April 21, 2025

Income Tax Rulings Directorate
Canada Revenue Agency
5th floor, Tower A, Place de Ville
320 Queen Street
Ottawa ON K1A 0L5
Attention: Yannick Roulier

Via email: Yannick.Roulier@cra-arc.gc.ca

Dear Mr. Roulier,

Re: Technical Interpretation Request Relating to EIFEL and Cross-Border Trust Holding Foreign Personal Use Property

Enclosed is a submission from the Tax Technical Committee of STEP Canada on technical interpretation request relating to EIFEL and cross-border trust holding foreign personal use property.

Further to email and phone communications between STEP and the CRA in late March, the Society of Trust and Estate Practitioners (Canada) (STEP) is submitting a technical interpretation request regarding whether the existence of a Canadian-resident trust holding a foreign personal-use property can in itself cause an affiliated group of Canadian entities to be exposed to the excessive interest and financing expenses limitation (EIFEL) rules contained in section 18.2.

Due to the significant impact this may have to Canadian corporation's corporate income tax return filings, we respectfully request that the CRA provide guidance on this matter before June of 2025 so that impacted corporations with December year-ends can file their T2 returns in compliance with the Act.

We would be pleased to discuss our submission with you as soon as you are able. Please address any questions to Michael Dodick, Chief Operating Officer, STEP Canada at mdodick@step.ca

Yours truly,

Rachel Blumenfeld, LLB, TEP
Chair, STEP Canada

Ian Lebane, LLB, LLM, TEP
Chair, STEP Canada Tax Technical Committee

Submission Of the Tax Technical Committee of STEP Canada on Technical Interpretation Request Relating to EIFEL and Cross-Border Trust Holding Foreign Personal Use Property

Context

Taxpayers avoid the application of the excessive interest and financing expenses limitation (EIFEL) rules contained in section 18.2 of the Income Tax Act if they qualify as an "excluded entity" under subsection 18.2(1). Canadian corporate groups with taxable capital of $50,000,000 or more and interest and financing expenses of more than $1,000,000 must rely on paragraph (c) of the "excluded entity" definition to avoid the tax impact and associated filing requirements of section 18.2.

A Canadian resident may be subject to US estate tax on US-situs property. It is common for Canadians to plan around US estate tax by acquiring US personal-use real estate with Canadian-resident trusts in which the financial contributor to the trust has no beneficial interest, powers, or rights in or over the trust property. Contributions to such trusts are typically made from personal assets of the financial contributor. Even if the trust has to borrow to acquire the US real estate, any interest expense is generally not deductible because of the personal-use nature of the property.

For US estate tax purposes, where the spouse of the contributor to the trust is a beneficiary of the trust, it is usually advisable for the contributor to pay rent to use the US real estate owned by the trust after the death of the spouse beneficiary. Usually, the rent so collected is relatively minimal in relation to the value of the property owned by the trust such that this rental income is ancillary to the property's primary purpose of personal use and enjoyment.

Consider the following fact scenario:

- Mr. X and Mrs. X are married with one adult child ("Child").
- All individuals are residents of Canada.
- Mr. X wholly owns and controls several Canadian corporations (collectively referred to as "RECs"), each of which owns one or multiple Canadian real estate rental or development properties. All RECs have December 31 fiscal periods.
- Because Mr. X controls all of the RECs, all RECs are associated, related, and affiliated with each other under subsections 256(1), 251(2), and 251.1(1), respectively.
- The total "taxable capital employed in Canada" as the term is defined in section 181.2, of the associated group of RECs exceeds $50,000,000 in the particular year.
- The total "interest and financing expenses" as the term is defined in subsection 18.2(1), of all RECs exceeds $1,000,000 in the particular year.
- All or substantially all of the undertakings and activities of all of the RECs are carried on in Canada throughout the particular year.

- None of the interest and financing expenses of the RECs are paid to persons or partnerships that are "tax-indifferent" as the term is defined in subsection 18.2(1).
- Neither the above-mentioned individuals nor the RECs own any shares of a foreign affiliate throughout the particular year.
- In 2022, Mr. X settled a Canadian-resident irrevocable trust ("the Trust"), contributing $1,000,000 in cash upon settlement.
- The Trust used the $1,000,000 cash to purchase a US residence ("the US Cottage").
- Subsequent to the acquisition of the US Cottage, Mr. X occasionally contributed additional funds to the Trust to cover ongoing operating costs of the US Cottage.
- The sole assets of the Trust are the US Cottage and a US bank account containing funds necessary to operate the US Cottage.
- The Trust does not have any liability.
- The Trust's sole trustee is Mrs. X, and the Trust's sole beneficiaries are Mrs. X and Child.
- Since its acquisition, the US Cottage had been used primarily for the personal use and enjoyment of Mrs. X, Child, and Mrs. X's guest, Mr. X.
- The trust ownership structure for the US Cottage was established primarily to avoid US estate tax on Mr. X's passing and to simplify US probate.
- Because of the trustee's discretionary powers, Mrs. X is considered a "majority-interest beneficiary" of the Trust pursuant to subparagraph 251.1(4)(d)(i) and the definition of "majority-interest beneficiary" in subsection 251.1(3).
- Because Mrs. X is the spouse of Mr. X, the person who controls all of the RECs, Mrs. X is affiliated with each of the RECs pursuant to subparagraph 251.1(1)(b)(iii).
- Because each of the RECs is affiliated with Mrs. X, each REC is also affiliated with the Trust pursuant to subparagraph 251.1(1)(g)(ii). As a result, the Trust is an "eligible group entity" of each of the RECs by virtue of paragraph (b) of the definition of "eligible group entity" in subsection 18.2(1).
- Besides the Trust and the other RECs, the RECs have no eligible group entities throughout the particular year.

Questions

(a) Could ownership of a personal-use property such as the US Cottage in this fact scenario cause the Trust (and therefore all RECs) to fail to meet the requirement in subparagraph (c)(i) of the definition of "excluded entity" in subsection 18.2(1)?

(b) Can the CRA provide any guidance on what it considers to constitute "undertakings and activities" under subparagraph (c)(i)? For example, does the response to question (a) change if substantially all of the decisions regarding the US Cottage are made by the trustee while the trustee is in Canada?

(c) Does it matter if the Trust occasionally rents out the US Cottage during months when the beneficiaries and their family are not using it, or if non-beneficiary family members, such as Mr. X, pay rent to the Trust for their use of the property? Assume that any rental use is ancillary to the property's primary use (which is the personal use and enjoyment of the beneficiaries and family), that no structural change is made to the property to accommodate the rental use, and that no CCA deduction is claimed by the Trust. The rental revenue received by the Trust is includible in the computation of income of the Trust for both Canadian and US tax purposes.

The stated objective of the EIFEL rules was to address base erosion and profit shifting (BEPS) that potentially arise where Canadian taxpayers deduct excessive amounts of interest and other financing costs. In our view, these rules were not intended to apply to the acquisition of personal-use properties irrespective of whether those properties are located in Canada, because most of the interest and financing expenses associated with these properties are typically not deductible. To the extent that the property earns ancillary rental revenue, such as the rent earned from the financial contributor after the death of the spouse beneficiary, a pro rata portion of associated interest and financing expense may be deductible.

We note that the CRA's longstanding interpretation of "principal residence" under section 54 allows for incidental rental income, provided that there are no structural changes and no CCA is claimed. It is reasonable to extend similar logic to the interpretation of "undertaking and activities" in subparagraph (c)(i) of the "excluded entity" definition.

If the EIFEL rules apply to this scenario—in which the organization is wholly Canadian-based aside from one foreign personal-use property—the consequences appear disproportionately harsh. Each of the RECs and the Trust will be required to file Schedule 130, and may be subject to a non-compliance penalty in any particular year for failing to file or for incorrectly completing the schedule. Further, if EIFEL applies, the RECs may face limitations in their deduction of interest and financing expenses despite the fact that they conduct all of their operations in Canada and have no involvement in the US Cottage.

Applying the EIFEL rules to an otherwise domestic private business group solely because of the existence of a foreign personal-use property adds a significant layer of seemingly unwarranted tax cost, compliance cost and complexity to the group's compliance obligations. These businesses would likely have to seek assistance from specialists in the EIFEL rules beyond their normal advisors to accurately complete the EIFEL forms or to undertake planning with consideration of the EIFEL rules."