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May 1, 2018

The Honourable William Francis Morneau, P.C., M.P.
Minister of Finance
90 Elgin Street
Ottawa, Ontario K1A 0G5
Canada

Re: Proposed Change to Foreign Affiliate Reporting Requirements

Dear Minister Morneau:

On behalf of Tax Executives Institute Inc. (“TEI”), I am pleased to comment on the proposed change to the filing deadline for Form T1134, *Information Return Relating to Controlled and Not-Controlled Foreign Affiliates*, as detailed in the *Tax Measures: Supplementary Information* annex to the government’s 2018 federal budget plan (“Budget 2018”).¹

If adopted, the proposed change to the Form T1134 filing deadline would impose significant additional compliance costs and administrative burdens on Canadian taxpayers with foreign operations, while producing no material benefit to the Canada Revenue Agency (“CRA”) or its ability to efficiently administer the *Income Tax Act*.

In developing these comments, TEI conducted an online survey of Canadian members to better understand their Form T1134 preparation processes and the potential impact of the proposed change thereon. Overall, the survey responses indicate that accelerating the Form T1134 filing deadline would materially impact (1) their ability to obtain the required information and (2) the quality of information reported to the CRA, and would exacerbate the existing compliance burdens of Canadian corporate taxpayers in preparing their income tax returns and Forms T106.

The comments below include a more detailed discussion of our members’ concerns together with our recommendations. TEI respectfully requests an opportunity to meet with representatives of the Department of Finance and the CRA to discuss these concerns.

¹ Budget 2018, *Equality and Growth for a Strong Middle Class*, was tabled in the House of Commons by the Honourable William Francis Morneau, P.C., M.P., Minister of Finance, on February 27, 2018.

About TEI

Tax Executives Institute was founded in 1944 to serve the professional needs of in-house tax professionals. Today, the organization has 57 chapters in North and South America, Europe, and Asia, including four chapters in Canada. Our approximately 7,000 members represent 2,800 of the largest companies in the world, many of which either are resident or do business in Canada.

Over 15 percent of TEI's membership comprises tax professionals who are employed by Canadian businesses from all regions and a variety of industries, with our Canadian members belonging to chapters in Calgary, Montreal, Toronto, and Vancouver. TEI members must contend daily with the planning and compliance aspects of Canada's business tax laws. Many of our non-Canadian members (including those in Europe, South America, and Asia) work for companies with substantial activities and investments in Canada. These comments reflect the views of TEI as a whole but, more particularly, those of our Canadian constituency.

As the preeminent association of business tax professionals worldwide, TEI has a significant interest in encouraging the uniform and equitable enforcement of tax laws, and reducing the cost and burden of tax administration and compliance to the benefit of taxpayers and government. TEI is committed to maintaining a system that works—one that builds upon the principle of voluntary compliance, is consistent with sound tax policy, is easy to administer, and is efficient. The diversity, professional training, and global viewpoint of our members enable us to bring a balanced and practical perspective to the issues raised by the proposed change discussed herein.

Discussion

The *Income Tax Act* contains specific information reporting requirements with respect to foreign affiliates of Canadian taxpayers. Under current law, a corporate taxpayer is generally required to file an information return (i.e., Form T1134) annually with respect to each of its foreign affiliates within 15 months of its taxation year-end. One of the tax measures proposed in Budget 2018 would shorten—by more than half—this information return filing deadline by aligning it with the taxpayer's income tax return filing deadline, requiring Forms T1134 to be filed within six months of the taxpayer's taxation year-end. This proposal would apply to taxation years of a taxpayer that begin after 2019.

A. Concerns

1. Proposed Change Could Result in Filing of Inaccurate or Incomplete Returns

The foreign affiliate reporting regime was first introduced as part of draft legislation on March 5, 1996, to implement foreign-reporting requirements announced in the 1995 federal

budget plan. The original draft legislation had proposed a six-month deadline for taxpayers to file their foreign affiliate information returns (Form T1134). After extensive consultation with concerned taxpayers and stakeholder organizations, however, the final legislation adopted a number of important changes, including an expanded deadline for taxpayers to file their foreign affiliate information returns. That deadline, within 15 months after the end of the taxpayer's taxation year, remains the law to this day.

On August 7, 1996, TEI submitted comments to the Department of Finance concerning the proposed foreign affiliate reporting rules (the "1996 Submission").² One of the principal concerns raised in the 1996 Submission was that the six-month deadline proposed in the original draft legislation would subject taxpayers either (i) to inappropriate penalties for filing reports based on the best available—though possibly incomplete or estimated—information or (ii) to an obligation to amend or supplement the original data. The basis for this concern was straightforward: many foreign jurisdictions permit financial statements or tax returns of the foreign affiliates to be filed much later than six months following the close of the year.

In our view, the concern raised by TEI in the 1996 Submission remains equally valid today. Shortening the filing deadline to six months—a deadline that was expressly not adopted when the rules were enacted—would result in Forms T1134 being filed with incomplete or inaccurate information. The reason, again, is simply that much of the information required to be reported on Form T1134 is not available within the six-month period following the end of the taxation year. For example, in the United Kingdom financial statements are typically not available for up to nine months after the end of the taxpayer's accounting period, and corporate tax returns are not required to be filed until 12 months after the end of the corporation's taxation year. While TEI appreciates the transition period delaying the effective date of the new proposed rule, a transition period cannot solve the fundamental problem of incomplete or inaccurate information. There are no reasonably implementable system changes that taxpayers can make to address this concern—it arises solely from factors out of taxpayers' control. According to the survey of our members, very few large taxpayers would have the necessary information to accurately complete all of their Forms T1134 within six months.

Notably, the Organisation for Economic Cooperation and Development ("OECD") recognized this issue when determining the appropriate timeframe for member states to require taxpayers to file Country-by-Country Reports. In its final report on Action 13, *Transfer Pricing Documentation and Country-by-Country Reporting*, the OECD suggested that a 12-month filing deadline would be appropriate because in some cases financial information needed to complete a Country-by-Country Report (which is similar to certain information required to complete a T1134 form) may not be available until after tax returns are due:

31. With regard to the Country-by-Country Report, it is recognized that in some instances final statutory financial statements and other financial information that

² Tax Executives Institute, *Canadian Foreign Affiliate Rules*, 48 Tax Executive 398 (Sept.–Oct. 1996).

may be relevant for the country-by-country data described in Annex III may not be finalized until after the due date for tax returns in some countries for a given fiscal year. Under the given circumstances, the date for completion of the Country-by-Country Report described in Annex III to Chapter V of these Guidelines may be extended to one year following the last day of the fiscal year of the ultimate parent of the MNE group.

Canada adopted the 12-month filing deadline for Country-by-Country Reports, consistent with the OECD's suggested filing deadline.

In our view, if the Form T1134 filing deadline were accelerated to only six months after the end of the taxation year, many large corporate taxpayers would not be in a position to provide up-to-date financial information with respect to their controlled foreign affiliates because current financial statements and tax returns would not be available. These corporations would have to rely on financial statements and tax returns from the prior year to complete and file their Forms T1134 within six months after the end of the taxation year, which would result in the reporting of inaccurate and dated information to the CRA.

2. Proposed Change Would Not Reflect Commercial Realities

The stated purpose of the proposed change is to align the Form T1134 filing deadline with the deadline for filing a tax return (as opposed to nine months later). The tax measures proposed in Budget 2018 indicate that it is the Department of Finance's view that although the taxpayer's Forms T1134 are not due until 15 months after the end of its taxation year, the taxpayer needs to have most of the information necessary to complete its Forms T1134 to compute its income tax liability for the year. Thus, according to this view, the taxpayer should have all of the necessary information to complete and file its Forms T1134 at the same time that it files its income tax return of the year. As set forth below, this assumption is flawed—taxpayers do not need to have most of the information required by Form T1134 in order to compute their Canadian income tax liability for the year. Conversely, while foreign financial statements and tax returns are not necessarily required to compute a taxpayer's Canadian income tax liability, most of the TEI members surveyed replied that they do require foreign financial statements and tax returns in order to accurately complete Form T1134.

Aligning the deadlines for the preparation of income tax returns and Forms T1134 is not workable for large corporate taxpayers. Under the current income tax administration regime, large Canadian multinationals already face significant compliance burdens in preparing annual income tax returns, as well as related information returns, such as Forms T106, that are due within six months after the end of the taxation year. Much time and effort is expended to ensure that these returns are complete and accurate prior to the filing deadline. The same six-month period also includes significant financial accounting-related responsibilities arising from year-end and first quarter-end reporting requirements. Adding the completion and filing of

Forms T1134 would only exacerbate these existing compliance and reporting burdens for such taxpayers.

Compressing income tax filing deadlines within the same six-month period each year also presents major staffing concerns for many Canadian companies. Spreading out the compliance burden throughout a 15-month period provides more manageable workloads for tax department staff, and mitigates the need for temporary staffing during peak times and layoffs during non-peak times.

A large multinational corporation may have several hundred foreign affiliates, the vast majority of which being controlled foreign affiliates. Given the significant compliance and reporting burdens the taxpayer already faces, it would be impractical and inefficient for it to expend significant resources collecting financial information if that information was not relevant to computing the multinational's income tax liability. Thus, in practice, a large multinational corporation would typically focus its compliance efforts only on those controlled foreign affiliates whose activities generate foreign accrual property income ("FAPI") to the multinational and would compile only the relevant information needed to determine its income tax liability (i.e., it would compute only how much FAPI the particular controlled foreign affiliate generated for the year). The survey responses indicate that the vast majority of TEI members (a) compute FAPI separately from the Form T1134 filing process and (b) report FAPI on less than 15 percent of their Form T1134 returns.

In any event, even if a large multinational were to compile all of the information from each of its controlled foreign affiliates needed to determine its income tax liability (i.e., FAPI) within six months after the end of its taxation year, it would still be missing information needed to complete its Forms T1134 with respect thereto.

Forms T1134 require significant additional information that is not relevant for computing a Canadian multinational corporation's income tax liability for the year. For example, Form T1134 requires the taxpayer to list all of the gross revenue from property earned by a controlled foreign affiliate in the year irrespective of whether that gross revenue gives rise to FAPI. In many cases, a controlled foreign affiliate may earn gross revenue from property in a particular taxation year, but that gross revenue may not result in foreign accrual property income to the taxpayer because the gross revenue arose from an active business carried on by the controlled foreign affiliate (including from activities that are deemed to be an active business under paragraph 95(2)(a)). In such cases, the taxpayer would know that the activities (and thus the income) of its controlled foreign affiliate do not give rise to FAPI and thus it would not need to compile financial information related to that affiliate in order to compute its income tax liability for the year. This information, however, is still relevant for completing Form T1134.

Furthermore, Form T1134 requires a taxpayer to provide other information that may not be relevant to determining the taxpayer's income tax liability, including, among other things: (i)

the taxpayer's adjusted cost base in the shares of the particular affiliate; (ii) whether there was any internal re-organization that may have affected surplus balances of the particular affiliate; and (iii) whether the taxpayer or an affiliate of the taxpayer acquired or disposed of the shares of the particular affiliate. Form T1134 also requires other information, such as total assets, accounting income, book cost of shares, and breakdown of revenues. All of this information comes directly from the financial statements, which in many cases would not be available until well after the proposed six-month deadline.

3. A 15-Month Filing Deadline Would Not Impact CRA's Ability to Audit Taxpayers

In the *Tax Measures: Supplementary Information* annex to Budget 2018, the Department of Finance suggests that the CRA's ability to audit the activities of a taxpayer's foreign affiliates is prejudiced due to the nine-month delay between the submission of the taxpayer's income tax return and the filing of Forms T1134. We submit that this concern is unfounded.

First, as noted above, TEI members' experience is that the CRA does not seek to audit income tax returns and information returns immediately after they are filed. Generally speaking, the CRA may not audit the income tax return or information returns for a particular taxation year until several years after those returns have been filed. Thus, when the CRA does begin to audit a taxpayer's particular taxation year, the corresponding Forms T1134 would be available for the CRA to review. In practice, the nine-month delay between the filing of the income tax return and Forms T1134 has no impact on the CRA's ability to audit the taxpayer's foreign activities. Our survey revealed that a significant proportion of our members typically receive requests for copies of Forms T1134 only as part of the audit process, which may not begin until several years after the Forms T1134 are filed.

Second, we note that the tax measures proposed in Budget 2018 would also extend the normal reassessment period for income arising in connection with a foreign affiliate of a taxpayer. Under current law, the CRA generally has four years after its initial assessment in which to audit and reassess the taxpayer's tax liability with respect to the income of its foreign affiliates. The tax measures proposed in Budget 2018 would extend this reassessment period to seven years from the date of the CRA's initial assessment:

Given the complexity of audits that involve foreign affiliates and in order to ensure that the CRA has an opportunity to properly examine all activities in respect of foreign affiliates that are relevant to the Canadian tax base, Budget 2018 proposes to extend the reassessment period for a taxpayer by three years in respect of income arising in connection with a foreign affiliate of the taxpayer.

In our view, this additional reassessment period should provide the CRA with ample "opportunity to properly examine all activities in respect of foreign affiliates that are relevant to

the Canadian tax base”; shortening the Form T1134 filing deadline is wholly unnecessary to achieve this objective.

B. Recommendation

The proposed change to the filing deadline for Form T1134 would impose significant additional compliance costs and administrative burdens on large Canadian corporate taxpayers, while producing little or no practical benefit to the CRA. For all of the reasons stated above, TEI recommends that the current filing deadline of within 15 months after the end of the taxpayer’s taxation year be retained.

If, after due consideration and consultation with taxpayers, the government were still inclined to accelerate the filing deadline for Form T1134, then TEI would recommend—at most—aligning the Form T1134 filing deadline with the filing deadlines for Country-by-Country Reports (i.e., to within 12 months after the end of the taxpayer’s taxation year). Given that some of the information required to complete a multinational corporation’s Forms T1134 and its Country-by-Country Reports is somewhat similar in nature, such an approach might reduce certain duplicate efforts and reporting costs for some taxpayers, and would provide a more realistic period for Canadian companies to gather all of the required information.

These comments were prepared under the aegis of TEI’s Canadian Income Tax Committee, whose Chair is Paul T. Magrath. Watson M. McLeish, TEI Tax Counsel, coordinated their preparation. If you have questions about TEI’s comments, please contact Mr. Magrath at (905) 944-5000, extension 7264, or paul.magrath@huawei.com, or Mr. McLeish at (202) 470-3600 or wmcleish@tei.org.

Respectfully submitted,
Tax Executives Institute, Inc.



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International President

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