

# CPTS Breakfast Series

15(2)/17(1)/Cash Pooling

1 November 2023

# 15(2)/17(1)/Cash Pooling

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1. 15(2) and 17(1) legislative refresher
2. Some potential pitfalls
3. What is a cash pooling arrangement?
4. Cash pooling – CRA audit and M&A issues
5. Pertinent loan or indebtedness (PLOI) – background and some current issues

## Key takeaways

While the shareholder loan rules have been around for a considerable amount of time, more recent legislative changes (PLOI, certain foreign affiliate amendments, application of 15(2) to partnerships) have introduced additional complexity. Furthermore, recent CRA interpretations have introduced additional considerations in this area.



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# Loans owed by non-residents – subsection 15(2) refresher

- ▶ For ITA 15(2) to apply, there must be a shareholder, a corporation, and a debt owed by the shareholder to the corporation
- ▶ The shareholder must be a person or partnership that is neither a Canadian corporation nor a partnership whose membership is composed entirely of corporations resident in Canada
- ▶ The rules apply not only to a person or partnership that is itself a shareholder of a corporation, but also to a person or partnership that is
  - ▶ Connected \*\*\* with the shareholder of a corporation; or
  - ▶ a member of a partnership, or a beneficiary of a trust, that is a shareholder of a corporation.

\*\*\* a person or partnership is connected with a shareholder of a corporation if the person or partnership

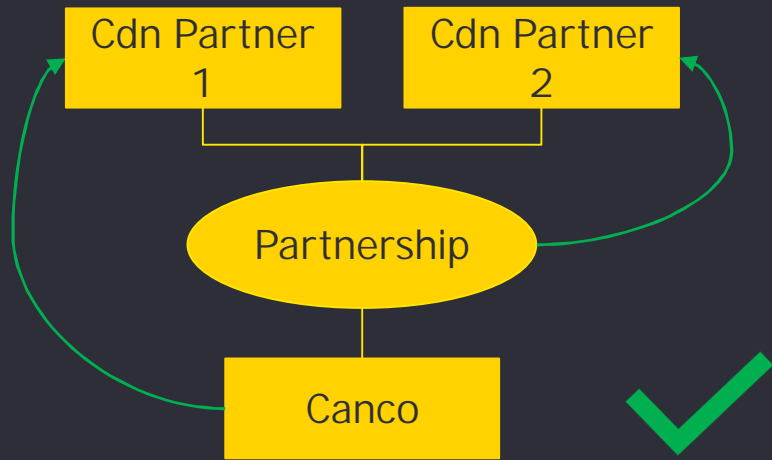
- ▶ does not deal at arm's length with the shareholder; and
- ▶ is not a foreign affiliate of
  - ▶ the corporation, or
  - ▶ a person resident in Canada with which the corporation does not deal at arm's length.

## Exceptions to ITA 15(2)

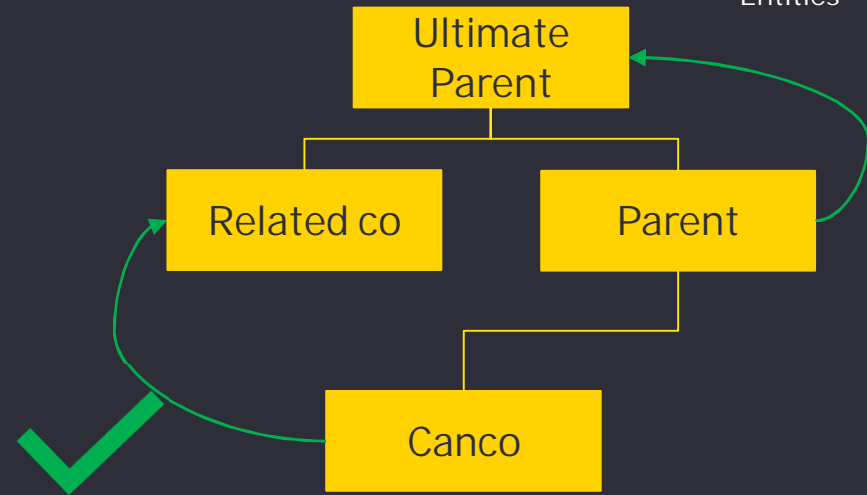
15(2.11)	pertinent loan or indebtedness (PLOI) received or incurred after March 28, 2012
15(2.2)	indebtedness between non-resident persons
15(2.3), 15(2.31)	debt arising in the ordinary course of the creditor's business (e.g., a sale) or a loan made in the ordinary course of the lender's ordinary business of lending money
15(2.4)	debt owed by shareholder-employee in their capacity as employee
15(2.5)	debts owed to private corporations by certain trusts
15(2.6)	debt repaid within one year after the end of the taxation year of the creditor in which the debt arose - cannot be part of a series of loans or other transactions and repayments

# Some quick examples

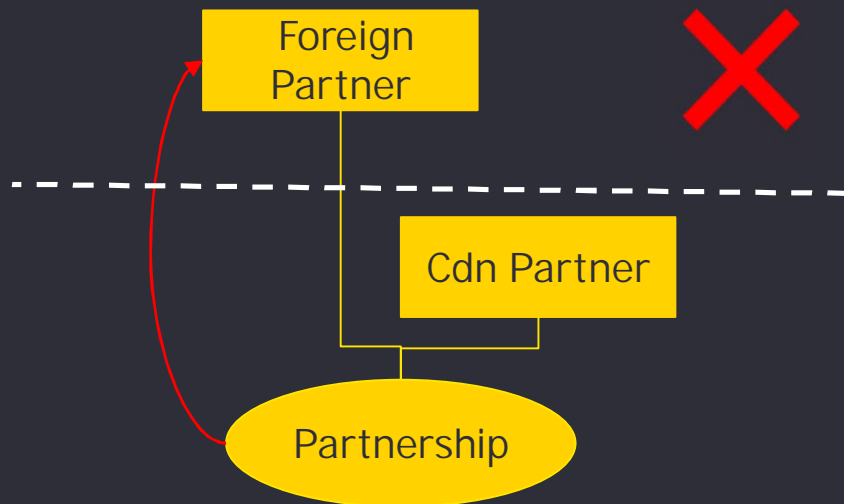
All Canadian Entities



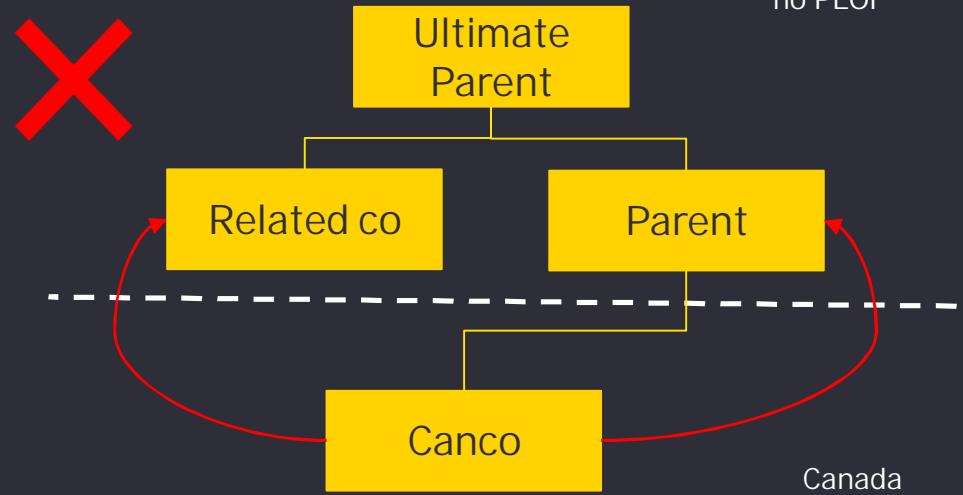
All Canadian Entities



Foreign jurisdiction no PLOI



Foreign jurisdiction no PLOI



# Loans owed by non-residents – subsection 17(1) refresher

- ▶ A Canadian-resident corporation may be deemed to receive income if it is owed money by a non-resident person and the interest payable on the debt is less than a prescribed amount.
- ▶ If the amount owed has been or remains outstanding for more than a year from the time it was advanced or loaned, subsection 17(1) deems the corporation to receive income, unless it meets certain exceptions.
- ▶ The deemed income inclusion is calculated as the amount by which interest on the amount owing, computed at the CRA's prescribed rate, exceeds the actual interest received or receivable in the year in respect of the amount owing for the periods in the year.

## Exceptions to ITA 17(1)

17(7)	withholding tax has been paid on the amount owing (e.g. 15(2) loan)
17.1	Section 17 does not apply to a loan that is a pertinent loan or indebtedness (PLOI)

### What is a pertinent loan or indebtedness (PLOI)?

Subsection 15(2.11) provides an exception to subsection 15(2) deemed dividend for a pertinent loan or indebtedness (PLOI) received or incurred after March 28, 2012.

The exception is available where the Canadian-resident corporation is controlled by the non-resident debtor or a non-arm's length non-resident. Filing of joint election provides no deemed dividend under paragraph 214(3)(a). Instead, the loan will be subject to interest imputation under section 17.1.

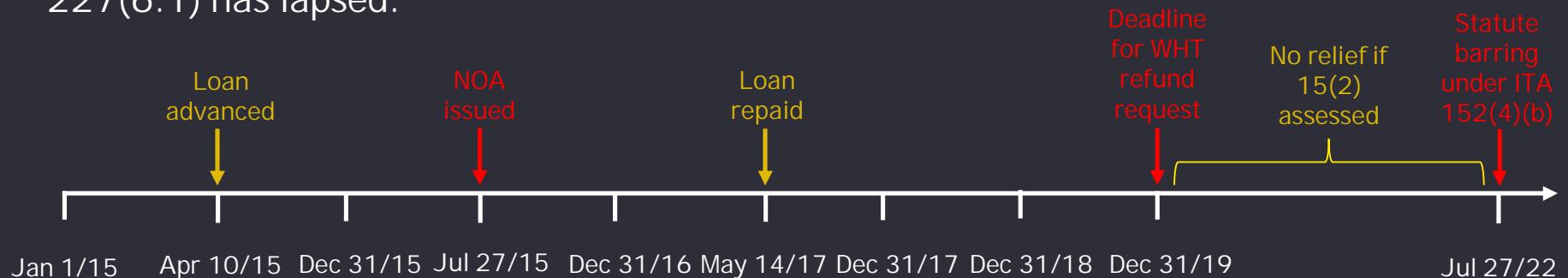
PLOI elections also available to partnership structures in certain fact patterns.

# Potential pitfalls

1. Inappropriate reliance on subsection 15(2.3) – this subsection provides that trade amounts are excluded from subsection 15(2). A frequent pitfall is reliance on this subsection when the trade receivable are not paid within 12 months. In this fact pattern CRA considers such amounts to be subject to subsection 15(2):

“When trade debts are not paid according to the creditor's normal terms of payment, but such debts are settled within 12 months of being incurred, bona fide arrangements are considered to have been made at the time the indebtedness arose.” [Source: IT-119R4 – Debts of Shareholders and Certain Persons Connected With Shareholders dated August 7, 1998 at paragraph 15.]

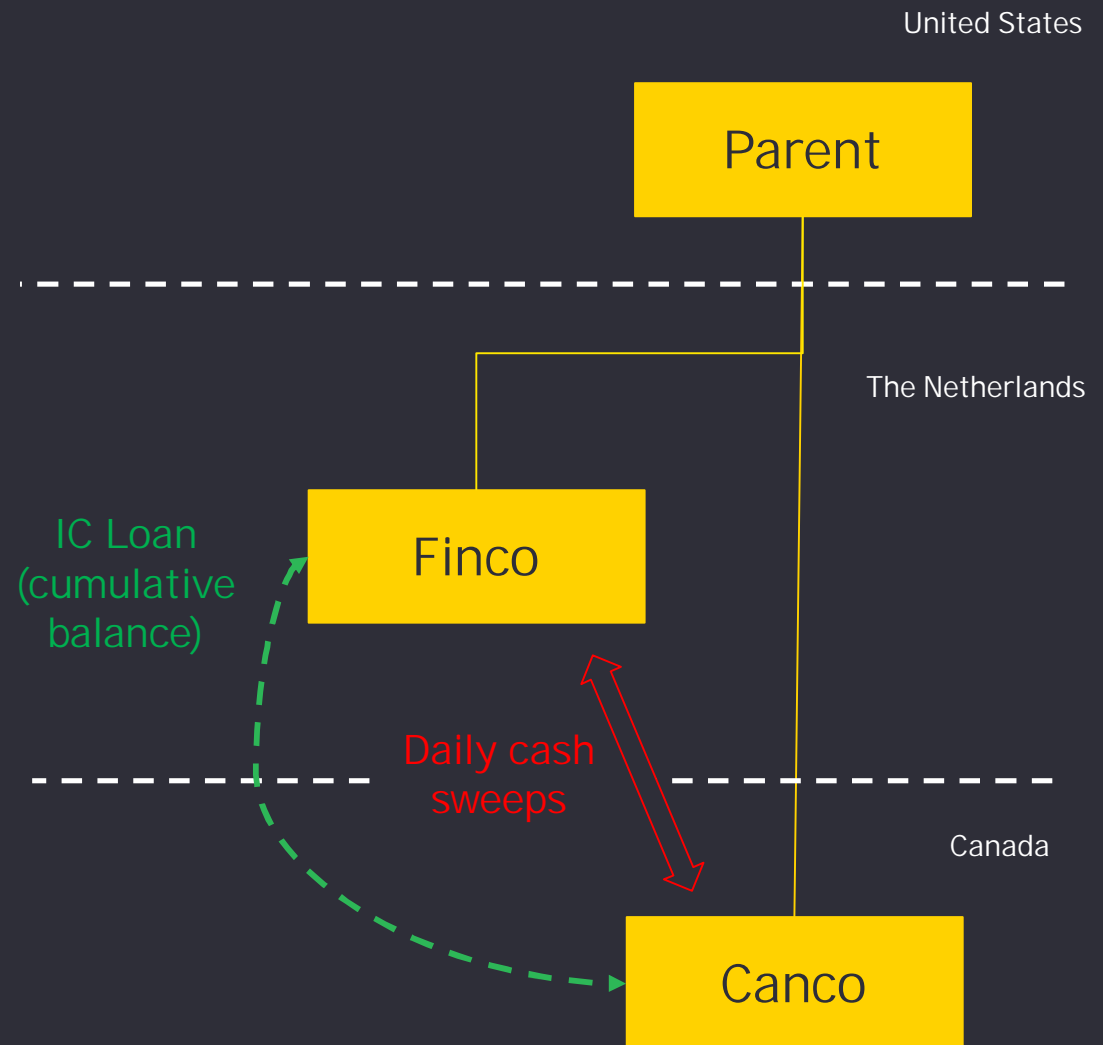
2. Application of 15(2) will be a “wash” because amount was repaid – Subsection 227(6.1) which provides for a refund of withholding tax paid on a subsection 15(2) provided such request must be made within two years following the calendar year that includes the repayment. However the assessment of tax under Part XIII of the Act is not subject to any statute of limitations and the extended statute of limitation for transactions with non-arm's length non-residents can increase the risk of a 15(2) assessment after access to subsection 227(6.1) has lapsed:



# What is a cash pooling arrangement?

- ▶ Not defined in the ITA
- ▶ Commonly used by multinational to manage liquidity and reduce global borrowing costs
- ▶ CRA discusses in ITR 2017-068263117:
  - ▶ Two types: 1) physical cash pooling and 2) notational cash pooling
  - ▶ Since notational cash pooling arrangements do not move cash, avoid 15(2) risk
  - ▶ No general directorate policy on cash pooling arrangements – each plan analyzed on the particular facts
  - ▶ Directorate approach is to “break the cash pooling arrangement down into its constituent parts and applying the provisions of the Act on the basis of the underlying legal rights and obligations or relationships”

## Physical Cash Pooling Example Structure



# Cash pooling – tax compliance issues

- ▶ In order to appropriately manage tax consequences, transaction data must be obtained for cash pooling arrangements on a daily basis. The accuracy and completeness of this data is crucial where pertinent loan or indebtedness (PLOI) elections are made.

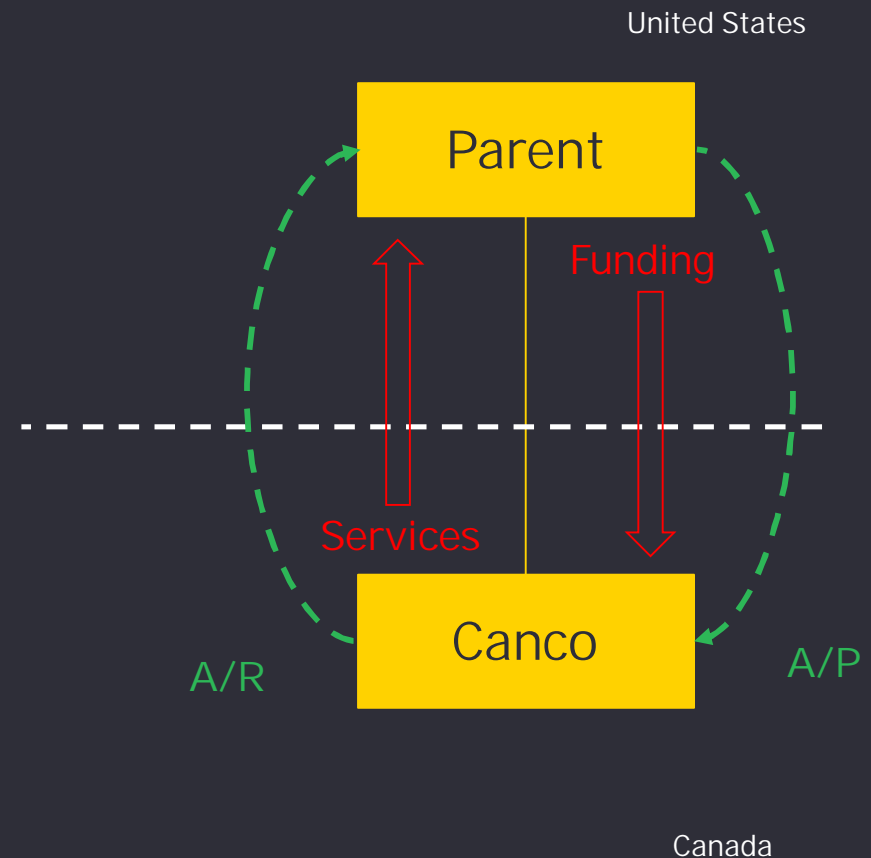
Date	Amount Lent to Parent	Repayment Amount	Cumulative Balance	Loan Repaid Date
04/01/2021	81,613.72	(122,420.58)	10,241,278.68	01/02/2021
05/01/2021	241,166.42	(5,383.34)	10,477,061.76	01/02/2021
06/01/2021	2,176,804.10	-	12,653,865.86	01/02/2021
07/01/2021	-	(2,183,967.11)	10,469,898.75	
12/01/2021	113,006.58	(169,509.87)	10,413,395.46	01/02/2021
14/01/2021	80,514.80	-	10,493,910.26	01/02/2021
15/01/2021	9,366.01	(65,449.06)	10,437,827.21	01/02/2021
19/01/2021	-	(37,965.62)	10,399,861.59	
20/01/2021	-	(5,154,202.40)	5,245,659.19	
21/01/2021	1,875,442.51	(47,940.73)	7,073,160.97	04/02/2021
22/01/2021	239,846.56	-	7,313,007.53	04/02/2021
25/01/2021	210,320.04	(24,200.00)	7,499,127.57	04/02/2021
26/01/2021	-	(56,503.29)	7,442,624.28	
27/01/2021	24,387.33	(24,387.33)	7,442,624.28	04/02/2021
29/01/2021	10.00	-	7,442,634.28	04/02/2021
31/01/2021	3,107.48	(7.99)	7,445,733.77	04/02/2021

- ▶ Considerations:
  - ▶ Most cash pooling arrangements provide for payments to be applied to the oldest borrowing (FIFO)
  - ▶ Net daily advances and repayments or account for each transaction?
  - ▶ How to incorporate interest?



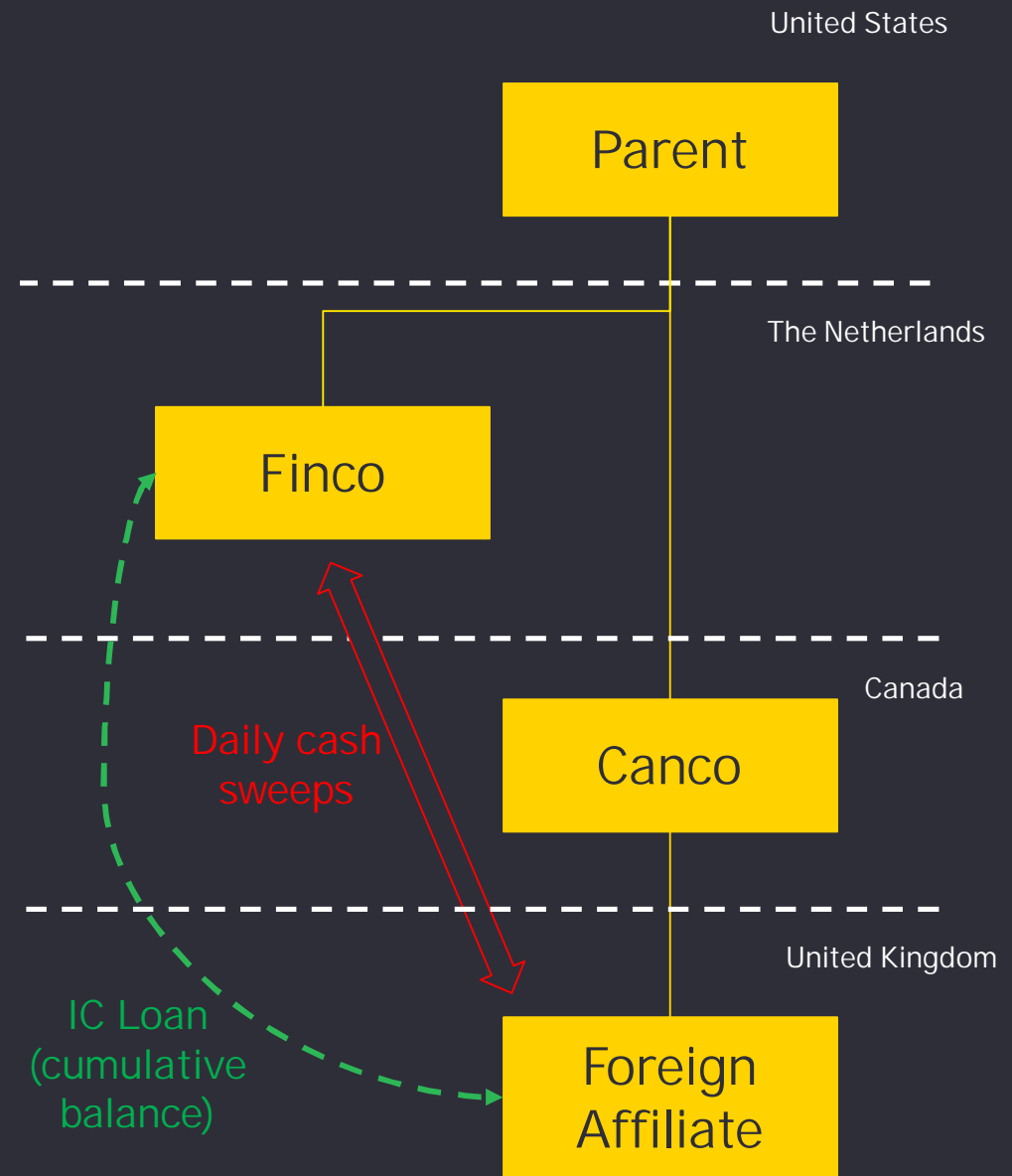
# Managing M&A transactions and CRA audits

- ▶ Tracking is also important to manage queries in the course of a tax due diligence or CRA audit
  - ▶ T106s show Canco receivables owing by NR parent in respect of services rendered
  - ▶ Target advised that the receivables are repaid regularly since parent sends cash down to fund Canco's operations
  - ▶ But Canco's TB shows a receivable balance for services and a separate intercompany payable balance
- ▶ Importance of proper documentation
  - ▶ Tracking and positions taken
  - ▶ Legal agreements and corporate resolutions
  - ▶ Accounting records
- ▶ Even though there is no mischief, the risk exists



# Managing M&A transactions and CRA audits

- ▶ Similar issues arise in a 'sandwich' structure due to 90(6) upstream loan rules
- ▶ Is repayment part of a series of loans or other transactions and repayments?
  - ▶ ITR 2017-068263117 – "... the Cash Pooling Arrangement appears to be structured in a manner that results in automatic daily cash sweeps which produce a "rolling forward" of the inter-company loans from Canco to Finco. If that is the case, we believe that a respectable argument could be made that the automatic daily cash sweeps constitute a series of loans or other transactions and repayments and as such, the exception under subsection 15(2.6) should not apply as it would otherwise result in a perpetual deferral of the inclusion under subsection 15(2)."



# Other PLOI considerations

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## 1. Compliance considerations

- ▶ PLOI interest is calculated daily
- ▶ PLOI election requires disclosure of monthly borrowings and repayments
- ▶ Ability to amend PLOI election if initial data was incomplete or incorrect
- ▶ New forms for PLOI election coming in F24

## 2. PLOI and 247

- ▶ 17.1 provides for deemed income inclusion to Canco for a PLOI at the prescribed rate (9%), less actual rate of interest, if any
- ▶ CRA was asked whether 247(2) can apply to the loan (resulting in additional income if arm's length rate is greater than 9% and potential TP penalties)
- ▶ ITR 2019-080548117 (Sept 6, 2023):
  - ▶ "Subsection 247(2) can apply to debts owing by a non-resident person to a Canadian resident corporation with which the non-resident person does not deal at arm's length, to which subsection 17.1(1) applies. (...) there is no conflict between those two provisions and they do not interfere with their policy objectives."

## 3. PLOI and 80.4(2)

- ▶ 80.4(2) imputes an interest benefit on a shareholder (or connected person) where Canco has made a low or no interest loan, thereby giving rise to a deemed dividend and withholding tax
- ▶ The benefit is computed as interest at the prescribed rate less "the amount of interest for the year paid on all such loans and debts" (80.4(2)(e)(i))
- ▶ Assuming Canco has a 15(2) and made a PLOI election, but there is no interest on the loan or interest is just accrued and not paid – CRA has proposed to assess a benefit under 80.4(2)

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