International Fiscal Association

IFA Canada | YIN SESSION

Circling the Roundtable 2018

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Wednesday, June 13, 2018

Q1: New U.S. GILTI Tax

*One of the measures introduced under US tax reform is the "global low-taxed intangible income" or "GILTI" rules in the Internal Revenue Code section 951A. Under those rules a U.S. corporation may be subject to tax on a current basis with respect to active business income earned by a controlled Canadian subsidiary, even if that Canadian subsidiary does not have a permanent establishment in the U.S. Under Article VII of the Canada-U.S. Tax Convention ("**Convention**"), however, business profits of a corporation resident in Canada that does not have a permanent establishment in the U.S. shall be taxable only in Canada.*

Will the CRA agree to accept requests for competent authority relief under Article XXVI of the Convention on the basis that the taxes imposed under the GILTI rules may be in violation of Article VII of the Convention?

Q1: New U.S. GILTI Tax

Response:

- CRA will not accept competent authority relief requests under Article XXVI in these circumstances.
- Limited situations in which the Convention overrides United States' taxation of its own residents (see paragraph 3 (a) of Article XXIX "Miscellaneous Rules" - no reference to Article VII).
- In these circumstances, foreign tax credit may be claimed for Canadian taxes paid and there should be no additional US tax payable by US parent.
- Article XXIV "Elimination of Double Taxation" does not apply in these circumstances.

Q2: Principal Purpose Test in MLI

*In Question 8(d) at the 2017 CTF Annual Tax Conference CRA Roundtable, the CRA refrained from commenting on the examples set out in paragraphs 182 and 187 of the Commentary to Article 29 of the then draft 2017 OECD Model Tax Convention ("**OECD Model**") with respect to the "object and purpose" clause within the principal purpose test ("**PPT**") of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, commonly referred to as the Multilateral Instrument ("**MLI**").*

Q2: Principal Purpose Test in MLI

Background Information

- PPT is in MLI's Article 7 "Prevention of Treaty Abuse"

  Treaty benefit can be denied if it is reasonable to conclude that one of the principal purposes of the arrangement or transaction was to gain the benefit unless it is established that granting that benefit is in accordance with the object and purposes of the relevant treaty provisions

- OECD Examples helpful given ambiguity and limited interpretive guidance with respect to the PPT.

Q2: Principal Purpose Test in MLI

Background Information

- On May 28, 2018, Canada tabled NWMM formalizing its intention to introduce legislation to enact the MLI.

- No announcement to remove reservation on Article 7(4) of the MLI.
  - Article 7(4) allows treaty benefits denied under PPT to be granted in full or in part by the competent authorities in certain circumstances.

- Query if PPT rulings will align with GAAR/domestic rulings?

Q2: Principal Purpose Test in MLI

(a) Now that the OECD Council has approved the contents of the 2017 update to the OECD Model, will the CRA comment on what weight it will give to the examples in paragraphs 182 and 187 of the Commentary on Article 29 of the 2017 OECD Model in determining whether a particular structure or transaction satisfies the object and purpose clause within the PPT of the MLI?

Response

- CRA will consider OECD Model examples in treaty application and interpretation (*Crown Forest [1995] 2 SCR 802).*
- Application of PPT depends facts, circumstance, statutory laws, case laws and the wording, object and purpose of the relevant treaty.

Q2: Principal Purpose Test in MLI

(b) As it is our understanding that Canada intends to ratify the MLI in 2018, what additional guidance does the CRA intend to provide in 2018 (on a unilateral or bilateral basis with specific treaty partners) to provide investors with sufficient certainty/clarity in determining when the PPT of the MLI may apply, particularly with respect to private equity and other collective investors?

Response:

- Taxpayers who want “certainty” should obtain advanced ruling request.
- Review other Articles in the particular Treaty; relevant competent authority agreement; existing rulings.

Q2: Principal Purpose Test in MLI

(c) *Once the MLI becomes effective, there will be increased uncertainty with respect to the application of treaty benefits under its PPT. In order to allow investments and distributions to be made on a timely basis, will the CRA commit to providing rulings on the PPT of a particular covered treaty on an expedited basis? If so, can the CRA provide an estimate on how long it expects that it would take between when a completed PPT ruling is submitted to the time that such a ruling is issued (assuming timely responses by the taxpayer to any factual queries that may be raised by the CRA)?*

Response:

- No commitment to expedited rulings; no estimated time limit.
- Process will require input from various different groups.

Q3: Interaction between ss. 91(5) and 93.1(2)(d)(i)

Background & relevant dispositions

Sub-paragraph 93.1(2)(d)(i)

- Applies when a partnership receives a dividend from a foreign affiliate ("**FA**")
- Limits the amount otherwise generally deductible by a Canadian corporation ("**Canco**" or the "**partner**") under 113 (via par. 93.1(2)(a) to (c))
- Limit equal to:

> " where the corporation resident in Canada is a member of the partnership, the amount deductible by it under section 113 in respect of the dividend (…) shall not exceed the portion of the amount of the dividend included in its income pursuant to subsection 96(1)"

Sub-section 96(1)

- Income computation for a taxpayer that is a member of a partnership
- 96(1)(c) : computation of income on a source by source basis
- 96(1)(f): income retains its character in the hands of the partner
- the income attributed to a member is a **net amount** (expenses claimed at the partnership level and allocated based on respective source)

Q3: Interaction between ss. 91(5) and 93.1(2)(d)(i)

<u>Background & relevant dispositions</u> (cont'd)

Sub-section 91(5)

- Applies in computing partnership income under 96(1), but not limited to
- Specific deduction in respect of dividends received on shares of a controlled FA
- To ensure that a shareholder of a CFA is not taxed twice on FAPI (i.e. upon repatriation)
- For partnerships, Reg. 5900(3) deems dividend to be from taxable surplus (i.e. generated from FAPI)
- With respect to a dividend prescribed to have been paid out of taxable surplus, deduction equal to the lesser of
  - The portion of the dividend in excess of the amount deductible under 113(1)(b); and
  - Excess of amount to be added under par. 92(1)(a) over 92(1)(b) deduction

Q3: Interaction between ss. 91(5) and 93.1(2)(d)(i)

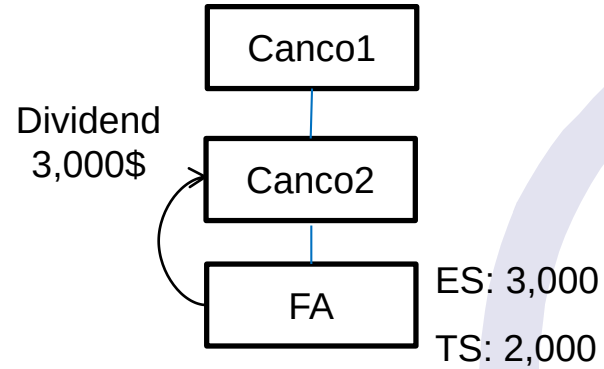
Question

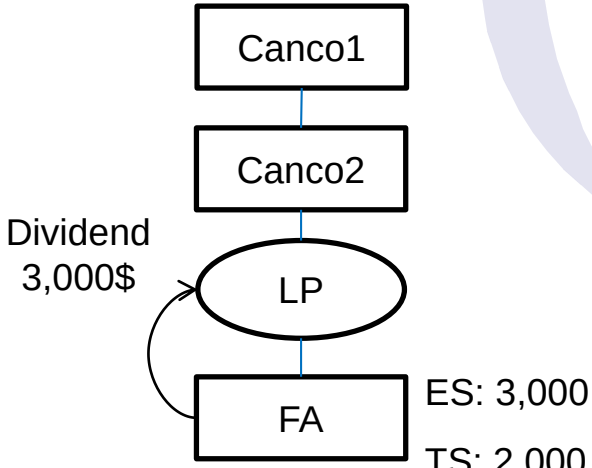
In the hypothetical facts (on next slide), is subsection 91(5) deduction taken into account in determining the amount referred to in subparagraph 93.1(2)(d)(i)?

Preliminary response

- Expenses such as interest relating to acquisitions by a partnership of FA shares are not to be taken into account in applying the limitation in s. 93.1(2)(d)(i).
- Only the subsection 91(5) deduction is taken into account when determining the limit referred to in s. 93.1(2)(d)(i).

Q3: Interaction between ss. 91(5) and 93.1(2)(d)(i)





Alternative A – direct ownership

Dividend income	3,000
Interest expense (Canco)	(300)
113(1) deduction (Canco)*	(3,000)
Net taxable loss:	(300)

*ES reinstatement and TS reduction

Alternative B- Partnership structure

Partnership gross income	3,000
Interest expense	(300)
91(5) deduction	(2,000)
Income allocated to partner (96(1))	700
113(1)(a) deduction (3,000 dividend minus 2,000 91(5) deduction)	(1,000)
Net taxable loss	(300)

Q4: Penalties for Non-Residents

According to current CRA publications, non-resident persons that earn income from carrying on business in Canada during a year are subject to the same rules as residents regarding the filing of income tax returns. However, for tax years after 1998, non-resident corporations that carry on a "treaty-protected business" as defined in subsection 248(1) of the Act, during a tax year are required to attach a completed Form T2SCH91, Schedule 91, Information concerning claims for treaty-based exemptions, to their T2 Return to support claims for treaty exemption.

Assume a non-resident files a treaty-based return, as described above, based on a reasonable belief that the non-resident was not taxable in Canada as it did not have a permanent establishment in Canada. If it is later determined by the CRA that the non-resident was unable to claim treaty protection (e.g., on the basis that it did have a permanent establishment in Canada), would the CRA seek to impose late-filing penalties, such as for not timely filing T106 forms, and/or penalties for failing to complete contemporaneous documentation under section 247 of the Act? Would the CRA consider providing relief under subsections 220(3) and (3.1) of the Act?

Q4: Penalties for Non-Residents

Response

- Returns, forms, elections and documents must be filed in a timely manner.
- Requests for relief under 220(3) and (3.1) in the form of extensions and waiver of penalties may be considered - IC07-1R1 “Taxpayer Relief Provisions”.
- CRA did not mention due diligence defense.
  - *Bruce Douglas v. The Queen,* 2012 TCC 73 (informal procedure)
  - *Home Depot of Canada Inc. v. The Queen,* 2009 TCC 281 (general procedure)

Q5: Meaning of “merged or combined” in s. 40(3.5)(c)(i)

Background & relevant dispositions

Sub-sections 40(3.3) and (3.4)

- Application triggered when conditions provided for in ss. 40(3.3.) are met
- Effectively suspends a loss that would otherwise be realized upon the transfer of a capital property between affiliated entities

Subsection 40(3.5)

- In the context of the application of sub-sections 40(3.3) and (3.4)
- To the extent it applies, effectively extends the application of the suspended loss rules in specific situations:

  - 40(3.5)(c)(i): “the particular corporation is merged or combined with one or more other corporations”
  - 40(3.5)(c)(ii): “the particular corporation is wound up in a winding-up to which subsection 88(1) applies”
  - 40(3.5)(c)(iii): “the particular corporation is liquidated and dissolved , the liquidation and dissolution is a qualifying liquidation and dissolution (as defined in the ITA)”

Q5: Meaning of “merged or combined” in s. 40(3.5)(c)(i)

Question

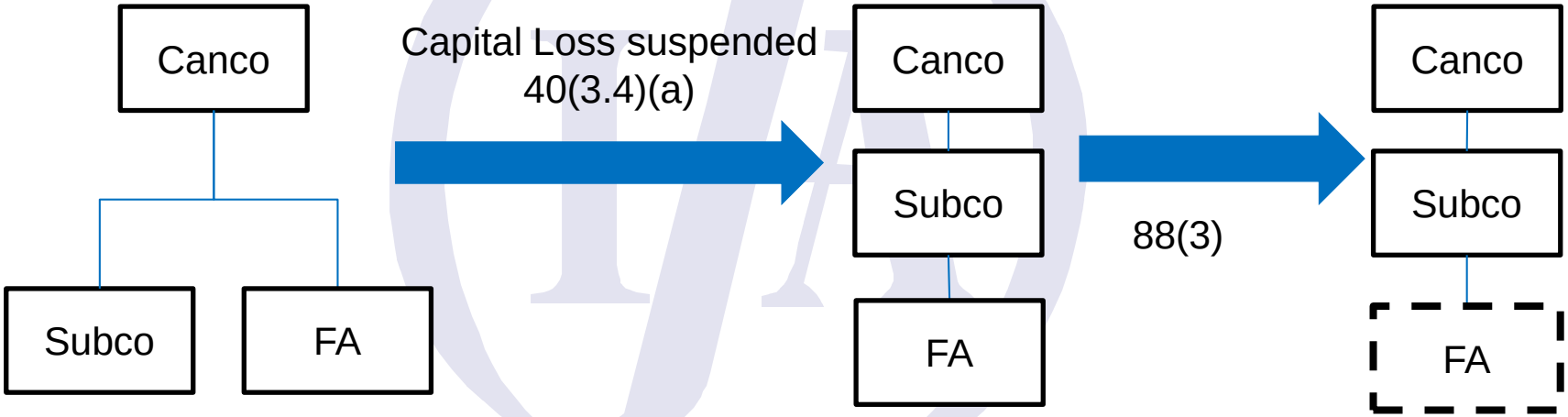
As it relates to the suspended loss, do the deemed continuity rules in subparagraph 40(3.5)(c)(i) of the Act apply on the wind-up of an FA (i.e. 88(3) liquidation)?

Preliminary response

- The phrase “**merged or combined**” as used in s. 40(3.5)(c)(i) is broad and encompassing, and may include a winding-up or liquidation.
- The word “**formed**” as used in s. 40(3.5)(c)(i) in a broad manner (…) this implies that the word “formed” as used in that provision is to be interpreted broadly and would include an entity in place after a reorganization (for example, a s. 86(1) reorganization), even though no new entity may be formed in the traditional sense.
- In our view, this textual analysis, when combined with a textual and purposive analysis of s. 40(3.5), supports a conclusion that the deemed continuation rules in s. 40(3.5)(c)(i) apply to the wind-up of FA in this case. Specifically, with respect to context, s. 40(3.5) extends the application of the suspended loss rules to a number of reorganizations. Although the proposed example does not fall within the ambit of s. 40(3.5)(c)(ii) or (iii), it is our view that subparagraph (c)(i) applies to the wind-up.

Q5: Meaning of “merged or combined” in s. 40(3.5)(c)(i)

Background



- Particular corporation not there anymore
- Reference to specific wind-up provisions, but not to ss. 88(3)

Q6A: Mutual Agreement Procedure ("MAP") Program

Background

- *The MAP program is a service provided by the CRA to assist taxpayers in resolving cases of double taxation or taxation not in accordance with the provisions of a tax convention. The MAP process requires co-operation from taxpayers to achieve the goal of resolving such cases.*
- *A dispute resolution mechanism (…) In Canada, the minister of national revenue authorizes senior CRA officials to try resolving tax dispute under tax conventions that Canada has with other countries. These senior officials are referred to as the competent authority. A similar authorization usually takes place in Canada's treaty partner countries.*

(2016 Report)

Question

The Canadian Competent Authority Services Division ("CASD") has not released a Mutual Agreement Procedure ("MAP") report since 2014/15. During this time the OECD has released additional guidance on Base Erosion and Profit Shifting issues. With this in mind, are you able to comment on any trends that the CASD has identified in respect to MAP cases over the last few years? Has there been an increase or decrease in the number of MAP cases received by CASD?

Q6A: Mutual Agreement Procedure ("MAP") Program

Preliminary response

- The 2016 MAP report was published on April 13, 2018. Delay to align the OECD MAP reporting timeframe (since 2016, adopted a calendar year to publish).
- In 2016, Canada accepted 124 negotiable cases and 164 non-negotiable cases.
- CASD reports that it has not noticed any major trends over the past few years.

Other comments in the report:

- Transactional net margin method (TNMM) continued to be the most frequently employed transfer pricing methodology
- The report includes other statistics including, outcome, number of cases per industry, transfer pricing methodology used, initiating country, etc.

Q6B: Advance Pricing Arrangements ("APAs")

Background

An APA is a formal **agreement** between a taxpayer and one or more tax authorities to determine and set **transfer prices** for transactions between the taxpayer and its related parties. APAs typically run five years or more with the possibility of renewal and rollback.

- The purpose of the APA program is to provide a co-operative process for resolving transfer pricing issues prospectively.
- The APA process includes the following stages:
  - prefiling meeting(s);
  - the APA request;
  - the acceptance letter;
  - the APA submission;
  - preliminary review of the APA submission and establishment of a case plan;
  - review, analysis, and evaluation;
  - negotiations;
  - agreements;
  - the post-settlement meeting; and
  - APA compliance.

Q6B: Advance Pricing Arrangements ("APAs")

Background (cont'd)

- Latest APA report shows a 50% reduction in APA applications accepted
- Observation: it seems that CASD is conducting a full review of the issues prior to accepting an APA submission, which was apparently not the case before

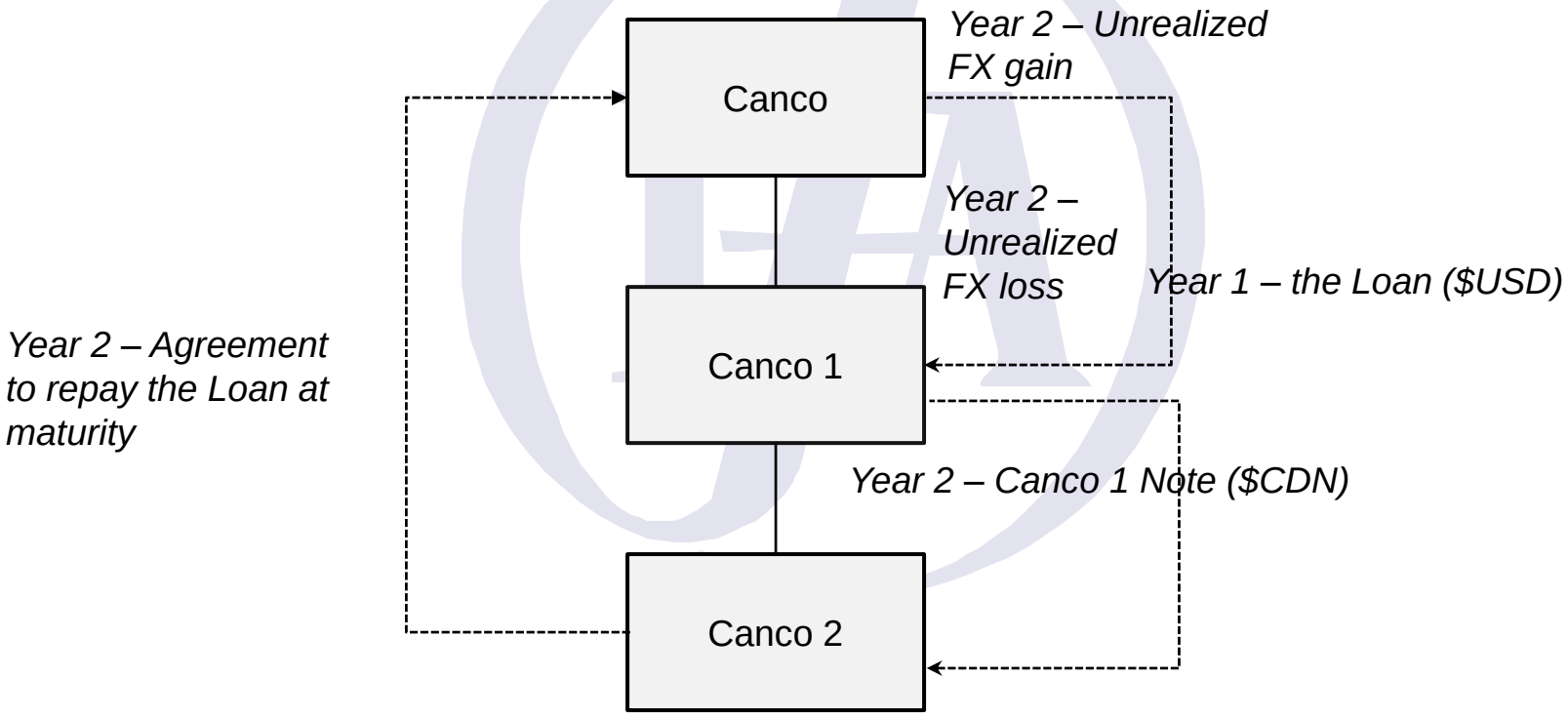
Question

Does CASD intend to stay the course in its approach regarding how it accepts files into the APA program?

Preliminary response

- There was a decrease in applications accepted in 2016. However, there was also an increase in applications pending. That means those that were submitted but not accepted yet.
- CRA recognizes the importance of tax certainty and, while we exercise tremendous effort to ensure that submissions are complete prior to their acceptance, and will continue to do so, we also strive to maximize efficiency in the process.

Q7: Undertaking to Repay and subsection 39(2)



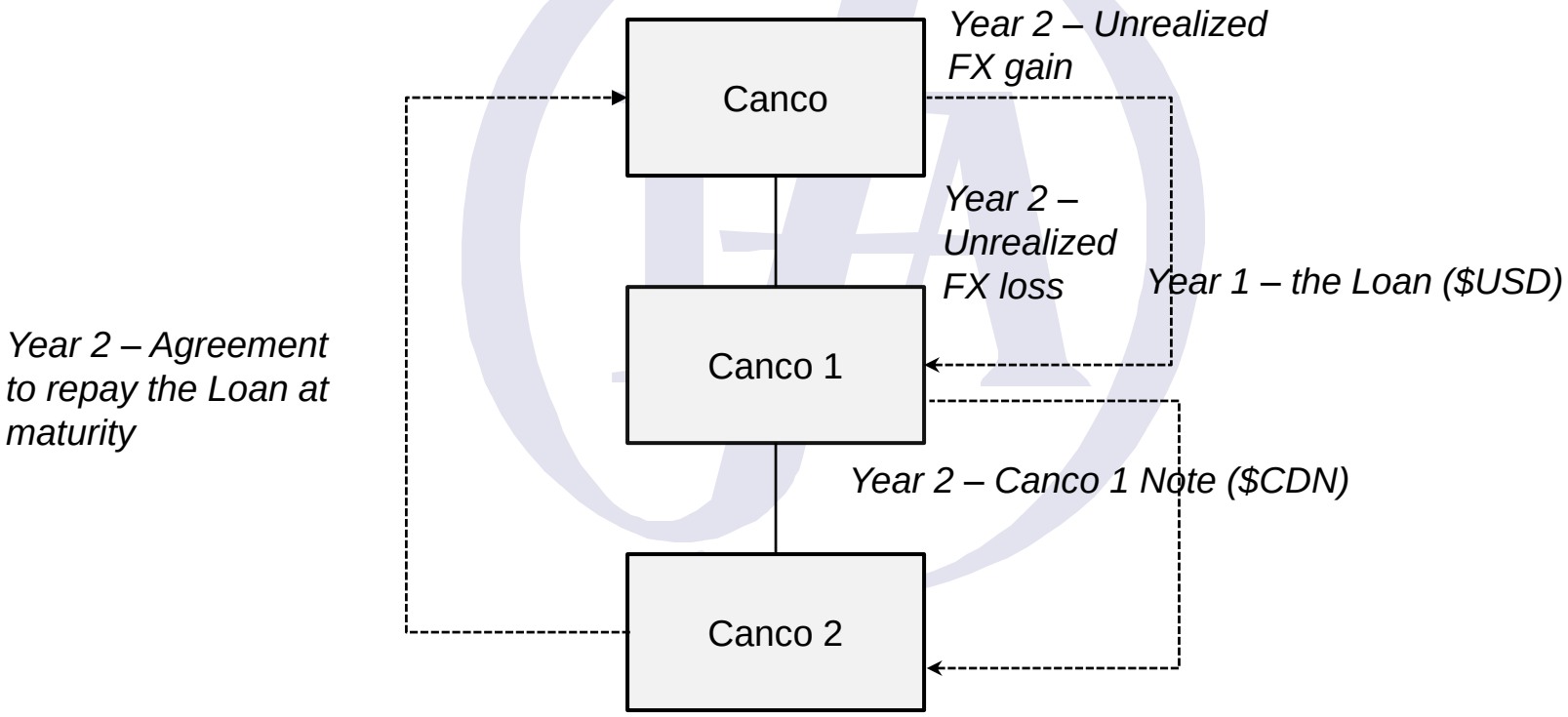
- Canco, Canco 1 and Canco 2 do not deal at arm's length and are related and affiliated corporations.

Q7: Undertaking to Repay and subsection 39(2)

Hypothetical facts:

- Year 1:
  - Canco 1 realizes capital gain.
  - Canco advances US$ Loan to Canco 1.
- Year 2:
  - Canco has unrealized FX Gain in respect of the Loan and Canco 1 has unrealized FX Loss.
  - Canco 2 undertakes to pay Loan on behalf of Canco 1.
    - Under provincial law, it is assumed that this does not result in novation of the Loan, substitution of Loan by new debt, discharge, rescission or extinguishment of the Loan.
  - In consideration, Canco 1 issues Canco 1 Note payable to Canco 2.
    - Principal amount of the Canco 1 Note equals the Canadian dollar equivalent of the US dollar principal amount of the Loan based on the exchange rate at the time of issuance of Canco 1 Note.
    - FMV of the Canco 1 Note at the time of issuance equals principal amount.
  - Canco 1 retains its obligations under the Loan. There is no change to principal amount, interest rate or maturity date of the Loan.

Q7: Undertaking to Repay and subsection 39(2)



- Canco, Canco 1 and Canco 2 do not deal at arm's length and are related and affiliated corporations.

Q7: Undertaking to Repay and subsection 39(2)

Will the undertaking by Canco 2 in year 2 to repay the Loan on behalf of Canco 1 result in Canco 1 sustaining a loss that subsection 39(2) of the Act will deem to be a capital loss from the disposition of currency other than Canadian currency that Canco 1 can carry-back to offset the capital gain that it realized in year 1?

Response:

- The undertaking to repay the Loan on behalf of Canco 1 will not result in a capital loss under subsection 39(2).
- *MNR v. Consolidated Glass* [1957] SCR 167, the SCC held that a loss means “absolute and irrevocable, finality”.
- Capital gains/losses considered to be made on settlement or extinguishment of debt (i.e. novation, discharge, substitution, rescission or extinguishment).

Q8: Update on entity classification

Question

Can the CRA provide us:

a) With an update of the current status of the Working Group's study of compliance issues relating to Delaware and Florida LLPs and LLLPs, and
b) With an update on any new entities or arrangements that have recently been considered?

Q8(a): Update on entity classification

Background

- 2017 IFA CRA Roundtable : An update was given on the administrative grandfathering applicable to Delaware and Florida limited liability partnerships ("LLPs") and limited liability limited partnerships ("LLLPs") formed before April 26, 2017.
- The relief allows such entities to file as partnerships for all prior and future tax years, provided these conditions are met:
    - the entity and its members have not taken inconsistent filing positions between partnership and corporate treatment;
    - there has not been a significant change in the membership or activities of the entity; and
    - the entity cannot be being used to facilitate abusive tax avoidance.
- Delaware and Florida LLPs and LLLPs formed after April 25, 2017 or before that date but offside of the conditions will be assessed as corporations for all purposes of Canadian income tax law

Q8(a): Update on entity classification

Preliminary response

Following last year's conference, further submissions were received and the following clarifications were provided this year:

- the condition that inconsistent filing positions as between partnership and corporation cannot have been taken will not be met if, because of **the IFA 2016 announcement** that these entities were corporations for Canadian tax purposes, resulted in **protective** T1134s being filed or in a business number being requested or granted, or a T2 having been filed;
- the condition that a significant change in the membership of the entity cannot have taken place will not be met as a result **of transfers between non-arm's length parties**, or as the result of issuance of memberships to non-arm's lengths parties;
- if a particular entity **was initially set up as an LLC**, and then was converted to a Delaware or Florida LLP or LLLP, this would not, in and of itself, prevent the entity from taking advantage of the administrative practice, allowing for the grandfathering of partnership status, to the extent all the other conditions are met; and
- in a similar vein to last year's announcement, the clarifications will apply to an LLP or LLLP under US jurisdiction other than Delaware and Florida provided that they have similar attributes to the Delaware and Florida LLPs or LLLPs and that they were formed before 26 April 2017.

Q8(b): Update on entity classification

French SLP (Société de Libre Partenariat)

- Was asked to rule that a French SLP was a partnership for Canadian income tax purposes
- Based on information obtained, SLP would have possessed characteristics of both corporations and limited partnerships.

Facts supporting the conclusion that entity is not a partnership

- separate legal personality - not sufficient in itself
- No legal authority to support an effective entitlement on the part of the members to share profits and losses
- Computation of earnings at the SLP entity level, with a distribution mechanism for its members akin to the declaration and payment of dividends – important factor

Conclusion : the CRA was unable to rule that it would be a partnership for Canadian income tax purposes

Q9: T1134s and CbC reporting

Question

Why is it necessary for a Canadian parent of a multinational group which is obligated to file CbC reporting forms in Canada to also file T1134s? Has the CRA surveyed its large file case managers to enquire whether or not T1134s are, in fact, used as a risk assessing tool in the context of companies of a size that are subject to CbC reporting? Does the CRA have any plan to assess, on an ongoing basis, whether both forms of reporting are required in order for it to efficiently perform its audit function?

Q9: T1134s and CbC reporting

T1134 – overview of information disclosed

Part / section	Details (simplified)
I - Identification	• Entity information (address, etc.) and Org. Chart
II (sect. 2) – FA Information	• Identification of the FA • Year of becoming an FA • Principal activities • Country of residence and of operations • Is the FA a CFA • Total book cost per FA • Equity percentage in the FA
II (sect. 3) – Financial information per FA	• Total assets of the FA • Accounting net income before tax • Income or profit tax paid or payable
II (sect. 4) – Surplus accounts	• Dividend paid during the year • Transaction affection the surplus account • Sale or acquisition of shares of an FA
III (sect. 1) – Employees / business	• Number of employees and business activity code
III (sect. 2) composition of revenue	• Breakdown of certain types of income (interest, royalties, etc..)

Q9: T1134s and CbC reporting

CbCR – overview of information disclosed

Part / section	Details (simplified)
I – Reporting entity	• Identification of reporting entity and role
II (table 1) – overview of allocation of income, taxes and business activities per jurisdiction	• Revenues – unrelated party • Revenues – related party • Profit (Loss) before tax • Income tax paid • Income tax accrued • Stated capital • Accumulated earnings • Number of employees • Tangible assets and cash
II (table 2) – List of entities within the group	• Name of entities in tax jurisdictions • Identification information per entity (address, etc..) • Tax number • Tax jurisdiction

Q9: T1134s and CbC reporting

Preliminary response

What taxpayers are required to file in CbC reporting and the T1134s overlap in some respects, but they are not identical. In general terms, the existing requirements for reporting in the T1134 are more detailed than for CbC reporting, while the CbC reporting provides a higher level of information and uniformity of reporting across jurisdictions.

As CRA gains more experience with the increased sources and new filing requirements, CRA may consider reviewing this overlap to reduce unnecessary duplication where possible.

Q10: Proposed New Filing Deadline for T1134 Forms

The February 27th, 2018 Federal Budget included an amendment to the due date for the filing of T1134 forms. The amendment will reduce the timeline from 15 months after a taxpayer's taxation year to six months after a taxpayer's taxation year, which will align it with the filing of Canadian corporate tax returns.

It had been our understanding that one of the main reasons for the longer timeline for the filing of T1134 forms is the length of time that it takes in some foreign jurisdictions for the finalization of financial statements and tax returns. As the T1134 form requires information regarding the net income and tax paid in the foreign jurisdiction, in many cases the requisite information will not be available to allow a timely filing of the form under the revised timeline. In addition, in many cases taxpayers will not have the resources required to complete the T1134 forms at the same time that they are completing their tax returns (e.g., many employees work overtime to complete their tax returns in a timely manner and simply won't have the capacity to simultaneously complete additional work on T1134 forms).

Q10: Proposed New Filing Deadline for T1134 Forms

Will the CRA confirm that it will provide relief under subsections 220(3) and (3.1) of the Act in the form of extensions and waivers of penalties for all situations in which taxpayers are unable to timely file their T1134 forms, including situations where there is a lack of sufficient financial information available within the newly restricted time period that will be required to complete and file the forms?

Q10: Proposed New Filing Deadline for T1134 Forms

Response:

- No blanket relief - CRA will consider waivers and/or extension requests on a case-by-case basis.
- In the case of a controlled foreign affiliate, information should be available but if not, the T1134 can be filed with missing information.
- Penalties may apply to incomplete forms, but taxpayers may find relief in “reasonable effort” exception (paragraph 162(5)(a)) or due diligence exception (subsection 233.5(c.2)).