

Bill C-28 Foreign Affiliate Elections —Approaching Filing Deadline

Companies with foreign affiliates could be affected by a number of generally relieving technical amendments to the foreign affiliate rules that became effective after Bill C-28¹ received royal assent on December 14, 2007. While most of the amendments apply retroactively, a Canadian taxpayer can elect to extend the benefit of certain provisions to even earlier taxation years. These elections are due June 30, 2008, for taxpayers with 2007 calendar taxation years. Elections that are not filed on time might not be accepted, which could have various surplus and foreign accrual property income (FAPI) implications for the Canadian taxpayer.

The decision of whether to file a Bill C-28 election requires an analysis of:

- the ownership history of the foreign affiliate group of the Canadian taxpayer; and
- the transactions and reorganizations undergone by the affiliates.

Information and resources to make this assessment might not be practically available. However, at a minimum, elections that are expected to be tax-neutral or beneficial to the Canadian taxpayer should be filed.

Background

Many of the foreign affiliate amendments in Bill C-28 were introduced as part of a larger package of draft legislation released by the Department of Finance on December 20, 2002. That package was subsequently revised, expanded and reissued on February 27, 2004. The February 2004 proposed amendments addressed a number of technical anomalies in the foreign affiliate rules and introduced significant prospective policy changes. Bill C-28 contains only the former.

As mentioned, the foreign affiliate amendments in Bill C-28 generally are relieving in nature. Many correct unintended tax implications. Others simplify the FAPI recharacterization requirements. Most are retroactive, some to various dates in 2000 and others to dates in 2002 or 2004. Elections will allow taxpayers to extend the retroactive application period for certain amendments or a group of amendments to taxation years of their foreign affiliates that begin after 1994.

Filing Implications

The elections in Bill C-28 must be filed on or before the filing due date for the taxpayer's taxation year that includes the day on which Bill C-28 received royal assent (December 14, 2007). For a taxpayer that has a December 31 taxation year, the elections must be filed by **June 30, 2008**.

The ability to file an election late is not addressed in the coming-into-force provisions of the bill. Therefore, there is the risk that late-filed elections will not be accepted by the Minister. This could have surplus and FAPI implications for the Canadian taxpayer. For example, the characterization of dividend payments from a foreign affiliate could be affected if the

1. Bill C-28 – *An Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 19, 2007 and to Implement Certain Provisions of the Economic Statement Tabled in Parliament on October 30, 2007.*

surplus balances of the affiliate were computed on the basis that a technical amendment election will be filed. In some instances, FAPI could result and reduce the available non-capital losses of the Canadian taxpayer. An unfiled or unaccepted election could also indicate an internal tax control deficiency if a tax liability is recognized for financial reporting purposes. Because of these and other potential implications, it is critical for a Canadian taxpayer to assess whether it needs to file any Bill C-28 elections.

How to File an Election

The foreign affiliate elections in Bill C-28 must be filed in writing by a taxpayer. No prescribed forms exist. By filing a written election within the prescribed due-date, the particular amendment(s) will apply retroactively to taxation years of all foreign affiliates of the taxpayer that begin after 1994. The coming-into-force provisions allow the Minister to assess tax, interest and penalties to take into account a filed election.

On account of the extended retroactive application period provided by the elections, a foreign affiliate could cease to be a foreign affiliate of the Canadian taxpayer at some time between its inception and the present. For example, the original Canadian taxpayer could have amalgamated or dissolved, or the foreign affiliate could have been transferred from one Canadian taxpayer to another. The coming-into-force provisions of the bill do not address these situations.

Historically, the Canada Revenue Agency (CRA) has accepted other elections filed on behalf of a predecessor corporation or from a corporation that has liquidated but not dissolved. Given this history, the foreign affiliate elections in Bill C-28 are likely to be accepted in comparable circumstances. However, an election cannot be filed for a dissolved Canadian corporation, because it no longer exists. Legal measures are required to resuscitate the dissolved taxpayer before a filed election will be accepted.

A taxpayer that disposed of a foreign affiliate during the extended retroactive application period likely will be able to make the election to apply the amendment during the time the affiliate was a foreign affiliate of the taxpayer.

Next Steps

Taxpayers should assess whether they need to file any of the Bill C-28 elections. This assessment requires a review of historic transactions involving all foreign affiliates for taxation years that begin after 1994 and end before the retroactive effective date of the particular amendment (i.e., generally for taxation years of the affiliate that begin after 1999). Collecting information for this assessment could require significant time because it involves re-constructing the history and transactions undertaken by foreign affiliates.

At a minimum, consideration should be given to filing elections that are expected to typically be beneficial to affected taxpayers, even if the election may be tax-neutral for the taxpayer. Filing these elections would prevent the risk that the taxpayer subsequently determines that an election should have been filed after the filing due-date has passed. Beneficial elections include those for paragraph 95(2)(n) and clause 95(2)(a)(ii)(D). These provisions essentially broaden the rules to recharacterize FAPI of a foreign affiliate of a Canadian taxpayer.

Apart from an election that provides for an extended retroactive application period for a group of amendments (the "Global Section 95 Election"), the elections cannot be revoked. The Global Section 95 Election can be revoked on or before the filing due date for the taxpayer's taxation year that includes December 14, 2010 (the third anniversary of the day Bill C-28 received royal assent). For example, a taxpayer with a December 31 taxation year, can revoke the Global Section 95 Election only on or before June 30, 2011. Because this election can be revoked, the affected taxpayer should consider filing this election. However, filing this election is not necessarily beneficial for all taxpayers, because it extends the retroactive application period for a number of amendments, rather than for one amendment, thereby increasing the potential for an unfavourable tax consequence.

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