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REFDATE 130906  
SUBJECT "more closely connected business activities"  
SECTION 212.3(16)

Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CRA. Prenez note que ce document, bien qu'exact au moment émis, peut ne pas représenter la position actuelle de l'ARC.

PRINCIPAL ISSUES: For purposes of the "more closely connected business activities" test in paragraph 212.3(16)(a), is the subject corporation required to carry on active business activities itself?

POSITION: No

REASONS: To determine whether the investment of a particular corporation resident in Canada ("CRIC") in a particular subject corporation meets the business activities test contained in paragraph 212.3(16)(a), the business activities of the subject corporation and all subject subsidiary corporations (as that term is described in paragraph 212.3(16)(a)), on a collective basis, must be considered

XXXXXXXXXX

2013-047467  
Angelina Argento

September 6, 2013

Dear XXXXXXXXXXXX:

Re: Paragraph 212.3(16)(a) "more closely connected business activities"

We are writing to you in response to your email query of January 15, 2013, wherein you ask us to assume the following hypothetical facts:

1. NR Parent is a non-resident corporation.
2. Canco is a corporation resident in Canada which carries on an active business in Canada. Canco is controlled by NR Parent.
3. US Holdco is a corporation resident in the United States. US Holdco is a wholly-owned subsidiary of Canco. US Holdco is a controlled foreign affiliate (as that term is defined in subsection 95(1) of the Income Tax Act ("Act") of Canco). US Holdco is a holding company and does not carry on any active business activities directly.
4. US Opco is a corporation resident in the United States that carries on active business activities in the United States that are on March 30, 2012, and are expected to remain, similar to Canco's business activities in Canada. US Opco is a wholly-owned subsidiary of US Holdco. US Opco

is the only corporation in which US Holdco has an equity percentage (as defined in subsection 95(4) of the Act). US Opco is a controlled foreign affiliate of Canco.

5. Other than US Opco, there are no other non-resident corporations that do not deal at arm's length with Canco that carry on business activities similar to the business activities carried on by Canco in Canada.

6. On March 30, 2012, Canco makes an investment (as defined in paragraph 212.3(10)(a) of Act) in US Holdco.

There are several exceptions to the application of subsection 212.3(2) of the Act (commonly known as "the foreign affiliate dumping rules"), including the exception in subsection 212.3(16). You ask whether for the purposes of the "more closely connected business activities" test in paragraph 212.3(16)(a) of the Act, the subject corporation (US Holdco, in the hypothetical case above) must itself also carry on active business activities similar to the business activities carried on by Canco in Canada.

#### Our Comments

The Canadian income tax system is based on the principle of voluntary self-assessment. As mentioned in IC 70-6R5, the Directorate provides written confirmations of the tax implications inherent in particular transactions only where the transactions are proposed and are the subject matter of an advance income tax ruling submitted in the manner set out in the Circular. Where the transactions have already been completed, it is up to the taxpayer to determine the tax treatment of a completed transaction. However, the tax services offices may, after considering all the facts and documents in the course of an audit, determine whether a transaction has received the appropriate tax treatment.

To assist you in the process of self-assessment, we are prepared to provide the following general comments which we hope will be of assistance in the determination of the tax treatment of a transaction. Since these are general comments, they may not fully apply to your particular situation.

Paragraph 212.3(16)(a) states, in part, as follows:

"Subject to subsection (19), subsection (2) does not apply to an investment in a subject corporation made by a CRIC if the CRIC demonstrates that all of the following conditions are met:

(a) the business activities carried on by the subject corporation and all other corporations (those other corporations in this subsection and subsection (17) referred to as the "subject subsidiary corporations") in which the subject corporation has, at the investment time, an equity percentage (as defined in subsection 95(4)) are at the investment time, and are expected to remain, on a collective basis, more closely connected to the business activities carried on in Canada by the CRIC (corporation resident Canada)...than to the business activities carried on by any

non-resident corporation with which the CRIC, at the investment time, does not deal at arm's length, other than ... " (Emphasis Added).

The Explanatory Notes to subsection 212.3 of the Act state, in part, as follows:

"The first condition, in paragraph 212.3(16)(a), generally requires that the business activities of the subject corporation and any...subject subsidiary corporation in which the subject corporation has an equity percentage, be collectively, more closely connected to the business activities carried on by the CRIC...in Canada than to those of any other non-resident corporation that does not deal at arm's length with the CRIC... For these purposes, "business activities" is intended to refer to active business operations rather than simply investing in shares in other companies and the management and governance activities that may relate thereto." (Emphasis Added).

In our view, to determine whether the investment of a particular corporation resident in Canada in a particular subject corporation meets the business activities test contained in paragraph 212.3(16)(a), one must collectively consider the business activities of the subject corporation and all subject subsidiary corporations. In the hypothetical example above, the condition in paragraph 212.3(16)(a) of the Act will be satisfied if the collective business activities carried on by US Holdco and the subject subsidiary corporations (being only US Opco, in this case) are on March 30, 2012 and are expected to remain, more closely connected to the business activities carried on in Canada by Canco than to the business activities carried on by any non-resident corporation with which Canco does not deal at arm's length.

Consistent with the views expressed in the Explanatory Note above, it is our view that the simple holding of shares by a holding company such as the holding of shares of US Opco by US Holdco in the hypothetical example above, is not a business activity and would therefore be ignored for the purposes of this test. Accordingly, the collective business activities of US Holdco and US Opco would be comprised only of those carried on by US Opco. Since those business activities, based on the facts above, were at the investment time and were expected to remain, more closely connected to the business activities carried on in Canada by the CRIC than to any business activities carried on by any non-resident corporation with which the CRIC does not deal at arm's length, the first condition in paragraph 212.3(16)(a) of the three part test in subsection 212.3(16) of the Act would be met.

We hope this information is of assistance to you.

Yours truly,

Olli Laurikainen, CPA, CA  
for Division Director  
International Division  
Income Tax Rulings Directorate

Legislative Policy and Regulatory Affairs Branch  
Canada Revenue Agency