International Fiscal Association

IFA Canada | YIN WEBINAR

Circling the Roundtable

Sarah Chiu
Felesky Flynn LLP

Angelo Nikolakakis
EY Law LLP

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Agenda

IFA 2017 Conference, April 25 & 26, Toronto

- CRA Roundtable
- Finance Roundtable (select issues)

CRA ROUNDTABLE

1. Interaction Between ss. 17(1) and 247(2)

Background

- Under subsection 17(1), income may be imputed to a corporation resident in Canada in respect of an amount owing by a non-resident person, based on a prescribed rate
- Under subsection 247(2), an amount in respect of a transaction entered into with a non-arm's length non-resident may be adjusted to reflect arm's length terms and conditions

1. Interaction Between ss. 17(1) and 247(2)

Question

- Where a corporation resident in Canada makes a non-interest-bearing loan to a wholly-owned non-resident subsidiary, could the CRA provide its views on the potential application of subsection 17(1) and/or subsection 247(2) in the following two scenarios?

  a) The loan remains outstanding for more than one year and does not qualify for the controlled foreign affiliate exception in subsection 17(8).

  b) The loan remains outstanding for one year or less and it would, if it had been outstanding for more than one year, have qualified for the controlled foreign affiliate exception in subsection 17(8).

Comments

- Response to 1(a) – *subsection 247(2) may apply*
- Response to 1(b) – *subsection 247(2) should not apply*

- Question builds on CRA document 2003-0033891E5, “Section 17 and subsections 247(2) and (7)” (February 6, 2004)
- Context and purpose of subsection 247(7)

2. Application of Section 247 to FAPI Computations

Background

- Section 247 may apply in respect of transactions with non-arm's length non-residents

Question

- Does the CRA consider section 247 to apply in computing a foreign affiliate's FAPI in respect of a taxpayer, in the context of a transaction between the foreign affiliate and another non-resident person?

Comments

- Response to 2
  - *Generally, yes*
  - *In this context, CRA generally would not challenge the pricing of the transaction if:*
    - *Pricing reviewed by tax authority of the country in which the FA is resident*
    - *Pricing determined to be in accordance with transfer pricing legislation or guidelines of that country*
    - *Legislation and guidelines of that country adopt the arm's length principle*
  - *IC 87-2R currently under review*

3. U.S. LLPs and LLLPs

Background

- At the 2016 CTF annual conference, the CRA announced that it had established an internal working group to study compliance issues related to Florida and Delaware LLPs and LLLPs arising from its prior announcement that it would generally consider such entities to be corporations for Canadian tax purposes
- As part of this announcement, the CRA indicated that it was open to a prospective approach whereby prior filings would, in certain circumstances, be allowed to stand

Question

- Can the CRA provide an update on the activities of the working group?

Comments

- Response to 3
  - *"Administrative Grandfathering" for Delaware and Florida LLP/LLLPs (and other similar US entities) formed before April 26, 2017 to continue to file as partnerships*
  - *subject to three conditions*
    1. *All members and the entity file consistently treating entity as a partnership (including prospectively)*
    2. *No significant changes to membership or entity activities*
    3. *Entity cannot be used to facilitate abusive tax avoidance*
    - *CRA may reassess entity or members on the basis that the entity is a corporation for one or more taxation years*
  - *Entity can choose to re-file as corporations for all years*
  - *Entity formed after April 25, 2017 assessed as corporation*

4. Subsections 261(20)/(21) and Foreign Affiliates

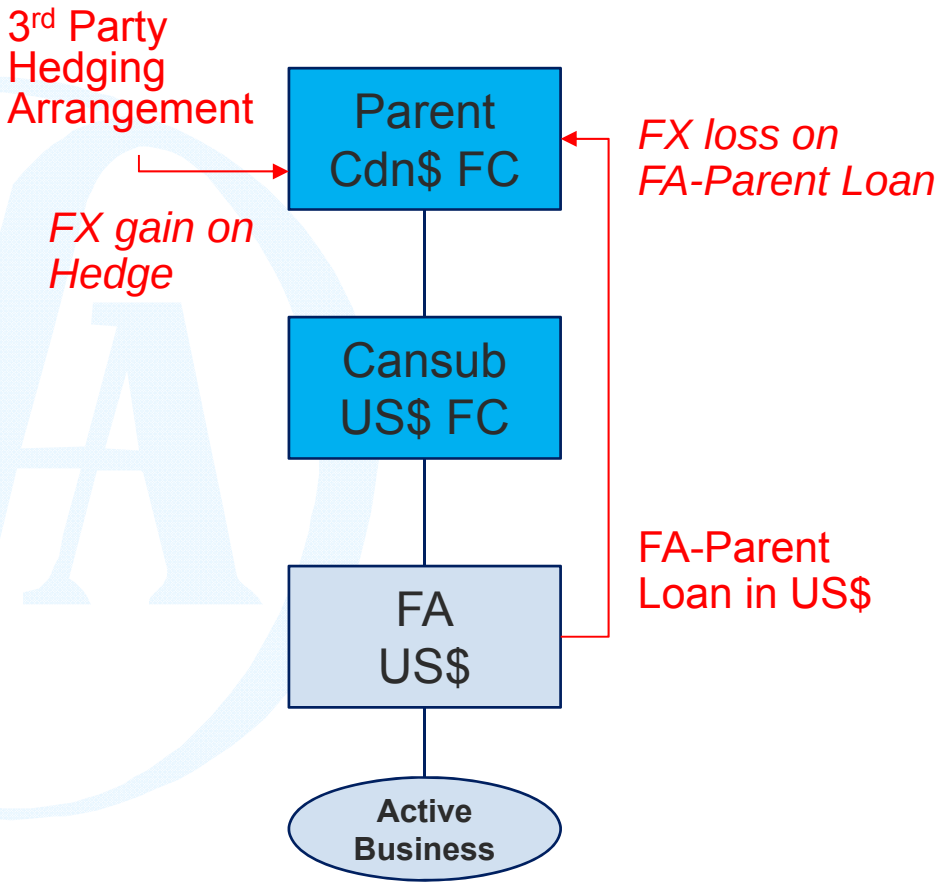
Background

- Subsections 261(20) and (21) deny FX losses in respect of specified transactions between related taxpayers with different "tax reporting currencies"
- Subsection 261(1) defines
  - "tax reporting currency" as the currency in which a taxpayer's "Canadian tax results" are determined
  - "Canadian tax results" as any amount that is relevant in computing income, taxable income, or taxable income earned in Canada
- Subsection 261(6.1) deems a FA, for purposes of computing FAPI, to have an elected functional currency that is the same as that of the taxpayer of which FA is a FA

4. Subsections 261(20)/(21) and Foreign Affiliates

Question

- Does the CRA agree that the conditions in subsection 261(20) would not be met in this case because FA is deemed to have an elected functional currency only for purposes of determining its FAPI?



Comments

- Response to 4
  - *Conditions in subsection 261(20) met and subsection 261(21) applies*
  - *Loan is a FAPI loan*

5. FTCG Rules and Brazilian Interest on Equity

Background

- Foreign tax credit generator (**FTCG**) rules in subsections 91(4.1) to (4.7) deny a deduction for foreign accrual tax (**FAT**) if a "specified owner" is considered under relevant foreign law to own less than all shares of a particular corporation than it is considered to own under the Act (**Lesser Ownership Test**)
- Lesser Ownership Test is deemed by subsection 91(4.7) to be met if, under relevant foreign law, dividends or similar payments on shares held by specified owner are treated as interest or another form of deductible payment

Question

- Under Brazilian law, corporations can choose to make tax deductible distributions to shareholders, within certain limits (called "interest on equity" or **IOE**). Under what circumstances, if any, would the CRA consider such distributions to meet the conditions of subsection 91(4.7)?

Comments

- Response to 5
  - *Conditions in subsection 91(4.7) met and subsection 91(4.1) applies to deny FAT applicable to FAPI for the year the deductible dividend is paid (including FAT of other subs above or below in the affiliate chain)*

6. T1134 Filing Issues

Background

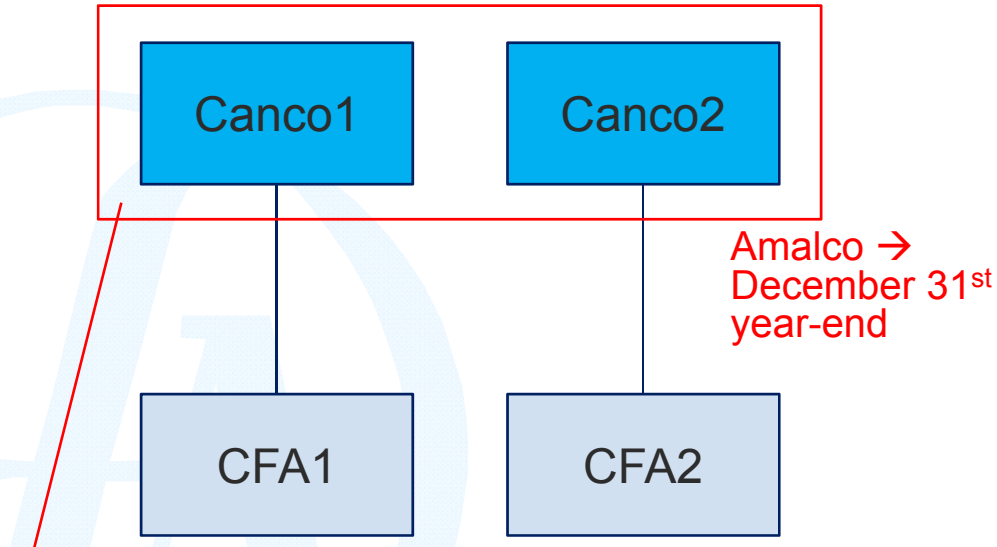
- CRA has previously provided administrative relief from certain duplicate or repetitive reporting for Form T1134 to reduce the compliance burden for a reporting entity
- Duplicate reporting often arises due to requirement of a reporting entity to file a T1134 for foreign affiliates and controlled foreign affiliates owned at any time in the reporting entity's taxation year

6. T1134 Filing Issues

Question

a) Assume each of Canco1, Canco2, CFA1 and CFA2 has a December 31st tax year-end, and that Canco1 and Canco2 amalgamate on August 1st

Would CRA consider extending its administrative relief to situations where there is a deemed year-end due to an amalgamation of two or more Canadian corporations, such as in this example?



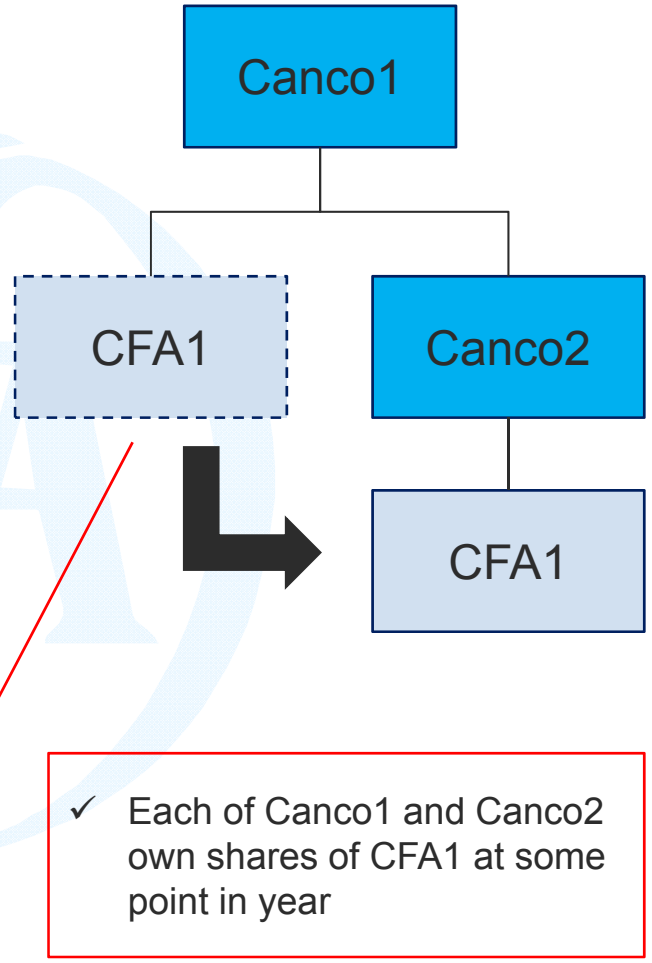
- ✓ Canco1 owned CFA1, Canco2 owned CFA2, in short year ended July 31st
- ✓ Neither CFA1 nor CFA2 has a tax year ending in July 31st short year-end
- ✓ Canco1 and Amalco must each file a T1134 for CFA1, Canco2 and Amalco must each file a T1134 for CFA2

6. T1134 Filing Issues

Question

b) Assume Canco1 transfers CFA1 to Canco2 mid-year

Would CRA consider extending its administrative relief to situations where multiple Canadian taxpayers or partnerships in a related group are required to file a T1134 for the same FA even though information reported may be minimal for reporting entities that do not own FA at end of year, such as in this example?



6. T1134 Filing Issues

Question

c) For Canadian taxpayers with large FA groups, the requirement to paper file T1134 forms and related attachments is extremely burdensome. Often an additional copy of all forms and attachments is requested by CRA auditors when their audit is commenced.

Is there an expected time frame for being able to file T1134 forms and attachments electronically?

Comments

- Response to 6(a) and (b)
  - *No. Administrative relief not consistent with policy of obtaining an accurate record of the history of FAs and transparency of offshore structures and entities*
- Response to 6(c)
  - *Anticipated that corporations will be able to file T1134 and T106 returns electronically by mid-2017*
  - *Work is ongoing to allow supporting documents to also be submitted electronically*

7. Clause 95(2)(a)(ii)(D) Issues Regarding U.S. LLCs

Background

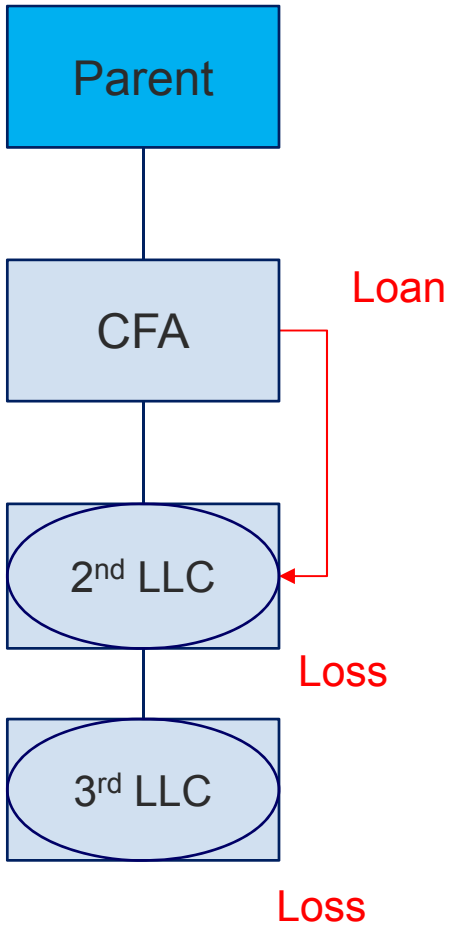
- Issues can arise under subclause (IV) of clause 95(2)(a)(ii)(D) (**Cap D**) where the 2nd affiliate and/or 3rd affiliate are disregarded LLCs
- Conditions for sub-subclause (IV)2 require that, for each disregarded 2nd affiliate and 3rd affiliate, and for each of their relevant taxation years that end in the taxation year of the foreign affiliate making the loan
  - Their members/shareholders at the end of the year be subject to tax in a country other than Canada
  - On all or substantially all of the income of the disregarded affiliate for a relevant taxation year

7. Clause 95(2)(a)(ii)(D) Issues Regarding U.S. LLCs

Question

a) Assume either 2nd affiliate (2nd LLC) or 3rd affiliate (3rd LLC) has a loss in a taxation year ending after loan was made to 2nd LLC, and all other Cap D conditions are met.

   Can CRA confirm that, notwithstanding reference to "income" in sub-subclause (IV)2, interest paid or payable on loan to 2nd LLC would be eligible for recharacterization?



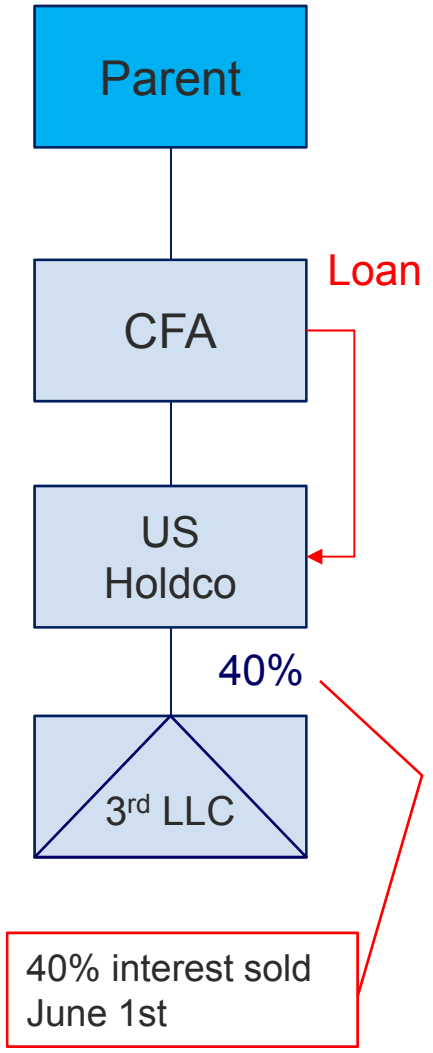
7. Clause 95(2)(a)(ii)(D) Issues Regarding U.S. LLCs

Question

b) Assume 2nd affiliate (US Holdco) owns 40% of 3rd LLC which is a partnership for US purposes, with an arm's length U.S. resident owning other 60%. 3rd LLC and its members all have December 31st tax year-ends.

US Holdco sells its 40% interest in 3rd LLC to an arm's length U.S. resident on June 1st and no deemed year-end arises for US tax purposes. US Holdco is subject to tax on its share of 3rd LLC's income for period from January 1st to May 31st.

Would CRA consider "end of year" requirement to be met, notwithstanding that US Holdco is not a member of 3rd LLC at its year-end (December 31st)?



Comments

- Response to 7(a) – *Yes*
- Response to 7(b) – *No*
  - *Finance has been alerted that this result appears inconsistent with the purpose and intent of the provision*

8. NR4 Reporting for Non-taxable Amounts

Background

- Previous versions of CRA's Guide T4061 *NR4 – Non-Resident Tax Withholding, Remitting, and Reporting* stated that an information return is required where amounts are paid or credited that are subject to withholding under Part XIII
- More recent versions of this Guide appear to suggest that an information return is required for amounts identified in Regulation 202(1) that are paid or credited by a resident of Canada to a non-resident person regardless of whether the payment is subject to Part XIII withholding

8. NR4 Reporting for Non-taxable Amounts

Question

- Can CRA clarify the reporting obligations for amounts paid or credited by a resident of Canada to a non-resident person?
- For example, is a Canadian resident required to file an information return for interest paid or credited to an arm's length non-resident person if the interest is not subject to Part XIII withholding?

Comments

- Response to 8 – *Yes. NR4 filing is required under Regulation 202(1) irrespective of whether Part XIII tax amounts are owed*
- See also CRA document 2016-0677351E5, “Withholding on remuneration paid to a non-resident” (March 9, 2017)

9. Computation of Earnings for a Disregarded U.S. LLC

Background

- CRA's response to Question 11 at 2016 CTF Annual Conference indicated a change in position regarding computation of earnings of a disregarded US LLC carrying on an active business
  - **2009 Position** → compute earnings under subparagraph (a)(i) of definition of "earnings" in Regulation 5907(1) (**Earnings Definition**)
  - **2016 Position** → compute earnings under subparagraph (a)(iii) of Earnings Definition
- CRA indicated change in position due to introduction of Regulation 5907(2.03) in 2011
- Revised position applies to taxation years ending after August 19, 2011

9. Computation of Earnings for a Disregarded U.S. LLC

Questions

Given fact that surplus computations have been completed, and balances relied on, for the past 5 years, would CRA be willing to consider following positions:

a) For taxation years of LLC beginning prior to November 29, 2016, taxpayer may choose whether to compute LLC's earnings based on either the 2009 Position or the 2016 Position?

b) To extent of dividends received by a Canadian taxpayer on or before November 29, 2016, or in respect of other transactions completed prior to that date that rely on surplus computations based on the CRA's 2009 Position, taxpayer may compute LLC's earnings based on that 2009 Position?

Comments

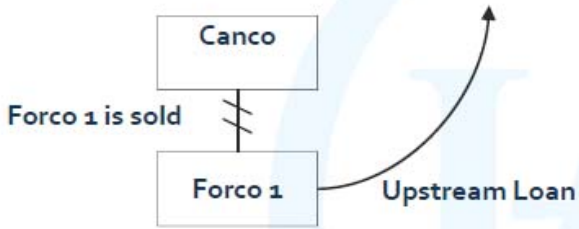
- Response to 9
  - *Taxpayer can use 2009 Position to calculate earnings of a disregarded US LLC for taxation years ended on or before November 29, 2016*
    - *Subject to the taxpayer and all taxpayers related to the taxpayer using the 2009 Position to calculate their earnings for all their FAs that are disregarded US LLCs for all taxation years ending on or before November 29, 2016*
  - *2016 Position can also be used by the taxpayer and all taxpayers related to the taxpayer for all taxation years ending on or before November 29, 2016*
  - *For all taxation years ended after November 29, 2016, the 2016 Position must be used*

FINANCE ROUNDTABLE

Finance Roundtable

Upstream Loan Rules - Repayment Requirement

Example



- The tax community has requested an expansion of the repayment requirement (paragraph 90(8)(a) and subsection 90(14)) to deem certain other "triggering events" to be treated as a repayment for purposes of the upstream loan rules
- Triggering events would include transactions that cause the upstream loan to no longer represent a "synthetic distribution" of funds from a foreign affiliate
- The example shown here involves a creditor affiliate ceasing to be a foreign affiliate of the taxpayer

Question:

Can Finance provide an update on the status of its work relating to this issue?

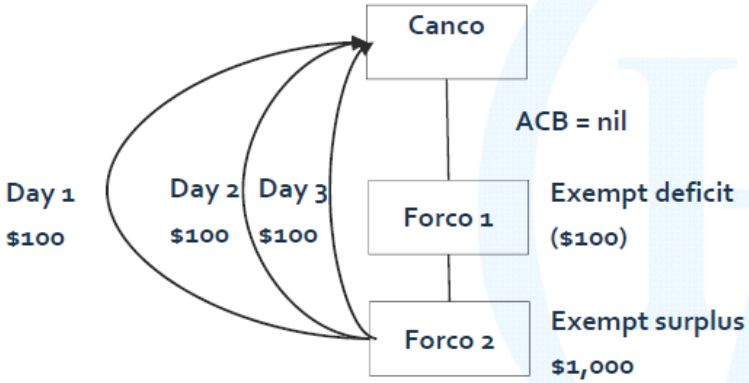
Comments

- Response re: Upstream Loan Repayments
  - *Taxpayers can take steps to mitigate this issue (e.g., by making actual repayments) and the CRA has provided some administrative relief (e.g., for certain temporary repayments)*
  - *Finance is considering what triggering events (if any) should be considered equivalent to repayment and included in these rules. Finance plans to undertake a considered and full analysis.*

Finance Roundtable

Upstream Loan Rules – "Blocking Deficits"

Example



- There are situations in which "**blocking deficits**" cause unanticipated results with respect to the reserve mechanism
- Each upstream loan must be analyzed as a separate notional distribution at the time that Forco 2 advanced the loan. It does not appear to be possible, when applying paragraph 90(9)(a) to a new upstream loan amount, to assume the movement of surplus on prior notional distributions. In this example, Forco 1 will continue to have a $100 deficit for the purposes of each notional distribution made by Forco 2. As a result, Canco will not be able to claim a subsection 90(9) deduction in respect of any of the upstream loans despite having sufficient net surplus in the group

Question:

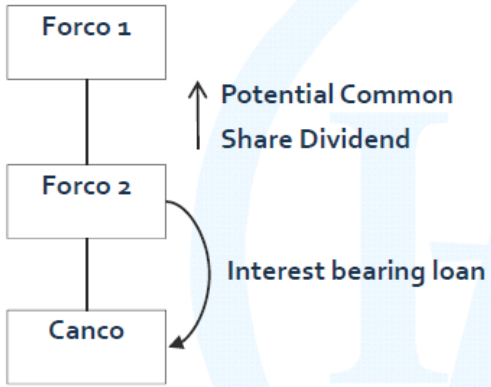
Can Finance provide an update on the status of its work relating to this issue?

Comments

- Response re: Upstream Loan Blocking Deficits
  - *Finance's view is that this isn't much of a live issue because the CRA is granting some administrative relief*
  - *General policy is that Canco should be able to receive a loan without any net income inclusion if a distribution would have given the same result*

Character Substitution Rules

Example



Key requirement in paragraph 212(3.6)(a):

"… at any time at or after the time … an obligation to pay or credit an amount as … a dividend on the shares, either immediately or in the future and either absolutely or contingently …"

Question:

Can Finance expand on the intent of this condition in paragraph 212(3.6)(a) and, specifically, whether common shares with no obligation inherent in the share terms to declare a dividend were intended to be excluded from the character substitution rules?

Comments

- Response re: Character Substitution
  - *The provision is intended to address situations where the back-to-back loan rules are circumvented using instruments with different legal characters*
  - *Dividends paid on common shares and on preferred shares could be caught, depending on whether the linkage test is met. All facts and circumstances will be considered, including the timing and quantum of dividend payments.*

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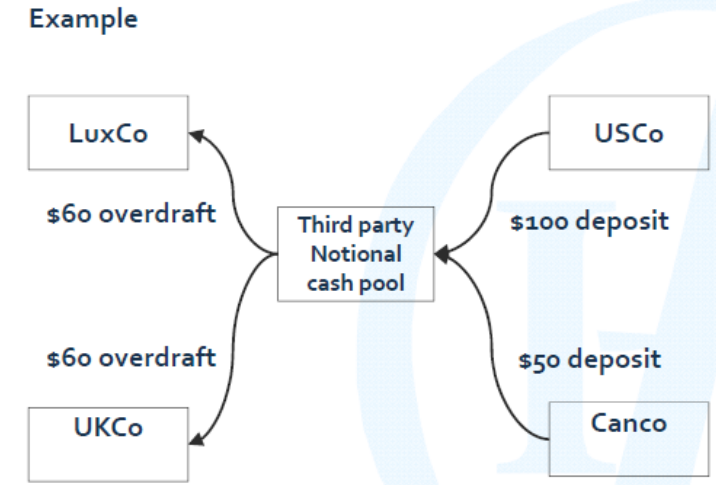
Back-to-Back Shareholder Loan Rules



USCo, Canco, LuxCo, and UKCo do not deal at arm's length

Multiple deemed loans

- 15(2.17) – each of LuxCo and UKCo ("intended borrowers") would be considered to have received a loan from Canco of $50
- Net deposit of $30 in notional cash pool is ignored for purposes of determining deemed loan from Canco

Question:

Can Finance confirm that the intent of the back-to-back shareholder loan rules is to limit the aggregate amount of loans deemed to have been made by Canco to the amount Canco has loaned to the "immediate funder"?

Comments

- Response re: Back to Back Loan Rules
  - *The intent of these rules is to limit the aggregate deemed loans to amounts that Canco has loaned to the immediate funder – no double counting is intended*

Finance Roundtable

- Domestic anti-treaty shopping rules announced in Budget 2014 will be abandoned in favour of the Multi-Lateral Treaty Instrument which Canada intends to sign.

Finance Roundtable

- Finance clarified that Budget 2016 comments regarding “cash boxes” continue to apply and there is no intended implication from omitting mentioning “cash boxes” in Budget 2017.
- Budget 2016 comments regarding “cash boxes”
  - “In two areas, however, where the revisions to the Transfer Pricing Guidelines are not yet complete, the Canada Revenue Agency will not be adjusting its administrative practices at this time… Work is also continuing to clarify the definition of risk-free and risk-adjusted returns for minimally functional entities (often referred to as “cash boxes”). Canada will decide on a course of action with regards to these measures after the outstanding work is complete.”