



Changes to the Closely-related Test

The Budget tabled by the Minister of Finance on March 22, 2016, proposed legislative amendments to section 128 of the *Excise Tax Act*, which provides the rules for determining whether a particular corporation and another corporation are closely related. These amendments are included in Bill C-29, the *Budget Implementation Act, 2016, No. 2*. This GST/HST Notice explains these proposed amendments. Any commentary in this publication should not be taken as a statement by the Canada Revenue Agency (CRA) that the proposed amendments will become law in their current form. All legislative references are to the *Excise Tax Act* (the Act) unless otherwise indicated.

Background

Determining whether two corporations are closely related is important in establishing whether elections can be made under sections 150 and 156. Briefly, section 150 permits corporations that are members of a closely related group (each member of which, among other things, must be closely related to each other) to elect to treat certain taxable supplies made between them as supplies of financial services and therefore exempt from GST/HST. Similarly, section 156 generally permits certain corporations that are closely related to jointly elect to treat certain taxable supplies made between them as having been made for no consideration. The election under section 156 may also be made by a closely related Canadian partnership as defined in that section.

Whether two corporations are closely related is also important with respect to eligibility for the offset provision under subsection 228(7) and for purposes of paragraph (t) of the definition of financial service in subsection 123(1). Subsection 228(7) and the *Offset of Taxes (GST/HST) Regulations* provide that certain amounts of tax payable or remittable by a particular corporation may be offset by the amount of any tax refund or rebate to which another corporation is entitled, if that other corporation is closely related to the particular corporation. Paragraph (t) excludes from the definition of financial service various services prescribed by the *Financial Services and Financial Institutions (GST/HST) Regulations*.

Section 128

Section 128 sets out the rules for determining whether corporations are closely related for purposes of Part IX of the Act. Under existing paragraph 128(1)(a), a particular corporation and another corporation are closely related at any time if at that time not less than 90% of the value and number of the issued and outstanding shares of the capital stock of the other corporation, having full voting rights under all circumstances, are owned by:

- the particular corporation,
- a qualifying subsidiary of the particular corporation,
- a corporation of which the particular corporation is a qualifying subsidiary,
- a qualifying subsidiary of a corporation of which the particular corporation is a qualifying subsidiary, or
- any combination of the aforementioned corporations or subsidiaries.

La version française de la présente publication est intitulée *Modifications apportées au critère de personnes étroitement liées..*



Under paragraph 128(1)(b), a particular corporation is closely related to another corporation if the other corporation is a prescribed corporation under the *Closely Related Corporations (GST/HST) Regulations* in relation to the particular corporation. These regulations extend the definition of closely related corporations in certain circumstances generally where shares are owned by employees or held in trust.

Where two corporations are closely related to a third corporation, they are considered closely related to each other.

For purposes of determining closely related status, an investment fund that is a member of a mutual insurance group is deemed to be a corporation.

Proposed amendments to section 128 and the *Closely Related Corporations (GST/HST) Regulations*

It is proposed that, in addition to the existing criteria of paragraph 128(1)(a), **qualifying voting control** in respect of the other corporation would have to be held by a corporation described in any of the five bullets above. In certain cases qualifying voting control would also be required for purposes of paragraph 128(1)(b) and the *Closely Related Corporations (GST/HST) Regulations*.

Meaning of qualifying voting control

Under proposed subsection 128(1.1), a person or group of persons would hold qualifying voting control in respect of a corporation at any time if at that time

- (a) the person, or the members of the group collectively, as the case may be, own shares of the corporation to which are attached not less than 90% of the shareholder votes that may be cast in respect of each matter, other than a matter
 - (i) for which a statute of a country, or of a state, province, or other political subdivision of a country, that applies to the corporation provides, in respect of the vote of the shareholders of the corporation on the matter, that
 - (A) any shareholder of the corporation has voting rights that are different from the voting rights that the shareholder would otherwise have under the letters patent, instrument of continuance or other constating instrument by which the corporation was incorporated or continued, including any amendment to, or restatement of, the constating instrument, or
 - (B) holders of a class or series of shares of the corporation are entitled to vote separately as a class or series, or
 - (ii) that is a prescribed matter or a matter that meets prescribed conditions or arises in prescribed circumstances (none are currently proposed to be prescribed); or
- (b) the person or group, as the case may be, is a prescribed person or group in relation to the corporation (none are currently proposed to be prescribed).

Thus, in order for a person (or group of persons) to be considered to hold qualifying voting control of another corporation, 90% or more of shareholder votes in respect of all corporate matters must be held and controlled by the person, with limited exceptions. Where there are any matters in respect of which a statute of a country, state, province, or other political subdivision of a country, that applies to the corporation provides that the votes of the shareholders of the corporation in respect of the matter are different from the voting rights that the shareholders would otherwise have pursuant to the corporation's constating documents, then that matter is not considered for the purposes of determining whether a particular person holds qualifying voting control in respect of the corporation.

For example, subsection 183(3) of the *Canada Business Corporations Act* provides that “each share of an amalgamating corporation carries the right to vote in respect of an amalgamation agreement whether or not it otherwise carries the right to vote.” Therefore, the distribution of voting rights in respect of the shareholders vote on an amalgamation agreement is not considered when determining whether a person holds qualifying voting control of a corporation.

Matters for which such statutes entitle holders of a class or series of shares to vote separately as a class or series are also not considered when determining whether a person holds qualifying voting control of a corporation.

For example, a corporation incorporated under the *Canada Business Corporations Act* is authorized to issue shares of more than one class or series. Subsection 176(1) of that Act provides that holders of shares of a class or series are entitled to vote separately as a class or series on a proposal to amend the corporation’s articles with respect to specific matters, such as increasing the rights or privileges of any class of shares having rights or privileges equal or superior to the shares of such class. Therefore, the matters listed in subsection 176(1) of the *Canada Business Corporations Act* entitling the holders of shares of a class or series to vote separately as a class or series are not considered for purposes of determining whether a person holds qualifying voting control of the corporation.

Also, for purposes of determining whether a particular person holds qualifying voting control of a corporation, proposed subsection 128(4) provides that the particular person would be deemed not to own a share at a particular time if

- (a) another person has a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently, to control the voting rights attached to the share, unless the right is not exercisable at the particular time because its exercise is contingent on the death, bankruptcy or permanent disability of an individual; and
- (b) the other person is not closely related to the particular person at the particular time.

Accordingly, where the shareholder voting rights attached to a share that is owned by a particular person are subject to a right (under a contract, in equity or otherwise) of control by another person who is not closely related to the particular person, that share is generally excluded in determining whether the particular person has qualifying voting control of the corporation in question. However, if the particular person and the other person are closely related, this exclusion will not apply.

Meaning of qualifying subsidiary

A **qualifying subsidiary** of a particular corporation is generally defined in subsection 123(1) as another corporation, not less than 90% of the value and number of issued and outstanding shares of which, having full voting rights under all circumstances, are owned by the particular corporation. It is proposed that, in addition to the existing criteria, the particular corporation would have to hold qualifying voting control in respect of the other corporation.

Closely Related Corporations (GST/HST) Regulations

Similarly, it is proposed that, in addition to the existing criteria in the *Closely Related Corporations (GST/HST) Regulations*, a corporation would have to hold qualifying voting control in respect of another corporation for the two corporations to be considered closely related.

More specifically, the proposed amendments to the Regulations provide that a particular corporation and another corporation would be considered to be closely related:

(a) where the following conditions are met:

(i) ownership of 90% or more of the total value and number of all the specified shares¹ of the other corporation is held:

(A) by the particular corporation,

(B) by a corporation that is closely related to the particular corporation under paragraph 128(1)(a),

(C) by

I) employees of

- the other corporation,
- a corporation closely related to the other corporation under paragraph 128(1)(a),
- the particular corporation, or
- a corporation closely related to the particular corporation under paragraph 128(1)(a)

where the employee-owned shares cannot be publicly traded and became shares of the employee as a result of the employment of that employee; or

II) a corporation where the employees referred to above hold qualifying voting control and own 90% or more of the total value and number of all specified shares of that corporation where the employee-owned shares cannot be publicly traded and became shares of the employee as a result of the employment of that employee; or

(D) in trust for the benefit of the other corporation or of an employee(s) referred to above where the shares cannot be publicly traded and beneficial ownership of the shares of the employee arose as a result of the employment of that employee;²

(ii) at least 50% of the total value and number of the specified shares of the other corporation is held by the particular corporation or a corporation closely related to the particular corporation under paragraph 128(1)(a); and

(iii) the particular corporation would hold qualifying voting control in respect of the other corporation if it were to own

- all of the issued and outstanding shares of the capital stock of the other corporation referred to under (a) (i) and
- all of the issued and outstanding shares of the capital stock of the other corporation that are not specified shares and that would be included under (a)(i) if they were specified shares; or

(b) where qualifying voting control of the other corporation is held by, and 90% or more of the total value and number of all the specified shares of the other corporation is owned by

- the particular corporation,
- a corporation that is closely related to the particular corporation under paragraph 128(1)(a),
- a corporation that is a prescribed corporation in relation to the particular corporation for having met all the conditions described above under (a), or
- any combination of the corporations referred above under (b).

¹ "Specified share" in these Regulations means an issued and outstanding share of the capital stock of a corporation having full voting rights under all circumstances.

² Shares held in trust for the benefit of an employee or owned by a corporation 90% owned by employees that also hold qualifying voting control, are treated as being employee-owned.

Coming into force provisions

The proposed amendments to section 128, the definition of qualifying subsidiary in subsection 123(1), and the *Closely Related Corporations (GST/HST) Regulations* would generally apply as of March 22, 2017. However they would also apply as of March 23, 2016

- in respect of an election under section 150 or 156 that is to become effective on a day that is after March 22, 2016, but before March 22, 2017, unless the election is filed on or before March 22, 2016, and
- for the purposes of applying paragraphs 4(3)(b) and (c) of the *Financial Services and Financial Institutions (GST/HST) Regulations*, in respect of a supply of a service if the agreement for the supply is entered into after March 22, 2016, but before March 22, 2017, and it is not the case that all or substantially all of the service will be performed before March 22, 2017.

Proposed amendments to section 156

Section 156 generally permits certain corporations and Canadian partnerships that are closely related to jointly elect to treat certain taxable supplies made between them as having been made for no consideration. While section 128 describes the circumstances under which two corporations may be closely related, subsection 156(1.1) describes the circumstances under which two partnerships or a partnership and a corporation may be closely related for purposes of the section 156 election.

Amendments are proposed for subsection 156(1.1) which are similar to those described above for section 128. Specifically, proposed amendments to clause 156(1.1)(a)(ii)(A) stipulate that a particular Canadian partnership and another person that is a Canadian partnership would be closely related at any time if, at that time, the particular Canadian partnership

- holds qualifying voting control in respect of a corporation that is member of a qualifying group³ of which the other Canadian partnership is a member, and
- owns at least 90% of the value and number of the issued and outstanding shares, having full voting rights under all circumstances, of the capital stock of the corporation.

Similarly, proposed amendments to subparagraph 156(1.1)(b)(i) provide that a particular Canadian partnership and another person that is a corporation would be closely related at any time if, at that time

- qualifying voting control in respect of the corporation is held by:
 - the particular partnership;
 - a corporation or a Canadian partnership, that is a member of a qualifying group of which the particular partnership is a member; or
 - any combination of the aforementioned corporations or partnerships; and
- not less than 90% of the value and number of the issued and outstanding shares, having full voting rights under all circumstances, of the capital stock of the corporation are owned by the entities listed in the sub-bullets above.

Additionally, proposed amendments to subparagraph 156(1.1)(b)(ii) provide that a particular Canadian partnership and a particular corporation would be closely related where qualifying voting control in respect of another corporation is held by, and not less than 90% of the value and number of the issued and

³ For purposes of the section 156 election a qualifying group is defined in subsection 156(1) to mean a group of corporations, a group of Canadian partnerships, or a group of Canadian partnerships and corporations, each member of which is closely related to each other member of the group.

outstanding shares, having full voting rights under all circumstances, of the capital stock of the other corporation are owned by

- if the other corporation is a member of a qualifying group of which the particular partnership is a member, the particular corporation, and
- if the other corporation is a member of a qualifying group of which the particular corporation is a member, the particular partnership.

Coming into force provisions

The proposed amendments to subsection 156(1.1) would apply as of March 22, 2017. However they would also apply as of March 23, 2016, in respect of an election under section 156 that is to become effective on a day that is after March 22, 2016, but before March 22, 2017, unless the election is filed on or before March 22, 2016.

Proposed transitional rule applicable to section 150

Section 150 generally permits corporations that are members of a closely related group (each member of which, among other things, must be closely related to each other) to elect to treat certain taxable supplies of property made by way of lease, licence, or similar arrangement and of services between them as supplies of financial services and therefore exempt from GST/HST. Subsection 150(2) describes certain supplies that are excluded from the election, such as an imported taxable supply as defined in section 217.

A proposed transitional rule provides that certain supplies would be excluded from the election if:

- the supply is made between a person and a corporation that have jointly made an election under subsection 150(1), and the person and the corporation;
 - are not members of the same closely related group at any time after the day the agreement for the supply is entered into and before March 22, 2017, or
 - are not members of the same closely related group on March 22, 2017;
- the election is in effect both on March 22, 2016, and on the day the agreement for the supply is entered into; and
- the agreement is entered into after March 22, 2016, and before March 22, 2017.

In respect of supplies meeting these conditions, the transitional rule provides that the following supplies would be excluded from the election (that is, the following supplies would not be treated as financial services under section 150):

- a supply of a service where it is not the case that all or substantially all of the service will be performed before March 22, 2017, or
- a supply of property by way of lease, licence, or similar arrangement where it is not the case that all or substantially all of the property will be delivered or made available to the recipient of the supply before March 22, 2017.

Example

Corporation A and Corporation B have an election under section 150 in place on March 22, 2016. Corporation A owns 90% of the value and number of the issued and outstanding shares, having full voting rights under all circumstances, of the capital stock of Corporation B. However, Corporation A does not have qualifying voting control of Corporation B, as set out in the proposed changes to section 128 and consequently, they would not be members of the same closely related group on March 22, 2017. They

enter into an agreement on January 1, 2017 for the provision of services by Corporation A to Corporation B. Under the agreement, 60% of the services will be performed before March 22, 2017 and the remaining 40% on or after that date.

Since the corporations are not members of the same closely related group on March 22, 2017 and not all or substantially all of the services to be provided under the agreement will be performed before that date, none of the services performed under this agreement would be deemed to be financial services.

Further information

All GST/HST technical publications are available on the CRA website at cra.gc.ca/gsthstech.

To make a GST/HST enquiry by telephone:

- for general GST/HST enquiries, call Business Enquiries at 1-800-959-5525
- for technical GST/HST enquiries, call GST/HST Rulings at 1-800-959-8287

If you are located in Quebec, call Revenu Québec at 1-800-567-4692 or visit their website at revenuquebec.ca.

If you are a selected listed financial institution (whether or not you are located in Quebec) and require information on the GST/HST or the QST, go to cra.gc.ca/slfi or

- for general GST/HST or QST enquiries, call Business Enquiries at 1-800-959-5525
- for technical GST/HST or QST enquiries, call GST/HST Rulings SLFI at 1-855-666-5166