Excessive Interest and Financing Expenses Limitation

Overview

New sections 18.2 and 18.21 of the *Income Tax Act* (the "Act"), together with new paragraph 12(1)(l.2), are the core rules of the new excessive interest and financing expenses limitation ("EIFEL") regime. This regime comprises rules consistent with the recommendations in the report under Action 4 of the Group of 20 and Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting Project (the "BEPS Action 4 report").The BEPS Action 4 report recommends certain limitations on the deductibility of interest and other financing costs to address BEPS.

Consistent with the BEPS Action 4 report, the objective of the EIFEL regime is to address BEPS 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. To this end, as recommended in the Action 4 report, the rules adopt an "earnings stripping" approach, which restricts a taxpayer's (or group's) deductions for interest expense and other financing costs to an amount that is commensurate with the taxable income generated by its activities in Canada. In general terms, the EIFEL rules limit the amount of net interest and financing expenses (being the taxpayer's interest and financing expenses net of its interest and financing revenues) that may be deducted in computing a taxpayer's income to no more than a fixed ratio of earnings before interest, taxes, depreciation and amortisation ("EBITDA"). For this purpose, the main elements are:

- *Fixed ratio*: Pursuant to the definition "ratio of permissible expenses" in new subsection 18.2(1), the applicable fixed ratio is 30%. In order to facilitate transition to the new regime, a fixed ratio of 40% applies only for taxation years beginning on or after October 1, 2023 and before January 1, 2024 (subject to an anti-avoidance rule that denies a taxpayer the benefit of the 40% ratio, generally where the taxpayer undertakes a transaction to extend the period for which that ratio otherwise applies).
- *Interest and financing expenses and revenues*: The interest and other financing expenses of the taxpayer that are within scope of the new rules are set out in the definition "interest and financing expenses" in subsection 18.2(1) (which is the main definitions subsection for the new regime). Notably, they include, among other things, interest and financing expenses that are "capitalized" and deducted as capital cost allowance or as amounts in respect of resource expenditure pools; an imputed amount of interest in respect of certain finance leases; certain amounts that are economically equivalent to interest or that can reasonably be considered part of the cost of funding; and various expenses incurred in obtaining financing. The definition "interest and financing revenues" captures the taxpayer's interest income, as well as other income from the provision of financing. An anti-avoidance rule is included to ensure that certain amounts are included in interest and financing expenses, or excluded from interest and financing revenues.
- *EBITDA*: The taxpayer's EBITDA is referred to in the rules as "adjusted taxable income" (defined in subsection 18.2(1)), and is determined based on amounts taken into account in

computing its tax liability under Part I of the Act, rather than amounts reported in in its financial statements. A taxpayer's adjusted taxable income is its taxable income (or, in the case of a non-resident taxpayer, taxable income earned in Canada), determined under Part I of the Act, as adjusted for certain items. In general terms, the adjustments add amounts to taxable income to effectively reverse deductions for the taxpayer's interest and financing expenses, certain tax expenses and capital cost allowance, as well as certain other amounts; and subtract amounts to effectively reverse inclusions in taxable income for interest and financing revenues and untaxed income, as well as certain other amounts.

Notably, because it is based on taxable income, the taxpayer's adjusted taxable income reflects deductions for dividends received under section 112 (for inter-corporate dividends) and 113 (for dividends received from foreign affiliates). Thus, the new rules can limit the deductibility of interest expense incurred to invest in shares that produce such dividends. Adjusted taxable income is also reduced by losses deducted under section 111, except to the extent they are attributable to the taxpayer's net interest and financing expenses for a prior taxation year.
The main operative rule of the EIFEL regime, which denies deductibility of net interest and financing expenses that exceed the permissible level, is in new subsection 18.2(2). That subsection applies to taxpayers that are corporations or trusts (the definition "taxpayer" in subsection 18.2(1) excludes natural persons and partnerships). It also applies in computing a non-resident taxpayer's taxable income earned in Canada.

Similar to the approach under the thin capitalization rules in the Act, the EIFEL rules also apply indirectly in respect of partnerships, as interest and financing expenses and revenues of a partnership are attributed to members that are corporations or trusts, in proportion to their interests in the partnership. Where a taxpayer has excessive interest and financing expenses, as determined under the rules, new paragraph 12(1)(l.2) – which is analogous to paragraph 12(1)(l.1) of the thin capitalization rules – includes an amount in the taxpayer's income in respect of the taxpayer's share of partnership interest and financing expenses.

The EIFEL rules generally apply mechanically; there is no avoidance or purpose condition for the operative rules to apply. They also apply after existing limitations on the deductibility of interest and financing expenses in the Act, including the thin capitalization rules (subsection 18(4) is amended to clarify this ordering). Any expenses whose deductibility is denied under such existing limitations are excluded from a taxpayer's interest and financing expenses for purposes of the new rules.

Exceptions

To ensure the new rules are appropriately targeted at significant BEPS risks, exceptions from the rules are provided for "excluded entities" (defined in subsection 18.2(1)), which generally comprise:

- Canadian-controlled private corporations that, together with any associated corporations, have taxable capital employed in Canada of less than $50 million (i.e., the top end of the phase-out range for the small business deduction);

- Groups of corporations and trusts whose aggregate net interest expense among their Canadian members is $1,000,000 or less; and
- Certain standalone Canadian-resident corporations and trusts, and groups consisting exclusively of Canadian-resident corporations and trusts that carry on substantially all of their business in Canada. This exclusion applies only if, in general terms, no non-resident is a material foreign affiliate of, or holds a significant interest in, any group member, and no group member has any significant amount of interest and financing expenses payable to a non-arm's length "tax-indifferent investor" (as defined in subsection 248(1)).

Excluded interest

The EIFEL rules allow two taxable Canadian corporations to jointly elect that one or more payments of interest or lease financing amounts (as defined in subsection 18.2(1)) made by one to the other in a taxation year be excluded from the new interest limitation under subsection 18.2(2). This exclusion applies if the conditions in the definition "excluded interest" in subsection 18.2(1) are met. Among other conditions, the two corporations must be "eligible group corporations" in respect of each other, which is defined in subsection 18.2(1) as, essentially, corporations that are related or affiliated (in determining affiliation for these purposes, section 251.1 is to be read without reference to the definition "controlled" in subsection 251.1(3)). This election is principally intended to ensure that the EIFEL rules do not negatively impact transactions that are commonly undertaken within Canadian corporate groups to allow the losses of one group member to be offset against the income of another group member.

Exempt interest and financing expenses

To ensure that the new rules do not apply to limit the deductibility of interest and financing expenses that are incurred in respect of certain Canadian public-private partnership infrastructure projects, an exception is provided for "exempt interest and financing expenses" (defined in subsection 18.2(1)).

The exception will generally apply to third-party interest and financing expenses that are incurred in respect of a borrowing or other financing that was entered into in respect of an agreement with a Canadian public sector authority to design, build and finance (or design, build, finance, operate and maintain) real or immoveable property owned by a public sector authority, where those interest and financing expenses are economically borne by the Canadian public sector authority.

Group ratio rules

The "group ratio" rules are in new section 18.21. Where the conditions in new subsection 18.21(2) are met, the Canadian members of a group of corporations and/or trusts can jointly elect into the group ratio rules for a taxation year (special rules allow certain standalone entities that are not part of any group to also elect into the group ratio rules). In that case, instead of the maximum amount a group member is permitted to deduct in respect of interest and financing expenses for the year being determined by reference to the 30% fixed ratio (or 40%, for the transitional year), it is determined in accordance with the group ratio rule in subsection 18.21(2).

In essence, the group ratio rules allow a taxpayer to deduct interest and financing expenses in excess of the fixed ratio, provided the taxpayer is a member of an accounting consolidated group whose ratio of net third-party interest expense to book EBITDA exceeds the fixed ratio and the group is able to demonstrate this based on audited consolidated financial statements. The "consolidated group" is defined in subsection 18.21(1) as an ultimate parent and all the entities that are fully consolidated in the parent's consolidated financial statements, or that would be if the group were required to prepare such statements under IFRS.

The consolidated group's net third-party interest expense and book EBITDA are referred to in these rules as the "group net interest expense" and "group adjusted net book income", respectively, and are defined in subsection 18.21(1). They are determined based on amounts in the group's audited consolidated financial statements, with appropriate adjustments. There is an exclusion from group net interest expense for certain interest payments to persons or partnerships that are outside the consolidated group but that do not deal at arm's length with one or more consolidated group members; that have a significant equity interest in any Canadian group member; or a significant equity interest in which is held by any Canadian group member.

Under the group ratio rule in subsection 18.21(2), the maximum amount of interest and financing expenses the consolidated group members are collectively permitted to deduct is generally determined as the total of each Canadian group member's adjusted taxable income multiplied by the group ratio. The group allocates this maximum deductible amount among its Canadian group members in its group ratio election. This "flexible" allocation mechanism allows taxpayers to allocate the group ratio deduction capacity where it is most needed.

The group ratio rules contain certain limitations that are mainly intended to account for the possibility that some group members may have negative book EBITDA, or the group as a whole may have negative book EBITDA, such that a simple formulaic determination of the group ratio could give unreasonably high or meaningless results. These limitations are found in the definition "group ratio", in subsection 18.21(1), and the "allocated group ratio amount" rule in subsection 18.21(2).

Excess capacity and cumulative unused excess capacity

If a taxpayer's net interest and financing expenses exceed the maximum permitted for a taxation year, there are two mechanisms that could nonetheless enable the taxpayer to deduct all or a portion of this excess.

The first applies to the extent the taxpayer has "excess capacity" (as defined in subsection 18.2(1)) for any of its three immediately preceding taxation years that it has not used for another purpose in any of those preceding years (the rules, in effect, provide a three-year carry-forward of excess capacity). In general terms, the taxpayer's "excess capacity" for a taxation year is the amount, if any, by which the maximum amount it is permitted to deduct in respect of interest and financing expenses for the year (determined as its fixed ratio multiplied by its adjusted taxable income, plus its interest and financing revenues for the year) exceeds its actual interest and financing expenses for the year. A taxpayer is treated as not having excess capacity for any taxation year in which it is subject to the group ratio. A taxpayer's unused excess capacity is the portion that has not been either used to deduct the taxpayer's own excess interest and financing expenses for another year, or transferred by the taxpayer to another group member in a previous year.

The taxpayer's unused excess capacity carryforwards from the three taxation years immediately preceding a given taxation year are automatically applied to reduce the amount of interest and financing expenses whose deductibility would otherwise be denied under subsection 18.2(2) in the given year. The amount of excess capacity that is used in this manner is referred to as the taxpayer's "absorbed capacity" for the given taxation year (defined in subsection 18.2(1)). This mechanism is intended to "smooth" the impact of earnings volatility under the EIFEL rules.

The second mechanism applies where the taxpayer does not have sufficient unused excess capacity carryforwards of its own, but has one or more other Canadian group members that have "cumulative unused excess capacity" they can transfer to the taxpayer. A group member's cumulative unused excess capacity for a taxation year is the amount available to transfer to other group members in the year, and is essentially its excess capacity for the year plus its unused excess capacity carryforwards from the three immediately preceding taxation years. Transfers of cumulative unused excess capacity require a joint election by the transferor and transferee under new subsection 18.2(4), and can only be made between two entities where each is either a taxable Canadian corporation or a fixed interest commercial trust, and the entities are "eligible group entities" in respect of each other (as defined in subsection 18.2(1)). The transferee's resulting "received capacity" amount can reduce the amount of interest and financing expenses whose deductibility is otherwise denied to the transferee under subsection 18.2(2). The transferor's cumulative unused excess capacity is reduced by any amounts transferred to other group members, as well as by the taxpayer's own absorbed capacity.

"Financial institution group entities" (defined in subsection 18.2(1)) are prohibited from transferring their cumulative unused excess capacity outside of their financial group. Financial institutions would be expected to often have excess capacity because their regular business activities tend to result in interest income exceeding their interest expense. This restriction is intended to ensure such net interest income cannot be used to shelter the interest and financing expenses of entities that do not carry on financial businesses or activities ancillary to those of a financial institution.

Carryforwards of denied interest and financing expenses

Interest and financing expenses that are denied under subsection 18.2(2), and amounts included in a taxpayer's income under paragraph 12(1)(l.2) in respect of the taxpayer's share of a partnership's interest and financing expenses, are carried forward indefinitely. There is no carry-back for such amounts; however, the three-year carry-forward of excess capacity (reflected in a taxpayer's "cumulative unused excess capacity") is in substance equivalent to a carry-back of denied interest and financing expenses.

The carry-forward of denied interest and financing expenses is provided under new paragraph 111(1)(a.1), which allows a taxpayer to deduct its prior-year "restricted interest and financing expenses" (defined in subsection 111(8)) in computing its taxable income. This deduction is available in two circumstances. First, a taxpayer can deduct its restricted interest and financing expenses to the extent of its excess capacity for a taxation year. Second, a taxpayer can deduct such amounts to the extent it has "received capacity" for a taxation year, as a result of having received a transfer out of the cumulative unused excess capacity of another group member.

A taxpayer's excess capacity or received capacity, as the case may be, is automatically reduced to the extent of its restricted interest and financing expense carryforwards. In effect, this reflects a mandatory "ordering rule", whereby those amounts must be applied to enable the deduction of prior-year restricted interest and financing expenses, before a taxpayer can transfer its excess capacity to another group member or use its received capacity to deduct its excess interest and financing expenses for the current year. Like the three-year carry-forward of excess capacity, the carry-forward of restricted interest and financing expenses is intended to smooth the impact of earnings volatility under the EIFEL rules.

Continuity rules for new tax attributes

In connection with the new EIFEL regime, amendments to sections 87 and 88 of the Act ensure that, where a particular corporation undergoes an amalgamation or winding-up, its carryforwards of restricted interest and financing expenses and cumulative unused excess capacity generally are inherited by the new corporation formed on the amalgamation or the parent corporation in respect of the winding-up.

Amendments are also made to sections 111 and 256.1, to address the impact of a change of control (or "loss restriction event") on a taxpayer's EIFEL tax attributes. Similar to the treatment of non-capital loss carryforwards under existing subsection 111(5), a taxpayer's carryforwards of restricted interest and financing expenses generally remain deductible following a loss restriction event, to the extent the taxpayer continues to carry on the same business following the loss restriction event. However, a taxpayer's cumulative unused excess capacity does not survive a loss restriction event.

Transitional rules

Transitional rules are included in the enacting legislation for the EIFEL regime. Under these rules, a taxpayer can elect, jointly with its other group members, if any, to have special rules apply for the purpose of determining the excess capacity of the taxpayer (and each group member, if any) for each of the three taxation years (referred to as the "pre-regime years") immediately preceding its first taxation year in respect of which the EIFEL rules apply. Absent these transitional rules, a taxpayer would not have excess capacity for any of the pre-regime years because the EIFEL rules otherwise do not apply in respect of the pre-regime years. The transitional rules, in effect, allow electing taxpayers a three-year carry-forward of their excess capacity (as determined under the special transitional rules) for pre-regime years, as this excess capacity is included in computing a taxpayer's cumulative unused excess capacity.

In determining a taxpayer's excess capacity for pre-regime years, the transitional rules seek to approximate what would have been the unused portion of the taxpayer's excess capacity – after being used for transfers to other group members with excess interest and financing expenses over the maximum permitted, and to deduct the taxpayer's own excess interest and financing expenses for any pre-regimes years – had the EIFEL rules applied in respect of the pre-regime years.

Effective date

The EIFEL rules generally apply in respect of taxation years that begin on or after October 1, 2023. An anti-avoidance rule applies, to cause the EIFEL rules to apply earlier for a particular taxpayer, if the taxpayer undertakes a transaction or series of transactions to trigger an early taxation year-end for the purpose of deferring the application of the EIFEL rules. The rules apply with respect to existing as well as new borrowings.

Clause 1

Partnership – interest and financing expenses add back

ITA
12(1)(l.2)

New paragraph 12(1)(l.2) provides an income inclusion for a taxpayer that is a member of a partnership, as part of the new excessive interest and financing expenses limitation (EIFEL) regime. The core rules for this new regime are in new sections 18.2 and 18.21. For more information, see the commentary on those sections.

In general terms, new paragraph 12(1)(l.2) includes an amount in a taxpayer's income for a taxation year – in respect of the taxpayer's share of the interest and financing expenses for the year of partnerships of which the taxpayer is a member – if the taxpayer's total interest and financing expenses for the year exceed the amount of such expenses that the taxpayer is permitted to deduct, as determined under subsection 18.2(2). This income inclusion is in lieu of a denial of a deduction under subsection 18.2(2), but with similar effect, and is analogous to paragraph 12(1)(l.1) of the thin capitalization rules.

The reason the income inclusion under paragraph 12(1)(l.2) is needed is that income is calculated at the partnership level and allocated to partners on a net basis (i.e., after any deduction of amounts at the partnership level in respect of the interest and financing expenses). Consequently, deductions for the partnership's interest and financing expenses cannot be denied at the partner level under subsection 18.2(2). The income inclusion effectively adds back to the partner's income the relevant portion of the interest and financing expenses that are deducted at the partnership level.

The amount included under paragraph 12(1)(l.2) in a taxpayer's income for a taxation year is determined by the formula A x B.

Variable A is essentially the total of the taxpayer's share of the interest and financing expenses for the year of all partnerships of which the taxpayer is a member. All of these amounts are included in computing the taxpayer's interest and financing expenses under paragraph (h) of the description of A in the definition “interest and financing expenses” in subsection 18.2(1), with an exclusion for any amounts included in the taxpayer’s income under paragraph 12(1)(l.1) of the thin capitalization rules.

There is no income inclusion under paragraph 12(1)(l.2) in respect of “excluded interest” or “exempt interest and financing expenses”. For more information, see the commentary on the definitions “excluded interest” and “exempt interest and financing expenses”.

Variable B integrates the income inclusion under paragraph 12(1)(l.2) with the excessive interest and financing expenses limitation in subsection 18.2(2).

By virtue of subparagraph (i) of variable B, no amount will be included in the taxpayer’s income under paragraph 12(1)(l.2) if the taxpayer is an “excluded entity” for a taxation year (as defined in subsection 18.2(1)), as such entities are similarly not subject to the limitation in subsection 18.2(2).

If the taxpayer is not an excluded entity, the amount determined for B is the proportion determined under the first formula in subsection 18.2(2) in respect of the taxpayer for the year. This is the proportion of the taxpayer’s interest and financing expenses that exceeds the maximum permitted under subsection 18.2(2). While this proportion is generally used to determine the proportion of the taxpayer’s deductions in respect of interest and financing expenses that is denied under subsection 18.2(2), the proportion can nonetheless be computed and applied for purposes of paragraph 12(1)(l.2), even in a year when the taxpayer’s only interest and financing expenses are derived from its share of partnership expenses.

Thus, paragraph 12(1)(l.2), in effect, includes in a taxpayer’s income an amount representing the proportion, of the taxpayer’s share of the interest and financing expenses of partnerships of which it is a member, that is determined to be “excessive” based on the limitation under subsection 18.2(2).

New paragraph 12(1)(l.2) applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Source of income

ITA
12(2.02)

Subsection 12(2.02) mainly ensures that any income inclusion under paragraph 12(1)(l.1) for a non-resident partner will be taxable in Canada to the same extent as income earned through the partnership.

This subsection is amended to provide for similar treatment in respect of any income inclusion under new paragraph 12(l)(l.2). For further information, see the commentary on paragraph 12(1)(l.2) and section 18.2.

This amendment applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 2

Limitation on deduction of interest

ITA
18(4)

Subsection 18(4) provides thin capitalization rules to limit deductions, by corporations and trusts, in respect of interest on debt owing to certain specified non-residents. If the amount of debt owing to specified non-residents exceeds a debt-to-equity ratio of 1.5-to-1, subsection 18(4) limits the deductibility of interest on that debt to the extent that the interest would otherwise be deductible (i.e., in the absence of subsection 18(4)).

Subsection 18(4) is amended, consequential on the introduction of new section 18.2, which contains the main operative provisions of the new excessive interest and financing expenses limitation regime. This amendment provides that the limitation under subsection 18(4) applies only in respect of interest that would, in the absence of section 18.2 (as well as subsection 18(4)), be deductible in computing income from business or property. This is intended to ensure that the thin capitalization rules apply in priority to the interest restriction in new section 18.2.

For more information, see the commentary on new section 18.2.

This amendment applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 3

<u>Excessive interest and financing expenses limitation</u>

Definitions

ITA
18.2(1)

New subsection 18.2(1) defines a number of terms that apply for the purposes of sections 18.2 and 18.21 in determining the application of the new excessive interest and financing expenses limitation.

“absorbed capacity”

A taxpayer’s absorbed capacity for a taxation year is essentially the amount of its excess capacity, carried forward from previous years, that is used in a taxation year to reduce or eliminate a denial of deductions in respect of interest and financing expenses that would otherwise occur under subsection 18.2(2).

More specifically, the taxpayer’s excess capacity for its three immediately preceding taxation years is included in its cumulative unused excess capacity for a taxation year, and its absorbed capacity is essentially the lesser of its cumulative unused excess capacity for the year (determined before the reduction resulting from the taxpayer’s absorbed capacity for the year) and its amount of interest and financing expenses that would otherwise be denied in the year.

The taxpayer’s absorbed capacity is automatically included in variable E of the formula in subsection 18.2(2), thus reducing or eliminating a denial of interest and financing expenses that would otherwise arise under that subsection. The taxpayer’s cumulative unused excess capacity is reduced to the extent of the taxpayer’s absorbed capacity.

In effect, the consequences of an amount of absorbed capacity under the rules reflect a mandatory “ordering rule”, whereby a taxpayer is required to use its own excess capacity carryforwards first to deduct its own otherwise denied interest and financing expenses, before it can use any remaining excess capacity (reflected in its cumulative unused excess capacity) to effect a transfer to another group member by way of an election under subsection 18.2(4). Consequently, a taxpayer cannot transfer an amount of cumulative unused excess capacity to another group member to deduct their otherwise denied interest and financing expenses for the year in priority to the taxpayer using its carryforwards to deduct its own otherwise denied interest and financing expenses for the year.

Notably, a taxpayer cannot have excess capacity for a taxation year if it has absorbed capacity for that year. This is because a taxpayer has absorbed capacity only for a year where it has interest and financing expenses that exceed its capacity to deduct those expenses in the year. For more information, see the commentary on the definition “excess capacity”.

“adjusted taxable income”

A taxpayer’s adjusted taxable income is a measure of its earnings before interest, taxes, depreciation and amortization (EBITDA) and is determined based on tax, rather than accounting, concepts.

In basic terms, a taxpayer’s adjusted taxable income for a taxation year is its taxable income (or, in the case of a non-resident, its taxable income earned in Canada) for the year, adjusted to reverse: (i) any deductions for interest and financing expenses, certain tax expenses and capital cost allowance; and (ii) income inclusions for interest and financing revenues, untaxed income, and certain other amounts.

Since the starting point in determining adjusted taxable income is a taxpayer’s taxable income, notably, it effectively excludes dividends that are deductible under section 112 or 113 (being inter-corporate dividends and certain dividends received from foreign affiliates, respectively). It is also generally reduced by losses deducted by the taxpayer under section 111 (subject to an add-back under paragraph (h) of variable B to the extent a non-capital loss is attributable to deductions in respect of interest and financing expenses or other amounts described in paragraphs (b) to (g) or (i) of variable B, as discussed below).

A taxpayer's adjusted taxable income is relevant principally in determining the maximum amount a taxpayer is permitted to deduct in respect of interest and financing expenses, under the limitation in new subsection 18.2(2), in computing its income for a taxation year. Generally under subsection 18.2(2), a taxpayer's deductions in respect of such expenses (net of the taxpayer's interest and financing revenues) for a year are limited to no more than a fixed ratio of its adjusted taxable income for the year (although the limit is also a function of any carryforwards of excess capacity, or transfers of excess capacity received by the taxpayer in the year). For more information, see the commentary on new subsection 18.2(2).

Adjusted taxable income is also relevant in determining a taxpayer's absorbed capacity or excess capacity for a taxation year (both as defined in this new subsection 18.2(1)). For more information, see the commentary on those definitions.

Adjusted taxable income for a taxation year is determined by the formula: A + B – C.

Variable A is capable of being a positive or negative number. It is determined by taking either (i) the taxpayer's taxable income (or, for non-residents, taxable income earned in Canada) for the year, or (ii) the negative number equal to its non-capital loss, and then subtracting the foreign accrual property losses (FAPLs) of any controlled foreign affiliates of the taxpayer (or a partnership of which the taxpayer or another controlled foreign affiliate of the taxpayer is a member) to the extent the FAPLs derive from net relevant affiliate interest and financing expenses (as further discussed below).

Allowing variable A to be a negative number where the taxpayer has a non-capital loss ensures that the add-backs under variable B do not generate excessive adjusted taxable income. For example, if a taxpayer had a non-capital loss for a taxation year and its amount for variable A were treated as nil (instead of as a negative number), when its interest and financing expenses were added back under variable B, this could give the taxpayer adjusted taxable income – thus allowing it to deduct interest and financing expenses under subsection 18.2(2) – generated from the interest and financing expenses themselves, as opposed to operating earnings. This result would be inappropriate in policy terms.

Consistent with this rationale, in determining a taxpayer's variable A amount, it is similarly necessary to subtract an amount equal to the lesser of (i) a FAPL of a controlled foreign affiliate of the taxpayer for an affiliate taxation year, and (ii) the excess of the affiliate's relevant affiliate interest and financing expenses over its relevant affiliate interest and financing revenues for the affiliate taxation year.

The amounts in variable A are determined without regard to any denial of deductions for interest and financing expenses under subsection 18.2(2) or relevant affiliate interest and financing expenses of a controlled foreign affiliate under subclause 95(2)(f.11)(ii)(D)(I). Variable A is also determined without regard to income inclusions in respect of partnership-level interest and financing expenses under paragraph 12(1)(l.2) or subclause 95(2)(f.11)(ii)(D)(II). Thus, these denied amounts and income inclusions do not increase adjusted taxable income.

Variable B "adds back" a number of amounts to, in effect, reverse the impact on the taxpayer's adjusted taxable income of a taxpayer's deductions for interest and financing expenses, certain tax expenses and capital cost allowance, among other deductions, all of which are reflected in its taxable income included under variable A. The amounts added back under variable B include:

- the taxpayer's interest and financing expenses for the year;
- any amount deducted under paragraph 20(1)(a) as capital cost allowance, or under the various provisions enumerated in paragraph (b) of variable B in relation to resource expenses, other than any portion of those amounts that is capitalized and therefore already added back under paragraph (a) of variable B as interest and financing expenses;
- any amount deducted under subsection 20(16) as a terminal loss for the year, other than any portion of that amount that can reasonably be considered to be attributable to interest and financing expenses and therefore is already added back under paragraph (a) of variable B;
- any amounts deducted, in computing the taxpayer's taxable income for the year, under paragraph 110(1)(k) (in respect of Part VI.1 tax) or paragraph 111(1)(a.1) (in respect of restricted interest and financing expenses); and
- any amount deducted by the taxpayer under subsection 104(6), other than any portion of that amount that has been designated under subsection 104(19) for the year (i.e., deemed to be a taxable dividend received by the beneficiary and, for certain purposes, not by the trust), in order to ensure that deductions for interest and financing expenses of a trust are not denied solely because the trust claims a deduction in respect of income distributed to its beneficiaries.

In the case of amounts deducted under paragraph 20(1)(a) or subsection 20(16) in computing the income of a partnership of which the taxpayer is a member, paragraph (d) of variable B adds back an amount in respect of the taxpayer's share of those deducted amounts (other than any capitalized interest and financing expenses portion of those amounts), in computing the taxpayer's adjusted taxable income for its taxation year in which the partnership's fiscal period ends. This provision applies on a source-by-source basis, with the partnership's deduction under paragraph 20(1)(a) or subsection 20(16) in computing its income from each source being attributed to the taxpayer based on its pro rata share of the partnership's income or loss from the source.

Amounts described in variable B (e.g., amounts deducted under paragraph 20(1)(a) as capital cost allowance) are not added back if they can reasonably be considered to be in respect of a borrowing that results in exempt interest and financing expenses. This is consistent with paragraph (j) of variable C, which disregards income derived from activities funded, in whole or in part, by such a borrowing in determining adjusted taxable income. For more information, see the commentary on the definition "exempt interest and financing expenses".

Variable I in the formula in paragraph (d) reduces the amount of the add-back in respect of amounts that were deducted under paragraph 20(1)(a) or subsection 20(16) in computing a partnership's loss, to the extent the taxpayer is denied a deduction in respect of its share of the loss under the partnership "at-risk" rule in subsection 96(2.1).

To the extent the taxpayer deducts an amount, in respect of the previously denied loss, under paragraph 111(1)(e) in a later year, paragraph (e) of variable B in turn provides relief by way of an add-back in the later year. Where the previously denied loss was for a pre-regime year, the add-back applies in the same manner as in the case of denied losses for regime years. This is consistent with the intended application of the add-back under paragraph (h) of variable B in respect of non-capital losses for pre-regime years (see the commentary below).

Paragraph (h) of variable B adds back the portion of a non-capital loss for another taxation year (referred to in that paragraph as the "taxpayer loss year") that is deducted by the taxpayer under paragraph 111(1)(a). The add-back applies to the extent that the loss can reasonably be considered to derive from amounts deducted by the taxpayer in the taxpayer loss year in respect of its interest and financing expenses or other amounts described in paragraphs (b) to (g) or (i) of variable B of the definition "adjusted taxable income" (notably, including capital cost allowance and amounts in respect of resource expenses). The add-back is reduced by the taxpayer's interest and financing revenues and any amounts described in paragraphs (b) to (f), (h) or (j) of variable C of the definition "adjusted taxable income" for the taxpayer loss year, as well as any inclusion in the taxpayer's income for the taxpayer loss year under paragraph 12(1)(l.2).

Variable Z.1 further reduces a taxpayer's add-back in respect of a non-capital loss by any FAPL of a controlled foreign affiliate for an affiliate taxation year ending in the taxpayer loss year, to the extent that the FAPL derives from the affiliate's relevant affiliate interest and financing expenses net of its relevant affiliate interest and financing revenues. This reduction also applies in the case of a FAPL of a controlled foreign affiliate of a partnership of which the taxpayer or another controlled foreign affiliate of the taxpayer is a member.

The add-back under paragraph (h) of variable B is consistent with the add-backs under variable B in respect of a taxpayer's interest and financing expenses and other deductible amounts. Just as the add-backs under the other paragraphs of variable B, in effect, ensure that these deductible amounts do not reduce the taxpayer's adjusted taxable income for the taxpayer loss year in which they were deducted, the add-back under paragraph (h) ensures that the application of a non-capital loss deriving from these amounts does not affect the taxpayer's adjusted taxable income for a taxation year in which the loss is deducted.

The add-back under paragraph (h) of variable B applies not only where a taxpayer deducts a non-capital loss carried forward (or carried back) from a taxation year in respect of which the EIFEL rules apply, but also where a taxpayer claims a deduction in respect of a non-capital loss carried forward from a pre-regime taxation year that derives from an amount described in variable B. In this regard, although the EIFEL rules do not apply in respect of a pre-regime taxation year, it is intended that a taxpayer can nevertheless be considered to have interest and financing expenses and interest and financing revenues for those years, to the extent such amounts are relevant for the purposes of applying the EIFEL rules for a taxation year in respect of which the rules apply. In particular, those definitions are intended to apply in determining the extent to which a pre-regime loss derives from a variable B amount.

Notably, because a taxpayer’s interest and financing expenses do not include “excluded interest” or “exempt interest and financing expenses” (both as defined in subsection 18.2(1)), this add-back does not apply to the extent the loss derives from excluded interest or exempt interest and financing expenses.

Finally, paragraph (i) of variable B provides for an add-back where a FAPL of a controlled foreign affiliate for an affiliate taxation year (referred to as the “affiliate loss year”) is applied under variable F of the definition “foreign accrual property income” in subsection 95(1) in computing the affiliate’s FAPI for another affiliate taxation year that ends in the taxpayer’s taxation year (or in the fiscal period of a partnership of which the taxpayer or a controlled foreign affiliate of the taxpayer is a member at any time). The rationale for this add-back is similar to the rationale for the add-back in paragraph (h) of variable B. Generally, it applies to the extent that a FAPL derives from deductions in respect of the affiliate’s relevant affiliate interest and financing expenses (net of its relevant affiliate interest and financing revenues and any amount included in respect of the affiliate under subclause 95(2)(f.11)(ii)(D)(II) for the affiliate loss year).

Variable C effectively reverses income inclusions for several amounts that are included in computing the taxpayer’s taxable income (and thus income under variable A), by reducing the taxpayer’s adjusted taxable income for the year by the following amounts:

- the taxpayer’s interest and financing revenues for the year (paragraph (a) of variable C);
- an amount included in the taxpayer’s income for the year as “recapture” of capital cost allowance under subsection 13(1), including an amount included indirectly in the taxpayer’s income as the taxpayer’s share of a recapture amount of a partnership (paragraphs (b) and (c) of variable C);
- certain amounts included in the taxpayer’s income for the year in respect of the disposition of resource properties or other recovery of resource expenses (paragraph (d) of variable C);
- the taxpayer’s foreign-source income, to the extent it is sheltered from Canadian tax by foreign tax credits under subsection 126(1)) (in respect of non-business income) or subsection 126(2) (in respect of business income) (paragraphs (e) and (f) of variable C);
- notional income included in the taxpayer’s income under section 110.5 (paragraph (g) of variable C);
- an amount included in the income of a taxpayer as a beneficiary of a trust under subsection 104(13), to reflect that this amount is effectively included in the adjusted taxable income of the trust by virtue of the add-back under paragraph (g) of variable B (paragraph (h) of variable C), other than any portion of that amount that

  - has been designated under subsection 104(19) for the year (i.e., deemed to be a taxable dividend received by the beneficiary and, for certain purposes, not by the trust), or
  - gives rise to a deduction under paragraph 94.2(3)(a) in computing the foreign accrual property income of a controlled foreign affiliate of the taxpayer;
- any amount of the taxpayer's taxable income that is not subject to tax under Part I of the Act, because it is exempt from tax under the Act or any other Act of Parliament (paragraph (i) of variable C); and
- the amount that would be the income or loss of the taxpayer, or would be the taxpayer's share of the income or loss of a partnership of which it is a member, if the taxpayer or partnership had no income other than income that can reasonably be considered to be derived from activities funded, in whole or in part, by a borrowing that results in exempt interest and financing expenses (paragraph (j) of variable C).

"affiliate taxation year"

An affiliate taxation year of a controlled foreign affiliate of a taxpayer means the period for which the affiliate's accounts have been ordinarily made up, but no such period may exceed 53 weeks. This is the same as the definition of "taxation year" of a foreign affiliate in subsection 95(1).

"aggregate participating percentage"

The definition "aggregate participating percentage" has the same meaning as in subsection 91(1.3). In the context of the EIFEL regime, it is relevant in determining a taxpayer's specified participating percentage in respect of a controlled foreign affiliate for an affiliate taxation year.

For more information, see the commentary to the definition "specified participating percentage".

"cumulative unused excess capacity"

A taxpayer's cumulative unused excess capacity for a particular year is the total of the taxpayer's unused excess capacity for the year and the three immediately preceding years. Thus, cumulative unused excess capacity is the attribute that enables a three-year carry-forward of the taxpayer's excess capacity. The term "excess capacity" is also defined in new subsection 18.2(1).

This definition reflects the taxpayer's "unused" excess capacity in that the taxpayer's excess capacity for the three immediately preceding years is reduced, under this definition, by amounts of transferred capacity (which are amounts that the taxpayer has previously transferred to eligible group corporations under subsection 18.2(4)) and amounts of absorbed capacity (which are amounts that have been used to reduce or eliminate a denial under subsection 18.2(2) of the taxpayer's interest and financing expenses). The resulting balance, which is the taxpayer's cumulative unused excess capacity for the year, is the maximum amount that the taxpayer may transfer to other eligible group corporations in that year.

An amount of transferred capacity reduces the taxpayer's cumulative unused excess capacity for the year following a transfer year, whereas the reduction for absorbed capacity occurs in the same year in which the amount of absorbed capacity arises. This is because the taxpayer's cumulative unused excess capacity for a particular year represents the total amount available for transfer in that year. Consequently, although any amount transferred in that year effectively comes out of the taxpayer's excess capacity for that year and unused excess capacity for the three immediately preceding years, the consequent reductions to excess capacity apply for the purposes of determining the taxpayer's cumulative unused excess capacity for years following the transfer year.

Because a taxpayer's absorbed capacity for a taxation year reduces its cumulative unused excess capacity for that year, the total amount that a taxpayer can transfer to another group member in a year, by way of an election under subsection 18.2(4), is reduced by the taxpayer's absorbed capacity in that year. Thus, there is in effect a mandatory "ordering rule", whereby a taxpayer is required to use its excess capacity carryforwards first to deduct its own otherwise denied interest and financing expenses, before it can use any remaining excess capacity (reflected in its cumulative unused excess capacity) to effect a transfer to another taxpayer.

The reductions to excess capacity, in determining the taxpayer's cumulative unused excess capacity, are made under subparagraph (b)(i) (in respect of transferred capacity) and (b)(ii) (in respect of absorbed capacity). Both subparagraphs follow the same general structure:

- First, they provide the total amount by which excess capacity is to be reduced, being the taxpayer's total transferred capacity amount or absorbed capacity for the year when those amounts arose.
- Second, they specify the taxation years (each referred to as a "relevant year") for which excess capacity is to be reduced. In the case where the taxpayer has one or more amounts of transferred capacity for a taxation year, there are to be reductions (in a total amount equal to the total of the taxpayer's transferred capacity amounts for the year) to the taxpayer's excess capacity for one or more of that year and the three immediately preceding years. Where the taxpayer has an amount of absorbed capacity for a taxation year, the reductions (in a total amount equal to the absorbed capacity) are made to the taxpayer's excess capacity for one or more of the three immediately preceding years. Notably, in all cases, the relevant years are determined by reference to the transfer year or absorbed capacity year, as the case may be, rather than by reference to the taxation year for which the taxpayer's cumulative unused excess capacity is being determined.
- Third, they provide that the reductions are made to the unused portion of the taxpayer's excess capacity for the relevant years. The unused portion is the excess capacity remaining after reductions to reflect amounts of transferred capacity and amounts of absorbed capacity for the taxpayer's taxation years preceding the transfer year or absorbed capacity year, as the case may be. In addition, reductions to excess capacity resulting from absorbed capacity that arises in the transfer year are also effected in determining the taxpayer's unused excess capacity for the relevant years in respect of the

transfer year. All of these reductions in determining the unused portion of excess capacity for the relevant years are made in accordance with the rules in paragraph (b) of this definition.

- Finally, they provide “ordering rules” to determine for which of the taxpayer’s relevant years its unused excess capacity will be reduced. The ordering rules are in paragraph (b) of the definition and ensure that a reduction will apply first to the earliest relevant year; then to the next-earliest relevant year; and so on.

In determining a taxpayer’s cumulative unused excess capacity for a particular taxation year, where one or more of the three taxation years immediately preceding the particular year is a taxation year in respect of which the EIFEL rules did not yet apply (subject to certain anti-avoidance rules, the EIFEL rules apply in respect of taxation years beginning on or after October 1, 2023), there are elective transitional rules that apply for the purpose of determining the taxpayer’s excess capacity for those preceding years. For more information, see the commentary on the transitional rules, following the commentary on new subsection 18.21(8).

Example

Assumptions

- *At all relevant times, a taxable Canadian corporation (“Canco1”) is a member of a group of related corporations (collectively, the “group”) consisting of one other taxable Canadian corporation (“Canco2”) and several non-resident corporations.*
- *At no time is Canco1 or Canco2 an excluded entity or a financial institution group entity.*
- *Canco1 and Canco2 both have a December 31 taxation year-end.*
- *Canco1 and Canco2 do not elect to have the group ratio rule in subsection 18.21(2) to apply for any taxation year.*
- *For both Canco1 and Canco2, the 2024 taxation year is the first year in respect of which section 18.2 applies. Canco1 and Canco2 both have nil excess capacity for taxation years preceding 2024.*
- *Canco1 has interest and financing expenses of $15 million for each taxation year.*
- *Neither Canco1 nor Canco2 has any interest and financing revenues for any taxation year.*
- *For the 2024 taxation year, Canco1 has the deductibility of $10 million of its interest and financing expenses denied under subsection 18.2(2).*
- *For the 2025 taxation year, Canco1 has base deduction capacity (which, in this example, means a taxpayer’s ratio of permissible expenses for the year multiplied by its adjusted taxable income for the year) of $50 million.*
- *For the 2026 taxation year, Canco1 has base deduction capacity of $35 million.*

- *For the 2027 taxation year, Canco1 has base deduction capacity of $5 million.*
- *For its 2024 to 2027 taxation years, Canco2's interest and financing expenses and base deduction capacity are such that a "transfer" under subsection 18.2(4) of Canco1's cumulative unused excess capacity for any of those years would not increase the amount of interest and financing expenses or restricted interest and financing expense deductible by Canco2 in any of those years.*
- *For the 2028 taxation year:*
    - *Canco1 has base deduction capacity of $30 million.*
    - *Canco2 has excess interest (determined as the excess of its interest and financing expenses over its base deduction capacity) of $20 million and does not have any cumulative unused excess capacity.*
- *For the 2029 taxation year:*
    - *Canco1 has no base deduction capacity for the year.*
    - *Canco2 has excess interest of $10 million.*

Analysis

<u>2025</u>

In 2025, Canco1's base deduction capacity of $50 million exceeds its interest and financing expenses of $15 million by $35 million. Thus, Canco1's $10 million restricted interest and financing expense carryforward from 2024 is deductible under paragraph 111(1)(a.1).

Canco1's excess capacity for its 2025 taxation year is $25 million, calculated as A – B – C where:

- *A is its base deduction capacity of $50 million;*
- *B is its interest and financing expenses of $15 million; and*
- *C is its deductible restricted interest and financing expense of $10 million.*

Canco1's cumulative unused excess capacity for its 2025 taxation year is also $25 million, since it did not have any excess capacity for prior years.

<u>2026</u>

In 2026, Canco1's base deduction capacity of $35 million exceeds its interest and financing expenses of $15 million by $20 million, and it has no remaining restricted interest and financing expense carryforwards. Therefore, Canco1's excess capacity for the 2026 taxation year is $20 million.

Canco1's cumulative unused excess capacity for its 2026 taxation year is $45 million, being the total of its excess capacity of $20 million for 2026 and $25 million for 2025.

Canco1's cumulative unused excess capacity for its 2026 taxation year is $45 million, being the total of its excess capacity of $20 million for 2026 and $25 million for 2025.

<u>2027</u>

In 2027, Canco1's base deduction capacity of $5 million is less than its $15 million of interest and financing expenses for the year. Therefore, Canco1 has no excess capacity for the year.

Canco1 has absorbed capacity of $10 million for its 2027 taxation year, being the lesser of:

- *its cumulative unused excess capacity of $45 million for 2027 (which, for the purpose of determining a taxpayer's absorbed capacity for a year, is always computed before the reduction for that absorbed capacity); and*
- *the amount by which its interest and financing expenses exceed the total of its base deduction capacity and interest and financing revenues (which, in this case, are nil) for the year, which excess is $10 million for 2027.*

Canco1's base deduction limit under subsection 18.2(2) is increased by its absorbed capacity, which is reflected in variable E of the formula in that subsection, allowing it to deduct all of its interest and financing expenses for 2027.

Canco1's cumulative unused excess capacity for 2027 is $35 million, calculated as A + B where:

- *A is its excess capacity for 2027, which is nil; and*
- *B is the total of its excess capacity for 2024, 2025 and 2026. However, for the purpose of computing its cumulative unused excess capacity, its excess capacity for 2025 is reduced by its absorbed capacity for 2027. The relevant excess capacity amounts are as follows:*
    - *Canco1's excess capacity for 2024 is nil;*
    - *Canco1's 2025 excess capacity of $25 million is reduced to $15 million;*
        - *The reduction is the lesser of its 2025 excess capacity and its absorbed capacity for 2027, which is $10 million; and*
    - *Canco1's 2026 excess capacity is $20 million.*
        - *It is not reduced to reflect Canco1's absorbed capacity for 2027, since the reduction applies first to the earliest year in which there is unused excess capacity, being 2025.*

<u>2028</u>

In 2028, Canco1 can fully deduct its interest and financing expenses and has excess capacity of $15 million for the year (determined as its base deduction capacity of $30 million minus its interest and financing expenses of $15 million).

Canco1's cumulative unused excess capacity for its 2028 taxation year is $50 million, calculated as A + B where:

- *A is its excess capacity for 2028, which is $15 million; and*
- *B is the total of its excess capacity for 2025, 2026 and 2027, with its excess capacity for 2025 being reduced to reflect its absorbed capacity for 2027.*
    - *Canco1's excess capacity for 2025 is $15 million (after the $10 million reduction for its absorbed capacity for 2027);*
    - *Canco1's excess capacity for 2026 is $20 million; and*
    - *Canco1's excess capacity for 2027 is nil.*

Canco1 and Canco2 can jointly elect under subsection 18.2(4) to "transfer" $20 million of Canco1's cumulative unused excess capacity for 2028 to Canco2. This results in Canco2 having received capacity of $20 million for 2028, which increases Canco2's base deduction limit under subsection 18.2(2) (by being reflected in variable D of that subsection) and allows Canco2 to deduct all of its interest and financing expenses for the year.

<u>2029</u>

In 2029, as in 2027, Canco1's interest and financing expenses exceed its base deduction capacity for the year. Thus, as in 2027, Canco1 will have absorbed capacity – provided it has a positive cumulative unused excess capacity for the year (determined before any reduction for its absorbed capacity for 2029).

For the purpose of determining Canco1's absorbed capacity for 2029, its cumulative unused excess capacity for 2029 – which, for this purpose, is determined before the reduction for its absorbed capacity for 2029 – is $30 million, calculated as A + B where:

- *A is Canco1's excess capacity for 2029, which is nil; and*
- *B is the total of Canco1's excess capacity for 2026, 2027 and 2028, taking into account reductions for its absorbed capacity of $10 million for 2027 and its transferred capacity of $20 million for 2028. The relevant excess capacity amounts are as follows:*
    - *Canco1's excess capacity for 2025 is not included (reflecting the three-year carry-forward period). However, its 2025 taxation year is a "relevant year" for the purpose of determining the reductions for its absorbed capacity for 2027 and transferred capacity for 2028, such that:*
        - *Its excess capacity for 2025 continues to be treated as having been reduced to $15 million, to reflect its $10 million absorbed capacity for 2027; and*
        - *This remaining $15 million of its excess capacity for 2025 is reduced to nil, to reflect its transferred capacity for 2028;*
    - *Canco1's $20 million excess capacity for 2026 is reduced to $15 million. This reduction is for the $5 million by which its $20 million transferred capacity for*

2028 exceeds the $15 million reduction made to its excess capacity for 2025 in respect of that transferred capacity;

  - *Canco1's excess capacity for 2027 is nil*
  - *Canco1's excess capacity for 2028 is $15 million;*

Canco1's absorbed capacity for 2029 is, therefore, $15 million, being the lesser of:

- *its cumulative unused excess capacity for the year (as determined above, before any reduction for its absorbed capacity for 2029), which is $30 million; and*
- *the excess of its interest and financing expenses over the total of its base deduction capacity and interest and financing revenues (which in this case, are nil) for the year, which excess is $15 million.*

As a result of its absorbed capacity for 2029, Canco1's cumulative unused excess capacity for 2029 is $15 million (being its $30 million cumulative unused excess capacity calculated above, before the reduction for its absorbed capacity, minus its $15 million absorbed capacity). More specifically, for the purpose of determining Canco1's cumulative unused excess capacity for 2029, the 2029 absorbed capacity reduces the remaining portion of Canco1's excess capacity for 2026 (after the $5 million reduction for its transferred capacity for 2028) from $15 million to nil.

Canco1 and Canco2 can jointly elect under subsection 18.2(4) to "transfer" $10 million of Canco1's cumulative unused excess capacity for 2029 to Canco2. This results in Canco2 having received capacity of $10 million for 2029, which allows Canco2 to deduct all of its interest and financing expenses for the year. It also results in Canco1 having a $10 million transferred capacity for 2029, which will be applied as a reduction to its excess capacity for 2028 for the purpose of determining its cumulative unused excess capacity in subsequent taxation years.

"eligible group entity"

An eligible group entity, in respect of a taxpayer resident in Canada, at any time, is in general terms a corporation or trust that is resident in Canada and that the taxpayer is, at that time, related to or affiliated with.

For purposes of paragraphs (a) and (b) of this definition, subsections 18.2(16) and (17) contain supporting rules in determining whether persons are related or affiliated, specifically addressing trustees, control by His Majesty in right of Canada or a province, and beneficiaries that are arm's length registered charities or non-profit organizations. In addition, persons are not considered to be affiliated if they otherwise would be solely because of the definition "controlled" in subsection 251.1(3). The applicable standard of corporate control for these purposes is *de jure* control.

Paragraphs (c) and (d) are special rules for discretionary trusts. Paragraph (c) applies when the entity whose connection to the taxpayer is being tested is a trust, whereas paragraph (d) applies when the taxpayer itself is a trust. In either case, discretionary beneficiaries of a trust are effectively treated as meeting the requisite connection standard in respect of the trust, except, where the taxpayer is a trust, beneficiaries of the trust that are arm's length registered charities or non-profit organizations. Thus, the rules provide that a trust and a beneficiary with a discretionary interest in the trust are generally eligible group entities in respect of one another.

This definition is relevant for, among other things, the purposes of applying the definition "excluded entity", the transfer of cumulative unused excess capacity in subsection 18.2(4) and the group ratio rule in subsection 18.21(2).

An anti-avoidance rule is included in subsection 18.2(9) to address certain circumstances where a taxpayer becomes or ceases to be an eligible group entity in respect of another taxpayer. For more information, see the commentary on subsection 18.2(9).

"excess capacity"

A taxpayer's excess capacity for a taxation year is essentially a measure of the amount by which the taxpayer's "capacity" for deducting interest and financing expenses under the EIFEL rules, generated by its own taxable income and interest and financing revenues for the year, exceeds the amount of its actual interest and financing expenses for the year plus its carryforwards of restricted interest and financing expenses from previous years. Thus, the taxpayer's excess capacity for a taxation year is determined without regard to its excess capacity carried forward from preceding years, or any "received capacity" of the taxpayer resulting from transfers from other group entities in the year.

More specifically, a taxpayer's excess capacity for a taxation year is the amount determined by the formula A – B – C, where:

- Variable A represents the taxpayer's capacity to deduct interest and financing expenses for the year, measured as its ratio of permissible expenses multiplied by its adjusted taxable income, plus its interest and financing revenues for the year (subject to the reduction described below).
- Variable B is the taxpayer's total interest and financing expenses for the year; and
- Variable C is the amount of restricted interest and financing expenses from previous years that are deductible by the taxpayer under paragraph 111(1)(a.1) in the year.

In determining a taxpayer's deduction capacity under variable A for a taxation year, there is a reduction that applies if:

- the taxpayer has net interest and financing revenues for the year (i.e., its interest and financing revenues exceed its interest and financing expenses), and
- the taxpayer would have "negative" adjusted taxable income for the year if the definition of that term allowed it to be a negative amount (i.e., if it contained an override of section 257).

The amount of this reduction is determined as the taxpayer's ratio of permissible expenses multiplied by the lesser of the absolute value of the amount that would be its negative adjusted taxable income for the year and its net interest and financing revenues for the year (i.e., variable H multiplied by variable I).

Absent this reduction, the amount that would be the taxpayer's negative adjusted taxable income would not, in these circumstances, be appropriately reflected in its deduction capacity.

In general, negative adjusted taxable income is reflected as a non-capital loss, which reduces the "positive" adjusted taxable income – and thus the taxpayer's deduction capacity – that would otherwise arise in the year in which the non-capital loss carry-over is deducted. This ensures the taxpayer does not have deduction capacity to the extent it does not have adjusted taxable income on a net basis across those years.

If a taxpayer has net interest and financing revenues for a taxation year, however, its non-capital loss, if any, will be less than the absolute value of its negative adjusted taxable income. Thus, the deduction of the non-capital loss carry-over by the taxpayer in another year will not reduce the taxpayer's deduction capacity by an amount commensurate with its negative adjusted taxable income. The reduction described above ensures that the portion of the negative adjusted taxable income that is not reflected as a non-capital loss is nonetheless reflected as a reduction to deduction capacity.

For an illustration of this reduction in determining a taxpayer's excess capacity, see the example in the commentary to the definition "excluded interest".

A taxpayer's excess capacity can be used for three purposes.

First, pursuant to paragraph 111(1)(a.1), a taxpayer's restricted interest and financing expense carryforwards from previous years are deductible to the extent of the taxpayer's excess capacity for the year (as determined without regard to such deductions). By virtue of variable C in the definition "excess capacity", a taxpayer's deductible restricted interest and financing expense carryforwards from previous years automatically reduce its excess capacity for the year. This reduction occurs regardless of whether the taxpayer in fact deducts these amounts in the year, to ensure that it cannot choose to effectively preserve its cumulative unused excess capacity to transfer to other group members, in preference to deducting its restricted interest and financing expense carryforwards. This reflects a mandatory "ordering rule", whereby a taxpayer is, in effect, required to first apply its excess capacity against its restricted interest and financing expense carryforwards from previous years (to enable their deduction), before it can use any remaining excess capacity to effect a transfer of excess capacity to another group member by way of an election under subsection 18.2(4).

Second, a taxpayer's excess capacity for a taxation year is included in its cumulative unused excess capacity for the year and for the three immediately following years, which a corporate taxpayer can effectively transfer to an eligible group corporation in respect of the taxpayer for the year by designating it as "received capacity" of the transferee in an election under subsection 18.2(4). For more information, see the commentary on the definition "cumulative unused excess capacity" and subsection 18.2(4).

Third, a taxpayer can use its excess capacity to allow the deduction of interest and financing expenses for a later taxation year that would otherwise be denied under subsection 18.2(2). More specifically, a taxpayer's cumulative unused excess capacity for a taxation year – which, as noted, includes the taxpayer's excess capacity from the three immediately preceding years – is automatically applied to enable the taxpayer to deduct amounts of interest and financing expenses that would otherwise have been denied in the year. This occurs by virtue of the taxpayer's "absorbed capacity" for the year being included in variable E of the formula in subsection 18.2(2). For more information, see the commentary on the definition "absorbed capacity".

A taxpayer that elects, along with its corporate group, to have the group ratio rules in section 18.21 apply for a taxation year is treated as having nil excess capacity for that year. This reflects, first, that the group ratio rules in subsection 18.21(2) provides a separate mechanism for calculating the capacity to deduct interest and financing expenses at the group level and then allocating this capacity among group members for a year. Second, it reflects an intention that, for any taxation year in respect of which a taxpayer is subject to the group ratio, it cannot accrue excess capacity that is carried forward to later years as cumulative unused excess capacity.

"excluded entity"

A taxpayer that is an excluded entity for a taxation year is not subject to the deduction restrictions under new subsection 18.2(2), nor an income inclusion under new paragraph 12(1)(l.2), in respect of its interest and financing expenses for the year.

Excluded entities generally do not pose significant base erosion and profit shifting risks targeted by the new EIFEL rules.

A taxpayer is an excluded entity for a particular taxation year if it satisfies the conditions in any of paragraphs (a) to (c).

Under paragraph (a), a taxpayer is an excluded entity for a particular taxation year if, throughout the particular year, it is a Canadian-controlled private corporation that, together with any associated corporations, has taxable capital employed in Canada of less than $50 million (i.e., the top end of the phase-out range for the small business deduction). These entities are relieved from the application of the EIFEL rules because they are Canadian controlled and are small or medium sized businesses.

Under paragraph (b), a taxpayer is an excluded entity for a taxation year if it is part of a group whose Canadian members have total interest and financing expenses (net of interest and financing revenues) for the year of $1,000,000 or less. These taxpayers are excluded from the application of the EIFEL rules because they do not have significant net interest and financing expenses on a Canadian group-wide basis. The group can include corporations and trusts. Notably, the interest and financing revenues of any group member that is a financial institution group entity are excluded to ensure their net interest and financing revenues do not shelter the interest and financing expenses of other group members.

Exempt interest and financing expenses are included in determining if the group's net interest and financing expenses exceed $1,000,000. For more information, see the commentary on the definition "exempt interest and financing expenses".

Under paragraph (c), a particular Canadian-resident taxpayer is an excluded entity if it is a standalone entity or a member of a group (defined to include all "eligible group entities" in respect of the particular taxpayer) that consists exclusively of Canadian-resident taxpayers, provided that:

- the particular taxpayer and all other group members carry on all or substantially all of their businesses, undertakings and activities in Canada;
- the group's foreign affiliate holdings, if any, are *de minimis*, meaning the greater of the book cost of all foreign affiliate shares held by the group and the fair market value of the assets of all foreign affiliates held by the group does not exceed $5,000,000;
- no person or partnership is
    - a specified shareholder or specified beneficiary (both as defined in subsection 18(5), for the purposes of the thin capitalization rules) of the particular taxpayer, or any eligible group entity, that is a non-resident; or
    - a partnership where more than 50% of the fair market value of the interests in the partnership are held by non-residents, and the property of the partnership includes more than 25% of the equity in the particular taxpayer or any eligible group entity; and
- all or substantially all of the interest and financing expenses of the particular taxpayer and each eligible group entity in respect of the particular taxpayer, are paid or payable to persons or partnerships other than tax-indifferent investors (as defined in subsection 248(1)) that do not deal at arm's length with the particular taxpayer or any eligible group entity.

Subsection 18.2(14) provides an anti-avoidance rule that deems certain recipients of interest and financing expenses to be non-arm's length tax-indifferent investors. For more information, see the commentary on subsection 18.2(14).

"excluded interest"

The definition "excluded interest" sets out the conditions that must be satisfied in order for two members of the same corporate group to elect to have a payment of interest or a lease financing amount (as defined in subsection 18.2(1)) made from one to the other excluded from the limitation under subsection 18.2(2). This election is principally intended to ensure that the EIFEL rules do not negatively impact on corporate transactions that are often undertaken within Canadian corporate groups to allow the losses of one group member to be offset against the income of another group member.

More specifically, excluded interest is not included in determining the interest and financing expenses (as defined in subsection 18.2(1)) of a taxpayer for a taxation year. As a result, a deduction in respect of excluded interest will not be denied under subsection 18.2(2) or result in an income inclusion under paragraph 12(1)(l.2). However, excluded interest is also not included in the interest and financing revenues of the payee, which limits the extent to which it can “shelter” the payee’s interest and financing expenses from the limitation under subsection 18.2(2) or increase the payee’s excess capacity (as defined in subsection 18.2(1)), as the case may be.

In general, interest expenses and interest income are disregarded in computing a taxpayer’s adjusted taxable income. This occurs by virtue of the “add-back” for interest and financing expenses under variable B of the definition “adjusted taxable income” in subsection 18.2(1), and the exclusion of interest and financing revenues under variable C of that definition. Because excluded interest is not reflected in the payer’s interest and financing expenses or the payee’s interest and financing revenues, however, it is not disregarded in computing adjusted taxable income, but rather generally reduces that of the payer and increases that of the payee.

For an amount of interest or a lease financing amount to be excluded interest it must satisfy a number of conditions.

Notably, the amount must be paid or payable by a corporation or partnership to another corporation or partnership (referred to as the “payer” and “payee”, respectively) in respect of a debt or lease. Throughout the period during which the amount accrued (referred to as the “relevant period”), the debt must be owed by the payer to the payee, or the lease must be between them. Thus, excluded interest treatment is not available, for example, where interest accrues during a period when the debt is held by another person or partnership, and the debt is subsequently transferred to the payee, or assumed by the payer, before the interest is paid or payable.

In addition, throughout the relevant period and at the time of payment, the payer and payee must both be taxable Canadian corporations, and eligible group entities (as defined in subsection 18.2(1)) in respect of one another, unless one or both are partnerships. If the payer or payee is a partnership, similar conditions apply in respect of the members of the partnership. If the payer is a “financial institution group entity” (as defined in subsection 18.2(1)), the election will only be available if the payee is also such an entity.

Finally, the payer and payee (or, if the payer or payee is a partnership, each member of the payer or payee) are required to jointly elect in writing in prescribed manner and specify the amount of interest, or the lease financing amount, which they wish to have treated as excluded interest, as well as the amount of the debt at the beginning and end of the relevant period or the fair market value of the leased property at the time the lease began. Taxpayers may treat all or any portion of an interest payment, or lease financing amount, as excluded interest. The result of this election is that the amount is excluded interest for the single taxation year in respect of which the election was filed.

The joint election must be filed in respect of the taxation year or fiscal period of the payer and payee in which the amount of interest or the lease financing amount is paid, or in respect of which the amount is payable. It is intended that the election be filed for the year or fiscal period when the amount paid or payable is deductible or is included in income. For example, if accrued interest is deductible in a particular taxation year but becomes paid or payable in a later taxation year, the election must be filed for the particular year.

Example

Assumptions

- *Canco is a wholly-owned subsidiary of Forco, a non-resident corporation.*
- *For its taxation year ending December 31, 2025, Canco has a non-capital loss carryforwards balance of $50 million, consisting of losses incurred as a result of transactions entered into in the ordinary course of its retail sales business.*
- *Canco is the sole shareholder of CanSub, which is expected to have significant income from its wholesale business in its taxation year ending December 31, 2025.*
- *Canco and CanSub enter into a series of transactions, the effect of which is that CanSub becomes indebted to Canco and has $10 million in interest (the "Interest") paid and payable in 2025 in respect of the debt. The series of transactions has no material interprovincial effects.*
- *In 2025, CanSub would have taxable income of $10 million, before taking into account the Interest.*
- *Canco deducts $10 million under paragraph 111(1)(a) in respect of its non-capital loss carryforwards, in computing its taxable income for 2025.*
- *Throughout the period during which Interest accrues, both Canco and CanSub are taxable Canadian corporations and Canco is an eligible group corporation in respect of CanSub.*
- *The group ratio rule in subsection 18.21(2) does not apply in respect of Canco or CanSub for their 2025 taxation year.*

Analysis – with "excluded interest" election

If CanSub and Canco duly elect under paragraph (e) of the definition "excluded interest" in respect of the Interest, this amount is treated as excluded interest.

Because excluded interest is not included in computing CanSub's interest and financing expenses, subsection 18.2(2) does not limit the amount that CanSub may deduct in respect of the Interest in computing its income for its 2025 taxation year.

As a result of the Interest, CanSub's taxable income for 2025 is nil. Consequently, in computing CanSub's adjusted taxable income, the amount determined for variable A in the definition "adjusted taxable income" is nil. No amount in respect of the Interest is added back under *paragraph (a) of variable B of that definition, since excluded interest is not included in CanSub's interest and financing expenses. Thus, assuming CanSub does not have any other amounts described in variable B (e.g., interest and financing expenses) or C (e.g., interest and financing revenues) of that definition, its adjusted taxable income for 2025 is nil.*

The Interest is included in computing Canco's income for its 2025 taxation year. Canco's $10 million deduction in respect of its non-capital loss carryforwards reduces its taxable income – and thus the amount determined for variable A in computing its adjusted taxable income for the year – to nil. In addition, since excluded interest is not included in computing Canco's interest and financing revenues, the Interest is not subtracted in computing Canco's adjusted taxable income, under variable C of the definition of that term. Assuming Canco does not have any amounts described in variable B or C of that definition, Canco's adjusted taxable income for 2025 is nil.

Because excluded interest is not included in computing Canco's interest and financing revenues, the Interest does not increase Canco's deduction capacity (under variable C in subsection 18.2(2)) or its excess capacity (under variable F of the definition of that term).

Analysis – without "excluded interest" election

If CanSub and Canco do not jointly elect to treat the Interest as excluded interest, $10 million will be included in CanSub's interest and financing expenses and in Canco's interest and financing revenues for their 2025 taxation year.

As a result, the amount that CanSub may deduct in respect of the Interest is subject to the limitation in subsection 18.2(2).

In determining CanSub's adjusted taxable income for 2025, the amount determined for variable A of the definition of that term (which is determined without regard to any interest deductions denied under subsection 18.2(2)) is nil, since CanSub's taxable income is nil. However, because the Interest is included in CanSub's interest and financing expenses, it is added back under paragraph (a) of variable B in computing CanSub's adjusted taxable income. Thus, assuming CanSub does not have any other amounts described in variable B or C, its adjusted taxable income for 2025 is $10 million.

CanSub's adjusted taxable income of $10 million results in $3 million of deduction capacity under subsection 18.2(2) (determined, under paragraph (b) of variable B of that subsection, by multiplying $10 million of adjusted taxable income by a ratio of permissible expenses of 30%). In order for CanSub to deduct the remaining $7 million of the Interest, absent any cumulative unused excess capacity or interest and financing revenues of its own, CanSub will require a transfer, under the election in subsection 18.2(4), out of Canco's cumulative unused excess capacity.

In determining Canco's adjusted taxable income, Canco's $10 million deduction in respect of its non-capital loss carryforwards reduces its taxable income – and thus the amount determined for variable A in the definition "adjusted taxable income" – to nil. The $10 million included in Canco's interest and financing revenues in respect of the Interest (as a result of not electing *"excluded interest" treatment) is subtracted under variable C in computing its adjusted taxable income. In the absence of section 257, this would cause Canco's adjusted taxable income for 2025 to be negative $10 million. However, because of section 257, Canco's adjusted taxable income cannot be a negative amount and is thus nil.*

Although Canco has nil adjusted taxable income, it nonetheless has excess capacity, derived from its interest and financing revenues, by virtue of variable F in paragraph (b) of the definition "excess capacity". However, because Canco's adjusted taxable income would, absent section 257, be negative $10 million, variables H and I of the "excess capacity" definition reduce Canco's excess capacity deriving from its interest and financing revenues from $10 million to $7 million (i.e., $10 million minus the product of 30% and $10 million). For further information on this reduction, see the commentary to the definition "excess capacity".

Assuming Canco does not have any interest and financing expenses or deductible restricted interest and financing expense for the year, its excess capacity for 2025 is $7 million. This amount is included in determining Canco's cumulative unused excess capacity for 2025, under paragraph (a) of the definition of that term.

Provided that the requirements of subsection 18.2(4) are met, Canco and CanSub may jointly elect to designate Canco's $7 million cumulative unused excess capacity as an amount of transferred capacity of Canco and received capacity of CanSub for the 2025 taxation year. In computing CanSub's interest deduction limit for the year under subsection 18.2(2), this $7 million received capacity is, under variable D in that subsection, added to CanSub's $3 million deduction capacity deriving from its adjusted taxable income, such that CanSub is entitled to deduct $10 million in respect of the Interest.

"excluded lease"

A "lease financing amount", representing an implicit interest expense in respect of a lease, is included in the lessee's interest and financing expenses, and the lessor's interest and financing revenues, unless the lease is an excluded lease.

A lease to which subsection 16.1(1) applies is treated as an excluded lease, because the effect of the lessor and lessee jointly electing under that subsection is that the lessee has a deemed interest expense in respect of the lease, which is already included in its income and financing expenses (as defined under subsection 18.2(1)).

In recognition that the specified leasing property rules in the Regulations, like the new EIFEL rules, generally seek to distinguish leases that are (or are more likely to be) used as substitutes for financing from those that are used for operational purposes (which are generally excluded from the rules), the other categories of excluded lease are based on exclusions from the "specified leasing property" definition in of subsection 1100(1.11) of the *Regulations*. Generally, these other categories of excluded lease are leases with a term of less than one year, leases of property with a fair market value of $25,000 or less, and leases in respect of "exempt property".

The reason that paragraphs (b) and (c) of the definition "excluded lease" refer to leases or property that would (or would not) be considered, for the purposes of the specified leasing property rules, to satisfy certain requirements for exclusions from the definition “specified leasing property”, is to ensure that various anti-avoidance and application rules in section 1100 also apply for the purposes of determining whether a lease or property satisfies the requirements in the definition “excluded lease”. These include, for example, the various rules relating to exempt property in paragraphs 1100(1.13)(a) to (a.2); and the anti-avoidance rules in paragraphs 1100(1.13)(b) and (c), relating to leases with a term of less than one year and leases of property with a fair market value of $25,000 or less, respectively.

Certain other types of lease (or leases in respect of certain types of property) that are excluded from the “specified leasing property” definition are not excluded leases for the EIFEL rules. For example, leases in respect of non-depreciable property and intangible property, and leases entered into between non-arm’s length persons, are specifically excluded from “specified leasing property” but are not excluded leases (unless they meet the specific requirements in the definition “excluded lease”).

“exempt interest and financing expenses”

The definition of “exempt interest and financing expenses” is relevant for purposes of providing an exemption from the EIFEL rules for interest and financing expenses incurred in respect of the financing of typical Canadian public-private partnership (P3) infrastructure projects.

Exempt interest and financing expenses do not pose significant base erosion and profit shifting risks targeted by the new EIFEL rules.

Pursuant to variable A of the definition “interest and financing expenses”, exempt interest and financing expenses are not included in a taxpayer’s interest and financing expenses. Accordingly, they are not subject to a deduction denial under subsection 18.2(2) or an income inclusion under paragraph 12(1)(l.2).

Other effects flow from not including exempt interest and financing expenses in interest and financing expenses. For example while the latter are added back in computing adjusted taxable income (paragraph (a) of variable B of the definition of that term), there is no such add-back for exempt interest and financing expenses.

Expenses that would otherwise be interest and financing expenses of a taxpayer will be exempt interest and financing expenses to the extent they were incurred by the taxpayer or a partnership of which the taxpayer is a member in respect of a borrowing or other financing where

- the taxpayer or partnership entered into an agreement with a “public sector authority” (also as defined in subsection 18.2(1)) to design, build and finance, or design, build, finance, maintain and operate, real or immovable property owned by a public sector authority;
- the borrowing or other financing was entered into in respect of the agreement;
- it can reasonably be considered that all or substantially all of the expenses were economically borne by the public sector authority (for example, where the public sector

authority makes capital payments under a project agreement to cover the financing expenses of the project); and

- the expenses were paid or payable to arm's length persons.

"financial institution group entity"

The definition "financial institution group entity" is relevant mainly in applying the restrictions on the ability of such an entity to transfer its cumulative unused excess capacity to other members of its corporate group under subsection 18.2(4). These restrictions are intended to address anomalies in applying the EIFEL rules in respect of corporate groups that include financial institutions. For certain financial institutions, the nature of their regular business activities is such that interest income and expenses may more appropriately be considered as in the nature of operating amounts. Relatedly, the interest income of these entities will often exceed their interest expense. The restrictions on transfers by financial institution group entities are intended to ensure that this net interest income cannot be used to inappropriately shelter the interest and financing expenses of taxpayers that are members of the same corporate group, but which do not principally carry on financial businesses or activities.

In general terms, financial institution group entities are entities whose regular business activities involve the lending of money, dealing or investing in indebtedness or other financing transactions, or that are eligible group entities in respect of such an entity and, generally, either provide regulated financial services or carry on activities all or substantially all of which support the activities or business of other financial institution group entities. This would include, for example, an entity that is an eligible group entity in respect of a bank and provides routine or specialized "back office" services to the bank, such as information technology or risk analysis.

There are two restrictions imposed in respect of financial institution group entities.

First, for the purpose of paragraph (b) in the definition "excluded entity" in subsection 18.2(1), which generally provides an exclusion from the limitation in subsection 18.2(2) for taxpayers that are members of groups with net interest and financing expenses of $1,000,000 or less in a taxation year, the interest and financing revenues of a financial institution group entity are excluded in computing the group's net interest and financing expenses.

Second, a financial institution group entity can only transfer, under subsection 18.2(4), its cumulative unused excess capacity to another financial institution group entity or, subject to certain limitations, to an insurance holding corporation or a special purpose loss corporation.

Additionally, under the transitional rules, the "group net excess capacity" (essentially the excess capacity available to be carried forward into the EIFEL regime) is determined without reference to any income or expense amounts of financial institution group entities.

For more information, see the commentary on the definition "excluded entity" in this subsection and on subsection 18.2(4).

"fixed interest commercial trust"

The definition “fixed interest commercial trust” is relevant for purposes of the transfer of cumulative unused excess capacity between certain eligible group entities under subsection 18.2(4), as only entities that are taxable Canadian corporations or fixed interest commercial trusts may make or receive transfers under that subsection. The definition relies on concepts and conditions found in subsection 94(1), specifically the definition “fixed interest” and clauses (h)(ii)(A) to (C) of the definition “exempt foreign trust”. Essentially, a fixed interest commercial trust is a trust resident in Canada that is a non-discretionary trust (i.e., a fixed interest trust) and meets any of the conditions in the above-noted clauses of the definition “exempt foreign trust”, which generally test the commerciality of the trust.

“foreign accrual property loss”

The definition “foreign accrual property loss” has the meaning assigned by subsection 5903(3) of the *Income Tax Regulations*. This definition is relevant in applying the EIFEL rules in respect of controlled foreign affiliates of taxpayers.

“insurance holding corporation”

The definition “insurance holding corporation” is relevant for the purposes of the restrictions on the ability of financial institution group entities to transfer their cumulative unused excess capacity under subsection 18.2(4). For more information, see the commentary on that subsection.

“interest and financing expenses”

The definition “interest and financing expenses” includes interest and various other financing-related expenses and losses, but does not include any exempt interest and financing expenses (which are generally expenses incurred in respect of certain public-private partnership infrastructure projects). For more information, see the commentary on the definition “exempt interest and financing expenses”.

The deductibility of a taxpayer’s interest and financing expenses that are described in any of paragraphs (a) to (g) or (i) of variable A of this definition is potentially subject to denial under new subsection 18.2(2). If the expenses are incurred at the level of a partnership and attributed to the taxpayer under paragraph (h) of variable A of this definition, they may instead give rise to an income inclusion to the taxpayer under new paragraph 12(1)(l.2).

A taxpayer’s interest and financing expenses are “added back” in determining its adjusted taxable income for the year, under paragraph (a) of variable B of that definition.

A taxpayer’s interest and financing expenses for a particular taxation year are the total of the amounts described in paragraphs (a) to (j) of variable A, minus the total of the amounts described in variable B.

Variable A

Paragraph (a) of variable A includes, in a taxpayer’s interest and financing expenses for a particular taxation year, amounts paid or payable as, on account of, in lieu of payment of or in satisfaction of, interest. This description is similar to that in paragraph 12(1)(c), which is the rule requiring a taxpayer to include interest received or receivable in computing its income. For greater certainty, it includes amounts that are deemed or treated as interest under the Act (e.g., under subsection 16(1)), but specifically excludes amounts that are paid or payable by a credit union in respect of its shares and are deemed to be interest under subsection 137(4.1).

The amounts described in subparagraph (a)(i) are included if, absent the new limitation under subsection 18.2(2), they would be deductible in the particular year. The year in which they are deductible need not be the same year in, or in respect of which, they are paid or payable.

These amounts are included regardless of the particular provision of the Act under which they are deductible, except that paragraph (a) does not include amounts that are deductible under a provision referred to in subparagraph (c)(i). In addition to preventing double-counting in computing interest and financing expenses, this exception is intended to ensure that certain discretionary deductions in respect of mainly capitalized interest and financing expenses are included in interest and financing expenses (by virtue of paragraph (c) in this definition) only to the extent that a deduction is in fact claimed for the year.

The following amounts are not included in the taxpayer's interest and financing expenses under paragraph (a):

- "Excluded interest", which is generally interest, or a lease financing amount, paid or payable by the taxpayer to another member of its corporate group that the parties have jointly elected to treat as such. For more information, see the commentary on the definition "excluded interest";
- An amount deemed to be interest under subsection 137(4.1); and
- An amount that is interest and financing expenses under another paragraph of the definition, to prevent double-counting of such amounts in determining interest and financing expenses.

Paragraph (b) of variable A includes in a taxpayer's interest and financing expenses for the particular year amounts that, absent subsection 18.2(2), would otherwise be deductible in the particular year

- under any of subparagraphs 20(1)(e)(ii) to (ii.2) and paragraphs 20(1)(e.1) and (e.2), in respect of various financing-related expenses; or
- under paragraph 20(1)(f), for amounts paid in respect of the principal amount of certain debt obligations issued at a discount.

In certain cases, financing expenses may be otherwise described in, for example, paragraph 20(1)(e) but a taxpayer may take the position that the expenses are deductible under another provision of the Act (such as section 9), such that they are not deductible under paragraph 20(1)(e). In paragraph (b), the phrase "and on the assumption that [the amount] is not deductible under another provision of this Act" is intended to ensure that these expenses are nonetheless included in a taxpayer's interest and financing expenses.

Paragraph (c) of variable A includes in interest and financing expenses amounts that are in respect of interest, or any of the various financing-related expenses that would otherwise be included in the taxpayer's interest and financing expenses for some year by virtue of paragraph (b) of this definition, but that generally have been "capitalized" or otherwise included in resource-expense pools (for example, by virtue of subsection 18(3.1) for certain costs in relating to construction; or as a result of an election under any of subsections 21(1) to (4), in respect of interest or various financing expenses). These amounts are included in the taxpayer's interest and financing expenses for the particular year in which the taxpayer claims them as deductions in respect of capital cost allowance under paragraph 20(1)(a), or in respect of resource expenses under any of the provisions listed in subparagraph (c)(i). This includes where the taxpayer claims a deduction under section 66.7 in respect of amounts that have been included in successor pools. Because amounts are included in interest and financing expenses under paragraph (c) only in the year in which they are claimed, they are not included for any year in which they have become deductible but have not yet been claimed as deductions by the taxpayer.

To facilitate compliance, paragraph (c) only includes in interest and financing expenses capitalized amounts that are paid or payable on or after February 4, 2022.

Since a taxpayer's undepreciated capital cost, or remaining balance in its resource expense pools, generally will not be attributable exclusively to interest and financing expenses, paragraph (c) of variable A requires that the taxpayer determine the portion of an amount it claims in respect of its capital cost allowance or resource expenses for a particular year that can "reasonably be considered" to be attributable to the interest or financing expenses. It is expected that this portion would generally correspond to the proportion of the claimed amount that the interest and financing expenses included in the relevant expense pool are of the taxpayer's undepreciated capital cost or undeducted balance of a resource expense pool, as the case may be.

If subsection 18.2(2) denies a deduction for any portion of an amount included in the taxpayer's interest and financing expenses by virtue of paragraph (c) or (d) of variable A of this definition, then the rule provided in subsection 18.2(3) ensures that the taxpayer's undepreciated capital cost or resource expense pool is reduced to the extent of the denied portion. For more information, see the commentary on subsection 18.2(3).

Under paragraph (d) of variable A, where a taxpayer suffers a terminal loss in a year, any portion that can reasonably be considered to represent capitalized interest or financing expenses described in subparagraph (c)(ii) of variable A is included in the taxpayer's interest and financing expenses.

Paragraph (e) of variable A includes in interest and financing expenses certain amounts that are not included under any of the other paragraphs in this definition, but can reasonably be considered to be part of the cost of funding with respect to a borrowing or other financing of the taxpayer or a non-arm's length person or partnership. This is intended to include amounts that are, in economic terms, part of the costs incurred in relation to the funding of a business or investment. This would include, for example, an amount that is not included under paragraph (a) because it does not have the legal character of interest, but which is economically equivalent to interest.

An amount is included in a taxpayer’s interest and financing expenses for a particular taxation year under paragraph (e) only if all the conditions in that paragraph are met.

First, subparagraph (e)(i) requires that the amount be paid or payable by, or a loss of, the taxpayer and deductible in computing its income for the particular year (absent section 18.2). Alternatively, the amount must be a capital loss that is offset against the taxpayer’s taxable capital gains for the particular year, or is deductible under paragraph 111(1)(b) in computing its taxable income for the particular year. It is not expected that equity financings would satisfy all the requirements of paragraph (e). These types of financings do not typically give rise to a deduction, a loss or a capital loss that would satisfy the requirement in subparagraph (e)(i), and that subparagraph specifically excludes amounts that are deductible under subparagraph 20(1)(e)(i) (as expenses incurred in the course of issuing equity interests in the taxpayer).

Second, subparagraph (e)(ii) requires that the amount arise under or as a result of an agreement or arrangement that is entered into as, or in relation to, a borrowing or other financing of the taxpayer or a non-arm’s length person or partnership. Thus, the agreement or arrangement can either itself constitute or provide a financing, or be ancillary to a financing. The reference to “borrowing or other financing” is intended to describe a range of agreements or arrangements that procure financing, in an economic sense.

The agreements and arrangements contemplated by subparagraph (e)(ii) include, among other things, derivative contracts used in a wide range of situations. For example, it can include a derivative contract that is entered into for the purpose of hedging any risk in relation to a borrowing or other financing (including currency, interest rate or payment risk), and a derivative contract that itself includes a material financing or funding component. The types of derivative contracts that can meet the conditions in paragraph (e) of this definition include cash or physically-settled swap agreements, forward purchase or sale agreements, forward rate agreements, futures agreements, securities lending agreements, sale and repurchase agreements (“repos”), and option agreements.

Derivative contracts can be considered to include a financing or funding component, for example, where they have mismatched payment or delivery requirements, which can, in economic terms, result in a financing or funding of either party during all or part of the term of the particular contract. This can result from either party having the right to use any cash, cash equivalents or other securities transferred or delivered to them during the term of the particular agreement or arrangement (net of any amounts they are obligated to transfer or deliver to the other party during the term of the particular agreement or arrangement). Examples include (i) forward agreements with material prepayment or pre-delivery obligations, (ii) swap agreements with material mismatched payment or collateralization requirements, and (iii) securities lending agreements or repos (whether or not they are “securities lending arrangements” for the purposes of section 260).

An amount under a derivative contract could satisfy the necessary conditions in subparagraph (e)(ii) of variable A even where the derivative contract is in relation to a borrowing or other financing that is anticipated to be entered into sometime in the future, and even if it is subject to a contingency, since subparagraph (e)(ii) provides that the borrowing or financing can be entered into "currently or in the future, and absolutely or contingently".

Third, to be included in interest and financing expenses under paragraph (e) of variable A, the amount paid or payable must satisfy the requirement in subparagraph (e)(iii) such that it can reasonably be considered to increase or be "part of" the "cost of funding"; this includes amounts that increase the cost of funding as a result of any hedge of the cost of funding or of the borrowing or other financing. In the case of a derivative contract entered into for the purpose of hedging a risk in relation to a borrowing or other financing, an amount paid or payable under, or a loss resulting from, the contract constitutes a cost of funding. The phrase "cost of funding" would include any amount that can reasonably be considered compensation for the time value of money. In the context of the derivative contracts examples outlined above, where the effect of the agreement or arrangement is to fund a business or investment, the combined cash flows must economically include an amount that can reasonably be considered to be in respect of compensation for the use of the cash, cash equivalents or securities that constitute the funding.

While not definitive for purposes of paragraph (e) of variable A, the manner in which an amount is characterized under the applicable generally accepted accounting principles may provide guidance with respect to the types of amounts considered economically equivalent to interest or otherwise treated as financing expenses.

Paragraph (f) of variable A includes in interest and financing expenses generally any expenses or fees, in respect of agreements or arrangements described in paragraph (e) of variable A, that would, in the absence of section 18.2, be deductible by the taxpayer in the year and are not included in the taxpayer's interest and financing expenses under paragraph (b) of variable A of this definition. The policy is that expenses and fees in respect of an agreement or arrangement that is treated as a financing transaction should themselves be included in the taxpayer's interest and financing expenses. Because these agreements or arrangements may, in many cases, not be described in any of the provisions listed in paragraph (b) of variable A, the associated expenses and fees would consequently not be included under that paragraph. Including these expenses and fees in a taxpayer's interest and financing expenses ensures neutrality between taxpayers' choice of financing arrangements. These expenses and fees are included if they are incurred in contemplation of, in the course of entering into or in relation to, the agreement or arrangement. Expenses or fees incurred "in relation to the agreement or arrangement" would include, for example, those incurred in making payments under the agreement or arrangement, taking steps to secure the receipt of payments under the agreement or arrangement, or modifying the terms and conditions of the agreement or arrangement.

Paragraph (g) of variable A includes in interest and financing expenses the portion, of any lease payment that would be deductible in the absence of subsection 18.2(2), that is a "lease financing amount". This essentially imputes a financing cost to lessees in respect of their lease payments. Lease payments made in respect of excluded leases, or in respect of which an "excluded interest" election is made, do not give rise to interest and financing expenses under paragraph (g). For more information, see the commentary on the definitions “lease financing amount”, “excluded interest” and “excluded lease”.

Paragraph (h) of variable A essentially includes in a taxpayer’s interest and financing expenses its share of the interest and financing expenses of a partnership of which the taxpayer is a member. This includes interest and financing expenses described in paragraphs (a) to (g) of variable A that are deducted in computing the income of a partnership. It also includes the relevant affiliate interest and financing expenses of a controlled foreign affiliate (described in paragraph (j) of variable A) held through a partnership.

The attribution of partnership-level interest and financing expenses applies on a source-by-source basis, with the partnership’s interest and financing expenses in respect of each source being attributed to the taxpayer based on its pro rata share of the partnership’s income or loss from the source. These amounts are included in the taxpayer’s interest and financing expenses for its taxation year in which the partnership’s fiscal period ends.

The amount included under paragraph (h) of variable A is subject to reductions under variable F and G of that paragraph, if applicable. The reduction under variable F ensures that, if paragraph 12(1)(l.1) of the thin capitalization rules applies to include an amount in the taxpayer’s income in respect of the taxpayer’s share of partnership-level interest and financing expenses, that amount reduces the amount that is included in the taxpayer’s interest and financing expenses under paragraph (h).

The reduction under variable G applies where the partnership deducts interest and financing expenses in computing its loss from a source, and the limited partnership “at-risk” rule in subsection 96(2.1) applies to restrict the taxpayer’s ability to deduct its share of the partnership loss.

Paragraph (i) of variable A is related to variable G of paragraph (h). It applies where the taxpayer claims an amount under paragraph 111(1)(e), in respect of a partnership loss, that was previously denied under subsection 96(2.1) for a preceding taxation year. In that case, the portion of the amount claimed that would, in the absence of subsection 18.2(2), be deductible under paragraph 111(1)(e) that is attributable to a variable G amount from a previous taxation year is included in the taxpayer’s interest and financing expenses.

Paragraph (j) of variable A essentially includes in the taxpayer’s interest and financing expenses for the particular year its share of a controlled foreign affiliate’s relevant affiliate interest and financing expenses for an affiliate taxation year ending in the particular year.

In general terms, relevant affiliate interest and financing expenses consists of the amounts described in the definition “interest and financing expenses” that are taken into account in determining the foreign accrual property income of a controlled foreign affiliate for an affiliate taxation year. The extent to which the relevant affiliate interest and financing expenses are attributed to a taxpayer is determined by reference to the taxpayer’s specified participating percentage in respect of the affiliate for the affiliate taxation year.

For more information, see the commentary on the definitions “relevant affiliate interest and financing expenses” and “specified participating percentage”.

Variable B

The amounts described in variable B are deducted from the amounts described in variable A and reduce the amount of interest and financing expenses of a taxpayer for a particular taxation year.

Paragraph (a) of variable B includes amounts received or receivable (other than as a dividend or an amount in respect of exempt interest and financing expenses) by the taxpayer in a year, or a gain for a year, in connection with an agreement or arrangement entered into in relation to a borrowing or other financing of the taxpayer, or a non-arm’s length person or partnership, to hedge the cost of funding with respect to the borrowing or other financing or to hedge the borrowing or other financing. The amounts must be included in computing the income of the taxpayer for the year and must reasonably be considered to reduce the cost of funding with respect to the borrowing or other financing. In effect, the amounts described in paragraph (a) are limited to amounts received or receivable in respect of a hedge, including any gain realized on a derivative contract that hedges a risk (including currency, interest rate or payment risk) in relation to the borrowing or other financing.

Paragraph (b) of variable B ensures that a taxpayer’s interest and financing expenses are reduced where an amount that would be described under paragraph (a) of variable B, if it were received by the taxpayer, is received or receivable by a partnership of which the taxpayer is a member.

“interest and financing revenues”

The interest and financing revenues of a taxpayer for a taxation year include interest income and certain other financing-related income and gains, to the extent that these amounts are included in computing the taxpayer’s income for the year.

This definition is relevant in two key respects. First, a taxpayer’s interest and financing revenues for a taxation year increase the amount of interest and financing expenses it is permitted to deduct in that year under subsection 18.2(2). In effect, the limitation under that subsection applies to the taxpayer’s net interest and financing expenses (i.e., its interest and financing expenses minus its interest and financing revenues).

Second, interest and financing revenues are included in computing a taxpayer’s “excess capacity” for a taxation year. For more information, see the commentary on the definition “excess capacity”.

A taxpayer’s interest and financing revenues for a year are subtracted in determining the taxpayer’s adjusted taxable income for the year, under paragraph (a) of variable C of that definition.

A taxpayer’s interest and financing revenues for a taxation year are the total of the amounts described in paragraphs (a) to (g) of variable A, minus the amount described in variable B.

Variable A

Variable A is the total of all amounts described in paragraphs (a) to (g), other than any amount described in variable B of the definition “interest and financing expenses” (this exclusion is to prevent taxpayers from, in effect, double-counting certain amounts). For more information, see the commentary on the definition “interest and financing expenses”.

Paragraph (a) of variable A includes amounts received or receivable as, on account of, in lieu of payment or in satisfaction of interest, but does not include:

- “Excluded interest”, which is generally interest, or a lease financing amount, received or receivable by the taxpayer from another member of its corporate group that the parties have jointly elected to treat as such. For more information, see the commentary on the definition “excluded interest”.
- Amounts paid or payable by a credit union, in respect of its shares, that are deemed to be interest under subsection 137(4.1).
- An amount that is interest and financing revenues under another paragraph of this definition, to prevent double-counting of such amounts in determining interest and financing revenues.

Paragraph (b) includes in a taxpayer’s interest and financing revenues for the year amounts included in the taxpayer’s income because of the deeming rule in subsection 12(9) or section 17.1, which would not otherwise be included under paragraph (a) (or any other paragraph of this definition).

Paragraph (c) of variable A includes in a taxpayer’s interest and financing revenues for the year amounts in respect of a guarantee, or similar credit support, to the extent they are included in computing the taxpayer’s income for the year.

Paragraph (d) of variable A includes in interest and financing revenues certain amounts that are received or receivable by the taxpayer and that are not included under any of the other paragraphs in this definition, but that effectively increase, or are part of, the return of the taxpayer, or a person or partnership that does not deal at arm’s length with the taxpayer, on a loan or other financing owing to or provided by the taxpayer or the person or partnership that does not deal at arm’s length with the taxpayer, including from any hedge of the return on the loan or other financing or of the loan or other financing. These amounts are roughly the converse of the amounts included in a taxpayer’s interest and financing expenses under paragraph (e) of variable A of that definition, and include amounts that are not included under paragraph (a) of variable A of this definition because they do not have the legal character of interest, but which are economically equivalent to interest. See the commentary on paragraph (e) of variable A of the definition “interest and financing expenses”.

The amounts under paragraph (d) of variable A are included in the taxpayer’s interest and financing revenues for a taxation year only if all of the conditions in that paragraph are met. The amount must be included in computing the taxpayer’s income for the year (if the amount is a capital gain, only the taxable portion will be included in interest and financing revenues). In addition, the amount must be received or receivable (other than as a dividend), or be a gain, under or as a result of an agreement or arrangement that is entered into as, or in relation to, a loan or financing owing to or provided by the taxpayer or a person or partnership that does not deal at arm's length with the taxpayer. An example of such an agreement or arrangement is a derivative contract entered into to hedge a risk (including currency, interest and payment risk) in relation to a loan or other financing.

Paragraph (e) of variable A includes in a taxpayer's interest and financing revenues the portion of a lease payment included in the taxpayer's income that is a "lease financing amount" (as defined in subsection 18.2(1)). This essentially imputes a financing return on lease payments received by lessors. Lease payments received in respect of excluded leases, or in respect of which an "excluded interest" election has been made, do not give rise to interest and financing revenues. For more information, see the commentary on the definitions "lease financing amount", "excluded interest" and "excluded lease".

Paragraph (f) of variable A essentially includes in a taxpayer's interest and financing revenues its share of interest and financing revenues of a partnership of which the taxpayer is a member. This includes interest and financing revenues described in paragraphs (a) to (e) of variable A that are included in computing the income of a partnership. It also includes the relevant affiliate interest and financing revenues of a controlled foreign affiliate held through a partnership.

The attribution of partnership-level interest and financing revenues applies on a source-by-source basis, with the partnership's interest and financing revenues in respect of each source being attributed to the taxpayer based on its pro rata share of the partnership's income or loss from the source. These amounts are included in the taxpayer's interest and financing revenues for its taxation year in which the partnership's fiscal period ends.

Paragraph (g) of variable A essentially includes in the taxpayer's interest and financing revenues for the year its share of a controlled foreign affiliate's relevant affiliate interest and financing revenues for an affiliate taxation year ending in the year.

In general terms, relevant affiliate interest and financing revenues consist of the amounts described in the definition "interest and financing revenues" that are taken into account in computing the foreign accrual property income of a controlled foreign affiliate for an affiliate taxation year. The extent to which these amounts are attributed to the taxpayer is determined by reference to the taxpayer's specified participating percentage in respect of the affiliate for the affiliate taxation year.

For more information, see the commentary on the definitions "relevant affiliate interest and financing revenues" and "specified participating percentage".

Under variable H of the formula in paragraph (g), any deduction under subsection 91(4) in respect of foreign accrual tax (within the meaning of subsection 95(1)) reduces the amount included in the taxpayer's interest and financing revenues in respect of the relevant affiliate interest and financing revenues to which the foreign accrual tax relates. A tracing approach is to be used to determine the extent to which an amount of foreign accrual tax is in respect of a particular amount of relevant affiliate interest and financing revenues.

The reduction under variable H applies if an amount is deducted under subsection 91(4) in any taxation year. Thus, if relevant affiliate interest and financing revenues are included in a taxpayer's interest and financing revenues for a particular taxation year and the taxpayer deducts an amount under subsection 91(4) for foreign accrual tax in respect of those revenues in a subsequent taxation year, the amount included in the taxpayer's interest and financing revenues for the particular year is reduced to reflect the subsection 91(4) deduction in the subsequent year.

Variable B

The amounts described in variable B are deducted from the amounts described in variable A and reduce the amount of interest and financing revenue of a taxpayer for a taxation year.

Paragraph (a) of variable B applies if a taxpayer has an amount paid or payable, or a loss or capital loss, under or as a result of an agreement or arrangement entered into in relation to a loan or other financing owing to or provided by the taxpayer, or a person or partnership that does not deal at arm's length with the taxpayer, to hedge the return in respect of the loan or other financing. This amount is subtracted in computing the taxpayer's interest and financing revenues, to the extent it was deductible in computing the taxpayer's income and can reasonably be considered to reduce the return of the taxpayer, or a person or partnership that does not deal at arm's length with the taxpayer, in respect of the loan or other financing. In effect, the amounts described in paragraph (a) are limited to amounts paid or payable in respect of a hedge, including any loss realized on a derivative contract that hedges a risk (including currency, interest rate or payment risk) in relation to the loan or other financing.

Paragraph (b) of variable B ensures that a taxpayer's interest and financing revenues are reduced where an amount that would be described under paragraph (a) of variable B, if it were received by the taxpayer, is received or receivable by a partnership of which the taxpayer is a member.

In addition, there is an anti-avoidance rule in subsection 18.2(13) that can cause an amount not to be included in interest and financing revenues. For more information, see the commentary on that subsection.

"lease financing amount"

The portion of any lease payment (other than in respect of an excluded lease) that is a lease financing amount that would, absent subsection 18.2(2), be deductible by a lessee or included in income of a lessor, is included in the lessee's interest and financing expenses and the lessor's interest and financing revenues, respectively. For more information, see the commentary on the definition "excluded lease".

A lease financing amount is an implicit financing expense that is imputed in respect of certain lease payments for purposes of determining a taxpayer's interest and financing expenses or interest and financing revenues. This approach is intended to reflect that, economically, a lease and a loan may be readily substitutable for one another.

The quantum of the lease financing amount is calculated in accordance with the rules and assumptions set out in paragraphs (a) to (c) of the definition. Essentially, the lease is treated as a notional loan with a principal amount equal to the fair market value of the leased property, and the lease payments are re-characterized as blended payments of principal and interest, with the interest (which is the lease financing amount) being calculated in accordance with the prescribed rate in effect at the time the lease began, determined under section 4302 of the Regulations.

"public sector authority"

This definition is relevant for the purpose of determining a taxpayer's exempt interest and financing expenses for a taxation year. For more information, see the commentary on that definition in this subsection.

A public sector authority includes His Majesty in right of Canada or a province, certain government authorities or entities described in paragraphs 149(1)(c) to (d.6) of the Act, as well as certain registered charities that are school authorities, public colleges, universities or hospital authorities as defined in subsection of the *Excise Tax Act*.

"ratio of permissible expenses"

A taxpayer's ratio of permissible expenses is the percentage that is multiplied by the taxpayer's adjusted taxable income in determining the taxpayer's capacity to deduct interest and financing expenses under the formula in subsection 18.2(2), before amounts in respect of a taxpayer's interest and financing revenues, received capacity and absorbed capacity for the year are added. A taxpayer's ratio of permissible expenses is also relevant to the determination of its excess capacity and absorbed capacity for a taxation year. For more information, see the commentary on the definitions of those terms.

For most years and for most purposes, a taxpayer's ratio of permissible expenses is 30%.

To facilitate the transition to the EIFEL rules, however, this percentage is 40% for any taxation year of the taxpayer that begins on or after October 1, 2023 and before January 1, 2024, subject to an anti-avoidance rule that is included in transitional rules in the enacting legislation for the EIFEL rules. The anti-avoidance rule applies a ratio of 30% (instead of 40%) for a taxpayer's taxation years beginning on or after October 1, 2023 and before January 1, 2024, if a transaction or event, or series of transactions or events, results in the taxpayer having an "early" year-end in that calendar year, and it is reasonable to consider that one of the reasons for the transaction, event or series was to delay the application of the 30% ratio (in other words, to have the 40% ratio apply for a longer period, or for more taxation years, than it otherwise would have).

Because the purpose of providing a 40% ratio for the 2023 transitional year is to facilitate taxpayers' adjustment to the new EIFEL regime, rather than to allow the creation of additional tax attributes that can be realized in later years, the 40% ratio does not apply for the purpose of determining the taxpayer's cumulative unused excess capacity for any taxation year in which the 30% ratio applies (i.e., any taxation year beginning after 2023). Instead, for any such taxation year, the taxpayer's cumulative unused excess capacity is determined on the basis that its excess capacity for any taxation year beginning on or after October 1, 2023 and before January 1, 2024 is computed using the 30% ratio. In effect, this ensures that a taxpayer does not accumulate excess capacity based on a 40% ratio and then carry this forward (through its cumulative unused excess capacity) to a year in which a 30% ratio applies.

“received capacity”

A taxpayer has received capacity for a taxation year if the taxpayer is the transferee in respect of an election under subsection 18.2(4) for the year and all the conditions of subsection 18.2(4) are met. In that case, the amount designated in the election is an amount of received capacity of the taxpayer for the year. A taxpayer can have multiple amounts of received capacity for a taxation year, if it is the transferee under multiple elections filed under subsection 18.2(4) for the year.

A taxpayer’s received capacity for a taxation year is relevant in determining the amount the taxpayer can deduct in the year under paragraph 111(1)(a.1) in respect of its carryforwards of restricted interest and financing expense. It is also relevant in determining the amount of a taxpayer’s restriction for interest and financing expenses under subsection 18.2(2) (received capacity is variable D in the formula in that subsection).

For more information, see the commentary on subsections 18.2(2) and 18.2(4), and paragraph 111(1)(a.1).

“relevant affiliate interest and financing expenses”

A controlled foreign affiliate’s relevant affiliate interest and financing expenses is, essentially, the amount that would be its interest and financing expenses if the affiliate were considered a taxpayer resident in Canada (and thus subject to the EIFEL rules) for the purpose of computing its foreign accrual property income (FAPI) (this hypothetical is set out in paragraph (b) of this definition, which requires a determination of the amount that would be the affiliate’s interest and financing expenses, if clause 95(2)(f.11)(ii)(A) were read without regard to its reference to subsection 18.2(2)).

Relevant affiliate interest and financing expenses generally includes the affiliate’s interest and various other financing-related expenses described in variable A of the definition “interest and financing expenses”, less the amounts described in variable B of that definition, to the extent that those amounts described in variables A and B are taken into account in computing the amounts referred to in subparagraph 95(2)(f)(i) or (ii). The one exception is that, for this purpose, amounts described in paragraph (j) of variable A of the definition “interest and financing expenses” are excluded, to ensure that a lower-tier controlled foreign affiliate’s relevant affiliate interest and financing expenses are not, in effect, double-counted by also being included in those of an upper-tier controlled foreign affiliate.

A taxpayer’s share of the relevant affiliate interest and financing expenses of its controlled foreign affiliates for affiliate taxation years ending in a taxation year of the taxpayer is included in the taxpayer’s interest and financing expenses for the year. To the extent that the deductibility of the taxpayer’s interest and financing expenses is denied under subsection 18.2(2), clause 95(2)(f.11)(D) will generally apply to deny the deductibility of relevant affiliate interest and financing expenses of a controlled foreign affiliate of the taxpayer in computing FAPI.

For more information, see the commentary on paragraph (j) of variable A of the definition “interest and financing expenses” and new clause 95(2)(f.11)(D).

Interest and various other financing-related expenses that are deductible in computing a foreign accrual property loss of a controlled foreign affiliate are included in the affiliate’s relevant affiliate interest and financing expenses. This is because the amounts referred to in subparagraph 95(2)(f)(ii) include an affiliate’s loss from a property, from a business other than an active business or from a non-qualifying business.

To avoid circularity, paragraph (a) of this definition ensures that an affiliate’s relevant affiliate interest and financing expenses is determined without regard to any deductions denied, or amounts included in income, under clause 95(2)(f.11)(ii)(D).

“relevant affiliate interest and financing revenues”

A controlled foreign affiliate’s relevant affiliate interest and financing revenues is, essentially, the amount that would be its interest and financing revenues if the affiliate were considered a taxpayer resident in Canada (and thus subject to the EIFEL rules) for the purpose of computing its FAPI (i.e., if the reference to subsection 18.2(2) in clause 95(2)(f.11)(ii)(A) were disregarded).

Relevant affiliate interest and financing revenues generally includes the affiliate’s interest income and certain other financing-related income and gains described in variable A of the definition “interest and financing revenues”, less the amounts described in variable B of that definition, to the extent that those amounts are taken into account in computing the amounts referred to in subparagraph 95(2)(f)(i) or (ii). The one exception is that, for this purpose, amounts described in paragraph (g) of variable A of the definition “interest and financing revenues” are excluded, to ensure that a lower-tier controlled foreign affiliate’s relevant affiliate interest and financing revenues are not, in effect, double-counted by also being included in those of an upper-tier controlled foreign affiliate.

A taxpayer’s share of the relevant affiliate interest and financing revenues of its controlled foreign affiliates for affiliate taxation years ending in a taxation year of the taxpayer is included in the taxpayer’s interest and financing revenues for the year.

For more information, see the commentary on paragraph (g) of variable A of the definition “interest and financing revenues”.

Because the affiliate’s relevant affiliate interest and financing revenues are included in determining the taxpayer’s interest and financing revenues, the specific anti-avoidance rule in new subsection 18.2(13) applies in determining the amount that is the relevant affiliate interest and financing revenues and the portion of that amount that is attributable to the taxpayer.

Only amounts that are actually included in computing FAPI are included in relevant affiliate interest and financing revenues. As a result, amounts that are re-characterized as income or loss from an active business under paragraph 95(2)(a) or (2.44)(b) are not included.

“special purpose loss corporation”

The definition “special purpose loss corporation” is relevant for the purposes of the restrictions on the ability of financial institution group entities to transfer their cumulative unused excess capacity under subsection 18.2(4). For more information, see the commentary on that subsection.

“specified participating percentage”

A taxpayer’s specified participating percentage in respect of a controlled foreign affiliate for an affiliate taxation year is the percentage that is the taxpayer’s aggregate participating percentage (as defined in subsection 91(1.3) of the stub-period FAPI rules) in respect of the affiliate for the affiliate taxation year, determined without regard to any deductions denied or amounts included in income under new clause 95(2)(f.11)(ii)(D) in computing FAPI. Paragraphs (a) and (b) of the definition “specified participating percentage”, in effect, ensure that a taxpayer has a specified participating percentage in respect of an affiliate where the affiliate’s FAPI is less than $5,000 or the affiliate has a FAPL.

A taxpayer’s specified participating percentage in respect of a controlled foreign affiliate for an affiliate taxation year is relevant in determining, among other things, the taxpayer’s share of the affiliate’s relevant affiliate interest and financing expenses for the affiliate taxation year (which is included in the taxpayer’s interest and financing expenses), and the taxpayer’s share of the affiliate’s relevant affiliate interest and financing revenues (which is included in determining the taxpayer’s interest and financing revenues).

For more information, see the commentary on the definitions “interest and financing expenses” and “interest and financing revenues”, as well as the definition “restricted interest and financing expense” in amended subsection 111(8).

“taxpayer”

The definition “taxpayer” provides that references to a taxpayer in sections 18.2 and 18.21 do not include a natural person or a partnership. As a result, the limitation on deductions for interest and financing expenses in subsection 18.2(2) applies only to corporations and trusts, including in respect of their share of the interest and financing expenses of any partnerships of which they are members.

For further information on the application of the EIFEL rules in relation to corporations and trusts that are members of partnerships, see the commentary on paragraph (h) of the definition “interest and financing expenses”, as well new paragraph 12(1)(l.2).

“transaction”

The definition “transaction” provides that a transaction includes an arrangement or an event. This is relevant for the purposes of the anti-avoidance rules in new subsections 18.2(13) and (14), and subsection 18.21(8).

“transferred capacity”

A taxpayer has an amount of transferred capacity for a taxation year if the taxpayer is the transferor in respect of an election under subsection 18.2(4) for the year and all the conditions of subsection 18.2(4) are met. In that case, the amount designated in the election is an amount of transferred capacity of the taxpayer for the year. A taxpayer can have multiple amounts of transferred capacity for a taxation year, if it is the transferor under multiple elections filed under subsection 18.2(4) for the year.

A taxpayer's transferred capacity for a taxation year reduces the taxpayer's cumulative unused excess capacity, starting in the following year. The total of a taxpayer's amounts of transferred capacity for a taxation year can never exceed its cumulative unused excess capacity for that year.

For more information, see the commentary on the definition "cumulative unused excess capacity" and subsection 18.2(4).

Excessive interest and financing expenses limitation

ITA
18.2(2)

New subsection 18.2(2) is the main operative rule of the new EIFEL regime, which implements the recommendations of the BEPS Action 4 report to limit certain taxpayers' deductions for interest and financing expenses to a proportion of their earnings. It applies to taxpayers that are corporations or trusts ("taxpayer" is defined in subsection 18.2(1) to exclude natural persons and partnerships), including non-resident corporations and trusts. The rule does not apply to a taxpayer for a taxation year if the taxpayer is an excluded entity for the year. For more information, see the commentary on the definition "excluded entity" in subsection 18.2(1).

In general terms, subsection 18.2(2) denies a deduction for a proportion (determined under the formula in that subsection) of each of a taxpayer's interest and financing expenses. So, for example, if the formula calculates to 1/5 in respect of a taxpayer for a particular taxation year, and the taxpayer's interest and financing expenses for the year consist of $180 million of interest payable in respect of a particular loan and a $50 million guarantee fee payable, then $36 million of the interest expense and $10 million of the guarantee fee are non-deductible under new subsection 18.2(2) (and become a restricted interest and financing expense within the meaning of new subsection 111(8)).

However, subsection 18.2(2) does not apply to a taxpayer's share of the interest and financing expenses of any partnerships of which it is a member, which is included in the taxpayer's interest and financing expenses under paragraph (h) of that definition in subsection 18.2(1). Instead, the taxpayer is subject to an income inclusion under new paragraph 12(1)(l.2) in respect of such expenses. For more information, see the commentary on that paragraph.

The proportion determined for the taxpayer under subsection 18.2(2) also applies under new subclause 95(2)(f.11)(ii)(D)(I) in determining the deductibility of the "relevant affiliate interest and financing expenses" (defined in subsection 18.2(1)) of a controlled foreign affiliate of the taxpayer in computing the affiliate's FAPI. Thus, using the example above, if a controlled foreign affiliate of the taxpayer had $50 million of relevant affiliate interest and financing expenses for its affiliate taxation year ending in the taxpayer's taxation year, then $10 million of the relevant affiliate interest and financing expenses is non-deductible in computing the affiliate's FAPI under subclause 95(2)(f.11)(ii)(D)(I). The same proportion is also applied in determining the amount included in FAPI under subclause 95(2)(f.11)(ii)(D)(II) in respect of the interest and financing expenses of a partnership of which the affiliate is a member.

For more information, see the commentary on clause 95(2)(f.11)(ii)(D).

Subsection 18.2(2) only denies a deduction in respect of amounts of interest and financing expenses that would be deductible absent section 18.2. Thus, if another provision of the Act (e.g., the thin capitalization rules in subsection 18(4)) denies a deduction for a portion of an interest or financing expense, subsection 18.2(2) does not apply in respect of that non-deductible portion, which is not included in the taxpayer's interest and financing expenses for the purposes of these rules.

In addition to denying deductions for interest and financing expenses in computing income from a business or property, subsection 18.2(2) denies deductions in computing taxable income (under subdivision C of Part I) in the case of amounts, in respect of limited partnership losses, included under paragraph (i) of variable A of the definition "interest and financing expenses".

The proportion of a taxpayer's interest and financing expenses that are denied is determined by the formula $(A – (B + C + D + E))/F$. In general terms, variable A is the taxpayer's total interest and financing expenses for the year, and $B + C + D + E$ represents the maximum amount the taxpayer is permitted to deduct in the year in respect of interest and financing expenses. Thus, the numerator in the formula represents the taxpayer's "excessive" interest and financing expenses: the amount by which the taxpayer's expenses exceed the amount it is allowed to deduct in the year.

Variable F is the denominator and represents the total of the otherwise deductible amounts in respect of interest and various other financing-related expenses that are included in computing the taxpayer's interest and financing expenses under variable A of that definition and that may be subject to limitation under subsection 18.2(2). Thus, variable F does not take into account any reductions, under variable B of the definition "interest and financing expenses", for income or gains that reduce the taxpayer's cost of funding. This is to ensure that the proportion determined under the formula represents the proportion of each of the taxpayer's interest and other financing-related expenses for which deductibility is denied under subsection 18.2(2), which would in many cases be overstated if variable F took into account the reductions under variable B of the definition "interest and financing expenses".

Consistent with this general approach in variable F, where the taxpayer's interest and financing expenses for the year includes any amount in respect of the relevant affiliate interest and financing expenses of a controlled foreign affiliate, paragraph (b) of variable F, in effect, excludes from variable F any reductions that apply in computing the relevant affiliate interest and financing expenses by virtue of variable B of the definition "interest and financing expenses".

The proportion determined by the formula is, therefore, the proportion of the otherwise deductible interest and financing expenses for the year that exceed the amount of deductions in respect of such expenses that it is permitted under subsection 18.2(2) for the year.

As noted, variable A is the taxpayer's total interest and financing expenses for the year. Notably, this amount includes the taxpayer's share of the interest and financing expenses of a partnership (included under paragraph (h) of that definition); thus, these expenses are relevant in determining the proportion under the formula, notwithstanding that subsection 18.2(2) does not deny a deduction in respect of these expenses (but, as noted, they are instead subject to an income inclusion under new paragraph 12(1)(l.2)).

The taxpayer's interest and financing expenses do not include "excluded interest", which is generally interest, or a "lease financing amount", paid or payable to another taxable Canadian corporation in the same group that the taxpayer and the other corporation jointly elect to have treated as such (and that satisfies the other conditions in the "excluded interest" definition in subsection 18.2(1)). Thus, subsection 18.2(2) does not restrict the deductibility of such intra-group payments of interest or lease financing amounts. For more information, see the commentary on the definitions "excluded interest" and "lease financing amount".

A taxpayer's interest and financing expenses also exclude its "exempt interest and financing expenses", such that the latter are not restricted under subsection 18.2(2). In general terms, exempt interest and financing expenses are interest and various other financing-related expenses that are paid to third parties and that are incurred in respect of certain Canadian public-private partnership infrastructure projects. For more information, see the commentary on the definition "exempt interest and financing expenses".

Variable B reflects the "earnings stripping" approach of the new rules, which generally limit the amount of interest and financing expenses (net of interest and financing revenues) that may be deducted in computing a taxpayer's income to no more than a fixed ratio of the taxpayer's "adjusted taxable income" (defined in subsection 18.2(1)). A taxpayer's adjusted taxable income is a version of earnings before interest, taxes, depreciation and amortization (EBITDA) that is based on tax, rather than accounting, concepts.

Unless the taxpayer is a member of a corporate group that elects into the "group ratio" rules for a taxation year, the amount determined for variable B for the year is the taxpayer's adjusted taxable income for the year multiplied by its ratio of permissible expenses for the year (being 40%, if the year begins on or after January 1, 2023 but before January 1, 2024; and 30% for all subsequent years).

If the taxpayer is a member of a group that elects to apply the group ratio for a taxation year, then the amount for variable B is determined under subsection 18.21(2). In essence, the group ratio rules allow a taxpayer to deduct interest and financing expenses in excess of the 30% fixed ratio (or 40% for the transitional year) where the taxpayer is able to demonstrate that the ratio of its consolidated group's net third-party interest expense to book EBITDA (referred to as the "group ratio") exceeds the fixed ratio. For more information, see the commentary on section 18.21.

If the taxpayer's interest and financing expenses for a taxation year exceed the applicable ratio of its adjusted taxable income, the taxpayer may nonetheless be able to avoid having the deductibility of this excess denied under subsection 18.2(2). There are three additional sources of "capacity" to deduct interest and financing expenses, reflected in variables C, D and E, respectively.

Variable C is the taxpayer's interest and financing revenues for the year. It reflects that the EIFEL regime is intended to limit a taxpayer's net interest and financing expenses (i.e., its interest and financing expenses net of interest and financing revenues) to a fixed percentage of adjusted taxable income.

Variable D is only available to corporate taxpayers and fixed interest commercial trusts, and is the taxpayer's total received capacity for the year, which essentially represents any amounts of excess capacity of another group member that have been "transferred" to the taxpayer for the year under the joint election in new subsection 18.2(4). This amount must, however, first be reduced by any amounts deductible by the taxpayer in the year under new paragraph 111(1)(a.1) in respect of restricted interest and financing expense for a preceding taxation year. In effect, these rules require the taxpayer to apply its received capacity first against its restricted interest and financing expenses from previous years, before it can apply received capacity to enable the deduction of current-year interest and financing expenses that would otherwise be non-deductible under the EIFEL rules.

For more information, see the commentary on the definition "cumulative unused excess capacity" in subsection 18.2(1), subsection 18.2(4) and paragraph 111(1)(a.1).

Variable E of the formula is relevant where the taxpayer would otherwise have interest or financing expenses denied under subsection 18.2(2) for the year but has excess capacity carried forward from any of the three immediately preceding taxation years that it has not yet used. In these circumstances, the taxpayer has "absorbed capacity" for the year, which increases its deduction capacity and thereby reduces the amount of its interest and financing expenses that are denied under subsection 18.2(2) for the year. The absorbed capacity essentially is the portion of the taxpayer's excess capacity carryforwards that are automatically applied to allow the taxpayer to deduct interest and financing expenses that would otherwise be denied under subsection 18.2(2). For more information, see the definition "absorbed capacity" in subsection 18.2(1).

Amount deemed deducted

ITA
18.2(3)

Subsection 18.2(3) applies where new subsection 18.2(2) denies the deductibility, in computing a taxpayer's income for a taxation year, of all or a portion of a particular amount that is described in paragraph (c) or (d) of the definition "interest and financing expenses". The amounts described in those paragraphs are generally amounts of interest or other financing-related expenses that are capitalized or otherwise included in resource-expense pools, and are claimed by the taxpayer as deductions in respect of capital cost allowance, foreign exploration and development expenses, foreign resource expenses, Canadian exploration expenses, Canadian development expenses, Canadian oil and gas property expenses or section 66.7 successor expenses, or as a terminal loss. For more information, see the commentary on the definition “interest and financing expenses” in subsection 18.2(1).)

Subsection 18.2(3) deems the denied portion of the particular amount to have been deducted by the taxpayer, to ensure it is deducted in computing a taxpayer’s total depreciation allowed for property of a prescribed class (as defined in subsection 13(21)) or the balance of its undeducted resource expenses, as the case may be. This is intended to ensure that the taxpayer does not get a “double benefit”, by retaining these amounts within its undepreciated capital cost or undeducted resource expenses and deducting them in a future year, while at the same time deducting an amount under paragraph 111(1)(a.1) in a later year as a restricted interest and financing expense in respect of the denied portion.

The deeming rule in this subsection applies for the purposes of determining the amounts referred to in paragraphs 18.2(3)(a) to (g) in respect of any taxpayer at any time, and not only the taxpayer that incurred the expense or had its deduction denied under subsection 18.2(2). This ensures the rule applies, for example, in relation to “successor pools” of resource expenses, as well as in cases where expense pools are “inherited” by a new corporation on an amalgamation or by a parent corporation on a winding-up.

Transfer of cumulative unused excess capacity

ITA
18.2(4)

New subsection 18.2(4) provides an election that allows a taxable Canadian corporation or a fixed interest commercial trust (referred to as the “transferor”) to effectively transfer all or a portion of its cumulative unused excess capacity to another taxable Canadian corporation or fixed interest commercial trust (referred to as the “transferee”) that is a member of the same corporate group. This transfer mechanism is intended to accommodate misalignments between net interest and financing expenses and adjusted taxable income among the Canadian group members, which could result in some group members exceeding the 30% fixed ratio (or 40% fixed ratio, for the transitional year) permitted under the EIFEL rules, and other group members having ratios below the permitted fixed ratio.

Where all of the conditions of subsection 18.2(4) are met, the amount that a transferor and a transferee designate in their joint election is an amount of “transferred capacity” of the transferor and an amount of “received capacity” of the transferee for their respective taxation years.

A transferor’s transferred capacity for a taxation year reduces its cumulative unused excess capacity for the following year. For more information, see the commentary to the definition “cumulative unused excess capacity” in subsection 18.2(1).

To ensure the integrity of the rules, paragraph 18.2(4)(e), in effect, renders all of the transferor’s transfers for the year invalid if the total of the transferred capacity amounts designated by the transferor in elections for the year exceeds its cumulative unused excess capacity for that year.

As a consequence, all of the amounts of received capacity otherwise accruing to the transferees under those elections would be nullified. To accommodate situations where a reassessment results in an over-transfer (e.g., by increasing the amount of the transferor's interest and financing expenses for its taxation year in which the transfer election was made), paragraphs 18.2(4)(d), (h) and (i) provide for the filing of an amended election. Paragraph 18.2(4)(h) ensures that an amended election supersedes the prior election.

However, the ability to file an amended election is provided for the sole purpose of allowing taxpayers to alter the amount designated in the election in cases where a reassessment results in a change in the transferor's cumulative unused excess capacity, or in the transferee's interest and financing expenses or restricted interest and financing expense; it is not intended to be used for retroactive tax planning. In particular, paragraph 18.2(4)(i) provides that an amended election is not available in respect of a taxation year if the transferor "over-transferred" in a prior election for that year, where the over-transfer does not result from any change under a reassessment,. An amended election is also not available where subsection 18.2(9) applies because there has been a manipulation of entity status in order to obtain a tax benefit, unless the Minister grants permission to amend the prior election under subsection 18.2(5).

Although the mechanism under subsection 18.2(4) is described as a "transfer", the transferred amount is not included in the transferee's excess capacity or cumulative unused excess capacity. Thus, the transferee cannot carry it forward for use in later years or transfer it to other taxpayers. Rather, as noted, the transferred amount is "received capacity" of the transferee, which can be used only in the taxation year of the transferee in respect of which it was received – and in only two ways.

First, received capacity is automatically applied against any restricted interest and financing expense of the transferee (which is defined in subsection 111(8) generally as carryforwards of interest and financing expenses denied under subsection 18.2(2) in a previous year), thereby allowing the taxpayer to deduct these under paragraph 111(1)(a.1).

Second, any remaining received capacity is included in variable D of the formula in subsection 18.2(2), which has the effect of reducing the amount of the transferee's interest and financing expenses for which deductibility is denied under that subsection.

Because received capacity can only be used by the transferee in the year in respect of which it is received, and for only the two purposes described above, if, by virtue of one or multiple transfers under subsection 18.2(4) in a taxation year, a transferee is transferred received capacity in excess of the amount it can use in the year, this excess reduces the transferor's cumulative unused excess capacity but cannot be used by the transferee for any purpose (and thus is of no benefit).

The deduction of restricted interest and financing expense under paragraph 111(1)(a.1) is discretionary. However, the fact that the amount of received capacity of the taxpayer that is included in variable D of subsection 18.2(2) is reduced for amounts deductible in the year under paragraph 111(1)(a.1) effectively creates an "ordering rule", which prevents a transferee from using its received capacity to deduct its current-year interest and financing expenses in priority to any restricted interest and financing expense carryforwards.

Notable aspects of the conditions in paragraphs 18.2(4)(a) to (j), all of which must be met to have an effective transfer, are as follows:

- Paragraph (a) requires that the transfer is of the cumulative unused excess capacity of the transferor for a taxation year that ends in the taxation year of the transferee in which the transferee receives the received capacity. Paragraph 249(2)(a) allows this condition to be met where the taxation year of the transferor is coterminous with that of the transferee.
- Paragraph (b) requires that the transferor and transferee be eligible group entities (as defined in subsection 18.2(1)) in respect of one another at the end of their respective taxation years, which is intended to ensure they are members of the same corporate group. The taxpayers are not required to be eligible group entities in respect of one another throughout the entirety of their respective taxation years, since such a requirement would not accommodate certain corporate reorganizations. However, the manipulation of eligible group entity status in order to meet this condition and be eligible to make an election under subsection 18.2(4) could trigger the application of the anti-avoidance rule in subsection 18.2(9).
- Paragraph (c) provides that a transferor that is a financial institution group entity is permitted to transfer only to other financial institution group entities, or to insurance holding companies or special purpose loss corporations, subject to certain limitations. For more information, see the commentary on the definition “financial institution group entity” in subsection 18.2(1).
- Paragraph (d) provides certain filing requirements in respect of the election, including that it must specify the amount of transferred capacity, which will also be received capacity of the transferee.
- Paragraphs (f) and (g) are special rules applicable where a financial institution group entity transfers to either an insurance holding corporation or a special purpose loss corporation, respectively. In these cases, the amount of cumulative unused excess capacity that may be transferred to these entities is capped, essentially, at the amount that is necessary to give effect to certain loss consolidation (or “debt push-down”) transactions within financial institution groups. The caps are intended to ensure that a financial institution group entity’s cumulative unused excess capacity can only be used (through the transfer mechanism) to support the deductibility of interest expense that has been shifted into financial institutions group entities, and not into related group entities that are not financial institution group entities.
- Paragraph (h) in effect provides that the transfer is not valid and effective unless the transferee files (or is deemed by subsection 18.2(7) to have filed) an information return that meets the requirements of subsection 18.2(6). This essentially requires reporting of all the transfers under subsection 18.2(4) received by group members within the calendar year. For more information, see the commentary on subsections 18.2(6) and (7).

Late or amended election

ITA
18.2(5)

New subsection 18.2(5) enables an election under subsection 18.2(4) to be late-filed, or amended in circumstances beyond those in which subsection 18.2(4) allows for amended elections, with Ministerial permission.

Summary – cumulative unused excess capacity transfers

ITA
18.2(6)

New subsection 18.2(6) applies if a transferor and a particular transferee jointly elect under subsection 18.2(4) to designate all or a portion of the transferor's cumulative unused excess capacity to be received capacity of the particular transferee for a taxation year.

The particular transferee is required to file an information return within six months after the end of the calendar year in which its taxation year, in respect of which it has received capacity, ends. The return must contain the information required by the Canada Revenue Agency to be reported in respect of all elections under subsection 18.2(4) that are filed by:

- The particular transferee for the year; or
- Any other transferee that is an eligible group entity in respect of the particular transferee for a taxation year ending in the calendar year.

Summary – filing by designated filer

ITA
18.2(7)

New subsection 18.2(7) allows transferees that are eligible group entities in respect of one another to jointly elect to designate a taxpayer (referred to as the "designated filer") to file an information return required by subsection 18.2(6) for a calendar year. The effect of designating a designated filer is to relieve the electing transferees (other than the designated filer) of the reporting requirement under subsection 18.2(6) for the calendar year.

Assessment

ITA
18.2(8)

New subsection 18.2(8) requires the Minister of National Revenue to assess or reassess any taxpayer to take into account an election or amended election filed under subsection 18.2(4), even where the assessment or reassessment would otherwise be statute-barred.

Anti-avoidance – group status

ITA
18.2(9)

New subsection 18.2(9) is an anti-avoidance provision that prevents the manipulation of eligible group entity or financial institution group entity status where it is reasonable to consider that one of the main purposes of either becoming or ceasing to be an eligible group entity in respect of another taxpayer or a financial institution group entity is to enable any taxpayer to obtain a “tax benefit”, as that term is defined in subsection 245(1).

There are a number of scenarios in which the manipulation of eligible group entity or financial institution group entity status could give rise to a tax benefit and thus trigger the application of this subsection. For example, a taxpayer may seek to become an eligible group entity in respect of another taxpayer in order to be eligible to elect to make or receive a transfer of cumulative unused excess capacity under subsection 18.2(4), to treat certain interest payments or “lease financing amounts” (as defined in subsection 18.2(1)) as “excluded interest” or to have the group ratio rule in subsection 18.21(2) apply. Conversely, a taxpayer may seek to cease being an eligible group entity in respect of another taxpayer in order to qualify (or allow another taxpayer to qualify) as an “excluded entity” for the year. Another example is that a taxpayer could seek to either become or cease to be an eligible group entity in respect of one or more other taxpayers in order to obtain a certain advantage under the transitional rules (contained in the enacting legislation for section 18.2) that apply for the purposes of determining taxpayers’ excess capacity for pre-regime years. As transfers of cumulative unused excess capacity from a financial institution group entity are generally limited to other financial institution group entities, taxpayers may seek to manipulate financial institution group entity status in order to become eligible to receive such a transfer, or to avoid the restrictions applicable where a transferor is a financial institution group entity.

In all of these scenarios, tax benefits would generally result, directly or indirectly, in the absence of this anti-avoidance rule.

The reference in subsection 18.2(9) to enabling “any taxpayer” to obtain a tax benefit allows the anti-avoidance rule to apply whether the tax benefit sought is that of either of the taxpayers that have become or ceased being eligible group entities in respect of one another, the taxpayer that has become or ceased to be a financial institution group entity or that of any other taxpayer.

Benefits conferred

ITA
18.2(10)

New subsection 18.2(10) provides that, for the purpose of Part I, a benefit is not considered to have been conferred on a transferee as a consequence of an election or amended election under subsection 18.2(4) between the transferor and the transferee. This new subsection applies whether or not property is acquired by the transferor as consideration for filing the election or amended election.

Consideration for election

ITA
18.2(11)

New subsection 18.2(11) provides rules that apply where property is acquired by a transferor as consideration for filing an election or amended election under subsection 18.2(4). If the property is owned by the transferee immediately before that time, the transferee is deemed to have disposed of the property at its fair market value but is not entitled to deduct any amount in respect of the transfer except any loss resulting from the deemed disposition. The cost at which the property was acquired by the transferor is considered to be equal to the property's fair market value. Neither the transferor nor the transferee is required to add any amount in computing income only because of the acquisition of the property or because of the filing of the election or amended election under subsection 18.2(4) (although the deemed disposition could result in an amount being added in computing the transferee's income).

Partnerships

ITA
18.2(12)

New subsection 18.2(12) is intended to effectively "look through" tiers of partnerships for the purposes of subsection 18.2.

Subsection 18.2(12) provides that a person or partnership that is a member of a partnership that is in turn a member of another partnership is also deemed to be a member of the other partnership. It also provides that a person's share of a partnership's income or loss includes the person's direct or indirect, through one or more other partnerships, share of that income or loss. In other words, a member's share of the income or loss of a lower-tier partnership includes the amount to which it is directly or indirectly entitled.

Anti-avoidance – interest and financing revenues and expenses

ITA
18.2(13)

New subsection 18.2(13) is an anti-avoidance rule that is intended to prevent a taxpayer's interest and financing revenues from being inflated, or its interest and financing expenses from being understated, as a result of certain types of transactions. If it applies, a particular amount that would otherwise be included in a taxpayer's interest and financing revenues under variable A of the definition of that term is not so included, or a particular amount that would otherwise be deducted in computing its interest and financing expenses under variable B of definition of that term is not so deducted.

Amounts included in a taxpayer's interest and financing revenues, or deducted in computing its interest and financing expenses, generally reduce a taxpayer's net interest and financing expenses that may be subject to the limitation in subsection 18.2(2) (or, in other cases, increase the taxpayer's "excess capacity", which can be used to allow the taxpayer to deduct interest and financing expenses from prior or future years, or to allow other group members to deduct interest and financing expenses). Although these amounts are included in computing the taxpayer's income or loss, the purpose of the anti-avoidance rule is to ensure these amounts are not taken into account in determining interest and financing revenues or expenses in appropriate circumstances.

The anti-avoidance rule applies if any of the requirements set out in paragraphs 18.2(13)(a) to (c) are satisfied. However, even if none of these requirements is satisfied in respect of a particular amount, the general anti-avoidance rule in section 245 may apply in appropriate circumstances.

Paragraph (a)

Paragraph 18.2(13)(a) addresses transactions involving non-controlled foreign affiliates. It applies if the particular amount is connected with a deduction in computing the foreign accrual property income (FAPI) of a corporation that is a foreign affiliate, but not a controlled foreign affiliate, of the taxpayer or of a person or partnership not dealing at arm's length with the taxpayer. This would be the case where, for example, a taxpayer receives an interest payment directly from a non-controlled foreign affiliate of the taxpayer, or indirectly from such an affiliate through an intermediary, and the interest payment is deductible in computing the affiliate's FAPI. These transactions raise integrity concerns in the context of the EIFEL rules in that, if they were to result in interest and financing revenues (or reductions to interest and financing expenses), this could effectively convert amounts that would otherwise have been included in an affiliate's taxable surplus or reduced an affiliate's taxable deficit – and thus could ultimately have resulted in an increase to the amount included in the taxpayer's adjusted taxable income on a subsequent distribution from the affiliate – into interest and financing revenues, while the affiliate's interest expense would not be included in computing the taxpayer's interest and financing expenses. This would provide an inappropriate tax benefit, since a dollar of interest and financing revenues results in greater capacity to deduct interest and financing expenses than a dollar of adjusted taxable income.

Paragraph (b)

Paragraph 18.2(13)(b) applies if the particular amount is, directly or indirectly and in whole or in part, received or receivable by the taxpayer (or a partnership of which it is a member) from

- a non-arm's length person that is
    - not subject to the EIFEL regime by reason of being an "excluded entity" (as defined in subsection 18.2(1)) or a natural person; or
    - if the taxpayer is not a "financial institution group entity" or an "insurance holding corporation" (both as defined in subsection 18.2(1)), a financial institution group entity; or
- a partnership, any member of which is an excluded entity, a natural person or, if the taxpayer is not a financial institution group entity, a financing institution group entity.

The transactions described in paragraph (b) raise integrity concerns because, absent subsection 18.2(13), they would allow payments between non-arm's length persons that have the effect of increasing the recipient's capacity to deduct interest and financing expenses (e.g., by generating interest and financing revenues), while a payer is indifferent to any corresponding increase in their interest and financing expenses because they are not subject to the EIFEL rules (e.g., an excluded entity or a natural person). In the case of a payment from a financial institution group entity to a non-arm's length person that is not such an entity, if an amount in respect of the payment were included in the payee's interest and financing revenues, this could allow, in substance, the same result as a transfer of cumulative unused excess capacity that is prohibited by paragraph 18.2(4)(c).

Paragraph (c)

Unlike paragraph (b), paragraph (c) is not limited to transactions among non-arm's length persons. In addition, the requirements set out in paragraph 18.2(13)(c) are conditioned on a "main purpose" requirement.

In particular, one of the main purposes of a transaction (defined in subsection 18.2(1) to include an arrangement or event) or series of transactions must be to include the particular amount under variable A of the definition "interest and financing revenues", in computing the taxpayer's interest and financing revenues, or under variable B of the definition "interest and financing expenses", in computing the taxpayer's interest and financing expenses. If a main purpose of any transaction in a series, or of the series as a whole, is to achieve one of these effects, this purpose test is met.

It is not necessary that all participants in a transaction or series intend that the transaction or series cause the amount to increase interest and financing revenues or reduce interest and financing expenses. Rather, the focus is on whether it is reasonable to consider that one of its main purposes is to have this effect. This would generally be determined from the perspective of the taxpayer whose interest and financing revenues and interest and financing expenses are being determined, or any other person or partnership that would benefit from an increase to the taxpayer's interest and financing revenues or a decrease in its interest and financing expenses (e.g., a person that may receive a transfer from the taxpayer's cumulative unused excess capacity as a result of an election under subsection 18.2(4)).

Two types of transactions or series of transactions are targeted by paragraph 18.2(13)(c).

Subparagraph (i)

The first is a transaction or series that results in a deductible amount that effectively offsets, in whole or in part, the income inclusion to the taxpayer in respect of the particular amount, where there is an asymmetry in treatment between that deductible amount and the particular amount under the EIFEL regime.

More particularly, the test is satisfied if the deduction is available to the taxpayer, or a person or partnership not dealing at arm's length with the taxpayer, in computing its income or loss for a taxation year, and the amount (for which the deduction is available) is not included in variable B of the "interest and financing revenues" definition or variable A of the "interest and financing expenses" definition. In other words, the test in this subparagraph is met if the deductible amount does not reduce interest and financing revenues or increase interest and financing expenses, such that there is an asymmetry between the treatment of the deductible amount and the particular amount under the EIFEL regime. This could occur, for example, where a taxpayer that is otherwise subject to an interest limitation under subsection 18.2(2) receives an interest payment (which, absent subsection 18.2(13), would be included in its interest and financing revenues) from a person or partnership that is indifferent to an increase in its interest and financing expenses (for example, because it has unused interest deduction capacity, or it is an excluded entity, a tax-exempt entity, a natural person or a non-resident) and, as part of the same transaction or series, the taxpayer makes a deductible payment back to the person or partnership that is not included in the taxpayer's interest and financing expenses (e.g., a service fee or royalty).

These transactions (or series) raise integrity concerns in that, absent subsection 18.2(13), the overall result is an increase to the taxpayer's interest and financing revenues in an amount that exceeds the net income inclusion to the taxpayer (or a person or partnership that does not deal at arm's length with the taxpayer). This result is, in substance, contrary to the basic principle that an amount is to be included in interest and financing revenues only to the extent it is included in computing income subject to tax.

Subparagraph (ii)

The second type of transaction targeted by paragraph 18.2(13)(c) is a transaction or series in which an amount that does not increase interest and financing revenues (or reduce interest and financing expenses) is converted, replaced or otherwise substituted with another amount that does. In other words, this subparagraph addresses transactions or series that put taxpayers in a more favorable position in terms of determining results under the EIFEL regime without otherwise materially altering the computation of income or loss for a taxation year.

This test is satisfied if two conditions are met, both of which compare how the particular amount, or an amount for which the particular amount is substituted, may reasonably be considered to have been treated had the transaction or series not occurred.

The first requires that the particular amount – or, if the particular amount was substituted for another amount, the other amount – would have been included in computing the income or loss of the taxpayer or a non-arm's length person or partnership. This condition is not satisfied if the particular amount or other amount, as the case may be, would have been included in computing the income or loss as a dividend. Thus, the rule does not apply where, for example, an equity instrument is replaced with a debt instrument.

The second test requires that the particular amount or other amount would not be included under variable A of the "interest and financing revenues" definition, or variable B of the "interest and financing expenses" definition. This ensures that the application of subparagraph 18.2(13)(c) is limited to cases where the transaction or series effectively converts or substitutes amounts that would not increase interest and financing revenues (or reduce interest and financing expenses) with amounts that, absent subsection 18.2(13), would result in such an increase or reduction.

For example, subparagraph (ii) may apply where one of the main purposes of the transaction or series was for the particular amount to increase interest and financing revenue or reduce interest and financing expenses and, absent the transaction or series, an amount would have been included in income but would not have increased interest and financing revenues or reduced interest and financing expenses. This can occur, for example, where the transaction or series results in a service or royalty agreement being replaced with a loan agreement.

GAAR

Subsection 18.2(13) does not purport to address all scenarios in which a transaction or series that increases interest and financing revenues or reduces interest and financing expenses is considered not to be appropriate in policy terms. It is intended that the general anti-avoidance rule may apply to any transaction that results in an increase of interest and financing revenues or a reduction in interest and financing expenses in appropriate circumstances, even where new subsection 18.2(13) may not otherwise apply.

Anti-avoidance – excluded entity

ITA
18.2(14)

New subsection 18.2(14) is an anti-avoidance rule for the definition "excluded entity" in new subsection 18.2(1). In general terms, an excluded entity is not subject to the deduction restrictions under new subsection 18.2(2), nor an income inclusion under paragraph 12(1)(l.2), in respect of its interest and financing expenses for the year.

The new definition "excluded entity" contains a condition, in subparagraph (c)(iv), that requires that, in order for a taxpayer to be an excluded entity, all or substantially all of the interest and financing expenses of the taxpayer and of any eligible group entity in respect of the taxpayer must be paid or payable to persons or partnerships other than non-arm's length tax-indifferent investors. For this purpose, new subsection 18.2(14) deems a person or partnership to be a non-arm's length tax-indifferent investor if an amount of interest and financing expenses is paid or payable to the person or partnership as part of a transaction or event or series of transactions or events, and it can reasonably be considered that one of the main purposes of the transaction, event or series is to avoid that amount being paid or payable to a non-arm's length tax-indifferent investor.

Example 1

Back-to-Back Transaction

Assumptions:

- *Canco1 is a corporation resident in Canada;*
- *Pensionco is a Canadian pension fund that is a tax-indifferent investor;*
- *Canco2 is a corporation resident in Canada that is not a tax-indifferent investor;*
- *Pensionco and Canco1 do not deal with each other at arm's length;*

- *Pensionco enters into a transaction with Canco2, and Canco2 enters into a transaction with Canco1 (the "Back-to-Back Transactions"); and*
- *Under the Back-to-Back Transactions, Pensionco loans funds to Canco2, and Canco2 loans funds to Canco1 on which interest is paid or payable to Canco2.*

Analysis:

If it can reasonably be considered that one of the main purposes of either of the Back-to-Back Transactions, or of the series that includes those transactions, is to avoid any portion of the interest and financing expenses of Canco1 being paid or payable to a non-arm's length tax-indifferent investor (in this case Pensionco), Canco2 will be deemed to be a non-arm's length tax-indifferent investor in respect of Canco1.

Example 2

Interest Strip Transaction

Assumptions:

- *Canco1 is a corporation resident in Canada;*
- *Forco is a non-resident corporation that is a tax-indifferent investor;*
- *Canco1 and Forco do not deal with each other at arm's length;*
- *Canco2 is a corporation resident in Canada that is not a tax-indifferent investor;*
- *Forco loans funds to Canco1 on which interest is paid or payable (the "Loan"); and*
- *Canco2 enters into a transaction with Forco (the "Interest Strip Transaction"), whereby Canco2 acquires the right to receive the amount of interest paid or payable on the Loan from Canco1, but not the principal amount of the Loan.*

Analysis:

If it can reasonably be considered that one of the main purposes of the Interest Strip Transaction is to avoid any portion of the interest and financing expenses of Canco1 being paid or payable to a non-arm's length tax-indifferent investor (in this case Forco), Canco2 will be deemed to be a non-arm's length tax-indifferent investor in respect of Canco1.

Deemed eligible group entities

ITA
18.2(15)

New subsection 18.2(15) is a deeming rule for the definition "eligible group entity" in new subsection 18.2(1). It deems two taxpayers to be eligible group entities in respect of each other where they are eligible group entities in respect of the same third taxpayer. The use of the term "taxpayer" in this provision is meant to include both corporations and trusts.

Eligible group entities – related

ITA
18.2(16)

New subsection 18.2(16) provides two rules relevant in determining whether entities are eligible group entities in respect of each other by reason of being related. For these purposes, a reference to a trust does not include the trustee (this rule is provided for greater certainty and based on paragraph 251.1(4)(c) in respect of "affiliated persons") and entities are not deemed to be related solely because of control by the Crown.

Eligible group entities – affiliated

ITA
18.2(17)

New subsection 18.2(17) provides two rules relevant in determining whether entities are eligible group entities in respect of each other by reason of being affiliated. For these purposes, entities are deemed not to be affiliated solely because of control by the Crown, or because an entity is a beneficiary that is a "majority-interest beneficiary" (within the meaning of subsection 251.1(3)) that is also an arm's-length registered charity or non-profit organization.

Allocated Group Ratio Amount

Section 18.21 sets out the "group ratio" rules that are available to potentially reduce a taxpayer's excessive interest and financing expenses limitation under subsection 18.2(2). In general terms, the group ratio rules allow a taxpayer to deduct interest in excess of the fixed ratio where the taxpayer is able to demonstrate that the ratio of the consolidated group's net third-party interest expense (referred to in the rules as "group net interest expense", as defined in subsection 18.21(1)) to the consolidated group's book EBITDA (referred to in the rules as the "group adjusted net book income", also defined in subsection 18.21(1)) exceeds the fixed ratio. In that case, Canadian group members can elect to determine their deductible amount of interest and financing expenses based on the consolidated group's ratio multiplied by the adjusted taxable incomes of the Canadian group members, subject to certain limitations. The group then allocates this deductible amount among the Canadian group members in the form that effects the election. This "flexible" allocation mechanism allows taxpayers to allocate the group ratio deduction capacity where it is most needed. The amount so allocated, referred to in these notes as the "allocated group ratio amount" or AGRA, replaces the fixed ratio amount otherwise applicable for variable B of the formula in subsection 18.2(2).

The group ratio rules contain certain limitations that are mainly intended to account for the possibility that some group members may have negative book EBITDA, or the group as a whole may have negative book EBITDA, such that a simple formulaic determination of the group ratio could give unreasonably high or meaningless results. Paragraph 18.21(2)(c) limits the AGRA to the lesser of the consolidated group's net third-party interest expense and the net adjusted taxable income of the Canadian group members.

Group ratio – definitions

ITA
18.21(1)

Subsection 18.21(1) sets out definitions that apply in determining the “allocated group ratio amount” (AGRA) of a taxpayer. Certain definitions in subsection 18.2(1) also apply in determining AGRA.

“acceptable accounting standards”

The definition “acceptable accounting standards” is relevant for the definition “consolidated financial statements” and, by virtue of subsection 18.21(6), the definitions “consolidated group”, “equity-accounted entity”, “group adjusted net book income”, “specified interest expense”, “specified interest income” and “ultimate parent”. It means International Financial Reporting Standards (IFRS) and generally accepted accounting principles in Canada, Australia, Brazil, member states of the European Union or the European Economic Area, Hong Kong (China), Japan, Mexico, New Zealand, the People’s Republic of China, the Republic of India, the Republic of Korea, Singapore, Switzerland, the United Kingdom and the United States. This list is predicated on the notion that differences between IFRS and generally accepted accounting principles in these jurisdictions would not provide a material competitive advantage or disadvantage to any entity using these standards.

“consolidated financial statements”

The definition “consolidated financial statements” is relevant for the definitions “consolidated group”, “equity-accounted entity”, “fair value amount”, “group adjusted net book income”, “net fair value amount”, “relevant period”, “specified interest expense”, “specified interest income” and “ultimate parent”. It is also referred to in subsections 18.21(2), (6) and (7). It means financial statements prepared in accordance with a relevant “acceptable accounting standard”, also defined in subsection 18.21(1), in which the assets, liabilities, income, expenses and cash flows of two or more entities are presented as those of a single economic entity.

For greater certainty, the consolidated financial statements include, for these purposes, the notes to the financial statements. The use of the word “relevant” before “acceptable accounting standards” is meant to ensure that there must be a logical connection between the entities so consolidated and the accounting standards that are used to present their economic results. For example, generally accepted accounting principles in New Zealand would not likely be relevant for presenting the financial results of a group of companies based entirely in North America.

This definition is subject to the interpretation rule in paragraph 18.21(6)(a), as described below.

“consolidated group”

The definition “consolidated group” is central to the AGRA rules in section 18.21.

A consolidated group means two or more entities in respect of which “consolidated financial statements” (also defined in subsection 18.21(1)) are required to be prepared for financial reporting purposes, or would be so required if the entities were subject to IFRS. Within the "consolidated group" definition, a "member of the consolidated group" is also defined for the purposes of section 18.21, being each such entity of the group, which includes an "ultimate parent" (also defined in subsection 18.21(1)). An "equity-accounted entity", also defined in subsection 18.21(1), is not considered a member of the group.

There are interpretive rules in paragraph 18.21(6)(a) and subsection 18.21(7) that apply for the purposes of this definition.

"equity-accounted entity"

The definition "equity-accounted entity" is relevant for the definitions "consolidated group", "group adjusted net book income", "specified interest expense" and "specified interest income". It means an entity the net income or loss of which is included in the consolidated financial statements of a consolidated group under the equity method of accounting. In general terms, these entities are not accounted for on a line-by-line basis in consolidated financial statements.

This definition is subject to the interpretive rule in paragraph 18.21(6)(a).

"equity interest"

The definition "equity interest" is relevant for the definition "specified non-member", also defined in subsection 18.21(1). It means a share of the capital stock of a corporation, an interest as a beneficiary under a trust, an interest as a member of a partnership or any similar interest in respect of any entity.

"fair value amount"

The definition "fair value amount" is relevant for the definition of "net fair value amount", which in turn, is relevant in the computation of "group adjusted net book income" (GANBI). It means an amount reflected in the net income or loss reported in the consolidated financial statements of the consolidated group where the carrying value of any asset or liability is measured using the fair value method of accounting and the amount reflects a change in the carrying value of the asset or liability that is included in either variable C (net income reported in the consolidated financial statements) or H (net loss reported in the consolidated financial statements) of GANBI.

This definition is subject to the interpretive rule in paragraph 18.21(6)(a).

"group adjusted net book income"

The definition "group adjusted net book income" (GANBI) is a key term in the AGRA rules as it is the amount used as the denominator in the "group ratio" determination. In essence, it is a consolidated group's EBITDA, as adjusted for certain items. It is based on the consolidated financial statements of the group for a relevant period.

GANBI is calculated by formula, in a similar fashion to the calculation of EBITDA in that items in respect of interest, tax, depreciation and amortization are added back to the net profit or loss of the enterprise to obtain an adjusted net profit or loss amount. The items identified to determine the GANBI, or the information required to determine the amount of certain items, generally will be found in the consolidated financial statements of the group, or may be found in the notes to such statements. Further work to determine amounts in the relevant working papers or from other sources may be necessary in order to properly calculate the GANBI.

Variables C, D, E, F and G are additions, and variables H, I, J, K, L, M and N are subtractions, in determining GANBI.

Variable C is the amount, if any, of the group's net income for the year as reported in its consolidated financial statements for the relevant period. If the group has a net loss for the year, it is picked up in variable H. "Relevant period" is also defined in subsection 18.21(1) and is described below.

Representing the "T" in EBITDA, variable D adds back the income tax expense of the group as reported in the consolidated financial statements.

Representing the "I" in EBITDA, variable E adds back the group's interest expense, by reference to the definition "specified interest expense", as described below. However, the latter definition is modified for GANBI purposes so that capitalized interest is not included in the add back, as it should be taken into account in the group's depreciation and amortization amount, because it is generally added to the capital cost of an asset and depreciated over time.

Variable F is generally intended to represent the "DA" in EBITDA, being the add backs for depreciation and amortization. Variable F also adds back charges taken in computing profit that are in respect of the impairment or the write-off of a fixed asset, any loss from the disposition of a fixed asset and, if the Canadian group members have elected to exclude fair value amounts from the calculation of GANBI in accordance with subsection 18.21(4), a negative net fair value amount. Finally, variable F adds back any expenses, charges, deductions or losses that are similar to those specifically enumerated.

Variable G relates to equity-accounted entities. As a general matter, the AGRA rules are intended to recognize the income (or loss) generated by such entities for purposes of GANBI. However, consistent with the EBITDA concept, the portions of such income or loss that relate to the typical EBITDA addbacks must also be accounted for. As such, it is necessary to obtain information in respect of the income tax (per variable D) and depreciation and amortization (per variable F) amounts of any equity-accounted entities and to add back the consolidated group's share of these amounts in the calculation of GANBI. As the definition "specified interest expense" already includes interest and related expenses in respect of equity-accounted entities, no further adjustment is required in this regard.

Variable H is the first of the negative adjustments in GANBI and addresses net losses reported in the consolidated financial statements.

Variables I to M essentially mirror the addback items but reflect income or receipts rather than expenses or charges that have been taken into account in the computation of the group's net profit or loss. In particular, variable K allows Canadian group members that have elected to exclude fair value amounts from the calculation of GANBI in accordance with subsection 18.21(4) to add back a positive net fair value amount.

Variable N excludes in calculating GANBI any portion of net income reported in the consolidated financing statements that can reasonably be considered to be derived from activities funded, in whole or in part, by a borrowing resulting in exempt interest and financing expenses.

If the result of the GANBI formula is negative, it is intended that section 257 would make GANBI nil.

This definition is subject to the interpretive rule in paragraph 18.21(6)(a) in respect of the use of accounting terms.

“group net interest expense”

The definition “group net interest expense” (GNIE) is a key term in the AGRA rules as it is the amount used as the numerator in the “group ratio” determination. In essence, it is a consolidated group’s net third party interest expense for a relevant period.

Variable A is the main component of the GNIE and is the amount by which the “specified interest expense” of the group exceeds the “specified interest income” of the group, for a relevant period. For more information, see the commentary on these defined terms.

Variable B represents the amount by which the variable A amount is reduced in arriving at the GNIE. It is generally meant to back out any interest paid to “specified non-members”, which are essentially entities that are not members of the consolidated group but that have a significant connection with the group. For more information, see the commentary on that defined term.

Variable E is the main component of variable B in that it adds up all amounts of “specified interest expense” that are paid or payable to specified non-members of the group. Variable F represents the amount by which the variable E amount is reduced for “specified interest income” received or receivable from the specified non-member in respect of which “specified interest expense” is paid or payable. Section 257 is intended to make E minus F nil in respect of a particular “specified non-member” where the amount for variable F is greater than the amount for variable E. In other words, “specified interest income” in respect of a “specified non-member” is only taken into account to the extent that it does not exceed “specified interest expense” in respect of the “specified non-member”.

“group ratio”

The definition “group ratio”, as its name suggests, is a key component of the group ratio rules in section 18.21. However, it is only one component of the AGRA – determined under subsection 18.21(2) – which is the ultimate amount that is used in the EIFEL provision in subsection 18.2(2).

The “group ratio” definition contemplates two scenarios.

Paragraph (a) provides that, if GANBI is a positive amount, the “group ratio” is determined as the ratio of GNIE to GANBI. If GANBI is not a positive amount, paragraph (b) provides that the group ratio is nil.

“net fair value amount”

The definition “net fair value amount” is relevant for paragraph (d) of variable F, and variable K, in the computation of “group adjusted net book income” (GANBI). It means the positive or negative total amount of all positive or negative fair value amounts in the consolidated financial statements.

“relevant period”

The definition “relevant period” refers to the period for which the consolidated financial statements of a consolidated group are presented. It is essentially the period in respect of which the amounts under section 18.21 are computed.

“specified interest expense”

The definition “specified interest expense” is a key component of the numerator (i.e., the GNIE) in the group ratio determination. It generally includes amounts of interest and similar types of financing expenses, as determined for financial reporting purposes.

Variable A adds up the various interest and financing expenses referred to in paragraphs (a) to (d). Variable B backs out any dividends included in those variable A amounts.

Paragraph (a) is the principal component of “specified interest expense” and includes all amounts of interest expense, whether reported as a line item itself in the consolidated financial statements or included in determining other such amounts.

Paragraph (b) deals with capitalized interest. This is generally intended to capture interest that is included in the balance sheet value of an asset.

Paragraph (c) includes guarantee fees, standby charges and arrangement or similar fees. These expense are not interest but are similar in nature in that they are generally related to borrowings or other credit facilities.

Paragraph (d) includes the consolidated group’s share of the interest and similar expenses of equity-accounted entities.

Exempt interest and financing expenses in respect of a Canadian public-private partnership infrastructure project are not included in “specified interest expenses”. For more information, see the commentary on the definition “exempt interest and financing expenses” in subsection 18.2(1).

Variable B is the total amount of dividends included in the determination of the amounts referred to in paragraphs (a) to (d) of variable A. It addresses the fact that some shares of corporations may be treated as debt for financial reporting purposes. Thus, any payment of dividends on such shares may be treated as a payment of interest expense for financial reporting purposes. However, these dividend payments are not deductible in computing the income of the paying corporation for tax purposes. As such, these dividends are excluded from “specified interest expense”.

This definition is subject to the interpretation rules in paragraphs 18.21(6)(a) and (b).

“specified interest income”

The definition “specified interest income” is the income analogue to the definition “specified interest expense” and is structured in a similar manner. The only exception is that capitalized interest has no income analogue.

“specified non-member”

The definition “specified non-member” is relevant for the GNIE definition. GNIE does not include any amount of “specified interest expense” that is paid or payable to a specified non-member. (These excluded amounts are reduced by “specified interest income” that is received or receivable from the specified non-member). Essentially, the concept of a “specified non-member” is intended to identify those persons or partnerships that are considered to have a close connection to a consolidated group, while not being members of the group.

Paragraph (a) includes certain persons or partnerships that do not deal at arm’s length with a member of the consolidated group.

Paragraph (b) looks up an ownership chain and targets certain situations where a person or partnership, alone or together with non-arm’s length parties, has “equity interests” (as defined, and discussed elsewhere in these notes) that give it 25% or more of the votes or value of a member of the consolidated group.

Paragraph (c) looks down an ownership chain and targets certain situations where a member of the consolidated group, alone or together with non-arm’s length parties, has “equity interests” (as defined, and discussed elsewhere in these notes) that give it 25% or more of the votes or value of another entity.

This definition is subject to the anti-avoidance rule in subsection 18.21(8).

“ultimate parent”

The definition “ultimate parent” is mainly relevant in relation to the definition “consolidated group” and refers to the top entity in the group’s organizational structure. It is the entity in respect of which the consolidated financial statements of the group are prepared.

This definition is subject to the interpretation rule in paragraph 18.21(6)(a).

Allocated group ratio amount

ITA
18.21(2)

Subsection 18.21(2) is the operative provision of the group ratio rule in section 18.21 and determines the “allocated group ratio amount” (AGRA) that may be used as an alternative to the fixed ratio’s interest deduction capacity under subsection 18.2(2).

If all conditions in subsection 18.21(2) are satisfied, corporations and trusts that are “eligible group entities” in respect of each other and that are members of the same consolidated group throughout a relevant period may elect to allocate an amount to each such entity (referred to as a

“Canadian group member”) under paragraph 18.21(2)(b) for each taxation year ending in the relevant period (referred to as a “relevant taxation year”). That amount (referred to in these notes as the “allocated group ratio amount” or AGRA) becomes, subject to the limitations set out in paragraph 18.21(2)(c), the amount determined under this subsection that replaces the amount otherwise used in variable B of subsection 18.2(2) under the fixed ratio rules.

“Eligible group entity” is defined in subsection 18.2(1) and requires each such entity to be resident in Canada.

Paragraph 18.21(2)(c) sets a limit on the total amount allocated. If that limit is exceeded, the AGRA is nil.

The AGRA limitation is the least of the following amounts:

- (i) The total of each amount that is a Canadian group member’s adjusted taxable income multiplied by the “group ratio” of the consolidated group. This subparagraph will not apply if the group ratio is nil. In that case, the limit will be the lesser of the amounts determined under subparagraphs (ii) and (iii).
- (ii) The “group net interest expense” (GNIE) of the consolidated group.
- (iii) The total of the “adjusted taxable income”, determined without reference to section 257, of each Canadian group member for the year. The override of section 257 is intended to ensure that aggregate taxable income is reduced by losses of any Canadian group members.

Similar to the transfer mechanism in subsection 18.2(4), subsection 18.21(2) allows for amended elections, subject to conditions, where a Canadian group member is reassessed, necessitating a reallocation of the allocated group ratio amount. For more information, see the commentary to subsection 18.2(4).

Late or amended election

ITA
18.21(3)

New subsection 18.21(3) authorizes the Minister to allow late-filed, amended or revoked elections under subsection 18.21(2) where the Canadian group members meet certain conditions and the Minister considers that it would be just and equitable to permit the change. This provision may be needed where, for example, the financial statements of the group are restated such that amounts relevant to the group ratio must be re-determined.

Fair value amounts - election

ITA
18.21(4)

Subsection 18.21(4) is the election required for “fair value amounts” to be excluded by Canadian group members from the calculation of GANBI. See the commentary to the definitions of “fair value amount”, “group adjusted net book income” and “net fair value amount”.

There is only one opportunity for Canadian group members to jointly make this election – which is the first time that a joint election is made under subsection 18.21(2) for the group ratio to apply. If this election under subsection 18.21(4) is made, an election under subsection 18.21(4) is deemed to have been made in each subsequent taxation year of each Canadian group member, and if such an election is not made, an election under subsection 18.21(4) is deemed not to have been made in each subsequent taxation year of each Canadian group member.

Assessment

ITA
18.21(5)

New subsection 18.21(5) requires the Minister of National Revenue to assess or reassess any taxpayer to take into account an election or amended election filed under subsection 18.21(2), even where the assessment or reassessment would otherwise be statute-barred.

Use of accounting terms

ITA
18.21(6)

Subsection 18.21(6) ensures that the allocated group ratio amount (AGRA) is determined largely by reference to accounting concepts. However, a specific exception is provided in the case of the term “dividend”, as used in the definitions “specified interest expense” and “specified interest income”. For these purposes, the term “dividend” is to be given its meaning for the purposes of the *Income Tax Act*.

Single member group

ITA
18.21(7)

Subsection 18.21(7) provides a number of deeming rules in respect of a “single member group”. These rules are intended to enable the application of the group ratio rules in section 18.21 to taxpayers that are not members of a consolidated group.

Anti-avoidance

ITA
18.21(8)

Subsection 18.21(8) provides an anti-avoidance rule in respect of the “group net interest expense” (GNIE) computation. It is intended to address the risk that the allocated group ratio amount could be deliberately inflated with amounts of interest and similar expenses that are paid or payable to certain third parties outside the consolidated group.

Specifically, where a portion of "specified interest expense" is paid or payable by a member of a consolidated group to a person or partnership that is not a member of the group as part of a transaction or a series of transactions, and it can reasonably be considered that one of the main purposes of the transaction or series is to avoid that portion being carved out of GNIE (which is what variable E of that definition would otherwise do), then the person or partnership is deemed to be a "specified non-member" in respect of the group for the relevant period. This would bring that portion and any other amount of specified interest expense paid or payable by a group member to that person or partnership for the relevant period squarely into variable E of the GNIE definition.

Example 1

Back-to-Back Transactions

Assumptions:

- *Canco is a corporation resident in Canada that is a member of a consolidated group (the "Group");*
- *Forco1 is a non-resident corporation that is not a member of the Group nor is it (absent the application of subsection 18.21(8)) a specified non-member of the Group;*
- *Forco2 is a non-resident corporation that is not a member of the Group but is a specified non-member of the Group;*
- *Forco2 loans funds to Forco1, and Forco1 loans funds to Canco on which interest is paid or payable to Forco1.*

Analysis:

If it can reasonably be considered that one of the main purposes of these transactions is to avoid the inclusion of any portion of the interest paid or payable by Canco in the amount for variable E in the GNIE definition, Forco1 will be deemed to be a specified non-member. If this is the case, the interest would be included in variable E of GNIE.

Example 2

Interest Strip Transaction

Assumptions:

- *Canco is a corporation resident in Canada that is a member of a consolidated group (the "Group");*
- *Forco1 is a non-resident corporation that is not a member of the Group nor is it (absent the application of subsection 18.21(8)) a specified non-member of the Group;*
- *Forco2 is a non-resident corporation that is not a member of the Group but is a specified non-member of the Group;*

- *Forco2 loans funds to Canco on which interest is paid or payable (the "Loan");*
- *Forco2 enters into a transaction with Forco1 (the "Interest Strip Transaction") whereby Forco1 acquires the right to receive the amount of interest paid or payable on the Loan from Canco, but not the principal amount of the Loan.*

Analysis:

If it can reasonably be considered that one of the main purposes of the Interest Strip Transaction is to avoid the inclusion of any portion of the interest paid or payable by Canco on the Loan in the amount for E in the GNIE definition, Forco1 will be deemed be a specified non-member. If this is the case, the interest would be included in variable E of GNIE.

Coming Into Force

New sections 18.2 and 18.21 apply in respect of taxation years of a taxpayer that begin on or after October 1, 2023, subject to an anti-avoidance rule and a transitional election.

Where applicable, the anti-avoidance rule accelerates the application of sections 18.2 and 18.21, as well as various related provisions, to a taxation year that begins before 2023 and ends in that year. The anti-avoidance rule applies if, as a result of a transaction or event, or series of transactions or events, any of the taxpayer's three taxation years immediately preceding its first taxation year that begins on or after January 1, 2023, is a "short" taxation year, and it is reasonable to consider that one of the purposes for the transaction, event or series was:

- to defer the application of the EIFEL rules to the taxpayer, or
- in effect, to increase the amount of any taxpayer's excess capacity, as determined under the transitional rules discussed below, for a taxation year preceding the effective date of the EIFEL rules.

Transitional Rules

There are two separate sets of transitional rules included in the enacting legislation for the EIFEL rules. The first is an anti-avoidance rule that denies a taxpayer the benefit of the 40% ratio of permissible expenses otherwise applicable for taxation years that begin on or after October 1, 2023 and before January 1, 2024, generally where the taxpayer undertakes a transaction to extend the period for which the 40% ratio applies. For more information, see the commentary on the definition "ratio of permissible expenses" in subsection 18.2(1).

The second set of transitional rules applies for the purpose of determining the cumulative unused excess capacity of a taxpayer that is a corporation or a fixed interest commercial trust for a taxation year, which is by definition determined based on the taxpayer's excess capacity for the year plus its excess capacity for the three immediately preceding taxation years (reflecting a three-year carry-forward of excess capacity). Absent these transitional rules, such a taxpayer would not have excess capacity for any of the three taxation years (referred to as the "pre-regime years") immediately preceding its first taxation year (referred to as the "first regime year") in respect of which the EIFEL rules apply, because the EIFEL rules otherwise do not apply in respect of the pre-regime years. These transitional rules, in effect, allow taxpayers to elect to determine their excess capacity for the pre-regime years in accordance with special rules and carry forward their excess capacity so determined for a pre-regime year for three taxation years, by including it in computing their cumulative unused excess capacity.

In order to benefit from these transitional rules, a taxpayer and all eligible group entities in respect of the taxpayer that are also corporations or fixed interest commercial trusts (referred to in the transitional rules as "eligible pre-regime group entities") must jointly elect to have these rules apply. Absent a valid joint election, the taxpayer's excess capacity for all its pre-regime years is deemed to be nil. For the purposes of these transitional rules, the eligible pre-regime group entities in respect of the taxpayer are determined at the end of the taxpayer's first regime year. The joint election must be filed by the filing-due date of the group member with the earliest filing-due date for the first regime year. The election must allocate the "group net excess capacity" (described below) for the pre-regime years among the taxpayer and eligible pre-regime group entities in respect of the taxpayer, and these allocated amounts are treated as their excess capacity for the specific pre-regime years to which they are allocated. The rules governing these allocations are explained in more detail below.

If a valid joint election is filed, a taxpayer's excess capacity for the pre-regime years is determined in accordance with special rules, which are required because a taxpayer's cumulative unused excess capacity for a taxation year is intended to include only the unused portions of its excess capacity for the three immediately preceding taxation years. In the steady-state system after the rules apply generally, the unused portion of excess capacity is determined, under the definition "cumulative unused excess capacity", by reducing excess capacity by the taxpayer's "absorbed capacity" and "transferred capacity", which represent the portions of its excess capacity that the taxpayer has already used to deduct its own excess interest and financing expenses (i.e., such expenses exceeding the amount it would have been permitted to deduct for the year under subsection 18.2(2)) or to allow other group members to deduct their excess interest and financing expenses in prior years. Since the EIFEL rules do not otherwise apply in respect of the pre-regime years, however, the taxpayer necessarily will not have used any of its excess capacity for pre-regime years for these purposes.

Special transitional rules are therefore provided to determine the taxpayer's unused excess capacity for the pre-regime years, in order to ensure consistency with the usual rules for determining a taxpayer's cumulative unused excess capacity and prevent it from being overstated. They are intended to approximate what the taxpayer's unused excess capacity would have been had the EIFEL rules applied in respect of the pre-regime years. Thus, they seek to replicate, in a relatively simple and administrable way, the extent to which the excess capacity of the taxpayer and eligible pre-regime group entities for pre-regime years would have been used to allow for the deduction of the excess interest and financing expenses of the taxpayer and eligible pre-regime group entities for pre-regime years.

In effect, the transitional rules net any excess interest and financing expenses of the taxpayer and eligible pre-regime group entities in respect of the taxpayer for any pre-regime years against any excess capacity of the taxpayer and those eligible pre-regime group entities for those years, in determining a taxpayer's excess capacity (as well as the excess capacity of the eligible pre-regime group entities). This is intended to approximate reductions for transfers of excess capacity to other group members that have excess interest and financing expenses in pre-regime years, which would have occurred had the EIFEL rules applied for pre-regime years, as well as reductions for where a taxpayer's excess capacity for one pre-regime year would have been used to allow the taxpayer to deduct its own excess interest and financing expenses in another pre-regime year.

The special rules for determining the taxpayer's excess capacity for each pre-regime year (which is, notionally, the unused portion of its excess capacity) can be broken down into three main steps.

The first step is to determine the "excess capacity otherwise determined" or "excess interest" of the taxpayer and each eligible pre-regime group entity for each pre-regime year. A taxpayer's "excess capacity otherwise determined" for a pre-regime year is the amount that would be determined as its excess capacity for that year if that definition applied in respect of the pre-regime year. A taxpayer's "excess interest" for a pre-regime year is the amount by which its interest and financing expenses for the year exceed the amount of interest and financing expenses that it would have been permitted to deduct for that year had subsection 18.2(2) applied in respect of that year. Subject to any group ratio election made by the taxpayer, the amount the taxpayer would have been permitted to deduct is determined as its ratio of permissible expenses multiplied by its adjusted taxable income, plus its interest and financing revenues.

In determining the excess capacity otherwise determined or excess interest of the taxpayer and each eligible pre-regime group entity for each pre-regime year:

- If a taxpayer was subject to a loss restriction event in a pre-regime year, its excess capacity otherwise determined or excess interest for any pre-regime year preceding that event is deemed to be nil.
- The ratio of permissible expenses that is to be used in determining these amounts is the one that, under the definition "ratio of permissible expenses" in subsection 18.2(1) (and subject to the above-noted anti-avoidance rule provided in the transitional rules), applies for the taxation year for which the taxpayer's cumulative unused excess capacity is being determined. Thus, for some corporate groups, the excess capacity otherwise determined or excess interest of the taxpayer and each eligible pre-regime group entity for each pre-regime must be determined twice: once using the 40% ratio of permissible expenses that generally applies for taxation years beginning on or after October 1, 2023 and before January 1, 2024, for the purpose of determining the taxpayer's cumulative unused excess capacity for those years; and a second time using the 30% ratio that applies for subsequent taxation years, for the purpose of determining the taxpayer's cumulative unused excess capacity for those subsequent years (this will generally be relevant for taxation years that begin in 2024 and 2025, and in 2026 for many taxpayers, given the three-year carry-forward period for excess capacity).

- As an alternative to using the applicable ratio of permissible expenses in determining excess capacity otherwise determined or excess interest, corporate groups can elect to have the group ratio rule in subsection 18.21(2) apply for one or more pre-regime years, provided they meet the conditions in that subsection (but with the filing deadline for the requisite election being determined by reference to the first regime year rather than a pre-regime year). While a group ratio election results in the taxpayer and eligible pre-regime group entities having nil excess capacity for the group ratio year, electing into the group ratio for a pre-regime year can nonetheless be beneficial in certain cases, in that it generally results in lower amounts of excess interest of the taxpayer or eligible pre-regime group entities for a pre-regime year.

The reason that taxpayers for which the 40% transitional fixed ratio applies for their first regime year are required to determine excess capacity otherwise determined and excess interest twice – once using the 40% ratio, and then again using the 30% ratio – is that no excess capacity that derives from the 40% transitional fixed ratio (in excess of what would be derived under a 30% ratio) is permitted to be carried forward to a taxation year in which the 30% ratio applies. Thus, these amounts must be computed using the 30% ratio in determining cumulative unused excess capacity for any taxation year for which the 30% ratio applies.

The second step is to determine the "group net excess capacity" for the pre-regime years, which is the total of the excess capacity otherwise determined of the taxpayer and all eligible pre-regime group entities for all pre-regime years, net of the total of the excess interest of the taxpayer and eligible pre-regime group entities for all pre-regime years. Thus, the group net excess capacity represents the net excess capacity of the corporate group for the period spanning the pre-regime years. Consistent with the approach under the EIFEL rules more generally, the excess capacity otherwise determined of any financial institution group entity is excluded in the determination of group net excess capacity.

In the case of taxpayers for whom the 40% ratio applies for their first regime year, the group net excess capacity is computed twice: the first time based on the excess capacity otherwise determined and excess interest of the taxpayer and each eligible pre-regime group entity for each pre-regime year as determined using the 40% ratio, and the second time based on those amounts determined using the 30% ratio.

The third step is to allocate, in the joint election under the transitional rules, the group net excess capacity to the taxpayer and the eligible pre-regime group entities for specific pre-regime years. The portion of the group net excess capacity that is allocated to a taxpayer or eligible pre-regime group entity for a pre-regime year is deemed to be the excess capacity of the taxpayer or eligible pre-regime group entity, as the case may be, for that pre-regime year. The allocated amount for a given pre-regime year thus effectively replaces the amount that would otherwise have been determined as the taxpayer's excess capacity (the taxpayer's "excess capacity otherwise determined") for the given pre-regime year under the definition "excess capacity" in subsection 18.2(1), if that definition applied in respect of pre-regime years. The taxpayer's deemed excess capacity for a pre-regime year is, in effect, subject to both the usual three-year carry-forward by virtue of being included in the taxpayer's cumulative unused excess capacity, and the ordinary rules under that definition that reduce excess capacity to reflect its utilization in the form of amounts of transferred capacity and absorbed capacity.

Where applicable, the group must make two allocations in its joint election: one for the group net excess capacity as determined using the 40% ratio, and the other for the group net excess capacity determined using the 30% ratio. The first allocation determines the excess capacity, for each pre-regime year, of the taxpayer and each eligible pre-regime group entity, for the purpose of determining their respective cumulative unused excess capacity for taxation years in which the 40% ratio applies (generally, taxation years beginning on or after October 1, 2023, and before January 1, 2024). The second allocation applies for the purpose of determining the respective cumulative unused excess capacity of the taxpayer and eligible pre-regime group entities for subsequent taxation years (given the three-year carry-forward period for excess capacity, this will generally be relevant for taxation years beginning in 2024 and 2025, and in 2026 for taxpayers whose first regime year is 2024). This means that, for some taxpayers, the amount deemed to be their excess capacity for a given pre-regime year will be different for the purpose of computing their cumulative unused excess capacity for their first regime year than for the purpose of computing their cumulative unused excess capacity for subsequent years.

In addition, these allocations must meet three specific requirements set out in the transitional rules, or else the taxpayer’s excess capacity for a pre-regime year is deemed to be nil. The first requirement is that the total amount of excess capacity that a taxpayer is allocated for its pre-regime years, from the group net excess capacity, cannot exceed its net excess capacity for its pre-regime years. A taxpayer’s net excess capacity for its pre-regime years is the amount, if any, by which the total of all amounts each of which is its excess capacity otherwise determined for any pre-regime year exceeds the total of all amounts each of which is its excess interest for any pre-regime year. Thus, if a taxpayer’s total excess interest for its pre-regime years is greater than or equal to its total excess capacity otherwise determined for its pre-regime years, then it cannot be allocated any excess capacity for any pre-regime years, and thus its excess capacity for each of those years will be nil for the purpose of determining its cumulative unused excess capacity for any taxation year. In that case, any net group excess capacity for the pre-regime years can be allocated only to eligible pre-regime group entities in respect of the taxpayer that have net excess capacity for the pre-regime years.

The second requirement is that the excess capacity allocated to a taxpayer for a given pre-regime year cannot exceed its excess capacity otherwise determined for that pre-regime year.

The third requirement is that the total excess capacity allocated to the taxpayer and eligible pre-regime group entities for their pre-regime years cannot exceed the group net excess capacity. If the corporate group allocates a total amount greater than the group net excess capacity, then the excess capacity of the taxpayer and all of the eligible pre-regime group entities for each of their pre-regime years is deemed to be nil.

Clause 4

Non-capital losses, etc., of predecessor corporations

ITA
87(2.1)

Subsection 87(2.1) allows a corporation formed on an amalgamation of two or more other corporations (referred to as a "new corporation" and the "predecessor corporations", respectively) to deduct the unclaimed losses of its predecessor corporations, subject to the restrictions on the use of losses imposed by section 111 and subsection 149(10) of the Act.

Consequential on the introduction of new section 18.2 and new paragraph 111(1)(a.1), which are part of the new excessive interest and financing expenses limitation regime, paragraphs 87(2.1)(a) and (b) are amended to provide similar "continuity" treatment in respect of unused restricted interest and financing expense of each predecessor corporation. "Restricted interest and financing expense" is the amount of interest and financing expenses for which deductions were denied under subsection 18.2(2) (or amounts were included in income under paragraph 12(1)(l.2)) in prior years. For more information, see the commentary on paragraph 111(1)(a.1) and the definition "restricted interest and financing expense" in subsection 111(8).

Subsection 87(2.1) is also amended to add new paragraph 87(2.1)(a.1).

New subparagraph 87(2.1)(a.1)(i) provides a similar continuity treatment in respect of the various amounts that are relevant in computing a taxpayer's cumulative unused excess capacity, which is defined in new subsection 18.2(1) and essentially reflects the three-year carry-forward of a taxpayer's excess capacity (as also defined in that subsection). This is intended to allow the cumulative unused excess capacity of the new corporation to be determined as though the new corporation were the same corporation as, and a continuation of, the predecessor corporations.

If new subsection 111(5.01) applies on a loss restriction event to restrict the cumulative unused excess capacity of a predecessor corporation, this restriction will also apply to the new corporation because subsection 111(5.01) provides that the restriction applies in respect of all taxpayers for all taxation years ending after the loss restriction event. For further information, see the commentary on that subsection.

New subparagraph 87(2.1)(a.1)(ii) applies a continuity rule where a non-capital loss of a predecessor corporation is attributable to deductions in respect of net interest and financing expenses. To the extent the new corporation deducts an amount in respect of the loss in a post-amalgamation year, this continuity rule is intended to ensure that an amount in respect of the portion of the loss deriving from the net interest and financing expenses is added back in determining the new corporation's "adjusted taxable income" (as defined in new subsection 18.2(1)) for the year. Thus, for the limited purpose of determining this add-back amount, subparagraph 87(2.1)(a.1)(ii) deems the new corporation to be the same corporation as the predecessor corporation, such that, for this purpose, the predecessor's interest and financing expenses and interest and financing revenues for the pre-amalgamation years are considered those of the new corporation.

Finally, paragraph 87(2.1)(d) is amended to ensure that the general rule that subsection 87(2.1) has no effect on the income of the new corporation does not prevent an amount in respect of interest and financing expenses from being deductible in a post-amalgamation year where the new corporation has cumulative unused excess capacity resulting from subparagraph 87(2.1)(a.1).

The amendments to paragraphs 87(2.1)(a) and (b) apply in respect of amalgamations that occur on or after October 1, 2023. New paragraph 87(2.1)(a.1) and amended paragraph 87(2.1)(d) apply in respect of amalgamations that occur in any taxation year.

Clause 5

Non-capital losses, etc., of subsidiary

ITA
88(1.1)

Subsection 88(1.1) allows a parent corporation under certain circumstances to carry forward the non-capital losses, restricted farm losses, farm losses and limited partnership losses of a subsidiary corporation that has been wound up.

Consequential on the introduction of new section 18.2 and new paragraph 111(1)(a.1), which are part of the new excessive interest and financing expenses limitation (EIFEL) regime, subsection 88(1.1) is amended in a number of respects to provide similar carry-forward treatment to a parent corporation in respect of the wound-up subsidiary's unused restricted interest and financing expense. A "restricted interest and financing expense" is the amount of the subsidiary's interest and financing expenses for which deductions were denied under new subsection 18.2(2), or amounts were included in income under paragraph 12(1)(l.2), in a prior taxation year. For more information, see the commentary on paragraph 111(1)(a.1) and the definition "restricted interest and financing expense" in subsection 111(8).

Subsection 88(1.1) is amended such that the carry-forward treatment in respect of the subsidiary's restricted interest and financing expense applies in respect of a parent corporation for the purposes of paragraph 111(1)(a.1), which is the provision that in certain circumstances allows such amounts to be deducted in computing a taxpayer's taxable income.

Consistent with the current approach to losses under subsection 88(1.1), the subsidiary's restricted interest and financing expense for a particular taxation year (referred to as the "subsidiary expense year") is allocated between a particular business carried on by the subsidiary (referred to as the "subsidiary's expense business"), to the extent it can reasonably be regarded as an expense or loss incurred in the course of carrying on the subsidiary's expense business, and any other source.

New paragraph 88(1.1)(d.2) deems the portion of the subsidiary's restricted interest and financing expense that is attributable to the subsidiary's expense business to be restricted interest and financing expense of the parent from carrying on the subsidiary's expense business for the parent's year in which the subsidiary's expense year ended. However, this deeming rule applies only to the extent that the conditions in paragraphs (a) and (b) of subsection 88(1.1) are met, which essentially require that the portion of a restricted interest and financing expense was not deducted by the subsidiary and would have been deductible to the subsidiary after the commencement of the winding-up. Consistent with the current treatment of losses under this subsection, the deemed restricted interest and financing expense is also deemed not to have been deductible by the parent for years beginning before the winding-up commenced.

New paragraph 88(1.1)(d.3) provides for similar treatment of the subsidiary's restricted interest and financing expense allocated to any other source.

Paragraph 88(1.1)(e) currently limits the use that can be made of the subsidiary corporation's non-capital losses and farm losses if either the parent or the subsidiary undergoes an acquisition of control. This paragraph is amended to ensure that this limitation applies similarly in respect of the subsidiary corporation's restricted interest and financing expenses.

Finally, paragraph 88(1.1)(f) currently allows the parent to elect to deem a loss of the subsidiary that would otherwise be a loss of the parent for a taxation year beginning after the commencement of the winding up to be a loss of the parent for the immediately preceding taxation year. New paragraph 88(1.1)(g) allows the parent to make a similar election if a portion of the subsidiary's restricted interest and financing expense would otherwise be the parent's restricted interest and financing expense for a taxation year beginning after the commencement of the winding up.

These amendments apply in respect of windings-up that begin on or after October 1, 2023.

Cumulative unused excess capacity of subsidiary

ITA
88(1.11)

New subsection 88(1.11) is part of the new excessive interest and financing expenses limitation regime located mainly in sections 18.2 and 18.21.

If a subsidiary corporation has been wound up in circumstances described in subsection 88(1.1), new subsection 88(1.11) applies for the purposes of determining the parent's cumulative unused excess capacity, which is defined in new subsection 18.2(1) and essentially reflects a three-year carry-forward of excess capacity (as also defined in that subsection).

This subsection is introduced to provide continuity treatment to the parent in respect of the subsidiary's cumulative unused excess capacity.

This is achieved by attributing to the parent the principal amounts that are relevant in determining the subsidiary's cumulative unused excess capacity. In particular, any absorbed capacity, excess capacity or transferred capacity (each as defined in subsection 18.2(1)) of the subsidiary for a taxation year is deemed to be absorbed capacity, excess capacity or transferred capacity, respectively, of the parent for its taxation year in which the subsidiary's year ends. By attributing to the parent not only the subsidiary's excess capacity, but also its absorbed capacity and transferred capacity, this rule, in effect, provides continuity in the parent only in respect of the subsidiary's excess capacity that is not "used" by the subsidiary before the winding-up.

Notably, if new subsection 111(5.01) applies on a loss restriction event to restrict the cumulative unused excess capacity of the subsidiary, that restriction will also apply to the parent because that subsection provides that the restriction applies in respect of all taxpayers for all taxation years ending after the loss restriction event. For further information, see the commentary on subsection 111(5.01).

New subsection 88(1.11) applies in respect of windings-up that begin on or after October 1, 2023.

Clause 6

Deemed year-end

ITA
91(1.2)

Subsection 91(1.2) is the operative provision of the "stub-period FAPI" rules. Its general effect is to ensure the appropriate amount of foreign accrual property income (FAPI) is included in a taxpayer's income under subsection 91(1) where:

- the taxpayer is subject to an acquisition of control and the FAPI earned by a foreign affiliate of the taxpayer prior to the acquisition of control is not included in another taxpayer's income because of the application of paragraph 95(2)(f.1); or
- the taxpayer's interest in a foreign affiliate is reduced in certain circumstances.

Subsection 91(1.2) is amended to include a reference to new clause 95(2)(f.11)(ii)(D), to make the stub-period FAPI rules applicable for the purposes of applying the new excessive interest and financing expenses limitation (EIFEL) rules in respect of taxpayers with controlled foreign affiliates.

For more information, see the commentary on clause 95(2)(f.11)(ii)(D).

This amendment applies in respect of taxation years of foreign affiliates ending in taxation years of taxpayers beginning on or after October 1, 2023. However, it also applies in respect of a taxation year of a foreign affiliate that ends in an earlier taxation year of a taxpayer if any of the three immediately preceding taxation years of the taxpayer is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 7

Adjusted cost base of share of foreign affiliate

ITA
92(1)

Subsection 92(1) provides additions and deductions that apply in computing, at any time in a taxation year, the adjusted cost base (ACB) to a taxpayer resident in Canada of any share owned by the taxpayer of the capital stock of a foreign affiliate of the taxpayer.

Paragraph 92(1)(a) is amended consequential on the introduction of new clause 95(2)(f.11)(ii)(D), which applies the new excessive interest and financing expenses limitation (EIFEL) to the computation of the foreign accrual property income (FAPI) of a controlled foreign affiliate.

For more information, see the commentary on clause 95(2)(f.11)(ii)(D).

This amendment ensures that any ACB adjustments under subsection 92(1) are determined without regard to any denials of deductions under new subclause 95(2)(f.11)(ii)(D)(I) in respect of relevant affiliate interest and financing expenses of a controlled foreign affiliate, or income inclusions under new subclause 95(2)(f.11)(ii)(D)(II) in respect of such expenses of a partnership of which a controlled foreign affiliate is a member.

If clause 95(2)(f.11)(ii)(D) applies with the overall effect of reducing a foreign accrual property loss (FAPL), this can result in the amount included in the taxpayer’s income under subsection 91(1) in a year when the FAPL is claimed being greater than it would have been in the absence of the application of that clause. In that case, the amendment to paragraph 92(1)(a) ensures that the ACB adjustment is determined based on the lesser amount that would have been included under subsection 91(1) if clause 95(2)(f.11)(ii)(D) had never applied.

This amendment applies in respect of taxation years of foreign affiliates ending in taxation years of taxpayers beginning on or after October 1, 2023. However, it also applies in respect of a taxation year of a foreign affiliate that ends in an earlier taxation year of a taxpayer if any of the three immediately preceding taxation years of the taxpayer is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 8

Deemed corporation

ITA
94.2(2)

Subsection 94.2(2) of the Act provides certain deeming rules that are relevant for the purposes of applying a number of provisions of the Act in respect of a trust that meets the conditions in subsection 94.2(1). Paragraph 94.2(2)(a) deems such a trust to be a non-resident corporation that is controlled by the beneficiary referred to in that subsection and, where applicable, by a taxpayer whose controlled foreign affiliate is such a beneficiary. Paragraph 94.2(2)(b) deems each beneficiary to own a proportion of the issued shares of each class that is commensurate with the fair market value of the beneficiary's beneficial interest in the corresponding class of interests in the trust.

Consequential on the introduction of new section 18.2, which is part of the new excessive interest and financing expenses limitation (EIFEL), subsection 94.2(2) is amended to provide that the deeming rules in that subsection also apply for the purposes of section 18.2 and the new definition “restricted interest and financing expense” in subsection 111(8).

This amendment applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 9

ITA
95(2)(f.11)

Paragraph 95(2)(f.11) provides certain application rules for the purposes of the foreign affiliate income, gain and loss computation rules in paragraph 95(2)(f). Subparagraph 95(2)(f.11)(ii) applies in respect of income or loss from property and non-active businesses of a foreign affiliate of a taxpayer, as required to be computed under subparagraph 95(2)(f)(ii) in respect of the taxpayer.

Clause 95(2)(f.11)(ii)(A) is amended to provide that the Act is to be read without reference to subsection 18.2(2) – the main operative rule in the new excessive interest and financing expenses limitation (EIFEL) regime – in determining the income or loss from property, non-active businesses and non-qualifying businesses of a controlled foreign affiliate of a taxpayer, which are generally required by subparagraph 95(2)(f)(ii) to be computed on the basis the affiliate is resident in Canada. The effect of this amendment is that, in computing a foreign affiliate's foreign accrual property income (FAPI), there is no separate determination under subsection 18.2(2) of the proportion of the affiliate's interest and financing expenses that are "excessive" and the deductibility of which would thus be denied if that subsection applied in computing FAPI. Since no such proportion is separately determined in respect of the affiliate under subsection 18.2(2), paragraph 12(1)(l.2) also does not apply to include amounts in the affiliate's FAPI in respect of interest and financing expenses of a partnership of which it is member. There is similarly no determination under the EIFEL rules of a foreign affiliate's "excess capacity" or "cumulative unused excess capacity", and no ability for a foreign affiliate to transfer or receive such amounts under subsection 18.2(4).

While subsection 18.2(2) applies only in respect of a taxpayer and not a foreign affiliate of the taxpayer, new subclause 95(2)(f.11)(ii)(D)(I) provides that where a proportion of a taxpayer's interest and financing expenses for a taxation year (referred to as a "taxpayer year") are determined under subsection 18.2(2) to be excessive and thus subject to denial under that subsection, the same proportion of a controlled foreign affiliate's "relevant affiliate interest and financing expenses" (as defined in subsection 18.2(1)) is denied in computing the affiliate's FAPI for an affiliate taxation year ending in the taxpayer year. Similarly, subclause 95(2)(f.11)(ii)(D)(II) includes in computing a controlled foreign affiliate's FAPI an amount, in respect of interest and financing expenses of partnerships of which the affiliate is member, that is also determined by reference to the proportion of the taxpayer's interest and financing expenses determined to be excessive under subsection 18.2(2).

Clause 95(2)(f.11)(ii)(D) applies only in respect of a foreign affiliate that is a controlled foreign affiliate of a taxpayer at the end of the affiliate taxation year. Thus, the EIFEL regime does not impact the computation of FAPI of foreign affiliates that are not controlled foreign affiliates. In addition, this clause does not apply in computing FAPI of a foreign affiliate in respect of a taxpayer that is an “excluded entity” (as defined in subsection 18.2(1)) for a taxation year in which the affiliate’s taxation year ends.

These amendments apply in respect of taxation years of foreign affiliates ending in taxation years of taxpayers beginning on or after October 1, 2023. However, they also apply in respect of a taxation year of a foreign affiliate that ends in an earlier taxation year of a taxpayer if any of the three immediately preceding taxation years of the taxpayer is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 10

Agreement or election of partnership members

ITA
96(3)

Subsection 96(3) provides rules that apply if a member of a partnership makes an election under certain provisions of the Act for a purpose that is relevant to the computation of the member's income from the partnership. In such a case, the election will be valid only if it is made on behalf of all the members of the partnership and the member has authority to act for the partnership.

Consequential on the introduction of the new excessive interest and financing expenses limitation (EIFEL) regime, subsection 96(3) is amended to add a reference to the definition “excluded interest” in new subsection 18.2(1). As a result, a member of a partnership that is a payee or payer of an amount of interest or a “lease financing amount” (as defined in subsection 18.2(1)) may make an election on behalf of all members of the partnership under paragraph (e) of that definition to treat that amount as excluded interest for purposes of the EIFEL regime (provided the other requirements of that definition are satisfied).

This amendment applies in respect of taxation years that begin on or after October 1, 2023.

Clause 11

Restricted interest and financing expenses

ITA
111(1)(a.1)

New paragraph 111(1)(a.1) permits taxpayers to deduct in computing taxable income for a taxation year such portion as they may claim of their restricted interest and financing expense for taxation years preceding the year, not exceeding the amount determined by the formula A + B included in the provision, as described below.

A taxpayer's "restricted interest and financing expense" for a taxation year is a new defined term in subsection 111(8). Generally, it represents the amount of the taxpayer's interest and financing expenses for the year for which deductions were denied under new subsection 18.2(2) (or in respect of which amounts were included in income under new paragraph 12(1)(l.2)).

For more information, see the commentary on the new definition "restricted interest and financing expense" in subsection 111(8).

The amount a taxpayer may deduct under paragraph 111(1)(a.1) for a taxation year in respect of its restricted interest and financing expense for prior years is limited to the taxpayer's excess capacity for the year plus its total received capacity for the year (where both of those terms are as defined in new subsection 18.2(1)). For this purpose, the taxpayer's excess capacity is the amount it would be if no amount were deductible by the taxpayer under paragraph 111(1)(a.1). The effect, when taken together with the reduction to excess capacity under variable C in the definition of that term, is that a taxpayer's excess capacity for a taxation year is first applied to allow the taxpayer to deduct its unused restricted interest and financing expense from prior years, and the taxpayer can then elect to transfer any remaining excess capacity to other group members under subsection 18.2(4). For more information, see the commentary to the definition "excess capacity" in subsection 18.2 and to subsection 18.2(4).

While, unlike certain losses to which subsection 111(1) applies, restricted interest and financing expense can only be carried forward to future taxation years, and not back to prior years, the rules, in effect, provide a three-year carry-forward of excess capacity, as reflected in the taxpayer's cumulative unused excess capacity (as defined in subsection 18.2(2)). This provides comparable results to a three-year carry-back of restricted interest and financing expense.

New paragraph 111(1)(a.1) applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Limitation on deductibility

ITA
111(3)

Subsection 111(3) of the Act sets out limitations on the amount that can be deducted or claimed under subsection 111(1) in respect of a non-capital loss, net capital loss, restricted farm loss, farm loss or limited partnership loss.

Subparagraph 111(3)(a)(i) reduces the amount that a taxpayer can deduct, in computing taxable income for a particular taxation year, in respect one of these losses for a taxation year by the total of amounts deducted in respect of the loss in preceding taxation years. Paragraph 111(3)(b) is an ordering rule that provides that no amount is deductible in respect of a non-capital loss, net capital loss, restricted farm loss, farm loss or limited partnership loss for a taxation year until a loss of the same type for a preceding taxation year has been deducted (i.e., losses of each type must be deducted in the order in which they arose).

Subparagraph 111(3)(a)(i) and paragraph (b) are amended consequential on the introduction of new paragraph 111(1)(a.1), which is part of the new excessive interest and financing expenses limitation regime whose core rules are in new sections 18.2 and 18.21. These amendments ensure that deductions under paragraph 111(1)(a.1) for restricted interest and financing expense are subject to limitations similar to those that already apply to losses.

The amendment to subparagraph 111(3)(a)(i) ensures that amounts deducted in respect of a restricted interest and financing expense in preceding taxation years under paragraph 111(1)(a.1), in computing taxable income or a non-capital loss, will reduce the amount deductible in respect of the restricted interest and financing expense in later taxation years. As a result of the amendment to the ordering rule in paragraph 111(3)(b), the same first-in, first-out rules that apply to losses will also apply to restricted interest and financing expense.

Paragraph 111(3)(a) is also amended to include new subparagraph (a)(iii), which is relevant where subsection 18.2(2) restricts a deduction under paragraph 111(1)(e) in respect of an amount claimed by a taxpayer in respect of a limited partnership loss. For more information, see the commentary on paragraph (i) of the definition "interest and financing expenses" in subsection 18.2(1).

New subparagraph (a)(iii) ensures that the portion of the claimed amount that is restricted under subsection 18.2(2) can only be applied in future taxation years as a restricted interest and financing expense and subject to the requirements of paragraph 111(1)(a.1).

These amendments apply in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Loss restriction event – certain losses and expenses

ITA
111(5)(a)

Paragraph 111(5)(a) of the Act provides that, if a taxpayer is subject to a loss restriction event, the taxpayer's non-capital losses and farm losses for a taxation year ending before that event are deductible by it in computing its taxable income for later years only if certain conditions are met.

Consequential on the introduction of new paragraph 111(1)(a.1), which is part of the new excessive interest and financing expenses limitation (EIFEL) regime whose core rules are in new sections 18.2 and 18.21, paragraph 111(5)(a) is amended to restrict, in a manner similar to non-capital losses and farm losses, the deductibility of a taxpayer's restricted interest and financing expenses for taxation years ending before a loss restriction event. Such expenses will be deductible by the taxpayer in a taxation year ending after that event only to the extent they can reasonably be regarded as having been incurred in the course of carrying on a business, the taxpayer carries on that business in the later year and the conditions in subparagraphs 111(5)(a)(i) and (ii) are satisfied.

This amendment applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Loss restriction event – cumulative unused excess capacity

ITA
111(5.01)

New subsection 111(5.01) of the Act is introduced in connection with the new excessive interest and financing expenses limitation (EIFEL) regime, the core rules of which are in new sections 18.2 and 18.21. This subsection is intended to ensure that, where a particular taxpayer is subject to a loss restriction event at any time, its excess capacity for taxation years ending before that time cannot be utilized by the particular taxpayer (or any other taxpayer) in a taxation year ending after that time.

To ensure this result, in general terms, certain pre-loss-restriction-event amounts are disregarded for taxation years ending after the loss restriction event. In particular, the cumulative unused excess capacity of any taxpayer for any taxation year ending after that time is determined without regard to the various amounts of the particular taxpayer for taxation years ending before that time that are otherwise relevant to the determination of cumulative unused excess capacity (specifically, the particular taxpayer's absorbed capacity, excess capacity and transferred capacity).

A taxpayer's "cumulative unused excess capacity" for a taxation year generally represents the unused portion of its excess capacity for the three immediately preceding years. It can be used by a taxpayer, in certain circumstances, to either deduct interest and financing expenses that would otherwise be denied under subsection 18.2(2), or to allow another member of the corporate group to do so by designating a portion of the cumulative unused excess capacity as "received capacity" of the other member in an election under subsection 18.2(4). Thus, the main effect of subsection 111(5.01) is to prevent the excess capacity of the particular taxpayer that was subject to the loss restriction event, for taxation years ending before that event, from being used for any of these purposes in taxation years ending after that event. For more information, see the commentary on the definition "cumulative unused excess capacity" in new subsection 18.2(1).

Notably, the restriction in subsection 111(5.01) applies in respect of "any taxpayer for any taxation year" that ends after the loss restriction event. Thus, for example, if the particular corporation that was subject to the loss restriction event subsequently amalgamates with another corporation, the restriction in subsection 111(5.01) will apply in determining the cumulative unused excess capacity of the new corporation resulting from the amalgamation, notwithstanding subsection 87(2.1).

New subsection 111(5.01) applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Definitions

ITA
111(8)

Subsection 111(8) set out the definitions that apply for the purpose of section 111. The amendments to this subsection apply in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

“non-capital loss”

The definition “non-capital loss” determines a taxpayer’s non-capital loss for a taxation year using a formula. Variable E of this formula lists certain amounts to be included in a taxpayer’s non-capital loss.

Consequential on the introduction of new paragraph 111(1)(a.1), which is part of the new excessive interest and financing expenses limitation regime, variable E is amended to include, in determining a taxpayer’s non-capital loss for a taxation year, an amount deducted in the year under paragraph 111(1)(a.1), in respect of the taxpayer’s restricted interest and financing expense for a preceding taxation year.

“restricted interest and financing expense”

New definition “restricted interest and financing expense” is introduced in conjunction with the new excessive interest and financing expenses limitation in new section 18.2.

A taxpayer’s restricted interest and financing expense for a taxation year is, in general terms, the portion of its interest and financing expenses for the year (as defined in subsection 18.2(1)) for which a deduction is denied by ne subsection 18.2(2), or that results in an income inclusion under paragraph 12(1)(l.2) in respect of the taxpayer’s share of the interest and financing expenses of a partnership of which it is a member.

A taxpayer’s restricted interest and financing expense also includes its share of the portion of a controlled foreign affiliate’s relevant affiliate interest and financing expenses (as defined in subsection 18.2(1)) for which a deduction is denied by new clause 95(2)(f.11)(ii)(D) in computing foreign accrual property income (FAPI). It also includes the taxpayer’s share of a

FAPI inclusion under that clause in respect of the affiliate's share of the interest and financing expenses of a partnership of which it is a member. In both cases, the taxpayer's share is determined by reference to its specified participating percentage (as defined in subsection 18.2(1)) in respect of the affiliate for the affiliate taxation year.

For more information, see the commentary on new clause 95(2)(f.11)(ii)(D) and the definition "specified participating percentage" in subsection 18.2(1).

The definition "restricted interest and financing expense" is most directly relevant to new paragraph 111(1)(a.1), which generally allows a taxpayer to carry forward its restricted interest and financing expense for a taxation year and deduct it in computing its taxable income for any of its subsequent taxation years, to the extent of its excess capacity and received capacity for any of those years, subject to any applicable restrictions under subsection 111(3), paragraph 111(5)(a) and section 256.1.

For more information, see the commentary on paragraph 111(1)(a.1).

The amendments to section 111 apply in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Exception

ITA
111(9)(a)

Subsection 111(9) restricts the loss carryovers that a taxpayer may claim for a year during which the taxpayer was not resident in Canada. The general purpose of the rule is to ensure that non-residents cannot apply, against Canadian-source income, losses from sources that are outside the Canadian tax system.

The preamble of this subsection is amended to add a reference to a taxpayer's restricted interest and financing expense for a taxation year. This amendment ensures that a taxpayer's restricted interest and financing expense for a year during which it is not resident in Canada is subject to the same restrictions that apply in respect of loss carryovers.

This amendment applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 12

Definitions

ITA
248(1)

Subsection 248(1) of the Act defines various terms that apply for the purposes of the Act.

Subsection 248(1) is amended to add the definitions “absorbed capacity”, “cumulative unused excess capacity”, “excess capacity”, “interest and financing expenses”, “interest and financing revenues” and “transferred capacity”, so that the definitions of these terms in subsection 18.2(1) apply for the purposes of the Act (except, in the case of the definition “interest and financing expenses”, for the purposes of the definition “economic profit” in subsection 126(7)).

Subsection 248(1) is also amended to add the definition “restricted interest and financing expense”, so that the definition of this term in subsection 111(8) applies for the purposes of the Act.

This amendment applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 13

Definitions

ITA
256.1(1)

“specified provision”

The definition “specified provision” is relevant in applying the anti-avoidance rules in subsections 256.1(3) and (6), which deem an acquisition of control to occur in certain circumstances.

This definition is amended to add a reference to new subsection 111(5.01), which restricts the extent to which amounts may be included in determining a taxpayer’s cumulative unused excess capacity (as defined in new subsection 18.2(1)) following a loss restriction event. This amendment ensures that the restriction in subsection 111(5.01) is treated similarly to other provisions referred to in this definition.

This amendment applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 14

ITR
5903(5)

Subsection 5903(5) provides for the flow-through of foreign accrual property losses (FAPLs) on certain foreign mergers or liquidations involving foreign affiliates.

Consequential on the introduction of the new excessive interest and financing expenses limitation (EIFEL) regime, subsection 5903(5) is amended to extend its application to new section 18.2. This ensures that, in computing the adjusted taxable income (as defined in new subsection 18.2(1)) of a taxpayer, a foreign merger or liquidation does not prevent the application of certain add-backs in respect of FAPLs of controlled foreign affiliates.

For more information, see the commentary on the definition “adjusted taxable income” in subsection 18.2(1).

This amendment applies in respect of taxation years of foreign affiliates ending in taxation years of taxpayers beginning on or after October 1, 2023. However, it also applies in respect of a taxation year of a foreign affiliate that ends in an earlier taxation year of a taxpayer if any of the three immediately preceding taxation years of the taxpayer is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 15

Interpretation

ITR
5907(1)

Subsection 5907(1) provides definitions for the purposes of Part LIX of the Regulations.

In connection with the introduction of the new excessive interest and financing expenses limitation (EIFEL) regime, the definitions “earnings”, “net earnings” and “net loss” are being amended.

These amendments apply in respect of taxation years of foreign affiliates ending in taxation years of taxpayers beginning on or after October 1, 2023. However, they also apply in respect of a taxation year of a foreign affiliate that ends in an earlier taxation year of a taxpayer if any of the three immediately preceding taxation years of the taxpayer is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the reasons for the transaction, event or series was to defer the application of the EIFEL regime.

“earnings”

The definition “earnings” is relevant for the purpose of computing the surpluses and deficits of a foreign affiliate. Subparagraph (a)(iii) of the definition provides that earnings from an active business of a foreign affiliate of a taxpayer resident in Canada for a taxation year means the amount that would be the affiliate's income from the active business for the year under Part I of the Act if the business were carried on in Canada, the foreign affiliate were resident in Canada and the Act were read without reference to certain of its provisions. That subparagraph applies only where the affiliate is not required by the income tax law of the country in which it is resident, or carries on the business, to compute the income or profits from the active business.

Subparagraph (a)(iii) is amended to add a reference to new subsection 18.2(2) so that, in determining the amount that would be the foreign affiliate's income from an active business, the Act is to be read without reference to the main operative rule of the new EIFEL regime.

“net earnings”

The definition “net earnings” is relevant for the purposes of computing the surpluses and deficits of a foreign affiliate. Paragraph (b) of the definition ensures that the foreign accrual property income (FAPI) of a foreign affiliate is included in computing the affiliate's “taxable earnings” and, ultimately, “taxable surplus” or “taxable deficit”.

Paragraph (b) is amended to provide that a controlled foreign affiliate’s FAPI for purposes of determining its net earnings is to be determined without regard to the application of new clause 95(2)(f.11)(ii)(D) of the EIFEL rules. This ensures that the affiliate’s “taxable earnings” and “taxable surplus” or “taxable deficit” are determined without regard to any of the following:

- a denied deduction under new subclause 95(2)(f.11)(ii)(D)(I) in respect of the affiliate’s relevant affiliate interest and financing expenses; and
- a FAPI inclusion under new subclause 95(2)(f.11)(ii)(D)(II) in respect of interest and financing expenses of partnerships of which the affiliate is a member.

For more information, see the commentary on clause 95(2)(f.11)(ii)(D).

“net loss”

The definition “net loss” is relevant for the purposes of computing the surpluses and deficits of a foreign affiliate. Subclause (b)(i)(A)(I) of the definition is amended on a similar basis to the amendment to paragraph (b) of the definition “net earnings”, described above.