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CANADA: MORE READY THAN EVER FOR CBC REPORTING

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Introduction

Further to the introduction of section 233.8 into the *Income Tax Act* (Canada) (**Act**) in the fall of 2016, the Canada Revenue Agency (the "**CRA**"), the administrative body responsible for the enforcement of the Act, issued form RC4649, Country-by-Country Report, and RC4651, Guidance on Country-by-Country Report. Subject to some notable differences, Canada's guidance is consistent with the Organisation for Economic Co-operation and Development's ("**OECD"**) recommendations.

On October 21, 2016, federal Finance Minister Bill Morneau tabled a notice of ways and means motion that implemented country-by-country reporting into Canadian tax legislation. The measures implemented into Canadian law were consistent with the minimum standard recommended in Action 13 of the OECD's base erosion and profit shifting initiative.

The Canadian legislation requires multinational enterprises with total annual consolidated group revenue of €750 million (US$838.5 million) or more to file country-by-country reports. The filing deadline for a country-by-country report depends on the fiscal year end of the entity. A country-by-country report is required to be filed in Canada for fiscal years of multinational enterprise groups beginning on or after January 1, 2016.

Since the implementation of country-by-country reporting, Canadian tax practitioners have urged taxpayers to think about country-by-country reports in advance of the filing deadline in order to ensure consistency between the various tax documents filed. This advice was difficult to adhere to as there was no guidance from the CRA about the precise method of enforcing the newly enacted country-by-country provision. Fortunately, this has changed with the CRA's release of the country-by-country reporting form and its accompanying guidance. Given that the first country-by-country report for a multinational enterprise could be filed this year, it is not surprising that the CRA has stated that it intends to provide a reasonable degree of flexibility for filing a country-by-country report in Canada for the initial reporting year.

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RC4649 — Country-By-Country Reporting Form

The RC4649 form released by the CRA follows the format suggested by the OECD. The form requires taxpayers to provide some basic information about the reporting entity, the role of the entity in the OECD's reporting hierarchy (i.e., whether the entity is the ultimate parent entity, surrogate parent entity, or constituent entity), and certain other reporting metrics. The country-by-country reporting form also requires taxpayers to provide additional details on constituent entities, including the taxpayer's identification number and the location of the business.

RC4651 — Guidance On Country-By-Country Reporting Form

The CRA's guidance on country-by-country reporting, a 17-page document, covers many key areas of the country-by-country initiative that are also covered in the OECD guidance. The CRA openly acknowledges that the seeds of the country-by-country reporting were planted by the OECD.

However, the CRA takes a number of views that are divergent from those of the OECD guidance and takes the position that where there are differences between the OECD model legislation and the Canadian country-by-country reporting legislation, the Canadian country-by-country reporting legislation takes precedence. Taxpayers need to be mindful of the differences to ensure that they are fully compliant with Canadian tax law.

Taxand's Take

Certain approaches advocated for by the CRA differ from those recommended by the OECD. Circumstances could arise where Canadian practices differ from those of the OECD. It is expected that in these situations the CRA will likely take a position that is aligned with Canadian practices rather than those of the OECD. As a result, it is extremely important that multinationals with Canadian operations are mindful of the unique aspects of Canadian country-by-country reporting requirements.

CURRENT ITEMS OF INTEREST

Canada Signs Treaty Shopping Agreement

On June 7, 2017, Canada signed the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*. As a result, Canada's tax treaties with other participating jurisdictions will be modified with an added preamble and technical rule. The Department of Finance issued a brief technical explanation of what this means for Canada's tax treaties. Essentially, a principal purpose test will be added to the treaties. Benefits under a tax treaty will be denied where one of the principal purposes of an arrangement or transaction is to obtain a benefit under that tax treaty. Canada also adopted a provision of the BEPS minimum standard that will result in adding a mandatory binding arbitration provision to its bilateral treaties.

CRA Publishes Draft Changes to Voluntary Disclosure Program

The CRA released a draft information circular which contains proposed changes to the voluntary disclosure program ("VDP") on June 9, 2017. An online consultation has been launched, and comments on these proposed changes will be accepted up until August 8, 2017. The draft information circular specifically relates to income tax disclosures. Changes relating to disclosures for GST/HST and excise tax purposes are addressed in a separate draft GST/HST Memorandum.

With respect to income tax disclosures, several changes to the VDP are proposed in accordance with recommendations made by the Offshore Compliance Advisory Committee. The most notable change is that relief from interest and penalties will be limited in certain circumstances. Essentially, major cases of non-compliance will receive less generous relief than what is otherwise offered by the program. The draft circular lists examples of situations that would be considered major cases of non-compliance:

- active efforts to avoid detection through the use of offshore vehicles or other means,
- large dollar amounts,
- multiple years of non-compliance,
- a sophisticated taxpayer,
- the disclosure is made after an official CRA statement regarding its intended focus of compliance or following CRA correspondence or campaigns,
- any other circumstance in which a high degree of taxpayer culpability contributed to the failure to comply.

Where a voluntary disclosure falls into one of these situations, the taxpayer is only granted relief from gross negligence penalties (as opposed to all penalties in other cases). Moreover, interest relief will not be available in such situations.

Going forward, the VDP will require the payment of the estimated tax liability as a condition of eligibility for the program.

The following types of applications will no longer be eligible for the VDP:

- applications involving transfer pricing;
- applications from corporations with gross revenue exceeding $250 million; and
- applications that disclose income from proceeds of crime.

Also, computation of interest relief will be modified. Where the program used to grant interest relief for the years preceding the three most recent years of returns, the VDP will only provide relief for 50% of the interest in those periods.

If all of the proposed changes are implemented, they will apply as of January 1, 2018.

Progress of Legislation

Bill C-44, *An Act to implement certain provisions of the budget tabled in Parliament on March 22, 2017 and other measures*, was reported back to the House of Commons with (non-tax related) amendments, and was subsequently read for the third time in the House of Commons. Last week, the bill was read for the first and second times in the Senate, and is currently referred to the Standing Senate Committee on National Finance. Aspects of the bill have been subject to heavy debate and controversy, namely:

- the formation of the Canada Infrastructure Bank,
- increasing excise tax on beer and spirits, and
- modifying financial oversight.

An independent senator has tabled a motion to remove the infrastructure aspects of the bill altogether so they can be studied separately. Given all of the conflict surrounding Bill C-44, it remains to be seen whether the bill will pass before the summer break.

Interest Rates for Third Quarter of 2017

The CRA announced the prescribed annual interest rate that applies to amounts owed to/by the CRA to individuals and corporations for the third quarter of 2017 (July 1 to September 30). There are no changes since the previous quarter, except for the rate applicable to corporate taxpayers' pertinent loans or indebtedness, which increased to 4.55%.

RECENT CASES

Official language rights of witnesses and counsel violated — matter sent back for new hearing

The CRA had determined that Mazraani, an insurance agent, was not engaged in insurable employment with Industrielle Alliance ("IA"). On appeal to the Tax Court, Mazraani was held to have engaged in insurable employment. IA was appealing the Tax Court decision on the basis that its constitutional language rights were violated. Other grounds raised concerned apprehension of bias and whether the judge erred in determining Mazraani was engaged in insurable employment. When IA's counsel indicated that his witness would be testifiying in French, Mazraani indicated that he would need an interpreter. Instead of adjourning the hearing to arrange for an interpreter, a compromise was reached that the witness would testify in English except for technical issues which would be dealt with in French. Mazraani argued that there were no language rights violations as witnesses and counsel were bilingual and everyone agreed to address the Tax Court in English. He argued that the language rights issue was raised as a strategic move to ambush the Tax Court judgment.

The appeal was allowed, the judgment of the Tax Court was quashed, and the matter sent back for a new hearing before a different judge. Everybody appearing before a federal court has the right to use the official language of their choosing and simultaneous translation from one language to the other must be made available. One's ability to speak both languages is irrelevant. The judge wrongly favoured English to accommodate Mazraani's limited understanding of French. Despite efforts by the Tax Court judge to have the hearing conducted in English, significant portions of testimony were given in French when witnesses found themselves unable to express themselves in English. Although the judge translated some testimony into English, a significant amount of testimony was left untranslated. Given Mazraani's indication that he would need an interpreter if testimony were to be given in French, the failure to provide an interpreter violated his language rights. The language rights of IA's counsel and witnesses were violated when they were prevented from testifying in French. Delays could have been avoided had the hearing been adjourned to provide interpretation services. Having determined that language rights were violated, there is no need to consider whether the judge's numerous interventions and questions gave rise to an apprehension of bias or to consider the insurable employment issue.

¶49,664, *Industrielle Alliance, Assurance et Services Financiers Inc v. Mazraani and MNR*, 2017 DTC 5046

Taxpayer not entitled to judicial review of CRA's decision to restrict his farming loss deductions

The taxpayer was a physician. For certain taxation years from 1981 to 2006, the CRA restricted the taxpayer's deductible farming losses on the ground that farming was not his chief source of income during those years. On the Crown motion, the Federal Court struck the taxpayer's application for judicial review on jurisdictional grounds (2014 FC 504), finding that the matters raised fell within the jurisdiction of the Tax Court. On appeal to the Federal Court of Appeal, the taxpayer argued that the Federal Court judge: (a) erred in finding that the Federal Court lacked jurisdiction to grant him the remedies that he was seeking; and (b) should also have addressed his cause of action based on his argument that the restricted farming loss provisions of the ITA upon which the CRA had relied violated his section 15 Charter rights to freedom from discrimination.

The taxpayer's appeal was dismissed. The arguments raised by the taxpayer could not succeed, and his application for judicial review failed to raise a cognizable administrative law claim. The Federal Court judge was correct in finding that the Federal Court could not grant the taxpayer the remedy being sought. Nor could that Court examine the taxpayer's constitutional argument, since the Supreme Court has held on numerous occasions that it must be vigilant "to ensure that a proper factual foundation exists before measuring legislation against the provisions of the Charter" (see *Donovan v. Ontario (Attorney General)*, [1990] 2 S.C.R. 1086).

¶49,663, *Grenier v. A-G Canada*, 2017 DTC 5044

Tax debtor bankrupt provided with conditional discharge

The bankrupt owed a total of $982,827.07 to the Canada Revenue Agency, and that amount comprised 91.54% of her total debt. The Trustee in Bankruptcy applied for her discharge from bankruptcy, and the CRA sought a conditional

discharge, with terms which included the repayment of 20% of the tax debt. Those terms were not opposed by the Trustee.

An order was issued for a conditional discharge, on terms. The Court noted that, as the amount owed by the bankrupt in unpaid taxes comprised 91.4% of her total debt, she fell within the definition of a personal income tax debtor under section 172.1 of the *Bankruptcy and Insolvency Act*. Under section 172.1, the Court was authorized to refuse the discharge, suspend the discharge, or provide a discharge on conditions set by the Court. In making its decision, the Court was required to consider the circumstances of the bankrupt at the time she incurred the personal income tax debt, any efforts made by the bankrupt to pay the personal income tax debt, any actions taken by the bankrupt to repay other debts in preference to her income tax debt, and the bankrupt's financial prospects for the future. It held, with respect to those four factors, that the bankrupt had lived a relatively lavish lifestyle while failing to report her income and receiving government benefits. There was no evidence of any efforts to repay the tax amounts at issue but the bankrupt had made payments of other debts owed. The Court noted that the bankrupt was in good health, was employed full-time, and was likely to be in the work force for another decade. Finally, the Court concluded that information provided by the bankrupt with respect to her finances, including testimony before the Court, was inconsistent and not credible. The jurisprudence provides that with bankrupts who are ill-intentioned, dishonest, indifferent, or misleading, the purpose of the legislation shifts from being remedial towards the protection of society and the sanctioning of inappropriate behaviour. The Court held that the bankrupt fell within that category and should be sanctioned by being required to repay 20% of her tax debt. The Court concluded that it was reasonable, in the circumstances, to expect the bankrupt to be able to pay the $200 per month sought by the Canada Revenue Agency. An order was issued providing for a conditional discharge requiring the bankrupt to make such repayment on those terms and, in addition, requiring her to obtain an assessment of and recommended treatment for her gambling addiction.

¶49,665, *Re: Anh Thi Dinh*, 2017 DTC 5047

Following issuance of net worth reassessments, minister ordered to reassess to delete penalties for gross negligence, and to recalculate amounts to be added to taxpayer's reported income

The taxpayer operated a retail flower business as a sole proprietor. In net worth assessments made beyond the normal reassessment period, the minister added to the taxpayer's reported income for 2002 to 2006, for income tax purposes, the respective amounts of $51,842, $77,774, $68,403, $128,090, and $114,140. Penalties for gross negligence were also imposed. Corresponding net worth assessments covering the taxpayer's unreported income for GST purposes were also made, and these also included penalties for gross negligence. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was allowed in part. To justify reassessments made beyond the normal reassessment period, the minister must establish misrepresentation on the taxpayer's part which is attributable to neglect, carelessness, willful default, or fraud (see clause 152(4)(*a*)(i) of the *Income Tax Act* (the "ITA")). In the present proceedings, there still existed a discrepancy between the income reported by the taxpayer and the income calculated by the minister using the net worth method. In addition, the taxpayer failed to explain this discrepancy adequately. The minister therefore discharged the burden of proof necessary to justify the reassessments in issue being made beyond the normal reassessment period in this case. Conversely, the minister failed to demonstrate the degree of gross negligence on the taxpayer's part needed to justify the imposition of the penalties for gross negligence. "Gross negligence" in this context means greater neglect than simply a failure to use reasonable care (see *Laplante v. The Queen*, 2008 DTC 4822 (TCC)). In addition, the taxpayer managed to demolish some of the minister's assumptions concerning the quantum of the unreported income in issue, and the minister also made some concessions as well. As a result of the foregoing findings, the minister was ordered to reassess, deleting the penalties for gross negligence but taking into account the concessions made, in addition to giving effect to the evidence produced by the taxpayer concerning the quantum of his unreported income in issue.

¶49,661, *Lee v. The Queen*, 2017 DTC 1041

Pleadings speculating about motives and concerning sentencing were struck

The taxpayer filed a motion requesting that certain paragraphs of the Reply to his Notice of Appeal relating to his criminal conduct in conducting his business be struck. The taxpayer was a police officer who had a business in 2010

and 2011 of buying and importing cheese and other products from the United States and reselling them to Canadian restaurants. He was charged and convicted of conspiracy to smuggle goods into Canada. He did not report any income from that business and was reassessed in 2013 for unreported income of $23,916 and $84,216, and gross negligence penalties were assessed. He was appealing the quantum of income and the penalties and argued that the pleadings regarding his criminal conduct were irrelevant in determining those issues. The minister made assumptions regarding the taxpayer's motives for not reporting income as part of their reasoning in levying penalties.

The motion to strike pleadings was allowed with respect to three pleadings. There are stringent tests for striking pleadings. They may be struck if they are irrelevant, have no chance of success, are vexatious, disclose no reasonable grounds for appeal, or may prejudice or delay the trial. The burden is on the party attacking the pleadings. The assumptions of fact relied on by the minister inform the taxpayer of the factual basis upon which he has been assessed. His criminal activity is relevant for determining amounts to be included in income and penalty assessment. The pleadings regarding the taxpayer's criminal charges and conviction should not be struck. They do not prejudice nor will they be a cause for delay. They have a reasonable prospect of success in defending the amounts included in income and the penalties levied. The pleadings relating to his sentencing and assumptions speculating about his motives for not reporting income should be struck as being irrelevant. They do not defend the validity of the assessment. Gross negligence penalties are assessed if the taxpayer knowingly made false statements but allegations speculating about the motives for not reporting income are irrelevant.

¶49,662, *Heron v. The Queen*, 2017 DTC 1042

INTERNATIONAL NEWS

ICC Warns of Double Tax Risks Surrounding ' Substance' Tests

This article originally appeared in Wolters Kluwer's Global Tax Weekly Issue 240.

The International Chamber of Commerce ("ICC") has called on governments to adopt uniform, predictable rules to determine the location of economic activity when applying new international tax rules centered on substance.

The ICC noted that in light of recent international tax developments, namely the OECD's BEPS project, the notion of economic substance has attracted attention in a number of countries, especially given the lack of standards on how it can be understood in the context of BEPS. This, it said, is likely to result in double taxation for companies with respect to their international tax and transfer pricing arrangements.

It said: "The concept of economic substance serves as a key criterion for determining whether an economic activity is established only legally or whether there is personnel and an organizational structure. The challenge with any economic substance requirements is their factual nature and the wide leeway for varying interpretations of their content."

"The absence of clear standards on how economic substance can be understood in the context of BEPS; different perspectives, compounded by a lack of experience due to limited guidance; as well as a potentially increasing number of additional sources will most likely create new conflicts in the near future with evident risks of uncertainty and interpretation."

In order to provide certainty to businesses, the ICC said that governments must look at a multinational company's affairs holistically so that they can recognize the different perspectives of the parent country state, the source state, and any intermediary company state.

Hatch Says Republicans Making Progress in Tax Reform Talks

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Speaking at a recent conference, Senate Finance Committee Chairman Orrin Hatch (R–Utah) said Republicans are making progress on negotiating a final tax reform package.

He told the Bloomberg Global Transfer Pricing Conference at the National Press Club: "We're not done with tax reform just yet — but, we are getting closer. While the media loves to tell stories about divisions among Republicans, the truth is that, on tax reform, Republicans in the Senate, the House, and the White House are largely in agreement. In fact, I'd say that we agree on roughly 80 per cent of the key issues. For example, we agree, by and large, on the need to provide significant tax relief for middle-class workers and families. We agree on the need to bring down tax rates on

businesses — both corporations and pass-throughs — in order to create jobs and grow the economy. And, we agree on the need to fix our international tax system in order to make our nation more competitive while also preventing base erosion. Now, I won't go into specifics today, but there are some high-profile items in the remaining 20 per cent. And, there are some differences of opinion regarding most of those items."

"Bridging that gap and finding the path forward is going to take some serious discussion and compromise, and those talks are ongoing. My hope is that people will be willing to adjust their expectations and bend on their preferences in order to make our larger shared goals a success."

Noting criticism for the Republicans' tax proposals among Democrats, Hatch said nonetheless: "I am still hoping that tax reform can be bipartisan. Most Republicans are ready and willing to work with the President to get tax reform done. And, at the end of the day, we should have the procedural tools in place that will allow us to pass tax reform even if the Democrats . . . are unwilling to work with us. But, tax reform does not have to be a partisan exercise. Our current tax system imposes undue hardships on Republican and Democratic voters alike. Republicans and Democrats own businesses that they'd like to see grow and expand. Republican and Democrat workers would like to see their wages grow. Therefore, both Republicans and Democrats in Congress should be willing to relieve those hardships and improve the business conditions in our country, which is why members of both parties have been clamoring for tax reform in recent years. So, while I do find the rhetoric we're hearing from some of the louder voices on the other side a little discouraging, I am going to keep working at it."

Discussing the need for the bill to be deficit-neutral to avoid requiring a supermajority in Congress, he said: "I don't believe an up-front commitment to revenue neutrality should be necessary in order to move forward on tax reform. However, we do have some budget hawks in our conference who will have a difficult time supporting a package that adds to the deficit, and we'll have to take that into account, because, once again, we can't afford to lose too many votes. Personally, I don't see a problem with a tax reform proposal that loses revenue in the short term if we can show that it will help put our economy on a better growth path. But, like I said, we'll need to see where the votes are."

"Regarding all of these issues, it is important to keep in mind . . . that this process, if it's going to be successful, needs to be about the art of the doable. We all have our wish-lists for what we'd like to see in tax reform. And, currently our odds for success in this effort are better than they've been in roughly 30 years. As a result, some will assuredly want to swing for the fences on this exercise. But, while I believe we should be ambitious, we must also be realistic. At the end of the day, any bill or proposal that can't get 51 votes in the Senate and 218 votes in the House is, not to put too fine a point on it, a waste of time."

Concluding, he said, during the ongoing compromise, his goal is to "find the proverbial 'sweet spot,' that will maximize the growth potential of the final package without jeopardizing its prospects for passage. To that end, I am in constant contact with the administration and the leaders in the House, as well as the Senate leadership, in an ongoing effort to find that balance."

UK's Hung Parliament Puts Some Proposals in Jeopardy

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The outcome of the UK's general election on June 8 could weaken the UK's negotiating position in Brexit talks, tax experts have said.

Prime Minister Theresa May had called the general election to ensure the UK would have the same government in place, covering the full duration of the two-year Brexit discussions and beyond. The next election would otherwise have taken place in 2020.

The election was called to consolidate the Conservative Party's hold over UK politics. However, the opposition Labour Party did considerably better than expected, and the Conservatives lost seats overall, despite gaining seats in Scotland.

The Conservative Party now lacks a parliamentary majority.

James Ross, Tax Partner at McDermott Will & Emery, said the result "increases the likelihood of a 'soft' Brexit, so groups worried about losing the benefit of EU Directives to minimize withholding tax on intragroup interest, dividend, and royalty payments may want to hold fire before unwinding their UK holding company structures."

May had said previously that the UK would push for a "hard Brexit", which would involve a total separation of the UK from the EU, including from the Single Market and Customs Union. A "soft Brexit" would instead see the UK

negotiating to hold on to some elements of its existing relationship with the EU while still dropping its membership of the bloc.

Discussing the likelihood that a coalition will be formed, Ross said that whatever the structure of the new government, the corporate tax base changes that were dropped before the election are likely to be resurrected, which means that large groups will have to grapple with new restrictions on the deductibility of interest and on the carry-forward of tax losses.

"Meanwhile, the election result places plans to reduce corporation tax to 17 per cent from 2020 'in doubt'," he added.

Correction

Tax Topics No. 2361, dated June 8, 2017, featured *Tax Treatment of Non-Arm's Length Transfer for $1: Sale or Gift?* At the end of the second paragraph, the amount of the taxable capital gain was incorrectly stated to be $100,000. It in fact should read as "a (nearly) $250,000 taxable capital gain, $100,000 of which is taxed for the second time." The implications, however, remain the same: an onerous tax burden to the transferee may be triggered if the rules are enforced. We apologize for any confusion this may have caused.

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