

Subsection 89(11) Election Not To Be a CCPC for Certain Purposes: Be Careful What You Wish For

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The ITA has two primary corporate tax regimes that relate to private corporations: the Canadian-controlled private corporation (CCPC) regime and the non-CCPC regime. As always, the definitions of the two regimes are fairly straightforward. And, as always, the complexities lie in the details.

A CCPC is defined in subsection 125(7) to be any private corporation that is a Canadian corporation, other than certain exceptions that are outlined in paragraphs (a) through (d). A private corporation is defined under subsection 89(1) to include, generally speaking, any corporation that is resident in Canada, is not a public corporation, and is not controlled by a public corporation. A Canadian corporation is one that is incorporated in Canada or resident in Canada.

A non-CCPC, in the context of this article, is any private corporation that meets the definition of "private corporation" set out above but otherwise does not meet the conditions of a CCPC.

One important feature of this dichotomy is that when a corporation changes its status from CCPC to non-CCPC, or vice versa, a deemed year-end occurs immediately before the change, pursuant to subsection 249(3.1) . The purpose of this provision is presumably to divide the regular fiscal year into a "CCPC portion" and a "non-CCPC portion," with a view to simplifying the calculation of taxes and certain other tax attributes. However, if the deemed year-end falls in the middle of a business cycle, a mid-year change in year-end could be disruptive to an operating business.

To mitigate this issue, a corporation that is undergoing a status change could make an election under subsection 89(11) . A corporation that makes this election is deemed not to be a CCPC at any time in or after the particular taxation year, for the purposes described in paragraph 125(7)(d) of the definition of "Canadian-controlled private corporation." These purposes are as follows:

- the small business deduction, pursuant to subsection 125(1) ;
- the eligible dividend regime, specifically, and subsections 89(4) to (6) and (8) to (10), paragraphs 87(2)(vv) and (ww), and the definitions "excessive eligible dividend designation" (EEDD), "general rate income pool" (GRIP), and "low rate income pool" (LRIP) in subsection 89(1); and
- the deemed year-end pursuant to subsection 249(3.1) , as discussed above.

It should be noted that paragraph 125(7)(d) includes no reference to section 123.3. As we discuss below, this causes inconsistencies in how subsection 89(11) is applied. The election takes effect at the beginning of the year to which it applies. In other words, a CCPC is deemed not to be a CCPC for the above-listed purposes from the first day of the year to which the election applies. Therefore, because of

the exception related to subsection 249(3.1) , a CCPC making this election is exempt from the deemed year-end rule and continues to use its natural year-end. CRA technical interpretation 2014-0550191I7 (October 22, 2014) reflects this position.

It should be noted that the recently introduced "substantive CCPC" regime did not contain any corresponding amendments to subsection 89(11) . Subsection 248(1) defines a "substantive CCPC" as a private corporatio

- that is not a CCPC *and*
- that is controlled, directly or indirectly, by one or more Canadian residents.

Therefore, it is assumed that a CCPC that changes its status to that of a substantive CCPC could elect under subsection 89(11) and still be exempt from the deemed year-end rule.

To illustrate this concept, let us consider an example. A corporation, Aco, that is a CCPC has a natural year-end of December 31, 2023, and its sole shareholder, Mr. A, leaves Canada on December 1, 2023. If no election were made, the result for Aco, pursuant to subsection 249(3.1), would be a deemed year-end of November 30, 2023. If, during 2023, Aco made an election under subsection 89(11), the corporation would be deemed to become a non-CCPC for the purposes of subsection 249(3.1), effective January 1, 2023. Thus, the deemed year-end of November 30, 2023 would be avoided, and Aco would continue to use December 31 as its year-end.

This seems straightforward enough. The corporation must keep in mind, however, that this election has other consequences. As noted above, the subsection 89(11) election also causes the corporation not to be a CCPC for the purposes of the eligible dividend regime. This result, given that the election takes effect on the first day of the year, could have unintended consequences if a corporation pays dividends early in the fiscal year but does not decide to make this election until later in the year.

Generally speaking, a CCPC with a GRIP balance available has a choice of paying either eligible dividends (to the extent that there is GRIP) or non-eligible dividends.

A non-CCPC, however, does not have this choice. The subsection 89(11) election is deemed to take effect on the first day of the year; therefore, a non-CCPC is required by subsection 89(8) to calculate its opening LRIP balance as of that date. Furthermore, a non-CCPC is required to pay out non-eligible dividends to the extent that it has an available LRIP balance, on the basis of paragraph (b) of the definition of EEDD in subsection 89(1). A non-CCPC can pay eligible dividends only after the LRIP balance is reduced to nil.

If, therefore, a corporation pays eligible dividends early in the year and then files the subsection 89(11) election later in that same year, this election could put those eligible dividends offside the EEDD calculation (because of the fact that subsection 89(8) may cause the corporation to have an LRIP balance) and subject the corporation to the penalty tax under section 185.1.

Another potential trap is the filing-due date for the election. The wording of subsection 89(11) indicates that the election is due on or before the filing-due date of the corporation for a particular taxation year. Therefore, if a corporation has a December 31, 2023 year-end, the filing-due date for the election would apparently be June 30, 2024.

To illustrate, let us return to the example above. Mr. A left Canada on December 1, 2023. If no election were made, Aco would have a deemed year-end of November 30, 2023, pursuant to subsection 249(3.1). If the subsection 89(11) election were made, Aco would be exempt from the deemed year-end rule and would have no year-end on November 30, 2023. Therefore, it would seem that Aco's filing-due date for the election would be June 30, 2024, which is the filing-due date for Aco's T2 for the year ending on December 31, 2023. In technical interpretation 2010-0377251E5 (October 20, 2010), however, the CRA's position is that the filing-due date of the election is based on the notional deemed year-end, despite the fact that the result of making the election is that no deemed year-end occurs. We question whether the CRA's position is correct, given that subsection 89(11) clearly refers to "a corporation that files with the Minister on or before its filing-due date for a particular taxation year an election in prescribed form to have this subsection apply." Cautious tax advisers may want to follow the CRA's position. A subsection 89(11) election is not permitted to be late-filed because it is not a prescribed election for the purposes of subsection 220(3.2).

Another question is how to calculate taxes in a year in which a corporation makes a subsection 89(11) election. Returning to the example above, let us assume that Aco earned property income in both the period of January 1 to November 30, 2023 and the period of December 1-31, 2023. Logically, it seems that the property income earned before Mr. A's departure should be subject to refundable dividend tax, and the property income earned after his departure should not be: a factual change in CCPC status would occur on December 1 because of the change in Mr. A's residence. This is the case despite the fact that the election deems there not to be a year-end at that point in time. However, no mechanism for addressing this situation seems to exist in the Act. Refundable dividend tax is charged under section 123.3, the preamble of which states that refundable tax applies if the corporation is a CCPC throughout the year or a substantive CCPC at any point in time during the year. In this particular case, Aco is not a CCPC throughout the year. This is because, once Mr. A leaves Canada and becomes a non-resident, the requirement in paragraph (a) of the definition of CCPC—that a corporation not be controlled by a non-resident—is no longer met. Furthermore, Aco would not be a substantive CCPC, since Mr. A is no longer a resident of Canada. The fact that Aco is neither a CCPC throughout 2023 nor a substantive CCPC at any time in the year would seem to indicate that no refundable tax would be applicable to any of the taxable income that Aco earned in 2023. This result makes little sense, but it appears to be in line with the legislation. We note, in particular, that section 123.3 is not among the provisions listed in paragraph (d) of the CCPC definition in subsection 125(7), for which a corporation that has made an election under subsection 89(11) is deemed not to be a CCPC. And yet the consequence seems to be the same. We also note that the CRA has no position on this matter.

In addition, the T2 corporate tax return itself is inconsistent with subsection 89(11) in the following respects:

- The T2 requires the preparer to disclose that a corporation made a subsection 89(11) election during the year. As noted above, this election has several consequences, only one of which involves a change in the corporation's status. However, the T2 provides no place for the taxpayer to indicate that the specific purpose of the election was to avoid a deemed year-end caused by an actual change in status of the corporation. Also, it is not possible for the taxpayer to indicate that a corporation is a non-CCPC that made a subsection 89(11) election during the year: attempting to provide such an indication will generate an efile exclusion in certain types of professional tax-preparation software, and—if the return is paper-filed—it will probably result in a followup query from the CRA. Rather, certain professional tax-preparation software forces the selection of "CCPC" in box 40 as the type of corporation when a subsection 89(11) election is made for that particular year.

- If the subsection 89(11) election is made in a year when the corporation's status factually changed from a CCPC to a non-CCPC, and the corporation earned property income during that year, the logical result should be that refundable tax is charged for the portion of the year when the corporation was a CCPC and is not charged for the portion when the corporation was not a CCPC. However, section 123.3 does not read this way, and it does not allow taxable income to be bifurcated in this way. But professional tax-preparation software requires the corporation making the 89(11) election to indicate on the T2 that it is a CCPC, with the result that refundable tax is charged for the whole year. This result is not consistent with a literal reading of section 123.3.

As we have noted in the past, the ITA has grown so complex that certain provisions do not appear harmonized with other provisions. A complete review of the statute is long overdue.

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BIBLIOGRAPHIC INFORMATION

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