C = \$50
  - A = \$50 - \$20 = \$30
  - reduced by Canco's share through LP of CFA Holdco's current year FAPL claimed prior to application of EIFEL rules
  - B = 0 + \$20 = \$20
  - Canco's share through LP of CFA Holdco's interest expense to bank which is included in RAIFE
  - C = 0



## Partnerships – Example 1 (cont.)

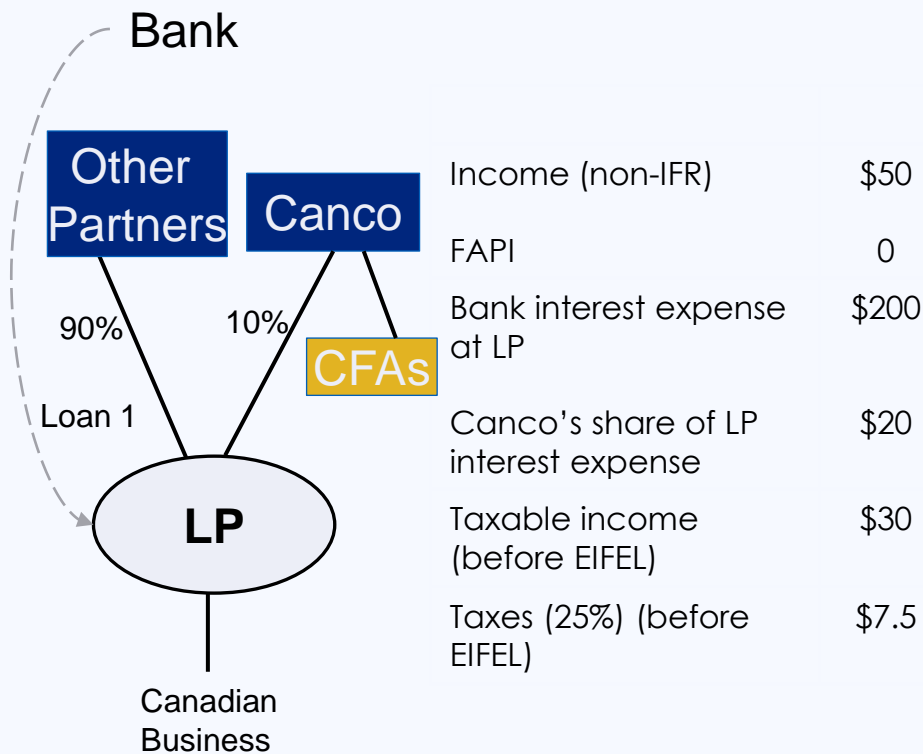
- % of disallowed interest per ss.18.2(2) =  $(\$20 - (30\% \times \$50)) / \$20 = 25\%$ 
  - Denied interest at Canco = 0
  - But s.12(1)(1.2) income inclusion to Canco = \$5
    - i.e.  $\$20 \times 25\%$
  - Denied interest at CFA Holdco in respect of LP = 0
    - As LP is generally not a taxpayer for s.18.2 purposes
    - FAPL (post EIFEL) in respect of LP = \$20
- Canco's taxable income (post EIFEL) = \$55
- Canco's RIFE = \$5
- Administrative/compliance burden where LP is not wholly owned





## Partnerships – Example 2

- Canco earns income from its Canadian business, owns CFAs directly and invest in a minority interest in LP
- LP borrows from Bank to invest in its Canadian business
- Canco's ATI =  $A + B - C = \$50$ 
  - $A = \$30$  (assumes sufficient at-risk amount for Canco to deduct its share of LP loss)
  - $B = \$20$ 
    - Canco's share of LP's interest expense to bank
  - $C = 0$



## Partnerships – Example 2 (cont.)

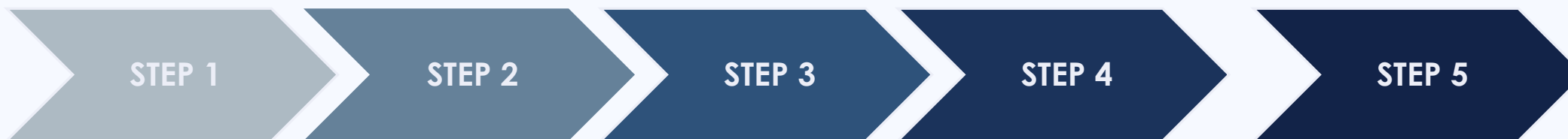
- % of disallowed interest per ss.18.2(2) =  $(\$20 - (30\% \times \$50)) / \$20 = 25\%$ 
  - Denied interest at LP level = 0
  - As LP is generally not a taxpayer for s.18.2 purposes
  - But s.12(1)(l.2) income inclusion to Canco = \$5
  - i.e.  $\$20 \times 25\%$
- Canco's taxable income (post EIFEL) = \$35
- Canco's RIFE = \$5
- Canco's ACB in LP is not increased by the RIFE – potential double tax if, for example, Canco sells its interest in LP
- Administrative/compliance burden where LP is not wholly owned

# PRE-REGIME ELECTION

# Pre-regime Election

- Pre-regime election allows taxpayers to determine their excess capacity, if any, for the pre-regime years, and carry that excess capacity forward by including it in computing their cumulative unused excess capacity
- Joint election must be made by the taxpayer and all eligible group entities (corporations or fixed interest commercial trusts) in respect of the taxpayer at the end of the taxpayer's first regime year ("eligible pre-regime group entities) by the taxpayer's filing due date for the first regime year
- **If no election is made, pre-regime capacity available for carry forward is nil**
- 40% ratio of permissible expenses applicable to:
  - taxation year beginning on or after October 1, 2023 and before January 1, 2024
  - base deduction capacity to be calculated for pre-regime periods using 30% and 40%
  - excess capacity transferred from pre-regime period to a taxation year commencing on or after October 1, 2023 and before January 1, 2024 should be determined at 40%. Any excess capacity could be lost

# Computing the Pre-Regime Excess Capacity



Determine “**eligible pre-regime group entities**” in respect of the taxpayer, **at the end** of the taxpayer’s **first regime year**

Determine the “**excess interest**” or “**excess capacity otherwise determined**” of the taxpayer and the “**eligible pre-regime group entities**”

Determine the “**net excess capacity**” of the taxpayer and the “**eligible pre-regime group entities**” for the pre-regime years

Determine the “**group net excess capacity**” of the eligible pre-regime group

Make a joint election and include the allocation of the “**group net excess capacity**” to the taxpayer and the “**eligible pre-regime group entities**”, subject to certain limitations

# Pre-regime Year Excess Capacity Limitations

The allocation in Step 5 must meet the following requirements:

- Total amount of excess capacity that a taxpayer is allocated for its pre-regime years cannot exceed its net excess capacity for its pre-regime years
- Excess capacity allocated to a taxpayer for a given pre-regime year cannot exceed its excess capacity otherwise determined for that pre-regime year
- Total excess capacity allocated to the taxpayer and eligible pre-regime group entities for the pre-regime years cannot exceed the group net excess capacity

# 1st Pre-regime Year – Computation of Excess Capacity

Pre-Regime Year - 2021				
	December 31, 2021			
	Totals	Company A	Company B	Company C
Interest and Financing Expenses ("IFE")	\$ 230,000.00	\$ 90,000.00	\$ 90,000.00	\$ 50,000.00
Interest and Financing Revenues ("IFR")	\$ 130,000.00	\$ -	\$ 100,000.00	\$ 30,000.00
Taxable Income	\$ 700,000.00	\$ 250,000.00	\$ 400,000.00	\$ 50,000.00
<b>Adjusted Taxable Income ("ATI")</b>	<b>\$800,000.00</b>	<b>\$ 340,000.00</b>	<b>\$ 390,000.00</b>	<b>\$ 70,000.00</b>
<b>Fixed Ratio</b>		<b>30%</b>	<b>30%</b>	<b>30%</b>
<b>Base Deduction Capacity = ATI x Fixed Ratio</b>		<b>\$ 102,000.00</b>	<b>\$ 117,000.00</b>	<b>\$ 21,000.00</b>
<b>Excess interest for a pre-regime year</b>		<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Excess capacity otherwise determined</b>		<b>\$ 12,000.00</b>	<b>\$ 127,000.00</b>	<b>\$ 1,000.00</b>

## 2nd Pre-regime Year – Computation of Excess Capacity

Pre-Regime Year - 2022				
	December 31, 2022			
	Totals	Company A	Company B	Company C
Interest and Financing Expenses ("IFE")	\$ 350,000.00	\$ 300,000.00	\$ 50,000.00	
Interest and Financing Revenues ("IFR")	\$ 45,000.00	\$ -	\$ 25,000.00	\$ 20,000.00
Taxable Income	\$ 280,000.00	\$ 100,000.00	\$ 150,000.00	\$ 30,000.00
<b>Adjusted Taxable Income ("ATI")</b>	<b>\$585,000.00</b>	<b>\$ 400,000.00</b>	<b>\$ 175,000.00</b>	<b>\$ 10,000.00</b>
<b>Fixed Ratio</b>		<b>30%</b>	<b>30%</b>	<b>30%</b>
<b>Base Deduction Capacity = ATI x Fixed Ratio</b>		<b>\$ 120,000.00</b>	<b>\$ 52,500.00</b>	<b>\$ 3,000.00</b>
<b>Excess interest for a pre-regime year</b>		<b>\$ 180,000.00</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Excess capacity otherwise determined</b>		<b>\$ -</b>	<b>\$ 27,500.00</b>	<b>\$ 23,000.00</b>



## 3rd Pre-regime Year – Computation of Excess Capacity

Pre-Regime Year - 2023				
	December 31, 2023			
	Totals	Company A	Company B	Company C
Interest and Financing Expenses ("IFE")	\$ 250,000.00	\$ 150,000.00	\$ 100,000.00	
Interest and Financing Revenues ("IFR")	\$ 75,000.00	\$ 30,000.00	\$ 25,000.00	\$ 20,000.00
Taxable Income	\$ 570,000.00	\$ 140,000.00	\$ 400,000.00	\$ 30,000.00
<b>Adjusted Taxable Income ("ATI")</b>	<b>\$745,000.00</b>	<b>\$ 260,000.00</b>	<b>\$ 475,000.00</b>	<b>\$ 10,000.00</b>
<b>Fixed Ratio</b>		<b>30%</b>	<b>30%</b>	<b>30%</b>
<b>Base Deduction Capacity = ATI x Fixed Ratio</b>		<b>\$ 78,000.00</b>	<b>\$ 142,500.00</b>	<b>\$ 3,000.00</b>
<b>Excess interest for a pre-regime year</b>		<b>\$ 42,000.00</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Excess capacity otherwise determined</b>		<b>\$ -</b>	<b>\$ 67,500.00</b>	<b>\$ 23,000.00</b>

# Allocation of Group Net Excess Capacity

Pre-Regime Excess Capacity Summary (\$)				
	Total	Company A	Company B	Company C
2021 Excess Interest	-	-	-	-
2021 Excess Capacity Otherwise Determined	140,000	12,000	127,000	1,000
2022 Excess Interest	(180,000)	(180,000)	-	-
2022 Excess Capacity Otherwise Determined	50,500	-	27,500	23,000
2023 Excess Interest	(42,000)	(42,000)	-	-
2023 Excess Capacity Otherwise Determined	90,500	-	67,500	23,000
<b>Group Net Excess Capacity</b>	<b>59,000.00</b>	<b>(210,000)</b>	<b>222,000</b>	<b>47,000</b>
<b>Excess Capacity</b>		-	222,000	47,000
Allocation of Group Net Excess Capacity (\$)				
2021	-			
2022	-			
2023	59,000	-	49,000	10,000
	<b>59,000</b>	-	49,000	10,000

Company A's net excess capacity is negative therefore its excess capacity is deemed to be nil for the pre-regime year

Allocated amounts can be split as required provided the amount allocated does not exceed the excess capacity for the relevant year and total allocated does not exceed the group net excess capacity

Allocated amounts form part of each entity's cumulative unused excess capacity in the first regime year

# First Regime Year – Computation of Excess Capacity

First Regime Year - 2024				
	December 31, 2024			
	Totals	Company A	Company B	Company C
Interest and Financing Expenses ("IFE")	\$ 618,000.00	\$ 450,000.00	\$ 100,000.00	\$ 68,000.00
Interest and Financing Revenues ("IFR")	\$ -			
Taxable Income	\$ 550,000.00	\$ 50,000.00	\$ 400,000.00	\$ 100,000.00
<b>Adjusted Taxable Income ("ATI")</b>	<b>\$ 1,168,000.00</b>	<b>\$ 500,000.00</b>	<b>\$ 500,000.00</b>	<b>\$ 168,000.00</b>
<b>Fixed Ratio</b>		30%	30%	30%
<b>Base Deduction Capacity = ATI x Fixed Ratio</b>		<b>\$ 150,000.00</b>	<b>\$ 150,000.00</b>	<b>\$ 50,400.00</b>
<b>Excess interest for first regime year</b>		<b>\$ 300,000.00</b>	<b>\$ -</b>	<b>\$ 17,600.00</b>
<b>Excess capacity for first regime year</b>		<b>\$ -</b>	<b>\$ 50,000.00</b>	<b>\$ -</b>

# First Regime Year – Cumulative Unused Excess Capacity

<b>First Regime Year Excess Capacity Summary (\$) - with pre-regime election</b>				
	<b>Total</b>	<b>Company A</b>	<b>Company B</b>	<b>Company C</b>
Opening Cumulative Excess Capacity	59,000	-	49,000	10,000
2024 Excess Capacity	50,000	-	50,000	-
2022 Excess Interest	(317,600)	(300,000)	-	(17,600)
Absorbed Capacity	10,000			10,000
Transferred Capacity	(99,000)		(99,000)	
Received Capacity	99,000	99,000		
Current Year Denied Interest		201,000	-	7,600
Total Interest Expense in the Year		450,000		68,000
EIFEL		45%		11%
<b>First Regime Year Excess Capacity Summary (\$) - without pre-regime election</b>				
	<b>Total</b>	<b>Company A</b>	<b>Company B</b>	<b>Company C</b>
2024 Excess Capacity	50,000	-	50,000	-
2024 Excess Interest	(299,900)	(300,000)	-	(17,600)
Absorbed Capacity	-	-	-	-
Transferred Capacity	(50,000)		(50,000)	
Received Capacity	50,000	50,000		
Current Year Denied Interest	267,600	250,000		17,600
Total Interest Expense in the Year		450,000		68,000
EIFEL		59%		26%

## Group Ratio Election in Pre-Regime Year

- Corporate groups can elect to have the group ratio apply for one or more pre-regime years
- Filing deadline for the group ratio in the pre-regime years is determined by reference to the **first regime** year
- If a group ratio election is made, there is **no excess capacity** for that year
- The group ratio can still be beneficial to lower amounts of excess interest in a pre-regime year

# 2nd Pre-regime Year – Group Ratio

2nd Pre-Regime Year - 2022				
December 31, 2022				
	Totals	Company A	Company B	Company C
Interest and Financing Expenses ("IFE")	\$ 350,000.00	\$ 300,000.00	\$ 50,000.00	\$ -
Interest and Financing Revenues ("IFR")	\$ 45,000.00	\$ -	\$ 25,000.00	\$ 20,000.00
Taxable Income	\$ 280,000.00	\$ 100,000.00	\$ 150,000.00	\$ 30,000.00
<b>Adjusted Taxable Income ("ATI")</b>	<b>\$ 585,000.00</b>	<b>\$ 400,000.00</b>	<b>\$ 175,000.00</b>	<b>\$ 10,000.00</b>
<b>Group Ratio</b>		<b>45%</b>	<b>45%</b>	<b>45%</b>
<b>Base Deduction Capacity using Group Ratio</b>		<b>\$ 180,000.00</b>	<b>\$ 78,750.00</b>	<b>\$ 4,500.00</b>
<b>Excess interest for pre-regime year - Group Ratio</b>		<b>\$ 120,000.00</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Fixed Ratio</b>		<b>30%</b>	<b>30%</b>	<b>30%</b>
<b>Base Deduction Capacity = ATI x Fixed Ratio</b>		<b>\$ 120,000.00</b>	<b>\$ 52,500.00</b>	<b>\$ 3,000.00</b>
<b>Excess interest for a pre-regime year - Fixed Ratio</b>		<b>\$ 180,000.00</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Excess capacity otherwise determined - Fixed Ratio</b>		<b>\$ -</b>	<b>\$ 27,500.00</b>	<b>\$ 23,000.00</b>

# Allocation of Group Net Excess Capacity – Group Ratio

		Pre-Regime Excess Capacity Summary (\$) - Group Ratio				
		Total	Company A	Company B	Company C	
2021 Excess Interest		-	-	-	-	
2021 Excess Capacity Otherwise Determined		140,000	12,000	127,000	1,000	
2022 Excess Interest		(120,000)	(120,000)	-	-	
2022 Excess Capacity Otherwise Determined		-	-	-	-	deemed nil as no excess capacity where group election
2023 Excess Interest		(42,000)	(42,000)	-	-	
2023 Excess Capacity Otherwise Determined		90,500	-	67,500	23,000	
<b>Group Net Excess Capacity</b>		<b>67,500.00</b>	<b>(150,000)</b>	<b>194,500</b>	<b>23,000</b>	
<b>Excess Capacity</b>				<b>194,500</b>	<b>23,000</b>	
		Allocation of Group Net Excess Capacity (\$)				
2021		-				
2022		-				
2023		67,500	-	50,000	17,500	
		<b>67,500</b>	<b>-</b>	<b>50,000</b>	<b>17,500</b>	Higher amount of Group Net Excess Capacity to Allocate – compared to \$49,000 and \$10,000 in slide 34

Overall higher Group Net Excess Capacity compared to without Group Ratio Election in 2022 - \$59,000 – see slide 34



# Pre-regime Election

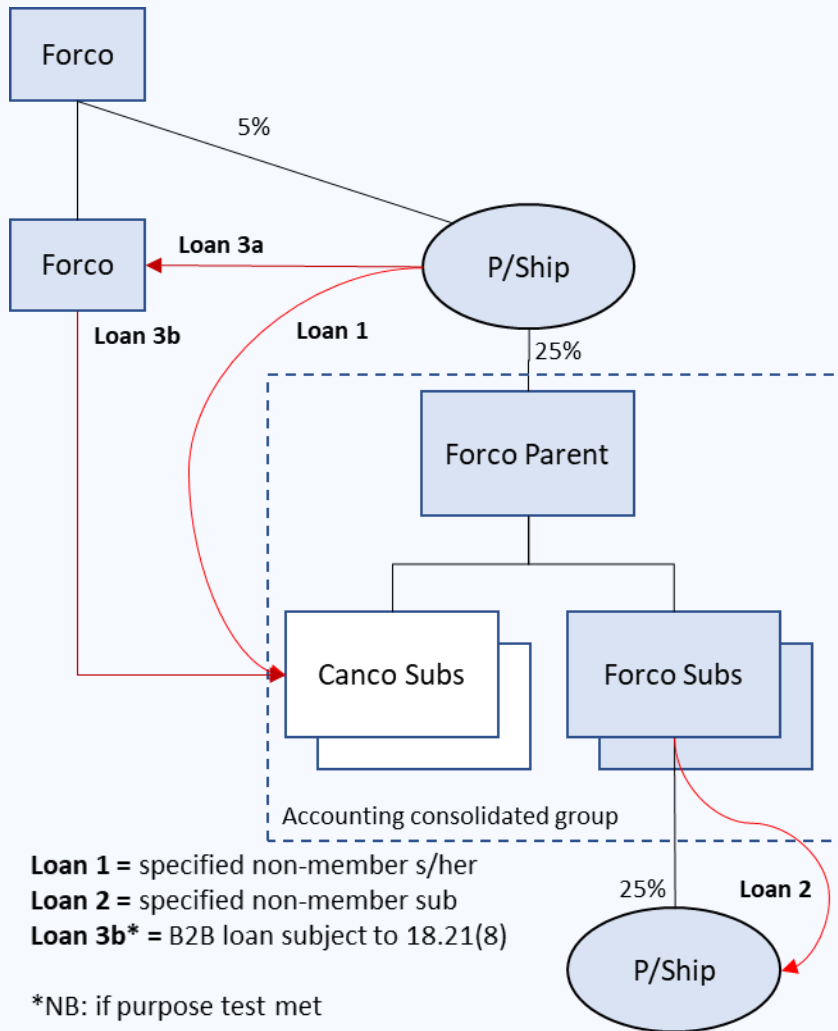
- s.87(2.1)(a.1)(i) continuation rules for determining cumulative unused excess capacity on amalgamations apply to amalgamations that occur in any taxation years.
- Impact of short taxation years as a result of pre-regime amalgamations.
- s.88(1.11) continuation rules for determining cumulative unused excess capacity on s.88(1.1) windup currently drafted to apply to windings-up that begin on or after October 1, 2023
  - Finance considering extending to pre-regime windings-up
- If the taxpayer or an “eligible pre-regime group entity” in respect of the taxpayer was subject to a loss restriction event at the beginning of any of its pre-regime years, its excess capacity and excess interest for any pre-regime year that precedes that year are deemed to be nil.
- See Appendix for table summarizing other continuity rules on amalgamations, winding-ups and loss restriction events.



# GROUP RATIO

# Group Ratio

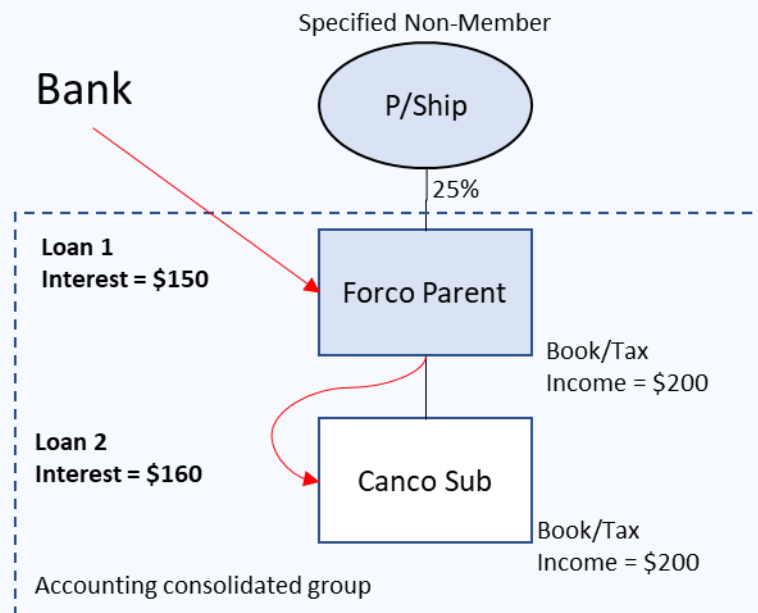
- Taxpayer can deduct IFE in excess of the fixed ratio provided the taxpayer is a member of an accounting consolidated group and elects.
- “**Group Ratio**” is the group’s net interest expense (“**GNIE**”) over the group’s adjusted net book income (“**GANBI**”)
- Some matters to be aware of:
  - Can be unclear which entity will be the “ultimate parent” under IFRS (e.g., for investment funds)
  - Issues with 50/50 co-investment entities or co-investments where control is shared as per the USA
  - Specified non-members can reduce the Group Ratio
  - Accounting differences (e.g., book vs. tax characterization of interest expense; also IFE is broader than “specified interest expense” in 18.21(1))
  - Impact to the election if group ratio amount is over allocated (e.g., by \$1).
  - Excess capacity deemed to be nil in a group ratio year (cannot carry forward)
  - Group ratio can be lower than the fixed ratio



## Group Ratio – Specified Non-Member

- Group Ratio generally reduced for any net interest paid to a “specified non-member” which can result in a higher limitation compared to the fixed ratio
- A “specified non-member” is not a member of the consolidated group but satisfies any of below tests at any time in the period:
  - does not deal at arm’s length with a member of the group; or
  - 25% vote or value shareholder (aggregate non-arm’s length persons); or
  - 25% vote or value subsidiary
- Anti-avoidance rule for back-to-back amounts s. 18.21(8) - “one of the main purposes” test

# Group Ratio – Specified Non-Member Example



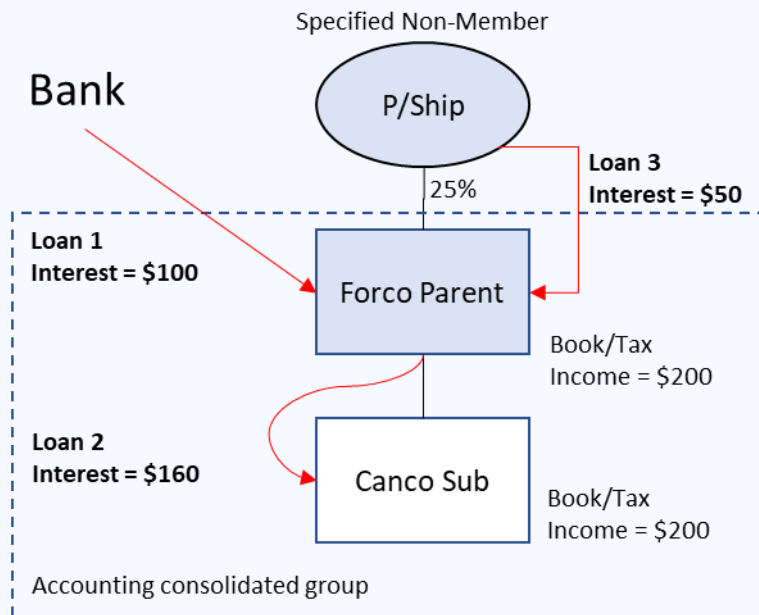
Item	Canco Sub	Forco	Group
Other income	360	190	550
Interest revenue / (exp) group	-160	160	0
Interest exp. (3rd party)	0	-150	-150
Interest exp. (specified non-member)	0	0	0
Book/Tax Income	200	200	400
ATI	360		

GNIE	150	A
GANBI	400	B
Group Ratio	38%	A/B
EIFEL %	15%	$[\$160 - (38\% \times \$360)] / \$160$
Canco RIFE	\$ 24	$[\$160 \times 15\%]$

NB: Canco Sub interest deduction will not exceed GNIE of \$150

**Group ratio = 38% (better than 30% default method)**

# Group Ratio – Specified Non-Member Example



Item	Canco Sub	Forco	Group
Other income	360	190	550
Interest revenue / (exp) group	-160	160	0
Interest exp. (3rd party)	0	-100	-100
Interest exp. (specified non-member)	0	-50	-50
Book/Tax Income	200	200	400
ATI	360		

GNIE	100	A
GANBI	400	B
Group Ratio	25%	A/B
EIFEL %	44%	[\$160 - (25% x \$360)]/\$160
Canco RIFE	\$ 70	[\$160 x 44%]

NB: Canco Sub interest deduction will not exceed GNIE of \$100

**Group ratio reduces to 25% (worse than 30% default method)**

# NON-CAPITAL LOSSES

THING TO CONSIDER IN LOSS CARRY FORWARD / BACK  
SITUATIONS

## EIFEL & Non-Capital Losses

- NCLs deducted in a taxation year may be partly or wholly added back under variable B(h) of the ATI definition
- Amount of addback depends on the proportion of certain amounts over the NCL for the “taxpayer loss year”: “**J x K/L**”
  - J = NCL deducted in current year
  - K = Lesser of (i) NCL for the taxpayer loss year and (ii) “formula” amount
  - L = NCL for the taxpayer loss year
- Generally, the more the NCL is generated from:
  - Operational expenses = reduced addback
  - IFE, CCA, Resource pools, etc. = increased addback

## Carryforward of Pre-Regime NCLs

- If a taxpayer carries forward pre-2023 NCLs and deducts them in an EIFEL taxation year, that carry forward will reduce taxable income and ATI (except to the extent such losses derive from an amount described in variable B, e.g., pre-regime IFE, CCA etc.).
- For example: if an NCL carryforward is **sourced from operating losses** and deducted in 2024, this will reduce 2024 ATI, potentially causing RIFE in 2024.
- Contrast: if an NCL carryforward is **sourced entirely of net interest expense** and deducted in 2024, there is no impact to 2024 ATI.
- Counterintuitive result?



# Carryforward Pre-Regime NCL Example

## No addback var. B(h) = IFE denial in 2024 year

	2020	2024	Workings: Before NCL deducted	2024
Operational income (loss)	(700)	1,000	ATI	1,000
IFE	-	(300)	IFE allowed @30%	300
TI / (NCL)	(700)	700	IFE deducted	(300)
NCL (deducted)	700	(700)	IFE denied	-
TI	-	210		
NCL balance	-	-	Workings: After NCL deducted	2024
RIFE balance	-	210	ATI before Var. B(h) addback	300
			+ Var. B(h) addback	-
<i>Var. B(h) calculation</i>			=ATI	300
NCL deducted 2024		700 J	IFE allowed @30%	90
IFE + CCA in loss year 2020		- K	IFE deducted	(300)
NCL for the loss year 2020		700 L	IFE denied	210
Add back = J * K/L		-		

## EIFEL & Non-Capital Losses

- Remember, where a taxpayer carries back or carries forward an NCL to another year (“**claim year**”), that can change ATI in the claim year.
- The above result occurs where this is a partial or no addback to ATI under variable B(h), resulting in revised ATI.
- The calculation of other amounts that rely on ATI needs to be considered (e.g., “excess capacity”, “absorbed capacity”) including impact across taxation years.

# EIFEL & Non-Capital Losses – Carryback, full addback var. B(h)

## Full addback var. B(h) = No IFE denial in 2025 loss year

	2024	2025		2024	2025
Operational income (loss)	2,000	-	<i>Workings: Before NCL deducted</i>		
IFE	(300)	(300)	ATI	2,000	-
CCA	(700)	(700)	IFE allowed @30%	600	-
TI / (NCL)	1,000	(1,000)	IFE deducted	(300)	(300)
NCL deducted	(1,000)	1,000	Excess capacity	300	-
TI	-	-	Absorbed capacity	-	300
NCL balance	-	-	IFE denied	-	-
RIFE balance	-	-			
			<i>Workings: After NCL deducted</i>		
<i>Var. B(h) calculation</i>			ATI before Var. B(h) addback	1,000	-
NCL deducted 2024		1,000 J	+ Var. B(h) addback	1,000	-
IFE + CCA in loss year 2025		1,000 K	=ATI	2,000	-
NCL for the loss year 2025		1,000 L	IFE allowed @30%	600	-
Add back = J * K/L		1,000	IFE deducted	(300)	(300)
			Excess capacity	300	-
			Absorbed capacity	-	300
			IFE denied	-	-

- Full addback under variable B(h)
- No change to ATI in deduction year
- Therefore no change to excess capacity and absorbed capacity
- No impact to deductible IFE

# EIFEL & Non-Capital Losses – Carryback, partial addback var. B(h)

**Partial addback var. B(h) = IFE denial in 2025 loss year**

	2024	2025
Operational income (loss)	2,000	(500)
IFE	(300)	(300)
CCA	(700)	(700)
TI / (NCL)	1,000	(1,500)
NCL deducted	(1,000)	1,000
TI	-	-
NCL balance	-	400
RIFE balance	-	100

*Var. B(h) calculation*

NCL deducted 2024	1,000	J
IFE* + CCA in loss year 2025	1,000	K
NCL for the loss year 2025	1,500	L
Add back = J * K/L	667	

*\*Only deductible IFE? Iterative calculation required?*

	2024	2025
<i>Workings: Before NCL deducted</i>		
ATI	2,000	-
IFE allowed @30%	600	-
IFE deducted	(300)	(300)
Excess capacity	300	-
Absorbed capacity	-	300
IFE denied	-	-
<i>Workings: After NCL deducted</i>		
ATI before Var. B(h) addback	1,000	-
+ Var. B(h) addback	667	-
=ATI	1,667	-
IFE allowed @30%	500	-
IFE deducted	(300)	(300)
Excess capacity	200	-
Absorbed capacity	-	200
IFE denied	-	100

- Partial addback under variable B(h)
- Changes ATI in deduction year.
- Changes excess capacity and absorbed capacity.
- Impacts deductible IFE in 2025, converting some of the NCL carry forward to RIFE in 2025

## EIFEL & Non-Capital Losses – Other Items to Note

- NCL deduction may cause IFE to be denied in loss year → **iterative recalculation of variable B(h) addback in claim year?**
- Deducting losses from multiple years requires **multiple variable B(h) calculations** because the calculation is performed for **each loss year**.
- Variable B(h) addback requires **multiple inputs**, including FAPLs and RAIFE.
  - Generally, certain FAPLs further reduce a taxpayer's addback in respect of an NCL (appears not relevant if no RAIFE)

## EIFEL & Non-Capital Losses – Other Items to Note

- Technical clarification requested by Joint Committee in variable A of the definition of ATI so that a taxpayer can choose to carryback more of an NCL from one year to ensure taxable income can be reduced to nil in another year, provided the excess portion of the NCL deducted is treated as RIFE.

## Some Takeaways

- **Pre-Regime Election:** applies separate rules; care required for pre-regime reorganizations (windups, amalgamations)
- **Partnerships:** can produce anomalies (e.g., ACB recognition)
- **Foreign affiliates:** FAPLs have implications for deducting interest at the Canadian level
- **Group Ratio:** debt from specified non-members can reduce the ratio
- **Deducting NCLs:** limitation increases when sourced from operational losses

**Overall: it's a modelling exercise requiring extensive data input**

# APPENDIX



# Continuity Rules

	<b>s.87(1) Amalgamation</b>	<b>s.88(1.1) Winding Up</b>	<b>Loss Restriction Event</b>
CUEC	s.87(2.1)(a.1)(i) deems new corporation to be same corporation as each predecessor for purposes of determining new corporation's absorbed capacity, excess capacity and transferred capacity in determining its CUEC Applies to amalgamations that occur in any taxation year	s.88(1.11) deems absorbed capacity, excess capacity and transferred capacity of the subsidiary for a taxation year to be absorbed capacity, excess capacity and transferred capacity, of the parent for its taxation year in which the subsidiary's year ends Currently drafted to apply to windings-up that begin on or after October 1, 2023; Finance considering extending to pre-regime windings-up	s.111(5.01) - CUEC of any taxpayer for any taxation year that ends after a LRE determined without regard to any absorbed capacity, excess capacity or transferred capacity of the taxpayer for any taxation year that ended before the LRE Excess capacity otherwise determined and excess interest for any pre-regime year preceding a LRE are deemed to be nil
RIFE	s.87(2.1)(a) & (b) deems new corporation to be same corporation as each predecessor for purposes of determining new corporation's RIFE and applying rules restricting deductibility of RIFE by the new corporation Applies to amalgamations that occur on or after October 1, 2023	s.88(1.1) amended to provide the carry-forward treatment for the subsidiary's RIFE in respect of the parent New rules in s.88(1.1)(d.2), (d.3), (g) and amendment to s.88(1.1)(e) consistent with current treatment of losses under s.88(1.1) Apply to windings-up that begin on or after October 1, 2023.	s.111(5)(a) amended to restrict deductibility of RIFE for taxation years ending before a LRE in a manner similar to non-capital losses – "property" RIFE for taxation years ending before the LRE lost
IFE and IFR for variable B(h) of ATI	s.87(2)(a.1)(ii) deems new corporation to be same corporation as each predecessor Applies to amalgamations that occur in any taxation year	No continuity rule under current draft Joint Committee recommended s.88 should include a similar rule	Current s.111(5)(a) restrictions