A New Decade: Revisiting Tax Consolidation in Canada, Mate

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Abstract: The last time the Canadian government was on the verge of formalizing a loss transfer system for Canadian corporate groups was in 2010. With the dawn of a new decade, it seems appropriate to re-examine some of the policy options for the income tax treatment of corporate groups in Canada. This paper examines why this issue has been a vexed one for Canadian tax policy and what, if anything, should be done about it. It is argued that a stronger application of the enterprise doctrine does not necessarily mean a better regime on policy grounds and therefore any implementation by Canada should proceed with caution. The paper first explores the history of the rise of corporate groups in the modern economy and why the enterprise doctrine is appropriate for taxation of corporate groups. The paper then examines the current system in Canada with respect to loss utilization and the provincial considerations that are unique to Canada. Using Australia as a case study of a country that has embraced the single entity concept to its fullest, I then apply it to the Canadian context. Through this exercise I argue that while Australia's model may address neutrality and equity grounds, the cost to administer are too burdensome for it to be a viable solution. In the end, Canada should not adopt a full consolidation tax system. If Canada is to move on this issue, they should proceed with caution and at most formalize the existing loss utilization rules. This will make the system more transparent and allow the government to monitor the actual costs to the provinces.

Contents

1) What is Corporate Group Taxation? And Why Do We Care? 3

a) Enterprise Doctrine 4

b) Policy Reasons to Apply Enterprise Doctrine 6

2) Canada's Current Approach 8

3) The Provincial Perspective 9

4) What Alternatives Exist? 11

5) Case Example: Australia 13

6) Evaluating the Australian Model in Canada 15

a) Provincial Concerns 15

b) The Policy Objective of Simplicity Takes Precedence 17

c) If it's Not Broke, Why Fix It? 20

7) Conclusion 21

With the dawn of a new decade, it seems appropriate to re-examine some of the policy options for the income tax treatment of corporate groups in Canada. The last time there was serious discussion about corporate group taxation was around 2010, when the Canadian government announced in its budget that it would consider the introduction of a "formal system of loss transfer or consolidated reporting".[1] At that time, it looked like the Canadian government was on the verge of formalizing a loss transfer system for Canadian corporate groups. A formal system of corporate group taxation would eliminate the competitive advantage that foreign corporations have over Canadian corporations on neutrality and equity grounds, which would help raise revenue for provinces and Canada as a whole. Yet, 10 years later nothing has changed. Canada remains one of the few developed countries without any formal system allowing for the sharing of tax attributes within a corporate group setting.

A 2000 Statistics Canada survey estimated that there were about 95,000 large Canadian public corporations in corporate groups.[2] Together, they held up to $324 billion of losses and tax attributes that could be used to shelter up to $49 billion of federal tax.[3] Those numbers may have increased over time. But why is *this* the case: Why after several public and private consultations with key stakeholders, resulting in recommendations for implementing a corporate group tax system does Canada remain at an impasse? And what, if anything, should be done about it?

This paper will explore and analyze the issue of corporate group taxation in Canada. It will be argued that a strong reason for the lack of progress in this space is because there is not a

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[1] Canada, Department of Finance, 2010 Budget, Budget Plan, March 4, 2010, at 386.
[2] Maureen Donnelly and Allister Young, "Policy Options for Tax Loss Treatment: How Does Canada Compare?" (2002) 50:2 *Canadian Tax Journal* 429-472 at 472.
[3] John Burghardt and Sarah Chiu, "'Loss' Is Just a Four-Letter Word: Policy, Practice, and Proposals," in *Report of Proceedings of the Sixty-Fifth Tax Conference*, 2013 Conference Report (Toronto: Canadian Tax Foundation, 2014), 14:1-43 at 1.

suitable alternative to the status quo of informal loss utilization. This paper first explores the history of the rise of corporate groups in the modern economy and why the enterprise doctrine is appropriate for the taxation of corporate groups. This paper then discusses the current system in Canada with respect to loss utilization, and the provincial considerations that are unique to Canada. This is followed by a brief discussion of the policy options available to Canada with Australia being used as a case study of a country that has completely embraced the enterprise doctrine. The final part of this paper evaluates whether Australia's experience could work in Canada and argues that a stronger application of the enterprise doctrine does not necessarily mean a better regime on policy grounds and therefore any implementation by Canada should proceed with caution.

1) What is Corporate Group Taxation? And Why Do We Care?

In order to understand why the income tax treatment of corporate groups has been a problematic question of Canadian tax policy, one needs to look to the history of corporations. Before the 19th century, companies were formed under charter with individuals as shareholders.[4] In legal terms, this means a corporation and its shareholders are separate legal entities and, structurally, there are only two levels: individual shareholders and their corporations. Over time, corporate groups began to appear and, since the late 19th century, have grown exponentially in size, scope and complexity.[5] It is now typical to have corporate groups that span multiple jurisdictions comprised of hundreds of companies and are multi-tiered structures.

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[4] Antony Ting and Daniel HK Ho, "*Tax Consolidation: Does it Have to be Complex for Hong Kong*" (2012), 42: 2 *Hong Kong Law Journal* 145-166.
[5] Ibid., at 148.

a) Enterprise Doctrine

In Canada, the basic unit of taxation for corporate income is the corporation as a standalone entity.[6] The "taxpayer's income for the year" is calculated as the net income from each source. The Act set outs rules requiring inclusions or deductions for the listed sources found in subdivision a (office or employment), subdivision b (business or property) and subdivision c (capital gains and losses) of Division B of Part I of the Income Tax Act.[7] Thus, the basic theory of a comprehensive income tax for individual taxpayers is determined on a *net basis*, in order to assess a taxpayer's "ability to pay".[8] Joining these two concepts together means that income from one part of a corporation can be offset by losses from another part (i.e. net basis), while losses by one corporation may not be used directly against the income of another corporation (i.e. standalone basis), even though both corporations are part of the same corporate group.[9]

As you can see, corporate groups present severe challenges to the traditional separate entity doctrine that treats a company as a separate legal entity from its shareholders. In the modern economy, there are *bona fide* reasons why businesses are not operated by a single company, but by a corporate group under the common control of a parent company.[10] However, without a group taxation system, there is a deterrent to operate through separate corporations

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[6] Canada, Department of Finance, *The Taxation of Corporate Groups, Consultation Paper* (Ottawa: Department of Finance, November 2010) (www.fin.gc.ca/activty/consult/tcc-igs-eng.asp), at 3 (the "Consultation Paper").
[7] RSC 1985, c. 1 (5th Supp.), as amended (the "Act").
[8] Stephen R. Richardson and Michael Smart, "Tax Loss Utilization and Corporate Groups: A Policy Conundrum" (2013), 6:3 *The School of Public Policy Publications* 1-25. While most income tax systems provide for income from a business or investment to be calculated on a net basis, and for losses from various sources to offset income from a taxpayer's other sources in a year, there are restrictions with respect to offsetting losses from employment income.
[9] The Consultation Paper, supra note 6, at 3.
[10] For example, limiting the liability of the shareholder with different ventures, financial considerations, maintaining separate profit centers and ensuring greater management autonomy are just a few reasons that come to mind.

because of the potentially increased tax costs. As opposed to holding onto a vestige of older times when the economy was far simpler and corporate groups did not exist, several areas in corporate law are changing with the times and being augmented by the doctrine of "enterprise law".[11]

The enterprise law doctrine focuses on the corporate group as an economically integrated unit where economic substance overrides the legal form of individual companies that make up the corporate group.[12] In economic terms, the shareholders of a corporation indirectly own its assets, and corporate profits and losses accrue to their benefit or detriment, notwithstanding that, the corporation is a separate legal personality from its shareholders. There are many rules that look through the corporation to its ultimate beneficiary: the shareholder.[13] For example, with respect to corporate dividends, we consider the fact that the corporation pays its dividend with after-tax dollars. Hence, in certain circumstances, we allow individual shareholders a credit for taxes that the corporation pays.

The question then becomes: How should tax law respond to these changes to our modern economy? Should corporate groups pedantically treat each company as a separate taxable unit, or should they be treated as one single taxable unit on a reasonable case-by-case basis? The response by different governments has been *ad hoc*, inconsistent, and scattered along a continuum of how closely that government applies the enterprise doctrine.[14] These different degrees of application are most likely a result of a country's compromise between conflicting

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[11] Ting and Ho, supra note 4, at 148.
[12] Ibid.
[13] There is the potential for the doubling, tripling, etc. of certain tax benefits when the corporate tax system is based on a standalone basis. Accordingly, the Act recognizes this and moves towards a larger unit of taxation for a corporate group. For example, the association rules in section 256 prevent the multiple generation of the small business deduction and the stop-loss rules in section 40 prevent the realization of losses of certain property within a corporate group.
[14] Ting and Ho, supra note 4, at 148.

policy objectives and constraints.[15] The following section discusses the policy reasons why a country would want to shift to a corporate income tax system that recognizes the enterprise doctrine more fully.

b) Policy Reasons to Apply Enterprise Doctrine

There are clear policy objectives of why a government would want to address corporate group taxation in their income tax system. If corporate tax systems are designed to raise revenue for the government, they should do so in the most economically efficient way possible.[16] This means mitigating any distortions that separate legal personality can create. An efficient tax system, as the theory goes, then helps to provide a more competitive environment for businesses, which makes that country a more preferred investment destination compared to a country that is less efficient.[17]

The neutrality principle dictates that a tax system should not create incentives for taxpayers as to how to carry out a particular transaction or whether to engage in a transaction to begin with.[18] The enterprise doctrine rewards tax neutrality because it does not favour one type of business structure over another. Since Canada's corporate tax system taxes each corporation as a separate entity, some corporations within a commonly controlled group may be paying tax while other corporations within that same group may have unused tax losses, deductions or credits, which is inefficient because as a whole that corporate group is not paying tax on a net basis. A single corporation that carries on business activities through two or more divisions is arguably economically equivalent to two or more commonly controlled corporations carrying on

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[15] Ibid.
[16] The Consultation Paper, supra note 6, at 2.
[17] Ibid.
[18] Ting and Ho, supra note 4, at 150.

with the same business activities. Yet, without a proper group tax system, a taxpayer will be incentivized to carry on business through a single corporation because it is less costly to do so.

Not only does taxing similar structures make a tax system more efficient, it also makes it fairer. "Horizontal equity" implies that taxpayers in similar situations should bear the same burden of taxation.[19] In our modern economy where corporate groups are now more common than ever before, horizontal equity dictates that these multiple corporations be allowed in some way to combine the net income from one source in one corporation against a loss from a source in another corporation like a single corporation can with its separate divisions. Thus, without a proper group tax system, it is unfair to require taxpayers to conduct their business activities through a single corporation, especially if there are legitimate non-tax reasons to do so.

Finally, most Organization for Economic Co-Operation and Development countries have adopted some form of group taxation.[20] In fact, Canada is the only G7 country and one of the few developed countries that does not have a formal corporate group taxation system in place.[21] A formal system of corporate group taxation would eliminate the competitive advantage that foreign corporations have over Canadian corporations, which would help raise revenue for provinces and Canada as a whole. Given the growing response by other countries in applying the enterprise doctrine through the introduction of corporate group taxation, the question becomes what makes this issue such a difficult one for Canada.

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[19] Stephen R. Richardson and Michael Smart, "Tax Loss Utilization and Corporate Groups: A Policy Conundrum" (2013), 6:3 *The School of Public Policy Publications* 1-25.
[20] PricewaterhouseCoopers, comments on *The Taxation of Corporate Groups, Consultation Paper*, submitted to Department of Finance, April 8, 2011.
[21] Ibid.

2) Canada's Current Approach

Although there is no formal legislation when attempting to offset profits and losses between members of a corporate group, taxpayers can achieve this result by using various provisions of the Act.[22] The Canada Revenue Agency ("CRA") has approved a number of "self-help" strategies developed to permit corporations to transfer income and losses among members of the corporate group.[23] Some of the methods which corporate groups are able to use include: (1) financing arrangements, whereby one member of a corporate group borrows funds to invest in preferred shares of another member (with the interest expense reducing income in the borrower, and matching interest income in the transferor, usually the member that has the losses); (2) corporate reorganizations such as amalgamations and wind-ups with loss carry-forward pools into the profitable group member; and (3) transfers of property between group members on a tax-deferred basis, "in order to shift income-producing activities to, or to realize a gain on the final disposition of the property in, a particular group member."[24]

The transfer of losses through these "self-help" strategies is attractive because it provides the necessary level of consolidation within a group to monetize the tax attributes of its members without the complexity of an actual consolidation.[25] Arguably, Canadian corporations that are able to use this informal system are in a better position than corporations in other jurisdictions with consolidation systems, because the ownership threshold for permitting such transactions in Canada are generally lower and thus, the opportunity for potential transfer may be greater.[26]

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[22] Nick Pantaleo and Jeffrey C. Johns, "Toward a New System for the Taxation of Corporate Groups in Canada: Has the Time (Finally) Come?" in *Report of Proceedings of the Sixty-Second Tax Conference*, 2010 Conference Report (Toronto: Canadian Tax Foundation, 2011), 35:1-33.
[23] PricewaterhouseCoopers, supra note 20.
[24] The Consultation Paper, supra note 6, at 5.
[25] Pantaleo and Johns, supra note 22.
[26] Richardson and Smart, supra note 19.

However, on another level, business and legal constraints can preclude the use of such techniques and put the current system at a considerable disadvantage to a formal group taxation regime. For example, corporate groups may not be able to amalgamate for non-tax reasons. Moreover, the current system does not easily accommodate the monetization of tax attributes other than non-capital and capital losses. The biggest drawback for these self-help strategies (especially intragroup financings) is that they can be costly to implement and only practically available to large corporations, with a significant amount of resources being devoted to the design, execution and compliance of such transactions.[27] On top of all of this, the current system gives rise to uncertainty, even though the CRA has by administrative fiat approved such arrangements. For instance, whether such arrangements are considered "market" to move losses between corporations and whether they trigger general anti-avoidance rules with respect to an inappropriate shifting of profits between provinces are questions that cannot be answered with the same level of certainty as legislation can.[28] In short, the current system has a number of shortcomings and puts Canadian corporations with losses in a potentially worse situation than those in other countries that provide formal tax loss transfer or tax consolidation systems.

3) The Provincial Perspective

In Canada, the Constitution Act, 1867 (formerly BNA Act)[29], gave Parliament unlimited taxing powers and restricted those of the provinces to mainly direct taxation (taxes on income and property, rather than on activities such as trade).[30] Federal corporate income taxes are legislated under the provisions of the Act. Provincial and territorial income taxes are levied

[27] Pantaleo and Johns, supra note 22, at 11.
[28] Ibid.
[29] The Constitution Act, 1867, 30 & 31 Vict., c. 3, as amended.
[30] While section 91 of the Constitution Act permits the federal government to raise money by any mode or system of taxation, the provinces have a limited authority pursuant to section 92 to raise revenues with only direct taxation in the province.

under various provincial statutes. Apart from Alberta and Québec, the CRA administers the collection of taxes through corporate tax collection agreements. Because provinces and territories subject to tax collection agreements must use the federal definition of "taxable income" this means that those provinces[31] employ the same tax base as the federal government and, by implication, any change to the federal tax base, including adoption of a corporate group tax system, will also impact to some degree provincial revenues.[32]

Where a corporation carries on business in more than one province, the rules for allocating corporate taxable income among the provinces and territories are well established.[33] Under the interprovincial taxable income allocation rules ("ITIAR"), a taxpayer must identify whether there is a permanent establishment ("PE") in a province. Where a corporation has a PE in more than one province, ITIAR is used to apportion taxable income among the provinces.[34] Due to Canada's harmonized sub-national tax base, it is therefore challenging to make any changes to our income tax system without having the provinces first on board. Besides if any changes were unilaterally made, it would create an unwanted separation between federal and provincial corporate income tax bases, removing any benefits obtained from such harmonization.[35] Indeed, in Ontario's submission to the Consultation Paper, it stated that it supported the federal government's review of taxation of corporate groups "if changes could

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[31] While Alberta and Québec can develop their own definition of "taxable income" in practice they follow the federal definition.

[32] Tax Executives Institute, Inc., comments on *The Taxation of Corporation Groups, Consultation Paper*, submitted to the Department of Finance, April 8, 2011.

[33] The Consultation Paper, supra note 6, at 5.

[34] Ibid. The general formula for allocating income is the sum of gross payroll and sales in a province, divided by two.

[35] Alexandre Laurin, *Cleaning Up the Books: A Proposal for Revamping Corporate Group Taxation in Canada*, C.D. Howe Institute Commentary no. 284 (Toronto: C.D. Howe Institute, March 2009).

further improve the competitiveness and efficiency of the Canadian tax system, while *ensuring that the provinces receive the revenue to which they are entitled*"[36] (emphasis my own).

With respect to corporate groups, the allocations calculated for provincial taxation purposes are different for each group member since these rules are applied at the corporate entity level. Under the current system, changes in the income of various group members utilizing approved financing arrangements can shift taxable income (or losses) between the provinces, resulting in a permanent loss of the latter province's tax base. The current system's lack of transparency means that the net result of such shifts is unclear, as the direction of loss shifting varies from corporate group to corporate group.[37] This in turn perpetuates the distrust the provinces already carry of adopting a new corporate group tax system[38] in the future, which probably explains why Canada has been in a standstill since 1985.[39] Putting this altogether, Canada is caught between a rock and a hard place; a competitive tax system is crucial to attracting investment income, stimulating economic growth and ultimately, generating more provincial revenue. Yet, even with all these known tangible benefits, provinces do not want to adopt a more formal system because they fear the new system will only perpetuate the problems that they currently experience.

4) What Alternatives Exist?

If Canada is to consider the introduction of a group taxation regime, it may find inspiration from the many other consolidation regimes that currently exist around the world. As one commentator has pointed out, it is "difficult to establish an exact 'family tree' of the group

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[36] Ontario Ministry of Finance, comments on *The Taxation of Corporate Groups, Consultation Paper*, submitted to the Department of Finance, April 21, 2011.
[37] The Consultation Paper, supra note 6, at 5.
[38] Pantaleo and Johns, supra note 22, at 28.
[39] According to Pantaleo and Johns, the federal government could not reach an agreement with the provinces for a loss transfer system with respect to the 1985 discussion paper.

taxation regimes around the world". Lines are hard to follow. Exceptions abound."[40] One useful way to organize these alternatives is to see how much the group taxation regime embraces the enterprise doctrine around two key tax attributes: intragroup loss offset and intragroup asset transfer. Classification in terms of these two tax attributes can cover most types of group taxations around the world .[41] These attributes lie on a scale of how a government recognizes the economic integration of corporate groups in their tax system, with a consolidation system[42] at one end and a formal loss transfer system at the other.

The range of approaches within this spectrum between consolidation and loss transfer is contingent on the policy choices made with respect to several structural elements. They are as follows: (1) the degree to which the tax system treats the group as a single entity, (2) the degree of control to determine the group, (3) whether the election to consolidate is mandatory, (4) the treatment of pre-consolidation losses, and (5) the consolidated group's losses, assets, and intragroup shares (on entry, during consolidation and on exit).[43] As one moves along the spectrum from loss transfer to consolidation, the system can be expected to be more complex and strengthen the link between the unit of taxation and the integrated economic unit. Thus, a consolidation system that provides flexibility on eligibility, and for what period of time, would, for instance, be situated on a midway point on this range because it would not treat the corporate group as a single entity in all cases.[44]

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[40] Yoshihiro Masui, "General Report," in International Fiscal Association (IFA), Group Taxation, Cahiers de droit fiscal international, vol. 89b (Amersfoort, the Netherlands: Sdu Fiscale & Financiële Utigevers, 2004), 21-67, at 29 in Antony Ting, "The Unthinkable Policy Option? Key Design Issues Under a System of Full Consolidation" (2011) 59:3 *Canadian Tax Journal* 421-462 at 427.

[41] Ting and Ho, supra note 4, at 152.

[42] For the purposes of this discussion, "consolidation" refers to a full consolidation regime under which a group of resident companies under the common control of a parent company is treated as one single taxpayer, which means not only filing a single consolidated tax return, but permitting losses between groups and tax-free asset transfers.

[43] Ting, supra note 40, at 432.

[44] The Consultation Paper, supra note 6, at 7.

The next section provides an overall evaluation of the Australian regime along the attributes previously mentioned – intragroup loss offset and intragroup asset transfer – and highlighting the structural elements chosen. This evaluation will be used to assess whether the Australian model would be beneficial within Canada's constitutional landscape.

5) Case Example: Australia

The Australian consolidation regime is unlike any other in the world: It fully embraces the doctrine, taxing a corporate group as a single entity. This means multiple tiers of ownership are collapsed into one and are treated as parts of the parent company, rather than separate entities.[45] Unlike the United States, which employs an "entity-based" model, Australia is the world's first "asset-based" model. The data suggests this approach is popular among Australian corporate groups: approximately 83% of wholly-owned groups in the medium to large business sector (groups with revenue of more than $50 million) and 93% of wholly-owned groups in the large business sector (groups with revenue of more than $250 million) fall within the consolidation regime.[46] This popularity is most likely because the business community appreciates the "step-up" cost bases and offset of pre-consolidation losses against the group profits that happens.[47]

Like Canada before the introduction of the consolidation regime, Australia had several limited "grouping reliefs", including intragroup loss transfers, and rollover relief for intragroup asset transfers, but still treated corporations as single taxpayers.[48] The Australian government

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[45] Antony Ting, "Australia's Consolidation Regime: A Road of No return?" (2010) 2 *British Tax Review* 162-193 at 167.
[46] The Australian Government and the Tripartite Working Group, *Multiple Entry Consolidated Groups – Review Report of the Working Group* (Australia: The Australian Government and the Tripartite Working Group, April 2014) (https://treasury.gov.au/sites/default/files/2019-03/MEC-groupsreview.pdf).
[47] Ting, supra note 45, at 193.
[48] Ibid., at 165.

chose to adopt the consolidation regime on the policy grounds of reducing the compliance and administrative costs associated with companies dealing with dual cost bases, and also as an anti-avoidance measure.[49]

First, let's understand Australia's system based on the five structural elements mentioned in section 4). Australia's consolidation regime is based on the single entity rule, whereby subsidiaries for income tax purposes are part of the head company. The definition of an eligible group member is restricted to resident companies, which includes trusts and partnerships and the ownership threshold is substantially 100 percent.[50] Groups that choose to consolidate must include all 100% owned entities under an "all-in" rule, and the choice to consolidate is irrevocable.

On entry of a company into a consolidated group, pre-consolidation losses are transferred to the parent company, which then become available for offset against the consolidated group's taxable income. With respect to treatment of losses on exit, Australia has adopted the "stay-with-the-group" approach.

The tax-free transfer of assets among consolidated group members is another significant advantage of Australia's consolidation regime. However, Australia takes a unique approach with respect to the treatment of assets of a company on entry into, and exit from, a consolidated group. Because Australia is the only country that has adopted an "asset-based" approach to the treatment of the assets of a subsidiary, pre-consolidation cost bases of assets are generally wiped out and reset. On exit from the consolidated group, the share cost base is reconstructed by pushing up the cost bases of assets that the company takes away from the group.

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[49] Ibid.
[50] Ting, supra note 40, at 436.

Now that I have outlined the design of the Australian model, the final section of this paper will assess whether such a model is appropriate in Canada by evaluating it under traditional tax policy grounds of neutrality, equity and simplicity. It will be argued that the appropriate regime for Canada will be one that respects provincial concerns but will be simple in its administration, which in short, is not Australia.

6) Evaluating the Australian Model in Canada

Let us now compare the fit of the Australian model in Canada, along two dimensions.

a) Provincial Concerns

The most significant benefit of any kind of consolidation system is the ability to offset taxable income and losses among members during consolidation. However, given Canada's strong sub-national taxing system, any viable solution would have to address implications with respect to provincial tax revenue. Under the current system, losses of one group member with a single PE in Province B could be transferred to offset taxable income to another group member with a single PE in Province M, thereby reducing tax revenues for Province M and increasing future revenues for Province B due to reduced loss carry-forwards. However, with respect to Australia's model, loss transfer would no longer need to be employed because the subsidiaries effectively cease to exist – effectively amalgamating them into a single corporation. In fact, provincial taxes payable would continue to be determined with the existing ITIAR. Hence, by treating the corporate group as a single economic unit like Australia does, revenue integrity actually would be improved by ensuring that intragroup transactions and utilization of third-party

financing do not impact the allocation of income among the provinces.[51] In this sense, Australia's model is a clear winner with respect to addressing provincial concerns.

In Australia, pre-consolidation losses get transferred to the parent company upon entry to the consolidated group, to be available for offset against the consolidated group's taxable income. The Australian model permits the parent company to have made those losses in the year when the transfer occurs.[52] Contrast this with other consolidation regimes, which "quarantine" losses, so any offset is only permitted against the taxable income from the subsidiary that created the loss.[53] While Australia has developed a concept to deal with unrestricted utilization of transferred losses, there are problems with these rules and one can imagine either a dip or spike in revenue if they are not applied properly.[54] On the whole though, businesses would be able to use losses more rapidly and cost-effectively. Thus, the real fiscal cost to the provinces would be the divergence between the time value of money of a business being able to take advantage of losses more quickly compared to the existing system.[55] At first blush, it appears that if Canada were to adopt the Australian model, the provinces would be amendable on the basis that ITIAR would still apply and while aggregate revenues may be down (because of the fact businesses would now be able to utilize all of their losses), no one province would be bearing the loss disproportionately.

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[51] Ontario Ministry of Finance, supra note 36.
[52] Ting, supra note 45, at 181.
[53] Ibid., at 179.
[54] Australia does have a mechanism called available fraction ("AF") which produces similar results to those of the quarantine policy, namely the amount of pre-consolidation losses that a corporate group can utilize is equal to the amount of taxable income of that company calculated on a standalone basis.
[55] Laurin, supra note 35, at 12.

b) The Policy Objective of Simplicity Takes Precedence

Commentators have argued that Canada's current system is neither neutral nor equitable, urging the adoption of a consolidation system. They argue that it is unfair to mandate that a business operate through a single corporation solely for tax reasons, when operating through separate corporations remains economically the same in outcome as a corporation with several divisions. Canada can solve for these policy objectives if it were to adopt Australia's consolidation regime the thinking goes.

Under Australia's consolidation regime, all subsidiary members of a consolidated group are treated as "parts" to the parent company. An important implication of this means that intragroup asset transfers are completely ignored. Consequently, a taxpayer is not required to trace intragroup asset transfers during consolidation, keep notional records of any deferred gains or losses on those transfers, or recapture the gain or loss when either the transferor or transferee exit the corporate group.[56]A Canadian taxpayer, therefore, would not be incentivized to change their behavior in adopting one corporate form versus another, since all levels of ownership would collapse into one (as in the Australian model). Nor would it need to arrange their affairs in a certain way to transfer assets from one member to another in a group, since transfer of assets would virtually have no tax consequences.

As the saying goes, "some things are too good to be true" and this might be the case for implementing a strong consolidation regime in Canada. While the policy of adopting a strong enterprise doctrine by collapsing all the subsidiaries into the parent may satisfy provincial concerns, but at what cost? It does beg the question: What the cost bases of subsidiaries' assets

[56] Ting, supra note 45, at 169.

should be?[57] Under the Australian model, cost bases of assets in general are erased and substituted with a reset cost base indefinitely. And here lies the rub: To accomplish this there exists a set of complex rules – known as the tax cost setting ("TCS") rules that are designed to achieve the push down of share cost bases to the underlying assets.[58] Similarly, when a member leaves the consolidated group, the share cost base is reconstituted by pushing up the cost bases of assets that it takes from the group.

While delving into the intricacies of the TCS rules is beyond the scope of this paper, it is trite to say that the TCS rules are complicated. In practice, taxpayers have found that identifying their assets (especially intangibles) is an art rather than science, which gets more difficult the more corporations are in a group.[59] The meaning of "assets" and "liabilities" used to allocate the share purchase cost to an individual asset is controversial, because it blends tax concepts with accounting concepts.[60] For instance, accounting liabilities not only include loans borrowed by a corporation to acquire assets, but also other items that do not have much to do with the relationship to the asset cost. Even valuation of assets and liabilities is challenging under the TCS rules, which relies heavily on fair market values that can be susceptible to avoidance opportunities.[61]

This complexity is reflected in the fact that Australia's consolidation regime dominates "over 600 pages of technically challenging legislation and is supplemented by over 100 tax rulings and determinations".[62] With more legislation means more compliance and monitoring costs and accordingly, the Australian Tax Office ("ATO") has had to invest considerably to

[57] Ibid.
[58] Ibid., at 170.
[59] Ibid., at 174.
[60] Ibid.
[61] Ibid.
[62] Ibid., at 166.

implement the regime, including the publication of the Consolidation Reference Manual (the ATO's Consolidation Manual), which consists of over 1,400 pages.[63] Put simply, no matter how fair or how neutral Australia's tax system is designed to be, if it cannot be administered efficiently or if the compliance requirements are too burdensome, it will fail to optimize revenue to Australia's government.[64]

If the bedrock of Canada's corporate income tax system is founded on the concept of separate legal personality, arguably any interaction between consolidation provisions and other parts of the Act will become more difficult as well. As Donnelly and Young highlight: "Are we ready, in the name of economic efficiency, to set aside the basic legal principals around the separate legal existence of the corporation, such as limited liability and the separation of ownership and management?"[65] Could even our corporate law cope with such a wholesale shift when common law jurisprudence has signaled a preference of form over substance? How could directors satisfy their solvency requirements when they declare a dividend-in-kind of property when there is no cost base? What happens if there is a mismatch between what the legal documents purport a transaction to be, and the tax calculations that are made when the business reconstructs the cost base on exit? There are so many questions that come to mind.

A good proxy to see if something is worth pursuing is asking others who have experienced the activity whether they would do it again. According to one commentator, Professor Antony Ting ("Ting"), the answer does not seem promising, which should give Canada some pause. In fact, Ting argues that while there are some distinct advantages of the Australian

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[63] Ibid.

[64] Peter W. Hogg, Joanne E. Magee, and Jinyan Li, *Principles of Canadian Income Tax Law,* 8th ed. (Toronto, Ontario: Carswell, 2013) at 45.

[65] Maureen Donnelly and Allister W. Young, "Policy Forum: Group Relief for Canadian Corporate Taxpayers-At Last?" (2011) 59:2 *Canadian Tax Journal* 239-263 at 255.

model over other countries' consolidation regimes, the tradeoff for these advantages – namely the complexity and problems associated with them – is not worth the trouble for other countries to endure.[66] And while some will argue that simplicity seems like an impossible goal given that the Act is thought to be one of the most complex statutes in Canada,[67] this does not preclude us from trying and making sure we do not make it even more needlessly complex. Put another way, a stronger application of the enterprise doctrine in a consolidation regime does not necessarily imply a better regime on policy grounds.

c) If it's Not Broke, Why Fix It?

While it seems like the Australian model could adequately please the provinces, I have argued that this does not outweigh the costs associated with the increase complexity and heavier compliance obligations that would be generated. Yet, the provinces seem to realize there are real benefits to a new system of corporate group taxation. Referring to the question: What is Canada trying to solve for? If the purpose is to formalize group loss utilization, then this entails a well-defined specific purpose and is relatively simple in its execution. If Canada is trying to implement consolidation for tax purposes, that is something entirely different. I do not believe Canada is trying to create a consolidation system for tax purposes. There is little evidence that stakeholders want tax consolidation and the accompanying increase in compliance costs.[68]

What has been clear in the literature is that provinces have fears over the current loss utilization techniques and corresponding shifting of provincial income. The irony is that the provinces also recognize the importance of the benefits of moving to a new system of corporate group taxation on neutrality and equity grounds. Given these two apparent dichotomies, I suggest

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[66] Ting, supra note 45.
[67] Hogg et al., supra note 64, at 45.
[68] Donnelly and Young, supra note 65, at 255.

the answer for Canada is to formalize the current system. By doing this, Canada will have now more improved transparency of the system and can monitor loss transfers among the provinces.[69] If the government can precisely measure the quantum of losses being shifted, then steps can be taken to manage the problem.[70]

No doubt legislation to implement a regime allowing loss utilization would inevitably add complexity to the Act, however, it would be insignificant compared to what would be required if Canada were to adopt Australia's model. Formalizing the current system will absolutely lead Canada to refine and improve the new system as we understand the implications over time, however, it is still better than the present situation which sub-optimizes certainty, is not as transparent as it can be and is costly to implement.

7) Conclusion

Ten years have passed since the last formal discussion on income tax treatment of corporate groups in Canada with little movement in this regard. Since that time, corporate groups have only become more prolific. This has caused tension between the traditional view of corporations as having separate legal personality versus the economic reality that corporations in a group are an integrated unit. While there exists a patchwork of "self-help" strategies available to taxpayers to utilize losses, there are business and legal constraints that can preclude the use of such techniques, which puts Canadian taxpayers at a disadvantage to a taxpayer subject to formal group taxation on neutrality and fairness grounds.

A strong reason for this impasse is unlike unitary systems or with federations that impose corporate tax at the central government (i.e. Australia) or have unharmonized sub-national tax

[69] Pantaleo and Johns, supra note 22, at 29.
[70] Ibid.

bases (i.e. the United States),[71] Canada has a harmonized sub-national tax base, which means provincial concerns of revenue loss have to be considered.

The various options for group taxation fall within a spectrum between consolidation and loss transfer with the former embracing corporate groups as an integrated economic unit. Using Australia as a case example of a country that encompasses the enterprise doctrine, it is shown there are some distinct advantages of taxing a corporate group as a single entity. However, these advantages come at a huge cost to the policy ground of simplicity. Applying the Australian model to Canada, it is shown that while provincial concerns of revenue loss can be addressed through ITIAR, the compliance and administrative costs to Canada, if it were to adopt Australia's regime would be too great.

The final part of this paper suggests that Canada should take incremental steps towards group taxation. The most prudent decision would be to formalize the status quo. This will address neutrality and equity grounds, but not be overly complicated. Moreover, it generates the necessary data needed to compile a complete picture on the actual cost to the provinces. Naturally, one still needs to apply the structural elements of a consolidation regime in order to formalize loss utilization to the Canadian context. The specific framework to address these matters will have to be a job best left for someone else.

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[71] Martha O'Brien, "Corporate Group Taxation: The Slow Lane to New Policies in Canada and the EU" working paper, (February 2013) at 21.

Checklist for Research Papers (must be submitted together with your research paper)	
Requirements	Yes/No?
1. Title	Yes
· is interesting and engages the reader?	Yes
· reflects the content of the essay?	Yes
· original (your own title)?	
2. Title page	Yes
· contains first and last name of writer?	Yes
· instructor name and name of the course?	Yes
· word count (excluding Title page, Abstract, TOC and Bibliography)?	
3. Formatting	Yes
· double spaced?	Yes
· "normal" margins?	Yes
· 12 point, Times or Courier font?	Yes
· pages are consecutively numbered in the upper right-hand corner?	
4. Abstract	Yes
· captures the essence of the paper?	Yes
· main point/thesis included?	Yes
· main supporting points/evidence included?	Yes
· up to 2/3 of a page in length?	

5.	**Table of Content**	Yes
·	level 1 headings directly relate to the title/topic?	Yes
·	level 2 headings directly relate to level 1 headings?	
6.	**Introduction**	Yes
·	general opening sentence linked to topic?	Yes
·	tells the reader the main argument or purpose of essay?	Yes
·	main sources of evidence to support the thesis/argument?	Yes
·	roadmap or preview/summary of main points/themes to be developed?	
7.	**Body paragraphs**	Yes
·	contain a topic sentence at the beginning of each paragraph?	Yes
·	show evidence of linking words and transitions?	Yes
·	provide evidence and examples to support claims/argument?	Yes
·	make connections between ideas (cohesion)?	
8.	**Conclusion paragraph**	Yes
·	mirrors the introduction?	Yes
·	summarizes /reviews main points/argument?	Yes
·	provides a new insight or emerging questions that arise from the research?	Yes
·	offers some interesting final thought or suggestions for further consideration?	
9.	**Citation/attribution**	Yes
·	Canadian Tax Foundation's guide followed?	
10.	**Language**	Yes
·	spell checked?	
	• appropriate academic and professional tone and word choices?	

• proofread or edited for grammatical accuracy?	